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Servicer Evaluation: Freddie Mac

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Table Of Contents

Servicer Evaluation: Freddie Mac

Ranking Overview	
Commercial Master	
Overall ranking	ABOVE AVERAGE
Subrankings	
Management and organization	ABOVE AVERAGE
Loan administration	ABOVE AVERAGE
Outlook	Stable
Financial position	SUFFICIENT

Key Ranking Factors

- Experienced and tenured senior management team;
- Effective and comprehensive employee training and development program;
- Historically low mortgage loan delinquency rates;
- Integrated and effective technology systems;
- Comprehensive subservicer (Seller/Servicer) oversight program;
- Sound audit and control environment, albeit with a longer-than-average internal audit cycle compared to those of most servicers;
- Homogenous multifamily property portfolio, with limited exposure to other commercial property types;
- Continued financial support and implicit guarantee from the U.S. government; and
- Conservatorship under the Federal Housing Finance Agency (FHFA), with an uncertain future.

Opinion

S&P Global Ratings' ranking on Freddie Mac Multifamily Asset Management and Operations (AMO) as a commercial loan master servicer is ABOVE AVERAGE. The outlook for the ranking is stable.

The ranking reflects our view of the company's experienced senior management team, effective staff training, integrated technology systems, sound audit and control environment, and comprehensive servicer oversight program. We also considered the company's homogenous property portfolio, longer-than-average internal audit cycle, and ongoing FHFA conservatorship.

Key Changes Since Our Last Review

- The "serviced by others" portfolio (primarily non-securitized) increased to $73 billion as of Dec. 31, 2017, from $63.1 billion as of June 30, 2016, and the traditional K-Deal portfolio balance increased to approximately $172 billion as of

Dec. 31, 2017, from nearly $123.0 billion as of June 30, 2016.

- As of Dec. 31, 2017, AMO was the appointed master servicer on 31 K-deals for a total of $12.1 billion in unpaid principal balance (UPB), 44 small-balance securitized transactions for a total of $10.5 billion in UPB, and four Q-deals with a combined total UPB of $1.4 billion.
- The senior vice president AMO retired at year end 2017. The senior vice president of multifamily operations and operational risk was promoted to fill this role.
- Freddie Mac created a formalized advancing committee for approvals on certain Freddie Mac master serviced loans.
- The Property Reporting System (PRS) was updated in March 2017 to allow for system-to-system integration for Seller/Servicers who use this system to submit annual property assessment data.
- The FHFA issued its 2018 Conservatorship Scorecard (CS), lowering the annual multifamily lending cap to $35.0 billion from $36.5 billion in 2017, excluding carve-outs for green loan, affordable, and certain underserved housing segments.
- In December 2017, the FHFA announced each government-sponsored enterprise (GSE), including Freddie Mac, is entitled to maintain a $3 billion capital reserve.

Outlook

Our outlook for the ranking is stable, which reflects our view that the company is expected to continue as a fully capable master servicer for commercial mortgage loans. Freddie Mac Multifamily AMO has established processes and systems and a demonstrated ability to administer the Freddie Mac Multifamily mortgage loan portfolio.

Although the future existence and/or role of Freddie Mac has been under discussion internally within Freddie Mac, and externally within various levels of the U.S. government, for several years, we expect that it will remain business as usual for the foreseeable future. In our view, there does not appear to be any imminent changes to Freddie Mac's role.

In addition to conducting an on-site meeting with servicing management, our review includes current and historical Servicer Evaluation Analytical Methodology (SEAM) data through Dec. 31, 2017, as well as other supporting documentation provided by the company.

Profile

Servicer Profile	
Servicer name	Federal Home Loan Mortgage Corp. (d/b/a Freddie Mac)
Primary servicing location	McLean, Va.
Parent holding company(i)	Federal Housing Financing Agency Conservatorship (September 2008)
Loan servicing system	Multiple (see the Systems And Technology section)

(i)Federal Housing Financing Agency is the conservator of Freddie Mac (not a parent holding company). d/b/a--Doing business as.

Freddie Mac was chartered by the U.S. Congress in 1970 with a public mission to provide liquidity, stability, and affordability to the U.S. housing market. Freddie Mac fulfills its mission by conducting business in the secondary mortgage market and purchasing loans through a national network of mortgage lenders; it does not make loans directly.

Freddie Mac Multifamily's mission is to promote an ample supply of affordable rental housing by purchasing mortgages collateralized by apartment buildings with five or more units. Freddie Mac has been funding and servicing multifamily mortgages since 1993, and as of Dec. 31, 2017, it had cumulatively provided more than $525 billion in financing for approximately 79,000 multifamily properties.

