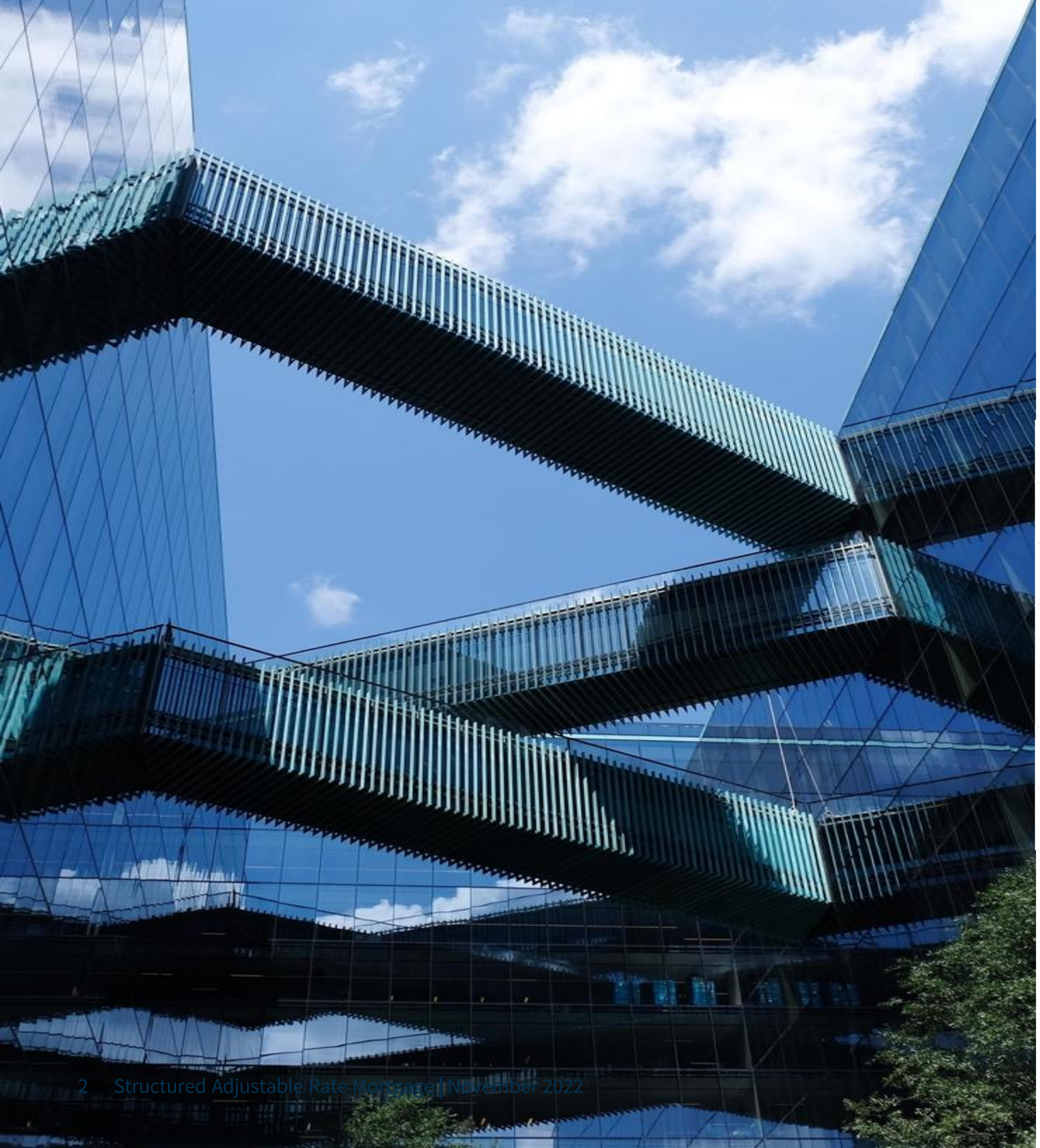
Structured Adjustable Rate Mortgage Loans (SARM Loans)

Presented by Multifamily Training

Fannie Mae®



Learning Objectives

- Definition of a Structured Adjustable-Rate Mortgage Loan
- Benefits of a SARM Loan
- Introduction to interest rate caps
- SARM Loan exit options
- Conversion feature
- Comparison of SARM Loan to other variable rate options
- Question and Answer

What is the Structured Adjustable-Rate Mortgage Loan (SARM Loan)?

SARM Loan =

A variable rate Mortgage Loan with no lifetime or periodic maximum interest rate built into the Loan Documents. The rate adjusts each month according to changes in the underlying interest rate index.

