Fannie Mae®

Multifamily Selling and Servicing Guide

Effective as of November 25, 2019

Fannie Mae®

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Summary of Changes

HIGHLIGHTS
Effective **November 25, 2019**, Fannie Mae is increasing the minimum Credit Facility transaction size to $100 million. In addition, for Rent-Stabilized Properties, Fannie Mae is also: • providing new underwriting guidance; and • updating the Small Mortgage Loan requirements for - Key Principal Guaranty Obligations, - Underwritten Net Cash Flow (Underwritten NCF), - Property Condition Assessments (PCAs), - Replacement Reserves, and - Financial Statements.

Changes

The minimum Credit Facility transaction size is increasing from $55 million to $100 million.

The new Rent-Stabilized Properties section in Part II, Valuation and Income, provides guidance for

- underwriting Property income,
- preparing refinance risk analyses,
- determining the Underwriting Value,
- reviewing fund Sponsors, and
- funding Replacement Reserves.

For Small Mortgage Loans:

- Key Principal Guaranty Obligation: You must obtain a Non-Recourse Guaranty from each Key Principal for any Small Mortgage Loan.
- Underwritten NCF: You must deduct owner-occupied units as an expense unless the Mortgage Loan is Tier 3 or Tier 4, or the Property contains 24 or more units.
- PCAs: You must require a PCA if Replacement Reserves are required.
- Replacement Reserves: You must require full or alternative funding of Replacement Reserves for any Tier 2 Small Mortgage Loan not located in an Eligible MSA, or on a Rent-Stabilized Property located in the New York-Newark-Jersey City, NY-NJ-PA MSA.
- Financial Statements: Clarified the wording to align with the financial requirements in Part I, Chapter 3. You must obtain a schedule of owned real estate assets and signed financial statements.

Questions

Please contact your Deal Team with any questions.

Chapter 2 Valuation and Income

Section 201 Market and Valuation

201.01 Market Analysis

Requirements

You must:

- Evaluate the Property's market area, identifying its strengths and weaknesses.
- Take these characteristics into account when structuring the Mortgage Loan.

201.02 Appraisal

Requirements

You must obtain an Appraisal that:

- is prepared by a qualified, state-licensed or -certified appraiser;
- conforms to the requirements in the USPAP; and
- meets any governmental regulations in effect when the Mortgage Loan was originated, including the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

201.02A Appraiser Role and Qualifications

Requirements

You must:

- Provide the appraiser with all documents needed to accurately assess the value of the Property.
- Ensure the appraiser:
  - provides a complete, accurate description of the Property and the market;
  - provides an opinion of the market value of the Property, supported by market data, logical analysis, and sound professional judgment; and
  - uses an industry standard form of Appraisal that is appropriate for

the size and structure of the Mortgage Loan.

When selecting an appraiser, you must document that the appraiser is licensed or certified, as appropriate, under applicable state law.

When using an appraiser, you must ensure that the appraiser (whether third-party or in-house):

- Acts independently.
- Does not participate in the Mortgage Loan approval.
- Is not a member of the loan origination or underwriting staff.

201.02B Valuation Date

Requirements

You must update any Appraisal if the Appraisal Date is more than 6 months before the Commitment Date.

If the Appraisal Date is more than 12 months before the Commitment Date, then a new Appraisal of the Property is required.

Guidance

For an Appraisal that is dated less than 12 months before the Commitment Date, you may have the appraiser provide an update that complies with USPAP guidelines, dated within 6 months of the Commitment Date.

201.02C Appraised Value

Requirements

You must ensure that the appraiser provides an opinion of the market value of the Property on an “as is” basis.

You may also request that the appraiser provide an opinion of the market value of the Property on an “as completed” basis, but you must only use an “as completed” Appraisal for the opinion of Appraised Value if all of the following conditions apply:

- less than 12 months have passed between when the Borrower acquired the Property and the Commitment Date;
- for any capital improvements made after the Mortgage Loan Origination Date to be considered in an “as completed” Appraisal,

they must be:

- Immediate Repairs listed in the PCA; or
- improvements identified by the Borrower, if you concur that the improvements will add value to the Property;

- all capital improvements are included in either the Completion/Repair Agreement or the Rehabilitation Reserve Agreement;
- sufficient funds to complete all capital improvements are deposited into either the Completion/Repair Escrow or the Rehabilitation Reserve Account:
  - for capital improvements identified as Immediate Repairs, the funds must cover any higher funding percentage you require; and
  - for capital improvements identified by the Borrower, the funds must cover the estimated cost (including an allowance for cost overruns); and
- all capital improvements are required to be completed in a timely manner:
  - those identified by the Borrower must be completed within 12 months after the Mortgage Loan Origination Date; and
  - for others identified as Immediate Repairs, a shorter time period may be required by Part II, Chapter 4: Inspections and Reserves, Section 403: Completion/Repairs.

201.03 Underwriting Value

Requirements

Your Underwriting Value must not exceed the Appraised Value, as reduced by any adjustments you deem necessary to account for property deficiencies that cannot be cured within 6 months after the Appraisal Date.

If less than 12 months have passed between the Borrower's acquisition of the Property and the Commitment Date, your Underwriting Value must not exceed the lower of

- the Appraised Value, or
- the sum of:
  - the Property acquisition price;
  - the cost of capital improvements or repairs which increase the

value of the Property, if

  - they are completed and fully paid, or
  - sufficient funds to complete them are deposited in an escrow or reserve account; and

- actual acquisition costs, not to exceed 3% of the acquisition price, such as:
  - loan origination fees;
  - appraisal fees;
  - title search fees;
  - title insurance fees;
  - survey fees;
  - taxes;
  - deed-recording fees; and
  - credit report charges.

Section 202 Income Analysis

202.01 Underwritten Net Cash Flow (Underwritten NCF)

Guidance

Underwritten NCF may differ significantly across assets and will be driven by circumstances particular to the Property. Therefore, when calculating the Underwritten NCF, you should:

- Use both objective and subjective measures to determine the revenue generated and the expenses incurred at the Property.
- Use the best information available, including historical Property performance and anticipated Property operations.
- Use your best efforts to obtain operating statements for the previous 3 years.
- Obtain the prior full-year operating statement or, at a minimum, an operating statement covering the trailing 6 months (annualized).
- Consider whether the Property can achieve the Underwritten NCF within 12 months after the Mortgage Loan Origination Date, absent unexpected market conditions or other unforeseen events.

