

## RISK MANAGEMENT

Our business of purchasing mortgages and mortgage-related securities, funding these purchases and guaranteeing the payment of principal and interest on the mortgage-related securities we issue exposes us to three broad categories of risk: operational risks, market risk, and credit risk. Managing these risks is a critical function for us as our effectiveness influences our ability to accomplish our mission as well as the level and stability of our earnings and long-term value. Our strategies for managing operational risks, market risk, and credit risk are based upon the principle that risk should be understood, measured and managed directly by our business areas, with appropriate, independent oversight.

### Risk Oversight

We oversee business area management of operational, market and credit risks through our Enterprise Risk Oversight group led by the Chief Enterprise Risk Officer, who reports directly to the Chief Executive Officer. The Chief Enterprise Risk Officer provides advice to senior management on key risk management issues and provides reporting on risk matters to the Audit Committee of the Board of Directors. Within the Enterprise Risk Oversight function, the Operational Risk Oversight group, the Market Risk Oversight group and the Credit Risk Oversight group each provide independent oversight. Oversight of our financial reporting processes and internal controls occurs through the Chief Financial Officer. The Chief Financial Officer provides overall guidance on the internal controls framework and communicates an assessment of internal controls to senior management and the Audit Committee of the Board of Directors on a regular basis. The Chief Financial Officer has established an internal controls organization to oversee the adequacy of internal controls across the enterprise.

Our Internal Audit and Corporate Compliance Divisions play key roles in our risk oversight process. Internal Audit assesses whether our risk management, control and governance processes are adequate and functioning effectively. Corporate Compliance helps ensure that we comply with statutory and regulatory requirements, and related corporate policies that govern our business activities. Internal Audit reports to the Audit Committee. The Chief Compliance Officer reports directly to the Chief Executive Officer and provides reports on compliance matters to the Audit Committee.

The Board of Directors oversees risk management through the Audit Committee, the Finance and Capital Deployment Committee and the Mission and Sourcing Committee. An independent director chairs each of these Committees.

### Operational Risks

#### *Summary*

Operational risks represent the potential for financial loss resulting from failed or inadequate controls with respect to process, technology, people or external events. Operational risks are present in all of our business processes, including financial reporting. While we have made strides in remediating internal control weaknesses with respect to financial reporting, we have a significant number of internal control issues that have not been fully remediated and considerable challenges remain. Some of these control issues represent “material weaknesses” in our internal controls over financial reporting. We have detailed these material weaknesses and remediation activities in — “*Internal Controls over Financial Reporting*”. We have focused intense effort in 2004 on identifying and remediating control design issues; however, we may discover new control weaknesses as we complete our controls effectiveness testing effort which is currently underway.

Our process for managing operational risks is to identify, measure, remediate, and monitor all key sources of operational risks. To improve our ability to manage operational risks, we have undertaken a number of corporate initiatives. In 2004 we implemented corporate-wide ethics training; an enhanced employee hotline process for reporting concerns, including those relating to our financial reporting processes; a revised corporate disclosure policy; an enhanced Disclosure Committee; and a New Products Committee. We believe these initiatives have strengthened our entity-level control, and emphasized a “tone from the top” of strong integrity and ethical behavior.

*Freddie Mac*

A major corporate reorganization in early 2005 resulted in a functional organization structure with responsibilities for operations and technology under a new executive vice president position. We also completed a full integration of all financial accounting functions under the Chief Financial Officer to enable greater accountability and role clarity.

Finally, we have undertaken a key initiative to improve our capabilities to better measure our operational risks. We have defined an operational risks framework that we believe is consistent with the Basel II Advanced Measurement Approach scheduled to be adopted by large U.S. banks. See “BUSINESS — Regulatory and Governmental Matters — Other Regulatory Matters.” The framework includes common risk language, the operational loss event, tracking key risk indicators and control self-assessments. We believe that the implementation of this framework improves our operational risks management capabilities. We are in the early stage of a multi-year effort to fully implement the components of this framework.

### *Sources of Operational Risks*

**Process Risk.** Process risk includes transaction execution, modeling, and vendor management risk.

Transaction execution risk is mitigated through comprehensive product development processes, suitable approval authorities, data quality standards and identification and execution of control procedures. While we are exposed to the risk of loss from failure to develop or follow appropriate processes for our business transactions, process risk management enables us to fulfill our commitment to introduce new products and programs to improve homeownership opportunities for low- and moderate-income borrowers and to meet our customers’ needs. We have strengthened our controls over the new product process with the creation of a New Products Committee, designed to clearly identify the requirements for implementing all new product ideas.

We make significant use of business and financial models. In 2004, we strengthened our processes to validate assumptions, model code and theory. We have enhanced our oversight processes, including establishing a corporate function to focus on the key models used in management decisions and financial reporting. While controls over model risk have been enhanced, significant efforts remain with respect to controls over model applications. We plan to further remediate model oversight issues during 2005.

Vendor management is critical for us because we currently outsource to external parties certain key functions. These functions include processing functions for trade capture, market risk management analytics, asset valuation (Blackrock Financial Management, Inc.), and processing functions for mortgage loan underwriting (Electronic Data Systems Corporation). We may enter into similar outsourcing relationships in the same or other business areas in the future. If one or more of these key external parties were not able to perform their functions for a period of time or at an acceptable service level, there is a risk that our financial condition or results of operations would be adversely affected, perhaps materially. Our use of vendors also exposes us to the risk of a loss of intellectual property or a breach of confidentiality or other harm. We endeavor to mitigate these risks through detailed vendor requirements, active vendor management, legal contracts, business continuity planning, and third party review of vendors. In addition, to ensure the integrity of data used in financial reporting, we have implemented quality assurance processes valuations and processes performed by Blackrock.

**Technology Risk.** Technology risk includes the risk of inadequate or failed systems, inappropriate systems implementation and inadequate system security that allows unauthorized access to computer systems. We monitor computer security measures and applications and we use corporate information access policies and periodic access reviews to verify that only authorized personnel have access to our systems. We identified material weaknesses related to system security, change management and information technology application and general controls during our control reviews in 2004. These weaknesses related not only to financial reporting systems, but other business applications as well. Remediation efforts to correct these weaknesses began in 2004 and will continue through 2005. See “*Internal Controls over Financial Reporting*” for more information concerning internal control issues related to our systems.

We are making significant investments to build new financial reporting systems and to move to more effective and efficient business processing systems. During the transition period, however, we are more reliant on end-user computing systems than we prefer. End-user computing systems increase the risk of errors in

*Freddie Mac*

some of our core operational processes and increase our reliance on monitoring controls. In addition, changes in management controls for these systems required significant enhancement in 2004. We are mitigating this risk by improving our documentation and moving responsibility for key end-user systems to the Information Technology Group. See “— *Internal Controls over Financial Reporting*” for more information concerning end-user system issues and mitigation activities.

**People Risk.** People risk includes the risk of inadequate or unqualified staffing, as well as the risk of employee errors and internal fraud. We mitigate this risk at the entity-level through the use of professional recruiting staff, employee screening and targeted retention actions. At the business-unit level this risk is mitigated by employee training and development activities and supervisory review of staff. People risk was generally a significant risk during 2003 and, to a lesser extent, during 2004, with large staff additions in both the accounting and information technology areas to address financial reporting processes and control remediation. During 2003 and 2004, we also made extensive use of consultants. In the fourth quarter of 2004 the use of consultants began to decline significantly. This trend has continued in 2005, and while people risk is still elevated, it has begun to decline.

**External Event Risk.** We are exposed to the risk that a catastrophic event, such as a terrorist event or natural disaster, could result in a significant business disruption and an inability to process transactions through normal business processes. To mitigate this risk, we maintain and test a business continuity plan and have established backup facilities for critical business processes and systems away from, although in the same metropolitan area as, our main offices. In 2004, we began an effort to determine the feasibility of establishing an alternate site for critical business processes that has a separate power grid, labor pool and geographic location. We are in the early phases of this effort.

We are also exposed to the risk that our sellers or servicers misrepresent the mortgages they sell to us, or sell or service these mortgages in a manner inconsistent with our selling requirements or servicing guidelines, and as a result, adversely affect our income or asset values. We rely on a variety of preventative and detective controls to mitigate this risk. In particular, we use quality control reports and reviews, on-site audits and investigations of situations involving possible fraud to identify problems. We also require sellers and servicers to represent and warrant to us that the loans they sell to us or service for us meet our standards. We impose minimum net worth, insurance and other eligibility requirements to help ensure that our sellers and servicers have the capability and incentive to meet our standards. See “Credit Risks” and “BUSINESS — Predatory Lending” for more information on how we manage the risk of sellers and servicers.

### ***Internal Controls over Financial Reporting***

Improving internal controls over financial reporting and addressing material weaknesses were top priorities in 2004 and continue to be in 2005. As we are working to strengthen our control environment we focused on managing the operational risks related to inaccurate or incomplete financial reporting to our stakeholders. Throughout 2004, there were a number of material weaknesses and other control deficiencies in our internal controls over financial reporting that required our attention. They were:

- significant integration issues among numerous core business, accounting, and external service provider operations and over-reliance on end-user computing systems for certain major activities;
- inadequate controls over data input and systems limitations in financial processes;
- inadequate supervisory review of the preparation of journal entries in certain accounting units;
- end-user computing solutions with both insufficient documentation and change controls;
- inadequate staffing and systems to support the appropriate scope of independent price verification of financial instruments used in the preparation of financial statements;
- lack of formal change management and oversight processes over certain models used to support financial reporting;
- insufficient monitoring controls within financial operations and related reporting functions;

*Freddie Mac*

- insufficient documentation controls regarding roles and responsibilities related to certain data correction activities;
- technology implementation control deficiencies, including changes in management processes that allow access to production environments by developers; and
- access by some business end-users to production databases.

In order to compensate for these material weaknesses we have had to perform extensive verification and validation procedures to ensure our financial statements are fairly presented in accordance with GAAP. This work began with the completion of process documentation for our controls over financial reporting and an internal review to assess the design of internal controls over these processes. Our objective was to assess the quality of the controls design and to initiate substantive actions to improve any design weaknesses. This effort identified additional material weaknesses in our controls design related to:

- lack of documentation and evaluation of information technology general and application controls;
- weaknesses in certain processes surrounding the accounting for security impairment; and
- weaknesses in management's processes for identifying deficiencies in controls over financial reporting.

We undertook considerable work in 2004 to address the risks of the material weaknesses in our financial reporting processes. This work resulted in the risks related to many weaknesses either being fully remediated or reduced. However, as of the end of 2004, we still had several material weaknesses within our financial reporting controls. These weaknesses must be monitored closely and compensating procedures must be executed to ensure there is no material impact to our financial reporting. We continue to place considerable management emphasis on the development and execution of plans to reduce and eventually eliminate the risk associated with these remaining weaknesses. The remaining material weaknesses as of December 31, 2004 include:

- end-user computing controls;
- monitoring controls within financial operations;
- information technology general and application controls;
- management risk and control self-assessment process; and
- integration between Operations and Finance.

In 2004 the focus was on improving the controls design and in addressing design weaknesses in our financial reporting controls. We plan to remediate the existing material weaknesses described above by the end of 2005, except for the material weakness related to integration between Operations and Finance. For this weakness, we will apply risk reduction techniques in 2005, but do not expect to remediate fully until 2006. Further, we are addressing other control deficiencies that are not material weaknesses, as they still represent risks in our control environment.

The next step in our plan is to test the operating effectiveness of the controls over financial reporting. Controls testing will provide evidence that the controls are working as designed, or will indicate where we have deficiencies. Additionally, we are pursuing actions to fully document and test our entity-level controls and controls over third party vendors. Entity-level controls include components such as: our Code of Conduct, employee hotline, anti-fraud program and compliance program. Third party controls are those controls that ensure the information and services we receive from third party vendors are well controlled and meet our quality requirements.

There are continued risks to our financial reporting timeline as we strive to fully remediate the remaining material weaknesses and enhance our internal control environment. As we execute testing we may also encounter additional material weaknesses that we need to address. We manage these timeline and scope risks through a centralized internal controls and program management office with significant involvement of key executives.

*Freddie Mac*

## Interest-Rate Risk and Other Market Risks

We are exposed to the risk that changes in interest rates or in other market factors will adversely affect our cash flows, the fair value of net assets and/or future earnings. We take an active and disciplined approach to the management of these risks. Our disciplined approach to risk management is essential to generating fair value growth for stockholders in a wide range of interest-rate environments. Our interest-rate risk exposure results primarily from mortgage loans and mortgage-related securities held in our Retained portfolio and the liabilities funding this portfolio. To a lesser extent, we are also exposed to interest-rate risk through our credit guarantee activities.

### *Oversight of Interest-Rate Risk and Other Market Risks*

The purpose of the Market Risk Oversight group is to provide independent oversight of market risk, including interest-rate risk, and to enhance our market risk measurement and management capabilities so that they are consistent with industry best practice. Market Risk Oversight fulfills its mission by reporting to senior management concerning the key investment strategies and market risks taken throughout the corporation, the consistency of market risk positions with stated strategies and the appropriateness of limits and policies related to risk exposure. The Models and Methods group, also a part of the Enterprise Risk Oversight function, is responsible for independently assessing the design and adequacy of all key models, including prepayment models.

### *Sources of Interest-Rate Risk and Other Market Risks*

**Retained Portfolio.** Our Retained portfolio activities expose us to interest-rate risk and other market risks. This exposure results primarily from the uncertainty as to when borrowers will pay the outstanding principal balance of mortgage loans and mortgage-related securities held in the Retained portfolio, known as prepayment risk, and the resulting potential mismatch in the timing of our receipt of cash flows on our assets versus the timing of our obligation to make payments on our liabilities. For the vast majority of our mortgage-related investments, the mortgage borrower has the option to make unscheduled payments of additional principal or to completely pay off a mortgage loan at any time before its scheduled maturity date (without having to pay prepayment penalties) or to hold the mortgage to its stated maturity. The borrower's option makes the timing and amount of mortgage prepayments (and thus the timing and amount of mortgage cash flows received by us) very sensitive to changes in interest rates, among other factors.

The Retained portfolio comprises mortgage investments with a range of different characteristics, including different stated maturities, underlying collateral, principal and interest payment structures and prepayment patterns. To manage the interest-rate risk associated with this wide range of mortgage-related investments, we employ a risk management strategy that seeks to substantially match the duration characteristics of our assets and liabilities. We use various instruments, including short-term debt, callable and non-callable long-term debt and interest-rate derivatives, to mitigate the risk that mortgage investments may prepay faster or slower than expected.

The types of interest-rate risk and other market risks to which we are exposed through our Retained portfolio are described below.

- **Duration Risk.** Duration is a measure of a financial instrument's price sensitivity to changes in interest rates. We actively manage duration risk through asset selection and structuring (that is, by identifying or structuring mortgage-related securities with attractive prepayment and other characteristics), by issuing a broad range of both callable and non-callable debt instruments and by transacting in interest-rate derivatives.

We monitor duration against limits and reporting thresholds established by senior management and the Board of Directors. Our interest-rate sensitivity is estimated and reported through our PMVS and duration gap measures. These measures are estimated on a daily basis and publicly reported on a monthly basis. See "*Measurement of Interest-Rate Risk*" below.

*Freddie Mac*

Although duration risk has been maintained at relatively low levels as indicated by our PMVS and duration gap estimates (see “*Measurement of Interest-Rate Risk — PMVS and Duration Gap*”), fair value gains or losses will generally occur as market conditions change. For example, fair value gains or losses occur when our duration gap is positive or negative and the level of interest rates or shape of the yield curve changes.

- **Convexity Risk.** Convexity is a measure of how much duration changes as interest rates change. Convexity risk primarily results from mortgage prepayment risk. We actively mitigate this risk by maintaining a high percentage of callable debt and option-based derivatives relative to the fixed-rate mortgage assets held in the Retained portfolio.

We do not, however, hedge all prepayment option risk that exists at the time a mortgage is purchased or that arises over its life. For the portion of risk not hedged at the time of purchase, we undertake frequent rebalancing actions in order to keep our interest-rate risk exposure within our internal limits (see “*Use of Derivatives and Interest-Rate Risk Management — Use of Derivatives — Adjust Funding Mix*” below). Although convexity risks have been maintained at relatively low levels as indicated by our PMVS estimate (see “*Measurement of Interest-Rate Risk — PMVS and Duration Gap*”), fair value gains or losses will generally occur as market conditions change. For example, because we do not hedge all of the prepayment risk inherent in our mortgage investment portfolio, fair value gains or losses occur from changes in the relationship between interest-rate volatility expected at the time a mortgage loan is acquired and the volatility actually experienced (see “*Volatility Risk*” below for more information).

- **Yield Curve Risk.** Yield curve risk is the risk that non-parallel shifts in the yield curve (such as a flattening or steepening) will adversely affect our cash flows, fair value of net assets and/or future earnings. Changes in the shape, or slope, of the yield curve often arise due to changes in the market’s expectation of future interest rates at different points along the yield curve, including expectations regarding action by the Federal Reserve Board. For this reason, we evaluate our exposure to yield curve risk by examining potential reshaping scenarios at various points along the yield curve. Our yield curve risk under a specified yield curve scenario is reflected in our PMVS-Yield Curve, or PMVS-YC, disclosure.
- **Volatility Risk.** Volatility risk is the risk that changes in the market’s expectation of the magnitude of future variations in interest rates will adversely affect our cash flows, fair value of net assets and/or future earnings. The market’s expectation about the future volatility of interest rates, or implied volatility, is a key determinant of the value of an interest-rate option. Higher expected volatility implies a greater likelihood that the expected life of a mortgage asset will either extend or contract. For example, higher interest-rate volatility implies a higher likelihood that interest rates will decline to levels that make mortgage prepayments attractive to homeowners, thereby making their prepayment option more valuable and making our mortgage assets subject to their prepayment option less valuable. We manage volatility risk through asset selection and by maintaining a consistently high percentage of option-embedded liabilities (e.g., callable debt) and option-based derivatives relative to our mortgage assets. We monitor volatility risk by measuring exposure levels on a daily basis and we maintain internal limits on the amount of volatility risk exposure.
- **Basis Risk.** Basis risk is the risk that interest rates in different market sectors will not move in tandem and will adversely affect our cash flows, fair value of net assets and/or future earnings. This risk arises principally because we hedge mortgage-related investments with LIBOR- and Treasury-based interest-rate derivatives. We do not actively manage the basis risk arising from funding Retained portfolio investments with our debt securities, also referred to as mortgage-to-debt option-adjusted spread risk. See “*CONSOLIDATED FAIR VALUE BALANCE SHEETS — Key Components of Changes in Fair Value of Net Assets — Effect of changes in option-adjusted spread (mortgage-to-debt spread)*” for additional information. We also incur basis risk when we use LIBOR- or Treasury-based instruments in our risk management activities. We monitor the fair value fluctuations associated with these basis risks and manage this exposure

Freddie Mac

by adjusting our mix of LIBOR- and Treasury-based instruments and our debt in response to changes in the expected interest-rate relationships in these different markets. We monitor basis risk on a daily basis and maintain internal limits on the amount of basis risk exposure.

