

# Marty's News And Notes

All the news that's fit to read... Vol. 4, Issue 12 December 2004

## THE TOP 10 TRENDS AND TRUTHS OF 2004



With 2004 rapidly disappearing in the rearview mirror, it seems like a good time to get the flavor of what happened in single-family, factory-built housing, trends that arose and the general state of affairs. I've identified 10 top categories which, in my eyes, are significant, thus worthy of review.

I've put them into an ascending order of importance, with the countdown starting at number 10. While I absolutely expect no one will entirely agree with me on the list or the order, I do think most of my Top 10 are noteworthy events. So, with champagne in hand, the ball dropping in Times Square, let's look at Marty's Top 10 Trends and Truths of 2004.

### 10. The Seeming Shift From Multi-Sections to Single-Sections

I have pompously taken credit for being on the forefront of long ago predicting a resurgence of HUD single-sections. The shift in chattel lending

terms would almost require smaller, less costly homes. Enter the single-section. Shorter repayment terms, bigger downs and tighter underwriting would all force less expensive homes.

That \$77,000 multi-section home going into leasehold communities with a couple of sugar-free ounces of a down payment, 30-year terms, and 75 percent defaults are a nightmare permanently seared in the collective memories of previous industry lenders. Nobody does that now, so predicting a return to many more single-section homes seemed obvious.

How far will it go? I don't think we are there yet. As community lending resurrounds, if it does, I expect singles to lead the way.

### 9. MHI and MHARR

While factory-built housing is a small industry, it is not content to speak with one voice. No, it has two associations. The Manufactured Housing Institute (MHI) is the larger of



the two and Manufactured Housing Association for Regulatory Reform (MHARR) is the more compact and directed. MHI is certainly dominated by homebuilders, but every other industry segment is present and has a voice.

MHARR seems almost entirely builder-supported and driven, with an agenda proactively geared towards regulatory concerns. While MHI has much of the same focus, I'm not sure it's quite so "laser-beamed" directed. Rattling around in the halls of "HUDville," I have noticed philosophical and operational differences between the two.

I'm not sure an industry of 150,000-170,000 HUDs and modulars combined needs two associations, especially since the "words and music" of each is now different. I've been involved in a couple of different indus-

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**Much thanks to Wayne Beamer, my new editor on this newsletter, for his expertise in all things factory-built housing as well as his writing, editing and redesign skills. Contact him at beamertravis@sbcglobal.net.**

try initiatives where the prevailing opinion at the two differed, at times widely.

As the industry drops to about 7.5 percent of all new housing starts – yes HUDs and mods combined – it might behoove us to try to find a way to play the same music and sing the same tune.

## 8. Pulte Fabrication

Damn, those large homebuilders are tough competitors. With structures long in place emphasizing the great ease of home-buying and shopping for a loan (driven by low-cost financing available to all tiers of buyers), they've stolen much of factory-built housing's thunder. And just when you figured they had beaten us to a pulp, now they've joined us.

Yes, they've started building homes in factories... You know, factory-built homes. They had done it before, but had seemed to jettison their efforts in the recent past. Now they are back. One day very soon, I assume we'll be knocking on their door to join our association(s) so they can be with other factory home builders.

Supposedly, the word on the street is that Pulte is already well underway with a new factory and process to build homes in factories under assembly line conditions, incorporating all the advantages we've claimed to have except their process seems a couple generations ahead of us. (I've heard they need more advantages so they can crush out our remaining 7.5 percent penetration.)

Absent in this site-builder/fac-



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tory-builder distinction that's been made for years between us and them is how much we resemble each other, almost more than we are distinct. Think about it. The only real distinction is that our homes are built in an indoor factory, with homes moving through a line. Conversely, site builders have an outdoor factory with the lines moving through the home. I think that's the way to view it.

Perhaps, this industry will do some of those same things they've been doing in the future and vice-versa. They go to building homes indoors like we do, and our builders go to building subdivisions for their homes, like they do.

The similarities converge daily, but are we intruding on them, or they on us? What do you think?

## 7. Chattel Lending: An Endangered Species?

Assuming, as a lender, you not only want to get all your principal back after loaning out money, but you'd like to see at least 10 percent interest as well, MH chattel lending may not be for you. Think about this: The performance of chattel loans over the past eight years or so has been so dismal and disastrous, even Bill Gates' fortune would have been endangered had he invested in MH ABS securities instead of Microsoft. Lucky him...

With many things remaining on this industry's plate to be resolved, let me assure you chattel lending is not for the faint of heart. At present, only severe discipline in loan buying – avoiding lower credit tiers and many in-community loans – allows

for lender survival. Lower credit tiers and in-community placements have experienced devastating loan losses in the last eight years. But avoiding the two has resulted in severe volume restrictions for our lenders too.

