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LUMENT WHITEPAPER

OPPORTUNITIES IN THE MANUFACTURED HOUSING COMMUNITY SECTOR

MANUFACTURED HOUSING COMMUNITIES

Interest in affordable paths to homeownership and the growing popularity of lower density living are raising the profile of the manufactured housing option among American households and investors. At the same time, the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac are making concerted efforts to better serve this historically underfinanced market at both the individual homeowner and community levels.

The combination of robust cash flow growth, particularly in Sunbelt and Western markets, cap rate compression, and liquidity provided by the GSEs makes a compelling case for **manufactured housing community (MHC)** acquisitions and refinances. As increased competition has left market participants looking for an edge amidst compressing cap rates, the importance of working with an experienced MHC lender with access to short- and long-term loan programs has become more apparent. The following provides an in-depth analysis of the recent performance of rental MHCs, sales volume and pricing trends, and loan and underwriting trends in the MHC space.

SIZING UP
Manufactured Housing Community

Before we explore the growing interest in the MHC sector, take a moment for a refresher on its size and importance.

6.8M
Occupied manufactured homes.

5.5%
Of our nation's housing stock.

18M
Home to 18 million people.
(American Community Survey)

95,000 NEW UNITS
Shipped in 2020, nearly DOUBLE the 2011 figure.

$88,200
The median cost of a new manufactured home is less than 1/4 the cost of a new site built home.

MORE THAN 45,000
Total MHCs.

20,000
Of which are professionally managed

10,000
Have market values of $1M or more

1,000
Estimated resident-owned communities

500
Communities, with roughly 70,000 sites, owned by institutional investors

The Performance of the SITE RENTAL MARKET

The COVID-19 pandemic affected American housing preferences in profound ways. Increasingly, households are seeking lower density options with larger floor plans, home offices, and dedicated space for entertaining or distanced learning. This phenomenon accelerated pre-existing migration trends favoring smaller cities and Sunbelt states and catalyzed the advancement of newer industries – including modular homes and single-family rentals. It also elevated the manufactured home option as an affordable ownership option within reach of most families. Consequently, demand for MHC site rentals has increased.

Indeed, mobile home sales[i] and internet traffic to websites that provide referrals to MHC sites increased during the pandemic. Visits to a popular referral website[ii] increased more than 20% during the first months of the pandemic, and another 8% from October to March. Moreover, net absorption of MHC sites and rental units appears to have surged more than 400% during the 12 months ended March 2021 as compared to the prior year.

OCCUPANCY TRENDS

Rising demand for a limited supply of space[iii] typically leads to increased occupancy, and the manufactured housing market is no exception. Available data suggest that occupancy in the GSE financed segment of this asset class has risen consistently for years and currently approaches 96%. For purposes of evaluating asset class performance, the Fannie Mae DUS® and Freddie Mac Optigo® portfolios represent the largest samples and most reliable and consistent MHC performance data. In June, the sample consisted of nearly 2,600 properties, roughly 20% of the MHC universe of properties valued at $1 million or greater.

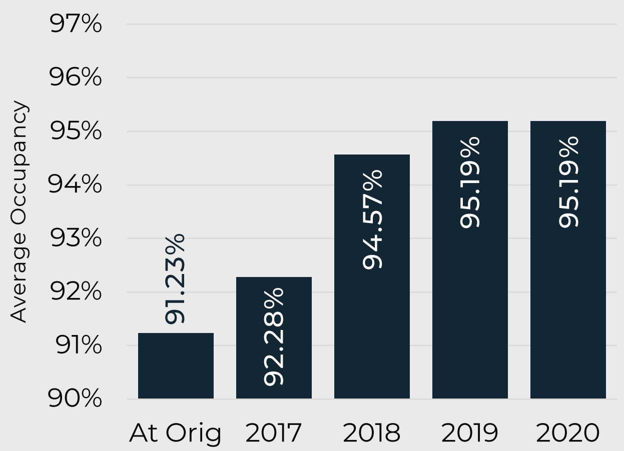
A subset of 877 properties was identified from which continuous performance data were collected since 2018. The value-weighted average year-to-date 2020 occupancy rate of the same-store subset was 95.2%, comparing favorably to 91.2% at origination and 94.6% and 95.2% in 2018 and 2019, respectively, demonstrating steady improvement in recent years. Among a larger 1,219 same-store sample of portfolio properties with observations for 2019 and 2020, the value-weighted occupancy rate was 96.1% in 2020, up from 95.6% in 2019.

