REDACTED

Federal Housing Finance Agency
Office of Inspector General

FHFA Has Taken Supervisory Actions to Address Multifamily Risk Management Deficiencies at Freddie Mac, but Current Market Conditions Present Challenges

This report contains redactions of information that is privileged or otherwise protected from disclosure under applicable law.

Evaluation Report • EVL-2025-002 • March 6, 2025

EXECUTIVE SUMMARY

PURPOSE

The Federal Housing Finance Agency (FHFA or Agency) is responsible for, among other things, the supervision of Fannie Mae and Freddie Mac (collectively, the Enterprises). FHFA's Division of Enterprise Regulation (DER) conducts examinations and performs ongoing monitoring of the Enterprises to assess their safety and soundness.

We conducted this evaluation to assess FHFA's supervisory actions regarding Freddie Mac's multifamily line of business. We focused on DER's efforts to ensure Freddie Mac addresses known risk management deficiencies, including adverse examination findings issued by FHFA.

RESULTS

We concluded that DER is taking supervisory actions to address multifamily risk management deficiencies at Freddie Mac. These deficiencies gave rise to (1) adverse examination findings between 2021 and 2023; (2) DER's downgrade of risk management of multifamily credit exposures from "generally satisfactory" to "needs improvement" after the 2023 annual examination cycle; and (3) DER's determination that the Enterprise's board of directors and management governance of model risk and multifamily risk management "needs improvement."

Management documents its corrective actions to address such findings in remediation plans, some of which require multiple years to complete. We observed that DER supervisory personnel required an interim plan from management that focused on corrective actions in the short-term as well, and required periodic reporting to DER. DER examiners monitor management's progress against remediation plans and make semiannual updates to the examination record.

DER has communicated its findings directly to Freddie Mac's Board of Directors (the Board) and obtained the Board's commitment to oversee management's corrective actions. Looking forward, DER expects to include multifamily risk management in the scope of the upcoming annual examination cycle.

While Freddie Mac's management implements corrective actions under the Board's oversight, the Enterprise's multifamily business continues to operate in market conditions that present challenges. Among other factors, multifamily loans originated prior to 2020 carry lower interest rates than current market rates, and it is uncertain whether those loans will be able to refinance at the higher market rates. In addition, industry-wide increases in repair and maintenance costs, which were not offset by corresponding rent growth, contribute to uncertainties over the impact of current conditions on the multifamily business and warrant DER's continued attention.

We made no recommendations in this report.

This report was prepared by Jacob Kennedy, Senior Investigative Evaluator; Jason Ramserran, Management and Program Analyst; and Joseph Colon, Program Analyst. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report. This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaoig.gov, and www.oversight.gov.

Kyle D. Roberts
Deputy Inspector General for Evaluations /s/

TABLE OF CONTENTS ....

ABBREVIATIONS

Board	Freddie Mac Board of Directors
DER	Division of Enterprise Regulation
Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
OIG	FHFA Office of Inspector General

BACKGROUND

FHFA's Supervisory Role

FHFA is responsible for, among other things, the supervision of the Enterprises. The Agency conducts supervision using a risk-based approach to identify risks, evaluate the effectiveness of risk management systems and controls, and assess compliance with applicable laws and regulations. FHFA's DER conducts examinations and performs ongoing monitoring of the Enterprises to assess their safety and soundness. This report focuses on FHFA's supervision of Freddie Mac's multifamily line of business.

Freddie Mac's Multifamily Business Is Operating in Challenging Market Conditions Without Adequate Capital

Freddie Mac fulfills its mission of providing liquidity to the mortgage market and supporting FHFA's affordable housing goals and conservatorship objectives by, among other things, purchasing and securitizing multifamily residential mortgage loans originated by lenders.[1] These activities expose the Enterprises to multifamily credit risk. That is, an Enterprise may incur credit losses if a multifamily borrower defaults or a counterparty fails to provide the agreed upon services. Freddie Mac's multifamily mortgage portfolio was $467 billion as of December 31, 2024.[2]

FHFA has noted "recent stress" in the commercial real estate sector overall, and "challenges" for the multifamily industry in particular.[3] FHFA's most recent report to Congress dated June 2024 noted elevated interest rates as a challenge to housing markets, and Freddie Mac's multifamily midyear outlook in July 2024 reported that multifamily mortgage rates increased 260 basis points (from 4.7 percent to 7.3 percent) between the first quarter of 2022 and the third quarter of 2023.[4]

