Volume 6, Issue 5

MAY 2006

Martin V. Lavin

"LIFE AFTER THE HAVENER REPORT"

Marty's News & Notes

Featuring news about the Factory-Built Housing Industry
And all the news that's fun to read...

Inside this issue:

Life After the Havener Report

On April 21, 2006, a few days after the very successful Las Vegas MH Congress, held at Paris Hotel, a stock analyst's report hit from cyberspace, delivered to the thousands of A. G. Edwards investor clients via email.

The report was authored by Arthur L. Havener, analyst in the Equity Research - Real Estate Investment Trusts (REITS), of A. G. Edwards in St. Louis, Missouri. Havener has shaken the industry in the past with his blunt industry assessments, but this report really rocked the boat. (314-955-3436 haveneral@agedwards.com)

I reviewed it carefully, spent a lot of time with Havener's conclusions, and sent it to a select inner-group of my sounding boards for color. To a man (and woman) they found little they could fault as inaccurate. The general response was, "holy craps, he knows!"

Based on what I consider to be industry feedback from reliable sources, I distributed the report to my newsletter list. My purpose was to make available a blunt third party assessment of the industry from an intelligent and knowledgeable source, with comments made about the industry that we need to address. And if not address, they at least need to be comprehended by the industry at large.

Painful Report

Painful as it can be, and Haverner's report can leave you withered, I firmly believe you need to see yourself as others see you. I clearly learned that lesson over 14 years ago when a foto taken of me revealed a man who had gained so much weight as to be embarrassing. The camera's eye caught my actual appearance, as I looked to others, and I didn't like it.

Now, I could have cut the foto up, and forgot about it, but still remained obese. Or I could have altered my life eating patterns to lose weight, and regain an appearance that is at least passable. I chose to change myself, losing over 100 pounds and successfully keeping it off for many years now.

The industry has a lot of weight to lose. Havener is our camera and it remains to be seen how we'll deal with this latest "candid snapshot" of the appearance of the manufactured housing industry to the world at large. It is not the only camera we've had, The Roper Report was an ugly snapshot about a year ago, and AARP and others have chastened us as well. Most fotos sent our way have been burned by us. We didn't like the picture, but did little to change the image.

"..I firmly believe you need to see yourself as others see you."

Powers Survey

The industry has been criticized in the past for being tone-deaf, failing or refusing to hear feedback from its consumers and regulators. It has gotten its hearing back lately, witness the ongoing J. D. Powers survey of the satisfaction level of new homebuyers. While the industry's hearing aid is not transmitting everything said to it, it still was effective enough to hear the results of the Roper Report, which led to the new home CSI being conducted by Powers. I suspect the results of that survey will be heard loud and clear by our manufacturers, then acted upon.

I have stated in the past that when remarks are made about us by AARP or the Ford Foundation or Art Havener, that these comments are "feedback". They are a form of Consumer Satisfaction Index (CSI). We haven't really reacted very well to this feedback, seemingly cocksure in our continued industry model, the one which has seen several periods of home shipment volume reductions of 50% and even more. It's troubling that we should continue to have such faith in that model. This especially so during the last 8-10 years which has seen the nation's greatest housing boom in its history, while we saw only bust. If you follow ole Marty's prime rule you have to watch what is happening, not what industry supporters are saying.

So it now leaves open whether the very candid and disturbing Havener report will result in more tone deafness or strike a responsive chord.

So what are Havener's points and how apropos are they? Let's go down the list of some of his assertions and give them the validity test to determine whether there is even a scintilla of evidence (as lawyers like to say), or whether there is no plausible truth to his statements. I'll start at the beginning of his report and frame his points (taking some license), in my own words:

POINT #1 The industry offers little optimism that it can increase its housing market share, there being fundamental constraints.

