Multifamily Selling and Servicing Guide

Effective as of August 1, 2019

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Chapter 12 Structured Adjustable Rate Mortgage (SARM) Loans

Section 1201 Description

Requirements

A SARM Loan is an ARM Loan with an external Interest Rate Cap.

Product Description	
Plan Numbers	• 03488 for 1-month LIBOR. • 03487 for 3-month LIBOR.
Term	5 to 10 years
Funding Type	MBS or cash
Index	1- or 3-month LIBOR
Interest Rate Floor	Must not be less than the combined • Guaranty Fee, plus • Servicing Fee, plus • investor spread.
Prepayment Availability	After a 1-year lock-out period, may be voluntarily prepaid per the selected prepayment option.
Minimum Loan Amount	$25 million
Interest Rate	Equals the • Index, plus • Guaranty Fee, plus • Servicing Fee, plus • investor spread.
Interest Rate Adjustment	• Occurs every 1 or 3 months depending on the Index. • Has no limit on number or size of rate changes.
Interest Rate Cap	Required for the entire term of theSARM Loan.

Product Description	
Amortization and Interest Accrual Method	Amortizes with fixed monthly principal installments based on a calculated actual/360 fixed rate payment.
Conversion to Fixed Rate	Permitted, with no prepayment penalty and minimal re-underwriting, between the 1st day of the 2nd Loan Year and the last day of the 4th month preceding the end of the Mortgage Loan term.
Rate Lock	• 45-day commitments. • No rate change may occur before Delivery.

Section 1202 Underwriting

Requirements

You must calculate the minimum underwritten DSCR based on an amortizing debt service constant.

Minimum Underwritten DSCR	
Variable Underwriting Rate	Equals: • the applicable 1-month LIBOR Index or 3-month LIBOR Index at the time of Rate Lock; plus • the Mortgage Loan margin equal to - the Investors required spread over the applicable 1-month LIBOR Index or 3-month LIBOR Index, plus - the Guaranty Fee, plus - the Servicing Fee; plus • a 3% interest rate spread; plus • a cap cost factor (seePart III, Chapter 12: Structured Adjustable Rate Mortgage (SARM) Loans, Section 1205.03: Including the Cap Cost Factor in the Variable Underwriting Rate of this Chapter for the cap cost factor calculation) if the Borrower does not purchase an Interest Rate Cap for the full term of the SARM Loan at loan origination.

Minimum Underwritten DSCR	
Debt Service Constant	Equals • the Variable Underwriting Rate, plus • the applicable amortization factor based on the Variable Underwriting Rate.

You must ensure that the maximum SARM Loan amount is the lowest of the amount:

- calculated applying the applicable minimum DSCR per Form 4660 for both the
  - Variable Underwriting Rate for the adjustable interest rate, and
  - Fixed Rate Test described in the Form 4660;
- calculated using the applicable maximum LTV Ratio per Form 4660;
- calculated using the minimum Cap Strike Rate, if set by Fannie Mae; and
- you determined is appropriate.

You must use the Fixed Rate Test interest rate to determine the UPB for the refinance risk analysis per Part II, Chapter 2: Valuation and Income, Section 203: Refinance Risk Analysis.

Guidance

The amortization used to underwrite the SARM Loan is different than the actual SARM Loan amortization schedule, which uses fixed monthly principal installments.

Section 1203 Actual Amortization Calculation

Requirements

You must amortize SARM Loans on a straight line basis over the total loan term. The amount of amortization due during the Mortgage Loan term is the same amount that would be due, in total, for a comparable fixed rate loan. When you calculate the amortization due, you must consider

- the loan term,
- amortization schedule,
- any interest only period, and
- the Pricing and Underwriting Tier.

To calculate SARM Loan amortization, you must use fixed rate pricing with an interest rate equal to:

- an indicative MBS investor yield; plus
- the lower of:
  - the lowest Guaranty Fee and Servicing Fee in the Pricing Memo for a hypothetical actual/360 fixed rate Mortgage Loan with the same loan term and Pricing and Underwriting Tier as the SARM Loan; or
  - the Guaranty Fee and Servicing Fee quoted by the Deal Team for a fixed rate Mortgage Loan when you request pricing for the SARM Loan.

Operating Procedures

1. You must obtain quotes for a hypothetical actual/360 fixed rate Mortgage Loan.

For example, for a SARM Loan with a 10-year loan term...	
Guaranty Fee quoted by Fannie Mae	0.95%
Servicing Fee quoted by Fannie Mae	+ 0.55%
US Treasury and investor spread (quoted by Fannie Mae or Third Party MBS Investor)	+ 4.00%
Gross Note Rate	= 5.50%

You must use the same 5.50% annual interest rate to calculate the amortization for the 10-year SARM Loan.

