MOBILE HOME PARK INVESTING

A HANDBOOK TO UNLOCKING THE POTENTIAL OF A NICHE ASSET CLASS

EVOKE CAPITAL

What Are Mobile Home Parks?

A Brief History

The origin of the mobile home park (MHP) dates back to the early 20th century with the proliferation of automobiles and an increasingly traveled highway system. As the popularity of recreational travel increased in the early 1900s, landowners began creating more parks and offered amenities to traveling Americans. Also referred to as trailer parks, these plots of land typically housed small travel trailers with wheels attached.

In the years before the Great Depression, these travel trailers were typically associated with mobility instead of affordable housing solutions. But as economic decline affected many Americans' standards of living, these trailers became a cheap form of housing that also touted the benefit of moving where work was available.

Later, World War II contributed significantly to developing more trailer parks as it provided a quick form of mass housing for defense workers. Post World War II, the population boom and housing shortage led to an even greater demand for quickly and easily constructed housing. As a result, trailer parks began being marketed as inexpensive, transitionary housing as single-family homes were being developed to meet growing demand.

In the 1950s, as demand for trailers continued to skyrocket, manufacturers started creating wider units associated with longer-term housing. Over the next three decades, these trailers would evolve into the familiar mobile home shape we see today.

The Homes and Communities of Today

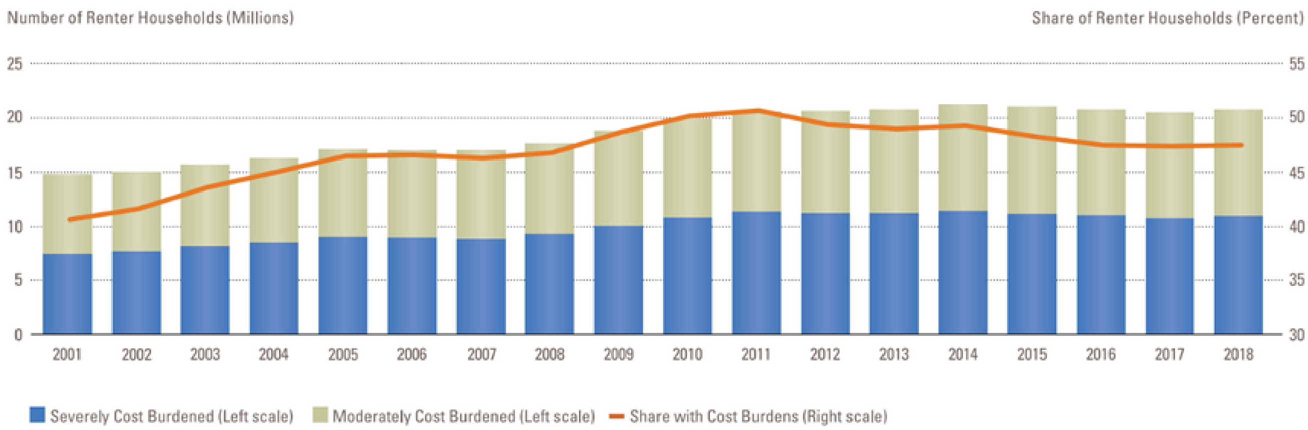
The quality of mobile homes has changed tremendously over the last few decades, so much so that many on the higher end are deemed "manufactured homes" instead of mobile homes. These mobile homes, or manufactured homes, are built off-site in a factory, then transported and affixed to mobile home parks. Compared to a traditional stick-built home, mobile homes are faster to build and far less expensive. On the open market, many mobile homes sell at a third or fourth of what single-family homes sell for and, despite the lower cost, boast of amenities similar to that of a typical home.

Mobile home parks, or manufactured housing communities, have come a long way from their origins as dirt lots for recreational travel trailers. Today's communities have amenities such as paved roads, street lights, municipal utilities, and clubhouses. Residents who own and place their mobile home in a community pay monthly lot rent and fees for community services.