---

[1] Multifamily housing refers to properties with five or more units and includes, for example, apartment buildings, senior independent or assisted living properties, student housing, cooperatives, and manufactured housing communities. *See generally*, OIG, *Fannie Mae and Freddie Mac in the Multifamily Market* (Sept. 7, 2017) (WPR-2017-002). See FHFA, *2023 Report to Congress,* for details on multifamily housing goals and conservatorship objectives. Freddie Mac's 2023 annual report and quarterly reports filed with the U.S. Securities and Exchange Commission provide additional details on the Enterprise's multifamily business practices, operating results, and capital position. See Freddie Mac, *2024 Annual Report (Form 10-K)*, for the most recent annual report.

[2] Freddie Mac, *2024 Annual Report (Form 10-K)*, at 3. For details regarding Freddie Mac's multifamily business line, see the Enterprise's 2024 *Form 10-K* and the Enterprise's website, Multifamily—Freddie Mac.

[3] *See* FHFA, *2023 Report to Congress*, at 3 and 16 (June 14, 2024).

[4] *See* Freddie Mac Multifamily, *2024 Midyear Multifamily Outlook,* at 5 (July 23, 2024). From March 2022 through July 2023, the Federal Reserve Board of Governors raised the federal funds rate eleven times by a total of 525 basis points or 5.25 percent. For more information, see Board of Governors of the Federal Reserve System (Dec. 18, 2024).

Rent growth in the multifamily sector is slowing and property expenses are increasing at a faster pace, causing operating income growth to decline.[5] Freddie Mac believes these factors together contribute to uncertainties that maturing loans will be able to refinance into loans at current, higher market rates.[6] Refinancing stress poses a risk to Freddie Mac as it could result in delinquencies and defaults at loan maturity.

According to FHFA, Freddie Mac does not meet FHFA's regulatory capital requirements and lacks adequate capital to support the risks associated with its business.[7] This deficient capital position limits the Enterprise's ability to absorb unexpected losses and increases the need for effective internal controls and processes.

DER Identified Multifamily Risk Management Deficiencies at Freddie Mac During the 2021-2023 Annual Examinations

During the 2021 annual examination cycle, DER examined a model used in multifamily risk management decisions. While examiners described Freddie Mac's multifamily risk management as [redacted] after the 2021 annual examination cycle, DER issued adverse examination findings.[8] DER also determined that certain risk management practices [redacted].[9]

DER examiners found additional deficiencies during the 2022 annual examination cycle. The scope of that examination cycle included Freddie Mac's multifamily loan acquisition process and underwriting standards. DER found, in pertinent part, that management [redacted]. DER downgraded its prior internal supervisory assessment of the quality of multifamily risk management after completing

[5] *See* Freddie Mac Multifamily, *Multifamily Maturity Risk*, at 4 (Jan. 2024).

[6] Multifamily loans typically have shorter terms than single-family mortgages and can have sizable balloon payments due at maturity. Multifamily borrowers may refinance at loan maturity to avoid the lump sum balloon payment. For more information, see OIG, *Fannie Mae and Freddie Mac in the Multifamily Market*, at 5 (Sept. 7, 2017) (WPR-2017-002).

[7] *See* FHFA, *2023 Report to Congress*, at 16 (June 14, 2024). For more information about FHFA's regulatory capital requirements and framework, see FHFA's capital regulations at 12 C.F.R. Part 1240.

[8] According to FHFA's Advisory Bulletin 2017-01, *Classifications of Adverse Examination Findings*, adverse examination findings "...are typically risk management deficiencies, increases in risk exposures, or violations of laws, regulations, or orders that affect the performance or condition of a regulated entity...." Throughout this report we use the term "deficiencies" consistent with this language.

[9] DER applied relevant standards from FHFA's Prudential Management and Operations Standards. For further information on these standards, see generally 12 C.F.R. Part 1236.

the 2022 examination cycle. The downgrade was also based on the Enterprise's shift to a [redacted].[10]

The scope of DER's 2023 annual examination cycle included the multifamily business's capacity to take and manage risk, model risk management, and credit risk transfer. DER issued [redacted] adverse examination findings and concluded, among other things, that certain Freddie Mac [redacted]. At the completion of the annual examination cycle, DER maintained its prior internal supervisory assessment of multifamily risk management. FHFA reported to Congress in June 2024 that Freddie Mac's Board and senior management's governance "needs improvement" in the oversight of multifamily risk management.[11] FHFA also reported that risk management of multifamily credit risk exposures was downgraded to "needs improvement."[12]

OBJECTIVE AND SCOPE ....

