



## Best Practices for Servicers of Securitized Small Balance Loans (SBLs)



As the Master Servicer on all of our SBLs, we share common goals with our Servicers—providing investors in our SB-Deals with accurate, timely reporting of financial information and consistently high performance. Because achieving both of these goals is essential to winning marketplace loyalty, we have developed these best practices based on your frequently asked questions to help our Servicers meet a wide range of customer needs with greater efficiency and certainty.

We developed this resource to deliver creative solutions to our Servicers to meet the needs of our customers and investors.

While these best practices address the most common information and communication issues, they are a work in progress. It is our intent to actively maintain this resource to meet the ever changing needs of our Servicers. Only by working together can we maintain an industry-leading Servicing Standard. Please share these best practices with your teams and, if you have any questions, we encourage you to contact me at (703) 714-2936 or [Michelle Orsi](mailto:Michelle.Orsi) at (703) 714-3193.

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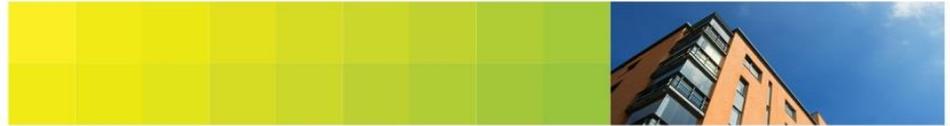


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## Financial Statement Collections

### Assessment Requirements

| Assessment Type        | Condition  | Due Date   |
|------------------------|--|--|
| Annual CREFC           | Any SBL Mortgage with a UPB >\$250,000   | 5/31   |
| Mid-Year Rent Schedule | Any SBL Mortgage with a Loan Agreement <i>revision date of 11/08/2016 or after</i> | 25 calendar days after the end of the second quarter |
| Quarterly CREFC        | Watchlist Loan   | 5/31 (1Q due)<br>8/31 (2Q due)<br>11/30 (3Q due)     |

### Borrower Education

Deploy a pro-forma template and instructions to address frequently asked Borrower questions regarding layout, categorization and completeness. Use this opportunity to educate the Borrower on categorizing such line items as R&M and Capital Expenditures.

### Delivery

Do not wait until the due date to submit all assessments. Submit assessments on a rolling basis.

### Past Due Financials

Take proactive measures to ensure the Borrower complies with covenant requirements. Maintain an active dialogue with the Borrower/property management and hold them accountable for failure to comply. The Servicer should use discretion and enforce a financial penalty for non-compliance where applicable.

### Variance Comments

Provide detail behind the driving factors leading to the financial condition threshold triggers and avoid stating obvious mathematical percentage changes. Deliver a well-written variance comment describing what is happening at the property, in the market and/or with the sponsor that is influencing the financial condition.

## Property Inspection Process

### Borrower Education

Explain to the borrower in detail the property inspection process. Define routine maintenance, deferred maintenance and life safety in advance to allow the borrower to rectify any such issues prior to the scheduled inspection. Relay the importance of functional smoke detectors and current inspection tags on fire extinguishers prior to the physical inspection. Describe the additional reporting requirements for deferred maintenance and/or life safety.

### Clearing Items

Acceptable proof of completion is subject to variance based on severity of the issue, but sufficient evidence may include: photos, lien waivers, proof of payment and notice from authorities for code violations. In some instances, a subsequent property inspection may be required to close out an item at the Servicer's discretion.



### **Life Safety Issues**

Imminent vs. General. Life Safety is an indication of inadequate protections in case of an emergency and/or a result of non-compliance with code requirements that increase the possibility of personal injury or death.

Life Safety is considered a mandatory review threshold pursuant to the CREFC Watchlist Guidelines, however the nature of the deficiency may influence the timing of inclusion on the Servicer Watchlist. It is the responsibility of the Servicer to determine the severity of risk based on the deficiency and to document the event on the Servicer Watchlist accordingly.

- Imminent Life Safety issue loans should be placed on the Servicer Watchlist immediately, and immediate action should be taken with the borrower to obtain satisfactory evidence that the deficiency has been cured. The Servicer must report all significant Life Safety Hazards to Freddie Mac at [MF Master Servicer SBL@FreddieMac.com](mailto:MF_Master_Servicer_SBL@FreddieMac.com). Imminent Life Safety is held to the same standards and surveillance requirements as provided for PR-90 and other such priority repairs.
- General Life Safety issue loans may require additional due diligence and dialogue with the Borrower to confirm status and scope in order to determine severity of the issues for reporting purposes. In most cases, the Servicer may take an additional 30 days from the date of the first reporting cycle to give time for Borrower to remediate prior to recommending an addition to the Servicer Watchlist. Examples may include: trip hazards, smoke detector batteries, fire extinguisher tags.