For purposes of assessing metro level performance, we narrowed the MHC universe to the 31 largest metropolitan markets by number of communities for which a robust data set is available. This group encompasses nearly 10% of the universe of larger communities and sites. The sample is concentrated in California, Florida, and Texas, with smaller clusters in the Midwest and Pacific Northwest.

Findings indicate that average site occupancy in the 31 markets stood at 95.1% during the first quarter 2021, representing the highest metric recorded in the past five years. Indeed, the latest datum is likely the highest occupancy level observed in this sector since the 1990s. Quarterly data show that average site occupancy increased throughout the pandemic, rising about 40 basis points (bps), or 0.40%, during the first half of 2020, and another 65 bps in the nine months ended in March 2021. Interim spring reporting indicates that gains continued in April and May.

Figure 1.

MHC OCCUPANCY TRENDS
Same-Store Properties

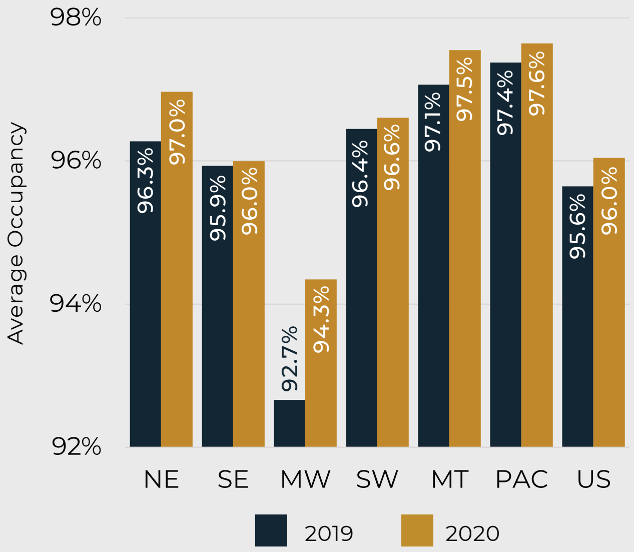


Sources: Trepp, Fannie Mae, Lument Research tabulations.

The largest rate gains were chalked in metros with above-average site availability (Atlanta, Indianapolis, and Detroit), low-density markets located within short distances of high-cost California cities (Inland Empire, Sacramento, and Las Vegas), and affordable low-tax retirement destinations (Jacksonville, Tampa). Markets characterized by high site rents (San Jose, Sarasota, Chicago, and Austin) recorded the only year-on-year occupancy decreases in the sample.

Figure 2.

MHC OCCUPANCY BY REGION
Same-Store Properties



Sources: Trepp, Freddie Mac, Fannie Mae, Lument Research tabulations.

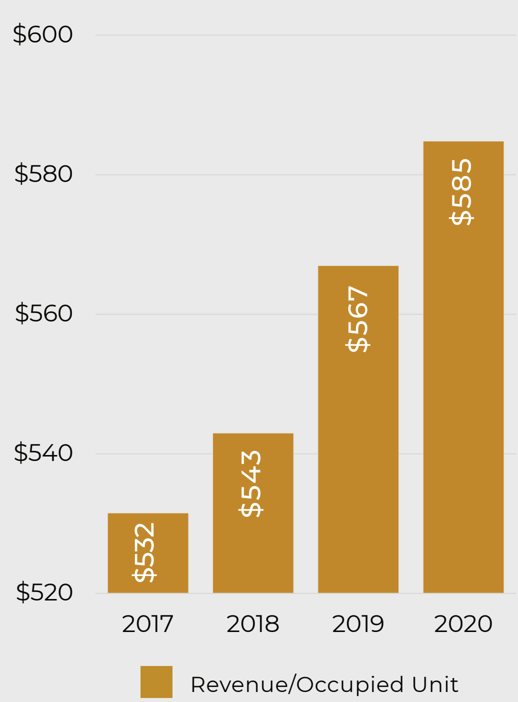
REVENUE TRENDS

Manufactured housing revenues consist primarily of site rents and utility fees paid by owner-occupants, and to a lesser degree, home rent payments made by non-owner tenants of homes leased by the community owner. The average effective gross income collected per occupied unit of same-store properties secured by GSE loans in 2020 was $581, representing a unit-weighted average increase of 3.70% over 2019 collections. By way of comparison, sample occupied site revenues increased by an average of 4.83% in 2019, and by a compound annual rate of 4.15% since 2017.

