



# Fannie Mae Training: Changes to the Structured Adjustable-Rate Mortgage Loan (SARM)

October 2024



# Agenda



**New SARM  
Changes**



**Benefits and  
Features**



**Underwriting  
and Post-  
Closing**



**Submitting and  
Delivery**



# SARM Enhancements and Changes



*Image: Broadstone Kendrick, Denver, CO*

# Strengthening the SARM

**Maintain a strong variable rate product and meet the market for Fannie Mae's most used variable-rate loan product.**



# Enhancements and Changes

## Summary

Changes	New SARM Parameters	Existing SARM Parameters
Streamlined UPB Calcs	4 U/W Tests	5 U/W Tests
Tier 2 DSCR	Refer to Form 4660	Refer to Form 4660
Tier 2 LTV	Refer to Form 4660	Refer to Form 4660
Loan Term	5 year	5, 7 and 10 years
Interest-Rate Cap Term	5 year	3-5 year
Replacement Interest-Rate Cap Escrow (when applicable)	<ul style="list-style-type: none"><li>Escrow fully funded at 110% at closing</li><li>Release of excess funds is allowed</li></ul>	<ul style="list-style-type: none"><li>Funded monthly over the original cap term</li><li>No release of excess escrow funds</li></ul>

Note: These terms are applicable to DUS Flow loans, Structured Transactions have different tolerances on max LTV, loan term, and cap term.

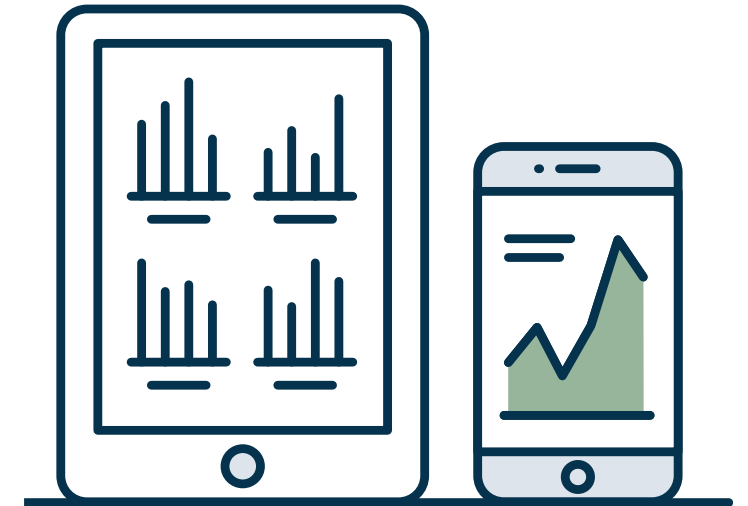


# U/W Tests and Max. Note Rate

New SARM Parameters	Existing SARM Parameters
1. Fixed Rate Test	1. Fixed Rate Test
2. Max LTV Test	2. Max LTV Test
3. Max Note Rate Test	3. Variable UW Rate Test
4. Pay Rate Test	4. Min Strike Test
	5. Pay Rate Test

**Max Note Rate** = Minimum Cap Strike Rate  
G + S Fee  
Investor Spread

**Minimum Cap Strike Rate** is set by Fannie Mae and reviewed every quarter at a minimum.



# Loan Term and Sizing

## Product Type Considerations

### Conventional & MAH

- SARM loans will be quoted with a 5-year term

### Structured Transactions

- SARM Loans may have terms up to 7 and 10 years for certain product types

## Sizing by Tier

TIER	Min UW DSCR	Max LTV (Conv.)	Max LTV (MAH)
2	Refer to Form 4660		
3	Refer to Form 4660		
4	Refer to Form 4660		

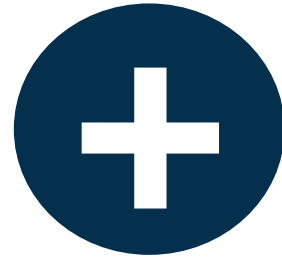
\*Refer to the latest Form 4660 for current DSCR/LTV requirements



