

## Small Balance Loan Prepayments

As of November 2020

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### Executive Summary

- This report presents a summary of Freddie Mac Multifamily Small Balance Loan (SBL) voluntary prepayment activity over the past 12 months (from December 2019 through November 2020).
- We summarize prepayment speeds in aggregate and by product type, vintage, prepayment type, prepayment phase and FRESB deal.
- Prepays increased over the past 12 months, as expected. The average constant prepayment speed (CPR) is approximately 8.9% over the past 12 months. The prepay speeds for the 2015 and 2016 vintages are about double the overall average.
- Based on historical performance to date, we find that prepay speeds increase with loan seasoning and declining prepay penalties. As loans season and a growing population of loans move into periods with lower prepayment penalties, we expect prepayment activity to pick up.
- The focus of this report is on voluntary prepayments. There have been very few defaults in the SBL program – only \$5.7 million (2 basis points) in aggregate losses on a total securitized balance of over \$29.6 billion in the program's history since November 2015. See the most recent SBL Performance Report, available [here](#).
- See our [SB-Deal® Investor Presentation](#) for background information on the program's history, mortgage products, the Freddie Mac Optigo® network and FRESB bond structure.

Freddie Mac Multifamily formally added the SBL line of business to its lending platform in October 2014. This program targets loans between \$1 million and \$7.5 million and offers prepay flexibility to borrowers.

Through November 2020<sup>1</sup>, Freddie Mac has funded and securitized over 11,100 SBLs totaling over \$29.6 billion of original unpaid principal balance (UPB), of which about \$5 billion have prepaid. The majority of these loans have been funded in the last few calendar years.

### Prepayment Options Background

SBL products include both hybrid ARMs and fixed-rate products across multiple loan terms, all with an array of prepayment options. SB loans generally offer more prepay flexibility than our Conventional Loans, where the standard K-Deal<sup>®</sup> fixed-rate loan has a lockout period followed by defeasance.

### Exhibit 1: Loan Products & Available Prepayment Options

The Freddie Mac SBL program offers borrowers prepayment options along with a number of different products.

Option	Hybrids			Fixed-Rate			
	5H	7H	10H	5F	7F	10F	
1	54321, 1%	5544321, 1%	5544332211, 1%	54321	5544321	5544332211	45%
2	321(3), 1%	3(2)2(2)1(3), 1%	3(3)2(3)1(4), 1%	321(3)	3(2)2(2)1(3)	3(3)2(3)1(4)	7%
3	YM or 1%	YM or 1%	YM or 1%	YM or 1%	YM or 1%	YM or 1%	43%
4	310(3), 0%	N/A	N/A	310(3)	N/A	N/A	5%
	36%	8%	12%	5%	6%	33%	100%

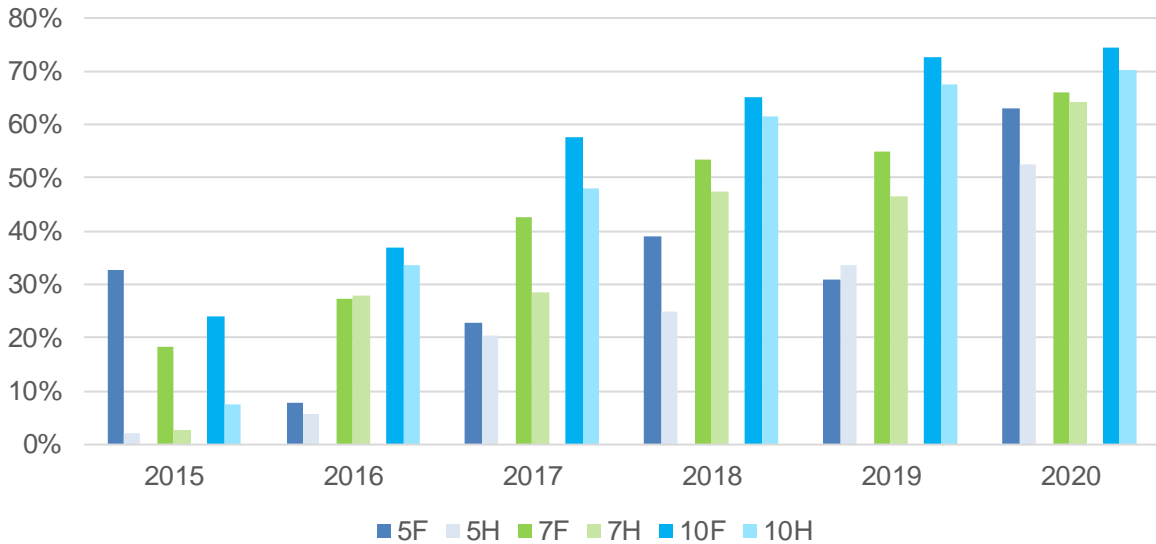
Source: Freddie Mac. We frequently use shorthand above to define the products; for example, we refer to the 5-year Hybrid as “5H” and the 10-year Fixed Balloon as “10F.” Option 3 refers to Yield Maintenance but includes YM or 1% +1%, 1%. See the SBL Product page at <https://mf.freddiemac.com/product/sbl.html> for more details.