Figure 3.

MHC AVERAGE REVENUE PER PAD

Same-Store Properties (2018-2020)



Sources: Trepp, Fannie Mae, Freddie Mac, Lument Research tabulations.

In 2020, the Southwest (4.62%) posted the largest average occupied unit revenue gains for the second consecutive year. The Midwest (4.42%) moved from last in 2019 to second, followed by the Pacific (3.91%), Southeast (3.89%), Mountain (3.84%), and Northeast (2.67%) regions.

The inventory-weighted average surveyed rent among the 31 market group was approximately $840 in 1Q21. These rent costs compare favorably not only to average apartment rents in the same markets of nearly $1,400, but to class-C+ and class-B- workforce housing units as well, where rents average about $1,100.

Manufactured housing rent trends are less volatile than market rate apartments. Although most manufactured homes are technically mobile, the cost of transporting a unit to another community is prohibitive, often at least $5,000 or more, inhibiting rent-driven relocations, thereby creating some degree of price inelasticity during periods of weak economic growth.

This characteristic typically works to the advantage of investors during periods of economic weakness. The pandemic recession of 2020 was no exception. Site rents nationally were firm throughout the recession, outperforming comparable apartment trends. Rents in the sample markets increased 2.0% year-on-year in 1Q21, comparing favorably to a 0.5% advance (Yardi Matrix) among market rate apartments generally, and a gain of about 1.4% in the workforce housing segment.

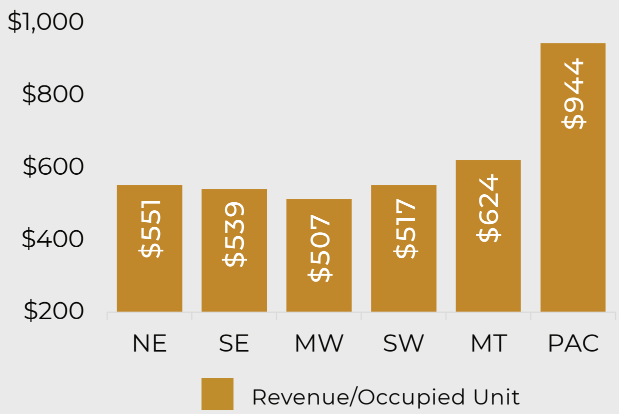
Above-average rent growth was observed in markets that benefited from migration from nearby higher cost, more densely populated areas. Phoenix, Houston, and San Antonio posted the strongest year-on-year gains in 1Q21, as rents in each case rose more than 3%, to a degree at the expense of Los

Angeles and Austin, where site rent declined moderately. Otherwise, the distribution of annual growth rates was narrow. About 60% of markets recorded results between 1.3% and 2.3%, and the standard deviation of outcomes was about one-half as large as comparable metro market rate multifamily trends.

Figure 4.

MHC REVENUES PER PAD BY REGION

Same-Store Properties



Sources: Trepp, Fannie Mae, Freddie Mac, Lument Research Tabulations.

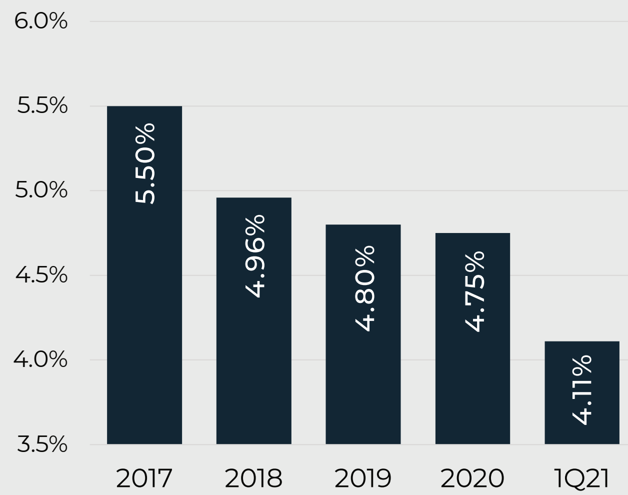
Manufactured Housing INVESTMENT SALES TRENDS