The Current State of Mobile Home Parks

Demand Drivers

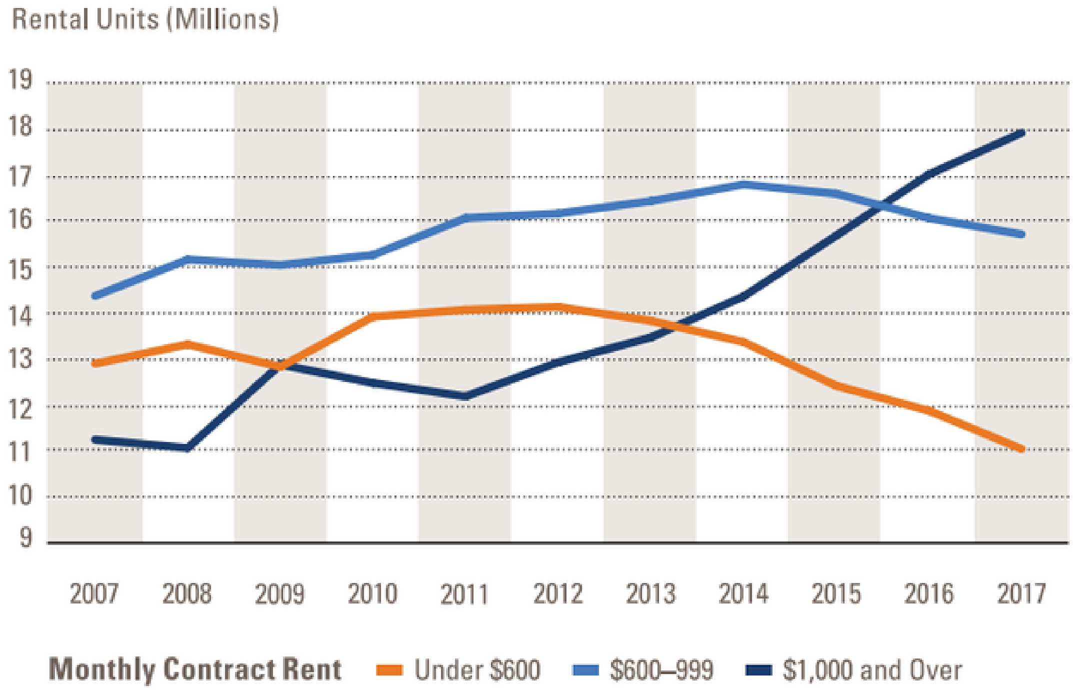
Both the Number and Share of Cost-Burdened Renters Remain Near Record Highs



Notes: Moderately (severely) cost-burdened households pay more than 30% (more than 50%) of their income for housing. Households with zero or negative income are assumed to have burdens, while households paying no cash rent are assumed to be without burdens.
Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates.

Americans are experiencing rapidly increasing living costs and a shortage of affordable, non-subsidized housing. For example, the National Low Income Housing Coalition states a deficit of over 7 million affordable homes for the 10.8 million extremely low-income families. In addition, the Joint Center for Housing Studies of Harvard University noted in their 2020 report that nearly half of renter households are moderately rent-burdened, spending more than 30 percent of their income on housing, while 40 percent of renter households are considered severely cost-burdened, spending more than 50 percent.

Strong Growth in High-Cost Rentals Has Coincided with Dramatic Declines in Low-Cost Units



Notes: Rental units may be occupied, vacant for rent, or rented but unoccupied; excludes units occupied without cash rent. Dollar values are adjusted for inflation using the CPI-U for All Items Less Shelter. Contract rent excludes all utilities paid separately.

Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates via IPUMS USA.

Given all the data that points to the apparent solution of developing more affordable units, private developers aren't doing so. The costs of labor and materials to build traditional apartments and homes makes it insensible to develop lower-rent units. As a result, developers have more incentive to create higher-priced units. With existing supply, many private real estate groups instead buy and renovate units to chase higher market rents. Between 2012 and 2017, the number of units renting for $1,000 or more shot up by 5 million, while the number of low-cost units under $600 fell by 3.1 million.

As costs rise and the affordable housing supply dwindles, more Americans will be forced to look for a form of housing with lower prices that still grants a similar quality of life.

Enter Mobile Homes

Mobile home parks offer the most affordable market-rate housing in many markets. Communities have monthly lot rent that is less than half the market rate for two-bedroom apartments. This land lease structure makes mobile home parks a unique form of housing. Residents experience the benefits of low-cost home ownership and pay low lot rents to community owners to keep common areas and utility connections.

