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2020 GlobalCapital US Securitization Awards

CMBS Deal of the Year

Freddie Mac K-F73

Issuer: Freddie Mac
Co-lead managers and joint bookrunners: Morgan Stanley & Co LLC, and Goldman Sachs and Co LLC
Co-managers: Amherst Pierpont Securities LLC, BofA Securities Inc, CastleOak Securities LP, and Wells Fargo Securities LLC

THE SPECTRE of the transition from Libor to Sofr has loomed over the market for several years with many technical issues still being worked out. Many in the market feel that the whole issue will end up in court, with judges being asked to decide the one fundamental question of who will end up paying for it. Against that backdrop, it takes a brave and committed issuer to step up to the plate and very publicly do a deal that breaks that logjam. For Freddie Mac, it was market leadership of the very highest order.

The $766m multifamily deal was issued from Freddie Mac's K-deal platform. All of the underlying multifamily mortgages are Libor-based. It was structured to have two separate classes of senior bonds: one, the AL class, was $566m and indexed to Libor; the second, the AS class, was $200m and pegged to Sofr. The key, ground-breaking aspect to the deal is that Freddie Mac will provide a guarantee on the AS class that covers any basis mismatch if the Sofr-based index exceeds the Libor-based index. Furthermore, the underlying multifamily mortgages and the AL class will convert to an alternate index, which may be Sofr, if Libor ceases to be published.

> **"We wanted to prove that this could be done and pave the way"**

The AL class was priced at a discount margin of 60bp, while the AS class was priced at a discount margin of 67bp. In total, 13 accounts bought the bonds, which were priced in the second week of December. These were money manager accounts, banks and credit unions, all entities that will soon need to move away from Libor.

"Our K-F73 deal was another example of us leading the multifamily industry in the capital markets," says Deborah Jenkins, executive vice president and head of multifamily business at Freddie Mac in McLean, Virginia. "In particular, our goal was to provide support for the Sofr bond market ahead of any loans priced on a Sofr rate. We wanted to prove to the market that this could be done and pave the way for other issuers as well."

Robert Koontz

Deborah Jenkins

Understandably, investors liked the deal and particularly applauded the willingness of Freddie Mac to take the basis mismatch risk as a way to mitigate the transition risk of moving from Libor to Sofr.

"We took the risk so as not to insert any other counterparty risk into the trust — we wanted to take this issue off the table," says Robert Koontz, senior vice president of multifamily capital markets at Freddie Mac. "The investment community was very receptive to this new asset class because there was a need for this product."

This is reflected in the *GlobalCapital* US Securitization Awards polling. The K-F73 deal won the most number of votes overall and garnered the highest number of investor votes, with 39% of respondents from the buy side voting it to be the CMBS deal of the year.

According to Koontz, a lot of time was spent with investors to educate them on the mechanics of how the bond would work. A lot of time was also spent working with the agency's regulator, the Federal Housing Finance Agency.

"We work really closely with the FHFA on important strategic issues like this," says Jenkins. "We absolutely need to start this process and show that these deals could get done."

K-F73 has paved the way for the overall US securitization market to manage the switch to Sofr. Other issuers may have more difficulty, as it sets a precedent for them to shoulder the risk, but Freddie did the right thing, and was ultimately recognized by the wider market. ▲