Exploration:

We are now into the fourth or fifth year of a meandering 125-135,000 new annual HUDCode shipments, if you forget the various hurricanes and FEMA ordered homes. While there is some optimism by a number of industry participants for an increase to 140,000 new home shipments this year, non-FEMA, in a two million new housing starts market, our total percent of new housing is at historic lows.

Assessment:

There is more than a grain of truth here unless you think barely hanging on is cause for optimism.

POINT #2 Havener continues to believe the Manufactured Housing Institute (MHI) reflects a relatively "ineffective platform", its segregated constituency restricting the trade association from making necessary changes to policies, business practices and procedures.

Exploration:

I'm hesitant to touch this one with a ten foot pole as in my own case the staff of MHI has done everything I have asked them to do for me, and more. I cannot criticize that aspect in any way. At the same time, I have been on innumerable blue ribbon committees to try to identify the fracture points in our business model and attempt to put an effective cure in place. I must report that in spite of an obvious (at least to me), need to change many of the things we do, change has been elusive. There are many constituencies at play here and consensus on the items that could positively impact our business have been difficult. I think changes in the model, which are germinating as I write, will come from the CSI, the image campaign, and the normal pressures arising from making a profit and staying in business. And frankly, Havener is not the only one questioning this point.

Assessment:

I'd like to say he is wrong, but I can't. I do think that maybe we need to view MHI as a vehicle for an exchange of industry information, networking opportunity and legislative and regulatory watchdog. I'm not sure they can be faulted for failure to be the change agent Havener wants. It may be a role they can't play. No, it is a role they will not be allowed to play.

POINT #3 The manufactured home manufacturers continue to fail to take responsibility for proper home set up. Consumers have little recourse when dissatisfied.

Exploration:

Let's not quibble on this one, there is too large a body of evidence that in general, with some real exceptions, we are guilty as charged. The Roper Report spoke to this point, our critics hammer us on the point, and our latest hope hinges on the MH Home Improvement Act, still not in effect, and in my opinion, unlikely to be the answer. The problem is that when you've fallen as far as we have in the eyes of the consumer, the burden to satisfy is far higher than normal. You have to bend over backwards, perhaps to ridiculous lengths for some period of time to overcome the perception. We have not been good as an industry in bending over backwards.

Assessment:

The Roper Report said it all, and little has changed in the time since, yet.

POINT #4 The lack of home financing options continue to plague the industry.

Exploration:

For those of you on Mars since 1998, the MH industry went into a funk staring 1999, caused by poor loan quality, which led to huge investor losses on our asset backed security bonds, which led to lenders going bankrupt or simply withdrawing, which created a severely limited appetite by investors for MH loans. Loan performance data shows clearly that 1) siting location of the home and 2) equity in the home are the two most important factors, of many. This means that leasehold communities, especially blue-collar types, are lethal to loan in without recourse (an ugly word), or large down payments for sketchy credits, or maybe very high FICO protections. While there is abundant money for the right loans there is not an abundance of the right loans.

Assessment:

Next!

POINT #5 The industry's efforts to garner greater investor confidence are plagued by the lack of quality and reliable information.

Exploration:

I discussed this last month and mentioned that the Census Bureau may well de-fund for 2007 the gathering of what little data we now have, which combined with what Tom Beers, the MHI economist can produce on his own, is about all we have. Meanwhile over at site-built, thousands of people are busy populating innumerable studies with endless figures, leading to a data-rich environment. When I reported the possible Census Bureau exit, no groundswell of indignation was evidenced to me. I see little concern about the lack of data, and yet it is damaging beyond belief. The industry has historically dealt in ignorance. Why change now?

Assessment:

You're kidding me, right, to question the validity of this one?

POINT #6 The industry lacks an efficient secondary market to sell pre-owned homes.

Exploration:

The industry cares precious little about reselling pre-owned homes and while an MLS has been pushed forward, there is so far to go here that I can't even fathom where the finish line is, to say nothing of seeing it.

Assessment:

True.