### **Managing Aged Items**

If the Servicer is unable to obtain satisfactory evidence within 120 days after the first notice to the Borrower (if the nature of the risk and/or cost estimate triggered a notice provision), escalate the situation. Consider obtaining a limited scope property inspection report for the specified area of concern, suspending reserve disbursements and/or instituting replacement reserves (to the extent permitted under the loan documents).

### **Notice Provisions**

If deferred maintenance is >\$10,000 (or if Life Safety Hazards, environmental, moisture or mold issues are present), the Servicer must notify the Borrower within 30 days following the inspection of the need to undertake corrective action to address each specific identified risk. The Servicer must confirm that the Borrower has received this notice but immediate follow up is not required. The condition of the property will be re-evaluated at the time of the next inspection. If deferred maintenance >\$25,000 (or issues pose an imminent Life Safety Hazard to the tenants or property's structure or value), the Servicer must follow up in a timely manner until such risks have been remediated. Repetitive issues not remedied from the prior inspection should be noted and notice sent even if <\$10,000. Follow-up should take into account the nature of the risk.

### **Training**

Ensure professional staff and third parties are certified to perform property site inspections and adhere to Freddie Mac guidelines. Ensure all inspectors confirm that any Priority Repair (to include PR-90) listed on the Physical Risk Report (Form 1104) is completed at the time of the first annual inspection.



## **Priority Repairs (to include PR-90 Repairs)**

### **Clearing Items**

For any SBL Mortgage with a Loan Agreement form revision date of 11/02/2015 or earlier, acceptable proof of repair completion may vary based on severity, but may include: photos, lien waivers, proof of payment and notice from authorities for code violations. The Borrower is required to maintain records as evidence of completion. The Lender has the right to request such documentation. The first annual inspection is an opportunity to close out items. If the inspector is unable to identify the previous conditions, consider the item closed.

For any SBL Mortgage with a Loan Agreement form revision date of 11/8/2016 or after, Freddie Mac will create a single Loan Item Tracking (LIT) entry in the Property Reporting System (PRS) that captures all of the Priority Repairs identified on the Physical Risk Report (Form 1104). Within 30 calendar days after deeming any Priority Repair (to include PR-90) item complete, the Servicer is required to go into PRS and update the LIT accordingly.

### **Clearing Items (Building Code)**

The Servicer must use discretion when determining if the Borrower has corrected all of the underlying issues that gave rise to the existing building code violations (to the extent such issues are within Borrower's control) and all such corrective work has been performed in a lien-free, good and workmanlike fashion.

### **Managing Aged Items**

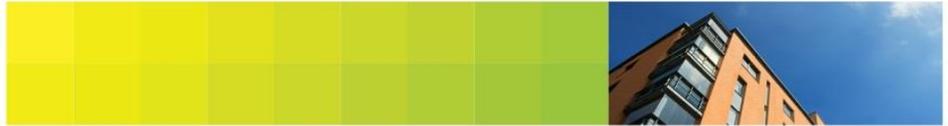
For any SBL Mortgage with a Loan Agreement form revision date of 11/02/2015 or earlier, if the Servicer is unable to obtain satisfactory evidence within 60 days after the due date, the Servicer must use discretion to remedy the non-compliance and take into account severity and Borrower cooperation. Consider obtaining a limited scope property inspection report for the specified area of concern, suspending reserve disbursements and/or instituting replacement reserves (to the extent permitted under the loan documents).

### **Notice Provisions**

For any SBL Mortgage with a Loan Agreement form revision date of 11/02/2015 or earlier, the Servicer should manage notifications to the Borrower until sufficient cure proof has been received for all items identified as a Priority Repair (to include PR-90).

- If Priority Repairs remain outstanding 30 days after the due date, the Servicer should issue a Reservation of Rights letter and forward a copy to [MF\\_Master\\_Servicer\\_SBL@FreddieMac.com](mailto:MF_Master_Servicer_SBL@FreddieMac.com).
- If Priority Repairs remain outstanding 60 days after the due date, the Servicer should issue a Default Notice and forward a copy to [MF\\_Master\\_Servicer\\_SBL@FreddieMac.com](mailto:MF_Master_Servicer_SBL@FreddieMac.com).

