

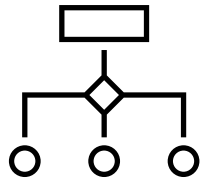
Borrower Due Diligence Update

April 13, 2023



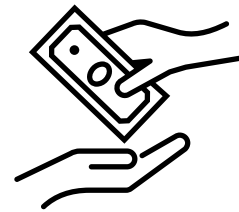
Purpose of the Update

Risk-based assessment and clarification of borrower-related due diligence requirements that fall into three main categories:



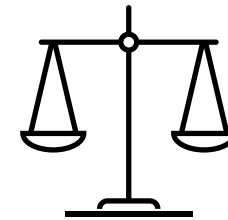
Borrower Principal Types

Evaluation of ultimate control and equity (Key Borrower Principal) to guide financial, credit and experience assessment



Contingent Liabilities

Focus on liabilities with the greatest repayment risk (recourse debt on properties with negative equity and litigation not covered by insurance)

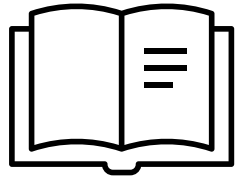


Types of Legal Proceedings

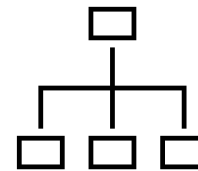
Attention to financial crimes, government actions, and more recent criminal and civil proceedings

Impacts of the Update

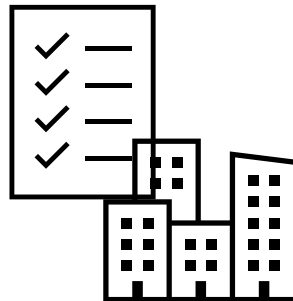
The update is rather extensive and therefore has impacts to several documents you currently use:



The Freddie Mac *Multifamily Seller/Service Guide* (April 13 update) will reflect new definitions



Organizational Chart Guidance documents on mf.freddiemac.com will be updated



Borrower/ Borrower Principal Certificate (Form 1115/ 1115SBL) and Real Estate Schedule (Form 1116) revisions to reflect new definitions as well as clarified requirements

Borrower Principal Analysis – Overview

Clearer requirements for which types of parties on the organizational chart must submit due diligence focus on **role** and **impact to the credit decision**

NOT CHANGING

KYC requirements:

- Disclosure of Borrower Principal/Non-U.S. Equity Holders (complete organizational chart)
- Database searches (OFAC, FHFA SCP List, Exclusionary List)
- Web Searches

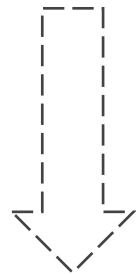
Due Diligence documentation:

- Form 1115, Form 1116, Certified Financial Statements, Credit Reports (individuals only)

CHANGING

4 different sub-types of Borrower Principals:

- Pass-Through Level
- First Level
- Intermediate Level
- Final Level



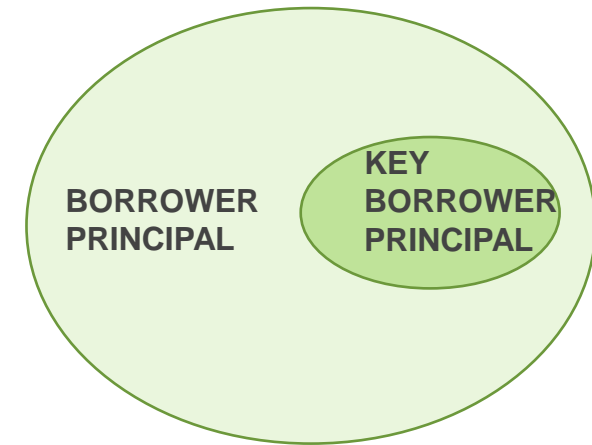
Introducing new type of Borrower Principal:

Key Borrower Principal



New Term – Key Borrower Principal

- Industry term used to identify the individual or entity considered critical to the ongoing successful operation of the property
- Like the previous concept of “Final Level Borrower Principal”
- Requires a thoughtful review of the organizational chart to identify these individuals or entities
 - Need to also consider pre-approved Transfers
 - Private Investment Fund concept along path of Control is unchanged (can be a Key Borrower Principal)
- **Must be clearly identified in the Mortgage Transaction Narrative Analysis (MTNA)**



New Term – Key Borrower Principal (cont'd)

Borrower Principal – CLARIFIED

- **Key Borrower Principal**
- Any individual or entity that has, or is pre-approved by lender to take over, Control (direct or indirect) of borrower*
 - GP/ Managing Member or Non-Member Manager
 - Grantor of revocable trust/ Trustee of irrevocable trust
- Any person or entity with aggregate interest (direct or indirect) in Borrower **≥ 25%**
- Any other party at FM's discretion

** Or borrower-affiliated Seniors Housing Operator or Master Tenant, if applicable*

Key Borrower Principal – NEW

- Any Guarantor, regardless of ownership interest (even if not in org structure of borrower)
- Any party with Ultimate Control of Borrower
- LIHTC Syndicator
- Senior Housing Operator/ Master Tenant (and Ultimate Control thereof, if Borrower Affiliate)
- Any Pre-Approved Transferee
- Any non-Controlling person or entity that:
 - Has aggregate interest in borrower **≥ 50%**
 - Is not owned by another person or entity that owns **≥ 50%** aggregate interest
- Any other party at Freddie Mac's discretion (i.e., Required Equity Owner)

