

New Insurance Coverage Requirements – Your Questions and Our Answers

Blanket Policies

If a loan is currently escrowing for insurance, and the borrower has obtained a blanket insurance policy, is there a process for eliminating the escrow?

You can make that request to the Multifamily Portfolio Services Asset Transaction team. Contacts for the team are Dave Goozman and Ed Gagermeier. Please use the insurance waiver request form found in the MultiSuite® Portfolio Services Job Aids page at https://multifamily.freddiemac.com/multisuite/service/docs/insurance_waiver_form.doc

For a blanket policy, is the 1 percent deductible a location limit or complete blanket limit?

The blanket policy deductible is 1 percent of the replacement cost of the property that is insured. It is not 1 percent of the complete blanket limit. The maximum allowable deductible for a blanket property insurance policy is \$250,000.

Replacement Cost

If there is an agreed-amount endorsement, is it safe to assume that the replacement cost used by the insurance company is acceptable?

It is acceptable to use the replacement cost used by the insurance company, but Freddie Mac requires that if an agreed-amount provision is used, the agreed amount must equal the replacement cost. To be sure, you may want to ask the insurance company to provide documentation of its replacement cost calculation, including explanation of how it determined the replacement cost amount.

If the insurance agent is calculating the replacement cost, the Servicer is required to ensure that the insurance company has been given all applicable data in order to accurately calculate the replacement cost — specifically what data is considered applicable by Freddie Mac?

Freddie Mac does not have a list of specific information that must be provided. Rather, we expect you to use data that you determine is reliable and accurate, based on standard industry practices for property valuation and construction cost estimating. Insurance underwriters also can provide guidance on the information they may require.

What if a loan closes with replacement cost of \$20,000,000 based on the appraisal and upon renewal the insurance company provides replacement cost of only \$15,000,000. Can we allow the borrower to reduce the coverage?

We recognize there may be a difference of opinion on the amount of replacement cost between the appraiser, the insurance company, and others. And although we have suggested several sources to verify the replacement cost, we also want the Seller/Servicer to be satisfied that the replacement cost used to obtain the insurance coverage is the best estimate of the replacement cost. If an updated replacement cost estimate is credible, then adjustment of the insurance limits may be valid.

Does Freddie Mac have minimum acceptable per square foot limits for replacement cost?

No, Freddie Mac does not have a minimum acceptable per square foot limit.

What sources are other servicers using at the annual review of insurance other than the appraisal used at closing? Will Freddie Mac look for documentation of this in the file?

While we expect Seller/Servicers to document the loan file with information used to determine replacement cost, Freddie Mac would only review that information during a regular Seller/Servicer audit. We recognize that the appraisal used at closing is an important source of information, but expect that Seller/Servicers will exercise appropriate due diligence in their annual review of the property's replacement cost.

Does Freddie Mac require a new appraisal every year to update the replacement cost?

No, although we have listed the appraisal as one resource for verifying replacement cost, Freddie Mac does not require you to obtain an appraisal annually. We anticipate that many Seller/Service providers will use the cost approach or an insured value appraisal obtained at origination to evaluate the replacement cost initially. Seller/Service providers should exercise appropriate due diligence in their annual review of the property's replacement cost.

If you have an apartment complex with several buildings, would Freddie Mac accept a probable maximum loss (PML) study?

The Freddie Mac Seller/Service Guide (Guide) requires that property insurance limits be at least equal to a property's replacement cost. We have seen PML studies used to gauge appropriate levels of insurance coverage for large property portfolios where required full replacement cost limits were not available. Such data will be evaluated on a case-by-case basis.

Joint Loss Agreement and Boiler and Machinery Coverage

What is a joint loss agreement?

A joint loss agreement is an endorsement added to a boiler and machinery policy that prorates the policy limits with another property policy when both policies provide coverage on a similar basis. It is generally mirrored by an endorsement on the property policy. When a loss is payable, the insurer determines whether and to what extent it is a boiler and machinery or a property loss. This agreement is typically a "no cost" policy improvement that insurance companies readily provide. A joint loss agreement can minimize intercompany disputes should a claim arise.

