

Small Balance Loan Prepayments

Data as of November 2019

Research

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

Anita Yang
(571) 382-3286
cheng-ying_yang@freddiemac.com

Sara Hoffmann
(571) 382-5916
sara_hoffmann@freddiemac.com

Capital Markets

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

Robert Armitage
(571) 382-5993
robert_armitage@freddiemac.com

- This report presents a summary of Freddie Mac Multifamily Small Balance Loan (SBL) voluntary prepayment activity over the past 12 months (from December 2018 through November 2019).
- We summarize prepayment speeds in aggregate and by product type, vintage, prepayment type, prepayment phase and FRESB deal.
- Prepays slowly increased over the past 12 months, as expected. The average constant prepayment rate (CPR) is approximately 7.5% over the past 12 months. The 2015 and 2016 vintages prepay speed is 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 \$2.3 million in aggregate losses on a total securitized balance of over \$24.5 billion in the program’s history since November 2019. 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.
- In October of 2019, we released a five-year anniversary piece that summarizes our SBL program since inception, such as geographical concentrations, annual fundamental performance and affordability. The report is available [here](#).

Freddie Mac Multifamily formally announced 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 2019¹, Freddie Mac has funded and securitized over 9,300 SB loans totaling over \$24.5 billion of original unpaid principal balance (UPB), with the majority of loans funding in the last few calendar years. For this report, which excludes third-party seasoned loans, the original UPB is approximately \$24 billion, with roughly \$3 billion of loans having prepaid.

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 prepay 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%	YM or 1%	YM or 1%	YM or 1%	YM or 1%	YM or 1%	39%
4	310(3), 0%	N/A	N/A	310(3)	N/A	N/A	5%
Total % Business	37%	8%	10%	4%	7%	34%	100%

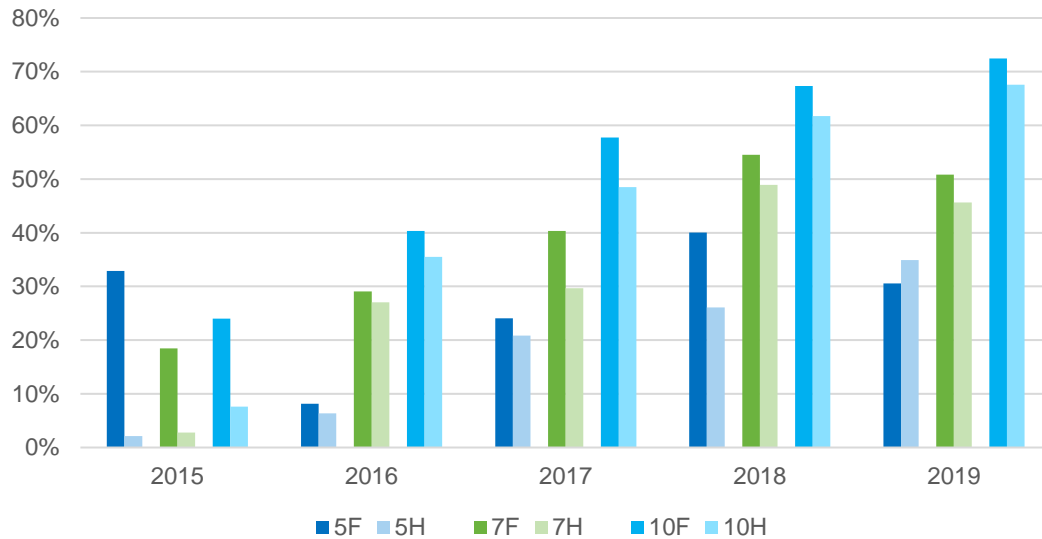
Source: Freddie Mac. We frequently use shorthand above to define the products; for example, we refer to the 5-year Hybrid as “5H” and the 10-year Fixed Balloon as “10F.” Option 3 refers to Yield Maintenance but includes YM or 1% +1%, 1%. See the SBL Product page at <https://mf.freddie.com/product/sbl.html> 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 borrowers select, making up approximately 71% of our current business. Option 1 – loans that start with a 5% prepay premium – remains the most prevalent and makes up 48% of total business, which is down from 53% 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.

¹ All data points in this report are as of November 2019 unless otherwise mentioned.