- **Prepayment Model Risk.** Prepayment model risk is the risk that actual mortgage prepayment behavior will differ from the prepayment behaviors we forecast using our proprietary internal models and will adversely affect our cash flows, fair value of net assets and/or future earnings. These models are used to determine the estimated duration and convexity of mortgage assets for our PMVS and duration gap measures. To mitigate prepayment model risk, we perform extensive monthly testing of actual results against model results and sensitivity analysis to facilitate informed asset selection and risk management decisions. However, expected returns can be affected by differences between prepayments forecasted by the models and actual prepayments.
- **Foreign Currency Risk.** Foreign currency risk is the risk that fluctuations in currency exchange rates (e.g., foreign currencies to the U.S. dollar) will adversely affect our cash flows, fair value of net assets and/or future earnings. Our exposure to foreign currency risk arises primarily because we issue debt denominated in currencies other than the U.S. dollar, our functional currency. In the case of our €Reference Notes® securities program, we are obligated to make periodic interest and principal payments in Euros. We mitigate the risk associated with fluctuations in currency exchange rates by entering into swap transactions that effectively convert foreign-denominated obligations into U.S. dollar denominated obligations.

**Credit Guarantee Activities.** Changes in interest rates and credit expectations cause fluctuations in the fair value of our existing credit guarantee portfolio. We do not hedge these changes in the fair value of our existing credit guarantee portfolio, other than the interest-rate exposure related to net buy-ups. We also hedge expected gains or losses resulting from our mortgage security program cycles. Timing differences caused by mortgage security program cycles can lead to significant interest expense, particularly in a rapidly declining interest-rate environment. If the interest rate paid to a PC investor is higher than the reinvestment rate on payments received from mortgage borrowers, we bear the cost difference, recognized as interest expense, for the time period between when the borrower pays us and when we reduce the PC balance.

While year-to-year changes in the fair value of the guarantee portfolio may have a significant impact on the fair value of net assets, we believe that changes in the fair value of our existing guarantee portfolio are not a good indication of long-term fair value expectations because such changes do not reflect the strong probability that, over time, replacement business will largely replenish guarantee fee income lost because of prepayments.

#### *Use of Derivatives and Interest-Rate Risk Management*

**Use of Derivatives.** To manage interest-rate and other market risks, we use derivatives primarily to:

- hedge forecasted issuances of debt and synthetically create callable and non-callable funding;
- hedge foreign-currency exposure associated with certain debt issuances; and
- regularly adjust or rebalance our funding mix in order to more closely match changes in the interest-rate characteristics of our mortgage assets.

*Hedge Forecasted Debt Issuances and Create Synthetic Funding.* We typically commit to purchase mortgage investments on an opportunistic basis for a future settlement date that often ranges from two weeks to three months after the date of the commitment. To facilitate larger and more predictable debt issuances that contribute to lower funding costs, we use interest-rate derivatives to hedge the anticipated debt issuances associated with these periodic mortgage purchases. In doing so, we economically hedge the interest-rate risk exposure from the time the mortgage is committed to be purchased to the time the debt is issued. We typically fund mortgage investments with a combination of callable and non-callable debt of various maturities in order to better match the cash-flow and optionality characteristics of the mortgage investments. Through the use of interest-rate derivatives, we can synthetically create the substantive economic equivalent of these various funding structures. For example, the combination of a series of short-term debt issuances over a defined

*Freddie Mac*

longer-term period and a pay-fixed swap with the same maturity is the substantive economic equivalent of a long-term debt instrument of comparable maturity. Similarly, the combination of non-callable debt and a swaption, or option to enter into a receive-fixed swap, with the same maturity as the non-callable debt, is the substantive economic equivalent of callable debt. The ability to either issue debt or synthetically create its substantive economic equivalent through derivatives increases funding flexibility, allows us to better match asset and liability cash flows and often reduces the overall funding cost.

*Hedge Foreign-Currency Exposure.* We also use derivatives to hedge foreign-currency exposure associated with foreign currency denominated debt issuances, such as our €Reference Notes® securities program, as discussed above in “*Sources of Interest-Rate Risk and Other Market Risks — Retained Portfolio — Foreign Currency Risk.*” Through the use of derivatives, we are able to mitigate nearly all currency risk at the time of debt issuance.

*Adjust Funding Mix.* As market conditions dictate, we undertake rebalancing actions in order to keep our interest-rate risk exposure within management limits. As interest rates decline, mortgage prepayments tend to increase and the expected life of mortgages tends to decrease. In this environment, we typically enter into receive-fixed swaps or purchase Treasury-based derivatives to adjust the duration of our funding to offset the declining mortgage duration. As interest rates increase, prepayments tend to decrease and lengthen the expected life of mortgages. In this case, we typically enter into pay-fixed swaps or sell Treasury-based derivatives in order to adjust the duration of our funding to offset increasing mortgage duration.

**Types of Derivatives.** We use derivatives that are common in the financial markets to conduct our risk management activities. The majority of our derivative positions fall into the following four categories:

- LIBOR-based interest-rate swaps;
- LIBOR- and Treasury-based exchange-traded futures;
- LIBOR- and Treasury-based options (including swaptions); and
- Foreign currency swaps.

In addition to swaps, futures and options, our derivative positions include certain purchase and sale commitments and other contractual agreements including swap guarantee derivatives and credit risk-sharing agreements discussed further below.

*Forward Purchase and Sale Commitments.* We routinely enter into forward purchase and sale commitments for mortgage loans and mortgage-related securities. Most of these commitments are derivatives subject to the requirements of SFAS 133 and accordingly must be recorded at fair value on our consolidated balance sheets.

*Prepayment Management Agreement.* Practices of seller/servicers may affect prepayment levels on mortgages that underlie PCs. As a result, mortgages underlying some PCs may be prepaid faster than similar mortgages underlying other PCs, adversely affecting our management and guarantee income and the performance of our mortgage-related securities. We have taken steps to achieve prepayment experience on PCs that is consistent with market norms. Beginning in 2002, we required that certain mortgage pools delivered to us between 2001 and 2003, which we considered to pose elevated risk of prepayment, be covered by a prepayment management agreement to partially compensate us for the adverse financial impacts caused by disproportionately higher mortgage prepayments. We also offered an incentive through an adjusted guarantee fee level on certain mortgage deliveries when the prepayment experience of the mortgage pools is within defined ranges. This type of agreement is accounted for as a derivative in accordance with SFAS 133 and classified as no hedge designation, with changes in fair value recorded as Derivative gains (losses) on the consolidated statements of income. This type of agreement is reflected at fair value on our consolidated balance sheets in the Derivative assets, at fair value, or Derivative liabilities, at fair value, caption. At December 31, 2004 and 2003, approximately \$113.7 billion and \$152.5 billion, respectively, of the mortgages underlying PCs included in our Total mortgage portfolio (see “Table 8 — Freddie Mac’s Total Mortgage Portfolio Based on Unpaid Principal Balances”) were subject to this type of agreement. Amounts due to us under this type of agreement are reported as a component of our Management and guarantee income.

*Freddie Mac*

*Swap Guarantee Derivatives.* We guarantee the payment of principal and interest on (a) multifamily mortgage loans that are originated and held by state and municipal housing finance agencies to support tax-exempt multifamily housing revenue bonds, (b) tax-exempt multifamily housing revenue bonds that support pass-through certificates issued by third parties, and (c) Freddie Mac pass-through certificates which are backed by tax-exempt multifamily housing revenue bonds and related taxable bonds and/or loans. In connection with these guarantees we have also guaranteed the sponsor's or the borrower's performance as a counterparty on any related interest-rate swaps used to mitigate interest-rate risk. Guarantees of these interest-rate swaps entered into after June 30, 2003 are treated as derivatives in accordance with SFAS 149 and are reported as swap guarantee derivatives. The notional amount of these swap guarantees was \$408 million and \$31 million at December 31, 2004 and 2003, respectively.

**Summary of Derivative Positions.** The fair value of our derivatives was a net asset balance of \$15.0 billion and \$15.8 billion at December 31, 2004 and 2003, respectively. In our consolidated balance sheets, derivative instruments are presented in Derivative assets, at fair value or Derivative liabilities, at fair value. See "Table 35 — Total Derivative Portfolio" for a summary of notional amounts and fair values by product type.

### ***Derivative-Related Risks***

Our use of derivatives exposes us to derivative market liquidity risk and counterparty credit risk. We are subject to derivative market liquidity risk, described below, arising from possible difficulties in entering into and exiting out of derivatives to meet our needs. Counterparty credit risk arises from the possibility that the counterparty will not be able to meet its contractual obligations.

**Derivative Market Liquidity Risk.** Derivative market liquidity risk is the risk that we may not be able to enter into or exit out of derivative transactions at a reasonable cost. A lack of sufficient capacity or liquidity in the derivatives market could limit our risk management activities, increasing our exposure to interest-rate risk. Limited liquidity or capacity in the derivatives market could make derivatives that we need for risk management purposes either unavailable or prohibitively expensive. To help maintain continuous access to derivative markets, we use a variety of products and transact with many different derivative counterparties. In addition to over-the-counter, or OTC, derivatives, we also use exchange-traded derivatives, asset securitization activities, callable debt, and short-term debt to rebalance our portfolio.

To mitigate the risk that we may be unable to enter into or replace derivatives transactions at reasonable cost, we limit our duration and convexity exposure to each counterparty. At December 31, 2004, the largest single notional balance of our 25 approved OTC counterparties listed in "Table 50 — Derivative Counterparty Credit Exposure" was \$60.9 billion, or 13 percent, of the total notional balance of our OTC interest-rate swaps, option-based derivatives and foreign currency swaps.

**Derivative Counterparty Credit Risk.** Exchange-traded derivatives, such as futures contracts, do not measurably increase our counterparty credit risk because changes in the value of open exchange-traded contracts are settled daily through a financial clearinghouse established by each exchange. OTC derivatives, however, expose us to counterparty credit risk because transactions are executed and settled between us and the counterparty. When an OTC derivative has a market value above zero at a given date (*i.e.*, an asset reported as Derivative assets, at fair value on the consolidated balance sheets), then the counterparty could potentially be obligated to deliver cash, securities or a combination of both having that market value to satisfy its obligation to us under the derivative.

We actively manage our exposure to counterparty credit risk. We use several tools to manage and minimize counterparty credit risk including:

- review of external rating analyses;
- strict standards for approving new derivative counterparties;
- ongoing monitoring of our positions with each counterparty by type of derivative;
- diversification of counterparties (discussed under "Derivative Market Liquidity Risk");

*Freddie Mac*

- master netting agreements and collateral agreements; and
- stress-testing to evaluate potential exposure under possible adverse market scenarios.

On an ongoing basis, we review the credit fundamentals of all of our derivative counterparties to confirm that they continue to meet internal standards. Internal ratings, credit, capital and trading limits are assigned to each counterparty based on quantitative and qualitative analysis, which we update and monitor on a regular basis. Additional reviews are completed when market conditions dictate or events affecting an individual counterparty occur.

*Derivative Counterparties.* Our standards for entering into OTC interest-rate swaps, option-based derivatives and foreign-currency swaps include rigorous internal credit and legal reviews. Our derivative counterparties carry external credit ratings among the highest available from major rating agencies. All of these counterparties are major financial institutions and are experienced participants in the OTC derivatives market.

*Master Netting and Collateral Agreements.* We use master netting and collateral agreements to reduce our credit risk exposure to our active OTC derivative counterparties for interest-rate swaps, option-based derivatives and foreign-currency swaps. Master netting agreements provide for the netting of amounts receivable and payable from an individual counterparty, which reduces our exposure to a single counterparty in the event of default. For example, if we have a gain position on one derivative and a loss position on another derivative with the same counterparty, then the gain can be netted with the loss to determine the amount of our net exposure to the counterparty. On a daily basis, the market value of each counterparty's derivatives outstanding is calculated to determine the amount of our net credit exposure, which is equal to derivatives in a net gain position by counterparty after giving consideration to collateral posted. Our collateral agreements require most counterparties to post collateral for the amount of our net exposure to them above the applicable threshold. Collateral posting thresholds are generally tied to a counterparty's credit rating. Derivative exposures and collateral amounts are monitored on a daily basis using both internal pricing models and dealer price quotes. Our derivative counterparties typically transfer collateral within one to three business days based on the values of the related derivatives. As described further below, this time lag in posting collateral can affect our net uncollateralized exposure to derivative counterparties.

The collateral posted by counterparties serves to protect us against the risk of counterparty credit losses. Collateral posted by a derivative counterparty is typically in the form of cash, U.S. Treasury securities, agency securities or other mortgage-related securities. In the event a counterparty defaults on its obligations under the derivatives agreement and the default is not remedied in the manner prescribed in the agreement, we have the right under the agreement to direct the custodian bank to transfer the collateral to us or, in the case of non-cash collateral, to sell the collateral and transfer the proceeds to us.

Table 50 summarizes our exposure to counterparty credit risk in our derivatives. This table is useful in understanding our credit risk related to our derivative portfolio.

**Table 50 — Derivative Counterparty Credit Exposure**

December 31, 2004						
Rating <sup>(1)</sup>	Number of Counterparties <sup>(2)</sup>	Notional Amount	Total Exposure at Fair Value <sup>(3)</sup>	Exposure, Net of Collateral <sup>(4)</sup>	Weighted Average Contractual Maturity (in years)	Collateral Posting Threshold <sup>(5)</sup>
(dollars in millions)						
AAA <sup>(6)</sup>	2	\$ 3,041	\$ 498	\$498	2.5	Mutually agreed upon
AA+	1	597	399	32	23.9	\$10 million or less
AA	5	110,692	3,096	25	4.4	\$10 million or less
AA-	7	135,041	5,199	36	5.2	\$10 million or less
A+	6	153,867	6,505	—	5.1	\$1 million or less
A	3	56,530	1,478	8	5.1	\$1 million or less
A-	1	210	11	2	7.0	\$1 million or less
Subtotal <sup>(7)</sup>	25	459,978	17,186	601	5.0	
Other derivatives <sup>(8)</sup>		138,822	—	—		
Prepayment management agreement <sup>(9)</sup>		113,692	—	—		
Commitments <sup>(10)</sup>		32,952	40	40		
Credit derivatives <sup>(11)</sup>		10,926	—	—		
Swap guarantee derivatives <sup>(9)</sup>		408	—	—		
Total derivatives		<u>\$756,778</u>	<u>\$17,226</u>	<u>\$641</u>		

December 31, 2003						
Rating <sup>(1)</sup>	Number of Counterparties <sup>(2)</sup>	Notional Amount	Total Exposure at Fair Value <sup>(3)</sup>	Exposure, Net of Collateral <sup>(4)</sup>	Weighted Average Contractual Maturity (in years)	Collateral Posting Threshold <sup>(5)</sup>
(dollars in millions)						
AAA	2	\$ 2,825	\$ 283	\$283	3.6	Mutually agreed upon
AA+	1	604	303	5	24.7	\$10 million or less
AA	4	119,409	1,610	29	4.6	\$10 million or less
AA-	7	237,048	7,091	250	4.1	\$10 million or less
A+	6	236,944	5,922	133	5.4	\$1 million or less
A	3	87,001	2,143	95	5.2	\$1 million or less
A-	4	1,018	19	1	3.3	\$1 million or less
Subtotal <sup>(7)</sup>	27	684,849	17,371	796	4.8	
Other derivatives <sup>(8)</sup>		141,381	—	—		
Prepayment management agreement <sup>(9)</sup>		152,548	—	—		
Commitments <sup>(10)</sup>		89,520	101	101		
Credit derivatives <sup>(11)</sup>		15,542	7	7		
Swap guarantee derivatives <sup>(9)</sup>		31	—	—		
Total derivatives		<u>\$1,083,871</u>	<u>\$17,479</u>	<u>\$904</u>		

- (1) We use the lower of S&P and Moody's ratings to manage collateral requirements. In this table, the rating of the legal entity (or the guarantor of the legal entity) is stated in terms of the S&P equivalent.
- (2) Based on legal entities. Affiliated legal entities are reported separately.
- (3) For each counterparty, this amount includes derivatives with a net positive fair value (recorded as Derivative assets, at fair value) including the related accrued interest receivable/payable (net) (recorded in Accounts and other receivables, net and Accrued interest payable).
- (4) Total Exposure at Fair Value less collateral held as determined at the counterparty level.
- (5) Counterparties are required to post collateral when their exposure exceeds agreed-upon collateral posting thresholds. These thresholds are typically based on the counterparty's credit rating and are individually negotiated.
- (6) At December 31, 2004, two of our derivative counterparties were rated AAA. In early 2005, one of these counterparties was downgraded to AA+. With respect to this downgraded counterparty, there was no Total Exposure at Fair Value at December 31, 2004 as the fair value of the underlying derivatives were in a net liability position at that date.
- (7) Consists of OTC derivative agreements for interest-rate swaps, option-based derivatives, excluding written options, and foreign-currency swaps. Written options do not present counterparty credit exposure, because we receive a one-time up-front premium in exchange for giving the holder the right to execute a contract under specified terms, which generally puts us in a liability position.
- (8) Consists primarily of exchange-traded contracts, which do not measurably increase our exposure to counterparty credit risk because changes in value of open exchange-traded contracts are settled daily through a financial clearinghouse established by each exchange.
- (9) See "Use of Derivatives and Interest-Rate Risk Management — Types of Derivatives" for additional information concerning the nature of the prepayment management agreement and swap guarantee derivatives.
- (10) Consists of OTC derivative agreements for forward purchase and sale commitments.
- (11) See "Credit Risks — Mortgage Credit Risk — Mortgage Credit Risk Management Strategies" for additional information about credit derivatives.

Over time, our exposure to certain counterparties for OTC interest-rate swaps, option-based derivatives and foreign-currency swaps varies depending on changes in fair values which are affected by changes in period-end interest rates, the implied volatility of interest rates, foreign-currency exchange rates and the amount of derivatives held. Our uncollateralized exposure to counterparties for OTC interest-rate swaps, option-based derivatives and foreign-currency swaps, after applying netting agreements and collateral, decreased to \$601 million as of December 31, 2004 from \$796 million as of December 31, 2003. This decrease in uncollateralized exposure was due to the following three factors:

- decreases in the differences between fair value estimates used by our derivative counterparties in determining the value of collateral to be posted and the estimates of derivative fair values used in our financial reporting;
- smaller market movements during the time period between when a derivative was marked to fair value and the date we received the related collateral. Our derivative counterparties typically post collateral one to three business days after we request collateral; and
- decreases in the exposure below the posting thresholds of our derivative counterparties.

As indicated in Table 50, approximately 97 percent of our counterparty credit exposure for OTC interest-rate swaps, option-based derivatives and foreign currency swaps was collateralized at December 31, 2004. In the extremely unlikely event that all of our counterparties for these derivatives were to have defaulted simultaneously on December 31, 2004, our maximum loss for accounting purposes would have been approximately \$601 million. As discussed below, in *“Derivative Portfolio Stress-Testing,”* however, our economic loss, as measured by our potential additional uncollateralized exposure, may be higher than the \$601 million uncollateralized exposure of our derivatives if we were not able to replace the defaulted derivatives in a timely fashion.

*OTC Forward Purchase and Sale Commitments Treated as Derivatives.* Since the typical maturity for our OTC commitments is less than one year, we do not require master netting and collateral agreements for the counterparties of these commitments. Therefore, as indicated in Table 50, the exposure to OTC commitments counterparties of \$40 million and \$101 million as of December 31, 2004 and 2003, respectively, was uncollateralized. The decrease in uncollateralized exposure was due to a significant decrease in the volume of unsettled commitments as of December 31, 2004, which contributed to the reduction of notional amounts for OTC commitments treated as derivatives.