If boiler and machinery and special form policies are written with the same insurance company, is the joint loss agreement still required?

No, the joint loss agreement is designed to provide an agreement between two different carriers, and so it is not required if a single carrier provides both coverages.

Does Freddie Mac have a standard joint loss agreement, and if so what is the form number?

No, Freddie Mac does not have a standard joint loss agreement. The insurance carriers produce such standard language.

Is boiler and machinery coverage now required on all properties with a central heating system, rather than only properties with a steam or pressure system?

Yes, Freddie Mac now requires boiler and machinery coverage for any property with a central heating, cooling and ventilation (HVAC) system. This change was implemented because the insurance market has categorized properties with central HVAC systems as higher risk than properties with individual HVAC units.

Polybutylene (PB) Piping and Galvanized Steel
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Has Freddie Mac added any insurance requirements related to PB piping and galvanized steel to the Guide?

We have not added any requirements at this time, but we are reviewing these topics.

Implementation

If insurance policies renew prior to Sept. 1 and have deductibles that meet the new requirements, can we approve the coverage or do we need to enforce current requirements?

Borrowers can take advantage of the new requirements today, including the higher deductibles. You do not need to enforce the current requirements. We provided a longer lead time for implementation to make sure Servicers and borrowers have adequate time to prepare.

Windstorm Insurance

What if our state's wind pool coverage has coinsurance and does not offer an agreed-amount endorsement?

Although we developed our requirements in light of the coverage available through the various state wind pools, we recognize that some wind pools may not meet all of our requirements. Contact your Freddie Mac regional office representative to address any specific questions for new loans or Dave Goozman or Ed Gagermeier in Asset Transactions for policy renewals.

Is the 5 percent maximum deductible for a windstorm policy in a Tier 1 location regardless of the loan balance?

Yes, the 5 percent maximum deductible applies regardless of the loan amount.

Does Freddie Mac base the Tier 1 property's 5 percent deductible for windstorm coverage on total insured value (TIV) (which includes rent loss and contents) instead of replacement cost?

Freddie Mac's requirement is based on replacement cost, not TIV. We recognize that some insurance policies base the percent deductible on TIV and will take that issue into consideration on a case-by-case basis.

Wind Insurance through the state wind pools in many states does not cover business income or rent insurance and you cannot purchase this in the normal insurance marketplace without a large deductible and high insurance premium — What should the Seller/Servicer do?

The Seller/Servicer should ensure that the borrower's business interruption/rent loss coverage provides coverage for losses due to a windstorm. If this coverage is not provided under the state windstorm policy, the borrower must seek that coverage under other policies. If the borrower is unable to obtain business interruption/rent loss coverage for windstorm damage, the Seller/Servicer must contact the Freddie Mac regional office for new mortgages, or for existing loans, contact Dave Goozman and Ed Gagermeier. Please use the insurance waiver request form found in the MultiSuite Portfolio Services Job Aids page at https://multifamily.freddiemac.com/multisuite/service/docs/insurance_waiver_form.doc

Flood Insurance

For a loan with a master insurance policy that does not include the National Flood Insurance Program (NFIP) layer but has zone A & V coverage in the master policy, will we have to require the borrower to purchase NFIP effective 9/1/07?

The requirement going forward is for full replacement coverage through the combination of NFIP and private flood insurance as of the next policy renewal after September 1, 2007. For alternative coverage arrangements, you must obtain the approval of the Multifamily Portfolio Services Asset Transaction team. Contacts for the team are Dave Goozman and Ed Gagermeier. Please use the insurance waiver request form found in the MultiSuite Portfolio Services Job Aids page at https://multifamily.freddiemac.com/multisuite/service/docs/insurance_waiver_form.doc

Do we need to retroactively go back and require full replacement cost coverage on properties in flood zones? If the borrower can obtain flood insurance through a difference in conditions policy that is less expensive than the NFIP, will you still enforce the requirement for NFIP?

