Fannie Mae

Multifamily Interest Rate Cap FAQs

This document provides answers to frequently asked questions related to **interest rate caps** for Fannie Mae loan products.

What is an Interest Rate Cap?

The standard hedge for floating rate transactions with Fannie Mae is an interest rate cap. Currently, we are not accepting swaps as hedges for interest rate risk, except in special circumstances. Interest rate caps act like an insurance policy to hedge against interest rate fluctuations and protect Borrowers against paying interest above the underwritten rate. The interest rate cap agreement is a contract between the Borrower and an approved Interest Rate Cap seller ("Provider") that provides the Borrower with payments at the end of each period when the index interest rate exceeds the **Cap Strike Rate**. The interest rate cap provides a ceiling (or cap) on the Borrower's out-of-pocket interest payment on the Mortgage Loan, with the Provider paying the difference between the Cap Strike Rate and interest index rate. Due to the short term of an interest rate cap agreement, a replacement interest rate cap is required when an existing interest rate cap expires before the variable rate Bond conversion or Mortgage Loan Maturity Date.

Who sells Interest Rate Caps for Multifamily Transactions?

Below is a list of approved Providers for Borrowers who are required to purchase an Interest Rate Cap for a Mortgage Loan. The financial institutions listed below meet Fannie Mae's current credit ratings requirements and all other criteria as determined by Fannie Mae for sellers of interest rate caps:

- The Bank of New York Mellon;
- Commonwealth Bank of Australia;
- Royal Bank of Canada;
- SMBC Derivative Products Ltd. and SMBC Capital Markets, Inc.;
- UBS;
- US Bank National Association; and
- Wells Fargo Bank, N.A.

As of this date, Fannie Mae's criteria require that the Provider must have a credit rating:

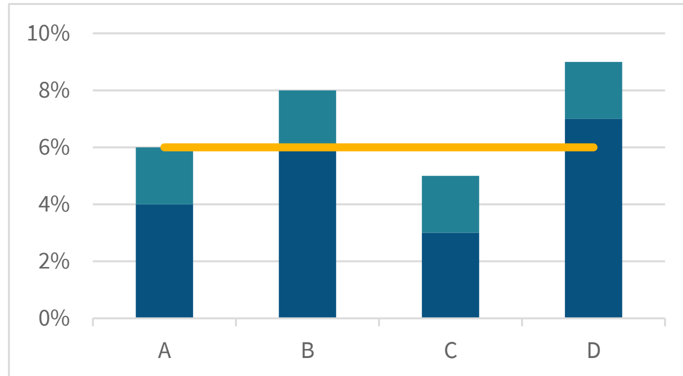
- from Standard & Poor's, of at least:
  - an A issuer or senior debt rating; or
  - an A-1 short-term rating; and
- from Moody's, of at least:
  - an A2 issuer or senior debt rating; or
  - a P-1 short-term rating.

A Borrower must use the Providers on this list to purchase new Interest Rate Caps or replacements for expiring interest rate caps. However, the exclusion of a Provider included on a previous list does not indicate that Fannie Mae believes any existing interest rate hedge sold by that Provider should be terminated and replaced prior to its expiration date. Fannie Mae will notify any Lenders and the Providers if Fannie Mae determines that a ratings downgrade or other adverse event for a given Provider necessitates a termination and replacement of an existing interest rate cap.

How Does the Interest Rate Cap Work?

This section offers four examples describing how interest rate caps function. Remember, in every interest rate cap, the Borrower will pay an upfront premium to the Provider, who in turn, agrees to pay the Borrower if the variable index rises above a predetermined level, called the **strike rate**. The **strike rate** is the specified percentage above which a payment by the Interest Rate Cap Provider will be owed.

1. The total amount of the interest rate cap - known as the **notional amount** – must equal or exceed the unpaid principal balance of the mortgage loan.



$10 Million Cap w/ 6% Strike Rate

Cap Scenario	Margin	30-day avg SOFR	Note Rate	Cap Payment
A	2%	4%	6%	0%
B	2%	6%	8%	0%
C	2%	3%	5%	0%
D	2%	7%	9%	1%

In scenario A, Borrower has a $10 million, 10-year Structured ARM loan with a loan margin of 2%, an interest rate index of 30-day average SOFR and a strike rate of 6%. The Borrower buys a 5-year interest rate cap with a notional amount of $10 million and a strike rate of 6% indexed to 30-day SOFR rates. When the cap is purchased, 30-day average SOFR is 4% and the Borrower pays the full note of 6%, which comprises of index plus the 2% loan margin (scenario A).

In scenarios B and C, the index is at or below the strike rate and the Borrower will not receive payments from the cap Provider.

The Borrower and cap Provider typically settle any cap payments on a monthly basis. To ensure compliance, Fannie Mae usually requires that payments from the cap Provider pass through the Servicer.

In Scenario D, the Interest Rate Cap Reaches the Strike Rate. SOFR index rate has now risen to 7%. The Borrower will continue to pay the index plus (2%) margin. However, the cap Provider would pay 1% on behalf of the Borrower to the Servicer, as the index exceeds the negotiated strike rate. This effectively caps the borrower's net note rate payments to 8%.

The Borrower is always obligated to make the full payment required under the note irrespective of any payments received from the cap Provider.

How are Cap Payments Collected?

