COBA7® presents....

'Pre-Qualification Worksheet (PQW) As Screening Tool'

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__Preview:__ Like most small operators, our community managers perform three very important roles: property management, home sales, and site leasing. If they waste time with unqualified sales prospects, they'll never get around to property management. The PQW is our way of helping them zero-in on sales prospects with ability and motivation to fulfill their commitment to obtain title to one of our new or used manufactured homes.

Our firm has sold approximately 300 new and used manufactured homes in four communities during the past 25 years, using Lease-Option (L-O) contracts. We do so for one reason: to fill vacant rental sites! That accomplishes three purposes: increases site rent revenue, upgrades communities, and reduces common area maintenance expenses. We're only interested in L-O contracts with "buyers" who want to own their home, i.e. going from point "A" (renter) to point "B" (homeowner, holding title to his/her home). Hence, we only want to enter into L-O contracts with "buyers" who can, and will, fulfill their commitment to buy their home from us. Conversely, we're not interested in the "churn and burn" sales model, involving "selling"' to anyone who can fog a mirror, planning/expecting them to default, and having to start the sales process over & over again. So, what is the definition of 'qualified buyer' and, more importantly, how do we efficiently find them? The likelihood of someone fulfilling a financial commitment, whether rental or purchase, depends on their ability and willingness to pay. That generally involves a review of credit records, verification and analysis of employment and income, and review of debt-to-income (DTI) ratios (i.e. front ratio involves housing costs; back ratio involves total debt). Since community owners are landlords, we also pay attention to an applicant's rental history, and to the amount of money the lessee is willing to put at risk, just as any landlord pays attention to the amount of a security deposit, or lender pays attention to a downpayment. And since we don't want criminals and troublemakers in our communities, we also pay attention to criminal history, if any.

Since we know what information to check, to maximize likelihood of getting good residents and committed buyers, do we check all that information on every prospective home buyer who walks through our door? If so, we'll spend LOTS of time processing applications, and have to hire additional personnel for property management. However, the answer for our firm, during the past five years, has been to use the "Pre-Qualification Worksheet", or PQW.

The PQW consists of a simple spreadsheet, which community managers review with those interested in buying our homes. It involves eight questions and takes less than five minutes to complete. But, you ask, 'How can one be sure the answers to the questions are accurate?' We tell the prospect we charge a $50 application fee, BUT that we're not interested in charging a fee if he/she isn't qualified to buy! The script goes like this:

"There's no charge for this pre-qualification analysis. As long as you answer our questions honestly and accurately, our analysis of your likelihood of being approved to buy our homes will be as accurate as we can make it. If we do think you would be approved, and you want to proceed with the application process, we charge a $50 application fee. __Please know we verify ALL of the information you give us.__ If the information you've given us is accurate and your application is denied, we will refund your $50. If the information you've given us is not accurate and we deny your application, you will forfeit the $50 application fee. And, if your application is approved, we will apply the $50 application fee to your downpayment."

Here are the eight questions in the PQW:

- Which of the following statements best describe what your current and previous landlords will say when we contact them about your rental history?

- How much are you paying in monthly rent now?

- How long have you been renting at this address?

- Which of the following statements best describe what we will find when we contact law enforcement authorities about your criminal history, if any?

- Which of the following statements best describe what we will find when we retrieve your credit report?

• How much money do you have available for a downpayment?

• What debt obligations do you presently have?

• What is your gross monthly income from various sources?

What are some of the questions frequently asked about the PQW?

• Why enter this information from applicants onto an Excel spreadsheet? We use the income and debt information to compute Debt-To-Income ratios – the best indication of an applicant's ability to afford site rent and house payments in the future. We allow about 30% for the maximum front-end ratio (i.e. housing cost percentage of gross income) and about 40% for maximum back-end ratio (i.e. total debt percentage of gross income). We do, however, increase those limits for higher income individuals?

• Which DTI ratio is most important? Many applicants satisfy the front-end ratio but fail the back-end ratio because of excessive additional debts like car, truck, alimony, and personal loans.

What do government regulations say about the PQW?

Regulation Z (Truth in Lending), in the Dodd-Frank Act, requires creditors to make a good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling. Although this may not specifically apply to the rental or leasing of community sites and homes, it seems reasonable to assume the use of a pre-qualification tool like the PQW, which includes two DTI ratios, would be strongly encouraged by current regulations.

• Why retrieve the applicant's credit record? While we generally place more emphasis on downpayment and DTI ratios than credit, we want the applicant to know we know who he/she has, and hasn't, paid in the past. We also ask for written explanations of derogatory credit, to impress on the applicant the importance of good credit. We're also interested in the credit trend (hopefully improving), and we compare addresses shown on the credit report to those listed on the application to ensure no landlords are omitted.

• Are the results of the PQW only "approved" or "disapproved"?

No, the PQW allows us to counsel applicants on the house they can afford. They may not be able to qualify for a new house, but could qualify for a less expensive, used one. Some applicants think they can only afford a used home when they can qualify for a new one. If they can't qualify for a house now, we can suggest things they can do to qualify in the future – e.g. more savings, pay off some debt.

• Can we ask those financial questions of applicants? Unlike independent street retailers, community owners are renting a site and a home. As such, community owners are allowed to ask any questions other landlords, renting apartments or houses, might ask.

• What are examples of some applicants deemed unqualified by the PQW?

  o those earning minimum wage or on minimal fixed incomes, the applicant who used his $250 monthly raise to take on a $500 monthly truck payment

  o those who think they can move into a new, $45k home with little/no downpayment, the couple who claims their credit score is 800 (his is 400 & hers 400!),

  o the drug dealer or prostitute with great income, but not someone most families want as neighbors.

• What effect on sales defaults have you experienced through use of the PQW? We began using our PQW five years ago. Since then, our sales defaults have dropped significantly. We have sold 35 new homes in four communities in two states, and only experienced two defaults. Neither home was damaged. Both were resold immediately, for the existing balance owed plus all default-related costs.

Spencer Roane, MHM®, president of Pentagon Properties, Inc., Atlanta, Ga., owns and manages four land lease communities in Georgia and Texas. 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 past 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. His writings about sales of manufactured homes in communities via Lease-Option contracts are posted at www.Lease-OptionMHSales.com. Contact him at spencer@roane.com or (678) 428-0212. *Website:* www.leaseoptionmhsales.com