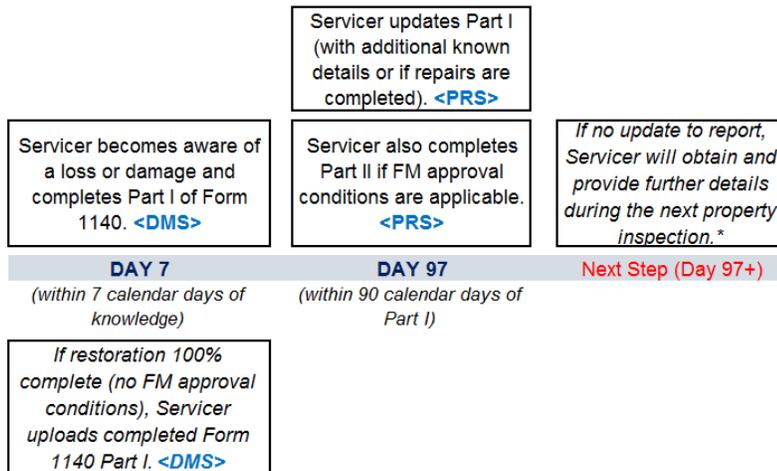
For any SBL Mortgage with a Loan Agreement form revision date of 11/8/2016 or after, the Borrower will be personally liable to the Lender for repayment of a portion of the indebtedness equal to any loss or damage suffered by Lender as a result of the Borrower failing to complete any of the Priority Repairs (to include PR-90) identified in the Physical Risk Report.



- If at the time of the first annual inspection and subsequently thereafter, the Servicer identifies any item listed as a Priority Repair (to include PR-90) on the Physical Risk Report (Form 1104) that has not been completed, the Servicer should issue a reminder notice to the Borrower for non-compliance which references the Loss or Damage Recourse provision of the Loan Agreement. To the extent funds are held in escrow for Priority Repairs (to include PR-90), the funds will remain with the Servicer until such time the Borrower voluntarily provides sufficient cure proof and/or at the time of loan payoff or maturity. Subsequent notices to the Borrower are not required for any non-Life Safety item.
- Any Life Safety item that is newly identified in conjunction with a property inspection or pre-existing (originally listed on the Physical Risk Report as a Priority Repair or PR-90) should be actively monitored by the Servicer until completion.

## Hazard Loss Reporting

### Managing Aged Updates



\* To the extent a loan is designated for securitization, Freddie Mac will closely monitor and contact the Servicer as necessary.

### Notification

Complete and submit Form 1140 – Part I Hazard Loss Notification & Plan no more than seven calendar days after learning that a loss or damage has occurred to a property, regardless of whether the Borrower plans to submit an insurance claim. Upload Form 1140 to the Document Management System (DMS), click the “File Submission” link and select “Submit to Hazard Loss” from the drop-down menu to automatically notify Freddie Mac of the form submitted to DMS. <See Loan Compliance Desk Reference for further directions for DMS>

If restoration is already 100% complete by the time the Servicer is made aware of the loss (and none of the Freddie Mac approval conditions described in Section 43.8(a)(3) exist), the Servicer should upload a fully completed Part I of Form 1140 to DMS and use the “File Submission” link to “Submit to Hazard Loss.”



## Reporting Requirements

Within 90 calendar days after initially providing Part I of Form 1140, the Servicer must:

- Update PRS with any details that the Servicer did not know, or otherwise did not include on its initial submission of Part I
- If none of the Freddie Mac approval conditions listed below apply, Part II of Form 1140 is not required. Otherwise, complete Part II of Form 1140 by day 90 for Freddie Mac review and approval, and upload directly to the corresponding PRS entry. [<See Loan Compliance Desk Reference for further directions for PRS>](#)
  - The Mortgage is in default
  - The damage affects 10% or more of the property's total units
  - The Mortgage is on the Servicer Watchlist
  - The Borrower's insurance coverage is insufficient to cover the loss to the property or loss of rents/business income
  - Death or serious injury has resulted from the event

Under most circumstances, Freddie Mac will delegate responsibility for managing and approving disbursement requests to the Servicer. If delegation of disbursement requests is not approved, the Servicer should submit Form 1140-DR to the corresponding PRS entry.

