

A Letter From

Jerome Lienhard
Senior Vice President, Global Debt Funding

Dear Freddie Mac Investor,

Over the past six months members of our Investor Relations team have met with several hundred investors in cities across North America as well as in more than a dozen European and Asian countries. Despite the variety of institutions and investment strategies, our team reports great similarity among the questions posed by our investors.

Generally speaking, past investor discussions focused on trends in the capital markets and the performance of our securities. More recently, however, our investors have begun asking specific questions about the U.S. housing market and Freddie Mac's strategies and market position.

From my perspective this shift is good news. When investors ask the "tough questions" about the fundamentals of our business, it is a sign that our securities have become an important part of their overall investment strategy.

Because we are committed to giving you the information you need to make an informed decision, I've asked colleagues from across the company to address the questions we hear most often. ■



Questions From Our Investors

Question:
Are you concerned about a "housing bubble" in the United States?

Frank E. Nothhaft
Chief Economist

Home price growth has been strong in the U.S. during the past few years. In 2001, for example, the average single-family home appreciated 7 percent. Gains like this have prompted some to speculate that a housing price bubble is in the making, and that it may pop if the recovery stalls. However, strong growth in asset prices does not necessarily suggest a price bubble, and declines in home values in some local markets, like California's Silicon Valley, does not prove that a bubble has burst. In fact, the last time the average house price fell year-over-year in the U.S. was more than 60 years ago, when the nation was still in the grips of the Great Depression. In contrast, this year we have emerged from the shallowest recession in U.S. economic history.

Today's housing prices are driven by economic fundamentals, and overall they continue to remain strong:

This Issue

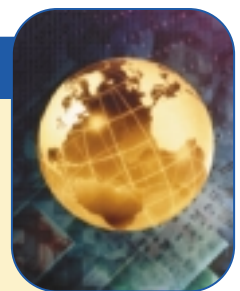
Are you concerned about a "housing bubble" in the United States?

With such a strong housing market and low interest rates, what kind of growth can we expect from Freddie Mac?

How would you describe the current political climate?

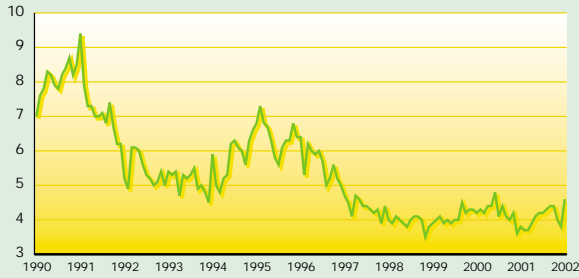
What role do derivatives play at Freddie Mac?

How has the recession affected Freddie Mac's credit results?



New Home Inventories Are Exceedingly Lean

Months Supply of New Homes for Sale

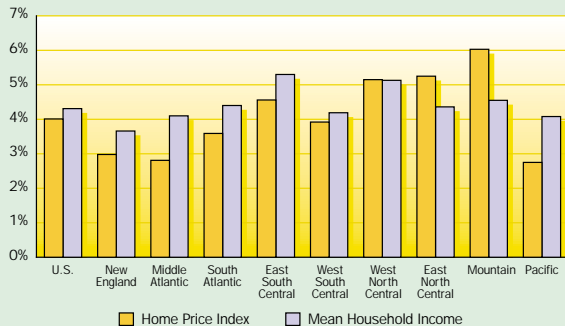


Source: Bureau of Census

- Household incomes are growing. Over the past decade, incomes have grown 4.5 percent, while home price growth averaged 4 percent.
- The inventory of unsold homes is at one of the lowest levels since Freddie Mac was chartered in 1970—there is no overbuilding that would contribute to a decline in house prices.
- And mortgage affordability remains high, thanks to continuing low interest rates.

Home Value Growth Has Been in Line With Income Growth

Annualized Growth Rate Over 1990-2000



Source: Freddie Mac and Census Bureau

The outlook for the next decade is very bright for growth in the housing market. Population growth and changing demographics will lead to more households. The mortgage market will grow as families finance a greater percentage of the value of their homes and large numbers of first-time buyers enter the market.

Clearly, Freddie Mac is at the center of a market that is well positioned for sustaining strong, steady growth. Current forecasts indicate that by the end of the decade consumers will buy 64 million homes. To finance those homes, consumers will borrow \$14–16 trillion in mortgage loans by 2010. And we will be there to help fund those loans. ■

Question:

With such a strong housing market and low interest rates, what kind of growth can we expect from Freddie Mac?

