DELIVERY

By Martin V. Lavin

What does the term *delivery* mean in relation to MH lending? In other words, when has the seller "delivered" the home and the borrower "accepted" the home so that the lender can feel good about "funding" the home?

These questions have been on my mind as lenders struggle to increase their loan quality without greatly sacrificing volume. Prior to writing this article, I called many of this industry's best lenders and could not get a standard definition or, more importantly, what triggers the funding process.

Some lenders fund upon acceptance of a fully completed loan package with no further audits. This is still a popular method. Others fund only after some degree of auditing, primarily by phone, while others audit by phone and on-site visits. Everyone uses a different method, but audits seem to be increasing in frequency.

All that said, because the delivery process in the manufactured housing world is still being defined, the financial side of the home transaction equation has been negatively affected.

Those simple questions I asked earlier highlight much of the uncertainty faced by manufactured housing lenders, retailers and new home owners as sales transactions wind down to their inevitable conclusion.

Vaguely familiar?

See if this real world situation I encountered sounds all too familiar and uncomfortable.

My firm funded a home, and the retailer sent us the retail installment contract. A call was made to the retailer who assured us the home was sited, the skirting installed, all the options were on the premises and the borrower/buyer was just entranced by his new home.

Apparently, the enchantment did not last long. The loan resulted in a first payment default.

With rare exception, there is no good excuse for a first payment default. When that happens, the lender—in this case my company—obviously made a mistake or violated some rule that protects the firm from incurring bad loans.

I was selected to determine the cause of this default. My mandate was to investigate the causes and ensure it never occurred again.

Never is a long time.

I drove up the road to the community where the home was "sited." In the wide green area between the roadway and the rental community sat our collateral.

I could see the curtains blowing through some of the windows that were already smashed. My heart sank as I drove closer. I verified the serial number. It was the home, but I had hoped it would not be.

I started asking neighbors what they knew. Everyone seemed to know the details, except us, of course. The retailer had brought the home to the community and started setting it up. Because he had been in a hurry for his money, the retailer discounted the contract with us long before its siting was completed or all the options delivered and attached.

Once the retailer got his money, however, he seemed less inclined to finish the job. Consequentially, he and the buyer started to squabble. One thing led to another, and the borrower told him to shove it. The buyer never moved in, and certainly never took "delivery" of the home.

Because the home wasn't ready in the buyer's eyes, the deal was never finalized. Never mind that by signing the installment contract, giving it to the retailer and the retailer getting his money from the lender that the transaction seemed to be complete. Monthly payments were due to start in 30 days and continue thereafter for the term of the contract.

Finally, the community owner, disgusted with the process and in need of the lot, moved the home—now a repo—to the side.

The borrower didn't get the home the way he was promised and was unconcerned about his obligations. Feeling he had no other recourse, the borrower simply never made a payment.

As you're reading this article, a similar scenario is playing out somewhere in the real world. If not commonplace, it is none too rare.

The reasons

Why did this happen? There had been no delivery of the home by the retailer and no acceptance of the home by the buyer/borrower. Unfortunately, the lender didn't do the things that would have revealed the truth and provided more protection.

Delivery and acceptance are legal conditions. If you want to know more about them, a lawyer can quote you chapter and verse on case law and other niceties that determine legally whether delivery and acceptance have taken place. You should be guided by their response.

But you and I deal in large numbers of deliveries and acceptances that precede the funding of all the contracts we buy. How do we know when to go ahead?

Generally, a retailer delivers specific property (a home) to a predetermined location (the agreed-upon site) to be set up in an agreed-upon fashion (block foundation, etc.). This includes connections to utilities, with the other agreed-upon property in the home (furniture, appliances, air conditioning, carport, etc.) and all at an agreed-upon price and time frame.

When the retailer has completed this delivery properly, the buyer is now essentially obligated, by contract and seller performance, to accept the property. Acceptance encompasses taking delivery, as agreed upon, and making prompt or agreed upon pay-

ments for the goods.

Once that's completed, a deal is struck and the retailer is entitled to sell his contract to the lender and receive his money.

(This description sounds a little simplistic because so many facts intervene to alter this pattern. But any situation I propose will never be all encompassing or representative of each delivery.)

Upon proper delivery and acceptance, the borrower is legally and ethically bound to make his payments because he got what he bargained for. In this eventuality, there can be no question of a first payment default because the borrower had no proper grievances. The deal occurred in textbook fashion.

But, as lenders, we are not really interested in who's right or wrong. We don't want people pointing fingers at each other, with us in between holding the bag. Lenders simply want to know they have a borrower who properly owes us for the home and is, just as we thought when we approved him for the loan, going to pay as due and has no legal or practical excuses not to. That is why delivery is so important.

One way to determine proper delivery is to take the retailer's word that delivery has been made and the proof of that is the borrower's contract. As popular as this method has been in the past, lenders are no longer quite so eager to take a retailer's word for the delivery.

Experience has shown that not everyone can be trusted, as I found out when I saw that abandoned home with its curtains blowing in the wind and sitting beside the road already vandalized. Many years later, I still get a queasy stomach thinking about it.

The audit trail

After a long absence, many lenders are now doing telephone audits to corroborate the retailer's assertions that the sale has been made and delivery and acceptance completed.

Typically, lenders ask customers for details about the loan, down payment, purchase price and trade-in, and if all the prep work necessary to site the home has been completed. This review is done to verify whether the loan should be funded.