Borrower Principal Due Diligence Requirements

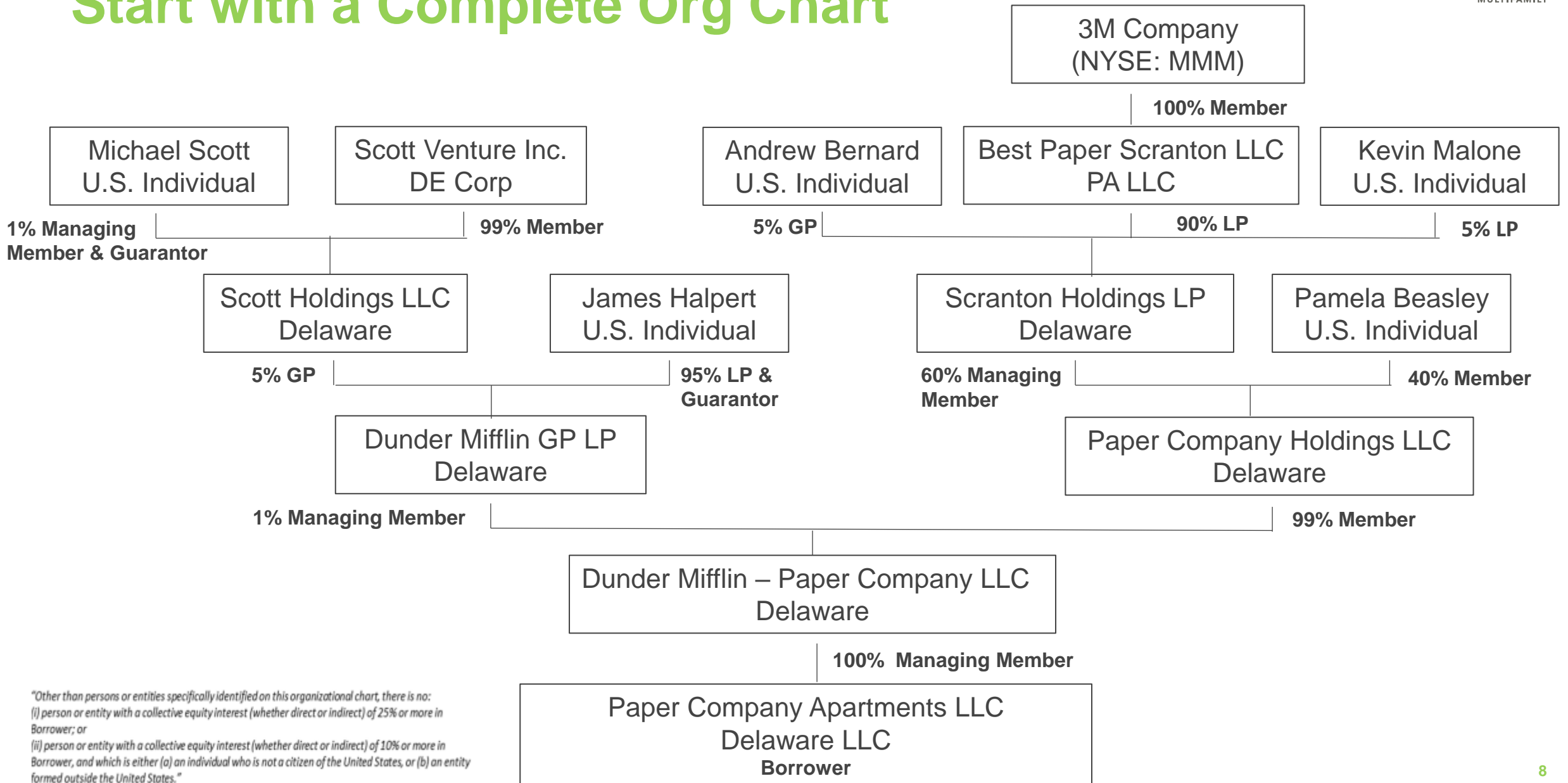
	Form 1115	Form 1116	Financial Statement	Credit Report
Borrower ¹	Yes	Only if not an SPE/SAE	Yes ²	Individuals only
Key Borrower Principal	Yes	Yes²	Yes²	Individual Guarantors only
Borrower Principals that are not Key Borrower Principals	No	No	No	No

¹ Master Tenants and Seniors Housing Operators must complete the Borrower section of Form 1115