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

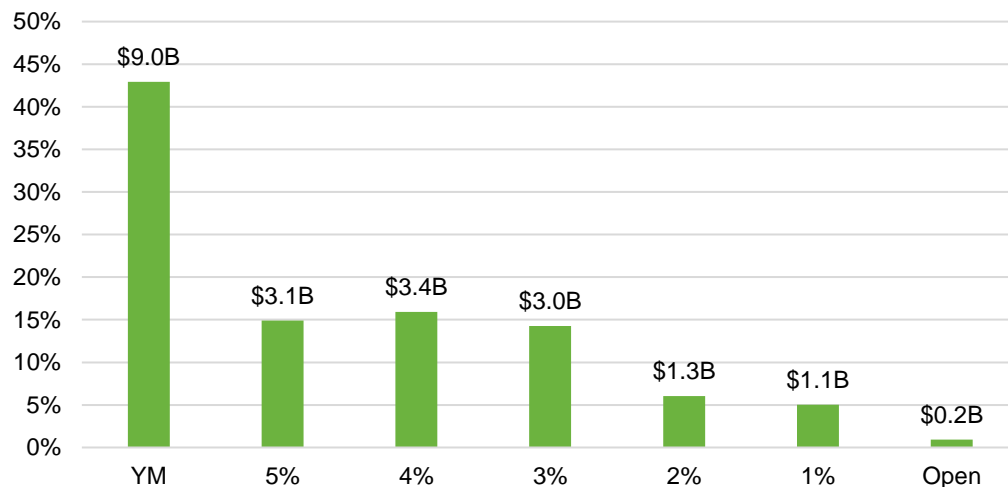
A higher share of borrowers opt for Yield Maintenance, especially with 10-year terms



Source: Freddie Mac

A number of factors drive prepay behavior, including an incentive to prepay when rates fall or when property values rise. But a high prepay premium 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 doubled in comparison with the trailing three years, which can be expected given recent market trends. Interest rates declined during 2019 and property prices continued trending upward. With loans continuing to season, all these factors produce increased incentive for borrowers to prepay. The population of loans with the most flexible prepay has doubled, from about \$600 million to \$1.3 billion as of November 2019.

Over the trailing 12 months, 573 loans have prepaid, making the total since the program's inception around 1,000 loans. The 12-month average CPR is 7.5% as of November 2019. 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](#). For additional details around FRESB loan payoffs, please reference our [SB-Deal Performance presentation](#).

Prepayments increased throughout 2019, most notably with prepay Option 1 and older vintages

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

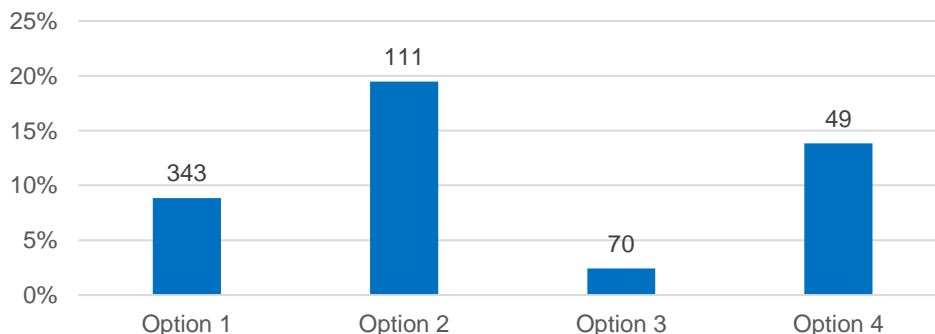
Prepay Option	1	2	3	4				Totals
Loan Count	343	111	70	49				573
Prepay Phase	YM	5%	4%	3%	2%	1%	Open	
Loan Count	70	54	145	97	102	78	27	573
Vintage	2015	2016	2017	2018	2019			
Loan Count	95	175	212	86	5		573	
Product	5H	7H	10H	5F	7F	10F		
Loan Count	215	37	37	56	48	180		573

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 343 loans of the 573 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 8.8%, as seen in Exhibit 5. Respectively, Options 2 and 4 have seen much higher prepay rates at 19.5% and 13.8%, due to the greater prepayment flexibility they provide.

