Volume 7, Issue 9 & 10

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SEPTEMBER-OCTOBER 2007

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"FIXING CHATTEL LENDING"

SPECIAL DOUBLE EDITION

Marty's News & Notes

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

Marty's Memo This letter is so long that it serves as a "Special Double Edition" being the September and October 2007 newsletter. There just was no easy way to make it shorter based on the material covered.

FINANCIAL FORUM

As I get ready to journey to New York City to attend the MHI Manufactured Housing Finance Forum, to be held at the Marriott Financial Center, October 4, 2007, I struggle to fulfill the promise I made my readers last month. I said there that this month I would propose some measures that I think need to be instituted to correct the existing deficiencies of the ***chattel lending model***. I do not believe we can have much of an industry recovery without much better chattel lending especially in land lease communities, and have been saying so for years now.

I'm still surprised some folks fail to understand even today that MH chattel lenders haven't "lost their nerve," and are not "conspiring" to control the market for lending. No, the reality is far easier to explain. If heretofore (pre-2003) the basics and statistics of MH chattel lending were poorly understood, today that has all changed. While the "smart" industry lenders have continuously updated their loan performance figures, always seeking the keys to more expansive lending while remaining profitable, the general understanding of MH chattel lending still survives today on ***immense caution***. Profitable MH chattel lending is still very much a niche product best practiced cautiously and therein lies the constraint to increasing the shipments of HUDCode homes.

In order to believe that chattel lending is the key to industry growth, one has to reflect with clarity on the inability, so far, of real estate secured HUDCode transactions to lift the shipments to any extend. As the late 1990's progressed and chattel deliveries first stalled, then plummeted, many industry participants and outside pundits believed conforming and non-conforming real estate mortgaged HUDCode sales, tied to the land, would pick up the slack. That was not to be.

Drop to low levels

While chattel secured home, placed in land lease communities and scattered sites were dropping to unimagined low levels, real estate secured transactions did in fact increase slightly, but hardly enough to make up the loss of at least 150,000 chattel financed homes no longer being financed as the Greenseco Finance chattel model fell from favor, its non-profitability lethal for those using it, and dangerous even to bystanders, especially the borrowers who lost their homes in record numbers. That episode was a preview of coming attractions of the current sub prime prob-

lem presently on lenders' plates. (Ain't lending in a freewheeling fashion great fun!) And I can tell you from experience that MH lending in a survivable fashion is hard work, with few "high five" moments, with rocks and hard places hemming you in.

On the one side, too much caution leads to low loan volume, originating insufficient loans causes high costs per loan, with that endangerment. At the other extreme, greater loan volume may require avoiding safe underwriting and safeguard protocols, the limiter on expansive lending. There are no guarantees or formulas one can follow on these constraints to assure success. And therein lies the "big problem" for MH. Needed loan caution and too few high credit applicants equals low volume. That has depressed shipments.

As we survey the last 50 years of lending on our product, there has been a constant effort to "main-stream" the product. By that I mean allowing an intelligent lender, with good money availability, at market rates, staffed by average lending personnel, to enter the MH lending market, proceed as they might lending on boats, or cars or site-built housing, and stand a good chance of financial success, creating a lengthy history of profits. This makes a lending product popular with banks, credit unions and finance companies and spurs industry success. It is indisputable that only successful MH lending can revive this industry. Keeping it a niche product for just a few companies to exploit might help them, but will do little for the totality of the market. The ability to mainstream the product has thus far eluded successful chattel lending.

Come and go

Historically, while innumerable lenders have come and gone in the industry, profitability has eluded almost all of them, with exceptionally few successes coming to mind. Only the two lenders of **Clayton Homes of Maryville, TN** and **Triad Financial of Jacksonville, FL** come quickly to mind as long-time MH lenders with continuous presence over 25 years or more. Other than that, lenders have come and gone. That of and by itself says a great deal about lending on MH, most of which, historically 80-85%, has been chattel, especially into land lease communities.

The greatest "HUD-type" home shipments actually occurred before the introduction of the HUDCode in 1976, during the 1969-1973 period, averaging 477,000 homes per year. Now, In an era of far greater population, and continued "affordable housing" demand, our 100,000 home shipments pace of this year proclaims loudly "something is very wrong."

During the 1960's and early 1970's era the "automobile lending model" was in vogue for MH lending. Apparent down payments were generally higher than today (if not actual), homes were far more modest, repayment terms were far shorter, and mobile home parks, where the vast majority of homes sold where sited, were in the hands of people whose primary source of income was from the sales of the homes going into the parks. It wasn't until much later that rental income from the parks became the greatest income producer rather than the sales of homes. When this occurred throughout the industry, it brought new players and large changes occurred which are still being sorted out even now.

