CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders of Freddie Mac:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows, and of stockholders' equity present fairly, in all material respects, the financial position of Freddie Mac, a stockholder-owned government-sponsored enterprise (the "company"), and its subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We have also audited in accordance with auditing standards generally accepted in the United States of America the supplemental consolidated fair value balance sheets of the company as of December 31, 2004 and 2003. As described in "NOTE 16: FAIR VALUE DISCLOSURES," the supplemental consolidated fair value balance sheets have been prepared by management to present relevant financial information that is not provided by the historical-cost consolidated balance sheets and is not intended to be a presentation in conformity with generally accepted accounting principles. In addition, the supplemental consolidated fair value balance sheets do not purport to present the net realizable, liquidation, or market value of the company as a whole. Furthermore, amounts ultimately realized by the company from the disposal of assets or amounts required to settle obligations may vary significantly from the fair values presented. In our opinion, the supplemental consolidated fair value balance sheets referred to above present fairly, in all material respects, the information set forth therein as described in "NOTE 16: FAIR VALUE DISCLOSURES."

As discussed in "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES," the company adopted the provisions of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" and FASB Staff Position 45-2 "Whether FASB Interpretation No. 45, 'Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,' Provides Support for Subsequently Accounting for a Guarantor's Liability at Fair Value," as of January 1, 2003.

McLean, Virginia
June 1, 2005

FREDDIE MAC
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	2004	2003	2002
	(dollars in millions, except share-related amounts)		
Interest income			
Mortgage loans	$ 4,007	$ 4,251	$ 4,290
Mortgage-related securities in the Retained portfolio	28,460	29,051	30,039
Cash and investments	3,136	3,796	4,147
Total interest income	35,603	37,098	38,476
Interest expense			
Short-term debt	(2,908)	(2,785)	(4,303)
Long-term debt	(22,950)	(22,083)	(21,337)
Total interest expense on debt securities	(25,858)	(24,868)	(25,640)
Due to Participation Certificate investors	(708)	(1,641)	(1,236)
Total interest expense	(26,566)	(26,509)	(26,876)
Income (expense) related to derivatives	100	(1,091)	(2,075)
Net interest income	9,137	9,498	9,525
Non-interest income (loss)			
Management and guarantee income (includes interest on Guarantee asset for Participation Certificates of $257, $244 and $242)	1,382	1,653	1,527
Gains (losses) on "Guarantee asset for Participation Certificates, at fair value"	(1,135)	(1,461)	(2,176)
Income on "Guarantee obligation for Participation Certificates"	732	925	592
Derivative gains (losses)	(4,475)	39	5,302
Hedge accounting gains (losses)	743	644	187
Gains (losses) on investment activity	(348)	(1,114)	1,799
Gains (losses) on debt retirement	(327)	(1,775)	(674)
Resecuritization fees	159	352	276
Other income	230	493	321
Non-interest income (loss)	(3,039)	(244)	7,154
Non-interest expense			
Salaries and employee benefits	(758)	(624)	(593)
Professional services	(588)	(311)	(155)
Occupancy expense	(60)	(52)	(42)
Other administrative expenses	(144)	(194)	(184)
Total administrative expenses	(1,550)	(1,181)	(974)
(Provision) benefit for credit losses	(143)	5	(122)
REO operations income (expense)	3	(7)	(4)
Housing tax credit partnerships	(281)	(200)	(160)
Minority interests in earnings of consolidated subsidiaries	(129)	(157)	(184)
Other expenses	(271)	(696)	(432)
Non-interest expense	(2,371)	(2,236)	(1,876)
Income before income tax expense	3,727	7,018	14,803
Income tax expense	(790)	(2,202)	(4,713)
Net income	$ 2,937	$ 4,816	$ 10,090
Preferred stock dividends and issuance costs on redeemed preferred stock (including $0, $0 and $5 of issuance costs on redeemed preferred stock)	(210)	(216)	(239)
Net income available to common stockholders	$ 2,727	$ 4,600	$ 9,851
Basic earnings per common share	$ 3.96	$ 6.69	$ 14.22
Diluted earnings per common share	$ 3.94	$ 6.68	$ 14.17
Weighted average common shares outstanding (thousands)			
Basic	689,282	687,094	692,727
Diluted	691,521	688,675	695,116
Dividends per common share	$ 1.20	$ 1.04	$ 0.88

The accompanying notes are an integral part of these financial statements.

FREDDIE MAC
CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
	(dollars in millions)	
Assets		
Retained portfolio		
Mortgage loans:		
Held-for-investment, at amortized cost	$ 58,852	$ 57,804
Reserve for losses on mortgage loans held-for-investment	(114)	(174)
Held-for-sale, at lower of cost or market value	2,582	2,530
Mortgage loans, net of reserve	61,320	60,160
Mortgage-related securities:		
Available-for-sale, at fair value (includes $194 and $282 pledged as collateral that may be repledged)	590,461	581,326
Trading, at fair value (includes $0 and $32 pledged as collateral that may be repledged)	11,842	18,200
Participation Certificate residuals, at fair value	845	671
Total mortgage-related securities	603,148	600,197
Retained portfolio	664,468	660,357
Cash and investments		
Cash and cash equivalents	35,253	23,142
Investments:		
Mortgage-related securities:		
Trading, at fair value (includes $0 and $6 pledged as collateral that may be repledged)	—	32,817
Participation Certificate residuals, at fair value	—	(5)
Non-mortgage-related securities:		
Available-for-sale, at fair value	29,830	31,228
Trading, at fair value (includes $0 and $23 pledged as collateral that may be repledged)	—	1,314
Total non-mortgage-related securities	29,830	32,542
Total mortgage-related and non-mortgage-related securities	29,830	65,354
Securities purchased under agreements to resell and Federal funds sold	32,197	20,582
Cash and investments	97,280	109,078
Accounts and other receivables, net	7,286	8,067
Derivative assets, at fair value	15,257	16,180
Guarantee asset for Participation Certificates, at fair value	4,516	3,686
Real estate owned, net	741	795
Other assets	5,736	5,286
Total assets	$795,284	$803,449
Liabilities and stockholders' equity		
Debt securities, net		
Senior debt:		
Due within one year	$282,303	$295,262
Due after one year	443,772	438,738
Subordinated debt, due after one year	5,622	5,613
Total debt securities, net	731,697	739,613
Due to Participation Certificate investors	13,654	13,205
Accrued interest payable	7,329	7,345
Guarantee obligation for Participation Certificates	4,065	2,904
Derivative liabilities, at fair value	226	357
Reserve for guarantee losses on Participation Certificates	150	125
Other liabilities	5,238	6,484
Total liabilities	762,359	770,033
Commitments and contingencies (Notes 1, 3, 4 and 13)		
Minority interests in consolidated subsidiaries	1,509	1,929
Stockholders' equity		
Preferred stock, at redemption value	4,609	4,609
Common stock, $0.21 par value, 726,000,000 shares authorized, 725,882,280 shares issued and 690,606,185 shares and 688,573,911 shares outstanding, respectively	152	152
Additional paid-in capital	873	814
Retained earnings	30,728	28,837
Accumulated other comprehensive income (loss), (AOCI) net of taxes, related to:		
Available-for-sale securities	4,339	6,349
Cash flow hedge relationships	(7,924)	(7,837)
Minimum pension liability	(8)	(10)
Total accumulated other comprehensive income (loss), net of taxes	(3,593)	(1,498)
Treasury stock, at cost, 35,276,095 shares and 37,308,369 shares, respectively	(1,353)	(1,427)
Total stockholders' equity	31,416	31,487
Total liabilities and stockholders' equity	$795,284	$803,449

The accompanying notes are an integral part of these financial statements.

FREDDIE MAC
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Year Ended December 31,					
	2004		2003		2002	
	Shares	Amount	Shares	Amount	Shares	Amount
	(dollars and shares in millions)					
Preferred stock, at redemption value						
Balance, beginning of year	92	$ 4,609	92	$ 4,609	92	$ 4,596
Preferred stock issuances	—	—	—	—	6	300
Preferred stock redemptions	—	—	—	—	(6)	(287)
Preferred stock, end of year	92	4,609	92	4,609	92	4,609
Common stock, par value						
Balance, beginning of year	726	152	726	152	726	152
Common stock, end of year	726	152	726	152	726	152
Additional paid-in capital						
Balance, beginning of year		814		744		671
Stock-based compensation, before tax effect of $20, $23 and $23		56		64		65
Income tax benefit from employee stock option exercises		20		16		16
Preferred stock issuance costs		—		—		(2)
Common stock issuances		(17)		(10)		(6)
Additional paid-in capital, end of year		873		814		744
Retained earnings						
Balance, beginning of year		28,837		24,955		15,710
Net income		2,937		4,816		10,090
Preferred stock dividends declared		(210)		(216)		(234)
Common stock dividends declared		(836)		(718)		(611)
Retained earnings, end of year		30,728		28,837		24,955
AOCI, net of taxes						
Balance, beginning of year		(1,498)		2,340		(557)
Changes in unrealized gains (losses) related to available-for-sale securities, net of reclassification adjustments		(2,010)		(5,868)		8,017
Changes in unrealized gains (losses) related to cash flow hedge relationships, net of reclassification adjustments		(87)		2,040		(5,120)
Change in minimum pension liability		2		(10)		—
AOCI, net of taxes, end of year		(3,593)		(1,498)		2,340
Treasury stock, at cost						
Balance, beginning of year	37	(1,427)	39	(1,470)	31	(948)
Common stock issuances	(2)	74	(2)	43	(1)	33
Common stock repurchases	—	—	—	—	9	(555)
Treasury stock, end of year	35	(1,353)	37	(1,427)	39	(1,470)
Total stockholders' equity		$31,416		$31,487		$31,330
Comprehensive income						
Net income		$ 2,937		$ 4,816		$10,090
Changes in AOCI, net of taxes, net of reclassification adjustments		(2,095)		(3,838)		2,897
Total comprehensive income		$ 842		$ 978		$12,987

The accompanying notes are an integral part of these financial statements.

FREDDIE MAC
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2004	2003	2002
	(dollars in millions)		
Cash flows from operating activities			
Net income	$ 2,937	$ 4,816	$ 10,090
Adjustments to reconcile net income to net cash provided by operating activities:			
Hedge accounting (gains) losses	(743)	(644)	(187)
Unrealized (gains) losses on derivatives not in hedge accounting relationships, net	2,758	(1,079)	(5,941)
Asset related amortization — premiums, discounts and hedging basis adjustments	1,329	995	(404)
Debt related amortization — premiums and discounts on certain debt securities and hedging basis adjustments	3,318	2,318	374
Losses on debt retirement	327	1,775	674
Provision for credit losses	143	(5)	122
(Gains) losses on investment activity	738	2,625	(1,784)
Purchases of held-for-sale mortgages	(31,698)	(82,074)	(55,275)
Sales of held-for-sale mortgages	30,965	84,329	49,035
Repayments of held-for-sale mortgages	162	390	1,097
Net proceeds from purchases and sales of trading securities	38,672	8,935	7,170
Change in accounts and other receivables, net	2,149	4,394	3,238
Change in amounts due to Participation Certificate investors, net	529	(22,369)	7,705
Change in accrued interest payable	(513)	(217)	(1,207)
Change in income taxes payable	756	(1,090)	(484)
Change in Guarantee asset for Participation Certificates, at fair value	(830)	(1,362)	711
Change in Guarantee obligation for Participation Certificates	1,173	1,606	272
Change in Participation Certificate residuals, at fair value	(170)	(389)	326
Change in deferred income taxes	(346)	737	2,690
Other, net	196	219	2,559
Net cash provided by operating activities	51,852	3,910	20,781
Cash flows from investing activities			
Purchases of available-for-sale securities	(276,573)	(446,036)	(451,510)
Proceeds from sales of available-for-sale securities	85,583	143,513	176,928
Proceeds from maturities of available-for-sale securities	178,148	242,044	178,991
Purchases of held-for-investment mortgages	(14,241)	(17,570)	(13,197)
Repayments of held-for-investment mortgages	11,511	15,283	12,999
Proceeds from sales of REO	1,552	1,327	980
Net (increase) decrease in securities purchased under agreements to resell and Federal funds sold	(11,615)	2,461	10,457
Derivative premiums and terminations, net	(193)	3,333	(4,062)
Investments in housing tax credit partnerships	(69)	(32)	(65)
Net cash used for investing activities	(25,897)	(55,677)	(88,479)
Cash flows from financing activities			
Proceeds from issuance of short-term debt	826,020	900,073	2,048,131
Repayments of short-term debt	(841,638)	(881,860)	(2,099,206)
Proceeds from issuance of long-term debt	187,878	258,371	269,386
Repayments of long-term debt	(184,295)	(210,841)	(141,257)
Repayments of minority interest in consolidated subsidiaries	(405)	(376)	(350)
Proceeds from issuance of preferred stock, net of issuance costs	—	—	298
Redemption of preferred stock	—	—	(287)
Proceeds from issuance of common stock	57	33	27
Repurchases of common stock	—	—	(555)
Payment of cash dividends on preferred stock and common stock	(1,046)	(934)	(845)
Repayments of housing tax credit partnerships notes payable	(415)	(349)	(316)
Net cash (used for) provided by financing activities	(13,844)	64,117	75,026
Net increase in cash and cash equivalents	12,111	12,350	7,328
Cash and cash equivalents at beginning of period	23,142	10,792	3,464
Cash and cash equivalents at end of period	$ 35,253	$ 23,142	$ 10,792
Supplemental cash flow information			
Cash paid for:			
Interest	$ 23,257	$ 25,562	$ 26,590
Derivative interest carry	325	578	3,239
Income taxes	363	2,538	2,491
Non-cash investing and financing activities:			
Securitized and retained available-for-sale securities formed from prior period purchases of held-for-sale mortgages	272	1,681	2,910
Transfers from mortgage loans to REO	1,546	1,570	1,127
Investments in housing tax credit partnerships financed by notes payable	1,184	702	896
Transfers from held-for-sale mortgages to held-for-investment mortgages	198	179	209

The accompanying notes are an integral part of these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Freddie Mac (the "company") is a stockholder-owned, government-sponsored enterprise ("GSE") established by Congress in 1970 to provide a continuous flow of funds for residential mortgages. Freddie Mac's obligations are the company's alone and not insured or guaranteed by the United States of America ("U.S.") or any other agency or instrumentality of the U.S.

Freddie Mac plays a fundamental role in the American housing finance system, linking the domestic mortgage market and the global capital markets. Freddie Mac's participation in the secondary mortgage market includes providing its credit guarantee for residential mortgages originated by mortgage lenders and investing in mortgage loans and mortgage-related securities held in Freddie Mac's Retained portfolio. Through its credit guarantee activities, Freddie Mac securitizes mortgage loans by issuing Mortgage Participation Certificates ("PCs") to third-party investors. Freddie Mac also resecuritizes mortgage-related securities that are issued by Freddie Mac or the Government National Mortgage Association ("Ginnie Mae"), as well as non-agency entities. Securities issued through Freddie Mac's resecuritization activities are referred to as Structured Securities. Freddie Mac also guarantees multifamily mortgage loans that support housing revenue bonds issued by third parties and it guarantees other mortgage loans held by third parties, which are included in the definition of PCs and Structured Securities. In each case, under U.S. generally accepted accounting principles ("GAAP"), securitized mortgage-related assets that back PCs and Structured Securities that are held by third parties are not reflected as assets of Freddie Mac. However, Freddie Mac does retain an obligation to guarantee the payment of principal and interest on issued PCs and Structured Securities, which usually results in the recognition of a guarantee asset and guarantee obligation on the company's consolidated balance sheets.

Freddie Mac's financial reporting and accounting policies conform to GAAP. Certain amounts in prior periods have been reclassified to conform with the current presentation.

Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (a) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (b) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The use of certain estimates in preparation of the financial statements is described below.

A significant estimate that is prevalent in the company's financial statements is the estimation of fair value for financial instruments, including derivative instruments, required to be recorded at fair value under GAAP. The measurement of fair value is fundamental to the presentation of Freddie Mac's financial condition and results of operations and, in many instances, requires management to make complex judgments. In general, Freddie Mac records financial instruments at an estimate of the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value is generally based on (i) quoted prices, (ii) market parameters obtained from third-party dealers, pricing services or based on direct market observations in active markets or (iii) derived from such prices or parameters, where available. If quoted prices or market parameters are not available, fair value is based on internal valuation models using market data inputs or internally developed assumptions, where appropriate. The use of different pricing models and assumptions could produce materially different estimates of fair value. See "NOTE 16: FAIR VALUE DISCLOSURES" for further discussion of fair value estimates.

Freddie Mac also makes other significant estimates and judgments in:

- determining the expected future cash flows (including the timing and amounts of prepayments) of mortgage-related assets in the Retained portfolio;
- assessing when securities are other-than-temporarily impaired;
- assessing the reserves for credit losses on mortgage loans and guarantee losses on PCs;
- assessing Freddie Mac's legal and tax contingencies;

- estimating the expected timing and amounts of future issuances of non-callable debt and redemptions of callable debt; and
- determining other matters that affect the reported amounts and disclosure of contingencies in the financial statements.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 5, "Accounting for Contingencies" ("SFAS 5"), contingencies that might result in gains are not recorded prior to realization; whereas, contingencies that might result in losses are accrued currently if it is probable a liability has been incurred and the amount is reasonably estimable. Loss contingencies that are considered reasonably possible are not accrued, but are required to be disclosed. Loss contingencies that are considered to have a remote probability of occurrence are not required to be accrued or disclosed in accordance with SFAS 5.

Consolidation and Equity Method of Accounting

The consolidated financial statements include the accounts of the company and its subsidiaries. All material intercompany transactions have been eliminated in consolidation. For each entity with which Freddie Mac is involved, the company makes a determination as to whether the entity should be considered a subsidiary of the company and included in the company's consolidated financial statements. Freddie Mac consolidates all subsidiaries in which it holds more than 50 percent of the voting rights and has the ability to exercise control over the entity. Based on its exercise of control over them, the company consolidates its two majority-owned Real Estate Investment Trusts ("REITs"), Home Ownership Funding Corporation I and Home Ownership Funding Corporation II. The company also consolidates the accounts of wholly-owned JB 8000, Inc. (previously Ignition Mortgage Technology Solutions, Inc.). The equity and net earnings attributable to the minority shareholder interests which relate to the company's consolidated subsidiaries are reported separately in the consolidated balance sheets as Minority interests in consolidated subsidiaries and in the consolidated statements of income as Minority interests in earnings of consolidated subsidiaries, respectively.

In addition to voting interests in an entity, a controlling financial interest may also exist in entities through arrangements that do not involve voting interests. Beginning in 2003, the company evaluated entities deemed to be variable interest entities under the revision to Financial Accounting Standards Board ("FASB") Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46-R"). FIN 46-R provides guidance for determining when a company must consolidate the assets, liabilities and activities of a variable interest entity. A variable interest entity is an entity (a) that has a total equity investment at risk that is not sufficient to finance its activities without additional subordinated financial support from other entities or (b) where the group of equity holders does not have the ability to make significant decisions about the entity's activities, or the obligation to absorb the entity's expected losses or the right to receive the entity's expected residual returns, or both. If an entity is a variable interest entity, the company must determine if its variable interest is significant and whether the company is the "primary beneficiary." Under FIN 46-R, a company is considered the primary beneficiary and must consolidate a variable interest entity when it absorbs a majority of expected losses or expected residual returns, or both. See "NOTE 3: VARIABLE INTEREST ENTITIES" for additional discussion and information regarding the consolidation of variable interest entities.

The company uses the equity method of accounting for companies over which it has the ability to exercise significant influence, but not control. Under the equity method of accounting, Freddie Mac reports its recorded investment as part of Other assets on the consolidated balance sheets and recognizes its share of the entity's net income or losses in the consolidated statements of income with an offset to the recorded investment on the consolidated balance sheets. Losses are recognized up to the amount of investment recorded.

The company regularly invests as a limited partner in qualified low-income housing tax credit ("LIHTC") partnerships that are eligible for federal tax credits. These tax credits are reported as reductions in the company's provision for income taxes pursuant to Emerging Issues Task Force ("EITF") Issue 94-1, "Accounting for Tax Benefits Resulting from Investments in Affordable Housing Projects" ("EITF 94-1"). Freddie Mac accounts for the investments which are not consolidated using the equity method of accounting, in accordance with Statement of Position ("SOP") No. 78-9, "Accounting for Investments in Real Estate Ventures" ("SOP 78-9"). For partnerships accounted for under the equity method, Freddie Mac's recorded investment is reported as part of Other assets on the consolidated balance

sheets and its share of partnership income or loss is reported in the consolidated statements of income as Non-interest expense — Housing tax credit partnerships. The company's obligations to make delayed equity contributions that are unconditional and legally binding are recorded at their present value in Other liabilities on the consolidated balance sheets. To the extent that the company's cost basis in qualified low-income housing tax credit partnerships is different than the book basis reflected at the partnership level, the basis difference is amortized over the life of the tax credits and included in the company's share of earnings (losses) from housing tax credit partnerships. Freddie Mac periodically reviews these investments for impairment and adjusts them to fair value when a decline in market value below the recorded investment is deemed to be "other than temporary" under GAAP. Impairment losses are included in the consolidated statements of income as part of Non-interest expense — Housing tax credit partnerships.

Cash and Cash Equivalents and Statements of Cash Flows

Freddie Mac accounts for highly liquid investment securities with an original maturity of three months or less and used for cash management purposes as cash equivalents. Cash collateral obtained from counterparties to derivative contracts where Freddie Mac is in an unrealized gain position is recorded as Cash and cash equivalents.

In the consolidated statements of cash flows, cash flows related to the acquisition and termination of derivatives other than forward commitments are generally classified in investing activities, without regard to whether they are designated as a hedge of another item. Cash flows from commitments accounted for as derivatives under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") that result in the acquisition or sale of mortgage securities or mortgage loans are classified in either: (a) investing activities for available-for-sale securities or mortgage loans classified as held-for-investment or (b) operating activities for trading securities or mortgage loans classified as held-for-sale. Cash flows related to mortgage loans classified as held-for-sale are classified in operating activities unless the loans have been securitized and retained as available-for-sale PCs within the same reporting period, in which case they are classified as investing activities. The periodic cash flows on certain derivatives, which are recorded in the consolidated statements of income on an accrual basis either in Income (expense) related to derivatives or in Derivative gains (losses), are reported in operating activities. Cash flows related to guarantee fees, including buy-up and buy-down payments ("Buy-Ups" and "Buy-Downs," respectively), are classified as operating activities, along with the cash flows related to the collection and distribution of payments on the mortgage loans underlying PCs. Buy-Ups and Buy-Downs are discussed further below in "Guarantor Swap Transactions Executed Prior to January 1, 2003." Cash flows related to the repayment of the original issue discount on short-term, zero-coupon debt are reported as operating activities.

Freddie Mac reclassified certain amounts from those previously reported on the consolidated statements of cash flows for the years ended December 31, 2003 and 2002. Specifically, for the years ended December 31, 2003 and 2002, Net cash provided by operating activities decreased by $572 million and $983 million, respectively, while Net cash used for investing activities decreased by $432 million and $86 million, respectively, and Net cash (used for) provided by financing activities increased by $140 million and $897 million, respectively. These adjustments are corrections primarily related to certain timing differences on cash paid for interest related to short-term Discount notes and certain accruals related to the acquisition of loans underlying Freddie Mac mortgage-related securities. In addition, Freddie Mac revised previously reported supplemental cash flow disclosures related to Cash paid for Interest for the years ended December 31, 2003 and 2002. This adjustment was made to include cash paid related to original issue discounts on short-term Discount notes in conformity with the current period presentation and resulted in increasing previously reported amounts by $2,710 million and $4,596 million for the years ended December 31, 2003 and 2002, respectively.

Freddie Mac often retains Structured Securities created through resecuritizations of mortgage-related securities held by the company. The new Structured Securities the company acquires in these transactions are classified as available-for-sale or trading based upon the predominant classification of the mortgage-related security collateral the company contributed. There were $428 million and $322 million of non-cash net transfers to the available-for-sale classification from the trading classification related to resecuritization transactions in 2004 and 2003, respectively.

Transfers of Financial Assets that Qualify as Purchases or Sales

Freddie Mac accounts for transfers of financial assets pursuant to the requirements of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 140"), and, prior to April 1, 2001, SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 125"), collectively referred to as "SFAS 125/140." If Freddie Mac determines that it surrenders control over assets that it transfers to a third party, Freddie Mac accounts for such transfers as sales to the extent its counterparty provides consideration other than beneficial interests in the transferred assets (*e.g.*, cash). Likewise, if Freddie Mac determines that it obtains control over assets that were transferred to it, it accounts for such transfers as purchases to the extent Freddie Mac provides consideration other than beneficial interests in exchange for the transferred assets. Freddie Mac accounts for cash-based transfers of financial assets that do not qualify as sales as secured borrowings.

If a transfer of financial assets qualifies as a sale, Freddie Mac continues to carry on its consolidated balance sheets any retained interests in securitized financial assets. Such retained interests generally take one of two forms. First, in connection with its right to receive guarantee payments (as further discussed below), Freddie Mac recognizes a retained interest that is classified on its consolidated balance sheets as Guarantee asset for Participation Certificates, at fair value. (This retained interest is referred to below as a "GA".) Second, Freddie Mac recognizes PCs (or Structured Securities issued by the company using PCs held in its portfolio) that are not transferred to third parties upon the completion of a securitization of mortgage loans (or, in the case of Structured Securities, upon the resecuritization of PCs or Structured Securities held in portfolio). PCs and Structured Securities that are held in portfolio are accounted for pursuant to the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). The carrying amounts of all of such retained interests are determined by allocating the previous carrying amount of the transferred assets between assets sold and the retained interests based upon their relative fair values at the date of transfer.

Upon completion of a transfer of financial assets that qualifies as a sale, Freddie Mac also de-recognizes all assets sold and recognizes all assets obtained and liabilities incurred. In this regard, Freddie Mac recognizes the fair value of its recourse obligation to guarantee the payment of principal and interest of PCs and Structured Securities transferred in sale transactions. The initial fair value of such recourse obligations is intended to reflect the estimated amount that Freddie Mac would be required to pay to a third party of similar credit standing to be relieved of Freddie Mac's obligations under the guarantee contract. The portion of such recourse obligations that relates to Freddie Mac's non-contingent obligation to stand ready to perform under its guarantee is recognized as Guarantee obligation for Participation Certificates (or as a "GO"), while the portion of such recourse obligations that relates to incurred losses on securitized assets is recognized for consolidated balance sheet purposes as Reserve for guarantee losses on Participation Certificates. Such recourse obligations serve as a reduction of proceeds in the calculation of the corresponding gain (loss) on the sale of transferred PCs and Structured Securities. The fair value of a recognized recourse obligation is estimated using an expected cash flow approach consistent with Statement of Financial Accounting Concepts No. 7, "Using Cash Flow Information and Present Value in Accounting Measurements" ("CON 7"). These recourse obligations are valued independently of corresponding GAs. The resulting gain (loss) on sale of transferred PCs and Structured Securities is reflected in Freddie Mac's consolidated statements of income as a component of Gains (losses) on investment activity.

Subsequent Measurement of Recognized GAs — Freddie Mac generally views recognized GAs as financial assets that can be prepaid or otherwise settled in a manner that may prevent Freddie Mac from recovering substantially all of its recorded investment. As a result, Freddie Mac generally accounts for GAs like debt instruments classified as trading under SFAS 115. All changes in the fair value of recognized GAs are reflected in earnings as a component of Gains (losses) on "Guarantee asset for Participation Certificates, at fair value." All guarantee-related compensation that is received over the life of the loan in cash is reflected in earnings as a component of Management and guarantee income. See "NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS" for a discussion of the attribution of GA-related cash flows.

Subsequent Measurement of Recognized GOs — With respect to the subsequent measurement of recognized GOs for the year ended December 31, 2002, Freddie Mac accounts for recognized GOs at fair value. All changes in fair value are reflected in Freddie Mac's consolidated statements of income as a component of Income on "Guarantee obligation for Participation Certificates."

With respect to the subsequent measurement of recognized GOs for the years ended December 31, 2004 and 2003, Freddie Mac subsequently measures such liabilities using a systematic and rational method of amortization. More specifically, Freddie Mac amortizes recognized GOs into earnings in proportion to the rate of unpaid principal balance decline of securitized mortgage loans. Periodic amortization of recognized GOs is reflected in earnings as a component of Income on "Guarantee obligation for Participation Certificates." Freddie Mac subsequently measures its contingent obligation to make guarantee payments pursuant to the provisions of SFAS 5, which requires that credit losses be recognized in earnings when assessed as both probable and estimable. See discussion below in "Recently Adopted Accounting Standards and Accounting Changes" for further discussion concerning the change in methods used by Freddie Mac to subsequently measure recognized GOs.

Guarantor Swap Transactions Executed Prior to January 1, 2003

Guarantor Swaps represent transactions in which third-party institutions transfer mortgage loans to Freddie Mac in exchange for issued PCs that are backed by such mortgage loans. In return for providing its guarantee on such issued PCs, and similar to PCs described above in "Transfers of Financial Assets that Qualify as Purchases or Sales," Freddie Mac earns a management and guarantee fee ("G-Fee") that is paid to Freddie Mac over the life of an issued PC. It is also common for Buy-Ups or Buy-Downs to be exchanged between Freddie Mac and its counterparties upon the issuance of a PC. Buy-Ups represent upfront payments that are made by Freddie Mac, which increase the G-Fee that Freddie Mac will receive over the life of the PC in connection with its guarantee. Buy-Downs represent upfront payments that are made to Freddie Mac, which decrease (*i.e.*, partially prepay) the G-Fee that Freddie Mac will receive over the life of the PC in connection with its guarantee. Moreover, Freddie Mac may receive upfront, cash-based payments as additional compensation for its guarantee of mortgage loans with certain credit risk related characteristics ("Credit Fees"). Finally, and as additional consideration received on such exchanges, Freddie Mac may receive various types of seller-provided credit enhancements that correspond to securitized mortgage loans. The accounting for the primary components of Guarantor Swaps executed prior to January 1, 2003 follows.

