Federal Housing Finance Agency

Duty to Serve

FHFA presents Snapshots from Fannie Mae's & Freddie Mac's Duty to Serve Underserved Markets Plans for Small Financial Institutions

Effective January 1, 2018

Snapshots from Fannie Mae's and Freddie Mac's Duty to Serve Underserved Markets Plans: Small Financial Institutions

Compiled by the Federal Housing Finance Agency

FHFA has compiled Snapshots from Fannie Mae's and Freddie Mac's Duty to Serve Underserved Markets Plans addressing activities that support small financial institutions. To access the Duty to Serve Underserved Markets Plans in their entirety, please visit FHFA's Duty to Serve website.

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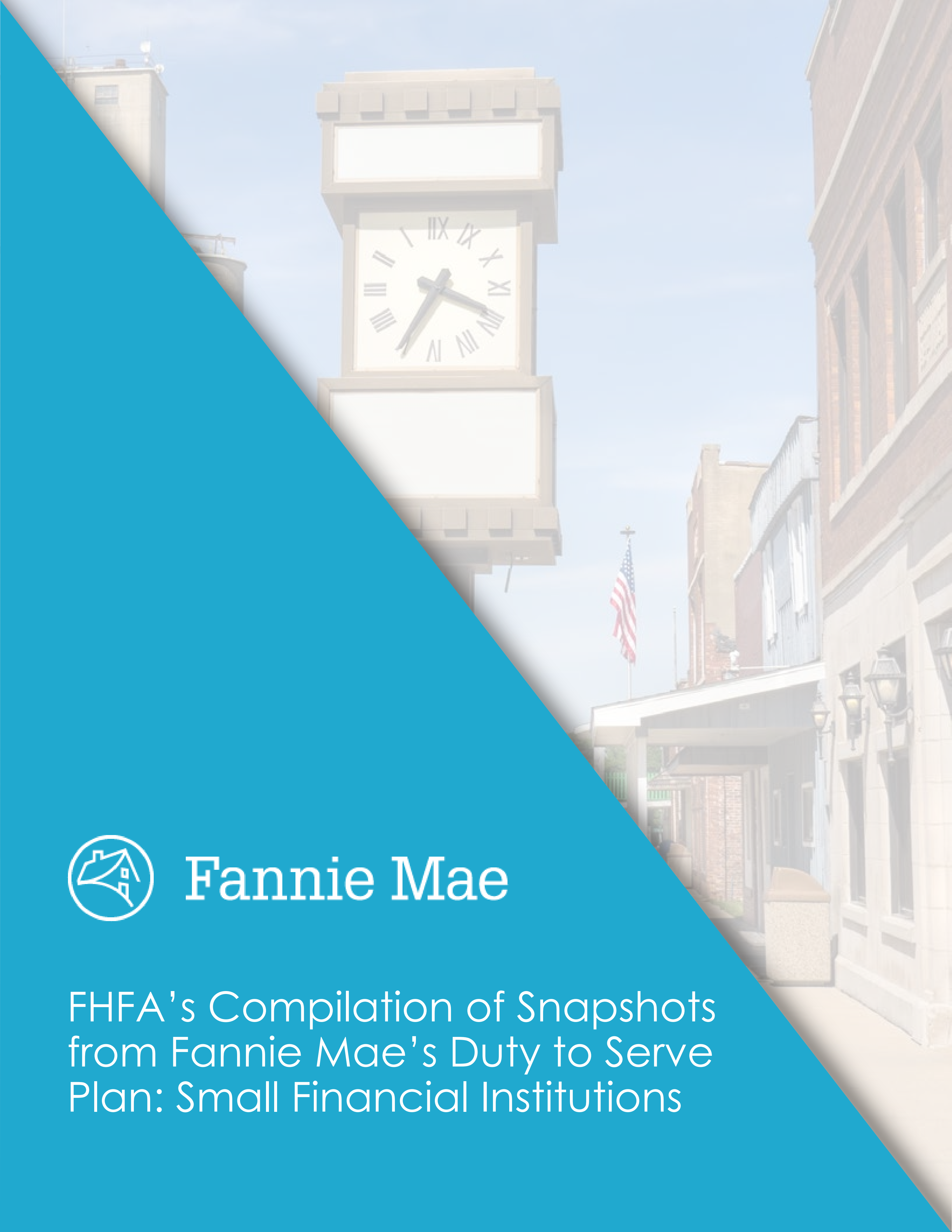

Fannie Mae

FHFA's Compilation of Snapshots from Fannie Mae's Duty to Serve Plan: Small Financial Institutions

F. Regulatory Activity: Financing of small multifamily rental properties (12 C.F.R. § 1282.34 (d) (1)).

1. *Objective #1: Adopt an effective approach to purchase small multifamily loans from financial entities with $10 billion or less in assets and purchase loans (Test and Learn, Partner and Innovate, Do What We Do Best).*

Meeting the Challenges
Financing small multifamily properties has several key challenges, including: • A lack of standardization in underwriting and documentation. • A lack of economies of scale in the loan origination process due to the small size of each loan. • Smaller, individual owners that do not necessarily meet a standard sponsor profile. • Loans are made by community banks and smaller institutions that may not choose to deliver loans via Fannie Mae DUS lenders. To address these challenges, Fannie Mae will: • Pursue outreach and research to determine an effective approach to addressing the challenges identified.