Loans with Option 1 saw the highest number of loans prepay, however Option 2 has the highest CPR rate in the past 12 months

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

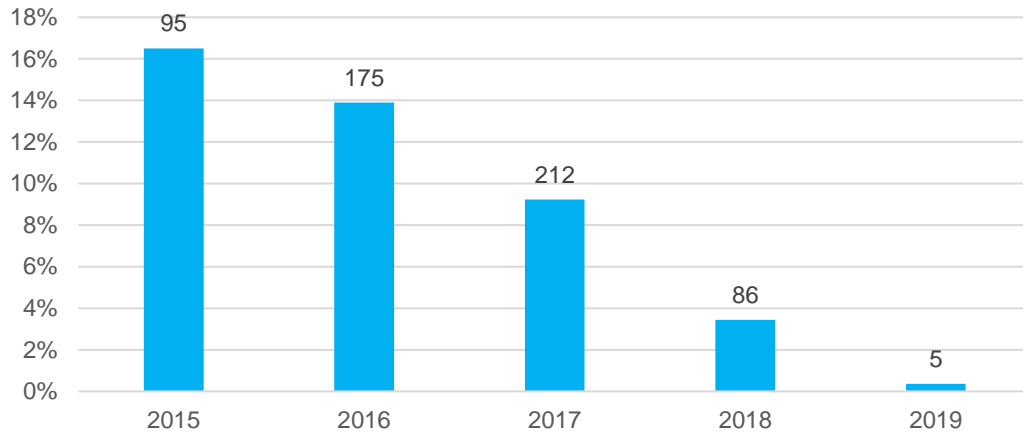


Source: Freddie Mac

A large number of loans that have prepaid come from earlier vintages, specifically in 2016-2017, as loans in those vintages have had time to season. Exhibit 6 demonstrates loans that originated in 2015 have the highest prepay speed with a 12-month average CPR of 16.5%. This is followed by 13.9% for 2016 vintages and continues to trend down to a low rate of 0.4% for 2019.

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

There is a downward sloping CPR curve given the seasoning factor

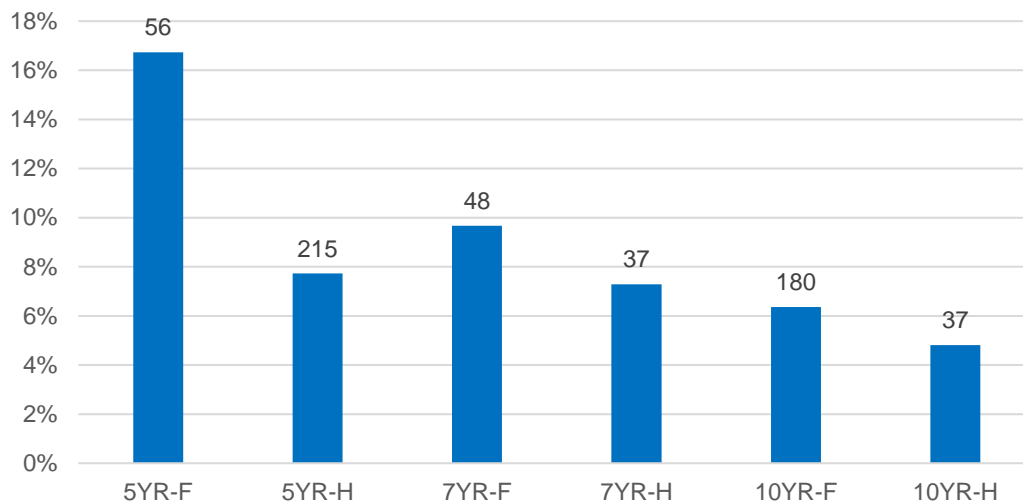


Source: Freddie Mac

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 around 16.7% to 9.7%, respectively. However, the number of prepaid loans is greatest amongst the 5-year hybrid (5H) and 10-year fixed-rate (10F) products, with 215 and 180 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

