



IN-COMMUNITY LENDING

A VALUE PROPOSITION FOR MH COMMUNITIES

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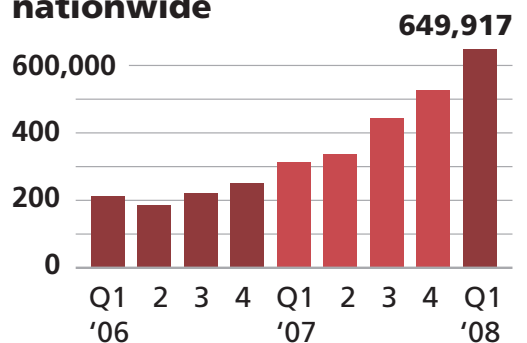
The current distress in the US mortgage market has significant implications on the manufactured housing industry. Just as the increase in the availability of sub-prime mortgages hastened the loss of the MH industry's housing market share, the current mortgage market meltdown represents an opportunity for the industry to regain much of its historical consumer base. One barrier to recovering that historical base is the dwindling availability of chattel financing.

With the loose underwriting standards in the MH industry, which began roughly in 1999, and the subsequent fall of Conseco, the number of chattel lenders has consistently decreased. The loss of Origen, which at the time of the suspension of its mortgage originations in March of this year was the MH industry's third largest lender, underscores the severity of this decline. In response to this decline, manufactured housing community owners have increasingly become lenders to the homeowners in their communities. While early "in-community" programs were generally smaller, undercapitalized and loosely structured, these newer programs are considerably larger, more complex and highly capitalized operations. And, while many of these programs are still in their infancy, indications are that in-community lending programs can be operated effectively and are beneficial to both community owners and MH community residents.

Foreclosures rise

Nationwide foreclosure filings for the first quarter of 2008 increased 23 percent from the previous quarter.

New foreclosures nationwide



SOURCE: RealtyTrac

AP

Defining In-Community Lending

There are many variations of the lending programs offered by today's community operators. For purposes of this discussion, we have defined in-community lending as any home financing program through which a community owner, operator, management company or affiliate provides credit either directly or indirectly to a homeowner.

Examples of in-community programs include, but are not limited to:

- Seller financing through community owned retailers
- Third-party loan programs guaranteed by the community owner
- Lease-to-own/lease option programs
- Rental programs

While these very different programs have been aggregated for the purpose of this discussion, it should be pointed out that each program has very distinct characteristics and each will perform differently in terms of borrower default frequency, loss severity and program profitability.¹ We urge anyone seeking to implement an in-community lending program to get information specific to the type of program being implemented.

The Value Proposition

The value proposition for community owners is best illustrated by looking at the advantages and challenges that chattel lenders face in servicing homeowners in MH communities. Over the past decade, chattel lenders have significantly refined their lending practices and policies. Chattel lenders now benefit from extensive credit risk assessment experience, generally pay a lower cost than community owners for the money they use to lend to homeowners, and have a greater overall supply of money to lend.

Chattel lenders do, however, face a number of significant challenges in today's credit environment. These challenges include lower credit score borrowers, which represent greater credit risks; decreasing home values, which increase potential loss severities on default; and a shortage of broader real estate debt capital, which could threaten long-term MH community financing. While these challenges have caused lenders to modify their lending guidelines, most chattel lenders feel that improvements made over the last decade will allow them to weather the current credit crisis.

Conversely, community owners have a number of unique advantages when making home loans to residents within their communities. These advantages include: improved ability to collect monthly loan payments by being onsite daily; the ability to reduce losses due to home damage; and greater speed in recovering a home and remarketing it for resale. Some community owners have elected to create a form of "subsidy" through in-community financing by blending rent and loan payments to accommodate weaker credit and/or lower income borrowers.

Notwithstanding these advantages, community owners face an equally long list of challenges in setting up and operating a lending program. Lending programs require dedicated human resources and large ongoing capital commitments. The continued increase in state and federal lending guidelines requires extensive record keeping and ongoing compliance with ever-changing regulations. Most importantly, community owners must acknowledge that lending is a business in and of itself, which requires a considerable long-term commitment if it is to be done successfully.

Early Results

As stated previously, today's in-community lending programs are still in their infancy. Based upon historical loan performance data provided by MH lending sources,² the majority of borrower defaults occur after 24 months. The average chattel loan is retired, refinanced or defaults in less than 7 years. In contrast to the chattel lending industry's multi-decade history, many of the current in-community loan programs were created within the last 3 years. That said, there is early evidence that these in-community programs are often providing homeowners with lower cost financing and are experiencing fewer defaults than third party chattel lending programs.

Tables summarizing portfolio performance of some existing in-community loan programs can be found on manufactured-housing.org, click on industry data. All of the programs are modeled as "conventional" lending programs. In all cases, the programs utilize third parties for some or all of their loan origination or loan servicing services.

Final Thoughts

In-community lending programs will continue to expand as more community owners look to broaden financing options available to residents. This expansion of in-community lending will supplement, but not replace, existing third-party lender chattel finance programs, thereby increasing the availability of

¹Default frequency refers to the percentage of loans which default as a percentage of the number of overall loans made. Loss severity refers to the shortfall between the outstanding principal balance at the time a loan defaults and the amount the lender "recovers" upon the resale of the home.

²MH lending sources include to 21st Mortgage, Triad Financial Services, Inc., Origen Financial Services and PMH Financial, Inc.

financing to MH homeowners. Another important, though tangential, benefit from in-community lending programs is that they further align the community owner's interests with those of community residents. With the community operator as the lender, the likelihood of large rent increases, which may negatively impact a resident's ability to make both rental and mortgage payments, is greatly reduced.

As community owners contemplate starting or expanding an in-community lending program, they should consider the following:

1. Decide why you want to offer an in-community financing program. While the obvious answer may be increasing or retaining occupancy, a community operator needs to determine in advance the resources it will commit and the expected outcome of the program. Will the program be an additional source of revenues? Preserve occupancy? Increase occupancy? Finally, keep in mind that the impact of occupancy gained through in-community lending programs, especially if a large portion of the occupancy gains are recent, often does not carry the same value for lenders or buyers of your community should you look to refinance or sell.

2. Stick to your program: the plan you create based upon your business objectives should be the plan you follow. If you find yourself needing to change the objectives of the program, you should revisit the strategy you created when you started the program.

3. Allocate sufficient resources: lending programs take considerable time and money to set up and operate. Determine in advance the resources that you will commit to the program.

4. Seek out and utilize third party lenders and lending resources to set up and operate your lending program. The chattel lending industry has the benefit of many very extremely talented, smart and

experienced people and companies. The chattel mortgage industry has already survived the downturn that the broader housing finance marketplace is currently experiencing. Anyone looking to start a lending program or who is already operating a program should consider partnering with an established industry lender or loan program administrator. ■

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