Accounting For Guarantee Fees, Buy-Up, Buy Down and Credit Fees — G-Fees (as adjusted for Buy-Downs received) are recognized as Management and guarantee income on an accrual basis over the corresponding guarantee period in accordance with the provisions of EITF Issue No. 85-20, "Recognition of Fees for Guaranteeing a Loan."

Buy-Up amounts paid at PC issuance are recognized on the consolidated balance sheets as a GA if the corresponding PCs are held by third parties and are accounted for like a debt security that is classified as trading under SFAS 115. If a Buy-Up was paid in connection with PCs that Freddie Mac holds, the Buy-Up is recognized on the company's consolidated balance sheets as a component of Participation Certificate residuals, at fair value ("PC residuals"), which is discussed further below.

Buy-Down and Credit Fee amounts that were received at PC issuance prior to January 1, 2003 are deferred on Freddie Mac's consolidated balance sheets as an adjustment of Other liabilities. These amounts are amortized into Management and guarantee income pursuant to the requirements of SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases" ("SFAS 91").

If Freddie Mac were to purchase, and then subsequently sell for GAAP purposes, a PC that was issued prior to January 1, 2003 as part of a Guarantor Swap (and for which a GA and GO were never previously recognized), it would recognize, as a GA, the fair value of its contractual right to receive guarantee fees, and would also recognize, as a GO, the fair value of its obligation to guarantee the payment of principal and interest on such securities. Such assets and liabilities would be subsequently measured in a manner that is consistent with principles described above in "Transfers of Financial Assets that Qualify as Purchases or Sales."

Accounting For Incurred Credit Losses — Freddie Mac measures its contingent obligation to make guarantee payments pursuant to the provisions of SFAS 5, which requires that credit losses be recognized in earnings when assessed as both probable and estimable.

Accounting For Credit Enhancements — Premium payments on purchased pool insurance are recognized as Other Assets, which are amortized into Non-interest expense (a) on a straight-line basis over three-month periods to the extent that premiums paid were quarterly-based or (b) on a level yield basis to the extent that Freddie Mac paid related pool insurance premiums upfront and in full. Otherwise, credit enhancements do not receive recognition at the inception of executed Guarantor Swap transactions.

To the extent that related PCs that correspond to received credit enhancements (and for which a GA and GO were never previously recognized) are purchased and then subsequently sold for GAAP purposes by Freddie Mac, the fair value of received pool insurance or recourse is recognized as a component of GAs, while the fair value of primary mortgage insurance ("PMI") is recognized as a component of GOs. Such amounts are subsequently measured in a manner that is consistent with principles described above in "Transfers of Financial Assets that Qualify as Purchases or Sales."

Guarantor Swap Transactions Executed on or after January 1, 2003

Freddie Mac accounts for Guarantor Swaps that were executed on or after January 1, 2003 pursuant to the requirements of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). As exchange transactions, executed Guarantor Swap transactions are recognized by Freddie Mac at the inception of such transactions on a fair value basis. The accounting for each of the components of Guarantor Swap transactions executed on or after January 1, 2003 follows.

Accounting For Guarantee Fees — As consideration received in connection with a guarantee-related exchange transaction, Freddie Mac recognizes the fair value of its contractual right to receive guarantee fees as a GA at the inception of an executed guarantee. Consistent with principles described above, such assets, which are classified as Guarantee asset for Participation Certificates, at fair value, are subsequently measured on a fair value basis. All changes in the fair value of recognized GAs are reflected in earnings as a component of Gains (losses) on "Guarantee asset for Participation Certificates, at fair value." All guarantee-related compensation that is received over the life of the loan in cash is reflected in earnings as a component of Management and guarantee income.

Accounting For Guarantee Obligations — GOs are initially measured as the greater of (a) fair value or (b) the contingent liability amount required by SFAS 5 to be recognized at inception of an executed guarantee. The fair value of a recognized GO is estimated using an expected cash flow approach consistent with CON 7. Such liabilities are valued independently of corresponding GAs that are recognized in connection with such transactions. That portion of Freddie Mac's estimated guarantee liability that relates to its non-contingent obligation to stand ready to perform under a PC guarantee is recognized as Guarantee obligation for Participation Certificates, while that portion of its estimated guarantee liability that relates to its contingent obligation to make payments under its guarantee is recognized for consolidated balance sheet purposes as Reserve for guarantee losses on Participation Certificates.

Freddie Mac subsequently measures recognized GOs by amortizing such liabilities into earnings in proportion to the rate of the unpaid principal balance decline of securitized mortgage loans. Periodic amortization of recognized GOs is reflected in earnings as a component of Income on "Guarantee obligation for Participation Certificates." Freddie Mac subsequently measures its contingent obligation to make guarantee payments pursuant to the provisions of SFAS 5, which requires that credit losses be recognized in earnings when assessed as both probable and estimable.

Accounting For Credit Enhancements — With respect to those credit enhancements that are received in connection with Guarantor Swaps and other similar exchange transactions of PCs:

- pool insurance is recognized as an Other asset at its fair value;
- recourse and/or indemnifications that are provided by counterparties to Guarantor Swap transactions are recognized at fair value as Other assets; and
- PMI is recognized at inception at fair value as a component of recognized GOs.

Credit enhancements that are separately recognized as Other assets are amortized into earnings as Non-interest expense. Such assets are specifically amortized over related contract terms at the greater of results calculated by amortizing recognized credit enhancements (a) in proportion to the rate of unpaid principal balance decline of covered mortgage loans or (b) on a straight-line basis over a credit enhancement's contract term.

Accounting For Inception Differences Between Consideration Received and Guarantee Obligations Incurred — Because GAs, GOs and credit enhancement-related assets that are recognized at the inception of an executed Guarantor Swap are valued independently of each other, net differences between such recognized assets and liabilities may exist at inception. Net positive differences between such amounts are deferred on Freddie Mac's consolidated balance sheet as a component of Guarantee obligation for Participation Certificates and are hereinafter referred to as "Deferred Guarantee Income". Net negative differences between GAs, GOs and credit enhancement-related assets that are recognized at the inception of executed financial guarantees are expensed immediately to earnings as a component of Non-interest expense — Other expenses.

Deferred Guarantee Income is amortized into earnings at a rate that is commensurate with the observed decline in the unpaid principal balance of securitized mortgage loans. Periodic amortization of recognized Deferred Guarantee Income is reflected in earnings as a component of Income on "Guarantee obligation for Participation Certificates."

Accounting For Buy-Ups, Buy-Downs and Credit Fees — Cash payments that are made or received in connection with Buy-Ups and Buy-Downs are recognized as adjustments of recognized Deferred Guarantee Income. Likewise, Credit Fees that Freddie Mac received at inception are also recognized as adjustments of recognized Deferred Guarantee Income.

MultiLender Swap-Based Issuances of PCs

Freddie Mac issues PCs through its MultiLender Program that are backed by mortgage loans delivered to Freddie Mac by more than one third party. Freddie Mac may itself contribute mortgage loans to MultiLender pools from which PCs are then issued and delivered to third parties (and to Freddie Mac, to the extent that Freddie Mac contributed mortgage loans to a MultiLender pool). Freddie Mac accounts for its contributions of mortgage loans to a MultiLender pool as partial sales of those assets, the sold portion of which is dependent upon the contribution of collateral made by Freddie Mac relative to third parties. The portion of a MultiLender Swap transaction that qualifies as a sale is accounted for in the same manner as transfers described above that are accounted for as sales. The remaining portion of such PC issuances and transfers are accounted for in a manner consistent with the accounting for PCs issued through the Guarantor Program (as described above).

PC-for-Structured Security Swap Transactions

Freddie Mac issues and transfers Structured Securities to third parties in exchange for PCs and non-Freddie Mac mortgage-related securities. Freddie Mac cannot freely pledge or exchange the securities that are delivered to it by third parties in these exchanges. As a result, Freddie Mac does not view such exchanges as triggering sale accounting recognition under SFAS 125/140. Additionally, Freddie Mac does not account for such exchanges pursuant to the requirements of FIN 45 given that the guarantees on newly-issued Structured Securities constitute guarantees of Freddie Mac's own performance associated with guarantees on PCs or Structured Securities that underlie the newly-issued Structured Securities (guarantees of one's own performance are exempt from the requirements of FIN 45). As a result, Freddie Mac does not recognize any incremental GAs or GOs on such transactions. Rather, Freddie Mac defers and amortizes into income on a straight-line basis that portion of the transaction fee that Freddie Mac receives on such transactions that relates to the estimated fair value of the company's future administrative responsibilities for issued Structured Securities. In cases where Freddie Mac retains portions of the Structured Securities, a portion of this fee is deferred under the requirements of SFAS 91. The balance of transaction fees received, which relates to compensation earned in connection with structuring-related services rendered by Freddie Mac to third parties, is recognized immediately in earnings as Non-interest income — Resecuritization fees.

Purchases of PCs or Structured Securities for Which Recognized GAs and GOs Exist

The purchase of a PC or Structured Security prompts the extinguishment of a corresponding, recognized GO. Likewise, and where applicable, the purchase of such securities also prompts the extinguishment of the unamortized balance of Deferred Guarantee Income, Buy Downs and Credit Fees.

Freddie Mac records the de-recognition of an extinguished GO against earnings as a component of Gains (losses) on investment activity. Correspondingly, recognized GAs are reduced by an amount equal to the-then fair value of an extinguished GO, an adjustment of which is also reflected in earnings as a component of Gains (losses) on investment activity. All recognized GAs in this case are then reclassified on Freddie Mac's consolidated balance sheets as a component of "Participation Certificate residuals, at fair value" ("PC Residuals").

The unamortized balance of Deferred Guarantee Income, Buy-Downs and Credit Fees received are extinguished as a basis adjustment to the recognized value of purchased PCs. Like purchase discounts, such basis adjustments are subsequently amortized into earnings as Interest income pursuant to the requirements of SFAS 91 using the effective interest method.

PC Residuals

PC residuals relate to certain PCs or Structured Securities held by Freddie Mac and represent the fair value of the expected future cash flows associated with the guarantee contracts that are inherent within such securities.

A PC residual is recognized by Freddie Mac in connection with PCs or Structured Securities held by Freddie Mac that (a) were previously transferred to third parties as part of transactions that were accounted for either as sales pursuant to the provisions of SFAS 125/140 sale or as guarantee transactions that are subject to the provisions of FIN 45 (such that a GA and GO was previously-established for held PCs or Structured Securities), (b) were formed from mortgage loans purchased through Freddie Mac's Cash Window ("Cash Window Purchases") and that were never transferred to third parties, (c) were purchased by Freddie Mac from third parties in contemplation of the related issuance of such PCs through the Guarantor Program or (d) relate to Buy-Ups paid in connection with purchased PCs that had not previously been included as part of a transfer that was accounted for as a sale under SFAS 125/140 or as part of a guarantee transaction that was subject to the provisions of FIN 45.

Like a recognized GA, a PC residual is accounted for like a debt security and is classified as either available-for-sale or trading under SFAS 115. PC residuals relating to PCs or Structured Securities that previously went through either a SFAS 125/140 sale or were accounted for pursuant to FIN 45 are classified as trading under SFAS 115. PC residuals relating to PCs held in portfolio that were formed from Cash Window Purchases and that were never transferred to third parties are generally classified as available-for-sale under SFAS 115. The same treatment applies to PC residuals that correspond to PCs purchased by Freddie Mac from third parties in contemplation of their issuance through the Guarantor Program, except that any portions of these PC residuals that relate to Buy-Ups paid by Freddie Mac are accounted for as trading investments.

All changes in the fair value of PC residuals that are designated as trading are reflected in earnings as a component of Gains (losses) on investment activity. All changes in the fair value of PC residuals that are accounted for as available-for-sale are reflected as a component of Accumulated other comprehensive income (loss), net of taxes ("AOCI"), a component of Stockholders' equity.

Recognized PC residuals consist of a variety of cash flows that are primarily recorded through interest income. See "NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS" for a discussion of the attribution of GA and PC Residual-related cash flows.

Due to Participation Certificate Investors

Timing differences between Freddie Mac's receipt of scheduled and unscheduled principal and interest payments from seller/servicers on mortgages underlying PCs and the subsequent pass through of those payments on PCs owned by third-party investors results in the liability Due to Participation Certificate investors. In those cases, payments from seller/servicers are generally received in a given month, yet the PC

balance is not reduced for payments of principal until the first day of the next month and Freddie Mac releases the cash (principal and interest) to the PC investor on the fifteenth day of that next month. The company generally invests these principal and interest amounts received in short-term investments from the time Freddie Mac receives the amounts until the time Freddie Mac pays the PC investor. Interest income resulting from investment of principal and interest payments from seller/servicers is reported in interest income over the period earned.

For unscheduled principal prepayment amounts, these timing differences result in an expense accrual upon prepayment of the mortgage as the related PCs continue to bear interest to the PC investor at the PC coupon rate from the date of prepayment until the date the PC security balance is reduced, while generally no interest is received from the mortgage on that prepayment amount during that same time period. The expense recognized upon prepayment is reported in Interest expense — Due to Participation Certificate investors.

Freddie Mac reports PC coupon interest amounts relating to its investment in PCs consistent with the accounting practices generally applied by third party investors in PCs. Accordingly, the PC coupon interest on prepayments of a mortgage pending remittance on PCs held by Freddie Mac is reported as both Interest Income — Mortgage-related securities in the Retained portfolio and Interest expense — Due to Participation Certificate investors. Scheduled and unscheduled principal payments received by Freddie Mac that relate to its investment in PCs are reported as a reduction to its investment in PCs on the consolidated balance sheets.

Mortgage Loans

Mortgage loans that management may sell are classified as held-for-sale. If a decision is made to retain the loan, the loans are transferred to the held-for-investment portfolio. Loans transferred to the held-for-investment portfolio are transferred at lower of cost or market value. Lower-of-cost-or-market value adjustments, in this case, are treated as basis adjustments of such mortgage loans and are subsequently amortized into interest income over the period held.

Held-for-sale mortgages are included in the Retained portfolio and reported at lower of cost or market value, on a portfolio basis, with losses reported in Gains (losses) on investment activity. Consistent with SFAS No. 65, "Accounting for Certain Mortgage Banking Activities" ("SFAS 65"), premiums and discounts on loans classified as held-for-sale are not amortized as interest revenue during the period that such loans are classified as held-for-sale.

For a description of how Freddie Mac determines the fair value of its held-for-sale mortgage loans, see "NOTE 16: FAIR VALUE DISCLOSURES."

Mortgage loans that management has the ability and intent to hold for the foreseeable future or to maturity are classified as held-for-investment. These mortgage loans are reported at their outstanding principal balances, net of deferred fees and costs (including premiums and discounts). These deferred items are amortized into interest income over the estimated lives of the mortgages using the effective interest method. The company uses actual prepayment experience and estimates of future prepayments to determine the constant yield needed to apply the effective interest method. For purposes of estimating future prepayments, the mortgages are aggregated by similar characteristics such as origination date, coupon and maturity.

The company recognizes interest income on mortgage loans on an accrual basis, except when management believes the collection of principal or interest is doubtful.

Reserves for Losses on Mortgage Loans Held-for-Investment and Losses on PCs

Freddie Mac maintains a Reserve for losses on mortgage loans held-for-investment to provide for credit losses inherent in that portfolio. The Reserve for losses on mortgage loans held-for-investment is determined pursuant to the provisions of SFAS 5 and SFAS No. 114, "Accounting by Creditors for Impairment of a Loan — an Amendment of FASB Statements No. 5 and 15" ("SFAS 114") as more fully described below. Freddie Mac also maintains a Reserve for guarantee losses on Participation Certificates to provide for losses incurred on mortgages underlying PCs or Structured Securities held by third parties. The Reserve for guarantee losses on Participation Certificates is determined pursuant to the provisions of SFAS 5 and SFAS 114. The Reserve for losses on mortgage loans held-for-investment and Reserve for guarantee losses on Participation Certificates are collectively referred to as "loan loss reserves." Increases in loan loss reserves are reflected in earnings as a component of the (Provision) benefit for credit losses. Decreases in loan loss reserves

are reflected through either (a) charging-off such balances (net of recoveries) where realized losses are recorded or (b) a reduction in the (Provision) benefit for credit losses.

Loan loss reserves are also increased upon the sale of PCs and Structured Securities for which Freddie Mac incurred losses on the underlying mortgage loans while such securities were held by Freddie Mac. From an earnings perspective, such incurred losses are recognized as a component of Gains (losses) on investment activity through, where applicable (a) the subsequent measurement of corresponding PC residuals that are classified as trading (and to which such PCs or Structured Securities relate), (b) the recognition of impairment-related losses on such securities (*i.e.*, to the extent that such securities do not have recognized PC residual balances associated with them that are classified as trading) or (c) as a component of gain (loss) on sale of such securities. Upon the sale of such PCs or Structured Securities, incurred losses are classified on the consolidated balance sheets as Reserve for guarantee losses on Participation Certificates.

Single-family loan portfolio

In accordance with SFAS 5, Freddie Mac estimates incurred credit losses on homogeneous pools of single-family loans using statistically-based models that evaluate a variety of factors, resulting in a range of probable losses related to impaired single-family mortgage loans at the balance sheet date. The homogeneous pools of single-family mortgage loans are determined based on common underlying characteristics including year of origination, loan-to-value ratio and geographic region. In determining the loan loss reserves for single-family loans, Freddie Mac determines the point within the range of probable losses that represents the best estimate of incurred losses.

The factors used to estimate incurred losses at period-end include:

- actual and estimated loss severity trends for similar loans;
- actual and estimated default experience;
- actual and estimated proceeds from PMI and other credit enhancements;
- actual and estimated pre-foreclosure real estate taxes and insurance;
- the year of the loan origination;
- geographic location; and
- estimated selling costs should the underlying property ultimately be foreclosed upon and sold.

Freddie Mac frequently validates and updates the models and factors to capture changes in actual loss experience, as well as changes in underwriting practices and in its loss mitigation strategies. Freddie Mac also considers macroeconomic and other factors including:

- regional housing trends;
- applicable home price indices;
- unemployment and employment dislocation trends;
- consumer credit statistics;
- recent changes in credit underwriting practices;
- extent of third party insurance; and
- other measurable factors that influence the quality of the portfolio at the balance sheet date.

Favorable trends in these macroeconomic and other factors produce a reserve requirement toward the lower end of the range; adverse trends in these factors produce a reserve requirement toward the higher end of the range. Management then adjusts the level of loan loss reserves to the level required based on its best assessment of these factors.

Multifamily loan portfolio

Freddie Mac also estimates a range of incurred credit losses on the multifamily loan portfolio. Management considers all available evidence in determining this range including: adequacy of third-party credit enhancements and an evaluation of the repayment prospects of, and fair value of collateral underlying the individual loans. The review of the repayment prospects and value of collateral underlying individual loans

occurs within the context of property-specific and market-level risk characteristics including apartment vacancy rates, apartment rental rates, and property sales information, under several scenarios. Management reviews the range of probable losses and selects the point within the range that represents the best estimate of incurred losses. Loans individually evaluated for impairment include loans that become 60 days past due for principal and interest, certain loans with observable collateral deficiencies and loans whose contractual terms were modified due to credit concerns. When loan loss reserves for individual loans are established, consideration is given to all available evidence such as present value of discounted expected future cash flows, fair value of collateral and credit enhancements.

Non-performing Loans

Non-performing loans consist of (a) loans that were previously delinquent whose terms have been modified and, therefore, are now considered part of Freddie Mac's impaired loan population ("troubled debt restructurings" or "TDRs"), (b) serious delinquencies and (c) nonaccrual loans. Serious delinquencies are those single-family loans that are 90 days or more past due, and multifamily loans that are more than 60 days but less than 90 days past due. Also included in this category are multifamily loans greater than 90 days past due but where principal and interest are being paid to Freddie Mac under the terms of a credit enhancement agreement. Non-performing loans generally accrue interest in accordance with their contractual terms unless they are in nonaccrual status. Nonaccrual loans are loans where interest income is recognized on a cash basis, and only include multifamily loans greater than 90 days past due. For nonaccrual loans, any existing accruals are reversed against interest income unless they are both well secured and in the process of collection. For single-family loans greater than 90 days past due, interest income is accrued; however, reserves for uncollectible interest on single-family loans are estimated using statistical models, which quantify accrued but uncollectible interest. Freddie Mac reports this reserve as a reduction to the accrued loan interest balance in Accounts and other receivables, net.

Impaired loans include single-family loans, both performing and non-performing, that are TDRs. Multifamily impaired loans are defined as performing and non-performing TDRs, loans 60 days or more past due (except for certain credit-enhanced loans) and certain mortgage loans with real estate collateral values less than the outstanding unpaid principal balances. See "Table 6.2 — Impaired Loans" in "NOTE 6: LOAN LOSS RESERVES" for further discussion.

Freddie Mac has the option to purchase mortgage loans out of PC pools under certain circumstances, such as to resolve an existing or impending delinquency or default. Freddie Mac's general practice is to purchase the mortgage loans out of pools when the loans are 120 days delinquent. These repurchased loans are recorded on Freddie Mac's consolidated balance sheets at their purchase price (*i.e.*, the mortgage loan's unpaid principal balance), as adjusted for the effects of (a) the related amount of recognized GAs, PC residuals and security premiums and discounts (where applicable) and (b) the extinguishment of a proportionally related amount of recognized Buy-Downs, Credit Fees, GOs and Day One Differences (where applicable). Additionally, that portion of amounts classified in Reserve for guarantee losses on Participation Certificates that relates to a purchased loan is reclassified to Reserve for losses on mortgage loans held-for-investment.

Charge-Offs

The loan loss reserves are reduced for charge-offs when a loss is specifically identified and is virtually certain of occurring. For both single-family and multifamily mortgages where the original terms of the mortgage loan agreement are modified for economic or legal reasons related to the borrower's financial difficulties, losses are recorded at the time of modification in accordance with SFAS 114 and the loans are accounted for as TDRs. For mortgages that are foreclosed upon and thus transferred to Real estate owned, net or involved in a pre-foreclosure sale, losses at the time of transfer or pre-foreclosure sale are charged-off against Reserve for losses on mortgage loans held-for-investment. In the case of real estate owned ("REO") transfers, losses arise when the carrying basis of the loan (including accrued interest) exceeds the fair value of the foreclosed property (after deduction for estimated selling costs and consideration of third-party insurance or other credit enhancements). REO gains arise and are recognized immediately in earnings when the fair market value of the acquired asset (after deduction for estimated disposition costs) exceeds the carrying value

of the mortgage (including accrued interest). REO gains and losses (subsequent to foreclosure) are included in REO operations income (expense).

Investments in Securities

The company classifies mortgage-related securities and non-mortgage-related securities as available-for-sale or trading, as defined in SFAS 115. Freddie Mac currently does not classify any securities as held to maturity although the company may elect to do so in the future. Securities classified as available-for-sale and trading are reported at fair value with changes in fair value included in AOCI and Gains (losses) on investment activity, respectively. See "NOTE 16: FAIR VALUE DISCLOSURES" for more information on how Freddie Mac determines the fair value of securities.

The company records forward purchases and sales of securities that are specifically exempt from the requirements of SFAS 133 on a trade date basis. Securities underlying forward purchases and sales contracts that are not exempt from the requirements of SFAS 133 are recorded on contractual settlement date.

For most of the company's investments in securities, interest income is recognized using the retrospective effective interest method in accordance with SFAS 91. Deferred items, including premiums, discounts and other basis adjustments, are amortized into interest income over the estimated lives of the securities. The company uses actual prepayment experience and estimates of future prepayments to determine the constant yield needed to apply the effective interest method. The company recalculates the constant effective yield based on changes in estimated prepayments as a result of changes in interest rates and other factors. When the constant effective yield changes, an adjustment to interest income is made for the amount of amortization that would have been recorded if the new effective yield had been applied since the mortgage assets were acquired.

For certain of the company's investments in securities, interest income is recognized using the prospective effective interest method in accordance with EITF No. 99-20 "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets" ("EITF 99-20"). The company specifically applies such guidance to beneficial interests (including undivided interests which are similar to beneficial interests) in securitized financial assets that (a) can contractually be prepaid or otherwise settled in such a way that the company may not recover substantially all of its recorded investment (such as interest-only strips) or (b) are not of high credit quality at the acquisition date. EITF 99-20 requires that the company recognize as interest income (throughout the life of a retained interest) the excess of all estimated cash flows attributable to these interests over its principal amount using the effective yield method. The company updates its estimates of expected cash flows periodically and recognizes changes in calculated effective yield on a prospective basis.

Freddie Mac reviews securities for other-than-temporary impairment whenever the security's fair value is less than its amortized cost. Impairment is evaluated considering a number of indicators which include the severity of the decline in fair value, credit ratings and the length of time the investment has been in an unrealized loss position. In addition to these indicators, Freddie Mac recognizes impairment when qualitative factors indicate that the company may not recover the unrealized loss. When evaluating the impairment indicators and qualitative factors, Freddie Mac considers its intent and ability to hold the investment until a point in time at which recovery can be reasonably expected to occur. Impairment losses on manufactured housing securities exclude the effects of separate financial guarantee contracts that are not embedded in the securities since the benefits of such contracts are not recognized until claims become probable of recovery under the contracts. When a security is deemed to be impaired, the cost basis of the security is written down to fair value, with the loss recorded to Gains (losses) on investment activity. The security cost basis is not changed for subsequent recoveries in fair value. For securities within the scope of EITF 99-20, as described above, other-than-temporary impairments are defined as occurring whenever there is an adverse change in estimated cash flows coupled with a decline in fair value below the amortized cost basis.

Gains and losses on the sale of securities are included in Gains (losses) on investment activity, including those gains (losses) reclassified into earnings from AOCI. The company uses the specific identification method for determining the cost of a security in computing the gain or loss.

Repurchase and Resale Agreements

Freddie Mac enters into repurchase and resale agreements primarily as an investor or to finance its security positions. Freddie Mac also enters into (a) "dollar roll" transactions, which consist of simultaneous agreements with the same counterparty to sell a security and purchase similar securities at a future date at an agreed-upon price and (b) "reverse dollar roll" transactions, which consist of simultaneous agreements with the same counterparty to purchase a security and sell similar securities at a future date at an agreed-upon price. These transactions are accounted for pursuant to SFAS 125/140. In this regard, such transactions are accounted for as purchases and sales when the transferor relinquishes control over transferred securities. These transactions are accounted for as secured financings when the transferor does not relinquish control over transferred securities. Freddie Mac's policy is to take possession of securities purchased under agreements to resell and reverse dollar roll transactions. The amount of mortgage-related and non-mortgage-related securities pledged and that may be repledged under repurchase agreements and dollar roll transactions is presented parenthetically in the relevant securities captions in the consolidated balance sheets.

Debt Securities Issued

Debt securities issued by Freddie Mac are classified as either Due within one year or Due after one year based on their remaining contractual maturity. The classification of interest expense on debt securities as either short-term or long-term is based on the original contractual maturity of the debt security. Deferred items, including premiums, discounts, issuance costs and hedging-related basis adjustments, are amortized and reported through interest expense using the effective interest method over the period during which the related indebtedness is outstanding or, for callable debt, over the period during which the related indebtedness is expected to be outstanding. For callable debt, changes in the expected call date are reflected prospectively as an adjustment to the effective yield on the debt. Amortization of hedging-related basis adjustments is initiated upon the termination of the related hedge relationship, whereas amortization of premiums, discounts and issuance costs begins at the time of debt issuance. Deferred items, including premiums, discounts and hedging-related basis adjustments are reported as a component of Debt securities, net whereas issuance costs are reported as a component of Other assets. Debt securities denominated in a foreign currency are translated into U.S. dollars using foreign exchange spot rates at the balance sheet dates and any gains/losses are reported in Non-interest income (loss) — Other income.

Contemporaneous exchanges of cash between the company and a creditor in connection with the issuance of a new debt obligation and satisfaction of an existing debt obligation are accounted for as extinguishments with recognition of gains or losses in earnings if the debt instruments have substantially different terms. If the debt instruments do not have substantially different terms, the transaction is accounted for as an exchange rather than an extinguishment. In this case, the fees associated with the new debt obligation, along with the existing unamortized premium, discount or other basis adjustments on the existing debt obligation, are considered a basis adjustment on the new debt obligation and are amortized as an adjustment of interest expense over the remaining term of the new debt obligation.

Derivatives

Generally, derivatives are financial instruments with little or no initial net investment in comparison to their notional amount and whose value is based upon an underlying asset, index, reference rate or other variable. They may be privately negotiated contractual agreements that can be customized to meet specific needs, including certain commitments to purchase and sell mortgage loans, mortgage-related securities and debt securities, or they may be standardized contracts executed through organized exchanges. All derivatives are reported at their fair value on the consolidated balance sheets. The fair value of derivatives is generally reported net by counterparty, provided that a legally enforceable master netting agreement exists. Derivatives in a net asset position are reported as Derivative assets, at fair value. Similarly, derivatives in a net liability position are reported as Derivative liabilities, at fair value.

Currently, the majority of the company's derivatives are not designated in hedge accounting relationships. For those derivatives not designated as an accounting hedge, fair value gains and losses are reported as Derivative gains (losses) in the consolidated statements of income. For purchase and sale commitments of securities classified as trading under SFAS 115, fair value gains and losses are reported as Gains (losses) on investment activity in the consolidated statements of income.

Subject to certain qualifying conditions, Freddie Mac may designate a derivative as either a hedge of the cash flows of a variable-rate instrument or forecasted transaction ("cash flow hedge"), a hedge of the fair value of a fixed-rate instrument ("fair value hedge") or a foreign-currency fair value or cash flow hedge ("foreign currency hedge"). In order to be designated as an accounting hedge, the derivative must initially be expected to be highly effective in offsetting the changes in cash flows or fair value of the hedged item resulting from the hedged risk. In addition, the documentation of the hedging designation must include identification of the hedged item, the hedging instrument, the risk exposure and corresponding risk management objective, how effectiveness will be assessed and how ineffectiveness will be measured.