# Interest Rate Caps

DUS Flow Loans

**5** year  
**loan** term



**5** year  
**cap** term



**New: Loan Term must  
match cap term**



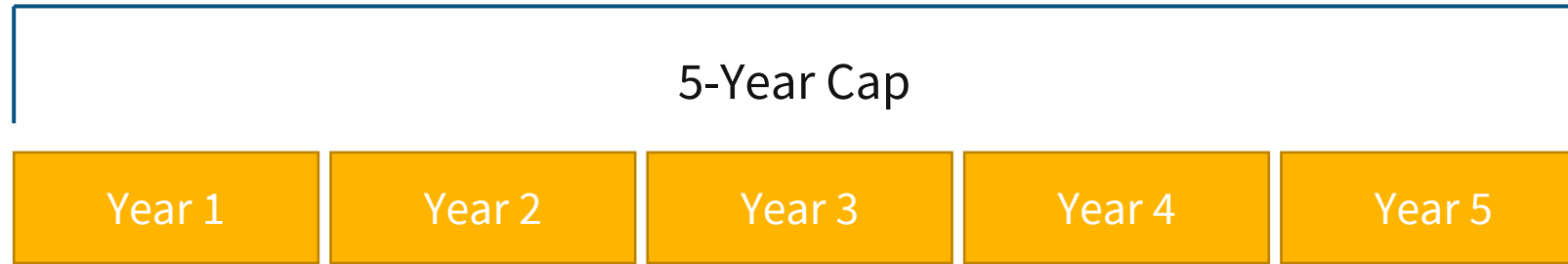
**No replacement cap  
escrow required**



# Interest Rate Caps

## DUS Flow Loans

5-Year Loan:



# Interest Rate Caps

## Structured Transactions

These requirements apply to loans with an initial interest rate cap that will mature before the SARM loan matures