Meeting the Challenges
• Work with existing and other lenders to bridge the gap between smaller institutions, unique sponsors, and Fannie Mae. • Pursue a pilot program to test potential product enhancements to increase loan purchases.

SMART Factors

Fannie Mae will undertake the following measurable Actions in the years indicated.

Year	Actions

2018	• Engage stakeholders in discussions to gain knowledge and understanding of the challenges facing this market to determine an effective approach to broadening the market and increasing Fannie Mae purchases of small multifamily loans from institutions with $10 billion or less in assets (Institutions ≤$10B) including:
	  o Identify 10 Institutions ≤$10B that actively finance small multifamily loans for possible future engagement. As part of this process, Fannie Mae will examine our current offerings and market reach to confirm any existing gaps and determine whether there are non-Fannie Mae lenders that could help to fill such gaps. In addition, Fannie Mae will assess our current portfolio of small loans originated by Institutions ≤$10B to determine characteristics such as geography, LTVR and DSCR, performance, etc.
	  o Work with three DUS lenders to consider and build or enhance correspondent networks with Institutions ≤$10B.
	• Based on the analysis completed above, design and implement a pilot program focused on increasing purchases of small multifamily loans from Institutions ≤$10B to test and learn about the perceived gaps (e.g. product, geography, affordability) and risks as well as the potential for standardization and securitization.
	  o Identify lenders to participate in the pilot program. The pilot lenders will be chosen on characteristics such as experience and success in the small loan market, relationships with smaller loan originators, financial condition, and geographical coverage.
	  o Based on work completed in 2018, confirm the Baseline and loan purchase goals for 2019.

2019	• Commence the pilot program and purchase 273 small multifamily loans from Institutions ≤$10B, representing approximately a three percent increase over the Baseline. o **Baseline:** The average number of small multifamily loans purchased by Fannie Mae from Institutions ≤$10B over the last four years (2014: 230 loans; 2015: 210 loans; 2016: 257 loans; 2017: 274 loans[24]) is 243 loans per year. However, given that purchases in 2016 and 2017 both exceeded 243 loans, the average of the purchases in 2016 (257) and 2017 (274), or 265 loans, is being used as the Baseline. • In Q4 2019, prepare a review of the pilot program results to date and identify what, if any, changes might be required based on performance to date coupled with ongoing industry outreach and research. • Confirm pilot loan purchase goals for 2020 based on review of results.
2020	• Purchase 283 small multifamily loans from Institutions ≤$10B, representing a seven percent increase over the Baseline.

24 Fannie Mae purchased 137 small multifamily loans from Institutions ≤$10B through 6/30/17, annualized as 274 loans.

Year	Actions
	• Continue to monitor the results of the pilot, and identify what changes, if any, might be required based upon performance to date. • Make determination of next steps for the pilot: to continue as a pilot for further examination, to approve some of all of the pilot as product enhancements to be rolled out, or to terminate the pilot due to adverse findings with regard to safety and soundness or other issues. • Plan for the 2021 – 2023 Duty to Serve Plan.

Establishing an efficient program focused on small multifamily property loans originated by Institutions ≤$10B could greatly increase liquidity to this market. Fannie Mae will base our program on research on potential market opportunities for small multifamily loans and on potential partners that qualify as Institutions ≤$10B that are engaged in originating small multifamily loans. Our actions under this Objective will meet notions of safety and soundness, which will be incorporated into our arrangements with the subject financial institutions as well as in the purchases of loans, which will be subject to appropriate underwriting guidelines and credit risk standards. Based on Fannie Mae's experience acquiring small multifamily loans and working with a wide variety of lenders, we have determined that this Objective is realistic and may be achieved within the time periods described.

Criteria	2018	2019	2020
Evaluation Factor:	Loan Product	Loan Purchase	Loan Purchase
Income Levels:	Very Low-, Low-, and Moderate-Income Levels for all Years		

C. Regulatory Activity: Financing by small financial institutions of rural housing (12 C.F.R. § 1282.35(c) (3)).

1. Objective #1: Through outreach and developing solutions, Fannie Mae will increase purchases of single-family loans in rural areas from small financial institutions (Do What We Do Best).

Meeting the Challenges
One of the biggest challenges in rural areas for small financial institutions is access to the secondary market and affordable capital. To address this challenge Fannie Mae will: • Purchase an additional 4,873 to 6,623 rural single-family loans from small financial institutions over three years, which equates to an estimated additional $848 million to $1.2 billion of liquidity.

SMART Factors

Fannie Mae will undertake the following measurable Actions in the years indicated.