Similar to counterparties for OTC interest-rate swaps, option-based derivatives and foreign-currency swaps, we monitor the credit fundamentals of our OTC commitments counterparties on an ongoing basis to ensure that they continue to meet our internal risk-management standards.

*Derivative Portfolio Stress-Testing.* Market values of derivatives can change significantly when market conditions change. As a result, we monitor the risk that our uncollateralized exposure to each of our OTC counterparties for interest-rate swaps, option-based derivatives and foreign-currency swaps will increase under certain adverse market conditions. We perform severe market stress tests on a daily basis to evaluate the potential additional uncollateralized exposure we have to each of these derivative counterparties. The market stress test assumes changes in the level, slope and implied volatility of interest rates and changes in foreign-currency exchange rates over a brief time period. The market stress test also assumes high OTC counterparty default rates coupled with low recovery rates to calculate our potential exposure to each OTC counterparty.

To date, we have not incurred any credit losses on OTC derivative counterparties or set aside specific reserves for institutional credit risk exposure. We do not believe such reserves are necessary, given our counterparty policies and collateral requirements.

### ***Derivative Tables***

Table 51 shows the notional amount for each of our hedge accounting categories under SFAS 133 and the corresponding impact of those positions on our consolidated financial statements. The application and effectiveness of our hedging strategies can materially affect Stockholders' equity and the timing of our

*Freddie Mac*

recognition of earnings. See “NOTE 12: DERIVATIVES” to the consolidated financial statements for more information concerning our hedging activity.

**Table 51 — Summary of the Effect of Derivatives on Selected Consolidated Financial Statement Captions**

Description	Consolidated Balance Sheets					
	December 31, 2004			December 31, 2003		
	Notional Amount	Fair Value (Pre-Tax) <sup>(1)</sup>	AOCI (Net of Tax) <sup>(2)</sup>	Notional Amount	Fair Value (Pre-Tax) <sup>(1)</sup>	AOCI (Net of Tax) <sup>(2)</sup>
	(dollars in millions)					
Fair value hedges-open	\$113,101	\$12,317	\$ —	\$ 145,690	\$10,185	\$ —
Cash flow hedges-open	21,214	228	(25)	141,903	(2,808)	(1,927)
No hedge designation <sup>(3)</sup>	622,463	2,486	—	796,278	8,446	—
Subtotal	756,778	15,031	(25)	1,083,871	15,823	(1,927)
Balance related to closed cash flow hedges	—	—	(7,899)	—	—	(5,910)
Total	<u>\$756,778</u>	<u>\$15,031</u>	<u>\$(7,924)</u>	<u>\$1,083,871</u>	<u>\$15,823</u>	<u>\$(7,837)</u>

Description	Consolidated Statements of Income					
	Year Ended December 31, 2004		Year Ended December 31, 2003		Year Ended December 31, 2002	
	Hedge Accounting Gains (Losses) <sup>(4)</sup>	Derivative Gains (Losses) <sup>(5)</sup>	Hedge Accounting Gains (Losses) <sup>(4)</sup>	Derivative Gains (Losses) <sup>(5)</sup>	Hedge Accounting Gains (Losses) <sup>(4)</sup>	Derivative Gains (Losses) <sup>(5)</sup>
	(dollars in millions)					
Fair value hedges-open	\$742	\$ —	\$697	\$—	\$241	\$ —
Cash flow hedges-open	1	2	(53)	29	(54)	116
No hedge designation <sup>(3)</sup>	—	(4,477)	—	10	—	5,186
Total	<u>\$743</u>	<u>\$(4,475)</u>	<u>\$644</u>	<u>\$39</u>	<u>\$187</u>	<u>\$5,302</u>

- (1) The fair values of derivatives (netted by counterparty as permitted by GAAP) are presented as Derivative assets, at fair value, and Derivative liabilities, at fair value, on our consolidated balance sheets. The fair values for futures are directly derived from quoted market prices. Fair values of other derivatives are derived primarily from valuation models with incorporation of market-based inputs.
- (2) Derivatives that meet specific criteria are accounted for as cash flow hedges under SFAS 133. Changes in the effective portion of the fair value of these open derivatives contracts are recorded in AOCI, net of taxes. Net deferred gains and losses on closed cash flow hedges (*i.e.*, where the derivative is either terminated or redesignated) are also classified in AOCI, net of taxes, until the related forecasted transaction is determined to be probable of not occurring or affects earnings.
- (3) A significant portion of our derivatives is not designated in hedge accounting relationships and is reported as no hedge designation. For most derivatives not qualifying as an accounting hedge, fair value gains and losses are reported as Derivative gains (losses) on our consolidated statements of income. For purchase and sale commitments of securities classified as trading under SFAS 115 (with notional balances of approximately \$0 billion, \$78 billion and \$147 billion at December 31, 2004, 2003 and 2002, respectively), fair value gains and losses are reported as Gains (losses) on investment activity on our consolidated statements of income and therefore, those fair value gains and losses are not included above.
- (4) Hedge accounting gains (losses) arise when the fair value change of a derivative does not exactly offset the fair value change of the hedged item. For further information, see “NOTE 12: DERIVATIVES” to the consolidated financial statements.
- (5) Includes gains or losses reclassified from AOCI, net of taxes, as a result of the termination of cash flow hedge designations because we determined that the related forecasted transaction is probable of not occurring.

*Effect on Consolidated Financial Statements.* As Table 51 shows, a significant portion of our derivatives was not designated in hedge accounting relationships at December 31, 2004 and 2003. Derivatives that are not in qualifying hedge accounting relationships generally increase the volatility of reported Net income because they are marked to fair value through earnings without the offsetting change in value of the economically hedged exposures also being recognized in earnings. For information about our hedging activities, see “CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Income (Loss) — Derivative Gains (Losses).”

To qualify for cash flow hedge accounting treatment, hedged forecasted transactions must be considered probable of occurring. In addition, SFAS 133 imposes a variety of operational requirements that must be met. At December 31, 2004, \$21,214 million notional amount of derivative contracts was designated in cash flow hedge relationships, including \$1,576 million notional amount of foreign-currency swaps and \$19,638 million notional amount of commitments. The current fair value of the derivatives included in cash flow hedge relationships is recorded on the consolidated balance sheets as Derivative assets, at fair value, or Derivative liabilities, at fair value. For derivatives that receive cash flow hedge accounting treatment under SFAS 133, the effective portion of the change in fair value of the derivative asset or derivative liability is presented in the Stockholders’ equity section of our consolidated balance sheets in AOCI, net of taxes. The effective portion of

Freddie Mac

the derivative generally offsets, on a cumulative basis, the cumulative change in the present value of the hedged cash flows.

As of December 31, 2004, the net cumulative change in the fair value of all derivatives designated in cash flow hedge relationships that were still open or for which the forecasted transactions had not yet occurred since SFAS 133 was implemented on January 1, 2001 (net of amounts previously reclassified to earnings through December 31, 2004) was a loss of approximately \$7.9 billion on an after-tax basis. This amount was related almost entirely to \$7.9 billion of deferred losses on closed cash flow hedge relationships. The majority of the closed cash flow hedges related to the hedging of the variability of cash flows from forecasted issuances of debt with various derivatives. Closed cash flow hedges involve derivatives that have been terminated or are no longer designated in cash flow hedge relationships. Fluctuations in prevailing market interest rates have no impact on the deferred portion of AOCI, net of taxes, relating to losses on closed cash flow hedges. Therefore, the \$7.9 billion in deferred losses related to closed cash flow hedges will be recognized as a reduction of earnings as the originally hedged forecasted transactions affect earnings, unless it becomes probable that the forecasted transaction will not occur. If it is probable that the forecasted transaction will not occur, then the entire deferred amount associated with the forecasted transaction will be reclassified into earnings immediately. See “Table 39 — Scheduled Amortization of Net Deferred Losses in AOCI to Income Related to Closed Cash Flow Hedge Relationships” for more information on expected reclassifications to income of net deferred losses related to closed cash flow hedges during future periods.

Table 52 summarizes the notional amounts for each type of derivative, including our new contracts, maturities and terminations during the year. This information indicates the level and type of derivative activity undertaken during the year and reflects our use of different derivative products in the execution of our risk management strategies. The notional amounts of our derivatives are a reference point to determine the payments owed between us and our counterparties under the contracts. The notional amount of a derivative is not an indication of the fair value of the position or of the cash flows related to the position. In most market environments, derivatives have fair values that are a small percentage of their notional amount.

**Table 52 — Changes in Derivative Notional Amounts**

	Year Ended December 31, 2004			
	Derivative Notional Amount <sup>(1)</sup>			
	Beginning Balance	New Contracts	Maturities/ Terminations <sup>(2)</sup>	Ending Balance
	(dollars in millions)			
Interest-rate swaps:				
Pay-fixed	\$179,751	\$163,369	\$ (248,077)	\$ 95,043
Receive-fixed	107,417	230,194	(254,009)	83,602
Basis (floating to floating)	424	—	(330)	94
Total interest-rate swaps	<u>287,592</u>	<u>393,563</u>	<u>(502,416)</u>	<u>178,739</u>
Option-based:				
Call swaptions	217,338	45,555	(72,948)	189,945
Put swaptions	123,611	32,911	(131,347)	25,175
Other option-based derivatives <sup>(3)</sup>	20,379	17,923	(19,321)	18,981
Total option-based	<u>361,328</u>	<u>96,389</u>	<u>(223,616)</u>	<u>234,101</u>
Futures	130,798	489,176	(490,864)	129,110
Foreign-currency swaps	46,512	19,428	(9,090)	56,850
Subtotal	<u>\$826,230</u>	<u>\$998,556</u>	<u>\$(1,225,986)</u>	<u>\$598,800</u>
Prepayment management agreement				113,692
Commitments				32,952
Credit derivatives				10,926
Swap guarantee derivatives				408
Total				<u>\$756,778</u>

	Year Ended December 31, 2003			
	Derivative Notional Amount <sup>(1)</sup>			
	Beginning Balance	New Contracts	Maturities/ Terminations <sup>(2)</sup>	Ending Balance
	(dollars in millions)			
Interest-rate swaps:				
Pay-fixed	\$135,758	\$ 228,727	\$ (184,734)	\$ 179,751
Receive-fixed	149,397	162,363	(204,343)	107,417
Basis (floating to floating)	4,941	136	(4,653)	424
Total interest-rate swaps	<u>290,096</u>	<u>391,226</u>	<u>(393,730)</u>	<u>287,592</u>
Option-based:				
Call swaptions	131,679	125,839	(40,180)	217,338
Put swaptions	129,881	93,237	(99,507)	123,611
Other option-based derivatives <sup>(3)(4)</sup>	27,522	26,519	(33,662)	20,379
Total option-based	<u>289,082</u>	<u>245,595</u>	<u>(173,349)</u>	<u>361,328</u>
Futures	228,411	444,830	(542,443)	130,798
Foreign-currency swaps	43,687	23,193	(20,368)	46,512
Subtotal <sup>(4)</sup>	<u>\$851,276</u>	<u>\$1,104,844</u>	<u>\$(1,129,890)</u>	<u>\$ 826,230</u>
Prepayment management agreement				152,548
Commitments				89,520
Credit derivatives				15,542
Swap guarantee derivatives				31
Total				<u>\$1,083,871</u>

(1) Notional amounts are used to calculate the periodic amounts to be received and paid and generally do not represent actual amounts to be exchanged or directly reflect our exposure to institutional credit risk. Notional amounts are not recorded as assets or liabilities in our consolidated balance sheets.

(2) Includes foreign currency translation adjustments to notional amounts as of the date presented.

(3) Primarily represents written options.

(4) Subsequent to the issuance of our Information Statement dated September 24, 2004, we decreased the beginning balance of Other option-based derivatives for the year ended December 31, 2003 by \$585 million. The effect of this change was a decrease to the beginning balance at that date to \$851,276 million from \$851,861 million. We also increased new contracts of Other option-based derivatives by \$585 million. The effect of this change was an increase to new contracts at that date to \$1,104,844 million from \$1,104,259 million.

The total notional amount of our derivatives (excluding the prepayment management agreement, commitments, credit derivatives and swap guarantee derivatives) decreased by \$227.4 billion from December 31, 2003 to December 31, 2004. See “CONSOLIDATED BALANCE SHEETS ANALYSIS — Derivative Assets and Liabilities, at Fair Value” for information on the factors driving the decrease in notional amounts during 2004.

Table 53 summarizes the change in derivative fair values for the periods presented. See “Table 54 — Derivative Fair Values and Maturities” for a breakdown of our derivative fair values by derivative type. Also see “CRITICAL ACCOUNTING POLICIES AND ESTIMATES — Fair Value Measurement” for a discussion of how changes in fair values affect our financial results under GAAP.

**Table 53 — Changes in Derivative Fair Values**

	Year Ended December 31,	
	2004	2003
	(dollars in millions)	
Beginning balance — Net asset (liability) .....	\$15,823	\$ 9,426
Net change in:		
Futures <sup>(1)</sup> .....	(214)	(609)
Commitments .....	221	(483)
Credit derivatives .....	(7)	1
Swap guarantee derivatives .....	(1)	—
Other derivatives: <sup>(2)</sup>		
Changes in fair value .....	(627)	6,572
Fair value of new contracts entered into during the period <sup>(3)</sup> .....	1,733	4,841
Contracts realized or otherwise settled during the period .....	(1,897)	(3,925)
Ending balance — Net asset (liability) .....	<u>\$15,031</u>	<u>\$15,823</u>

(1) The fair value changes for futures are determined by the individual exchanges on which they are traded, and not by us.

(2) Includes fair value changes for OTC interest-rate swaps, option-based derivatives and foreign-currency swaps.

(3) Consists primarily of cash premiums paid or received on options and the initial value of interest-rate swaps after we have exercised related swaptions.

Table 54 shows the notional amount and fair value for each derivative type and the maturity profile of the positions. The fair values of the derivative positions are presented on a product-by-product basis, without netting by counterparty. The fair value of a longer-term derivative generally will vary more over time than a comparable derivative with a shorter maturity. A positive fair value in Table 54 for a derivative product category is the estimated amount, prior to netting by counterparty, that we would be entitled to receive if we terminated those transactions. A negative fair value is the estimated amount, prior to netting by counterparty, that we would owe if we terminated the derivatives in that product category.

**Table 54 — Derivative Fair Values and Maturities**

	December 31, 2004					
	Notional Amount	Total Fair Value <sup>(1)</sup>	Fair Value <sup>(2)</sup>			
			Less than 1 Year	1 to 3 Years	Greater than 3 and up to 5 Years	In Excess of 5 Years
			(dollars in millions)			
Interest-rate swaps:						
Pay-fixed .....	\$ 95,043	\$(2,879)	\$ 20	\$ (21)	\$ (20)	\$(2,858)
Receive-fixed .....	83,602	2,394	40	319	170	1,865
Basis (floating to floating) .....	94	1	—	—	—	1
Total interest-rate swaps .....	<u>178,739</u>	<u>(484)</u>	<u>60</u>	<u>298</u>	<u>150</u>	<u>(992)</u>
Option-based:						
Call swaptions .....	189,945	4,988	237	1,997	1,158	1,596
Put swaptions .....	25,175	267	207	56	—	4
Other option-based derivatives .....	18,981	2	—	4	2	(4)
Total option-based .....	<u>234,101</u>	<u>5,257</u>	<u>444</u>	<u>2,057</u>	<u>1,160</u>	<u>1,596</u>
Futures .....	129,110	(33)	(33)	—	—	—
Foreign-currency swaps .....	56,850	10,303	3,370	2,116	1,026	3,791
Prepayment management agreement .....	113,692	—	—	—	—	—
Commitments .....	32,952	(9)	(9)	—	—	—
Swap guarantee derivatives .....	408	(1)	—	—	—	(1)
Subtotal .....	<u>745,852</u>	<u>15,033</u>	<u>\$3,832</u>	<u>\$4,471</u>	<u>\$2,336</u>	<u>\$ 4,394</u>
Credit derivatives .....	10,926	(2)				
Total .....	<u>\$756,778</u>	<u>\$15,031</u>				

(1) The fair value by derivative type presented on this table is shown prior to netting by counterparty. The fair value of derivatives presented on the consolidated balance sheets, however, is netted by counterparty as permitted by GAAP, and is reported in the Derivative assets, at fair value, and Derivative liabilities, at fair value captions.

(2) Fair value is categorized based on the years from December 31, 2004 until the contractual maturity of the derivative.

See “CONSOLIDATED RESULTS OF OPERATIONS” and “CONSOLIDATED BALANCE SHEETS ANALYSIS” for more information regarding how these changes in fair value affect our financial results.

Table 55 provides a summary of the contractual terms of our pay-fixed and receive-fixed swaps. This table provides information about the effect of interest-rate swaps on net interest yield if the derivative is in a fair value or cash flow hedge relationship. If the derivative is classified as no hedge designation, the derivative does not affect our net interest yield, but rather is reported in Derivative gains (losses) on our consolidated statements of income.

**Table 55 — Contractual Terms of Pay-Fixed and Receive-Fixed Swaps**

	December 31, 2004					
	Pay-Fixed/ Receive-Variable			Receive-Fixed/ Pay-Variable		
	Notional	Pay Rate	Receive Rate <sup>(1)</sup>	Notional	Pay Rate <sup>(1)</sup>	Receive Rate
	(dollars in millions)			(dollars in millions)		
<b>Swaps</b>						
Maturity less than 1 year	\$ 4,282	2.34%	2.19%	\$11,032	3.48%	2.17%
Maturity 1 to 3 years	4,703	3.84	2.38	24,581	3.92	2.20
Maturity greater than 3 and up to 5 years	15,147	3.99	2.37	15,751	3.67	2.22
Maturity in excess of 5 years	27,205	4.91	2.30	32,238	5.19	2.22
Subtotal	<u>51,337</u>			<u>83,602</u>		
<b>Forward-starting swaps<sup>(2)</sup></b>						
Maturity greater than 3 and up to 5 years	1,625	3.73	—	—	—	—
Maturity in excess of 5 years	42,081	6.20	—	—	—	—
Subtotal	<u>43,706</u>			<u>—</u>		
Total	<u>\$95,043</u>			<u>\$83,602</u>		
	December 31, 2003					
	Pay-Fixed/ Receive-Variable			Receive-Fixed/ Pay-Variable		
	Notional	Pay Rate	Receive Rate <sup>(1)</sup>	Notional	Pay Rate <sup>(1)</sup>	Receive Rate
	(dollars in millions)			(dollars in millions)		
<b>Swaps</b>						
Maturity less than 1 year	\$ 4,900	5.76%	1.18%	\$ 21,106	1.40%	2.38%
Maturity 1 to 3 years	31,073	2.69	1.17	18,247	1.73	3.88
Maturity greater than 3 and up to 5 years	15,967	3.63	1.17	11,249	1.99	3.99
Maturity in excess of 5 years	65,395	4.91	1.17	24,202	1.66	5.64
Subtotal	<u>117,335</u>			<u>74,804</u>		
<b>Forward-starting swaps<sup>(2)</sup></b>						
Maturity 1 to 3 years	—	—	—	8,520	—	2.83
Maturity greater than 3 and up to 5 years	220	4.49	—	3,260	—	3.21
Maturity in excess of 5 years	62,196	6.11	—	20,833	—	5.07
Subtotal	<u>62,416</u>			<u>32,613</u>		
Total	<u>\$179,751</u>			<u>\$107,417</u>		

- (1) The weighted-average rate payable and receivable is as of the date indicated. Because the rates of the swaps are floating, these rates will change as prevailing interest rates change. The variable legs of these swaps are generally based on LIBOR or Euro Interbank Offered Rate.
- (2) Represents interest-rate swap agreements scheduled to begin on a future date. Generally, the interest rate associated with the variable leg of the swap is set when the first payment cycle begins and is periodically reset thereafter.