The final element prior to funding is to verify that the delivery and acceptance has been made, and all the loan details are completed as required.

Lenders are increasingly aware that borrowers have been frequently *coached* by retailers to tell them what they want to hear. Lenders protect themselves through tricky questioning and following quickly into hesitations or uneasiness. This approach does not always work, but it is far better than doing nothing.

Still, in this industry—one in which too many questions go unanswered—any lender who does too much auditing risks the ire of the sellers of our product. In turn, retailers may shift their business to lenders less eager to audit and not overly anxious to know loan details.

Unfortunately, this dynamic remains in the marketplace even today. Lenders cite the cost of audits as a barrier to performing them, instead of considering what happens when they don't. And, in the back of their minds, retailers view audits as making them non-competitive in origination vol-

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ume. They want to attract volume by making lending easy. Too many hard questions are seen as a barrier.

I recently spoke to a just laid-off regional manager of a large lender about this. Though quick to admit that he didn't condone fraud, he was slow to ask all the questions he would have liked. His fear was getting a reputation of being hard to do business with.

Inspections

Because of the relatively complex nature of the land/home business and the need for appraisals, inspections are much more common. The appraiser and others may visit the home several times. Stage-funded loans may also get interim visits by the lender or other audits will occur, especially by phone.

Commonly, a land/home loan will get more scrutiny than a chattel loan because the act of certifying title to the property and an inspection by the appraiser before the final disbursements usually provides some degree of verification of delivery. (This article speaks primarily to the chattel business, however.)

Some lenders are using physical inspection only as an occasional check against suspected non-compliance, while others are physically checking almost every delivery. These inspections might be done by their own personnel, but more commonly through third-party agents. They visit the home, check the serial number, eyeball the overall size and ensure the home is fully sited and occupied (or about to be).

If the home is occupied, an inspector may ask new home owner about the status of the deal. Buyers usually open up in these situations. But the bare minimum the lender wants to know is if the home is there and fully sited or close to it.

After inspecting homes prior to funding them, I've found a high percentage aren't completely ready for delivery and not all property promised is delivered. How many of these transactions would ultimately be completed after the fact by the retailer is hard to say, but most will be. Still, this scenario creates the basis for disputes in a very high percentage of transactions, even if they do not become problems.

Everyone has accepted goods prior to the "final" completion of the sales process. Autos come to mind as products in which this has happened often through the years. It probably has happened to you and I bet things didn't go well most of the time. Even if you eventually got everything you felt you were entitled to, you probably still view that transaction negatively.

Surveys tell us this happens a lot in the manufactured housing industry too. Pre-delivery audits tell us it is happening as much as ever.

So, do you care? Is it a problem? How do you protect yourself? My recommendation for lenders is to protect themselves at all times. Protection in our business comes from knowledge and that is usually confirmed or discovered through audits. As a wise man once said, "Trust, but verify."

Audits can mean everything from speaking to retailers and buyers by phone to personal, on- site visits. I can't tell you how much information to verify, but you will begin to see trends based on client profiles and defaults.

Since strong borrowers rarely default, you might be well served to audit these loans only occasionally, when something doesn't seem right. Furthermore, the reason these folks have greater credit capability is that, in general, they have often made better life choices. They are better positioned to protect themselves from improper deliveries and more likely to protect you as they do themselves.

On this subject, a smart lender once said jokingly, "Give me a 750 FICO score borrower that has a proven ability and desire to pay his obligations and I don't care about loan details." There is more than a grain of truth to this assertion.

On the other hand, lower credit tiers have more problems. They are usually struggling to make the deal work and accept no or low down payment charades and other loan deficiencies. An anxiety to complete the transaction influences them to go along with misrepresentations regarding many loan details. In the end, they frequently accept much less than perfect delivery of the home.

Even if you attempt to audit the transaction, the buyer may have been coached on a story to tell the lender anticipating they will achieve their ultimate aim of home ownership. And this is laudable, if it's honestly done. After the excitement of moving into their new home subsides, however, home owners faced with the reality of their financial situation—augmented by inadequate delivery—may opt to default.

Any auditing must occasionally require more than telephone contact and that is expensive. But is it justified? That depends on your view of how much the veracity of the loan details affect defaults.

In other words, if a given credit profile defaults by the same percentage if you do or don't audit, then why do it? This means the defaults are not caused by the details of the loan but other factors that are inherent only in the credit profile or the stars.

Not for a moment do I believe this. I believe that if the deception on the transaction is added to a lower credit profile, it greatly increases the default rate. After all, the deception means the down payment is less than you thought, not more. And other credit factors will likewise be positively overstated, not the reverse.

Take that client with marginal credit, whose credit worthiness has been enhanced based on bogus information, then add improper delivery and acceptance to the mix. How much baggage can a bad loan take before it ruptures?

You get the idea. Is it any wonder these loans, if unaudited and funded, are likely to lead to grief.

My pursuit of a standardized definition of a "delivery" in the manufactured housing industry has been frustrated. In a vacuum, not being on the front lines trying to transact business, everyone could tell me the dangers and at least some ways they protect themselves.

But those same people, placed in an aggressive environment of protecting their loan volume turf from competitors, actually seemed less willing to do the things they thought necessary for adequate protection.

Sad to say, it appears easier to deal with the appalling levels of defaults and the destructive writeoffs they cause. This I understand. But in an industry environment where, when things are done right, we have 14 to 20 percent defaults over the life of the average portfolio, do we need more?

I doubt it. □

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