Martin V. Lavin

Out the other side:
Yes, lending is changing

The first "shipments decrease year" for HUD Code housing was 1999, and the fallback was so gentle few could have imagined the drop to today. From the 372,800 homes shipped in 1998, to the 81,890 homes shipped in 2008, we have experienced a steady disaster, which seems unable to end. For those of you "math challenged," that is a 78 percent decrease.

Shipments continue to drop, with 2009 levels of under 70,000 homes deemed entirely possible. While no one is banging a gong to let us know the precise moment, at some point you almost think the manufactured housing industry as we have known it since 1950 has died. Many industry participants are now either completely gone or seriously wounded, with the only antidote being more sales volume. Costs and capacity have already been pared beyond anyone's imagination.

Add to this the current economic morass into which this nation and the world has stepped, and one wonders what the catalysts will be for an industry resurgence. It is for this resurgence everyone in manufactured housing awaits, as they have since 1999, with a notable lack of success. Even as the conventional housing market underwent the incredible run from 2002 until early 2008, HUD Code housing did not participate in that upswing. They grew, we fell, but they have now joined us; however, note that they have not decreased 78 percent from their top.

Does this mean the manufactured housing industry is essentially gone except for some intrepid companies surviving the low consumer demand and difficult financing for our product? We've explored that subject pretty extensively in my previous writings, and the good news for me is that my oft-controversial opinions of doom have turned out to be right. Unfortunately, the bad news for all of us is that, again, I've been right. Frankly, I far more would have preferred to be wrong and have a vibrant, growing HUD Code home industry. That is not happening and is unlikely to happen in the near future.

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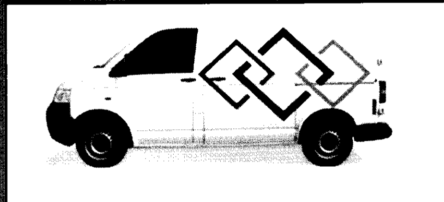

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So, what is likely to happen in the manufactured housing industry going forward? Well, demand for affordable housing has not ended, nor has the industry's ability to provide it. It's just that as the industry model arose over the last 50 years, retail financing has been mostly chattel loan driven, used to finance homes into land lease communities and onto scattered site placements. What every lender finally figured out is that except in isolated, carefully controlled conditions, the historic industry chattel lending model was a loser, especially into land lease communities.

This realization has slowly but surely cut off the lifeblood of any lending endeavor; the flow of funds from investors to industry lenders. First, the asset-backed security (ABS) markets abandoned our industry. As ABS retreated, various industry participants tried to lend with their own money, but lending on housing by non-financial institutions just takes too much of it to do it successfully, save very unique circumstances.

As late 2008 approached, even the very strongest of the industry companies lost their funding liquidity, cutting their lending. This left only a small handful of retail lenders to serve the industry, and they learned long ago they can only survive by a highly constrained lending regime. Yes, they do chattel loans, but their discipline makes the process difficult, and only the best credits need apply. Regrettably, a large number of good credits and HUD Code housing have not customarily walked the same path. It is this lack of demand by good credits for our product that has doomed us with lenders and ultimately led to the illiquidity.

So, if all of the above is true, in what direction do we head? Like a running back with a football, you head to daylight. Admittedly daylight right now is scarce, but that is where one must head, or be trapped in the backfield.

And where is there daylight?

Well, some land lease community operators, mostly the larger ones, are creating some daylight with their own lending money. That book isn't finished being written yet, but the history of industry firms using their own money to finance HUD Code housing does not give one reason to believe it will be anything less than challenging. We'll see where this well-meaning effort to keep homesites full in their communities goes, but be guided by the past.

The other place we find some daylight is with the industry's remaining chattel lenders, who at this

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point are mostly using bank or credit union money to fund their loans. While these are all nice people with whom to deal, getting enough good applicants to consider our housing has kept this channel under $1 billion in annual originations recently. Nice, but one can't really build much of an industry around that volume.

The next channel is your local hometown bank, which likes to do residential loans for primary homes, and if you do the work as a home seller to convince them of the loan protections you bring to them along with your loans, they can be a godsend. These relationships can be hard to cultivate, the program can be pulled without notice, and often a recourse obligation can run with the lending. There can be daylight here, but run to it with sunglasses on to protect yourself even as you protect the bank and get loans financed. Cultivate this avenue carefully.

The FHA Title I program for chattel loaned homes has been available all along and is in the current homestretch of a needed rewrite. There had been various criticisms of the manner in which their loan loss insurance works and in the loan amount caps, but the reality is that the totality of the Title I program what with appraisals, rigorous underwriting, and various other program quirks have driven little volume. Less than 2,000 loans closed per year recently because the program lacks the one element so favored by the industry: transaction ease. It lacks the slam-bang of: see the home on Sunday; sign a contract Monday; get an approval Tuesday; use Wednesday for verifications; close with paperwork on Thursday; and, watch your big screen TV on Friday in your own shiny, new HUD Code home, in "land lease heaven."

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That scenario won't work in Title I, and I suspect the upcoming changes will only relieve the lack of lending with this program on the margin. The expected bonanza by industry sources on Title I seems misguided to me.