Year	Actions
2018	• Facilitate meetings with three regional wholesale lenders and one credit union service organization or one large aggregator to discuss the creation of an alternative business model allowing small financial institutions access into the secondary market – by Q3 end. • Purchase between 18,000 and 18,250 single-family loans in rural areas from small financial institutions, representing an approximate five to six percent increase over the Baseline. o **Baseline:** The average of the total number of rural loans purchased by Fannie Mae from small financial institutions in rural areas is 13,998 loans. (2014: 10,383; 2015: 14,401; 2016: 17,209) However, given that in 2016 the number of single-family rural loans purchased (17,209) was higher than the three-year average, the Baseline is being established at 17,209. • Assist small financial institutions in meeting rural areas loan delivery requirements by engaging 25 small financial institutions to facilitate participation in a Fannie Mae training program on loan delivery and related requirements.
2019	• Purchase between 18,500 and 19,000 single-family loans in rural areas from small financial institutions, representing an approximate eight to 10 percent increase over the Baseline. • Expand lender outreach to an additional 25 small financial institutions (i.e., lenders not approached in 2018) to facilitate participation in a Fannie Mae training program on loan delivery and related requirements.
2020	• Purchase between 20,000 and 21,000 single-family loans in rural areas from small financial institutions, representing an approximate 16 to 22 percent increase over the Baseline. • Expand lender outreach to an additional 25 small financial institutions (i.e., lenders not approached in 2018 or 2019) to facilitate participation in a Fannie Mae training program on loan delivery and related requirements.

Increasing the purchase volume of single-family loans in rural areas from small financial institutions provides direct liquidity to the market. Fannie Mae has a significant presence in the rural area housing loan market and maintains established relationships with small financial institutions engaged in the financing of rural housing. Fannie Mae has the systems, operations, and resource tools needed to facilitate efficient rural area housing loan delivery in a safe and sound manner. In addition, underwriting standards and credit guidelines that are simplified and consistent with safety and soundness will continue to be applied to improve acquisition of this product. Fannie Mae has significant experience purchasing loans in particular markets. Based on this experience and the available resources, Fannie Mae has determined that this Objective is realistic and may be achieved within the time periods described. The ultimate opportunity available in this market is to acquire an increased number of rural area single-family loans from small financial institutions.

Criteria	2018	2019	2020
Evaluation Factor:	Loan Purchase	Loan Purchase	Loan Purchase
Income Levels:	Very Low-, Low-, and Moderate-Income Levels for all Years		

2. *Objective #2: Purchase single-family rural loans through bulk transactions from small financial institutions (Analyze, Innovate and Do What We Do Best).*

Meeting the Challenges
Single-family mortgage loans originated in rural areas do not always conform to Fannie Mae's credit or collateral standards for a variety of reasons. As a result, small financial institutions tend to hold these loans in their portfolios and not deliver them into the secondary market. To address these challenges, Fannie Mae will:
• Conduct significant market outreach, research, and data acquisition to identify opportunities to prudently purchase portfolio rural single-family loans in bulk. Data analyses and research will also be performed to gather information to assess financial risk of these bulk transactions.

SMART Factors
Fannie Mae will undertake the following measurable Actions in the years indicated.

Year	Actions
2018	• Engage five single-family small financial institution lenders to identify and analyze the loan level details of their portfolios and associated lending terms to identify opportunities to purchase loans in bulk – by Q3 end. • Assess Fannie Mae's operational and system capabilities including a servicing assessment (if necessary) to handle bulk transaction deliveries. • Pursue internal approval to purchase rural single-family loans that may be considered illiquid assets and may remain on Fannie Mae's balance sheet for the life of the loans and not be eligible for securitization – by Q4 end.
2019	Subject to internal approval and availability in the market, Fannie Mae will: • Purchase between 600 and 700 single-family rural loans through bulk transactions. o **Baseline**: Fannie Mae has not purchased single-family rural loans through bulk transactions from small financial institutions in the last three years and, therefore, cannot establish a reasonable Baseline. • Expand lenders outreach to an additional 10 small financial institution lenders (i.e., lenders not approached in 2018).

Year	Actions
2020	Subject to internal approval, Fannie Mae will: • Purchase between an additional 700 and 800 single-family rural loans through bulk transactions. • Expand lender outreach to an additional 10 small financial institution lenders (i.e., lenders not approached in 2018 or 2019).

There is insufficient data available to determine what the current market opportunity is or the types of loans that are available for the purchase of the subject loans in bulk transactions from small financial institutions. However, if the loan purchases are made, it will provide direct liquidity to small financial institutions that lend in rural areas. Fannie Mae has the existing capability to purchase single-family loans through bulk transactions without requiring any additional Enterprise-level development. Based on this experience and the available resources, Fannie Mae believes this Objective may be achieved within the time periods described. All loan purchases made under this Objective will be supported by thorough economic, risk, and operational analyses, will be subject to Fannie Mae's governance and approval processes, and will only be made consistent with safety and soundness concerns.

Criteria	2018	2019	2020
Evaluation Factor:	Loan Product	Loan Purchase	Loan Purchase
Income Levels:	Very Low-, Low-, and Moderate-Income Levels for all Years		

Freddie Mac
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FHFA's Compilation of Snapshots from Freddie Mac's Duty to Serve Plan: Small Financial Institutions

Activity 3 – Financing by Small Financial Institutions of Rural Housing: Regulatory Activity

A small financial institution is defined for Duty to Serve purposes as one with less than $304 million in assets. During the FHFA listening sessions and our public outreach, we heard that, in many rural areas, these institutions are the only source of financial services. They are well-positioned to understand the needs and know the stakeholders in their communities.

