



THE 5 MINUTE 'BACK OF THE NAPKIN' MHP ANALYSIS

Dear Fellow Investor & MHP Enthusiast,

As you might already know, there is no substitute for thorough underwriting and due diligence. Therefore, this quick guide serves only to give you the skill to very quickly identify if a subject park is worth taking 'a further look'. This guide may look long, but once you read through it, you'll see the actual mechanics of doing a 'back of the napkin' are quick and simple.

That also being said, each investor is a little different in how they approach risk, reward, and their overall business plan and investment thesis.

So, please, use this tool as a 'back of the napkin' review for when you are considering potential parks to purchase.

To your success,

Chris

The first few questions you will want to ask a seller or broker when reviewing an MHP/RVP:

- How many total developed lots does the park have?
 - Developed meaning, lots that have utilities currently ran to them
- How many of those lots are occupied with homes?
 - How many of those homes are owned by the owner of the park, aka park owned homes (POH)?
 - If the owner owns any homes, what are the general ages/conditions?
 - How many are owned by your tenants(TOH)?
 - How many of them are rent to own contracts(RTO)?
- What do they charge each resident for home rent?
- What do they charge residents for lot rent?
- How is water supplied to the park?
 - Either a private well or municipal/city water
 - Do they include water in the rent, bill it back to the tenant, or does the tenant pay the water company directly?
- How is sewer supplied to the park?

- Typically either municipal/city sewer, septic tanks, a waste water treatment plant, or a lagoon.
- Does the owner bill back for the sewer, does the owner include it in the rent, or does the tenant pay it directly to the utility company.
- Does each tenant pay their power bill directly to the power company, are their lots sub-metered, or do they include electric in the rent?
- Are there any other utilities supplied at the park to residents?
 - Such as gas, trash service, etc.
- What are the roads made out of?
 - Typically asphalt, concrete, dirt, gravel, or a mix
 - Does owner maintain the roads, or does the city?
- Who manages the park?
 - Usually self-managed, an off-site 3rd party, or an on-site manager which can be a professional company or a trusted park resident
- Are there any other expenses out of the ordinary?
 - Examples might include special taxes, if the park is in a flood zone and has to carry special flood insurance, an operating permit for a private utility system, etc.

MARKET SPECIFIC QUESTIONS / ITEMS YOU'LL WANT TO CONSIDER

These are items and pieces of information you'll usually gather up yourself or through a broker:

- What is the median home prices for the market?
 - Very low median home prices mean affordable housing isn't as in demand.
- What are the median incomes for the market?
 - Pay attention to median incomes to make sure people can afford your rents.
- What direction is population trending?
 - A couple of soft years in population growth are ok, but a market that has been consistently in decline for years could spell trouble. Obviously, you ideally want growth.
- What does the job market look like?
 - Does the town only have 1 major employer, or perhaps none?
 - Ideally you want a relatively diversified economy with jobs in inelastic industries such as defense, education, & healthcare.
 - Have jobs been leaving the market?
- How are the schools?
 - The schools don't all have to be A+, but if several are failing where your park is zoned that could be an issue.
- Is there high crime?
 - Is the town in general experiencing severe crime issues?

Now that you've made the determination the market itself is acceptable, take your data that you have gathered up about the park itself.

Let's use an example of a 50 site mobile home park that is 100% filled up, with no park owned homes.

You are going to:

- Multiple all of the occupied/paying lots by the lot rent.
 - So, if there are 50 sites all paying \$300/month in lot rent, you're looking at \$15,000/month gross assuming perfect collections from tenants.
 - Multiple that by 12 to get your annual gross income. In this example, you're looking at \$180,000/year in annual gross income.
 - In this example, we assume no park owned home income. I'll get to that in a second.
- Now that you have your gross income of \$180,000, you are going to use a different expense ratio based on the infrastructure of the park, namely, roads and utilities.
 - Use 30-35% if the park is on municipal/city utilities and the city maintains those utility lines plus the roads.
 - Use 35% if the park is on municipal/city utilities but the park owner maintains the roads and the residents are paying the utilities direct to the utility companies or being billed back by the owner at 100% recapture.
 - Use 40% if the park is on a well/septic system and the roads are maintained by the owner.
 - Use 45%+ if the park is on a well and a wastewater treatment plant or lagoon system, and the owner maintains the roads.
 - You may need to go higher than 50% if the park has severe issues and operational costs.
- Keep in mind, the industry standard is around 30-40% and a lot can affect that such as condition of utilities, condition of roads, what the owner is and isn't including in the rent, etc. Again, this isn't full underwriting.
- So, again using the 50 site park example, let's say it has municipal/city utilities and the owner has to maintain the roads which are in decent shape. So we'll use 35%.
 - $35\% \times \$180,000 = \$117,000$ in net operating income(NOI).
 - I usually shave off another few percentage points to account for missed rent payments too, and potential unforeseen costs, but that's up to you.
- Now we're going to put a cap rate on this park. If you don't know what a cap rate is, in short, it is essentially the return you would earn on the park if you were to pay all cash for it. An 'unleveraged return'.
 - You determine cap rate by dividing your NOI by the purchase price, which will yield a percentage.
 - You can reverse engineer that to by dividing the NOI by a desired cap rate to arrive a purchase price.
- Many investors don't pay attention to the cap rate if there is very quick value-add to be had, such as, increasing lot rents quickly after purchase.