### **Measurement of Interest-Rate Risk**

We measure our exposure to key interest-rate risks every day against both internal management limits and limits set by the Board of Directors. Throughout 2004 our interest-rate risk remained low and well below management and Board limits.

**PMVS and Duration Gap.** Our interest-rate sensitivity disclosures provide a set of management estimates that convey a useful assessment of the amount of our interest-rate risk at a given point in time. This section describes our primary interest-rate risk measures: PMVS and duration gap. PMVS is measured in two ways, one measuring the estimated sensitivity of our portfolio market value (as defined below) to parallel moves in interest rates (PMVS-L) and the other to nonparallel movements (PMVS-YC). We calculate PMVS-L and PMVS-YC every business day. PMVS-L and PMVS-YC are based on the assumption of instantaneous yield curve shifts; therefore neither measure includes the effect on fair value of any rebalancing actions that we would typically take to reduce our risk exposure.

*Freddie Mac*

- PMVS-L shows the estimated loss in pre-tax portfolio market value, expressed as a percentage of our after-tax fair value of net assets attributable to common stockholders (measured as fair value of net assets less the fair value of preferred stock) from an immediate adverse 50 basis point parallel shift in the level of LIBOR rates (that is, when the yield at each point on the LIBOR yield curve increases or decreases by 50 basis points). We believe the use of an immediate 50 basis point shift in the LIBOR yield curve is a conservative estimate of interest-rate risk. The periodic disclosure in our Monthly Volume Summary report, which is available on our website at [www.FreddieMac.com](http://www.FreddieMac.com), reflects the average of the daily PMVS-L estimates for a given reporting period (a month, quarter or year). (We are providing this Internet address solely for the information of interested persons. We do not intend this Internet address to be an active link and are not using references to this Internet address here or elsewhere in this Information Statement to incorporate additional information into this Information Statement.)
- PMVS-YC shows the estimated loss in pre-tax portfolio market value, expressed as a percentage of our after-tax fair value of net assets attributable to common stockholders, from an immediate adverse 25 basis point change in the slope (up and down) of the LIBOR yield curve. The 25 basis point change in slope for the PMVS-YC measure is obtained by shifting the two-year and ten-year LIBOR rates by an equal amount (12.5 basis points), but in opposite directions. LIBOR rate shifts between the two-year and ten-year points are interpolated. The periodic disclosure in our Monthly Volume Summary report, which is available on our website at [www.FreddieMac.com](http://www.FreddieMac.com), reflects the average of the daily PMVS-YC estimates for a given reporting period (a month, quarter or year).
- Duration gap estimates the net sensitivity of the fair value of our financial instruments to movements in interest rates. Duration gap is presented in units expressed as months. On a daily basis, we estimate the fair value and effective duration of our financial assets and liabilities, including derivatives. The fair value of each instrument is multiplied by its duration to determine the instrument's duration dollars. Duration dollars are then aggregated to estimate the portfolio's net duration dollar exposure. To calculate duration gap, the net duration dollar exposure is divided by the fair value of total interest-earning assets and expressed in months. A duration gap of zero implies that the change in value of assets from an instantaneous rate move will be accompanied by an equal and offsetting move in the value of debt and derivatives thus leaving the net fair value of equity unchanged. However, because duration does not capture convexity exposure (the amount by which duration itself changes as rates move), actual changes in fair value from interest-rate changes may differ from those implied by duration gap alone. For that reason, management believes duration gap is most useful when used in conjunction with PMVS. The periodic duration gap disclosure in our Monthly Volume Summary report, which is available on our website at [www.FreddieMac.com](http://www.FreddieMac.com), reflects the average of the daily duration gap estimates for a given reporting period (a month, quarter or year).

In measuring the expected loss in portfolio market value, which is the numerator in the fraction used to calculate the PMVS percentages, we estimate the sensitivity to changes in interest rates of the fair value of all interest-earning assets and interest-bearing liabilities, including short-term interest-earning assets and interest-bearing liabilities and all derivatives on a pre-tax basis. When we calculate the expected loss in portfolio market value and duration gap, we also take into account the cash flows related to certain credit guarantee-related items, including net buy-ups and expected gains or losses due to net interest from security program cycles. In calculating the expected loss in portfolio market value and duration gap, we do not consider the sensitivity to interest-rate changes of the following assets and liabilities:

- *Guarantee fee portfolio.* Except for the guarantee-related items mentioned above (*i.e.*, net buy-ups and net interest from security program cycles), the sensitivity of the fair value of the guarantee fee portfolio to changes in interest rates is not included in calculating the expected loss in portfolio market value or duration gap because we believe the expected benefits from replacement business provide an adequate hedge against interest-rate changes.
- *Other assets with minimal interest-rate sensitivity.* Other assets, primarily including non-financial instruments such as fixed assets and REO, are not included in the calculation of the expected loss in

portfolio market value or duration gap because of the minimal impact they would have on both PMVS and duration gap.

The fair value of the guarantee fee portfolio and certain other assets with minimal interest-rate risk sensitivity is included in the estimate of the after-tax fair value of net assets attributable to common stockholders, which is the denominator of the fraction used to calculate the PMVS-L and PMVS-YC percentages.

While PMVS and duration gap estimate the exposure of the fair value of net assets attributable to common stockholders to changes in interest rates, they do not capture the potential impact of certain other market risks, such as changes in volatility, basis, prepayment model, mortgage-to-debt spread and foreign currency risk. The impact of these other market risks can be significant. See “*Sources of Interest-Rate Risk and Other Market Risks*” for further information.

Our PMVS and duration gap estimates are determined using models that involve interest-rate and prepayment assumptions made in our best judgment. In addition, in the case of PMVS, daily calculations are based on an estimate of the fair value of our net assets attributable to common stockholders. Accordingly, while we believe that PMVS and duration gap are useful risk management tools, they should be understood as estimates rather than precise measurements.

*PMVS Results.* Table 56 provides estimated point-in-time PMVS-L and PMVS-YC results at December 31, 2004 and 2003. To supplement the PMVS-L results based on an assumed 50 basis point shift in the LIBOR yield curve, Table 56 also provides year-end PMVS-L estimates assuming an immediate 100 basis point shift in the LIBOR yield curve. Because we do not hedge all prepayment option risk, the duration of our mortgage assets changes more rapidly as changes in interest rates increase. Accordingly, as shown in Table 56, the PMVS-L results based on a 100 basis point shift in the LIBOR curve are disproportionately higher than the PMVS-L results based on a 50 basis point shift in the LIBOR curve. We disclose the average daily, quarterly and annual PMVS-L and PMVS-YC results in our Monthly Volume Summary report.

**Table 56 — Portfolio Market Value Sensitivity Assuming Shifts of the LIBOR Yield Curve**

	<u>Portfolio Market Value Sensitivity</u>			<u>Potential Pre-Tax Loss in Portfolio Market Value (millions)</u>		
	<u>PMVS-YC</u>	<u>PMVS-L</u>		<u>PMVS-YC</u>	<u>PMVS-L</u>	
	<u>25 bp</u>	<u>50 bp</u>	<u>100 bp</u>	<u>25 bp</u>	<u>50 bp</u>	<u>100 bp</u>
<b>At:</b>						
December 31, 2004 .....	0%	3%	8%	\$25	\$725	\$2,083
December 31, 2003 .....	0%	2%	9%	\$20	\$559	\$2,171

Derivatives have enabled us to keep our interest-rate risk exposure at consistently low levels in a wide range of interest-rate environments. By keeping PMVS-L and PMVS-YC low, we have been able to reduce the exposure of the fair value of our stockholders’ equity to adverse changes in interest rates.

Table 57 shows that the low PMVS-L risk levels for the periods presented would generally have been substantially higher if we had not used derivatives to manage our interest-rate risk exposure.

**Table 57 — Derivative Impact on PMVS**

	<u>Before Derivatives</u>	<u>After Derivatives</u>	<u>Effect of Derivatives</u>
<b>At December 31, 2004</b>			
PMVS-L (50bp) .....	7%	3%	(4)%
PMVS-YC (25bp) .....	1%	0%	(1)%
<b>At December 31, 2003</b>			
PMVS-L (50bp) .....	6%	2%	(4)%
PMVS-YC (25bp) .....	0%	0%	0%

*Freddie Mac*

*Duration Gap Results.* We disclose the average daily, quarterly and annual duration gap in our Monthly Volume Summary report. Table 58 provides estimated average duration gap results for December 2004 and 2003.

**Table 58 — Duration Gap**

<u>Average for the Month of December,</u>	<u>Duration Gap</u> (in months)
2004 .....	(1)
2003 .....	0

## Credit Risks

Our Total mortgage portfolio is subject to credit risks. See “Table 8 — Freddie Mac’s Total Mortgage Portfolio Based on Unpaid Principal Balances” for more information on the composition of our Total mortgage portfolio. We are subject primarily to two types of credit risk — mortgage credit risk and institutional credit risk. Mortgage credit risk is the risk that a borrower will fail to make timely payments on a mortgage owned or guaranteed by us. Institutional credit risk is the risk that a counterparty that has entered into a business contract or arrangement with us will fail to meet its obligations. A portion of the revenue that Freddie Mac earns from management and guarantee fees is designed to compensate the firm for taking on credit risk.

### *Oversight of Credit Risks*

The purpose of the Credit Risk Oversight group is to provide independent oversight of the corporate-wide credit risk management functions, including asset selection, portfolio management, loss mitigation, and institutional counterparty risk. In particular, Credit Risk Oversight is responsible for providing senior management with regular, independent evaluations of whether credit risks are effectively identified, measured, managed, and controlled. The Models and Methods Oversight group, a part of the Enterprise Risk Oversight function, is responsible for independently assessing the design and adequacy of all key credit risk models.

### *Mortgage Credit Risk*

Defaults by mortgage borrowers result in losses if we are unable to collect amounts due through the sale of the underlying properties, restructuring the mortgage loans or by using other loss mitigation strategies. The discussion below describes our mortgage credit risk management strategies and summarizes our credit performance.

**Mortgage Credit Risk Management Strategies.** Our strategies for managing mortgage credit risk focus on five primary areas:

- underwriting requirements and quality control standards;
- credit enhancements;
- portfolio diversification;
- loss mitigation activities; and
- other risk management activities.

*Underwriting Requirements and Quality Control Standards.* All mortgages that we purchase have an inherent risk of default. Through our underwriting and quality control processes, we seek to understand the underlying risk in a given mortgage we securitize or purchase for our Retained portfolio to ensure that we adequately price for the risk we assume. Our current business model relies on a process of delegated underwriting for the single-family mortgages we purchase or securitize. That is, we provide originators with a series of guidelines to follow in the underwriting of a mortgage and they represent and warrant to us that the mortgages sold to us meet these guidelines. We subsequently review a sample of these loans and if we determine that any loan is not in compliance with our underwriting standards, we may require the seller/

*Freddie Mac*

servicer to repurchase that mortgage or make us whole in the event of a default. To assist us in purchasing mortgages that can be sold to us, we provide originators with automated underwriting software tools, such as Loan Prospector® and other quantitative credit risk management tools to evaluate and purchase single-family mortgages and monitor the related mortgage credit risk. Loan Prospector® combines information on the key indicators of mortgage default risk, such as loan-to-value ratios, credit scores and other mortgage and borrower characteristics to generate credit risk classifications. These statistically-based risk assessment tools increase our ability to distinguish among single-family loans based on their risk, return and importance to our mission. On a negotiated basis, we may allow seller/servicers to underwrite mortgages for sale to us using other proprietary automated underwriting systems.

For 2004 and 2003, Loan Prospector® was used to evaluate approximately 61 percent and 64 percent, respectively, of our single-family purchase volume prior to purchase. As part of our post-purchase quality control review process, we use Loan Prospector® to evaluate the credit quality of virtually all single-family mortgages that were not evaluated by Loan Prospector® prior to purchase. Loan Prospector® risk classifications influence both the price we charge to guarantee loans and the sample of loans we review in quality control. As such, Loan Prospector® provides an effective credit risk management tool.

For multifamily mortgage loans, unless the mortgage loans have significant credit enhancements, we use an intensive pre-purchase underwriting process for the mortgages we purchase. Our underwriting process includes assessments of the local market, the borrower, the property manager, the property’s historical and projected financial performance and the property’s physical condition, which may include a physical inspection of the property. In addition to our own inspections, we utilize third-party appraisals and environmental and engineering reports.

*Credit Enhancements.* For most of the mortgage loans in our Total mortgage portfolio (other than non-Freddie Mac mortgage-related securities and that portion of issued Structured Securities that is backed by Ginnie Mae Certificates), we retain the primary risk of loss in the event of default by the borrower on the underlying mortgage. Our charter requires that, to be eligible for purchase, single-family mortgages with loan-to-value ratios above 80 percent at the time of purchase be covered by (a) primary mortgage insurance or (b) certain other credit protections. In addition, for some mortgage loans, we elect to share the default risk by transferring a portion of that risk to various third parties through a variety of other credit enhancement vehicles. Mortgage loans covered by primary mortgage insurance and these other credit protections are referred to as credit-enhanced mortgages. Proceeds received from these credit enhancements are applied to offset credit losses and to Net interest income for that portion that represents forgone interest not previously recognized related to individual mortgage loans that default.

Table 59 shows the credit-enhanced portion of our Total mortgage portfolio (excluding non-Freddie Mac mortgage-related securities and Structured Securities issued by us that are backed by Ginnie Mae Certificates).

**Table 59 — Credit-Enhanced Percentage of the Total Mortgage Portfolio<sup>(1)</sup>**

	December 31,		
	2004	2003	2002
Credit-enhanced <sup>(2)</sup> .....	19%	21%	27%

- (1) Non-Freddie Mac mortgage-related securities are excluded from this table because they do not expose us to primary risk of loss in the event of a default by the borrower on the underlying mortgage. That portion of Structured Securities backed by Ginnie Mae Certificates is excluded because the incremental credit risk to which it exposes us is considered de minimis. See “Table 33 — Credit Characteristics of Mortgages and Mortgage-Related Securities in the Retained Portfolio” for additional information about our non-Freddie Mac mortgage-related securities.
- (2) Credit enhancements primarily include third party primary loan-level mortgage insurance, third party pool insurance and other arrangements in which the lender or a third party has retained a portion of the default risk by pledging collateral or agreeing to accept losses on loans that default. In many cases, the lender’s or third party’s risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

The percentage of our Total mortgage portfolio (excluding Structured Securities backed by Ginnie Mae Certificates and non-Freddie Mac mortgage-related securities held by us) with credit-enhancements decreased from 2002 to 2004. This decrease was primarily due to a high level of refinance loans acquired in 2003 and 2004, which tend to have lower loan-to-value ratios and, therefore, generally do not require credit

enhancements. Our ability and desire to expand the portion of our Total mortgage portfolio with credit enhancements will depend on our evaluation of the credit quality of new business purchase opportunities, our portfolio risk profile and the future availability of effective credit enhancements at prices that permit an attractive return.

Primary mortgage insurance is the most prevalent type of credit enhancement protecting our Total mortgage portfolio and is obtained on a loan-level basis for certain single-family mortgages. Primary mortgage insurance transfers varying portions of the credit risk associated with the mortgage to a third party insurer. The amount we obtain on any mortgage depends on our charter requirement and our assessment of risk. We may from time to time agree with the insurer to reduce the amount of coverage that is in excess of our charter's minimum requirement and may also furnish certain services to the insurer in exchange for fees paid by the insurer. As is the case with credit enhancement agreements generally, these agreements often improve the overall value of purchased mortgages and thus may allow us to offer lower guarantee fees to sellers.

After primary mortgage insurance, the most prevalent type of credit enhancement that we use is pool insurance. With pool insurance, a mortgage insurer provides insurance on a pool of loans up to a stated aggregate loss limit. Our pool insurance contracts cover losses ranging between approximately 0.69 percent and 5.00 percent of the aggregate unpaid principal balance of the pooled loans at the time of purchase. In addition to a pool-level loss coverage limit, some pool insurance contracts may have limits on coverage at the loan level. For pool insurance contracts that expire before the completion of the contractual term of the mortgage loan, we seek to ensure that the contracts cover the period of time during which we believe the mortgage loans are most likely to default.

Other forms of credit enhancements on single-family mortgage loans include collateral (including cash or high-quality marketable securities) pledged by a lender, government guarantees, and recourse agreements (under which we may require a lender to repurchase loans that default). In some instances, our agreements with insurers limit the insurance to a stated aggregate loss.

For multifamily mortgages, we occasionally utilize credit enhancements to mitigate risk. The types of credit enhancements used for multifamily mortgage loans include recourse, third-party guarantees or letters of credit, subordinated participations in mortgage loans or structured pools, and cross-default and cross-collateralization provisions. With a cross-default provision, if the loan on a property goes into default, we have the right to declare specified other mortgage loans of the same borrower or certain of its affiliates to be in default and to foreclose those other mortgages. With a cross-collateralization provision, we have the additional right to apply excess proceeds from the foreclosure of one mortgage to amounts owed to us by the same borrower or certain of its affiliates relating to other multifamily mortgage loans we own. We also receive similar credit enhancements for Multifamily PC guarantor swaps; for tax-exempt multifamily housing revenue bonds that support pass-through certificates issued by third parties for which we provide our guarantee of the payment of principal and interest; for Freddie Mac pass-through certificates that are backed by tax-exempt multifamily housing revenue bonds and related taxable bonds and/or loans, and for multifamily mortgage loans that are originated and held by state and municipal agencies to support tax-exempt multifamily housing revenue bonds for which we provide our guarantee of the payment of principal and interest. For information about our maximum coverage in regards to these credit enhancements, see "NOTE 4: FINANCIAL GUARANTEES" to the consolidated financial statements.

While the use of credit enhancements reduces our exposure to mortgage credit risk, it increases our exposure to institutional credit risk. See "*Institutional Credit Risk*" for more information.

*Portfolio Diversification.* A key characteristic of our credit risk portfolio is broad diversification along a number of critical risk dimensions. We continually monitor a variety of mortgage loan characteristics such as product mix, loan-to-value ratios and geographic concentration, which may affect the default experience on our overall mortgage portfolio, and may seek to reinsure a portion of our portfolio if we observe unacceptable levels of concentration.

*Product Mix.* Table 60 presents the distribution of underlying mortgage assets for total PCs and Structured Securities issued and outstanding.