Exhibit 1 above shows the mix of SBL products and available prepay types, along with the percentage of total origination volume across product types and prepayment options. The 5-year hybrid and 10-year fixed-rate loans are the primary products borrowers select, making up approximately 70% of our current business. Option 1 – those where loans start with a 5% prepay penalty – remains the most prevalent. These make up 45% of total business, which is down from 48% a year ago. The second most popular prepay option is yield maintenance, especially for the 10-year fixed-rate loan. Over the past few years, the share of borrowers choosing yield maintenance has increased, mostly in our 10-year products, as seen below in Exhibit 2.

<sup>1</sup> All data points in this report are as of November 2020 unless otherwise mentioned. This analysis excludes third-party seasoned loans not typical of the program.

**Exhibit 2: Percentage of Active Loans with Yield Maintenance by Vintage and Product Type**

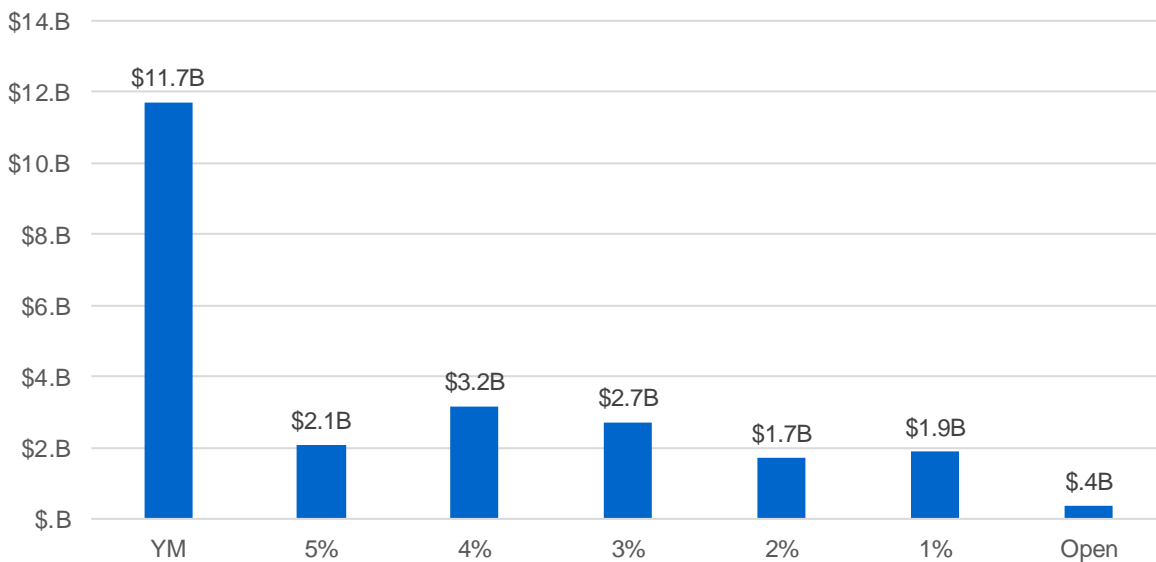
Yield maintenance is more prevalent with newly originated loans and those with longer terms.



