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# Understanding Freddie Mac's Requirements for Forward Commitment or Mod Rehab Projects

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As the need for affordable multi-family housing grows, fueled by robust tax and financing incentives from Freddie Mac, more and more developers are taking on these projects as a significant part of their portfolio assets. However, with many new changes, additions and revisions to Freddie Mac's programs and requirements, some lenders are confused, particularly if they are new to the multi-family market. The agency has outlined three reports that need to be submitted as part of either a Forward Commitment (a guarantee that Freddie will finance the loan once project is completed) or its recently-introduced Mod Rehab Construction Program (a loan is already on books, but there is a cost-per-unit that must be met to qualify).

Freddie Mac has established a specific set of qualifications for the Architectural and Property Condition consultant. Each are slightly different but are required depending on the scope engaged. Understanding these guidelines fully before embarking on the development ensures a smoother and more successful endeavor for the borrower.

## **FIRST THINGS FIRST: PRE-CONSTRUCTION ANALYSIS**

A Pre-Construction Analysis Report is the first step for all Mod Rehab and Forward Commitment projects. This involves a combination of a [Property Condition Report](#) (pursuant to Freddie Mac's guidelines outlined in section 62 of their multi-family seller/service guide) and a Document and Cost Review (as meticulously outlined in section 63 of the same guide). The Property Condition Report largely follows ASTM industry-standard guidelines, but with added scope. There is often confusion about whether this requires providing one cohesive report or two separate ones. Technically, it is supposed to be one conglomerated report, but Freddie Mac will accept two separate components. Clients prefer to separate the Property Condition Report and Document Cost Review paperwork because it allows different parties on the client side to review the Property Condition Report, which typically is performed before a Document and Cost Review, and therefore accelerates the process. An experienced due diligence provider can prepare this report both ways; however, the report(s) must be updated if the Property Condition Report is dated more than six months prior to the date of the full underwriting package is delivered to

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Freddie Mac as the Pre-Construction Analysis Report relies on the Property Condition Report date. If this occurs, the Architectural Consultant may require a new inspection to verify current conditions; however, this is at the discretion of Freddie Mac.

### **IF IT'S VACANT LAND, IS A SITE VISIT REALLY NECESSARY?**

Another essential differentiation of the Freddie Mac requirements is that if the project involves new construction on vacant land or if the property consists of a parking lot with no vertical development, then a site visit is not required. However, confirmation of the vacant condition is required by utilizing either a Phase I Environmental Assessment (of any kind, not necessarily adhering to Freddie guidelines) or aerial photography from a reputable and appropriate source that is no more than six months old from the date of engagement. Should the site in question be found to have vertical development of any kind, then a Property Condition Report in accordance with Sections 62.3-62.7 will be required as part of the Pre-Construction Analysis Report scope. This has previously caused confusion for clients about unnecessary site visit and report costs, and has now been clarified with the September guide updates.

### **FOR REHABS: COMPARING CURRENT CONDITIONS WITH PLANNED RENOVATIONS**

If the development is a rehab project, the due diligence professional consultant must perform a Property Condition Report as part of the

Pre-Construction Analysis Report. The project must be assessed independently of the budget, in its current state prior to the renovation, for all issues large and small. As part of the deliverable, a set of pre- and post-renovation tables utilizing Freddie Mac's Form 1105 are juxtaposed, in which all identified issues will be addressed. It's important for clients to note that due diligence findings don't always line up with the goals of planned renovations. Developers often reposition their project as a bigger real estate objective, and are not looking at (or concerned with) all the meticulous details that a Property Condition Report tends to examine. The consultant discusses all problems with the client to figure out the best approach on how to address or remediate it. Red flags, such as replacing Federal Pacific Electric Stab-lok panels (or other problematic materials) as part of the rehab have financial implications for the borrower. It is in the borrower's best interest to alleviate all property deficiencies, problems and red flags as part of the rehab construction to alleviate financial repercussions and unnecessary future risk.

### **MONITORING DURING CONSTRUCTION**

Once the construction process begins in earnest, there is a monthly monitoring of the loan, consisting of basic [construction risk management](#) principles including such things as periodic (monthly) site visits along with discussions with the construction team and review of such elements as

percentage completion, milestones, construction pay applications, change orders, and budgets. This ensures a smooth, timely, cost-effective project completion timeline. A full scope of construction monitoring guidelines, reports and requirements can be found in section 63.4(a-d) of the Freddie Mac multi-family guide.

### **PROJECT CLOSE OUT: TIMING IS EVERYTHING**

Finally, the project is closed out with a Post Construction and Analysis Report unique to the specific requirements of Freddie Mac's multifamily guide. This report must include the results of a property inspection meeting the requirements of Sections 62.3-62.7 and a narrative evaluation certifying that the following is true:

- The project was completed substantially in conformance with the plans and specifications included in the full underwriting package submitted to Freddie Mac prior to the issuance of the commitment.
- The quality and workmanship is acceptable.
- The project is substantially in compliance with all applicable federal, State and local laws, ordinances and codes related to zoning, subdivision and use, building and housing accessibility (including the Americans with Disabilities and Fair Housing Acts), health matters and fire safety.
- Certificates of occupancy and any

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- other required permits were issued
- Either no deferred maintenance or life safety hazards were observed; or, if such observations are made, identification of the cost to cure each deferred maintenance or life safety hazard
- And for a Forward Commitment, a reserve analysis is provided.

In addition, specific documentation must be received before the report can be submitted including a copy of the following:

- Architect's certificate of substantial completion
- Final punch list from the architect of record
- Final payment certification
- Final lien waiver from the general contractor
- Release of payment and performance bonds
- Release of bonds required by any governmental authority
- Final certificate(s) of occupancy, and
- Reserve analysis, if not completed previously or if revisions to the previously completed analysis are recommended
- A summary of all change orders and an analysis of all material changes
- And for a Forward Commitment, the Architectural Consultant must also review a third-party (accountant) audited cost certification for total project costs including hard and soft costs.

This last bullet point can significantly delay the final deliverable if not initiated promptly, which in

turn slows up the conversion. It is in the borrower's best interest to get the necessary deliverables to their accountant as soon as possible. The full scope of the Post-Construction Analysis Report is laid out in section 63.5(a-b) of the Freddie Mac multi-family guide.

The timing of deliverables for the Post Construction and Analysis Report is often confusing to clients, and is worth clarifying. For Forward Commitment projects, the Architectural Consultant must inspect the property and provide a Post-Construction Analysis Report no more than six months prior to the conversion. However, for Mod Rehab projects, after receiving all construction completion documentation, the consultant only has two weeks to complete and submit the Post-Construction Analysis Report in accordance with section 63.5a. Because this is a very tight timeline, borrowers and developers cannot afford any delays, and must engage the services of a highly skilled and experienced due diligence professional that can execute these reports in a meticulous and timely fashion. For Mod Rehabs, this process is somewhat easier because they don't require the third-party accounting cost certification.

The Post Construction Report is done by the Architectural Consultant after the final draw, the final payment certification (final unconditional lien waivers), and after the third-party accounting report has been received. Once all documentation, including specific requirements outlined in section 63.5b of the Freddie Mac multi-family guide, have been received, then the Consultant should visit the

site and compile the final report.

## NAVIGATING YOUR WAY TO SUCCESS

Having a thorough understanding of the intricacies of the new Freddie Mac Forward Commitment and Mod Rehab guidelines is essential for developers and Lenders seeking to take advantage of a robust multi-family market and tax credit incentives for low-income housing. And, when in doubt, rely on a consultant that is well-versed in these programs to help you navigate through.



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