POINT #7 The challenging environment of LLC's has led many property owners to larger and growing numbers of renters in their communities, contributing to a higher turnover in the LLC.

Exploration:

If higher turnover is the only negative aspect of this plan, then we should all be happy. There are consequences here beyond merely turnover, none of them positive. My exchange of emails with Affordable Residential Communities explored the consequences of this model in detail, years ago, as they sought to make this work. My writings on this point are numerous enough to be redundant if I continue. I understand vacancies, but the better answer to vacancy is to determine why rent-to-own is the remaining alternative and why the community doesn't present an attractive place to live for the type of residents you wish to attract. That might be a good place to start.

Assessment:

Havener is pretty savvy in this area, follows it closely, and is no fool when it comes to this segment. I'd be foolish to try to contradict what is generally the result of this strategy: rent-to-own.

POINT #8 MHI has not demonstrated it is capable of altering the very negative stigma attached to its product.

Exploration:

This one finally hits where we live. Slowly but surely the regulation strangling our industry migrated from the Northeast and Pacific Coast, and is traveling along the two coasts, spreading its tentacles of prohibition, strangling our siting opportunities. States with enormous housing needs and lots of rural land like say Connecticut and Massachusetts, sell 300-500 new homes per year, when the demand is a multiple of that figure. Now it crawls down to the Carolinas, heretofore very MH friendly, but now less so. And why? Because the people who control our destiny simply don't want much to do with us. Witness the FEMA home placements in Louisiana. The misperceptions of factory-built housing persist. Our defense is on an ad-hoc basis, rising to repel some of the negative perceptions that arise in multiplicity daily. We fail to control the conversation to any degree at present, we are always on the defensive. It is my firm conviction that until we consistently and professionally sell America the very important role factory-built housing plays in the housing mix, we will continue to see increasing siting constrictions, which so limit our potential. How can we wait?

Assessment:

MHI is very capable of working to alter this negative perception but so far has been disinclined to do so. Pick up that phone and call Chris Stinebert, MHI President at 703-558-0400 and tell him we need this. Kevin Clayton, easily the most powerful man in Trailerville these days, got an earful at the Illinois Association meeting on this point in early May. We have to get the word out that the image campaign is Mission #1. Go to it!

<u>POINT #9</u> During this extraordinary single family housing market, MH lost ground in terms of new home sales, acceptance of product, and financing options.

Exploration:

In 1973 we were 50% of all new housing starts. Most of the '80's and '90's we were between 17% and 21% of all new housing starts. Recently we are about 7% of all new housing starts. Site-built housing has significantly more aggressive financing options, and it's lending is profitable.

Assessment:

Yes.

<u>POINT #10</u> Unlike site-built housing, MH continues to be regarded as "inferior housing" by the general public.

Exploration:

If you have strong contradictory proof of the inaccuracy of Havener's ascertain here, send it to me at my address on the back page.

Assessment:

Yes, I think it's true.

<u>POINT #11</u> The affordable family LLC's are facing serious challenges.

Exploration:

I leave it for Havener, George Allen and others to thrash this one out. I'd be lying if I said I had heard of no challenges for the segment.

Assessment:

Put it on the watch list.

<u>POINT #12</u> The US is on the verge of a very powerful demographic change with wealthy "baby boomers" demonstrating a high propensity to travel. Clearly resort destinations and the retirement demographic is the "sweet spot" for the industry.

Exploration:

It took twelve points to reach the first <u>very positive trend</u> affecting our industry. This is a good and powerful trend. Some are already riding it. It's far different from many of our former clients and puzzling to many industry participants. These are not the $30,000 per year total family income prospects we have feasted on in the past and who are now incapable of fueling a very large industry. These "Boomers" want an entirely different offering, are eons more sophisticated and demanding, and will look to a whole new industry structure. The model does and has existed, but financing, amenities and professionalism, to say nothing of a "good deal" will be hot buttons. Not all participants will succeed here, some will for awhile, until they kill the goose. Others will "get it" and build a far better model than the old one.