For a derivative qualifying as a cash flow hedge, Freddie Mac reports changes in the fair value of these instruments in AOCI to the extent the hedge is effective. The remaining ineffective portion, calculated using the hypothetical derivative method, is reported as Hedge accounting gains (losses). This method requires the company to develop a hypothetical derivative whose terms match those of the hedged item and compare estimated changes in the fair value of the hypothetical derivative to changes in the fair value of the hedging derivative. In general, Freddie Mac recognizes the associated amounts reported in AOCI as Income (expense) related to derivatives during the period or periods in which the hedged item affects earnings. If the hedged item relates to a forecasted issuance of debt, Freddie Mac reclassifies the associated amount reported in AOCI into earnings as Net interest income over the periods when the debt is issued and affects earnings. Amounts reported in AOCI related to changes in the fair value of commitments to purchase or sell securities that are designated as cash flow hedges are recognized as interest income for assets held and Gains (losses) on investment activity for assets sold.

If the hedged item in a cash flow hedge is the forecasted issuance of debt, and the occurrence of the forecasted transaction becomes probable of not occurring, the amount in AOCI is reclassified to earnings immediately. If Freddie Mac expects at any time that continued reporting of a net loss in AOCI would lead to recognizing a net loss on the combination of a hedging instrument and the hedged transaction (and related asset acquired or liability incurred) in one or more future periods, the loss is reclassified immediately into earnings for the amount that is not expected to be recovered.

For a derivative qualifying as a fair value hedge, Freddie Mac reports changes in the fair value of the derivative as Hedge accounting gains (losses) along with the changes in the fair value of the hedged item attributable to the risk being hedged. When the hedge is terminated or redesignated, the fair value adjustment to the carrying amount of the hedged asset or liability is amortized to earnings as a component of the hedged item's interest income or expense over the remaining life of the hedged item using the effective yield method.

If a derivative no longer qualifies as a cash flow or fair value hedge, the company discontinues hedge accounting prospectively. Freddie Mac continues to carry the derivative on the consolidated balance sheets at fair value and records further fair value gains and losses in the consolidated statements of income as Derivative gains (losses) until the derivative is terminated or redesignated.

The periodic interest cash flows related to derivative contracts currently accrued, which are derived primarily from interest-rate swap contracts, are classified as Income (expense) related to derivatives for derivatives in hedge relationships and as Derivative gains (losses) for derivatives not in hedge accounting relationships.

Inception gains or losses associated with commitments to purchase mortgage loans are deferred. With respect to those purchase commitments that have been designated as cash flow hedges, inception gains or losses are considered together with that portion of the cumulative change in fair value of such derivative instruments that are recognized in AOCI for the purpose of determining whether a net deferred loss exists that, as described above, should be reclassified to earnings. Additionally, and similar to derivative-related gains that are recognized as a component of AOCI, deferred inception-based gains on mortgage purchase commitments will be reclassified into earnings in the same period or periods during which acquired mortgage loans affect earnings. Specifically, inception gains or losses are:

- Recognized as a component of the gain or loss on sale of corresponding mortgage loans (either in whole loan or securitized form); or
- Recognized as interest income over the life of the corresponding mortgage loans at the point that, where applicable, such mortgage loans are reclassified as held-for-investment.

Real Estate Owned

REO is carried at the lower of cost or fair value (after deduction for estimated disposition costs). Amounts expected to be received from third-party insurance or other credit enhancements are reported when the claim is filed and are recorded as a component of Accounts and other receivables, net in the consolidated balance sheets. Material development and improvement costs relating to REO are capitalized. Operating expenses on the properties, net of any rental or other income, are included in REO operations income (expense). Estimated declines in REO fair value that result from ongoing valuation of the properties are provided for and charged to REO operations income (expense) when identified. The resulting valuation allowance is treated as a lower of cost or fair value adjustment to the basis of the properties. Any gains and losses on REO dispositions are included in REO operations income (expense).

Income Taxes

Freddie Mac uses the asset and liability method of accounting for income taxes pursuant to SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under the asset and liability method, deferred tax assets and liabilities are recognized based upon the expected future tax consequences of existing temporary differences between the financial reporting and the tax reporting basis of assets and liabilities using enacted statutory tax rates. To the extent tax laws change, deferred tax assets and liabilities are adjusted, when necessary, in the period that the tax change is enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. For all periods presented, no such valuation allowance was deemed necessary by management. Reserves are recorded for income tax and contingent interest where the potential for loss is probable and reasonably estimable in accordance with SFAS 5.

Income tax expense includes (a) deferred tax expense, which represents the net change in the deferred tax asset or liability balance during the year plus any change in a valuation allowance and (b) current tax expense, which represents the amount of tax currently payable to or receivable from a tax authority plus amounts accrued for expected tax deficiencies (including both tax and interest). Income tax expense excludes the tax effects related to adjustments recorded to AOCI.

Stock-Based Compensation

In December 2002, FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure — An Amendment of FASB Statement No. 123" ("SFAS 148"). This statement provides alternative methods of transition for a voluntary change to the fair value expense recognition method of accounting for stock-based employee compensation under SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). The annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002, and the interim disclosure provisions are effective for interim periods beginning after December 15, 2002.

Freddie Mac initially adopted the fair value compensation expense provisions of SFAS 123 prospectively for awards granted, modified or settled on or after January 1, 2002, in accordance with SFAS 123's original transition provision. However, as permitted by SFAS 148, Freddie Mac elected to adopt SFAS 123 retroactively to January 1, 1995. Accordingly, Freddie Mac records compensation expense equal to the estimated fair value of the stock-based compensation on the grant date, amortized on a straight-line basis over the vesting period, which is generally three to five years for options, restricted stock and restricted stock units and, starting in 2003, three months for the Employee Stock Purchase Plan ("ESPP"). The offset to the recorded compensation expense is an adjustment to Additional paid-in capital in Freddie Mac's consolidated balance sheets.

The fair value of options to purchase shares of Freddie Mac common stock, including options issued pursuant to the ESPP, is estimated using a Black-Scholes option pricing model, taking into account the exercise price and expected life of the option, the market value of the underlying stock and its expected volatility, expected dividends on the stock and the risk-free interest rate for the expected term of the option. The fair value of restricted stock and restricted stock unit awards is based on the grant-date fair value of Freddie Mac's common stock.

As discussed in "NOTE 11: STOCK-BASED COMPENSATION," awards under the company's stock compensation plans, including employee stock options, restricted stock units ("RSUs") and restricted stock, generally provide for dividend-equivalent rights. For employee stock options, the dividend-equivalent feature is

contemplated in the fair value estimate by using a dividend yield of zero as a Black-Scholes model input. Accordingly, compensation expense for these dividend-equivalents is recognized through amortization expense recognition. For restricted stock and RSUs, the value of the dividend-equivalents is reflected in the market price of a share of common stock. The fair value of restricted stock and RSUs on the grant date is recognized as compensation expense over the vesting period.

Incremental compensation expense related to modification of awards is based on a comparison of the fair value of the modified award with the fair value of the original award before modification (measured using the shorter of the remaining or revised term). Furthermore, the company generally expects to settle its stock-based compensation awards in shares. In the limited cases in which an award may be cash-settled only in the event of a contingency such as involuntary termination, Freddie Mac accounts for the award as an equity award until the contingency becomes probable, when liability accounting is triggered. Under SFAS 123, liabilities are initially measured at intrinsic value with changes in intrinsic value recognized as earnings.

For stock-based compensation granted prior to 1995, Freddie Mac continues to apply the provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, typically no compensation expense is recorded if the option exercise price is equal to the market price of the stock on the date of grant. Freddie Mac recognized compensation expense for restricted stock grants and dividend-equivalent rights associated with stock options. Furthermore, no compensation expense was recognized for the ESPP since it is a qualifying plan under tax regulations.

Earnings Per Common Share

Basic earnings per common share is computed as net income available to common stockholders divided by the weighted average common shares outstanding for the period. Diluted earnings per common share is determined using the weighted average number of common shares during the period, adjusted for the dilutive effect of common stock equivalents. Dilutive common stock equivalents reflect the assumed issuance of additional common shares pursuant to certain of the company's stock-based compensation plans that could potentially reduce or "dilute" earnings per share, based on the treasury stock method as defined in SFAS No. 128, "Earnings per Share" ("SFAS 128").

Comprehensive Income

Comprehensive income, as defined in SFAS No. 130, "Reporting Comprehensive Income" ("SFAS 130"), is the change in equity, on a net of tax basis, resulting from transactions and other events and circumstances from non-owner sources during a period. It includes all changes in equity during a period, except those resulting from investments by owners and distributions to owners. For Freddie Mac, comprehensive income is composed of net income plus changes in the unrealized gains and losses on available-for-sale securities, the effective portion of derivatives accounted for as cash flow hedge relationships, and changes in the minimum pension liability.

Reportable Segments

Freddie Mac has one business segment for financial reporting purposes because the company did not meet the criteria for reporting business segments that are prescribed in SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS 131"), for any period presented in the consolidated financial statements.

Recently Adopted Accounting Standards and Accounting Changes

Consolidation of Variable Interest Entities — In January 2003, the FASB issued FIN 46. FIN 46 provides guidance for determining when a company must consolidate the assets, liabilities and activities of a variable interest entity. In addition, various disclosures are required about variable interest entities when an entity is not the primary beneficiary but holds a "significant variable interest" in a variable interest entity.

In December 2003, the FASB released FIN 46-R. The revision captured much of the guidance to date that had been provided by the FASB for implementation of FIN 46, clarified FIN 46 and revised certain effective dates for implementation. Freddie Mac adopted FIN 46-R for 2003. The implementation had no effect on the company's consolidated financial statements in 2004 or 2003. In 2004, the company determined that five low-income housing tax credit partnerships, West*Mac Associates Limited Partnership ("West*Mac"), the owner and developer of the company's headquarters, and a reinsurance company should be consolidated pursuant to the requirements of FIN 46-R. Prior to 2004, Freddie Mac consolidated these

entities in accordance with other applicable requirements under GAAP. Finally, the company also has significant variable interests in certain variable interest entities that are not consolidated because the company is not the primary beneficiary. See "NOTE 3: VARIABLE INTEREST ENTITIES" for more information concerning variable interest entities.

Accounting For Financial Guarantees — Effective January 1, 2003, Freddie Mac adopted FIN 45 and FASB Staff Position FIN 45-2, "Whether FASB Interpretation No. 45, 'Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,' Provides Support for Subsequently Accounting for a Guarantor's Liability at Fair Value" ("FSP FIN 45-2"). FIN 45 requires that Freddie Mac recognize the fair value of the company's obligation to guarantee the payment of principal and interest on PCs and other mortgage pass-through certificates that are issued by the company that are transferred to third parties. Such guidance also requires that the company recognizes the fair value of any consideration received in connection with the execution of such guarantees, which primarily includes the company's contractual right to receive guarantee fees. In consideration of FSP FIN 45-2, effective January 1, 2003, Freddie Mac subsequently measures that portion of recognized guarantee obligations that relates to the company's non-contingent obligation to stand ready to perform using a systematic and rational method of amortization, while the company's contingent obligation to make payments under executed guarantees is accounted for pursuant to the requirements of SFAS 5. The implementation of FIN 45 and other such accounting changes in 2003 had a significant impact on Freddie Mac's accounting for PC guarantees. Additionally, on January 1, 2003, Freddie Mac reclassified $110 million to Reserve for guarantee losses on Participation Certificates representing that portion of recognized guarantee obligations that was attributable to estimated incurred losses on outstanding PCs or Structured Securities on that date.

Accounting For Credit Enhancements — Effective January 1, 2003, Freddie Mac no longer measures recognized credit enhancements on a fair value basis subsequent to the initial recognition of the credit enhancement. This change was made in conjunction with the change in the method by which recognized guarantee obligations are subsequently measured for consolidated financial statement purposes. This change necessitated a corresponding modification in the balance sheet classification of those credit enhancements that were previously recognized as a component of GAs and PC residuals since recognized GAs and PC residuals are subsequently measured on a fair value basis. In this regard, effective January 1, 2003, $189 million related to credit enhancements was reclassified to Other assets ($128 million from the GA and $61 million from PC residuals) and, correspondingly, is amortized into earnings as a component of Other expenses at the greater of amounts calculated by amortizing recognized credit enhancements (a) in proportion to the rate of unpaid principal balance decline of covered mortgage loans or (b) on a straight-line basis over a credit enhancement contract term. The implementation of FIN 45 also resulted in a change in when credit enhancements were recognized for consolidated financial statement purposes. Based upon the view expressed in FIN 45 that guarantee transactions constitute exchange transactions, Freddie Mac now recognizes the fair value of credit enhancements as consideration received in connection with Guarantor and MultiLender Swap transactions (and other, similar transactions) as of the issuance date of those PCs that were issued on or after January 1, 2003. Prior to January 1, 2003, Freddie Mac did not recognize credit enhancements for consolidated balance sheet purposes until a PC or Structured Security to which such credit enhancements related was included in a transfer that qualified as a sale under SFAS 125/140.

Derivative Instruments and Hedging Activities — On July 1, 2003, Freddie Mac adopted SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"). SFAS 149 amended and clarified the financial accounting and reporting for derivatives to incorporate decisions made by the FASB and the FASB's Derivative Implementation Group subsequent to the original issuance of SFAS 133 and in connection with other FASB projects. Under SFAS 149, purchase commitments for certain loans to be classified as held-for-investment must be accounted for as derivatives. The implementation of SFAS 149 did not have a material effect on the consolidated financial statements.

In September 2003, the Office of the Chief Accountant of the Securities and Exchange Commission ("SEC") published interpretive guidance on SFAS 133. To be consistent with the SEC guidance published at that time, Freddie Mac is reporting the income statement effects of derivatives not currently designated in hedge accounting relationships under SFAS 133 in a single line item on the company's consolidated statements of income, Derivative gains (losses) for all periods presented. Prior to 2003, the accrual for periodic cash settlements in accordance with the contractual terms of derivatives not in hedge accounting

relationships was recorded in Net interest income as a component of Income (expense) related to derivatives. Therefore, for periods prior to 2003, the impact of the accrual for these periodic derivative cash settlements has been reclassified from Income (expense) related to derivatives to Derivative gains (losses). The effect of this reclassification on the company's consolidated statements of income was to increase Net interest income by $639 million for 2002 and decrease Non-interest income by the same amounts. These reclassifications had no effect on net income.

Recently Issued Accounting Standards

Certain Loans or Debt Securities Acquired in a Transfer — In December 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, ("AICPA"), issued SOP No. 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer" ("SOP 03-3"). SOP 03-3 addresses the accounting for differences between the contractual cash flows and the cash flows expected to be collected from purchased loans or debt securities if those differences are attributable, in part, to credit quality. The scope of SOP 03-3 is limited to purchased loans or debt securities with evidence of deterioration of credit quality since origination acquired by completion of a transfer for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. SOP 03-3 requires purchased loans and debt securities to be recorded initially at acquisition cost (typically fair value in an arms-length purchase). SOP 03-3 is effective for certain loans and debt securities acquired after December 31, 2004. The adoption of SOP 03-3 is not expected to be material to the company's financial position or results of operations.

Other-than-Temporary Impairment — In September 2004, the FASB voted unanimously to delay certain portions of EITF 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-1"), subject to further consideration. Subsequently, the FASB deferred this consideration pending resolution of other related matters. The deferral applies to both debt and equity securities and specifically applies to impairments caused by interest rate and sector spreads. In addition, the provisions of EITF 03-1 that have been deferred relate to the requirements that a company declare its intent to hold the security to recovery and designate a recovery period in order to avoid recognizing an other-than-temporary impairment charge through earnings. The FASB may address other-than-temporary impairments further in a future project. The FASB's actions to defer the impairment measurement consensus did not change the separate disclosure consensus in EITF 03-1, which remains effective. The incremental disclosures required by EITF 03-1 are included in "NOTE 5: RETAINED PORTFOLIO AND CASH AND INVESTMENTS PORTFOLIO."

Stock-Based Compensation — In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment" ("SFAS 123-R"), which replaces the existing SFAS 123 and supercedes APB 25. Also, in March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB 107") which provides additional guidance on the application of SFAS 123-R. SFAS 123-R requires companies to measure and record compensation expense for stock options and other share-based payments based on the instruments' fair values. SFAS 123-R is effective for interim and annual reporting periods beginning after June 15, 2005. As noted above in "Stock-Based Compensation," the company has applied the fair value compensation expense provisions of SFAS 123 retroactively to January 1, 1995. The impact of the adoption of SFAS 123-R is not expected to be material to the company's financial position or results of operations.

Implicit Variable Interests — In March 2005, the FASB issued FASB Staff Position No. FIN 46(R)-5, "Implicit Variable Interests Under FASB Interpretation No. 46 (Revised December 2003)" ("FSP FIN 46(R)-5"). FSP FIN 46(R)-5 provides guidance on when an indirect relationship could be deemed an implicit variable interest that should be considered in assessing whether or not to consolidate certain entities. Determination as to whether an implicit variable interest exists should be based on whether the company, through its relationship with the related party, will absorb the variability of the variable interest entity. FSP FIN 46(R)-5 is effective for the company beginning April 1, 2005. The impact of adoption is not expected to be material to the company's financial position or results of operations.

NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS

Types of Securitization Transactions Executed By Freddie Mac

Freddie Mac issues two types of mortgage-related securities: Mortgage Participation Certificates ("PCs") and Structured Securities. PCs represent undivided interests in pools of mortgage loans that are secured by either single-family or multifamily loans. Similarly, Structured Securities represent undivided interests in PCs or other mortgage-related securities that are issued by either Ginnie Mae or non-agency issuers. Freddie Mac guarantees the payment of principal and interest on all issued PCs and Structured Securities.

Freddie Mac issues PCs in several different ways:

- Single-family mortgage loans that are purchased by Freddie Mac through its Cash Window are either retained by Freddie Mac in its Retained portfolio or are sold through auction in the form of issued PCs. Some single-family mortgage loans in the Retained portfolio are securitized and, therefore, are held as investments in the form of PCs. Mortgage loans that are purchased through the Cash Window and not retained by Freddie Mac are pooled together with other single-family mortgage loans that are received in connection with PC swap-based transactions that it executes with various lenders (and which Freddie Mac refers to as "MultiLender Swaps"). In this case, issued PCs that are not delivered to third party lenders in connection with MultiLender Swap transactions are sold by Freddie Mac for cash consideration through an auction.

- Freddie Mac commonly issues PCs to third parties through PC-swap-based transactions where either single-family or multifamily mortgage loans are delivered to Freddie Mac in exchange for PCs backed by such pools of mortgage loans. In this regard, and unlike MultiLender Swap transactions, the pools of mortgage loans formed in this case relate exclusively to mortgage loans that are delivered to Freddie Mac by a single lender.

Freddie Mac sells PCs that are held in its Retained portfolio in resecuritized form as Structured Securities. More specifically, Freddie Mac issues single and multi-class Structured Securities that are backed by PCs and other mortgage-related securities held in portfolio and subsequently transfers such Structured Securities to third parties in exchange for cash consideration. Freddie Mac also commonly issues Structured Securities in exchange for PCs and other mortgage-related securities that are delivered to it by third party dealers who, in turn, sell such Structured Securities to retail and institutional investors.

Retained Interests Created Through The Securitization Process

Freddie Mac's retained interests in securitized and resecuritized mortgage-related assets include the following:

- PCs retained by Freddie Mac that are backed by conforming single-family mortgage loans and multifamily mortgage loans for which Freddie Mac paid cash consideration.

- Structured Securities retained by Freddie Mac in connection with the resecuritization of PCs and mortgage-related securities that are issued by Ginnie Mae and non-agency entities.

- Freddie Mac's contractual right to receive a negotiated fraction of the interest-related cash flows of securitized mortgage loans which relates to compensation due Freddie Mac in connection with its guarantee and administration of payments of principal and interest on issued PCs. This retained, undivided interest is referred to as a GA.

- PC residuals, which relate to certain PCs and Structured Securities held by Freddie Mac and represent the fair value of the expected net future cash flows of guarantee and bond administration cash flows that are contractually distinct from that of such corresponding PCs or Structured Securities.

Unpaid Principal Balances of Issued PCs and Structured Securities

Table 2.1 below presents the unpaid principal balances of issued PCs and Structured Securities as of December 31, 2004 and 2003.

Table 2.1 — Issued PCs and Structured Securities Based on Unpaid Principal Balances[1][2]

	December 31,	
	2004	2003
	(dollars in millions)	
PCs and Structured Securities:		
Held by third parties	$ 852,270	$ 752,164
Held by Freddie Mac in the:		
Retained portfolio[3]	356,698	393,135
Cash and investments portfolio[4]	—	16,769
Total issued PCs and Structured Securities[5][6]	$1,208,968	$1,162,068

(1) Excludes mortgage loans and mortgage-related securities traded, but not yet settled.
(2) Due to the nature of security program remittance cycles of issued PCs and Structured Securities, the unpaid principal balances of the underlying mortgage loans do not equal the unpaid principal balances of issued PCs and Structured Securities. See "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Due to Participation Certificate Investors" for more information.
(3) With respect to mortgage loans purchased through Freddie Mac's Cash Window that were internally securitized as PCs and held as available-for-sale investments in the Retained portfolio, the company recognized losses of $1 million and $178 million for the years ended December 31, 2004 and 2003, respectively, that correspond to permanent lower-of-cost-or-market value adjustments that were recognized in connection with such mortgage loans. Such lower-of-cost-or-market value adjustments were treated as basis adjustments to such issued PCs and, as such, are amortized into interest income over the holding period of such securities.
(4) Represents PCs and Structured Securities held by Freddie Mac in connection with PC market-making and support activities, which are reflected in Investments on the consolidated balance sheets. In the fourth quarter of 2004, Freddie Mac ceased its PC market-making and support activities accomplished through its Securities Sales & Trading Group business unit and its external Money Manager program.
(5) As further discussed in "NOTE 4: FINANCIAL GUARANTEES," these amounts include:
- $3,015 million and $4,729 million of Structured Securities backed by Ginnie Mae Certificates at December 31, 2004 and 2003, respectively.
- $5,432 million and $5,044 million at December 31, 2004 and 2003, respectively, that pertain to Freddie Mac's guarantee of (a) the payment of principal and interest on (i) tax-exempt multifamily housing revenue bonds that support pass-through certificates issued by third parties; and (ii) multifamily mortgage loans that are originated and held by state and municipal housing finance agencies to support tax-exempt multifamily housing revenue bonds; and (b) Freddie Mac pass-through certificates which are backed by tax-exempt multifamily housing revenue bonds and related taxable bonds and/or loans together with scheduled principal payments on such bonds and/or loans.
- $1,806 million and $2,278 million at December 31, 2004 and 2003, respectively, of single-family mortgage loans held by third parties for which Freddie Mac provided a credit guarantee.

(6) PCs and Structured Securities exclude $723,429 million and $637,491 million at December 31, 2004 and 2003, respectively, of Structured Securities backed by resecuritized PCs and other previously issued Structured Securities. These excluded Structured Securities do not increase Freddie Mac's credit related exposure and consist of single-class Structured Securities backed by PCs, Real Estate Mortgage Investment Conduits, or REMICs and principal-only strips. The notional balance of interest-only strips of $105,703 million and $91,192 million at December 31, 2004 and 2003, respectively, is excluded because this table is based on unpaid principal balances. Also excluded are modifiable and combinable REMIC tranches and interest and principal classes, which collectively total $1,097,336 million and $988,600 million at December 31, 2004 and 2003, respectively, where the holder has the option to exchange the security tranches for other pre-defined security tranches.

At December 31, 2004 and 2003, approximately 86 percent and 78 percent, respectively, of issued PCs and Structured Securities (excluding securities issued by Freddie Mac and backed by Ginnie Mae Certificates or non-agency mortgage-related securities and other securities guaranteed by Freddie Mac) had corresponding GAs, GOs or PC residuals recognized on Freddie Mac's consolidated balance sheets. The percentage of these PCs and Structured Securities that had corresponding GAs, GOs or PC residuals due to the adoption of FIN 45 accounting on January 1, 2003 was 39 percent and 30 percent, at December 31, 2004 and 2003, respectively. As of December 31, 2004 and 2003, 87 percent and 81 percent, respectively, of PCs and Structured Securities held by third parties had a related GA and GO established.

Gains and Losses on Transfers of PCs and Structured Securities that are Accounted for as Sales

Freddie Mac recognized pre-tax gains of approximately $356 million, $711 million and $874 million for the years ended December 31, 2004, 2003 and 2002, respectively, on transfers of PCs and Structured

Securities that were accounted for as sales under SFAS 125/140. In connection with the derivation of such gains (losses), Freddie Mac has:

- developed and consistently applied a methodology for determining the order in which to record extinguishments of GOs and the recognition of retained interests because PCs within an individual CUSIP are fungible in nature;
- de-recognized for financial statement purposes the carrying value of the sold portion of securitized assets as of the end of the month in which a sale has occurred; and
- recorded extinguishments of GOs as of the beginning of the month in which the purchase of corresponding PCs or Structured Securities has occurred.

Key Valuation Assumptions Associated with Recognized GAs, GOs, Credit Enhancements and PC Residuals that Correspond to PCs or Structured Securities Backed by Single-Family Mortgages

Freddie Mac recognizes GAs and GOs for PCs backed by residential mortgage loans and multifamily mortgage loans in conjunction with transfers accounted for as sales under SFAS 125/140 as well as, beginning on January 1, 2003, transactions that do not qualify as sales, but are accounted for as guarantees pursuant to the requirements of FIN 45. At December 31, 2004 and 2003, GAs totaled $4,516 million and $3,686 million on Freddie Mac's consolidated balance sheets and of these amounts, approximately $88 million (or approximately 2 percent) and $24 million (or less than 1 percent), respectively, related to guarantees of multifamily mortgage loans. Consequently, the following discussion of key valuation assumptions and corresponding sensitivity analysis of recognized GAs, GOs, credit enhancements and PC residuals focuses solely on PCs and Structured Securities backed by single-family mortgage loans.

Recognized GAs

Fair values of recognized GAs were calculated using an expected cash flow approach. Specifically, Monte Carlo simulations were used to project monthly prepayment and default rates across 300 house price and interest rate scenarios. Through December 31, 2002, Monte Carlo simulations were also used to project monthly loss severity rates because recognized GAs for those periods included the fair value of pool insurance, recourse and indemnifications. As discussed in "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES," Freddie Mac discontinued the inclusion of these credit enhancements as components of recognized GAs effective January 1, 2003 and monthly loss severity rates are no longer included as part of Monte Carlo simulations used to project future cash flows associated with GAs. Monte Carlo projections were used to forecast GA-related future cash flows associated with approximately 360,000, 330,000 and 210,000 groups of mortgage loans for 2004, 2003 and 2002, respectively, that are distinguished based upon differing combinations of various loan attributes (these groups of loans are referred to as "Loan Group"). Freddie Mac then discounted their forecasted cash flows using factors that were derived from modeled forward interest rates (for each scenario path) to which Freddie Mac then applied a trailing average option-adjusted spread of up to 24 months that was based on spot interest-only security prices. The trailing average option-adjusted spreads ranged between 127 and 313 basis points from January 1, 2004 to December 31, 2004, and between 313 and 766 basis points from January 1, 2003 to December 31, 2003.

Based upon the foregoing, Freddie Mac recognized as GAs the average of the present value of the GA-related cash flows generated for each Loan Group for each of the referenced scenarios. Effective January 1, 2003, Freddie Mac modified the composition of GA-related cash flows used to derive fair value as a result of changes to its accounting policies (which are further described in "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES").

Recognized GOs

GOs are recognized at fair value at the inception of an executed guarantee. The fair value of a GO constitutes a component of the valuation of a PC residual (where a recognized PC residual is effectively equivalent to the net fair value of the underlying GA and GO). Like the cash flows associated with recognized GAs, GO-related future cash flows associated with each referenced Loan Group are estimated using Monte

Carlo simulation. The components of estimated future cash flows associated with GOs include: (a) estimates of expected future credit losses using statistically based models that evaluate a variety of factors (such as default experience and loss severity trends), as well as an estimated risk premium for the uncertainty in expected credit losses that would be required to be paid to a third party with a credit standing similar to Freddie Mac; (b) estimates of the costs to administer the collection and distribution of payments on the mortgage loans underlying a PC; and (c) expected net cash flows due to security program cycles. When deriving the present value of GO-related cash flows for each scenario for each Loan Group, Freddie Mac uses a convention that is similar to the methodology described above to discount GA-related future cash flows, except that a London Interbank Offered Rate ("LIBOR") rate is generally used to discount such cash flows. Additionally, projected credit related costs that are factored into the GO-related cash flows are benchmarked periodically to the non-conforming loan securitization market.

Like recognized GAs, Freddie Mac recognized as GOs the average of the present value of the GO-related cash flows generated for each Loan Group for each of the scenarios.

Recognized PC residuals

PC residuals relate to certain PCs and Structured Securities held by Freddie Mac in its Retained portfolio and Cash and investments portfolio and represent the fair value of the future cash flows of guarantee contracts that specifically correspond to such PCs. By the end of 2004, the company had ceased certain PC market-making and support activities and the Cash and investments portfolio no longer held mortgage-related securities. Since the future cash flows associated with such guarantee contracts are represented by those that define a PC's corresponding GA and GO, the fair value of a recognized PC residual is effectively equivalent to the fair value of a GA less that of a corresponding GO. Accordingly, the fair value of recognized PC residuals is determined in a manner that is reflective of the methodologies described above for recognized GAs and GOs.

Recognized Credit Enhancements

Many of the credit enhancements that Freddie Mac employs in connection with securitized mortgage loans are recognized at fair value at the inception of each contract. Future credit enhancement-related cash flows associated with each referenced Loan Group are estimated using a Monte Carlo simulation. More specifically, based upon the terms of a credit-enhancement contract, the portion of the total GO-related future cash flows estimated for each Loan Group that would be reimbursed to Freddie Mac by a third party (*e.g.*, a mortgage insurer) are identified as the estimated future cash inflows due Freddie Mac on each of such contracts. These projected cash inflows are then discounted using a LIBOR rate.