Freddie Mac purchases mortgages from approved Seller/Servicers and targeted affordable housing correspondents according to Freddie Mac guidelines. The multifamily division has approximately 700 employees, and it is supported by more than 175 additional Freddie Mac employees across finance, technology, legal, enterprise risk management, and human resources departments. The majority of Freddie Mac employees are headquartered at the McLean, Va. campus, with additional multifamily staff located in three regional offices (Chicago, Los Angeles, and New York) along with eight field offices.

On Sept. 6, 2008, the FHFA placed Freddie Mac and Fannie Mae in conservatorship. The conservator assumed all powers of the board, management, and shareholders; the FHFA reconstituted the Freddie Mac board of directors and executive management team. During conservatorship, the FHFA has made an effort to distinguish the GSE's multifamily division from the residential loan single-family businesses, which suffered losses during the housing crisis, whereas the multifamily business weathered the crisis and continued to generate positive cash flow while providing liquidity to the multifamily mortgage industry. Since entering conservatorship and through Dec. 31, 2017, Freddie Mac distributed $112.4 billion of dividends to the U.S. Treasury, while receiving $71.3 billion of cumulative cash draws (but none since 2013). It is anticipated, however, that FHFA, as conservator, will submit a draw request on Freddie Mac's behalf to the U.S. Treasury under the purchase agreement in the amount of $312 million due to Freddie Mac's net worth deficit at Dec. 31, 2017.

On Dec. 21, 2017, the FHFA issued its 2018 CS, which established objectives, performance targets, and measures for 2018. The 2018 CS requires Freddie Mac to limit new annual multifamily business to $35.0 billion or less (excluding carve-outs for green loans, affordable, and certain underserved housing segments), which is a reduction from the $36.5 billion 2017 limit. The CS also requires Freddie Mac to transfer a meaningful portion of credit risk on newly acquired mortgages, subject to FHFA target adjustments, as may be necessary to reflect market and economic considerations. Freddie Mac uses their K-Deal securitization model, which was adopted in 2009, as the primary vehicle to transfer credit risk.

In December 2017, the FHFA announced that each GSE would be permitted to retain a $3 billion capital reserve as of the end of 2017.

Loan purchases and guarantees

During 2017, Freddie Mac Multifamily funded $73.2 billion in new business volume for 6,091 multifamily properties containing nearly 820,000 apartment units, and it had securitized $56.7 billion in UPB of multifamily loans in K-Deal transactions during 2017. As of Dec. 31, 2017, Freddie Mac had not realized any credit losses under its K-Deal guarantees, and its total mortgage portfolio delinquency was nominal at 0.01%. As of Dec. 31, 2017, 168 loans were on the Seller/Servicer's watchlist, totaling $1.7 billion in UPB, or 0.9% of the outstanding loan balance.

Freddie Mac Multifamily sources its loans from approximately 29 approved Seller/Servicers (an additional 17 are approved for servicing only or negotiated transactions), which are licensed in either conventional, small-balance, and/or affordable housing loan products. The Seller/Servicers must meet Freddie Mac's standards for both origination and servicing of multifamily loans, including maintaining minimum financial requirements and satisfactory annual audit results. After Freddie Mac purchases a loan from a Seller/Servicer, the servicer typically maintains the loan servicing and asset management duties. The servicer's roles and responsibilities are clearly defined in the Freddie Mac Multifamily Seller/Servicer Guide (SSG). In the event of a loan default, the servicer prepares an initial package for Freddie Mac to review; Freddie Mac then controls the resolution process.

In addition to the K-Deals, Freddie Mac has various other product types that make up approximately $241 billion as of Dec. 31, 2017 (for more information about these portfolio/product types, see the Appendix of this report). However, consistent with the goal to migrate to a securitization model, the percentage of K-Deal transactions in the portfolio has increased since our last review, comprising 71.3% of UPB as of Dec. 31, 2017, compared with 67.1% as of June 30, 2016.

Table 1

Master Servicing (Serviced By Others)

As of Dec. 31, 2017

Product type	Loan/bond count	Loan/bond count (%)	Unpaid principal balance (mil. $)	Unpaid principal balance (%)
Participation certificates (45 & 75 Day)	363	1.73	317	0.1
Participation certificates (55 Day)	75	0.36	1,304	0.5
TEBS	633	3.02	5,429	2.2
Bond credit enhancements	565	2.69	9,975	4.1
Retained portfolio (for sale)	1,783	8.50	20,537	8.5
Retained portfolio (for investment)	1,381	6.58	17,702	7.3
K-Deals(i)	10,895	51.92	172,123	71.3
Q-Deals	1,035	4.93	1,811	0.7
SB-Deals	4,212	20.07	9,499	3.9
R-Deals	43	0.20	2,791	1.2
Total	20,985	100.00	241,487	100

(i)K-Deal info also includes ML deals (securitized TEL). TEBS--tax-exempt bond securitization.