Freddie Mac is committed to partnering with small financial institutions to leverage their market knowledge, experience and stakeholder network and to maximize the secondary market impact in the rural housing market.

During the Plan Term, Freddie Mac intends to increase purchase volume of loans on rural housing made by small financial institutions.

OBJECTIVE A: INCREASE LOAN PURCHASES FROM SMALL FINANCIAL INSTITUTIONS SERVING RURAL REGIONS

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Purchase	**1, 2 and 3**	**VLI, LI, MI**	**Not Applicable**

Freddie Mac intends to increase purchases of rural housing loans made by small financial institutions with assets of less than $304 million to generate liquidity and expand the distribution of capital. We plan to engage more deeply with small financial institutions that are already approved Freddie Mac seller/servicers to increase the purchase of both new and seasoned rural housing loans. We also intend to expand our outreach and support to increase the number of small financial institutions that can be approved as direct Freddie Mac seller/servicers or that sell to us through an aggregator. We believe that our incremental and strategic approach will increase our purchase share.

Baseline

The table below reflects Freddie Mac's actual purchase volume of mortgages in rural areas from depositories only (banks and credit unions) that we could identify as having an asset size of less than $304 million. In the future, we will enhance our reporting capabilities in this segment to reflect all lenders that meet the small financial institution definition. The overall loan count represents Freddie Mac's market volume of loans from small financial institutions in rural areas excluding the high-needs rural regions without a limiter for the Duty to Serve qualifying-income segment of very low-, low- and moderate-income volume. The income-qualifying loan count represents only the population of loans that meet the Duty to Serve qualifying-income segment of very low-, low- and moderate-income volume. It should be noted that the historical loan volume previously represented in Freddie Mac's initial draft Plan did not distinguish the loan population by qualifying income, but instead included all conventional loans on owner-occupied properties from small financial institutions that are in rural regions.

The baseline for this objective is an average of the loans Freddie Mac purchased from small financial institutions that meet income-qualifying criteria for Duty to Serve in the last three years (2014 through 2016), which is 3,894 loans. The numbers represent purchase-money originations and refinances for owner-occupied properties of very low-, low-, and moderate-income borrowers.[67]

Freddie Mac Loan Purchase Volume – Small Financial Institutions[68]			
Year	**2014**	**2015**	**2016**
Overall Loan Count	6,474	9,655	10,951
Income-Qualifying Loan Count (A three-year average of this loan count was used to establish the baseline)	2,899 loans	4,250 loans	4,533 loans
Baseline	3,894		

Target

Freddie Mac's purchase share of mortgages in rural areas from small financial institutions has been increasing since 2014 and was boosted by refinance volumes in prior years. Although we anticipate a decline in refinance volume over time, we will aim to gradually increase our purchase of loans in rural regions over the Plan cycle. We intend to use a variety of tactics with small financial institutions, including leveraging various execution options for loan purchase including purchasing loans via our bulk execution path where feasible, conducting outreach, offering technical training and providing toolkits that enable these lenders to lend confidently to very low-, low-, and moderate-income homebuyers.

Freddie Mac will commit to achieving the following loan purchases in rural regions for very low-, low-, and moderate-income borrowers in the following years:

Purchase Targets – Small Financial Institutions		
Year 1 – 2018	**Year 2 – 2019**	**Year 3 – 2020**
4,550 – 4,700 loans	4,700 – 4,900 loans	5,000 – 6,000 loans

Market Opportunity and Impact

This objective will provide liquidity of more than $460 million per year to small financial institutions that serve high-needs rural regions. Freddie Mac believes that deliberately increasing our engagement with small financial institutions to provide liquidity will notably improve access to credit in rural markets because we have heard that these lenders are limited in resources, available products and outreach capacity. Targeted loan volume may also include manufactured homes titled as real estate and as personal property (in years 2 and 3) and provides direct liquidity to the market.

Freddie Mac's increased market share will benefit these markets by improving the availability of affordable financing, including Freddie Mac's Home Possible and Home Possible Advantage mortgages. We anticipate this objective will be very challenging due to the varied operational systems used by small financial institutions; different missions and levels of financing; distinct financial products offered; and the large number of geographic areas served. Furthermore, Freddie Mac's forecast for 2018 relative to 2016 includes higher interest rates, continued reduction in refinance share, higher consumer prices and a 25% decrease in single-family origination volume, all of which contribute to making it a challenge to meet the targets reflected above. Developing relationships with small financial institutions not currently doing business with Freddie Mac will require a significant investment in resources to support and sustain the level of purchase growth targeted in the Plan cycle. Additionally, as we add new lenders to our customer base, it will take time before we realize loan purchases while lenders navigate through the onboarding process.

Freddie Mac believes our commitment to outreach and support for seller/servicers with experience and good track record in rural areas will expand this market in a safe and sound manner.