Freddie Mac recognizes as an Other asset the average of the present value of the credit enhancement-related cash flows generated for each Loan Group for each of the scenarios related to pool insurance, recourse and indemnifications. The average of the present value of the credit enhancements-related cash flows generated for each Loan Group for each of the scenarios related to primary mortgage insurance is recognized at inception at fair value as a reduction of recognized GOs.

Credit enhancements that were recognized as Other assets had a carrying value of approximately $232 million and $200 million at December 31, 2004 and 2003, respectively.

Other Retained Interests

Other Retained Interests (as defined in footnote 3 to "Table 2.3 — Sensitivity Analysis") are valued based upon observed market or matrix-based prices (for the latter, prices for comparable securities, as adjusted for product-specific attributes, are used as a basis to value such interests). Because these interests are not model-valued, the corresponding valuation assumptions are not provided in Table 2.2 below. Sensitivity analysis of these interests (as shown in "Table 2.3 — Sensitivity Analysis") is estimated using a company model that is not the source of the actual valuation used to determine their carrying value.

Table 2.2 summarizes the key assumptions Freddie Mac used in fair value measurements of recognized GAs, GOs and PC residuals.

Table 2.2 — Key Assumptions Utilized in Fair Value Measurements[1]

	2004		2003		2002	
	GA, GO and PC residual		GA, GO and PC residual		GA, GO and PC residual	
Assumptions	Range[6]	Mean[7]	Range[6]	Mean[7]	Range[6]	Mean[7]
Internal rates of return[2]						
GA	(1.4)% - 13.6%	6.7%	4.5% - 15.1%	9.4%	5.9% - 15.7%	9.4%
GO	1.3% - 9.4%	5.3%	1.9% - 9.5%	5.6%	3.8% - 8.2%	6.0%
PC residual	0.0% - 11.9%	6.1%	4.0% - 12.2%	7.6%	5.1% - 11.8%	7.4%
Prepayment rates[3]	6.8% - 58.6%	18.8%	7.5% - 62.9%	22.6%	8.8% - 54.6%	22.5%
Default rates[4]	0.1% - 8.5%	1.1%	0.1% - 8.5%	1.2%	0.1% - 8.1%	1.2%
Loss severity rates[5]	4.0% - 46.0%	23.9%	4.0% - 46.0%	24.6%	3.6% - 48.4%	22.9%

(1) The assumptions included in this table relate to those used to measure the fair value of single-family GAs, GOs and PC residuals at the time of securitization and the subsequent fair value measurements, which occurred throughout each of the years presented. Additionally, the range of assumptions used to facilitate the valuation of recognized credit enhancements was consistent with those provided above for recognized GOs.

(2) The internal rates of return ("IRR") reported above represent a duration weighted average of the discount rates used to value recognized GAs and GOs. Such rates were derived by determining a single rate that equated (a) the simple average of future cash flows (for all 300 scenario paths described above) of the GA and GO for each Loan Group with that of (b) the calculated fair value of the GA and GO for each Loan Group. With respect to PC residuals, IRRs reported above represent the weighted average of the derived IRR values for corresponding GAs and GOs (where weightings are based upon the fair values of corresponding GAs and GOs). Negative IRRs can occur when sufficiently large negative option adjusted spreads are applied to LIBOR. When Freddie Mac calibrates its modeled discounted cash flows to the traded price of an interest-only security, a negative option-adjusted spread can result when the traded price exceeds the implied market value of the modeled discounted cash flows. A negative option-adjusted spread is necessary to calibrate the implied market value of the modeled discounted cash flows to the traded price.

(3) Scenario average Prepayment rates are simulated on a monthly frequency, although rates reported above represent an unpaid principal balance weighted average of annualized values of such Prepayment rates.

(4) Default rates are simulated on a monthly frequency, although Default rates reported above represent simple averages of cumulative default rates determined for each of the 300 scenarios for each Loan Group.

(5) Loss severity rates reported above represent the ratio of (a) the simple average of cumulative credit losses generated for each scenario to (b) defaulted unpaid principal balance for each Loan Group.

(6) The lowest value in each presented range represents the first percentile IRRs, prepayment rates, default rates and loss severity rates throughout 2004, 2003 and 2002. Likewise, the highest value in each range represents the 99th percentile IRRs, prepayment rates, default rates and loss severity rates throughout 2004, 2003 and 2002.

(7) Reported values represent the weighted average value of all IRRs, prepayment rates, default rates and loss severity rates throughout the 2004, 2003 and 2002 periods.

Weighted average lives of GAs and PC residuals during 2004, 2003 and 2002 ranged between 1.2 – 8.7 years, 1.0 – 8.6 years and 1.5 – 7.8 years, respectively, while the average derived weighted average lives of GAs and PC residuals for the same periods were 5.2, 4.8 and 5.0 years, respectively. Such derived weighted average lives are reflective of prepayment speed assumptions cited in Table 2.2 above.

The sensitivity analysis in Table 2.3 below illustrates estimated changes in the fair value at December 31, 2004 of recognized GAs, PC residuals and other retained interests (which are further described below) based upon:

- 100 basis point and 200 basis point increases and decreases in discount rate assumptions;
- 10% and 20 increases and decreases in prepayment rate assumptions;
- 10% and 20% increases in default rate assumptions; and
- 10% and 20% increases in loss severity rate assumptions.

GOs are not included in the sensitivity analysis in Table 2.3 since such items are not subsequently measured on a fair value basis in the consolidated balance sheets.

Table 2.3 — Sensitivity Analysis

	At December 31, 2004		
	PC residual[1]	GA[2]	Other retained interests[3]
	(dollars in millions)		
Fair value	$ 845	$4,516	$ 713[4]
Weighted average IRR assumptions:	5.8%	6.1%	10.8%
Impact on fair value of 100 bps upward change	$ (28)	$ (161)	$ (23)
Impact on fair value of 200 bps upward change	$ (54)	$ (312)	$ (44)
Impact on fair value of 100 bps downward change	$ 29	$ 172	$ 25
Impact on fair value of 200 bps downward change	$ 59	$ 348	$ 52
Weighted average prepayment rate assumptions:	19.0%	19.5%	14.3%
Impact on fair value of 10% upward change	$ (16)	$ (207)	$ (28)
Impact on fair value of 20% upward change	$ (32)	$ (393)	$ (53)
Impact on fair value of 10% downward change	$ 17	$ 231	$ 32
Impact on fair value of 20% downward change	$ 36	$ 490	$ 68
Weighted average default rate assumptions:	1.0%	1.0%	N/A[5]
Impact on fair value of 10% upward change	$ (65)	$ (3)	N/A[5]
Impact on fair value of 20% upward change	$(130)	$ (7)	N/A[5]
Weighted average loss severity rate assumptions:	24.0%	N/A[6]	N/A[5]
Impact on fair value of 10% upward change	$ (86)	N/A[6]	N/A[5]
Impact on fair value of 20% upward change	$(174)	N/A[6]	N/A[5]

(1) At December 31, 2004 and 2003, approximately $107 million and $47 million, respectively, of recognized PC residuals were classified as available-for-sale representing, as a function of the unpaid principal balances of related PCs or Structured Securities, approximately 17 percent of recognized PC residuals. Therefore, approximately 83 percent of the future changes in fair value of recognized PC residuals would be recognized in earnings, while the balance of such future changes in fair value would be reflected in AOCI, net of taxes.

(2) At December 31, 2004, GAs totaled $4,516 million on Freddie Mac's consolidated balance sheet and of that amount, approximately $88 million (or approximately 2 percent), relates to PCs backed by multifamily mortgage loans. The sensitivity analysis presented in Table 2.3 relates solely to GAs associated with PCs backed by single-family mortgage loans.

(3) Includes interest-only securities that were issued by Freddie Mac as part of a resecuritization transaction for which sale accounting treatment was applied, and Freddie Mac securities that were (a) purchased at a premium (to par) of 10 percent or greater and (b) associated with either a securitization or resecuritization transaction for which sale accounting treatment was applied. Also included are Freddie Mac securities held by the company for which securitized / resecuritized mortgage-related assets were (a) not of high credit quality and (b) associated with either a securitization or resecuritization transaction for which sale accounting treatment was applied.

(4) Includes accrued interest.

(5) Sensitivities of reported fair value to changes in default and loss severity rates associated with Other retained interests for which a recognized PC residual exists are captured in the corresponding column entitled PC residual. Otherwise, with respect to Other retained interests for which a PC residual was not recognized, such securities are valued for consolidated financial statement purposes at the observed market price for such securities, which reflect inherent credit protection provided by Freddie Mac. In this case, changes in the reported fair value of such securities would not be affected by variations in default and loss severity assumptions and, as a result, a corresponding sensitivity analysis was not prepared.

(6) Severity of loss has no impact on the underlying cash flows of the guarantee asset or the resultant fair values.

The sensitivity analysis in the preceding table is hypothetical. Each of the calculated effects summarized above was determined by adjusting only one assumption at a time, as opposed to having determined a hypothetical effect on fair value based upon assumed, correlating changes in more than one assumption (where, in reality, a change in one assumption would generally result in changes to one or more of the other specified assumptions). Additionally, any corresponding hedge transactions executed by Freddie Mac were not considered in determining the hypothetical effects summarized above. Results provided above should not be extrapolated to either (a) other sensitivity analyses in which changes in other assumptions are made or (b) to other securities held by Freddie Mac.

Periodic Cash Flows on Transfers of Securitized Interests and Corresponding Retained Interests

Table 2.4 below summarizes:

- cash flows received by Freddie Mac in connection with transfers of PCs and Structured Securities to third parties that were accounted for as sales and where retained interests related to guarantee activities were initially recognized or resulted from a resecuritization transaction;
- contractual guarantee-related cash flows received by Freddie Mac in connection with recognized GAs (as further discussed below);
- contractual guarantee-related cash flows received by Freddie Mac in connection with recognized PC residuals (as further discussed below);
- receipts of payments of principal and interest on Other retained interests; and
- amounts paid by Freddie Mac to repurchase delinquent mortgage loans that back PCs and Structured Securities.

Table 2.4 — Details of Cash Flows

	Year Ended December 31,		
	2004	2003[1]	2002
	(dollars in millions)		
Cash flows from:			
Transfers of Freddie Mac securities that were accounted for as sales	$152,662	$347,874	$241,214
Cash flows received on retained interests:			
GAs[2]	1,086	891	771
PC residuals[2]	524	449	325
Other Retained Interests	491	810	654
Purchases of delinquent or foreclosed loans[3][4]	(4,931)	(5,822)	(5,039)

(1) Certain cash flow amounts previously reported for the year ended December 31, 2003 have been revised to reflect current year quantification methods.
(2) Amounts specifically correspond to guarantee fee-related cash flows of recognized GAs and PC residuals, and do not reflect cash flows received in connection with certain credit enhancements whose fair value in 2002 was also reported as GAs or PC residuals or certain GO-related cash flows whose value was reported as a component of recognized PC residuals. Total cash flows received on recognized GAs during 2004, 2003 and 2002 were $1,086 million, $891 million and $820 million, respectively. Total net cash flows received on recognized PC residuals during 2004, 2003 and 2002 were $227 million, $140 million and $169 million, respectively. Total GA cash flows and total net cash flows received on PC residuals in 2004 are exclusive of proceeds received in connection with credit enhancements.
(3) Represents delinquent mortgage loans purchased out of securitized pools that back issued PCs or Structured Securities.
(4) Subsequent to the release of Freddie Mac's Information Statement dated September 24, 2004, the company revised the methodology for disclosing the Purchases of delinquent or foreclosed loans. The effect of this was a $473 million decrease and an $87 million decrease in the balances for the years ended December 31, 2003 and 2002, respectively.

Attribution of GA- and PC Residual-Related Cash Flows

As previously discussed, GAs and PC residuals are financial assets accounted for on a fair value basis. Similar to other financial assets, cash flows received in connection with GAs and PC residuals represent both a return *on* such assets (*i.e.*, imputed interest) as well as a return *of* such assets (*i.e.*, return of principal). Freddie Mac receives cash flows on these assets related to contractual guarantee fees. Additionally, Freddie Mac receives or pays other cash flows associated with PC residuals that relate to the PC guarantee contract, such as credit-related expenses and administrative expenses.

Rather than recording a portion of the cash flows associated with GAs and PC residuals as a reduction of their respective recorded amounts, similar to a return of principal, the related income and expense amounts are recorded directly on the consolidated statements of income based on the nature of such cash flows. For example, guarantee-related cash inflows are recorded as Management and guarantee income. As these cash flows are received, the remaining cash flows (and the related GA and PC residual fair values) decrease. These decreases related to the GA and PC residuals are reflected in the Gains (losses) on Guarantee asset for Participation Certificates, at fair value and Gains (losses) on investment activity, respectively.

Recognized GAs — Guarantee Fee-Related Cash Flows

Freddie Mac recorded $1,086 million, $891 million and $771 million of income associated with guarantee-related cash flows received during 2004, 2003 and 2002, respectively. These amounts were recorded as Management and guarantee income. Of such amounts, approximately $257 million, $244 million and $242 million, respectively, related to imputed interest. The remaining portion related to return of principal, which totaled $829 million, $647 million and $529 million for 2004, 2003 and 2002, respectively.

Recognized GAs — All Cash Flows

As noted above, Freddie Mac discontinued the inclusion of credit enhancements as a component of recognized GAs effective January 1, 2003. As a result, imputed interest amounts reported above for 2004 and 2003 do not consider cash flows received that relate to credit enhancements that were previously recorded as a component of recognized GAs. With respect to amounts reported in 2002, Freddie Mac recorded total income of $820 million associated with recognized GAs. Approximately $259 million of such amounts constitute imputed interest, while the remaining portion, which totaled $561 million, related to return of principal for 2002.

Recognized PC Residuals

Freddie Mac recorded $524 million, $449 million and $325 million of income associated with guarantee-related cash flows received in connection with the GA component of recognized PC residuals during 2004, 2003 and 2002, respectively. These amounts were recorded as interest income. Of these amounts, approximately $117 million, $109 million and $96 million during 2004, 2003 and 2002, respectively, related to imputed interest. The remaining portion related to return of principal, which totaled $407 million, $340 million and $229 million during 2004, 2003 and 2002, respectively.

Considering all cash flows related to recognized PC residuals (*i.e.*, related to both the GA and GO components of recognized PC residuals), the amount of imputed interest on PC residuals was approximately $67 million, $66 million and $73 million during 2004, 2003 and 2002, respectively. Consistent with the description above, however, cash flows used to derive the imputed interest for 2004 and 2003 were exclusive of proceeds received in connection with credit enhancements.

NOTE 3: VARIABLE INTEREST ENTITIES

The company is a party to numerous entities that are considered to be variable interest entities ("VIEs") under FIN 46-R. These VIEs include low-income housing tax credit partnerships, West*Mac, certain asset-backed investment trusts, certain Structured Securities transactions and a mortgage reinsurance company. In addition, Freddie Mac buys the highly-rated senior securities in certain mortgage securitization trusts that are VIEs. Highly-rated senior securities issued by these securitization trusts are not designed to absorb a significant portion of the variability created by the assets/collateral in the trusts. Freddie Mac's investments in these securities do not represent a significant variable interest in the securitization trusts. Further, Freddie Mac invests in securitization entities that are qualifying special purpose entities ("QSPEs") as described in SFAS 125/140. Interests in these QSPEs are exempt from FIN 46-R because of the company's inability to unilaterally liquidate or change the QSPE. See "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES" for further information regarding FIN 46-R.

Low-Income Housing Tax Credit Partnerships

Freddie Mac invests as a limited partner in low-income housing tax credit partnerships formed for the purpose of providing funding for affordable multifamily rental properties. These low-income housing tax credit partnerships invest directly in limited partnerships that develop or rehabilitate multifamily rental properties. Completed properties are rented to qualified low-income tenants, allowing the properties to be eligible for federal tax credits. A general partner operates the partnership, identifying investments and obtaining debt financing as needed to finance partnership activities. Although these partnerships generate operating losses, Freddie Mac realizes a return on its investment through reductions in income tax expense that result from tax credits and the deductibility of the operating losses. The partnership agreements are typically structured to meet a required 15-year period of occupancy by qualified low-income tenants. These investments were made between 1989 and 2004. At December 31, 2004, Freddie Mac did not guarantee any obligations of these partnerships and Freddie Mac's exposure is limited to the amount of its investments.

West*Mac

Freddie Mac is one of two general partners in West*Mac, which was formed in 1986. The purpose of West*Mac is to acquire, develop and manage certain real property located in McLean, Virginia. This real property is Freddie Mac's corporate headquarters.

Asset-Backed Investment Trusts

Freddie Mac invests in a variety of non-mortgage-related, asset-backed investment trusts. These investments represent interests in trusts consisting of a pool of receivables or other financial assets, typically credit card receivables, auto loans or student loans. The trusts act as vehicles to allow originators to securitize assets. The originators of the financial assets or the underwriters of the deal create the trusts and typically own the residual interest in the trust assets.

Securities are structured from the underlying pool of assets to provide for varying degrees of risk. Primary risks include potential loss from the credit risk and interest rate risk of the underlying pool. Freddie Mac invests in these securities to manage its cash flows, create a diverse source of liquidity and achieve profitable investment returns. These investments were made between 2000 and 2004.

Structured Securities — T-Series Transactions

In T-Series transactions (or alternative collateral deals), a seller or sellers of mortgage loans transfers mortgage loans to a trust specifically for the purpose of issuing securities collateralized by the mortgage loans. These T-Series transactions issue various senior and subordinated interests. Freddie Mac guarantees and purchases certain of the senior interests. Simultaneous with this guarantee and purchase, Freddie Mac issues and guarantees Structured Securities. These Structured Securities represent an interest in the senior interests of the T-series transactions. The subordinated interests are generally either held by the seller or other party or sold in the capital markets.

Mortgage Reinsurance Company

In May 1998, Freddie Mac transferred credit risk to a consolidated special purpose entity in a reinsurance transaction.

Consolidated VIEs

As of December 31, 2004, the company had investments in five low-income housing tax credit partnerships, West*Mac and the mortgage reinsurance company referred to above, of which Freddie Mac was the primary beneficiary. These are consolidated pursuant to the requirements of FIN 46-R. Prior to 2004, Freddie Mac consolidated these in accordance with other applicable requirements under GAAP. Table 3.1 represents the carrying amounts and classification of consolidated assets that are collateral for the consolidated VIEs.

Table 3.1 — Assets of Consolidated VIEs

Consolidated Balance Sheets Line Item	December 31, 2004 (dollars in millions)
Cash and cash equivalents	$ 51
Accounts and other receivables, net	170
Other assets	239
Total assets of consolidated VIEs	$460

The investors in the obligations of consolidated VIEs have recourse only to the assets of those VIEs and do not have recourse to the company.

VIEs Not Consolidated

As of December 31, 2004, the company had unconsolidated investments in 149 low-income housing tax credit partnerships in which Freddie Mac had a significant variable interest. The size of these partnerships at December 31, 2004, as measured in total assets, was $7.5 billion. These partnerships are accounted for using the equity method, as described in "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES." As a limited partner, Freddie Mac's maximum exposure to loss equals the book value of its equity investment. As of December 31, 2004, Freddie Mac's maximum exposure to loss on unconsolidated low-income housing tax credit partnerships, in which Freddie Mac had a significant variable interest, was $2.9 billion.

At December 31, 2004, the company had investments in three trusts related to non-mortgage-related, asset-backed securities in which Freddie Mac had a significant variable interest. These trusts had total assets of $12.8 billion. At December 31, 2003, the company had investments in 15 trusts related to non-mortgage-related, asset-backed securities in which Freddie Mac had a significant variable interest. These trusts had total assets of $7.9 billion. As an investor, Freddie Mac's maximum exposure to loss consisted of the book value of its investment. As of December 31, 2004, Freddie Mac's maximum exposure to loss on non-mortgage-related, asset-backed investment trusts in which Freddie Mac had a significant variable interest was approximately $3.4 billion. As of December 31, 2003, Freddie Mac's maximum exposure to loss on non-mortgage-related, asset-backed investment trusts in which Freddie Mac had a significant variable interest was approximately $1.8 billion. These investments are typically senior interests rated A1 and P1 by Standard & Poor's and Moody's, respectively, which is the short-term equivalent to between A and AAA in typical long-term rating scales.

At both December 31, 2004 and 2003, the company had investments or guarantees related to two T-Series transactions in which Freddie Mac had a significant variable interest. Freddie Mac's involvement in the T-Series transactions began in 1996 and 2002, respectively. The size of these transactions at December 31, 2004 and 2003, as measured in total assets, was $170 million and $367 million, respectively. As of December 31, 2004 and 2003, Freddie Mac's maximum exposure to loss on T-Series transactions in which Freddie Mac had a significant variable interest was $147 million and $339 million, respectively, consisting of the book value of the company's investments plus incremental guarantees of the senior interests that are held by third parties.

NOTE 4: FINANCIAL GUARANTEES

Freddie Mac executes a variety of financial guarantees. Each of the principal types of such guarantees, including relevant qualitative and quantitative information associated with such items, is further discussed below.

Principal and Interest Guarantees of PCs and Structured Securities

As is further discussed in "NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS," Freddie Mac issues two types of mortgage-related securities: PCs and Structured Securities. PCs represent undivided interests in pools of mortgage loans that are secured by either single-family or multifamily mortgage loans. Similarly, Structured Securities represent undivided interests in PCs or other mortgage-related securities that are issued by either Ginnie Mae or non-agency issuers. Freddie Mac guarantees the payment of principal and interest on all issued PCs and Structured Securities. Freddie Mac's guarantees related to Structured Securities include its guarantees on PCs or any non-Freddie Mac mortgage-related securities that underlie these Structured Securities.

Depending upon the manner by which Freddie Mac transferred PCs or Structured Securities to third parties in 2004 and 2003, all such transfers, which totaled $365,108 million and $713,787 million, respectively, were accounted for pursuant to the requirements of FIN 45 and SFAS 125/140. Upon completion of the transfer of PCs or Structured Securities to third parties, Freddie Mac recognizes the fair value of its obligation to make guarantee payments. The methods by which Freddie Mac accounts for its guarantees of PCs and Structured Securities are further discussed in "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES."

The maximum potential amount of future principal payments Freddie Mac could be required to make in connection with the unpaid principal balance of all PCs and Structured Securities held by third parties totaled $852 billion and $752 billion at December 31, 2004 and 2003, respectively. Included in these amounts are $5.4 billion and $5.0 billion at December 31, 2004 and 2003, respectively, that pertain to guarantees related to multifamily housing revenue bonds that come in three principal forms. First, Freddie Mac provides a guarantee of the payment of principal and interest on tax-exempt multifamily housing revenue bonds that support pass-through certificates issued by third parties. These housing revenue bonds are collateralized by mortgage loans on low- and moderate-income multifamily housing projects. Second, Freddie Mac issues pass-through certificates which are backed by tax-exempt multifamily housing revenue bonds and related taxable bonds and/or loans. Freddie Mac guarantees all scheduled principal on the bonds or loans, and guarantees interest on the certificates. And third, Freddie Mac guarantees the payment of principal and interest related to low- and moderate-income multifamily mortgage loans that are originated and held by state and municipal agencies to support tax-exempt multifamily housing revenue bonds. Additionally, Freddie Mac provided credit guarantees of $1.8 billion and $2.3 billion at December 31, 2004 and 2003, respectively, of single-family mortgage loans held by third parties.

As part of these guarantee arrangements, Freddie Mac also provides a commitment to advance funds, commonly referred to as "liquidity guarantees," totaling $5.0 billion and $4.5 billion, at December 31, 2004 and 2003, respectively, to enable the repurchase by others of tendered tax-exempt pass-through certificates and housing revenue bonds that are unable to be remarketed. Any repurchased securities would be pledged to Freddie Mac as collateral for such funding until such time as the securities could be remarketed. There have been no payments made to date by Freddie Mac under this type of loan commitment.

Generally, the contractual terms of Freddie Mac's guarantees on PCs and Structured Securities are 15 to 30 years. However, the actual term of each guarantee may be significantly less than the contractual terms due to the prepayment characteristics of the mortgage-related assets that back PCs and Structured Securities. Maximum potential interest payments Freddie Mac could be required to make associated with these guarantees are not expected to significantly exceed 120 days of interest at the certificate rate, given that Freddie Mac generally begins a process to purchase the defaulted mortgages when they have been delinquent for 120 consecutive days.

In connection with PCs or Structured Securities backed by single-family mortgage loans, Freddie Mac had maximum coverage totaling $27.2 billion and $27.1 billion in primary mortgage insurance at

December 31, 2004 and 2003, respectively, $3.5 billion and $4.1 billion in pool insurance and other credit enhancements at December 31, 2004 and 2003, respectively, and $4.1 billion and $4.6 billion in recourse to lenders at December 31, 2004 and 2003, respectively. In addition, $2.6 billion and $4.1 billion of outstanding Structured Securities relate to Ginnie Mae Certificates, which are backed by the full faith and credit of the U.S. government, at December 31, 2004 and 2003, respectively. With respect to PCs and Structured Securities backed by multifamily mortgage loans, Freddie Mac had maximum combined credit enhancements totaling $9.1 billion and $9.5 billion at December 31, 2004 and 2003, respectively.

At December 31, 2004, Freddie Mac had a recognized Guarantee obligation for Participation Certificates on the consolidated balance sheets of $4.1 billion, which included $1.3 billion of Deferred Guarantee Income. At December 31, 2003, the Guarantee obligation for Participation Certificates totaled $2.9 billion, which included $0.8 billion of Deferred Guarantee Income. In addition, the company had a Reserve for Guarantee Losses on Participation Certificates that totaled $150 million and $125 million at December 31, 2004 and 2003, respectively, for incurred credit losses that were recognized in conjunction with PCs and Structured Securities held by third parties.

Guarantees of Stated Final Maturity of Issued Structured Securities

Freddie Mac commonly issues Structured Securities with stated final maturities that are shorter than the stated maturity of the underlying mortgage loans. If the assets that back such Structured Securities have not fully matured as of the stated final maturity date of such securities, either Freddie Mac will sponsor an auction of the underlying assets or a third party who holds a par-based call option on such underlying assets will exercise its option to purchase such underlying assets (an option which, if exercised, would provide cash flows that Freddie Mac would pass through to investors in such Structured Securities). If an auction occurs, Freddie Mac would pass through proceeds received to investors of such Structured Securities. To the extent, however, that auction proceeds are insufficient to cover unpaid principal amounts due to investors in such Structured Securities, Freddie Mac is obligated to fund such principal. With respect to such guarantees of stated final maturity, Freddie Mac effectively writes a cash-settled put option to investors in such Structured Securities. Such guarantees are accounted for as derivative instruments pursuant to the requirements of SFAS 133.

As of December 31, 2004 and 2003, the maximum potential amount of payments Freddie Mac could be required to make under such guarantees was $9.2 billion and $8.4 billion, respectively, which represents the outstanding unpaid principal balance of the underlying mortgage loans. At both December 31, 2004 and 2003, the total fair value of recognized liabilities concerning such guarantees was $1.0 million. The longest remaining contractual maturity of any outstanding written put option was 15 years and 16 years at December 31, 2004 and 2003, respectively; however, the actual terms may be significantly less than the contractual terms as the amortizing notional balance is linked to prepayable mortgage loans.

Indemnifications

In connection with various business transactions, Freddie Mac provides indemnification to counterparties for breaches of standard representations and warranties in contracts entered into in the normal course of business. It is difficult to estimate Freddie Mac's maximum exposure under these indemnification agreements since in many cases there are no stated or notional amounts included in the indemnification clauses. However, the contingencies triggering the obligation to indemnify have not occurred. Freddie Mac's assessment is that the risk would be remote. Such representations and warranties pertain to hold harmless clauses, adverse changes in tax laws and potential claims from third parties related to items such as actual or alleged infringement of intellectual property. At December 31, 2004 and 2003, there were 14 and 13 identified transactions, respectively, that contain intellectual property related indemnifications, as defined by FASB Staff Position No. 45-1, "Accounting for Intellectual Property Infringement Indemnifications under FASB Interpretation No. 45." Freddie Mac had not recorded any liabilities related to these indemnifications in its consolidated balance sheets as of December 31, 2004 and 2003 because it was not probable that the company would be required to make payments under these contractual agreements on those dates.

Other Guarantees

Freddie Mac has guaranteed the performance of interest-rate swap contracts in two circumstances. First, as part of a resecuritization transaction, Freddie Mac transferred certain swaps and related assets to a third party. Freddie Mac guaranteed that interest income generated from the assets would be sufficient to cover the required payments under the interest-rate swap contracts. In the other circumstance, Freddie Mac guaranteed that a customer would perform under an interest-rate swap contract linked to the customer's variable rate mortgage. The maximum remaining terms of any of these guarantees at December 31, 2004 and 2003 was 29 years and 27 years, respectively; however, the actual terms may be significantly less than the contractual terms as the amortizing notional balance of the swaps is linked to prepayable mortgage loans. The maximum potential amount of future payments under the guarantees was $50 million and $136 million at December 31, 2004 and 2003, respectively. The company has not established a liability on its consolidated balance sheets at December 31, 2004 and 2003 because it was not probable that it would be required to make payments under these contractual arrangements on those dates.

Freddie Mac provides guarantees to reimburse servicers for premiums paid to acquire servicing in situations where Freddie Mac requires the original seller to repurchase the loan and the original seller is unable to perform under a separate agreement to reimburse the servicer for those servicing premiums. Freddie Mac's servicing related premium guarantees are payable according to a vesting schedule for up to five years from the date of purchase of servicing rights. Freddie Mac's servicing-related premium guarantees issued in 2003 and 2004 extend through 2008 and 2009, respectively. The maximum potential amount of future payments under the guarantees was $113 million and $151 million at December 31, 2004 and 2003, respectively. The company has not established a liability on its consolidated balance sheets at December 31, 2004 and 2003 because it was not probable that it would be required to make payments under these contractual arrangements on those dates.