Most Cap Providers are not billed. As result, Servicers are using several ways to bill a Borrower to cover the note rate. The Provider is required to make a payment directly to the Servicer if the Cap index exceeds the Cap Strike Rate on the 1st day of the month corresponding with the monthly loan payment date. Servicers may elect to bill the Borrower the full payment amount and issue the Provider's payment as a credit. If a Servicer initially receives the Cap Provider payment ahead of all payments, the Servicer may apply the credit to that period and then the Borrower is responsible for making the payment for the remaining balance. If the loan is in payment default, no payment may be applied to the loan with Fannie Mae approval.

The Interest Rate Cap is assigned to Fannie Mae at closing and all payments on the cap should be made directly to the Servicer, unless other arrangements are approved at closing. Servicers may work with their borrowers to determine the most efficient process for billing and collecting payments while a Cap is in-the-money. If the Borrower remits the net amount to the Servicer, the payment from the Cap provider must be deposited into the P&I custodial account. If the Borrower makes the full payment amount, the Servicer may hold the Cap payment in a custodial escrow or suspense account, until such time as it is returned to the borrower or credited to the loan in a future month.

How is the size of the Replacement Cap Escrow calculated?

Initial interest rate caps are required to have terms ranging between three to seven years. Because interest rate caps typically have shorter terms than the loans they hedge, Borrowers are required to make monthly escrow payments to fund the purchase of a **replacement cap** upon expiration of the initial interest rate cap. Escrow payments are based on 100 percent of estimated cap replacement costs; typically escrow payments are spread over the same term as the initial cap and paid on a monthly basis.

Example

Loan Term	Initial Interest Rate Cap Term	Escrow Payments for Replacement Cap Begin...
10 years	5 years or less	Immediately
10 years	7 years	At the end of year 2. For caps with terms greater than five years, escrow payments begin five years before the expiration of the existing cap.

The replacement cap escrow must be re-sized at least once per year or more frequently if required or permitted in the loan documents. At the end of each 12-month period, the Servicer must reevaluate the cost of a replacement cap with the same strike rate and notional amount as required in the loan documents. If the cost of the replacement cap increases, the monthly escrow payments must be increased accordingly to ensure sufficient funds will be available upon purchase of the replacement cap at the end of the escrow period. If the estimated cost of the replacement cap decreases, there is no adjustment to the monthly escrow payments. Servicers adjust the payment in their systems and begin to bill the borrower for the new amount.

Any amount left in the escrow account after the purchase of a replacement cap may be refunded to the Borrower or used to fund subsequent escrow requirements.

When can an Interest Rate Cap be terminated?

If a Borrower prepays the Mortgage Loan, the interest rate cap remaining for the life of the Mortgage Loan may be released to the Borrower. Waivers to go unhedged for variable rate debt are not available from Fannie Mae at this time. After a Mortgage Loan is paid in full, an interest rate cap can be traded or released. Release of Interest Rate Cap documentation can be forwarded to Fannie Mae Servicing along with other release of lien documents. If Fannie Mae terms conflict with Interest Rate Cap Provider, the Provider will determine the pathway for terminating the cap. Please contact your Provider for more information.

Other Frequently Asked Questions

FAQs Relating to Interest Rate Caps for New Loans

Q: Does the Servicer have to put the cap provider's payment into the custodial account?

A: Yes

Q: Can the Servicer provide the Borrower credit for the cap payment during the same billing period as the cap payment is received?

A: Yes, if the cap payment is received by the Servicer and then the Borrower would then owe the net amount.

Q: Is there a waiver for shorter term replacement caps?

A: Currently, waivers for shorter terms may be considered by Fannie Mae and limited to priority borrowers and repeat Fannie Mae Borrowers with $100 million and above in current Fannie Mae exposure. Approval of a shorter term cap is also subject to the overall Credit of the transaction, inclusive of the Sponsor's experience with Fannie Mae as well as with externally capped ARM loans.

Q: What is Fannie Mae's deadline to receive full monthly payment?

A: Fannie Mae's remitting deadline for all funds due is the 18th of the month.

Q: Is there an option to get forbearance to avoid default if the Cap is economically unavailable?

A: No.

Q: Can the interest rate cap be waived entirely?

A: Fannie Mae does not provide waivers on interest rate caps at this time. Please refer to the Loan Documents, which require an interest rate cap to be in place at all times during the life of the loan.

Q: Can I receive a waiver for a 1-year interest rate cap term?

A: No, Fannie Mae does not allow 1-year interest rate caps at this time.

FAQs Relating to Interest Rate Caps for Existing Loans

Q: Is there an option to get a shorter term? On the replacement cap?

A: As stated above waivers may be requested for shorter cap terms.

Q: Is there a maximum amount the escrow can increase?

A: No

Q: Can the Servicer reset the escrow at a greater frequency than once per year?

A: Yes, if permitted in the loan documents

Q: What forms of collateral are allowed for interest rate cap escrow?

A: Cash is a required form of collateral. Acceptable forms of collateral are outlined in **Form 6442** – Section 4.01(a) through 4.01(k).

Supporting Documentation

- Multifamily - Industry Partners - Interest Rate Cap Providers
- Fannie Mae Best Practices in Managing Interest-Rate Hedges
- Fannie Mae Interest Rate Cap Requirements