2. You must calculate the fixed monthly principal installment required over the term of the SARM Loan following these steps:

Step 1: Using an actual/360 interest accrual method, calculate the aggregate amortization amount that would be collected over the term of the SARM Loan based on the:

- principal amount of the SARM Loan;
- lowest applicable interest rate for a hypothetical actual/360 fixed rate Mortgage Loan with the same loan term, and Pricing and Underwriting Tier as the SARM Loan, rounded to 3 decimal places; and
- required amortization period.

Step 2: Divide the aggregate amortization amount determined in Step 1 by the number of amortizing monthly installments in the SARM Loan term. For example, the number of monthly installments would be:

- 60, for a 5-year amortizing Mortgage Loan;
- 84, for a 7-year amortizing Mortgage Loan;
- 120, for a 10-year amortizing Mortgage Loan; or
- 108, for a 10-year Mortgage Loan with 1 year of interest-only.

The result is the fixed monthly principal installment.

Example: Assume a 10-year Tier 2 fixed rate Mortgage Loan with a

- 5.500% per annum Gross Note Rate,
- 360-month amortization period, and
- $25 million loan amount.

Calculate the fixed monthly principal installment as follows:

Step 1: Calculate the aggregate principal amortization amount that would be collected over the term of the Mortgage Loan if it had a fixed rate.

Estimate the month and year in which the first full monthly loan payment would be made, based on an actual/360 amortization schedule. The total amount of amortization depends on both

- the number of days (i.e., 28, 29, 30, or 31) in the month prior to each loan payment date, and
- when the next leap year occurs.

Assuming

- a SARM Loan amount of $25 million,
- a 30-year amortization term,
- a debt service constant calculated using the Gross Note Rate of 5.500% (6.8134680% debt service constant),
- an actual/360 interest accrual method,
- an issue date of December 1, 2018, and
- a first loan payment date of January 1, 2019,

the aggregate amount allocated to principal over 120 payments is $4,114,494.17.

Step 2: Calculate the fixed monthly principal installment by dividing the aggregate amortization amount by the total number of amortizing payments during the SARM Loan term.

Calculate the fixed monthly principal installment...	
Aggregate amortization	$4,114,494.17
Divided by total payments	120
Equals fixed monthly principal	$34,287.45

Section 1204 Prepayment Terms

1204.01 Generally

Requirements

The following table describes various situations and the applicable prepayment provisions; see Part V, Chapter 2: Reporting and Remitting, Section 213: Prepayment Premium Sharing for Prepayment Premium calculations and sharing between you and Fannie Mae.

Situation	Prepayment Provisions
Borrower attempts to make a voluntary prepayment during the 1st Loan Year.	Borrower may not make a voluntary prepayment during the 1st Loan Year (i.e., a voluntary prepayment is locked out).
SARM Loan is accelerated during the prepayment lockout period.	Borrower owes a 5% Prepayment Premium.
Borrower makes a prepayment sometime after the 1st Loan Year and before the 3 months before Maturity Date for any reason other than a casualty or condemnation.	Borrower owes a Prepayment Premium.
SARM Loan converts to a fixed rate Mortgage Loan.	Borrower does not owe a Prepayment Premium.
Borrower makes a prepayment during the 3 months before the Maturity Date.	Borrower does not owe a Prepayment Premium.
Borrower makes a prepayment due to casualty or condemnation.	Borrower does not owe a Prepayment Premium.

1204.02 Prepayment Option 1 – Declining Prepayment Premium Schedule

Requirements

For a voluntary prepayment after the 1-year lockout period using Prepayment Option 1, you must use Schedule 4 of the Multifamily Loan and Security Agreement - Prepayment Premium Schedule (Graduated Prepayment Premium – ARM, SARM) (Form 6104.10) with the applicable Prepayment Premium percentage listed in this table.

Loan Year	5-Year Term	7-Year Term	10-Year Term
1 (Locked Out)[1]	N/A	N/A	N/A
2	4%	4%	4%
3	3%	3%	3%
4	2%	2%	2%
5	1%	1%	1%
6	N/A	1%	1%
7	N/A	1%	1%
8	N/A	N/A	1%
9	N/A	N/A	1%
10	N/A	N/A	1%
1During the lockout period, the Borrower may not voluntarily prepay the SARM Loan. If the SARM Loan is accelerated during the lockout period, the Borrower owes a 5% Prepayment Premium.			

