

Preferred Equity Guide Update

April 2025



Fannie Mae®

Preferred Equity (“PE”) Changes

GOALS

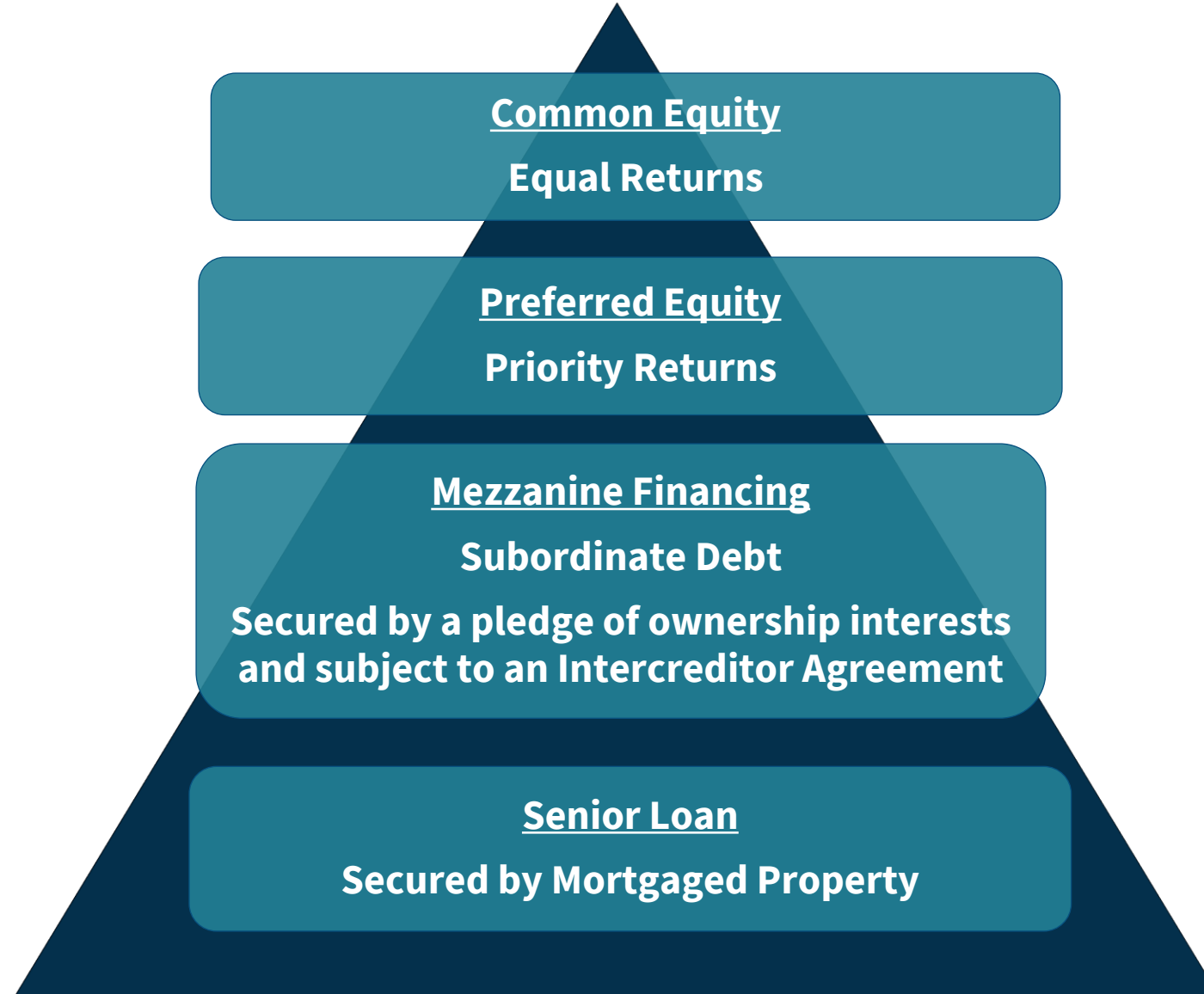
Simplify and Clarify the Guide

Expand PE Options

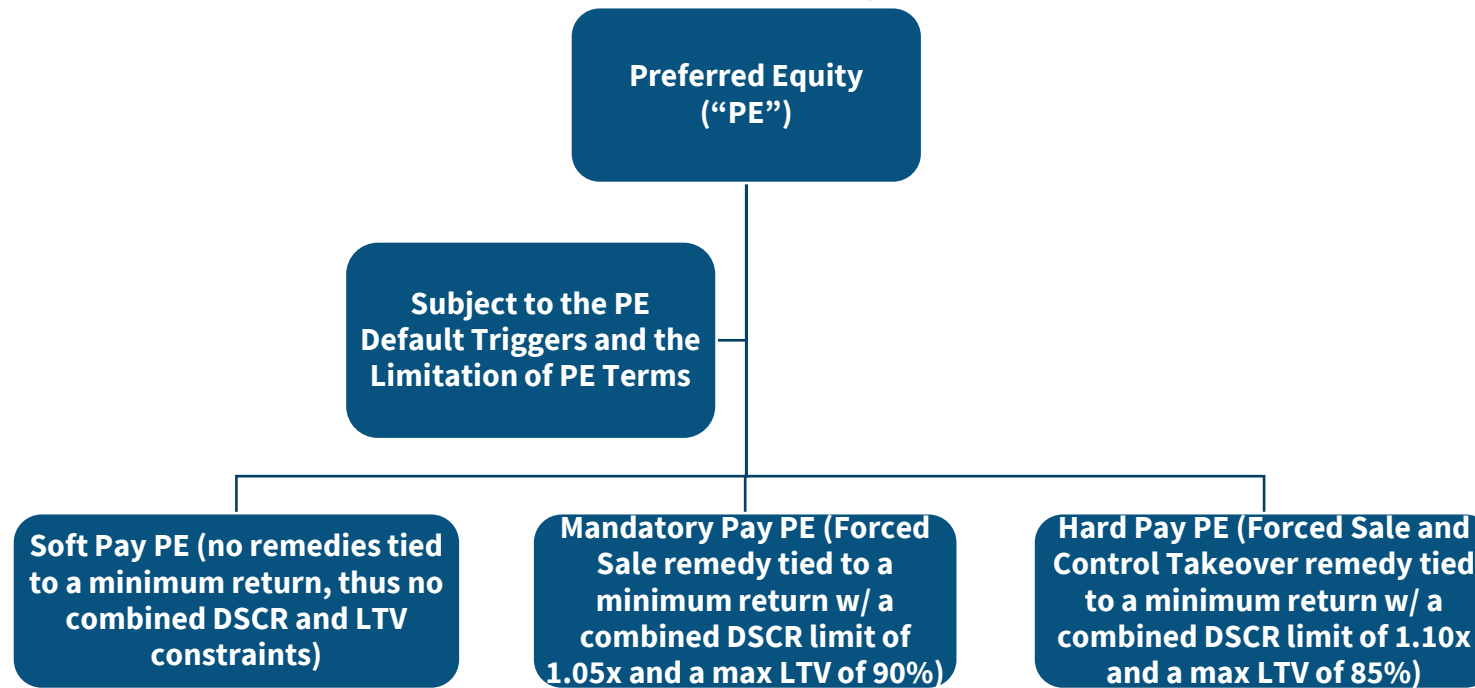
**Define Acceptable PE Default Triggers
and Terms**

**Provide for Delegation and/or
Streamline Preview**

Capital Stack for Commercial Real Estate Investments



Preferred Equity Flow Chart



- Combined DSCR is based on the first mortgage with a 30-year amortization and the portion of PE interest-only return rate that triggers a Forced Sale or Control Takeover remedy. Combined LTV is based on the first mortgage loan balance and the total PE investment amount.
- The PE investor is required to be underwritten as a Key Principal for:
 - Mandatory and Hard Pay PE and for Soft Pay PE if it has any of the Control Takeover rights covered in Items 1-7 of Part II of the PE Checklist (Form 6441).
- The PE investor is underwritten as a Principal in Soft Pay PE if the Control Takeover is limited to Items 8-11 of Part II of the PE Checklist - felony, fraud, false statements and death/incompetence.
- The PE Default Triggers allow for a Forced Sale and/or a Control Takeover except the PE Default Trigger related to a minimum return only applies to Mandatory and Hard Pay PE.
- For Hard Pay PE, the investor must have owned, operated or asset-managed at least 25,000 multifamily units in the past five years.



