

Small Balance Loan Prepayments

As of July 2021

Research

Jun Li
(571) 382-5047
jun_li@freddiemac.com

Xiaojun Li
(571) 382-4967
xiaojun_li@freddiemac.com

Michael Donnelly
(571) 382-3632
michael_donnelly@freddiemac.com

Capital Markets

Paul Kolling
(571) 382-5725
paul_kolling@freddiemac.com

Emily Wang
(571) 382-5982
emily_wang@freddiemac.com

- This report presents a summary of Freddie Mac Multifamily Small Balance Loan (SBL) voluntary prepayment activity over the past 12 months (from August 2020 through July 2021).
- We summarize prepayment speeds in aggregate and by product type, vintage, prepayment type, prepayment phase and FRESB deal.
- Prepayments increased over the past 12 months, as expected. The average constant prepayment rate (CPR) is approximately 10.2% over the past 12 months. The 2015 and 2016 vintages prepayment speed is about double the overall average.
- Based on historical performance to date, we find that prepayment speeds increase with loan seasoning and declining prepayment 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 \$11.8 million (4 basis points) in aggregate losses on a total securitized balance of over \$32.8 billion in the program's history since October 2014. 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 prepayment flexibility to borrowers.

Through July 2021¹, Freddie Mac has funded and securitized over 12,400 SB loans totaling over \$32.8 billion of original unpaid principal balance (UPB), of which approximately \$7 billion have prepaid. The majority of these loans have been funded in the last few calendar years.

Prepayment Options Background

SBL loan 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 prepayment flexibility than our Conventional Loans, where the standard K-Deal® 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			Total % Business
	5H	7H	10H	5F	7F	10F	
1	54321, 1%	5544321, 1%	5544332211, 1%	54321	5544321	5544332211	48%
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)	8%
3	YM or 1%, 1%	YM or 1%, 1%	YM or 1%, 1%	YM or 1%	YM or 1%	YM or 1%	40%
4	310(3), 0%	N/A	N/A	310(3)	N/A	N/A	4%
Total % Business	35%	7%	12%	5%	6%	34%	100%

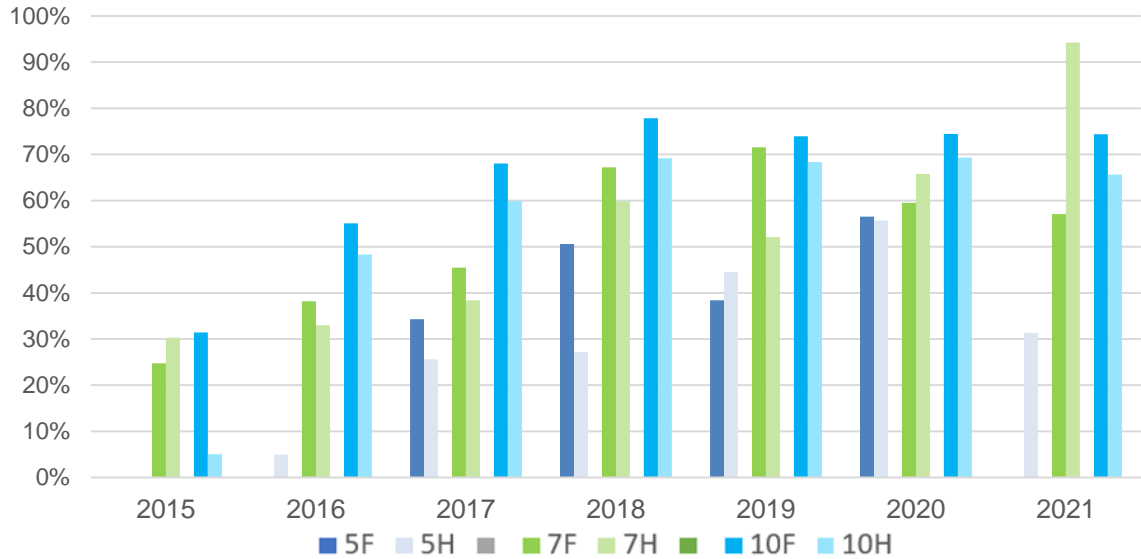
Source: Freddie Mac. We frequently use shorthand above to define the products; for example, we refer to the 5-year Hybrid as “5H” and the 10-year Fixed Balloon as “10F.” Option 3 refers to Yield Maintenance but includes legacy YM or 1% +1%, 1% loans. See the SBL Product page at <https://mf.freddie.com/product/sbl.html>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

