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"GRINDING ON"

Marty's News & Notes

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

GRINDING ON

As 2007 ended, the industry saw no sign of relief anywhere. It was becoming obvious by the December 12, home shipments report for October of 2007, which was only slightly up, that home shipments for 2007 were unlikely to reach 100,000 homes. For the many pundits and analysts who hung on deep into the year that we could still break 100,000 homes and that we would get a late fourth quarter bounce in shipments, the October report cut deeply. Any illusion of 100,000+ home shipments slipped from our fingers, with only November and December shipments left to be counted.

November Report

On January 3, 2008, the November shoe fell, with a report of a decrease of 5.5% for the November 2007 home shipments. Never mind that only a year ago we lamented at 117,508 shipments for all of 2006. Here we were, about 20,000 shipments less for 2007, with seemingly no end in sight. It makes those 575-580,000 home shipments of the 1972-1973 period even more astonishing. And it was only 10 years ago we hit almost 373,000 homes shipped in 1998. In the past we discussed in this newsletter how that shipments level was reached and the improbability that will happen again. Now as we approach 2010, and the new century is well underway, we have dropped almost 300,000 homes from our 1998 shipments total, with few prospects for relief.

Proper response?

The November decrease of 5.5% settled any illusion about the sub prime mess inuring to our benefit, and threw into speculation whether the response by the industry to the current, and long-term industry *debilitus*, is sufficient, or even whether the approach is the correct one. If the comments to me by friends and readers is any indication, there is widespread doubt the industry response is appropriate or focused in the right area. It is also evident that the industry leadership is circling the wagons, so as to avoid any contrary opinion from outside, continuing to advance the theory a Washington, D.C.-focused campaign, jousting over alternative construction letters or "subsidies" from various sources, is the right cure. Perhaps I will stand to be corrected, but remember **Marty's First Rule:** "Never mind what people are saying, watch what is happening." And the rhetoric is of miraculous D.C. victories even as we approach 95,000 home shipments.

And what is happening has decapitated a whole industry as it struggles to continue to unload unsurvivable loans onto now educated investors. Me thinks that course, as shown in the last ten years of events, is unlikely to result in much good. But, then again, what do I know?

Lending survivability

But if I were to be asked, my response would be that the strongest emphasis should be on concentrating on measures calculated to make our lending far more survivable, far more profitable. I think you all know this needs much more work than has been attempted or accomplished. At the same time, I fear that the market is relentlessly taking us down to a level of business that is survivable under the current lending conditions. That is happening and we are not stopping it. Perhaps we are incapable of stopping it. It almost seems that the current level of survivable business is from a low of 85,000 HUD homes to 125,000 on the upside. Without a whole new round of changes in the marketplace and/or in our industry, it is hard to see how or why it will be more. It is long past since most industry participants have grudgingly accepted this.

ASSET CLASSES MEET

While MHI has curtailed its meeting schedule, eliminating the Winter Meeting, I see the **National Communities Council of MHI** is holding its own Winter Meeting at the Fairmont Hotel in Dallas, TX on February 11-12. (Can other divisions be far behind?) Like all industry segments, the LLC folks have plenty to discuss and I applaud them for going the extra mile to keep their conversation open, as the rest of us wait until the MHI Summer meeting in *early June, 2008*.

This meeting by the NCC folks will be followed by the February 26-27 **"National State of the Asset Class" Caucus** at Fountainview Estate in Tampa, Florida. This is being hosted by **George Allen** and others with the stated "NSAC Caucus goal is to examine and discuss aspects of manufactured housing and land lease community operations affecting all of us."

George has promised a "frank discussion of business model(s) for the future," amongst many other important subjects. I plan to attend and listen with rapt attention. You can reach George at 877-633-4764 for details. It should be well attended.

THE FUTURE?