- However, to be on the safe side, if you want to enter a deal with some cushion, you should consider purchasing parks at cap rates higher than what your debt service is going to be. Especially for newer investors in my opinion.
 - For example, if banks are loaning at 6.5% on average, to be on the safe side, you'd want to enter at least a 7% cap rate, and more is better.
- So, if you want to make an offer on this particular park at an 8% cap rate you would:
 - Divide that \$117,000 by 8%(0.08).
 - Yielding a price of: \$1,462,500, and price per site of \$29,250.
- It's important to note, cap rates are different for every market. It'd be tougher to find an 8% cap rate in an expensive market like Miami, Florida than a small town in the Midwest for example.
- Now, let's use this same example, but pretend half of the park has tenant owned homes just paying a lot rent of \$300/month, but the other half are park owned homes, where the owner rents the homes out too for a grand total of \$1,000 per unit.
 - Park owned home income is a controversial topic in the mobile home park space because many buyers do not like park owned homes, and some banks will not loan on the income from them, depending on the home.
 - However, it should be noted that park owned homes do deserve value assigned to them assuming that:
 - The homes are in reasonably good condition
 - They are not so old that their life expectancy is nearing the end
 - They are not located in a terrible market
 - The owner is able to rent them or has a track record of selling them
- There is more than one way to assign value to park owned homes:
 - You can assign a shell value to them. NADA is a resource where you can usually look this up.
 - For example, a 1990 Single Wide, etc. in XYZ market in fair condition would be worth between \$5,000-\$20,000
 - You can capitalize a portion of the income they are generating adjusting for higher expenses.
 - For example, this 1990 Single Wide, etc. in XYZ market in fair condition is generating \$1,000/month in rental income, so because the home is older and let's assume XYZ market is not so great and the condition is only fair, we'll capitalize \$400-\$500 of the income, assuming 50% expenses.
- There is a bit of art and science to this. Some investors will not count any POH income, others prefer POH income.
- **NOTE*** - If you are going to capitalize POH income, but then have plans to sell the homes, you need to be careful because if you are depending on that income to pay part of your note to the bank, and then you sell the home and lose that cash flow you are going to have to make that up somewhere.

- So, back to the example of our 50 lot park where 25 are POH.
 - Assume the market is decent and so are the homes and the owner's renting them for \$1,000.
 - You can either count a portion of that income, maybe 50% or so because remember your expenses will be much higher if you're dealing with park owned homes.
 - Or like we talked about you can find out the shell value, and base your offer on a portion of that value. I.e, home would likely sell for \$8,000, so you offer \$5,000 to adjust for carrying costs, transfer taxes, etc.
- So in our example, at \$5k per home, that'd be \$125,000 on top of the \$1,462,500 leaving you with \$1,587,500 to include the POHs.
- Now, if you can just purchase parks based on the real estate and lot rents, you're going to be in good shape. However, most owners are not going to throw in decent POH in good markets for free.
 - It will be difficult to come across a park in say Miami, Florida with new POHs in it where the owner is willing to sell the park on just lot rent value.
- So, now that you've done a quick 'back of the napkin' on this park, you determine that a fair price would be somewhere in the neighborhood of \$1,587,500 before doing any further due diligence or underwriting with true financials.
- If the owner is asking \$3m or the broker has it listed for that, you know that unless you're totally missing something, this park is overpriced.
- If the park is priced somewhere reasonably close to this figure though, even if it's higher, it's likely worth a further look using more financial analysis.

Remaining Notes to Consider:

- If you are truly buying a park to operate it as a park, don't get sucked into paying for land value. That is for developers who will change the use of the park. Yes, some day you may be able to repurpose the park, but that will be up to you.
- Vacant lots with no utilities on them whatsoever should not be assigned value
- Vacant lots with utilities on them but are not legally allowed to be filled in also deserve no value
- Always verify the park is legally compliant and has a valid operating permit
- For RTO contracts, unless you are in the business of buying and holding notes, you should not capitalize that income as it is finite. If you want to buy the notes too you can arrange that with a seller.
- While TOHs are not going to be your problem in terms of maintenance, it's important to note their age and condition. If they have a short lifespan, you may be filling that lot in sooner than you think. If you can't fill that lot in, the lot is small, or there's some restriction, you should take note of that.

Thanks for reading and I hope you found this useful!