Exhibit 1 above shows the mix of SBL products and available prepayment 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 selected by borrowers, making up nearly 70% of our current business. The most popular prepayment option is loans that start with a 5% prepayment penalty – Option 1. These loans make up 48% of total business, which is up from 45% in January 2021. The second most popular prepayment option is yield maintenance, particularly for 10-year fixed-rate loans. Over the past few years, the share of borrowers choosing yield maintenance has increased, especially in our 7- and 10-year products, as shown below in Exhibit 2.

¹ All data points in this report are as of July 2021 unless otherwise stated. This analysis excludes third-party seasoned loans not typical of the program.

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

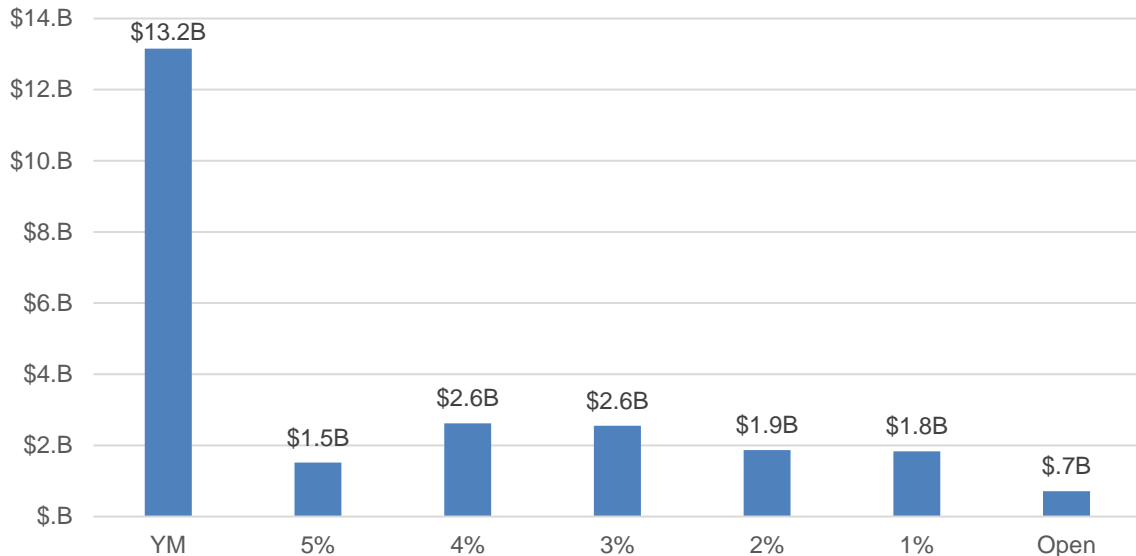
Exhibit 2: Percentage of Active Loans with Yield Maintenance by Vintage and Product Type



Source: Freddie Mac

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

Exhibit 3: Outstanding Loan Balance by Prepayment Phase



Source: Freddie Mac.

Prepayment Speeds by Loan Characteristics

From August 2020 through July 2021, the number of loans that prepaid increased 38% in comparison with December 2019 through November 2020. Interest rates remained at or near record lows in 2021 while property price growth accelerated. With loans continuing to season, all these factors produce an increased incentive for borrowers to prepay. The population of loans with the most flexible prepayment terms (1% or open) has increased slightly, from about \$2.3 billion in January 2021 to \$2.5 billion as of July, but still remains less than 11% of UPB.

