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"Chattel, Chattel, Everywhere; and Most of it Ain't Worked"

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Marty's News & Notes

Featuring news about the Factory-Built Housing Industry
Contributing to the industry discussion...

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MORE CONSOLIDATION

Those of you who care about industry affairs and plow through this rag monthly know that it was in the June newsletter "And then there was one", that I mused about the rapidly increasing pace of industry consolidation. I didn't name too many names, but amongst these I did, I supposed in the letter that the **Berkshire-Hathaway** owned **Clayton Homes Group**, and the rival **Champion Homes** were likely to be consolidators, picking up some of the other industry builders. Easy guess, eh?

On August 28th, the "big" shoe dropped as the third largest **Fleetwood Homes** shareholder, with 11.8% of the company, urged in a letter filed with the SEC that Fleetwood seek a "sale" (merger), through a stock swap, to **Champion Homes**. Apparently the advice to merge resulted from continued weakness in Fleetwood stock and a possible $20 million or so savings if the two companies merged, and perhaps $300-400 million in increased revenues. Fair enough, in Trailerville that is real money. There is undoubtedly some sense in combining these two, although one can question the match in various areas. Not the least of which is that together their corporate balance sheet doesn't improve greatly.

Good Fit?

Furthermore, it smacks of combining Ford and Chevy, two companies whose products fit many of the same spectrums, with factories and retailers in view of each other. I admit the strategy makes sense in terms of possible "corporate overhead" terms, but what about the cost of closing factories, sales locations duplication and the danger industry sales could continue to fall?

In an increasing marketplace perhaps the sales could stay constant or even increase, which might make the deal sweeter. The HUD marketplace has hardly stirred souls for years, and in spite of strident screams by analysts that the real estate sub prime mess could "work to the industry's advantage", we've seen no sign of that. Unless of course, you view 15-25% year over year HUD home shipments decreases as being to our advantage. My myopia doesn't view it that way.

What help?

I have steadfastly maintained that the sub prime quagmire was unlikely to help us. Quite the contrary. Should real estate lose their sub prime customers, they are welcome to come shop us, but we can't help them. Short of the 40% down payment program offered by **21st Mortgage** and **Origen Financial**, HUDville lenders cannot help too many of the real estate sub primers. We don't finance sub prime clients in any numbers. And to prove the point this will work against us, in the last week of August one of our major lenders announced possible loan tightening, obviously inspired by the sub prime mess. Big help!

And in my view, this is where the **Fleetwood/Champion** merger falls down. Their consolidation does nothing to ease the constrained lending existing. The same deficiencies on this front they face individually they will face if they are combined.

Trying to change

Admittedly the industry, under new **MHI president Gail Cardwell**, has shown a stated desire to attack those fracture points which consign the industry to its constrained financing model, especially in chattel, (home only) lending. But there is much to do, and while I greatly admire the efforts of industry members to move to a better place the chattel-lending model, time is not on our side. The continuing slide shows that, and no degree of "the rate of home shipments decline is decreasing" spin by pundits and industry associations will keep the factories open and profitable. Still, despite all, the recent MHI inspired move to change the industry model gets a **"5"** rating from Marty, my highest.

And if at one time many thought **escaping upwards** to modular home construction was the best answer, the sobering results of the last few years reveal constraints. Recent modular shipments have cooled in the last couple of years. While modulars enjoy the same identical conventional financing as site built, there are barriers hemming in mods to about 2% or less of new single-family housing starts. I dissected all this years ago in my **"Land/Home Conundrum"** piece, which you'll find, on my web site, www.martylavin.com. Very nice product, that, but the product has yet to catch on in other than low volume, low housing demand areas. It is still a work in process.

Shotgun approach

The industry is and has been rife with rhetoric and attempts to build more attractive homes, using more innovative methods, sales consultants urging more professional approaches to dealing with the public, all the while as the trade associations endlessly petition government and others for various changes and dispensations from laws and regulations. All very wonderful stuff, but it has done precious little to change industry dynamics.

You see, this is a **financing led HUDCode industry depression** which has tumbled the long time "Greentree chattel model", which once fueled a lengthy industry sales model averaging 250,000 homes per year, with annual variances of as many as 80,000 homes less and 130,000 more. Since 1998, results have tumbled to unbelievable depths, now running about **100,000 HUDCode homes annually**, as we all await the "big rebound", often predicted but never delivered. How long the industry will believe this recovery fable under the present lending conditions remains to be seen. And it's not the lenders who need to change. **It is the industry model which must be altered for chattel lending to work on a broader scale.**

What does not remain to be seen and the mantra the industry must adopt is that it does not know yet how to deliver north of 200,000 new homes annually (or even 150,000 homes) without ***far more vibrant chattel, home only financing***. And by that I mean a model that would be profitable to lenders by accommodating less than terrific credit, by stopping the ravages of the number of defaults (important), and losses upon default, repossession and disposition of the home by the lender (all-important). All products cause loan defaults and MH certainly has its share, but it is the deep losses on default which cripple our product lending. That, and the inability of the homeowner to resell his home when he wants and pay off his note with sales proceeds. Another repo. All those factors which lead to the quick and deep loss of value of chattel financed homes must be addressed, or at the very least clearly identified, so they can be avoided if possible.