NOTE 5: RETAINED PORTFOLIO AND CASH AND INVESTMENTS PORTFOLIO

Table 5.1 summarizes amortized cost, estimated fair values and corresponding gross unrealized gains and gross unrealized losses by major security type for available-for-sale mortgage-related securities held in the Retained portfolio and available-for-sale non-mortgage-related securities held in the Cash and investments portfolio at December 31, 2004 and 2003, respectively.

Table 5.1 — Available-For-Sale Securities

	December 31, 2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in millions)			
Retained portfolio				
Mortgage-related securities issued by:				
Freddie Mac	$348,034	$5,506	$(1,438)	$352,102
Fannie Mae	58,922	950	(353)	59,519
Ginnie Mae	1,677	86	(1)	1,762
Other	166,738	1,700	(380)	168,058
Obligations of states and political subdivisions	8,751	301	(32)	9,020
Total mortgage-related securities	584,122	8,543	(2,204)	590,461
Cash and investments portfolio				
Non-mortgage-related securities:				
Asset-backed securities	21,668	120	(55)	21,733
Obligations of states and political subdivisions	8,098	—	(1)	8,097
Total non-mortgage-related securities	29,766	120	(56)	29,830
Total available-for-sale securities	$613,888	$8,663	$(2,260)	$620,291

	December 31, 2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in millions)			
Retained portfolio				
Mortgage-related securities issued by:				
Freddie Mac	$378,956	$ 7,010	$(1,540)	$384,426
Fannie Mae	75,705	1,524	(385)	76,844
Ginnie Mae	2,785	134	(1)	2,918
Other	107,522	2,152	(265)	109,409
Obligations of states and political subdivisions	7,449	306	(26)	7,729
Total mortgage-related securities	572,417	11,126	(2,217)	581,326
Cash and investments portfolio				
Non-mortgage-related securities:				
Asset-backed securities	16,209	394	(7)	16,596
Corporate debt securities	4,698	230	(4)	4,924
Obligations of states and political subdivisions	9,494	—	—	9,494
Commercial paper	150	—	—	150
Preferred stock	64	—	—	64
Total non-mortgage-related securities	30,615	624	(11)	31,228
Total available-for-sale securities	$603,032	$11,750	$(2,228)	$612,554

In 2004, 2003 and 2002, Freddie Mac received proceeds of $85,583 million, $142,167 million and $172,964 million, respectively, from the sale of securities from its available-for-sale portfolio. The proceeds received resulted in gross realized gains of $800 million and gross realized losses of $203 million in 2004, gross realized gains of $1,903 million and gross realized losses of $1,077 million in 2003 and gross realized gains of $1,575 million and gross realized losses of $257 million in 2002.

Management has determined that the $2,260 million of gross unrealized losses on the company's available-for-sale mortgage-related and non-mortgage-related securities at December 31, 2004 are not other

than temporary in nature. Management conducts periodic reviews to identify and evaluate investments that have indications of impairment. Impairment losses related to investments are recognized in earnings if fair value is less than amortized cost and the decline is considered other than temporary. See "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES" for additional information about the company's impairment accounting policies.

Table 5.2 below shows the fair value of available-for-sale securities in a gross unrealized loss position at December 31, 2004 and how long they have been in that position.

Table 5.2 — Available-For-Sale Securities in a Gross Unrealized Loss Position at December 31, 2004

	Less than 12 months		12 months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			(dollars in millions)			
Retained portfolio						
Mortgage-related securities issued by:						
Freddie Mac	$103,976	$ (713)	$34,161	$ (725)	$138,137	$(1,438)
Fannie Mae	20,727	(134)	9,913	(219)	30,640	(353)
Ginnie Mae	77	—	52	(1)	129	(1)
Other	55,398	(268)	4,323	(112)	59,721	(380)
Obligations of states and political subdivisions	1,025	(17)	591	(15)	1,616	(32)
Total mortgage related-securities	181,203	(1,132)	49,040	(1,072)	230,243	(2,204)
Cash and investments portfolio						
Non-mortgage related securities:						
Asset-backed securities	9,242	(51)	205	(4)	9,447	(55)
Obligations of states and political subdivisions	582	(1)	7	—	589	(1)
Total non-mortgage related securities	9,824	(52)	212	(4)	10,036	(56)
Total	$191,027	$(1,184)	$49,252	$(1,076)	$240,279	$(2,260)

At December 31, 2004, gross unrealized losses on available-for-sale securities were $2,260 million, or approximately one percent of the fair value of such securities in an unrealized loss position, as noted in Table 5.1 and Table 5.2. The gross unrealized losses relate to approximately 54 thousand individual lots representing approximately 10 thousand separate securities. Freddie Mac routinely purchases multiple lots of individual securities at different times and at different costs. The company determines gross unrealized gains and gross unrealized losses by specifically identifying investment positions at the lot level; therefore, Freddie Mac often holds several lots of one security including both unrealized gain and unrealized loss positions, depending upon the amortized cost of the specific lot.

The following is a summary of management's analysis of why available-for-sale securities in an unrealized loss position are not considered other than temporarily impaired:

- **Freddie Mac securities.** The unrealized losses on Freddie Mac securities are primarily a result of movements in interest rates. The extent and duration of the decline in fair value relative to the amortized cost have not met the company's criteria that are used to indicate other-than-temporary impairment as described in "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES." The company reviews the estimated credit exposure of the mortgages underlying these securities. As a result of this review, management has determined that these securities are not other than temporarily impaired. See "NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS" for further information on Freddie Mac's estimates of credit exposure and credit support.
- **Fannie Mae securities and Obligations of states and political subdivisions.** The unrealized losses on Fannie Mae securities and Obligations of states and political subdivisions are primarily a result of movements in interest rates. The extent and duration of the decline in fair value relative to the amortized cost have not met the company's criteria that are used to indicate other-than-temporary impairment and no other facts or circumstances existed to suggest that the decline was other than temporary. The issuer guarantees related to these securities have led management to conclude that any credit risk is minimal.

- **Other securities in the Retained portfolio and Asset-backed securities.** The unrealized losses on mortgage-related securities included in Other and Asset-backed securities are principally a result of movements in interest rates. The extent and duration of the decline in fair value relative to the amortized cost have not met the company's criteria that are used to indicate other-than-temporary impairment. These securities are all investment grade (*i.e.*, rated BBB– or better on a Standard & Poor's ("S&P") equivalent scale).

Table 5.3 summarizes the estimated fair values by major security type for trading securities at December 31, 2004 and 2003, respectively.

Table 5.3 — Trading Securities

	December 31,	
	2004	2003
	Fair Value	Fair Value
	(dollars in millions)	
Retained portfolio		
Mortgage-related securities issued by:		
Freddie Mac	$11,398	$17,590
Fannie Mae	385	586
Ginnie Mae	59	24
Total	11,842	18,200
Cash and investments portfolio		
Mortgage-related securities issued by:		
Freddie Mac	—	17,266
Fannie Mae	—	15,052
Ginnie Mae	—	490
Other	—	9
Total	—	32,817
Non-mortgage-related securities:		
Asset-backed securities	—	52
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies	—	479
Commercial paper	—	341
Corporate debt securities	—	437
Debt securities issued by foreign governments	—	5
Total	—	1,314
Total trading securities	$11,842	$52,331

In the fourth quarter of 2004, as part of an effort to realign the company's business around its mission and core business, Freddie Mac decided to cease its PC market making and support activities accomplished through the company's Securities Sales & Trading Group business unit and its external Money Manager program. In connection with ceasing these activities, the trading securities held in the Cash and investments portfolio were disposed of by the end of 2004. During the periods these trading assets were held, they were reported at fair value with the changes in fair value included in Gains (losses) on investment activity. Interest income on these trading assets was included in Net interest income. The Net proceeds from purchases and sales of trading securities reported in the company's consolidated statement of cash flows for 2004 of approximately $39.0 billion was primarily driven by the disposition of securities classified as trading from the Cash and investments portfolio. In connection with ceasing these activities, Freddie Mac incurred approximately $18 million of employee severance and related costs and approximately $5 million of other expenses during the fourth quarter of 2004.

In addition, Freddie Mac's investments in mortgage-related securities held by its Securities Sales & Trading Group business unit were generally hedged by entering into forward sales of mortgage-related securities. When determining the fair value of these positions, the held investment was valued at the current market, or spot, price, while the forward sale commitment was valued at the discounted sales, or forward, price. The spot-forward difference between the trading security and the forward sale commitment resulted in a loss in Gains (losses) on investment activities that was offset by Net interest income on the held position. This spot-forward difference was $976 million, $981 million and $938 million in 2004, 2003, and 2002, respectively.

The portion of Gains (losses) on investment activity that relates to trading securities held in the trading portfolio at December 31, 2004, 2003 and 2002 is $(240) million, $(402) million and $1,293 million, respectively.

Issuers Greater than 10 Percent of Stockholders' Equity

At December 31, 2004, Freddie Mac held available-for-sale and trading securities with a fair value of $59,904 million guaranteed by Fannie Mae that represented 191% of Total stockholders' equity. No other individual issuer at the individual trust level exceeded 10 percent of Total stockholders' equity at December 31, 2004.

Table 5.4 summarizes, by major security type, the remaining contractual maturities and weighted average yield of available-for-sale mortgage-related and non-mortgage-related securities at December 31, 2004.

Table 5.4 — Maturities and Weighted Average Yield of Available-For-Sale Securities

December 31, 2004	Amortized Cost	Fair Value	Weighted Average Yield[1]
	(dollars in millions)		
Retained portfolio			
Total mortgage-related securities[2]			
Due 1 year or less	$ 81	$ 81	3.22%
Due after 1 through 5 years	5,187	5,380	5.31
Due after 5 through 10 years	18,362	19,042	5.66
Due after 10 years	560,492	565,958	4.54
Total	584,122	590,461	4.58
Cash and investments portfolio			
Non-mortgage-related securities			
Asset-backed securities[2]			
Due 1 year or less	46	47	2.68
Due after 1 through 5 years	14,115	14,166	3.27
Due after 5 through 10 years	6,679	6,692	2.76
Due after 10 years	828	828	2.48
Total	21,668	21,733	3.08
Obligations of states and political subdivisions			
Due 1 year or less	1,103	1,102	1.81
Due after 1 through 5 years	36	36	1.95
Due after 5 through 10 years	72	72	1.94
Due after 10 years	6,887	6,887	2.04
Total	8,098	8,097	2.01
Total non-mortgage-related securities			
Due 1 year or less	1,149	1,149	1.84
Due after 1 through 5 years	14,151	14,202	3.27
Due after 5 through 10 years	6,751	6,764	2.75
Due after 10 years	7,715	7,715	2.09
Total	29,766	29,830	2.79
Total available-for-sale securities			
Due 1 year or less	1,230	1,230	1.94
Due after 1 through 5 years	19,338	19,582	3.82
Due after 5 through 10 years	25,113	25,806	4.87
Due after 10 years	568,207	573,673	4.50
Total	$613,888	$620,291	4.49%

(1) The weighted average yield is calculated based on a yield for each individual security held at the balance sheet date. The numerator for the individual security yield consists of the sum of (a) the year-end interest coupon rate multiplied by the year-end unpaid principal balance and (b) the annualized amortization income or expense calculated for December 2004 (excluding any adjustments recorded for changes in the effective rate). The denominator for the individual security yield consists of the year-end amortized cost of the security excluding effects of other-than-temporary impairments.
(2) Information provided for mortgage-related securities and asset-backed securities is based on contractual maturities, which may not represent their expected lives. Obligations underlying these securities may be prepaid at any time without penalty.

Table 5.5 presents the changes in AOCI, net of taxes, related to available-for-sale securities. The Net unrealized holding (losses) gains, net of tax (benefit) expense line represents the net fair value adjustments recorded on available-for-sale securities throughout the year after the effects of the company's statutory tax rate of 35 percent. The Net reclassification adjustment for realized (gains) losses included in net income, net of tax (expense) represents the amount of those fair value adjustments, after the effects of the company's statutory tax rate of 35 percent, that have been recognized in earnings due to a sale of an available-for-sale security or the recognition of an impairment loss. See "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES" for further information regarding the component of AOCI related to available-for-sale securities.

Table 5.5 — AOCI, Net of Taxes, Related to Available-For-Sale Securities

	Year Ended December 31,		
	2004	2003	2002
	(dollars in millions)		
Beginning balance	$ 6,349	$12,217	$ 4,200
Net unrealized holding (losses) gains, net of tax (benefit) expense of $(920), $(3,107) and $4,583, respectively	(1,709)	(5,770)	8,512
Net reclassification adjustment for realized (gains) losses included in net income, net of tax (expense) of $(162), $(53) and $(267), respectively[1]	(301)	(98)	(495)
Ending balance	$ 4,339	$ 6,349	$12,217

(1) Includes impairment losses on available-for-sale securities, where the decline in fair value is considered to be other than temporary, of $72 million, $438 million and $422 million, net of tax for the years ended December 31, 2004, 2003 and 2002, respectively.

Collateral Pledged

Freddie Mac enters into several types of secured financing transactions, including interest-rate swap, repurchase and resale agreements. See "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES" for more information regarding secured financing transactions.

Freddie Mac's counterparties are required to pledge collateral for reverse repurchase transactions and most interest-rate swap agreements after giving consideration to collateral posting thresholds, which are generally related to a counterparty's credit rating. Even though it is Freddie Mac's practice not to repledge assets held as collateral, based on master agreements, a portion of the collateral can be repledged. At December 31, 2004 and 2003, the fair value amount of collateral held by Freddie Mac under secured lending transactions and interest-rate swap agreements that was available for repledging was approximately $3 million and $8,200 million, respectively. This decrease was primarily a result of the company ceasing operations of its PC market-making and support activities accomplished through its Securities Sales & Trading Group business unit and external Money Manager program during the fourth quarter of 2004.

Freddie Mac is also required to pledge collateral for margin requirements with some custodians in connection with secured financing and daily trade activities. Based on agreements between Freddie Mac and the custodians, as illustrated in Table 5.6, some collateral may be permitted by contract to be repledged by the custodian. Freddie Mac has parenthetically disclosed on the consolidated balance sheets the fair value of assets pledged as collateral with the right to repledge. Table 5.6 summarizes all assets pledged as collateral by the company including assets that the secured party can repledge and those that cannot be repledged.

Table 5.6 — Collateral Pledged

	December 31,	
	2004	2003
	(dollars in millions)	
Assets pledged with ability for secured party to repledge (parenthetically disclosed on the consolidated balance sheets)		
Available for sale	$ 194	$282
Trading	—	61
Subtotal	194	343
Assets pledged without ability for secured party to repledge		
Available for sale	221	558
Trading	—	28
Subtotal	221	586
Total assets pledged	$ 415	$929

Cash and Cash Equivalents

Table 5.7 summarizes the components of Cash and cash equivalents for the years ended December 31, 2004 and 2003, respectively.

Table 5.7 — Cash and Cash Equivalents

	December 31,	
	2004	2003
	(dollars in millions)	
Interest-bearing[1]	$35,199	$23,100
Non-interest-bearing	54	42
Total	$35,253	$23,142

(1) Includes collateral that Freddie Mac holds when its exposure to its derivative counterparties exceeds mutually agreed upon limits. Interest earned on the collateral is paid to the counterparties at the contractual rate, while Freddie Mac retains any interest earned above the contractual rate.

NOTE 6: LOAN LOSS RESERVES

Freddie Mac maintains separate loan loss reserves for mortgage loans in the Retained portfolio that it classifies as held-for-investment and for credit-related losses associated with certain mortgage loans that underlie PCs held by third parties.

Table 6.1 summarizes loan loss reserve activity during 2004, 2003 and 2002.

Table 6.1 — Detail of Loan Loss Reserves Balance

	December 31,								
	2004			2003			2002		
	Reserves related to:			Reserves related to:			Reserves related to:		
	Retained Mortgages	PCs Outstanding	Total Loan Loss Reserves	Retained Mortgages	PCs Outstanding	Total Loan Loss Reserves	Retained Mortgages	PCs Outstanding	Total Loan Loss Reserves
	(dollars in millions)								
Beginning balance	$ 174	$125	$ 299	$ 177	$ 88	$ 265	$ 103	$121	$ 224
Provision (benefit) for credit losses[1]	111	32	143	76	(81)	(5)	146	(24)	122
Charge-offs[2]	(300)	—	(300)	(224)	—	(224)	(171)	—	(171)
Recoveries[1][2]	160	—	160	145	—	145	99	—	99
Adjustment for change in accounting[3]	—	—	—	—	110	110	—	—	—
Transfers-out during the period[4]	—	(20)	(20)	—	(11)	(11)	—	(9)	(9)
Other transfers, net, during the period[5]	(31)	13	(18)	—	19	19	—	—	—
Ending balance	$ 114	$150	$ 264	$ 174	$125	$ 299	$ 177	$ 88	$ 265

(1) Freddie Mac reclassified certain income for the full 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, it 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 and a $6 million decrease in Provision (benefit) for credit losses during 2003 and 2002, respectively. As a result of these reclassifications, it increased recoveries by $26 million and $15 million for the full years ended December 31, 2003 and 2002, respectively.

(2) It is Freddie Mac's practice to purchase mortgage loans from the pools that underlie PCs principally at the point the mortgage loan is identified as being 120 days past due. Upon repurchase, that portion of amounts classified in Reserve for guarantee losses on Participation Certificates that relates to a purchased loan is reclassified to Reserve for losses on mortgage loans held-for-investment. since all credit losses related to off-balance sheet PCs are preceded by the purchase of a delinquent mortgage loan from the PC pool, all charge-offs or recoveries are presented in the Retained Mortgages columns above.

(3) 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.

(4) 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.

(5) 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.

Impaired Loans

Total loan loss reserves, as presented in "Table 6.1 — Detail of Loan Loss Reserves Balance," consists of a specific valuation allowance related to impaired loans, which are presented in Table 6.2, and an additional reserve for other probable incurred losses which equaled $261 million, $289 million and $240 million at December 31, 2004, 2003 and 2002, respectively. The company's recorded investment in impaired loans and the related valuation allowance are summarized in Table 6.2.

Table 6.2 — Impaired Loans[1]

	December 31,								
	2004			2003			2002		
	Recorded Investment[2]	Specific Reserve	Net Investment	Recorded Investment[2]	Specific Reserve	Net Investment	Recorded Investment[2]	Specific Reserve	Net Investment
	(dollars in millions)								
Impaired loans having:									
Related-valuation allowance	$ 46	$(3)	$ 43	$ 60	$(10)	$ 50	$ 169	$(25)	$ 144
No related-valuation allowance[3]	2,261	—	2,261	2,309	—	2,309	2,077	—	2,077
Total	$2,307	$(3)	$2,304	$2,369	$(10)	$2,359	$2,246	$(25)	$2,221

(1) Single-family impaired loans include performing and non-performing TDRs. Multifamily impaired loans are defined as performing and non-performing TDR loans, loans 60 days or more delinquent except for certain credit enhanced loans and certain mortgage loans with real estate collateral values less than the outstanding unpaid principal balances. For more details on multifamily impaired loans, see "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES."
(2) Recorded Investment includes the unpaid principal balance of mortgage loans plus other amortized basis adjustments, which are modifications to their carrying value.
(3) Impaired loans with no related valuation allowance primarily represent performing single-family TDR loans.

For the years ended December 31, 2004, 2003 and 2002, the average recorded investment in impaired loans was $2,310 million, $2,330 million and $2,029 million, respectively.

Interest income on multifamily impaired loans is recognized on an accrual basis for loans performing under the original or restructured terms and on a cash basis for non-performing loans, which collectively totaled approximately $13 million, $16 million and $22 million for the years ended December 31, 2004, 2003 and 2002, respectively. For single-family performing and non-performing loans, Freddie Mac recognizes interest income on an accrual basis and establishes reserves for estimated accrued, but uncollectible, interest for these loans as of the consolidated balance sheet dates. Gross interest income on impaired single-family loans totaled $157 million, $160 million and $129 million for the years ended December 31, 2004, 2003 and 2002, respectively.

Delinquency Rates

Table 6.3 summarizes the delinquency rates for Freddie Mac's Total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities and that portion of Structured Securities that is backed by Ginnie Mae Certificates at December 31, 2004, 2003 and 2002.

Table 6.3 — Delinquency Performance[1]

	December 31,		
	2004	2003	2002
Delinquencies, end of period			
Single-family:[2]			
Credit-enhanced portfolio[3]	2.75%	2.96%	2.07%
Non-credit-enhanced portfolio	0.24%	0.27%	0.28%
Total portfolio	0.73%	0.86%	0.77%
Multifamily[4]	0.06%	0.05%	0.13%

(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.

NOTE 7: REAL ESTATE OWNED

Table 7.1 provides a summary of Freddie Mac's REO activity.

Freddie Mac obtains REO properties when it is the highest bidder at foreclosure sales of properties that collateralize non-performing single-family and multifamily mortgage loans owned by the company. Upon acquiring single-family properties, Freddie Mac establishes a marketing plan to sell the property as soon as practicable by either listing it with a sales broker or by other means, such as arranging a real estate auction. Upon acquiring multifamily properties, Freddie Mac may operate them with third-party property-management firms for a period to stabilize value and then sell the properties through commercial real estate brokers. For each of the three years ended December 31, 2004, the weighted average holding period for single-family disposed REO properties was less than one year and the weighted average holding period for multifamily disposed REO properties was about two years.

Table 7.1 — Real Estate Owned

	REO, Gross	Valuation Allowance	REO, Net
	(dollars in millions)		
Balance, December 31, 2001	$ 505	$ (58)	$ 447
Additions	1,197	(70)	1,127
Dispositions and write-downs	(1,032)	52	(980)
Balance, December 31, 2002	670	(76)	594
Additions	1,663	(93)	1,570
Dispositions and write-downs	(1,422)	53	(1,369)
Balance, December 31, 2003	911	(116)	795
Additions	1,641	(95)	1,546
Dispositions and write-downs	(1,685)	85	(1,600)
Balance, December 31, 2004	$ 867	$(126)	$ 741

Freddie Mac recognized losses of $67 million, $50 million, and $5 million on REO dispositions for the years ended December 31, 2004, 2003 and 2002, respectively, which are included in REO operations income (expense). Valuation allowance includes impairment write-downs on fair value of assets and selling expenses related to REO property holdings. This allowance is shown as part of REO operations income (expense) on the consolidated statements of income. Freddie Mac reclassified certain components of REO operations income (expense) for the years ended December 31, 2003 and 2002 to (Provision) benefit for credit losses to conform with the 2004 presentation.

NOTE 8: DEBT SECURITIES AND SUBORDINATED BORROWINGS

Debt securities are classified as either Due within one year or Due after one year based on their remaining contractual maturity. Table 8.1 summarizes the balances and effective interest rates at December 31, 2004 and 2003 for debt securities, as well as subordinated borrowings.

Table 8.1 — Total Debt Securities, Net

	December 31,			
	2004		2003	
	Balance, Net[1]	Effective Rate[2]	Balance, Net[1]	Effective Rate[2]
	(dollars in millions)			
Senior debt, due within one year:				
Short-term debt securities[3]	$196,639	2.05%	$212,035	1.11%
Current portion of long-term debt	85,664	3.33	83,227	3.61
Senior debt, due within one year	282,303	2.44	295,262	1.81
Senior debt, due after one year	443,772	4.36	438,738	4.34
Subordinated debt, due after one year	5,622	6.15	5,613	6.15
Senior and subordinated debt, due after one year	449,394	4.38	444,351	4.36
Total debt securities, net	$731,697		$739,613	

(1) Includes unamortized discounts and premiums. Current portion of long-term debt, and Senior and subordinated debt, due after one year, also include foreign-currency-related and hedging-related basis adjustments.
(2) 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.
(3) Effective rate previously reported for December 31, 2003 has been revised.

Freddie Mac finances the purchase of mortgage loans and mortgage-related securities primarily through the issuance of Senior debt and Subordinated debt.

Senior Debt, Due Within One Year

As indicated in Table 8.2, a majority of Senior debt, due within one year (excluding current portion of long-term debt) consisted of discount notes, paying only principal at maturity. Discount notes and medium-term notes are unsecured general obligations. Certain medium-term notes that have original maturities of one year or less are classified as Short-term debt securities. Securities sold under agreements to repurchase are effectively collateralized borrowing transactions where Freddie Mac sells securities with an agreement to repurchase such securities. These agreements require the underlying securities to be delivered to the dealers who arranged the transactions. Federal funds purchased are unsecuritized borrowings from commercial banks that are members of the Federal Reserve System.

Table 8.2 provides additional information related to Freddie Mac's debt securities due within one year.

Table 8.2 — 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[1]	Balance, Net[2]	Weighted Average Effective Rate[3]	
	(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	$282,303				

	2003				
	At December 31,		Average Outstanding During the Year		Maximum Balance, Net Outstanding at Any Month End
	Balance, Net	Weighted Average Effective Rate[1]	Balance, Net[2]	Weighted Average Effective Rate[3]	
	(dollars in millions)				
Discount notes[4]	$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[5]	1,611	0.96	2,283	0.94	8,296
Swap collateral obligations[6]	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	$295,262				

(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 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 has been revised to conform with the 2004 presentation.

Senior and Subordinated Debt, Due After One Year

Table 8.3 summarizes Freddie Mac's Senior and Subordinated debt, due after one year at December 31, 2004 and 2003.

Table 8.3 — Senior and Subordinated Debt, Due After One Year

		December 31,			
		2004		2003	
	Contractual Maturity[1]	Balance Outstanding[2]	Interest Rates	Balance Outstanding[2]	Interest Rates
		(dollars in millions)			
Senior debt, due after one year[3]:					
Fixed-rate:					
Medium-term notes — Callable[4]	2006 - 2029	$180,957	1.63% - 8.05%	$159,939	1.30% - 9.00%
Medium-term notes — Non-callable	2006 - 2028	8,587	1.00% - 7.69%	6,460	1.00% - 8.12%
U.S. dollar-denominated Reference Notes® securities	2006 - 2032	167,622	1.88% - 7.00%	181,901	1.50% - 7.00%
€Reference Notes® securities	2006 - 2014	28,967	3.50% - 5.75%	24,954	3.50% - 5.75%
Other[5]	N/A	—	N/A	6	12.10% - 12.90%
Floating-rate:					
Medium-term notes — Callable[6]	2006 - 2030	33,041	Various	28,412	Various
Medium-term notes — Non-callable[5][7]	2007 - 2026	1,207	Various	16,440	Various
Zero-coupon[8]:					
Medium-term notes — Callable	2014 - 2034	7,078	0%	6,608	0%
Medium-term notes — Non-callable	2006 - 2034	1,968	0%	1,723	0%
Foreign-currency-related and hedging-related basis adjustments		14,345		12,295	
Total senior debt, due after one year		443,772		438,738	
Subordinated debt, due after one year:					
Fixed-rate[9]	2011 - 2016	5,547	5.25% - 8.25%	5,545	5.25% - 8.25%
Zero-coupon[8]	2019	75	0%	68	0%
Total subordinated debt, due after one year		5,622		5,613	
Total senior and subordinated debt, due after one year		$449,394		$444,351	

(1) Represents contractual maturities at December 31, 2004.
(2) Represents unpaid principal balance of long-term debt securities and subordinated borrowings, net of associated discounts or premiums.
(3) For debt denominated in a currency other than the U.S. dollar, the outstanding balance is based on the exchange rate at the date of the debt issuance. Subsequent changes in exchange rates are reflected in Foreign-currency-related and hedging-related basis adjustments.
(4) Includes callable Estate Notes[SM] and Freddie Notes[SM] of $11,850 million and $11,041 million at December 31, 2004 and 2003, respectively. These debt instruments represent medium-term notes that permit persons acting on behalf of deceased beneficial owners to require Freddie Mac to repay principal prior to their contractual maturity date.
(5) Amounts for 2003 have been revised to conform with the 2004 presentation.
(6) Includes callable Estate Notes[SM] and Freddie Notes[SM] of $6,142 million and $4,132 million at December 31, 2004 and 2003, respectively. See related footnote (4) above concerning the nature of these debt instruments.
(7) Includes medium-term notes of $800 million and $700 million at December 31, 2004 and 2003, respectively, which are repayable in whole or in part at the option of the beneficial owner, acting through the holder, on or after November 22, 2002 and prior to November 20, 2007 at 100% of the principal amount plus accrued interest.
(8) Balance outstanding is net of associated discounts of $32,649 million and $37,870 million as of December 31, 2004 and 2003, respectively.
(9) Includes callable subordinated debt of $3,491 million and $3,490 million at December 31, 2004 and 2003, respectively.

A portion of Freddie Mac's long-term debt is callable. Callable debt gives Freddie Mac the option to redeem the debt security on one or more specified call dates or at any time on or after a specified call date. Table 8.4 summarizes the maturities, balances and effective interest rates at December 31, 2004 for callable debt (including current portion of callable debt and callable debt due after one year) by estimated call period.

Table 8.4 — Callable Debt, Due After One Year (including current portion of callable debt)

Estimated Call Period	Contractual Maturity	Balance Outstanding[1]	Effective Rate[2]
	(dollars in millions)		
2005	2005 - 2022	$ 20,255	2.84%
2006	2006 - 2021	39,316	2.63
2007	2007 - 2019	37,425	3.15
2008	2008 - 2019	23,953	3.46
2009	2009 - 2019	26,798	4.03
Thereafter	2010 - 2034	91,512	5.09
Total		$239,259	3.91%

(1) Represents unpaid principal balance of callable long-term debt securities and subordinated borrowings. However, callable zero-coupon debt is reflected on a net basis (*i.e.*, net of associated discounts of $28,825 million) and its estimated call period is based on contractual maturity.
(2) 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.

Table 8.5 summarizes the contractual maturities of long-term debt securities (including current portion of long-term debt) and subordinated borrowings outstanding at December 31, 2004, assuming callable debt is paid at contractual maturity.

