

ARA NATIONAL[®]
MANUFACTURED
HOUSING GROUP

WHITEPAPER
INDUSTRY REVIEW

CREDIT CRISIS TWICE OVER

The manufactured home (“MH”) industry serves the home ownership needs of the lower income demographic of our country, as affordable housing, if you will, for the “working class” as well as the 55+ seniors population. This has presented a number of challenges for the support systems of this industry. This industry has always struggled to find a good and consistent source of home financing for its customers. Traditionally, the MH community model consisted of leasing pad sites to MH homeowners and the stock for housing either came from newly constructed homes from a manufacturer, or pre-owned homes. During the 1990s and early 2000s there was plentiful availability of financing for homes. However, more recently the industry suffered its own subprime meltdown when a number of poorly written loans that were bundled up into pools and subsequently sold to Fannie Mae rapidly soured. The aforementioned created a credit crisis where the lending sources rapidly dried up.



The industry property owners and manufacturers created a bridge for this lending gap by providing a number of “Band-aid approach” solutions. Manufacturers of new homes began providing financing to borrowers and the MH community owners started guaranteeing home buyers’ loans and even providing financing themselves for pre-owned homes. This was all made possible by the availability and accessibility of bank debt to the manufacturers and park owners. If we fast forward to 2008, the access to bank debt shriveled like a raisin; the bank failed, the bank was sold, or the borrowers reached their lending limit with their relationship institution. This crisis currently haunts the industry and it is struggling to get political attention given its minor position in the scheme of the current financial environment. At the macro level, the industry cannot flourish and at the micro level, unless an owner has the capital to sustain a home lending program, the property may experience a slow and painful decline in occupancy resulting in reduction of services provided by the park owner as well as the risk of ever increasing deferred maintenance. As you may be beginning to understand, these are not simple management turnarounds or a one-time capital infusion. There is a lending pandemic that has created a new operating model that can only sustain the successful operations of a manufactured home park with a fully-funded private lending and servicing group as a part of its platform.



There are many sophisticated operators who have transitioned their operations in just this way. Unfortunately, the majority of this industry is not institutional (institutional ownership is approximately 3%) and can best be described as “mom and pop”, with only 10% of the market having 200+ pad sites in the respective community. Additionally, with no secondary market for chattel loans (chattel is the industry reference to the homes because they are technically personal property), there has been nominal progress with financial institutions to create a solution to fill this void for community residents. Most industry players feel that the answer will be an affordably-driven political solution that will

force certain institutions as a part of their mandate to guarantee securitized, appropriately-underwritten loan pools. This will probably not take place until after the securitized pool market for commercial real estate re-stabilizes sometime in the future.

COMPARISONS BETWEEN MANUFACTURED AND MULTI-FAMILY HOUSING

Since there seems to be a greater familiarity with multi-family (“MF”) housing, we thought that it might be instructive to point out some of the differences and similarities between the two which may help highlight the management operational challenges that exist and are compounded when a MH project is in distress.

Manufactured and Multi-family Housing Differences		
	Manufactured Housing	Multi-family
Amenity packages (clubhouse, pool, landscaping, etc)	similar	
Underwriting process	similar	
Rent control restrictions if applicable	similar	
Lenders	Fannie - but only finances the top 5% of MH Freddie - not currently lending on MH but have plans to put a program in place for 2010 - 2011 Regional and local banks	
Tenant ownership	homes owned by tenant, land leased	apartment and land leased
Individual home financing provided by	lender, manufacturer, and/or park owner	n/a
Default rate	low due to equity in homes	variable
Annual turnover of renters	10 - 20% (low due to cost to move homes)	50 - 100% (can be very transient)
Utilities	mixture of public and private systems	individual and/or master metered
Average community densities	4 - 11+ sites per acre	10 - 40+ apartments per acre, depends on zoning
Industry size	3.3 million sites	9.5 million units (approximately)
Average annual household income	\$35,000	\$116,000
Operating expense ratios	40%	55%

Sources: REIS, Foremost Insurance Group, Manufactured Housing Institute (MHI)