Those of you who read my November Newsletter know that I have prepared, but have not yet released a 5-10 year industry prediction, with my best guesses for what the future will bring the factory built housing industry, with special emphasis on the HUD-Code segment. Although almost entirely written, I have not yet decided to release it, as it is not humorous reading. Quite the contrary, I struggle to find any silver lining.

I was, however, surprised at the large number of requests for the predictions, should I decide to release them. Every author knows that no matter what you write, only a very small percentage of your readers ever bother to make any remark to you about what they thought of the piece. I've written numerous articles for the Manufactured Home Merchandiser, which has a far greater circulation than my newsletter, and getting more than 3-5 responses from readers is rare. And anyone who has written for publication knows this is common.

Therefore, the 50+ responses I got requesting my predictions was surprising to me. It shows the level of interest in any materials which can throw some light at what is likely to occur in the future in factory built housing. Oh, and I learned from several readers that they promise not to have any dangerous weapons within their reach as they read my admittedly troubling predictions. That makes me feel better.

THE GAO REPORT

Dull reports

I tend to like reading those nice dull reports prepared by think tanks, government and quasi-government agencies. So when I hear of a report that mentions manufactured housing, especially with an emphasis on lending, I quickly find it, download, and then with a quiet moment at hand, read it several times, to assure full sink-in, going back to it as necessary.

Some months back I found a **Government Accounting Office (GAO)** report on the effects of proposed legislative changes to the manufactured home loan program. The study looked at the pending FHA Title I (chattel) program changes which would 1.) increase loan limits; 2.) insure each loan; 3.) incorporate stricter underwriting requirements; 4.) set up-front premiums to assure program viability; and 5.) charge annual premiums, again, for viability. Let's say that numbers 1 and 2 are pleasing to the industry while 3, 4 and 5 are decidedly not. And let's further say these are all major changes to the program.

Matters reviewed

The GAO was asked by several U.S. senators to review; 1.) selected characteristics of manufactured housing and the demographics of the owners; 2.) federal and state consumer protections for owners of manufactured housing; and 3.) the potential benefits and costs of the proposed changes for borrowers and the federal government.

I reviewed the findings carefully and I don't think that we came off too badly in the characteristics of the homes nor demographics of the homeowners. In those regards the industry looks good. Concerning state and federal consumer protections, in the main as an industry, we did not look good in the report. The report noted few consumer protections, such as RESPA closings, increasing park closings with little or no homeowner compensation, and little ability to benefit from home value increases, especially when the home is placed into land lease sitings. No big secrets or revelations here, but still, areas of weakness for our industry.

The final area, the benefits and costs portion, seemed little geared towards the benefits. There seemed far more concern about the potential cost to the government with the program changes, than with the benefits accruing. It was acknowledged that the "proposed changes for borrowers include loans big enough to buy larger homes and to provide more financing as more lenders participate in the program." That certainly is good for the industry, whose contention has been that the present low loan limits have driven the annual loans from 24,000 loans in 1990 to about 1,400 loans in 2006.

Low loan limits

I personally am not convinced that the low loan limits are the only reason the program volume has shrunk. At its height in 1990, other lending was extremely constricted. MH Lending today is quite rational. Bring a customer with a record of having met their obligations to a lender and lending is available. It's just no longer available in circumstances where experience has proven that the applicant is likely to default, and that the default is likely to have a large chargeoff. Lending for that type of loan is not readily available.

So with loan limits of about $48,000 in Title I, which takes in a great portion of single section homes sold new, and with singles being an increasing part of the mix, one would believe that there would be more than 1,400 homes per year using the program. Obviously, there is more to this matter than only the low loan limits.

