



# Multifamily Selling and Servicing Guide

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## 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 ( $\$250,000 \text{ cost} \div 60 \text{ months}$ ).



# 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.

## I

**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

## M



## 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