Fannie Mae

Multifamily Mortgage Business Lender Letter 20-08

April 24, 2020

To: Multifamily Lenders and Servicers

From: Chris Flynn, Vice President, Credit Underwriting

Subject: Lender Letter 20-08 | COVID-19 Underwriting Guidance

HIGHLIGHTS
Please refer to these underwriting considerations during the COVID-19 national emergency.

We are experiencing an unprecedented economic environment resulting from the national COVID-19 pandemic. The economic shock of temporary business closures and the spike in unemployment has wide-ranging implications for multifamily underwriting. The following are additional underwriting considerations that may be applicable during this challenging time.

***Key Principals, Principals, and Guarantors**:* The pandemic has placed additional economic strains on property operations. Expanded Sponsor due diligence may be warranted, including:

- Analysis of the Sponsor's recent Schedule of Real Estate Owned (SREO) and portfolio-level collections data with a focus on any concerning market concentrations.
- Additional review of a Sponsor's current liquidity position given recent market fluctuations and the possible demand for increased liquidity.
- Heightened focus on any office, commercial, or retail properties and active development exposure that are included on the SREO. Future performance of non-multifamily assets should be considered as you evaluate a Sponsor's financial strength.
- For Small Mortgage Loans, Sponsor financial strength may be a concern, and recent credit reports should be analyzed with particular attention to debt utilization rate and any recent late payments, as these may indicate an early signal of financial stress.

***Property Inspection and Appraisal**:* Your safety and the well-being of tenants and Borrowers are paramount. While you and any third-party inspectors are expected to assess the value and physical condition of a Property, access to occupied units may not be feasible because of various shelter-at-home orders. Please refer to Supplement 20-03 for current inspection and appraisal protocols.

Immediate Repairs*:* Property and unit access limitations may also impact Immediate Repair item completion timelines, which may need to be extended until conditions are safer. Please contact your Deal Team for any variance requests for life safety repairs and remediation work for code violations. These will be evaluated on a case-by-case basis.

Minimum Occupancy*:* When determining whether a Property meets Minimum Occupancy requirements (Multifamily Selling and Servicing Guide Part II, Chapter 1, Section 105), physical occupancy is determined when a tenant physically occupies the unit and has commenced paying rent. If a tenant has been paying rent, but rent on the unit is currently delinquent, that delinquency is considered economic vacancy rather than physical vacancy.

Income and Collections*:* With the extension of shelter-at-home orders, we anticipate further impacts to rent collections. The impact on income and collections will vary by location and tenant profile. However, the following measures can provide further insight at the Property level:

- **Residential Income – Stress Testing**
  - Collecting a Borrower-certified current month rent roll and delinquency report can indicate the potential magnitude of increasing economic vacancy.
  - Borrower actions to retain tenants (such as re-negotiating leases or implementing payment plans) may indicate a reduction in Gross Potential Rent (GPR) and exit strategy growth rates.
  - Applying a stressed economic vacancy rate to the underwritten GPR provides insight into the potential magnitude of delinquent or uncollectible rents that a Borrower could tolerate while still covering operating expenses and debt service.
  - While stress testing provides a relevant underwriting metric during this time, recently implemented additional reserve escrow requirements provide enhanced protection against an extreme decline in income over an extended period.
- **Commercial Income – Essential vs Non-Essential Business**
  - *Essential vs. Non-Essential Commercial Tenants*: The Department of Homeland Security has issued a “Memorandum on Identification of Essential Critical Infrastructure Workers during COVID-19 Response” identifying essential businesses. Generally, any income derived from a “non-essential” commercial tenant should not be included in underwritten Effective Gross Income at this time.
  - *Commercial Income for Essential Tenants*: Even an “essential” business may not be operating at full capacity. When determining actual income from occupied commercial space, a commercial tenant should not only be physically occupying the space and paying rent, but also operating its business as intended and generating income sufficient to meet lease obligations. Consider adjusting the underwritten commercial vacancy percentage higher than 10%.

- Even when jurisdictional shelter-at-home orders are lifted, there may be an extended period before businesses resume normal operations. Ultimately underwriting any commercial income may warrant evidence of sustainability.

Paycheck Protection Program: Lender Letter 20-07 provides guidance for Borrowers who want to apply for an unsecured loan under the new Paycheck Protection Program.