You may:

- Rely, for acquisitions only, on the Borrower's budgeted operating statements.
- Calculate the Underwritten NCF more conservatively, if warranted by circumstances particular to the Property.

Requirements

You must use the following table to calculate Underwritten NCF for all Mortgage Loans unless another table is provided in the applicable Part III chapter based on the specific product.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
CALCULATION OF NET RENTAL INCOME		
1		GROSS RENTAL INCOME – actual rents in place for occupied units, plus market rents for vacant units based on a current rent roll (multiplied by 12). The Property must have Stabilized Residential Occupancy by Qualified Tenants.
2	PLUS	To the extent deducted as an operating expense, rents for other non-revenue units (e.g., model units deducted in the “model apartment” operating expense in the “general and administrative” category, or actual rent from employee units deducted in the “employee” operating expense in the “payroll and benefits” category).
	EQUALS	GROSS POTENTIAL RENT (GPR)
3	MINUS	Premiums (e.g., identifiable additional income from furnished units or short term leases) and/or corporate premiums (e.g., identifiable additional income from corporate units, housekeeping services, etc.).

4	MINUS	Physical vacancy – market rents for vacant units based on a current rent roll (multiplied by 12).[1]
5	MINUS	Concessions - the aggregate amount of forgone residential rental income resulting from incentives granted to tenants for signing leases, such as free rent for 1 or more months, move-in allowance, etc.[1]
6	MINUS	Bad debt - the aggregate amount of unpaid rental income determined to be uncollectable: include any adjustments to other Income for bad debt.[1]
	EQUALS	NET RENTAL INCOME (NRI)[2]
1 The total of Items 4, 5, and 6 must equal the greater of • the difference between the trailing 3-month net rental collections (annualized) and GPR, or • 5% of GPR. 2 NRI must reflect projected operations for the underwriting period. a. You must assess the NRI using these parameters and fully support any changes: • Assess the individual month NRI within the prior full-year operating statement or, at a minimum, an operating statement covering at least the trailing 6 months (annualized). • If there are fluctuations, you may use an NRI that exceeds the trailing 3-month NRI, as long as the NRI does not exceed the highest 1-month NRI used in the trailing 3-month NRI calculation. b. You must assess declines in NRI using these parameters: • Assess whether there was any decline in NRI for the trailing 3-month period compared to the trailing 6-month period and the trailing 12-month period. • If the decline in NRI for the trailing 3-month period is greater than 2% compared to either the trailing 6-month period or the trailing 12-month period, you must adjust downward the NRI to an amount that is 2% less than the lowest NRI for the trailing 1-month, 3-month, 6-month, or 12-month period. • You must make a minimum 2% adjustment to NRI; however, you are expected to make additional downward adjustments as appropriate to reflect current market conditions not reflected in historical operations.		
CALCULATION OF OTHER INCOME		

7	PLUS	Actual other income (except premiums and corporate premiums) generated through ongoing operations. The income must: • be stable; • be common in the market; • exclude one-time extraordinary non-recurring items; and • be supported by prior years. You must assess the individual month other income within the prior full-year operating statement or, at a minimum, an operating statement covering at least the trailing 6 months (annualized). If there are fluctuations, you may use other income that exceeds the trailing 3-month other income (annualized), as long as it does not exceed the highest 1-month other income used in the trailing 3-month other income calculation. When determining the other income, you must • adjust Items 8 through 12, and • include specific income for Items 13 through 15 when applicable.
CALCULATION OF COMMERCIAL INCOME		
8	PLUS	Actual income from occupied commercial space (and parking revenue for commercial spaces, if applicable).
9	PLUS	Actual income from STR units.
10	MINUS	10% of the actual commercial income (total of Items 8 plus 9).[3]
3 If net commercial income is greater than 20% of EGI, then reduce to 20% of EGI.		

11	PLUS	Premiums, provided that the income must: • be stable or increasing; • be typical (in type and amount) in the market; • be supported by prior years; and • not exceed the income generated over the most recent year or trailing 12-month period.
12	PLUS	Corporate premiums, provided that this income must: • not be included for more than 10% of the Property's units; • be stable or increasing; • be typical (in type and amount) in the market; • be supported by prior years; and • not exceed the income generated over the most recent year or trailing 12-month period.
13	PLUS	Laundry and vending.
14	PLUS	Parking - income from residential parking/garage spaces.

15	PLUS	All other income, include the following: • application fees; • cable; • club house rental; • fees charged tenants for returned checks due to insufficient funds (NSF); • forfeited security deposits; • ~~insurance proceeds (rent loss only);~~ • late fees; • miscellaneous; • non-refundable fees; • pet fees; • reimbursements; • storage; • temporary tenants; • utility; and • other. The following must not be included: • corporate tax and refunds; • delinquency; • Financial Accounting Standards Board 13 straight-line lease income; • gain on sale; • insurance proceeds~~ (except rent loss)~~; • interest income; • interest on security deposits; • mobile home sales; • partnership funds received; • sales tax collected; • security deposits collected; • security deposits returned; • straight-line lease income; and • tax reimbursement from real estate taxes.
	EQUALS	EFFECTIVE GROSS INCOME (EGI)
CALCULATION OF OPERATING EXPENSES		

16	MINUS	Line-by-line stabilized operating expenses. Stabilized operating expenses are the expenses during normal ongoing Property operations, not affected by a lease-up, rehabilitation, or other short-term positive or negative factors. Non-recurring, extraordinary expenses must not be included. You must assess: • past operating history; • the appraiser's expense analysis; • all information available to you (including Property contracts, utility bills, real estate tax assessments, insurance policies, and comparable assets); and • the Borrower's budget (in the case of an acquisition). You must analyze historical operations at the Property and apply an appropriate increase over the prior year's operations in determining an estimate. All expenses associated with STR must be underwritten in their respective expense line items. These expenses include cleaning, furnishing, and repairs.
16(a)	MINUS	Property management fee equal to the greatest of: • 3% of EGI[4]; • actual property management fee (exclude any portion of a non-arm's length property management fee that is subordinated to the Mortgage Loan); or • market property management fee.
4 Minimum property management fee may be 2.5% of EGI (rather than 3% of EGI) provided that the: • underwritten management fee is at least $300 per unit; • actual management fee is equal to or less than the underwritten management fee; • Mortgage Loan has an original principal amount greater than $3 million; and • market management fees support the underwritten management fee for similarly sized properties.		

