Commercial Real Estate

Manufactured home community financing handbook

By Tony Petosa, Nick Bertino, and Erik Edwards

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About the authors

Tony Petosa, Nick Bertino, and Erik Edwards specialize in financing multifamily properties — manufactured home communities (MHC) and apartments — for Wells Fargo Multifamily Capital. They have more than 75 years of combined experience in the industry, and are active in numerous trade associations and advisory councils advocating expanded lending opportunities within the MHC sector.

Wells Fargo offers Freddie Mac (Freddie), Fannie Mae (FNMA), conduit, balance sheet, and correspondent lending programs. Since 2000, Wells Fargo has originated more than $11 billion in financing within the MHC sector. Wells Fargo was named Community Lender of the Year (12 years in a row) by the Manufactured Housing Institute, has been #1 in total loan volume origination since 2000 according to George Allen's annual National Registry of Landlease Community Lenders, and has been the #1 commercial real estate lender in the U.S. since 2009 according to the Mortgage Bankers Association (MBA).

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Contents

Preface

The manufactured home community (MHC) sector continues to receive attractive financing terms from lenders as it has demonstrated that it is one of the strongest performing asset classes, regardless of economic cycle. In fact, Wells Fargo Securities reported a 158.3% return for MHC REITs over a five-year period — significantly higher than the 108.6% return on the S&P 500 or the 78.2% return offered by Industrial REITs (the next best performing real estate asset class) over the same period. As a result, MHC owners remain well positioned in terms of financing options.

Total commercial real estate lending volume in 2017 outpaced 2016 as the much-talked-about "maturity wave" from the last bull market cycle peaked, and many loans from that period were refinanced. Despite warnings from some pundits that these loans were overleveraged when they were originated and primed for default, most of the maturing loans from the 2006 – 2007 vintage were absorbed by the government sponsored enterprises (GSEs), banks, life insurance companies, and conduit lenders with little to no fanfare. Additionally, stern warnings about the Commerical Mortgage Backed Securities (CMBS) market collapsing under the weight of recent "risk retention" requirements vanished as the CMBS market stormed ahead with $95.343 billion in production, a 26% increase from 2016.

Also, both Fannie Mae and Freddie Mac set lending records for the third year in a row, originating $73.2 billion and $67.1 billion, respectively, in total multifamily mortgages (including mortgages on MHCs). Additionally, the Federal Financing Housing Agency (FHFA), the regulator of Fannie Mae and Freddie Mac, announced that in 2018 MHCs will continue to be excluded from the annual lending cap set for the GSEs. As a result, interest rate spreads for MHC properties will very likely remain materially lower than those for conventional apartment properties throughout the rest of 2018.

From a regulatory perspective, many in the commercial mortgage industry remain hopeful that the Trump administration and Republican lawmakers will scale back many of the post-crash regulations. In fact, in March of this year, the U.S. Senate passed a bill easing regulations stemming from the Dodd-Frank Act and reducing oversight of banks with assets below $250 billion.

As we enter the second quarter of 2018, volatility has crept into the financial world with wild swings in the stock market coupled with increasing interest rates. The 10-year U.S. treasury yield eclipsed 2.90% earlier this year, marking a significant uptick from the 2.43% close at the end of December 2017, as well as a four-year high. While interest rate spreads have tightened during this same period, generally all-in interest rates have moved higher. Some expect that property capitalization rates, which have compressed to historical lows, may come under pressure as a result.

With the headwinds of higher inflation and rising interest rates on the horizon, it is now more important than ever for MHC owners to assess their current financing situations to determine what type of financing structures (fixed, variable, long-term, short-term, etc.) will best suit their business plans over the coming years. The good news is that, despite the recent market volatility and upward interest rate movement, we have yet to see any adverse impact to MHC values and, as mentioned earlier, lending options for MHC properties remain plentiful.

— Tony, Nick, and Erik

Section 1:
General information

Lending alternatives

Due to the strong historical performance of MHCs, borrowers have an abundant array of attractive financing options available for acquiring or refinancing MHCs. While the same lending alternatives have been available since the economic recovery gained traction in 2012 — GSE lenders, banks and thrifts, conduit lenders (CMBS), life insurance companies, and debt funds — each lending program offers distinct advantages and disadvantages in underwriting parameters, loan structures, interest rates, closing costs, servicing, and how the lender responds to the whims of the market.

According to the Mortgage Bankers Association (MBA), the level of commercial and multifamily mortgage debt outstanding at the end of 2017 was $3.18 trillion, $200.3 billion higher than at the end of 2016, or an increase of 6.7 percent. Multifamily mortgage debt outstanding rose to $1.26 trillion, which was an increase from 2016 and corresponds to continued growth in property values. The following discussion provides an overview of the current lending environment and alternatives for MHCs and the overall multifamily lending market.

Government-sponsored enterprises (GSEs)

FNMA and Freddie are the two GSEs that actively lend on MHCs, and both have proven to be reliable sources of financing through numerous market cycles, including the last prolonged recession. FNMA and Freddie continue to maintain a dominant market share among multifamily lenders holding $606 billion, or 48% of the total multifamily debt outstanding. During 2017, agencies saw their holdings increase by $85 billion, or 16%. FNMA and Freddie have the directive from their regulator, the Federal Housing Finance Agency (FHFA), to enhance the flow of credit to multifamily properties nationwide. In the second quarter of 2014, Freddie received approval from the FHFA to begin lending on MHCs, resulting in greater competition nationwide for these loans. Freddie's entry into the sector was reflective of a more expansive role for GSEs being charted out by FHFA Director Mel Watt after he assumed office in 2014. Treasury Secretary Steven Mnuchin continues to receive pressure from some law makers to reform the GSEs but, to date, no material movement has been made. That being said, during Senate Banking Committee hearings, Mr. Mnuchin continues to state that reforming FNMA and Freddie remains a top priority of the Trump administration. Exactly how this reform will materialize is unknown, but the administration views the 30-year mortgage as an essential part of maintaining a healthy multifamily market and has indicated it is important that these loans retain the backing by a government guarantee.

FNMA loans are obtained through delegated underwriting and servicing (DUS) lenders who are authorized to underwrite, process, close, and service loans for FNMA. Freddie loans are accessed through a network of correspondent lenders, called seller/servicers, who perform a similar role as FNMA's DUS lenders. Since FNMA DUS lenders share risk with FNMA, more decisions are delegated to DUS lenders than to Freddie seller/servicers. In both cases, lenders must qualify to become designated GSE lenders by demonstrating financial strength, underwriting expertise, loan servicing experience, and capacity to generate and handle meaningful loan origination volume.

GSEs offer very attractive terms for MHCs nationwide, including various fixed- and floating-rate loan terms, early rate-lock options, and supplemental loans. While the FHFA has placed annual volume caps on GSEs for some multifamily loans, such as market rate apartments, certain types of affordable and small multifamily properties, as well as MHCs, were excluded from these caps in 2016, 2017, and again in 2018. In 2017, FNMA booked $65 billion (up considerably from $55.3 billion in 2016) and Freddie booked $73.2 billion (up considerably from $56.8 billion in 2016) in overall new multifamily financing, a record for both.

Because of the exclusion of MHC loans from their annual volume caps, FNMA and Freddie typically price MHC loans aggressively when compared to market rate multifamily-capped business. Both Freddie and FNMA have also been responsive to market changes in the MHC sector. For example, both GSEs will now finance MHCs having up to (and sometimes more than) 25% park-owned rental homes as a standard underwriting guideline, and they have also demonstrated an increased willingness to lend on well-maintained two- and three-star quality properties in most markets based on solid operating history and professional management. FNMA and Freddie loans are nonrecourse and typically allow borrowers to apply for an FNMA or Freddie supplemental loan (second trust deed) after the first year of the initial loan term, which is a feature that distinguishes GSEs from commercial mortgage-backed securities (CMBS) lenders whose standard programs prohibit secondary financing. Both FNMA and Freddie have experienced excellent performance with their MHC loans, and we expect them to remain very active lending on MHCs in 2018.

Banks and thrifts
According to the MBA, banks and thrifts increased their multifamily mortgage debt outstanding from $382.9 million to $403.9 million, a 5.5% increase from 2016 to 2017. However, overall market share dipped slightly from 33.2% to 32.0%. Improved bank balance sheets along with favorable tailwinds of rising property values have resulted in banks and thrifts expanding loan origination efforts since the market recovery in 2012. It is anticipated that banks and thrifts will continue to be active players in the market in 2018, but will take a more cautious approach to underwriting properties and borrowers.

Large national banks can usually lend nationwide, while regional banks are typically limited geographically to the footprint of the bank's retail network, as many banks prefer to lend only to those borrowers to whom they can provide additional banking services. Pricing for loans is often affected by the deposit relationship and other banking services being provided. Furthermore, as banks typically require a personal guarantee, their underwriting focuses not only on the property fundamentals, but often more intensely on the financial strength and credit history of the individual providing the personal guarantee. Closing costs are often lower than other lending alternatives and rates remain competitive, but fixed rates are typically shorter term or adjust during the term.

Some banks consider MHCs to be a "special purpose" property type outside the scope of their normal lending activity, and therefore approach MHC lending and leverage in a conservative manner. However, there are substantial differences in bank lending programs across the country for MHCs. In some regions, such as the West Coast, there are banks that market specifically to the MHC sector and offer attractive low transaction-cost programs.

CMBS (conduit) lenders
CMBS, or conduit, lenders originate and pool loans that are sold in the capital markets. CMBS loans first gained popularity in the 1990s, filling a void in traditional lending that resulted from the savings and loan (S&L) crisis and the prolonged lending downturn that followed. The CMBS and securitization market provides lenders with liquidity by enabling them to sell their loans and distribute risk across a large pool of investors with different appetites for risk and returns. However, CMBS interest rate spreads respond instantaneously to fluctuations in the market with rates rising when investor sentiment turns to a "risk off" mentality.

The CMBS market went into hibernation during the financial crisis. Higher loan delinquencies during the Great Recession resulted in extensive CMBS bond defaults, making it difficult to attract investors back to the market. In 2010 and 2011, the CMBS market began to reemerge with early transactions benefiting from conservative underwriting parameters.

The CMBS industry and the banks which are its core participants are now subject to provisions of the Dodd-Frank Act, which was enacted in 2010. It requires lenders to maintain risk in the loans they originate after the loans are securitized by retaining some of the securities in the loan pool. These regulations were enacted to avoid the lending excesses that led to the financial crisis, but many feel that reform of Dodd-Frank is needed, arguing that the regulations have stymied the availability of capital, while increasing expenses for both lenders and borrowers.