Almost always, when MH lending pre-2000 was viewed as a "semi-main-stream product," banks were drawn by the "big interest rates," (you know how lenders like those!) and the belief, mistaken though it was, that lending on "trailers" was "just like" lending on houses or cars, "but just a little harder." (Chuckle, chuckle.) Don't believe that? Review the period of 1991-2000 when 30-40 banks were prominent in MH lending with that belief. If MH lending was "harder," that "big rate" would save them in the end. Yes, of course, and that is why they are all now departed, all posting huge losses.

The first go round of these MH lender losses occurred in 1974-1977, and took a very large number of lenders out of the market forever. I well recall my visits to New England and North Carolina banks in the late 1980's, and early 1990's soliciting MH lending investors for our loan company. To say that I was treated roughly almost always, understated the reception. These folks still had deep wounds from their previous MH lending episodes and conversations were short before a curt "no," ended the audience, and I was shown the door. "Get out of here you trailer rat!"

Wall Streeters

Today of course, the refugees from the late 1990's

– 2000's downfall in MH lending populate lender staff at enumerable banks and Wall Street firms. Their experience was so bad and our market size of profitable lending is so small, why get involved? Why indeed.

And as I head to the Wall Street/MHI lending conference, that very thought is on my mind because I think that it is very much on the mind of many of the participants we expect to attend. "After the crippling losses suffered by MH securitized loans from originations between 1994-2003, perhaps the greatest percentage ABS bond losses of all time, what are the reasons we should get involved in MH receivables?" I assume they will ask that? At the very minimum, they should be thinking it.

And there are some positive answers we can give. Fraud in loans is far less than previously. Loan documentation is very good, a previous weakness. Loans are made to far, far better credit risk than before and defaults will be decreased by an order of magnitude of 3-5 times less than before. Interest rates are significantly higher as compared to site-build housing than before and should render a good investor yield. And finally, you have a better customer, buying a better house, with more loans tied to land in some fashion, with ABS bond-performance-prediction recently being met and even surpassed. All pretty good stuff, frankly.

Good, but not enough

I am unfortunately reminded of the response of the black-hooded Master Beta, his face unrecognizable in the candlelight, the guardian of my fraternity's selection of new pledges hoping to become brothers, as the sponsoring brother enumerated the attributes and achievements of the pledge seeking brotherhood at the fraternity: "Good, but not enough." Yes, all the positives I've enumerated above are great, but as the Wendy's lady asked, "Where's the volume?" You see, the industry lenders have rationalized lending to become survivable based on loan quality, but they are having great difficulty changing other aspects of the industry model, which without changing, loan volume cannot increase much, hamstringing the often predicted (not by me), but never achieved "Great Leap Forward" in HUDCode shipments. There simply is no loan volume increases yet as new and used home sales are skimpy. Great HUDCode home buying demand? Yes, but primarily coming from a non-financeable group of buyers.

The HUDCode industry has recently grafted many elements of rational lending, enumerated above, unto an overall industry model, which has arisen over many years of insufficient safeguards activity, lacking transparency, with few borrower/lender protections, and the industry seems incapable of sorting out what the final changes need to be or how they can be implemented. I think the situation is pretty clear; the marketplace has already rationalized MH lending into an 80-130,000 homes per year industry, even now as company consolidation continues to drive down capacity and costs for people and places no longer needed in the industry. A permanent resizing is almost in place. Anyone who does not recognize that must be listening to industry rhetoric rather than viewing industry results.

And it may be that the conference participants do in fact believe we are just in an industry down cycle, with a "cyclical retreat" about to end, bouncing us back as sub prime buyers, previously going into all those site-built houses, flood back to us to move into our landlease communities, where sufficient homesite vacancy exists to fuel some great years.

♫♪♫ **Happy days are here again.** ♫♪♫

I'll be looking for that story to be told October 4th. I will not be telling it because I can't sing that song. Yes, I can tell of the good, but we have too far to go yet. And like Ponce de Leon, who traveled all over the southern US, including the Florida Everglades dressed in armor on horseback, looking for gold, it is conceivable the journey I prescribe for the industry will be like Ponce's; quest, unsuccessful. (Although if he didn't find gold, he did explore Florida, without whose incredible success, the total MH industry over the last 50 years may well have been a ninth smaller.) Thus, the sad truth is that the measures I and others recommend for industry salvation may not rescue it.

Setting for change

All right, let's get into the measures that in my mind need to occur in order to start a new industry shipments increase, sustainably derived, and tending to make it a more mainstream lending product. You cannot create a larger industry without a profitable and survivable lending model, which can successfully

accommodate at least double the present volume, in an attempt to grow it into the long-term home shipments annual pace of 250,000 homes. This will require survivable lending to an average FICO tier at least 60 FICO points lower than recent ABS portfolios and increased buying demand from reasonable credits. We do not need more 580-620 FICO demand.

I've spoken to a number of people lately, industry stalwarts, who finally agree with me that the industry model is broken. They recognize that the present grafting of a highly protective underwriting and loan closing regime onto an otherwise disorderly industry model may well benefit some individual industry participants, but in the end will create a far smaller industry. That is what we see now. Some few prosper even as the industry sinks further.