Trade in MHC assets increased in recent years as commercial real estate investors came to better appreciate the sector's attractive risk and return attributes. Regional management companies also expanded through acquisitions to achieve economies of scale. Sales volume of properties valued at $1 million or more nearly doubled between 2017 and 2020, rising to more than $4 billion last year, a market record. The average price paid per home site also advanced in 2020, reaching approximately $57,750, representing a 25% increase from 2017.

Figure 5.

MHC CAP RATE TRENDS

Properties Valued > $8mm



Sources: Trepp, Lument Research tabulations.

Cap rates fell accordingly. The value-weighted average implied cap rate applicable to MHC acquisitions for which underwritten net cash flow data are available declined from the mid-5% area in 2017 to 4.75% in 2020. Using underwritten net cash flows from Trepp and reported arm's length transaction prices, the weighted average initial yields of investment quality MHC property transactions were about 4.4% in 2020 and 4.1% in the first quarter 2021, levels comparable to institutional quality multifamily trades.

Historically, transaction pricing has been, to a degree, tiered by size and quality. Properties of 200 units or more tend to trade for materially lower going-in yields than smaller or lower quality communities. Recent transactions of large communities were priced to yields below 4.5% – in many cases below 4% — while smaller assets were priced to yields above 5%, often materially so.

MHC price premiums for large communities are primarily attributable to growing interest in the asset class by nationwide owner/managers and institutional investors. Diversified portfolio investors are increasing exposure to the asset class because of its stable and somewhat countercyclical property cash flows and the potential for expanding margins through management efficiencies. Indeed, institutional, insurance company, managed fund, and private equity buyers are playing a growing role in the MHC property markets, accounting for more than 25% of investment volume since 2019.

Recently, funds and other national investors have expanded buying programs to include lower quality and some smaller communities, reflecting increased confidence in their ability to drive management cost economies. Consequently, cap rate spreads between quality and size tiers have compressed and are likely to decrease further.

GSE Manufactured Housing Community LOAN PROGRAMS

Fannie Mae and Freddie Mac are active lenders in the MHC market under their respective Delegated Underwriting and Servicing (DUS®) and Optigo® lines of business, and each recently enhanced its program to align with regulatory "duty to serve" requirements. In addition, recent adjustments in GSE regulatory lending caps requiring higher concentrations in "mission driven business" areas, of which manufactured housing is an example, have encouraged the enterprises to increase activity in the sector.

The DUS® and Optigo® programs are similar in many respects. Eligible properties must be stabilized and managed by owners or third parties with demonstrable records of success – with or without age restrictions – consisting of manufactured homes meeting HUD safety standards. Single purpose entity (SPE) vehicles are required, but loans are non-recourse (subject to standard carve-outs) and assumable by qualified buyers. Fixed and floating rates are available, as are interest only periods up to the full term of the loan. Fixed-rate loans are subject to prepayment provisions and are, in most cases, structured as a yield maintenance provision. Subtle differences exist in program structures and underwriting guidelines (see table below).

Table 1.

KEY MHC UNDERWRITING DIFFERENCES

GSE Programmatic Differences

	FANNIE MAE DUS®	FREDDIE MAC OPTIGO®
MINIMUM SIZE (PADS)	50	5
MAX AMORTIZATION	360 months	360 months
TERMS (IN MONTHS)	60 – 360	60 – 120*
MAX LOAN-TO-VALUE	80%	80%
MAX LTV < 7-YR TTM	80%	75%
MINIMUM DSCR	1.25x	1.25x
MIN DSCR <7-YR TTM	1.25x	1.30x
MAX RENTAL MHU	35%+	25%
INTEREST ONLY	Up to full term	Up to full term*
SUPPLEMENTAL LOANS	Yes	Yes

* Exceptions permissible at the discretion of the investor.