Delegation for Preferred Equity

- **Soft Pay Preferred Equity that is fully compliant with the PE Checklist (Form 6441) is delegated.**
- **Mandatory Pay Preferred Equity is Pre-Review.**
- **Hard Pay Preferred Equity is Pre-Review.**



Common Equity w/ Preferred Equity Features

The following was added to Part 1, Section 303 of the Guide:

- **Lenders must review all organizational documents to ensure compliance with Section 1602 (which directs the Lender to the PE Checklist) to determine if any investor in the Borrower has unequal returns or the right to a Forced Sale or Control Takeover**
- **Lenders must identify any investor with Control Takeover as a Key Principal or Principal per the PE Checklist**
- **Lenders are not required to deliver a PE Checklist to Fannie Mae at pre-review or loan delivery, but may use the PE Checklist to facilitate their review.**



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Breaking Down the PE Checklist (Form 6441)

- **Introduction - Summary of Parties, Preferred Equity Interest Type and Documents Reviewed**
- **Part I – Determination of Permitted Equity Interest Type**
- **Part II – Permitted Equity Event of Default Triggers**
- **Part III – Limitations of Equity Terms**
- **Exhibit A – Organizational Chart and Governing Documents**
- **Exhibit B – Guidance on Acceptable Major Decisions**
- **Exhibit C – Other Material Financial Terms and Waterfall for Preferred Equity**
- **Exhibit D – Source and Use Schedule**
- **Exhibit E - Preferred Equity Refinance/Sale Exit Analysis**

PE Permitted Default Triggers

- **Violation of Non-recourse Carveouts**
- **Mortgage Loan Defaults**
- **Failure to meet a Minimum Return Threshold (Mandatory or Hard Pay PE)**
- **Failure to apply cash per operating agreement**
- **Failure to make capital contribution**
- **Major Decision without approval**
- **The occurrence of a bankruptcy event by Key Principal**
- **Felony, fraud, false statements, death and incompetence**



PE Limitations on Equity Terms

- **No Other Remedies**
- **No Cash Sweeps**
- **Fixed Return Rate without Escalations**
- **No Cash or Collateral Benefiting the PE**
- **Requirement for the PE to be full funded**
- **No Side Agreements**
- **No Cross-Collateral or Cross-Default unless related Mortgage Loans are also crossed**
- **Limited Rights to Acquire Additional Equity Interests**
- **Subordination of Guarantees to Mortgage Loan Guarantees**
- **No Redemption or Buy/Sell Provision that Forces a Redemption**
- **Ineligible Loans (can be considered on a pre-review basis) See PE Checklist for list of Ineligible Loans.**



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Preferred Equity Sizing Example

ABC Property	
Deal Name	ABC Property
Sponsor	Regional Sponsor
City/State	Atlanta, GA
Purpose	Acquisition + Rehab
Units / YOC	334 / 2001 (Renovated in 2023)
UW Value	\$54,182,755
Cap Ex (not Escrowed)	\$3,750,000
Total Capitalization	\$57,932,755
UW NCF	\$2,984,610
Loan / IO Term	5 -Years / 5 – Years
Amortization	30-Year
Mission	14% @ 60% AMI/ 93.4% @ 80% AMI



Deal Metrics	Soft Pay PE	Mandatory Pay PE	Hard Pay PE
UPB DUS 1 st Lien	\$33,023,755	\$33,023,755	\$33,023,755
Actual LTV DUS 1 st Lien	60.9%	60.9%	60.9%
Interest Rate DUS 1 st Lien	6.04%	6.04%	6.04%
Amortizing DS	\$2,386,130	\$2,386,130	\$2,386,130
Amortizing DSCR DUS 1 st Lien	1.25x	1.25x	1.25x
Total PE Rate/Minimum Return	12.75%/N/A	12.75%/4%	12.75%/4%
PE Amount	\$11,408,894 (1)	\$11,408,894	\$8,178,797
Combined-DSCR (1 st Mortgage + PE)	N/A	1.05x (1 st mortgage on a 30-year amort. & the Minimum Return on an actual basis)	1.10x (1 st mortgage on a 30-year amort. & the Minimum Return on an actual basis)
Combined LTV (1 st Mortgage + PE)	N/A	82% (subject to a maximum LTV of 90%)	76% (subject to a maximum LTV of 85%)

(1) Not restricted by DSCR or LTV constraints so it could be higher or lower.



