



Multifamily Mortgage Business Lender Letter 17-24

December 11, 2017

To: Multifamily Lenders

From: Rob Levin, Vice President for Multifamily Credit, Underwriting

Subject: Lender Letter 17-24 | Underwriting Guidance for Short Term Lodging Lease Pre-Review Mortgage Loans

Highlights

Fannie Mae is providing guidance for underwriting Mortgage Loans secured by a Property permitting **Short Term Lodging Leases**.

Short Term Lodging Leases

The Multifamily Underwriting Standards ("Form 4660"), effective August 28, 2017, included a new Pre-Review Mortgage Loan category related to a Property permitting short term lodging leases. For purposes of the Multifamily Selling and Servicing Guide ("Guide") and Form 4660, Short Term Lodging Leases or any Short Term Rental (collectively, "STR"), is defined as a lease or master lease (which include subleases, licenses, and other possessory interests, whether oral or written) of an individual dwelling unit for which the intended occupancy of the unit is for a period of less than 30 days, irrespective of the stated lease term. This guidance applies, but is not limited, to:

- corporate tenants/guest suites;
- Recreational Vehicle ("RV") Site rentals in a Manufactured Housing Community; and
- arrangements either between: (i) the Borrower and the tenant, where the tenant has an agreement with a short term rental platform or provider (e.g., Airbnb, VRBO®, etc.), or (ii) the Borrower and a short term rental platform or provider that permit tenants' offering of short-term rentals.

To assure that the residential nature of the Property being financed by Fannie Mae is maintained, any lease of STR units must be counted as a Commercial Lease, and will be subject to the 35% commercial limitations for total rentable area and Effective Gross Income ("EGI") described in Form 4660.

In addition to the requirements for Commercial Leases set forth in the Guide and Form 4660, Lenders should consider the guidance set forth in this Lender Letter when submitting the transaction for Pre-Review.

Underwriting Short Term Lodging Leases

The following should be considered when determining Underwritten Net Cash Flow ("NCF"):

- generally, a minimum 12 month history of collecting STR income at the Property is preferred;



- actual contract lease STR income, and any associated Corporate Premiums, should be treated as commercial income and reflected in the “Commercial Income” line item, and is subject to the required commercial income underwritten vacancy (typically minimum 10% per the Guide). For example, if monthly actual contract lease STR income is \$1,000 for a unit, then include \$12,000 (\$1,000 X 12 months) in the commercial income line item and then apply the applicable commercial income vacancy;
- all expenses associated with the STR should be underwritten in their respective expense line items, including, but not limited to, cleaning, furnishing, repair, etc.;
- any corresponding taxes, fees, etc. related to the STR that is imposed by the governing jurisdiction for the Property, should be underwritten in the “Other” expense line item and noted as such in the underwriting analysis; and
- Lender should also deduct as an “Other” expense the difference in actual lease STR income and an equivalent market rate apartment rent (as if leased as an apartment unit), if applicable, except for RV Site rentals. For example, if actual lease STR income for a unit is \$1,000 and market rate residential rent for that unit is determined to be \$900, then deduct \$1,200 (\$1,000 - \$900 = \$100 X 12 months) as an Other expense, and note as such in the underwriting analysis.

The following table summarizes the underwriting distinctions between the lease types. Transactions still must comply with all Guide requirements for Master Leases and calculating Underwritten NCF (including Corporate Premiums).

Lease/Master Lease Term or Occupancy	Compliance for Residential	Underwritten Income Type	Corporate Premium Category	Limitations	Examples
≥ 30 days	Yes	Residential	Corporate Premiums	N/A	Standard Residential Leases; Corporate Leases for residential units (such as to a corporation or other entity); and Master Leases (such as to a university)
< 30 days	No	Commercial	Commercial	5% of total number of residential units (except RV Sites, which must comply with Part IIIB, Chapter 6)	Same as above, plus Guest Suites, RV Sites, and vacation rentals (such as VRBO, Airbnb, etc.) Fannie Mae does not differentiate between Borrower-provided or third party-provided STR.

Other Considerations

Lenders should also consider the following:

- As required in the Multifamily Loan Agreement and Part IIIA, Chapter 3 of the Guide, the Lender must ensure that the STR is legally permissible and in compliance with applicable laws and zoning for that jurisdiction. Compliance with zoning and other applicable laws may not be waived.



- The Lender must request modifications to the Multifamily Loan Agreement, as Section 7.02(a)(3) does not permit Residential Leases (which include subleases, licenses, and other possessory interests in an individual dwelling unit, whether oral or written) with initial terms of less than one month without Lender's prior written consent. The modification memo request should include a maximum percentage or number of units that will be permitted to have an initial term of less than one month, and confirm that the Borrower has acknowledged that the income from such units will be treated by the Lender as commercial income. The proposed modification is subject to Fannie Mae's review and approval.
- The Borrower's or Master Lessee's insurance policy should cover any STR.
- The Master Lease should be 'residential' in nature (e.g., not operated as a hotel or other single room occupancy ("SRO") arrangement).

Example

A 100-unit conventional Multifamily Property where 5% of the units are STR. The residential rents are \$1,000 per month for 95 units, and \$3,000 per month for the 5 STR units. The square footage for the 95 residential units and 5 STR units are 1,500 each.

Gross Potential Rent:	\$1,140,000 [\$1,000 X 95 units X 12 months]
Less Actual Vacancy (e.g., 5%):	<u>(\$ 57,000)</u>
Net Residential Income:	\$1,083,000
Other Residential Income:	\$ 50,000
Total Commercial Income:	\$ 180,000 [\$3,000 X 5 STR units X 12 months]
Less 10% Commercial Vacancy:	<u>(\$ 18,000)</u>
Net Commercial Income¹:	<u>\$ 162,000</u>
Effective Gross Income (EGI):	<u>\$1,295,000</u>
<i>Less Operating Expenses</i>	
Less Property Management:	(\$ 38,850) [3% of EGI]
Less Real Estate Taxes:	(\$ 75,000)
Less Insurance:	(\$ 30,000)
Less*:	(\$ 200,000) [*includes Utilities, Water & Sewer, Repairs & Maintenance, Payroll & Benefits, Advertising & Marketing, Professional Fees, General & Administrative]
Less Other Expenses:	(\$ 120,000) [STR actual rents \$3,000 less \$1,000 residential market rate = \$2,000 X 5 STR units X 12 months ²]
Net Operating Income:	\$ 831,150
Less Replacement Reserves:	<u>(\$ 25,000)</u> [\$250 per unit]
Net Cash Flow:	\$ 806,150

¹Commercial Income Percentage = Net Commercial Income / EGI

$$(\$162,000 / \$1,295,000) = \underline{12.5\%}$$

Commercial Space Percentage = Leased Commercial Space / Total Space

$$\text{Residential Space} = 95 \times 1,500 = 142,500$$

$$\text{Leased Commercial Space} = 5 \text{ STR} \times 1,500 = 7,500$$

$$\text{Total Space} = 142,500 + 7,500 = 150,000$$

$$\text{Commercial Space Percentage} = 7,500 / 150,000 = \underline{5\%}$$

²Include any STR related expenses imposed by the governing jurisdiction in Other expenses.



Contact Us

Please contact your Deal Team with any questions.