And in defense, some have said to me that I've done a good job of analyzing the industry faults, but have paid little attention to the measures that could rationalize the defects. While I do not think I've entirely chronicled everything that could and should be done, I refer to those who make those comments to me to review my last 5 years of newsletters and see if they won't find everything there that I am going to write herewith. And if you can only read one, go to the **March 2004 newsletter**.

Words without actions in Chicago

At the Chicago Retreat which met several years back, I volunteered there that I thought the industry defects could easily be broken down into two key elements:

1. **The Roper Factors:** Those are items which our consumers identify as industry weaknesses tending to have our product sales, delivery, installation and after sale yield far less satisfaction than our customers would like.
2. **Home Value Deprecation:** Those industry practices which tend to cause the home to lose enough value that with a modest down payment at purchase, the home is not later resalable within a reasonable time so as to allow the homebuyer to gain sufficient proceeds to pay off his home loan. Presently, even with borrowers with high FICO's, this is a leading cause of repossessions.

I know that when I identified these two items I did not see much shaking of positive heads symbolizing, "you sure know your stuff, Marty. Those are the problems!"

Instead the reception was that a whole passel of factors were the problem, and one or more of those were the culprits leading to the industry slide. Fair enough, I'm in favor of correcting those identified factors, but note that without the stemming of home depreciation, industry growth is not really possible. And in the alternative, if you do stem it, then the "Roper Factors" while always important, take on less importance, although complete industry salvation will require action on both weaknesses.

General Measures

Let's start with general measures which tend to create a better consumer satisfaction and let's progress into measures which tend to reduce home depreciation. An easy breakpoint between the two is difficult as a better home warranty, as an example, will not only create better consumer satisfaction, but also tend to reduce home depreciation. And many measures will be like that.

Without prioritizing measures, let's just start a list.

Image Campaign

As I sat around **John Diffendal's** "investor dinner" in New York City the night before the MHI Financial Forum, my table was composed of several Wall Street investors, **Larry Keener, CEO of Palm Harbor Homes**, and myself. After listening to Keener and me respond to their queries, **Christopher Abbott, Senior Vice President of Chilton Investment Company** asked a simple question.

"You guys have a great story to tell, but I don't think the public knows it. Have you thought about a Go-RVing type campaign?" said Chris. Whoa, that made ole Marty jump for joy! You all know that has been one of my drumbeats for years. An Image Campaign to tell the public the role factory built housing plays in the American housing segment is simply a necessity. Every day that goes by we cripple ourselves because we are not doing it. And I'm tired of industry personnel who have no knowledge of these matters telling me 20 reasons why it shouldn't be done. I suggest it is not only necessary, but frankly, inevitable. Let's get the experts on these types of campaigns in-

volved and take such actions as are necessary to create success. Can we make it worse?

Builder Responsibility for integrity of the home installation/delivery

One of the big problems our consumers face is that they often feel left to their own devices after they buy. Our builders often don't want to take responsibility for the shortcomings of their retailers and their sub-contractors. The builders don't want to take responsibility for their retailers because they don't trust them. And the retailers don't want to take responsibility for the installation subcontractors, again, for lack of trust. Yet they seem to have no difficulty transferring the results of that mistrust to the consumer, and by default to the consumer's lender. This is a major problem and the new **MH Select Conforming Mortgage Program at Fannie Mae** is the first program that requires significant protections for the consumer from that weaknesses in the present model to protect the consumer. In a sense this is like the recourse model so effectively used by many for years in the industry to protect a vulnerable lender from the troubles of MH loans. This will ultimately have to spread to the chattel model as well.

Need an industry "insider"?

*Someone who knows his way around **HUDCodeville**?*

After 34 years of observing the scene Marty Lavin has seen most everything. Why repeat the same mistakes others have made.

Call Marty for a free consultation on how his experience and expertise can advance your agenda.

Call Marty at 802-862-1313

Longer and better home warranties

The consumer needs far better warranties and longer ones, say three years, to insulate him from the financial shocks home repairs or breakdowns can bring. In the event some major home system dies at 18 months after purchase and the repair is $300 or more, a default-causing event may have occurred and without the warranty providing this protection, we've potentially created a repossession. We also have a sour customer.

The automobile people understand this well. Other than Toyota and maybe Honda, I wouldn't buy a car without a comprehensive warranty based on the type of difficulties say a BMW or Mercedes can bring in the first 50,000 miles and the cost of those repairs. Most would never buy one of those vehicles without a comprehensive warranty. The companies understand this and all autos have good warranties, many of which include maintenance items as well. And make no mistake, warranty adherence is expensive, but far cheaper than selling a whole industry down the river for lack of overall consumer value.