16(b)	MINUS	Real estate taxes based on the greatest of: • actual future tax bill(s) covering a full calendar year; • prior full year's taxes multiplied by 103% (the 3% trending is not required for trailing 12-month or year-to-date annualized expenses); or • in California, the greater of - the Mortgage Loan amount, or - the assessed value, - multiplied by the millage rate plus any special assessments. You must consider any automatic tax reassessment upon acquisition in the next 12-month period. If the Property has real estate tax abatements, exemptions, or deferrals, they must: • be in effect at closing, per written documentation from the state or local tax assessor; and • survive a foreclosure on the Mortgage Loan such that Fannie Mae or a subsequent owner will retain the abatement, exemption, or deferral benefit (i.e., it is tied to the Property and not the owner).

16 (b) continued	MINUS	If the timeframe for the real estate tax abatement, exemption, or deferral is shorter than the Mortgage Loan term, you must consider • a Bifurcated Mortgage Loan structure (i.e., 2 notes secured by a single first Lien Security Instrument), • an amortization schedule that accommodates the elimination of the abatement, or • providing clear justification and support in the refinance analysis. If the Property is located in New York City and subject to the J-51 Tax Incentive Program where the Borrower has decontrolled rent-stabilized units (a Decontrol Event), you must adjust the current rents to reflect no rent decontrol benefits: • Calculate the base rent as the rent amount per unit prior to the Decontrol Event date. • Use the base rent for each applicable unit to determine the Gross Rental Income. • Increase the base rent by the appropriate percentage allowed under New York City Rent Stabilization laws per annum through the present rent roll date.
16(c)	MINUS	Insurance equal to: • the quoted expense, for insurance policies with a bona fide written quote from a reputable broker for a new 12-month policy; or • 110% of the current expense, for insurance policies with a remaining term less than 6 months.

16(d)	MINUS	Utilities, including the following: • building lights; • dumpster rental; • electricity; • fuel oil; • heat; • natural gas; • non-common area electric; • parking lot electric; • parking lot lights; • septic; • trash removal (including contract); • utilities; • vacant unit utilities; and • other.
16(e)	MINUS	Water and sewer.

16(f)	MINUS	Repairs and maintenance, including the following: • appliances; • building; • carpet; • cleaning; • common area maintenance; • decorating; • electrical; • elevator; • equipment repairs; • exterminating services; • floor covering replacement; • HVAC; • janitorial; • landscaping (exterior); • landscaping (interior/plants); • lawn and grounds; • lock/keys; • maid service; • make ready; • mechanical; • painting; • parking lot; • parking lot lighting repair; • pest control; • plumbing; • pool; • rubbish removal; • scavenger; • snow removal; • supplies; • supplies (cleaning); • turnover; • vacancy preparation; • water irrigation; • water treatment; • window covering repair/replacement (minor); and • other.

16(g)	MINUS	Payroll and benefits, including the following: • 401k; • bonuses; • contract labor (carpet cleaning); • contract labor (make ready); • contract work; • custodian salary; • employee benefits; • employee expense; • employee insurance; • FICA; • health benefits; • labor plumbing; • manager salaries; • payroll and benefits; • payroll and processing; • payroll taxes; • salaries; • salaries maintenance; • security personnel's salary; • subcontracted labor; • temporary help; • unemployment insurance; • worker's compensation; and • other.

16(h)	MINUS	Advertising and marketing, including the following: • apartment finder/guide; • banners; • brochures; • building signage; • finder's fee; • media commissions; • newspaper ads; • promotions; • resident relations; • signage; • supplies (marketing); • tenant relations; • Yellow Pages; and • other.
16(i)	MINUS	Professional fees, including the following: • accounting or tax preparation fees; • architectural fees; • attorney fees; • bookkeeping fees; • engineering fees; • legal fees/expense; • professional fees; and • other.

16(j)	MINUS	General and administrative, including the following: • ad valorem tax; • administrative fee; • alarm system; • answering service; • auto leasing; • auto repairs; • bank charges; • broker commission/fees; • business license; • cable; • cell phone/pager; • commissions; • computer repairs; • courtesy patrol; • credit check; • donations; • education; • entertainment; • equipment lease/rental; • eviction expense; • fire extinguisher; • freight and shipping; • leased equipment; • leasing commissions; • leasing office expense; • licenses; • life safety;

16 (j) continued	MINUS	• mileage; • miscellaneous general and administrative expenses; • model apartment; • moving expense; • office supplies; • office unit (non-revenue unit); • permits; • personal property taxes; • postage; • printing; • public relations; • rental commissions; • rental expense; • security; • security vehicle and maintenance vehicle; • space designs and drawings; • subscription dues; • telephone; • travel; • truck repairs; • uniform service; • utility vehicle; • vehicle lease; • vehicle repair and expense; and • other.

16(k)	MINUS	Other expenses, including the following: • ancillary expense; • franchise taxes and fees; • general building; • miscellaneous; • on-going costs associated with any Interest Rate Cap Agreement; • other expenses/costs; and • for STR, - taxes, fees, etc. imposed by the governing jurisdiction, and - if applicable, the difference in actual lease STR income and an equivalent market rate apartment rent (as if leased as an apartment unit). For example, if actual lease STR income for a unit is $1,000 and market rate residential rent for that unit is $900, then deduct $1,200 ($1,000 - $900 = $100 x 12 months) as an Other expense. Do not include the following: • amortization; • depreciation; • entity (i.e., filing, license, etc.); • financing fees; • initial or upfront costs associated with any Interest Rate Cap Agreement; • interest; • legal fees associated with securing Mortgage Loans; • life insurance; • owners draw; • partnership fees; • principal payments on any loan; • sales tax paid; and • trust account fees.