Activity 5 – Financing of Small Multifamily Rental Properties: Regulatory Activity

Small financial institutions, housing finance agencies, community banks and CDFIs serve an important role in supporting communities across the country, as well as providing financing for projects that are smaller or locally important. Many of the multifamily loans originated by these financial institutions are focused on these smaller projects. Buildings with five to fifty units account for more than one-third of the rental housing in the U.S.[107] Generally, rents in these smaller multifamily projects tend to be lower than those in larger buildings, especially the new Class A properties constructed in recent years.[108]

To enable small financial institutions to provide greater community benefit, particularly through five to fifty unit properties, we intend to increase access to liquidity through a full suite of multiple seasoned loan securitizations and guarantee offerings. Our objectives around products and purchases include the following:

- Develop a new offering for small balance loan (SBL) pool securitization.
- Develop a new offering for SBL pool credit enhancements.
- Develop a new offering for SBL Participation Certificate (PC) Securitization
- Purchase or guarantee seasoned SBLs from small financial institutions

Based on our outreach to small financial institutions, we understand that Freddie Mac can help this segment of the market by offering access to liquidity so these institutions can continue to grow and support affordable housing. Small financial institutions tend to hold their multifamily loans on their balance sheets, which limits new loan production, or to complete smaller, one-off loan portfolio sales, which is inefficient. As a result, these financial institutions are constrained in their lending abilities either by regulatory requirements or by access to balance sheet capital.

Regulators recommend that banks maintain commercial real estate ("CRE") loan levels on their balance sheets within certain metrics.[109] The two primary metrics that regulators focus on:

- Total reported loans for construction, land development and other land and if this population represents 100 percent or more of the bank's total capital
- Whether CRE levels remain below 300 percent of a bank's total risk-based capital

Banks with CRE concentrations above these levels may be targeted for more supervisory analysis and/or may be limited in their ability to underwrite new loans, thus decreasing the availability of capital for small multifamily properties. For example, our review of banks' CRE exposure indicated a correlation between these suggested thresholds and bank solvency.[110] A 2013 report from the Office of the Comptroller of the Currency and the Federal Reserve found that 23 percent of banks that exceeded supervisory levels for both CRE and construction and development loans failed during the three-year economic downturn, compared with less than one percent of banks that stayed below those levels.[111]

There are many challenges that limit the financing capabilities of small financial institutions. Freddie Mac is demonstrating its industry leadership by creating multiple solutions to these issues. With Freddie Mac participation, small financial institutions will have the capability to select products based on market conditions and their individual needs. With multiple options, institutions will be encouraged to originate and purchase more loans as a result of the increased stability and liquidity in the market.

OBJECTIVE A: DEVELOP A NEW OFFERING FOR SMALL BALANCE LOAN POOL SECURITIZATION

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Product	**1**	**VLI, LI, MI**	**Not applicable**

In Year 1 of the Plan, Freddie Mac will introduce a formal product for seasoned SBL pool purchases and securitizations for small financial institutions. This product will provide a standardized securitization mechanism for Freddie Mac to work with a larger group of small financial institutions seeking balance sheet relief. This will allow the small financial institutions to recycle capital back into new multifamily lending, thereby increasing liquidity for this market. Many of the multifamily loans originated by these financial institutions are focused on smaller projects. These properties account for one third of the rental housing market. Generally, rents in these smaller multifamily projects tend to be lower than those in larger buildings, especially the new Class A supply constructed in recent years.[112]

Baseline

Through 2016 we have completed three seasoned SBL pilot securitization transactions with institutions that meet Duty to Serve criteria. Freddie Mac has generally worked within a deliberate set of underwriting parameters for loans in these pools that have not been broadly marketed. We will look to leverage these prior transactions and the parameters used for them to inform, develop, and market formal standards. As we develop this formal offering, we will continue to pursue transactions under the parameters we have been using to date.

Challenges, Actions, and Market Impacts

Market Challenge	Freddie Mac Action
Commercial real estate loan levels limit additional lending ▪ As a result of holding these loans on their balance sheet, banks with CRE concentrations above certain levels may be targeted for more supervisory analysis and/or may be limited in their ability to underwrite new loans, thus decreasing the availability of capital for small multifamily properties. **Limited secondary market opportunities for small financial institutions** ▪ Small financial institutions typically either hold loans on their balance sheet, which constrains their ability to lend, or they create small pools and sell to each other to free up balance sheet space as needs arise.	**Year 1 – 2018** Develop and implement internal credit policy for seasoned SBL pool purchase and securitization that will enable borrowers to sell loans, free space on their balance sheet, and lend more loans while promoting market safety and soundness. 1) Introduce a formal product for seasoned SBL pool purchases and securitizations for small financial institutions. 2) Publish a product term sheet on our website that will include the following elements: a. Product overview and loan purpose b. Sponsor and/or property eligibility requirements c. Loan-to-Value limits d. Debt coverage limits e. Allowable lengths of loan term f. Allowable lengths of amortization