Assessment:

Yes, Arthur, there is a Santa Claus. At least for those who are good little boys and girls.

Haven't read this report? You should, and you should join in the industry conversation that will tend to lead us out of the woods. Havener has clearly highlighted the industry disconnects. Do I think this will lead to a sober reflection and galvanize into action? Oh, sure I do. Just as Roper did, all of those strategic planning meetings did, the blathering of those seeking change, and the calls for change from our many critics for the 34 years I've observed the scene. I expect this will have about the same impact on industry participants.

Monologue

This month I gave a couple of speeches to the MH associations at Illinois and Idaho, invited there by directors Bob Thieman at Illinois and Gub Mix in Idaho. I am always heartened by the very nice people which make up our industry and these two associations certainly didn't disappoint.

In Idaho, in mid-May, I shared the speaker's podium with Tim Williams of 21st Mortgage, the Berkshire-Hathaway unit of retail and inventory financing. Those of you who know Tim understand that he is a direct man who tells things as he sees them. He's been at it too long to be naïve at this point and the last 10 years have taught all us lenders some very painful lessons. Tim shared his most revealing figures for MH loan portfolio performance with the association.

I think the short analysis is that only at an MH meeting would default figures in the 35%-50% range not be cause for a complete meeting breakdown. Were you to present default figures in that range, with the attendant loses we suffer upon repossession and resale, at any other trade association meeting, there would be incredulity.

Presented at an RV, boat, site-built housing, sub-prime credit cards, or any other trade association, other than MH, there would be stunned silence. The good news, I suppose, is that MH now comprehends the enormity of our problem in loan performance. The bad news is that comprehending it is not the same as understanding its ramifications for the industry as a whole, and individually for them. It simply cannot fly that an industry model that features such gigantic losses, many times higher as a multiple over virtually any other loan you can name, can prosper, as a general proposition. And so it is that we now find ourselves at 1960-like volume levels with a far larger population base. This is serious, my friends.

I am severely criticized by some for daring to mouth these truths monthly. Tim Williams, no great shakes as an all-chuckles-kind-of-guy, said that before my speech I should hand out razor blades to help the digestion of the material. Yes, I do accept it is a grim assessment I frequently bring.

But it is not with rancor that I speak what I believe are truths about our failures. Never mind what I am saying and watch what is happening. Is there some variances I'm missing? Will a step up to 140,000 or 150,000 homes, non-FEMA, annually, demean my observations? This level would be at least 100,000 homes less than the long-term trend line, 230,000 homes less than 1998, and 440,000 homes less than we shipped in 1973. And this is not serious?

Look at the fotograph of the industry, cut it up if you don't like what you see or change what the camera captures the next time the shutter snaps. I don't like what the foto looks like. I want us to change the picture to a far better one. But continuing to cut the foto up or deny its ugliness will not change us to a better form.

That is why every month I urge us all to see ourselves clearly as others see us. Stop denying our deficiencies and correct them. That is the way the industry can reach the promise it has always had but rarely reached.

What did Dan Rolfes, former MHI chairman always say? If you continue to do things as you always have, the results are likely to be what they've always been. Amen.

MODULARS

Several years ago I wrote an article called "The Land/Home Conundrum" exploring why I didn't think modulars were the "next great thing". Regrettably it appears that I might have been right when the article was published in the Manufactured Housing Merchandiser in April, 2002.

MHI's National Modular Council released a report in late May noting that modular shipments were down 7.1 percent from the same first quarter period of 2005. It was couched in terms of our modular decline was in line with the overall housing decline of 7.2% for the period for single-family site-built residences.

