25 Lease-Option "Sales" of <u>New</u> Manufactured Homes Over 4 Years With <u>No</u> Defaults
By Spencer Roane 12/29/13

23 years ago we began selling manufactured homes (MHs) via Lease-Option (L-O) in land lease lifestyle communities (LLLCs) we own and manage. Our previous experience with rental MHs told us to avoid "churn & burn" sales. It took almost 20 years for us to learn how. So what's the secret to minimizing defaults? In chronological order, I'd submit that the following are very important:

- **Right home to sell.** Today's used homes are scarce, older, in poor condition, and expensive. New homes make better sales for us. In addition, homes must be functional, lower cost, have "eye candy", be well constructed, and stand behind a good warranty.
- **Right price.** Why try to make a killing on the sales price of a home when $1-2k over cost is a home run in terms of increasing cash flow, adding value to the LLLC, cutting common area costs, improving the appearance of the LLLC, and adding to the "community spirit"? We try to keep the L-O term to 12-13 years.
- **Right community** - appearance, residents, personnel, and site rent. George Allen has long been a proponent of lot rent plus home payments being commensurate with market-drive housing costs.
- **Right marketing** – attractive signage, sales center (not "office"), logo, point-of-purchase material, prospect follow-up. If you need help, Chris Nicely (<u>cnicely929@aol.com</u>, 865-385-9675) and Don Westphal (<u>don@dcwestphal.com</u>, 248-651-5518) are great consulting resources.
- **Right processing/underwriting** of applications.
- **Right follow-up** after the "sale" (community welcome, warranty).

Without suggesting that any of the other five considerations listed above are any less important, our experience suggests that "processing/underwriting" is VERY important – particularly verification of application information and establishing and applying acceptable limits for front-end and back-end Debt-To-Income (DTI) ratios.

Since we rent lots when we rent or lease MHs, we thoroughly review all of the following when considering an L-O application:

- Verification of rental history (no domestic or police problems, rental amount, payment history).
- Verification of employment (sources of income, type work, time on the job, monthly income, likelihood of continued employment).
- Credit report (payment history with creditors, monthly obligations, previous addresses).
- Income tax returns (historical income, dependents).
- Checking & savings account statements (income, expenses, & savings over a 3-month period, funds available for option payment, insurance, moving costs, etc.).
- Budget – income & expenses before & after entering into L-O contract.
- Criminal report (applicant can get copy from local police or sheriff's office).
- Debt-To-Income Ratios
    - Front-end ratio – housing costs (monthly lot rent plus monthly L-O payment) divided by total gross monthly income (generally acceptable ratio is below about 30%).
    - Back-end ratio – total monthly debt (housing costs, car payment, furniture payment, loan payment, child support, etc.) divided by total gross monthly income (generally acceptable ratio is below about 40%).

A tool we have found particularly helpful is one which we refer to as our "Pre-Qualification Worksheet" (PQW). Before asking the sales prospect to fill out an application, pay an application fee, or even look at homes, we ask the prospect to provide the following information, which we enter into the PQW spreadsheet:

- How much are you paying in rent now?
- What will your previous landlords say when we contact them about your rental history?
- What will your criminal history show when we contact law enforcement authorities?
- What will your credit report show?
- How much do you have available for a downpayment (option payment)?
- What monthly debt obligations are you currently responsible for?
- What is your gross monthly income from various sources?

Knowing the monthly lot rent at the LLLC the prospect is interested in, the prospect's monthly gross income, and the prospect's current monthly debt obligations, the PQW computes the maximum monthly L-O payment the prospect could make and still satisfy the DTI ratios (our PQW uses a sliding scale, based on an applicant's gross monthly income, for acceptable DTI ratios).

Alternatively, if we also know the monthly L-O payment on the home a prospect is interested in, the PQW computes the DTI ratios and flags acceptable or unacceptable values. If the prospect's DTI ratios are unacceptably high, our sales personnel can suggest the prospect consider a less expensive home or possibly pay off some recurring debt (eg – credit cards). If the prospect's DTI ratios are exceptionally low, our sales personnel can tell them that they might qualify for a more expensive home.

If our PQW indicates a prospect would be approved, based on the information the prospect provides us, we encourage him/her to complete our full application and pay the application fee. As long as the information provided by the prospect is accurate, he/she will be approved. We ensure the prospect knows that the application fee is non-refundable if our processing/underwriting reveals that information provided for the PQW is inaccurate.

Recently a prospect came into our office inquiring about renting a used home. When we discussed the benefits of home ownership and outlined our L-O program, she said she'd like to consider L-O on a used home. When we went through the PQW, she qualified for a new home – which she preferred and didn't realize she might qualify for.

A copy of our "Pre-Qualification Worksheet" is posted on the "Lease Option Documents" page of our website www.LeaseOptionMHSales.com

More stats? During the same 4 year period, we also sold 2 new MHs in our communities "all cash". Regarding new/pre-owned MHs (used homes which had been sold previously), we sold 15 used/pre-owned homes "all cash" and 59 other used/pre-owned homes on L-O contracts. All used/pre-owned homes were rehabbed to "very good" condition. L-O terms were commensurate with significantly lower costs. The L-O "buyers" on 20 of the used/pre-owned homes defaulted. 34% default rate on used/pre-owned homes vs. no defaults on new homes is a reflection of a buyer's preference for a home that has never been lived in (no odors, scratches, or other evidence of previous occupants), new systems and appliances, and a one-year warranty.

Spencer Roane, president of Pentagon Properties, Inc., Atlanta, Ga., owns and manages four land lease communities in Georgia and Texas. His firm has sold over 250 new & previously-owned manufactured homes in his communities over the past 20 years via Lease-Option contracts. Over the past 3+ years his firm has had no defaults on new home Lease-Option contracts. He is a member of the Georgia Manufactured Housing Association where he served as an officer and member of the board of directors. He is a member of the Manufactured Housing Institute (MHI) where he served on the National Communities Council (NCC) and the Disaster Housing Task Force. He is one of the organizers of meetings of the Southeast Community Owners (SECO). He holds a B.S. degree in Electrical Engineering, a M.S. degree in Industrial Management, and both Mortgage Loan Originator and Mortgage Broker S.A.F.E. Act licenses. Contact him at spencer@roane.com or (678) 428-0212. Pentagon Properties, Inc. website. Linkedin profile.