1204.03 Prepayment Option 2 - 1% Prepayment Premium Schedule

Requirements

For a voluntary prepayment after the 1-year lockout period using Prepayment Option 2, you must use Schedule 4 to Multifamily Loan and Security Agreement (Prepayment Premium Schedule-1% Prepayment Premium – ARM, SARM)(Form 6104.11) to document the required 1% Prepayment Premium.

Loan Year	5-Year Term	7-Year Term	10-Year Term
1 (Locked Out)[1]	N/A	N/A	N/A
2	1%	1%	1%
3	1%	1%	1%

Loan Year	5-Year Term	7-Year Term	10-Year Term
4	1%	1%	1%
5	1%	1%	1%
6	N/A	1%	1%
7	N/A	1%	1%
8	N/A	N/A	1%
9	N/A	N/A	1%
10	N/A	N/A	1%
1During the lockout period, the Borrower may not voluntarily prepay the SARM Loan. If the SARM Loan is accelerated during the lockout period, the Borrower owes a 5% Prepayment Premium.			

Section 1205 Interest Rate Caps

Requirements

Description	
Interest Rate Cap	Borrower must purchase a third-party Interest Rate Cap.
Interest Rate Cap Provider	Borrower must only obtain bids from providers approved by Fannie Mae as listed onwww.fanniemae.com/multifamily.
Interest Rate Cap Documentation	Must be on forms that are acceptable to Fannie Mae.
Minimum Interest Rate Cap Term	5 years. The Borrower must keep an Interest Rate Cap Agreement in place continually until the earlier of the • effective date of any permitted conversion to a fixed rate Mortgage Loan,or • Maturity Date of the SARM Loan.
Replacement Cap	You must ensure that the Borrower purchases a replacement cap if the Interest Rate Cap term expires before the conversion or Maturity Date of the SARM Loan.

Description	
Cap Cost Factor	Equals the cost of a replacement cap divided by the initial cap term.
Interest Rate Cap Reserves	Borrower must fund a cash reserve sufficient to purchase a replacement cap if the Interest Rate Cap term expires before the Maturity Date of the SARM Loan.
Cap Contract Process and Documentation	You must deliver all cap-related documentation to Fannie Mae, including the • Interest Rate Cap Agreement, and • Interest Rate Cap Reserve and Security Agreement (Form 6442). Fannie Mae will engage outside counsel at your expense to review all cap-related documentation.
Initial Interest Rate Cap Notional Amount	Notional amount of the initial Interest Rate Cap throughout its term must equal the original principal amount of the SARM Loan.

Guidance

You may require the Borrower to:

- pay Fannie Mae's costs, including legal fees; and
- fund a reserve for the payment of these expenses.

1205.01 Replacement Interest Rate Cap

Requirements

If the initial Interest Rate Cap expires before the Maturity Date of the SARM Loan, you must ensure that:

- The Borrower purchases a replacement Interest Rate Cap to cover the remaining term.
- The notional amount of any replacement cap equals the outstanding principal balance of the SARM Loan when the replacement cap becomes effective, and continues throughout the term of the replacement cap.
- The term of the replacement cap equals the remaining term of the SARM Loan, or a shorter term if previously approved and documented in the

Loan Documents.

- The Cap Strike Rate of the replacement cap is equal to or less than the Cap Strike Rate at Mortgage Loan origination (see Part III, Chapter 12: Structured Adjustable Rate Mortgage (SARM) Loans, Section 1205.02: Determining the Cap Strike Rate).

Guidance

The Borrower may purchase an Interest Rate Cap in advance if

- the initial cap goes into effect on the Mortgage Loan Origination Date, and
- the replacement cap goes into effect on the Maturity Date of the initial cap.

1205.02 Determining the Cap Strike Rate

Requirements

You must determine the maximum Cap Strike Rate. The sum of the following must not be greater than the rate (calculated using an underwritten debt service constant that includes amortization) that produces the minimum required Underwritten DSCR for the Pricing and Underwriting Tier of the SARM Loan:

- Cap Strike Rate; plus
- Guaranty Fee; plus
- Servicing Fee; plus
- investor spread; plus
- the higher of a cap cost factor (see Part III, Chapter 12: Structured Adjustable Rate Mortgage (SARM) Loans, Section 1205.03: Including the Cap Cost Factor in the Variable Underwriting Rate) or actual Interest Rate Cap escrow deposits, if an interest rate cap for the full term of the Mortgage Loan is not purchased at closing.

