BUSINESS BRIEFING
MANUFACTURED HOUSING

VALUATION & ADVISORY

A Cushman & Wakefield Business Briefing

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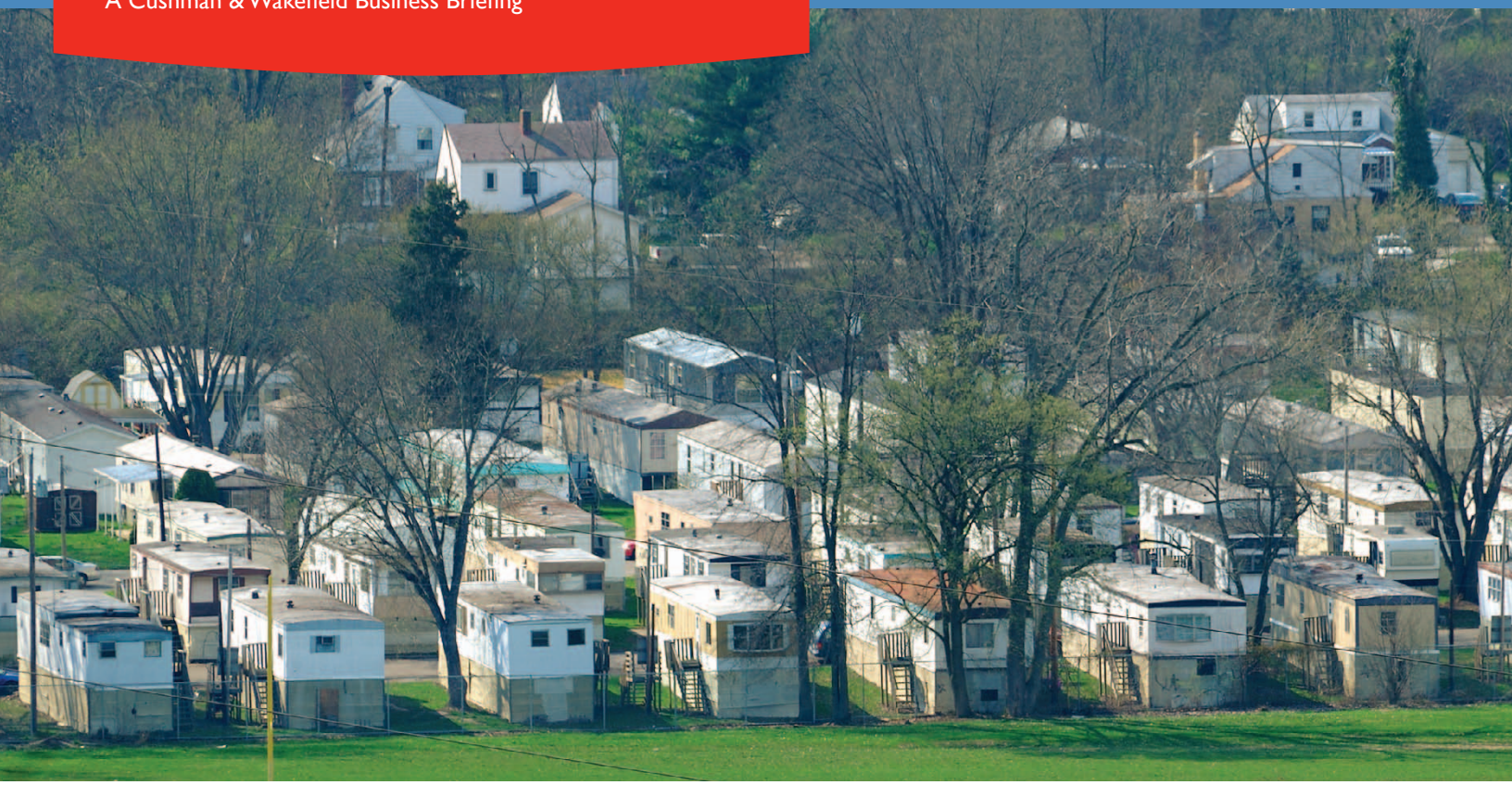

