



Multifamily Mortgage Business Lender Letter 19-05

June 5, 2019

To: Multifamily Lenders

From: Chris Flynn, Vice President for Multifamily Credit, Underwriting

Subject: Lender Letter 19-05 | Best Practices for Confirming Occupancy and Rental Income

HIGHLIGHTS

Fannie Mae is providing Guidance for the performance of property inspections and lease audits as part of the loan underwriting and due diligence process. The goal of this Guidance is to ensure that the Effective Gross Income (“EGI”) established through the underwriting process is accurate and supportable.

Background

The Multifamily Selling and Servicing Guide (the “Guide”) requires the Lender to 1) ensure that the Property meets minimum occupancy levels and 2) analyze property income to allow for accurate calculation of Effective Gross Income (“EGI”). This Lender Letter provides additional Guidance for property inspections and lease audits to help Lenders develop and maintain best practices for establishing property occupancy and EGI.

Guidance on Property Inspections to Confirm Occupancy

The Lender should confirm that units identified in the Property rent roll as occupied and leased are physically occupied by qualified tenants who are paying rent. The Lender should confirm occupancy as part of the required physical inspection of the Property by inspecting a sample of occupied and vacant units.

The Lender, not the Borrower or Borrower’s agent, should select the units to be inspected. These units should include a sample of all unit types from all buildings included in the Property. Fannie Mae recommends, as a best practice, inspecting the following minimum number of units as outlined below. The Lender may choose to inspect more or fewer units, depending on deal-specific needs:

- For Properties of 5 to 50 units, 5 occupied units and all vacant units up to a maximum of 15 vacant units;
- For Properties of 51 to 300 units, 10% of all units (occupied or vacant);
- For Properties of more than 300 units, 5% of all units, but not less than 30 (occupied or vacant);
- All units that have been vacant for more than 90 days; and
- All “down” units.



The Lender should notify property management of the upcoming inspection in writing. While the best practice outlined above allows for minimum unit sampling, Fannie Mae recommends that Lenders identify and request access to a unit sample size larger than the recommended minimum amount to allow for additional random sampling of units if necessary.

Guidance on Lease Audits and Confirmation of EGI

The Lender should perform a lease audit to verify Gross Rental Income and occupancy by reviewing a sample of executed lease agreements against the rent roll. Fannie Mae recommends, as a best practice, reviewing the number of leases outlined below. The Lender may choose to review more or fewer leases, depending on deal-specific needs.

- The recommended minimum number of lease agreements for review is as follows:
 - 10 lease agreements for Properties with less than 100 units;
 - The greater of 10% or 20 lease agreements for Properties with more than 100 units;
 - Minimum lease review counts should be increased at Lender's discretion if material discrepancies are detected in the initial review;
 - Leases reviewed should include all inspected units;
 - Leases reviewed should include recent renewal and new leases for verification of rent trends.
- The lease review should include a complete review of the tenant file, including but not limited to identification records, verification of employment and income, and credit verifications.
- The corresponding cash ledger or receipts journal should be reviewed to validate rent collections.
- A lease audit form or record should be compiled to record validation of lease terms against the Property rent roll.
- The Lender should use other resources such as appraisal and other comparable property information to validate secondary income related to RUBS, cable, laundry, parking, or any other tenant income reported on property operating statements.
- The Lender's notification letter for the audit should specify minimum lease audit requirements; however, it is a best practice to request full records access at the time of the lease audit. This will ensure that additional due diligence may be performed as needed for critical issues identified during the review.

Other Considerations Related to Inspections and Lease Audits

Lenders should also consider the following best practices in relation to the inspection and lease audit functions:

- **Timing** - Lender inspection and lease audit due diligence should be performed no more than 90 days prior to the Commitment Date. If deal-specific circumstances warrant a different inspection timeframe, the Lender should consider mitigants, including a borrower certification or other verification, to confirm that occupancy levels and rent roll information remains acceptable.
- **Notification** – Lender should use a standard inspection notification letter, management questionnaire, unit inspection and lease audit form.

Contact Us

Please contact your Deal Team with any questions.