Management And Organization

The management and organization subranking is ABOVE AVERAGE. We base our subranking on our view of the company's successful track record servicing multifamily real estate loans, experienced senior management team, leverage of technology, comprehensive training program, and sound control environment.

Organizational structure, staffing, and turnover

The multifamily division's executive vice president oversees a staff of over 700, including employees within operations, investments, strategic planning, and execution. There are seven lines of business (headcounts as of Sept. 30, 2017):

- Production and sales (109 employees);
- Affordable sales and investments (23);
- Underwriting and credit (223);
- Investments and advisory (33);
- Capital markets (41);
- Business and offerings management (25); and
- Asset management and operations (248).

The division is further supported by in-house legal, accounting, finance, technology, enterprise risk management, human resources, and communications staff.

Freddie Mac Multifamily AMO's senior vice president, who had been with the company since 2011, retired at year-end 2017. His internally promoted replacement has been with the company for over 20 years and was most recently the senior vice president of multifamily operations and operational risk. While continuing to perform some of her prior duties, she divided most of her prior responsibilities between other key individuals in asset management. In this position, as with her predecessor, she will be responsible for relationships with servicers and ongoing risk and loss mitigation efforts.

AMO is organized into four distinct areas:

- Multifamily Operations manages final delivery, settlement, and loan accounting, as well as internal oversight/governance, control, and customer compliance management. This area is also responsible for annual Seller/Servicer audits and updating the SSG.
- Surveillance actively monitors securitized transactions for risks, trends, and guarantor obligations, and it monitors the legacy loan portfolios' credit quality and performance. In addition, the unit is responsible for managing the master servicing surveillance functions, including investor reporting and watchlist management, as well as managing the risk-rating process.
- Servicer & Client Management (S&CM) is responsible for data collection, loan boarding, and insurance matters. The unit also implements business transformation including systems and processes to support AMO. S&CM is the main channel for Seller/Servicer communication and relationships.
- Special servicing within the master servicing function manages and monitors borrower transactions, services pre-securitization warehouse loans, and manages post-securitization loan issues.

As of Dec. 31, 2017, 181 employees in the AMO group had roles in master servicing and were all located in the McLean, Va. office. AMO continues to utilize outsourcing for assistance when volumes are high, but it does not outsource any remitting or reporting functions. While AMO's overall average industry experience and tenure levels are adequate for its ABOVE AVERAGE subranking, they are below those of other master servicers ranked STRONG by S&P Global Ratings, particularly at the middle-management and staff levels (see table 2).

The number of AMO's employees who had roles in master servicing increased to 181 from 172 at year end 2017 and 2016, respectively, in conjunction with the continued increase of K-Deal issuance volume. During 2017, AMO reported 12.2% overall turnover with nine of the 21 AMO employee departures moving to other divisions within the company. Other divisions of Freddie Mac have been a source of new hire activity in general, providing approximately 10% of the newly hired staff during 2017.

Table 2

Industry Experience/Company Tenure(i)

	Senior managers		Middle managers		Staff	
	Industry experience	**Company tenure**	**Industry experience**	**Company tenure**	**Industry experience**	**Company tenure**
Master	22	13	10	6	3	2

(i)As of December 31, 2017.

In our opinion, AMO continues to effectively manage its capacity, employee retention, and resources. We believe AMO's organizational structure provides appropriate oversight and accountability, and supports the master servicing duties and requirements associated with the various Freddie Mac Multifamily product portfolios, which are described in the appendix.

Training

Freddie Mac's talent development team consults with business areas to design, develop, and deliver a wide variety of learning programs to support the achievement of corporate and divisional goals. Highlights include:

- Freddie Mac University (FMU) is an integrated learning platform where employees can search and register for development opportunities in any of the four general knowledge centers: business expertise, managing people, personal effectiveness, and tools and technology.
- Training classes are web-based and instructor-led courses, and include resources and recommended reading. There are more than 175 instructor-led courses and 300 web-based offerings within the multifamily staff development offerings list.
- FMU offers employee performance management resources, multifamily divisional training, certification curriculums, and advanced programs.
- Freddie Mac employs full-time dedicated training personnel, and employee participation hours are formally tracked.
- AMO employees are expected to complete at least 40 hours of additional training on an annual basis.
- Management reviews employee progress quarterly to be sure they are in a position to meet their year-end target.
- Management reported that AMO full-time employees completed 37.4 hours of training on average during the trailing 12-month period ending Dec. 31, 2017, thereby slightly missing their targeted goal of 40 hours.

AMO's commitment to employee development along with the availability and access to comprehensive corporate training resources are viewed favorably.

Systems and technology

The AMO group primarily relies on the Enterprise!® system as a secure repository for their multifamily master servicing and investment fund program. They also extensively utilize legacy system applications, a Multifamily Processing System (MPS) database, and MultiSuite to support its core servicing processes, as described further below. The company continues to make enhancements to its technology systems, provide staff with effective up-to-date tools, improve and streamline efficiencies, and help investors access better information on the K-Deals.