Escrow



Funds Replacement Cap

**Escrows for replacement caps cannot be held for a longer than 36 months.**



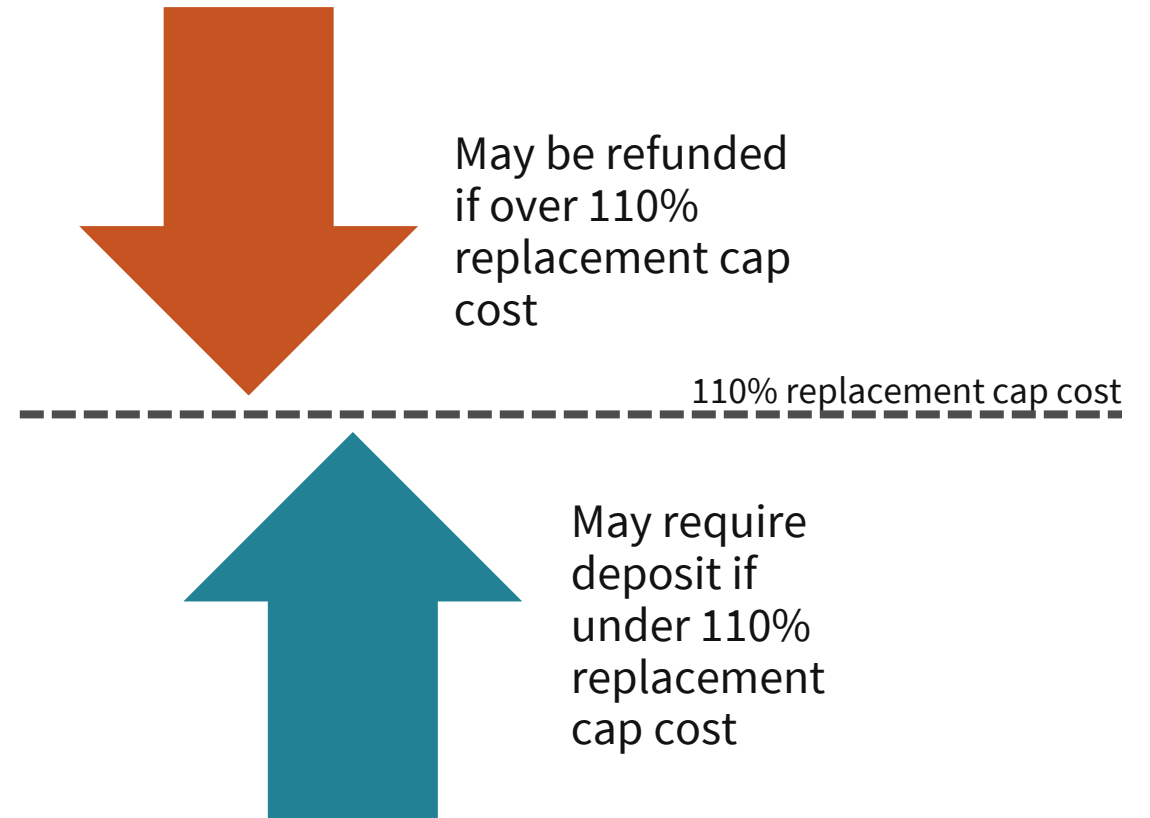
# Replacement Cap Escrows

Escrows are required to be funded at 110% of replacement cost over the life of the interest rate cap

Are the escrows ever adjusted?



Replacement cap escrows are adjusted or resized every six months relative to replacement cap costs. We now allow escrows to be adjusted up or down.



# Benefits and Eligibility



# SARM Eligibility



## Loan Size

\$25 Million minimum



## Borrower

Has prior experience with interest rate hedges



## Interest Rate Cap

- External cap required
- [Fannie Mae approved provider](#)



## Asset Types

- All are eligible
- Some require additional approval



# SARM Terms

**Loan Size**  
\$25 Million minimum

**Terms:**  
5 years  
(conventional)

**Asset Types**  
All (some require approval)

**Accrual**  
Actual 360  
**Amortization**  
Straight-line

**LTV/ DSCR:**  
Tier 2: Form 4660  
Tier 3: Form 4660  
Tier 4: Form 4660

**Pre-Review?**  
Yes

**Conversion**  
Option to convert to  
a fixed-rate loan

**SOFR Index**  
30-Day Average

**Prepayment**  
1% prepay or  
declining prepay



# SARM Loans Offer Flexibility

If your Borrower is...	Feature
Considering a shorter holding period	Ability to prepay: After a 1-year lockout, a 1% Prepayment Premium applies
Considering converting to a fixed-rate Mortgage Loan in the future	Mortgage Loan may be converted to fixed-interest rate starting in Year 2
Considering trends in interest rate movement	Take advantage of variable rate and benefit when interest rates decrease during loan term



# Prepay Options - Flexible Exits

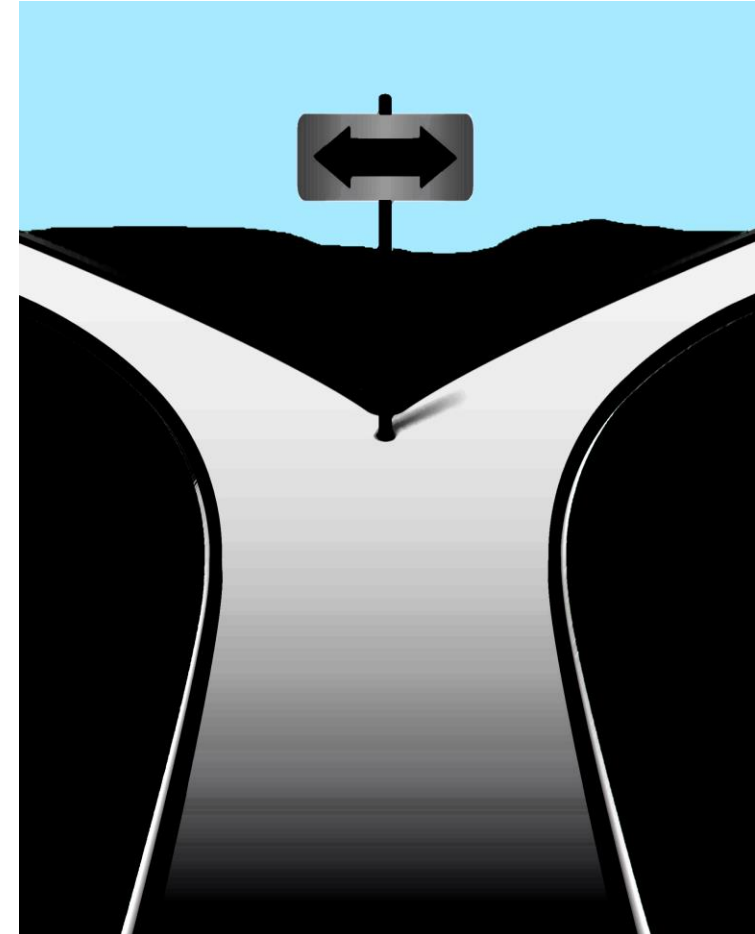
SARM Loans offers multiple flexible options for Borrowers depending on circumstances