	3) Gather feedback from the small financial institutions, HFAs, CDFIs, and community banks from whom we purchase and securitize loans (or attempt to) under Objective D, to refine this offering over time as necessary.
Underwriting Challenge	**Freddie Mac Action**
Bank sophistication ▪ Financial institutions, community banks and CDFIs that serve the VLI, LI, and MI markets will be smaller lenders than Freddie Mac Multifamily has partnered with historically. Freddie Mac's understanding of a bank's origination and servicing platforms will be critical for Freddie Mac to execute effectively and efficiently from a time and cost perspective. **Unfamiliarity with Freddie Mac and process** • Small financial institutions, community banks and CDFIs will likely be first-time customers to Freddie Mac Multifamily. New customers will need to learn Freddie Mac's underwriting and credit approach and approval process.	**Year 1 – 2018** 1) Freddie Mac Underwriting and Asset Management representatives will visit each new lender and have kickoff meetings to go over the bank's lending and servicing standards to determine whether there are any material differences in their platforms from ours and work to resolve any differences where possible. 2) Create a high-level process flow detailing the steps of executing a securitization of a seasoned pool. The process flow will highlight Freddie Mac's credit criteria and approval process for seasoned pools. 3) Provide at least one training session to each institution with which we do business.
Resource Challenge	**Freddie Mac Action**
Staffing ▪ Execution of a securitization of a seasoned small balance loan pool takes time to train a new customer on the Freddie Mac process relating to underwriting, servicing, legal due diligence, and securitization. ▪ The Freddie Mac staff must learn and understand the bank's origination and servicing platform for each new transaction.	**Year 1 – 2018** Freddie Mac will implement an internal working group to ensure that all resources are allocated appropriately and alignment is maintained throughout the increased execution of securitization of seasoned loan pools with a focus on the VLI, LI, and MI market. 1) Provide one to three training sessions covering product process and parameters, including underwriting and ongoing monitoring to internal staff via webinar or in person training sessions as appropriate for the audience.

Market Impact
Small financial institutions often hold their multifamily loans on their balance sheet which limits their potential to do new business and support more renters and communities and concentrates risk within particular institutions. We understand from our discussions with small financial institutions that this offering will alleviate the Commercial Real Estate regulatory requirements that constrain these institutions' abilities to generate new small multifamily loans. In addition to this CRE loan concentration relief, this offering will allow banks to benefit from having loans converted into marketable securities which benefit from Freddie Mac's guarantee of the timely payment of interest and the ultimate repayment of principal. Additionally, outside of the single, whole-loan sales banks typically engage in, there is not another efficient mechanism available in the market for banks seeking to offset large unpaid principal balances of multifamily loans. Flexible structuring options for the securities will allow banks to sell or retain securities and realize sales proceeds at settlement or achieve improved Risk-Weighted Assets on their balance sheet. Finally, there is a potential for banks to be approved as a primary servicer of the underlying loans following settlement which enables the banks to remain in a customer-facing position on the underlying loans while also receiving a servicing compensation fee. As our product becomes increasingly available to our network of seller/servicers and borrowers, we will see a growth of purchase volumes which will create additional liquidity in the market and promote market safety and soundness as risk is distributed away from the small institution, and away from Freddie Mac and the taxpayer. With Freddie Mac able to provide liquidity to the market, these institutions will have the capital to make more loans and support more properties and people.

OBJECTIVE B: DEVELOP A NEW OFFERING FOR SMALL BALANCE LOAN POOL CREDIT ENHANCEMENTS

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Product	**1**	**VLI, LI, MI**	**Not applicable**

In some situations, such as in a rising interest rate environment, small financial institutions may prefer to rely on a Freddie Mac credit enhancement structure of the loans on its balance sheet instead of a securitization. We plan to introduce a non-securitized alternative offering that employs credit tranching whereby Freddie Mac would guarantee the underlying small multifamily loans while the bank continues to hold the loans on its balance sheet. This supports small financial institutions that are seeking relief from heavy commercial real estate exposure, but are operating in an environmental that does not favor loan sale and securitization.

Therefore, in Year 1 of our Plan, we will develop a credit enhancement product that enables Freddie Mac to guarantee small balance loans on banks' balance sheets. This product is expected to be well received by small financial institutions that lack the in-house capital markets expertise required for securitizations.

Baseline

While Freddie Mac has the capacity to offer credit enhancements, and has done so for tax exempt bonds, it has not done so in the context of small loans or with small financial institutions, which are a materially different market segment with unique needs and risks.

Market Challenges, Actions and Impacts

<table>
<tr><th>Market Challenges</th><th>Freddie Mac Action</th></tr>
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Commercial real estate loan levels limit additional lending

- Banks with CRE concentrations above certain levels may be targeted for more supervisory analysis and/or may be limited in their ability to underwrite new loans, thus decreasing the availability of capital to support small multifamily properties.

Limited non-security options for balance sheet relief

- Outside of whole loan sales, small financial institutions do not have readily available outlets for multifamily loan concentrations on their balance sheets.
- A Freddie Mac credit enhancement may enable small financial institutions to achieve risk-based capital relief without the expenses and time requirements associated with a stand-alone securitization.