DEMAND CAUTIOUSLY RETURNS TO THE MANUFACTURED HOUSING SEGMENT

After years of suppressed growth following the recession, confidence is increasing in the manufactured housing segment due in large part to the improved housing market, shrinking unemployment levels and a return of financing. To report current trends, we have analyzed 12 years of comparable national sales data from the CoStar Group and the U.S. Census, focusing on four key variables: transaction volume, average price per unit, average net operating income per unit and average overall capitalization rate.

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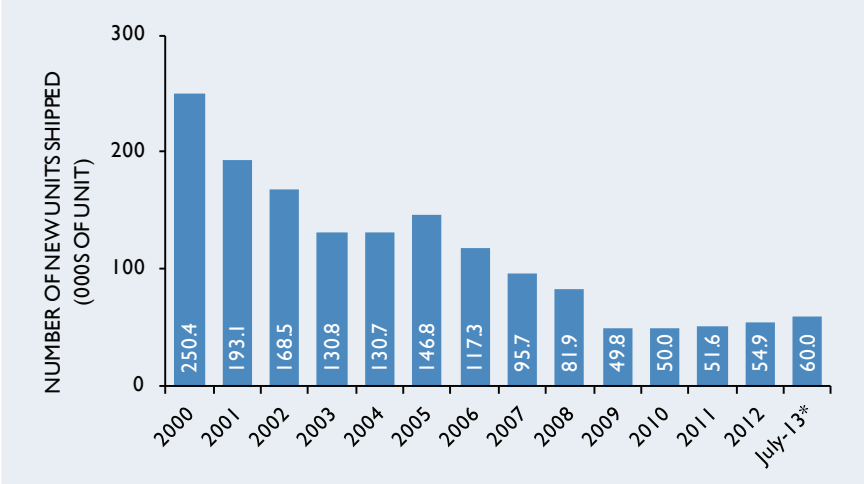
MARKET FUNDAMENTALS

Shipments, or starts as they are known in the manufactured housing industry, have sunk dramatically. Over the past several years, the manufactured home has become a less desirable option and during the last fifteen years, the number of units shipped fell from a peak of 373,100 units in 1998 to a low of 49,800 units in 2009. Illustrated in the following table, this number has shown only moderate growth from 2009 to 2011 but is now on pace to increase to 60,000 units in 2013 or an increase of 20 percent from 2009 for a fourth consecutive year of increases. As the availability of financing continues to improve, this trend is likely to continue in the mid-term.

SHIPMENTS OF NEW MANUFACTURED HOMES
UNITED STATES – 2000 TO JULY 2013*



Source: U.S. Commerce Department's Census Bureau *Annualized

Between 1991 and 1999 the manufactured housing industry expanded as the availability of financing on traditional site-built housing became constrained for many low- to middle-income families. The manufactured home, at nearly half of the cost, became the most viable option for many prospective home buyers. Following the recession of the early 2000s, efforts to spur the economy into recovery resulted in relaxed mortgage requirements on traditional homes, thus increasing purchase activity in this housing option. However, the subsequent fallout in the housing markets and related increase in foreclosure rates for site-built homes has exacerbated the lack of demand for new manufactured housing.

60,000

Starts are on pace to increase to 60,000 unites in 2013 for a fourth consecutive year of increases.

As traditional multifamily investors have enjoyed a substantial recovery with double digit percentage growth in sales prices and transactional velocity over the past 18 to 24 months, the manufactured housing industry has continued to struggle. Only recently has the asset class displayed signs of growth, largely due to the increase in sales prices of traditional site-built housing which has renewed demand for lower cost housing alternatives. This steady, moderate growth is expected to continue as large community owners partner with manufacturers in order to overcome financing challenges. Recently, Equity LifeStyle Properties partnered with Cavco Industries, one of the largest manufacturers of mobile homes, to provide a lending platform for Equity Lifestyles' home buying customers.

