



Bulletin

NUMBER: M2019-4

TO: Freddie Mac Multifamily Sellers and Servicers

September 26, 2019

SUBJECTS

In the September 27, 2019 Guide Bulletin, we are:

- Improving our systems for managing access to Multifamily applications for our System Administrators and Users
- Updating our corporate fidelity and errors & omissions coverage requirements
- Modifying our requirements for Small Balance Loan (SBL) Mortgages as follows:
 - Reserving the right to approve individuals and certain revocable trusts as Borrowers
 - Adding requirements for SBL guarantors
 - Aligning requirements for SBL Mortgages with principal balances exceeding \$6 million to be consistent with requirements for SBL Mortgages with principal balances of up to \$6 million
 - Removing certain requirements for SBL Mortgages secured by non-contiguous parcels
 - Eliminating the need to submit a *Seller/Servicer Fee Certificate* form with the underwriting package
- Updating Borrower requirements specific to Crowdfunding
- Clarifying that we will not purchase a Mortgage encumbered by a regulatory agreement that encumbers any property other than the Property
- Revising for consistency our inspection report requirements for wood-damaging insects
- Modifying our threshold for non-consolidation legal opinions
- Making non-substantive clarifications to our preferred equity requirements
- Updating our loan sizing requirement for Bridge to Resyndication Mortgages
- Revising our requirements for a Mortgage secured by a Section 8 Property, including changes to the definition of a Long-Term Section 8 contract and the requirements for transition reserves
- Streamlining our Chapter on ground lease Mortgages
- Revising our requirements for post-purchase reporting as follows
 - Modifying the conditions under which a *Loan Management Form (LMF)* must be submitted to Freddie Mac, effective with 2020 loan submissions
 - Updating our requirements for identifying and addressing Life Safety Hazards during the post-purchase annual inspection of a Property
 - Adding a clarification concerning the need for corrections to Form 1028, *Value-Add Monitoring Form*, and for the creation of a Loan Item Tracking (LIT) to meet reporting requirements
- Requiring registration documents for all rent regulated units with an agency registration component if applicable
- Housekeeping changes are being made to Form 1103, *Multifamily Environmental Assessment Form*, and Form 1105, *Property Condition Assessment*.

Effective dates

All revisions announced by this Bulletin are effective immediately, with the exception of the changes to requirements for the LMF, which will be effective January 1, 2020, for 2020 submissions.

Conclusion

More details on these changes are provided on the pages that follow. Guide text for the changes announced in this Bulletin is highlighted in green on AllRegs. If you have any questions about this Bulletin, please call your Freddie Mac representative.

Sincerely,

B. Stephen Lansbury
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Managing Access to our Applications for System Administrators and Users

As we improve our processes for managing access to our applications for System Administrators, we are updating the Glossary and Sections 2.12(a) and 2.13(b) with the current Multifamily Software Applications. We are also making non-substantive changes to our terminology in Section 2.13(b) in support of this effort.

Fidelity Bond and Errors and Omission Insurance Coverage Requirements

We are updating our corporate fidelity and errors & omissions (E&O) coverage requirements to align with industry standards, coverage availability and operational risk based on portfolio UPB. We are adjusting minimum coverage calculations, lowering the maximum coverage caps, and easing requirements for self-insurance and fidelity or E&O insurance provided by a captive insurance company. Our Pooling and Servicing Agreements and Sub-Servicing Agreements will reference these Guide requirements. Sections 3.16(b), 3.16(c) and 3.16(g) have been updated in support of this change.

We are also making minor editorial changes to Section 3.16 to clarify that Seller/Service providers must maintain, at all times, fidelity insurance and mortgagee's errors and omissions (E&O) insurance that meet all of the requirements of the Guide.

Small Balance Loan (SBL) Mortgage Requirements Updates

SBL Borrower Types

We are revising our requirements for SBL Mortgages to indicate that individual Borrowers and revocable trusts are no longer generally acceptable Borrower types. Rather, we now reserve the right to approve these Borrower types in our discretion. Section 9SBL2(a) is being modified to reflect this change.

Requirements for Guarantors

We are modifying Sections 9SBL.2(c) and 9SBL.2(d) to indicate the requirements that an entity must meet for Freddie Mac to approve the entity as a guarantor for SBL Mortgages. For an entity to be approved as a guarantor, it must provide evidence that it has at least twice the amount of our stated minimum net worth and liquidity requirements.