Source: Freddie Mac

A number of factors drive prepay behavior, including an incentive to prepay when rates fall or when property values rise. A high prepay penalty would mitigate both those factors. Currently, the majority of loans are still subject to high prepay penalties, either in the form of yield maintenance or relatively high points, as shown in Exhibit 3.

**Exhibit 3: Outstanding Loan Balance by Prepayment Phase**



Source: Freddie Mac

**Prepayment Speeds by Loan Characteristics**

In the past 12 months, the number of loans that prepaid increased 50% in comparison with 2019. Interest rates declined throughout 2020 while property prices continued to appreciate moderately. With loans continuing to season, all these factors produce increased incentive for borrowers to prepay. The population of loans with the most flexible prepay terms (1% or open) has increased, from about \$1.3 billion to \$2.3 billion as of November 2020, but still remains less than 10% of UPB.

Over the trailing 12 months, 785 loans have prepaid, making the total since the program’s inception around 1,700. The 12-month average CPR is 8.9% as of November 2020. Exhibit 4 presents a summary of payoffs across different prepay options, prepayment phase, vintage and product type in the past 12 months. For additional details on the number of prepays since inception, please see the [May 2019 SBL Prepay Report](#) and the [November 2019 SBL Prepay Report](#). For additional details around FRESB loan payoffs, please reference our [SB-Deal Performance Presentation](#).

**Exhibit 4: Payoff Summary by Loan Count in the Past 12 Months**

Prepayment Option	1	2	3	4				Total
	487	154	78	66				785
Prepayment Phase	YM	5%	4%	3%	2%	1%	Open	
	71	35	175	156	105	203	40	785
Vintage	2015	2016	2017	2018	2019	2020		
	103	204	221	190	66	1	785	
Product	5H	7H	10H	5F	7F	10F		
	358	47	50	54	56	220	785	

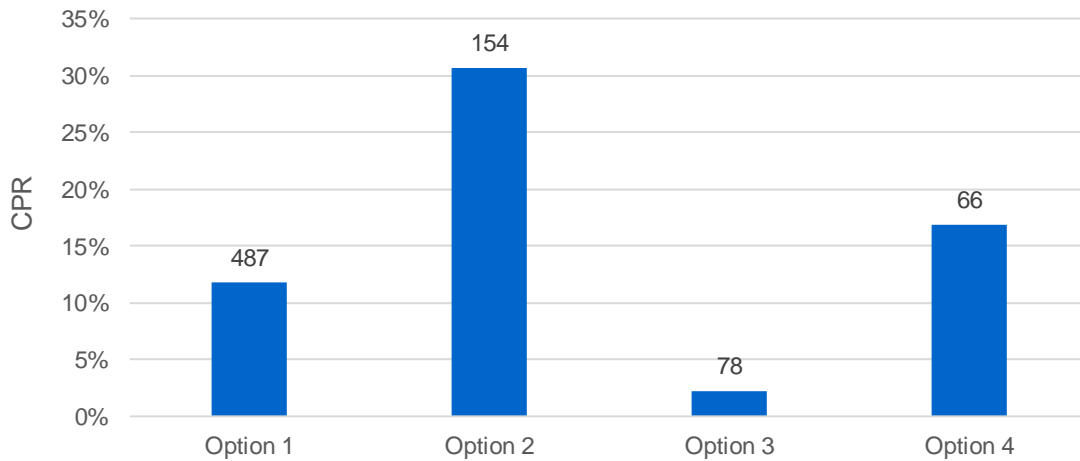
Source: Freddie Mac

In the following exhibits, we present prepay rates across vintage and other characteristics over the past 12 months. We’ve seen a large increase in prepayments from Option 1, at 487 loans of the 785 that have prepaid. However, since nearly half of all loans originated with Option 1, the actual CPR of Option 1 in the past 12 months is 12%, as seen in Exhibit 5. Options 2 and 4 have seen much higher prepay rates at 31% and 17%, respectively, due to the greater prepayment flexibility they provide.

Loan prepayments increased in 2020, with loans originated in 2016-2018 leading the way, and those with prepay Option 1.