SARM Loans Offer Flexibility

If your Borrower is…	Feature
Uncertain of its holding period	Ability to prepay: After a 1 year lock out, a 1% Prepayment Premium applies
Is looking for a lower payment	Lower principal payments than most adjustable loans, because the principal payments are based on an equivalent amortizing fixed-rate equivalent loan
Considering converting to a fixed-rate Mortgage Loan in the future	Mortgage Loan may be converted to fixed-interest rate starting in Year 2

SARM Loan Terms

Loan Size
$25 Million minimum

Terms:
5, 7 or 10 years

Asset Types
All (some require approval)

Accrual
Actual 360

DSCR/LTV:
Tier 2: 1.0x and 75%

Pre-Review?
Yes

Conversion
Option to convert to a fixed-rate Mortgage Loan

SOFR Index
30-Day Average

Prepayment
1% Prepay Premium or declining Prepayment Premium

Understanding the impact of a variable rate Mortgage Loan without an embedded cap

What are interest rate caps?

An interest rate cap is a financial instrument that gives the Borrower protection from large interest rate increases. The cap buyer receives payments at the end of each period in which the interest rate exceeds the agreed strike price.

A loan without a rate cap is exposed to market volatility.

To reduce interest rate risk, Fannie Mae requires the Borrower to purchase an interest rate cap for all SARM Loans.

Interest Rate Cap Management

Origination/Structuring

- Borrower will typically engage a hedge broker to bid the cap and assist with documentation
- Cap must be purchased from an approved counterparty and documented on approved Fannie Mae forms
- Counterparty must be obligated to make floating rate payments using 30-Day Average SOFR
- Minimum term of 5 years; Deal Team can provider waiver for shorter term