Nevertheless, a large resurgence of manufactured housing shipments faces multiple hurdles including the continued affordability of site-built homes (many of which remain well below replacement cost), as well as historically low interest rates and projected financial regulations that could further impede manufactured home lending.

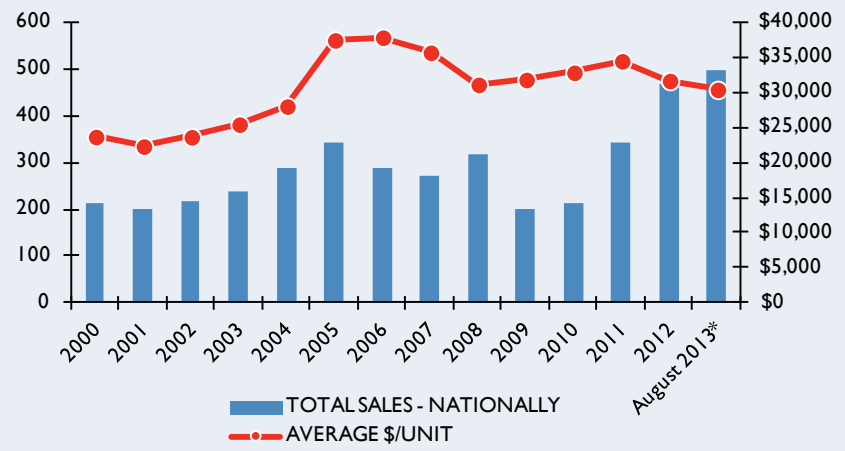
RESEARCH SPEAKS FOR ITSELF

The chart below shows the total sales and average price per unit since 2000. Sales activity first peaked in 2005 at 344 total sales but declined to a 10-year low of 202 sales in 2009. Since that time, sales have rebounded to 469 communities in 2012 and reached an all-time high of 495 communities as of year-to-date 2013 (annualized). This record activity is largely due to the increased competition for high-quality, traditional multifamily inventory which drove investors to seek alternative investments, primarily within higher quality, well-performing parks.

495

Sales have rebounded to an all-time high of 495 communities as of year-to-date 2013.

MANUFACTURED HOUSING COMMUNITY TRENDS
TOTAL SALES AND PRICE PER UNIT



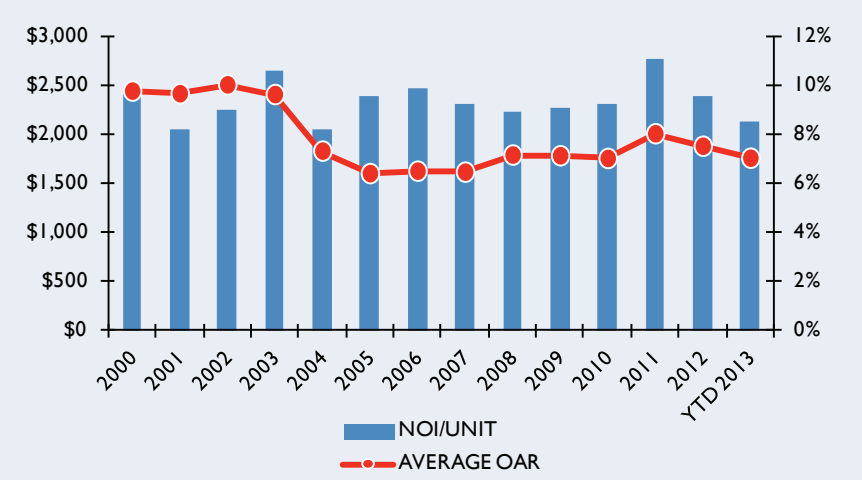
Source: CoStar *2013 Annualized

The average sale price peaked in 2006 at $37,841 per unit, a 69 percent increase over a five-year span from 2001. From 2006 to 2008, the average price decreased by 18 percent. Since that time, average per unit pricing has remained within a relatively narrow range.