Affordability brings residents to the mobile home park, and their ownership of the homes causes them to be long-term residents. Even if the nomenclature alludes to mobility, mobile homes don't often relocate after settling in a community due to high transportation costs and the resident's vested interest in staying in the community via home ownership. The Manufactured Housing Institute notes that over 60 percent of residents anticipate living in their homes for more than ten years, and 38 percent don't anticipate selling their homes.

A Diminishing Supply

Demand for mobile home parks has never been higher. There are an estimated 44,000 mobile home parks across the US, but the supply is diminishing. Many mobile home parks are shut down or redeveloped into apartment complexes, single-family home subdivisions, and commercial centers for several reasons.

The first is that land basis on which developers can acquire mobile home parks is low. Suppose the mobile home park operator keeps the land value low by keeping rents below market or failing to upgrade the park. In that case, there will come the point where a developer can acquire the mobile home park and repurpose it for a more profitable use. This is especially true in markets with growing populations and increasing economic development where affordable housing is needed the most.

The second reason for diminishing supply is that most municipalities have restrictive zoning regulations that prohibit the development of new mobile home parks. Because these communities often have a low basis, the city and county get less property tax revenue than a newly developed apartment building or retail center. There is an incentive from municipalities to repurpose land to its highest and best use. A mobile home park is often the most negligible revenue generating.

Another cause of the diminishing supply is when mobile home park operators mismanage their communities, causing them to be shut down for health and safety reasons. These operators are often the "mom and pop" owners who've become neglectful and tired of running their parks. They might also run out of cash reserves to upgrade the property, leading to infrastructure failures and hazards. Depending on the severity of the damage, some parks can still be salvaged, but many end up being shut down or sold to developers.

Mobile Home Parks as an Asset Class

Inelastic Demand, Recession Resilient, Downside Protection

Fundamentally, manufactured housing communities are supported by the inelastic demand caused by inflationary pressures and the severe shortage and underbuilding of affordable housing units. In the markets that Evoke Capital operates in, lot rents in manufactured housing communities take up less than 10 percent of the county reported household median income. On average, lot rents are less than half of what fair market rents are for two and three bedroom apartment units. To go a step further in demonstrating affordability, let's compare lot rents to government subsidized housing.

Across Evoke Capital's Midwest and Southeast communities, the 2022 Fannie Mae Area Median Income is between $65,000 to $90,000. If a four member family was earning 50 percent of the Area Median Income of $65,000 ($32,500), they would qualify for a rent ceiling of 30 percent of their annual income. That would be $32,500 x 30 percent = $9,750 in annual rent the family would have to pay. That's $812.50 per month of rent in a government subsidized housing unit. The lot rents in Evoke Capital's portfolio currently range between $300-$450 a month. There is simply no other asset class that offers rents this low while providing similar living amenities as apartments.

In times of prosperity, most market-rate housing stock gets renovated and repriced to capture mid-income households. Developers are incentivized to pursue higher-priced rental units as construction costs prevent them from creating non-subsidized units. Home prices also increase faster than wage growth. As a result, many lower-income households are chasing the dwindling supply of affordable units.

When economic conditions decline and consumers tighten spending, rent compression in higher-end living units causes a trickle-down effect that creates more demand for lower-priced units. This relocation of demand puts mobile home parks in a resilient position during recessions.

National trends continue to display a gap between the supply and demand for affordable housing. This gives mobile home parks a robust quality as they capture the large demographic of cost-burdened households. As a result, investors receive downside protection in their portfolios as mobile home parks perform well in both good and bad economic conditions.

Sticky Tenants

A unique attribute of mobile home parks is that the residents take on the qualities of both a renter and a homeowner. While a monthly lot rent is paid to lease the land, residents make a financial commitment to purchase and own their homes. Pride of ownership incentivizes residents to care more about what they own. In addition, the repair and maintenance responsibilities of the house are transferred to the resident.

