LENDERS TIGHTEN THE STANDARDS

by Martin V. Lavin

John Pollis, vice president of marketing for Fleetwood Homes, was addressing an audience in Palm Springs, Calif., on a beautiful Sunday afternoon. The setting was a first-class resort with five PGA golf courses, including some designed by Jack Nicklaus and Greg Norman.

So what kept almost 75 golf-loving executives inside on a Sunday afternoon in a golfer's paradise? An MHI meeting on Lenders' Best Practices (LBP).

Pollis and those in attendance were seeking the keys that would allow MH lenders to continue to finance the industry's products and still make a profit. The shrinking volume of lenders and loans has been a very scary development over the last two years. What at first was a lending blip in early 1999, became a full-fledged lending retreat in 2000 carrying over into today.

The new millennium has been less than kind to our industry. As the rest of the economy roared along unabated, we struggled to remain profitable, with survival replacing most other concerns.

A job for the task force

The LBP Task Force, an offshoot of the MHI Finance Committee, was given the job of setting up a program that allows lenders to subscribe to a set of standards to be inspected by third-party auditors.

Those subscribing and complying will get the equivalent of a "Gold Star" for a job well done and recognition from MHI as a "Best Practices Lender."

It is an honest effort being worked on by honorable people. They feel that coming to an agreement on broad standards everyone can agree on and act in accordance with can save the industry from the ravages of poor quality loan contractions. Those involved at the meeting had the health of the lending contingent and the entire industry in mind.

Pollis detailed the scourge fraud had brought on lenders and how it forced many out of the industry. A line had to be drawn and a stand had to be made.

Down payments and job verifications were the targets of his resolution. He wanted them verified in writing to protect companies from fraud claims and preserve the lending industry in general.

It would seem that these are two keystone elements of lending. So why did the motion fail?

The Task Force's goal was to create a trademark designation every lender could subscribe to that tells the world they are an intelligent, prudent lender using proven methods to originate and service loans.

In view of the universality of this very desirable aim, why wasn't it a slam-dunk for acceptance and implementation?

Can't reasonable people, all in the same industry, believing in similar philosophies and out to make a buck agree on a program broad enough so everyone can belong, but specific enough to keep people out of trouble?

In general, here were their concerns:

• Some folks genuinely believe that even broad agreements like this are so specific it has the potential to invite anti-competitive claims and investigations. Therefore they were unlikely to implement it, even though they may vote to adopt it.

• Some believe that adoption of either initiative is slanted to a certain style best engaged in by large, structured and very liquid lenders who have the ability to bring pricing to bear against its competition.

In their minds, by agreeing to this they surrender their advantages, audacity and initiative without increasing liquidity and availability of lower cost funds, putting them at a self-induced disadvantage.

• Some say adding one more auditing requirement increases their costs without any tangible benefit as they are already audited by several third parties. They view the program as redundant to their existing situation. They may vote for adoption but not implementation, if they go that far.

• Others simply believe that agreeing to be bound by the Best Practices will put them at a competitive disadvantage against a more aggressive lender.

The more aggressive originator will win loyalty by purchasing an occasional "bottom right-hand drawer" denial and get 10 good deals as a reward. This allows the aggressive lender the first look at all deals, which they view as being jeopardized if they are *just another* lender.

They regard the auditing details as unnecessary.

• There is concern Best Practices won't work unless everyone signs on. Early indications show very few have asserted their intent to approve and comply.

Two schools of thought

Pollis was frustrated as his resolution was defeated. In an industry so seemingly devastated by fraud, it would seem that a proposal to cut it down would be not only warmly received, but accepted and adopted. Such was not the case.

As the industry fumbled with what good lending practices are, I still did not see a total concurrence that something could be done to discourage the bad. And while I sounded the clarion call about sales fraud in this magazine more than two years ago, I still do not believe that eliminating fraud of and by itself is the only answer.

A lender needs to get good information on every loan. They must understand and anticipate the inherent risks in each individual loan and its constituted portfolio and understand the role of servicing, asset control and disposition, and how all of this relates to pricing. Sure it's a tall order, but it has to be done.

As I heard the chatter at the meetings, in the halls and over drinks, I thought there are undeniable degrees of beliefs and philosophies when it comes to MH lending.

There seemed to be two schools holding forth at Palm Springs. The first felt only a unified agreement to do something that will protect everyone from the foolish impulses of themselves and others can save the lenders from this downturn.

The second group believed signing on to such measures is redundant and a detriment to the independence they need in order to survive and prosper in this competitive world. How would these divergent views converge?

In spite of the foregoing, the Best Practices program was approved by the Finance Committee at Palm Springs and sent to the MHI Board of Directors where it was unanimously adopted.

Now the question is how many lenders will implement the program once there is a call for participants.

It would take some interesting turns to see the various positions meld in agreement to ensure sufficient lender participation to make the program successful.

Getting the ball rolling

Last December, the fax machine spit out a letter from the largest MH lender to all their retailers and loan originators. It said that as of Jan. 1, 2001, all loans originated will require down payment verification.

This was being done to improve the perception of the manufactured housing industry with Wall Street and the ratings analysts. The policy had the strong approval of manufacturers across the country and complied with key provisions of MHI's LBP program.

The calls and faxes started up again this January. With the MHI Winter Meeting coming up, the unfinished job of adding the "verification resolution" to the LBP came back to life. Its influence was already apparent even though it had not been adopted.

The manufacturer who originally introduced the verification resolution was not yet content, believing that the group's work was incomplete. In spite of the fact that a great deal of movement in the MH lending community had shifted to more verification and audits, it still was not enough in their opinion.

And while not every lender wanted to go overboard in verification of loan details, they didn't want to proceed like deaf, dumb and blind monkeys either. They wanted to continue verification tightening but still have the flexibility to audit credit risks in different ways and at varying levels. This had been a hang-up since the resolution was first proposed last September.

Now the sides were finally beginning to converge on a number of lending initiatives. The intent was to craft a final resolution that would be accepted at the winter meeting, addressing the concerns of those fueling the resolution and resisting it.

At the same time on another, but parallel front, final elements of the LBP program were being formalized. Third-party auditing requirements were being carefully massaged to allow maximum lender flexibility without gutting the impact of the validity of the certification.

At the LBP committee meeting in Washington, D.C., on a February afternoon, a compromise auditing requirement was adopted allowing about 10 of the largest and best lenders to signify an initial indication of intent to embrace and use the program. Only a month before, I would have thought this result most unlikely.

People of good faith accomplished wonderful things by putting this initiative on the table in a manner palatable to the broadest tier of lenders. Yet they kept the auditing requirement and compliance committee to ensure standards are met.

I can't help but believe that if properly done, the ultimate impact will be a reduction in the wild swings of our originations, fewer over-aggressive and fraudulent loans and an indication to asset-backed security markets that prudence has again infected MH lending. A long-term decreasing interest rate trend should result from this discipline.

Meanwhile, almost on the same front, but now divorced from LBP inclusion, the verification resolution became a decree to amend the Financial Services Division's "Code of Ethics."

After mild dissent from retailers, the resolution, in a highly modified form from the September version, passed easily. The "Code of Ethics" was amended putting the accent on prudent lending and verifications.

Two long and contentious issues were rendered acceptable to the largest lenders. The first glimpse of recovery in MH lending could come this year.

To the extent these programs allow us to reduce the shenanigans so prevalent in our business in the past, they will be a great boon to us all. They provide the framework for improvement and perhaps the desire to do the right thing. □

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