² Not required if entity is newly formed

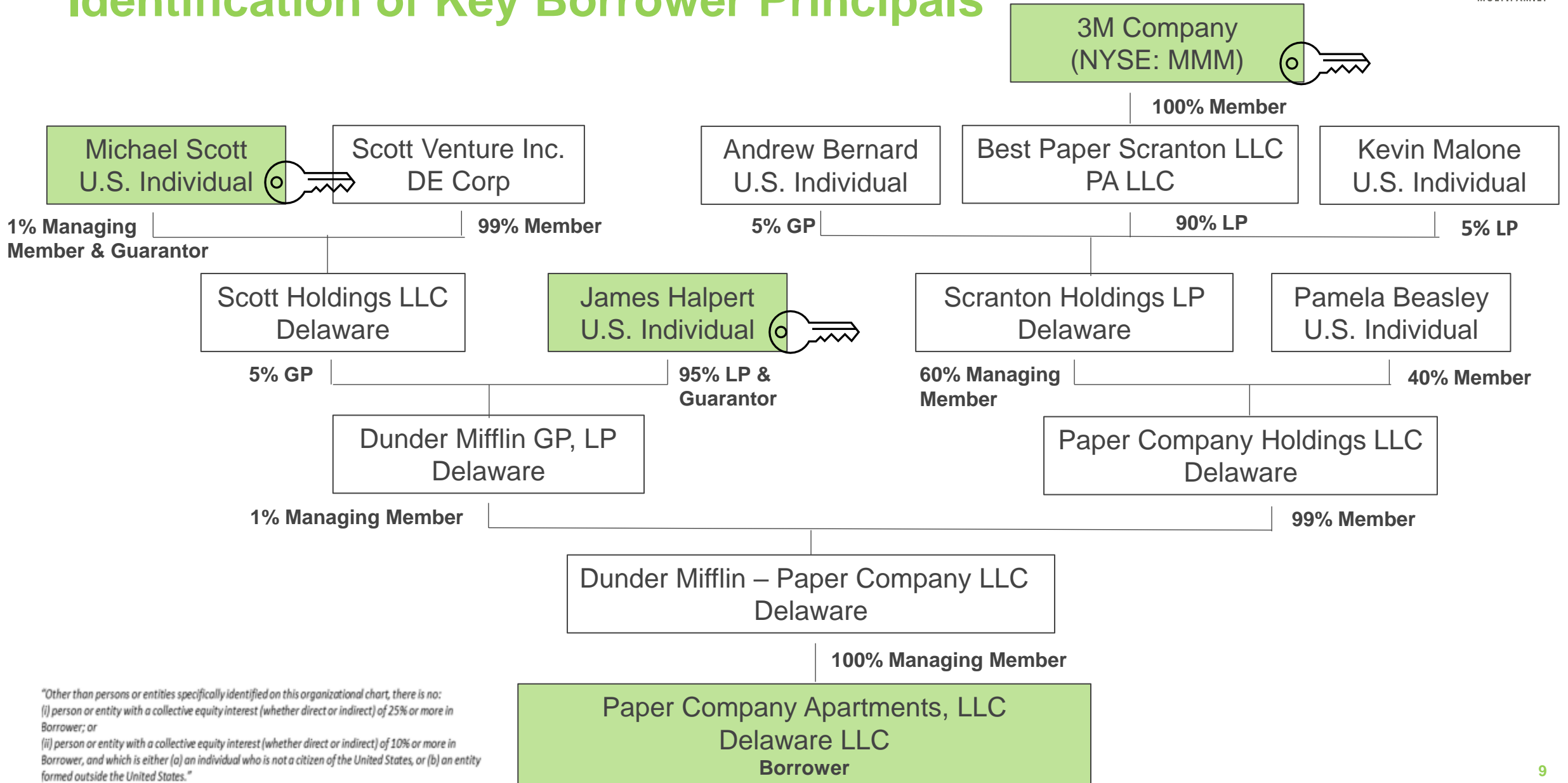
Note: Freddie Mac reserves the right to request additional due diligence on Borrower Principals at our discretion – e.g., if an adverse Web Search finding requires additional explanation

Start with a Complete Org Chart



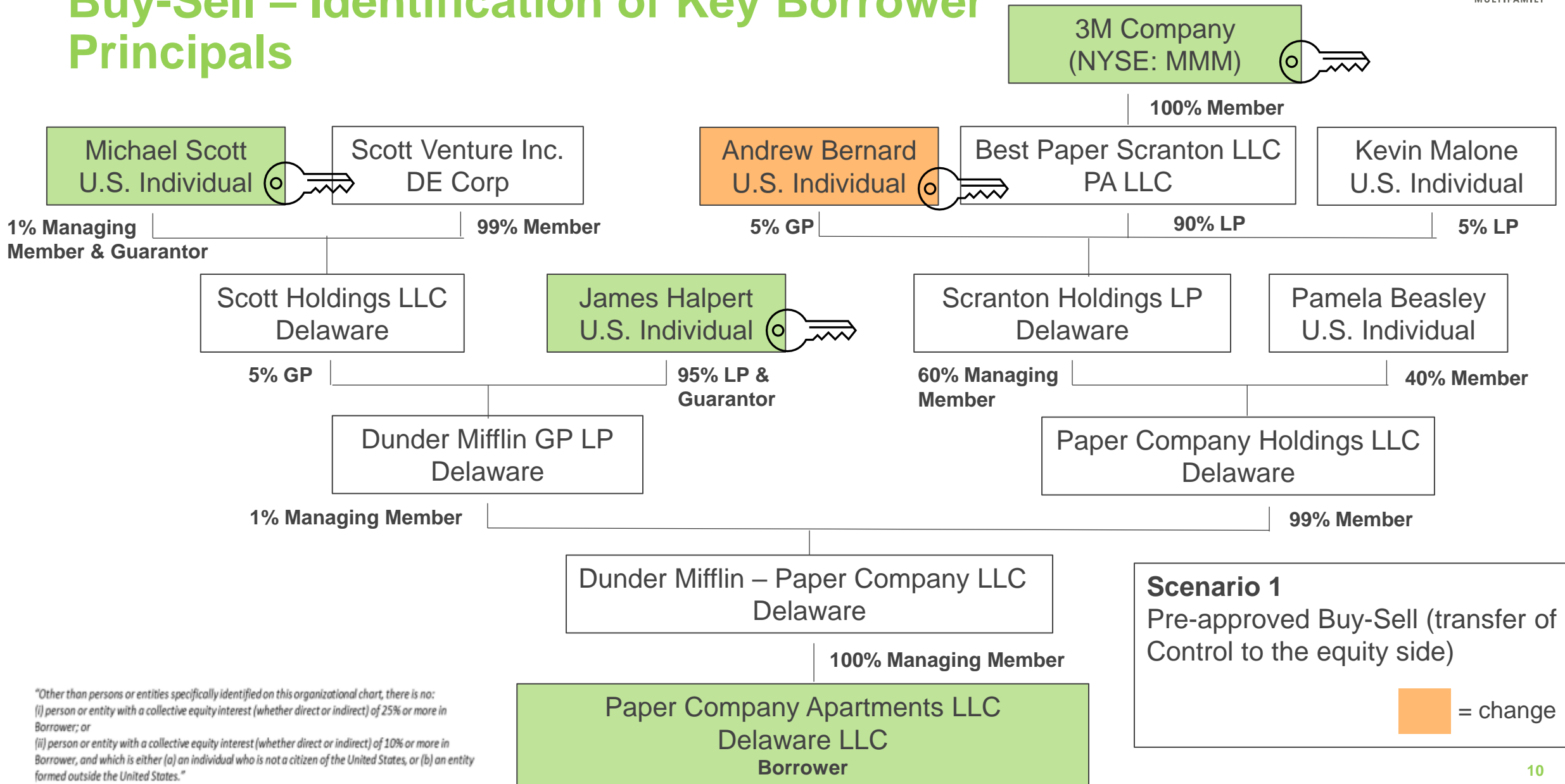
"Other than persons or entities specifically identified on this organizational chart, there is no:
(i) person or entity with a collective equity interest (whether direct or indirect) of 25% or more in Borrower; or
(ii) person or entity with a collective equity interest (whether direct or indirect) of 10% or more in Borrower, and which is either (a) an individual who is not a citizen of the United States, or (b) an entity formed outside the United States."