There was much trepidation leading up to the implementation of the CMBS risk-retention rules that went into effect on December 24, 2016. However, the concerns that the requirements would increase spreads did not play out, and 2017 was a strong year for CMBS loan production with volatility and spreads remaining very low. Bond buyers have actually embraced the structure and most prefer lenders having "skin in the game." This has resulted in a tightening of CMBS loan spreads, which has once again made conduit financing a competitive lending option to consider.

In 2017, CMBS (including Collateralized Debt Obligations and other Asset-Backed Securities) represented $43.5 billion of the multifamily mortgage debt outstanding or 3.4% of total market share according to the MBA. This is down from $47.9 billion in 2016 and demonstrates how the GSEs and banks have gained market share on MHC and multifamily assets that were previously only financeable through CMBS.

CMBS loans are nonrecourse, allowing sponsors to keep contingent liabilities off their books, and typically feature 10-year balloon payments with a 30-year amortization (full-term or partial interest-only may be available for quality properties and low-leverage transactions). For some, the benefits of conduit loans are offset by complex loan documents, high closing costs, approval uncertainty, and market-based pricing that is subject to change before loan closing due to adverse market conditions, and loan servicing that is often handled by a party other than the originating lender.

CMBS lenders in recent years have had difficulty winning multifamily loans because of other more competitive and consistent lending alternatives. Multifamily properties are highly desired among conduit lenders that need a diverse mix of property types for their loan pools, and as such they will price these aggressively. In order to win multifamily business, CMBS lenders often have to compete on the basis of higher leverage or be willing to finance lower-quality properties or borrowers.

A CMBS loan may be an option for lower-quality MHCs at high-leverage levels. If you ultimately choose to move forward with a CMBS lender, it is important to choose one that has demonstrated its dedication and capacity to staying in the

CMBS market for the long haul. Ideally, a borrower should choose a CMBS lender that offers balance sheet loans in addition to CMBS, just in case a backup option is needed. Finally, it is also beneficial to work with a lender that services its CMBS loans. A few CMBS lenders have taken steps to reduce fees and red tape associated with routine requests as a result of complaints related to the servicing of loans. Top CMBS lenders are cognizant of this backlash and have improved the customer experience.

Life insurance companies (Lifecos)
Lifecos have an ongoing need to invest money in long-term, fixed-rate investments, which include commercial real estate loans with defined maturities. Lifecos are portfolio lenders so they tend to not be immediately affected by the day-to-day fluctuations of the capital markets. However, they do respond throughout the year to market conditions, and individual lifecos can become less competitive later in the year as they fill their annual lending allocations. Lifecos currently hold 5.8% of the outstanding multifamily mortgage debt, which is identical to 2016, and their total mortgage debt outstanding in 2017 was $468 billion, including $73 billion of multifamily mortgage debt. Overall, their holdings increased by $13.6 billion, or 3.0% from 2016.

Lifeco pricing is attractive, but the lending profile for most lifecos remains focused on high-quality, preferably age-restricted MHCs in larger markets with financially strong and experienced borrowers. They can also be more conservative in terms of LTV, interest-only and general underwriting parameters versus other lending alternatives. Lifecos also generally pursue larger loan sizes (typically $5 million or higher).

Lifecos tend to have a pricing advantage for loans with fixed-rate terms in excess of 10 years, and they can offer the ability for borrowers to lock in the interest rate at the time of application. Long-term money is also available with fully amortizing terms up to 30 years.

Some lifecos will work directly with borrowers, particularly on larger transactions, but most of their loans are generated through networks of mortgage bankers who may also service the loans they originate. In addition to originating loans directly to borrowers, lifecos are active investors in the bonds sold by CMBS lenders.

Debt funds
Many real estate analysts expect the private lending market to play an increased role going forward, particularly financing higher risk projects, such as construction or redevelopment properties. Regulated lenders face additional capital constraints extending these types of loans, providing a competitive advantage to private capital in this segment of the market. Alternatively lenders, like debt funds, have become major players by filling a void left by banks, insurance companies, and other lenders by offering bridge and mezzanine loans for transitional assets. However, debt funds to date have not played a major role financing MHCs due to competition from traditional lending alternatives and because many debt funds focus on larger transactions.

A debt fund is an investment pool in which core holdings are fixed-income investments versus equity investments (stocks). Commercial real estate debt funds rose from the ashes of the financial crisis as investors identified an opportunity to step in and lend at higher rates to fill a liquidity void, while banks were temporarily sidelined. Investors were able to generate good returns, especially with the absence of bank competition immediately following the downturn, without the volatility of stocks and with the added security of being in a stronger creditor position on the underlying collateral.

Debt funds have a higher cost of capital than life insurance companies or banks as their money comes from investors with appetites for higher returns who are also willing to accept higher risk by relying on the funds' asset management capabilities. Since debt funds are unregulated, they can often lend on challenging properties or to borrowers with previous credit issues, such as bankruptcies and foreclosures. As a result, debt funds tend to do tougher deals at higher interest rates and with more complex loan structures (reserves, liquidity covenants, etc.) to ensure repayment of the debt. When working on a loan with a debt fund, the borrower should work with an attorney who is versed in the loan documents used for such a transaction.

In summary, financing is readily available for solid-quality MHCs in most markets, and lenders will continue to compete heavily for high-quality properties and borrowers. While disruptions in the capital markets can increase the cost of capital for investors in some areas, notably CMBS, inexpensive capital is still widely available across multiple platforms. Regardless of which lending platform you choose to pursue, always be sure to work with a lender who has a fundamental understanding of the MHC sector, as well as a track record of closing loans on MHCs.

A framework for assessing loan alternatives

Because you will likely have multiple lending options, it is important to have a clear vision of your investment goals and to formulate a general business plan before moving forward with a specific lender. After providing a preliminary quote, most lenders issue an application to the borrower. The application includes a summary of terms and underwriting assumptions. When this application is returned to the lender, it will require a good faith deposit to cover closing costs, such as third-party reports. Therefore, you should assess your alternatives before selecting a lender and returning its application along with deposit.

This process should include an analysis of the advantages and disadvantages of various loan alternatives and how they match up with your priorities.

When determining investment goals, contemplate the following questions:

- Am I comfortable with personal recourse, or is it a nonstarter?
- What do I want to achieve five and 10 years from now? For example, pay down debt or borrow additional money based on an increase in value?
- What is my likelihood of selling the property during these time frames?
- Am I comfortable taking interest-rate risk with an adjustable-rate loan, or would I prefer to lock in a long-term interest rate?

The answers to these questions will help determine what type of loan is appropriate.

Many lenders offer both floating-rate and fixed-rate loan programs. There is an inherent trade-off between floating- and fixed-rate programs. While some floating-rate programs offer interest rate caps or are fixed for a period of one to five years, there still exists the risk of an interest-rate increase in the future. As history has shown, there can be a risk in finding a lender to "take out" a short-term loan when it comes due if there is a market contraction on lending in general. The major advantage of floating-rate loans is that they often offer lower starting interest rates than fixed-rate loans, but many lenders add interest rate floors to their floating-rate loans, which diminish this advantage. Typically, floating-rate loans have the advantage of lower prepayment penalties when compared to fixed-rate loans.

Fixed-rate loans lock in an interest rate for a specific period of time, and have been an attractive option in recent years because of favorable treasury rates. Treasury rates, or yields, are the most common benchmark used to determine fixed-term interest rates, and treasury yields have been at or near historic lows in recent years, even when taking into account the increase in treasury yields we have experienced so far in 2018. Longer-term fixed-rate loans also enable an owner or investor to lock in his or her cost of capital for an extended period.

To achieve the lowest fixed rate, however, lenders typically need to structure fixed-rate loans with prepayment penalties that are usually more onerous than the prepayment provisions found on floating-rate loans. Prepayment penalties are, in part, the result of the lender needing to fix or "match fund," the cost of capital for the entire loan term. While some fixed-rate loan programs offer a defined prepayment penalty, usually as a percentage of principal balance, the lowest fixed rates are usually achieved through a yield maintenance or defeasance type of prepayment penalty.

The actual amount of a yield maintenance penalty is a function of the rate on the loan being paid off and treasury yields at the time the loan is prepaid, as well as the remaining loan term and balance at the time of prepayment. As a general statement, yield maintenance prepayment penalties are minimized if rates have increased since the time the loan was originated and are typically very large when a loan is paid off in the early years of the loan term. It is important to note that most loans offer an assumption provision, and a low fixed-rate loan can be attractive to a future buyer, as long as the loan amount is relatively high in proportion to a property's value. Since a fixed-rate loan typically has an open prepayment window near the end of the loan term, many borrowers also match the fixed-loan term to the anticipated holding period for the property.

Another important consideration in the past has been selecting the type of loan — a securitized (CMBS) loan or a balance sheet (portfolio) loan. CMBS loans, which are also referred to as conduit loans, usually offer high leverage and attractive rates, but are generally less flexible than portfolio loans. Conduit loans fell victim to the credit crisis in 2007 and all but disappeared. Since then, conduit lending has returned and it remains an alternative to consider, particularly for properties or borrowers who do not qualify for or want a GSE loan.

In an attempt to avoid the mistakes of the past, conduit lenders focus more heavily on escrows for replacements (and re-tenanting in the case of commercial projects), and often have a requirement of "lock boxes" with "cash management" if debt coverage deteriorates to a defined level. Many full leverage conduit loans require "cash management" from day one as a condition for closing the loan.

A portfolio loan, by definition, is held by a lender on its balance sheet during the loan term. These loans are typically originated by banks, credit unions, and life insurance companies. Conduit loans, by contrast, are intended to be held by a lender for a short period, ideally less than three months, and are then securitized — sold to bond investors. A portfolio or balance sheet lender can more readily modify certain aspects of a loan during the term should the need arise. However, there is no guarantee that a lender will agree to modify a loan in the future, and with fixed-rate loans, the lender may not be able to change the prepayment penalty for reasons discussed above.

A general disadvantage of portfolio loans is that the interest rates are typically higher, particularly on longer-term fixed-rate structures, and LTVs can be lower because of the use of more conservative underwriting parameters. Additionally, portfolio lenders may have more restrictive requirements related to the borrower's experience, as well as the quality and location of the property. Many portfolio lenders still have a perception of MHCs as "special purpose" properties and consequently may only lend on them on a conservative basis. Also, many portfolio lenders will require a personal guarantee from key principals of the property's ownership group.

