SBL Refinance Analysis

Revised as of September 29, 2020

A cash out refinance should include any transaction where the proceeds of the new loan exceed the balance of the existing first mortgage loan and any junior capital (such as a second mortgage, mezzanine debt or preferred equity) plus an allowance for Permitted Transactional Expenses. Permitted Transactional Expenses are defined as 1) Prepayment penalties paid by the borrower, 2) COVID-19 debt service reserve, and 3) Closing Costs as defined below, not to exceed 3% of the UPB of the new loan.

Closing Costs include the following:

- Mortgage origination fees (including Seller / Servicer fees and Freddie Mac's application fee) payable in connection with the new Mortgage, so long as they are not included in the interest rate.
- Broker fees
- Other reasonable closing or settlement costs paid by the borrower, such as mortgage registration taxes, recordation fees, survey, title searches and title insurance, attorney's fees, and credit report charges
- Fees for third party reports including appraisal reports, environmental reports, and property condition reports

Escrowed Discretionary Capital Improvements are excluded from the cap on closing costs of 3% of UPB.

If the sponsor is not including all the collateral from the existing loan in the new loan, the existing loan balance will be prorated for determination of cash out.

If the refinance request is based on an acquisition that has taken place within 12 months of full underwriting package submission to Freddie Mac, underwritten value will be based on the total acquisition cost defined as the sum of (1) the purchase price, and (2) the permitted and documented closing costs to third parties in an amount not to exceed 3% of the purchase price. Consideration may be given to capital expenditures completed in accordance with the underwriting guidance provided below.

A cash out transaction after a short-term hold period is subject to additional underwriting measures to ensure that the increased underwritten NOI and value are sustainable and well supported.

Increases in NOI and value can occur as a result of a new owner simply recognizing that the property's rents are below market and raising rents to the higher market levels. Increases in value and NOI can also result from the completion of a value-add investment strategy by the sponsor. Elements of a value-add strategy can include:

- Interior renovations (flooring, cabinetry, bathroom fixtures, appliances, new HVAC)
- Exterior renovations or improvements (adding amenities, lighting, fencing, landscaping)
- Curing deferred maintenance (replacing roofs, repaving parking surfaces, exterior painting, repairing siding)

The increase in value should be measured by the difference between the current Net Rental Income (NRI) and the NRI prior to the improvements. For underwriting purposes, the increase in value is measured by the increase in Net Rental Income, not Net Operating Income, to avoid the risk of a sponsor aggressively cutting expenses to an unsustainable level.

$$\frac{NRI_1 - NRI_0}{CapRate_1} = Value\ Increase\ from\ Change\ in\ NRI$$

The underwritten value for the new transaction should not materially exceed the sum of the sponsor's acquisition cost basis, plus the value increase from the change in NRI. The sponsor's acquisition cost basis should generally exclude the cost of discretionary capital improvements completed after acquisition, however in certain situations, costs incurred to cure deferred maintenance present at the time of acquisition may be appropriate to include in the cost basis.

Underwriting guidance:

1. In the case of a property benefiting from capital improvements, the sponsor should provide a detailed summary of the improvements that were completed, including a description of the improvements and evidence of the costs and categories of improvements.
    a. This information should be fully available prior to the inspection such that it can be verified.
2. Value must be supported by change in NRI (, the sponsor will provide a rent roll dated prior to the improvements to compare to the current rent roll).
    a. If a rent roll is not available supplemental documentation to support the increase in rent is required.
3. Credit for increased Other Income is only available when the increase in Other Income is evident in the historical operations for a period of at least 12 months. On an exception basis we may permit evidence of at least 6 months.
4. RUBS income must be based on a T12 trend; under certain circumstances we may allow a credit of the RUBS income based on a minimum of 6 months trend.
5. T12 collections must be provided, with no material deterioration in T3.
6. Taxes underwritten to greater of 80% of underwritten value and the appraiser’s estimate of taxes.
7. Underwritten expenses not less than T12, in the aggregate and by expense category, unless previously approved by Lender.
8. Borrower must provide support for acquisition price (within the last 2 years) or cost basis (e.g. existing Freddie Mac loan files, settlement statement from original purchase, title policy, tax return schedules, recording information, other public information)