17	MINUS	Ground rent for any Ground Lease or any master lease. Ground Lease bonus rent and/or escalations during the term of the Mortgage Loan must be considered when calculating Underwritten NCF and analyzing refinance risk.
	EQUALS	UNDERWRITTEN NOI
18	MINUS	Replacement Reserve expense, including • a minimum annual amount of $200 per unit, or • a greater amount if required in Part II, Chapter 4: Inspections and Reserves, Section 404: Replacement Reserve. Replacement Reserve expense must be included whether the escrow is funded or not.
	EQUALS	UNDERWRITTEN NCF

202.02 Underwritten DSCR

Requirements

You must calculate Underwritten DSCR per the following table.

Item	Function	Description
1		Underwritten NCF per Part II, Chapter 2: Valuation and Income, Section 202.01: Underwritten Net Cash Flow (Underwritten NCF).

Item	Function	Description
2	DIVIDED BY	Annual debt service for the Mortgage Loan amount. You must base debt service on a level debt service payment, including amortization, and the greater of • the actual note rate, or • the required Underwriting Interest Rate Floor per Form 4660.

When calculating Underwritten DSCR for a Mortgage Loan with an interest-only period, you must use the same level debt service payment, including amortization, regardless of the length of the interest-only period.

The Underwriting Interest Rate Floor, if applicable, is the lowest interest rate you may use to determine the Mortgage Loan amount. If the Gross Note Rate is below the required Underwriting Interest Rate Floor, per Form 4660, you must use the Underwriting Interest Rate Floor to establish the permitted Mortgage Loan amount. All underwriting Tier requirements must be based on the Underwritten NCF.

Section 203 Refinance Risk Analysis

☑ Requirements

You must:

- Analyze the ability of the Borrower to refinance the Mortgage Loan.
- Calculate the following:
  - a "reversion" cap rate, which is the expected capitalization rate that could be supported based on the projected NCF for the first year following the Mortgage Loan Maturity Date (for example, using the projected NCF in year 11 for a 10-year Loan term); and
  - a Refinance Interest Rate, which is the maximum interest rate that could be supported based on the UPB required DSCR and projected NCF for the first year following the Mortgage Loan Maturity Date.

203.01 Base Assumptions

Requirements

You must derive proforma NCF for the term of the Mortgage Loan as follows:

- Year 1: Underwritten NCF.
- Income Growth Rate: 2%.
- Economic Vacancy: hold underwritten economic vacancy level for the Mortgage Loan term.
- Expense Growth Rate:
  - 3%; and
  - for real estate taxes,
    - 3% (or 2% for California acquisitions), or
    - increase Property taxes if an abatement expires or taxes are expected to rise during the loan term followed by 3% trending, or
    - for refinance transactions in California only, no trending is required until the year in which the actual tax bill would surpass the underwritten taxes, then trend Property taxes at 2%.

You must estimate the principal amount of a Choice Refinance Loan as follows:

- Amortization: 30 years or the amortization for the applicable product or features.
- DSCR: The minimum Tier 2 DSCR for the applicable product or features, per Form 4660.
- LTV: The maximum Tier 2 LTV for the applicable product or features, per Form 4660.

Guidance

Since these base assumptions are indicative only, you may use more conservative estimates if warranted by circumstances particular to the Property.

In most cases, the combined effect of principal amortization and NCF growth should result in a refinancing at the minimum DSCR and maximum LTV for Tier 2, using a reasonable interest rate.

You should consider the following refinance parameters:

- A target reversion capitalization rate at least 2.0% greater than the initial capitalization rate used for determining Underwriting Value.
- A Refinance Interest Rate at least 2.25% greater than the current 10-year Amortizing Nationwide Underwriting Floor rate, per Form 4660.

203.02 Alternative Assumptions

Guidance

If you determine that the base assumptions do not appropriately estimate the Property's NCF over the Mortgage Loan term, you may undertake an alternative risk analysis using assumptions that deviate from the base assumptions.

You should specifically identify and support any deviations with reliable evidence and historical and projected market trends. You should state your conclusions and discuss any mitigating factors, such as the

- strength of the Sponsor or the submarket,
- Property's characteristics, or
- Property's operating history and performance.

Income and Expense Growth Rates: Income and expense trending should incorporate projected market rates based upon general economic, market, and submarket conditions from reliable sources. For example:

- Rents on recently signed leases should only be used for estimating income growth in years 1 and 2.
- Rent projections greater than 2% should not be used beyond year 4.
- When improvements in market economic occupancy or sustained market rental rate increases are widely anticipated, growth trends above 2% may be supported.
- Projections of income growth resulting from Property renovations or improved operations should be limited to the first 3 years.
- When a Property is subject to a scheduled reassessment or a tax abatement phase-in period, tax expense should be adjusted appropriately.
- When you expect to incur costs for tenant improvement allowances and leasing commissions, or to realize rent increases from the rollover of tenants, commercial income should be adjusted

appropriately.

Economic Vacancy: Properties in submarkets that are experiencing depressed economic conditions due to temporary demand or supply issues may be modeled to reflect the economic vacancy projected by a reliable source. If you expect a decrease in vacancy to achieve stabilized levels, you should consider

- the anticipated timing, and
- effect of decreased economic vacancy on projected income growth over the same time period.

Section 204 Cash Out Analysis

Requirements

You must examine the risk of allowing cash out to the Borrower (see Form 4660 for a description of cash out transactions).

Guidance

When underwriting a cash out transaction you should consider:

- the amount of hard equity remaining in the Property;
- the length of time the Borrower has owned the Property;
- the effective age and current physical condition of the Property;
- any improvement in asset quality over the ownership period;
- any improvement in the Property's operations (i.e., its NCF) or value over the ownership period; and
- whether an increase in the Property's value resulted from an increase in NCF or a decrease in the capitalization rate.