With modulars being just a blip percentage-wise of the overall housing market starts, its decline in the face of the long-time industry chatter about the "great growth" this segment would enjoy, seems disappointing. Any thought, as believed by many, that this was "the way out" of the HUDCode slump now seems unlikely. Any berating many modular producers were giving HUD-Code homes now seems not only pre-mature, but frankly misguided.

While mods do have the potential for far greater volume, my claim the industry needs to become the developers, setting up large modular fee-simple subdivisions, in direct competition with the site-builders needs to be proven to work. Our reliance for 40 years on the small "pick-up builder" seems to have proven that method is not likely to produce the modular volume the industry covets. Palm Harbor Homes seems the industry hot hand in this segment, though I have reasons to believe others will join the fray in a far more direct manner than heretofore in the near future.

If this segment really works in places other than rural America, where they are erected one at a time, we haven't as an industry made a persuasive case for it. We'll see if the rumored entrants can change the dynamics, building on the success of Palm Harbor and others.

The MHL Corp Annual Shipments Contest

There is some divergence of opinion with my shipments advisors, but the total home pace could be as high as 150,000 total HUDs and as low as 137,300. The early January and February blip caused by the last of the FEMA deliveries pushed the first quarter volume higher than seems sustainable, at the present shipments rate.

The approximately 3,500 FEMA homes delivered so far has made for a fast start for the year, with a March softening. I've had to do some interpolation of the data to try to fathom our annual shipments, but it certainly is in the ballpark that presently we have an annual pace of 140,000 HUD shipments including FEMA homes, and about 136,500 "normal" shipments.

Some would argue that 145,000 totals are still the "seasonally adjusted" shipments. My concern is that I do not see FEMA ordering any more homes for the year. They already have all they need in "inventory" at Hope, AR and elsewhere. That being the case, absent a pretty good upward trend as the year wears on, reaching 145-150,000 homes, at present, just is not in the cards.

Of course, we are not talking about giant increases in volume to go to higher levels. As little as 500 more homes per month could product far better results than the present pace. So let's call it 140,000 homes, "all – in", and 136,500 homes, without FEMA.

And who were those "savvy seers" from last winter who correctly predicted the current shipments rate? Obviously, as I review the predictions, we are in a shipments volume area where many entrants thought we might be.

In the "all-in" including FEMA home volume, the current leader is **Andy Pequer of American Modern Insurance Company** who clearly was paying attention. Andy is at **139,995 homes**, a mere whisper off the present rate. But there were a number of others who are real close, waiting for the final figures:

Len Bonifeld, the Florida newspaper columnist	**140,678**
Ken Fister, the Retailer from Kentucky	**140,140**
Austin Baidas of Four Seasons Homes	**139,975**
Dan Rinzema of Datacomp Appraisal	**139,600**
Leo Poggione the Retailer from Nevada	**139,000**

Any of these folks could be your leader at year end.

In the "normal" shipments pace, which means all homes, excluding any sold to FEMA, again, there are a number of people very close to the present shipments pace.

The leader, just 300 homes off the pace is **Brad Waite, the No. 1 guy at Land/Home Financial of California** at **136,800 homes**. Again, there were others very close to the pace, who could just as easily be the leaders, including:

D. C. Williams of Quality Home Center	**137,350**
Amy Bliss of the Wisconsin Association	**135,825**
Dick Ernst of Finmark in Texas	**135,666**

Again, its still early to get a true direction, but what little evidence we have so far bodes for a down year from the FEMA home engorged 2005 final, to a lower level. We'll all be watching to see where this all goes.

WIND POWER AND THE SHEIK

We are involved in a wind power farm in New York State. Throughout the East, wind turbines are controversial, the environmentalists very much against them. "No Wind Turbines" signs are everywhere in our town.

At a recent public hearing for approval of the turbines I send Abdul Sheik Mohammad to represent us at the meeting. He caused quite a stir.

Martin V. Lavin
350 Main Street
Burlington, VT 05401
Mhlmvl@aol.com
802-862-1313