Over the trailing 12 months, 1,082 loans have prepaid, making the total since the program’s inception around 2,500. The 12-month average CPR is 10.2% as of July 2021. Exhibit 4 presents a summary of payoffs across different prepayment options, prepayment phase, vintage and product type in the past 12 months.²

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

Prepayment Option	1	2	3	4				Total
	723	132	117	110				1082
Prepayment Phase	YM	5%	4%	3%	2%	1%	Open	
	108	40	210	203	135	293	93	1082
Vintage	2015	2016	2017	2018	2019	2020		
	150	246	255	268	135	28	1082	
Product	5H	7H	10H	5F	7F	10F		
	472	82	77	76	82	293	1082	

Source: Freddie Mac

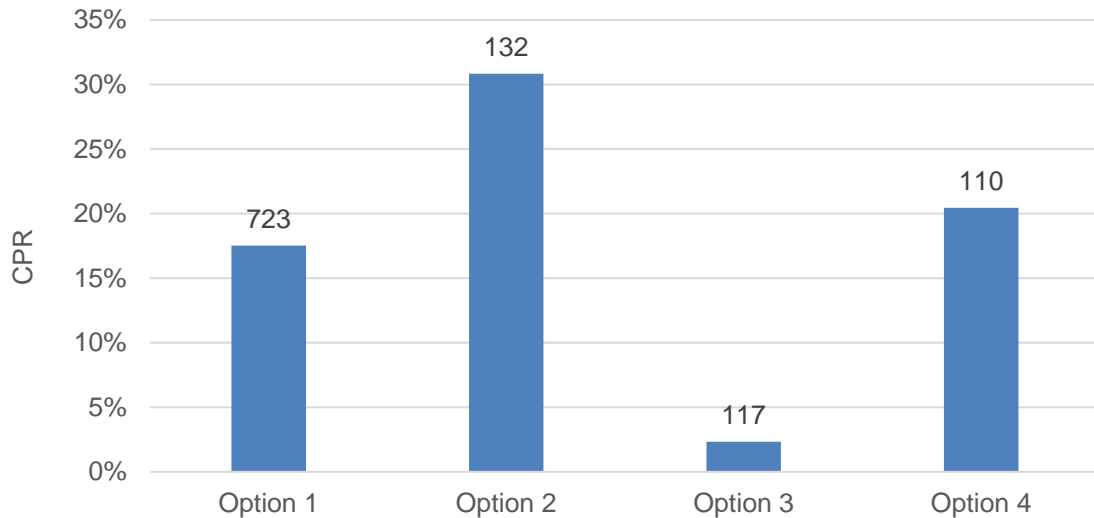
Loan prepayments increased in 2021, with loans originated 2016-2018 leading the way, and those with prepayment Option 1.

In the following exhibits, we present prepayment rates across vintage and other characteristics over the past 12 months. We have observed a large increase in prepayments from Option 1, at 723 loans of the 1,103 that have prepaid. However, because nearly half of all loans were originated electing Option 1, the actual CPR of Option 1 in the past 12 months is 18%, as shown in Exhibit 5. Options 2 and 4 have experienced higher prepayment rates at 31% and 20%, respectively, due to the greater prepayment flexibility they provide.

² For additional details on the number of prepaids since inception, please see the [May 2019](#), the [November 2019](#) and [November 2020](#) SBL Prepay Reports. For additional details around FRESB loan payoffs, please reference our [SB-Deal Performance Presentation](#).