The objective of our evaluation was to assess FHFA's supervisory actions regarding Freddie Mac's multifamily line of business, with a particular focus on DER's efforts to ensure Freddie Mac addresses known risk management deficiencies, including adverse examination findings issued by FHFA. The scope of the evaluation included the annual examinations DER conducted during 2021, 2022, and 2023 related to the multifamily line of business. The scope also included DER's actions to address the practices that led DER to downgrade its opinion of the quality of multifamily risk management.

RESULTS ....

DER Increased Supervisory Activities and Continues to Monitor Freddie Mac's Remediation of Examination Findings

We concluded that DER is taking supervisory actions to address multifamily risk management deficiencies. These deficiencies gave rise to (1) adverse examination findings between 2021 and 2023; (2) the downgrade in risk management of multifamily credit exposures from "generally satisfactory" to "needs improvement" after the 2023 annual examination cycle; and (3) DER's

---

[10] The Freddie Mac Board obtained FHFA's approval to adopt [redacted] multifamily business plan. According to FHFA instructions, a decision is required for "changes to or removal of board risk limits that would result in an increase in the amount of risk that may be taken by the Enterprise." *See* OIG, *FHFA Letters of Instruction to the Enterprises*, at 14 (July 23, 2018) (WPR-2018-004). The new business plan required FHFA to lift certain risk limits that applied to the multifamily business.

[11] *See* FHFA, *2023 Report to Congress*, at 17 (June 14, 2024).

[12] *Id.* at 16.

determination that the Enterprise's board of directors and management governance of model risk and multifamily risk management "needs improvement."[13] DER brought the results of its supervisory activities (e.g., targeted examinations and ongoing monitoring activities) and adverse examination findings to the attention of the Board and management. Additionally, DER is taking action to monitor remediation and management's corrective actions.

DER's Engagement with Freddie Mac's Board

During successive years, examiners identified risk management deficiencies, and DER issued examination findings that brought them to the attention of Enterprise management and the Board.[14] Management submitted remediation plans to DER for each adverse examination finding for review. DER reviewed the plans and provided feedback to management. In certain instances, DER's feedback resulted in changes to the remediation plans that addressed examiner concerns. Management is in the process of implementing the plans, and examiners monitor management's progress.

In May 2024, DER engaged with the Board and emphasized the need to provide additional oversight of management in its efforts to make improvements in multifamily risk management. DER discussed the results and conclusions of its 2023 annual examination with the Board and noted that certain multifamily risk management practices [redacted]. DER supervisory personnel further informed the Board that significant improvement in multifamily risk management was necessary during 2024 to avoid a management rating downgrade.

The Board acknowledged the severity of DER's findings and committed to provide additional oversight. The Board expects the changes will lead to a "transformational" shift in how the Enterprise manages multifamily risk.

DER's Increased Examination Activities

We previously acknowledged that DER increased supervisory activities to assess the Enterprises' respective risk profiles more accurately and more closely monitor the conditions that led to the downgrade in multifamily risk management.[15] In 2024, DER identified the multifamily business segment as an "area of focus for 2024…stemming from weakness identified in the 2023 exam

---

13 *See* FHFA, *2022 Report to Congress*, at 14 (June 15, 2023); FHFA, *2023 Report to Congress*, at 16 and 17 (June 14, 2024).

14 In 2021, DER cited Freddie Mac's [redacted]. DER also found deficiencies in the Enterprise's [redacted].

15 *See* OIG, Fiscal Year 2025 Management and Performance Challenges, at 3 (Oct. 4, 2024).

cycle and challenging market conditions." DER conducted at least five supervisory activities in 2024 related to the multifamily business segment. DER officials informed us that examiners will continue to conduct targeted examinations as part of the 2025 annual examination cycle to enhance their understanding of the risk landscape.

DER's Ongoing Remediation Efforts

DER has been monitoring Freddie Mac management's progress in remediating all examination findings from the 2021-2023 examination cycles. DER advised us that Enterprise management was on track to complete remediation of the 2021 examination finding by December 2024 in accordance with applicable remediation plans. DER will assess remediation during the 2025 examination cycle.