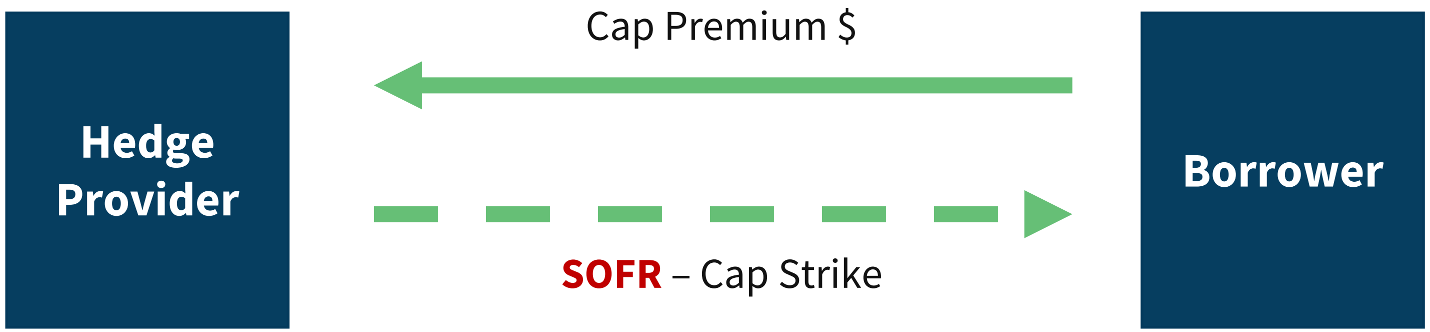
Commitment/Delivery

- Cap must be purchased by Mortgage Loan Delivery

Post Closing

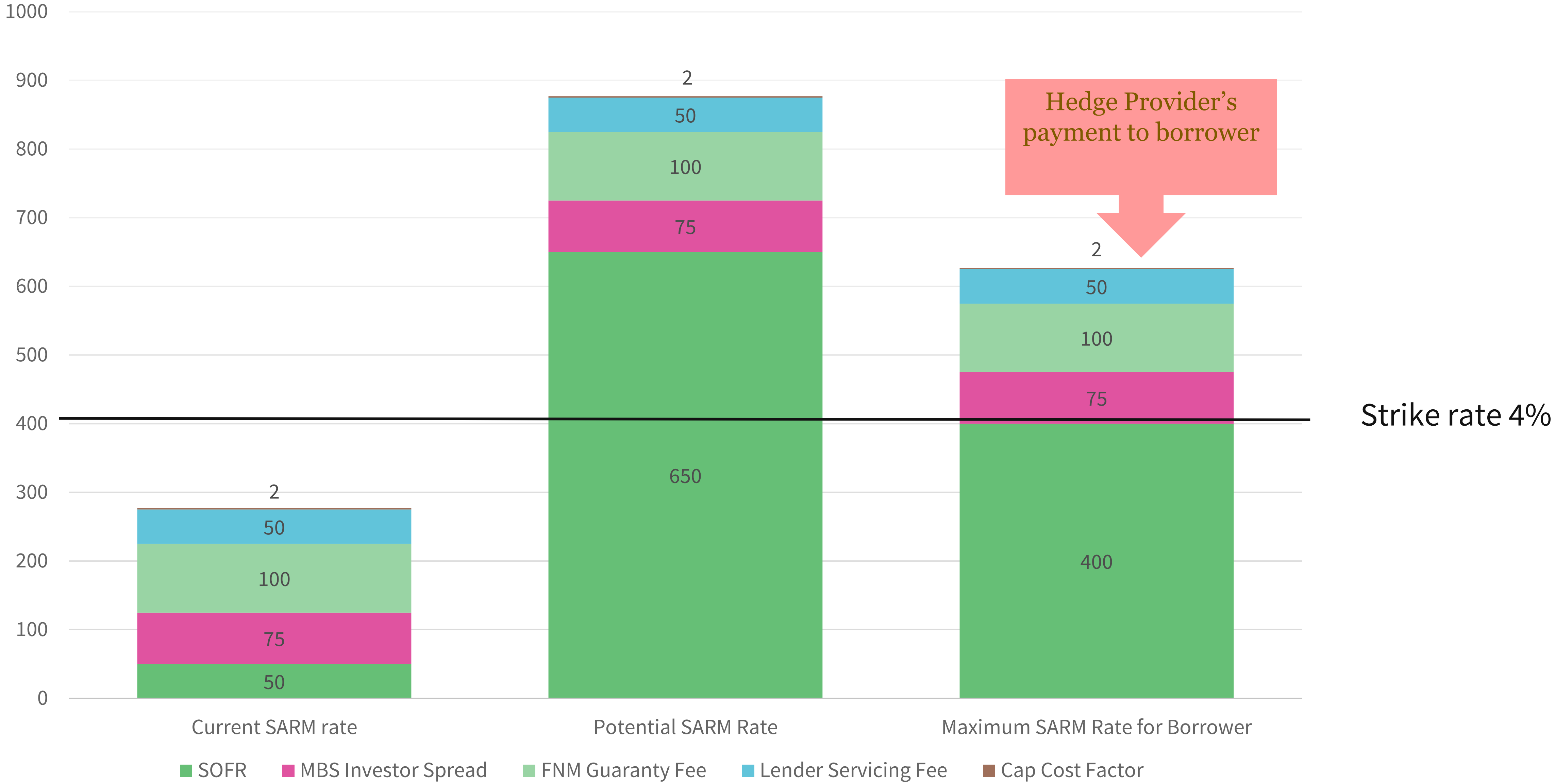
- A cap or escrow for a future cap must be in place for the entire loan term.
- Monthly payment into escrow for the replacement cap is required if initial cap expires prior to the Mortgage Loan Maturity Date
- Replacement cap costs adjusted upward bi-annually

Cap Payment and Flow of Funds



- The Borrower is responsible for purchasing the cap prior to Mortgage Loan Delivery
- Borrower's net upfront payment = Cap Premium
- Borrower's Net Ongoing interest payment = Lesser of 30-Day Average SOFR or Cap Strike Rate + Interest rate Spread
- Hedge Provider's interest payment = 30-Day Average SOFR – Cap Strike (only applies when 30-Day Average SOFR > Cap Strike Rate)