**Table 60 — Freddie Mac Issued and Outstanding PCs and Structured Securities<sup>(1)</sup>**

	December 31,			
	2004		2003	
	Total Issued PCs and Structured Securities	Outstanding PCs and Structured Securities <sup>(2)</sup>	Total Issued PCs and Structured Securities	Outstanding PCs and Structured Securities <sup>(2)</sup>
	(dollars in millions)			
Freddie Mac issued PCs and Structured Securities				
Single-family:				
Conventional:				
30-year fixed-rate <sup>(3)</sup> .....	\$ 689,945	\$509,923	\$ 649,719	\$449,281
15-year fixed-rate .....	347,135	224,627	355,800	197,677
ARMs/floating-rate <sup>(4)</sup> .....	102,273	59,089	81,184	39,868
Seconds <sup>(5)</sup> .....	—	—	2	2
FHA/VA .....	1,350	1,340	2,098	2,058
RHS and other federal guarantee loans	178	178	164	164
Alternative collateral deals <sup>(6)</sup> .....	16,560	8,125	17,486	11,478
Balloons/resets <sup>(7)</sup> .....	32,966	31,075	34,788	31,818
Structured Securities backed by Ginnie Mae Certificates <sup>(8)</sup> .....	3,015	2,628	4,729	4,059
Total single-family .....	<u>1,193,422</u>	<u>836,985</u>	<u>1,145,970</u>	<u>736,405</u>
Multifamily:				
Conventional .....	<u>15,546</u>	<u>15,285</u>	<u>16,098</u>	<u>15,759</u>
Total .....	<u>\$1,208,968</u>	<u>\$852,270</u>	<u>\$1,162,068</u>	<u>\$752,164</u>

(1) Excludes mortgage loans and mortgage-related securities traded, but not yet settled.

(2) Represents PCs and Structured Securities held by third parties.

(3) Also includes 20-year and 40-year fixed-rate mortgages.

(4) Includes ARM with 1-, 3-, 5-, 7- and 10-year initial fixed-rate periods.

(5) Represents mortgage loans on properties that are subordinate to the superior mortgage lien.

(6) Prior to 2004, alternative collateral deals included Structured Securities backed by non-agency securities, which were primarily backed by subprime mortgage loans; and to a lesser extent, FHA / VA loans and home equity loans. Beginning in 2004, alternative collateral deals included Structured Securities backed by non-agency securities, which were backed by a mixture of subprime and other (*i.e.*, prime) mortgage loans. The alternative collateral deal portion of outstanding PCs and Structured Securities consisted of \$1,587 million and \$2,572 million of fixed-rate, \$1,165 million and \$2,723 million of ARM/floating rate, \$5,286 million and \$6,040 million of FHA/VA, \$17 million and \$5 million of the Rural Housing Service and other federal guarantee loans, and \$70 million and \$138 million of seconds at December 31, 2004 and 2003, respectively.

(7) Mortgages whose terms require lump sum principal payments on contractually determined future dates unless the borrower qualifies for and elects an extension of the maturity date at an adjusted interest rate.

(8) Ginnie Mae Certificates which underlie the Structured Securities are backed by FHA/VA loans.

Table 61 presents the distribution of unsecuritized whole mortgage loans held in our Retained portfolio.

**Table 61 — Mortgage Loans Held in the Retained Portfolio<sup>(1)</sup>**

	December 31,	
	2004	2003
	(dollars in millions)	
<b>Single-family:</b>		
Conventional		
Fixed-rate <sup>(2)</sup> .....	\$21,409	\$24,902
Adjustable-rate <sup>(2)</sup> .....	990	1,245
Seconds .....	—	1
Total Conventional .....	<u>22,399</u>	<u>26,148</u>
FHA/VA — Fixed-rate .....	344	513
RHS and other federal guarantee loans .....	646	613
Total single-family .....	<u>23,389</u>	<u>\$27,274</u>
<b>Multifamily Mortgages:</b>		
Conventional .....	37,968	\$32,993
FHA/RHS .....	3	3
Total multifamily .....	<u>37,971</u>	<u>32,996</u>
<b>Total mortgages</b> .....	<u>\$61,360</u>	<u>\$60,270</u>

(1) Based on unpaid principal balances. Excludes mortgage loans traded, but not yet settled.

(2) We reclassified \$374 million of mortgage loans from Single-family Conventional Fixed-rate to Single-family Conventional Adjustable-rate for the year ended December 31, 2003 to conform with the 2004 presentation.

Product mix affects the credit risk profile of our Total mortgage portfolio. In general, 15-year fixed-rate mortgages exhibit the lowest default rate among the types of single-family mortgage loans we securitize and purchase, due to the accelerated rate of principal amortization on these mortgages and the credit profiles of borrowers who seek and qualify for them. The next lowest rate of default is associated with 30-year fixed-rate mortgages. Balloon/reset mortgages and ARMs typically default at a higher rate than fixed-rate mortgages, although default rates for different types of ARMs may vary. While ARMs are typically originated with interest rates that are initially lower than those available for fixed-rate mortgages, their interest rates also change over time based on changes in an index or reference interest rate. As a result, the borrower's payments may rise or fall, within limits, as interest rates change. As payment amounts increase, the risk of default also increases. In the low interest rate environment experienced during 2002, 2003 and 2004, this trend was reversed with ARMs exhibiting lower default rates than fixed-rate mortgages.

During 2004, there was a rapid proliferation of alternative product types, including initial interest-only loans (loans where the borrower pays only interest for a period of time before the loan begins to amortize), negative amortization loans (loans where the borrower's payment is capped and as a result the loan balance may actually increase due to the difference between the capped payment and the fully indexed payment), and Alternative A products (primarily loans originated based on stated income or asset information or where the borrower provides no supporting documentation of income, assets or employment). While each of these products has been on the market for some time, their prevalence increased in 2004. These products are designed to address a variety of borrower needs, including affordability issues and documentation issues. Each of these products is expected to default more often than our traditional product types. To date, we have purchased a limited amount of these products through our securitization programs, although we expect our participation in these products to grow over the coming years. We will monitor the growth of these products in our portfolio, and if appropriate, may seek credit enhancements to manage the incremental risk.

The subprime segment of the mortgage market primarily serves borrowers with lower quality credit payment histories. These mortgages typically carry a higher risk of default. Our participation in this market helps to increase the availability of mortgage credit and reduce the costs of homeownership for a broader spectrum of borrowers.

We participate in the subprime market segment in two ways. First, our Retained portfolio makes investments in non-Freddie Mac mortgage-related securities that were originated in this market segment. Substantially all of these securities were rated "AAA" by one or more rating agencies at the time of purchase.

*Freddie Mac*

These investments are included in the single-family and other mortgage-related securities portion of our non-Freddie Mac mortgage-related securities portfolio shown in “Table 33 — Credit Characteristics of Mortgages and Mortgage-Related Securities in the Retained Portfolio.” Second, we guarantee securities backed by subprime mortgages. (These securities comprise a portion of our “alternative collateral deals.”) These securities have previously been credit enhanced and at the time of our purchase most of these securities were “shadow rated” at least “BBB” (based on the S&P rating scale) by at least one nationally recognized credit rating agency which assessed the risks of the securities without regard to the benefits of our guarantee. In addition to the non-Freddie Mac mortgage-related securities discussed above, our Retained portfolio makes investments in some of the Structured Securities issued in these transactions.

The distribution of the single-family loans underlying our Total mortgage portfolio (excluding non-Freddie Mac mortgage-related securities, alternative collateral deals and that portion of Structured Securities that is backed by Ginnie Mae Certificates) by original and estimated current loan-to-value ratio ranges, credit scores, loan purpose, property type and occupancy type is shown in Table 62.

**Table 62 — Characteristics of Single-Family Mortgage Loan Portfolio<sup>(1)</sup>**

<u>Original LTV Ratio Range<sup>(2)</sup></u>	<u>December 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Less than 60% . . . . .	26%	26%	21%
Above 60% to 70% . . . . .	17	17	15
Above 70% to 80% . . . . .	42	41	43
Above 80% to 90% . . . . .	9	9	11
Above 90% to 95% . . . . .	5	6	8
Above 95% . . . . .	1	1	2
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>
Weighted average original loan-to-value ratio . . . . .	70%	70%	72%
<u>Estimated Current LTV Ratio Range<sup>(3)</sup></u>			
Less than 60% . . . . .	53%	44%	45%
Above 60% to 70% . . . . .	19	20	19
Above 70% to 80% . . . . .	18	23	22
Above 80% to 90% . . . . .	7	9	9
Above 90% to 95% . . . . .	2	3	3
Above 95% . . . . .	1	1	2
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>
Weighted average estimated current LTV ratio . . . . .	57%	61%	61%
<u>Credit Score</u>			
740 and above . . . . .	44%	44%	39%
700 to 739 . . . . .	23	23	23
660 to 699 . . . . .	18	17	18
620 to 659 . . . . .	9	9	10
Less than 620 . . . . .	4	4	4
Not Available . . . . .	2	3	6
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>
Weighted average credit score . . . . .	723	723	718
<u>Loan Purpose</u>			
Purchase . . . . .	28%	25%	34%
Cash-out refinance . . . . .	27	26	25
Other refinance . . . . .	45	49	41
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>
<u>Property Type</u>			
1 unit . . . . .	97%	97%	97%
2-4 units . . . . .	3	3	3
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>
<u>Occupancy Type</u>			
Primary residence . . . . .	94%	94%	94%
Second/vacation home . . . . .	3	3	3
Investment . . . . .	3	3	3
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>

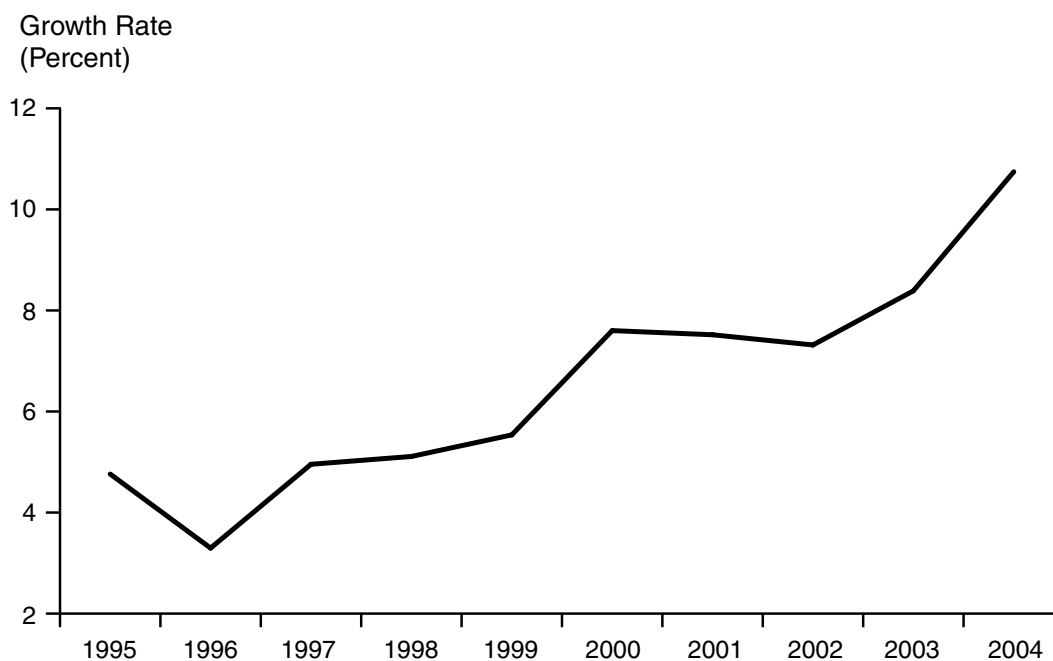
- (1) Based on the single-family mortgage portfolio (excluding non-Freddie Mac mortgage-related securities, alternative collateral deals and that portion of Structured Securities that is backed by Ginnie Mae Certificates), which totaled \$1,197 billion, \$1,151 billion and \$1,084 billion at December 31, 2004, 2003 and 2002, respectively.
- (2) Our charter requires that mortgage loans purchased with loan-to-value ratios above 80 percent be covered by mortgage insurance or other credit enhancements.
- (3) Current market values are estimated by adjusting the value of the property at origination based on changes in the market value of house prices since origination.

*Loan-to-Value Ratios.* Our principal safeguard against credit losses for mortgage loans in our single-family, non-credit-enhanced portfolio is provided by the borrowers' equity in the underlying properties. The weighted average original loan-to-value ratio decreased to 70 percent for the years ended December 31, 2004

and 2003 from 72 percent for the year ended December 31, 2002. Mortgage loans with higher loan-to-value ratios (and therefore lower levels of borrower equity) at the time of purchase are also protected by credit enhancements, since our charter requires that loans with loan-to-value ratios above 80 percent at the time of purchase be covered by mortgage insurance or certain other credit protections.

The likelihood of single-family mortgage default depends not only on the initial credit quality of the loan, but also on events that occur after origination. Accordingly, we monitor changes in house prices across the country and the impact of these house price changes on the underlying loan-to-value ratio of mortgages in our portfolio.

**Figure 1 — Annual House Price Appreciation**



As shown in Figure 1, house prices have risen significantly over the last ten years, and have grown very dramatically over the last three years. This house price appreciation has positively influenced the values of properties underlying the mortgages in our portfolio. The weighted average estimated current loan-to-value ratio of our single-family non-credit-enhanced portfolio decreased to 57 percent for the year ended December 31, 2004 from 61 percent for each of the years ended December 31, 2003 and 2002. The decrease is primarily the result of unusually strong house price appreciation. Despite these positive national trends, we remain vigilant in identifying possible weaknesses in regional geographic markets, particularly with respect to new loans originated in an environment of strong house prices, and may seek to reinsure a portion of this risk should we determine that the possibility of such weaknesses warrants action. Historical experience has shown that defaults are less likely to occur on mortgages with lower estimated current loan-to-value ratios. Furthermore, in the event of a default, higher levels of borrower equity in a property reduce the total amount of loss, thereby mitigating credit losses.

*Credit Score.* Credit scores are a useful measure for assessing the credit quality of a borrower. Credit scores are numbers reported by the credit repositories, based on statistical models, that summarize an individual's credit record and predict the likelihood that a borrower will repay future obligations as expected. FICO® scores, or FICO, developed by Fair, Isaac and Co., Inc., are the most commonly used credit scores today.

FICO scores are ranked on a scale of approximately 300 to 850 points. Statistically, consumers with higher credit scores are more likely to repay their debts as expected than those with lower scores. The weighted average credit score for the Total mortgage portfolio (based on the credit score at origination) remained high at 723 at both December 31, 2004 and 2003 and a slight increase from 718 at December 31,

*Freddie Mac*

2002, indicating strong credit quality borrowers. In particular, the percentage of the mortgage loans with an available FICO score of 740 or greater in the Total mortgage portfolio has remained at 44 percent at December 31, 2004 and 2003 and increased from 39 percent at December 31, 2002.

*Loan Purpose.* Mortgage loan purpose indicates how the borrower intends to use the funds from a mortgage loan. The three general categories are: purchase, cash-out refinance, or other refinance. In a purchase transaction, funds are used to acquire a property. In a cash-out refinance transaction, in addition to paying off an existing first mortgage lien, the borrowers obtain additional funds that may be used for other purposes, including paying off subordinate mortgage liens and providing unrestricted cash proceeds to the borrower. In other refinance transactions, the funds are used to pay off an existing first mortgage lien and may be used in limited amounts for certain specified purposes; such refinances are generally referred to as “no cash-out” or “rate and term” refinances. Other refinance transactions also include refinance mortgages for which the delivery data provided was not sufficient for us to determine whether the mortgage was a cash-out or a no cash-out refinance transaction. From a risk perspective, purchase transactions have the lowest likelihood of default (all else being equal), followed by no-cash out refinances, then cash out refinances. As a practical matter, however, no-cash out refinances tend to have lower loan-to-value ratios and higher credit scores than purchase transactions and as such, have better overall performance than purchase transactions. While a reduction in interest rates in 2003 increased the proportion of refinance mortgage loans in the Total mortgage portfolio from a total of 66 percent at December 31, 2002 to 75 percent at December 31, 2003, an increase in interest rates in 2004 slightly decreased the proportion of refinance mortgage loans in the Total mortgage portfolio to a total of 72 percent at December 31, 2004.

*Property Type.* Single-family mortgage loans are defined as mortgages secured by housing with up to four living units. Mortgages on one-unit properties tend to have lower credit risk than mortgages on multiple-unit properties. The proportion of one-unit properties in the Total mortgage portfolio remained the same over the past three years, accounting for 97 percent at December 31, 2004, 2003 and 2002.

*Occupancy Type.* Borrowers may purchase a home as a primary residence, second/vacation home or investment property that is typically a rental property. Mortgage loans on properties occupied by the borrower as a primary or secondary residence tend to have a lower credit risk than mortgages on investment properties. The proportion of primary and secondary residences in the Total mortgage portfolio remained the same over the past three years, accounting for 97 percent at December 31, 2004, 2003 and 2002.

*Geographic Concentration.* Since our business model involves purchasing mortgages from every geographic region in the U.S., we maintain a geographically diverse mortgage portfolio. This diversification provides protection from changing local and economic conditions. See “NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS” to our consolidated financial statements for more information concerning the distribution of our Total mortgage portfolio (excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates) by geographic region. Our Total mortgage portfolio’s geographic distribution was relatively stable from 2003 to 2004, and remains broadly diversified across these regions.

*Loss Mitigation Activities.* Within our credit portfolio, we expect and price for some mortgage loans to become non-performing due to changes in general economic conditions, changes in the financial status of individual borrowers or other factors.

Table 63 summarizes our non-performing assets. The increase in our non-performing assets from 2000 through 2003 was primarily driven by higher delinquencies associated with our alternative collateral deals. While these delinquencies result in higher levels of non-performing assets, we have limited loss exposure due to the credit enhancements associated with these securities. Prior to 2004, alternative collateral deals consisted only of Structured Securities backed by non-agency securities, which were primarily backed by subprime mortgage loans; and to a lesser extent, FHA/VA loans and home equity loans. Beginning in 2004, however, certain alternative collateral deals were backed by prime mortgage loans.

**Table 63 — Non-Performing Assets**

	December 31,				
	2004	2003	2002	2001	2000
	(dollars in millions)				
Troubled debt restructurings, or TDRs <sup>(1)</sup> . . . . .	\$2,297	\$ 2,370	\$2,164	\$1,617	\$1,389
Serious delinquencies <sup>(2)</sup> . . . . .	6,318	7,470	6,830	5,070	3,546
Non-accrual loans <sup>(3)</sup> . . . . .	27	21	47	44	9
Subtotal <sup>(4)</sup> . . . . .	<u>8,642</u>	<u>9,861</u>	<u>9,041</u>	<u>6,731</u>	<u>4,944</u>
REO, net <sup>(5)</sup> . . . . .	741	795	594	447	358
Total . . . . .	<u>\$9,383</u>	<u>\$10,656</u>	<u>\$9,635</u>	<u>\$7,178</u>	<u>\$5,302</u>

- (1) Includes previously delinquent loans whose terms have been modified. Some of these loans may be performing as a result of the modified terms. TDRs are considered part of our impaired loan population. Figures presented are based on unpaid principal balances of mortgage loans. See "NOTE 6: LOAN LOSS RESERVES" to the consolidated financial statements for additional information on impaired loans.
- (2) Includes single-family loans 90 days or more delinquent. For multifamily loans, the population includes all loans 60 days or more delinquent, but less than 90 days delinquent. Also included within this population are multifamily loans greater than 90 days past due but where principal and interest are being paid to us under the terms of a credit enhancement agreement. Also includes seriously delinquent loans in alternative collateral deals which totaled \$2,234 million, \$2,793 million, \$2,290 million, \$1,052 million and \$529 million at December 31, 2004, 2003, 2002, 2001 and 2000, respectively. See the discussion related to alternative collateral deal delinquencies following "Table 65 — Delinquency Performance."
- (3) Non-accrual mortgage loans are loans for which interest income is recognized only on a cash basis and only includes multifamily loans that are 90 days or more delinquent. Balance represents 2, 2, 3, 5 and 10 properties at December 31, 2004, 2003, 2002, 2001 and 2000, respectively. No single-family mortgage loans are classified as non-accrual. For single-family mortgages we recognize interest income on an accrual basis for all such loans, regardless of delinquency. We establish reserves for uncollectible interest that are estimated using statistical models which quantify accrued but unpaid interest at the consolidated balance sheet date. Mortgage loans placed on non-accrual status are considered part of our impaired loan population.
- (4) For the year ended December 31, 2004, \$443 million was included in net interest income and management and guarantee income related to these mortgage loans (excluding interest income related to alternative collateral deals). The amount of forgone net interest income and additional management and guarantee income that we would have recorded had these loans been current is \$65 million for the year ended December 31, 2004.
- (5) For more information about REO balances, see "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES" and "NOTE 7: REAL ESTATE OWNED" to the consolidated financial statements.