Vaughn Clarke
Chief Financial Officer

Freddie Mac has grown earnings consistently in a variety of economic environments, including those characterized by rapid rate increases and substantial interest rate declines. For example, while interest rates have shown considerable volatility since 1993, changing over a 400 basis point range, our earnings have grown consistently at nearly a 20 percent per annum rate during that period.

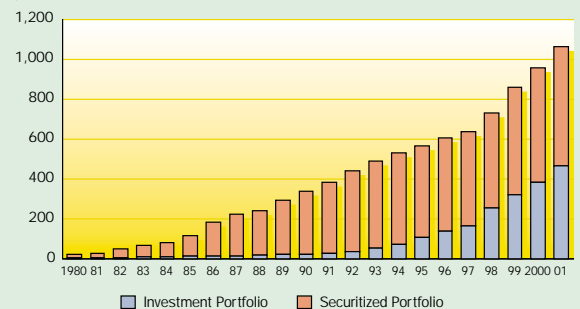
Freddie Mac's retained portfolio has been an excellent source of growth. We grow it opportunistically, investing in mortgages only when they meet our return requirements and we can prudently manage the interest-rate risk. Our goal is to generate strong and durable returns.

Since we began building our retained portfolio in 1994, we have enjoyed steady and consistent growth. In April of this year, however, the portfolio declined in size for the first time ever on a monthly basis, and it declined again in May. This resulted from a combination of tightening mortgage spreads, continued demand from other mortgage investors, and increasing refinance volumes.

Nonetheless, we expect this decline to be temporary. Demand for mortgages is expected to remain very strong and we expect mortgage debt outstanding to grow between 7 and 9 percent over the next decade. Our retained mortgage portfolio represents approximately 9 percent of conforming mortgage debt outstanding, demonstrating we have ample room to grow. ■

Freddie Mac's Portfolio Growth Has Been Strong and Steady

\$US Billions



Source: Freddie Mac

Question:

How would you describe the current political climate?

Jill Showell

Vice President, Government Relations

Policymakers in both major parties support Freddie Mac's public mission of supporting and expanding homeownership, and they understand the vital role we play in making lower-cost mortgage credit available to American families.

In both the Congress and the White House, Freddie Mac enjoys strong support for our housing mission. In fact, on June 17, Freddie Mac joined President Bush to announce a major initiative to substantially increase homeownership among minority families. At this announcement, the President recognized that Freddie Mac is important to achieving the Administration's goal of increasing minority homeownership rates, and he will be looking to us to help put an additional 5.5 million minority families in their own homes by the end of the decade. To help achieve this goal, Freddie Mac announced 25 initiatives that we will undertake with the Administration and industry partners to help minority families overcome a variety of barriers to homeownership.

In both the Congress and the White House, Freddie Mac enjoys strong support for our housing mission.

In Congress, virtually no support exists for changing the role of Freddie Mac in the housing finance system, or substantially changing our regulatory oversight. We expect oversight hearings in July that will generate discussion of our risk-based capital guidelines, our financial

disclosures and how well we are meeting our public mission. However, we do not expect anything of substance, or any legislative activity, to emerge from these hearings.

To be sure, we will continue to see occasional attacks from our detractors that will generate some negative headlines, but these attacks have not translated into substantive political risk, and have not impeded our ability to meet our mission. We remain fully committed and focused on making homeownership a reality for increasing numbers of Americans. ■

Question:

We have read a great deal about the consequences of the speculative use of derivatives. What role do derivatives play at Freddie Mac?

Nazir Dossani

Senior Vice President, Funding and Investments

Derivatives enable Freddie Mac to provide long-term fixed-rate mortgages to American homebuyers. We use them

to preserve value and to reduce the credit and interest rate risks in our mortgage portfolio. We most certainly do not use derivatives to speculate, nor do we trade derivatives to make profits.

Freddie Mac Uses The Most Basic Types of Derivatives

Reason for use of derivatives	Risks being hedged	Principle derivatives used	Notional amount as of 12/31/2001*
Lengthen debt maturity	Duration	Pay-fixed swaps	\$248 Billion
	Yield Curve	LIBOR futures and options	\$346 Billion
Shorten debt maturity	Duration, Yield Curve	Receive-fixed swaps	\$165 Billion
Reduce exposure to homeowner prepayment risk	Negative Convexity, Volatility	Swaptions	\$180 Billion
Eliminate foreign currency exchange risk	Foreign Exchange	Foreign currency swaps	\$44 Billion
Other			\$69 Billion
Total			\$1,052 Billion

* Notional amount reflects the reference amount from which the contractual payments on the derivative are calculated; it is not the amount at risk.

Those who know and understand our use of derivatives—our regulator and Wall Street analysts—all say that we use them in a responsible manner to reduce risk, not increase it. We use straightforward types of derivatives, such as exchange-traded options, Eurodollar futures, and over-the-counter interest rate swaps and swaptions.