Unlike apartments, mobile home parks experience lower turnover. Residents who commit to owning their homes in a community rarely move. The average mobile home park resident stays in a community for 15 years compared to 1.5 years in an apartment or single-family home. The hassle and decrease in turnover revenue and maintenance expenses are drastically reduced with resident-owned homes. Most operational and capital expenditures of owning a community are limited to the occasional upkeep of common areas and amenities.

But what happens when a resident moves? The most common outcome is that the resident sells their home and purchases another home at their new location. It makes little economic sense for residents to move their homes as there are high transportation costs and set-up fees (which can be north of $5,000-$10,000). On rare occasions, a resident may abandon their home. The typical procedure from the community owner is to file the necessary paperwork to claim title to that home. From there, the house can be marketed and sold to the next resident or replaced with a new home.

If default occurs, community owners initiate an eviction process. When a mobile home park resident gets evicted, their home is forfeited to the park. There is a vested interest from residents to consistently pay their lot rent in order to keep their mobile home. Compared to apartment renters, who live with more optionality and have no obligation to stay, mobile homeowners typically don't want to lose the investment in their homes. During the pandemic, many communities experienced default rates as low as 4 percent.

This combination of low operational and capital expenditures with a sticky tenant base gives manufactured housing communities a unique edge compared to other forms of rental real estate.

Value Add and Operations

Many mobile home parks are still inefficiently operated by individual "mom-and-pop" owners. Institutional capital represents only 23 percent of total communities. This lack of institutional competition gives private investors opportunities to acquire supply-constrained, cash-flowing assets and immediately capture value.

The most simple and common value add plays include landscaping, new signage, fencing and skirting repair, power washing and painting homes, road repair, removal of non-operational homes, utility bill back, and implementation of property management software. More operationally intensive plays include replacing private utility systems with city services and bringing new manufactured homes to vacant spaces.

Depreciation Benefits

Aside from producing high yields for investors, mobile home parks are tax-efficient assets that allow investors to keep more of their returns. Depreciation schedules for mobile home parks typically average 15 years compared to apartments at 27.5 years and commercial buildings at 39 years. Most of a park's taxable value comprises land improvements like roads and utility infrastructure. These can be depreciated at an accelerated schedule.

Keep in mind that capital gains and depreciation recapture tax would be owed when the park is sold but most likely at a lower rate than many investors' marginal tax bracket. This results in maximized after-tax net proceeds.

Higher Yields and Less Institutional Competitors

During times of interest rate hikes and economic uncertainty, investments generating positive cash flow reign supreme. Manufactured housing communities typically trade at higher capitalization rates (7-12%) than multifamily assets (5-6%). The combination of high going-in cap rates with low operational expenditures gives investors attractive cash-on-cash yields that outperform other multifamily investments.

With only three publicly traded REITs dedicated to manufactured housing, well-capitalized and experienced operators can generate significant returns in a fragmented industry. In addition, more minor, seasoned private investors can acquire inefficiently run parks, improve operations, upgrade the community, then sell them off at a premium to buyers who prefer to receive stabilized properties. Case in point: in August 2021, Evoke Capital purchased a mobile home park in Tuscaloosa, AL for $995,000. After improving the community, bringing lot rents closer to market, and stabilizing operations, the park sold for $1,400,000 in December 2022, giving investors north of a 60 percent internal rate of return and a 2.5x equity multiple.

But the doors are closing for private investors to acquire high-yielding mobile home parks as more sophisticated investors enter the scene. In recent years, large private equity groups like the Carlyle Group and Blackstone have started acquiring portfolios of manufactured housing communities. News of larger groups receiving these properties causes a trickle-down effect. As investor demand increases, cap rates will compress, and yields will become tighter. Many manufactured housing communities in the Western states are trading at cap rates identical to class A and B multifamily.

Investing With Evoke Capital

Evoke Capital focuses on acquiring manufactured housing communities located in growing markets where population is plentiful, employment sectors are diverse and strong, and political risk is minimal. Our portfolio consists of over 900 manufactured housing sites spread across 13 communities in Arizona, Kansas, Ohio, Indiana, Texas, Alabama, Georgia, and Pennsylvania.

If you're interested in investing or learning more about Evoke Capital,

go to www.evokecapital.net

and get in touch with us.

Pasha Esfandiary

pasha@evokecapital.net

evokecapital.net

EVOKE CAPITAL