SBL Mortgages with Principal Balances Exceeding \$6 Million

We are aligning our requirements for SBL Mortgages with initial principal balances exceeding \$6 million to be consistent with requirements for SBL Mortgages with initial principal balances up to \$6 million. We no longer require that a Borrower with an SBL Mortgage exceeding \$6 million be a Special Purpose Entity and we have removed requirements for a zoning report and survey.

Sections 8SBL.5, 29SBL.5, 9SBL.2(b), 18SBL.1(a), 55SBL.2, 60.12(g) and Exhibit 1, Section 1.2, SBL Underwriting are being revised to reflect this change.

SBL Mortgages Secured by Non-contiguous Parcels (Linked Buildings)

We are updating Section 8SBL.6(c) to indicate that transactions involving SBL Mortgages secured by non-contiguous parcels (Linked Buildings) must be prescreened by Freddie Mac. In support of this change we are updating Section 8SBL.6(f) to remove specific criteria for Linked Buildings and are revising the Glossary to note the prescreening requirement of Section 8SBL.6(c) for these Properties.

Retirement of Seller Fee Certificate Form

While we still require that Sellers provide us with information about any broker and correspondent fees they pay in connection with an SBL Mortgage, we are no longer requiring submission of the *Seller Fee Certificate* as the data will now be transmitted to Freddie Mac via the *Pipeline Management Tool (PMT)*. We are updating Section 55SBL.2 and Exhibit 1.2, the *SBL Underwriting Checklist*, with this change.

Borrower Requirements Specific to Crowdfunding

We are modifying our Glossary definition for Crowdfunding to refer to investment in a single Property under Title III or IV of the Jumpstart Our Business Startups (JOBS) Act.

We are revising Section 9.2(g) and adding Section 9SBL.2(g) to clarify that no direct or indirect Controlling interest in a Borrower, or any interest which could assume Control of Borrower, may consist of investments raised via Crowdfunding. It is acceptable to have crowdfunded investments in a fund, where investments are spread among multiple assets and not limited to a single Property.

Form 1115, *Borrower/Borrower Principal Certificate* and 1115SBL, *Borrower/Borrower Principal Certificate-SBL* have been updated in support of this change and crowdfunded interests in the Borrower must now be identified on these forms.

Mortgages Encumbered by Regulatory Agreements

We are updating Sections 8.14 and 8SBL.14 to clarify that a Mortgage is ineligible for purchase if it is encumbered by a regulatory agreement that encumbers any property other than the Property.

Wood-damaging Insect Inspection Reports

We are updating Sections 8.2(e) and 55.2 to indicate that a wood-damaging insect inspection report is not necessary if the Property has no wood framing or structural members as determined by either the Property Condition Report or Physical Risk Report, or the following conditions are met.

- A wood-damaging insect contract is in place and will remain in place for the term of the Mortgage, and
- There is no evidence of wood damage as determined by the Property Condition Report (if applicable).

Threshold for Non-Consolidation Legal Opinions

We have raised the threshold for requiring a non-consolidation opinion. We now require the opinion for all Mortgages with a UPB of \$40 Million or more. Section 9.11 has been revised to reflect this change.

Preferred Equity Housekeeping Changes

We have made clarifying revisions to Sections 11.6(a) and 11.6(b) to make it easier to read. No requirements were added or modified.

Bridge to Resyndication Mortgages

We are updating our loan sizing requirements for Bridge to Resyndication Mortgages to address situations in which an interest rate cap has been purchased. In addition to the as-is market value and the as-is NOI, the DCR and LTV parameters will be based on the greater of the 7-year comparable fixed-rate mortgage equivalent, or either of the following:

- If no interest rate cap is purchased, the sum of the 1-month LIBOR rate and the Gross Spread
- If an interest rate cap is purchased, the maximum capped note rate acceptable to Freddie Mac

This change can be found in Section 19.2(g).

Section 8 Contracts

Long Term and Short Term Section 8 Contracts

We are updating Section 23.3(a) with respect to Long-Term Section 8 contracts. A Section 8 contract is considered a Long-Term Section 8 contract if

- The term of the Mortgage is less than or equal to 20 years and the Section 8 contract is greater than or equal to the term of the Mortgage, or
- The term of the Mortgage is greater than 20 years and the Section 8 contract is greater than or equal to 20 years.

A Section 8 contract not meeting these requirements is considered a Short-Term Section 8 contract.

We also reworded Section 8 requirements in Section 23.3 to enhance readability, however, these changes do not represent a change in requirements.