Identification of Key Borrower Principals



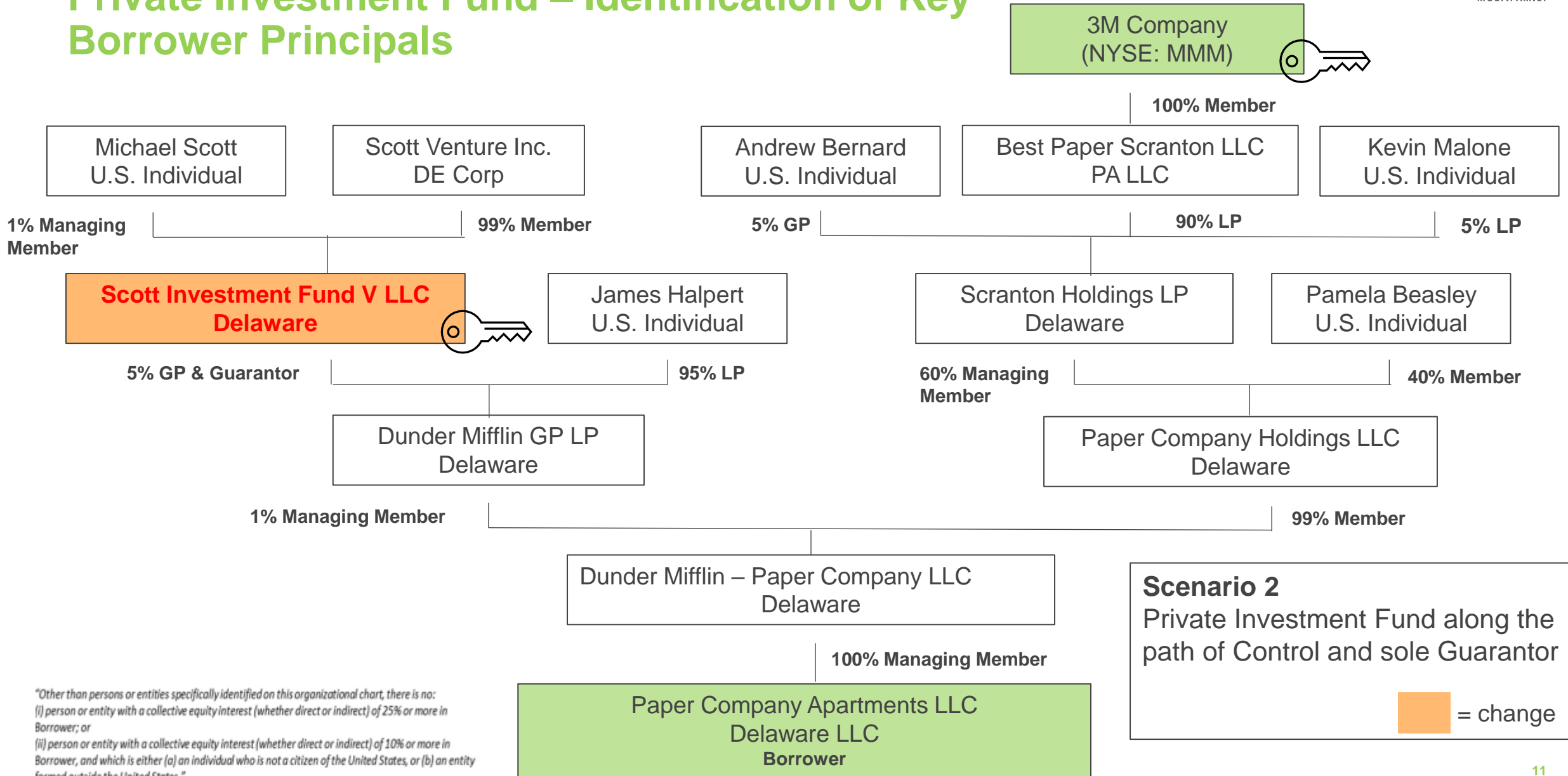
"Other than persons or entities specifically identified on this organizational chart, there is no: (i) person or entity with a collective equity interest (whether direct or indirect) of 25% or more in Borrower; or (ii) person or entity with a collective equity interest (whether direct or indirect) of 10% or more in Borrower, and which is either (a) an individual who is not a citizen of the United States, or (b) an entity formed outside the United States."