Loss mitigation activities are a key component of our strategy for managing and resolving troubled assets and lowering credit losses. Our loss mitigation strategy emphasizes early intervention in delinquent mortgages and alternatives to foreclosure. Foreclosure alternatives are intended to reduce the number of delinquent mortgages that proceed to foreclosure and, ultimately, mitigate our total credit losses by eliminating a portion of the costs related to foreclosed properties. Table 64 summarizes the number of loans involved in different types of single-family foreclosure alternatives.

**Table 64 — Single-Family Foreclosure Alternatives<sup>(1)</sup>**

	December 31,		
	2004	2003	2002
	(number of loans)		
<b>Foreclosure Alternatives<sup>(2)</sup></b>			
Repayment plans . . . . .	37,406	34,458	32,672
Loan modifications . . . . .	6,789	8,508	7,951
Forbearance agreements . . . . .	2,105	2,226	2,798
Pre-foreclosure sales <sup>(3)</sup> . . . . .	<u>2,010</u>	<u>1,755</u>	<u>1,531</u>
Foreclosure alternatives . . . . .	<u>48,310</u>	<u>46,947</u>	<u>44,952</u>

- (1) Based on the single-family Total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities, alternative collateral deals and that portion of Structured Securities that is backed by non-Freddie Mac mortgage-related securities.
- (2) Some mortgage loans may go through a foreclosure alternative more than once or may go through more than one type of foreclosure alternative. Additionally, the table represents only instances that successfully return the borrower to a current payment status, with the exception of pre-foreclosure sales, where the relationship with the borrower has concluded.
- (3) This amount includes third party sales and other foreclosure alternatives.

The increase in foreclosure alternatives from 2002 through 2004 was primarily driven by an enhanced effort by us and servicers to pursue loss mitigation for homeownership preservation and a favorable interest rate environment that facilitated the foreclosure alternatives. Repayment plans, the most common type of foreclosure alternative, mitigate our credit losses because they assist borrowers in returning to compliance with

the original terms of their mortgages. Loan modifications, the second most common type of foreclosure alternative, involve changing the terms of a mortgage and therefore are a more favorable alternative to the borrower during a declining interest-rate environment, such as we experienced during 2002 and the first half of 2003. Forbearance agreements, the third most common type of foreclosure alternative, provide a temporary suspension of the foreclosure process to allow additional time for the borrower to return to compliance with the original terms of the borrower's mortgage or to implement another foreclosure alternative.

Other single-family loss mitigation activities include providing default management tools designed to help single-family servicers manage non-performing loans more effectively. These tools include Early Indicator®, a system that estimates the probability that delinquent loans will be resolved or advanced through to a loss-producing state. In addition, we provide the servicers with a suite of self-management tools such as Timeline Manager, Workout Manager, Expense Manager and REO Manager. We also use Servicer Performance Profile reports to evaluate and manage the performance of our mortgage servicers based on their management of performing and non-performing loans.

We require multifamily servicers to closely manage mortgage loans they have sold us in order to mitigate potential losses. At least once a year, for loans over \$1 million, servicers must submit an assessment of the mortgaged property to us based on an inspection of the property and a review of the property's financial statements. We also evaluate these assessments internally and may direct the servicer to take specific actions to reduce the likelihood of delinquency or default. If a loan defaults despite this intervention, we then determine whether it is in our best interest to offer a reasonable foreclosure alternative to the borrower. For example, we may modify the terms of a multifamily mortgage loan which gives the borrower an opportunity to bring the loan current and allows the borrower to retain ownership of the property. Since multifamily seller/servicers are an important part of our loss mitigation process, we rate their performance regularly and conduct on-site reviews of their servicing operations to confirm compliance with our standards.

*Other Credit Risk Management Activities.* As noted previously, we purchase a broad range of mortgage products with differing degrees of default risk. To compensate us for unusual levels of risk in some mortgage products we may charge incremental fees above a base guarantee fee calculated on credit risk factors such as the mortgage product type, loan purpose, loan-to-value ratio, and other loan attributes. In addition, we occasionally use financial incentives and credit derivatives, as described below, in situations where we believe they will benefit our credit risk management strategy. These arrangements are intended to reduce our credit-related expenses and to help us manage purchase quality, thereby improving our overall returns.

In some cases, we also provide financial incentives in the form of lump sum payments to selected seller/servicers if they deliver a specified volume or share of mortgage loans meeting specified credit risk standards over a defined period of time. These financial incentives may also take the form of a fee payable to us by the seller if the mortgages delivered to us do not meet certain credit standards.

We have also entered into risk-sharing agreements that are accounted for as derivatives in accordance with GAAP. In part because the agreements may result in us making payments to the seller/servicer (depending upon actual default experience over the lives of the mortgages), they are considered credit derivatives, rather than financial guarantees under GAAP. Under these agreements, default losses on specific mortgage loans delivered by sellers are compared to default losses on reference pools of mortgage loans with similar characteristics. Based upon the results of that comparison, we remit or receive payments based upon the default performance of the specified mortgage loans. These payments are recorded in Management and guarantee income on the consolidated statements of income. The total notional amount of mortgage loans subject to these agreements was approximately \$10.9 billion and \$15.5 billion at December 31, 2004 and 2003, respectively. These risk-sharing agreements are classified as no hedge designation for purposes of applying SFAS 133, with changes in fair value recorded as Derivative gains (losses) on the consolidated statements of income. The fair value of these risk-sharing agreements is recorded in the Derivative assets, at fair value and Derivative liabilities, at fair value on the consolidated balance sheets, with net amounts of \$(2) million and \$5 million at December 31, 2004 and 2003, respectively.

Although these arrangements are part of our overall credit risk management strategy, we have not treated them as credit enhancements for purposes of describing our Total mortgage portfolio characteristics because

*Freddie Mac*

the financial incentive and credit derivative agreements may result in us making payments to the seller/servicer.

**Credit Performance.** The effectiveness of our credit risk management activities is reflected, in part, in the level of credit losses relative to our Total mortgage portfolio (excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates). To the extent we take on riskier assets, such as A- mortgages, and charge higher guarantee fees, credit losses may rise despite effective credit risk management activities. Therefore, while credit losses are a useful indicator of management activities, they must ultimately be considered relative to the revenue received for assuming the underlying credit risk. Several key statistics associated with potential and actual credit losses are detailed in the tables below.

*Delinquencies.* Table 65 summarizes the delinquency performance of our single-family and multifamily mortgage portfolios. “Table 66 — Single-Family — Non-Credit-Enhanced Delinquencies — By Region” and “Table 67 — Composition of Single-Family Mortgages by Year of Origination — Mortgage Portfolio and Non-Credit-Enhanced Delinquencies” provide a more detailed analysis of single-family delinquencies, by geographic region and year of origination.

**Table 65 — Delinquency Performance<sup>(1)</sup>**

	December 31,		
	2004	2003	2002
<b>Single-family<sup>(2)</sup></b>			
Non-credit-enhanced portfolio			
Delinquency rate <sup>(3)</sup> .....	0.24%	0.27%	0.28%
Total number of delinquent loans .....	19,691	21,063	20,946
Credit-enhanced portfolio <sup>(4)</sup>			
Delinquency rate <sup>(3)</sup> .....	2.75%	2.96%	2.07%
Total number of delinquent loans .....	54,913	66,283	58,768
Total portfolio			
Delinquency rate <sup>(3)</sup> .....	0.73%	0.86%	0.77%
Total number of delinquent loans .....	74,604	87,346	79,714
<b>Multifamily<sup>(4)</sup></b>			
Total portfolio			
Delinquency rate .....	0.06%	0.05%	0.13%
Net carrying value of delinquent loans (in millions) .....	\$ 35	\$ 24	\$ 49

(1) Based on the Total mortgage portfolio, excluding both non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates.

(2) Based on the number of mortgages 90 days or more delinquent or in foreclosure.

(3) Includes alternative collateral deals.

(4) Based on net carrying value of mortgages 60 days or more delinquent or in foreclosure.

The single-family total portfolio delinquency rate decreased by 13 basis points from December 31, 2003 to 0.73 percent at December 31, 2004. This decrease was driven by the single-family credit-enhanced delinquency rate, which decreased by 21 basis points from December 31, 2003 to 2.75 percent at December 31, 2004 and a 3 basis point decline in the single-family non-credit-enhanced portfolio. The decrease in the credit-enhanced delinquency rate was primarily associated with reduced delinquencies in our alternative collateral deals, the drop in the unemployment rate and continued house price appreciation. The multifamily delinquency rate was 0.06 percent at December 31, 2004, up from 0.05 percent at December 31, 2003. Multifamily delinquencies include certain mortgage loans where the borrowers are not paying as agreed, but principal and interest are being paid to us under the terms of a credit enhancement agreement.

Table 66 presents delinquency rates for the non-credit-enhanced portion of the single-family loans underlying our Total mortgage portfolio (excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates) by geographic region.

**Table 66 — Single-Family — Non-Credit-Enhanced Delinquencies — By Region** <sup>(1)(2)</sup>

	December 31,		
	2004	2003	2002
Northeast .....	0.24%	0.28%	0.30%
Southeast .....	0.31	0.32	0.34
North central .....	0.27	0.27	0.27
Southwest .....	0.26	0.28	0.28
West .....	0.15	0.19	0.23
Total all regions .....	0.24%	0.27%	0.28%

(1) Based on the number of mortgages 90 days or more delinquent or in foreclosure.

(2) See "NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS" to the consolidated financial statements for a description of these regions.

Regional delinquency rates generally declined in 2004. Reductions in the Northeast and West regions were the primary drivers behind the decrease in the overall delinquency rate. These regions' delinquency improvement is a result of improved economies and increased house price appreciation. The non-credit enhanced delinquency rate for the North Central region, which has been adversely impacted by declines in the manufacturing industry, remained unchanged despite the slight increase in the number of delinquent properties.

Table 67 presents the distribution of the single-family loans underlying our Total mortgage portfolio (excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates) and non-credit-enhanced delinquency rates by year of origination.

**Table 67 — Composition of Single-Family Mortgages By Year of Origination — Mortgage Portfolio and Non-Credit-Enhanced Delinquencies**

Year of Origination	December 31,					
	2004		2003		2002	
	Percent of Single-Family Balance <sup>(1)</sup>	Non-Credit-Enhanced Delinquency Rate <sup>(2)</sup>	Percent of Single-Family Balance <sup>(1)</sup>	Non-Credit-Enhanced Delinquency Rate <sup>(2)</sup>	Percent of Single-Family Balance <sup>(1)</sup>	Non-Credit-Enhanced Delinquency Rate <sup>(2)</sup>
Pre-1997 .....	3%	0.65%	6%	0.68%	11%	0.54%
1997 .....	1	0.83	1	0.82	3	0.51
1998 .....	3	0.49	4	0.45	11	0.26
1999 .....	2	0.78	3	0.73	8	0.44
2000 .....	1	1.94	1	1.78	3	0.91
2001 .....	6	0.59	10	0.48	26	0.19
2002 .....	16	0.26	24	0.18	38	0.05
2003 .....	44	0.06	51	0.01	—	—
2004 .....	24	0.03	—	—	—	—
As of December 31 .....	<u>100%</u>	0.24%	<u>100%</u>	0.27%	<u>100%</u>	0.28%

(1) Single-family Total mortgage portfolio, based on unpaid principal balances, excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates.

(2) Based on mortgages 90 days or more delinquent or in foreclosure.

Our single-family portfolio distribution by origination year was affected by heavy refinance volumes in recent years. At December 31, 2004, 84 percent of our single-family mortgage portfolio consisted of mortgage loans originated in 2002, 2003 or 2004. Mortgage loans originated in 2001 and earlier, which represent approximately 16 percent of our single-family mortgage portfolio, have delinquency rates that are generally higher than the overall portfolio delinquency rate due to the natural aging of the loans and, in some instances, to the weaker credit quality of these loans. For instance, mortgage loans originated in 2000 were generally for purchase transactions, which, as noted earlier, typically involve more risk resulting in weaker credit quality, as opposed to refinancing transactions. As a result, we have experienced higher than average early defaults and delinquency rates on these mortgage loans originated in 2000, but they represent only one percent of the single-family Total mortgage portfolio (excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates).

*Credit Loss Performance.* Some of the loans that are delinquent or in foreclosure result in credit losses. Table 68 provides detail on our credit loss performance, including REO activity, charge-offs and credit losses.

**Table 68 — Credit Loss Performance**

	Year Ended December 31,		
	2004	2003	2002
	(dollars in millions)		
<b>REO</b>			
REO balances:			
Single-family .....	\$ 740	\$ 758	\$ 593
Multifamily .....	1	37	1
Total .....	<u>\$ 741</u>	<u>\$ 795</u>	<u>\$ 594</u>
REO activity (number of properties): <sup>(1)</sup>			
Beginning property inventory .....	9,170	7,222	5,713
Properties acquired .....	18,489	17,750	13,520
Properties disposed .....	(18,055)	(15,802)	(12,011)
Ending property inventory .....	<u>9,604</u>	<u>9,170</u>	<u>7,222</u>
Average holding period (in days) <sup>(2)</sup> .....	177	174	185
REO operations income (expense): <sup>(3)</sup>			
Single-family .....	\$ (1)	\$ (4)	\$ (4)
Multifamily .....	4	(3)	—
Total .....	<u>\$ 3</u>	<u>\$ (7)</u>	<u>\$ (4)</u>
<b>CHARGE-OFFS</b>			
<b>Single-family:</b>			
Foreclosure alternatives, gross .....	\$ (47)	\$ (40)	\$ (46)
Recoveries <sup>(4)</sup> .....	21	17	17
Foreclosure alternatives, net .....	(26)	(23)	(29)
REO acquisitions, gross .....	(253)	(176)	(124)
Recoveries <sup>(3)(4)</sup> .....	139	127	80
REO acquisitions, net .....	(114)	(49)	(44)
Single-family totals:			
Charge-offs, gross .....	(300)	(216)	(170)
Recoveries <sup>(3)(4)</sup> .....	160	144	97
<b>Single-family charge-offs, net</b> .....	<u>(140)</u>	<u>(72)</u>	<u>(73)</u>
<b>Multifamily:</b>			
Charge-offs, gross .....	—	(8)	(1)
Recoveries <sup>(4)</sup> .....	—	1	2
<b>Multifamily charge-offs, net</b> .....	<u>—</u>	<u>(7)</u>	<u>1</u>
<b>Total Charge-offs:</b> <sup>(3)</sup>			
Charge-offs, gross .....	(300)	(224)	(171)
<b>Recoveries:</b>			
Related to primary mortgage insurance .....	85	94	61
Not related to primary mortgage insurance .....	75	51	38
<b>Total recoveries</b> <sup>(3)(4)</sup> .....	<u>160</u>	<u>145</u>	<u>99</u>
<b>Charge-offs, net</b> .....	<u>\$ (140)</u>	<u>\$ (79)</u>	<u>\$ (72)</u>
<b>CREDIT GAINS (LOSSES)</b> <sup>(5)</sup>			
Single-family <sup>(3)</sup> .....	\$ (141)	\$ (76)	\$ (77)
Multifamily .....	4	(10)	1
<b>Total</b> <sup>(3)</sup> .....	<u>\$ (137)</u>	<u>\$ (86)</u>	<u>\$ (76)</u>
In basis points: <sup>(6)</sup>			
Single-family <sup>(3)</sup> .....	(1.1)	(0.7)	(0.7)
Multifamily .....	—	(0.1)	—
<b>Total</b> <sup>(3)</sup> .....	<u>(1.1)</u>	<u>(0.8)</u>	<u>(0.7)</u>

(1) Includes single-family and multifamily REO properties.

(2) Represents weighted average holding period for single-family and multifamily based on number of REO properties disposed.

(3) We reclassified income of \$30 million and \$17 million for 2003 and 2002, respectively, from REO operations income (expense) to (Provision) benefit for credit losses to conform with the 2004 presentation. In addition, we reclassified certain expenses related to uncollectible interest on PCs held by third parties from Management and guarantee income to (Provision) benefit for credit losses to conform with the 2004 presentation. As a result of these reclassifications, we decreased charge-offs — single-family, net by \$26 million and \$15 million for 2003 and 2002, respectively.

(4) Includes recoveries of charge-offs primarily resulting from foreclosure alternatives and REO acquisitions on loans where a share of default risk has been assumed by servicers, mortgage insurers, or other third parties through credit enhancements. Recoveries of charge-offs through credit enhancements are limited in many instances to amounts less than the full amount of the loss.

(5) Equal to REO operations income (expense) plus Charge-offs, net.

(6) Calculated as credit gains (losses) divided by the average Total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates.

Overall, we continued to demonstrate strong credit performance during 2004, driven by effective risk management and the sustained strength of the single-family housing market. The following discussion provides additional analysis on key credit loss-related statistics and results.

Net credit losses (REO operations income (expenses) plus charge-offs, net) increased in 2004 as a result of the increase in single-family charge-offs. Single-family credit losses totaled \$141 million, or 1.1 basis points of the average Total mortgage portfolio in 2004. This represents an increase from the historically low levels of single-family credit losses experienced in 2003 (\$76 million or 0.7 basis points) and in 2002 (\$77 million or 0.7 basis points). Our multifamily portfolio produced a credit gain of \$4 million in 2004, compared to a \$10 million loss in 2003, and a \$1 million gain in 2002.

When we foreclose on a property, it may become part of our REO inventory. REO operations income (expense), a component of credit losses, includes the expenses incurred to foreclose, acquire, maintain and sell a property. REO inventory levels increased in 2004 in terms of number of properties held, although the dollar amounts decreased. The single-family REO balance was \$740 million at December 31, 2004, a change from \$758 million and \$593 million at December 31, 2003 and 2002, respectively. Although REO inventories increased, single-family REO income (expense) improved to expense of \$1 million in 2004 from expense of \$4 million in both 2003 and 2002 largely due to house price growth, recoveries from credit enhancements and reimbursements from seller/servicers. REO income arises when the fair market value of the acquired asset exceeds the carrying value of the mortgage loan or when we are able to sell the REO at amounts in excess of its carrying value.

Charge-offs, net, another component of credit losses, include losses and recoveries on mortgages that are transferred to REO or involved in a foreclosure alternative. Single-family charge-offs, net of recoveries, increased to \$140 million in 2004 from \$72 million in 2003 and \$73 million in 2002, largely due to decreases in the fair value of REO properties and increased REO acquisitions in the North Central region which continues to hold the largest share of REO inventory. Charge-offs, net are reflected on our consolidated balance sheets as a reduction in loan loss reserves. See “Table 71 — Loan Loss Reserves Activity” for more information.