Good, but not enough

MH lenders are now far better than ever at controlling virtually every aspect of loan quality, which reduces defaults and losses upon default. Still, the primary bulwark of their loan quality is high, or at least far higher credit quality, reducing the incidence of defaults. While the repo glut peaked some years ago in terms of pure numbers, which by itself has reduced the severity of losses by reducing the oversupply of homes competing to be liquidated, still loan losses of 50% or greater upon default and resale are common. Thus we see the 720+ FICO's of many loan portfolios so the lender can reduce the numbers of

defaults, while still accepting heavy repo losses, which also leads to the substantially higher interest rates charged for MH loans, especially for resales. A double whammy and leads to the caution all lenders exhibit originating MH loans, and to all-too-few MH lenders.

Again, let's say this together: **this depression in manufactured housing is caused by a long term industry model which continues to hang on from the "old days", almost essentially unchanged from 1950**, except that now the loan repayment terms are far longer, the loan advance is more generous, the home value far higher (even on a dollar adjusted basis) and interest rates are now far lower as compared to site built housing. While the loan origination model and underwriting have changed significantly, the manner in which the industry sells, delivers, guarantees, sites and resells homes is virtually untouched. The consequences of continuing unchanged are all around us. You are all intelligent enough to fathom the consequences of all those conditions. Need help? Look around you.

Better chattel means?

My observation has been that in much of the industry's eyes, "better chattel financing" meant more accommodative lender retail financing. No, not the full GreenTree model (and that of others!), but a sort of "GreenTree Lite". Not every FICO score under 620 would be financed, just most of them. Not 720 FICO coverage portfolios, but say 640-650 FICO's, would be the aim. All wonderful stuff, except lenders and investors while savoring the smell, refused to bite. It seems the survivors want to keep their jobs, volume be damned, unless industry model changes allowed program changes. That hasn't happened so far.

All this while land lease communities can increase rents without barriers (except of course, in rent controlled states and cities), retailers can mark the transaction up 150% or more, and "consumer satisfaction" and "value" were words, not actions. (Well, hell, that should work!)

No escrow closings, no trust funds, few disclosures, dealing with many unsophisticated first time home buyers the industry held on with the failed vestiges of its past lending heritage. Every attempt to impose a far stricter chattel model was challenged and shouted down. And I do not exempt our lenders from responsibility either. Rather than unilaterally requiring many of the measures they know are necessary for the industry to re-invigorate a survivable and far more expansive chattel model, most simply looked to reduce defaults by escaping upwards to high credits. That required the least explanation on their part and left unchanged the bulk of the problems which chattel lending suffers. Unable to legally "conspire" to uniformly impose all the measures the lenders needed for far greater loan security, it's illegal you know, they all continued to accept many loan ills through to the underwriting stage, but not in their outright policy, or approvals. No one wants to lose business, and in all lending, the loose hand gets the loans, taking loans from prudent lenders. It only remains to be seen whether they can hold their jobs thereafter. Experience shows that the "loose hand" absent some **extremely strong competitive advantage** is unlikely to prevail. Still, during their presence, adopting rational lending standards is not possible. This can block the changes that need to be made, although that is not the major issue presently. There are no "loose hands", but still insufficient loan requirements exist to loosen the credit requirements. That is the present obstacle, as no single lender is strong enough by itself to force it to happen.

This leaves it for MHI, the trade association to attempt to superimpose "best practices" on its lending contingent, to avoid any appearance of impropriety, as best practices are a roadmap, but a voluntary one. No one is compelled to act intelligently in this world, that's what freedom means. And there is no more revered freedom than the freedom to fail. At HUDville we have that one down well.

It's the financing, stupid

So as we look at industry consolidations, let's hope it's Volvo into Ford, a good move, rather than Chrysler into Daimler Benz, a bad move. Cerberus Capital's three-headed dog can't save us all, can he? In the automotive business, product is everything, with lending there well settled for many years. We thought the same about site built housing, but their present mess shows anyone can wander astray. In HUDville, lending is everything, with product far less a factor. Our homes are already imminently suitable to create a far larger industry, but not our lending model, based on

the present manner in which the industry operates. Our inability to face head-on the various weaknesses in our lending has crushed this entire industry and lowering corporate costs by themselves in a continuously decreasing marketplace is obviously only a temporary cure. The only permanent cure is to create conditions which allow far better financing, which must be far more survivable and profitable for lenders and investors, even while being able to accept lower credit standards. Now there's a task for the MHI Finance Committee! (Admittedly, quite a challenge.)

