

CHATTEL LENDING RETURNS TO LAND-LEASE COMMUNITIES

By Randall K. Rowe

After six tough years, encouraging signs are appearing that the availability of chattel financing for buyers of manufactured homes in land-lease communities is finally on the upswing. During the recent industry decline, all stakeholders, including chattel lenders, home manufacturers, home retailers, community residents and community owners, have paid a high price for the recent lack of economic alignment among these industry players. It is clear to the survivors of the downturn that the industry will never achieve its potential for providing attractive, affordable housing if the customer's overall experience is not the paramount objective of each industry participant as each delivers its respective piece of the manufactured housing experience.

Decline of the Old Model

Without dwelling on the past, it is still important to learn the lessons from the recent decline in the manufactured housing industry so that we will not be doomed to repeat the same mistakes in the future. Under the industry's Old Model, each participant focused exclusively on its own interests. The manufacturer wanted to sell a home but wanted its responsibility for the home to end at the factory door. The retailer wanted to make as much profit as possible on each home and included a number of high-margin add-ons to further increase profitability. Lenders were able to securitize all the loans they made, no matter how aggressive—and as the loans got larger, so did the fees. The home purchaser/community resident was commonly able to finance nearly 100 percent of a home's price and often was able to finance even more than the value of the home itself when add-ons such as life insurance, property insurance and extended warranties

were included. The community owner was making at most a one-year commitment—and often only a month-to-month commitment—to the resident. Finally, if there was a chattel loan default, the community owner viewed this as solely the lender's problem because the lender would continue paying the site rent rather than have the home removed from the site and lose all the value of the site improvements.

Not surprisingly, these practices resulted in an industry where homebuyers purchased homes at dramatically inflated prices. The homes frequently could not be resold for the loan amount, came with very limited customer service on the home warranty, were subject to the risk of uncertain annual rent increases and provided the home buyer little, if any, opportunity to build equity value in the home. Given the serious flaws in this business model, the end result was that everyone lost—the lender, manufacturer, retailer, community owner and most importantly, the customer.

For a while, each industry participant blamed the others:

"If the lenders hadn't made stupid loans, we wouldn't be in this mess."

"If the lenders had been willing to make new loans on repossessed homes, the collateral values would have held up better."

"If the retailer had been focused on a high-volume, low-margin approach instead of a high-margin, low-volume approach, the loans wouldn't have had so much air in them."

"If the community owner had stopped raising rents when distress hit the sector, certain residents might have been able to weather the storm without defaulting on their loans."

"If the manufacturers had been more customer service-oriented in servicing the home warranties, the customers would have been more willing to recommend manufactured housing to other customers."

And on and on and on... the Old Model was broken.

Preparing the foundation for the New Model

While weathering the gut wrenching downturn of the past six years, the manufactured housing industry's remaining participants have started to develop a New Model to rejuvenate the industry's sagging market share. MHI has taken the lead role in coordinating the modifications that need to be made across the industry, and because MHI represents manufacturers, lenders, retailers and community owners, it is uniquely positioned to lead the effort to build a New Model. With its reach throughout the industry, MHI is the best forum for industry participants to encourage each other to take a broader view of the roles they must play if the customer is going to view manufactured housing as a compelling housing solution—one that offers both exceptional value and a product that is as well-built and attractive as site-built alternatives.

During the last several years, a number of important initiatives have been undertaken that have now set the stage for the industry's renaissance. The most important of these are:

- The Lenders' Best Practices initiative, which sets lending standards that must be met to be certified as an LBP lender.
- The Truth-in-Invoicing Practices program, which provides consistent transparency about the actual price of a manufactured home from the manufacturer.
- The Community Attributes System, which provides lenders and potential residents with online information on communities.
- Standardized chattel lender/community owner agreements, which

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commit lenders to keep a repossessed home in the community and to finance the next buyer while requiring the community owner to forgo site rent after a default and to help refurbish and resell the home.

- Long-term lease initiatives, which tie future rent increases to third-party indices.

- Industry marketing programs that inform potential customers about the manufactured housing industry's high quality, affordable housing solution.

Together, these and other MHI initiatives form the foundation for much of the New Model.

New Model

The key concept behind the New Model is alignment. Since it takes multiple parties to deliver the manufactured housing product to the customer, alignment presumes that any industry model under which all parties do not prosper will eventually fail. While the individual interests of the home manufacturer, chattel lender, retailer and community owner are important, they must all be subordinated to the customer's interest in acquiring an attractive house that provides a great value, is located in a de-

sirable community, comes with great warranty service, is financed on a competitive basis and in which the customer builds or at least maintains his/her home equity. The New Model resolves all conflicts by focusing on improving the customer experience, which is the only way to increase market share for the manufactured housing industry.

The New Model requires a high level of cooperation among the manufacturer, lender, community owner and retailer, with the goal of delivering a superior customer experience. However, given the decimation of the retailer network in many markets, the community owner is increasingly becoming the primary marketer of the home. Since the community owner's goal is to fill homesites and establish long-term relationships with customers, most owners are willing to sell homes at a low profit margin that mirrors the margin a retailer would accept if it had the high-volume, low-margin business required under the New Model. Given the significant decline in annual manufactured home sales, it will be very difficult for retailers to convert to a high-volume, low-margin model until sales volumes recover, so community owners will

need to become more active in marketing the industry's product. With community owners taking on the additional role of home retailer, the net result—and one that is quite positive—is that the customer is getting a home at a fair price and chattel lenders are lending against fair values.