While transaction volume and average price per unit tracked well through 2007, the two variables have not paralleled each other over the past five years. Following the downturn in 2007/2008, the majority of the sale transactions consisted of higher quality assets as these properties were favored by investors and garnered higher prices per unit. As financing returned in earnest in 2011, coupled with increased competition from buyers within the asset class, total sales volumes have increased significantly and are up nearly 140 percent from a 2009 low.

The next chart shows the average net operating income per unit and the average overall capitalization rate. Until 2003, there was a gap between the overall capitalization rate and the income per unit, resulting in lower values per unit. The gap indicates an emphasis on cash flow with less consideration for future appreciation.

NATIONAL MANUFACTURED HOUSING COMMUNITY TRENDS
NOI/UNIT AND AVERAGE CAPITALIZATION RATES



Source: CoStar

Thereafter, rates and income have tracked more cohesively suggesting more confidence in the asset class over the long run. This suggests a balance between cash flow and appreciation. When the capitalization rates dip notably below income (such as 2005 through 2007), it suggests an emphasis on appreciation.

Coinciding with the boom of the residential real estate market, the average net operating income per unit rose in 2005 and 2006 to $2,467 per unit. This was accompanied by the lowest average capitalization rates of the past 10 years at 6.42 and 6.52 percent, respectively, a decrease of approximately 330 basis points from the average rate in 2000. Since the peak of the market, the average rate increased through 2011 to just over eight percent, driving average net operating income per unit to an all time high. Since that time, the market has steadily improved with overall rates most recently decreasing to 7.05 percent as of August 2013. As the two variables have begun to more closely track together once again, this could indicate a stabilization of the market, which would be consistent with the sentiment felt by market participants.

UNDERSTANDING EXPENSES IS CRITICAL

A property's historical operating history is invaluable in estimating market value. In instances where it is inconsistent or unavailable, expense comparables are helpful. The following table is a sampling of approximately 30 expense comparables located throughout the United States.

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2012/2013 NATIONAL OPERATING EXPENSES
DOLLAR AMOUNT PER SITE

	RANGE			% OF
EXPENSE CATEGORY	LOW	HIGH	AVERAGE	EXPENSES
Taxes	$33	$645	$254	16.63%
Insurance	$19	$177	$52	3.44%
Repairs & Maintenance	$21	$598	$194	12.75%
Administration	$8	$427	$109	7.15%
On-Site Management	$0	$734	$221	14.47%
Off-Site Management	$0	$708	$189	12.41%
Utilities	$24	$1,455	$468	30.67%
Advertising	$0	$220	$22	1.43%
Miscellaneous	$0	$98	$16	1.04%
Total Expenses	**$105**	**$5,062**	**$1,524**	**100.00%**
Expense Category			**39.72%**	
Total Facilities Responding	42			
Total Number of Sites	6,250			
Avg Sites per Community	149			

Source: Compiled by Cushman & Wakefield

Certain expense categories will vary more significantly from region-to-region and property-to-property depending upon a variety of characteristics as illustrated in the above table. Utilities (specifically water and sewer which can reach 50 percent of total operating expenses), are typically the most significant overall expense and their reimbursement is an important management task. On and offsite management can also vary widely given many parks are owner operated. That said, it is a compensable item to be considered in the overall estimate. For more specific income and expense information regarding a particular market, please contact us at your convenience.