You must ensure that the Cap Strike Rate at which the Borrower purchases any replacement cap is not greater than the Cap Strike Rate at which the initial cap was purchased.

Guidance

If the Borrower purchases an Interest Rate Cap with a Cap Strike Rate less than the maximum rate, then any replacement cap may still be purchased at a Cap Strike Rate that is less than or equal to the maximum rate.

You may calculate the initial Cap Strike Rate based on an interest-only underwritten debt service constant if the approved interest-only term is greater than or equal to the initial Interest Rate Cap term.

1205.03 Including the Cap Cost Factor in the Variable Underwriting Rate

Requirements

When determining the Variable Underwriting Rate used to calculate the minimum required Underwritten DSCR, you must include a cap cost factor based on the term of the SARM Loan and the term of the initial Interest Rate Cap.

You do not need to include a cap cost factor if the term of the initial Interest Rate Cap equals the term of the SARM Loan.

You must ensure that the cap cost factor equals

- the estimated cost of the replacement cap (when the term of the initial cap expires), divided by
- the term of the initial cap.

Operating Procedures

For example, to calculate the cap cost factor assuming a 5-year Interest Rate Cap and 7-year SARM Loan term:

- You must include an annual cap cost factor in the Variable Underwriting Rate.
- If the SARM Loan term is 7 years and an initial cap is purchased for a 5-year term, the cap cost factor equals the estimated cost of a replacement cap divided by 5 (the number of years of the initial interest rate term).
- The replacement cap has a 2-year term and a Cap Strike Rate equal to that of the initial cap.
- If a 2-year Interest Rate Cap at the initial Cap Strike Rate costs 20 basis points, you must divide 20 by 5, then add the result (4 basis points) to the Variable Underwriting Rate.

1205.04 Establishing Interest Rate Cap Reserves

Requirements

You must ensure that the Borrower has a cash reserve to purchase a replacement Interest Rate Cap if the term of the initial Interest Rate Cap is less than the term of the SARM Loan.

If the initial Interest Rate Cap Agreement has a term of 5 years, the Borrower must fund the cash reserve with each monthly Mortgage Loan payment during the term.

If the initial cap has a term of more than 5 years, the Borrower's monthly reserve payments for a replacement cap must start no later than 5 years before the existing cap expires.

You must calculate the monthly reserve payments for the first 12-month period using the estimated cost of the replacement Interest Rate Cap.

Guidance

Assuming that a 5-year Interest Rate Cap is initially purchased for a SARM Loan with a 10-year term, if

- the initial cap is purchased with a 6.50% Cap Strike Rate, and
- the cost of a replacement 5-year cap with a 6.50% Cap Strike Rate is $250,000,
- then the monthly reserve for the first 12-month period would be $4,166.67 ($250,000 cost ÷ 60 months).

1205.05 Interest Rate Cap Contract Documentation and Delivery

Operating Procedures

1. Cap Provider Payment

The Interest Rate Cap provider must make a payment directly to you if, on the 1st day of the month corresponding with the monthly loan payment dates of a LIBOR-based SARM,

- the 1-Month Index for a 1-month SARM Loan exceeds the Cap Strike Rate for a monthly settlement, or
- the 3-Month Index for a 3-month SARM Loan exceeds the Cap Strike Rate for a quarterly settlement.

Only disburse a provider payment to the Borrower if

- there is no Mortgage Loan default, and
- you have received all payments due under the Note for that month.

2. Timing

The Borrower must accept a bid for the initial Interest Rate Cap in writing from a Fannie Mae approved provider before you Deliver the SARM.

You must give Fannie Mae copies of all cap-related documentation when you deliver the SARM Loan.

3. Purchase Price

The Borrower must pay the entire purchase price for an Interest Rate Cap to the provider when the Interest Rate Cap Agreement is issued.

4. Pledge to Fannie Mae

The Borrower must execute Form 6442 to pledge its interest in the Interest Rate Cap and any reserve to Fannie Mae, as additional collateral for the SARM Loan.

Glossary

B

Borrower	Person who is the obligor under the Note. **Synonyms** • Borrowers • Borrower's

C

Cap Strike Rate	Maximum specified Index interest rate that will trigger a payment obligation by the Interest Rate Cap provider.