**Exhibit 5: CPR by Prepay Option in the Past 12 Months**

Loans with Option 2 had the highest CPR rate, while loans with Option 1 saw the most prepays over the past 12 months.

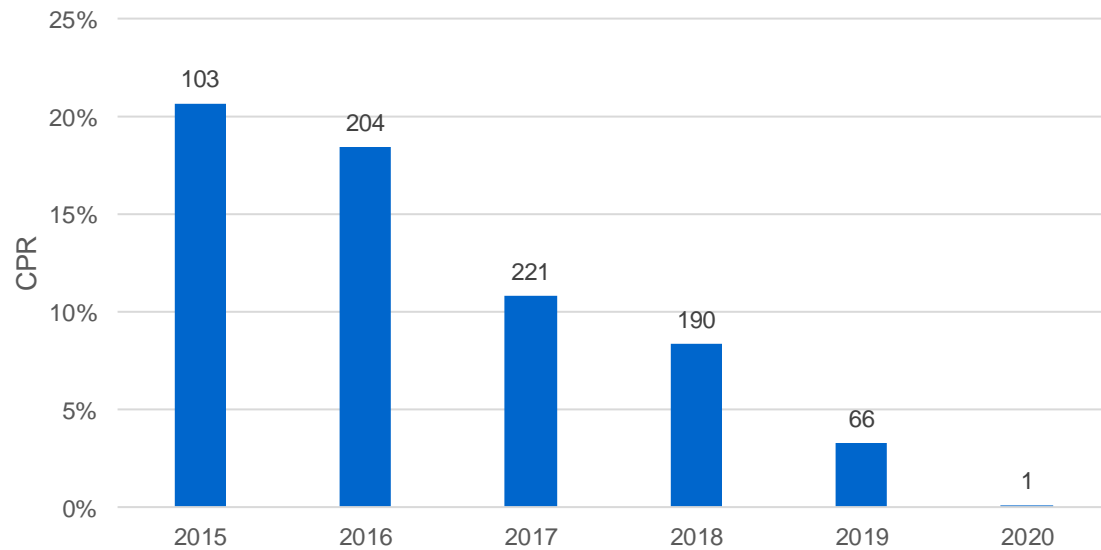


Source: Freddie Mac

The number of loans that have prepaid have largely come from the earlier vintages, specifically in 2016-2017, as loans in those vintages have had time to season. Exhibit 6 demonstrates that loans that originated in 2015 have the highest prepay speed with a 12-month average CPR of 21%, with each subsequent year having a slower CPR than the previous one, with 2020 essentially at 0.

**Exhibit 6: CPR by Origination Vintage and Payoff Loan Counts in the Past 12 months**

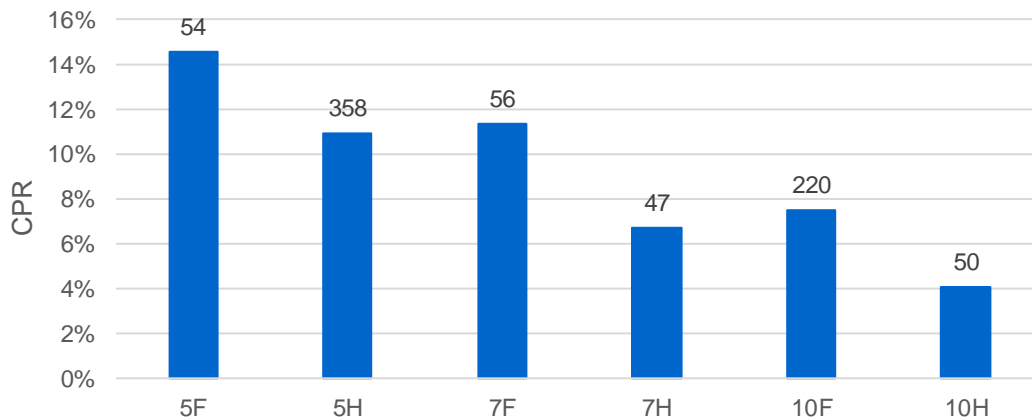
As loans season, the CPR rate increases.