Buy-Sell – Identification of Key Borrower Principals




"Other than persons or entities specifically identified on this organizational chart, there is no: (i) person or entity with a collective equity interest (whether direct or indirect) of 25% or more in Borrower; or (ii) person or entity with a collective equity interest (whether direct or indirect) of 10% or more in Borrower, and which is either (a) an individual who is not a citizen of the United States, or (b) an entity formed outside the United States."

Private Investment Fund – Identification of Key Borrower Principals

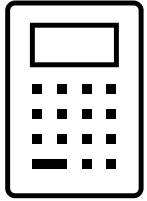


"Other than persons or entities specifically identified on this organizational chart, there is no: (i) person or entity with a collective equity interest (whether direct or indirect) of 25% or more in Borrower; or (ii) person or entity with a collective equity interest (whether direct or indirect) of 10% or more in Borrower, and which is either (a) an individual who is not a citizen of the United States, or (b) an entity formed outside the United States."

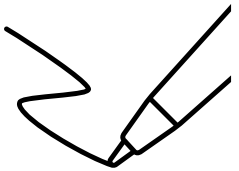
Scenario 2
Private Investment Fund along the path of Control and sole Guarantor

 = change

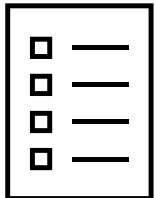
Contingent Liabilities – Analysis & Documentation



Risk-based approach now focuses on the potential impact to the Guarantor's overall financial capacity



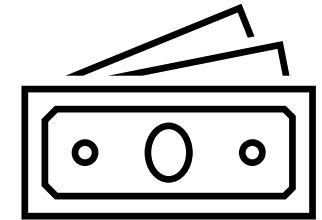
More appropriately focuses on the risk of repayment instead of targeting otherwise successful sponsors who are active developers with recourse debt in the normal course of business



Form 1115/1115SBL and Form 1116 will be updated to clarify the new requirements

Contingent Liabilities Simplified!

A liability, financial or legal, that may be incurred by an individual or entity, depending on the outcome of an uncertain future event

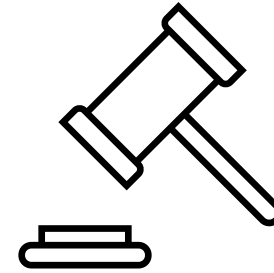


Includes the following three components:

1. Recourse debt and guaranties on properties with **negative equity only** (value of the property is less than the UPB of the associated loan)
2. Litigation **not fully covered by insurance** (excludes deductibles) – should include all amounts currently outstanding from judgments or settlements
3. Any other guaranties or contingent liabilities reported in the financial statements

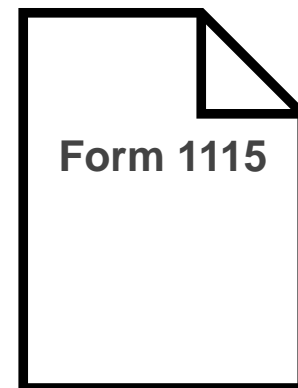
Legal Proceedings Clarified!

- **10-year lookback period** for most types of adverse events (i.e., felony conviction, insolvencies, civil proceedings with outstanding judgment, criminal or regulatory enforcement actions)
 - Does not apply to fraud, money laundering or terrorist financing activities (no time limit)
- Updated definition of “Conviction” (now also in both the Guide and Form 1115/1115SBL) to not only cover no contest pleas, but also Alford pleas as well as pardons not resulting in an expungement (otherwise not considered a Conviction)



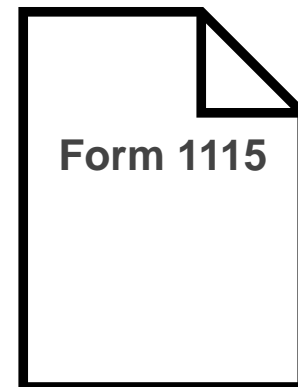
Updates to Form 1115/1115SBL

- Updates to the title and “Instructions and Definitions” section
 - Now called “Borrower and **Key** Borrower Principal Certificate”
 - Replaces prior definitions of Borrower Principal and Pass-Through, First, and Final levels with **Key Borrower Principal** definition
 - Includes definition of Ultimate Control
- References to Non-U.S. Equity Holders (including Part IV of the form) have been removed
 - Covered under the Organizational Chart requirements and Form 1114 Certification



Updates to Form 1115/1115SBL (cont'd)