Transition Reserves

We are revising the requirements for Transition Reserves. To eliminate the requirement for a Transition Reserve, the Borrower Principal net worth must be:

- Twice the Mortgage amount for a Mortgage less than \$10 million,
- \$20 million for a Mortgage greater than or equal to \$10 million and less than \$20 million, or
- Equal to the Mortgage amount for a Mortgage greater than or equal to \$20 million.

Borrower Principal liquidity must be equal to at least 12 months of debt service, regardless of the Mortgage amount.

We are now permitting a Transition Reserve to be released when the Borrower has secured a new fully executed Long Term Section 8 contract, subject to the following conditions:

- The Property, with the new Long-Term Section 8 contract rents, has achieved the current program minimum DSCR.
- The Property has achieved 90 percent occupancy for a minimum of 90 consecutive days.
- There are no defaults.
- The Property is in satisfactory physical condition, as determined by the most recent inspection conducted by Freddie Mac or the Servicer.

We have added the following conditions to the scenario for the release of a Transition Reserve when the Section 8 contract has expired and will not be renewed:

- The Property, at market rents, achieves the current program minimum DSCR.
- The Property is in satisfactory physical condition, as determined by the most recent inspection conducted by Freddie Mac or the Servicer.

These changes can be found in Section 23.3(f).

Underwriting Documentation

In a new Section 23.3(g), we have added the requirement for Sellers to include the Section 8 documentation specified in Section 55.2 in the underwriting package submitted to Freddie Mac.

Ground Lease Mortgages

We have streamlined and re-organized the content in Chapter 30, *Ground Lease Mortgages*. We recommend that Seller/Servicers review the Chapter in its entirety to familiarize themselves with our requirements for Ground Lease Mortgages.

Post-purchase Reporting

Loan Management Form (LMF)

Beginning with 2020 submissions, we will no longer require and PRS will no longer automatically create an LMF assessment for each Mortgage held by Freddie Mac. Instead, the Servicer will be required to evaluate a Mortgage and determine whether an LMF is required based whether any of the following conditions exists:

- The Borrower or the Property is in non-monetary default.
- There is any unauthorized rehabilitation or construction underway at the Property.
- The Borrower or Borrower Principal is in bankruptcy or is insolvent.
- There are problems or issues with any Reserves connected with the Mortgage or the Property.
- The Servicer cannot certify that the UCC filings are current.

If the Servicer determines that the Borrower has failed to comply with the terms and conditions of the Loan Documents, an LMF is required. The Servicer must email Freddie Mac to request that an LMF be created. In the LMF, the Servicer must describe the noncompliance and detail the Servicer's recommended actions.

We are also clarifying requirements for the timing of submission of the LMF.

These changes can be found in Sections 40.2(b), 40.6(a), and 40.6(c).

Post-purchase Annual Property Inspection

We are updating our requirements for the post-purchase annual property inspection as follows:

- Adding definitions for Imminent Life Safety Hazards and Potential Life Safety Hazards to the Glossary
- Requiring the property inspector to identify both Imminent and Potential Life Safety Hazards when assessing the physical condition of a Property
- Requiring the Servicer to
 - Include Imminent Life Safety Hazards and Potential Life Safety Hazards in its assessment of the physical condition of the Property
 - Distinguish Imminent Life Safety Hazards from Potential Life Safety Hazards in any notices that the Servicer sends to the Borrower concerning the need to take corrective action
 - Follow up with the Borrower if any Deferred Maintenance poses a significant deficiency affecting the Property's structure or value
 - For certain SBL Mortgages, work with the Borrower until all PR-90 Repairs that were identified as Life Safety Hazards are remediated or resolved
 - During any period in which Freddie Mac holds a Mortgage, report any identified catastrophic conditions to us immediately and contact the Borrower without delay to discuss repairs

These changes can be found in the Glossary and in Section 40.7(d).

Value-Add Mortgages

We are clarifying that a version of Form 1028 customized for each Property will be attached to the Loan Item Tracking (LIT) entry in PRS. If any corrections to the form are needed, or if a LIT item needs to be created in order to meet reporting requirements, these requests should be submitted to Freddie Mac.

Registration documents for all rent regulated units with an agency registration component

We are requiring that the Seller if applicable must provide copies of registration documents for all rent regulated units with an agency registration component. Section 55SBL.2 and Exhibit 1.2, the *SBL Underwriting Checklist*, have been updated to reflect this change.

Housekeeping Changes

- We are updating Form 1103, *Multifamily Environmental Assessment Form*, with a print to PDF button.
- We are making minor revisions to the Manufactured Housing Community section in Form 1105, *Property Condition Assessment*.