If the Servicer is requesting approval to permit the Borrower to pay down the Mortgage in lieu of restoring all or a portion of the damaged property, the Servicer must make a Consent Request Tracker (CRT) entry and submit corresponding consent request documentation to Freddie Mac.

## Watchlist Management

### Comments

Comments should be current and clearly articulate each of the following: driving risk factor(s) which triggered the addition to the Servicer Watchlist, brief property, loan and market description, summary of actionable items taken and/or planned with tangible dates. Be sure to include Servicer Watchlist comment dates.

### Communication

Initiate communication immediately with Freddie Mac Asset Management in the event of a payment delinquency or any other Servicer Watchlist trigger event that could negatively influence the risk outlook.

### Managing Aged Items

Take proactive measures to clear Servicer Watchlist loans by maintaining active dialogue with the Borrower/property manager and hold the Borrower accountable for failure to comply.

### Timing

If a loan has triggered one or more of the items within the Portfolio Review Guidelines (PRG), the loan should be reported on the Servicer Watchlist. However, there may be situations where the nature of the event may influence when the item appears on the Servicer Watchlist. It is in the Servicer's discretion to determine the severity of risk and document the event accordingly. The only exception is Financial Conditions because they are tangible triggers with clearly defined thresholds which should be added immediately. If the DCR or occupancy falls within the review threshold, flag it. Do not wait for the Master Servicer to do so.



For non-Imminent Life Safety Hazards (to include PR-90 Repairs & Priority Repairs), work with the Borrower/property manager to obtain satisfactory proof of completion during the 30 days immediately following the physical inspection before placing the loan on the Servicer Watchlist. This will mitigate easily remedied items and prevent placement on the Servicer Watchlist. For Imminent Life Safety Hazards (to include PR-90 Repairs & Priority Repairs, environmental, moisture or mold issues), add them to the Servicer Watchlist immediately and take swift action to obtain cure proof.

### **Training**

Ensure professional staff follow the CREFC Watchlist Guidelines. For financial condition issues, do not delay making additions to the Servicer Watchlist.

### **Reservation of Rights**

#### **Notification**

Issuing a Reservation of Rights letter is considered to be a prudent servicing practice in conjunction with enforcing the loan documents. It is important for a Servicer to work closely with Freddie Mac in handling adverse matters. For ease and efficiency, Freddie Mac suggests incorporating substantially the following language into a Reservation of Rights letter:

Except as otherwise expressly stated above, nothing contained herein and no action or inaction by the Lender, including without limitation the collection or retention of loan payments and other sums due Lender under the Loan Documents or the acceptance of performance of any other obligation of any kind under the Loan Documents by Borrower or Guarantor, shall (i) relieve or release Borrower or any Guarantor from any of their respective duties, obligations, covenants or agreements under the Loan Documents; (ii) constitute a waiver or release of any default by Borrower or Guarantor, or a limitation on the exercise of, any of the rights or remedies available to the Lender at law, in equity or under the Loan Documents arising from such default; or (iii) be deemed to constitute a modification or alteration of the terms, conditions or covenants of the Loan Documents, all of which remain in full force and effect as set forth therein. This [notice/letter] is being transmitted to you as a courtesy and is not intended as an admission that written notice or any communication of any kind is otherwise due the Borrower and/or any other party. ALL RIGHTS ARE HEREBY EXPRESSLY RESERVED.

#### **Disclaimer:**

Prior to using the reservation of rights language quoted above in correspondence with a borrower, guarantor, or other loan transaction party, the sender should consult the transaction documents relevant to the loan or related securitization (collectively, the "Loan Documents") to ensure such language is consistent with the terms of such Loan Documents.

If the suggested language above is used, a Servicer does not have to seek approval before issuance. Simply provide a final copy to [MF Master Servicer SBL@FreddieMac.com](mailto:MF_Master_Servicer_SBL@FreddieMac.com). If a Servicer prefers to use alternative language, a draft copy of the letter should be sent to [MF Master Servicer SBL@FreddieMac.com](mailto:MF_Master_Servicer_SBL@FreddieMac.com) for review and approval before issuance.

If a situation escalates and a Default Notice needs to be issued, a Servicer does not have to seek approval before issuance. Simply provide a final copy to [MF Master Servicer SBL@FreddieMac.com](mailto:MF_Master_Servicer_SBL@FreddieMac.com).

Upon receipt of issued notices (Reservation of Rights or Default Notice), Freddie Mac will create an LIT in PRS. It is the Servicer's responsibility to close out the LIT item within 30 calendar days of receiving cure proof.