Examples of factors that support cash out transactions include:

- retention by the Borrower of 10% or more hard equity in the Property;
- ownership of the Property for a period of time commensurate with the extent of cash out proceeds;
- maintenance of the Property in good condition, or improvement of its condition, during the ownership period;
- improvement in the Property's NCF over the ownership period; and
- an increase in the Property's value over the ownership period due to

an increase in NCF.

Section 205 Rent-Stabilized Properties

Guidance

For Rent-Stabilized Properties (e.g., located in New York State), you should:

- underwrite Property income based on current rents;
- exclude any potential rent increase for units converting to market rate from the projected NCF in the refinance risk analysis;
- assess and stress the cap rate used to determine the Underwriting Value, and consider obtaining an Appraisal before Rate Lock;
- for fund Sponsors or other Sponsors requiring minimum investment returns, consider whether the Sponsor's interests are aligned with the limited rent increases allowed under the law; and
- fund the Replacement Reserve to maintain the Property's physical condition.

Chapter 9 Small Mortgage Loans

Section 901 Generally

901.01 Description

Requirements

A Small Mortgage Loan is a Mortgage Loan with an original loan amount of less than or equal to $6 million and underwritten per this Chapter.

901.02 Applicability

Requirements

You may use this Chapter to underwrite conventional Mortgage Loans and the following products:

- MH Communities;
- MAH Properties; and

- market rate Cooperative Properties that are not Limited Equity Cooperative Properties.

Section 902 Key Principal Guaranty Obligation

Requirements

~~Per~~ You must obtain a ~~Form 4660~~Non-Recourse Guaranty~~,~~ (Form 6015) from each Key Principal ~~must execute either~~.

1. ~~a Payment Guaranty (Form 6020 series) for all recourse lending, or~~
2. ~~a Guaranty of Non-Recourse Obligations (Form 6015 series) for all non-recourse lending.~~

Section 903 Occupancy

Requirements

Small Mortgage Loans must achieve Stabilized Residential Occupancy as follows:

If the Property contains...	Then it must have...
10 or more units	at least 90% physical occupancy by Qualified Occupants for the 90 days immediately before the Commitment Date.
Less than 10 units	- no more than 1 vacant unit as of the Commitment Date, and - an average occupancy by Qualified Occupants of at least 90% for the 12-month period immediately before the Commitment Date.

If a Small Mortgage Loan is secured by an MH Community, then Stabilized Residential Occupancy must comply with Part II, Chapter 1: Attributes and Characteristics, Section 104: Minimum Occupancy.

Section 904 Corporate Leases; Leases to One Entity

Guidance

Entity leases are permitted; but you should analyze the effect of leasing

- more than 10% of the total residential units in the Property to corporations, partnerships, trusts, and other entities, or
- more than 5% of the total residential units to any single corporation, partnership, trust, or other entity.

Entity leases of residential units for residential purposes are considered residential space.

Section 905 Property Income Analysis

905.01 Small Mortgage Loan Underwritten NCF (Underwritten NCF)

Requirements

You must calculate Underwritten NCF as follows:

- for a MAH Property, per Part III, Chapter 7: Multifamily Affordable Housing Properties, Section 703: Property Income and Underwriting; except that Replacement Reserves may be calculated per the table in this Section;
- for a MH Community, per Part III, Chapter 6: Manufactured Housing Communities, Section 606: Property Income and Underwritten NCF;
- for a Cooperative Property, per Part III, Chapter 8: Cooperative Properties, Section 804: Income Analysis; and
- for all conventional Small Mortgage Loans, you must use the following table.

REQUIRED UNDERWRITTEN NET CASH FLOW (SMALL MORTGAGE LOANS)		
Item	Function	Description
CALCULATION OF NET RENTAL INCOME		
1		GROSS RENTAL INCOME – the lesser of - actual rents in place, or - market rents for occupied units, plus market rents for vacant units based on a current rent roll (multiplied by 12).[1]

2	PLUS	To the extent deducted as an operating expense, rents for other non-revenue units. For example: - model units deducted in the "model apartment" operating expense in the "general and administrative" category; - owner-occupied units[2] deducted in the "general and administrative" category; and - employee units[3] deducted in the "employee" operating expense in the "payroll and benefits" category.
	EQUALS	GROSS POTENTIAL RENT (GPR)
3	MINUS	Premiums and corporate premiums.
4	MINUS	Physical vacancy – market rents for vacant units based on a current rent roll (multiplied by 12).[4]
5	MINUS	Concessions – the aggregate amount of forgone residential rental income resulting from incentives granted to tenants for signing leases, such as free rent for 1 or more months, move-in allowance, etc.[4]
6	MINUS	Bad debt – the aggregate amount of unpaid rental income determined to be uncollectable: include any adjustments to other income for bad debt.[4]
	EQUALS	NET RENTAL INCOME (NRI)

1 (a) In the New York-Northern New Jersey-Long Island, NY-NJ-PA MSA, you may use actual rents in place plus projected increases for rent-regulated units that have rent increases scheduled before, or through, the first 12 months of the loan term. Any units subject to rent regulation on the Commitment Date must be treated as rent-regulated for this calculation even if converting to market rate after origination.
(b) For Properties located in New York City that are currently subject to the J51 Tax Incentive Program, you must ensure that the Gross Rental Income complies with Part II, Chapter 2: Valuation and Income, Section 202: Income Analysis.

2 You must deduct owner-occupied units as an expense unless ~~the Mortgage Loan is:~~

- the Mortgage Loan is Tier 3 or Tier 4, or

the Property contains 24 or more units.

~~a Tier 3 or Tier 4 Mortgage Loan; secured by a Property containing 24 units or more; or secured by a Property that~~

- ~~contains less than 24 units,~~

~~is a Tier 2 Mortgage Loan, and requires full personal liability of the Borrower.~~

3 You must deduct as an expense the portion of the market rent used as employee compensation.

4 The total of Items 4, 5, and 6 must be greater than or equal to

- 3% of GPR for the New York-Northern New Jersey-Long Island, NY-NJ-PA and San Francisco-Oakland-Fremont, CA, Metropolitan Statistical Areas (MSAs), if supported by market and property operations, or
- 5% of GPR for all other MSAs.