Table 8.5 — Senior and Subordinated Debt, Due After One Year (including current portion of long-term debt)

Annual Maturities	Contractual Maturity[1][2]
	(dollars in millions)
2005	$ 83,625
2006	83,447
2007	64,838
2008	46,092
2009	55,574
Thereafter	218,131
Total[1]	551,707
Net premiums, discounts, and foreign-currency-related and hedging-related basis adjustments[2]	(16,649)
Senior and subordinated debt, due after one year, including current portion of long-term debt	$535,058

(1) Represents unpaid principal balance of long-term debt securities and subordinated borrowings.
(2) For debt denominated in a currency other than the U.S. dollar, the outstanding balance is based on the exchange rate at the date of the debt issuance. Subsequent changes in exchange rates are reflected in Net premiums, discounts, and foreign-currency-related and hedging-related basis adjustments.

Freddie Mac records gains and losses on debt repurchases that are accounted for as extinguishments of debt based on the difference between the principal amount of the debt securities repurchased (adjusted for deferred premiums, discounts, and hedging gains and losses) and current market prices, and the write-off of related deferred debt issuance costs. Freddie Mac incurred pre-tax losses of $327 million, $1,775 million and $674 million on the repurchase of approximately $14.5 billion, $27.3 billion and $20.3 billion in principal amount of debt outstanding in 2004, 2003 and 2002, respectively.

NOTE 9: STOCKHOLDERS' EQUITY

Preferred Stock

During 2004 and 2003, Freddie Mac completed no preferred stock offerings (see "Table 9.1 — Preferred Stock" for more information). All 17 classes of preferred stock outstanding at December 31, 2004 have a par value of $1 per share. The company has the option to redeem these shares, on specified dates, at their redemption price plus dividends accrued through the redemption date. In addition, all 17 classes of preferred stock are perpetual and non-cumulative, and carry no significant voting rights or rights to purchase additional Freddie Mac stock or securities. Costs incurred in connection with the issuance of preferred stock are charged to Additional paid-in capital.

Table 9.1 provides a summary of Freddie Mac's preferred stock outstanding at December 31, 2004.

Table 9.1 — Preferred Stock

	Issue Date	Shares Authorized	Shares Outstanding	Total Par Value	Redemption Price per Share	Total Outstanding Balance[1]	Redeemable[2] On or After	NYSE Symbol[3]
		(shares and dollars in millions, except redemption price per share)						
1996 Variable-rate[4] . . .	April 26, 1996	5.00	5.00	$ 5.00	$50.00	$ 250	June 30, 2001	FRE.prB
6.14% . . .	June 3, 1997	12.00	12.00	12.00	50.00	600	June 30, 2002	FRE.prD
5.81% . . .	October 27, 1997	3.00	3.00	3.00	50.00	150	October 27, 1998	(5)
5% . . .	March 23, 1998	8.00	8.00	8.00	50.00	400	March 31, 2003	FRE.prF
1998 Variable-rate[6] . . .	September 23 and 29, 1998	4.40	4.40	4.40	50.00	220	September 30, 2003	FRE.prG
5.1% . . .	September 23, 1998	8.00	8.00	8.00	50.00	400	September 30, 2003	FRE.prH
5.3% . . .	October 28, 1998	4.00	4.00	4.00	50.00	200	October 30, 2000	(5)
5.1% . . .	March 19, 1999	3.00	3.00	3.00	50.00	150	March 31, 2004	(5)
5.79% . . .	July 21, 1999	5.00	5.00	5.00	50.00	250	June 30, 2009	FRE.prK
1999 Variable-rate[7] . . .	November 5, 1999	5.75	5.75	5.75	50.00	287	December 31, 2004	FRE.prL
2001 Variable-rate[8] . . .	January 26, 2001	6.50	6.50	6.50	50.00	325	March 31, 2003	FRE.prM
2001 Variable-rate[9] . . .	March 23, 2001	4.60	4.60	4.60	50.00	230	March 31, 2003	FRE.prN
5.81% . . .	March 23, 2001	3.45	3.45	3.45	50.00	173	March 31, 2011	FRE.prO
6% . . .	May 30, 2001	3.45	3.45	3.45	50.00	173	June 30, 2006	FRE.prP
2001 Variable-rate[10] . . .	May 30, 2001	4.02	4.02	4.02	50.00	201	June 30, 2003	FRE.prQ
5.7% . . .	October 30, 2001	6.00	6.00	6.00	50.00	300	December 31, 2006	FRE.prR
5.81% . . .	January 29, 2002	6.00	6.00	6.00	50.00	300	March 31, 2007	(5)
Total . . .		92.17	92.17	$92.17		$4,609		

(1) Amounts stated at redemption value.
(2) As long as the capital monitoring framework established by the Office of Federal Housing Enterprise Oversight ("OFHEO") in January 2004 remains in effect, any preferred stock redemption will require prior approval by OFHEO. See "NOTE 10: REGULATORY CAPITAL" for more information.
(3) Preferred Stock is listed on the New York Stock Exchange ("NYSE"), unless otherwise noted.
(4) The dividend rate resets quarterly and is equal to the sum of the three-month LIBOR plus one percent divided by 1.377, and is capped at 9.00 percent.
(5) Not listed on any exchange.
(6) The dividend rate resets quarterly and is equal to the sum of the three-month LIBOR rate plus one percent divided by 1.377, and is capped at 7.50 percent.
(7) Initial dividend rate is 5.97 percent per annum through December 31, 2004. Dividend rate resets on January 1, 2005 and on January 1 every five years thereafter based on a five-year constant maturity Treasury ("CMT") rate which is capped at 11.00 percent. Optional redemption on December 31, 2004 and on December 31 every five years thereafter.
(8) Dividend rate resets on April 1 every two years after April 1, 2003 based on the two-year CMT rate plus 0.10 percent and is capped at 11.00 percent. Optional redemption on March 31, 2003 and on March 31 every two years thereafter.
(9) Dividend rate resets on April 1 every year based on the 12-month LIBOR rate minus 0.20 percent and is capped at 11.00 percent. Optional redemption on March 31, 2003 and on March 31 every year thereafter.
(10) Dividend rate resets on July 1 every two years after July 1, 2003 based on the two-year CMT rate plus 0.20 percent and is capped at 11.00 percent. Optional redemption on June 30, 2003 and on June 30 every two years thereafter.

Common Stock Repurchase Program

In September 1997, Freddie Mac's Board of Directors authorized the company to repurchase up to five percent, or approximately 34 million shares, of its common stock outstanding as of September 5, 1997. Under this authorization, Freddie Mac repurchased no outstanding shares in 2004 and 2003 and 9.1 million outstanding shares in 2002. At December 31, 2004, approximately 13 million common shares remained available for repurchase under this authorization. Common stock repurchases are considered (assuming current financial reporting) when Freddie Mac is adequately capitalized and other more attractive investment opportunities are not available. Under OFHEO's January 29, 2004 framework for monitoring Freddie Mac's capital, Freddie Mac is currently required to obtain prior written approval from the Director of OFHEO before engaging in certain capital transactions, including the repurchase of any shares of common stock. See "NOTE 10: REGULATORY CAPITAL" for more information.

NOTE 10: REGULATORY CAPITAL

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("GSE Act") established risk-based, minimum and critical capital standards for Freddie Mac and Fannie Mae.

The risk-based capital standard determines the amount of capital that Freddie Mac must hold to absorb projected losses resulting from future adverse interest-rate and credit-risk conditions specified by the GSE Act, plus 30 percent mandated by the GSE Act to cover management and operations risk. The risk-based capital standard is based on stress test results calculated under two interest-rate scenarios prescribed by the GSE Act, one in which 10-year Treasury yields rise by as much as 75 percent (up-rate scenario) and one in which they fall by as much as 50 percent (down-rate scenario). The credit component of the stress tests simulates the performance of Freddie Mac's mortgage portfolio based on loss rates for the Benchmark Region. The criteria for the Benchmark Region are set forth by the GSE Act and are intended to capture the region that experienced the highest historical rates of default and severity of mortgage losses for two consecutive origination years. The risk-based capital requirement is the amount of Total capital needed to absorb the stress test losses in the most adverse scenario, plus 30 percent of that amount to cover management and operations risk. Total capital includes Core capital and general reserves for mortgage and foreclosure losses and any other amounts available to absorb losses that OFHEO includes by regulation. Core capital consists of the par value of outstanding common stock (common stock issued less common stock held in treasury), the par value of outstanding perpetual noncumulative preferred stock, additional paid-in capital and retained earnings, as determined in accordance with GAAP.

The minimum capital standard requires Freddie Mac to hold an amount of Core capital that is generally the sum of 2.50 percent of aggregate on-balance sheet assets, as determined in accordance with GAAP, and approximately 0.45 percent of outstanding mortgage-related securities guaranteed by Freddie Mac and other aggregate off-balance sheet obligations. As discussed below, in 2004 OFHEO implemented a framework for monitoring Freddie Mac's capital adequacy, which includes a targeted capital surplus of 30 percent of its minimum capital requirement.

The critical capital standard requires Freddie Mac to hold an amount of Core capital that is generally the sum of 1.25 percent of aggregate on-balance sheet assets, as determined in accordance with GAAP, and approximately 0.25 percent of outstanding mortgage-related securities guaranteed by Freddie Mac and other aggregate off-balance sheet obligations.

OFHEO is required to classify Freddie Mac's capital adequacy not less than quarterly.

To be classified as "adequately capitalized," Freddie Mac must meet both the risk-based and minimum capital standard. If Freddie Mac fails to meet the risk-based capital standard, it cannot be classified higher than "undercapitalized." Under OFHEO regulations, the company will be deemed "significantly undercapitalized" if it fails to meet the minimum capital requirement but exceeds the critical capital requirement. If Freddie Mac fails to meet the critical capital standard, Freddie Mac must be classified as "critically undercapitalized." OFHEO retains discretion to reduce Freddie Mac's capital classification by one level if OFHEO determines that Freddie Mac is engaging in conduct not approved by OFHEO that could result in a rapid depletion of Core capital or that the value of property subject to mortgage loans held or secured by Freddie Mac has decreased significantly.

OFHEO has never classified Freddie Mac as other than "adequately capitalized," the highest possible classification. When Freddie Mac is classified as adequately capitalized, the company can generally pay a dividend on its common or preferred stock without prior OFHEO approval so long as the payment would not decrease Total capital to an amount less than its risk-based capital requirement and would not decrease the company's Core capital to an amount less than the minimum capital requirement.

If Freddie Mac were classified as undercapitalized, the company would be prohibited from making a capital distribution (which includes common and preferred dividend payments, common stock repurchases and preferred stock redemptions) that would decrease its Core capital to an amount less than the minimum capital requirement. Freddie Mac also would be required to submit a capital restoration plan for OFHEO approval, which could adversely affect its ability to make capital distributions.

If Freddie Mac were classified as significantly undercapitalized, the company would be able to make a capital distribution only if OFHEO determined that the distribution satisfied certain statutory standards. Under these circumstances, Freddie Mac would be prohibited from making any capital distribution that would decrease its Core capital to less than the critical capital level, and OFHEO also could take action to limit Freddie Mac's growth, require it to acquire new capital or restrict it from activities that create excessive risk. Freddie Mac also would be required to submit a capital restoration plan for OFHEO approval, which could adversely affect its ability to make capital distributions.

If Freddie Mac were classified as critically undercapitalized, OFHEO would be required to appoint a conservator for the company unless OFHEO made a written finding that it should not do so and the Secretary of the Treasury concurred in that determination.

Factors that may adversely affect the adequacy of Freddie Mac's regulatory capital include declines in GAAP income, increases in the company's risk profile, and changes in the economic environment, such as large interest-rate or implied volatility moves or house price declines. In particular, interest-rate levels or implied volatility can affect the amount of Freddie Mac's Core capital, even if Freddie Mac is economically well hedged against interest-rate changes, because certain gains or losses are recognized through GAAP earnings while other offsetting gains or losses may not be.

Table 10.1 summarizes the company's regulatory capital requirements and surpluses at December 31, 2004 and 2003. Amounts for 2004 are as currently reported to OFHEO.

Table 10.1 — Regulatory Capital Requirements

	December 31,	
	2004	**2003**
	(dollars in millions)	
Minimum capital requirement[1]	$24,131	$23,774
Core capital[1][2]	35,009	32,985
Minimum capital surplus[1]	10,878	9,211
Critical capital requirement[1]	12,308	12,097
Core capital[1][2]	35,009	32,985
Critical capital surplus[1]	22,701	20,888
Risk-based capital requirement[3]	11,108	5,426
Total capital[3][4]	34,691	33,436
Risk-based capital surplus[3]	23,583	28,010

(1) OFHEO is the authoritative source of the capital calculations that underlie the company's capital classifications. For 2004, Freddie Mac amended the minimum and critical capital requirements, core capital and surplus amounts previously reported to OFHEO to incorporate adjustments reflected in Freddie Mac's consolidated financial statements. The 2004 minimum and critical capital requirements, core capital and surplus amounts are estimates and have been revised to reflect changes related to a closing agreement entered into with the Internal Revenue Service ("IRS") concerning the company's REIT subsidiaries. See "NOTE 14: INCOME TAXES" for further information.
(2) Core capital consists of the par value of outstanding common stock (common stock issued less common stock held in treasury), par value of outstanding perpetual noncumulative preferred stock, additional paid-in capital and retained earnings, as determined in accordance with GAAP.
(3) Risk-based and Total capital amounts are those calculated by OFHEO prior to the issuance of Freddie Mac's 2004 and 2003 financial results. OFHEO determined not to recalculate the risk-based capital amounts given that the minimum capital requirement remained the determining requirement for Freddie Mac's classification as adequately capitalized.
(4) Total capital includes Core capital and general reserves for mortgage and foreclosure losses.

On January 29, 2004, OFHEO announced the creation of a framework for monitoring Freddie Mac's capital due to the temporarily higher operational risk arising from the company's current inability to produce timely financial statements in accordance with GAAP. The framework includes a target capital surplus of 30 percent of Freddie Mac's minimum capital requirement, subject to certain conditions and variations; weekly monitoring; and prior approval of certain capital transactions, to verify that appropriate levels of capital are maintained. At December 31, 2004, Freddie Mac's estimated surplus in excess of the target surplus was approximately $3.6 billion. Had the target capital surplus been in effect at December 31, 2003, Freddie Mac's estimated surplus in excess of the target surplus would have been approximately $2.1 billion.

A failure by Freddie Mac to meet the target capital surplus would result in discussions between Freddie Mac and OFHEO concerning the reason for such failure. If OFHEO were to determine, based on these discussions and weekly monitoring, that Freddie Mac had unreasonably deviated from the framework established by OFHEO, the company would be required to submit a remedial plan or take other remedial steps.

In addition, Freddie Mac is required to obtain prior written approval from the Director of OFHEO before engaging in certain capital transactions, including the repurchase of any shares of common stock, redemption of any preferred stock or payment of preferred stock dividends above stated contractual rates. Freddie Mac also must submit a written report to the Director of OFHEO after the declaration, but before the payment, of any dividend on its common stock. The report must contain certain information on the amount of the dividend, the rationale for the payment and the impact on Freddie Mac's capital surplus.

OFHEO indicated that this framework is temporary and will be lifted when the Director of OFHEO determines that it should expire, based on Freddie Mac's reduction of operational risks, resumption of timely regulatory reporting that complies with GAAP and certain other factors.

Management believes that this monitoring framework will provide OFHEO with a mechanism to ensure that the company manages its business with continued prudence and appropriate levels of capital, taking into account that the company is not currently able to produce timely financial statements.

NOTE 11: STOCK-BASED COMPENSATION

Freddie Mac has three stock-based compensation plans under which grants are currently being made: the ESPP, as amended and restated in 2004, the 2004 Stock Compensation Plan (the "2004 Employee Plan") and the 1995 Directors' Stock Compensation Plan, as amended and restated in 1998 ("Directors' Plan"). Prior to the stockholder approval of the 2004 Employee Plan on November 4, 2004, employee stock-based compensation was awarded in accordance with the terms of the stockholder-approved 1995 Stock Compensation Plan (the "1995 Employee Plan"). Freddie Mac collectively refers to the 2004 Employee Plan and 1995 Employee Plan as the "Employee Plans."

Common stock delivered under these plans may be shares currently held by Freddie Mac as treasury stock, shares purchased by Freddie Mac in the open market or authorized but previously unissued shares.

ESPP: Freddie Mac has established a stockholder-approved ESPP that is qualified under Internal Revenue Code ("IRC") Section 423. Under the ESPP, substantially all full-time and part-time employees may purchase shares of common stock at a discount. During 2004, 2003 and 2002, the annual maximum market value of stock available for purchase was $20,000 per employee as determined on the subscription (grant) date. For grants made through 2004, the purchase price was equal to 85 percent of the average price of the stock on the subscription (grant) date or the average price of the stock on the purchase (exercise) date, whichever was lower.

The maximum number of shares of common stock authorized to be granted to employees under the ESPP prior to the effective date of the 2004 amendment and restatement was 12 million shares. At December 31, 2004, approximately 8.8 million shares had been issued under the ESPP and approximately 3.2 million shares remained available for grant. Grants under the ESPP in effect prior to its amendment and restatement ceased pursuant to its terms on December 31, 2004. On November 4, 2004, stockholders approved the amendment and restatement of the ESPP effective as of January 1, 2005. The restated ESPP authorizes granting 3.6 million shares in addition to the remaining 3.2 million shares discussed above. The amended and restated ESPP changes the expiration date to January 1, 2015.

Table 11.1 provides a summary of activity related to the ESPP.

Table 11.1 — Summary of ESPP Activity

	Year Ended December 31,		
	2004	2003	2002
Shares pledged[1]	250,899	145,866	1,000,370
Fair value on grant date[2]	$ 11.23	$ 10.72	$ 13.53
Shares purchased[1]	244,625	355,485	351,629
Purchase price[3]	$ 50.53	$ 41.76	$ 51.74

(1) Beginning in August 2003, employees pledged to purchase shares every three months with the purchase occurring three months later. Prior to August 2003, employees pledged to purchase shares on August 1 with purchase occurring on July 31 of the following year. As such, a portion of the shares purchased in a given year may relate to shares pledged in the previous year.
(2) Represents the fair value of ESPP options granted to employees. The 2004 fair value is the weighted average of the fair values on four separate grant dates. The 2003 fair value is the weighted average of the fair values on two separate grant dates and the 2002 fair value is the fair value on a single grant date.
(3) The 2004 purchase price is the weighted average of the purchase prices on four separate purchase dates. The 2003 purchase price is the weighted average of the purchase prices on two separate purchase dates and the 2002 purchase price is the purchase price on a single purchase date.

Employee Plans: Under the 2004 Employee Plan, Freddie Mac is permitted to grant to employees stock-based awards, including stock options with dividend equivalent rights, Restricted Stock Units ("RSUs") with dividend equivalent rights, restricted stock and Stock Appreciation Rights ("SARs"). Such awards are generally forfeitable for at least one year after the date of grant, with vesting provisions contingent upon service requirements. In addition, Freddie Mac has the right to impose performance conditions with respect to any awards under the 2004 Employee Plan. As of December 31, 2004, no SARs had been granted under the Employee Plans.

- Stock options granted under the Employee Plans allow for the purchase of Freddie Mac's common stock at an exercise price equal to the fair value of the common stock on the grant date. Options generally may be exercised for a period of 10 years from the grant date, subject to a vesting schedule

commencing on the grant date. Dividend equivalent rights provide participants with the right to receive, at the time stock options are exercised or upon expiration, an amount equal to the accumulated dividends declared on the stock from the date the options were granted.

- Each RSU entitles the participant to receive one share of common stock at a specified future date. RSUs do not have voting rights, but do have dividend equivalent rights, which are paid to the RSU holder as and when dividends on common stock are declared.
- Restricted stock entitles participants to all the rights of a stockholder, including dividends, except that the shares awarded are subject to a risk of forfeiture and may not be disposed of by the participant until the end of the restriction period established by Freddie Mac at the grant of the restricted stock.

The maximum number of shares of common stock authorized to be granted to employees under the 2004 Employee Plan is 12.9 million shares, which includes approximately 2.8 million remaining shares plus any future forfeited, cancelled or surrendered shares from the 1995 Employee Plan. At December 31, 2004, fewer than 0.1 million shares had been issued and approximately 12.9 million shares remained available for grant. Grants under the 2004 Employee Plan will cease upon the earlier of the exhausting of the authorized share pool or November 4, 2014.

Directors' Plan: Under the stockholder-approved Directors' Plan, Freddie Mac is permitted to grant stock options with dividend equivalent rights, restricted stock and RSUs with dividend equivalent rights to non-employee members of the Board of Directors ("Directors").

Under the Directors' Plan, on the date of the annual meeting, each reelected or reappointed Director is granted an option to purchase shares of Freddie Mac's common stock with a market value of approximately $150,000 on the date of the grant. Each such Director also receives restricted stock units relating to common stock with a market value of approximately $65,000 on the date of the award. The number of restricted stock units and shares subject to a stock option are calculated by dividing the dollar amount of the award by the market value of Freddie Mac's common stock on the date of grant. Through 2004, vesting with respect to both stock options and restricted stock units occurred in even increments over five terms on the Board, with 20 percent vesting at the end of every term of office, unless vesting was accelerated under certain circumstances including death, disability or retirement from the Board. A term is defined as the period between annual stockholders' meetings. Effective January 1, 2005 and thereafter, vesting occurs in even increments over four terms.

Through 2004, on the date of the annual meeting (or for new Directors elected by the Board or appointed by the President between annual meetings, the first meeting attended after their election or appointment), newly elected and newly appointed Directors received an option to purchase shares with a market value of approximately $300,000 and restricted stock units relating to common stock with a market value on the date of grant of approximately $130,000. During their second term of service, those Directors were not eligible to receive any additional grants. Beginning in 2005, newly elected or appointed Directors will receive the same grants as other Directors and they will be eligible to receive similar grants in their second term.

For Directors, stock options and restricted stock units have dividend equivalent rights that entitle the grantee to dividend equivalents on each share subject to the grant in the amount of dividends per share payable on Freddie Mac's outstanding shares of common stock. Dividend equivalents on stock options are accrued and are payable in cash upon exercise or expiration of the option. Dividend equivalents on restricted stock units are accrued as additional restricted stock units to be settled at the same time as the underlying restricted stock units.

The maximum number of shares of common stock authorized for grant to Directors under the Directors' Plan is 2.4 million shares. At December 31, 2004, a total of approximately 0.8 million shares had been issued and approximately 1.6 million shares remained available for grant. Grants under the Directors' Plan will cease upon the earlier of exhaustion of the authorized share pool or Freddie Mac's Annual Meeting of Stockholders in 2008.

See "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES," for a description of the accounting treatment for employee stock-based compensation, including grants under the ESPP and

Employee Plans. The accounting for stock options with dividend equivalent rights, restricted stock and RSUs granted under the Directors' Plan is identical to that of the Employee Plans.

Table 11.2 provides a summary of activity related to stock options under the Employee Plans and the Directors' Plan.

Table 11.2 — Employee Plans and Directors' Plan Stock Options Activity

	Year Ended December 31,					
	2004		2003		2002	
	Stock Options	Weighted Average Exercise Price	Stock Options	Weighted Average Exercise Price	Stock Options	Weighted Average Exercise Price
Outstanding, beginning of year	8,656,340	$46.89	9,231,105	$44.21	8,721,962	$37.56
Granted	1,343,554	61.09	1,216,442	53.28	1,686,285	64.12
Exercised	(1,861,617)	29.06	(1,052,156)	23.12	(997,127)	18.44
Forfeited or expired	(510,336)	58.84	(739,051)	57.18	(180,015)	51.52
Outstanding, end of year	7,627,941	$52.94	8,656,340	$46.89	9,231,105	$44.21
Options exercisable at year-end	4,018,666	$47.46	4,755,640	$38.23	4,508,095	$29.60
Weighted-average fair value of options granted during year	$ 25.04		$ 21.84		$ 28.13	

Table 11.3 provides a summary of activity related to restricted stock and RSUs under the Employee Plans and the Directors' Plan.

Table 11.3 — Employee Plans and Directors' Plan Restricted Stock and RSU Activity

	Year Ended December 31,					
	2004		2003		2002	
	Restricted Stock	Restricted Stock Units	Restricted Stock	Restricted Stock Units	Restricted Stock	Restricted Stock Units
Outstanding, beginning of year	566,635	1,295,722	1,089,327	359,227	1,478,779	51,632
Granted[1]	—	698,587	—	1,146,164	—	325,902
Lapse of restrictions	(240,514)	(145,340)	(381,103)	(114,240)	(383,199)	(10,457)
Forfeited	(161,340)	(224,341)	(141,589)	(95,429)	(6,253)	(7,850)
Outstanding, end of year	164,781	1,624,628	566,635	1,295,722	1,089,327	359,227
Weighted-average fair value of awards granted during year		$ 62.97		$ 55.01		$ 64.22

(1) RSUs granted under the Employee Plans were 673,720, 1,143,810 and 313,740 in 2004, 2003 and 2002, respectively. RSUs granted under the Directors' Plan were 24,867, 2,354 and 12,162 in 2004, 2003 and 2002, respectively.

Table 11.4 provides additional information for stock options outstanding under the Employee Plans and the Directors' Plan at December 31, 2004 by range of exercise prices.

Table 11.4 — Employee Plans and Directors' Plan Stock Options Outstanding

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding at December 31, 2004	Weighted Average Remaining Contract Life in Years	Weighted Average Exercise Price	Exercisable at December 31, 2004	Weighted Average Exercise Price
$9.00 to 14.99	7,960	0.2	$14.67	7,960	$14.67
15.00 to 24.99	648,812	1.1	19.81	648,812	19.81
25.00 to 34.99	369,271	2.4	34.22	369,271	34.22
35.00 to 44.99	919,490	5.0	41.56	695,809	41.60
45.00 to 54.99	1,610,027	6.0	50.69	679,337	47.54
55.00 to 64.99	3,102,483	7.1	62.13	1,057,661	62.38
65.00 to 68.99	969,898	5.3	67.66	559,816	67.70
	7,627,941	5.6	$52.94	4,018,666	$47.46

Compensation Expense: Compensation expense related to stock-based compensation plans charged to Salaries and employee benefits was $59 million, $65 million and $66 million for the years ended December 31, 2004, 2003 and 2002, respectively. The recognition of compensation expense affects Additional paid-in capital and, for awards that are probable of cash settlement, Other liabilities.

Table 11.5 summarizes the weighted-average assumptions used in determining the fair value of options granted under Freddie Mac's stock-based compensation plans using a Black-Scholes option pricing model.

Table 11.5 — Assumptions Used to Determine the Fair Value of Options

	Employee Stock Purchase Plan			Employee and Directors' Stock Compensation Plans		
	2004	2003	2002	2004	2003	2002
Dividend yield[1]	1.85%	2.01%	1.56%	—	—	—
Expected life	3 months	3 months	1 year	7 years	7 years	7 years
Expected volatility	17.8%	35.0%	21.0%	31.5%	32.0%	32.0%
Risk-free interest rate	1.33%	0.95%	1.75%	3.55%	3.40%	4.75%

(1) The dividend yield assumption is zero percent for the Employee Plans and Directors' Plan since options granted under these plans include dividend equivalent rights; thus, the fair value of these options would not be reduced for foregone dividends.

NOTE 12: DERIVATIVES

Freddie Mac principally uses the following types of derivatives:

- **LIBOR-Based Interest-Rate Swaps:** Interest-rate swaps are contractual agreements between two parties for the exchange of periodic payments based on a pre-determined amount ("notional") and agreed-upon fixed and floating interest rates.
- **LIBOR- and Treasury-Based, Exchange-Traded Futures Contracts:** Futures contracts are exchange-traded agreements that obligate one party to sell and another party to purchase a specified amount of a designated financial instrument at a specified price and date.
- **LIBOR- and Treasury-Based Options and Swaptions:** Options are exchange-traded or over-the-counter ("OTC") agreements in which the holder pays a one-time up-front premium to another party in exchange for the right, but not the obligation, to buy or sell a specified asset or enter into a contract at a specified price during a specified period of time. Option holders will generally exercise their options only if there is an economic advantage in doing so. Swaptions are OTC options to execute an interest-rate swap at a specific date and specific rates.
- **LIBOR- and Treasury-Based Interest-Rate Caps and Floors:** Interest-rate caps and floors are OTC agreements in which the holder pays a one-time up-front premium to another party in exchange for the right to receive interest payments based on a particular notional amount and the amount, if any, by which the agreed-upon index rate exceeds a specified maximum ("cap") or by which the agreed-upon index is below a specified minimum ("floor") rate.
- **Foreign-Currency Swaps:** Currency swaps are contractual agreements between two parties for the exchange of a specified amount of a designated foreign currency for a specified amount of U.S. dollars at the inception and termination of the contract. Each party will also make periodic interest payments on the currency it receives in the swap at agreed-upon fixed or floating interest rates.
- **Forward Purchase and Sale Commitments:** Forward purchase and sale commitments are OTC agreements that obligate one party to purchase (sell) and another party to sell (purchase) a specified amount of a designated financial instrument at a specified price and date.
- **Other:** Certain other agreements entered into are accounted for as derivatives in accordance with SFAS 133 or SFAS 149. These include (a) a prepayment management agreement in which Freddie Mac is partially compensated for the adverse impacts caused by disproportionately higher mortgage prepayments on certain mortgage pools; (b) credit risk-sharing agreements where Freddie Mac remits or receives payments based upon the default performance of certain mortgage loans; and (c) swap guarantee derivatives where Freddie Mac guarantees the sponsor's or the borrower's performance as a counterparty on certain interest-rate swaps.

Hedging Activity

Derivative instruments are reported at their fair value as either Derivative assets, at fair value, or Derivative liabilities, at fair value, on the consolidated balance sheets.