The derivative markets are extremely deep. The total notional value of both the OTC and exchange-traded derivative markets is estimated at approximately \$120 trillion. As of year-end 2001, the notional amount of Freddie Mac's derivative position was approximately \$1 trillion—significantly less than 1 percent of the total market.

We only deal with high-quality derivative counterparties. Freddie Mac performs regular credit reviews on all our counterparties and uses both rating agency and internal ratings to set exposure limits. We do business with 25–30

counterparties. Our top five counterparties represent approximately 60 percent of outstanding notional amounts. Freddie Mac employs master netting agreements to limit counterparty exposure and we mark-to-market our positions daily. Counterparties generally provide collateral in the form of cash or Treasury securities in a dollar amount equal to our net exposure. Collateral is held and valued by an independent third-party trustee.

Our exposure, net of collateral, was \$69 million as of December 31, 2001, or less than 1 percent of the notional amount outstanding. We have never incurred any credit losses on any of our derivative positions.

We use them (derivatives) to preserve value . . . to reduce credit risk and interest-rate risk in our mortgage portfolio.

Derivatives-Related Disclosures Reflect The Benefits Of Our Strong Process

The table below shows one of our new Annual Report disclosures, which provides considerable counterparty, market value and net exposure information.

Table 15 - Derivative Counterparty Credit Exposure
December 31, 2001

Rating (dollars in millions)	Number of Counterparties	Notional	Exposure at Fair Value	Exposure, Net of Collateral
AAA	2	\$ 62,274	\$ 0	\$ -
AA+	1	615	80	3
AA	5	168,730	393	26
AA-	13	260,599	558	40
A+	2	76,945	5	-
A	3	92,332	655	-
A	3	92,332	655	-
A-	1	190	-	-
BBB+	1	96	2	-
Total OTC derivatives	28	\$ 661,781	\$1,693	\$ 69
Exchange-traded derivatives		390,613		
Total derivatives		\$1,052,394		

I also want to emphasize that Freddie Mac is a leader in providing timely, comprehensive and transparent disclosure on our use of derivatives, which is both widely understood and appreciated by the capital markets. In fact, we recently issued our 2001 Information Statement, an annual report which includes new, in-depth disclosures about our use of derivatives, risk counterparties, and other risk management practices. ■

Question:

How has the recession affected Freddie Mac's credit results?

Robert Tsien
Senior Vice President and Chief Credit Officer

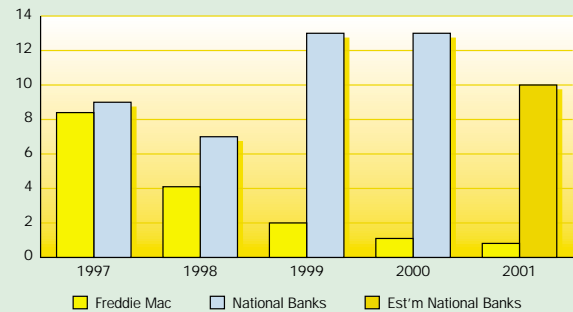
The recession is having only a very marginal impact on the credit quality of our portfolio. The first and most important thing to understand is that Freddie Mac deals in home mortgages, backed by significant borrower equity. Over time mortgages have proven to be among the safest asset classes because borrowers are less likely to default on their home mortgages than other types of loans.

To manage credit risk, we have a singular focus on residential mortgages, access to decades of information on 28 million single-family loans and a team of mortgage professionals that give us an unparalleled understanding of this asset class. Freddie Mac is also using technology to monitor loan performance over time. Today, we can identify the small proportion of loans that become delinquent sooner, and we can act quickly to mitigate risk. A loan that is modified through our loss mitigation process has about 20 percent of the losses of a loan that goes into foreclosure.

Freddie Mac's expertise in understanding and managing loan quality is why our credit performance is among the best in the industry. Freddie Mac's delinquency rates are

Our Credit Performance Has Been Stellar

Credit Losses In Basis Points of Total Portfolio



Source: National Bank Credit Loss Data - OCC's Quarterly Journals; national bank credit losses are calculated based on 1-4 family residential mortgage loans. 2001 data will be available 3Q2002

one-third lower than industry delinquency benchmarks. Our credit losses in 2001, in relation to our asset portfolio, amounted to only six-tenths of a basis point, which is pretty remarkable. In comparison, credit losses for U.S. commercial banks amounted to about 83 basis points.