There is yet another type of financing that became a popular lending option for MHCs after the exodus of most lenders in 2008: GSE or agency financing. In the past, the agency programs offered attractive and dependable terms primarily because of the favorable capital and market access available to them. This made FNMA a particularly reliable lending alternative for MHCs during periods of market upheaval. Seeing the success that FNMA experienced in lending to MHCs, Freddie tried to move into the MHC lending arena for several years, ultimately receiving regulatory approval in 2014 to lend on MHCs. Today, both FNMA and Freddie Mac provide viable financing options to MHC owners. Both remain committed to the sector in response to their regulator's mandate to address manufactured housing as one of the three identified underserved markets in the country.

Fannie Mae and Freddie Mac: An inside look

FNMA and Freddie Mac continue to be reliable lending sources for multifamily and MHC properties, while having remained in conservatorship since 2008. In December 2017, the FHFA announced that MHCs would again be excluded from the annual multifamily lending caps set for 2018.

While we appear to be in a state of "business as usual" with the GSEs in the near term, there are talks of possible changes in the future. Some would like to see these entities be privatized, operating without any explicit or implicit government guarantee. Others would prefer a return to their previous state, out of conservatorship and with implicit government backing. While a restructuring of the GSEs may be forthcoming, many anticipate an orderly transition coordinated with current market participants with the GSEs continuing to be involved with multifamily finance for the foreseeable future.

Fannie Mae

Initiated in 1988, the FNMA DUS program provides approved lenders the ability to originate and subsequently sell loans on multifamily properties, usually in the form of a mortgage-backed security (MBS). The MBS is purchased by investors at a low yield because the security is guaranteed by FNMA. The loan origination and closing process can be completed by the DUS lender without FNMA's involvement, as long as the collateral and borrowers meet established underwriting and pricing guidelines. MHCs were added as an eligible FNMA property type in 1999 when a pilot lending program was launched. FNMA currently works with 24 DUS lenders, but only a few of these lenders originate the bulk of the loans on MHCs.

DUS lenders typically service the loans they originate and retain a risk position through a loss-sharing formula with FNMA. As mentioned above, a DUS loan can be closed with little to no interaction with FNMA if the established lender guidelines are met.

While MHCs account for a relatively small percentage of FNMA's total multifamily lending activity, the volume of requests increased significantly during the last market downturn when other lenders left the market. FNMA has indicated that it continues to experience favorable performance with MHC loans.

FNMA DUS loans offer an assortment of financing structures and attractive pricing for both age-restricted and all-age MHCs. Borrowers have the ability to obtain a loan with defined fixed-rate terms between five and 30 years and typically amortized more than 30 years with a period of interest-only payments sometimes being available. In addition to fixed-rate terms, FNMA also offers adjustable-rate programs, which are priced over Libor and may include a built-in ceiling on the interest rate during the loan term, or a requirement for the borrower to purchase an interest-rate cap. In 2017, a new hybrid ARM program was added but this program is only available for loans up to $3 million in most markets, and up to $5 million in a smaller number of strong markets.

If you believe an FNMA loan may be a product consideration for you, you must first determine whether your property is eligible based on FNMA's underwriting guidelines. While the entirety of FNMA's guidelines is too extensive to list here, some MHC requirements worth noting are as follows:

- Amenity package is competitive in the marketplace
- Physical occupancy is 85% or greater
- Maximum density is 12 home sites per acre
- Majority of the property, including the entrance, is not located in a flood zone
- Preference that 50% or more of the sites can *accommodate* a double-wide (DW) home (the actual percentage of DW homes can be lower)

If a property does not meet all of the guidelines, it does not necessarily preclude the property from qualifying for an FNMA loan, but it does require the DUS lender to obtain a waiver from FNMA. This is achieved by successfully presenting compensating factors.

A standard FNMA MHC loan program has no established minimum or maximum loan amount, but loans are typically $2 million and above. The maximum loan-to-value (LTV) ratio is up to 80% on acquisitions and noncash-out refinances and 75% on cash-out refinances. The minimum debt service coverage ratio (DSCR) required is typically 1.25 times.

FNMA loans are nonrecourse with standard recourse carve-outs usually to the key principals for actions, such as fraud or unauthorized transfer of controlling interests. For lower leverage loans, most of the carveouts do not apply to the key principals. Loans are assumable (multiple times), subject to approval of the new borrower's credit and experience. Secondary or "supplemental" financing, which many find to be an attractive feature of the program, is available after the first year of the loan term. When a supplemental loan is obtained, the term is typically coterminous with the first mortgage, and the interest rate on the supplemental loan is based on the then-prevailing FNMA rates for supplemental loans.

Freddie Mac

As previously mentioned, Freddie announced its entrance into MHC financing at the MHI National Congress in April 2014, in Las Vegas. The entry of Freddie Mac into the sector has materially changed the competitive landscape resulting in more aggressive overall loan terms for MHCs, including an expansion of guidelines to qualify. Freddie closed its first MHC loan in July 2014, and closed approximately $1 billion of MHC loans by the end of 2015. In 2017, Freddie closed roughly $1.1 billion in MHC financing.

Freddie originates multifamily loans through a network of 22 lenders known as Freddie Mac Multifamily Approved Sellers/Servicers. Freddie Mac does not fully delegate any of its processes to its sellers/servicers and is more actively involved in the quoting and closing process than FNMA.

Freddie securitizes all of its MHC loans — putting approximately 5% MHC loans into each of its securitizations. Freddie provides both fixed- and floating-rate loans with terms from five to 10 years, but in 2017 they also began offering more routinely longer-term fixed structures, such as 12- and 15-year terms.

Freddie looks for communities with similar characteristics to those cited above for Fannie Mae. However, the biggest difference between the programs is that Freddie will lend on most properties located in flood zones so long as the risk is appropriately mitigated. This may include the borrower obtaining 12 months of business interruption coverage to include site rent for flood loss on those sites affected by the flood zone.

Another distinguishing factor is that Freddie often offers an "index lock" shortly after execution of a loan application designed to eliminate the volatility of the interest rate by locking in the treasury index. In the first quarter of 2015, Freddie expanded this program to include a lock of the interest rate spread for any market movement before closing. In order to take advantage of this option, the borrower is required to provide a 2% index lock deposit, which is refundable at loan closing. After index lock and before closing, the loan amount can move 5% up or down without any unwinding cost. Unlike CMBS loans, there are no margin calls if rates decline and the hedge is then in a loss position. In the worst-case scenario, when a loan is rate-locked and does not close, the maximum liquid damages the borrower will suffer in the Freddie program are limited to the 2% deposit.

Freddie Mac loans are also nonrecourse with standard recourse carveouts usually to the key principals for actions, such as fraud or unauthorized transfers of controlling ownership interests. For lower leverage loans, it may be possible to waive the requirement of a carveout guarantor, but this is easier to achieve after a borrower has already closed a loan with Freddie. Loans are assumable and Freddie also offers a secondary, or "supplemental," financing program. Freddie has also demonstrated a willingness to quote 80% LTVs for MHCs on a case-by-case basis. This is based in part on the solid performance that they have experienced so far with their MHC portfolio.

Even if you do not borrow from Freddie or FNMA, their lending on MHCs has provided more lending alternatives for borrowers and increased competition among lenders. The result has been better financing terms for MHC owners on a wider range of properties throughout the country.

Fannie Mae and Freddie Mac credit facilities

While most MHC owners are familiar with the standard lending programs offered by Fannie Mae and Freddie Mac, owners of multiple properties may be interested to know that they may also be eligible for another, albeit perhaps lesser known, program offered by both GSEs: the credit facility. The Fannie Mae Credit Facility and Freddie Mac Revolving Credit Facility can provide borrowers with flexibility and diversification along with attractive pricing and leverage. But there are differences between each GSE's credit facility that borrowers should be aware of so they can properly evaluate which program will ultimately be the best fit for their business plan.

Fannie Mae Credit Facility

The Fannie Mae Credit Facility has a minimum initial advance size of approximately $50 million with unlimited expansion capabilities. The term of the credit facility is 15 years, and it allows for staggered loan maturities of five to 15 years. The facility can be structured entirely as fixed rate, floating-rate, or a mixture of both fixed and floating rate. Any floating rate advances generally require the purchase of an interest rate cap or other hedging instrument, and can be converted to fixed rate during the term of the facility. In addition to being able to stagger the maturities of the loans within the facility, by choosing a mix of fixed- and floating-rate loans a borrower can also diversify the prepayment penalty structure of the facility to include yield maintenance, declining prepay penalties, and fixed prepayment penalty schedules.

The parameters of the credit facility can be up to 75% – 80% LTV with a minimum DSCR of 1.20x to 1.25x depending on property type. These underwriting parameters are set at both the facility, or "pool," level and individual property level. The facility allows for multiple property types, including MHCs and apartments. Interest-only and amortizing structures can be available based on property and pool performance. Furthermore, the facility allows for future additions, substitutions, and borrow-ups. No rebalancing of the facility is required, and there are no unused capacity fees. Just as is the case with the standard Fannie Mae MHC loan program, the Fannie Mae Credit Facility is nonrecourse with standard carveouts.

While the properties are underwritten on an individual basis, they are cross-collateralized and cross-defaulted with the facility being governed by a single Master Credit Facility Agreement. A benefit to this "crossed" structure is that weaker properties (i.e. properties with lower occupancy rates) receive credit enhancement from being crossed with stronger properties, thereby allowing weaker properties to receive more favorable underwriting treatment than they would if they were financed on a standalone basis. Moreover, because the aggregate size of the credit facility is much larger than the average size of the individual loans, the facility typically receives more aggressive interest-rate pricing than a single-property loan transaction.

Freddie Mac Revolving Credit Facility
The Freddie Mac Revolving Credit Facility typically has a minimum size of $100 million with expansion rights of up to 50% of the initial commitment amount. The term is five years and is interest-only with two one-year floating-rate extension options. Fixed- and floating-rate tranches are available, however the fixed-rate tranche cannot be more than 50% of the initial commitment amount and must be established and funded on the first day of the facility. The facility allows borrowers to lock in credit parameters and pricing terms before identifying properties, so it is well suited for borrowers looking to reposition assets on a short-term basis or acquire properties in the future.

The maximum LTV of the Freddie facility is 75% and the minimum DSCR will depend on the property type. Similar to Fannie Mae, property types allowed in the facility can include a mixture of MHCs and apartments. Unlike Fannie Mae, Freddie Mac does not require an interest rate cap on floating-rate debt, but does charge an unused commitment fee, as well as a seasoning fee beginning in the fourth year an asset is in the facility. Within the floating rate tranche, properties in the pool can be released without a fee charged when the property is refinanced with a Freddie Mac securitized product.