Our industry is not a 710 FICO business and lacking good in-community chattel placements severely constrains shipments, sales and demand. After all, if you have a real cash down payment and excellent credit, why not buy "standard housing" instead of "housing lite?"

The many measures I've repeatedly proposed to help industry lending still remain to be done. Chattel lending hangs on by the skin of its teeth. To the industry, I say, the old song refrain, "When will they ever learn," says it all.

## 6. Rent-to-Own, Rent-to-Buy, Self-Financing and Other Methods

All of these options listed above are being used to fill the substantial community vacancy existing in many locales. Constrained chattel lending, low leasehold community demand by financeable clients and unsettling rent increases in many locales, however, has put a damper on leasehold communities.

The community owners, in many cases not practiced in filling substantial vacancies, have grasped at desperate measures to refill their home sites.

Enter the rent-to-own and similar measures. Demand for in-community housing is coming today primarily from credit tiers starting with 650 FICO scores and downward.



These are not generally financeable prospects (and only realistic candidates if they have down payments in the 20-40 percent range). Thus, community owners have sought ways to cater to and accommodate this generally marginal buyer (renter).

There is no question certain geographically compact and highly directed organizations, with all of their assets close to home, can successfully affect this model. They lead a "SWAT team" of highly directed operatives, control every aspect of the community's existence, and are prepared to do the heavy lifting and often distasteful tasks necessary to succeed.

But, even with smaller organizations, the work necessary to succeed in that model may be so foreign to community ownership and management, the necessary style transition may be difficult. A full community, with a good mix of working-class home owners, interspersed with retirees, is "a rocking chair endeavor" compared to the requirements of financially marginal people renting their homes, theoretically to build equity, in order

to buy them. (Ah, the opportunity of a lifetime!)

The big question still remains whether this operating style can generally be successful, over wide community segments, in varying locations. That is especially the question when used on an industry scale, (not the "Mom and Pop" world) in the far-flung corners of HUDville.

Here's a more important question to consider: Can the model under which these leasehold communities were built – providing decent, affordable housing for these with the least housing choice – be resurrected, and what it would take to do it? I believe many community owners, but not all, spend some time with that consideration, remembering low incomes and bad credit need not reside in the same body.

Being poor does not necessarily make one a bum. In fact, far from it.

#### **5. Profitability Returns to The HUD Code World**

Reviewing the terrible financial toll of 1999-2003, you wondered

when the industry might return to profitability. The annual trip to the 2003 Louisville Show gave me a surprise preview to that answer, as numerous industry participants confided in me, while they were well aware of the great financial distress, they were doing well. Not everyone said this, but it was repeated enough that a trend was discernible.

The people in factory-built housing were learning to regain their profitability. They had downsized, cut costs, decided waiting for a return to "normalcy" wasn't prudent and learned again how to create profits.

Why isn't this 2004's most important development? For that question, I don't have a good answer. I do know you can't stay at the business table losing money forever. For the moment, I've been very content to observe a much more profitable industry landscape in 2004, and a highly heartening development it is. It is the first step back. Perhaps, it is even more important than are the keys to waiting out our industry's return, (if it happens).

#### **4. Lessening HUD Housing Demand**

We've had the sense in the last few years something was slightly different this time in "HUDville." (Yes, John Diffendal, as you said, just like the March 2000 NASDAQ – at 167 times the next year's earnings – just before the meltdown, nothing was different, even though everyone said it was.)

There is no doubt, beginning in the eye-opening period of year 2000, when our lenders were commonly charging interest rates of 500-1,200 basis points higher than conventional housing, this wasn't the same old HUD Code downturn. Certainly, we are experienced as an industry of highly cyclical activity to expect feast or famine. Thus, the 65 percent industry pullback that was unfolding didn't worry many for the long term. Most



of us only worried about tomorrow, not the future.

Early on, I was already investigating the “probable” shipment increases in the bounce-back year, based on past performance. As was unveiled recently by both John Diffendal and MHI economist James Clifton, strong double-digit increases have been the norm, at least in the past. Flashing forward to the present, a bevy of industry analysts are looking for that “cyclical low” to end this year, with 2005 rebounding strongly, if not as much as in past episodes.

I wrote an article for MH Merchandiser four years ago, “Differentials” (**download a free PDF of that article at <http://www.martylavin.com/writings.htm>**) which explored our extreme non-competitiveness with conventional housing. I believe

it is one of the most under-appreciated pieces I’ve ever written. It barely created a wave. I reread the piece as I wrote this, and boy, did I peg it! More, perhaps, than even I understood.