CALCULATION OF OTHER INCOME		
7	PLUS	Actual other income (except premiums and corporate premiums) generated through ongoing operations. The income must: - be stable; - be common in the market; - exclude one-time extraordinary, non-recurring items; and - be supported by prior years. You must assess the individual month other income within the prior full-year operating statement; or at a minimum, an operating statement covering at least the trailing 6 months (annualized).

CALCULATION OF COMMERCIAL INCOME

8	PLUS	Actual income from occupied commercial space (and parking revenue for commercial spaces, if applicable).
9	PLUS	Actual income from STR units.
10	MINUS	10% of the actual commercial income (total of Items 8 plus 9).[5]
5 If net commercial income is greater than 20% of EGI, then reduce to 20% of EGI.		
11	PLUS	Laundry and vending, parking, and all other income as detailed in Part II, Chapter 2: Valuation and Income, Section 202: Income Analysis.
	EQUALS	EFFECTIVE GROSS INCOME (EGI)
CALCULATION OF OPERATING EXPENSES		

12	MINUS	Line-by-line stabilized operating expenses. Stabilized operating expenses are the expenses during normal ongoing Property operations, not affected by a lease-up, rehabilitation, or other short-term positive or negative factors. Non-recurring, extraordinary operating expenses must not be included. You must assess: - past operating history; - the appraiser's expense analysis; - all information available to you (including Property contracts, utility bills, real estate tax assessments, insurance policies, and comparable assets); and - the Borrower's budget (in the case of an acquisition). You must analyze historical operations at the Property and apply an appropriate increase over the prior year's operations in determining an estimate. All expenses associated with STRs must be underwritten in their respective expense line items. These expenses include cleaning, furnishing, and repairs. You cannot include any operating expense that reflects blanket or bulk discounts that benefit the Borrower or Key Principal (e.g., blanket property or casualty insurance policies, or utilities purchased in bulk). Operating expenses must reflect the Property expenses on a stand-alone basis.
13	MINUS	Property management fee equal to the greatest of: - 3% of EGI; - actual property management fee (exclude any portion of a property management fee that is subordinated to the Mortgage Loan); or - market property management fee.

14	MINUS	Real estate taxes based on the greatest of: - actual future tax bill(s) covering a full calendar year; - prior full year's taxes multiplied by 103% (the 3% trending is not required for trailing 12-month or year-to-date annualized expenses); or - in California, the greater of the Small Mortgage Loan amount or the assessed value, multiplied by the millage rate, plus any special assessments. You must consider any automatic reassessment upon acquisition in the next 12-month period. You may use a reduced real estate tax payment if the Property's real estate tax abatements, exemptions, or deferrals meet the requirements in Part II, Chapter 2: Valuation and Income, Section 202: Income Analysis.
15	MINUS	Insurance equal to: - the quoted expense, for insurance policies with a bona fide written quote from a reputable broker for a new 12-month policy; or - 110% of the current expense, for insurance policies with a remaining term less than 6 months.
16	MINUS	Utilities, water and sewer, repairs and maintenance, payroll and benefits, advertising and marketing, professional fees, general and administrative, ground rent, and all other expenses as detailed in Part II, Chapter 2: Valuation and Income, Section 202: Income Analysis.
	EQUALS	UNDERWRITTEN NET OPERATING INCOME (UNDERWRITTEN NOI)

17	MINUS	Replacement Reserve expense equal to at least[6] - \$200 per unit, for a Property with an overall rating of 1, - \$250 per unit, for a Property with an overall rating of 2, or - \$300 per unit, for a Property with an overall rating of 3. The Property ratings are the ratings reported on the Comprehensive Assessment Addendum ("Comp Assmt Addendum") tab of the MBA Master Inspection Form.
	EQUALS	UNDERWRITTEN NET CASH FLOW (UNDERWRITTEN NCF)
6 If a PCA was completed, the Replacement Reserve must equal the amount required per Part II, Chapter 4: Inspections and Reserves, subject to a minimum of \$200 per unit.		

905.02 Underwritten DSCR

Requirements

You must calculate Underwritten DSCR per the following table.

UNDERWRITTEN DSCR[1,2]		
Item	Function	Description
1		Underwritten NCF as calculated in Part III, Chapter 9: Small Mortgage Loans, Section 905.01: Small Mortgage Loan Underwritten NCF (Underwritten NCF).

UNDERWRITTEN DSCR[1,2]		
Item	Function	Description
2	DIVIDED BY	Annual debt service for the Mortgage Loan amount. You must base debt service on a level debt service payment, including amortization, and the greater of - the actual note rate, or - the required Underwriting Interest Rate Floor.[3]
1 For a Small Mortgage Loan secured by an MAH Property underwritten per this Chapter, you must comply with the minimum DSCR requirement for an MAH Property per Form 4660. 2 For shorter amortization terms, you must - calculate the Underwritten DSCR based on the shorter period, and - comply with the minimum DSCR requirement per Form 4660. The mandatory NRI adjustments in Part II, Chapter 2: Valuation and Income, for Properties with declining NRI do not apply. 3 For a Small Mortgage Loan secured by an MAH Property underwritten per this Chapter, you must comply with the required Underwriting Interest Rate Floor for an MAH Property per Form 4660.		

Section 906 Property Management

☑ Requirements

To ascertain the property management requirements, you must determine how many years of experience, as of the Commitment Date, the Borrower or any Key Principal has owning or managing at least 1 multifamily property that is similar in size to the Property, based on the following:

Similar in Size	Unit Range
Small Properties	5 – 50 units

Medium Properties	51 – 100 units
Large Properties	101 or more units

As of the Commitment Date, a non-Local Borrower must have at least 2 years of multifamily ownership or property management experience with a property similar in size or larger than the Property.

Property management requirements are as follows.

Property Size	Professional property management or qualified on-site manager required if...
Less than 10 residential units	non-Local Borrower.
10 or more residential units	- non-Local Borrower, or - Local Borrower with less than 2 years of experience with a property similar in size or larger.

