

Operational Risk Assessments News Bulletin

Freddie Mac Multifamily Asset Management and Operations

Morningstar Assigns Freddie Mac 'MOR CS2' Ranking as a Commercial Mortgage Special Servicer and 'MOR TA3' Ranking as a Commercial Mortgage Trust Advisor; Forecast for Both Rankings is Stable.

Morningstar Credit Ratings, LLC (Morningstar) has assigned Freddie Mac Multifamily Asset Management and Operations (Freddie Mac) its 'MOR CS2' ranking as a commercial mortgage special servicer and its 'MOR TA3' ranking as a commercial mortgage trust advisor. The forecast for both rankings is Stable. Freddie Mac is a government sponsored enterprise currently operating under a conservatorship established on December 6, 2008 under the auspices of the Federal Housing Finance Authority (FHFA). The assigned rankings and Stable forecasts reflect our assessment of Freddie Mac's operational infrastructure and portfolio administration capabilities as a currently active special servicer and as a potential Trust Advisor.

In particular, Morningstar's rankings and forecast are based on these factors:

Special Servicing

- Highly Experienced Management and Asset Management Teams - Morningstar's view that Freddie Mac's management and asset management teams are highly experienced in administering distressed multifamily assets including health care facilities, senior housing, student housing, cooperative housing, and Section 8 housing assistance payment contracts.
- Accurate and Timely Reporting - Our view of Freddie Mac's capabilities to provide accurate and timely reporting, its responsiveness to information requests, and the overall quality of its asset-level reporting content. In particular, Freddie Mac effectively handles the exchange of pertinent information both with its seller servicers and its investors in commercial mortgage securitizations ("K deals").
- Excellent Recovery Results with Multifamily Assets - During 2012, Freddie Mac resolved 261 multifamily loans representing a total of nearly \$2.7 billion of unpaid principal balance (UPB) and liquidated 20 REO properties representing approximately \$149.5 million in net carrying value. Morningstar calculated that Freddie Mac's net proceeds-to-value on REO liquidations averaged 98.8 % during the first half of 2013 and 104% for full year 2012. Additionally, we believe that average hold times on resolved assets signify an expeditious disposition process.
- Well Controlled Asset Management and Sound Audit Function - Morningstar believes that Freddie Mac has diligent practices and procedures for soundly controlled asset management to mitigate risk and minimize losses to investors. In our view, the company's audit practices for its multifamily division also are solid and encompass not only a biennial formal internal audit schedule, but also quarterly self-administered, yet independent, internal audits performed by the multifamily division's Enterprise Risk Management department that test special servicing compliance with Freddie Mac's own policies and procedures and any K deal transaction requirements.
- Highly Transparent Asset Resolution Practices and Sound Conflicts of Interest Management - Our positive view of Freddie Mac's thorough performance reviews and formal audits of its seller/servicers, which inform and educate the staff at each entity on Freddie Mac's policies, procedures, and requirements for servicing Freddie Mac sponsored-loans. We believe this frequent two-way interaction not only mitigates the risk of errors but also enhances efficiencies by maintaining close communication with its network of seller/servicers. Since Freddie Mac has no affiliations with subordinate class purchasers on its K deal securitizations and has no ownership interests in or affiliations with third party vendors such as broker, property management, or appraisal firms, the company has no discernible conflicts of interest. Additionally, Freddie Mac has strict procedures for the process of selecting and approving third party vendors with a strict hierarchy of delegated authority for such decisions.
- Sound Technology Platform; Ongoing Efforts to Enhance and Consolidate Legacy Systems to a Single Platform - Our positive view of the company's recently upgraded asset management system, Freddie Mac Multifamily SMARTSM (Streamlined

Management Analytical and Reporting Tool). Freddie Mac also developed the SMART system to ultimately encompass the functionality that still resides in some stand-alone legacy applications. However, we have concerns regarding the company's disaster recovery preparedness. Freddie Mac current practices do not include scheduled recovery testing for its asset management system, and the company does not have sufficient alternate site availability for all key employees in case of a prolonged event. Additionally, the company has a permitted 30-day recovery timeframe for the main asset management system, which we believe heightens operational risk to the enterprise and should be addressed.

- Sufficient Capacity to Perform Special Servicing Functions - Based on Morningstar's calculation of Freddie Mac's assets-to-asset manager ratio, the company appears to have sufficient staff resources to keep pace with its recent asset transfers. In fact, its overall ratio of assets-to-asset manager stood at 11:1 for loan assets and 6:1 for REO assets as of the year ended 2012.

Trust Advisor

- Solid Capabilities Based on Diligent Track Record Overseeing Servicers - Our favorable view of Freddie Mac's proven experience in reviewing the work and recommendations of its seller servicers relating to such activities as borrower consents, asset status reports, and major decisions both for its balance sheet loans and its securitized transactions.
- Thorough Operational Review of Seller Servicers to Monitor Adherence to Freddie Mac Procedures and Requirements - Our view that Freddie Mac employs an extensive and well-designed performance review and audit program for its servicers. Freddie Mac's program proactively guards against errors or omissions on the part of servicers, which could lead to losses for Freddie Mac or its securitization investors.
- Solid Familiarity with CREFC Investor Reporting Package (IRP) - Our view that Freddie Mac's management and professional staff possess a sound knowledge of the investor reporting content, data templates, and decision-making considerations required of special servicers in securitized transactions.

As of December 31, 2012, Freddie Mac's active special servicing portfolio was approximately \$1 billion consisting of 78 assets. During 2012, Freddie Mac's asset resolutions were equivalent to approximately 78% of the specially serviced loans by loan count and 70% of the REO assets by property count that it held as of January 1, 2012.

Forecast

Stable. We expect Freddie Mac will continue to be an effective special servicer for its balance sheet portfolio and conduct proactive surveillance on its securitized transactions. We will continue to monitor its ongoing technology initiatives for its multifamily platform and expect the company to realize greater efficiencies as it further integrates applications and eliminates stand-alone legacy systems. We also believe the operation, through its current procedures, systems, and infrastructure, is suitably positioned to assume the roles and responsibilities of a trust advisor in a securitized transaction.

Our full commercial mortgage special servicer and trust advisor assessment report on Freddie Mac is forthcoming and will be made available on our website.

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