Also in 2024, DER required a step related to the remediation of an adverse examination finding not called for in its exam guidance. Specifically, DER required Freddie Mac management to prepare an "interim plan" within a three-month time period "[g]iven the identified [redacted] of Freddie Mac's [redacted]." The interim plan, among other things, required multifamily management to identify and communicate to FHFA appropriate interim actions it will take to ensure that the Enterprise does not assume an excessive level of multifamily risk.

Uncertainties Over the Impact of Market Conditions on Freddie Mac's Multifamily Credit Risk and Risk Management Warrant FHFA's Continued Attention

During our field work, DER leadership described the condition of multifamily risk management to be stable and not deteriorating. That said, DER is aware that Freddie Mac's remediation plans include deliverable dates that extend beyond 2025.

DER has also identified uncertainties and challenges that could adversely impact Freddie Mac's multifamily business and its ability to manage the risks to its multifamily business in the near term. The following topics are outside the scope of this evaluation but are germane to DER's future supervisory activities:

- There is increased risk that multifamily loans maturing in 2025 will face difficulty refinancing because current market interest rates are significantly higher than the original loan rate.[16] Additionally, industry-wide increases in operating expenses, which were not

[16] In 2023 and 2024, Freddie Mac reported it built up its credit reserve for multifamily "due to increased uncertainty in forecasted economic conditions and multifamily market conditions," in addition to "deterioration in overall loan performance and new loan purchases." *See* Freddie Mac, *Third Quarter 2023 Report (Form 10-Q)*, at 8 (Nov. 1, 2023); Freddie Mac, *2024 Annual Report (Form 10-K)*, at 46.

offset by corresponding rent growth, contribute to uncertainties over the impact of current conditions on the multifamily business.

- The Enterprise's remediation of DER's findings pertaining to [redacted] must be completed by the latter part of 2025. It is our view that it is unclear at this time whether those [redacted] will change meaningfully after management has updated the Enterprise's methodology.

- The potential impact of fraud on the multifamily portfolio is not fully understood at this time. Fraud-related events in 2023 prompted Freddie Mac to review and update multifamily policies and processes, and in 2024 Freddie Mac announced policy enhancements to strengthen underwriting due diligence and help deter fraud. Examples include requiring property inspections for more units, additional documentation for lease audits to confirm actual tenant payments, and additional appraisal review and appraisal independence requirements.[17] DER examiners have issued adverse examination findings during the 2024 annual examination that pertain to [redacted] practices. The future financial impact, if any, on Freddie Mac's multifamily business results is uncertain at this time.

Based on our results, we made no recommendations in this report.

FHFA COMMENTS AND OIG EVALUATION................................

We provided FHFA an opportunity to comment on a draft of this evaluation report. FHFA management provided technical comments on the draft report, which were considered in finalizing this report.

[17] *See* Freddie Mac, Multifamily Enhances Policies to Strengthen Due Diligence, Deter Fraud and Reduce Risks (Apr. 15, 2024).

APPENDIX I: METHODOLOGY………………………………………

To meet our objective, we:

(1) Reviewed reports of examination to understand the multifamily risk management deficiencies and emerging risks at Freddie Mac;

(2) Interviewed FHFA officials to:

  (a) Discuss actions the Agency is taking to address the risk management deficiencies that caused DER to downgrade Freddie Mac's multifamily risk management; and

  (b) Obtain DER's assessment of Freddie Mac's progress in addressing multifamily risk management deficiencies; and

(3) Reviewed relevant work products and workpapers from the multifamily-related ongoing monitoring activities and targeted examinations completed in the 2021, 2022, and 2023 examination cycles.

This evaluation was conducted between April 2024 and November 2024 under the authority of the Inspector General Act and in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation* (December 2020).

Federal Housing Finance Agency
Office of Inspector General

To report potential fraud, waste, abuse, mismanagement, or any other kind of criminal or noncriminal misconduct relative to FHFA's programs or operations:

- Call: 1-800-793-7724
- Fax: 202-318-0358
- Visit: www.fhfaoig.gov/ReportFraud
- Write: FHFA Office of Inspector General
  Attn: Office of Investigations – Hotline
  400 Seventh Street SW
  Washington, DC 20219