Freddie Mac's facility can be either crossed or uncrossed, and there is no minimum occupancy requirement. On a crossed facility, the minimum LTV and DSCR parameters are set at the facility level only, with no limits at the individual property level. On an uncrossed facility, each property is underwritten individually, and must meet minimum LTV and DSCR limits individually. No common ownership is required, which allows for different equity structures, and borrowing entities can be either Single Asset Entities or Single Purpose Entities.

From a big picture perspective, it is important to note that the Freddie Mac Revolving Credit Facility has a shorter term at five to seven years (inclusive of extensions) when compared to the Fannie Mae Credit Facility, which has a term of 15 years. One of the reasons for this is that the Freddie Mac facility is designed to be a feeder into Freddie Mac's standard securitized lending program. This is one of the reasons why Freddie's credit facility does not have a minimum occupancy requirement and can accommodate properties that may be "turnaround" in nature. Fannie Mae's credit facility, having a loan term of 15 years, can be utilized as a permanent financing vehicle in and of itself, and is typically better suited for a pool of properties that are already stabilized. Whether a borrower's credit needs are better aligned with the Fannie Mae Credit Facility or Freddie Mac Revolving Credit Facility, it is important to work with a lender who has experience not only with lending on MHCs, but also with closing credit facilities with Fannie Mae and Freddie Mac.

Section 2: Preparation before financing

Preparing your property and information for financing

It is highly recommended to start the financing process early in case unexpected delays occur. Before contacting a lender, the first step is to assess and prepare the property, your financial information, and your personal information for financing. This review should take into account the physical condition, the state of financial records, and market competitiveness of your community. In addition, you should prepare documents that will be needed to underwrite the loan and consider the manner in which information should be presented.

Take a step back and assess the overall asset quality, or curb appeal, of your community. Is the landscaping adequate and well maintained? Are the entrance and signage welcoming? Remember, these are your property's "front doors." Do the homes reflect pride of ownership, and are community regulations being enforced? Is the skirting surrounding the homes intact and in good shape? Is the average age of the homes, density of the community, and amenities in line with competitive properties in the local housing market? If not, be prepared to explain how you compete for residents and plan to sustain occupancy and rental rates going forward. These are all questions a lender will consider when screening a property.

You must have a good handle on market conditions and be prepared to identify and comment on the competitive set of properties. Are rents at market when compared to nearby manufactured home communities? What is the general demographic profile of the local housing market, and how does the property successfully compete for new residents?

After assessing the condition of the property and its market, it is likely that there will be some shortcomings. At the very least, have a plan for mitigating potential concerns, particularly if financing an acquisition. For example, perhaps the community being purchased has older homes. The business plan may be to replace or renovate these homes over time. Make the lender aware of your long-term plan, and describe how it will be implemented. If you have been successful completing similar improvements in a community you currently own, draw the lender's attention to that and provide details.

The next step is to evaluate the financial condition of the property. Typically, a lender will ask for a current rent roll along with property operating statements (income and expenses) for the past three years, as well as the most recent 12-month period, ideally broken out by month (commonly referred to as a trailing 12-month statement or "T12"). When examining the rent roll, the lender will likely look for rental, lender-owned, or investor-owned homes in the community. While property owners may be motivated to rent homes, from a lender's perspective, the fewer rental homes, the better. In most cases, the lender will discount additional rental income derived from rental homes and underwrite solely based on the site rent. A correctly structured rent-to-own program is more palatable to lenders than a rental without a path to resident ownership.

Keep in mind that during the loan closing process a lender may require bank statements for the previous six to 12 months to confirm that bank deposits are in line with rent rolls and operating statements from the same time period. The trend of rental income reflected on the trailing 12-month operating statement has a major effect on a lender's desire to make a loan and the determination of the loan terms.

In addition to the income stream from the site rents, lenders will examine the collection history of other income items. It is important that other income items are segregated on the historical statements, meaning separate line items for utility reimbursements, laundry facilities, late fees, and so on, should be detailed. A loan underwriter will try to determine whether these other incomes are sustainable through the foreseeable future. Typically, as long as a good history of collecting ancillary income is demonstrated, lenders will likely include this income in their underwriting.

In the evaluation of the property's historical income and expense statements, identify any large fluctuations in the numbers on either the income or expense side. For example, if there has been a significant increase in annual rental income in recent years, be able to explain why. Did the property experience a high vacancy rate during a recent year and, if so, why? What has been the history of rent increases, and are rents competitive and in line with the market?

You should conduct the same kind of analysis and explanation on the expense side, particularly with respect to expenses that may be unique to your ownership operations. If home office overhead is allocated to the property in lieu of a management fee, be sure to identify that expense, perhaps with a footnote, as a lender will automatically input a management fee even if one is not charged.

While it is common for property owners to expense (for tax purposes) as many items as possible on their operating statements, it benefits the property owner to identify and explain any expenses that are not directly related to the property's ongoing operation. An underwriter only needs to include expenses that the lender would incur if operating the property; therefore, you should provide an itemized breakdown of any capital or nonrecurring expense items that are embedded within the operating statements, such as paving or clubhouse improvements, whenever possible. If identified, the lender can remove these expenditures from the underwritten expenses because it will already be including a replacement reserve deduction for long-term improvements. The goal is to maximize the underwritten net operating income because this will typically translate into higher loan proceeds or a lower interest rate on the loan.

After providing the necessary information on the property, provide a general overview of yourself. What is your background and real estate experience, and how many other properties do you own? What is your financial strength in terms of net worth and liquidity? In general, most lenders want to see that the property owners have a combined net worth equal to or greater than the proposed loan amount and liquidity equal to 10% of that amount. This is not a hard and fast rule, particularly for larger loans more than $10 million, but if you meet these criteria, you are likely to have fewer questions asked about your creditworthiness.

Remember, you will likely need to guarantee the "carveouts" to the recourse sections of the loan. Many of these are events where the collateral is no longer available to the lender, including if there is an additional unauthorized encumbrance (such as another mortgage), if the property suffers a casualty and the borrower doesn't remit the insurance proceeds to pay off the loan, or if a borrower accepts rents after the property has already been foreclosed. These events are when the lender is looking for a person, or "warm body," to make good on any losses it incurs because of these specific actions.

Provide a business plan for the asset being financed. The lender will look at you not only as a borrower but also as a business partner, so outline your plan for operating the asset and demonstrate why the lender should do business with you. The manner in which you present information is an important factor that loan underwriters consider. Computerized and detailed accounting records are always the preference as this presents the borrower as an experienced, professional owner or manager.

Your rent roll should be detailed and accurate, arranged by unit number, no more than one month old, and should have totals and a summary at the end. You will also need to provide a history and current record of any rent delinquencies. Your operating statements should have separate line items for various revenue sources and expense items. It is also helpful to provide recent, good-quality color photos of the property. Loan underwriters prefer to receive information, including property photos, electronically via email.

If you take the time to prepare and present complete and coherent information, the lender should be able to provide deliverable loan quotes in less than a week. This also ensures you are obtaining the best terms available. Furthermore, by providing accurate and detailed information in the beginning, you will facilitate a much smoother loan approval and closing process.

Avoiding common mistakes

You can easily avoid certain mistakes during the financing process with some advance planning. Most of these mistakes can distract from the overall financing goal and cause unnecessary delays in the closing of the loan.

Mistake #1: Not verifying the lender's experience or reputation.
Can the lender close on the terms quoted? This is the million-dollar question, particularly in light of prior fallouts with conduits as several lenders exited the business. While there are no guarantees that the lender will close since unforeseen issues may arise during due diligence, the odds for success are higher if you are working with a lender with a proven track record of closing similar loans on MHCs. If unsure of a lender's track record and ability to close on your loan, ask for several references for examples of the recent comparable transactions the lender has closed.

Mistake #2: Failing to negotiate deal points in the lender's application letter.
It is common for a lender to request an expense deposit before processing a loan to cover transaction costs, such as third-party reports. However, after you determine that you are working with a dependable lender, ensure agreement relative to important loan terms in the application letter before executing the application and sending the required expense deposit. You should address important deal points before executing a loan application because they will be much more difficult to negotiate once the loan has been approved. It is important to know that most lenders will not acquiesce to all requested changes to the loan application, but at a minimum, you should understand all of the terms and conditions outlined in the application and address any concerns or questions upfront.

Mistake #3: Not engaging an experienced attorney.
Do you think you can close a deal on your own without the services of an attorney? This is unlikely, and generally not advised, even if the lender permits it. At a minimum, attorneys are typically needed to provide the lender with certain opinion letters, and also to ensure final loan documents reflect the terms that have been approved. Hiring a seasoned professional will

allow you to negotiate fair terms and save you money in the long run. Above all, do not sign loan documents without an understanding all of the details.

Mistake #4: Waiting to provide checklist items.
Once you begin the financing process, it will benefit everyone if you submit as many closing checklist items as you can (rent rolls, operating statements, personal financial statements, etc.) as quickly as possible. By doing this, the lender can assemble the package needed for committee approval, while waiting for completion of third-party reports. Waiting until the last minute to submit information will cause delays in getting the loan approved, or delay the closing once the loan is approved. More than once, we have experienced the expiration of a loan approval because information was not provided in a timely manner. With this in mind, it is also important to plan for checklist items that require lead time. For example, check your file to see if there is an existing "as-built" or American Land Title Association survey, which many lenders require as a condition of loan funding. If there is an existing survey, submit it to the lender for review at the beginning of the process. Many times, the lender can use an existing survey with limited updates. If there is not an existing survey, check with your lender to see if one will be required, and if so, order a new one early as it may take the surveyor three weeks or longer to complete it.

Mistake #5: Failing to review financial information before submitting.
You should review all pertinent personal and property-related financial information closely for accuracy before submitting to the lender. This includes rent rolls, operating statements, and personal financial statements. It is always more difficult to correct mistakes after providing information, particularly if you're arguing for a more favorable result. In addition, even with nonrecourse loans, the key principal has legal and financial exposure for the accuracy of financial information relied upon by the lender.

Mistake #6: Not knowing the terms of your current loan.
If refinancing an existing loan on a property, be sure to understand any payoff conditions or restrictions. The first item to check is whether or not the current loan has a prepayment penalty. If so, it may be wise to delay refinancing the existing debt until the prepayment penalty period expires or consider an early forward rate lock. Also, check with your existing lender to see if there is a notice provision, or if the existing loan must be paid off on a certain day of the month (some loans, for example, can only be paid off on the final day of the month). The current loan may also have a provision requiring interest to be paid through the end of a given month even if the loan is paid off early in the month, in which case loan funding and closing should be targeted toward month-end.

