To: Chair Representative Pam Marsh and Committee Members

RE: Comments and Testimony from Victor M. Baker in **Opposition** to HB 3054

My name is Victor M. Baker, and I am the Manager/Sole Member of Baker Mortgage Co., LLC, a mortgage brokerage firm located in Salem, Oregon. My company has been engaged in arranging permanent financing for the manufactured home community industry since its inception in 1983 and with particular emphasis on this niche market since 1990. I am an associate member of the Manufactured Housing Communities of Oregon since approximately 1992 and attend the organization's annual convention to provide market information to various owners, real estate brokers and appraisers.

I will limit my comments to the first provision of the bill wherein the intent is to change annual rent increases to not more than CPI. I have spoken with five lenders that I actively work with when arranging community financing to gauge their reaction to the proposed legislation contained in HB 3054. No lender is aware of the far-reaching scope of the proposed legislation and all lenders voiced similar concerns as to the effect on lending to this market. To understand the potential impact on lending, it is important to recognize some conventional underwriting techniques utilized by income property lenders.

- Lenders underwrite to current, in place rental income, there is no trending, forecasting or reliance on future rents.
- Lenders typically underwrite to in-place expenses, with some exceptions as noted below;
  - Renewal insurance premiums (current premium rather than previous year);
  - Property management;
  - Real estate taxes (unless a new tax roll has been released in which case the new amount is used);
  - Adjustments to market standards for soft expenses such as repairs and maintenance;
  - Inclusion of market standards for major capital improvements.
- This analysis produces Net Operating Income, commonly referred to NOI and represents property cash flow before debt service, amortization and depreciation.
- Debt Service Coverage Ratio (DSCR or DCR) represents the relationship of NOI to Debt Service (DS) and is expressed in a numeric fashion such as 1.25 and can range as high as 1.55. Higher DCR's produce lower loan amounts and represent either a more conservative lending philosophy or risk-based pricing incentives. Lenders utilize DSCR to calculate loan amounts for underwriting purposes.

There is a school of thought in the mortgage industry to analyze balloon risk for the proposed loan. Conventional loan terms usually utilize a 30-year amortization schedule for payment calculation and have a loan term of 10-years (balloon payment where balance must be paid off). Balloon risk is the ability of the property to generate sufficient NOI to qualify to refinance the mortgage balance. I spoke with one lender whose analysis includes balloon risk, and it can affect loan amount at origination (I have professional experience with this situation on a series of loans that closed in 2020). This analysis is especially prevalent in agency debt (Fannie or Freddie) as these loans are typically originated and sold post-closing to the secondary market as compared to bank portfolio loans where originated loans are held on the lender's balance sheet. It is worth noting that at the outset of COVID in 2020, Agency lending was still readily available while bank lending dried up (banks were fearful and uncertain of the future and agency loans had a ready and willing secondary market to buy the loans).

At present, there are significant upward adjustments occurring in the casualty insurance marketplace and owners are seeing double digit premium increases for the past few years. In addition, there are significant upward pressures on municipal utility rates for water, sewer and garbage, adding additional pressure to property operating results. If rent control limits rental income to CPI while expense increases are uncapped, it is easy to forecast declining NOI. Please do not construe this comment to suggest government should attempt to regulate expense controls, rather it is the opposite, that government should NOT regulate either component of income property ownership and rely on market conditions for sufficient corrective action.

If lenders become concerned about potential declining NOI, higher initial DCR's could be implemented into underwriting practices, reducing loan proceeds to property owners.

There is another issue that could come into play due to HB 3054. It is typical and commonplace that property owners execute loan agreements with affirmative and negative covenants as part of the loan documents. These covenants can include agreements to operate the property at specific DSCR's and require property owners to submit operating results at least annually or more frequently, if required. If rent control produces declining NOI below the covenant amount, lenders may categorize the asset as 'non-performing' even though timely payments are made. As I understand, if covenant breach continues, lenders may have the right to demand cash to pay the loan down to conform to covenants or reserve larger amounts of capital for potential loan loss. The second component has further negative consequences for lending. If regulating agencies force lenders to reserve more capital for loan loss, there is less capital available to deploy for new lending. Scarcity of lending capital would drive interest rates up as commercial real estate competes for funding in a finite global capital market. A further negative consequence would be that if lenders see declining NOI in a niche market property (MHC) in Oregon, it is reasonable to think that lenders will not be willing to lend into that market.

There are three arguments to recommend voting no on HB 3054. These arguments are summarized below:

1. Lender changes to underwriting protocol taking into account potential declining NOI during loan term.
2. Increased balloon risk analysis could lead to lower loan proceeds at origination.
3. Loan covenant defaults due to declining NOI could lead to adverse action by lender.

These arguments, when viewed in whole, could result in lenders exiting from the manufactured home community market in Oregon due to the perceived risk in the asset class. A lack of liquidity could produce a significant decrease in property values as owners choose to exit the market at all costs, further depreciating the asset value. I urge a **NO** vote on HB 3054.

Sincerely,

Victor M. Baker

Manager