So when you buy a Freddie Mac security, you're buying an asset backed by a company that is the best in the business at managing the risk of what is overall a very safe class of assets. ■

For More Information

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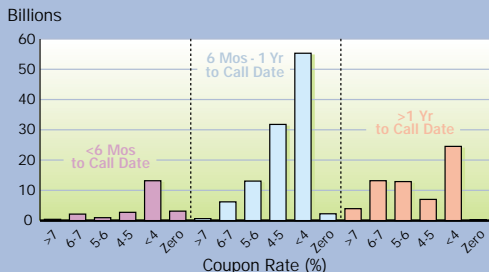
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Data Bank

Discount Notes and Reference Bills* Issued as of June 30, 2002

Maturity	2nd Qtr 2002 Par Amount Issued (billions)	YTD Par Amount Issued (billions)
< 1 Month (ex. Overnights)	37.44	110.12
1-2 Months	28.16	67.31
2-3 Months	1.51	3.29
3-6 Months	49.72	100.50
6 Months - 1 YR	21.60	52.07
TOTAL	\$138.44	\$333.29

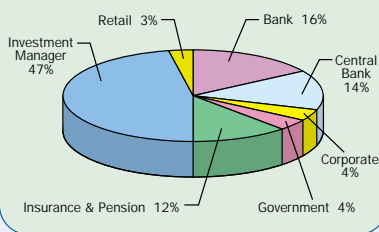
Callable MTNs Outstanding as of June 30, 2002



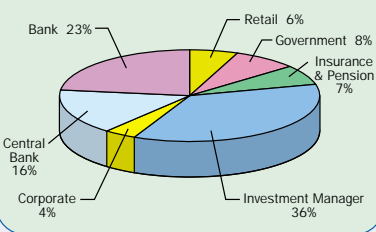
Maturity	Callable MTN O/S (billions)
1-3 YRS	56.7
3-5 YRS	33.3
5-10 YRS	27.9
> 10 YRS	54.9
TOTAL	\$172.8

through June 30, 2002

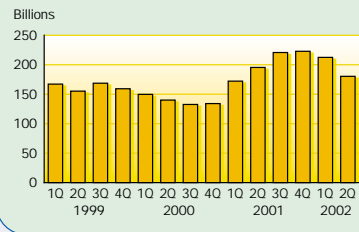
Reference Notes* Investor Distribution (ex. auctions)



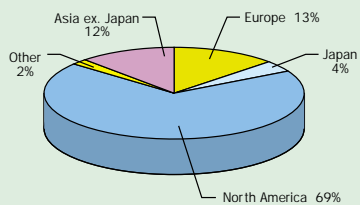
Syndicated Callable Investor Distribution



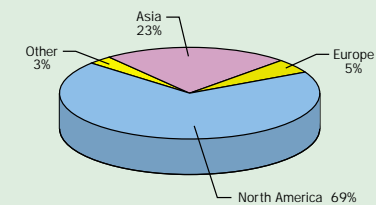
Discount Notes and Reference Bills Outstanding as of June 30, 2002



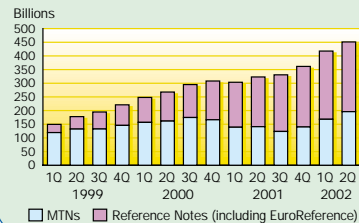
Reference Notes Geographic Distribution (ex. auctions)



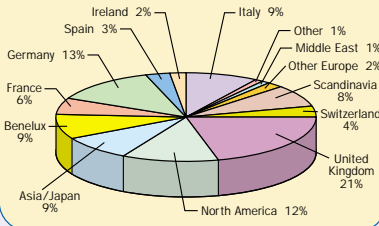
Syndicated Callable Geographic Distribution



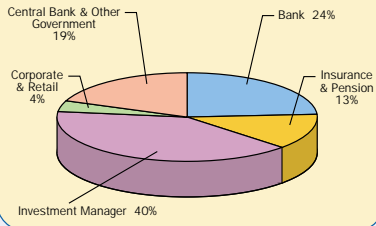
MTNs and Reference Notes Outstanding as of June 30, 2002



€Reference NotesSM Geographic Distribution



€Reference Notes Investor Distribution



€Reference Notes Outstanding as of June 30, 2002

Structure	Amount Outstanding	ISIN
3-Year 4.5% of 3/15/2004	€7.5 billion	XS0125902451
3-Year 4.63% of 5/15/2005	€5.0 billion	XS0146883581
5-Year 5.25% of 1/15/2006	€5.5 billion	XS0121336266
5-Year 4.63% of 2/15/2007	€5.0 billion	XS0142391209
10-Year 5.75% of 9/15/2010	€5.25 billion	XS0117858323
10-Year 5.13% of 1/15/2012	€5.0 billion	XS0136341814

For More Information

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