- Replaced questions in the Borrower section about Single Purpose Entity (SPE), recycled SPE, and SPE Equity Owner with questions about owning assets other than property or conducting business related to ownership of the property
- Reclassified questions into criminal activity, credit events, regulatory compliance/ litigation and structure for better organization
- Shortened time frame for most disclosures to **10 years** (previously 20 years)
 - Does not apply to fraud, money laundering or terrorist financing activities (no time limit)



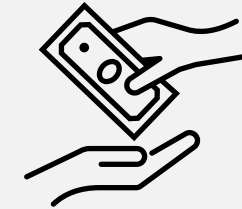
Updates to Form 1115/1115SBL (cont'd)



NET WORTH AND LIQUIDITY

Removed estimated Net Worth and Liquidity fields

- Certified Financial Statement now sole source document
- Reconciliation to Financial Statement no longer necessary

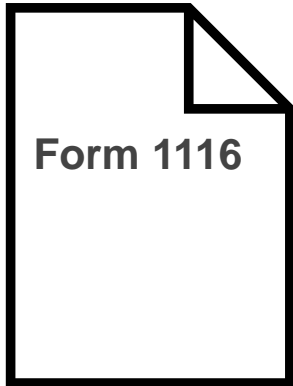


CONTINGENT LIABILITIES

Replaced generic question about Contingent Liabilities (CL) with specific questions about settlements or judgments not fully paid by insurance (explanation required)

- Form 1115/1115SBL now focuses on CLs related to legal actions and Form 1116 will focus on recourse debt obligations

Updates to Form 1116



- Same updates to instructions and terminology as Form 1115/1115SBL
- New column called “Recourse Amount” included to capture the amount of recourse/ guaranty associated with a particular asset
- Focus is on properties with negative equity (Outstanding Loan Amount exceeds Market Value)

Property Information											Ownership		Debt						Cash Flow																					
#	Property Name	Address	City	State	Status	Asset Type	Units	Year Built	Current Occupancy	Year Acquired	Company's Ownership Role	Company's Ownership	Lender	Loan Type	Maturity Date	Outstanding Loan Amount	Annual Debt Service	I/O or Amortizing	Recourse Amount	EGI	Operating Expenses	Current NOI																		
1																																								
2																																								
Insert		Delete Last																																						
Insert		Delete																																						
Total							#DIV/0!	###	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!																
Weighted average																																								
Minimum							0	0	0%	0	0.00%	0.00%	#####	\$0	\$0	#####	\$0	\$0	#####	\$0	\$0	#####	\$0																	
Maximum							0	0	0%	0	0.00%	0.00%	#####	\$0	\$0	#####	\$0	\$0	#####	\$0	\$0	#####	\$0																	
Total Recourse Amount on Properties where Outstanding Loan Amount Exceeds Current																			\$0																					
Total Recourse Amount on All Properties																			\$0																					
Comments																																								

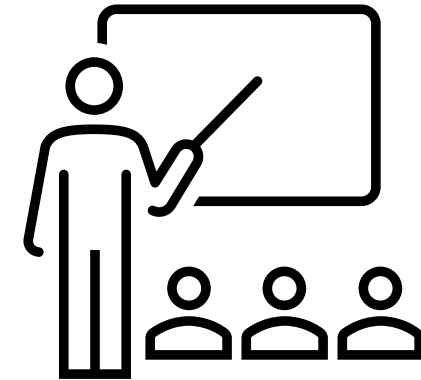
Key Takeaways

- **Clearer identification of parties:** New Key Borrower Principal concept will support a more consistent and thoughtful approach to full due diligence requirements
- **Greater efficiencies:** Updates to Form 1115/1115SBL eliminate the need to reconcile to multiple documents (certified financial statements and SREO) and provide clearer, risk-based questions in support of accurate reporting on the form
- **MTNA transparency:**
 - Key Borrower Principals must be identified
 - Financial information, SREO analysis, and assessment and evaluation of any adverse credit issues should be clearly and consistently documented