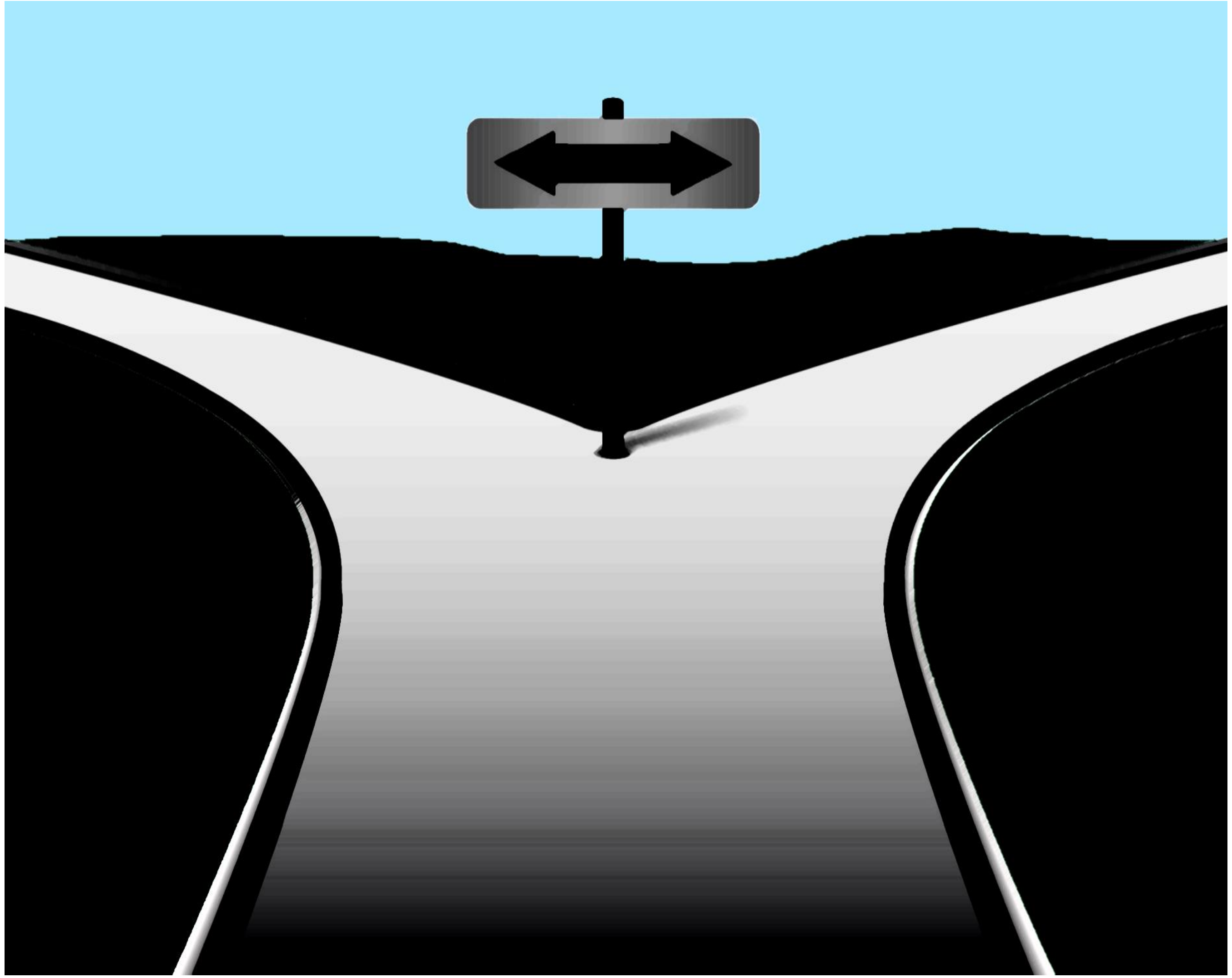
SARM Loan Interest Rate Example



Exit Options

SARM Loans offers multiple flexible options for Borrowers depending on circumstances

Option 1:
Eligible for Conversion to fixed interest rate



Option 2:
Mortgage Loan prepayment flexibility

Converting to Fixed-Rate

Conversion Terms:

- **Timing:** Any rate change date beginning with the first day of the second Loan Year and ending on the first day of the third month prior to the Mortgage Loan Maturity Date
- **Options:** 7 or 10 year fixed-rate loan terms
- **Pricing:** G&S fees for the then-current fixed-rate Mortgage Loan
- **Premium:** Lender can take a 25 bp premium on the trade of the MBS securitized by the new fixed-rate Mortgage Loan
- **Loan Amount**: No increase in loan amount at time of conversion; additional proceeds may be funded with a Supplemental Mortgage Loan

Key benefits of conversion:

- ✓ No prepayment penalty at time of conversion
- ✓ Minimal re-underwriting required to determine that current Net Cash Flow can support the new fixed-rate
- ✓ If an interest-only SARM Loan converts during the interest-only period and the new fixed rate loan term is greater than or equal to the original term, the remaining interest-only period may be carried over to the fixed rate Mortgage Loan
- ✓ Amortization schedule for the Fixed-Rate Mortgage loan can be “Re-set” to 30 years

Prepayment Premium Options

1% Prepayment Premium option
1 year lockout; 1% Prepayment Premium is payable until 3 months remain in the loan term

Declining Prepayment Premium option
1 year lockout, then declining Prepayment Premium (4% second year, 3% third year, 2% fourth year, 1% thereafter)

No Prepayment Premium during last 3 months of the loan term

Resources

- Multifamily Selling and Servicing Guide: Part III, Chapter 12
- FAQ: Variable Rate Conversions
- Job Aid: Entering SARMs into C&D
- Your Fannie Mae Deal Team
- MF Product Management Team:

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- Commitment and Delivery Questions:

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- Servicing and Payoff questions:

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- Structured Facilities conversion questions:

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