Commercial banks represent the primary alternative to agency financing. Bank loans may provide greater flexibility than GSE products with respect to covenants and may offer advantages associated with levering an existing relationship – yet shortcomings exist. In most cases, bank loans have recourse provisions requiring borrowers to provide personal guarantees. Borrowers seeking fixed interest rates may be required to enter into a separate interest rate swap contract, which typically increases the "all-in" cost spread and adds further legal and financial complexity to the transaction.

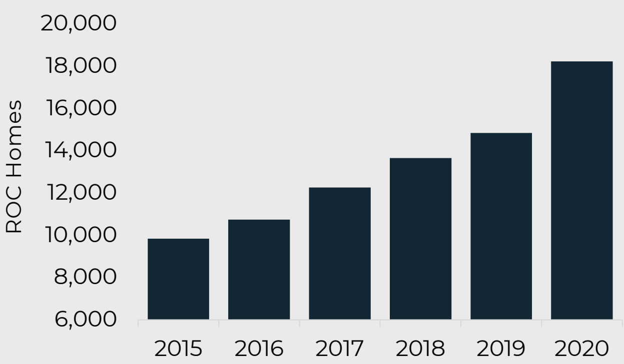
The principal concern regarding choice of lender is the likelihood of application approval and timely loan funding with minimal surprises. Generally, lenders and originators with deep experience with this asset class and its unique characteristics are most likely to deliver the best execution in the form of both loan terms and process. Processing delays and even delivery failures may occur with lenders lacking specific experience with the flood zone, park maintenance, and site lease issues that MHC transactions entail. Moreover, experienced GSE MHC lenders with a strong and consistent track record and reputation in the product type are more likely to obtain waivers to programmatic underwriting guidelines, which may make or break a successful execution.

Historically UNDERSERVED MARKETS

GSE MHC lending programs were recently expanded to better meet the needs of historically underserved rural markets and communities owned by residents and non-profit entities. Pricing incentives up to 30 basis points and third-party report reimbursements up to $10,000 are available to eligible properties that voluntarily provide tenant site lease protections (TSLPs) to at least 25% of ground lessees. TSLPs are intended to preserve the affordability of rented sites by bestowing tenants with certain rights that are not afforded in every state, including annually renewable leases (subject to just cause termination), minimum rent increase and community sale notification periods, rights to assign a ground lease to a credit eligible home buyer, and certain rights pertaining to payment grace periods and post-eviction home sales.

Figure 6.

RESIDENT-OWNED COMMUNITY INVENTORY
(ROCusa Communities)



Sources: Statistics reflect the number of MHC homes located in resident-owned communities affiliated with ROCusa, a non-profit organization.

TSLPs limit property management flexibility to some degree and may not be appropriate for every borrower. Borrowers who choose to pursue the pricing benefits should consult with a highly experienced lender to assess the risks and rewards and maximize available benefits.

The GSEs also have developed pilot programs for resident-owned communities (ROCs). As the name implies, ROCs are vehicles through which manufactured home owners can work cooperatively to acquire and operate their community. ROCs are growing in popularity as effective vehicles to protect mobile homeowners – many of whom are retired and living on fixed incomes – from excessive rent increases and to encourage capital investments in community infrastructure. Moreover, ROCs empower residents to govern their community under an elected board rather than relying on the actions of an unrelated owner.

Freddie Mac has taken the lead in the effort to assist communities in underserved rural areas to convert to resident-owned status or preserve affordability with lower cost, permanent financing. Both existing, stabilized ROCs and MHCs in the process of converting to resident-owned cooperatives are eligible for the program. In each case, the ROC must be structured as a non-profit entity, typically a cooperative, and own 100% of the community lots following settlement of the transaction. Shares in the cooperative entity must be at least 90% owned by residents, and no more than 5% of residents may be rental tenants occupying homes owned by the cooperative.

Loan terms up to 30 years are available, but loans must be fully-amortizing with fixed note rates. No programmatic maximum loan-to-value (LTV) is applied to loans to cooperative borrowers, providing for cash-out proceeds for approved capital improvements, and the minimum debt service coverage ratio (DSCR) for high-quality assets in preferred markets is 1.15x. Refinance loans may be sized to DSCR as low as 1.10x. Supplemental loans also are permitted, providing resident-owned communities with access to capital for renovations, utility improvements, or new site expansion.

Table 2.