Mistake #7: Not knowing your property's flood zone designation.
Even if you have previously verified whether or not your property is located in a flood zone, you should recheck before a refinance as the Federal Emergency Management Agency (FEMA) may have completed a review and adjustment of flood zone boundaries since you last checked the flood map for your property. When a property is located in a flood zone, there are alternatives to consider, including a possible letter of map amendment (LOMA) or letter of map revision (LOMR) (discussed in more detail below). In addition, lenders will consider mitigating factors you may want to present that are referenced in the following section.

Key issues for MHC lenders

There are a few key issues that lenders often focus on when determining whether a property should qualify for financing. It is important for MHC owners to not only be aware of these issues, but also to know what approaches may be taken to mitigate the lender's concerns. Some issues that regularly arise include rental homes, home obsolescence, recreational vehicle (RV) income, and flood zones.

Rental homes
Generally speaking, lenders prefer that MHCs have a limited number of rental homes. FNMA and Freddie's standard underwriting guidelines, for example, allow no more than 25% of the homes in a community to be park-owned and rented to tenants unless an underwriting waiver is received. This includes "rent-to-own", as well as straight rentals. Other lenders, including some conduits, will allow a higher percentage of park-owned rental homes, often with the following caveats:

1. The homes are owned by a separate affiliate and not part of the loan collateral.
2. The operations of the home rentals are separately accounted for and only the site rent is counted in the rental income of the property.
3. The borrower signs an agreement that he or she will not move any homes from the property while the loan is in place (the homes can be sold to individual residents) and signs a carveout guarantee covering any losses incurred by the lender as a result of movement of homes if they are transferred out of the property.

Conduit lenders will sometimes accept more than 25% park-owned rental homes by requiring a master lease for the affected sites. However, this may not be a palatable solution for the MHC owner, because in order to protect itself from maturity default (not being paid off when the loan is due), the lender will typically want the master lease to extend beyond the term of the loan — even to perpetuity.

Home obsolescence

Asset quality is one of the most important factors in a lender's willingness to make a loan, and this is largely influenced by the age, condition, and perceived obsolescence of the homes within the MHC. Items that a lender will focus on include whether hitches are attached to the homes, whether the skirting is intact, and whether the homes are in need of painting or updating, such as new siding.

This aesthetic factor is so important that it is often worthwhile for the property owner to take it upon himself or herself to improve the quality of the homes, not only by replacing older homes with newer homes but also by improving the existing homes, when possible, on turnover. Substantial benefits can be achieved by improving the quality of the homes in the community: it increases the financeability of the MHC, improves the marketability of the sites, confirms management's commitment to the property for the existing residents, and can often lower the cap rate and increase the value of the community.

Some MHC owners have successfully worked with existing residents of occupied homes to complete exterior improvements, such as new siding and steps or porches. This can best be accomplished when the MHC owner can identify for his or her residents a local contractor who can complete these improvements within community guidelines, and also offer the residents a loan to complete these improvements.

RVs

It is not uncommon for MHCs to have RV rental or storage sections, and lenders are typically willing to underwrite most, if not all, of this revenue stream, depending on the circumstances.

The first question is: where are the RVs located? It is the preference of most lenders that RVs be located in a separate and distinct section of the property rather than having RVs scattered intermittently throughout the community. Having RVs located in a separate section typically enhances the property's appeal from a resident perspective. After all, if you are a resident, would you rather look across the street at an RV with exposed hookups, or a skirted manufactured home with mature landscaping?

Other factors that lenders will focus on when analyzing RV income include the history of the income and any seasonality it may have. The longer a property can show a consistent RV income stream with little to no seasonality, the more willing lenders are to underwrite a higher level of that income. If a property has a short history of RV income or pronounced volatility, lenders will typically only give credit to a small percentage of the RV income. In cases where RV income is seasonal (high RV revenues during a few months of the year), lenders may require the establishment of a seasonality reserve to mitigate the monthly fluctuations in RV income.

If your MHC derives a material portion of its income from RV tenants, be prepared to support the underwriting of this income stream with detailed records that include original move-in dates of long-term RV tenants, as well as the length of leases signed by RV tenants. On your operating statements, you should break out RV income into short-term and annual revenue categories. If your annual RV tenants occupy park models, make the lender aware of this as it will be viewed as more stable.

Flood zones

Do you know if your MHC is located within a high-risk flood zone, either entirely or partially, as defined by the FEMA? If it is, additional investigation will be needed before you proceed. There was a time when FNMA was one of the few lenders that viewed flood zones negatively, but in recent years, we have seen many others, including Freddie and conduit lenders, follow suit.

Flood zones are geographic areas that FEMA has defined according to varying levels of flood risk. Any property located in an "A" or "V" zone — often referred to as a 100-year flood zone, or high-risk flood zone — can be viewed negatively by lenders, unless only a small number of sites are affected. It can also be problematic if the property entrance is in the flood zone as this could potentially hamper ingress to and egress from the property.

So, how does an MHC owner overcome flood zone concerns? Let us assume that only a portion of the sites within an MHC are located within a high-risk flood zone. In this case, most lenders will provide financing, but may make an underwriting adjustment to account for the sites located within the flood zone by not underwriting any income from those sites. However, the underlying source of the flood zone and the elevation of the homes compared with the flood zone elevation may enable the lender to include all of the sites and related income in the underwriting.

The cause for biggest concern is when the source of flooding is a moving body of water, such as a river or creek. In this instance, there is potential for a heavy storm to strengthen a normally docile creek to the point of being capable of displacing homes located within the flood zone. For this reason, many lenders require that any sites in the flood zone be removed from the underwritten rental income when the source of flooding is a moving body of water. If a moving body of water is not the source of flooding, however, the threat of damage to the homes is not as high and it may be possible to underwrite rental income from the sites located within the flood zone.

When a property is in a flood zone because of its location in a low-elevation area or being adjacent to a water-retention area, such as a pond, heavy rains may cause the water level to rise and result in flooding, but the water then recedes over time. This is a scenario in which you should consider the elevation of the homes, and you may need to hire a surveyor to provide a more detailed analysis. In addition to verifying exactly how many sites are located within the flood zone, a surveyor can determine the elevation levels of the homes located on those sites relative to the base-flood elevation (BFE) level. If the surveyor's findings show that the elevation levels of the floors of the homes are above the BFE of the flood zone, a lender may agree to underwrite the rental income from those sites, as there would be adequate data showing that any flooding should not displace the homes within the community.

Another alternative is to ask an experienced surveyor to determine if your property is a good candidate for a LOMA or LOMR. If it is, upon completion of field work, the surveyor can submit a LOMA or LOMR application to FEMA. FEMA will review the application and, assuming it has been completed appropriately, issue an amendment or revision to the current FEMA map in which it removes all or a portion of your property from the high-risk flood zone designation.

Property owners often wonder why simply obtaining the required flood insurance through the National Flood Insurance Program (NFIP) does not alleviate a lender's concern about an MHC being located in a high-risk flood zone. This is because NFIP coverage can only be purchased for permanent structures and improvements. Residents can obtain flood insurance for their homes, but the community owner is not a party to this coverage. MHCs have limited physical improvements, and the primary improvements to insure are structures, such as clubhouses or laundry facilities, which do not generate income. In fact, as part of the appraisal required when processing a loan, the appraiser provides an insurable replacement cost value that pertains only to the physical improvements at the property, and this is used to determine the appropriate property insurance coverage required for the improvements. There is usually a significant gap between the final appraised value of an MHC and the replacement cost value of the physical improvements. So, even if an MHC owner obtains flood insurance on the permanent structures, it is likely going to fall far short of covering the loan amount.

One solution that Freddie offers to MHCs located within flood zones is for the property owner to purchase additional business interruption coverage to specifically cover rent losses due to flooding for those sites located within the flood zone. You should be aware of the additional insurance premium cost to obtain such coverage as it may affect what loan amount can be achieved because the lender will need to underwrite the insurance expense at the higher premium level, therefore reducing the NOI used in the minimum debt service coverage ratio calculation.

Although you may not agree with some lender underwriting guidelines, it is always helpful to understand your audience and its concerns. Regardless of which hot button you may be faced with, it is important to work with an experienced MHC lender with prior experience in addressing these issues.

Section 3: Additional information

What to know before your loan comes due

While lenders have been expanding since the recession to accommodate ever-increasing lending demand, we may never again see the aggressive lending parameters that we experienced in the years preceding the lending crisis of 2008. Regardless of what the lending market will bring in the years to come, one truth remains: if manufactured housing community owners continue to demand loans, loans on these communities continue to perform, and the capital markets remain relatively healthy, lender demand will remain strong and there will be options for community owners.

That said, you still need to get yourself prepared. Even if you are current on your loan payments and feel that you have plenty of time to refinance, you will be in monetary default if you do not pay off your loan balance on the day your loan matures. As a first step, we recommend you dust off and review the loan documents from your current loan, particularly the promissory note, deed of trust/mortgage, and guaranty. At the outset, you should, at a minimum, have a clear understanding of the following topics:

1. **Is your loan a conduit loan?** This is a vital fact that you must determine first. Conduit loans are much more difficult to modify as the loan servicer is typically not authorized to make material changes to the loan. Balance sheet (non-conduit) loans potentially present greater flexibility for modifications as your loan approaches maturity.
2. **What are the maturity and default dates?** Is there a specific balloon maturity date, as opposed to a fully amortizing loan term that may have periodic interest-rate adjustments? If the loan was a conduit loan, does it have hyper-amortizing features that essentially provide an automatic workout once the anticipated repayment date (essentially what would have been the maturity date if this feature was not added) has passed? If the loan has matured, it is likely to be accelerated unless you can work out an extension with the special servicer.
3. **What is the default interest rate?** Most commonly, when a loan goes into default, the current interest rate will adjust to the default interest rate. This is typically the lesser of the current interest rate plus an additional margin (often 4% to 5%) or the maximum interest rate allowed by law. The bottom line is that the interest rate charged when a loan is in default will be substantially higher than what the rate had been throughout the loan term. To put this in perspective, imagine that just before the market meltdown, you obtained a $5 million conduit loan at 80% LTV, amortized over 30 years, with a fixed interest rate of 6%. During the loan term, the cash flow of your property was flat. You try to refinance your property at loan maturity, but because underwriting parameters are now more conservative and your property has not increased in value, you are unable to obtain a new loan for the property and the loan goes into default. The interest rate could then adjust to 11%. If the lender doesn't accelerate the loan balance and you are permitted to continue monthly payments, in this particular circumstance the default rate alone would increase your monthly loan payment by more than $17,000. As you can see, the purpose of implementing the default interest rate is to motivate the property owner to refinance or pay off the loan.
4. **What is your personal liability?** This issue may strongly shape your course of action. Was the loan made on a recourse or nonrecourse basis? Are you a carveout guarantor? These are important facts to ascertain. Recourse loans, for which the guarantors are fully liable for repayment of the entire loan, are typically made by a bank when the loan will be held on its balance sheet. Lenders make nonrecourse loans with limited carveouts for personal liability, and virtually all conduit, FNMA, Freddie, and many lifeco loans follow this structure. For a nonrecourse loan, the lender agrees to look only to your property for repayment, except for losses it may sustain for certain "bad boy" acts, such as fraud, diversion of rents or insurance proceeds, and waste and environmental contamination. If you are a carveout guarantor on a nonrecourse loan, be certain that you do not do anything (unless you determine that to be the best course of action, on balance) that will trigger personal liability.
5. **Is there a prepayment penalty or premium?** Payment of a loan more than a few months before maturity almost always involves a prepayment penalty or premium. For conduit loans, this typically takes the form of defeasance or yield maintenance. Defeasance is a complicated process that involves assembling a basket of U.S. treasury securities to substitute as collateral for the loan. Most borrowers engage a defeasance consultant to coordinate the defeasance process. Yield maintenance premiums are based on measuring the loss of yield over a U.S. treasury security, as if your prepayment proceeds are only invested in such a security, and are typically never less than 1% of your loan balance. Yield maintenance premiums are calculated by your lender and don't require outside consultants. Other loans may require a "stepped" prepayment premium or a fixed percentage of the unpaid principal balance. In short, know what is required and determine the impact against your available capital and refinancing proceeds.

6. **Is there an open prepayment window?** If you're deciding whether to pay off an existing loan before its maturity date, check the loan documents in further detail to determine whether there is an open prepay window when no penalty is assessed, as well as whether there are any restrictions on the day of the month the loan will need to be paid off. For many fixed-rate loans, the window when the loan can be prepaid without a prepayment penalty is the last three months before maturity. In addition, some loan documents may require that you pay off the loan on the first or last day of the month, or the full month of interest will be charged for the month in which the loan is paid off. If processing a new loan, make the new lender aware of this so that you avoid paying double interest during that month. In addition, the existing loan documents may require giving the existing lender written notice of at least 30 to 60 days before paying off the loan. Again, this is a point to be aware of if processing a refinance or selling a property.

   Even if your existing loan does not mature for 12 to 24 months, we strongly recommend you start exploring options for refinancing now. Remember, lenders hate surprises, so manage the expectations of the current lender and start early in case anything unexpected arises during closing.

Captive home finance programs

For many years, some MHC owners have been offering financing options for resident-owned homes within their communities. The housing market collapse of 2008, which reduced the number of chattel financing lenders and caused remaining lenders to dramatically tighten lending standards, hastened and in many ways necessitated an increase in MHC-owner financing as a way to maintain occupancy and income. While not all owners actively engage in captive home finance programs ("in-community" chattel financing, home lease, or rent-to-own leasing programs), many owners find it advantageous to incorporate their financing, leasing, and sales activities into their core operations.

Even though the real estate finance marketplace has recovered, there remains an absence of lenders in the chattel lending space.[1] Notwithstanding increased legislative and regulatory complexity, captive finance programs are likely to remain for the foreseeable future because:

- There are an insufficient number of potential residents in most markets who can pay cash for a home or qualify for affordable third-party financing to fill vacancies that occur naturally, let alone increase overall occupancy.
- Even age-restricted communities that are historically less affected by limited availability of chattel financing are finding that the declining number of retirees who have public or private pensions translates into fewer potential residents who can qualify for traditional financing.
- Community deterioration can result when residents are unable to sell their privately owned homes because financing for their purchaser is unobtainable. Even the most creditworthy owners will default if health, employment, or other circumstances force them to leave the community after they have been unsuccessful at selling their home. Owner-supported resale activity, including financing for FSBO sales, makes overall economic and financial sense and can slow or stem the vacancy snowball caused by chattel lending market illiquidity.
- The MHC industry is consolidating. Entities seeking to acquire existing properties need a full tool box to compete for communities that come up for sale. The absence of a captive finance platform likely means that other bidders will construct more favorable valuation models — resulting in lost growth opportunities for owners not able to project the benefits of captive finance into their projections.
- Captive home finance programs are being used not just to improve occupancy, but also to slow down or prevent the increasing vacancy, enhance home price stability, and create a competitive advantage for strategic acquisitions.

Done properly, captive home finance programs can produce positive results, such as:

1. Maintain or increase occupancy by extending credit to a wider spectrum of borrowers
2. Produce consistent site rent with the ability to implement periodic rent increases
3. Stem or slow the resident exodus occasioned by local, economic, or other conditions
4. Drive higher valuations of existing and potential acquisition properties
5. Improve overall property desirability by facilitating the retail sale of existing community homes
6. Demonstrate enhanced ability to periodically replace older homes with newer, better built, energy-efficient, and more desirable homes

We offer a few basic guidelines for consideration that can provide MHC owners the opportunity to maximize the benefits of captive finance programs:

1. **Focus on site rent.** Most successful captive home finance programs are operated with the express purpose of maximizing overall site revenues — a combination of individual rents and total occupancy. It is possible to generate home sale profits and loan interest income, but property values and the ability to obtain the most favorable real estate lending rates are most heavily influenced by recurring rental cash flows. A sales or finance program geared to generate high home-sales profit margins, or one that makes loans to unqualified applicants, may be attractive in the short term, but will end up being costly overall.

1. On November 12, 2014, U.S. Bank notified customers that it had elected to exit the Indirect Lending Manufactured Housing Business.

2. **Create standards.** Operate your captive home finance business with the same level of care and professionalism as you would require of a third-party company providing an essential service to your business. Many captive home finance programs were started out of necessity, convenience, or simply to make money. The value of these programs, and the value and liquidity of the loans and leases themselves, increases dramatically when you can provide statistical documentation regarding the performance of these programs. This might include:

    - Consistent borrower (FICO, income, length of employment, etc.), payment (has the borrower been delinquent and how delinquent — 30 days, 60 days, once, several times), collateral (year, model, description, size, etc.), and compliance (USA Patriot Act, Federal Reserve Bank Regulation Z, Dodd-Frank, etc.) documentation for each loan in your portfolio. Remember, these loans are being "purchased." Think of it as though you were purchasing a piece of property, and apply the legal standards to your lending business in much the same way as you would if you were purchasing a parcel of land.
    - Periodic analytical reviews of your loan portfolio by qualified third parties who will provide documentation of their findings. Is the paper you accepted in exchange for the home you sold of equal value? If not, what needs to change to provide better overall lending economics?
    - Third-party support in administering your programs. There are industry resources that provide fee-based expert services for origination, servicing, financial review, credit underwriting, and more. The fees you pay to these providers may end up being money well spent, not only by increasing the value and salability of your portfolio, but also by reducing fixed overhead.

3. **Consider sustainability**. Make the program sustainable. Ensure you have sufficient resources to meet seasonal demand and to replace older homes with new homes. You also need to make sure that your training, processes, and systems are sufficiently robust to ensure reliable and accurate reporting and recordkeeping.

4. **Look for leverage**. Few real estate investors purchase properties without leverage. Well-run captive home finance programs that adopt professional protocols will typically have access to the capital needed to operate on a leveraged basis and will thus be accretive to the overall real estate business that they support. In addition, lenders who can provide financing to community owners for homes owned and leased by the community have emerged. Financing is available not only for newly purchased homes, but also for existing Manufactured Home (MH) units as well.

5. **Pursue growth and marketability.** A well-run captive home finance company plays a critical strategic role in acquiring new properties, disposing of existing properties, or in situations where the entire business ownership transitions. Remember, sales valuation analytics are often driven off of the discounted value of the total rental income. All things being equal, a community operating at 90% occupancy is a more attractive and financeable asset than one at even 80%. That difference could be attributable to the well-run captive finance program.

6. **Regulatory and legislative compliance.** Federal and state consumer protection legislation has created problems for anyone originating loans in the residential housing space. We cannot overemphasize the need for MHC owners to ensure they are operating in compliance with all-state and federal requirements. Since these requirements are also being reviewed by the current administration and Congress for possible changes, an exhaustive examination of the various laws that comprise this regulatory web is beyond the scope of this handbook, but the MHC industry has a few highly qualified professional originators who provide regulatory-compliant origination platforms on a fee basis to community owners. These third parties typically offer analytical support, as well as servicing of the portfolios on a fee basis.

7. **Entity segregation.** It is wise for community owners to have their sales, leasing, and (if applicable) lending operations performed out of a related entity rather than through the land-owning entity. Not doing so increases the risk that land financing terms may be less favorable or that chattel equity may need to be pledged as collateral security for a loan on the community real estate. While the same "warm bodies" or principals may own and operate both the real estate entity and chattel lending or leasing entity, keeping them distinctly separate accomplishes two things:

    a. It clarifies the accounting from an MHC lender's underwriting perspective by separating the real estate operation from the chattel lending and leasing business.

    b. It helps to ensure that the MHC ownership entity is not violating any single-purpose entity (SPE) provisions in the property's mortgage loan documents.

8. **Leases and rent-to-own (RTO) strategies**. In addition to offering chattel financing, many community operators also find that renting homes is a strategy with multiple benefits, although there are certain risks that must be understood before embarking on a rental strategy. Considerations include:

    a. It is often much faster to find a tenant for an existing home than a buyer for the same home. Thus, frictional vacancy can be reduced with a well-run rental program.

    b. As a loss-mitigation strategy, when the community recovers a home following loan default, it may be advantageous to lease rather than to resell that home — depending upon various market and other considerations.

    c. MHC lenders often do not view rental homes or RTO homes favorably because of the perception that they result in a lower-quality resident and higher turnover.

d. While exceptions are always possible, particularly in the case of rent-controlled properties, lenders often limit the ratio of rental homes, including RTO homes to total occupied homes, in performing their underwriting calculations.

e. Considerable ongoing debate continues regarding terms that must either be in or absolutely absent from RTO contracts in order to achieve regulatory compliance. Lenders will generally view a well-written, regulatory-compliant RTO contract more favorably than a traditional rental home lease, particularly in the limited situations where the resident has institutional-quality credit or where a significant down payment in conjunction with execution of the RTO contract was made.

f. Finally, lenders have grown cautious about financing real estate where a significant number of leased homes comprise community occupancy unless covenants are obtained or documents are structured in such a way as to provide assurances that the homes will remain sited in the community should an event of default or even significant economic downturn occur.
Done properly, implementing a captive home finance strategy can increase the value of your community. Well-run operations can reduce overall vacancy and improve stabilized occupancy. Frictional vacancy associated with lengthy marketing periods required to sell turnover homes to persons capable of obtaining traditional financing is also reduced. The cumulative result of these activities is a more desirable place for your target customer to call home.