We cast our customers aside because with very limited warranties, meager warranty compliance, (See Roper Study) and short warranty term, the cost of home ownership, especially during the early years when the impact of homeownership has the greatest financial impact, can strain the homeowners ability to pay his loan, if an untoward event happens to his home.

Cost of home site occupancy

After we put the homeowner into the dwelling, we frequently turn them over to land lease communities, where the future cost of site occupancy has become an unknown, often with annual rent increases outstripping the ability of the homeowner to keep pace with costs through his earnings. This has contributed to substantial home value depreciation in land lease communities resulting in a large decrease in chattel lending into communities placements, to say nothing of homesite vacancy, as lenders protect themselves against the losses known to frequently occur therein. (Far too frequently.)

The high gross profit, low volume of sales model

The industry has evolved into low sales per location. This has seen an average of 36 homes delivered *annually* by the average retailer. A sales location selling over 100 homes is a giant retailer and very few exist. The sales volume at each location is so low that a high gross profit must be achieved on the home in order to have any chance to survive. Even today, with far more rational lending, it is not unusual to see loans being made that represent 125% of "invoice". Note that this does not exclude the "slush" already in the invoice, such as volume bonuses, advertising al-

lowance, dues, and other items. Nor does it encompass the customer's down payment, being the 5% or greater we see today in most lending. With down payments commonly averaging over 10% and invoice "slush" over 10% commonly; it is easy to see that basic home gross profit can easily be 145% of true invoice or more. Home value depreciation starts there. This type of mark-ups will have to be throttled back. The industry must try to move to the "high sales volume, low gross profit sales model."

We treat used homes differently from new for financing

Most lenders will admit that given similar underwriting and scrutiny, new homes and resale homes will perform in similar fashion. Still, the loan-to-value advance, the interest rate, and other loan factors are usually harsher for resales than for new. This continues the home value depreciation, as such treatment for resales creates value depreciation at first sale. The industry is not good at treating resale homes with the same respect it does new. In the whole they have tended to treat resales as "throwaways," and so they've become. Is there nothing we can learn from the treatment of resales at Honda, Mercedes, Audi, BMW, and others? Not so far, apparently.

Our home loan closings lack formality

The real estate industry has evolved a voluntary and mandatory sales and closing routine calculated to protect the consumer, who is often unsophisticated in these matters. While it hardly guarantees an entirely trouble free transaction, it does a far better job than we for consumers. Our industry has essentially refused to comply with real estate safeguards and only a few jurisdictions have forced such safeguards on us. We chafe at those few restraints. Transparency and consumer protections seem little on our mind.

So in MH we see few chattel loan escrow closings, or earnest money going into trust, little involvement by appraisers, or lawyers, or the many other measures tending to create transparency and safeguards for the consumer. When many of these measures are avoided, such as in chattel lending on MH, loan performance has been far below that of real estate loans. I can't help but think there is a serious lesson somewhere there.

But I realize we don't want these safeguards in place. It slows the "process" down.

The above, and others are concepts leading to the two deficiencies I identified at the Chicago meeting above. Without attending to these, **Roper and depreciation**, there is little beneficial change that is likely to result. The marketplace is currently rationalizing the MH industry, imposing an ever-lower shipments basis that is survivable. This is caused because lending cannot occur at the level that is needed without significant industry changes, and we have yet to find a way to increase greatly the attention of better credits in and to our products, igniting the demand side.

Changes in Attitudes

And what are those needed changes? In no particular order, we need help in these areas.

1. **Invoice Database** All invoices of all homes produced must go into an MHI controlled database available easily and inexpensively to lenders, appraisers, and homeowners, with the proper protections as they are accessed, delivered via the Internet. This also allows cradle to grave tracking of the home with uses we don't even know yet. While provided for every loan for new homes, the industry does not make them available for resales.

2. **Shorter loan repayment terms**When I polled our chattel lenders to prepare for this letter, to a person, they all recommended reduction of loan terms to 10-15 years on single section homes and 15-20 years on multi-sections, both with sales price cutoffs. Over $40,000 to get 15 years on singles, and over $60,000 to get 20 years on multi's. This would tend to reduce the negative impact of home value depreciation with far quicker paydown of the note. Sales proceeds would then more commonly allow note repayment.

3. **Tighter loan to value advance** Hey Marty, this ain't Russia, pal. What do you mean by trying to limit how much I can make on a home? Well, lenders limit what they advance on all sorts of products. If using an invoice to loan on autos succeeds it is because the allowable advance over true invoice rarely exceeds 10-12%, more commonly 5-7%. We have been allowing 140-150% of true invoice lending, and it is proven not to work well. A large loan advance to in-

voice amount guarantees home value depreciation. A high gross profit can only work on items which have high consumer demand coupled with scarcity of supply, say like diamonds. And even there prices are held up by manipulating the supply of an already scarce commodity. Last I looked manufactured housing had neither high demand from creditworthy buyers nor limited supply. Continuing to get the "deBeers markup" from a commodity in plentiful supply sold primarily to people on a budget is keeping the industry at low levels of volume. Tighter loan to value advances of not more than 10-20% over dead invoice, with limits on profit at sale will need to be instituted. This will reduce home value depreciation.