## Prepayment Flexibility

**1% Prepayment Premium option**  
1 year lockout; then 1% Prepayment Premium

**Declining Prepayment Premium option**  
1 year lockout, then declining Prepayment Premium (4%, 3%, 2%, and 1% thereafter)

**No Prepayment Premium during last 3 months of the loan term**



# Term Options – Convert to Fixed

## Conversion to Fixed-Rate

**Timing:** Any rate change date beginning with the first day of the second Loan Year and ending on the first day of the third month prior to the Mortgage Loan Maturity Date

**Options:** 5, 7, or 10 year fixed-rate loan terms

**Pricing:** G&S fees generally require use of current fixed-rate pricing grid; some allow the original G&S fees.

**Premium:** Lender can take a 25 bp premium on the trade of the MBS securitized by the new fixed-rate Mortgage Loan

**Loan Amount:** No increase in loan amount at time of conversion; additional proceeds may be funded with a Supplemental Mortgage Loan

- ✓ **No prepayment penalty at conversion**
- ✓ **Minimal re-underwriting required**
- ✓ **Amortization schedule can be “Re-set” to 30 years**



# Underwriting & Post-Closing



# Determining the Loan Amount

**Loan Amount is the lower of:**

1. **Fixed Rate Test:** Requires that the loan amount for a variable rate transaction be the same as or less than a comparable fixed rate transaction.
2. **Max LTV Test:** UPB that results from using the applicable LTV standards for SARMS
3. **Max Note Rate Test:** UPB that results from the max note rate (**Minimum Cap Strike Rate** + Investor Spread + Gfee + Sfee) at the minimum UW DSCR using the applicable standard for SARMS
4. **Pay Rate Test:** UPB that results from the pay rate (Index + Investor Spread + Gfee + Sfee) at the minimum amortizing DSCR for the fixed rate equivalent.

## **Minimum Cap Strike Rate:**

- Minimum Cap Strike Rate is an underwriting rate set by Fannie Mae and adjusted periodically based on market conditions.
- Fannie Mae currently (October 2024) requires a minimum 7.50% Cap Strike Rate.



# Straight Line Amortization

- **SARM amortization mirrors a comparable fixed rate deal.**
- You must obtain a fixed rate quote when SARM is quoted.
- Payments are flat across all amortization months.



# Why a Cap?

## Understanding the impact of a variable rate Mortgage Loan without an embedded cap

What are interest rate caps?



An interest rate cap is a financial instrument that gives the Borrower protection from large interest rate increases. The cap buyer receives payments at the end of each period in which the interest rate exceeds the agreed strike price.



A loan without a rate cap is exposed to market volatility.



To reduce interest rate risk, Fannie Mae requires the Borrower to purchase an interest rate cap for all SARM Loans.