ABC Property Preferred Equity Exit Analysis

Example is based on a Mandatory Pay PE Scenario

ABC Property - Preferred Equity ("PE") Exit Analysis					
Year	1	2	3	4	5
NCF	2,984,610	3,432,301	3,775,532	4,039,819	4,241,810
Senior Loan Debt Service (Interst Only)	1,994,635	1,994,635	1,994,635	1,994,635	1,994,635
Sale					33,546,000
Cash Flow Remaining for Equity Waterfall	989,975	1,437,667	1,780,897	2,045,184	35,793,175
1. Minimum Return @ 4%	456,360	456,360	456,360	456,360	456,360
2. Minimum Return @4% + 2.5% (a/k/a Current Return)	285,225	285,225	285,225	285,225	285,225
	6.5%	6.5%	6.5%	6.5%	6.5%
Remaining Cash Flow	248,390	696,082	1,039,312	1,303,599	35,051,590
3. Sponsor Asset Management Fee - 2%	59,692	68,646	75,511	80,796	84,836
Remaining Cash Flow	188,698	627,436	963,801	1,222,803	34,966,754
4. Sponsor Common Equity Return - until 6.50% earned	188,698	627,436	963,801	1,222,803	15,100,054
Remaining Cash Flow	0	0	0	0	19,866,700
5. PE Return Rate that Accrues (6.25%)/Total PE Rate of 12.75%	0	0	0	0	16,010,000
Remaining Cash Flow	0	0	0	0	3,856,700
Common IRR					10.89%
PE IRR					12.75%
Debt Yield at Loan Exit					12.84%
First Mortgage Refinance Max Rate					9.71%

Sources			Uses		
Common Equity	\$13,500,000	23.3%	Purchase Price	\$53,000,000	91.5%
Preferred Equity	\$11,409,000	19.7%	Cap Ex - No Escrow	\$3,750,000	6.5%
First Mortgage	\$33,023,755	57.0%	Closing Costs	\$1,182,755	2.0%
Total Sources	\$57,932,755	100.0%	Total Uses	\$57,932,755	100.0%



PE Scenario 1

PE Investor Profile

Mezzanine and PE investor primarily focused on multifamily investments and is affiliated w/ a direct ownership multifamily investment platform that owns > 25,000 units w/ FNMA loan exposure.



Soft PE

w/ Control Takeover limited to felony, fraud, false statements, death and incompetence (Items 8-11 on the PE Checklist)



Soft Pay PE

w/o Control Takeover limitations



Mandatory Pay PE



Hard Pay PE



PE Scenario 2

PE Investor Profile

PE Investor is Mezzanine and PE investor primarily focused on multifamily investments and is affiliated w/ a direct ownership multifamily investment platform that owns 17,000 multifamily units and has exposure to Fannie Mae.



Soft Pay PE
w/ Control Takeover limited to felony, fraud, false statements,
death and incompetence (Items 8-11 on the PE Checklist)



Soft Pay PE
w/o Control Takeover limitations



Mandatory Pay PE

Hard Pay PE



PE Scenario 3

PE Investor Profile

PE Investor is Mezzanine and PE investor in various property types (7 of which are multifamily Mezzanine and Preferred Equity investments). PE investor is not affiliated with a direct ownership multifamily investment platform.



Soft PE
w/ Control Takeover limited to felony, fraud, false statements,
death and incompetence (Items 8-11 on the PE Checklist)

Soft PE
w/o Control Takeover limitations

Mandatory Pay PE

Hard Pay PE



Key Operating Procedures to Highlights

Enter the PE Type in DUS Gateway (Required field under Details):

- ☐ - Not Applicable;
- ☐ - Hard Preferred Equity;
- ☐ - Mandatory Preferred Equity; or
- ☐ - Soft Preferred Equity



Under Deal Participants, enter PE Key Principal(s) or Principal(s) w/ “Preferred Equity Investor” as the Deal Participant Role



Complete Form the PE Checklist (Form 6441). Upload to Gateway if Pre-review and/or as a Delivery Document (only required at Delivery if not pre-review)

Benefits of this change in process

- Better insight into FNMA sponsors across the equity capital stack
- The ability to track our book of business with Preferred Equity structures to assess risk



Alignment with Asset Management

- **Transfer/Assumptions w/ Preferred Equity in the ownership structure will be pre-review for Asset Management if the Preferred Equity is not delegated per the PE Checklist (Form 6441).**
- **Mandatory Pay and Hard Pay Preferred Equity transactions are generally not permitted if the loan did not disclose the Preferred Equity structure at loan origination.**
- **Procedures will be in place to track Preferred Equity post-closing.**



Preferred Equity Transaction SME Team

- **Brian Holding and Kathy Iscra (Northeast Region)**
- **Carolyn Pleasants (Southeast Region)**
- **Alex Murphy (Central Region)**
- **Jack Reynolds (West Region)**
- **Members of the Preferred Equity Development SME Team (Kathy Iscra, Tray Flowers, Tim Verrilli, and Paul Gembara)**