4. **Using a standardized form** The more we standardize procedures, regulations, safeguards and underwriting, the more likely we make it easy to enter the industry and appeal to mainline lenders. Keeping MH a small niche industry with arcane operating procedures, documentation and practices tends to shield existing participants from competition, but under current conditions, creates a very small industry. Standardized forms, like everyone using the same credit application, delivering it to lenders by the Internet, and using standardized closing documents, as they do in conforming mortgages, is an important element to better action. The industry and lenders must move towards this if we are to mainstream the product lending.

5. **More use of appraisals** Without a doubt, using real value-based appraisals can reduce or influence sales. Yet, if the consumer does not like doing an appraisal for us, he surely can't avoid it by going to real estate. He will get one there if he goes forward. The use of "books" only, with standard lender formulas, and advance-to-invoice is no way to run a large, profitable industry, which delivers value to everyone. The book is only a cog in a complete appraisal, not to be used alone. The homeowner and his lender did not receive value with the past lending practices and the industry reduction reflects that. After all, during the 350,000 shipments for several years in a row in the late 1990's, most of the industry gained substantial profitability. However the losses by lenders, loan investors and horrific numbers of homeowner defaults and repossessions gave proof that value was not being delivered to all.

6. **Longer house warranties** The homebuilders must find a way to deliver a fairly comprehensive three-five year warranty for homeowner protection. This might be done by the use of appropriate third party warranties, the cost of which is built into the invoice of the home. This will help for the cost of home ownership for the early years when the borrower is most financially vulnerable.

7. **An MLS system** We have the beginnings of an MLS for MH in several venues already. Most are just in the beginning stages. Far more is needed. Perhaps some of the zeal the industry demonstrates on the alternative construction letter and other nuisance items could be directed at true issues, such as working towards a real MLS effort, training of MH resale brokers, and every element of creating an organized resale marketplace. Can we partner more effectively with Realtors? Without a well-organized resale market, the homeowner is left to his devices to resell his home. Failing frequently in that effort, he resorts to "giving the home back" to the lender, or selling at a sacrifice to another, which is not infrequently the community owner where the house is sited. The landlord often turns around and scores a "home run" on the sale. All great stuff, but without the availability of easy lending money, every time something like that happens, another nail gets driven into the coffin. Creating an organized resale marketplace would do far more to rescue the industry than HIA 2000.

8. **Manufacturers Statement of Retail Price (MSRP)** This is needed for two reasons. First of all it provides greater clarity and shopping comparison opportunities for the consumer. Secondarily, it allows the builders to "guide" its retailers into a proper sales profit, consistent with volume and profits for the builder and the retailer. The current lack of pricing guidance is a disrespect to our consumers, putting into his mind that we are a disreputable bunch, moving three walnut shells on the table, which shell is the pea under? Oops, there is no pea! Finally, the MSRP helps lenders deal with all customers being treated more alike. No one wants the black eye of "certain" consumers being treated differently. It's also illegal.

9. **Posted home prices** I really don't even know why this one is at issue. I go to the grocery store, look at 11 boxes of salt. Ten have a price, one doesn't. Let's see, you chose to take the one without the price to the check out? Well, you might, but most people don't. They do not like to buy items that are not priced as they fear they are not being treated fairly. Yet, nothing is more common in the industry than waiting for the "up" to demonstrate an interest in the home before he is quoted the price. "You see Marty, I wanna size him up before I quote a price to see how I can maximize my profit." A woman alone? One price. An African-American couple, another price. A white guy with tattoos, a different price. You see, it's the art of selling.

Yah, I see. It's the establishment early on that at manufactured housing a square deal is the deal you are least likely to get, setting the plate for all that follows. Read the Roper Report. And this is an issue AARP has railed about. Can't we make some people happy? Isn't it the right thing to do? What is the hold-up?

10. **Final Inspection of the home before delivery** No lender should fund a loan until it is convinced the home is properly delivered and the customer satisfied with the fact he got what he bargained for. While this is getting to be industry lender practice, we are not there yet. Until the industry has established a long-term track record of compliance, this must be required. The walk-through punch list the site builders use before their closing with customer sign-offs is a good start for us. Not fool proof, but one more safeguard for all parties to the transaction. Retailers resist this measure, as a lender I would want it badly. It is one more measure to assure the integrity of the process and to deliver more value to the consumer and his lender. It also keeps the sellers and builders on their toes making them do the right thing.