Highlights of AMO's systems and technology include:

- Enterprise! v.2015.05, adopted in April 2016, is used as a secure repository for loan-level master servicing and investment fund processing.
- MPS is an internal Freddie Mac system that processes the purchase and accounting of multifamily loans.
- MPS Loan Accounting is the record system for all loans.
- MPS Cash Management provides accounting for funds due and received by Freddie Mac for all multifamily products (excluding commercial mortgage-backed securities [CMBS], which uses an external banking application); the application interfaces with the corporate treasury group.
- MultiSuite for Bonds is the system of record for active bonds; it monitors Freddie Mac credit-enhanced bonds.
- MultiSuite for Bonds Tax-Exempt Bond Securitization (TEBS) option is the system of record for active TEBS bonds.
- MultiSuite for Bond Wires is used to submit trustees' draw requests; it is integrated with MPS to capture approval of the wire requests.
- MultiSuite for Investor Reporting provides loan and bond-level investor reporting from Seller/Servicers; it provides reporting on retained portfolio and bond credit enhancement payment activities.
- The Property Reporting System (PRS) is used by Seller/Servicers to submit annual property assessment data, including operating statements, property inspections, and borrower compliance analyses. PRS was updated in March 2017 to allow for system-to-system integration with Seller/Servicers. PRS SBL 2.0, which is the small-balance loan (SBL) enhancement, incorporates assessment collection and post-securitization master servicing assessment collection into PRS.
- The Insurance Compliance Tool (ICT) submits and tracks insurance compliance and waiver requests.
- Multifamily Securities Investor Access is a web-based interface that provides investor access for K-Deals, including Commercial Real Estate Finance Council Investor Reporting Package and select deal documents.
- The Consent Request Tracker (CRT) is a web-based tool that tracks and monitors primary, master, and special servicer performance on borrower requests (i.e., loan assumptions and property management changes). CRT was enhanced in August 2017 to provide custom reports, lock down dates, and business-to-business data integration.
- The Streamlined Management Analytical & Reporting Tool (SMART) is used for loan and portfolio surveillance, to develop business plans, and to assign loan risk ratings.
- The Document Management System is a web-based document management solution that enables electronic and paperless transmitting and sharing of documents for mortgage originations, underwriting, post-closing, and investor delivery.

Plans for 2018 and beyond include smaller but more frequent releases to enable the company to be nimble with system updates as needed. Further, a substantial budget has been approved for additional system enhancements over the next three years.

Overall, we believe AMO has a solid integrated technology platform to effectively analyze, monitor, and report on loans, collateral properties, and Seller/Servicers.

Each Freddie Mac Multifamily department, including AMO, maintains its own business continuity plan. Written updates to the plan are made at least annually and are required to comply with corporate policy. The last full business continuity test was completed in May 2017 with no significant issues identified. Each department also has a documented business impact analysis along with a systematic assessment of the potential financial, reputational, and operational impacts caused by critical incidents and disruptions. It is designed to identify recovery timeframes and requirements, and it helps allocate resources during an event. Updates are also conducted at least annually. AMO also maintains prudent data back-up and replication routines.

Freddie Mac's enterprise business continuity group, which operates within its Governance and Business Services (GBS) unit, works with business lines to mitigate the risk and impact of business disruptions. It is responsible for identifying recovery solutions consistent with Freddie Mac's recovery time objectives (RTOs). Freddie Mac's RTO is four hours for cash remittance processing and investor reporting. Its RTO for all other servicing functions is three days, which is in line with other S&P Global Ratings' ranked servicers. Freddie Mac performs disaster recovery testing quarterly, which is much more frequent that many other ranked servicers, which we view favorably.

Freddie Mac maintains an out-of-region (OOR) disaster recovery data center (OOR DR DC) site in Boulder, Colo., and OOR operations staff in its Chicago office intended to provide business continuity in the event of a disaster at or near the McLean headquarters. We reviewed Freddie Mac Multifamily OOR DR DC tests conducted in all four quarters during 2017. Minor issues were encountered during each test, but in each test period, most key performance indicators (KPI) reported 100% pass rates. When instances with less than 100% KPI success occur, GBS identified the issues and documented remediation plans, which it tracks and manages.

With respect to information security, Freddie Mac maintains formal cybersecurity protection plans, and carries cybersecurity insurance coverage, which many other ranked servicers do not carry. They also send their employees phishing emails at least monthly to help identify potential issues. A third party performs penetration testing regularly to evaluate any potential cybersecurity risk, which allows them to address any issues that may arise. The last test was conducted in the fourth quarter of 2017 and no material issues were identified.

Based on our review, we believe AMO has a comprehensive suite of systems, sound data back-up and information security protocols, and robust disaster recovery and business resumption plans, including quarterly testing, which is more frequent than that of most servicers who generally conduct testing annually.