INVESTMENT ENVIRONMENT

Some investors are hopeful that recent apartment research correlates to manufactured housing communities. As an example, according to the Joint Center for Housing Studies of Harvard University and the U.S. Census, home ownership is forecast to decrease from 65.0 percent (August 2013) to 63.7 percent by 2015. This compares to the all-time high for home ownership of 69.5 percent in 2005 as well as the 25-year low of 63.5 percent in 1986. Additionally, the current home ownership rate for the 25-54 year-old age group is at the lowest point since recordkeeping began in 1976. Plus, homeowners with damaged credit who experienced foreclosures and tightened underwriting conditions have strengthened rental demand, which suggests an increase in demand for low cost alternatives like manufactured housing in the near term. This, coupled with the current wave of baby boomers reaching their retirement years, bodes well for both senior as well as all age communities over the coming years.

Furthermore, there is equity money new to the asset class. These crossover investors often have experience in apartments, but are interested in the cash flow benefits associated with manufactured housing which have remained strong during the downturn. Some view manufactured housing as an attractive investment alternative due to lower turnover in tenancy and less elasticity in rates and vacancy. Moreover, with higher rates of return than apartments, manufactured housing is attracting new equity capital, which has seen a limited resurgence over the past two years.

We contrasted the CoStar data with information obtained through our interviews of market participants. We asked the participants to give their opinion of the capitalization rates associated with the different types of manufactured housing communities. The following chart summarizes those findings.

INVESTOR SURVEY – CAPITALIZATION RATES MANUFACTURED HOUSING COMMUNITIES			
PARK RATING	SURVEY DATE	RANGE	AVERAGE
★	Q3 2013	8.50% - 11.00%	9.92%
	Q3 2012	9.00% - 11.50%	10.17%
★★	Q3 2013	8.00% - 10.50%	9.17%
	Q3 2012	8.00% - 10.50%	9.42%
★★★	Q3 2013	6.50% - 8.00%	7.42%
	Q3 2012	6.50% - 8.50%	7.75%
★★★★	Q3 2013	5.50% - 7.50%	6.75%
	Q3 2012	6.50% - 8.50%	6.83%
★★★★★	Q3 2013	5.00% - 6.50%	5.58%
	Q3 2012	5.00% - 7.50%	5.67%
Total Average	**Q3 2013**	**5.00% - 11.00%**	**7.77%**
	Q3 2012	**5.00% - 11.50%**	**7.97%**

Source: Compiled by Cushman & Wakefield Western, Inc.

As expected, the capitalization rates decrease as the park rating increases showing the premium placed on higher quality assets. The average range of rates has tightened up slightly from the third quarter 2012 to the end of the third quarter 2013 coupled with a lowering of the average capitalization rate. The data shown by CoStar reported that the average capitalization rate was 7.05 percent at the end of the third quarter 2013, 72 basis points below the average reported by our market participant survey. However, it should be noted that the survey average provides equal weight to each park rating type while the CoStar average includes only parks which traded during the 2013 calendar year.

Market participants noted that overall rates may have bottomed out due to the spike in interest rates from their historic lows in May 2013. Nevertheless, demand for the asset class remains strong with limited high quality inventory available which should curb any considerable upward pressure to overall capitalization rates over the coming year. That said, it is important to use the survey range as a general guide and remain focused on the economic and physical circumstances of the party property when assigning an overall capitalization rate.

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SUMMARY

The trend of manufacturers producing larger and more costly units and the lack of financing had reduced the affordability of manufactured housing. However, the traditional housing market continues to improve with higher pricing and reduced inventories, which have begun to increased demand for housing alternatives. Furthermore, financing by Fannie Mae, commercial mortgage-backed securities (CMBS), traditional banks, and life insurance companies have each increased year over year bringing much needed capital to the asset class. As such, the manufactured housing segment is poised to return to near pre-recession levels, evidenced by four consecutive years of shipment increases, continued capitalization rate compression and increased transactional velocity.

Land-lease community owners and operators must continue to monitor costs to sustain viability. Looking forward, the manufactured housing industry has potential to regroup and strengthen over time.

The manufactured housing industry has potential to regroup and strengthen over time.

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