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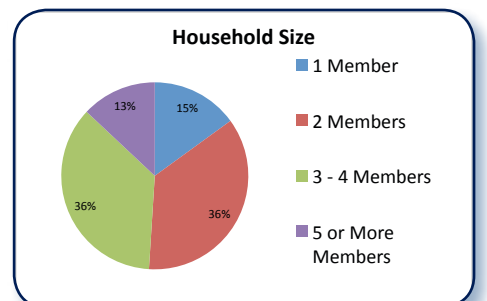
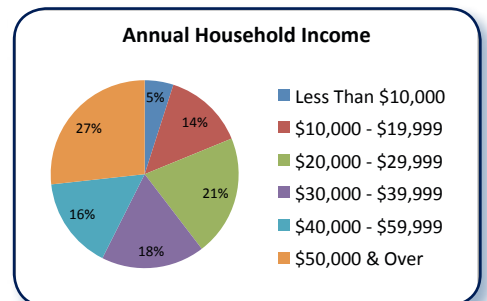
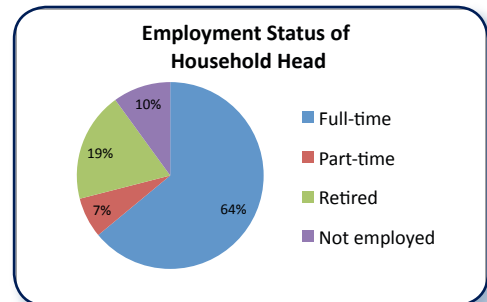
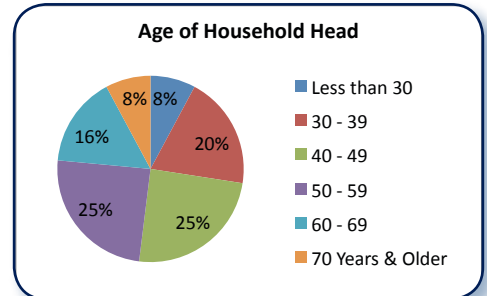
To further expand your education on just the MH community space, we would also like to include these graphs that provide additional industry insight. There are several glaring differences that become readily apparent between MH and MF communities - complexities created by having tenant-financed homes, very low turnover, and the industry’s size itself. Let’s tackle these issues.

Since the homes are owned by the tenant, they enjoy all the rights and freedoms of home ownership. As long as the tenant maintains the exterior and site in accordance with lease requirements, their home is their castle. For the most part, this tenant profile tries to maintain their homes; however the overwhelming majority of the MH tenancy is a lower income profile wherein economic struggles are problematic. Additionally, although many manufactured homes can stand the test of time, they certainly don’t have the shelf life of traditional “stick built” construction (an industry term for single-family construction) and are built with affordability and not necessarily the highest quality in mind. According to a study by the University of Georgia, the useful life of a manufactured home is 55 years.

It should be noted that there are some operating models whereby the park owner owns some or all of the manufactured homes on site and lease these homes like a traditional MF model. The foreclosing institution/ lender should be aware that these chattel assets are typically NOT a part of the loan collateral and can be removed by the borrower when the park is foreclosed leaving the lender (now owner) with a possibly unforeseen occupancy issue. Low turnover in a stabilized world is attractive but in a distress situation it significantly increases the time to stabilize a struggling MH community. MH communities operate more like a single-family neighborhood - they lease-up/sell-out slowly. It requires the tenant to make the biggest decision in their life to buy and live in a particular neighborhood. Along with the aforementioned and following the same logic, a negative MH community’s reputation is a long, slow turnaround.

Finally, as alluded to in the previous section, the industry’s size gives it little voice in the much bigger world at large. Only 7.5 million people live in manufactured housing and there are a third as many sites as apartment units. Given the industry’s tenant average household income, the real estate lending, and the real estate’s valuation impact in the marketplace, MH communities are a fraction of apartment and single-family.

MH MARKET DEMOGRAPHICS



Sources: 2005 Manufactured Homes: The Market Facts, by Foremost Insurance Company

IMPACT ON PRICING AND INVESTOR DEMAND

There are two primary issues materially impacting pricing and investor demand for Class 'B' (two to three-star) MH communities. Right now Fannie is only financing four and five-star communities and there are very few attractive alternatives. Risk to the buyer is increased by accepting recourse, and as such, will seek a higher return and cap rate. Although there are indications that Freddie may enter the MH space as a community lender next year, they are not currently active. The other issue is the lack of available home financing. This has made owning communities more capital intensive and has further pushed the investment market to require more reward for the risk.



Although there are issues relating to the capital markets, the operating environment for well funded all age and 55+, MH has never been more desirable. As a result, we are seeing increases in occupancy for all age MH communities for the first time in over five years and stability in the 55+ sectors. MH communities offer very low annual turnover, averaging 20% to 30%, and have mostly maintained their rent levels. Multi-family communities that are comparably priced have a turnover as high as 70% and have felt effective rents drop around 20% or more (adding concessions in most cases).