So why doesn't all this combine for lending in the industry to fuel a big expansion? You'll notice above that most money available for lending is coming from banks or government. We know these two lending avenues can provide for a small industry, but the current model in which they lend, which is a safe one, will not fuel a resurgent industry. In order for that to happen, these existing conduits and growing them must continue. But frankly much more is needed, and in order for that to happen, a change in industry mindset must occur. The transaction ease fostered by 50 years of faulty chattel lending by the likes of the Greenseco Chattel Financing model, so long in vogue in the industry, must dramatically change in order for our industry to evolve, which is needed to trigger greater volume. And it is and will be driven by funding liquidity, or a lack of it.

We're now certain, if ever we doubted it, that no matter how good a home our industry builds and how affordable it is, without consistent funding and demand for our homes by buyers with strong credits, those homes can only be sold with difficulty. So far, with no existing subsidy of the manufactured home buying public by either government or the retail lenders of old, HUD Code loans must perform satisfactorily on their own. To those industry participants who have claimed for so long that this all worked for years, I ask them to look at what has happened over the last 10 years, come to a sensible conclusion, and stop the silliness. It is what it is, not what we want it to be.

The big money, as Tom Cruise asked, is located today and in the foreseeable future in the Mortgage Backed Securities (MBS) markets. These are pools of loans sold to investors on Wall Street based on a well-defined set of loan protocols. Thus, assuming your loans meet these fairly and performance later bears out the portfolio representations, then the money spigot is open. Not easy today, as nothing is, but the spigot is open. Liquidity, good pricing, and consistent rules make this the best long-range option for the industry since we murdered the ABS market (which is now buried and unlikely to resurrect).

So, what's the catch, Marty? Don't you just love that everything comes with a catch? The catch is that the manufactured housing industry

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will have to alter much of its lending model to access the MBS markets, being much more like FHA Title I than it is "Industry Chattel Lending 1998-101." This means the industry will have to do chattel loans with much of the same requirements for real estate loans going into MBS.

Foremost amongst these steps is a market value based appraisal. No more cost-based appraisals, like 130 percent of invoice, etc. That may be used by the appraiser as a crosscheck on market value, but the value of the home will be a market value appraisal. Already I know from attending various meetings, that this one is being fought even as loan liquidity is virtually nonexistent and the objectors should have no options but to face reality. The MBS markets with the standard "TBA model" requires a market value appraisal...*period*. The "niche model" is far looser, but more difficult to effect.

Of course I am hardly surprised at the industry resistance, old habits die hard, and we are in the final stages of an industry long in denial over much of its model. Even to the end, as companies disintegrate, like petulant children, the acceptance of what must be done to create greater liquidity has been denied and resisted. To the end, very little acceptance, and instead, resistance to needed enhancements.

My compliments. This is one tough industry with disciplined outlooks; its members prefer to disappear than change, and it may be that the change is not possible. It could be that if the manufactured housing industry is forced to do the things conventional real estate has always been asked to do, that so constituted, this is not too big an industry.

We've seen graphically how things can get out of kilter quickly and dramatically, even when the real estate gurus altered their own rules to create subprime. Those loans took on the incidents of our loans, performing poorly, joining our downfall. We'll be given no second chance to implode, as we are the Kings of SubPrime, our feet held to the fire to follow the rules.

In 1988, as I struggled in our own manufactured housing lending endeavors to create more and better lending programs, I always told my people to go to the real estate loan guide and look there for direction. In 2009 I again repeat the same mantra to the industry; look to the real estate guide for programs, even if the loans are chattel perfected. It is only there that industry growth is possible and liquidity available, consistently, in the long run.

For those industry lenders now caught short by a lack of liquidity, they have to ask themselves, which I am sure they are, if they can afford to originate chattel loans in the future (if there is a future) in which their loans are illiquid because they have failed to originate to the MBS standards?

As an industry, this last is a good question, and frankly the future of the industry and its size depends on how this is answered and dealt with in the very near future.

Ain't change great?

Martin (Marty) V. Lavin, is a 36-year veteran of the manufactured housing industry from Burlington, Vermont. He is an attorney, consultant and expert witness to factory-built housing interests. Mr. Lavin is past chairman of the MHI Financial Services (2001-2004) and recipient of the Totaro Award for Outstanding Achievements in the Manufactured Housing Financial Services Industry. You may reach him at 802.862.1313, or email marty@martylavin.com. www.martylavin.com.

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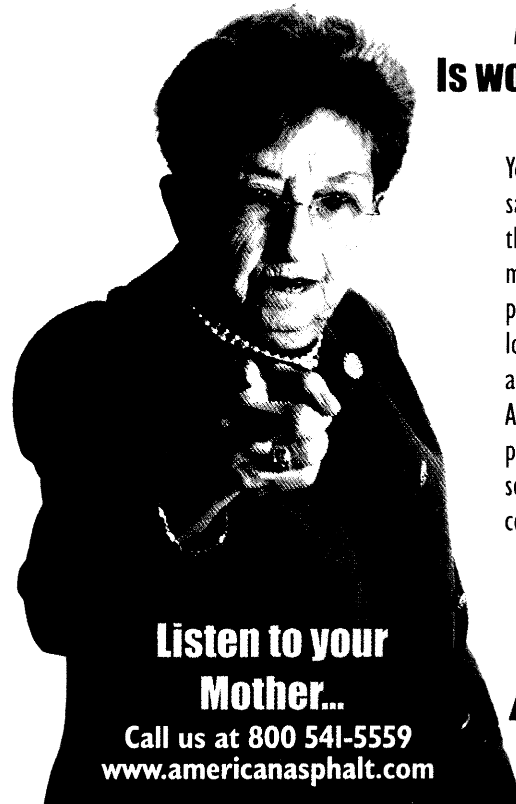

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