Reminders and Next Steps

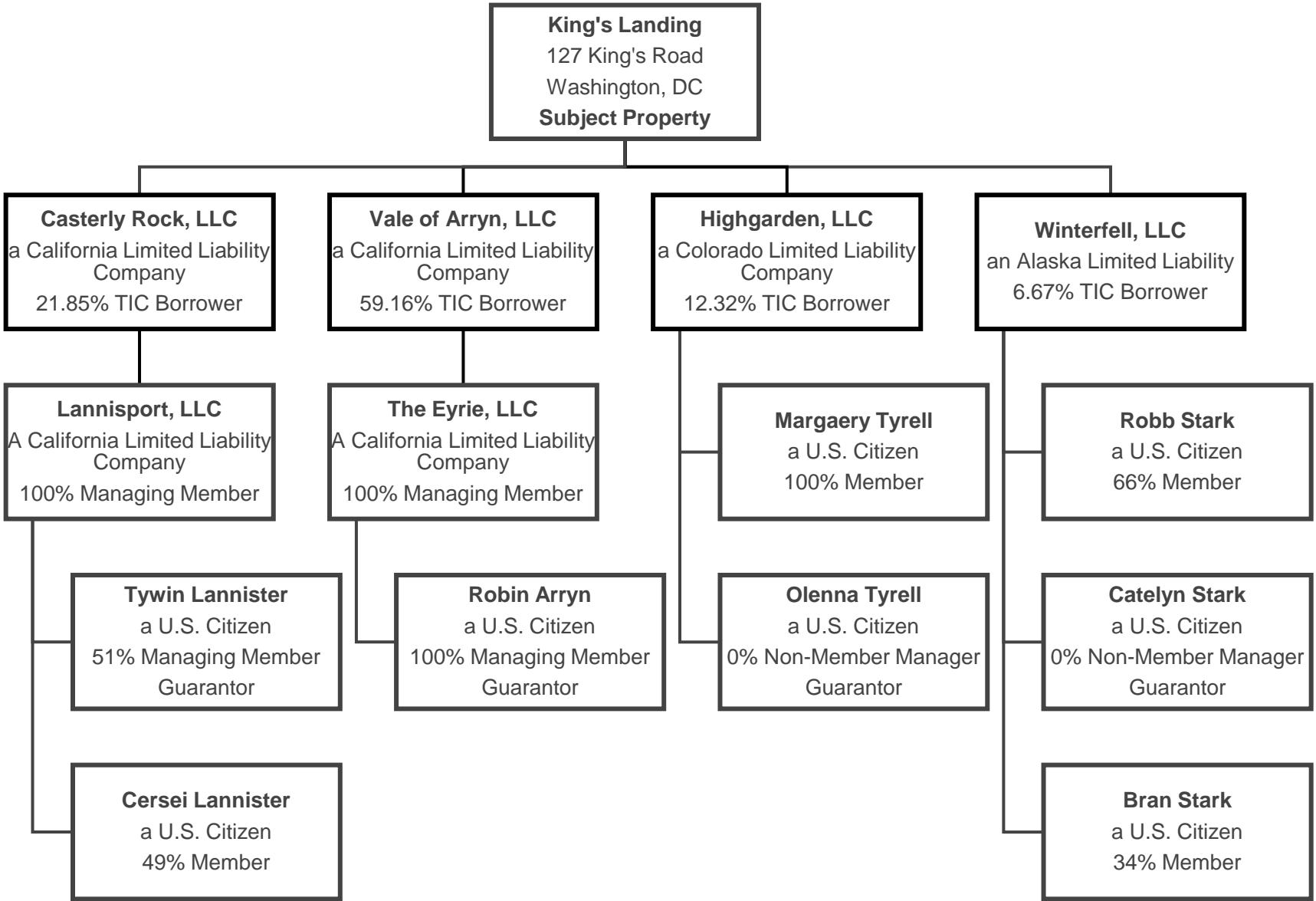
- Guide update on April 13
- New versions of the forms (dated April 13, 2023) **must be used as soon as possible**
 - If not using the most up-to-date Form 1116 – or SREO is provided in a different format – Recourse information must be provided in a different way
 - ✓ This information is needed in order to conduct a full review of contingent liabilities
- No impact to “Top Sponsor Program” – new form submissions will only be required as they become necessary as part of the normal update cycle