11. **Community Attribute System** An important compendium of the details of land lease communities in a database owned by MHI and operated by **Datacomp Appraisals of Grand Rapids, Michigan**. Still in its infancy, the data is building, the cost to get data is low, and over time the data can also be used to tandem with an in-park MLS. No lender should be lending in land lease communities without accessing this data. It doesn't take a genius to look at the 70+ attributes compiled therein, and if correct and current, a lender has a very good idea if that is a community wherein you want to lend. A $57,000 loan on a new multi section home being placed in a community comprised mostly of older single section homes, re-selling for around $12-15,000? You can make the loan, but five years from now, what do you think the home you financed will resell for? Can your homeowner write a check to pay-off the note amount above the proceeds of the sale? You better hope so. This is an important lender safeguard and allows better loan decisions. Lenders must use it and the data fields must be updated. It is a spur to community owners to work toward excellence.

12. **Better finance treatment of resales** No Virginia, all resale MH's are not crap-boxes to be financed for 10-15 years less term than when they sold new. Require a real value appraisal so the quick "appraisal book" standard formula won't undervalue (or overvalue) the home. We certainly should not have the significantly higher interest rates on resales than we now see on new. Perhaps we should not try for complete parity, but debasing the value of resales debases the new homes as well, and you see the result of that all around you. For profitable lending and delivery of value to the customer, as go the used so go the new.

13. **Proper and easy home identification** I did a quick study once on the damage caused by standard formula book appraisals coupled with improper home identification. I found the loss of value substantial. We all know the industry produces a bewildering variety of homes, often with enormous differences in selling price of the home, and some homes even being the same size and having similar model names. Yes, content does count in a home. Drywall construction, better windows, upgraded appliances, architectural details, better insulation and a number of other factors can make a big value difference.

Since builders do not provide good home identification in their serial number, the true content aspects of the home may not be readily available, except in the invoice. At resale, invoices are rarely available, if ever. Lenders being the highly pragmatic bunch they are will take the lowest value that home could be, often without a great deal of further inquiry. In the event of

calls to the factory for better home identification, some are helpful, but many are not. They already sold that home once and are little inclined to spend too much time on the matter. At times, asking up to $250 to retrieve the info. That will cut down on those requests, eh?

The invoice database I discussed above is a great way to properly identify the house. A second way is to use a standardized serial number as is used in the automobile and other businesses. The special serial number range could identify the many relevant factors so that by using the proper code sequence one could know all about the home. This would make home identification certain and more importantly, stop the guessing and depreciation of value occurring by use of standard valuation formulas because we can't properly identify the home easily, or at all.

As between the two, if I could only have one, I would prefer the serial number as once you know the serial number all the relevant information is available to you immediately and free of cost. But the invoice databank is important for good identification purposes and may also have cost data which appraisers love. Oh, but Marty, once they get that cost data that's all lenders will ever loan on resales, you say! We should be so lucky they would start lending that much commonly.

This one is the canary in the coal mine. By that I mean it will be a sure tip-off that if the industry is not serious about taking action to assist lenders, appraisers, and homeowners with proper home identification after the home is sold, and being resold, where can the industry start to solve our dilemma?

14. **Third party final home inspection** No loan should be funded without a reasonable inspection and assurances that the home installation is proper, the customer got what he bargained for, and the homebuyer has had a walk-through the house and is satisfied. Expensive you say? It will create problems because we find out the process is incomplete or wrong? The retailer doesn't want you to do this? Just think about those reasons for not doing it, as though defaults are cheaper or unhappy homebuyers don't cause industry problems. Continue to avoid this at your own peril.

15. **Quality of homes** I am the first to tell my clients that in general, the industry builds competent homes and actually some are better than competent. However, I've been in far too many homes which are three or more years old, and my impression has often been how "used" the home appears. Many times the visual impression is one of a home many years older than it is. Yes, I am aware some of our customers can be hard on a home. We can build for that.

It is easy to create extra space in MH and often builders will induce buyer interest by the large amount of space at very low per square foot costs, but use non-durable materials to achieve it. The downside is the home that appears so "worn" in short order that it creates problems at resale. The tatty home appearance reduces its appeal in contrast to the new similar home offering, which the home buyer can buy with more attractive financing, for little more in price than the payoff amount of the loan on the resale. Can you say, "home value depreciation," anyone.

Substituting more durable materials of better quality and reducing home size might be a wise tack for the industry. After all, that GM vehicle which commanded 49% of the entire U.S. auto market in 1977 taught us that it was a 50-70,000 mile automobile before troubles started. As people bought Toyotas they found that at 100,000-150,000 miles the vehicles were still giving good service. That played a giant role in the rise of foreign autos, especially the Japanese, and brought the American companies to their knees, all of us blaming the UAW for their problems. Yes, the UAW shares the blame, but so does the lousy auto GM and their counterparts produce. Consumers are not all stupid, are they? At least not the ones with good credit who make informed decisions.