The requirement going forward is for full replacement coverage through the combination of NFIP and private flood insurance as of the next policy renewal after September 1, 2007. For alternative

coverage arrangements, you must obtain the approval of the Multifamily Portfolio Services Asset Transaction team. Contacts for the team are Dave Goozman and Ed Gagermeier. Please use the insurance waiver request form found in the MultiSuite Portfolio Services Job Aids page at https://multifamily.freddiemac.com/multisuite/service/docs/insurance_waiver_form.doc

Where NFIP does not offer loss of rent coverage, what should the Seller/Servicer do?

The Seller/Servicer should ensure that the borrower's business interruption/rent loss coverage provides coverage for losses due to a flood. If this coverage is not provided under NFIP, the borrower must seek that coverage under other policies. If the borrower is unable to obtain business interruption/rent loss coverage for flood damage, the Seller/Servicer must contact the Multifamily regional office for new mortgages, or for existing loans, contact Dave Goozman and Ed Gagermeier. Please use the insurance waiver request form found in the MultiSuite Portfolio Services Job Aids page at https://multifamily.freddiemac.com/multisuite/service/docs/insurance_waiver_form.doc

Earthquake Coverage

Is the site-specific seismic report (SSSR) ordered by the Servicer or Freddie Mac? What vendors would provide SSSR?

In the past, Freddie Mac has initiated the engagement of vendors for SSSRs and PML studies; however, that is no longer Freddie Mac's standard practice. In addition, we do not endorse any specific vendors for such services. The Servicer should work with their Freddie Mac regional office representative to determine the best way to engage such services.

Can we get copies of the SSSR and PML reports from Freddie Mac?

The SSSR and PML reports should be available to all on the underwriting team.

Ordinance and Law Coverage

What is the determination of the full replacement cost?

Ordinance and law coverage is designed to supplement the property insurance coverage. If a covered loss destroys a pre-determined percentage of a building or property, the owners might be subject to complying with newer building codes when they rebuild, and, therefore, it might cost them more than the estimated replacement costs. The following building ordinance and law coverages typically are provided through endorsement on the property policy:

Coverage A – Coverage for loss to the undamaged portion of the building. This coverage will pay for loss in value of the undamaged portion of the property (or building) as a consequence of enforcement of an ordinance or law that requires demolition of undamaged parts of the same property (or building). Coverage A is included within the limit of insurance shown in the property policy applicable to the covered property (or building). Coverage A is essentially part of the "full replacement cost" amount of coverage on the property policy. A covered cause of loss under the property policy must occur in order to trigger the ordinance and law coverage. For example, if 50 percent of a building is destroyed by fire, then the ordinance and law coverage is triggered to cover the other 50 percent of the building's value if local ordinance requires the property to be rebuilt to new codes.

Coverage B – Demolition cost coverage. This coverage will pay the cost to demolish and clear the site of undamaged parts of a damaged building as a consequence of enforcement of an ordinance or law that requires demolition of the undamaged property.

Coverage C – Increased cost of construction coverage. This coverage will pay the increased cost to repair or reconstruct damaged or undamaged portions of a damaged building when the increased cost is a consequence of enforcement of ordinance or law.

What minimum coverage is required for ordinance and law coverage?

For Coverage A, loss to an undamaged portion of the building, the minimum coverage amount is the full replacement cost of the building or property. For Coverage B, demolition cost, the amount of coverage must be no less than the greater of the estimated full demolition expense of the single largest building on the Property or 10 percent of the full Replacement Cost of the Property. For Coverage C, increased cost of construction, the amount of coverage must be in an amount equal to no less than 10 percent of the full replacement cost of the property.

How should the estimated demolition cost be determined?

Demolition costs should be estimated using standard engineering practices based on the square footage of the largest building or 10 percent of the total property replacement cost.

Nonconforming Property

How often does Freddie Mac expect a Seller/Servicer to actively confirm that an individual property is conforming to local ordinances and zoning requirements?

In completing the annual assessment, the Servicer is asked to confirm that the property is in conformance. For most properties, the assessment takes place annually. We recommend that you verify the property's zoning status annually with the borrower.