Internal controls

Freddie Mac's 21-member GBS group provides a range of services to support AMO. A centralized operational risk management area assists AMO with crisis management, business continuity, fraud prevention, addressing audit issues, updating policies and procedures, information security, records retention, risk assessment and testing, and Sarbanes-Oxley related compliance.

Policies and procedures are extensive, thorough, well organized, and reviewed annually for potential updates or changes. The Multifamily Credit Policy department is required to approve procedure changes and updates. Credit policy governance updates are also captured and approved electronically through Sharepoint Workflow. Procedures are available online to all staff via SharePoint and AllRegs software.

The GBS group provides the AMO leadership team with key performance and key risk indicators, management reporting, and vendor management. They also provide the head of Multifamily and the CEO of Freddie Mac an executive summary covering the aforementioned areas. We take a favorable view of this level of reporting and believe it provides an additional level of control and dedication to oversight.

AMO engages with vendors primarily to support technology projects and assist with processing borrower consents. All vendors are subject to a competitive bid process and stringent corporate procurement requirements. Business units provide a quality score for each vendor quarterly based on a five point scale to assess vendor performance.

Vendor contracts are tracked for compliance with the contract terms and expiration to ensure timely renewal where appropriate. AMO targets staffing levels to ensure that core business operations can be performed by its employees and utilizes service providers for overflow capacity.

Freddie Mac has three lines of defense to manage its operational risk. The first line of defense includes leaders from the revenue-producing business units and IT. The second line includes leaders from the enterprise risk management and compliance departments as well as the chief risk officer, providing oversight of the first line of defense. Internal audit is the third line of defense, providing independent oversight of both the other lines of defense.

The internal audit group is an independent oversight function established by Freddie Mac's board. The general auditor reports functionally to the audit committee of Freddie Mac's board and administratively to the CEO. Internal audit uses a risk-based planning approach and completes a comprehensive risk assessment of the inherent risks related to each auditable line of business. Risk is scored based on operational, credit, and market risks, as well as strategic, reputation, regulatory, and legal issues. The resulting risk score is then used to determine the audit frequency based on a cycle between one and four years. Audit opinions are expressed in one of three categories: "satisfactory," "need strengthening," and "unsatisfactory."

Management reported that its 2017 multifamily audit universe encompassed 12 audits, of which one was risk-rated "medium/high" (two-year audit cycle), four were "medium/low" (three-year audit cycle), and seven were "low" (four-year audit cycle). In addition, seven of the 12 audits encompass AMO. None of the auditable entities within the multifamily universe were risk-rated "high" by internal audit.

The internal audits performed within AMO during 2017 were of low-risk rated areas, Operational Risk Governance and Customer Management. The audits each received a "satisfactory" opinion. The latest audit of Servicing and Cash Operations, which is rated medium-low, was performed in 2016 and contained a "need strengthening" opinion. Management had self-identified two major issues: inadequate master trust agreement and oversight (which was remediated in December 2016 with improved documentation regarding governance) and lack of an adequate security assessment around its loan accounting and cash management systems. Subsequent 2017 reviews followed up on the two issues. The master trust issue was reduced to minor from major, and the cash management systems issue was closed out and marked as completed.

While the internal audit cycle of AMO is somewhat less frequent than those of similarly ranked peers, we believe the overall audit plan is rigorous and suitable given the well-designed three lines of defense that Freddie Mac utilizes under a highly regulated regime. Further, the internal controls and compliance framework at AMO appear to be robust and effective.

CMBS master servicers are typically required to conduct annual reviews according to Uniform Single Attestation Program (USAP) standards or Regulation AB (Reg AB), or both. Freddie Mac's USAP minimum servicing standards compliance review yielded no issues. It is not subject to, nor does it perform, a Reg AB review. The 2017 USAP report has not yet been completed. Finally, the FHFA performs targeted exams of Freddie Mac every year; however, no recent audits have been scoped to include AMO.

Legal department

Freddie Mac's in-house legal team provides legal assistance to AMO. The lawyers and paralegals have experience with mortgage loan purchases, servicing, litigation, bankruptcy, securities, tax, and other specialties. The team also retains outside counsel as necessary to maximize efficiency and expertise. We believe AMO's legal function is adequately controlled.

Insurance and legal proceedings

The company has represented that it maintains adequate directors and officers coverage in line with the requirements of its portfolio size. It does not maintain an errors and omissions policy because it does not provide professional advice or opinions. Although the company faces a broad array of litigation from its ordinary course of business, Freddie Mac has not disclosed any material servicing litigation matters. Given its role as a GSE, we believe current legal and regulatory issues are generally manageable.