Exhibit 5: CPR by Prepayment Option in the Past 12 Months

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

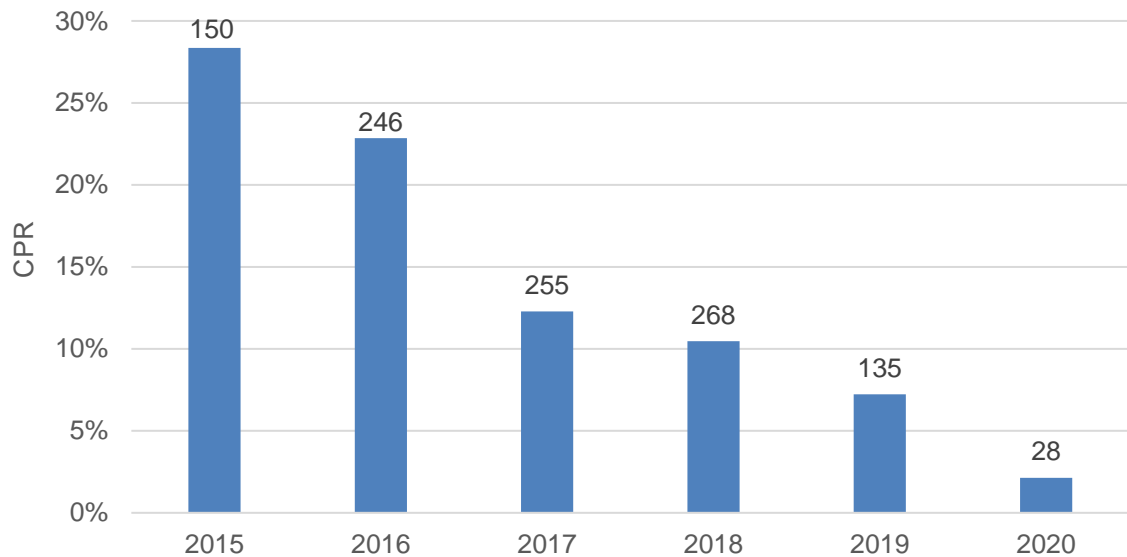


Source: Freddie Mac

The number of loans that have prepaid have largely come from the earlier vintages, specifically in 2016 to 2018, as loans in those vintages have had time to season. Exhibit 6 demonstrates that loans that originated in 2015 have the highest prepayment speed with a 12-month average CPR of 28%, with each subsequent year having a slower CPR than the previous one, with 2020 down to 2%.

As loans season, the CPR increases.

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

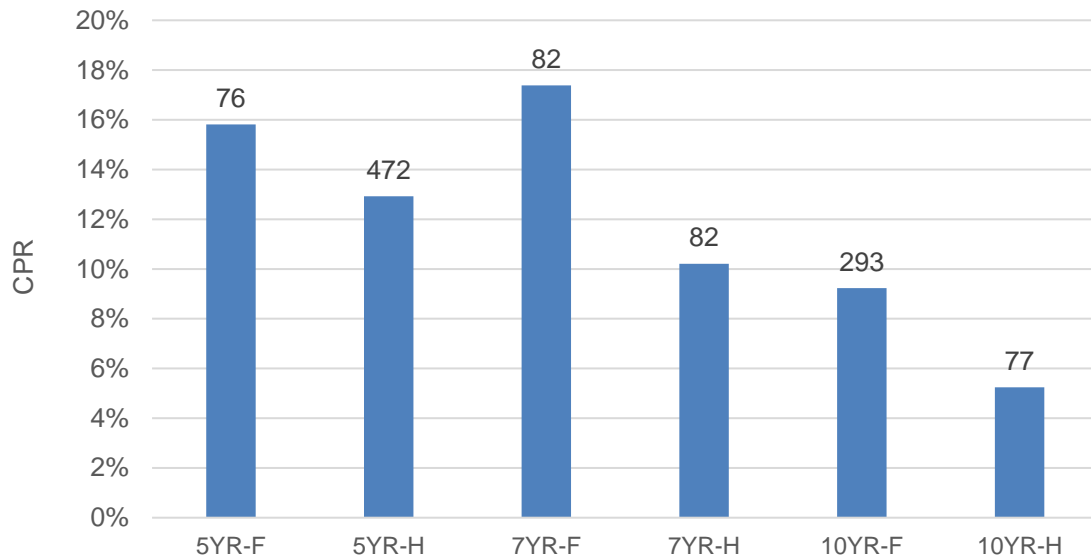


Source: Freddie Mac

Exhibit 7 below shows that prepayments occur across all product types. CPRs are fastest for the 5-year and 7-year fixed-rate products, with speeds of 16% to 17%. However, by far the greatest number of prepaid loans are among the 5-year hybrid (5H) and 10-year fixed-rate (10F) products, with 472 and 293 prepaids, respectively, as they are the most common loan types chosen by borrowers.