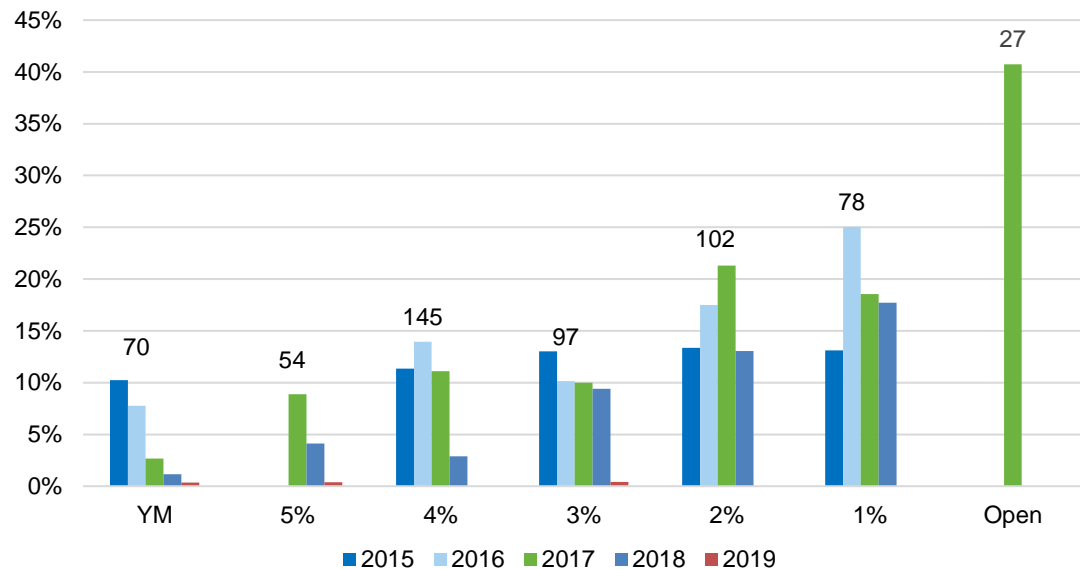
Longer term loans generally have more stringent prepay types and lower CPRs



Source: Freddie Mac

As loans season and enter lower prepayment premium periods, we expect loans to prepay more quickly and for CPRs to increase. This is illustrated below in Exhibit 8 where the prepayment speed and seasoning increases as the prepayment premium decreases.

Exhibit 8: CPR by Loan Prepayment Phase and Payoff Loan Counts in the Past 12 Months



Source: Freddie Mac

Exhibit 9 lists CPRs and prepay count by FRESB deal. Because the history is short and FRESB 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 9: CPR, Initial UPB and Loan Count of Payoffs by FRESB 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	10.0%	5	SB37	\$317	6.2%	10
SB2	122	17.9%	6	SB38	259	3.6%	4
SB4	192	4.8%	3	SB39	264	16.3%	15
SB5	144	20.7%	12	SB40	293	7.4%	9
SB6	202	15.4%	9	SB41	311	16.5%	13
SB7	63	0.0%	0	SB42	287	4.3%	6
SB9	445	17.2%	23	SB43	325	8.8%	13
SB10	148	12.2%	8	SB44	320	4.3%	4
SB11-2016	110	30.4%	13	SB45-2018	402	14.2%	16
SB12	167	14.5%	10	SB46	494	1.4%	2
SB13	401	4.7%	7	SB47	553	5.6%	14
SB14	310	9.7%	14	SB48	559	4.4%	11
SB15	302	13.7%	14	SB49	569	3.9%	9
SB16	350	8.8%	13	SB50	505	7.2%	13
SB17	386	17.9%	27	SB51	508	2.7%	5
SB18	118	12.0%	9	SB52	562	8.2%	16
SB20	293	8.4%	9	SB53	589	3.5%	9
SB21	94	20.4%	7	SB54	538	7.4%	14
SB22	255	14.0%	12	SB55	607	3.9%	5
SB23	342	20.3%	20	SB56	564	3.0%	8
SB24	259	14.7%	17	SB57	576	1.4%	3
SB25	233	12.2%	10	SB58-2019	622	1.7%	4
SB26-2017	221	11.3%	9	SB59	625	0.8%	2
SB27	246	13.9%	12	SB60	625	0.0%	0
SB28	323	13.8%	19	SB61	615	0.0%	0
SB29	217	9.5%	7	SB62	623	0.7%	1
SB30	307	8.9%	16	SB63	530	1.4%	1
SB31	264	8.3%	9	SB64	443	1.3%	1
SB32	322	5.7%	8	SB65	614	0.0%	0
SB33	220	7.1%	7	SB66	574	0.0%	0
SB34	327	7.7%	11	SB67	604	1.9%	1
SB35	317	9.5%	11	SB68	536	0.0%	0
SB36	350	5.1%	7				

Source: Freddie Mac

Summary

Historical prepayments have been relatively slow given that longer term loans incur significant fees to pay off early. As loans in the program season, along with low interest rates and strong multifamily price appreciation, the number of SB loans that prepaid within the past 12 months have nearly doubled when compared with the prior three years. Furthermore, the first wave of 5-year fixed maturities and 5-year hybrid changeovers are scheduled to reach those milestones in early 2020. However, there are many factors that drive prepayment behavior, some of which are idiosyncratic, and we believe it is too early in the program's history to develop precise expectations for future prepayment behavior.