GSE MHC LOAN PRICING TRENDS

YEAR	AVERAGE 10-YR UST YIELD	AVERAGE SPREAD OF 10-YR LOANS
2018	2.91%	1.58%
2019	2.14%	1.87%
2020	0.89%	2.09%
1Q21	1.32%	1.96%

Sources: Trepp, Federal Reserve, Lument Research tabulations.

GSE UNDERWRITING TRENDS

GSE lending activity in the MHC space increased significantly in 2020, reflecting escalating investor acquisitions, declining interest rates, and growing appreciation of the sector's role in addressing the nation's affordable housing needs. Available data indicate that the count of securitized MHC executions nearly doubled from 448 transactions in 2019 to at least 866 in 2020, propelling lending volume, according to Trepp reportage on securitized product, from $2.8 billion to $6.4 billion.

The value-weighted average fixed note rate for 10-year maturities declined 103 bps in 2020, from 3.86% to 2.83%, in spite of an expansion of pricing spreads from 187 bps in 2019 to 209 bps. Current rates range in the high-2.00% to mid-3.00% range. The broader value-weighted average of all GSE initial coupon rates, including floating rates, slipped 101 bps to 2.75%. Readers should bear in mind that the majority of capital markets analysts consider the current interest rate risk profile to be asymmetric, skewed toward higher term interest rates for the intermediate term, making it more likely that mortgage interest rates will rise than fall.

Valuations increased as interest rates fell. The average implied cap rate of 2020 single-asset originations decreased from 5.22% in 2018 to 4.93% in 2019, and further to 4.83% in 2020. Although average LTVs declined slightly from 61.0% to 60.6%, and DSCRs rose from 2.13x to 2.49x, lower rates facilitated a material decrease in average debt yields, which dropped from 8.41% in 2019 to 7.52% last year. Incomplete first quarter 2021 results suggest that this trend continued in the winter despite rising term interest rates. Respective value-weighted average cap rate and debt yield statistics declined to 4.13% and 7.15%, a DSCR rise to 2.98x notwithstanding.

Table 3.

GSE UNDERWRITING TRENDS

Value-weighted Average GSE MHC Loan Underwriting Metrics

YEAR	NOTE RATE	DSCR	LTV	IMPL. CAP RATE	DEBT YIELD
2018	4.34%	2.02	60.8%	5.22%	9.43%
2019	3.72%	2.13	61.0%	4.93%	8.41%
2020	2.86%	2.49	60.6%	4.83%	7.52%
1Q21	2.92%	2.98	60.5%	4.13%	7.15%

Sources: Trepp, Fannie Mae, Freddie Mac, Lument Research tabulations.

CONCLUSIONS

Manufactured housing is one of America's largest sources of naturally occurring affordable housing, providing a bridge to homeownership and housing stability to millions of working and retired American households. The GSEs are becoming increasingly active in providing capital for the sector in order to preserve available space, stabilize rental costs, and ensure ample liquidity for asset buyers and sellers.

The commitment to this sector by the GSE expands the ability of MHC owners to obtain economically priced non-recourse, long-term debt to secure the future of their assets and raise cash for capital improvements or general purposes. Likewise, the GSE presence empowers proven managers to grow through acquisition and encourages innovators to introduce fresh concepts that appeal to contemporary renters seeking affordable housing.

Deriving maximum benefit from these opportunities is a complex undertaking, requiring a lending partner with a comprehensive understanding of program guidelines and a deep well of trust built with the mortgage guarantor. Many lenders have entered this market in recent years as interest in the asset class has increased, but borrowers seeking to maximize their investment and close with certainty will profit by choosing one of the handful of originators with the decades of experience needed to achieve an optimal financing solution.

[i] Shipments of new manufactured homes in 2020 totaled 95,000 units, well below the 350,000-unit 1999 peak, but nearly twice the comparable 2011 figure and an increase of 17% from 2016. Sales in January 2021 proceeded at a 106,000-unit seasonally-adjusted annual rate, the fastest monthly pace in nearly four years.
[ii] https://www.mhvillage.com/.
[iii] Although consumer interest in this affordable ownership vehicle is on the upswing the national pad inventory is shrinking on the margin. Legacy communities have been converted to higher value residential and commercial real estate purposes in some instances, and zoning challenges and land costs place nearly insurmountable obstacles before new pad construction.