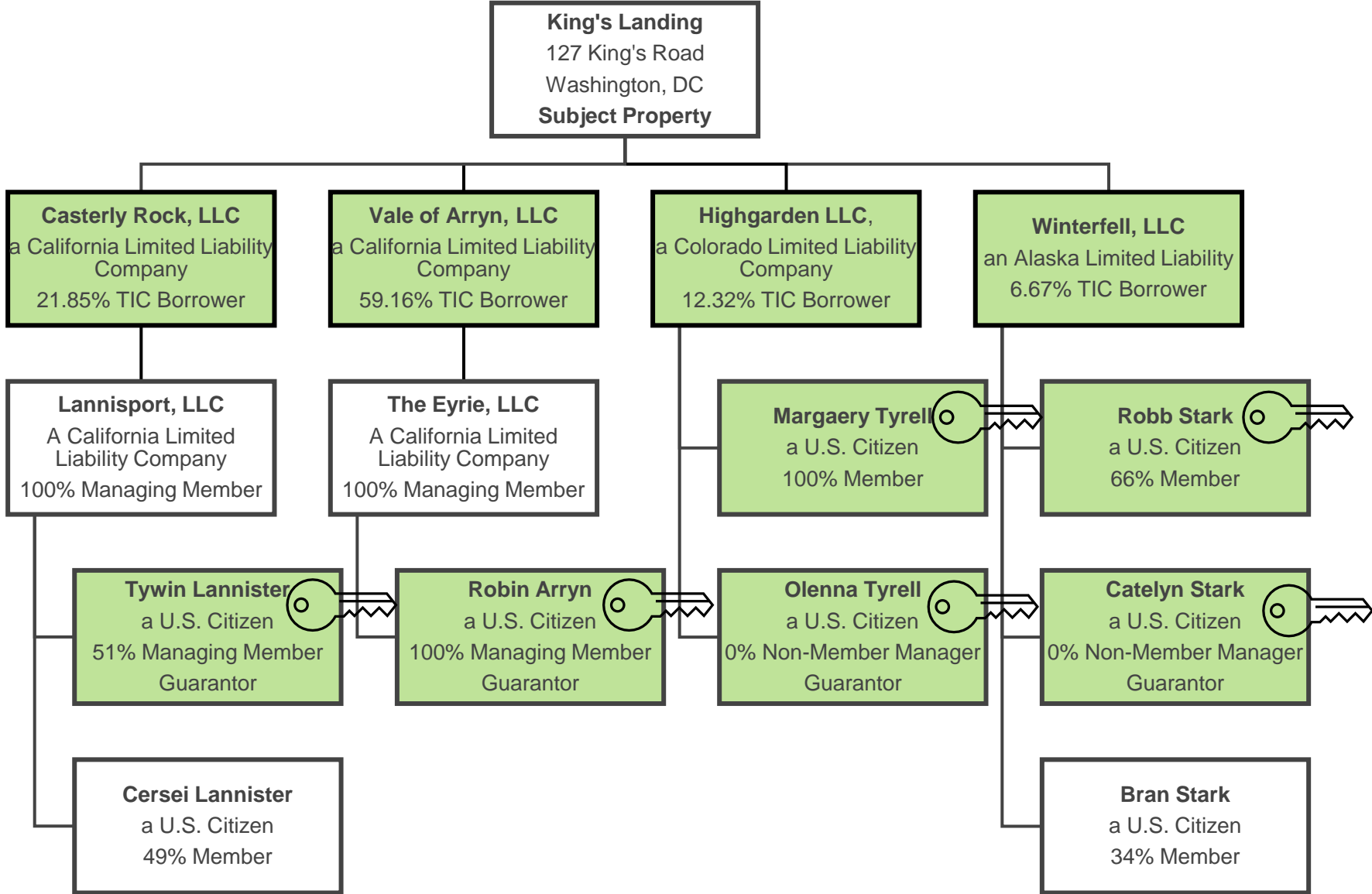
Appendix

Additional Org Chart Examples – Identification of Key Borrower Principals

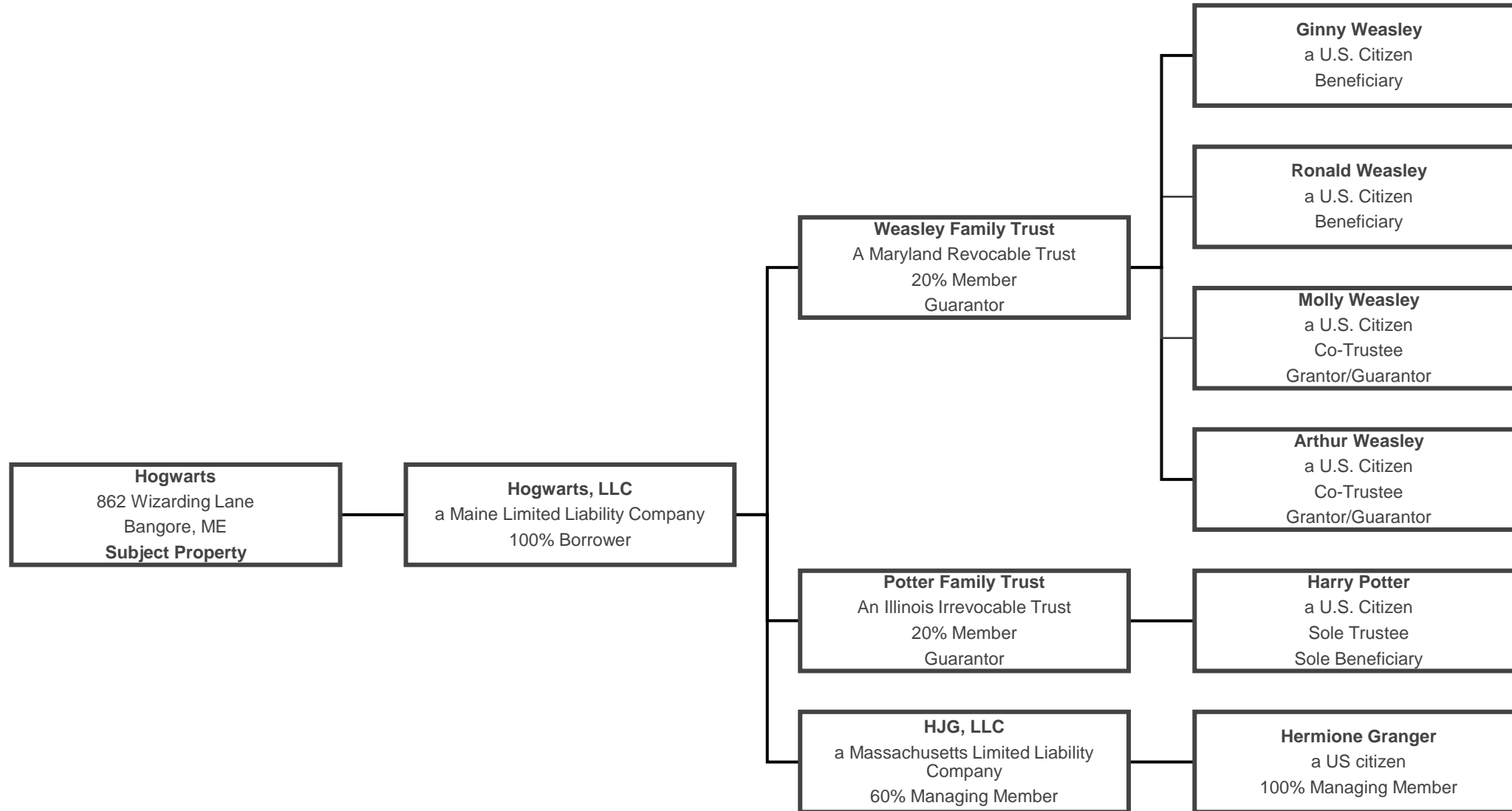
Complete Org Chart – Tenancy-In-Common (TIC) Example



Identification of Key Borrower Principals – TIC Example



Complete Org Chart – Trust Example



Identification of Key Borrower Principals – Trust Example