Our customers are primarily people on a budget with fewer housing options than more affluent homebuyers. While credit scores and a good credit rating are not really centered on income, obviously more income can fuel more options, often leading to better credit. Our customers, many with limited family incomes, can struggle to meet their obligations. Often a manufactured home ***is*** the home of their dreams, but the tightness of the lending constraints, finds many people unable to qualify. The number? Far too many to fuel our industry at its desired levels.

And why is chattel lending the key to volume in MH? Because the rental of the homesite reduces the upfront cost in buying their home. It also divorces ownership of the land under the home of the occupant, a definite weakness of the chattel land lease model, at least for the homeowner. But still, a modest home without the upfront land cost is where the industry has historically had its bulk of sales. That is very much missing now.

So as Fleetwood and Champion, or most anyone else, play the consolidation game the chattel lending deficiency hangs over its success. Short of the **Clayton Homes Group**, which has access to its parent's money to lend and special corporate MH lending expertise, no other industry lender has been as successful on the Clayton's scale. The two Clayton lenders, **Vanderbilt Mortgage** and **21st Mortgage**, pushing two billion dollars annually in originations are about double of all other industry lenders *combined*. Yet, all of the MH industry lenders are originating only about 20% of the total new and resale marketplace at best, a variety of other non-industry lenders financing the rest of the sales, particularly banks and credit unions.

It's all for better lending

MHI, by and through its chairman, **Barry McCabe** of **Hometown America of Chicago**, has put on a full court press to bring major changes to the industry model. One of the areas is the lending arena, where a group of industry participants has been identifying the lending model deficiencies and possible answers. While the group features many experienced and intelligent people, and I trust their resulting analysis and recommendations, it still remains for lenders to take such steps as they can individually to create a better, more accommodative program, while still remaining sufficiently profitable. That will be the immediate challenge. Resales financing would sure be a great place to start, where the present industry-lending model helps create home value depreciation.

One of the themes which has become Oprah-popular lately in the industry conversation has been a desire to have **"an alignment of interests"**. You know, lenders are so valuable that retailers will willingly accept using trust accounts for customer deposits and escrow closings. And in order to protect lenders, and spur their lending into land lease communities, the community owners will voluntarily reduce all rent increases for a homesite during its occupancy by a homeowner, until a change of homeownership allows an increase in the basic homesite rents. You know, like the "Saddlebrook model". But of course they will.

One the latest back-to-the-future devices is the use of **"recourse"** to entice a lender to lend beyond what he otherwise considers prudent, as the party with the recourse will make up some part, or even all of the losses suffered by the lender. As lender loan losses can be substantial, think through the concept of recourse. This does not mean that an "alignment of interests" with "recourse" cannot work on some scale. But, the dozens of mortgage lenders in real estate which have recently retired from the sub prime lending table did so because the alignment of interests was forced upon them to make good on recourse obligations that they willingly undertook, until the enormity of the recourse - forcing defaults led to bankruptcy or business closure. In a world where Countrywide Mortgage is under severe pressure with potential recourse obligations and liquidity, is there nothing we can learn about the end result of lending gone wrong and interlocking recourse obligations? So, yah, I think it a good idea to encourage lending that would

not otherwise be transacted except for recourse obligation. You can usually get 3-7 good years out of that before the collapse. Play your cards right and you can be in Costa Rica by then. Don't believe me? Look at the chaps who sold their chains of sales locations to builders in the late 1990's.

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And so?

What are we to make of all this?

1. Lenders need to determine a survivable underwriting and servicing model upon which to base their lending. MHI can help in this effort.

2. Creating substantially more accommodative lending on the back of recourse by parties who haven't the financial ability to fully fund a bad case loss scenario makes no sense, unless you are a Las Vegas based lender.

3. Industry participants can create "best practices" which can be available to adopt voluntarily, and lenders can "align" themselves with those adopting and using those measures, on the thought and to the extent these practices will tend to reduce lending losses. Slowly and carefully at first, until the point is proven that the measures work.

4. The industry should align themselves with HUD and/or the GSE's to encourage them to adopt completely new chattel programs which are profitable for lenders, appeal to a broad spectrum of lenders, simplify the work of lending on MH, reduce both defaults and losses upon default, and ultimately lead to far more and better financing from more sources. That can't happen under the present industry model and circumstances. Further, the industry predilection to lobby constantly to water down every lending program, may well seem to spur greater lending initially, but the record now shows that soon enough as the losses mount, lenders start dropping out, most never to return. Watering down just seems like a bad idea.