# Interest Rate Cap Management

New requirements are shown in blue

## Origination/Structuring

- Engage Cap Broker
- Purchase cap from approved provider
- Cap index: 30-Day Average SOFR

## Commitment/Delivery

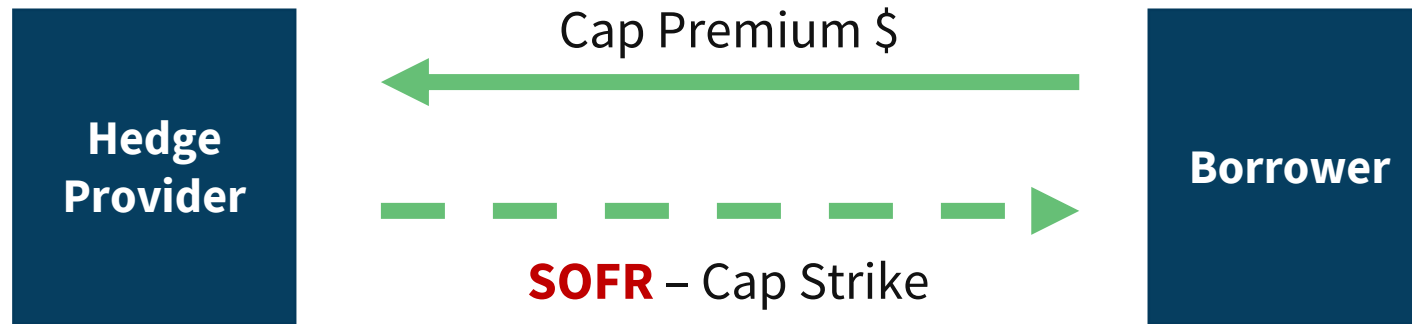
- Cap purchased
- **Escrow funding at 110% of replacement cost**

## Post Closing

- Cap in place
- Escrow for replacement cap (if required)
- **Replacement cap escrow cannot be held longer than 36 months**
- **Replacement cap costs can be adjusted upward or downward every 6 months**