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

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



Source: Freddie Mac

A total of 749 5-year hybrid loans that were originated prior to June 2016 converted to floating-rate by the July 2021 data cut-off of this report, as shown in Exhibit 8. Once converted, the standard prepayment penalty is 1%. Of those 749 loans, 375 either paid off or were refinanced prior to converting to floating-rate, while the remaining 374 converted to floating-rate, for an overall conversion rate of 50%. Of those loans that converted to floating rate, 28% or 106 loans paid off after they extended into their floating-rate period.

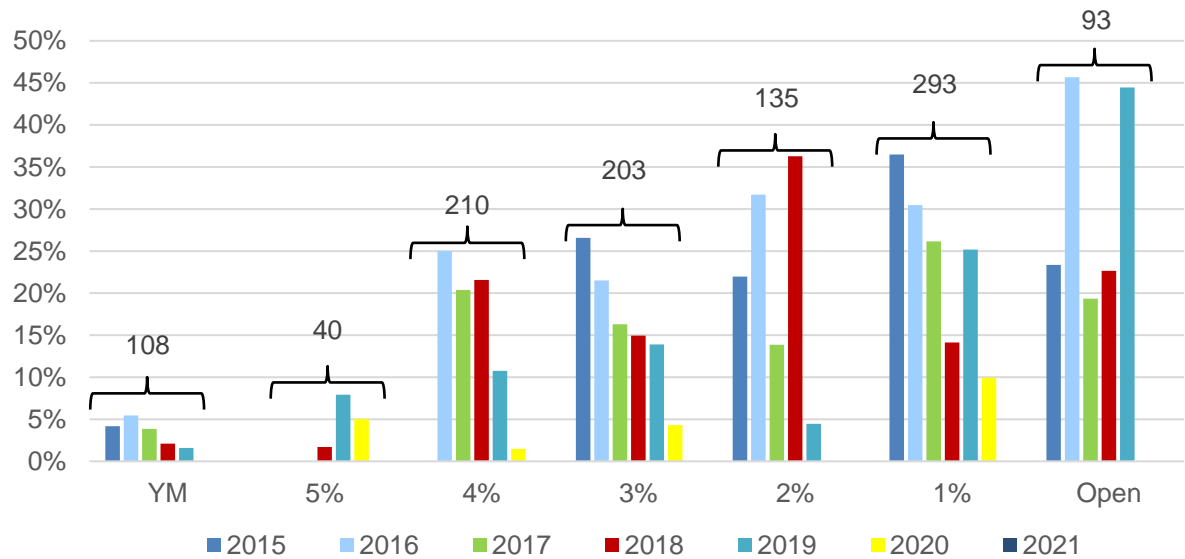
Exhibit 8: Analysis of 5-Year Hybrid Loan Conversion Rates