If the ordinance stated that if 50 percent of the building was destroyed, the building could not be rebuilt, would the replacement cost be 50 percent of the total building replacement cost? Is the replacement cost only for the buildings that are affected by the non-conformity?

Please see above answer under Coverage A. The ordinance and law coverage applies only to those buildings or properties that are non-conforming.

Sewer and Drain Coverage

How will we know if the property is prone to periodic sewer or drain backups caused by ground water external to the property?

Inspection and borrower input are the primary means for you to determine that sewer or drain backup is an issue for the property. The full disclosure process should also identify any issues.

ACORD Forms

Do you accept the ACORD 27 form or carrier and agent-specific forms like those from State Farm and Nationwide?

Talk to your Freddie Mac regional office representative about the use of ACORD 27 or a carrier-specific form in lieu of the ACORD 28. We will not accept any version of the ACORD 27 that has the same disclaimer language as the ACORD 28 (2006/07).

Does Freddie Mac require the ACORD 28 for renewals?

Freddie Mac does not require the Servicer to send a copy of the ACORD 28 or any other form of insurance renewal documentation to Freddie Mac. However, the Servicer must require the borrower to provide acceptable evidence of renewal to the Servicer. Acceptable documentation includes copies of the policy or policies, ACORD 28 (2003/10), or a binder. The Servicer must also retain a legible copy of each original policy in the mortgage file.

Does Freddie Mac require certified copies of insurance policies?

No, Freddie Mac no longer requires you to submit certified copies of the policy. You must only retain a copy of the policy for the mortgage file. You must, however, submit proof of insurance coverage at delivery of the mortgage to Freddie Mac. Proof of coverage includes ACORD 28 (2003/10) and ACORD 25 or a binder or a legible copy of the insurance policy.

Seniors Housing

Are the minimum coverage amounts required based on number of beds or number of licensed beds?

The limits are based on the number of beds.

Can the professional liability coverage be combined with the commercial general liability (CGL) policy?

Yes, the professional liability coverage can be written with the commercial policy as long as both coverages and deductibles comply with the applicable Freddie Mac requirements. For example, the coverage and deductible limits for general liability and the professional liability coverage are different.

Freddie Mac may not be shown as an additional insured on a professional liability insurance policy (see the Guide, Section 31.2(e))

Is it a problem when CGL and professional liability are combined and the professional liability insurance is written on a claims-made, not an occurrence basis?

If the borrower is unable to obtain an occurrence-based policy for professional liability insurance, Freddie Mac will accept a "claims made" policy form.

Endorsement of Loss Draft

Is there any specific endorsement language that Freddie Mac requires to be added to the back of the loss draft?

No. We provide guidance on the issue in the Guide, Section 43.8(d), but there is no specific language required for the Seller/Service to endorse the draft on Freddie Mac's behalf.

Captive Insurers

Captive insurers frequently provide professional liability. Does Freddie Mac need to review each captive arrangement prior to funding?

Yes. We have not defined any general standards for captive insurers and each arrangement is subject to review.

Workers' Compensation

Regarding Workers' Compensation changes, will the Seller/Service be required to verify, if the property has employees on each loan?

No, Freddie Mac will not require the Seller/Service to verify whether the borrower has employees at the property. Workers' Compensation coverage is regulated by federal and state laws applicable to businesses that have employees. It is not a loan-related coverage.

Non-Compliance

At what point are we required to notify Freddie Mac, when a loan is non-compliant?

For new loans, the Seller/Service should contact their Freddie Mac regional office representative. For existing loans, the Seller/Service should contact the Multifamily Portfolio Services Asset Transaction team. Contacts for the team are Dave Goozman and Ed Gagermeier.

Contact for Questions

Whom should the Seller/Service contact with questions?

For new loans, the Seller/Service should contact their Freddie Mac regional office representative.
For existing loans, the Seller/Service should contact the Multifamily Portfolio Services Asset Transaction team. Contacts for the team are Dave Goozman and Ed Gagermeier.