HOMETOWN AMERICA + CHATEAU: RAMIFICATIONS

By Martin V. Lavin

Editor's note: What follows is excerpted from Marty Lavin's recent Marty's Manufactured and Mobile Home News and Notes e-newsletter. Lavin comments on changes to the community side of the factory-built housing business that created interest among large REITs to consolidate and how the "Berkshire effect" is being felt in other industry sectors.

Let's get one thing straight about Hometown America's proposed purchase of Chateau Communities: I am a sideline observer. I am not working in the bowels of either organization, nor do I have any "mole" who is ferreting out confidential information to me. I merely surmise certain things from the affairs that have occurred and are continuing in the community business.

I am a community owner, albeit a modest one with years of experience. By 1972, I quickly learned at my first resident "uprising," you don't have an open meeting with all interested community tenants after their softball game. They all had bats!

Fifteen years later, I was already knocking on the doors of E.F. Hutton to try to convince them the world of land-lease communities was an oyster waiting to be shucked. My sales pitch must have been uninspiring as I couldn't get them interested. But I saw the light early, and believed.

Others played the investor money-attraction game better than I did and, in short order, purchased many excellent communities, as plenty were available. A large number came from the original owner/developer who often had rents well below market. And, best of all, his sales/price expectations clicked at lower multiples than today's astute sellers. So it goes...

Along the way, this newer crop of community investors duplicated many of the various mistakes I made. You can raise rents injudiciously but, eventually, there is a price to be paid. Homes can move and residents are not chained to their home sites. Once resident trust is eroded in your basic financial fairness, regaining it is a very difficult and time-consuming process.

A hundred sites at $150 per month amounts to about the same total rent as 70 sites at $210 per month, but never be fooled into believing a 30 percent vacancy rate doesn't matter. It does, and its various negative consequences have a corrosive effect on the property.

One time, I thought I could fix most utility shortcomings in my communities but found some defied correction or worse: They could put you into the uncomfortable grasp of "the man," a.k.a. state and local regulators who understand you may not even vote in the jurisdiction. But the residents in your community do and can be a force to be reckoned with. Wonder where their sympathies lie?

I also found those healthy, well-tanned elders living in many upscale communities had a resistance to most anything that might cost them money and had the time and inclination to wreck retribution or block any move I made. In short, communities of that type tended to look better in brochures than account books.

I have owned warehouses, apartments, strip malls, office buildings, various other buildings and speculative commercial land. All else being equal, money spent on expensive, commercial-use bare land, leased out on a triple-net basis with lender subordination to fee interest is the most delectable investment I know.

Once you are past that (and it is expensive and rare), there's nothing I like better than land-lease communities. They are everything you wished apartments were and more. But they have their limitations and bring challenges, as does all real estate.

There is a constant depreciation of the property itself, over which you have major control, but it is expensive. And, there is depreciation occurring in the resident's home over which you have much less control, but again, any attempt by you to correct this problem is expensive. In fact, recognition of the necessity for community upgrades over the history of this property type was slow in coming. Even worse, it is dawning on many with crushing force, especially during this retail lending constriction.

Although obsolescence and the need to upgrade are better recognized these days, making improvements is slow and expensive, especially with regard to the homes themselves. Remember, you don't own or control the home.

Unless you've taken away its "value" by excessive rent increases (in which case, you'll have vacancies), that home will still appeal to many buyers who view it as an alternative to paying rent, even if it is old and tired. Any dwelling in an area of housing need has a minimum value that competes with the general 2- and 3-bedrooms apartment rentals.

If apartment rents are $600 per month or more, even an older home in a desirable land-lease community can command $15,000-40,000 on resale depending on the site rent. The combination of a monthly home payment and site rent should roughly equal an ordinary monthly apartment rent.

As homes come up for sale, the diligent community owner might have to buy those homes to replace them. You hope there is urgency on the seller's part, so a reasonable deal can be made with him to site a new home. If that process holds up over time, you have just upgraded your community to some extent through your own "urban renewal."

Some owners who have been involved in this effort for many years are finding the process will never end. Homes constantly degrade and take your community down. You can only push the resident to upgrade so far, however, before you run afoul of his regulatory protectors.

Communities can degrade and infrastructures can deteriorate, leaving poor roads, inadequate electrical distribution, crushed sewer lines and corroded water pipes. (I am on a long mission to find the inventor of "Orangeburg pipe" so I can wring his neck. Who would sell a sewer pipe that flattens over time?)

Today, these matters are well known. The surplus of communities exhibiting one or more of these conditions is plentiful. The desire to invest in land-lease communities is so great, however, many times these warts continue to be overlooked. Poor locations, obsolete homes, small sites, heavy vacancies, trendy cap rates and questionable infrastructures are only some of the deficiencies being overlooked in a buyer's haste. Just as I did too.

As the patient money finds its way to community investors, creating a critical mass of properties one at a time just isn't cutting it. It takes too long. Besides, investors want quick action.

Many of the small to medium-sized community owners are fielding purchase requests frequently. They have what is much coveted: a large number of properties under one owner.

But most of these guys are pretty cagey and didn't come down with yesterday's rain. Many have been at this endeavor for years and have weathered lots of bumps along the way. In the process, they became good managers and are essentially content to baby-sit their properties, knowing they are in demand and are likely to remain so. What's the hurry?

The $2.2 billion offer from the patient money at Hometown for Chateau proves they are right. Chateau has critical mass with upwards of 65,000 home sites accumulated over a rapid 10-15-year period. They grew up rapidly and well.

Acquiring a portfolio that large the old fashioned way, some here, some there, would take a lifetime today. Further, the property available outside the grasp of the top 100 owners is not necessarily of the same high quality. Yes, there are many good properties available from smaller holders, but not like in 1995 or before.

So Hometown steps to the plate and makes a fair bid to control around 100,000 home sites, after the Chateau acquisition. Pretty impressive, considering I remember when the 20,000 mark was first crossed—not that long ago—and 5,000 was a big number in 1990.

What can we make of this? First is a realization that money is still coming into factory-built housing. The Hometown/Chateau deal is an eye-opener as was the Berkshire/Clayton announcement. All this activity means **something** . Expect new money in retail lending soon.

People don't pay a total of $4 billion in these two transactions without a belief in the inherent strength and longevity of the industry, regardless of how adroitly we manage to dismay investors on the retail lending side.

Of course, there are challenges on the community side. These large community accumulations have now forced the issue as to the pure managerial ability of the larger players. It's just never been done on this scale before. And it is one area of serious concern.

Still, these REITs are all competent players of great abilities. Nonetheless, I suspect the challenges will keep them busy. Yet the opportunity for these larger players to grow is interesting and even compelling.

How can you not play if the game is available to you? That is the question. What happens in games? There are winners and losers.

I suspect this community consolidation from medium to larger holdings will continue well into the foreseeable future. n

Martin V. Lavin is an attorney and 31-year veteran of the factory-built housing industry, with special emphasis on lending. He lives in Burlington, Vt., and is a consultant and expert witness to the industry. Lavin serves as chairman of MHI's Financial Services division and sits on the group's Executive Committee and Board of Directors. He also represents Mobile Home Lending Corp. Lavin also publishes a free industry newsletter, News and Notes. *To receive his newsletter, contact him at 802/862-1313, or by e-mail at MHLMVL@aol.com.*