Another aspect of the New Model requires the manufacturer to take more responsibility for the quality of the home delivered to the customer by taking a more active role in home installation, warranty service and satisfying customer expectations. Several manufacturers have begun taking responsibility for not only delivering the home but also setting it on its site in the community. This will dramatically reduce disputes among customers, manufacturers and community owners regarding whether problems with homes are caused by manufacturing defects or created when the home was set improperly. Manufacturers are finally beginning to understand that the homebuyer is their customer and that they need to be actively involved in assuring customer satisfaction or both their brand and the whole industry will suffer. Additionally, manufacturers are increasingly committed to pricing

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transparency, which allows customers to understand the real cost of the home they are purchasing and lets lenders know the real cost of the home on which they are lending.

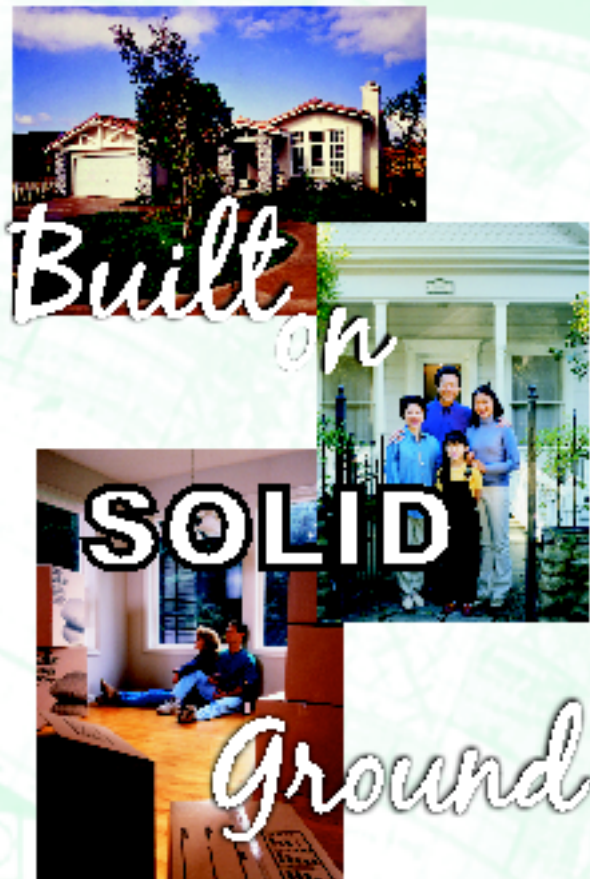
In addition to committing to Lenders' Best Practices, lenders are using increasingly sophisticated financial models to predict more accurately the creditworthiness of their borrowers. Lenders also expect community owners to be active partners in reducing the losses resulting from home repossessions. In that role, community owners typically agree to forego rent after a home is repossessed as long as the lender is committed to refurbishing the home, listing the home for sale and providing financing for the next buyer. If this cooperation does in fact reduce the lender's losses, then the cost of chattel financing can be reduced to levels more competitive with the cost of mortgage financing for site-built homes. In addition, chattel lenders increasingly want the community owner to offer a longer-term lease tied to a housing cost or cost of living index so there will be more predictability in the level of site rent increases over the holding period of the loan. Most recently, a number of lenders began offering more attractive rates on chattel loans if the community owner agrees to partially fund a loan reserve or to become the owner of a portion of the loan.

Finally, community owners are offering a variety of longer-term leases, marketing new and used homes in their communities at fair prices, working with lenders to reduce loan losses resulting from repossessed homes and credit-enhancing or even owning a part of new loans to reduce the chattel financing costs for prospective manufactured home buyers. The community owner's goal is to fill home sites with high quality residents who appreciate the housing value they are receiving. Ultimately, it is the community owner who has the closest (yes, every day) relationship with the homebuyer. If the industry is to grow once again, existing vacant home sites must be filled with satisfied residents.

It's all about alignment

By focusing on the needs of its customers, the manufactured home buyers/community residents, the industry has developed a still evolving New Model that aligns the economic interests of all industry participants as we deliver housing value to these customers. Year-to-date chattel loan volumes have increased, loans originated in the last couple of years are performing much better than loans originated before 2000 and, with the reduction in aggressive subprime lending, the housing solution this industry offers is increasingly compelling. While many of the improvements in alignment are relatively recent, hopefully the pain resulting from the previous lack of alignment will motivate industry participants to continue improving the New Model. As America increasingly searches for solutions to the problem of affordable housing, the factory-built housing industry needs to be a growing and increasingly obvious part of the answer. □

Randy Rowe is the chairman of Green Courte Partners LLC, a private-equity real estate investment fund focused on, among other sectors, manufactured housing communities. Over the last 36 months Green Courte Partners has acquired 21 properties representing more than 6,000 home sites. Contact him at 847/582-9400.



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