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Year 1 – 2018

Develop and implement internal credit policy for seasoned SBL pool credit enhancement that will enable lenders to lend more for small multifamily properties while promoting market safety and soundness.

1) Publish an official product term sheet on our website that identifies the product and the acceptable terms.
2) Include at least the following elements in the term sheet:
    a. Product overview and loan purpose
    b. Sponsor and/or property eligibility requirements
    c. Loan-to-Value limits
    d. Debt coverage limits
    e. Allowable lengths of loan term
    f. Allowable lengths of amortization
3) Gather feedback from the small financial institutions, HFAs, CDFIs, and community banks for whom we credit enhance loans (or attempt to) under Objective D, to refine this offering over time as necessary.

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<tr><th colspan="2">Market Impact</th></tr>
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In a rising rate environment, banks will need a way to free balance sheet capital without selling loans to investors at a loss. We understand from our discussions with small financial institutions that providing a credit enhancement offering would accomplish this, by allowing small financial institutions to access the tools of the capital markets used by larger institutions, for the benefit of their local communities. The offering will be designed consistent with safety and soundness.

This offering is foundational for market growth and increases the ability of small financial institutions to support more people and communities in any rate environment. Since small financial institutions do not have readily available outlets for multifamily loan concentrations on their balance sheets, Freddie Mac's offering will provide them with additional sources of capital that were previously unavailable to small financial institutions. Our credit enhancement will allow small financial institutions to achieve capital relief without the associated burdens of securitization. In creating this product, we are providing much needed liquidity to this market. Creating this loan product along with the products in Objectives A and C will have a substantial impact on this market.

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OBJECTIVE C: DEVELOP A NEW OFFERING FOR SMALL BALANCE LOAN PARTICIPATION CERTIFICATE ("PC") SECURITIZATION

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Product	**2**	**VLI, LI, MI**	**Not applicable**

Not all small financial institutions have the capital markets capacity or the volume of multifamily loans to engage in a securitization. They are, however, familiar with, and experienced in, PC securitizations. This is a third tool that can provide liquidity to small financial institutions.

Therefore, in Year 2 of our Plan, we will develop a new PC securitization product for small financial institutions. We anticipate that this offering will take a greater amount of time to develop than the securitization and credit enhancement offerings described above as there are two particular aspects of PCs we do not currently offer: (1) floating rate, and (2) rate reset periods, both of which are important to this segment of the market.

Baseline

Freddie Mac offers PCs for our conventional and Target Affordable loans, but has not issued them in this capacity with parameters in alignment with the seasoned SBL pool market.

Challenges, Actions and Market Impacts

Product Creation Challenge	Freddie Mac Action
Lack of scale to support securitization ▪ Many small financial institutions have the desire to securitize multifamily loans but lack the volume to justify the cost or support the economics of a stand-alone securitization. **Commercial real estate loan levels limit additional lending** ▪ Banks with CRE concentrations above certain levels may be targeted for more supervisory analysis and/or may be limited in their ability to underwrite new loans, thus decreasing the availability of capital for small multifamily properties.	**Year 2 – 2019** Develop and implement internal credit policy for small balance loan PC securitization that will enable lenders to lend more for small multifamily properties while promoting market safety and soundness. 1) The PC product should be offered in smaller sizes than what is typically required for the seasoned SBL product (more than $150 million). 2) Publish an official product term sheet on our website that identifies the product and the acceptable terms. 3) Include in the term sheet at least the following elements: a. Product overview and loan purpose b. Sponsor and/or property eligibility requirements c. Loan-to-Value limits d. Debt coverage limits

	e. Allowable lengths of loan term f. Allowable lengths of amortization 4) Gather feedback from the small financial institutions, HFAs, CDFIs, and community banks with whom we engage in PCs (or attempt to) under Objective D, to refine this offering over time as necessary.

Market Impact

This product will have a profound effect on small institutions that want to engage in PC securitization. This offering will provide more liquidity to the SBL with small financial institutions market, allowing these small institutions to purchase more loans. Small institutions will have familiarity with a PC product which should make for quick execution once the product is in place. As with our other SBL products, this will create long-term stability and liquidity.

A new SBL-specific PC offering will allow Freddie Mac to securitize SBL pools much more cost effectively and provide access to liquidity for more financial institutions. PC executions are familiar to many small financial institutions; thus we understand from our outreach that those that lack capital markets capacity will likely find it more adoptable than Freddie Mac's other securitization options.

A PC offering will round out a comprehensive suite of executions to meet the needs of small financial institutions which will allow them to support more people and communities. This is foundational for market growth and long-term stability.

OBJECTIVE D: PURCHASE/GUARANTEE SEASONED SMALL BALANCE LOANS FROM SMALL FINANCIAL INSTITUTIONS

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Purchase	**1, 2 and 3**	**VLI, LI, MI**	**Not applicable**

Freddie Mac's Structured Targeted Affordable Housing group has begun to develop the capacity to support a seasoned SBL pool business. As described above, we intend to leverage that capacity into formal product offerings available to small financial institutions that meet the Duty to Serve criteria.[113]

Assuming the successful adoption of our offerings described in Objectives A, B and C above, Freddie Mac intends to meet the following loan purchase/guarantee targets described below.

