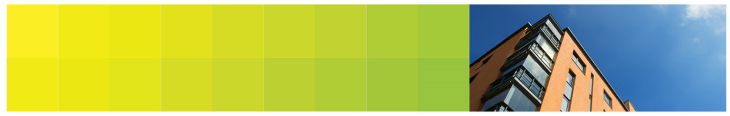

Hurricane Harvey – Freddie Mac Insurance Considerations

Hurricane Harvey has had a significant impact on parts of Louisiana and Texas, in particular, in recent days. The full extent of its impact will not be understood for some time. This presents challenges for our business as we try and determine exposure and impacts to the Multifamily communities in these areas. Insurance coverage and the associated recovery process take on heightened importance when catastrophic events such as these occur. We will lay out some of the considerations below. This is not meant to be all-encompassing but hopefully provides an overview of expectations and the process Freddie Mac Multifamily expects in the weeks and months ahead.

Based on most accounts, the primary cause of property damage due to Hurricane Harvey will be from flooding (followed by damage due to wind). The largest exposure for lenders and investors will be loans secured by properties that do not have sufficient flood insurance or any flood insurance. Although some Multifamily properties will have flood insurance due to requirements in place, we should expect that a significant population of properties will have no flood insurance because they were not located in an area in which flood insurance was required.

It is safe to assume that most, if not all, locations will have a hazard insurance policy that provides coverage for damages related to named storms (such as Hurricane Harvey). However, the courts have made it clear based on past storms that water damage other than wind driven rain is not insured under named storm coverage. In such instances, flood coverage would be all that applied to water damages not caused by wind. It’s still early in the process, but most expectations for the Houston area are that wind was not a big contributor to damages. If this is determined to be the case, named storm coverage would not provide much relief to the Houston area. This could be different for properties along the coast where wind was more of a factor.

Flood Insurance

In order to make a loan secured by a property located in a Special Flood Hazard Area (SFHA), most lenders must meet the minimum mandatory flood insurance purchase requirements under Federal Law. That requirement is to have flood insurance for any building located in a SFHA in an amount equal to the maximum insurance coverage available through a policy issued under the National Flood Insurance Program (NFIP), or the loan balance, whichever is less. The maximum flood coverage for Multifamily buildings under NFIP is $500,000 per building.

Freddie Mac’s flood requirements are broader but individual properties often warrant specific consideration. In general, for any building located in a SFHA, we look for flood insurance to be equal to the replacement cost value (RCV) of the first two stories, plus that of any basements, plus business income/rent loss equal to 12 months of the Effective Gross Income (EGI) associated with the building, regardless of how many stories. This amount of coverage is usually greater than the maximum building coverage available under an NFIP policy. This requirement does not apply to our Small Balance Loans (SBL). In the SBL program it is typical for borrowers to only carry NFIP-level flood insurance coverage.

Rent Loss insurance, often referred to as Business Income (BI), covers the loss of income that a business suffers following a disaster. It is important to note that BI is only recoverable if the damage sustained is from a covered peril. A building that is off-line due to flood damage will not receive rent loss payments from the insurance company if flood is not an insured peril under the policy. BI is only offered through private flood carriers. It is not provided in an NFIP policy.

Insurance Claims & Recoveries

We can expect the claims process to be very slow for a few weeks as flood waters continue to recede and borrowers and residents deal with the logistics of returning to their properties. Once access is available for owners, residents and insurance claim resources, the claims process should ramp up quickly. However, due to the sheer volume of claims, it is expected that the claims process will be drawn out for many properties. This could take weeks, months or even years in some situations.

We have received many questions regarding specifics of insurance coverage and the claims process. These are addressed in more detail in the appendix.

Freddie Mac Approach

Freddie Mac Multifamily understands the magnitude of the devastation surrounding Hurricane Harvey. We are also acutely aware of the human element to this storm and the impacts to residents, owners, and several of our business partners.

There are many questions and concerns about individual properties. Rest assured we have been at work on this since before the storm even started wreaking havoc. We are actively engaged and working closely alongside our talented and experienced servicers (Primary Servicers, Master Servicers, etc.) and other parties as needed. They bring expertise in the areas of assessing damages and dealing with the insurance claims and recovery process. We will continue to partner with them throughout this process.

We need to stress that this process will take time. It involves property-level details and coordination spanning hundreds of properties. But we will continue to ensure that our business community is updated as information is available and individual situations evolve. We encourage investors reach out to us for updates on individual properties in your portfolios rather than the Servicers to allow the Servicers the time needed to gather the information and ability to focus their resources on working with the Borrowers.

Thank you for your continued partnership during these challenging times.

Appendix - Insurance Facts

- Building damage reimbursement will be recovered as the repairs progress. Insurers will make a general assessment of the cost of repairs, and issue funds to Lender/borrower either for the full amount of estimated repair costs, or for an interim percent of the estimated costs in order to allow borrower to begin repairs. The faster the buildings are repaired and certified complete, the faster the insurer will issue final insurance proceeds.

- Replacement Cost Value (RCV) vs Actual Cash Value (ACV) reimbursement. If a borrower does not rebuild, then the insurance reimbursement will be paid out based on the building ACV, which is equal to RCV less depreciation. Note that National Flood Insurance Program (NFIP) policies for Multifamily buildings reimburse claims based on ACV, regardless of rebuild. That is one of the well-known limitations of NFIP General Property policies. NFIP policies also do not cover business income/rent loss, which is a significant part of a Multifamily loan's collateral.
- Business Income / Rent Loss (BI) is **only recoverable if the damage sustained is from a covered peril**
    - A building that is offline due to flood damage will not receive rent loss payment from the insurance company insuring the Property if flood insurance coverage is not provided under the policy
    - BI is only offered through private flood carriers – there is no BI coverage provided by an NFIP policy
    - Many SBL loans requiring flood coverage will only carry NFIP insurance

- Concurrent Losses
    - If damage is caused by both a covered and noncovered peril, BI will be recoverable only for the portion of the loss attributed to the covered peril
        - A building damaged by wind and flooding, but not insured against flood damage would receive payment only for the losses attributed to wind damage

- Civil Authority
    - A borrower may recover up to three weeks of BI due to a civil authority command or mandate, therefore even if a Property suffers no loss due to physical damage, BI may be recoverable for a period of up to three weeks for a loss of income due to, for example, a state-issued evacuation order
    - As in every case, BI would only be recoverable if the relevant peril is covered under the policy insuring the Property

- Payment of Business Income / Rent Loss Claims
    - Most BI has a "waiting period", which is similar to a policy deductible, but is based on a period of time rather than a set dollar amount
        - The waiting period is the amount of time that must pass while operations have ceased (in the case of multifamily rentals, while a rental unit is uninhabitable) in order to be eligible to receive payment for a loss of income
        - Waiting periods of 15 to 30 days are typical
        - The waiting period begins at the time of the loss
        - The insured must make reasonable efforts to ensure timely reporting of a loss event

- BI covers the actual loss sustained during the period of restoration
  - The period of restoration begins after direct physical loss occurs, and ends, generally, when repairs have been completed
  - The most common coverage is for 12 months of BI
  - The BI payments continue even if the policy expires during the term of those payments
- Extended Period of Indemnity (EPI)
  - An aspect of BI that provides additional loss payment after repairs have been completed
  - In general, EPI works to fill the income gap between the time a Property brings units back online, and the time those units become leased
  - EPI periods can range from one month to 365 days, with 90 days being standard for policies insuring multifamily properties
  - EPI is common, but not standard, and Freddie Mac requires a 90-day EPI only for loans with a UPB greater than $50M