Financing considerations in an increasing interest rate environment

In early 2018, we saw the 10-year treasury yield surpass 2.90% for the first time in four years. Industry analysts see a weakening dollar, rising oil prices, the potential for higher governmental spending domestically, and less central bank easing across the globe as reasons to believe that interest rates will continue their upward trend throughout the remainder of the year. In order to be prepared to face these potential headwinds, there are a few things MHC owners should take into consideration when assessing their current property financing situations and before entering into new financing structures.

- **Situation #1:** You currently have an adjustable rate loan on your property.
  - **Consider this:** You may be able to convert your adjustable rate to a fixed rate; or refinance into a fixed-rate loan more easily than you think.

Most adjustable-rate loans are structured with much more prepayment flexibility compared to long-term fixed-rate loans. With FNMA and Freddie adjustable-rate loans, for example, the prepayment penalty typically consists of a one-year lockout from prepayment followed by a 1% fixed prepayment penalty throughout the remainder of the loan term until the final three months when the loan can be paid off without penalty. In the case of FNMA, the standard adjustable rate program includes a fixed-rate conversion feature that allows the borrower to convert the adjustable rate to a fixed rate after the first year of the loan term. No prepayment penalty is charged at the time the loan converts to a fixed-rate, and only minimal reunderwriting is required to confirm that the current net cash flow of the property is sufficient to support the new fixed-rate terms. It is important to note, however, that when the borrower converts the adjustable rate to a fixed rate, no increase to the existing loan amount is permitted (unless the property qualifies for a new supplemental loan that is processed simultaneously with the rate conversion).

In the case of Freddie, while their adjustable rate loans do not provide a fixed-rate conversion option, they do waive the 1% prepayment penalty if the borrower refinances the existing adjustable-rate loan with a new Freddie fixed-rate loan (this is also the case when the borrower on a FNMA adjustable-rate loan refinances into a new FNMA fixed-rate loan). One reason this refinance option can be attractive is that it allows the borrower to pull out additional loan proceeds above and beyond the loan balance on the existing loan provided the cash flow of the property supports it. And, because the refinance is taking place with the same lender that holds the current debt, the refinance process will typically be less onerous since the lender is already familiar with the property and its performance.

- **Situation #2:** You would like to refinance your property now, and lock in a new long-term fixed rate, but your current loan is a fixed-rate loan with a large prepayment penalty.
  - **Consider this:** It may make sense to pay the prepayment penalty.

Most long-term fixed-rate loans are structured with prepayment penalties, such as yield maintenance or defeasance. While these prepayment penalties can be large, generally speaking the penalties decrease as treasury yields increase and the loan term approaches maturity. If you are nearing the end of your loan term, but not yet in the open window (when the loan can be prepaid without penalty), it may still be a smart move to pay off your current loan early, particularly if you are able to cash out an amount equal to or greater than the prepayment penalty and if you believe interest rates will continue to rise. Paying your loan off early may actually put you in position to lock in a new fixed rate that is lower than your current rate, while at the same time inherently extending the life of your fixed-rate loan term. Furthermore, depending on your individual situation, there may be a tax benefit you can take advantage of when incurring a prepayment penalty. However, we would recommend that you consult with your accountant or tax advisor before pursuing this course of action.

If you are looking to find a way to avoid paying the prepayment penalty all together, you may want to consider doing an early rate lock. FNMA and Freddie offer the ability to lock in an interest rate anywhere from five to six months (or possibly longer) in advance of closing. Life insurance companies, which tend to be more selective on asset quality and leverage, can provide forward rate lock options as long as 12 months before loan closing. It is important to note, regardless of the lending program, a meaningful rate-lock deposit will likely be required (typically 2% – 3% of the loan amount) and the longer the rate-lock period, the higher the interest-rate spread will be. Still, when timed properly, a forward rate lock enables a borrower to wait out the prepayment penalty associated with the existing loan and hedge against the risk of upward rate movement.

- **Situation #3:** You are contemplating obtaining a high-leverage interest-only loan.
  - **Consider this:** You may be putting your property at refinance risk in the future.

While 2007 may seem like a long time ago, it is important to remember that many commercial real estate owners at that time who had taken out high-leverage, short-term, interest-only loans found themselves in quite a bind when those loans matured. It is worth keeping the tough lessons learned from the last downturn in mind as we head into what may be an increasing interest rate environment. Imagine, for example, that you enter into a five-year fixed-rate loan at 80% loan-to-value (LTV) with a 1.25x debt service coverage ratio (DSCR). During the next five years, the cash flow of your property remains flat, while interest rates increase. When you go to refinance your property at loan maturity, you may be unable to qualify for a loan amount equal to or greater than your current loan balance (which would be the same as when the loan was originated since it did not amortize) because the property's cash flow will no longer cover the monthly debt service at a 1.25x DSCR if interest rates are higher. When this situation arises, the borrower is either forced to come out of pocket at the time of refinance, or the loan goes into maturity default, which typically triggers loan payments based on a much higher interest rate (known as the default interest rate) than the borrower had during the loan term.

Because of this potential refinance risk, in recent months we have seen lenders scale back the amount of interest only they are willing to provide on high-LTV and/or low-DSCR loan requests. Having said that, there are still instances where an interest-only loan can make sense in an increasing interest rate environment. Examples of this would be properties with upside potential because current rents are clearly below market, properties that have expansion capabilities, and lower leverage transactions.

In conclusion, the scenarios outlined above are just a sampling of the items one should consider when assessing commercial real estate financing in an increasing interest rate environment. While it is impossible to predict where interest rates are headed in the future, it is important for property owners to analyze the information that is available in the market at the time they are making financing decisions, and formulate a business plan to address any challenges that may be on the horizon.

Appendix

Historical MHC lending volume

(active lenders and mortgage brokers)

Numbers shown in millions of dollars

Lenders	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Totals
Wells Fargo Bank	629	418	324	381	659	501	560	540	1106	1740	1271	8129
Berkadia/Capmark Financial	207	79	92					684	650	440	732	2884
Onyx Capital (AIG)	265	185		141	162	215	230	310	260	250	400	2418
Security Mortgage Group	269	130	82	80	168	408	220	210	290	265	289	2411
Monroe and Giordano	343	116	73	90	203	161	161	194	107	136	201	1785
Collateral/Grandbridge Capital	93.5	109	284	111	251	134	108	40	168	227	197	1723
Northwestern Investments	95.6	40	95	70	24	39	119	391	145	454	247	1720
Tremont Realty	197	163	127	117	93	131	179	164	160	145	150	1626
Capital One (formerly Beech Street)					105	188	340	165	285	242	297	1622
PNC-ARCS Commercial Mortgage	71	89	45	7.5	26	95	206	147	130	429	217	1463
Walker & Dunlop								414	189	257	372	1232
Key Bank RE Capital										759	262	1021
C-III Commercial Mortgage						150	250	200	118	112	100	930
Holliday Fenoglio Fowler				43	57	57	146	142	123	134	137	839

Source: George Allen, Annual National Registry of Landlease Community Lenders (lenders and mortgage brokers with total volume of $500 million or more during the last 11 years).

Note: GE Capital ceased lending on MHCs after 2014.

Manufactured home community questionnaire

Property name: ____

Property address: ____

Prepared by: ____ Date: __________

Year built: __________ Number of sites: __________ Number of RV sites: __________

Resident profile: __________ % Family __________ % Adult (Age restricted? Yes / No)

Number of park-owned rental homes: __________ Acreage: __________

Physical occupancy: __________ % Current __________ % Previous Year ____________________

Is any of the property on a ground lease or subject to rent control? Yes / No

Approximate number or percentage of multisection homes in place: __________

Approximate number or percentage of sites that can accommodate multisection homes: __________

Is there a scheduled rent increase? Yes / No If yes, how much: ______________________________

When does the rent increase go into effect: Lease anniversary / specific date? ________

Please list the property amenities: ____

____

Please summarize any recent capital improvements to the property (within 3 years): ____________

____

Public utilities? Yes / No If no, please explain: ____________________________________

Management company: ______________________ Self-managed: ______________________

How many cars can park off the street at each home? ___________________________________

Is any portion of the property in a 100-year flood zone? Yes / No Number of sites:_________________

Borrower:

Is the property transaction an acquisition or refinance: Acquisition / Refinance

If acquisition, who is the seller: ______________________________

What is the purchase price: ____________ What is the estimated closing date: ____________

If refinance, what is the estimated unpaid balance: ____________

When is the maturity date: ____________ Who holds the current debt: ____________

If there is a prepayment penalty, when does it expire: ____________

How long has the property been under current ownership: ______________________________

Name of borrowing entity: ____________/TBD

Type of entity: LLC / Individual / Other Is this a single-asset entity: Yes / No

Who will sign the nonrecourse carveouts: ____________

Do they have any negative credit information (i.e., nonpayment, foreclosure, etc.): Yes / No

Does the borrower hold any other loans with Fannie Mae or Freddie Mac: Yes / No

Document checklist

Please provide the following items in order for us to provide you with a loan quote:

1. A current rent roll
2. The past three years of historical income and expense statements, including a recent trailing 12-month statement showing individual months of operation
3. Brief description of multifamily real estate experience, personal financial statement of the main principals, and schedule of real estate owned
4. Property photos

Please contact Tony Petosa, Nick Bertino, or Erik Edwards with any questions:

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Glossary of lending terms

All-in rate. The interest rate charged to a borrower on a loan. The all-in rate includes the benchmark rate used to set the loan, such as the 10-year treasury rate, plus the spread charged by the lender.

Amortization. An accounting term that refers to the process of allocating of an intangible asset over a specified time period. Also refers to the repayment of loan principal over time.

Assumability. A loan that is capable of being transferred to a new borrower, with no change in rate or terms of the loan. It also allows a borrower to sell a property and avoid paying a prepayment penalty because the loan is being transferred, not paid off. An assumption fee typically applies.

