

# Back to the Future

The  
**Subprime  
Lending Crisis**  
And Its Impact on  
Manufactured  
Housing





# re future

When Wayne Gretzky, arguably the greatest hockey player ever, was asked to explain his remarkable success after smashing all of the National Hockey League's scoring records, he said matter-of-factly, "I skate to where the puck is going to be, not where it has been." While that is sage advice for any aspiring hockey player, it is also excellent advice for everyone in the housing industry as we try to make sense out of the unprecedented volatility taking place in the mortgage market today.

Throughout the first half of 2007, the market's response to the poor performance of the subprime sector was obvious. The clamp-down on this business was swift, the judgment harsh. A number of subprime lenders have gone out of business. Wall Street investors were eliminating product features, imposing restrictions and requiring risk premiums in product pricing.

Unfortunately, in late July and early August, the situation got a lot worse. The market's fears about the problems in the subprime area spreading into the Alt-A (e.g. option ARMs, stated income and "piggyback" products) and parts of the prime market were realized. Several of the largest mortgage lenders announced serious delinquency problems and American Home Mortgage was forced to file for bankruptcy protection.

This article will focus on Mr. Gretzky's advice and look to where the mortgage "puck" is going to be in 2008. What will these changes mean for the future of the housing industry and, in particular, their impact on the manufactured housing industry?

While many in the industry were not surprised by the news of the spillover from the subprime market to the Alt-A and prime products, it is fair to say that investor reaction to these events "shocked" just about everyone in the industry, Wall Street and the Federal government. With these announcements indicating that the credit problems were intensifying throughout the mortgage market, investors lost all confidence in the performance of the private mortgage-backed securities (MBS) market (including securities with underlying assets of subprime, Alt-A

and even high-quality jumbo mortgages). The private capital markets literally seized up overnight and still remain that way as this article is written at the end of September.

Simply put, unless a loan can be sold to Fannie Mae, Freddie Mac, Ginnie Mae (FHA or VA) or held in a financial institution's portfolio, it has become virtually impossible to originate any other type of mortgages, including high-quality jumbo loans, and sell them as part of a private security, even if the security had a AAA rating. Stated another way, there is now little-to-no funding for mortgage products that comprised over 40 percent of the market just a year ago.

In response to these events, the Federal government has taken several actions. First, on August 31, President Bush, in a speech at the White House, gave the American public a tutorial on the sub-

prime problems and outlined a five-point plan to stabilize the markets. In his speech, President Bush said the following:

"The markets are in a period of transition, as participants reassess and re-price risk. This process has been unfolding for some time, and it's going to take more time to fully play out."

Many observers took this statement, as well as the White House event itself, to mean that the Bush Administration is growing more concerned about the impact of the mortgage market turmoil and recognizes that these problems are not nearly over and they are not going to be solved quickly or easily.

While the President's speech had more symbolism than substance for Wall Street analysts and political pundits, it did have substantive content for the mortgage and housing industries. The speech included strong support for

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FHA legislative reform, including modernizing the Title I Manufactured Housing program (MHI's primary legislative goal for 2007) and allowing FHA to refinance delinquent subprime loans caused by loans' automatic rate reset. Probably the most surprising element of the Administration's strategy called for greater transparency/disclosure of mortgage broker fees.

On September 18, the Federal Reserve took its own step to underscore the seriousness of the situation by surprising virtually everyone with a 50-basis-point cut in the Fed funds rate. Later that week, Treasury Secretary Paulson opened the door to increasing Fannie Mae's and Freddie Mac's mortgage limits on a temporary basis to address the lending crisis in the jumbo mortgage market.

What does this all mean for the mortgage industry in 2008? As a starting point,

several observations appear appropriate.

**1. Liquidity/financing capacity will not return quickly.**

Unfortunately, there is no easy answer to how long it will take for liquidity/financing capacity to return to the mortgage markets. This problem will last until investors are comfortable with the performance expectations and repricing of risk for these securities. For some products, liquidity may not return for years, if at all.

**2. There will be a dramatic shift in product availability.**

Once the liquidity/financing capacity returns, the mortgage industry will also be adhering to the tighter credit standards that have been implemented by all of the Federal and state regulators. What happened in early August has only rein-

forced to the regulators the need for strong and comprehensive action. For example, all nontraditional (option ARMS and interest-only) and subprime mortgages now must be underwritten to the fully indexed rate. Loans based on stated income and piggyback loans will be curtailed significantly in the coming months. The net effect of these changes will be to institutionalize (in effect making them "permanent") the tightening already implemented by investors. These underwriting changes will eliminate the use of these products as a means to qualify homebuyers for homes they could otherwise not afford. Industry observers will be interested in the impact these tightened credit standards in the subprime mortgage market will have upon manufactured home lending, including chattel lending.

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The universe of potentially eligible homebuyers for site-built homes has been reduced by the elimination of many mortgage products. We are returning to the times when homebuyers would qualify for mortgages at 2 or 3 times their annual incomes instead of 5 or 6 times their family incomes, as has been occurring the last several years.

These seismic market shifts in the mortgage industry will offer the manufactured housing industry significant opportunities in the months ahead. Manufactured housing offers homebuyers a quality product at a more reasonable price. With an affordability gap that is likely to widen because of the tightening credit standards, manufactured housing is uniquely positioned to offer many American families the dream of homeownership in a rapidly changing mortgage marketplace.

What can be done to minimize the impact of the liquidity/financing capacity crunch?

• **First and foremost, loans are available and still being made to qualified homebuyers.**

They are predominantly being made to homebuyers who meet the program

requirements and underwriting standards of Fannie Mae, Freddie Mac, FHA and VA. In addition, jumbo loans and even some of the highest grade alt-A loans are being originated, but at higher prices. Those that don't meet these underwriting standards and government loans are being held in the portfolios of financial institutions.

• **The importance of FHA modernization legislation becomes even more critical.**

MHI is working diligently on Capitol Hill to ensure that the reform of FHA's Title I (home-only) and Title II (land-home) programs are enacted as soon as possible. This reform legislation, particularly its higher mortgage limits, is critical to the manufactured housing industry's ability to offer competitive financing. While the FHA legislation was always important, the events of the past few months underscore FHA's value in a turbulent marketplace.

• **Fannie Mae and Freddie Mac can play a broader role.**

MHI is also committed to expanding the financing of manufactured housing through the products of Fannie Mae and Freddie Mac. MHI is rolling out a new initiative with Fannie Mae that will treat manufactured housing similar to site-built homes in determining underwriting criteria for future homebuyers.

MHI also supports initiatives to increase the availability of credit offered by Fannie Mae and Freddie Mac. MHI has pushed legislative language that mandates a "duty to serve" manufactured home lending by both organizations. MHI also believes their portfolios should be increased to provide more liquidity.

In conclusion, these are uncharted waters for the real estate finance industry and it will probably take at least several months for things to settle down. However, it is also important to remem-

ber loans are being made and will be made in the future.

The financing marketplace is literally going "back to the future" with respect to the types of loans that will be originated. Fannie Mae, Freddie Mac, FHA and VA are regaining their importance in the marketplace. Hopefully, they will be performing the roles for which they were created (i.e. ensuring homeownership opportunities for many lower- and middle-income homebuyers and the availability of refinancing alternatives.)

To paraphrase Wayne Gretzky, it is time to move to where the mortgage market is going and not where it has been. For the manufactured housing industry, the current market turmoil has created a significant opportunity to fill the affordability gap that has developed as a result of the credit problems in the site-built mortgage lending marketplace. ■

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