So even with the capital markets issues (which investors hope is temporary), the demand for owning profitable MH communities is strong because the MH asset class arguably provides one of the most stable cash flows in real estate. During the boom of the last seven years, though, it has been very difficult to find reasonably priced MH communities. In the current markets, we have seen many distressed MH assets. MH communities taken to market will attract active buyers that are local or regional, and private, who believe in the long term MH story. Investors are typically seeking a leveraged high teen to 20% return on the holding period so they can earn a 2x on equity, but will still accept lower returns for the higher quality assets.



We do have some major concerns regarding certain markets across the country such as parts of Michigan where the economic erosion continues to impact MH operations. Community owners consistently are raising rents even in the face of loss in occupancy and lower single-family stick built home prices. We do not feel these economics can last (i.e., can't continue to raise rents in this environment) and owners may be faced with lowering rents to keep occupancy over the near term, or at least until some of these market recoveries begin.

CONCLUSION

MH is a niche industry with nuances that make it a difficult asset class to manage and reposition without significant industry marketing knowledge and immediate and ongoing capital needs to sustain operational success. The alternative is a ship with a leak that will eventually sink. In almost every situation, the value of a MH community in the foreclosure process is worth more today than it will be tomorrow under the restraint of lender-owned management which doesn't have a vehicle to solve for the home lending issue.



WHY ARA NATIONAL MANUFACTURED HOUSING GROUP?

In this economy, it is extremely important to select disposition professionals that are industry-specific experts and can operate nationally, especially in specialty asset classes such as manufactured housing communities. In addition, the organization must have a team-oriented structure in place to promote open lines of internal communication with a shared database in order to stay on top of the evolving pool of investment groups. We feel that a combination of these skills yields buyers that will compete to pay the highest price with the lowest risk of renegotiating.



ARA's National Manufactured Housing Group specializes in the disposition of family and age restricted manufactured housing and recreational vehicle investment properties across the country. Misunderstood and overlooked just a few years ago, this asset class has grown into a mainstream investment product for ARA's private and institutional clients. Since this form of housing is typically the most reasonably priced for residents, with very low turnover and expense ratios, the sector arguably provides the most stable cash flow of any multi-housing investment product. Also, these assets tend to provide a yield that is favorable when compared to conventional multi-family product in any given market. In order to adjust to the changing needs of our clients, ARA has responded by creating a focused, experienced platform to provide representation in this market.



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Todd joins the ARA team providing significant expertise in the manufactured housing market. He provided sourcing of investment opportunities and due diligence services for a Chicago-based private equity firm focused on the acquisitions of manufactured housing communities. Todd is a member of the Manufactured Housing Institute (MHI).

Prior to his affiliation with ARA, Todd was with Hometown America, one of the largest privately held owners and operators of manufactured housing communities in the nation (127 communities with over 48,000 home sites). He spent almost 4 years with Hometown where he was directly responsible for 12 acquisitions totaling \$350M, the refinancing of almost \$550M of assets, and the disposition of 30 non-core assets totaling \$150M. Todd was also a key member in Hometown's take-private \$2.3B merger with Chateau Communities and asset manager for all assets acquired. While at Stockbridge Real Estate Funds, Todd was involved with the Yes! Communities joint venture with BaseCamp Capital, created to acquire Clayton Homes' 67 property, 18,500 site manufactured housing portfolio located in 19 states. His prior experience also included an asset management role with RREEF.

Todd holds a B.B.A. in Finance from the University of Colorado where he was the captain and coach of the Freestyle Ski Team.

Andrew manages the newly formed ARA National Manufactured Housing Group based in Austin and is a member of the Manufactured Housing Institute (MHI). He handles all aspects of the marketing process including client development, pricing strategies, valuation/modeling, and marketing, as well as negotiation and closing of transactions.

Prior to joining ARA, Andrew was a Vice President at a national brokerage company where he focused on new client development, financial underwriting, marketing and escrow management for multifamily transactions. He has been involved in the multifamily brokerage industry since 2002, closing almost 70 transactions totaling over \$120 million. His prior real estate experience also includes researching and analyzing multifamily agency securities for the commercial mortgage-backed securities trading desk at Donaldson, Lufkin & Jenrette and analyzing residential mortgage mergers & acquisitions while part of the finance team at Chemical Bank.

Andrew received his B.S. from Cornell University and his M.B.A. in Finance from the Wharton School of the University of Pennsylvania.

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