Guidance

A professional property management company should have an office within 100 miles of the Property and use a written management agreement that complies with Part II, Chapter 1: Attributes and Characteristics, Section 108: Property Management and Agreement.

A qualified on-site manager

- is not required to be a Property resident,
- should generally be on-site during normal business hours, and
- for at least 2 years the before the Commitment Date, should have either successfully managed the Property or have demonstrated management experience with a property similar in size or larger than the Property.

Section 907 Property Condition

907.01 Site Inspection by Lender or Other Third Party

Requirements

You must:

- Ensure a physical inspection of the Property is performed (including any Property securing a Small Mortgage Loan that is also a Choice Refinance Loan).
- Ensure that 1 of the following completes the physical inspection and the MBA Master Inspection Form:
  - a qualified employee with the experience required for a third-party evaluator per Part II, Chapter 4: Inspections and Reserves, Section 402: Property Condition Assessment (PCA);
  - a qualified appraiser; or
  - qualified third-party inspector.

If a non-employee appraiser or other third-party inspector performs the physical inspection, you must also have an employee visit the Property.

The site inspection must provide you with enough information to complete the MBA Master Inspection Form, including:

- an assessment of the current condition of the Property;
- an identification and cost estimate of any Immediate Repairs, which must be included in the appropriate Completion/Repair Agreement; and
- a general estimate of anticipated replacement and major maintenance needs.

For any Property consisting of multiple buildings, the site inspection must address the condition of all roofs, HVAC equipment, exterior façades, parking lots, exterior walkways, and balconies.

If a Mortgage Loan has a term greater than 10 years, then you must ensure that a new site inspection is performed in the 10th year of the loan term.

The date of the site inspection must meet the timing requirements for a PCA in Part II, Chapter 4: Inspections and Reserves, Section 402: Property Condition Assessment (PCA).

You must not Deliver any Small Mortgage Loan secured by a Property that has:

- an overall rating of “4” or “5” reported on the Comp Assmt Addendum tab of the MBA Master Inspection Form; or
- deferred maintenance with repair costs greater than 10% of the UPB.

907.02 Site Inspection by Borrower

Requirements

You must ensure that the Borrower or the Key Principal:

- Conducts a physical inspection of the Property.
- Certifies in the Multifamily Underwriting Certificate (Form 6460) that the physical inspection has been performed.

907.03 PCA

Requirements

A PCA is required:

- if the site inspection
  - notes structural or physical concerns, or
  - results in an overall rating of 3 being reported on the Comp Assmt Addendum tab of the MBA Master Inspection Form; or
- ~~for certain non-recourse lending per~~ Form 4660~~.~~
- when a Replacement Reserve is required per Part III, Chapter 9: Small Mortgage Loans, Section 908: Replacement Reserve.

Guidance

When a PCA is required, you may use:

- the Streamlined Property Condition Assessment Guidance (Form 4099.A), but the PCA must otherwise comply with Part II, Chapter 4: Inspections and Reserves, Section 402: Property Condition Assessment (PCA); and
- the Streamlined PCA Requirements (Form 4099.A) instead of the MBA Master Inspection Form, if you include the overall inspection rating as defined on the MBA Master Inspection Form.

Section 908 Replacement Reserve

Requirements

You must require either full funding or alternative funding (per Part II, Chapter 4: Inspections and Reserves, Section 404.03: Alternative Replacement Reserve Funding) of the Replacement Reserve for any Tier 2 Small Mortgage Loan on a

- Property not located in an Eligible MSA per Form 4660, or
- Rent-Stabilized Property located in the New York-Newark-Jersey City, NY-NJ-PA MSA.

For all other Small Mortgage Loans, you must determine whether to require ~~monthly deposits to~~funding of the Replacement Reserve.

If you do not require full funding, then you and the Borrower must execute either

- the appropriate Modifications to Multifamily Loan and Security Agreement (Replacement Reserve – Partially or Fully Waived) (~~Form 6620 series~~Form 6220), or
- the Modifications to Multifamily Loan and Security Agreement (Replacement Reserve – Alternative Funding) (~~Form 6221 series~~Form 6221).

Section 909 Environmental Matters and Inspections

Requirements

Before the Commitment Date, you must:

- Obtain an Environmental Screening of the Property using the ASTM E-1528 protocol.
- Perform a physical site inspection of the Property.
- Notify the Appraiser of any Recognized Environmental Condition or “non-scope considerations” that would impact the value of the Property.
- Determine if an O&M plan is appropriate to address a Recognized Environmental Condition.
- Determine if the state where the Property is located has an environmental super-lien statute, and ensure that the Property conditions are not likely to result in such a lien.
- Disclose any actual or suspected environmental conditions not

disclosed in the ESA.

- Evaluate the potential risk posed by any Recognized Environmental Conditions that could result in loss or liability to you, the Borrower, the Property, or Fannie Mae.
- Obtain a copy of any Phase I ESA that the Borrower has in its possession or can obtain.
- Determine, based on the findings of the environmental screening and analysis, whether a Phase I ESA is required and, if so, contract for the report.
- When indicated, contract for a Phase II ESA.
- Disclose any knowledge of actual or suspected environmental problems.

Guidance

You may contract portions of your environmental responsibilities to qualified parties. The environmental screening and analysis may be completed by:

- the engineer conducting the PCA (if one was required);
- a qualified employee; or
- a qualified non-employee.

Operating Procedures

If a qualified individual performs the environmental screening and analysis, you must:

- Identify the individual.
- Ensure that the individual certifies each environmental analysis.
- Submit a certified copy of each environmental analysis with Folder II of the Multifamily Mortgage Loan Delivery Package Table of Contents (Form 6502).

Section 910 Borrower, Key Principals, Guarantors, and Principals

Requirements

Except as described below, you must comply with all requirements for the Borrower, Key Principals, Guarantors, and Principals in Part I, Chapter 3: Borrower, Guarantor, Key Principals, and Principals.

910.01 Borrower Organizational Structure

Requirements

Any individual Borrower must be a U.S. citizen.

Although a single asset entity is preferred, the Borrower may be a multi-asset entity.