Let me be clear, HUD Code demand is still vibrant. It just comes from people you can’t finance or you may not want in your community. Our situation mirrors that of this nation’s airlines. For the fares they need to charge, they can’t remotely get enough passengers, and for the fares passengers want to pay, the airlines can’t survive. Our situation is similar.

Conventional housing has extremely low interest rates, available to a wide spectrum of credit tiers, with low and no down payments. Why? Their homes tend to appreciate, so if they make a mistake in any loan, and many are made, the repossession and

recovery is not a scalp-losing event. The ease of home purchase in conventional housing, their accommodative financing and ever more low-priced homes available from site builders, have wrecked havoc with our market segment.

They’ve also damaged our real appeal: Affordability.

Is this a permanent condition? Think about interest rate spreads between our housing and theirs, the ability to raise capital for financing, the appreciation/depreciation factors of both housing forms and, finally, translate that into competitiveness and, therefore, demand. Taking all of these things into account, I am uneasy.

### 3. Falling Into The “Niche”

I devoted last month’s newsletter to this topic, so I’ll keep it short this time. HUD Code homes are sailing along at about 6 percent of new housing starts, almost a 90 percent decrease from the 1972-73 period. Our industry retail financing is still unsatisfactory, our product somewhat noncompetitive. And our ability to resolve many issues – warranties, MSRP, industry database, Community Attributes System, continued repossessions, loan fraud, in-community homesite vacancies, ever more stringent zoning, poor distribution chain, poor resale market, and most importantly, home depreciation – are still works very much in process, often accompanied by endless quibbling.

Guess which of these scenarios is more likely to occur:

- The conventional housing industry is going to become less competitive so the factory-built housing industry can remain unchanged.
- The factory-built housing industry must change so we can catch up with everyone else.

I’m often frustrated because the industry acts as if it believes the former is the probable outcome, that we

## 2004 Shipments Contest Drawing to a Close

The MHL Corp Annual Shipments Contest zeros in to its final resting place. While November saw a surprising 12.8 percent increase over last November’s anemic numbers, the final 2004 count is unlikely to set much of an upward trend. From “the bunker in Burlington,” it looks like 131,000+ homes will be the final count.

That means Anthony DiMarco, the bright young mortgage broker at Security Mortgage in Rochester, N.Y., with his prediction of 131,000 homes deliveries, continues in the lead with one reporting period remaining. The only thing now open to question is whether last year’s final count of just under 131,000 homes will be beaten. The sugarplum thought of a big industry resurgence in 2004 moves onward to 2005. Wait till next year!

need to do nothing to ensure more profitable futures for one and all.

## 2. The GSEs are coming! The GSEs are coming!

Various government-owned and aided enterprises have dabbled in factory-built housing. During the scintillating days of ABS-showered money, delivered through dozens of industry lenders, government sponsored enterprises (GSEs) were around, but hardly a force.

Then, as the chattel constraints bit deep in the late '90s and early 2000s, the last kicks of a desperate industry flooded into the unwary loan arms of the GSEs and others, flooding them with paper your worst enemy shouldn't buy. But they did, and for whatever reason, they also loaded up on giant portfolios of Conseco loans. (Rumor has it, these loans weren't the best.)

Once the reality of what was occurring at Fannie Mae and Freddie Mac sunk in, the loan windows narrowed substantially and "shark cages" were erected to protect them. Say what you will about our two friendly GSEs in Washington, D.C. You can accuse them of MH loan naivete but, once engaged, they move quickly.

I attended a MHI/Fannie Mae meeting in D.C. in 2003 when it was obvious Fannie's Harold Lewis (a plain-spoken man) and his MH minions were fully engaged. They seemed somewhat agitated at both the poor performance of their factory-built home loans and the seeming lack of concern by the industry over their losses. As a lender, I could sympa-

thize.

Perhaps this is true in all industries – and certainly in factory-built housing – but there is scant concern when MH lenders lose their shirts. Generally, there is only a passing concern shown that another lender is lost to the industry. It's as though MH lenders were merely put on this earth to lose money to support the industry.

Presumably, it will all be made up in volume. Or, perhaps, a special place will be reserved in Lender Valhalla for those lenders who lose the most.

Now, Fannie and Freddie are sniffing around again. They seem to be carefully and methodically trying to bring money to the industry. I serve on several MHI committees interacting with Fannie on initiatives they've advanced. The gist seems to be that, in order for Fannie (and presumably Freddie) to aggressively re-enter the market, the industry must make changes. Who can blame them if they are looking to protect themselves from some of the shenanigans and miscreants that caused them previous losses...

So far, the progress I've seen is pretty slow. Our industry's position in general: The lack of transparency is good, and continuing to do the same things that have been done in the industry past will lead to a different result this time. On its face, that seems an absurd assumption, yet the battle



rages on. Without substantially better industry financing "the niche" is where we'll stay.