Loan Administration

The loan administration subranking for master servicing is ABOVE AVERAGE. Major factors supporting the subranking are Freddie Mac's comprehensive subservicer (Seller/Servicer) oversight program and its historically low mortgage loan delinquency rates. We also note that AMO has a homogenous multifamily property portfolio per their mandate, with no track record with other commercial property types.

As of Dec. 31, 2017, Freddie Mac was the named master servicer on 79 securitized transactions, including 31 K-Deals aggregating $12.1 billion in UPB, 44 small-balance loan deals aggregating $10.5 billion in UPB, and four "nontraditional" Q-Deals (supplemental loans, legacy loans, etc.) aggregating $1.4 billion in UPB. In addition, AMO performs many similar servicing and asset management activities for the Freddie Mac portfolio (see table 3). It has established processes and systems designed to complete the following traditional master servicing functions:

- Boarding and tracking each loan on MPS;
- Aggregating and reconciling loan data and funds from subservicers;
- Portfolio accounting;

- Advance tracking and recovery;
- Investor reporting and remittance;
- Collateral, loan, and portfolio-level surveillance;
- Subservicer performance and compliance monitoring; and
- Credit-related borrower consent requests management.

Table 3

Freddie Mac Servicing Portfolio

Includes portfolio, warehoused, and Master Serviced loans

	Unpaid principal balance (mil. $)	YOY change (%)	No. of assets	YOY change (%)
Dec. 31, 2017	72,971	4.9	10,641	28.0
Dec. 31, 2016	69,574	1.5	8,313	19.8
Dec. 31, 2015	68,554	1.2	6,937	10.0
Dec. 31, 2014	67,773	(8.1)	6,304	(11.7)
Dec. 31, 2013	73,734		7,137	

YOY--Year-over-year. SBO--Serviced by others. No.--Number.

Freddie Mac believes that the high level of customer service they offer distinguishes the company from other financing sources. To that end, it has made improving the borrower experience one of its key priorities. For instance, Freddie Mac refers to the SSG to define specific servicing standards for K-Deals. Additionally, their proprietary CRT system monitors servicer responsiveness and performance on all borrower requests. In particular, Freddie Mac has established challenging goals for their servicers of 30-day and 15-day turnaround times for assumptions and other types of borrower consents, respectively.

Delinquencies

As of Dec. 31, 2017, Freddie Mac's master servicing portfolio had a delinquency rate of 0.04% on all loans subserviced by its licensed Seller/Servicers (see table 4). The portfolio delinquency rate mirrors the level from our prior review on June 30, 2016, and the portfolio's delinquency rates are generally lower than those of other industry participants, including CMBS lenders. That being said, Freddie Mac had several properties that were affected by hurricanes Harvey and Irma. They continue to monitor the status of rebuilding efforts in communication with their lenders. It is anticipated that losses will be generally covered by the borrowers' insurance policies, and the rebuilding of most units should be completed within one year. Some short-term forbearance agreements were provided by Freddie Mac to borrowers located in the hurricane-affected areas, and they are being monitored both by Freddie Mac and their lender partners.

We believe the low delinquency level is attributable to Freddie Mac's stringent underwriting practices, proactive surveillance activities, and multifamily collateral focus.

Table 4

Master Servicing Delinquencies

	Dec. 31, 2017		Dec. 31, 2016		Dec. 31, 2015		Dec. 31, 2014		Dec. 31, 2013	
	Unpaid principal balance (mil. $)	No.	Unpaid principal balance (mil. $)	No.	Unpaid principal balance (mil. $)	No.	Unpaid principal balance (mil. $)	No.	Unpaid principal balance (mil. $)	No.
Master (SBO) loans	72,971	10,631	69,574	8,313	68,554	6,937	67,773	6,304	73,734	7,137
Average loan size	6.9	--	8.4	--	9.9	--	10.8	--	10.3	--
Delinquent (%)										
30 days	0.01		0.01		0.01		0.04		0.01	
60 days	0.00		0.00		0.00		0.03		0.04	
90+ days	0.03		0.03		0.03		0.04		0.07	
Total	0.04		0.04		0.04		0.11		0.12	

SBO--Serviced by others.

Advancing

Depending on the product, AMO may advance funds for scheduled principal and interest (P&I) payments, liquidity advances, credit enhancements, swap payments, full UPB payments at payoff, and other operating and property protection advances. Advance monitoring and recovery procedures are documented for the serviced by others portfolio, and all advances are adequately tracked in Enterprise! by the loan accounting group. Freddie Mac formalized their advancing committee process in early 2017. On deals where Freddie Mac is the appointed master servicer, the AMO executive team, including AMO vice presidents and directors, meet monthly to review the status of all master serviced loans with outstanding advances. The special servicing group prepares an advance determination memo addressing the likelihood of recoverability, which is provided to the advancing committee. The memo to the AMO executive team includes, at a minimum, the advances to date, occupancy status, appraisal values, broker opinions of value, future capital expenses, and estimated timeline for recovery. The committee then makes the recoverability determination.

