



Fannie Mae®

Multifamily Selling and Servicing Guide

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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 on https://multifamily.fanniemae.com .
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 <ul style="list-style-type: none">• 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.
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.



Description	
Cap Contract Process and Documentation	<p>You must deliver all cap-related documentation to Fannie Mae, including the</p> <ul style="list-style-type: none">• Interest Rate Cap Agreement, and• applicable Interest Rate Cap Reserve and Security Agreement (Form 6442 series). <p>Fannie Mae will engage outside counsel at your expense to review all cap-related documentation.</p>
Initial Interest Rate Cap Notional Amount	<p>Notional amount of the initial Interest Rate Cap throughout its term must equal the original principal amount of the SARM Loan.</p>

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 6-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 6-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 date, the 30-Day Average SOFR Index exceeds the Cap Strike Rate for a monthly 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 Loan.

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 the applicable Interest Rate Cap Reserve and Security Agreement ([Form 6442 series](#)) to pledge its interest in the Interest Rate Cap and any reserve to Fannie Mae, as additional collateral for the



SARM Loan.



Glossary

3

30-Day Average SOFR Compounded average of SOFR over a specified interest period of 30 days.

B

Borrower Person who is the obligor per 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.

G

Guaranty Fee Fee retained by Fannie Mae for credit enhancing a Mortgage Loan or assuming credit risk on a Mortgage Loan, and which may be expressed as a percentage.

Synonyms

- Guaranty Fees

I

Index Basis for determining the Gross Note Rate of an ARM Loan, including any required alternative index that may be determined necessary by Fannie Mae because the Index is no longer widely accepted or has been replaced as the index for similar financial instruments.



Interest Rate Cap

Interest rate agreement between the Borrower and a 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 Mortgage Loan interest payments.

Synonyms

- Interest Rate Caps
- 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

Investor

MBS Investor for an MBS Mortgage Loan, or Fannie Mae for a Cash Mortgage Loan.

Synonyms

- Investors
- Investor's

L

Loan Documents

All Fannie Mae-approved documents evidencing, securing, or guaranteeing the Mortgage Loan.

Synonyms

- Loan Document
- Mortgage Loan Document
- Mortgage Loan Documents

M



Maturity Date Date all Mortgage Loan amounts become fully due and payable per the Loan Documents.

Synonyms

- Maturity Dates

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's

Mortgage Loan Origination Date Date you fund a Mortgage Loan to the Borrower.

Synonyms

- Mortgage Loan's Origination Date
- Origination Date

N

Note Instrument evidencing a Mortgage Loan obligation, including

- Form 6010 series,
- any other Fannie Mae-approved note, and
- all applicable
 - addenda,
 - schedules, and
 - exhibits.

Synonyms

- Notes

P



Pricing and Underwriting Tier

Tier 1, Tier 2, Tier 3, or Tier 4 per the Multifamily Underwriting Standards (Form 4660).

Synonyms

- Tier

S

Security

MBS, PFP MBS, or REMIC.

Synonyms

- Securities

Servicing Fee

Fee a Servicer receives for collecting payments, managing operational procedures, and assuming your portion of credit risk for a Mortgage Loan, and which may be expressed as a percentage.

Synonyms

- Servicing Fees

V

Variable Underwriting Rate

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