Origination Month	Originated 5H Loans	Loans Paid off/ Refinanced	Loans Converted	First Interest Adjustment Date	Conversion Rate	Floating Loans as of July 2021
Oct-14	1	1	0	--	--	--
Nov-14	1	1	0	--	--	--
Dec-14	6	1	5	Jan-20	63%	5
Jan-15	5	5	0	Feb-20	38%	--
Feb-15	9	6	3	Mar-20	36%	0
Mar-15	14	10	4	Apr-20	33%	4
Apr-15	9	5	4	May-20	36%	1
May-15	9	6	3	Jun-20	35%	1
Jun-15	28	14	14	Jul-20	40%	7
Jul-15	31	14	17	Aug-20	44%	9
Aug-15	50	18	32	Sep-20	50%	20
Sep-15	68	32	36	Oct-20	51%	27
Oct-15	50	26	24	Nov-20	51%	14
Nov-15	42	18	24	Dec-20	51%	16
Dec-15	71	34	37	Jan-21	52%	23
Jan-16	53	26	27	Feb-21	51%	14
Feb-16	56	27	29	Mar-21	51%	25
Mar-16	70	42	28	Apr-21	50%	18
Apr-16	56	31	25	May-21	50%	22
May-16	53	18	35	Jun-21	51%	35
Jun-16	67	40	27	Jul-21	50%	27
Total:	749	375	374	--	50%	268

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 prepayment 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 prepayment 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 prepayment rate.

Exhibit 10: CPR, Initial UPB and Loan Count of Payoffs by FRESB Deal

Deal	Initial UPB			Paid off			
	M \$	CPR	Loan count in the past 12 months	Deal	M \$	CPR	Loan count in the past 12 months
SB001	121	20%	8	SB046	495	11%	16
SB002	122	22%	6	SB047	553	9%	15
SB004	192	30%	16	SB048	561	10%	21
SB005	145	31%	11	SB049	569	7%	15
SB006	202	28%	14	SB050	506	10%	21
SB007	101	9%	3	SB051	509	6%	9
SB009	445	22%	23	SB052	564	8%	15
SB010	148	23%	10	SB053	590	5%	11
SB011	110	19%	5	SB054	539	12%	18
SB012	167	20%	14	SB055	608	9%	19
SB013	401	27%	29	SB056	565	15%	27
SB014	310	19%	17	SB057	578	13%	30
SB015	302	25%	22	SB058	624	10%	26
SB016	350	33%	44	SB059	626	13%	29

SB017	387	23%	30	SB060	625	7%	18
SB018	118	33%	11	SB061	616	17%	39
SB020	293	19%	16	SB062	625	8%	11
SB021	94	17%	6	SB063	531	7%	14
SB022	255	20%	14	SB064	443	8%	12
SB023	342	24%	21	SB065	615	8%	20
SB024	259	18%	15	SB066	575	4%	9
SB025	233	18%	15	SB067	605	8%	13
SB026	221	11%	8	SB068	537	7%	15
SB027	246	17%	12	SB069	460	5%	11
SB028	323	12%	15	SB070	414	3%	4
SB029	217	11%	7	SB071	423	4%	9
SB030	307	21%	19	SB072	381	6%	7
SB031	264	7%	5	SB073	333	2%	3
SB032	322	10%	11	SB074	419	3%	4
SB033	221	19%	18	SB075	494	5%	8
SB034	328	34%	35	SB076	432	3%	5
SB035	317	8%	6	SB077	426	5%	8
SB036	351	12%	19	SB078	411	3%	4
SB037	317	6%	6	SB079	410	2%	1
SB038	259	9%	10	SB080	405	1%	2
SB039	264	16%	11	SB081	323	0%	0
SB040	294	8%	10	SB082	450	0%	0
SB041	312	15%	14	SB083	401	2%	1
SB042	288	4%	5	SB084	403	0%	0
SB043	326	6%	7	SB085	428	0%	0
SB044	321	8%	8	SB086	414	3%	1
SB045	403	10%	15	SB087	430	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 property price appreciation, the number of SB loans that prepaid in the past 12 months has increased 38% when compared with the 12 months ending in November 2020. Furthermore, the first wave of 5-year fixed-rate maturities and 5-year hybrid conversions reached those milestones in 2020, contributing to the higher level of prepayments. As discussed earlier, there are many factors that drive prepayment behavior, some of which are idiosyncratic. Accurately predicting future prepayment activity is difficult, but typically the more seasoned loans and those with lower prepayment penalties will prepay at higher rates than others.