

FEATURES: FINANCE/INVESTMENT

Fannie Mae and Freddie Mac's Multifamily Due Diligence Requirements

Published: July 27, 2009

Getting a loan from Freddie or Fannie? Then you need to know about what they will require in their due diligence—and what their 'hot buttons' are. Due diligence expert Evans Howell of Partner Engineering provides an exposition.

By Evans Howell, Partner Engineering

Every day we see the headlines, "Foreclosures are on the rise," "Another bank fails," and "The stock market is plummeting." In a time of such economic turmoil, many investors and lenders are sitting on the sidelines waiting to see how the economic crisis will turn out. Notwithstanding the apparent slowdown, it is not all doom and gloom. Despite lending concerns created by the Freddie Mac and Fannie Mae crises, financing for multifamily properties is still quite active. Furthermore, changes in underwriting are taking the market back to more historic norms, where Fannie Mae and Freddie Mac are the dominant players in the multifamily financial sector.

Given this "silver lining," purchasers and refinancers would be well served to understand their due diligence needs when working with these unique programs. Freddie Mac and Fannie Mae have each established their own set of guidelines for third-party reports, including Phase I Environmental Site Assessments (ESA), Property Condition Assessments (PCA), and Probable Maximum Loss (PML) evaluations. The basis for both sets of standards is the respective industry-accepted standard of the American Society of Testing Materials (ASTM) with a few modifications.



Fannie Mae and Freddie Mac each have specific screening requirements with respect to asbestos-containing materials, lead-based paint, radon gas emissions, and moisture intrusion. Both agencies also have unique "hot buttons" with respect to engineering concerns. During the environmental and engineering inspections, borrowers can expect the inspectors to observe each room within the individual tenant space with particular attention paid to water distribution piping materials, water heaters, waste and vent piping materials, air supply and return vents, interior mechanical components, electrical subpanels, unit level electrical amperage, electrical wiring for outlets and light switches, electrical wiring at water heater and hard fixture connections, windows and window coverings, interior ceiling and wall finishes, interior flooring materials, and appliances.

Attic spaces will be inspected to determine the presence of fire-retardant roofing materials. The inspectors will be interested in viewing the exteriors of the apartment buildings to note the overall condition of the building exterior finishes, roofing materials, roofing penetrations and flashing, exterior stairwells and railings, exterior balconies, walkways, and patio areas, surrounding drainage features, electrical distribution transformers, exterior mechanical equipment, solid waste disposal dumpsters and compactors, paved parking areas, carpools, and landscaping features. In addition to the apartment units, the inspectors will generally observe the leasing offices, clubhouses, pool areas, and any other amenities or common areas provided on the property as well as any central electrical, mechanical, and plumbing systems.

Worthy of note are the access requirements for the Phase I ESA and PCA inspections. Both agencies require that 10 percent of the total number of units be visually inspected, as well as 50 percent of any down units. To this end, it is important that tenants are notified in a timely manner to ensure that the required number of units is inspected as neither Fannie Mae nor Freddie Mac will generally deviate from the access requirement. The units should be randomly selected and spread throughout the subject buildings in order to allow for an accurate representation of property conditions. Access to units that are down for any reason will be critical to both the engineering and environmental inspectors.

As seasoned borrowers are already well aware, time on the back end of the process with both the Fannie Mae and Freddie Mac programs can be saved by proactive cooperation on the front end between buyers, sellers, management companies, on-site personnel, and consultants.

Purchasers and refinancers should be prepared to provide records of capital improvements made to the subject property within the past five years as well as specific information relative to the age of significant building and property components, including roofs, exterior paint, and pavement, to name but a few. It is also helpful to provide copies of any Operations and Maintenance Programs in place for the management of known or suspected asbestos-containing materials, lead-based paint, and/or moisture intrusion. Interviews with on-site personnel and persons with specialized knowledge of the subject property are an important aspect of both the environmental and engineering assessment processes. Lastly, timely completion of consultant questionnaires is strongly advised. Both written and verbal information from as many sources as possible is not only invaluable to the inspectors, but is required to meet the highest industry standard.

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