Baseline

Through 2016, we have securitized three seasoned SBL pools of different sizes that could have met Duty to Serve requirements, leading to a three-year average of one transaction or $292 million. We do not anticipate this to be representative of future purchase volume because small financial institutions typically have portfolios that are much smaller than what we have previously worked with in this space. Therefore, we anticipate deal sizes to be much smaller (approximately $100 million) than the three pools we have completed.

Targets

At the time of writing, and in the coming years, there is likelihood of a rising rate environment, which would reduce the amount of seasoned SBL purchase or guarantee volume we can do. These transactions from our baseline were executed in a favorable interest rate environment. In a rising interest rate environment, such as today, we would expect to execute fewer and smaller pools for the reasons described below. Given the favorable conditions that previously allowed for large purchases in the SBL market, our targets will start below the baseline and grow to reach the baseline in the third year. Therefore, we are setting our targets as described below. Should the market and interest rate environment change, or should we receive larger than anticipated demand, we will adjust these targets accordingly.

This target is set to leverage any of the three product offerings described above, as each may be beneficial in different scenarios, and we cannot predict which will be best for which institution.

Our first-year target is likely to be met by leveraging our existing parameters prior to the formal development of the securitization or credit enhancement offerings. It is important to note that, unlike typical single loan multifamily transactions, this type of transaction contains hundreds of loans that need to be underwritten from both a credit and legal perspective and have regularly taken six months to a year to develop and execute. Furthermore, banks need to seek regulatory guidance on the treatment of these transactions and often need board approval to enter into a term sheet. As such, in these early stages of product development, securing and closing transactions within a specified timeframe is highly unpredictable. Therefore, our 2018 target is highly appropriate and meaningful. As the years progress and we release more offerings, we will be better able to increase our target.

Year	Target
2018	The lesser of one transaction or $100MM
2019	The lesser of two transactions or $200MM
2020	The lesser of three transactions or $300MM

Market Challenges

There are a few challenges that are involved in purchasing or guaranteeing pools of these loans. The first issue is present in the interest rate environment. For this business model to operate effectively, interest rates at the time of securitization must be at or below interest rates at the time of loan origination. Because we would purchase, securitize, or guarantee loans 12 months after they were made, the buyer of the pool would be basing their return expectations on a spread over the Treasury or LIBOR index at the time of purchase. If the index is higher at the time of securitization than it was at the time the loan was made, then the bank would have to sell at a loss, we would have to buy it at a loss or the securitization investor would have to invest at a loss.

The second challenge is involved in the execution of the purchase. Securitizing seasoned SBL loans originated by other financial institutions can often take 6 or more months to complete, as each transaction normally has over 100 loans (in many cases, more than 200), each of which needs to be underwritten and reviewed from a legal perspective. Therefore, in order to complete a transaction in 2018, we will need to have received the agreement of the borrower in the first half of the year—the same year in which we are formally developing two of our three products. There will be a lead time with each product development before we can execute the first transaction under that product.

Third, with each new transaction we do, we must develop a new relationship with a financial institution. Conversely, the financial institution has its own fiduciary duties it needs to weigh as part of entering into a deal. This includes identifying and obligating resources on its side related to negotiating deal terms, analyzing the deal's impacts to its balance sheet, monitoring the deal, closing, and in many cases, servicing the loans post-closing. A financial institution's board typically needs to approve its entering into a term sheet and internal employees are assigned to work on a deal to assist in Freddie Mac's underwriting and legal review of the pool of loans. With each new relationship, we must ensure a financial institution is able to undertake this commitment. This combination of factors likely limits the institutions with which we could do business in a given year to a select few.

Market Impacts

The primary market impact will be found in the creation of liquidity for small financial institutions. The potential for new deals, coupled with past deal experience, is expected to further enhance Freddie Mac’s expertise with this securitization structure. With the Freddie Mac guarantee, market investors will become more familiar with Q series certificates, which are an innovative securitization that comprehensively distribute risk away from tax payers and provide liquidity to the market. Small financial institutions will then be able to sell loans and create additional liquidity, or hold them for balance sheet management purposes. This offering will provide more liquidity to the SBL market, and therefore allowing these small institutions to purchase more loans. As with our other SBL products, this will create long-term stability and liquidity.

With each transaction of $100 million we execute, we enable a small institution to lend another $100 million to support small multifamily properties. If the average property is about $3MM and 30 units, then that institution can lend to an additional 33 properties, for nearly 1,000 units of naturally occurring affordable housing. As we build momentum, increase predictability, increase our purchases and guaranties, and enable more lenders to increase their lending, we will increase our impact by supporting thousands of families per year making very low, low, and moderate incomes, all without relying on scarce public subsidies.

DISCLAIMER

Implementation of the activities and objectives in Fannie Mae's and Freddie Mac's Duty to Serve Underserved Markets Plans may be subject to change based on factors including FHFA review for compliance with the Charter Acts, specific FHFA approval requirements and safety and soundness standards, and market or economic conditions, as applicable.

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