Servicer and client management

The S&CM team manages the Seller/Servicer Performance Review (SSPR) process to provide customer performance data and strategic direction of the customer relationship. This team also captures all relevant property insurance information from the Seller/Servicers using ICT, and processes all waiver requests. It also uses PRS to collect assessment data such as property income and expense information, property inspection results, and borrower compliance information, which is used during the SSPR process.

Surveillance

The 27-member surveillance group monitors loan portfolios' credit quality, overall loan performance, and guarantees relating to the Freddie Mac bond and securitization programs. It uses information from the Seller/Servicers (e.g., operating statements and property inspections) along with internal and external models to:

- Risk-rate each loan and guarantee;

- Revalue collateral properties;
- Develop risk plans for higher-risk loans; and
- Coordinate with enterprise risk management and finance groups to establish adequate reserve levels.

The risk-rating process starts with an internally generated loan score, representing the "life loss number" associated with the loan. The SMART system further incorporates property-specific criteria such as the property inspection results, net operating income (NOI) and debt-service coverage ratio (DSCR) trends, loan-to-value (LTV), compliance issues, borrower payment trends, vacancy factors, and pending maturities. Based on this information, a risk rating of one to 10 is assigned; ratings of six and below are considered low risk. A risk rating of seven means the loan has some element of heightened risk, but default and/or loss is not expected. Nonetheless, these loans require business plans from the servicer and revaluation. Risk ratings from eight to 10 indicate a higher risk of default and losses are probable; loans in these categories are subject to revaluation, impairment recommendations, business plans, quarterly reviews, and possibly increased inspection frequency.

With the growth in K-Deal volume and the increase of the SBL product, AMO has allocated additional resources to monitor the portfolio by adding dedicated staff to this function. The team is broken out among K-Deal master servicing, SBL master servicing, and other reporting responsibilities, and also provides administrative support to all of surveillance.

We believe AMO continues to take a proactive approach to portfolio surveillance, and appears to have effective processes for identifying and managing high-risk loans.

Borrower consent requests

The special servicing group is responsible for borrower consent requests that are submitted by the Seller/Servicer on the borrower's behalf. Seller/Servicers perform initial reviews, produce a credit case including a recommendation on the transactions that they submit to AMO either for acknowledgement or consent. There were 4,300 consent requests processed during 2017, primarily addressing loan assumptions, partial collateral releases, and defeasance approvals. Other borrower consents addressed included easements, condemnations, modifications to loan documents, and repair escrow agreement modifications/extensions. Underscoring the challenge of the aforementioned timeliness goal, its Seller/Servicers have been able to "timely" complete these requests at a 60% success rate through Sept. 30, 2017.

Each request is evaluated for compliance with governing documents and credit policy and impact on collateral and associated risk (e.g., credit, interest rate, reputational, or operational). The goal is to preserve, protect and, if possible, improve Freddie Mac's risk position, while providing outstanding customer service. Delegated authority within AMO to approve the borrower consent requests is generally based on loan size and risk rating.

The CRT system is used to track and monitor borrower requests processed by the seller/servicers on their portfolios. The system gives AMO improved visibility into the status of the process and allows them enhanced reporting and monitoring.

Subservicer oversight

Seller/Servicers are expected to adhere to the servicing protocols and standards set forth in the SSG. Freddie Mac has made the borrower experience one of its key priorities, and compliance with the SSG is one way to ensure high service levels. The SSG is incorporated into the pooling and servicing agreements' definition of the "servicing standard," to which master and primary servicers must adhere. The customer compliance management (CCM) group updates the SSG at least quarterly; changes and updates are communicated to all key parties including Seller/Servicers, CMBS servicers, and investors via the AllRegs subscription site and bulletins sent to servicers from Freddie Mac.

Including portfolio and securitized loans, Freddie Mac oversees approximately 40 Seller/Servicers. CCM performs periodic audits of Seller/Servicers, the frequency of which is determined by the level of counterparty risk the Seller/Servicer poses to Freddie Mac. The audit function assesses the business operations, financial strength, and compliance with the SSG. CCM is responsible for reviewing annual Seller/Servicer certifications, monitoring ongoing program compliance, and eligibility to service Freddie Mac loans. CCM is also responsible for systems and applications associated with counterparty-level exposure tracking and monitoring.

CCM performs full-scope financial reviews of Seller/Servicers considered "moderate risk" or "high risk" at least once every three years covering all operational areas, controls, and financial stability (seven such full-scope audits were completed during 2017). Limited-scope audits (generally desktop; 21 occurred during 2017) rely on prior audit results and internal feedback to determine the audit scope. The audit program tests the Seller/Servicers' overall control environment, underwriting, closing, loan administration, asset management, loan accounting, investor reporting, and compliance with documents and specific loan regulations. Audit findings are classified as critical, major, or minor. Each Seller/Servicer is given an audit assessment score of "satisfactory compliance," "somewhat weak compliance," or "weak compliance." CCM prepares and delivers detailed performance reviews to senior management and the Seller/Servicer. Servicers who score below satisfactory compliance on their review will be audited more frequently.