No hedge designation

At December 31, 2004, most of the company's derivatives portfolio, except for a portion of interest-rate swaps, foreign-currency swaps and forward purchase and sale commitments, was not designated in hedge accounting relationships. Freddie Mac reports changes in the fair value of these derivatives as Derivative gains (losses) on the consolidated statements of income. For interest-rate swaps that are not designated in hedge accounting relationships, the associated interest received or paid is recognized on an accrual basis and recorded in Derivative gains (losses) on the consolidated statements of income.

Effective as of the beginning of the second quarter of 2004, Freddie Mac determined that substantially all pay-fixed interest-rate swaps and other derivatives that previously had been in cash flow hedge accounting relationships no longer met the hedged item shared risk exposure requirement and hedge effectiveness

assessment as required by SFAS 133. Consequently, Freddie Mac discontinued hedge accounting treatment for these relationships for financial reporting purposes effective as of the beginning of the second quarter of 2004, resulting in pay-fixed swaps with a notional balance of approximately $108 billion being moved from the cash flow hedge designation to no hedge designation.

Freddie Mac voluntarily discontinued hedge accounting treatment for a significant amount of its receive-fixed interest-rate swaps effective November 1, 2004, resulting in receive-fixed interest-rate swaps with a notional balance of approximately $50 billion being moved from a fair value hedge designation to no hedge designation.

Fair value hedges

Fair value hedges represent hedges of exposure to foreign currency fluctuations and changes in the fair value of a recognized liability. Freddie Mac uses interest-rate swaps, futures and foreign-currency swaps to hedge against the changes in fair value of fixed rate debt due to changes in benchmark interest rates, either the rate on U.S. Treasury obligations or LIBOR, or foreign currency fluctuations, or a combination of both. These derivatives may be executed to manage interest-rate risk at an aggregate portfolio level or at an individual debt instrument level. For accounting purposes, Freddie Mac ultimately links these derivatives to specific debt positions. Where derivatives were executed to manage interest-rate risk at an aggregate portfolio level, Freddie Mac frequently reset the amount of fixed-rate debt being hedged in order to maintain highly effective accounting hedges in this strategy. To accomplish this, the accounting hedges were typically terminated at the time of reset and the derivatives were contemporaneously redesignated in new hedge accounting relationships of fixed-rate debt. These derivatives were moved to no hedge designation effective November 1, 2004 as part of the voluntary discontinuance of hedge accounting treatment, as discussed above. Alternatively, when derivatives are executed for specific debt instruments, redesignation is typically not necessary to maintain highly effective accounting hedges. For 2004 and 2003, no amounts have been excluded from the assessment of effectiveness for derivatives designated as fair value hedges. For 2002, pre-tax losses of $103 million were excluded from the assessment of effectiveness for derivatives designated as fair value hedges. The excluded component represents the change in fair value related to the difference between the spot price and the forward price on certain sale commitments used as hedges of existing mortgage-related securities.

For a derivative qualifying as a fair value hedge, Freddie Mac reports changes in the fair value of the derivative as Hedge accounting gains (losses) on the consolidated statements of income along with the changes in the fair value of the hedged item attributable to the risk being hedged. Hedge ineffectiveness arises when the fair value change of a derivative is not equal to the fair value change of the hedged item. For 2004, 2003 and 2002, hedge ineffectiveness related to fair value hedges was a net $742 million gain, $697 million gain and $241 million gain, respectively, on a pre-tax basis, and was reported in Hedge accounting gains (losses). Hedge accounting gains (losses) will vary from period to period based on the notional amount of derivatives accounted for in hedge accounting relationships and the extent to which differences in the characteristics or terms of the derivative and the hedged item result in fair value changes that are not exactly offset. For example, a portion of derivatives in Freddie Mac's fair value hedges are forward starting and valued using forward rates while the hedged debt is valued using spot rates. Therefore, the difference between the spot rate and the forward rate generally produces ineffectiveness in these fair value hedges.

Cash flow hedges

Cash flow hedges represent hedges of exposure to the variability in the cash flows of a forecasted transaction. Freddie Mac uses interest-rate swaps, futures, foreign-currency swaps and forward purchase and sale commitments to hedge the changes in cash flows associated with the forecasted issuances of debt, forecasted purchase or sale of mortgage-related assets, and foreign currency fluctuations.

For a derivative qualifying as a cash flow hedge, changes in fair value are generally reported in AOCI, net of taxes, on the consolidated balance sheets to the extent the hedge is effective. The remaining ineffective portion is reported as Hedge accounting gains (losses) on the consolidated statements of income. For 2004, 2003 and 2002, hedge ineffectiveness related to cash flow hedges was a net $1 million gain, $53 million loss

and $54 million loss, respectively. No amounts have been excluded from the assessment of effectiveness for derivatives designated as cash flow hedges for 2004, 2003 and 2002.

At December 31, 2004, the maximum remaining length of time over which Freddie Mac has hedged the exposure related to the variability in future cash flows on forecasted transactions is 29 years. However, over 90 percent of the AOCI, net of taxes, balance at December 31, 2004 relating to cash flow hedges is attributable to cash flow hedges of the exposure related to the variability in future cash flows on forecasted transactions occurring in the next 10 years. The occurrence of forecasted transactions may be satisfied by either periodic issuances of short-term debt over the required time period or longer term debt, such as Reference Notes® securities, with maturities covering all or part of the remaining hedge time period.

AOCI amounts are reclassified to earnings as the associated hedged forecasted issuance of debt and forecasted mortgage purchase transaction affects earnings. During 2004, 2003 and 2002, pre-tax amounts reclassified into earnings also include net gains of $2 million, $29 million and $116 million, respectively, resulting from the determination that it was probable that forecasted transactions related to certain mortgage purchases and sales would not occur. At December 31, 2004, the total AOCI, net of taxes, related to cash-flow hedge relationships was a loss of $7.9 billion. The $7.9 billion in hedging losses related to cash-flow hedges was composed of less than $0.1 billion in net unrealized losses on open cash flow hedges and approximately $7.9 billion in deferred net losses on closed cash flow hedges. The unrealized fair value losses on open cash flow hedges can change substantially due to future changes in interest rates. Closed cash flow hedges involve derivatives that have been terminated or are no longer designated as cash flow hedges. Fluctuations in prevailing market interest rates have no impact on the deferred portion of AOCI relating to losses on closed cash flow hedges. The company estimates that approximately $1.6 billion, net of taxes, of the $7.9 billion of hedging losses in AOCI, net of taxes, at December 31, 2004 will be reclassified into earnings during 2005.

Table 12.1 presents the changes in AOCI, net of taxes, related to derivatives designated as cash flow hedges. The Net change in fair value related to cash flow hedging activities, net of tax benefit line represents the net changes in the fair value of the derivatives that were designated as cash-flow hedges throughout the year, after the effects of Freddie Mac's statutory tax rate of 35 percent, to the extent the hedges were effective. The Net reclassifications of losses to earnings, net of tax benefit line represents the AOCI amount, after the effects of Freddie Mac's statutory tax rate of 35 percent, that was recognized in earnings as the originally hedged forecasted transactions affected earnings unless it was deemed probable that the forecasted transaction would not occur. If it is probable that the forecasted transaction will not occur, then the entire deferred gain or loss associated with the hedge related to the forecasted transaction is reclassified into earnings immediately.

Table 12.1 — AOCI, net of taxes, Related to Cash Flow Hedge Relationships

	Year Ended December 31,		
	2004	2003	2002
	(dollars in millions)		
Beginning Balance[1]	$(7,837)	$(9,877)	$(4,757)
Net change in fair value related to cash flow hedging activities, net of tax benefit of $(1,089), $(352) and $(4,516), respectively[2]	(2,021)	(653)	(8,388)
Net reclassifications of losses to earnings, net of tax benefit of $1,042, $1,450 and $1,760, respectively[2]	1,934	2,693	3,268
Ending Balance[1]	$(7,924)	$(7,837)	$(9,877)

(1) Represents the effective portion of the fair value of open derivative contracts (*i.e.*, net unrealized gains and losses) and net deferred gains and losses on closed (*i.e.*, terminated or redesignated) cash flow hedges.
(2) Net reclassifications to earnings, net of tax expense includes the accrual of periodic cash settlements in accordance with the contractual terms of the derivatives designated in cash flow hedge relationships for all periods presented above.

NOTE 13: LEGAL CONTINGENCIES

Freddie Mac is involved as a party to a variety of legal proceedings arising from time to time in the ordinary course of business including, among other things, contractual disputes, personal injury claims, employment-related litigation and other legal proceedings incidental to the company's business. Freddie Mac is frequently involved, directly or indirectly, in litigation involving mortgage foreclosures. Freddie Mac is also involved in proceedings arising from its termination of a seller/servicer's eligibility to sell mortgages to, and service mortgages for, the company. In these cases, the former seller/servicer sometimes seeks damages against Freddie Mac for wrongful termination under a variety of legal theories. In addition, Freddie Mac is sometimes sued in connection with the origination or servicing of mortgages. These suits generally involve claims alleging wrongful actions of seller/servicers. Freddie Mac's contracts with its seller/servicers generally provide for them to indemnify the company against liability arising from their wrongful actions.

Freddie Mac is now subject to various legal proceedings, including regulatory investigations and administrative and civil litigation, arising from the restatement of its previously issued consolidated financial statements for the years 2000 and 2001 and the first three quarters of 2002 and the revision of fourth quarter and full-year consolidated financial statements for 2002 (collectively referred to as the "restatement"). Freddie Mac believes that a loss in connection with the proceedings arising from the restatement is probable and currently estimates the range of minimum loss to be from $75 million to $100 million. Freddie Mac has established a reserve of $75 million for this loss contingency in the second quarter of 2003, the period in which many of the legal proceedings were initiated. The ultimate resolution of these proceedings could result in losses lower than or in excess of the estimated range of minimum loss. Litigation and claims resolution are subject to many uncertainties and are not susceptible to accurate prediction. It is not possible for the company to reasonably estimate the upper end of the range of any additional losses that might result from the adverse resolution of any of these legal proceedings, or their potential effect on the company's financial condition or results of operations.

Securities Class Action Lawsuits. In June 2003, and thereafter, securities class action lawsuits were brought in three separate federal district courts against Freddie Mac and certain former executive officers in connection with the restatement. While most of the cases were voluntarily dismissed by the plaintiffs, the two remaining ones were consolidated and are now pending in the U.S. District Court for the Southern District of New York.

In essence, the plaintiffs in the consolidated action, claim that the defendants improperly managed earnings to create a misleading impression of steady earnings by Freddie Mac. Plaintiffs further allege that defendants engaged in a number of improper transactions that violated GAAP and that they made false and misleading statements regarding Freddie Mac's financial status. The complaint, which covers the period from June 15, 1999 through June 6, 2003, seeks unspecified compensatory damages, costs and expenses.

In March 2004, the plaintiffs in one of the cases, the Ohio Public Employees Retirement System and the State Teachers Retirement System, were appointed lead plaintiffs for the consolidated action. Freddie Mac filed a motion to dismiss the action in April, which was denied by the court on July 19, 2004. The case is now in the discovery phase.

Shareholder Derivative Lawsuits. Two shareholder derivative lawsuits were filed during 2003 against Freddie Mac and certain former and current executives and, in one of the suits, members of Freddie Mac's Board of Directors alleging breach of fiduciary duty and seeking indemnification in connection with the restatement. Both cases were ultimately assigned to the same judge in New York who is handling the securities class action lawsuits described above. In July 2003, all of the then current Board members were dismissed from the lawsuits in which they were named with the consent of the plaintiff. On January 16, 2004, Freddie Mac moved to dismiss one of the lawsuits brought by the Ester Sadowsky Testamentary Trust because of the plaintiff's failure to make a pre-suit demand. The court dismissed the case without prejudice on July 19, 2004. The other lawsuit is still pending, awaiting a response to the plaintiff's pre-suit demand notice by a Special Litigation Committee of Freddie Mac's Board of Directors. Subsequently, the Sadowsky plaintiff sent a demand notice to Freddie Mac and on March 4, 2005, filed a new complaint in an action in the same court.

The complaint was purportedly brought on Freddie Mac's behalf (as a nominal defendant) as a derivative action by a purported shareholder to recover damages Freddie Mac allegedly suffered in connection with certain events underlying the restatement of its financial statements. The defendants in the action include former officers, the current Board of Directors, ten former Directors, and five counterparties to transactions Freddie Mac executed. The plaintiff subsequently has amended its complaint by, among other actions, dropping Messrs. Syron and McQuade from the list of defendants. The plaintiff alleges claims for breach for fiduciary duties, indemnification, waste of corporate assets, unjust enrichment, and aiding and abetting breach of fiduciary duties. The Special Litigation Committee of Freddie Mac's Board of Directors is considering the allegations raised by this complaint.

Freddie Mac was also served on February 11, 2005, with an amended derivative complaint filed by shareholder E.L. Greenfield against the lead engagement partner of Arthur Andersen, Freddie Mac's former outside auditor, alleging breach of contract for failing to properly conduct audits of the company's financial statements. No ruling is sought against Freddie Mac, which is named as a nominal party to that suit.

ERISA Lawsuits. Two class action lawsuits were filed in 2003 in the U.S. District Court for the Southern District of Ohio against Freddie Mac, certain individuals, and the company's Retirement Committee alleging violations of the Employee Retirement Income Security Act ("ERISA"). Both actions were consolidated and transferred to the same judge in New York who is handling the securities and derivative lawsuits described above. In July 2004, Freddie Mac and the other defendants filed a motion to dismiss the consolidated ERISA lawsuit. That motion was denied on February 7, 2005, and the company along with the individual defendants have filed a motion for interlocutory appeal which is pending.

OFHEO Proceedings. In June 2003, OFHEO commenced a special investigation of the company in connection with the restatement. As part of this investigation, OFHEO took the testimony of certain Freddie Mac employees and directors, external third parties and former employees. OFHEO also requested and received documents from the company.

On December 9, 2003, Freddie Mac and OFHEO entered into a consent order and settlement which concluded OFHEO's investigation of the company. Under the terms of the consent order, Freddie Mac agreed to pay a civil money penalty of $125 million, which was recorded in the second quarter of 2003 (the period in which OFHEO commenced its special investigation), as well as to undertake certain remedial actions relating to governance, corporate culture, internal controls, accounting practices, disclosure and oversight. In agreeing to the consent order, Freddie Mac made no admission regarding any wrongdoing or any asserted or implied findings.

In December 2003, OFHEO filed administrative notices of charges against Freddie Mac and Messrs. Brendsel and Clarke, two former executive officers of Freddie Mac. In its charge against Freddie Mac, OFHEO seeks to have Freddie Mac take certain actions in connection with these individuals' salaries and compensation as well as their termination status with the company. Freddie Mac and Messrs. Brendsel and Clarke moved, among other things, to dismiss the OFHEO administrative charges. These motions are pending. On February 18, 2005, OFHEO filed an amended notice of charges against Messrs. Brendsel and Clarke, who opposed the amended notice on several grounds. On April 26, 2005, the Administrative Law Judge presiding over the OFHEO administrative proceeding ruled that the amended notice of charges against Messrs. Brendsel and Clarke did not clearly identify the factual and legal issues, and consequently ordered OFHEO to file a second amended notice of charges that must clearly set forth the factual and legal bases for the charges and satisfy several other requirements identified by the judge. The parties are also engaged in the discovery phase of the case.

In a separate action, the U.S. District Court for the District of Columbia issued orders finding that OFHEO lacked the authority to freeze the compensation and benefits provided under Mr. Brendsel's and Mr. Clarke's employment agreements. Freddie Mac was not a party to these actions. OFHEO has appealed these orders. Freddie Mac has paid Messrs. Brendsel and Clarke the compensation and benefits that were due them in accordance with the U.S. District Court's orders.

SEC Investigation. In June 2003, the SEC initiated a formal investigation of Freddie Mac in connection with the restatement. As part of the investigation, the SEC subpoenaed company documents and took the sworn testimony of various present and former Freddie Mac employees and directors, as well as third parties.

On August 18, 2004, Freddie Mac announced that it had received a "Wells Notice" from the staff of the SEC. The Wells Notice advised the company that the SEC staff is considering recommending that the SEC initiate a civil injunctive action against the company for possible violations of federal securities laws, including Section 10(b) of the Securities Exchange Act of 1934 and the SEC's Rule 10b-5, as well as Sections 17(a)(1), (2) and (3) of the Securities Act of 1933. The Wells Notice also indicated that the SEC staff may seek a permanent injunction and a civil money penalty in connection with the contemplated action. Freddie Mac continues to cooperate fully with the SEC's investigation as the company evaluates its response to the Wells Notice.

U.S. Attorney's Investigation. In June 2003, the U.S. Attorney's Office in Alexandria, Virginia commenced an investigation of Freddie Mac surrounding the restatement. As part of its investigation, the U.S. Attorney's Office requested and received documents and information from Freddie Mac, interviewed certain Freddie Mac employees and possibly other parties and took testimony before the grand jury. The investigation is still pending and Freddie Mac will continue to cooperate with the U.S. Attorney's Office.

Department of Labor Investigation. In July 2003, the Department of Labor ("DOL") began an investigation of Freddie Mac's Thrift/401(k) Savings Plan in relation to the restatement. In connection with the investigation, the DOL sought and received documents from the company as well as interviewed certain individuals who served as members of Freddie Mac's Retirement Committee. The investigation is still pending and Freddie Mac continues to cooperate fully with the DOL.

FEC Investigation. In March 2004, Freddie Mac provided certain information to the Federal Election Commission (the "FEC") concerning compliance with federal election laws. The FEC has been conducting an investigation into this matter and, in November 2004, subpoenaed documents and responses to interrogatories from Freddie Mac, which Freddie Mac subsequently provided. The FEC has also interviewed certain present and former Freddie Mac employees. The investigation is still pending and Freddie Mac will continue to cooperate with the FEC.

Antitrust Lawsuits. Since January 18, 2005, Freddie Mac and Fannie Mae have been named in multiple lawsuits alleging violations of federal and state antitrust laws and state consumer protection laws. All of the suits essentially allege that the defendants conspired to establish and maintain artificially high guarantee fees. One suit contains additional allegations of price fixing in connection with other mortgage fees, as well as a claim of illegally maintaining a monopoly in the market for conforming mortgages and the market for securitization of conforming mortgages. At present, it is not possible for Freddie Mac to predict the probable outcome of these lawsuits or any potential impact on Freddie Mac's business, financial condition or results of operations.

Other Inquiries. Freddie Mac receives inquires from the IRS in connection with its regular audits of Freddie Mac's tax returns for prior years, some of which relate to matters connected with the restatement. Freddie Mac continues to respond to these inquiries. See "NOTE 14: INCOME TAXES" for more information. The Committee on Energy and Commerce of the House of Representatives also sent Freddie Mac an inquiry relating to the restatement. Freddie Mac has responded to the Committee's inquiry.

NOTE 14: INCOME TAXES

Freddie Mac is exempt from state and local income taxes. Table 14.1 presents the components of the company's provision for income taxes.

Table 14.1 — Provision for Income Taxes

	Year Ended December 31,		
	2004	2003	2002
	(dollars in millions)		
Current tax provision	$1,136	$1,465	$2,023
Deferred tax provision (benefit)	(346)	737	2,690
Total provision for income taxes	$ 790	$2,202	$4,713

Table 14.2 summarizes Freddie Mac's deferred tax assets and liabilities.

Table 14.2 — Deferred Tax Assets/(Liabilities)

	December 31,	
	2004	2003
	(dollars in millions)	
Deferred tax assets:		
Deferred fees related to securitizations	$ 1,612	$ 1,550
Basis differences related to assets held-for-investment	—	195
Credit related items and reserve for loan losses	5	—
Employee compensation and benefit plans	166	141
Cash flow hedge deferrals and unrealized (gains) losses related to available-for-sale securities	1,930	801
Total deferred tax assets	3,713	2,687
Deferred tax liabilities:		
Premium and discount amortization	(1,961)	(1,958)
Basis differences related to assets held-for-investment	(502)	—
Basis differences related to derivative instruments	(2,478)	(3,468)
Credit related items and reserve for loan losses	—	(2)
Other items, net	(43)	(5)
Total deferred tax liabilities	(4,984)	(5,433)
Net deferred tax liabilities	$(1,271)	$(2,746)

Included in deferred taxes is the tax effect on the (a) net unrealized (gain) loss on available-for-sale securities and (b) net (gain) loss related to derivatives designated in cash flow hedge relationships, which are both reported in AOCI, net of taxes.

A valuation allowance has not been established against Freddie Mac's deferred tax assets at December 31, 2004 or 2003, as Freddie Mac has determined that it is more likely than not that all such tax assets will be realized in the future.

Table 14.3 reconciles the statutory federal tax rate to the effective tax rate.

Table 14.3 — Reconciliation of Statutory to Effective Tax Rate

	Year Ended December 31,		
	2004	**2003**	**2002**
Statutory corporate rate	35.0%	35.0%	35.0%
Tax-exempt interest	(4.7)	(2.1)	(1.2)
Tax credits	(7.3)	(3.0)	(1.1)
Provision (benefit) related to tax contingencies	(2.0)	0.4	(1.0)
OFHEO civil money penalty and loss contingency accrual	—	1.0	—
Other	0.2	0.1	0.1
Effective rate	21.2%	31.4%	31.8%

Impact of tax issues. The IRS has a policy to examine the income tax returns of large corporate taxpayers, including Freddie Mac, generally every year. Management believes that an adequate provision in accordance with SFAS 5 has been made for contingencies related to all income taxes and related interest. However, the ultimate outcome of these tax contingencies could result in a tax benefit or tax provision that could be material to Freddie Mac's quarterly or annual results of operations. Based on current knowledge and after consultation with outside counsel, management does not believe that liabilities arising from these matters, if any, will have a material adverse effect on Freddie Mac's consolidated financial condition.

Tax Years 1985 through 1990. In 1998, the IRS issued Freddie Mac a Statutory Notice which asserts income tax deficiencies for the company's first two tax years, 1985 and 1986. In the first quarter of 1999, Freddie Mac filed a petition in the United States Tax Court (the "Court") to contest the deficiencies. In the third quarter of 1999, the IRS issued a Statutory Notice for Freddie Mac's tax years 1987 through 1990, and Freddie Mac filed a petition in the Court. Subsequently, the Court combined the 1985 through 1990 tax years into one case. The principal matters in controversy in the case involve questions of tax law as applied to Freddie Mac's transition from non-taxable to taxable status in 1985 and primarily involve the amortization of certain intangible assets, the two most significant of which are:

- *Favorable Financing.* A number of financing arrangements where the contract rates of interest were less than the market rates of interest as of January 1, 1985 due to an increase in interest rates since the date on which Freddie Mac had entered into the respective arrangements; and
- *Customer Relationships.* Freddie Mac's business relationships with a substantial number of mortgage originating institutions that sold mortgages to Freddie Mac on a regular basis.

Tax Court Rulings. On September 4, 2003 and September 29, 2003, the Court decided favorably for Freddie Mac on two preliminary motions involving questions of law in the case. On September 4, the Court ruled favorably for Freddie Mac on the question whether Freddie Mac's intangibles are amortizable using, as the adjusted basis, the higher of (a) the regular adjusted cost basis or (b) the fair market value on January 1, 1985. On September 29, the Court ruled favorably for Freddie Mac on the question whether, as a matter of law, "favorable financing" (as defined above) was amortizable for tax purposes. As part of this case, Freddie Mac claimed, and the court agreed, that the economic benefit of this below-market financing as of January 1, 1985 is an intangible asset subject to amortization. In October 2003, the Court ruled unfavorably on two other less significant issues in the case.

While significant, the Court's rulings do not dispose of all of the matters in controversy in the case, which, upon final resolution by the Court of all such matters, are subject to appeal by the parties. In addition, Freddie Mac still must demonstrate that the intangible assets in question have an ascertainable value and have a limited useful life, the duration of which can be ascertained with reasonable accuracy. A trial on the value and useful life of Favorable Financing began in early June 2005.

In view of the favorable rulings described above and in accordance with GAAP, Freddie Mac recorded in the fourth quarter of 2002 a reduction in its tax reserves in the amount of $155 million. If the IRS were to

appeal the Court decisions and an adverse ruling resulted, Freddie Mac may reconsider its reserves related to this matter.

If Freddie Mac's tax position on the customer relationship amortization issue described above is upheld through the administrative and legal process, Freddie Mac will be able to recognize additional tax benefits that could be material in the quarter during which they are recognized. However, Freddie Mac is unable to provide assurances that any such tax benefits will be realized.

Tax Years 1991 through 1993. The IRS examination of Freddie Mac's federal income tax returns for the years 1991 through 1993 has been completed. In December 2001, the IRS issued a Statutory Notice for these years. In the first quarter of 2002, Freddie Mac filed a petition in the Court to contest the deficiencies. The principal matters in controversy in this case are the same questions at issue in the 1985 through 1990 case as applied to years 1991 to 1993, plus an additional question of tax law regarding the timing of taxation of Freddie Mac's management and guarantee fee income.

Tax Years 1994 through 1997. In the second quarter of 2002, the IRS completed its examination of Freddie Mac's federal income tax returns for the years 1994 through 1997. Freddie Mac is involved in discussions with the IRS Appeals Division regarding the company's disagreement with certain aspects of the examination report. The principal matter in controversy, other than the same questions at issue in the 1985 through 1993 cases, involve the character of losses on dispositions of mortgage-related securities.

Tax Treatment of REITs. In February 1997, Freddie Mac formed two REIT subsidiaries that issued a total of $4.0 billion in step-down preferred stock to investors. Under the IRS regulations in effect when the REITs were formed, the company believed that the dividend payments by the REITs to holders of the REITs' step-down preferred stock were fully tax deductible. In 1997, subsequent to the formation of Freddie Mac's REIT subsidiaries, the Department of the Treasury announced its intention to propose regulations that would retroactively limit the tax benefits attributable to the REITs, preferred stock and effectively eliminate the potential tax advantages of REITs that issued step-down preferred stock. On January 7, 2000, the Treasury issued final regulations that retroactively deny certain tax benefits attributable to Freddie Mac's REIT preferred stock for tax years ending on or after February 27, 1997. Based upon this guidance, the IRS challenged Freddie Mac's position that the REIT dividends were fully deductible. The company has since changed its position that the REIT dividends are fully deductible. Freddie Mac announced on May 12, 2005 that it entered into a closing agreement with the IRS that resolves issues related to the tax treatment of dividends paid on the step-down preferred stock. Freddie Mac and the IRS have agreed that Freddie Mac will only be entitled to deductions attributable to the step-down preferred stock transactions as if it had borrowed directly from the REITs' preferred shareholders. As a result of this closing agreement, Freddie Mac recorded a reduction in tax reserves of $94 million. See "NOTE 18: MINORITY INTERESTS" for more information concerning the REITs.

Tax Years 1998 through 2002. The IRS is currently examining Freddie Mac's tax returns for the years 1998 through 2002. This examination includes the years for which Freddie Mac has restated its financial reporting.

Tax Treatment of Linked Swaps. In August and September of 2001, Freddie Mac entered into a series of nine sets of paired swap transactions. Freddie Mac has reported and paid tax treating each pair of those swap transactions as a single integrated transaction for federal income tax purposes. In addition, two additional swaps were executed in November 2001. Although the facts and circumstances surrounding these swaps were different from the earlier swaps, Freddie Mac also reported and paid tax treating these swaps as a single integrated transaction for federal income tax purposes. There is a risk that the IRS could challenge Freddie Mac's tax treatment of all of these transactions ("the Linked Swaps") and make an adverse determination relating to this tax treatment. If this should occur, the potential aggregate additional tax liability could be as much as approximately $750 million plus interest.

Freddie Mac has not provided reserves for any tax issues related to these transactions because management has determined that the potential for loss does not meet the criteria for recognition under SFAS 5. The IRS is currently examining Freddie Mac's 2001 and 2002 tax returns, including the Linked Swaps transactions. The company does not know whether the IRS will assert a tax deficiency related to these

transactions as part of the current examination and if so, what the final resolution of those issues will be. If the IRS were to propose the maximum potential aggregate assessment and that additional tax liability was upheld through the administrative and legal process, the recognition of such additional liability could have a material adverse impact on Freddie Mac's results of operations in the quarter in which it was recognized. Based on current knowledge and after consultation with counsel, management does not currently believe that the final resolution of any issues that may arise from the Linked Swaps transactions will result in IRS adjustments that would have a material adverse impact on Freddie Mac's consolidated financial condition.

NOTE 15: EMPLOYEE BENEFITS

Defined Benefit Plans

Freddie Mac maintains a tax-qualified defined benefit pension plan ("Pension Plan") covering substantially all of its employees. Pension Plan benefits are based on years of service and the employee's highest average compensation (up to legal plan limits) over any consecutive 36 months of employment. Freddie Mac's general practice is to contribute to the Pension Plan an amount equal to at least the minimum required contribution, if any, but no more than the maximum amount deductible for federal income tax purposes each year. Based on a preliminary analysis, Freddie Mac currently believes that under applicable law no minimum contribution will be required and no tax-deductible contribution will be permitted for 2005. Therefore, Freddie Mac does not currently expect to contribute to its Pension Plan in 2005. Pension Plan assets are held in trust and investments consist primarily of listed stocks and corporate bonds. In addition to the Pension Plan, Freddie Mac maintains nonqualified, unfunded defined benefit pension plans for officers and certain other employees of the company (the "non-qualified pension plans"). The related retirement benefits for the nonqualified pension plans are paid from Freddie Mac's general assets. These nonqualified and qualified defined benefit pension plans are collectively referred to in this NOTE 15 as "defined benefit pension plans."

Freddie Mac maintains a defined benefit post-retirement health care plan ("Retiree Health Plan") that generally provides post-retirement health care benefits on a contributory basis to retired employees age 55 or older who rendered at least ten years of service (five years of service if retiree is eligible to retire prior to March 1, 2007) and who, upon separation or termination, immediately elected to commence benefits under the Pension Plan in the form of an annuity. The company's Retiree Health Plan is currently unfunded and the benefits are paid from Freddie Mac's general assets. This plan, along with the defined benefit pension plans, are collectively referred to in this NOTE 15 as "defined benefit plans."