D

Delivery	Meeting all of the data delivery requirements in Part IV A, Chapter 4: Delivery Procedures – Data, and submitting an acceptable Mortgage Loan Delivery Package per Part IV A, Chapter 5: Delivery Procedures – Documents. A Mortgage Loan is “Delivered,” when all documents, data, and information are correct, accurate, and able to be certified by Fannie Mae, with all required documents properly completed, executed, and recorded (if applicable), and any deficiencies are resolved to Fannie Mae’s satisfaction. **Synonyms** • Deliver • Delivered • Deliveries

F

Form 4660	Multifamily Underwriting Standards identifying Pre-Review Mortgage Loans and containing the minimum underwriting requirements (e.g., debt service coverage ratio, loan to value ratio, interest only, underwriting floors, etc.) for all Mortgage Loans. **Synonyms** • Multifamily Underwriting Standards

G

Gross Note Rate	Interest rate stated in the Loan Documents.
Guaranty Fee	Fee retained by Fannie Mae for credit enhancing a Mortgage Loan or assuming credit risk on a Mortgage Loan. **Synonyms** • Guaranty Fees

I

Index	Basis for determining the Gross Note Rate of an ARM Loan.
Interest Rate Cap	Interest rate agreement between the Borrower and a hedge provider for which the Borrower receives payments at the end of each period when the interest rate exceeds the Cap Strike Rate. The Interest Rate Cap provides a ceiling (or cap) on the Borrower's interest payments on the Mortgage Loan. **Synonyms** • Interest Rate Hedge • Interest Rate Hedges • Interest Rate Swap

Interest Rate Cap Agreement	Contract setting forth the terms and conditions of an Interest Rate Cap, Hedge, or Swap. **Synonyms** • Interest Rate Hedge Agreement • Interest Rate Swap Agreement

L

LIBOR	London Interbank Offered Rate is the benchmark interest rate banks quote to lend funds to one another in the international interbank market for short-term loans, or as replaced by an alternative Index determined by Fannie Mae.
Loan Documents	All documents evidencing, securing, or guaranteeing the debt obligation executed for a Mortgage Loan and approved by Fannie Mae. **Synonyms** • Loan Document • Mortgage Loan Document • Mortgage Loan Documents
Loan Year	Period beginning on the date of the Note and ending on the last day of the month that is 12 full months after the date of the Note, and each successive 12-month period thereafter.

M

Maturity Date	Date all amounts due and owing under the Mortgage Loan become fully due and payable per the Loan Documents. **Synonyms** • Maturity Dates
MBS	Mortgage-Backed Security

Mortgage Loan	Mortgage debt obligation evidenced, or when made will be evidenced, by the Loan Documents or a mortgage debt obligation with a Fannie Mae credit enhancement. **Synonyms** • Mortgage Loans
Mortgage Loan Origination Date	Date the Lender funds a Mortgage Loan to the Borrower. **Synonyms** • Mortgage Loan's Origination Date • Origination Date

N

Note	Current instrument evidencing a Mortgage Loan obligation, including Form 6010 series, any other note approved by Fannie Mae, and all applicable addenda, schedules, and exhibits. **Synonyms** • Notes

P

Prepayment Premium	When a Mortgage Loan prepayment is made, amount required to be paid by the Borrower in addition to the principal amount being prepaid and accrued interest per the related Loan Documents. **Synonyms** • Prepayment Premiums
Pricing and Underwriting Tier	Tier 1, Tier 2, Tier 3, or Tier 4 per the Multifamily Underwriting Standards (Form 4660).

Pricing Memo	Applicable DUS Pricing Memo or non-DUS Pricing Memo communicating pricing for various products and features to Lenders. **Synonyms** • Pricing Memos

R

Rate Lock	Agreement between the Lender and the Investor containing the terms of the Lender-Arranged Sale or Multifamily Trading Desk trade of the Mortgage Loan and the MBS terms and conditions relating to the underlying MBS, if applicable, which may be documented via a recorded telephone conversation. **Synonyms** • Rate Locks

S

Security	MBS, PFP MBS, or REMIC.
Servicing Fee	Fee a Servicer receives for collecting payments, managing operational procedures, and assuming Lender's portion of credit risk for a Mortgage Loan. **Synonyms** • Servicing Fees

T

Third Party MBS Investor	MBS Investor for an MBS Mortgage Loan that is not the Multifamily Trading Desk.

U

UPB	Unpaid Principal Balance

V

Variable Underwriting Rate	Rate for Structured ARM Mortgage Loans per Part III, Chapter 12: Structured Adjustable Rate Mortgage (SARM) Loans, Section 1202: Underwriting.