I've dealt with lenders all my life. Yes, you can negotiate with them as to whether the deck chairs should be blue or red, but the lenders call the shots. Period. Always have and always will. In our own lives, we recognize this as we deal with whomever finances our own endeavors. But as an industry, we take the position we can tell the lender what we'll do, and they better like it.

Do you find this attitude as astounding as I do?

Maybe, just maybe, as an industry, we need to stop negotiating non-negotiable points, get GSE money involved and move on with our industry lives. Don't like their programs? Don't use them, but individual intransigence is dooming many in this industry who want and need that money.

The first step has got to be a flow of money back into the industry. It has to be. Oh, say what? You say that every day that goes by we are ever closer to stupid money making its belated re-entry into retail HUD Codedom financing.

Well, if nothing has changed, and many feel that way, every day does indeed get us closer to a resolution. Shall we wait? I wouldn't wait for the GSEs to bring the "stupid money."

## 1. The New Math: Clayton + Oakwood + Buffett + Vanderbilt + 21st Mortgage = Powerhouse

Boy, talk about lemons and lemonade. Not too long ago, Clayton Homes and their lending arm got trapped by the asset-backed securities (ABS) market closedown, threat-

The logo for the Freddie Mac Foundation, featuring the text "Freddie Mac" in blue and "Foundation" in orange, with two red hearts to the right.



**Jim Clayton**

ening the company with grave harm. Clayton's business model required money for lending – lots of it – which they did not have, not being a bank. Their carefully laid plans were being sabotaged by the misdeeds of others. **(If you want to know more, download a free PDF of “The Berkshire Effect” on my Web site, under the “My Writings” tab at <http://www.martylavin.com/writings.htm>.)**

Coming seemingly out of nowhere, Warren Buffett's Berkshire-Hathaway made an offer for 100 percent of the Clayton Homes' stock and, after a contentious battle, prevailed. This left Buffett in charge, Jim Clayton gone to his rose garden with a serious bundle of cash for his stock, and his charismatic son, Kevin, running the show.

And the operative word is “running.”

Immediately, the new Buffett money, channeled through Vanderbilt Mortgage and Finance (Clayton Homes' lending subsidiary), cured the ABS shutdown. Being highly liquid, adept at loan origination and servicing, the Maryville, Tenn., lads took off.

That lean, no-nonsense heritage

from Jim Clayton's years at the helm combined with the Oracle of Omaha's financial liquidity fueled a high-octane industry assault. They were everywhere, selling homes, financing them, buying portfolios and creating the industry's current industry “900-pound gorilla.” (I've got to ask Jim if, in his wildest dreams, he really believed it would happen. Maybe, he'll answer that question in his updated book, “*First a Dream*,” to be released soon.)

Not too long afterward, the bankrupt Oakwood Homes – formerly a big competitor – became a part of the Clayton Homes consortium. However, by now, this acquisition was cleansed of bad loans, crippling obligations and bearing an excellent product line, with fine people and productive factories.

Immediately, profits rolled in from Oakwood. The new product lines it brought were a revelation to Clayton, which has been known as a Southeast-based builder of modest homes, going into communities, dad's backyard and rural settings. Oakwood's upscale offerings proved popular with folks in the West, targeting a customer very different from the former Clayton Homes.



**Kevin Clayton**

With excellent factories, strong personnel, desirable product and very proficient senior management, growth occurred quickly in Maryville. Tim Williams and Rich Ray came to the organization as Clayton purchased 21st Mortgage, extending their reach into independent retailers and floorplan financing.

All of this culminated with the late 2004 purchase of the \$4 billion Chase Manhattan manufactured housing portfolio. If there were any doubters left, and I know of none, this put an end to the skeptics. Besides, who else left in the industry has the muscle and guts to handle a \$4 billion portfolio and service it?

For the moment, Kevin Clayton, his people and all of Clayton Homes can bask in the great year 2004 was for their company. Gobbling up industry share was as predictable as Alexander the Great's spread across Asia Minor.

Is there a next benchmark and challenge for this dreadnought? Ultimately, a larger industry to conquer will capture the gaze of the Maryville boys, just as it must every industry participant.

### **An Epilogue**

In spite of my sharp remarks about some industry conditions I do not like, I remain optimistic. I am a big believer that things always have to get worse before they get better. Worse is already here. If the industry refuses to make substantial changes, in my mind, expect its further digression into a “niche” market. This will continue the decreasing long-term trend line from HUD Code housing occurring over the last 30 years.

It can be arrested and turned, but it will take more than stupid money to do so. We've counted on that since the industry was founded, and look where that got us.

**MVL**