Fannie Mae®

Multifamily Selling and Servicing Guide

Effective as of May 2, 2022

TABLE OF CONTENTS

Summary of Changes

HIGHLIGHTS
Effective for Mortgage Loans Committed on or after May 2, 2022 the Refinance Risk Analysis Base Assumptions were updated.

Primary Changes

- Clarified that the Refinance Risk Analysis calculates the Borrower's ability to refinance the Mortgage Loan in the first year after the Maturity Date.
- Updated the Income Growth Rate Base Assumption for Year 2 through the Mortgage Loan term to be either:
  - 2% for a
    - Student Housing Property,
    - Dedicated Student Housing Property,
    - Seniors Housing Property,
    - Multifamily Affordable Housing Property,
    - Structured Transaction, and
    - Mortgage Loan secured by multiple Properties; or
  - for all other Mortgage Loans, use the rent growth published in DUS Gateway for the Property's submarket.
- DUS Gateway's rent growth is based on Fannie Mae's portfolio and more accurately assesses refinance risk by:
  - reflecting current market conditions;
  - considering the cyclical multifamily real estate market; and
  - differentiating market and submarket performance.

Questions

Please contact the Fannie Mae 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		

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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. 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.
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]

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.		

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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; • 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; • 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		

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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).

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.
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.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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;

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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.

REQUIRED UNDERWRITTEN NCF
(CONVENTONAL LOANS)

Item	Function	Description
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.

REQUIRED UNDERWRITTEN NCF (CONVENTONAL LOANS)		
Item	Function	Description
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 prepare an exit strategy analyzing the Borrower's ability to refinance the Mortgage Loan in the year after the Maturity Date (e.g., use the projected NCF in year 11 for a Mortgage Loan with a 10-year term), by calculating a:

- ~~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.~~

- “reversion” cap rate, which is the expected capitalization rate that could be supported based on the projected NCF; and
- Refinance Interest Rate.

203.01 Base Assumptions

Requirements

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

- ~~Year~~Loan Year 1: Underwritten NCF.
- Income Growth Rate for subsequent Loan Years, use: ~~2%.~~
  - 2% for a
    - Student Housing Property,
    - Dedicated Student Housing Property,
    - Seniors Housing Property,
    - Multifamily Affordable Housing Property,
    - Structured Transaction, and
    - Mortgage Loan secured by multiple Properties; or
  - for all other Mortgage Loans, use the rent growth published in DUS Gateway for the Property's submarket.
- 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 Mortgage Loan UPB at the Maturity Date 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.~~
- Rent projections greater than the Base Assumption Income Growth Rate should not be used beyond Loan Year 4.
- When improvements in market economic occupancy or sustained market rental rate increases are widely anticipated, growth trends above ~~2%~~the Base Assumption Income Growth Rate 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.

▪ Refinance Interest Rate

Maximum interest rate that could be supported based on the UPB, required DSCR, and projected Net Cash Flow for the first year following the Maturity Date.

Synonyms

- Exit Interest Rate
- Exit Rate