Basis point (BP). A basis point is 1/100 of 1%. Example: 25 basis points are equal to 0.25%.

Capitalization rate. A capitalization or "cap rate" is the yield on an investment if paid for in cash. The capitalization rate is calculated by dividing the net operating income by the purchase price of the property.

Captive Finance Company. A chattel (personal property) finance company lending on homes in land lease communities on behalf of its affiliate, the property owner/operator.

Cash management. The controls put on a deposit account used to direct funds in a hard lock box arrangement.

Carveouts. These are exceptions to nonrecourse provisions, where the loan is nonrecourse except for lender losses caused by certain acts of the borrower. Examples of triggering events would be unlawful use of insurance proceeds (the property burns down and the borrower does not rebuild) and misappropriation of funds (rents collected by the borrower after they have already lost title to the property). These are sometimes referred to as the "bad boy" carveouts as the borrower usually has to actively do something to impair the collateral and trigger recourse. See also "key principal."

Chattel. Personal as opposed to real property — any tangible, movable property. A manufactured or mobile home would be considered chattel, and the financing of homes within a land-lease community is referred to as chattel financing.

Commercial mortgage-backed security (CMBS). A security backed by a pool of commercial mortgages as collateral. They are usually structured with individual loans to multiple borrowers (often referred to as conduit loans) with a mix of different property types, loan sizes, and locations. These loans are pooled, and bonds with varying degrees of risk and credit ratings are created and sold to investors.

Consumer Financial Protection Bureau. Federal finance regulatory agency established by Dodd-Frank bill.

Debt service coverage ratio (DSCR). An underwriting formula that is a parameter used to determine loan size and spread based on cash flow. The calculation is net operating income divided by loan payment. For lenders, the higher the DSCR, the less risky it is to take on the loan.

Debt yield. Net operating income divided by loan amount. This is a common underwriting constraint used for the sizing of conduit loans (i.e., the loan amount equals the net operating income divided by the lender's required debt yield).

Duty to Serve. The "Duty to Serve" statute requires Fannie Mae and Freddie Mac ("the agencies") to provide leadership to facilitate a secondary market for mortgages, including for chattel, on housing for very low-, low-, and moderate-income families in three underserved markets specified in the statute: manufactured housing, affordable housing preservation, and rural housing. The statute requires the Federal Housing Finance Agency (FHFA) to annually evaluate and rate each agency's compliance with their Duty to Serve requirements and to report annually to Congress on FHFA's evaluations. The rule sets forth specific activities that the agencies may consider undertaking, at their discretion, to be eligible to receive Duty to Serve credit, and provides that the agencies may propose additional activities.

Federal Housing Finance Agency (FHFA). FHFA is an independent federal agency responsible for regulating Fannie Mae, Freddie Mac, and 11 Federal Home Loan Banks. FHFA was established through The Federal Housing Finance Regulatory Reform Act of 2008.

Government-sponsored enterprises (GSEs). GSEs are financial institutions that were created by the U.S. Congress to provide liquidity in a given market segment. Fannie Mae, Freddie Mac, and U.S. Department of Housing and Urban Development (HUD) are examples of GSEs.

Holdback. A portion of the loan that is not released to the borrower until an additional requirement is met. A common example would be a holdback for a physical improvement related to deferred maintenance.

Homesite or site. The piece of realty, whether owned fee simple or leased, scattered or in a landlease or subdivision community, on which a factory-built home is or may be sited. Homesites or sites may also be referred to as lots, pads, spaces, or stalls. (GA)

HUD-Code manufactured housing. A general term associated with the type of factory-built housing whose federally preempted construction standards (e.g. using longitudinal steel chassis in the foundation or floor system) are enforced by the U.S. Department of Housing and Urban Development (HUD). (GA)

Key principal. The individual or entity that controls and manages the borrowing entity and who the lender determines is critical to the successful operation of the borrowing entity and the property. The key principal is typically responsible for recourse carveouts.

Landlord. A landlord is the owner of real estate which is rented or leased to an individual or business, which is called a tenant, lessee, or renter.

Lease. A contractual arrangement calling for the lessee (user) to pay the lessor (owner) for use of an asset.

Lease option. A lease that includes an option to purchase the home for a specified dollar amount, during or at the end of the lease term.

Lease-to-purchase. A type of self-finance, offered and provided by the property owner/operator, whereby lessee commits to make rent payments on a home, and in time, receives title to that home. (GA)

Lessee. A lessee is the person or business that rents land or property from a lessor (owner).

Lessor. The owner or title holder of an asset who gives another the right to temporary possession and use of the asset in exchange for rental payments.

Loan to value (LTV). An underwriting calculation that measures the amount of a loan as a percentage of the property's appraised value.

Lock box. A special deposit account set up by a lender and borrower to receive deposits from tenants for the purpose of prioritizing the use of the cash flow of a property.

Manufactured Housing Institute (MHI): The Manufactured Housing Institute is the national trade organization representing the factory-built housing industry. Its members come from all sectors of the manufactured and modular housing industries and 50 affiliated state organizations. Their web site contains links under Industry Resources to web sites for State Associations.

Mezzanine Debt: Bridges the gap between secured debt and equity and receives higher returns compared to other debt, but is typically unsecured.

Mortgage-backed security (MBS). A financing instrument sold by Fannie Mae (FNMA), or other regulated and authorized financial institutions, that is secured by an underlying mortgage. This security is used to lock the interest rate on a FNMA loan before closing when it is sold to an MBS investor.

Net operating income (NOI). NOI is typically calculated using in-place income being collected less stabilized operating expenses, but not including debt service, amortization, or depreciation. Expense deductions also include a management fee (even if not charged) and replacement reserve allowance. The NOI of a property is used to determine the calculation of the DSCR.

Nonrecourse debt. A type of debt in which the principals do not have personal liability for the loan. If the borrower defaults, the lender can seize the collateral (the property), but cannot seek further compensation, regardless of whether that collateral covers the full value of the defaulted amount. An exception is in the event of violation of a carveout.

Occupancy. There are two types of occupancy: Physical and Economic. Physical Occupancy within an MHC is the percentage of rentable homesites being occupied by tenants, calculated by dividing the number of occupied homesites by the total number of rentable homesites at the property. Economic Occupancy is the percentage of rent being collected, calculated by dividing homesite rent that has actually been collected by the potential homesite rent that could be collected if scheduled rent was collected for 100% of the total rentable homesites at the property.

Owner/operator. An inclusive term, commonly used to refer to the individual or business entity overseeing a community or communities on an ongoing basis. (GA)

Portfolio loan. A loan retained on the lender's balance sheet (as opposed to a loan that is originated and then securitized or sold). It is also referred to as a balance sheet loan.

Real estate investment trust (REIT). A REIT is a company that owns or finances income-producing real estate for the purpose of providing investors with a sustainable income stream, diversification from standard stocks and bonds, and the potential for long-term appreciation. REITs typically pay out all of their taxable income as dividends to shareholders. REITs allow both large and small investors to invest in large-scale commercial real estate properties and portfolios.

Real estate mortgage investment conduit (REMIC). The legal term for the pool that is used for collateral for the bonds that are issued in securitized lending.

Recourse debt. Repayment of the loan is guaranteed by personal assets of any principal guaranteeing a recourse loan. This provides additional collateral and a source of repayment beyond the property.

Replacement reserve. An allowance for long-term improvements at a property that is a deduction (expense) included by the lender in underwriting (NOI calculation). Funds may be collected into an account to be disbursed for these defined improvements, or it may only be a deduction made for underwriting. MHCs typically have annual replacement reserves of between $35 per site per year and $75 per site per year.

Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). Passed in 2008, the SAFE Act mandates states to license residential mortgage loan originators.

Single-purpose entity (SPE). Lenders often require each property to be owned by a separate single-purpose entity (SPE). This entity will not own other (material) assets or conduct other business. That way, if any of the borrower's other assets are forced into bankruptcy, the subject property could not be consolidated with the distressed property and used as collateral to pay off that debt. Such entities are known as "bankruptcy remote."

Skirting. The metal or vinyl sheathing, or other generally flameproof materials (e.g. nonbearing block wall) around all four sides of the home, extending from the bottom of the sited home to the ground, keeping out weather, animals, rain, and snow. Also referred to in some locales as foundation fascia. (GA)

Spread. The amount charged by a lender over a defined benchmark such as a treasury yield or swap rate. The spread is one component of the all-in interest rate.

Subordinate debt. A form of debt that ranks below other loans in terms of repayment priority. If a borrower defaults, subordinate debt providers will typically receive payment only after the senior debt is paid off in full.

Swap rate. A commonly used index for conduit loans, the swap rate is equal to the swap spread, plus the corresponding treasury yield.

Swap spread. The premium paid by the fixed-rate payer of an interest-rate swap over the yield of the treasury note with the same maturity as the swap.

Third-party reports. Usually ordered by the lender during the closing process, third-party reports commonly include appraisal, environmental, and property condition (engineering assessment) reports.

Trigger event. A post-closing operating covenant providing the lender the right to take a defined action to protect its collateral.

Underwriting interest rate floor. An assumed interest rate (not the actual interest rate paid) used for sizing a loan as it relates to the minimum DSCR required by the lender. It is often used when interest rates are low and for sizing loans with shorter terms (less than 10 years) and higher LTVs. In these instances, the interest rate actually paid by the borrower may be lower than the underwriting interest rate floor.

Yield maintenance. A prepayment penalty calculated on the basis that the lender will receive early payoff of the funds and reinvest those funds for the balance of the loan term in U.S. Treasuries. Effectively, the borrower is required to pay the difference between the interest rate and the treasury yield at the time of prepayment (the "yield maintenance") for the balance of the loan term. This is a common prepayment penalty used with fixed-rate term loans.

Note: (GA) at end of definition denotes borrowing with permission from George Allen's Official Manufactured Housing & Land Lease Lifestyle Community Lexicon & Glossary.

Notes

Tony Petosa, Nick Bertino, and Erik Edwards specialize in financing multifamily properties — manufactured home communities (MHC) and apartments. Wells Fargo offers Fannie Mae, Freddie Mac, balance sheet, conduit, and correspondent lending programs, and since 2000 has originated more than $11 billion in financing within the MHC sector. Wells Fargo was named Community Lender of the Year, for 12 years in a row, by the Manufactured Housing Institute, has been #1 in total loan volume origination since 2000 according to George Allen's annual National Registry of Landlease Community Lenders, and also #1 commercial real estate lender in the U.S. since 2009 according to the Mortgage Bankers Association (MBA).

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