16. **Factory invoice with clear dealer costs** The Truth in Invoice Practices Statement (TIPS) is calculated to try to create a verifiable home invoice so that any lender and its appraiser can clearly see what is being paid for the home. While recent changes have created more reliable invoices, the fact is that only within ranges can a lender today easily know what the retailer is paying for the home. Strange you say? I agree. Invoices should clearly show what the home costs the retailer. Period.

17. **Long term leases and Lender/Community Agreement** Many of our best rental homesites are bent on maximizing rents. Often that is done without

other considerations. In order to induce in-park lending, the elevated depreciation homes in land lease communities undergo all too frequently must be abated. One of the ways to do this is to negotiate Lender/Community Agreements which determine a course of dealings between the two, especially after default and repossession. This can save lenders large sums upon default, and gain the community owner's valuable assistance to handle the repo and resale.

The other necessary ingredient will be the use of long term leases to induce a lender to extend a loan for a home going into the community, tying the rent increases to real increases in operating expenses plus real increases in earning capacity of the homeowners. And since you've allowed people to borrow on 20-25 year loan terms, how do you close a land lease community without homeowners recompense! I wonder how our consumers feel as my "Google Alerts" send details of a new community closure almost daily? Would you trust us.

18. **Use of Indices for Long-Term Leases**
The current popular notion that a homeowner should be paying as homesite rent the capitalized value of the homesite according to the OFHEO index of single family residences, plus the increase in operating expenses has tended to be less than successful for both the landlords and the resident. The former getting increased vacancy and the latter suffering a high default rate caused by the resulting home depreciation. Lending in communities has suffered as a result. This industry cannot prosper without a strong chattel-into-land-lease business, and neither can the land lease contingent.

The homeowner who makes good life decisions, the type we need as lenders to finance, will not value the rental homesite anywhere near as much as the OFHEO. And that index usually overwhelms the resident's ability to pay based on annual earnings. As homesite rents increase annually, the resident "buys" the lot over every year, unlike the real estate secured borrower, who unless he refinances and gets money out, has fixed the cost of the purchase of the lot until he sells. With rising rents, we never fix the cost of homesite occupancy.

Lenders will want to be protected with long-term leases to create more surety that the value of their collateral will not drop in tandem with overzealous rent increases. As lenders we all understand the desire of landlords to maximize their return on their land lease community. Still, if done at homeowner/lender expenses, lenders must draw the line. The line drawn has tumbled in-community lending and without significant changes, is going to change little in the near to mid-term future.

It is here that a serious effort must be expended by the industry to correct the defects that in-community chattel lending encounters. It is here that a great loss of home shipments has come.

19. **Proper Installations, Proper Homes** Recently I heard a leading lender describe the actions his company has taken to create proper home installation. He rewards low set homes, those looking more like site built foundations than the easy-to-do, not-so-good looking high pier home installations so common heretofore. He wants to see covered entryways, proper porches, front and rear entry stairs, good architectural design. And this is not conforming mortgages, but chattel. And why is this industry-leading lender doing this?

Simple, Good installations, completed on time, delivered as agreed upon with the homebuyer, set low with a distinctive home creates far greater home satisfaction for the home buyer, AND when it comes time to resell the home, appeals much more to subsequent buyers than modest homes, poorly sited and installed, sitting on stilts up in the air. Thus reduces repossessions by greatly increasing the ability to resell and pay off the home loan through sales proceeds. To say nothing of the increased consumer satisfaction delivered, and increased homeowner desire to keep his home *because he likes it*.

This lender is using the carrot approach. He gives a substantial interest rate reduction for such installations. It may take more than that in the future.

20. **Too many defaults** Part of the defense sub prime lenders have given the media and regulations for the elevated defaults and repossessions likely to occur is that "they gave sub primers a chance for homeownership." I'm not sure how much currency this will have as Congress and the regulators stick their nose into the causes of the sub prime mess.

But I would guess that in the case of manufactured housing, were we to continue to loan into communi-

ties, with known default rates in the 35% range (even with good credits), that if we use the above excuse and justification we may well see an eyebrow or two raised. Me thinks that while the carrot approach can work well with a very hands-on lender who really works at his craft, in order to main-stream chattel lending in community placements may require a little more stick. And charging high chattel rates but having high defaults may work for those hard-ass Wall Streeters, but it is a poor business model. It smacks of "Buy Here, Pay Here" and is below what our dignity level should be. It may also catch the unwelcome attention of "busy bodies."

21. **Retailer/Builder Relationship** It seems that the relationship between these two important industry segments has always been a handful. Retailers with good financial capability and experience in the industry are rare. It has historically been a "bootstrap" industry where retailers came with little, made little over a business career, tried to hang in during the down times, and faded into the sunset.

Along the way consumers had various difficulties with them and consumer surveys find this industry participant, the retailer, with low grades. The industry itself views the retailer as a very weak link. The difficulties lenders have with them is legendary, although I must admit that lenders too often have failed to protect themselves.