CCM additionally reviews annual certifications submitted by Seller/Servicers, including attestations by chief servicing officers regarding package quality and adherence to the servicing standard. The certification package includes audited financial statements, its internal control structure, evidence of insurance, an external auditor's opinion, and net worth statement.

Financial Position

The financial position is SUFFICIENT.

Appendix: Freddie Mac Multifamily Portfolios/Product Types

Participation certificates (PC)

A seller delivers a pool of multifamily mortgages and receives a Freddie Mac Multifamily PC with a principal amount equal to the aggregate principal of the delivered mortgages. The PCs are mortgage pass-through securities issued and guaranteed by Freddie Mac. While the 45- and 75-day products are no longer offered in the marketplace, Freddie currently offers a 55-Day product. Master servicing functions include reconciling servicer reports and payments along with advancing funds.

Bond credit enhancements

Freddie Mac provides a credit enhancement for fixed- or variable-rate tax-exempt and taxable housing revenue bonds. The bonds that are credit-enhanced by Freddie Mac are secured by multifamily mortgages. Master servicing functions include advancing bond P&I, aggregating monthly bond draw requests for the bond trustee, aggregating all reporting and remittance data from servicers, and providing liquidity advances.

Retained portfolio

This consists of loans held for investment that were originated before the introduction of the K-Deals, and loans held for sale in the warehouse awaiting securitization. Master servicing functions include reconciling payments and servicer reports, delinquency monitoring, assessing loan risk ratings, and watchlists, and making property protection advances.

Tax-Exempt Bond Securitization (TEBS)

This is a proprietary execution through which a sponsor transfers tax-exempt multifamily housing revenue bonds and related taxable bonds or mortgages to Freddie Mac, and Freddie Mac issues senior class A certificates that are sold to investors and subordinate class B certificates that are privately placed with the sponsor and pledged to Freddie Mac. Master servicing functions include aggregating reports and payments, reconciling bonds and P&I payments, along with confirming and allocating funds.

Freddie Mac K-Deals

Freddie Mac aggregates mortgage loans acquired from Seller / Servicers and sells them to a third-party depositor, which places the loans in a real estate mortgage investment conduit (REMIC) trust, which in turn issues various classes of bonds. Freddie Mac purchases and guarantees the senior bonds and certain subordinate interest-only bonds. The remaining bonds are purchased by third-party investors. Freddie Mac then deposits the guaranteed bonds into a structured pass-through certificate (SPC) trust and issues guaranteed SPCs backed by the guaranteed bonds. Freddie Mac performs administrator functions (for the SPC trust, not the REMIC trust) including remitting funds to senior bond investors and bond-level reporting.

Freddie Mac SB-Deals

Freddie Mac aggregates small-balance mortgage loans purchased from Seller / Servicers and sells them to a third-party depositor, which places the loans in a REMIC trust, which in turn issues various classes of bonds. Freddie Mac guarantees the senior securities issued by the REMIC trust, which are then publicly offered. The unguaranteed securities issued by the third-party trust are privately offered to third-party investors. In some cases, a third party may act as a loan seller and Freddie Mac may issue SPCs. Freddie Mac is the appointed master servicer on these transactions, which aggregated $10.5 billion of UPB across 44 deals as of December 31, 2017.

Freddie Mac Q-deals

Similar to K-Deals, with the loans held in a REMIC trust, the key differences are as follows: Individual loans are never purchased onto Freddie Mac's balance sheet (rather, Freddie Mac purchases and insures senior bonds, which are sold to investors); and the underlying loans are not underwritten by Freddie Mac at origination (rather, they contain seasoned loans that are presented to Freddie Mac and an underwriting plan is crafted based on the pool's risk profile). Master servicing functions performed are similar to K-Deals.

Related Criteria

- Criteria - Structured Finance - Servicer Evaluations: Revised Criteria For Including RMBS, CMBS, And ABS Servicers On Standard & Poor's Select Servicer List, April 16, 2009
- Criteria - Structured Finance - Servicer Evaluations: Servicer Evaluation Ranking Criteria: U.S., Sept. 21, 2004

Related Research

- Freddie Mac ABOVE AVERAGE Commercial Master Ranking Affirmed; Outlook Is Stable, March 23, 2018
- Select Servicer List, Feb. 9, 2018
- Freddie Mac ABOVE AVERAGE Commercial Loan Master Servicer Ranking Affirmed; Outlook Is Stable, Jan. 26, 2017
- Freddie Mac, April 11, 2017