Guidance

If the Borrower owns multiple assets, then you should obtain and underwrite the Borrower's complete schedule of owned real estate assets. Your underwriting should include the nature, location, cash flows, outstanding mortgage debt, and contingent liabilities of each asset.

910.02 Co-Tenant Borrowers

Requirements

If a Co-Tenant Borrower is not an individual or a trust holding title to assets of an individual, each Key Principal must execute the applicable Guaranty per Part III, Chapter 9: Small Mortgage Loans, Section 902: Key Principal Guaranty Obligation.

Co-Tenant Borrowers must be

- individuals who are U.S. citizens,
- single-asset entities, or
- multi-asset entities.

910.03 Key Principals

Requirements

You must ensure that any individual Key Principal is a U.S. citizen.

910.04 Principals

Requirements

For Small Mortgage Loans, a Principal is any person or entity that holds direct or indirect interests of 50% or more in the Borrower.

910.05 Financial Statements

Requirements

~~For each Borrower, Key Principal, Guarantor and Principal, you~~You must obtain

- a schedule of owned real estate assets, and
- signed financial statements.

Instead of signed financial statements, you may obtain an equivalent signed net worth statement or personal financial statement (such as a form bank application from the Borrower certifying to its financial condition) that conforms to the aging requirements in Part I, Chapter 3: Borrower, Guarantor, Key Principals, and Principals.

910.06 Net Worth and Liquid Assets

Requirements

You must ensure that:

- the combined net worth of the Borrower and all Key Principals equals or exceeds the original principal amount of the Small Mortgage Loan; and
- the combined post-closing liquid assets (excluding any Small Mortgage Loan cash-out proceeds) of the Borrower and all Key Principals equal at least 9 monthly payments of P&I on the Small Mortgage Loan.

Guidance

You should:

- for net worth, consider the impact of current, long-term, and contingent liabilities compared to the Small Mortgage Loan amount;
- for liquidity, exclude the following unless you have reasonable justification:
  - retirement funds (such as IRAs and 401Ks); and

- promissory notes payable to the Borrower or a Key Principal, whether secured or unsecured; and

- verify liquid assets for the 2-month period immediately preceding the Borrower's loan application by obtaining copies of all applicable:
  - bank statements; and
  - investment portfolio statements.

Section 911 Credit Reports

911.01 Credit Report

Requirements

Within 90 days before the Commitment Date, you must obtain credit reports for all individual

- Borrowers,
- Key Principals,
- Guarantors, and
- Principals

from at least 2 of the following credit information services:

- Equifax;
- Experian; or
- TransUnion.

911.02 FICO Scoring

Requirements

You must ensure that all individual Borrowers, Key Principals, Guarantors, and Principals meet the Minimum FICO Requirement in Form 4660.

Guidance

To determine that the Minimum FICO Requirement is met, follow these guidelines:

If…	Then…
You obtain credit reports from 2 of the 3 credit information services for a Borrower, Key Principal, Guarantor, or Principal	Use the lower of the 2 scores.
You obtain credit reports from all 3 credit information services, for a Borrower, Key Principal, Guarantor, or Principal	Use the middle score.

If...	Then...
A Borrower, Key Principal, or Principal is married to another Borrower, Key Principal, Guarantor, or Principal	Use the lower FICO score of the 2 married individuals.
A Small Mortgage Loan has multiple individual Borrowers, Key Principals, Guarantors, or Principals	Use the average of their respective FICO scores.

911.03 Reviewing the Credit Report

Requirements

You must analyze the credit report for each individual Borrower, Key Principal, Guarantor, and Principal.

If the answer to any of the following Guidance questions is “yes”, then the Borrower, Key Principal, Guarantor, or Principal must give you satisfactory explanations, even if they meet the Minimum FICO Requirement.

Guidance

As you analyze the credit report, consider the following questions:

- Have any mortgage late payments occurred in the previous 36 months?
- Have any revolving or installment late payments occurred within the previous 12 months?
- Do you consider any of the credit card or other unsecured debt balances excessive?

- Have any tax liens been filed or reported within the previous 5 years?
- Have any discharged bankruptcies or mortgage foreclosures occurred within the previous 10 years?
- Are there any outstanding judgments or collections higher than $5,000?

Chapter 17 Structured Transactions

Section 1701 Description

Requirements

Structured Transactions consist of 1 or more Mortgage Loans governed by a master agreement, regardless of individual loan size or cross-collateralization.

There are 2 types of Structured Transactions: Credit Facilities and Bulk Deliveries. The terms for each Structured Transaction vary, and are negotiated based on the specific Properties and Sponsor needs.

Section 1702 Credit Facilities

Requirements

A Credit Facility is a Structured Transaction that

- is governed by a Master Credit Facility Agreement, and
- includes cross-collateralized and cross-defaulted Mortgage Loans and Properties.

The minimum Credit Facility transaction amount is $~~55~~100 million.

Guidance

A Credit Facility may also include:

- variable rate debt, fixed rate debt, or a combination of both;
- varied loan maturities and repayment terms;
- the ability to increase borrowing based on
  - increases in the aggregate DSCR, and
  - decreases in the aggregate LTV of the Properties;

- the ability to increase the amount of the Credit Facility by delivering additional Properties as collateral; or
- collateral substitutions and releases.

Operating Procedures

Credit Facilities require intensive Fannie Mae involvement, including the assignment of an in-house legal lead who will direct outside counsel services.

Fannie Mae will engage outside counsel at your expense to prepare all related documentation.

You may require the Borrower to

- pay these legal fees and expenses, and
- fund a deposit for their payment.

Section 1703 Bulk Deliveries

Requirements

A Bulk Delivery is a Structured Transaction that:

- is governed by a Bulk Delivery Agreement; and
- includes the ability to
  - add Mortgage Loans in the future, or
  - substitute a new Property for an existing Property as collateral.

Operating Procedures

Fannie Mae will engage outside counsel at your expense to prepare the Bulk Delivery Agreement.

You may require the Borrower to

- pay these legal fees, and
- fund a deposit for their payment.

- ## Rent-Stabilized Property

  Property where rent increases on more than 50% of the residential units are limited by state or local statutory controls, not by an Affordable Regulatory Agreement.