Lenders and builders are going to have to have far greater concerns over experience and financial capability of the retailer. Where those are insufficient, and that is common, retail lenders are going to have to secure back-up performance from the builders the retailer represents. Without this builder back-up the process continues to be a high default/large charge off endeavor which stands little chance of shipments increases, unless of course you believe that Greenseco Finance is alive and well in the wings, ready to burst back on the scene, chattel loans ablazing.

22. **Protected territories and a good chance to make a profit.** By being well capitalized, experienced and protected and guided by their franchiser builder, that is how we turn retail locations into real businesses with an excellent chance of industry success. We see this does work in some parts of the industry where builder-owned sales outlets are made financially capable through the parent's financial strength, their managers are carefully selected and guided, and they have protected territories. Often their managers are selected with greater care than their financed retailers. In these cases the builders have the same type distribution representation as the automobile companies, where franchised dealers are commonly experienced business people, with strong financial capability, and protected territories. In those instances where the factory owns the sales point in autos, it is done only to keep open a dealer-failed location important to them which will be sold out soon, or to partner with a minority person to help than profit sufficiently to become independent at this store, bolstered by factory financial strength with extremely tight business guidance. Usually the CFO at these stores reports to the auto company involved directly.

As an industry, this very perplexing matter will need serous attention. But whether the industry fixes it or the market does, it will be settled. The market is likely to settle it at lower shipments than a unified industry approach.

Final reflections

If you think you are exhausted reading this, think about writing it. And I'm not sure there may not be other needed measures. I have never before been able to sit down and read this laundry list of industry model enhancements needed to correct the failed model. And if you disbelieve me that the model is failed, I repeat the words of the **"World's Greatest Investor,"**

Warren Buffett.

In my **March, 2004 newsletter**, which was the early precursor to the comments in this letter, I quoted from Warren's February 27, 2004 statement to his shareholders. In part, regarding his view of the manufactured housing, Warren Buffet said the following:

"During those years, (the 1990's) moreover, both the quality and variety of manufactured houses consistently improved.

Progress in design and construction was *not matched*, however, by progress in *distri-*

***bution and financing*. Instead, as the years went by, the industry's business model increasingly centered on the ability of both the retailer and manufacturer to unload terrible loans on naïve lenders." (emphasis mine)**
(The above is from page 5 of Buffett's letter of February 27, 2004.)

He continues on, "A *different business model* is required, one that eliminates the ability of the retailer and salesman to pocket substantial money up front by making sales financed by loans destined to default. . . . Under a proper model – one requiring significant down payments and shorter-tern loans – the industry *will likely remain much smaller* than it was in the 90's." (emphasis mine)
(from page 6 of Buffett's letter of February 27, 2004)

The foregoing are the exact words as delivered from Warren Buffett to his shareholders. They are the words of the world's greatest investor as to how he sees the MH industry. To paraphrase a saying, when Warren talks, maybe as an industry we should listen.

And I agree with Mr. Buffett that if only down payments and shorter loan terms are involved, we are likely to remain much smaller. The measures I proposed are to start a return to the 250,000 annual home shipments industry long time trend line, with far more comprehensive action.

And why do I repeat Warren's words again in this newsletter? Because when I say what he says I know many people do not believe me. I'm a "nobody" and when I speak of a "failed industry model" in manufactured housing, people think they can disregard it. And for others, the enormity of a "failed model" is beyond their comprehension.

I can hear their words. "This industry has always worked in the past." Or, "The lenders have just lost their nerves." In reality what the lenders lost was their shirt. Finally, "This is simply a collusion by unknown entities to take advantage of the market."

The only people I know who are doing well would prosper even more with a robust market. Alleging market collusion is so childish and avoids reality so deeply, that I can only shake my head when I hear it. It's usually spoken from atop the "grassy knoll."

Warren Buffett is a SOMEBODY. As you read his words above, can you afford to ignore them? Hasn't he been proved right with such force that we should not doubt his words and undertake an immediate series of steps to correct the failed model?

That would seem an intelligent result, finally, and as the industry committees appointed by **MHI Chairman Barry McCabe** meet again in Hilton Head, SC, on October 21-23, we'll watch for industry progress. Can we rescue ourselves from the housing niche into which we've fallen and can't get up?

THE MHL CORP ANNUAL SHIPMENTS CONTEST

My "shipments seers," **John Diffendal, the BB&T hotshot,** and **Tom Beers, MHI economist,** savant of the SAAR shipments index, are both holding to around **99,500** homes for 2007. With the reports in through August, when we were "only " down 9.6% from August of last year, we are beginning to run out of year to recover. We may be soon joining the Chicago Cubs and Boston Red Sox in "wait till next year" chants.

At the present level of shipments the contest leader is last month's leader, **Dennis Ohnstad of Riley Homes in Urbana, Illinois**, who predicted 101,100 shipments for the year. I hope the University of Illinois' 5-2 record in football has been more pleasant than our shipments record to Dennis.

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