5. The industry must grasp that many things are important, but they all pale in comparison to helping achieve a more survivable and profitable model bringing a wider group of lenders to the industry. This cannot be done by "eyewash", but by real measures, many of which have been strongly resisted by the general industry. There still exists a mania in much of the industry that somehow a **Greenseco Financial** will return, and if the industry doesn't necessarily believe it can prosper upon its return, still the measures necessary to allow it or other lenders to survive are not accepted by enough industry members to prevail.

Bluntly put

So there is no misunderstanding of what I am trying to say in this newsletter, let me be very blunt. I do not think that with the present method the industry transacts business that any sort of strong home sales growth can occur. I say this because I do not believe the industry model allows any sort of survivable chattel lending except a model that is quite constrained, with insufficient scope to accommodate enough of our customers.

To survive, the lenders must protect themselves with very careful underwriting, topped by lending only to people who are quite **unlikely** to default. So long as this continues, which is especially true in land lease communities, muted industry activity can be anticipated.

While the industry spends a great deal of time dealing with areas of concern to it in regulatory activity and lobbying government on other issues, most of that activity will do little to spur industry activity. Most of it is just "make work". The industry needs to realize that **only changes** which directly or indirectly make industry lending safely accommodative, reaching deeper into the credit profile, while still being profitable, is the only way to start industry growth again. The sooner the industry accepts and helps implement lending geared towards that end, the sooner it will once again start its growth in home sales, and not before. And even then, it will take time. We'll see

if action starts on that front even as we study at MHI where the industry is at present and what it needs to do to get to a better place.

It is on this very point that the future of the industry hinges and whether the consolidation is merely a waypoint to worse, or a plateau upon which to mount the "Great Climb Back". (Mao, Mao, where are you when we need you?)

In my next letter I'll review some of the areas which I think will need serious and far-reaching attention if we are to make rational MH lending the catalyst for growth, because only it can make it happen.

THE MHL CORP. ANNUAL SHIPMENTS CONTEST

Well juice my fruits, after being as low as 91,400 homes as the annual rate in February of '07, the pace after the June number has "soared" to 101,500 homes. I actually speak with intelligent people who see this as a positive, that we are back over 100,000 homes; even though last year's figure was 117,500 homes. It seems in their mind that a drop of "only" 15% more from 2006 figures is "exciting". I can barely hold my water!

Still anxiously awaiting a real shipments **increase**, is the early September to-be-released July shipments number. Eagerly awaited because in order for the long-awaited bounce-back to happen we have to see some increases in shipments, not continued decreases. It has been some time since that has occurred. Is September the month?

Meanwhile, as we shoot up to that dazzling **101,500 homes shipments pace presently**, several contest entrants were clustered around that figure. Closest was **Dennis Ohnstad** of **Riley Homes** in **Urbana, IL**, with **101,100 homes**, and who stated a sincere desire the industry very quickly launch an **industry image campaign**, patterned after the very successful RV effort. Close by, but slightly off the money were **Bruce Stein** of **EEC, Inc.** in Waterford, MI at **102,327**, and **Lonnie Ray** of **Southern Fastening Systems, Inc.** in Muscle Shoals, AL, at **102,500**.

THE MHI HOUSING FINANCE FORUM

A step in the right direction is the upcoming MHI sponsored finance forum to be held October 4, 2007 at the Marriott Financial Center in New York City. A full day of speakers and networking will allow industry lenders and leaders to meet with and listen to outsiders who are now involved or have been in MH lending.

It is events like this which will allow conversations leading to a better chattel lending program in MH. My primary aim would be to meet with the outside analysts and money people and ask one question; **"In your opinion, what are the things this industry can do which will tend to create a more vital, more accommodative, but still profitable MH lending condition than now exists?"**

As an industry we certainly can tell them about the far better underwriting and documentations our industry's lenders have practiced for years, but that comes up short because of the emphasis on very high credits in order to make it work. Our loan volume presently is so low as to be almost irrelevant to them and destructive to the industry.

Until the money people can and will fund our lenders with less expensive and lower-credit-tier paper, because they believe the industry has taken strong measures to enhance MH lending, especially at the chattel end, what you see is what is likely to continue. This conference and others must be used to springboard needed changes in the industry.

We do have a good story to tell about loan performance of loans originated over the last five years. What we do not yet have to tell is how we expect to originate **far more paper**, with continued and predictable loan performance, rivaling the present ABS bond performance. That is the goal and the challenge.

I intend to attend the conference so I can report my version of what I saw and experienced there. It starts for me the previous night with a "selected invitation" dinner of insiders and outsiders, and ends the following day with a late afternoon "Networking Reception". I can hardly wait!

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