



**HGI**  
**WHITE PAPER**

Freddie Mac K Series Bonds:  
The Due Diligence Process



# EXECUTIVE SUMMARY

Harbor Group International, LLC (“HGI”) is the leading acquirer of Freddie Mac B-piece bonds, and one of the very few companies qualified to acquire these loan pools from Freddie Mac. HGI earned this distinction thanks to its robust national multifamily platform, almost four decades of operating experience in the sector, and deep equity resources to acquire these bonds. HGI employs a thorough and intensive due diligence process which creates an advantage we believe few competitors are capable of replicating.

HGI has been refining this process since it first began acquiring Freddie Mac bonds with the purchase of the “KF08” pool in 2015. The process seeks to thoroughly qualify each loan and its underlying asset, using every resource available. The ultimate goal is to create the best conditions for a stable loan pool in order to optimize returns for investors.

In this White Paper, we will provide insight into our due diligence process from start to finish, in order to give a thorough understanding of the robust team effort that goes into each successful transaction.

## TOP FREDDIE MAC B-PIECE BUYER

HGI and Freddie Mac’s longstanding, multidisciplinary relationship generates opportunities in both B-Piece investments and financing transactions.

### Freddie Mac B-Piece Buyer Rankings<sup>1</sup>

Buyers	2022	2021	2020	Total
Harbor Group International	10	9	9	28
Morgan Properties	6	8	10	24
Kayne Anderson Real Estate	6	7	6	19
Berkshire Group	6	6	6	18
Bridge Investment	3	7	7	17

1. Source: Commercial Mortgage Alert. Data as of 12/31/2022. CMA table figures represent total sizes of deals, which are shown by risk-retention structure. Excludes rake bonds.



# DUE DILIGENCE PROCESS

HGI employs a four-part due diligence process for each bond investment which takes place over a period of approximately 75 days, so that all possible information is gathered before the transaction proceeds. HGI's track record continues to enhance this process as the company often has direct experience acquiring, owning, or managing assets in the same market as the assets under due diligence.

## 1. Desktop Underwriting

Research begins at the desktop level, where we evaluate multiple financial and quantitative metrics. Close attention is paid to debt yield, DSCR, LTV, interest-only periods, seasoning, asset age, the sponsor's business plan, the quality and reputation of the sponsor, and the loan term. The goal is to gather as much detail as possible from data available to us.

HGI has access to in-house data on more than 500,000 apartment units throughout the U.S. due to its owned portfolio, credit investments and previous underwriting experience. This data is utilized alongside information that provides a picture of localized factors influencing an asset's performance. Our team also reads reviews posted on various relevant sites to gauge resident feedback on the on-site management and property reputation.

## 2. Site Visits

Even the most thorough desktop due diligence is no replacement for visiting an asset in person. HGI has a deep bench of experienced team members who tour each asset, speak to on-site management and evaluate the property's performance, paying close attention to the sponsor's business plan. The property's on-site management is evaluated and multiple factors are examined to see if the property is on track to meet the sponsor's business plan.

Additionally, on a different day, a representative of the HGI-designated special servicer visits certain assets. After visiting each asset, the HGI investment team and the special servicer will compose a detailed report on the site visit, outlining both risks and competitive advantages at each of the properties.

## 3. Stress Test/Exit Scenario Analysis

Once HGI's team has a thorough understanding of the sponsor's goals, the property's performance and the surrounding market, an underwriting stress test occurs. Each individual loan is evaluated in several hypothetical scenarios that include changes to vacancy, income, rents, interest rates, and expenses. The HGI team is looking to determine which properties are positioned to handle potential unexpected changes that may impact the business plan. Loans which HGI considers to be suboptimal performers in the stress test process are flagged for further review.

# DUE DILIGENCE PROCESS

## 4. Asset Rating Process

Upon completion of site visits and financial due diligence, each asset in the pool is rated based on its collective risk factors. All components of the due diligence process are carefully considered. HGI employs a three-color “stoplight” scale to rate the loans. Loans which HGI identifies as “red” or “yellow” will require careful attention going forward and may be candidates for removal from the pool. Properties in each loan pool that do not meet HGI’s exacting credit standards are removed from the pool. HGI’s long-term relationship with Freddie Mac is key to this process as the company has the right to negotiate with Freddie Mac to remove a certain number of loans from the pool based on credit quality.

## Conclusion and Results

HGI’s due diligence process has become a key competitive advantage to HGI as the company has the resources and the relationships necessary in order to perform such an extensive process on every transaction opportunity, which in turn improves

credit quality and helps mitigate risk for investors. To date, HGI has closed more than 60 transactions in 13 types of Freddie Mac bond pools. With each transaction, HGI’s market data continues to grow, providing HGI with valuable information which can be leveraged in all areas of the company’s business.

This effective due diligence process is one factor in the credit quality of HGI’s Freddie Mac bond portfolio. LTV’s on HGI bond purchases continue to decrease and HGI continues to diversify the types of bonds it acquires from Freddie Mac. Given the limited availability of this investment product and HGI’s extensive experience, HGI expects to continue to grow its Freddie Mac bond portfolio in both size and diversity.

HGI is proud to be able to provide the Freddie Mac bond product to investors, as part of a diverse multifamily investment portfolio that includes direct real estate, preferred equity & mezzanine loans, whole loans and ground-up development funding.

## HARBOR GROUP INTERNATIONAL, LLC

HGI and its affiliates control an investment portfolio of ~\$20 billion<sup>1</sup> including 5 million square feet of commercial space throughout the United States and the United Kingdom and 58,000 apartment units<sup>2</sup> in the United States. In addition to its corporate headquarters in Norfolk, Virginia, HGI maintains offices in New York City, Baltimore, Los Angeles, and Tel Aviv.

<sup>1</sup>As of 6/30/2023. AUM represents the total capitalized value of underlying assets, which includes direct and indirect real estate and real estate related investments, and the AUM of HGI’s affiliate, HGI Capital Management, LLC.

<sup>2</sup>Includes multifamily direct and preferred equity investments.



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