Table 69 and Table 70 provide detail by region for two key credit performance statistics, REO activity and charge-offs. Regional REO acquisition and charge-off trends follow a pattern that is similar to that of regional delinquency trends.

**Table 69 — REO Activity — By Region<sup>(1)</sup>**

	Year Ended December 31,		
	2004	2003	2002
	(number of properties)		
<b>REO Inventory</b>			
Beginning property inventory . . . . .	9,170	7,222	5,713
Properties acquired by region:			
Northeast . . . . .	1,500	1,600	1,683
Southeast . . . . .	5,499	5,378	3,533
North central . . . . .	5,787	4,643	3,180
Southwest . . . . .	3,926	3,503	2,435
West . . . . .	1,777	2,626	2,689
Total properties acquired . . . . .	<u>18,489</u>	<u>17,750</u>	<u>13,520</u>
Properties disposed by region:			
Northeast . . . . .	(1,562)	(1,674)	(1,798)
Southeast . . . . .	(5,596)	(4,476)	(3,012)
North central . . . . .	(5,111)	(3,908)	(2,420)
Southwest . . . . .	(3,605)	(3,018)	(2,019)
West . . . . .	(2,181)	(2,726)	(2,762)
Total properties disposed . . . . .	<u>(18,055)</u>	<u>(15,802)</u>	<u>(12,011)</u>
Ending property inventory . . . . .	<u>9,604</u>	<u>9,170</u>	<u>7,222</u>

(1) See “NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS” to the consolidated financial statements for a description of these regions.

**Table 70 — Single-Family Charge-offs and Recoveries By Region<sup>(1)(2)</sup>**

	<u>Year Ended December 31,</u>		
	<u>2004</u>	<u>2003<sup>(3)</sup></u>	<u>2002<sup>(3)</sup></u>
(dollars in millions)			
<b>Northeast</b>			
Charge-offs .....	\$ 24	\$ 21	\$ 27
Recoveries .....	<u>(10)</u>	<u>(10)</u>	<u>(13)</u>
Charge-offs, net .....	<u>14</u>	<u>11</u>	<u>14</u>
<b>Southeast</b>			
Charge-offs .....	84	62	42
Recoveries .....	<u>(49)</u>	<u>(44)</u>	<u>(24)</u>
Charge-offs, net .....	<u>35</u>	<u>18</u>	<u>18</u>
<b>North central</b>			
Charge-offs .....	92	54	31
Recoveries .....	<u>(49)</u>	<u>(35)</u>	<u>(20)</u>
Charge-offs, net .....	<u>43</u>	<u>19</u>	<u>11</u>
<b>Southwest</b>			
Charge-offs .....	66	43	28
Recoveries .....	<u>(35)</u>	<u>(32)</u>	<u>(17)</u>
Charge-offs, net .....	<u>31</u>	<u>11</u>	<u>11</u>
<b>West</b>			
Charge-offs .....	34	36	42
Recoveries .....	<u>(17)</u>	<u>(23)</u>	<u>(23)</u>
Charge-offs, net .....	<u>17</u>	<u>13</u>	<u>19</u>
<b>Total</b>			
Charge-offs .....	300	216	170
Recoveries .....	<u>(160)</u>	<u>(144)</u>	<u>(97)</u>
Charge-offs, net .....	<u>\$ 140</u>	<u>\$ 72</u>	<u>\$ 73</u>

- (1) See “NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS” to the consolidated financial statements for a description of these regions.
- (2) Includes recoveries of charge-offs primarily resulting from foreclosure alternatives and REO acquisitions on loans where a share of default risk has been assumed by servicers, mortgage insurers, or other third parties through credit enhancements. Recoveries of charge-offs through credit enhancements are limited in many instances to amounts less than the full amount of the loss.
- (3) We reclassified certain income for the years ended December 31, 2003 and 2002 from REO operations income (expense) to (Provision) benefit for credit losses to conform with the 2004 presentation. In addition, we reclassified certain expenses related to uncollectible interest on PCs held by third parties from Management and guarantee income to (Provision) benefit for credit losses to conform with the 2004 presentation. As a result of these reclassifications, we decreased charge-offs, net by \$26 million and \$15 million for the years ended December 31, 2003 and 2002, respectively.

Table 71 summarizes our loan loss reserves activity.

**Table 71 — Loan Loss Reserves Activity**

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(dollars in millions)				
<b>Total loan loss reserves<sup>(1)</sup>:</b>					
Beginning balance	\$ 299	\$ 265	\$ 224	\$ 229	\$ 217
Provision (benefit) for credit losses <sup>(2)</sup>	143	(5)	122	33	82
Charge-offs	(300)	(224)	(171)	(129)	(124)
Recoveries <sup>(2)(3)</sup>	160	145	99	101	62
Charge-offs, net <sup>(2)</sup>	(140)	(79)	(72)	(28)	(62)
Adjustment for change in accounting <sup>(4)</sup>	—	110	—	—	—
Transfers-out during the period <sup>(5)</sup>	(20)	(11)	(9)	(10)	(8)
Other transfers, net during the period <sup>(6)</sup>	(18)	19	—	—	—
Ending balance	<u>\$ 264</u>	<u>\$ 299</u>	<u>\$ 265</u>	<u>\$ 224</u>	<u>\$ 229</u>
Charge-offs, net to Total mortgage portfolio <sup>(7)</sup>	1.1bp	0.7bp	0.7bp	0.3bp	0.7bp
Coverage ratio (reserves to charge-offs, net)	1.9	3.8	3.7	8.0	3.7

- (1) Includes Reserves for loans held-for-investment in the Retained portfolio and Reserves for guarantee losses on Participation Certificates. See “NOTE 6: LOAN LOSS RESERVES” to the consolidated financial statements for more details.
- (2) We reclassified certain income for the full years ended December 31, 2003, 2002, 2001 and 2000 from REO operations income (expense) to (Provision) benefit for credit losses to conform with the 2004 presentation. In addition, we reclassified certain expenses related to uncollectible interest on PCs held by third parties from Management and guarantee income to (Provision) benefit for credit losses to conform with the 2004 presentation. This resulted in a \$15 million decrease, \$6 million decrease, \$1 million increase and \$3 million increase in (Provision) benefit for credit losses during 2003, 2002, 2001 and 2000, respectively. As a result of these reclassifications, we increased recoveries by \$26 million, \$15 million, \$9 million and \$5 million for the full years 2003, 2002, 2001 and 2000, respectively.
- (3) Includes recoveries of charge-offs primarily resulting from foreclosure alternatives and REO acquisitions on loans where a share of default risk has been assumed by servicers, mortgage insurers or third parties through credit enhancements. Recoveries of charge-offs through credit enhancements are limited in many instances to amounts less than the full amount of the loss.
- (4) On January 1, 2003, \$110 million of recognized guarantee obligations that was attributable to estimated incurred losses on outstanding PCs or Structured Securities was reclassified to Reserve for guarantee losses on Participation Certificates.
- (5) Represents the reclassification of the reserve amount attributable to uncollectible interest on outstanding PCs and Structured Securities, which is included as an offset to the related receivable balance within Accounts and other receivables, net on the consolidated balance sheets.
- (6) Represents the reclassification of the portions of guarantee obligations recognized upon the sale of PCs or Structured Securities that corresponds to incurred credit losses reclassified to Reserve for guarantee losses on Participation Certificates upon initial recognition of a guarantee obligation. In addition, the 2004 amount includes a reduction of loan loss reserves of \$31 million related to prior period adjustments for which the related income was recorded in Other income.
- (7) Calculated using the average Total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates.

We maintain two loan loss reserves — Reserve for losses on mortgage loans held-for-investment and Reserve for guarantee losses on Participation Certificates — at levels we deem adequate to absorb probable incurred losses on mortgage loans held-for-investment in the Retained portfolio and certain mortgages underlying PCs held by third parties. In certain circumstances, incurred losses related to PCs we hold are captured as part of mark-to-market adjustments that are recognized in connection with PC residuals, which represent the portion of the fair value of the PCs related to guarantee asset and guarantee obligation. See “CRITICAL ACCOUNTING POLICIES AND ESTIMATES — Credit Losses” and “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” to the consolidated financial statements for further information.

Loan loss reserves are increased through periodic charges to the provision for credit losses and decreased by charges-offs, net of recoveries. We record charge-offs to the loan loss reserves when the loss is specifically identifiable and virtually certain. For mortgages that are transferred to REO or involved in a pre-foreclosure sale, we record losses at the time of transfer or sale. For loans that have been modified, losses are recorded at the time of modification if the modification is a troubled debt restructuring.

As shown in “Table 71 — Loan Loss Reserves Activity,” total loan loss reserves decreased in 2004. This decrease was primarily due to transfers out from the reserves related to uncollectible interest and a reduction of reserves related to prior period adjustments for which the related income was recorded in Other income.

*Credit Risk Sensitivity.* As a part of our voluntary disclosure commitments made in October 2000, we provide public disclosure of credit risk sensitivity results on a quarterly basis on our website. The credit risk

*Freddie Mac*

sensitivity analysis assesses the assumed increase in the present value of expected single-family mortgage portfolio losses over ten years as the result of an estimated instantaneous five percent decline in house prices nationwide, followed by a return to more normal growth in house prices based on historical experience. An internally developed Monte Carlo simulation-based model is used to generate our credit risk sensitivity analyses. The Monte Carlo model uses an interest rate simulation program to generate numerous interest rate paths that, in conjunction with a prepayment model, are used to estimate mortgage cash flows along each path. We use this same model to calculate the expected default cost component of the Guarantee obligation for Participation Certificates and to estimate expected future default costs of mortgage loans and mortgage-related securities. In the credit rate sensitivity analysis, we adjust the house-price assumption used in the base case to estimate the level and sensitivity of potential credit costs resulting from a sudden decline in house prices. See “NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS” to the consolidated financial statements for more information.

The credit risk sensitivity results at December 31, 2004 and 2003 are shown in Table 72. Credit risk sensitivity results as of the end of each quarter in 2004 and the first quarter of 2005 are presented in “VOLUNTARY COMMITMENTS.”

**Table 72 — Credit Risk Sensitivity — Estimated Net Present Value (NPV) of Increase in Credit Losses<sup>(1)</sup>**

	Before Receipt of Credit Enhancements <sup>(2)</sup>		After Receipt of Credit Enhancements <sup>(3)</sup>	
	NPV	NPV Ratio <sup>(4)</sup>	NPV	NPV Ratio <sup>(4)</sup>
	(dollars in millions, except ratios)			
At:				
December 31, 2004	\$794	6.5bps	\$463	3.8bps
December 31, 2003	\$926	7.9bps	\$533	4.6bps

(1) Based on single-family Total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates.

(2) Assumes that none of the credit enhancements currently covering our mortgages has any mitigating impact on our credit losses.

(3) Assumes we collect amounts due from credit enhancement providers after giving effect to certain assumptions about counterparty default rates.

(4) Calculated as the ratio of net present value of increase in credit losses to the single-family Total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates.

### ***Institutional Credit Risk***

We are subject to credit risk from institutional counterparties to the extent they do not fulfill their obligations to us under the terms of specific contracts or agreements. Our primary institutional credit risk exposure, other than counterparty credit risk exposure relating to derivatives (which is discussed in “Interest-Rate Risk and Other Market Risks — *Derivative-Related Risks* — Derivative Counterparty Credit Risk”), arises from agreements with the following entities:

- mortgage seller/servicers;
- mortgage loan insurers;
- issuers, guarantors or third party providers of credit enhancements on non-Freddie Mac mortgage-related securities held in our Retained portfolio;
- mortgage investors and originators; and
- issuers, guarantors and insurers of investments held in our Cash and investments portfolio.

**Mortgage Seller/Servicers.** We are exposed to institutional credit risk arising from the insolvency of mortgage seller/servicers that remit to us monthly principal and interest payments on mortgages, provide credit enhancements such as recourse or collateral and represent and warrant that mortgages were originated in compliance with our standards. The servicing fee charged by mortgage servicers varies by mortgage product. We require our single-family servicers to retain a minimum percentage fee for mortgages serviced on our behalf, typically 0.25 percent of the unpaid principal balance of the mortgage loans. However, we do on an exception basis allow lower minimum servicing amounts. The credit risk associated with servicing fees relates

*Freddie Mac*

to whether we could transfer the servicing to an alternate servicer without a loss in the event the current servicer is unable to fulfill its responsibilities.

To protect us against these risks, we require seller/servicers to meet minimum financial capacity standards, insurance and other eligibility requirements. We institute remedial actions against mortgage seller/servicers that fail to comply with our standards. These actions may include transferring mortgage servicing to other qualified servicers or terminating our relationship with the mortgage seller/servicer.

We manage the credit quality of our multifamily seller/servicers by establishing institutional eligibility requirements for participation in our multifamily programs. These seller/servicers must also meet our standards for originating and servicing multifamily loans. We conduct regular quality control reviews of our multifamily mortgage seller/servicers to determine whether they remain in compliance with our standards.

**Mortgage Loan Insurers.** We bear institutional credit risk relating to the non-performance of mortgage insurers that insure purchased or guaranteed mortgages (see “*Mortgage Credit Risk — Mortgage Credit Risk Management Strategies — Credit Enhancements*” for more information). We manage this risk by establishing eligibility standards for mortgage insurers and by regularly monitoring our exposure to individual mortgage insurers. We also monitor the mortgage insurers’ credit ratings, as provided by nationally recognized credit rating agencies. In addition, we periodically review the methods used by the credit rating agencies. We also perform periodic on-site reviews of mortgage insurers to confirm compliance with our eligibility requirements and to evaluate their management and control practices. In addition, state insurance authorities regulate mortgage insurers. Substantially all mortgage insurers providing primary mortgage insurance and pool insurance coverage on single-family mortgages purchased during 2004 were rated “AA” or better by S&P. At December 31, 2004, there were seven mortgage insurers (the largest being Mortgage Guarantee Insurance Corporation) that each provided more than five percent of our Total mortgage insurance coverage (including primary mortgage insurance and pool insurance) and together accounted for approximately 99 percent of our overall coverage.

**Non-Freddie Mac Mortgage-Related Securities.** Investments for our Retained portfolio expose us to institutional credit risk on non-Freddie Mac mortgage-related securities to the extent that issuers, guarantors, or third parties providing credit enhancements, become insolvent. See “Table 33 — Credit Characteristics of Mortgages and Mortgage-Related Securities in the Retained Portfolio” for more information concerning our Retained portfolio.

Our non-Freddie Mac mortgage-related securities portfolio consists of both agency and non-agency mortgage securities. Agency mortgage-related securities, which are securities issued or guaranteed by Fannie Mae or Ginnie Mae, present minimal institutional credit risk exposure to us due to the high credit quality of the issuers and guarantors. Agency mortgage-related securities are generally not separately rated by credit rating agencies, but are viewed as having a level of credit quality at least equivalent to non-agency mortgage securities rated AAA (based on the S&P rating scale or an equivalent rating from other nationally recognized rating agencies). At December 31, 2004, we held approximately \$60 billion of agency securities, representing approximately four percent of our Total mortgage portfolio (see “Table 8 — Freddie Mac’s Total Mortgage Portfolio Based on Unpaid Principal Balances” for more information about our Total mortgage portfolio).

Non-agency mortgage securities may expose us to some institutional credit risk, if the nature of the credit enhancement relies on a third party to cover potential losses. However, most of our non-agency mortgage securities rely primarily on subordinated tranches to provide credit loss protection and therefore expose us to very limited counterparty risk. In those instances where we desire further protection, we may choose to mitigate our exposure with bond insurance or by purchasing additional subordination. Bond insurance exposes us to the claims paying ability of the bond insurer. Substantially all of the bond insurers providing coverage for non-agency mortgage securities held by us were rated AAA or equivalent by at least one nationally recognized credit rating agency. At December 31, 2004, we held approximately \$175 billion of non-agency mortgage-related securities. Of this amount, 97 percent were rated AAA or equivalent.

We manage institutional credit risk on non-Freddie Mac mortgage-related securities by only purchasing securities that meet our investment guidelines and performing ongoing analysis to evaluate the creditworthiness of the issuers and servicers of these securities and the bond insurers that guarantee them. To assess the

creditworthiness of non-agency securities, we may perform additional analysis, including on-site visits, verification of loan documentation, review of underwriting or servicing processes and similar due diligence measures. In addition, management regularly evaluates these investments to determine if any impairment in fair value requires an impairment loss recognition in earnings, warrants divestiture or requires a combination of both. See “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” to the consolidated financial statements for more information on impairments.

**Mortgage Investors and Originators.** We are exposed to pre-settlement risk through the purchase, sale and financing of mortgage loans and mortgage-related securities with mortgage investors and originators. This exposure primarily arose in connection with our Securities Sales & Trading Group business unit prior to its cessation of activities in the fourth quarter of 2004. Pre-settlement risk is the risk that a counterparty will not perform under the terms of a transaction due to adverse changes in market value between trade date and settlement date. The probability of such a default is generally remote over the short time horizon between the trade and settlement date. We manage this risk by evaluating the creditworthiness of our counterparties and monitoring and managing our exposures. In some instances, we may require these counterparties to post collateral.

**Cash and Investments Portfolio.** Institutional credit risk also arises from the insolvency of issuers or guarantors of investments held in our Cash and investments portfolio. This portfolio is generally used to meet both anticipated and unanticipated liquidity and working capital requirements (See “LIQUIDITY AND CAPITAL RESOURCES — Liquidity” for more information). Instruments in this portfolio are investment grade at the time of purchase and primarily short-term in nature, thereby significantly mitigating institutional credit risk in this portfolio. We regularly evaluate these investments to determine if any impairment in fair value requires an impairment loss recognition in earnings, warrants divestiture or requires a combination of both.

## QUARTERLY SELECTED FINANCIAL DATA

	2004				
	1Q	2Q	3Q	4Q	Full-Year
	(dollars in millions)				
Net interest income	\$2,126	\$2,625	\$ 2,321	\$2,065	\$ 9,137
Non-interest income (loss)	(26)	1,532	(3,691)	(854)	(3,039)
Non-interest expense	(503)	(548)	(603)	(717)	(2,371)
Income tax (expense) benefit	(285)	(855)	467	(117)	(790)
Net income (loss)	<u>\$1,312</u>	<u>\$2,754</u>	<u>\$(1,506)</u>	<u>\$ 377</u>	<u>\$ 2,937</u>
Basic earnings (loss) per common share <sup>(1)</sup>	\$ 1.83	\$ 3.92	\$ (2.26)	\$ 0.47	\$ 3.96
Diluted earnings (loss) per common share <sup>(1)</sup>	\$ 1.82	\$ 3.91	\$ (2.26)	\$ 0.47	\$ 3.94

	2003				
	1Q	2Q	3Q	4Q	Full-Year
	(dollars in millions)				
Net interest income	\$2,421	\$2,185	\$2,442	\$2,450	\$ 9,498
Non-interest income (loss) <sup>(2)</sup>	1,247	1,830	(2,294)	(1,027)	(244)
Non-interest expense <sup>(2)</sup>	(410)	(613)	(562)	(651)	(2,236)
Income tax (expense) benefit	(991)	(1,096)	126	(241)	(2,202)
Net income (loss)	<u>\$2,267</u>	<u>\$2,306</u>	<u>\$(288)</u>	<u>\$ 531</u>	<u>\$ 4,816</u>
Basic earnings (loss) per common share <sup>(1)</sup>	\$ 3.22	\$ 3.28	\$(0.49)	\$ 0.70	\$ 6.69
Diluted earnings (loss) per common share <sup>(1)</sup>	\$ 3.21	\$ 3.27	\$(0.49)	\$ 0.69	\$ 6.68

(1) Earnings per share is computed independently for each of the quarters presented. Due to the use of weighted-average common shares outstanding when calculating earnings per share, the sum of the four quarters may not equal the full-year amount. Earnings per share amounts may not recalculate using the amounts in this table due to rounding.