Source: Freddie Mac

Exhibit 7 below shows that prepays occur across all product types. CPRs are fastest for the 5-year and 7-year fixed-rate products, with speeds ranging from 11% to 15%. However, by far the greatest number of prepaid loans are amongst the 5-year hybrid (5H) and 10-year fixed-rate (10F) products, with 358 and 220 prepays, respectively, as they are the most common loans borrowers choose.

**Exhibit 7: CPR by Product Type and Payoff Loan Counts in the Past 12 Months**



Source: Freddie Mac

Loans with longer terms typically have more punitive prepay structures and lower CPRs.

A total of 285 5-year hybrid loans were originated prior to November 2015, meaning they would convert to floating-rate by the November 2020 data cut-off of this report, as seen in Exhibit 8. Of those 285 loans, 139 either paid off or were refinanced prior to converting to floating-rate, while the remaining 146 flipped to floating-rate, for an overall flip rate of 51%. This analysis excluded loans that paid off after they extended into their floating periods (the flip rate without these loans would be 45%). The vast majority of the flipped loans have the standard hybrid period 1% prepayment penalty, while a small fraction are open.

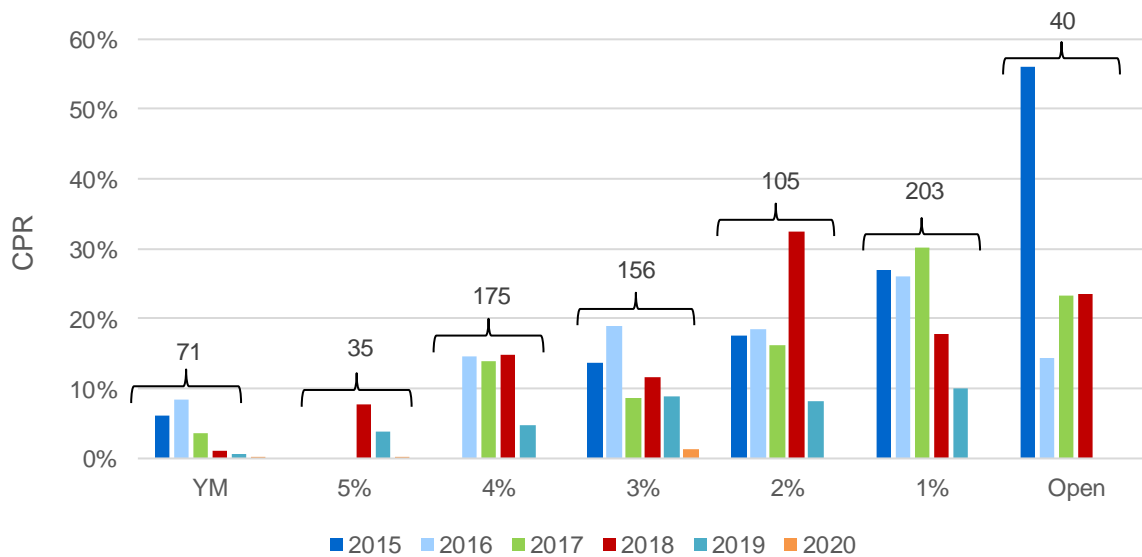
**Exhibit 8: Analysis of 5-Year Hybrid Loan Flip Rates**

Origination Month	Originated 5H Loans	Loans Paid Off/Refinanced	Loans Flipped	First Interest Adjustment Date	Flip Rate	Floating Loans as of Nov. 2020
Oct 2014	1	1	0	--	--	--
Nov 2014	1	1	0	--	--	--
Dec 2014	10	1	9	Jan 2020	75%	9
Jan 2015	5	5	0	Feb 2020	53%	--
Feb 2015	9	6	3	Mar 2020	46%	1
Mar 2015	14	10	4	Apr 2020	40%	4
Apr 2015	9	5	4	May 2020	41%	1
May 2015	9	6	3	Jun 2020	40%	3
Jun 2015	28	14	14	Jul 2020	43%	9
Jul 2015	31	14	17	Aug 2020	46%	14
Aug 2015	50	18	32	Sep 2020	51%	29
Sep 2015	68	32	36	Oct 2020	52%	35
Oct 2015	50	26	24	Nov 2020	51%	24
<b>Total:</b>	<b>285</b>	<b>139</b>	<b>146</b>		<b>51%</b>	<b>129</b>

Source: Freddie Mac

As loans season and enter lower prepayment penalty periods, we expect loans to prepay more quickly and for CPRs to increase. This is illustrated below in Exhibit 9 where the prepayment speed and seasoning increases as the prepay penalty decreases.