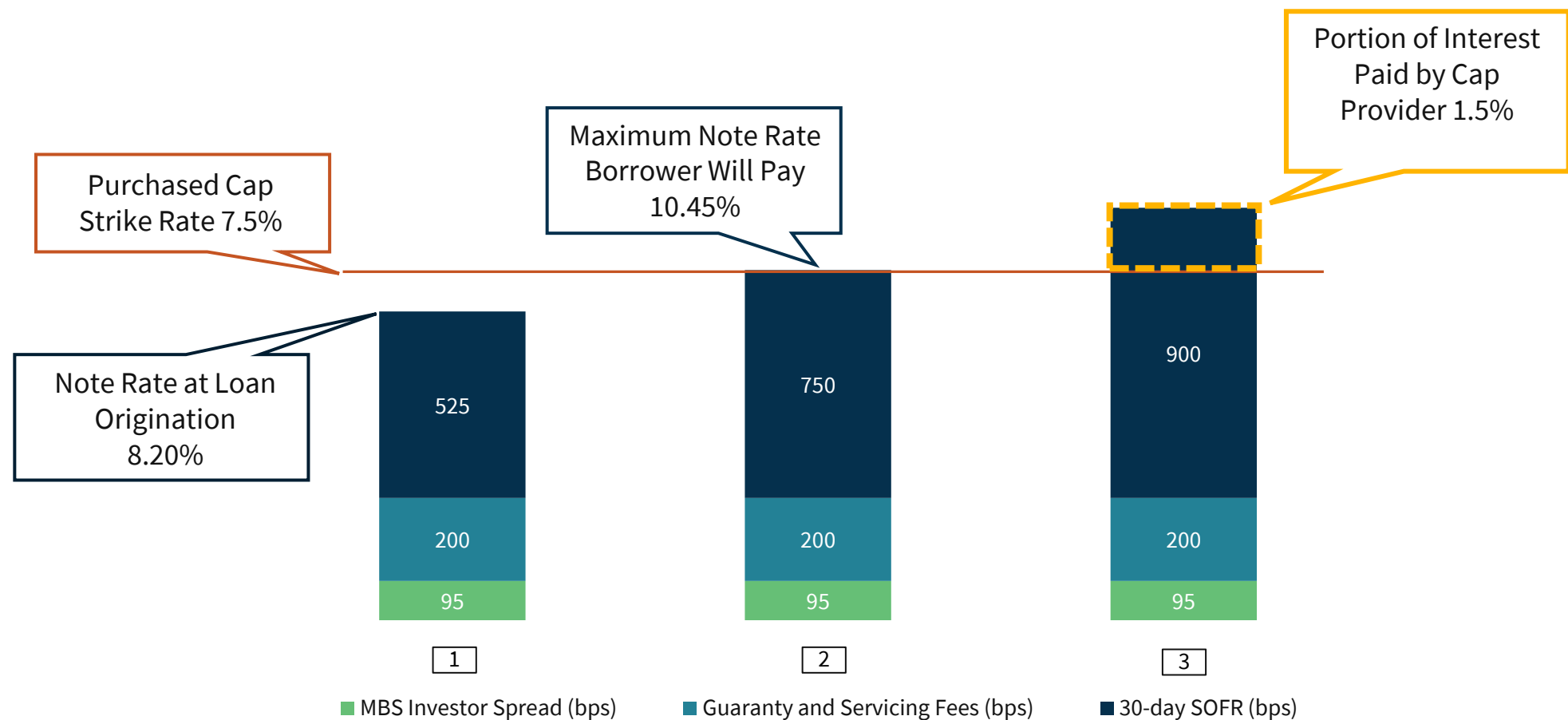
# Cap Payments + Flow of Funds



- The Borrower is responsible for purchasing the cap prior to Mortgage Loan Delivery
- Borrower's net upfront payment = Cap Premium
- Borrower's net ongoing interest payment = Lesser of 30-Day Average SOFR or Cap Strike Rate + Margin (Investor + G + S)
- Hedge Provider's interest payment = 30-Day Average SOFR – Cap Strike (only applies when 30-Day Average SOFR > Cap Strike Rate)



# How Do Interest Rate Caps Work?



# Changes to DUS<sup>®</sup> Gateway



Image: Paradise @PB3, Phoenix, AZ

# Submission and Commitment

Changes	New SARM Parameters	Existing SARM Parameters
DUS Gateway Requirements	Lender enters SARM Underwritten Cap Strike Rate field (new)	Lender enters Underwritten Stress / Max Lifetime Pass Through Rate
	Max Note Rate field (new) will be calculated by Gateway	Underwritten Variable / Max Lifetime Interest Rate is used
	Max Note Rate Constant field (new) will be calculated by Gateway	Underwritten Variable / Max Lifetime Rate Loan Constant is used



# Registration in DUS<sup>®</sup> Gateway

## New Loan Option Input Requirements

- In DUS<sup>®</sup> Gateway, Variable Rate Interest, enter
  - SARM Underwritten Cap Strike Rate (ask your Fannie Mae deal team)
  - Max Note Rate
  - Max Note Rate Loan Constant is a new field that will be populated by DUS<sup>®</sup> Gateway

The screenshot displays the 'Loan Options (5)' interface in the DUS Gateway. The top bar shows 'Select All' and 'LO1083303' with an 'ACTIVE' status. Below this, there's a section for 'Actions' with 'Expand All', 'Collapse All', and 'Collapse Summary' options. The main section is titled 'VARIABLE RATE INTEREST' and features a dropdown for 'Index Rate Type' set to '30 Day Average SOFR'. Below this, there are several input fields for loan parameters:

Value	Field Name	Icon
5.330%	Index Rate	i
0.600%	Total Variable Rate Investor Spread	i
0.960%	Variable Rate Guaranty Fee	i
0.640%	Variable Rate Servicing Fee	i
0.000%	Cap Cost Factor	i
7.530%	Actual Variable Interest Rate	i
7.500%	SARM UW Cap Strike Rate	i
9.700%	Max Note Rate	i
6.000%	UW Stress / Max Lifetime Pass Thr...	i
	UW Variable / Max Lifetime Intere...	i

The 'SARM UW Cap Strike Rate' and 'Max Note Rate' fields are highlighted with a green border.



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# DUS Gateway Demo