Moving on

But the report goes on. It recites it does not find a great deal of loan performance data upon which it can rely in studying manufactured housing lending. It is true enough that MH loan portfolio data has not been readily available in the past, but the ABS MH bond data today, say over the last five years, is readily available. Our Wall Street friends have kept careful books the last few years and billions of dollars of loan performance data is available. Admittedly, one does not want to duplicate those loans, but they certainly instruct you as to what ***not*** to do. I gather in the end GAO spoke with some current MH industry lenders and reviewed their own FHA MH portfolio. Most chattel lenders they would speak with currently are survivors only through loan caution, so that was a wise move. The review of their own FHA portfolios is a little more problematic. I think they modeled data to find the expected loan portfolio performance associated with the current program, and by extension, to determine what the likely future loan performance would be if Title I were reformed. They admittedly were not able to model many factors known within the MH lending industry to drive performance, such as the credit score or siting locations, as they found no FHA data they could use. FHA has not captured this in the past, but is expected to going forward.

Conclusion

But still, by modeling the existing FHA portfolio they did come to some conclusions. They looked at repossessed home recovery programs upon default and found wide variances by lenders on recovery amount after home repossession and resale. They also modeled program performance using a single up front "premium," (points), changed at loan closing, as high as 2.25% of loan amount, and additionally annual premiums, as high as one percent of the declining loan balance, all loans having both.

Conclusion: "The results of this analysis show that in all instances where borrowers had a moderate to high default risk, the fund experienced a loss – that is the present value of estimated cash outflow exceeded the present value of cash inflow." For those of you not from Washington, D.C., that means the program experiences a loss. This in spite of 1.) an upfront premium of 2.25% of the loan amount, 2.) an annual premium of 1% of the remaining balance,, 3.) that the lender had a high recovery rate (50%), and 4.) the borrower had a moderate default risk. Reducing the premiums, or the recovery-after-repo, coupled with moderate risks, introduced *significant* losses. In instances of high default risk, we know the answer, don't we gang, without reading the GAO report. No modeling need there. But the losses sustained with **moderate default rate borrowers** is not good news either.

The fund (program) had the best potential to experience gains (profits) in instances where 1.) the borrower had low default risk, 2.) both upfront and annual premiums charged were high, 3.) and lenders had a high probability of a good recovery after repossession. Jeepers, in a deja vu again moment, it seems Title I may morph into what I have been calling the current "720-FICO" model, very much in vogue throughout the industry with the MH lenders still in business.

Crazy lending again?

When I spoke of this report in my newsletter some months ago I mused that based on the better understanding FHA now has about MH lending, I doubted if after passage of Title I, the "window would be open." This is especially true since "from 1990 to 2002, FHA's cumulative defaults, expressed as a percentage of originated loans, did not drop below 10 percent and have exceeded 25% in 8 of 13 years," said the GAO report.

In view of the understanding arising from this report, the current caution afoot in Washington from the sub prime mess, the time left before final passage of the legislation, and the need for FHA to create some new "protective" policies and procedures, the recent stir of great positive impact from Title I seems a little over-done. And if the GAO report is read, believed, and implemented, then the Title I program may never be the industry hope some expect. Not without industry change to stem the loan default rate and the losses sustained at home repossession and resale.

It seems GAO has seen the future for FHA Title I and it seems similar to the present 720-FICO financing now present throughout the industry. Assuming that is all there is to it, what's the hubbub all about?

But…

Well there is more to it than the above. As I said, FHA has been chatting with our industry lending friends. The feedback I get is that FHA understands the need to buy deeper has to be coupled with other loan protections to save them. And today, even for the good credits the MH industry lenders buy, investor liquidity is virtually zero, even for good MH loans. Thank our real estate sub prime friends for that. So even if the only benefits the Title I program confers on the industry are better liquidity and slightly deeper buying, those two aspects are reason enough to work for the FHA Title I program changes.

Note that this might not result in a whole lot more new loans from the normal circumstances, but the present is not normal. As with all things, time will tell if the expected Title I changes are an industry converting event, or just one more press release.

THE MHL CORP ANNUAL SHIPMENTS CONTEST

It seems the 2007 home shipments are going to wind up in the 95-96,000 range. That makes **Patrick Hoffman of Marcus and Millichap Detroit**, the contest leader, with only the final December shipments figure to be released. Am I the only one who wants to scream?!!!

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