(2) Certain expenses related to uncollectible interest on PCs held by third parties were reclassified to (Provision) benefit for credit losses from Management and guarantee income to conform with the 2004 presentation. This resulted in a reclassification of \$4 million, \$3 million, \$5 million and \$3 million for 1Q 2003, 2Q 2003, 3Q 2003 and 4Q 2003, respectively, totaling a \$15 million reduction in the loss reported in Non-interest income (loss) with a corresponding increase in expenses reported in Non-interest expense during 2003.

## SUBSEQUENT ACCOUNTING REVISIONS

As we announced on May 12, 2005, we entered into a closing agreement with the IRS that resolves issues relating to the tax treatment of dividends paid on step-down preferred stock that our two REIT subsidiaries previously issued. The closing agreement resulted in changes to our 2004 financial results previously released in our Information Statement Supplement dated March 31, 2005. Specifically, we recorded a reduction in tax reserves, which are a component of Other assets, and a corresponding reduction in Income tax expense, totaling \$110 million. Of that amount, Income tax expense was reduced by \$94 million, which was the balance of the tax reserve related to this issue at January 1, 2004, and by a reversal of \$16 million of additional tax reserve recorded in 2004. The impact by quarter was an increase (reduction) to Net income of \$101 million, \$16 million, (\$9) million, and \$2 million, affecting the first, second, third and fourth quarters of 2004, respectively. In 2005 and thereafter, we will record tax benefits related to REIT preferred stock dividend payments in the consolidated financial statements consistent with the closing agreement. See "NOTE 14: INCOME TAXES" to the consolidated financial statements for additional information.

## ADDITIONAL INFORMATION

The following tables provide additional information about select captions on our consolidated balance sheets at December 31, 2004, 2003 and 2002.

**Table 73 — Fair Value of Securities**

	December 31,		
	2004	2003	2002
	(dollars in millions)		
<b>Available-for-sale securities</b>			
<i>Retained portfolio</i>			
<b>Mortgage-related securities issued by:</b>			
Freddie Mac .....	\$352,102	\$384,426	\$327,995
Fannie Mae .....	59,519	76,844	81,930
Ginnie Mae .....	1,762	2,918	5,175
Other .....	168,058	109,409	73,498
Obligations of states and political subdivisions .....	9,020	7,729	7,667
Total mortgage-related securities .....	<u>590,461</u>	<u>581,326</u>	<u>496,265</u>
<i>Cash and investments portfolio</i>			
<b>Non-mortgage-related securities:</b>			
Asset-backed securities .....	21,733	16,596	34,694
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies .....	—	—	12,493
Corporate debt securities .....	—	4,924	10,102
Obligations of states and political subdivisions .....	8,097	9,494	6,641
Commercial paper .....	—	150	2,240
Preferred stock .....	—	64	249
Total non-mortgage-related securities .....	<u>29,830</u>	<u>31,228</u>	<u>66,419</u>
<b>Total available-for-sale securities</b> .....	<u><u>\$620,291</u></u>	<u><u>\$612,554</u></u>	<u><u>\$562,684</u></u>
<b>Trading securities</b>			
<i>Retained portfolio</i>			
<b>Mortgage-related securities issued by:</b>			
Freddie Mac .....	\$ 11,398	\$ 17,590	\$ 28,535
Fannie Mae .....	385	586	519
Ginnie Mae .....	59	24	50
Total mortgage-related securities .....	<u>11,842</u>	<u>18,200</u>	<u>29,104</u>
<i>Cash and investments portfolio<sup>(1)</sup></i>			
<b>Mortgage-related securities issued by:</b>			
Freddie Mac .....	—	17,266	20,244
Fannie Mae .....	—	15,052	11,029
Ginnie Mae .....	—	490	1,062
Other .....	—	9	31
Total mortgage-related securities .....	<u>—</u>	<u>32,817</u>	<u>32,366</u>
<b>Non-mortgage-related securities:</b>			
Asset-backed securities .....	—	52	96
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies .....	—	479	1,004
Mutual funds .....	—	—	540
Commercial paper .....	—	341	479
Corporate debt securities .....	—	437	229
Debt securities issued by foreign governments .....	—	5	4
Other .....	—	—	57
Total non-mortgage-related securities .....	<u>—</u>	<u>1,314</u>	<u>2,409</u>
<b>Total trading securities</b> .....	<u><u>\$ 11,842</u></u>	<u><u>\$ 52,331</u></u>	<u><u>\$ 63,879</u></u>

(1) The reduction of trading securities within the Cash and investments portfolio in 2004 was attributable to us ceasing the operations of our PC market-making and support activities accomplished through our Securities Sales & Trading Group business unit and external Money Manager program during the fourth quarter of 2004.

For additional information about the securities we hold, see “NOTE 5: RETAINED PORTFOLIO AND CASH AND INVESTMENTS PORTFOLIO” to the consolidated financial statements.

*Freddie Mac*

**Table 74 — Senior Debt, Due Within One Year**

	2004				
	At December 31,		Average Outstanding During the Year		Maximum Balance, Net Outstanding at Any Month End
	Balance, Net	Weighted Average Effective Rate <sup>(1)</sup>	Balance, Net <sup>(2)</sup>	Weighted Average Effective Rate <sup>(3)</sup>	
			(dollars in millions)		
Discount notes . . . . .	\$180,198	2.04%	\$184,834	1.40%	\$212,715
Medium-term notes . . . . .	162	2.51	4,289	1.31	5,320
Securities sold under agreements to repurchase and Federal funds purchased	—	—	801	1.37	3,046
Swap collateral obligations . . . . .	16,279	2.24	13,549	1.36	16,279
Short-term debt securities . . . . .	196,639				
Current portion of long-term debt . . . . .	85,664				
Senior debt, due within one year . . . . .	<u>\$282,303</u>				
			(dollars in millions)		
	At December 31,		Average Outstanding During the Year		Maximum Balance, Net Outstanding at Any Month End
	Balance, Net	Weighted Average Effective Rate <sup>(1)</sup>	Balance, Net <sup>(2)</sup>	Weighted Average Effective Rate <sup>(3)</sup>	
			(dollars in millions)		
Discount notes <sup>(4)</sup> . . . . .	\$188,309	1.12%	\$207,374	1.21%	\$264,370
Medium-term notes . . . . .	5,300	1.18	1,243	1.32	5,300
Securities sold under agreements to repurchase and Federal funds purchased <sup>(5)</sup> . . . . .	1,611	0.96	2,283	0.94	8,296
Swap collateral obligations <sup>(6)</sup> . . . . .	16,082	1.02	11,694	1.13	16,082
Securities sold, not yet purchased . . . . .	733				
Short-term debt securities . . . . .	212,035				
Current portion of long-term debt . . . . .	83,227				
Senior debt, due within one year . . . . .	<u>\$295,262</u>				
			(dollars in millions)		
	At December 31,		Average Outstanding During the Year		Maximum Balance, Net Outstanding at Any Month End
	Balance, Net	Weighted Average Effective Rate <sup>(1)</sup>	Balance, Net <sup>(2)</sup>	Weighted Average Effective Rate <sup>(3)</sup>	
			(dollars in millions)		
Discount notes <sup>(4)</sup> . . . . .	\$163,202	1.61%	\$180,889	2.02%	\$211,393
Medium-term notes <sup>(4)</sup> . . . . .	1,015	2.07	5,528	2.39	8,163
Securities sold under agreements to repurchase and Federal funds purchased	15,262	1.08	13,882	1.39	21,472
Swap collateral obligations <sup>(6)(7)</sup> . . . . .	8,209	1.39	3,278	1.65	8,209
Securities sold, not yet purchased . . . . .	6,356				
Short-term debt securities . . . . .	194,044				
Current portion of long-term debt . . . . .	50,385				
Senior debt, due within one year . . . . .	<u>\$244,429</u>				

- (1) Represents the weighted average effective rate at the end of the period, which includes the amortization of discounts or premiums and issuance costs, but excludes the amortization of foreign-currency-related and hedging-related basis adjustments.
- (2) Includes unamortized discounts or premiums and issuance costs. Issuance costs are reported in the Other assets caption on the consolidated balance sheets.
- (3) Represents the approximate weighted average effective rate during the period, which includes the amortization of discounts or premiums and issuance costs, but excludes the amortization of foreign-currency-related and hedging-related basis adjustments.
- (4) Maximum Balance, Net Outstanding at Any Month End for 2003 and 2002 has been revised to conform with the 2004 presentation.
- (5) Balance, Net and Weighted Average Effective Rate for Average Outstanding During the Year for 2003 have been revised for Securities sold under agreements to repurchase and Federal funds purchased to conform with the 2004 presentation.
- (6) Weighted Average Effective Rate at December 31, 2003 and 2002 have been revised to conform with the 2004 presentation.
- (7) Balance, Net and Weighted Average Effective Rate for Average Outstanding During the Year for 2002 have been revised to conform with the 2004 presentation.

For additional information about our debt securities, see “NOTE 8: DEBT SECURITIES AND SUBORDINATED BORROWINGS” to the consolidated financial statements.

## VOLUNTARY COMMITMENTS

The following provides updated information on the Voluntary Commitments we made in October 2000. Additional information about our Voluntary Commitments is available on our website ([www.FreddieMac.com/investors](http://www.FreddieMac.com/investors)).

Description	Comments	Status
<p><i>1. Periodic Issuance of Subordinated Debt:</i></p> <ul style="list-style-type: none"> <li>• We will issue publicly traded and externally rated Freddie SUBS® on a semi-annual basis.</li> <li>• Freddie SUBS® will be issued in an amount such that "Voluntary Commitments' capital" less 0.45 percent of Outstanding PCs and Structured Securities will equal or exceed four percent of on-balance sheet assets by October 2003. Voluntary Commitments' capital is defined as the sum of Core capital (effectively equal to Stockholders' equity less AOCI, net of taxes), loan loss reserves and Freddie SUBS® outstanding.</li> </ul>	<ul style="list-style-type: none"> <li>• At December 31, 2004, the ratio of Voluntary Commitments' capital less 0.45 percent of Outstanding PCs and Structured Securities to total assets was 4.6 percent.</li> <li>• We cannot determine this ratio as of the end of any period in 2005 with specificity until we release the consolidated financial statements for the relevant period.</li> </ul>	<ul style="list-style-type: none"> <li>• We did not issue any Freddie SUBS® in 2004. As a result of not having current consolidated financial statements, our ability to issue subordinated debt may be limited.</li> <li>• As of December 31, 2004, we met this commitment.</li> <li>• We plan to update our disclosure for this commitment following the release of our 2005 consolidated financial statements for the relevant period.</li> </ul>
<p><i>2. Liquidity Management and Contingency Planning:</i></p> <ul style="list-style-type: none"> <li>• We will comply with principles of sound liquidity management set forth by the Basel Committee on Banking Supervision and will maintain more than three months' worth of liquidity (based on internal forecasts) assuming we have no access to new issue public debt markets.</li> <li>• In implementing this commitment, we will maintain at least five percent of on-balance sheet assets in liquid, marketable, non-mortgage securities. We will also maintain additional, liquid mortgage securities for use as collateral in short-term borrowings from dealer counterparties.</li> </ul>	<ul style="list-style-type: none"> <li>• For purposes of this commitment, we will maintain liquidity needed to meet our obligations to pay principal and interest related to our outstanding debt maturities, to pay PC investors the amounts due to them, to purchase mortgage loans and mortgage-related securities that we have committed to purchase as well as to fund operating expenditures. To fund these obligations in the event of market disruption, we could sell some securities from our Retained portfolio and liquidate non-mortgage investments from our Cash and investments portfolio. In addition, we could borrow against mortgage-related securities that are a component of our Retained portfolio by executing transactions in the repurchase agreement market. (Our ability to execute these and other strategies may be adversely affected by market conditions, operational constraints and other factors.)</li> <li>• Assets that meet this definition include Cash and cash equivalents (excluding operating cash accounts, cash posted as collateral by derivative counterparties and certain other balances), various non-mortgage investments such as municipal bonds, asset-backed securities, commercial paper and certain securities purchased under agreements to resell (reverse repos). This commitment no longer considers investments held by our Securities Sales &amp; Trading Group business unit or as part of our external Money Manager program as these operations ceased activity during the fourth quarter of 2004.</li> <li>• We cannot determine the percentage of on-balance sheet assets in liquid, marketable, non-mortgage securities as of the end of any period in 2005 with specificity until we release the consolidated financial statements for the relevant period.</li> </ul>	<ul style="list-style-type: none"> <li>• As of December 31, 2004, we met this commitment.</li> <li>• As of December 31, 2004, we met this commitment.</li> <li>• We plan to update our disclosure for this commitment following the release of our 2005 consolidated financial statements for the relevant period.</li> </ul>

## VOLUNTARY COMMITMENTS (continued)

Description	Comments	Status																																								
<p><b>3. Interest-Rate Risk Disclosures</b></p> <p>We will provide public disclosure of interest-rate risk sensitivity results on a monthly basis. Specifically, we will disclose the PMVS-L, which shows the expected impact on our portfolio market value from an immediate, adverse 50 basis point parallel shift in the yield curve. We will also disclose the PMVS-YC, which shows the same impact from an immediate, adverse 25 basis point change in the slope of the yield curve.</p>		<p>The full-year average PMVS-L and PMVS-YC for 2004 was 2 and 0 percent, respectively. 2005's monthly average PMVS results and related disclosures are provided in our Monthly Volume Summary, or MVS, which is available on our website, <a href="http://www.FreddieMac.com/investor">www.FreddieMac.com/investor</a>.</p>																																								
<p><b>4. Credit Risk Disclosures:</b></p> <p>We will provide public disclosure of credit risk sensitivity results on a quarterly basis. Compared to a base case in which house prices on average rise at rates consistent with long-term trends, these disclosures show the increase in the present value of expected single-family credit losses to us over a ten-year period assuming an immediate five percent decline in house prices followed by a resumption of the same long-term trend in house-price appreciation as in the base case.</p>	<p>An internally developed Monte Carlo simulation-based model is used to generate our credit risk sensitivity analyses. We use this same model to calculate the expected default cost component of the Guarantee obligation on Participation Certificates and to estimate expected future default costs of mortgage loans and mortgage-related securities. In this analysis, we adjust the house-price assumption used in the base case to estimate the level and sensitivity of potential credit costs associated with our existing single-family mortgage portfolio. See "NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS" to the consolidated financial statements for more information.</p>	<p>Our quarterly credit risk sensitivity estimates are as follows:</p> <table style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th colspan="2" style="text-align: center;">Before Receipt of Credit Enhancements<sup>(1)</sup></th> <th colspan="2" style="text-align: center;">After Receipt of Credit Enhancements<sup>(2)</sup></th> </tr> <tr> <th style="text-align: center;">NPV<sup>(3)</sup></th> <th style="text-align: center;">NPV Ratio<sup>(4)</sup></th> <th style="text-align: center;">NPV<sup>(3)</sup></th> <th style="text-align: center;">NPV Ratio<sup>(4)</sup></th> </tr> <tr> <th colspan="2" style="text-align: center;">(dollars in millions)</th> <th colspan="2" style="text-align: center;">(dollars in millions)</th> </tr> </thead> <tbody> <tr> <td colspan="4">As of:</td> </tr> <tr> <td style="text-align: center;">03/31/05</td> <td style="text-align: center;">\$756</td> <td style="text-align: center;">6.2 bps</td> <td style="text-align: center;">\$447</td> </tr> <tr> <td style="text-align: center;">12/31/04</td> <td style="text-align: center;">794</td> <td style="text-align: center;">6.5 bps</td> <td style="text-align: center;">463</td> </tr> <tr> <td style="text-align: center;">09/30/04</td> <td style="text-align: center;">879</td> <td style="text-align: center;">7.3 bps</td> <td style="text-align: center;">512</td> </tr> <tr> <td style="text-align: center;">06/30/04</td> <td style="text-align: center;">873</td> <td style="text-align: center;">7.3 bps</td> <td style="text-align: center;">522</td> </tr> <tr> <td style="text-align: center;">03/31/04</td> <td style="text-align: center;">872</td> <td style="text-align: center;">7.4 bps</td> <td style="text-align: center;">503</td> </tr> <tr> <td style="text-align: center;">12/31/03</td> <td style="text-align: center;">926</td> <td style="text-align: center;">7.9 bps</td> <td style="text-align: center;">533</td> </tr> </tbody> </table> <p>(1) Assumes that none of the credit enhancements currently covering our mortgages has any mitigating impact on our credit losses.</p> <p>(2) Assumes we collect amounts due from credit enhancement providers after giving effect to certain assumptions about counterparty default rates.</p> <p>(3) Based on single-family Total mortgage portfolio, excluding Structured Securities backed by non-Freddie Mac mortgage-related securities and Structured Securities backed by Ginnie Mae Certificates.</p> <p>(4) Calculated as the ratio of net present value of increase in credit losses to the total single-family mortgage portfolio, which excludes multi-family mortgages and Structured Securities backed by Ginnie Mae Certificates.</p>	Before Receipt of Credit Enhancements <sup>(1)</sup>		After Receipt of Credit Enhancements <sup>(2)</sup>		NPV <sup>(3)</sup>	NPV Ratio <sup>(4)</sup>	NPV <sup>(3)</sup>	NPV Ratio <sup>(4)</sup>	(dollars in millions)		(dollars in millions)		As of:				03/31/05	\$756	6.2 bps	\$447	12/31/04	794	6.5 bps	463	09/30/04	879	7.3 bps	512	06/30/04	873	7.3 bps	522	03/31/04	872	7.4 bps	503	12/31/03	926	7.9 bps	533
Before Receipt of Credit Enhancements <sup>(1)</sup>		After Receipt of Credit Enhancements <sup>(2)</sup>																																								
NPV <sup>(3)</sup>	NPV Ratio <sup>(4)</sup>	NPV <sup>(3)</sup>	NPV Ratio <sup>(4)</sup>																																							
(dollars in millions)		(dollars in millions)																																								
As of:																																										
03/31/05	\$756	6.2 bps	\$447																																							
12/31/04	794	6.5 bps	463																																							
09/30/04	879	7.3 bps	512																																							
06/30/04	873	7.3 bps	522																																							
03/31/04	872	7.4 bps	503																																							
12/31/03	926	7.9 bps	533																																							
<p><b>5. Public Disclosure of Annual Rating:</b></p> <p>We will obtain an annual credit rating assessing risk to the government or independent financial strength from a nationally recognized statistical rating organization and will disclose this rating to the public.</p>	<p>We have a "risk-to-the-government" credit rating of "AA-" from S&amp;P. Moody's has assigned us a Bank Financial Strength Rating of "A-." Both of these ratings are maintained on a surveillance basis, which means that the rating agencies are committed to notify the public if the rating is ever affected by a change in our financial condition.</p>	<p>As of May 23, 2005, S&amp;P's risk-to-the-government rating us was "AA-" and Moody's Bank Financial Strength Rating for us was "A-."</p>																																								