**Exhibit 9: CPR by Loan Prepayment Phase and Payoff Loan Counts in the Past 12 Months**



Source: Freddie Mac

Exhibit 10 lists CPRs and prepay count by Freddie Mac SB-Deal. Because the history is short and SB-Deals® are more heterogenous compared with K-Deals®, we observe an uneven, albeit generally downward trending prepayment history over time. Some of the unevenness can be attributed to large pools of loans in deals paying off, inflating the deal's CPR. However, in general, the longer the deal has been outstanding, the higher the prepay rate.

**Exhibit 10: CPR, Initial UPB and Loan Count of Payoffs by SB-Deal®**

Deal	Initial UPB, \$M	CPR	Paid-Off Loan Count in the Past 12 Months	Deal	Initial UPB, \$M	CPR	Paid-Off Loan Count in the Past 12 Months
SB1-2015	120	17%	9	SB43	325	7%	7
SB2	122	33%	8	SB44	320	4%	7
SB4	192	19%	13	SB45-2018	402	10%	16
SB5	144	22%	11	SB46	494	5%	9
SB6	202	20%	10	SB47	553	10%	15
SB7	100	11%	2	SB48	559	5%	12
SB9	445	12%	15	SB49	569	8%	15
SB10	148	21%	10	SB50	505	12%	20
SB11-2016	110	10%	4	SB51	508	9%	14
SB12	167	16%	12	SB52	562	4%	12
SB13	401	19%	31	SB53	589	5%	9
SB14	310	11%	13	SB54	538	12%	20
SB15	302	17%	19	SB55	607	6%	10
SB16	350	18%	22	SB56	564	8%	16
SB17	386	19%	17	SB57	576	12%	23
SB18	118	29%	15	SB58-2019	622	8%	24
SB20	293	18%	18	SB59	625	3%	9
SB21	94	6%	3	SB60	625	4%	12
SB22	255	20%	16	SB61	615	6%	13
SB23	342	17%	15	SB62	623	3%	5
SB24	259	18%	14	SB63	530	5%	7
SB25	233	12%	9	SB64	443	7%	10
SB26-2017	221	10%	7	SB65	614	4%	8
SB27	246	20%	13	SB66	574	2%	3
SB28	323	15%	17	SB67	604	3%	5
SB29	217	10%	7	SB68	536	1%	2
SB30	307	12%	10	SB69	459	2%	2
SB31	264	11%	14	SB70-2020	413	2%	3
SB32	322	8%	9	SB71	422	0%	1
SB33	220	14%	16	SB72	381	0%	0
SB34	327	13%	22	SB73	332	0%	0
SB35	317	7%	8	SB74	419	0%	0
SB36	350	5%	11	SB75	494	3%	1
SB37	317	11%	13	SB76	431	0%	0
SB38	259	3%	4	SB77	425	1%	1
SB39	264	19%	16	SB78	410	0%	0
SB40	293	4%	6	SB79	410	0%	0
SB41	311	12%	10	SB80	404	0%	0
SB42	287	5%	5	SB81	322	0%	0

Source: Freddie Mac





## Summary

Historically, prepayments have been relatively slow given that longer-term loans incur significant fees to pay off early. As loans in the program season, and due to record low interest rates and continued multifamily price appreciation, the number of SBLs that prepaid in the past 12 months has increased 50% when compared with a very active 2019. Furthermore, the first wave of 5-year fixed maturities and 5-year hybrid changeovers reached those milestones in early 2020, further contributing to the higher level of prepayments. But there are many factors that drive prepayment behavior, some of which are idiosyncratic. With only the most seasoned, shortest-termed loans reaching changeover or maturity, accurately predicting future prepayment activity is difficult, but we believe the more seasoned loans and those with lower prepayment penalties will prepay at higher rates than others.

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