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("Medicare Part D") was signed into law on December 8, 2003. Medicare Part D authorizes a federal subsidy for sponsors of retiree health care plans with prescription drug benefits that are at least actuarially equivalent to the prescription drug benefits available under Medicare Part D. In May 2004, the FASB issued FASB Staff Position ("FSP") 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," which supersedes FSP 106-1 of the same title. FSP 106-2 clarified the accounting for benefits provided by the new government subsidies. Freddie Mac, in consultation with its actuaries, has determined that the prescription drug benefits provided to participants by the Retiree Health Plan are at least actuarially equivalent to those available under Medicare Part D. Therefore, in accordance with the FSP 106-2 transition provisions, the effects of the future Medicare Part D subsidies are reflected as an actuarial gain, included in Net actuarial loss (gain) in Table 15.1, that reduces the year-end accumulated post-retirement benefit obligation for 2004 by $12 million. No determination has yet been made with respect to actuarially equivalent benefits provided to participants' spouses and dependents. The ongoing effect of the subsidy under Medicare Part D is to reduce the current service cost.

For financial reporting purposes, Freddie Mac uses a September 30 valuation measurement date for all of its defined benefit plans. The company is required to accrue the estimated cost of retiree benefits as employees render the services necessary to earn their pension and post-retirement health benefits. Freddie Mac's pension and post-retirement health care costs related to these defined benefit plans for 2004, 2003 and 2002 presented in the following tables were calculated using assumptions as of September 30, 2003, 2002 and 2001, respectively. The funded status of Freddie Mac's pension and post-retirement health care defined benefit plans for 2004, 2003 and 2002 presented in the following tables was calculated using assumptions as of September 30, 2004, 2003 and 2002, respectively.

Table 15.1 sets forth the changes in the benefit obligations and plan assets for the twelve months ended September 30, 2004 and 2003, the funded status at September 30, 2004 and 2003 and the amounts recognized in the consolidated balance sheets for the defined benefit plans at December 31, 2004 and 2003.

Table 15.1 — Defined Benefit Plan Obligations and Funded Status

	Pension Benefits[1]		Post-Retirement Health Benefits	
	2004	2003	2004	2003
	(dollars in millions)			
Change in Benefit Obligation:				
Benefit obligation at beginning of period	$339	$230	$102	$ 54
Service cost	24	16	10	6
Interest cost	20	16	6	3
Net actuarial loss (gain)	6	80	(15)	39
Benefits paid	(4)	(3)	(1)	—
Benefit obligation at end of period	$385	$339	$102	$102
Change in Plan Assets:				
Fair value of plan assets at beginning of period	229	160		
Actual return on plan assets	22	26		
Employer contributions	13	46		
Benefits paid	(4)	(3)		
Fair value of plan assets at end of period	$260	$229		
Funded Status:				
Funded status at end of period	(125)	(110)	(102)	(102)
Unrecognized net actuarial loss	112	120	40	60
Unrecognized prior service cost	1	2	(6)	(6)
Initial unrecognized net transition asset	1	1	—	—
Net amount recognized	$(11)	$ 13	$(68)	$(48)
Amounts Recognized in the Consolidated Balance Sheets:				
Other assets:				
Prepaid benefit cost	$ —	$ 29	$ —	$ —
Intangible and other assets	6	1	—	—
Other liabilities:				
Accrued benefit liability	(25)	(27)	(68)	(48)
AOCI:				
Minimum pension liability	8	10	—	—
Net amount recognized	$(11)	$ 13	$(68)	$(48)

(1) The benefit obligations refer to projected benefit obligations ("PBO"). The measurement of the PBO includes assumptions about the rate of future compensation increases.

The accumulated benefit obligation ("ABO") for all defined benefit pension plans was $282 million and $248 million at September 30, 2004 and 2003, respectively. The ABO represents the actuarial present value of future expected benefits, assuming current salary levels remain in effect.

The change in the minimum pension liability recognized in AOCI, net of taxes, was a $2 million decrease for the year ended December 31, 2004 and a $10 million increase for year ended December 31, 2003.

Table 15.2 provides additional information for defined benefit pension plans.

Table 15.2 — Additional Information for Defined Benefit Pension Plans

	2004		2003	
	Pension Plan	Non-qualified Pension Plans	Pension Plan	Non-qualified Pension Plans
	(dollars in millions)			
PBO	$356	$29	$301	$38
ABO	$262	$20	$221	$27
Fair value of plan assets	260	—	229	—
ABO over (under) fair value of plan assets	$ 2	$20	$ (8)	$27

Table 15.3 presents the components of the net periodic benefit costs with respect to pensions and post-retirement health benefits for the years ended December 31, 2004, 2003 and 2002. Net periodic benefit costs are included in the line Salaries and employee benefits on the company's consolidated statements of income.

Table 15.3 — Net Periodic Benefit Cost Detail

	Pension Benefits			Post-Retirement Health Benefits		
	Year Ended December 31,			Year Ended December 31,		
	2004	2003	2002	2004	2003	2002
	(dollars in millions)					
Service cost of current period	$ 24	$ 16	$ 12	$10	$ 6	$ 4
Interest cost on benefit obligation	20	16	14	6	3	3
Expected return on plan assets	(16)	(12)	(13)	—	—	—
Recognized net actuarial loss	7	3	—	5	2	1
Recognized prior service cost	—	—	—	(1)	(1)	(1)
Net periodic benefit costs	$ 35	$ 23	$ 13	$20	$10	$ 7

Tables 15.4 and 15.5 summarize the weighted average assumptions used to determine the benefit obligations at September 30, 2004 and 2003 and net periodic benefit costs recognized for the years ended December 31, 2004, 2003 and 2002, respectively.

Table 15.4 — Weighted Average Assumptions Used to Determine Projected and Accumulated Benefit Obligations

	Pension Benefits		Post-Retirement Health Benefits	
	September 30,		September 30,	
	2004	2003	2004	2003
Major Assumptions:				
Discount rate	5.75%	6.00%	5.75%	6.00%
Rate of future compensation increase	4.50%	4.50%	—	—

Table 15.5 — Weighted Average Assumptions Used to Determine Net Periodic Benefit Cost

	Pension Benefits			Post-Retirement Health Benefits		
	Year Ended December 31,			Year Ended December 31,		
	2004	2003	2002	2004	2003	2002
Major Assumptions:						
Discount rate	6.00%	7.00%	7.50%	6.00%	7.00%	7.50%
Rate of future compensation increase	4.50%	4.50%	4.50%	—	—	—
Expected long-term rate of return on plan assets	7.00%	7.25%	9.00%	—	—	—

For the 2004 and 2003 benefit obligations, Freddie Mac used the Moody's Aa Corporate Bond Rate Index as a basis for selecting the discount rate shown in Table 15.4. The expected long-term rate of return on plan assets for 2004 and 2003 is estimated using a portfolio return calculator model. The model considers the historical returns and the future expectations for returns for each asset class in the company's defined benefit plans in conjunction with Freddie Mac's target investment allocation to arrive at the expected rate of return.

The assumed health care cost trend rates used in measuring the accumulated post-retirement benefit obligation as of September 30, 2004 are 13 percent in 2005, gradually declining to an ultimate rate of five percent in 2011 and remaining at that level thereafter.

Table 15.6 sets forth the effect on the accumulated post-retirement health benefit obligation as of September 30, 2004, and the sum of the service-cost and interest-cost components of the net periodic post-retirement health benefit costs that would result from a one percent increase or decrease in the assumed health care cost trend rate.

Table 15.6 — Selected Data Regarding the Retiree Health Plan

	One Percent Increase	One Percent Decrease
	(dollars in millions)	
Effect on the accumulated post-retirement benefit obligation for health care benefits	$24	$(19)
Effect on the net periodic post-retirement health benefit cost components	4	(3)

Plan Assets

Table 15.7 sets forth Freddie Mac's Pension Plan weighted average asset allocations, based on fair value, at September 30, 2004 and 2003, and target allocation by asset category.

Table 15.7 — Pension Plan Assets by Category

	Target Allocation	Plan Assets at September 30,	
Asset Category	2003 - 2004	2004	2003
Equity securities	65.0%	61.2%	51.7%
Debt securities	35.0%	34.0%	28.0%
Other[(1)]	—	4.8%	20.3%
Total	100.0%	100.0%	100.0%

(1) Consists of cash contributions made in the third quarter of 2004 and 2003 that were not fully invested by September 30th of that year.

Freddie Mac's Retirement Committee has fiduciary responsibility for establishing and overseeing the Pension Plan's investment policies and objectives. The Retirement Committee reviews the appropriateness of the Pension Plan's investment strategy on an ongoing basis. Freddie Mac's Pension Plan employs a total return investment approach whereby a diversified blend of equities and fixed income investments are used to maximize the long-term return of plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan funded status, and corporate financial condition. Furthermore, equity investments are diversified across U.S. and non-U.S. listed companies with small and large capitalizations. Derivatives may be used to gain market exposure in an efficient and timely manner; however, derivatives may not be used to leverage the portfolio beyond the market value of the underlying investments. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, annual liability measurements and periodic asset/liability studies.

The Pension Plan assets did not include any direct ownership of Freddie Mac securities at September 30, 2004 and 2003.

Contributions

As discussed above, Freddie Mac does not currently expect to contribute to its Pension Plan in 2005. Any contributions to the company's Retiree Health Plan will be in the form of benefit payments since it is an unfunded plan.

Estimated Future Benefit Payments

Table 15.8 sets forth estimated future benefit payments expected to be paid for the defined benefit plans. The expected benefits are based on the same assumptions used to measure Freddie Mac's benefit obligation at September 30, 2004.

Table 15.8 — Estimated Future Benefit Payments

	Pension Benefits	Post-Retirement Health Benefits
	(dollars in millions)	
2005	$3.7	$0.9
2006	4.3	1.2
2007	5.2	1.6
2008	6.1	1.9
2009	7.5	2.4
Years 2010-2014	70.9	20.4

Defined Contribution Plans

Freddie Mac's Thrift/401(k) Savings Plan, a tax-qualified defined contribution pension plan (the "Savings Plan"), is offered to all eligible employees. Employees were permitted to contribute from 1 percent to 15 percent of their annual salaries to the Savings Plan, subject to limits set by the IRC. The company also maintains a non-qualified defined contribution plan for officers of the company designed to make up for benefits lost due to limitations on eligible compensation imposed by the IRC. Freddie Mac matches employees' contributions up to 6 percent of their salaries per pay period; the percentage matched depends upon the length of service. Employee contributions and Freddie Mac's matching contributions are immediately vested. In addition, Freddie Mac has discretionary authority to make additional contributions to the Savings Plan that are allocated uniformly on behalf of each eligible employee, based on salary level. Employees become vested in Freddie Mac's discretionary contributions after 5 years. Freddie Mac incurred costs of $29 million, $28 million and $22 million for the years ended December 31, 2004, 2003 and 2002, respectively, related to these plans. These expenses were included in Salaries and employee benefits on the consolidated statements of income.

See "NOTE 13: LEGAL CONTINGENCIES" for more information regarding civil litigation and a DOL investigation of Freddie Mac's Thrift/401(k) Savings Plan in relation to the restatement.

Executive Deferred Compensation Plan

The Executive Deferred Compensation Plan is an unfunded, non-qualified plan that allows certain key employees to elect to defer a portion of their annual salary and cash bonus, and certain key management employees to defer the settlement of restricted stock units received from Freddie Mac, as well as a portion of their annual salary and cash bonus, for any number of years specified by the employee, but under no circumstances may the period elected exceed his or her life expectancy. Deferred salary, cash bonus and stock units are credited to an employee's account as of the date such amounts or units would have otherwise been paid or settled by delivery of shares to the employee. Subject to provisions for hardship withdrawals and certain terminations of employment, deferred distributions are payable at the end of the deferral period in lump sums or installments over five, ten or fifteen years. Distributions are paid from Freddie Mac's general assets. Freddie Mac records a liability equal to the accumulated deferred salary, cash bonus and accrued interest as set forth in the plan, net of any related distributions made to plan participants. Freddie Mac recognizes expense equal to the interest accrued on deferred salary and bonus throughout the year. Expense associated with unvested deferred restricted stock units is recognized as part of stock-based compensation.

NOTE 16: FAIR VALUE DISCLOSURES

The consolidated fair value balance sheets in Table 16.1 present Freddie Mac's estimates of the fair value of the company's recorded assets and liabilities and off-balance sheet financial instruments as of December 31, 2004 and 2003. The fair value information on the consolidated fair value balance sheets includes the fair values of all items recorded in the consolidated balance sheets prepared in accordance with GAAP, as well as all off-balance sheet financial instruments that represent assets or liabilities of Freddie Mac that are not recorded in the GAAP consolidated balance sheets. These off-balance sheet items predominantly consist of the unrecognized guarantee assets and obligations associated with a portion of Freddie Mac PCs issued through the Guarantor Program as well as commitments to purchase multifamily and single-family mortgage loans that will be classified as held-for-investment in the GAAP financial statements and insurance contracts on manufactured housing investments. The valuations of financial instruments on the consolidated fair value balance sheets are in accordance with GAAP fair value guidelines prescribed by SFAS No. 107, "Disclosures about Fair Value of Financial Instruments" ("SFAS 107") and other relevant pronouncements.

Table 16.1 — Consolidated Fair Value Balance Sheets[1]

	December 31,			
	2004		2003	
	Carrying Amount[2]	Fair Value[3]	Carrying Amount[2]	Fair Value
	(dollars in billions)			
Assets				
Mortgage loans	$ 61.3	$ 63.3	$ 60.2	$ 62.5
Mortgage-related securities[4]	603.2	603.4	600.2	600.4
Retained portfolio	664.5	666.7	660.4	662.9
Cash and cash equivalents	35.3	35.3	23.1	23.1
Investments	29.8	29.8	65.4	65.4
Securities purchased under agreements to resell and Federal funds sold	32.2	32.2	20.6	20.6
Derivative assets	15.3	15.3	16.2	16.2
Guarantee asset for Participation Certificates	4.5	5.0	3.7	4.5
Other assets	13.7	13.3	14.0	13.2
Total assets	$795.3	$797.6	$803.4	$805.9
Liabilities and minority interest				
Total debt securities, net	$731.7	$737.0	$739.6	$749.8
Guarantee obligation for Participation Certificates	4.1	2.1	2.9	2.4
Derivative liabilities	0.2	0.2	0.4	0.4
Reserve for guarantee losses on Participation Certificates	0.2	—	0.1	—
Other liabilities[5]	26.2	25.7	27.0	23.9
Minority interests in consolidated subsidiaries	1.5	1.7	1.9	2.1
Total liabilities and minority interest	763.9	766.7	771.9	778.6
Net assets attributable to stockholders				
Preferred stockholders	4.6	4.1	4.6	4.4
Common stockholders	26.8	26.8	26.9	22.9
Total net assets	31.4	30.9	31.5	27.3
Total liabilities and net assets	$795.3	$797.6	$803.4	$805.9

(1) The consolidated fair value balance sheets do not purport to present the net realizable, liquidation or market value of Freddie Mac as a whole. Furthermore, amounts Freddie Mac ultimately realizes from the disposition of the assets or settlement of liabilities may vary significantly from the fair values presented.
(2) Carrying amounts equal the amounts reported on Freddie Mac's GAAP consolidated balance sheets.
(3) Methodologies employed to calculate fair values are periodically changed on a prospective basis to reflect improvements in the underlying estimation processes. The estimated impact of these improvements resulted in net after-tax changes to Total net assets of approximately $0.6 billion at December 31, 2004. The most significant of these changes occurred in the fourth quarter when Freddie Mac began using newly available market prices received from broker/dealers and reliable third-party pricing providers for the valuation of a greater portion of its debt instruments.
(4) The fair value of Mortgage-related securities reported in this table exceeds the carrying value because the fair value includes PC residuals related to Participation Certificates held in the Retained portfolio that are not recognized under GAAP because such PCs were issued prior to the implementation of FIN 45 in 2003.
(5) Fair values include estimated income taxes on the difference between the consolidated fair value balance sheets pre-tax net assets and the consolidated GAAP balance sheets pre-tax net assets.

Limitations

The consolidated fair value balance sheets do not capture all elements of value that are implicit in Freddie Mac's operations as a going concern since the consolidated fair value balance sheets only capture the values of the current investment and securitization portfolios. For example, the consolidated fair value balance sheets do not capture the value of new investment and securitization business that would likely replace prepayments as they occur. In addition, the consolidated fair value balance sheets do not capture the value associated with future growth opportunities in Freddie Mac's investment and securitization portfolios. Thus, the fair value of net assets attributable to stockholders presented in the consolidated fair value balance sheets does not represent an estimate of the net realizable, liquidation or market value of Freddie Mac as a whole.

Freddie Mac reports assets and liabilities that are not financial instruments (such as property, plant and equipment and deferred taxes), as well as certain financial instruments that are not covered by the SFAS 107 disclosure requirements (such as pension liabilities) at their GAAP carrying amounts in the consolidated fair value balance sheets. Management believes these items do not have a significant impact on Freddie Mac's overall financial condition or fair value results.

Valuation Methods and Assumptions

Fair value is generally based on independent price quotations obtained from third-party pricing services, dealer marks or direct market observations, where available. However, certain financial instruments are less actively traded and, therefore, are not always able to be valued based on prices obtained from third parties. If quoted prices or market data are not available, fair value is based on internal valuation models using market data inputs or internally developed assumptions, where appropriate.

The following methods and assumptions were used to estimate the fair value of assets and liabilities at December 31, 2004 and 2003.

Mortgage loans

Mortgage loans represent single-family and multifamily whole loans held in Freddie Mac's Retained portfolio. For GAAP purposes, management must determine the fair value of these mortgage loans to calculate lower-of-cost-or-market value adjustments for mortgages classified as held-for-sale. Management uses this same approach when determining the fair value of all whole loans, including those held for investment, for fair value balance sheet purposes.

Freddie Mac determines the fair value of mortgage loans based on comparisons to actively traded mortgage-related securities with similar characteristics, with adjustments for yield, credit and liquidity differences. Specifically, Freddie Mac aggregates mortgage loans into pools by product type, coupon and maturity and then converts the pools into notional mortgage-related securities based on their specific characteristics. Freddie Mac then calculates fair values for these notional mortgage-related securities using the process that is described in the "Mortgage-related securities" section, below.

As described above, the fair value of these mortgage loans also includes adjustments for yield, credit and liquidity differences. To accomplish this, the fair value of the single-family whole loans includes an adjustment representing the estimated present value of the additional cash flows on the mortgage coupon of the whole loan in excess of the coupon expected on the notional mortgage-related securities. For multifamily whole loans, the fair value adjustment is estimated by calculating the net present value of guarantee fees expected to be retained by Freddie Mac. This retained guarantee fee is estimated by subtracting the expected cost of funding and securitizing a multifamily whole loan of a comparable maturity and credit rating from the coupon on the whole loan at the time of purchase.

The implied guarantee fee is also net of the related credit and other components inherent in the company's guarantee obligation. For single-family whole loans, the process for estimating the related credit and other guarantee obligation components is described in the "Guarantee obligation for Participation Certificates" section. For multifamily whole loans, the process for estimating the related credit and other guarantee obligation components employs a market-based approach to estimate the potential credit obligation. This obligation is estimated by extracting the credit risk premium that multifamily whole loan investors require from market prices on similar securities. This credit risk premium is net of expected funding, liquidity and other risk premiums that are embedded in the market price of the reference securities.

Mortgage-related securities

Mortgage-related securities represent passthroughs and other mortgage-related securities classified as available-for-sale and trading, which are already reflected at fair value on the GAAP consolidated balance sheets. Mortgage-related securities consist of securities issued by Freddie Mac, Fannie Mae and Ginnie Mae as well as non-agency mortgage-related securities.

The fair value of securities with readily available third-party market prices is generally based on market prices obtained from broker/dealers or reliable third-party pricing service providers. Fair value may be estimated by using third-party quotes for similar instruments, adjusted for differences in contractual terms. For other securities, a market option-adjusted spread approach based on observable market parameters is used to estimate fair value. Option-adjusted spreads for certain securities are estimated by deriving the option-adjusted spread for the most closely comparable security with an available market price, using proprietary interest-rate and prepayment models. If necessary, management judgment is applied to estimate the impact of differences in prepayment uncertainty or other unique cash flow characteristics related to that particular security. Fair values for these securities are then estimated by using the estimated option-adjusted spread as an input to the interest-rate and prepayment models, and estimating the net present value of the projected cash flows. The remaining instruments are priced using other modeling techniques or by using other securities as proxies.

Mortgage-related securities also include PC residuals related to PCs held by Freddie Mac and reported in the mortgage-related securities line item. PC residuals are reported at fair value on Freddie Mac's consolidated balance sheets. Fair value for PC residuals is estimated in the same manner as described for guarantee assets and guarantee obligations for PCs below.

Cash and cash equivalents

Cash and cash equivalents largely consist of highly liquid investment securities with an original maturity of three months or less used for cash management purposes, as well as cash collateral posted by Freddie Mac's derivative counterparties. Given that these assets are short-term in nature with limited market value volatility, the carrying amount on the GAAP consolidated balance sheets is presumed to be a reasonable approximation of fair value.

Investments

At December 31, 2004, Investments consists solely of non-mortgage-related securities, which are reported at fair value on Freddie Mac's consolidated balance sheets. At December 31, 2003, Investments included non-mortgage-related securities and mortgage-related securities held in connection with PC market making and support activities, which were reported at fair value on Freddie Mac's consolidated balance sheets. Freddie Mac ceased its PC market making and support activities accomplished through the Securities Sales & Trading Group business unit and the external Money Manager program during the fourth quarter of 2004. The fair values of Investments are estimated using the methods described above in "Mortgage-related securities."

Securities purchased under agreements to resell and Federal funds sold

Securities purchased under agreements to resell and Federal funds sold principally consists of short-term contractual agreements such as reverse repurchase agreements involving Treasury and agency securities, Federal funds sold and Eurodollar time deposits. Given that these assets are short-term in nature, the carrying amount on the GAAP consolidated balance sheets is presumed to be a reasonable approximation of fair value.

Guarantee assets for Participation Certificates

At December 31, 2004 and 2003, Freddie Mac established guarantee assets for approximately 87 percent and 81 percent, respectively, of PCs and Structured Securities held by third parties. For more information regarding the accounting for guarantee assets related to PCs and Structured Securities, see "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES."

For fair value balance sheet purposes, guarantee assets are reflected for all PCs and Structured Securities held by third parties and are valued using the same method as used for GAAP fair value purposes. For a description of how Freddie Mac determines the fair value of its guarantee assets, see "NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS."

Derivative assets

Derivative assets, at fair value largely consists of interest-rate swaps, option-based derivatives, futures, and forward purchase and sale commitments that Freddie Mac accounts for as derivatives, which are reflected at fair value on the GAAP consolidated balance sheets. The fair values of interest-rate swaps are determined by using the appropriate yield curves to calculate and discount the expected cash flows for both the fixed-rate and floating-rate components of the swap contracts. Option-based derivatives, which principally include call and put swaptions, are valued using an option-pricing model. This model uses market interest rates and market-implied option volatilities, where available, to calculate the option's fair value. Market-implied option volatilities are based on information obtained from broker/dealers. The fair value of exchange-traded futures is based on end-of-day closing prices obtained from third-party pricing services. Derivative forward purchase and sale commitments are valued using the methods described for mortgage-related securities valuation, above.

The fair value of derivative assets considers the impact of institutional credit risk in the event that the counterparty does not honor its payment obligation. Freddie Mac's fair value of derivatives is not adjusted for expected credit losses because management obtains collateral from most counterparties typically within one to three business days of the daily market value calculation and substantially all of Freddie Mac's credit risk arises from counterparties with investment-grade credit ratings of A- or above.

Other assets

Other assets consists of accrued interest and other receivables, investments in qualified LIHTC limited partnerships that are eligible for federal tax credits, financial guarantee contracts for additional credit protection on certain manufactured housing asset-backed securities, real estate owned, property, plant and equipment, and other miscellaneous assets.

The receivables are financial instruments and are required to be measured at fair value for disclosure purposes pursuant to SFAS 107. Because these receivables are short-term in nature, management believes the carrying amount on the GAAP consolidated balance sheets is a reasonable approximation of their fair values. For the LIHTC partnerships, the fair value of expected tax benefits is estimated using expected cash flows discounted at a market-based yield. For the credit enhancements on manufactured housing asset-backed securities, the fair value is based on the difference between the market price of non-credit impaired manufactured housing securities and credit-impaired manufactured housing securities that are likely to produce future credit losses, as adjusted for management's estimate of a risk premium attributable to the financial guarantee contracts. The value of the contracts, over time, will be determined by the actual credit-related losses incurred and, therefore, may have a value that is higher or lower than management's market-based estimate.

The other categories of assets that comprise Other assets are not financial instruments required to be valued at fair value under SFAS 107, such as REO properties. The fair market value of REO properties is calculated using a model-based approach, incorporating market sales data, that estimates a discount to full fair market value for a comparable property that has not been subject to foreclosure proceedings. This adjustment is intended to capture the sale price discount generally evidenced in the market for properties that have been subject to a foreclosure sale.

Other non-financial assets included in Other assets represent an insignificant portion of the GAAP consolidated balance sheets. Because any change in their fair value would not be a meaningful part of Freddie Mac's fair value of net assets business results, Freddie Mac has not adjusted the carrying amount on the GAAP consolidated balance sheets for estimates of the fair value of these non-financial assets.

Total debt securities, net

Total debt securities, net represents short-term and long-term debt used to finance Freddie Mac's assets and, for GAAP presentation, is net of deferred items, including premiums, discounts and hedging-related basis adjustments. It includes both non-callable and callable debt as well as short-term zero coupon discount notes. The fair value of the short-term zero coupon discount notes is based on a discounted cash flow model with market inputs. The valuation of other debt securities is generally based on market prices obtained from broker/dealers, reliable third-party pricing service providers, or direct market observations. In the fourth quarter of 2004, Freddie Mac began using newly available market prices received from broker/dealers and

reliable third-party pricing services for the valuation of a greater portion of its debt instruments. Previously the calculation of the fair value of these instruments was based primarily on an internal model using available market inputs.

Guarantee obligation for Participation Certificates

Freddie Mac does not establish guarantee obligations for all PCs and Structured Securities held by third parties for GAAP purposes. In addition, guarantee obligations are not carried at fair value for GAAP purposes. For fair value balance sheet purposes, guarantee obligations reflect the fair value of Freddie Mac's guarantee obligation on all PCs held by third parties. Additionally, for fair value balance sheet purposes, guarantee obligations are valued using the same method as used for GAAP to determine the guarantee obligation's initial fair value. For information concerning the company's valuation methodologies and accounting policies related to guarantee-related credit losses, see "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES," and "NOTE 2: TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS."

Reserve for guarantee losses on Participation Certificates

The carrying amount of the Reserve for guarantee losses on Participation Certificates on the GAAP consolidated balance sheets represents GAAP loan loss reserves for off-balance sheet PCs that are not already accounted for under SFAS 125/140. This line item has no basis in the consolidated fair value balance sheets, because the estimated fair value of all expected default losses is included in the guarantee obligation reported on the consolidated fair value balance sheets, as discussed above.

Derivative liabilities

See discussion under "Derivative assets" above.

Other liabilities

Other liabilities principally consists of amounts due to PC investors (*i.e.*, principal and interest), funding liabilities associated with investments in LIHTC partnerships, accrued interest payable on debt securities and other miscellaneous obligations of less than one year. Management believes the carrying amount of these liabilities is a reasonable approximation of their fair value, except for funding liabilities associated with investments in LIHTC partnerships, for which fair value is estimated using expected cash flows discounted at a market-based yield. Also, management adjusts the GAAP-basis deferred taxes for consolidated fair value balance sheets purposes. Fair values include estimated income taxes on the difference between the consolidated fair value balance sheets pre-tax net assets and the consolidated GAAP balance sheets pre-tax net assets.

Minority interests in consolidated subsidiaries

Minority interests in consolidated subsidiaries primarily represent preferred stock interests that third parties hold in Freddie Mac's two majority-owned REIT subsidiaries. In accordance with GAAP, Freddie Mac consolidated the REITs. The fair value of the third-party minority interests in these REITs was based on the estimated value of the underlying REIT preferred stock determined by management based on a valuation model adjusted to consider the impact of embedded call options, using market-based information to the extent available.

Net assets attributable to preferred stockholders

To determine the preferred stock fair value, Freddie Mac uses a market-based approach incorporating quoted dealer prices.

Net assets attributable to common stockholders

Net assets attributable to common stockholders is equal to the fair value of net assets (the difference between the fair value of Freddie Mac's assets and the fair value of liabilities and minority interest), less the fair value of net assets attributable to preferred stockholders.

NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS

Mortgages and Mortgage-Related Securities

Table 17.1 summarizes the geographical concentration of mortgages and mortgage-related securities that are held by Freddie Mac or that are collateral for PCs and Structured Securities excluding:

- $3,015 million and $4,729 million of mortgage-related securities issued by Ginnie Mae that back Structured Securities at December 31, 2004 and 2003, respectively, because these securities do not expose Freddie Mac to meaningful amounts of credit risk;
- $59,715 million and $77,289 million of agency mortgage-related securities at December 31, 2004 and 2003, respectively, because these securities do not expose Freddie Mac to meaningful amounts of credit risk;
- $175,163 million and $114,772 million of non-agency mortgage-related securities held in the Retained portfolio at December 31, 2004 and 2003, respectively, because geographic information regarding these securities is not available. With respect to these securities, Freddie Mac looks to third party credit enhancements (*e.g.*, bond insurance) or other credit enhancements resulting from the securitization structure (*e.g.*, subordination levels) supporting such securities as a primary means of managing credit risk; and
- $29,830 million and $48,585 million of non-Freddie Mac mortgage-related securities and mortgage-related securities held in its Cash and investments portfolio that are important to Freddie Mac's financial management and the company's ability to provide liquidity and stability to the mortgage market at December 31, 2004 and 2003, respectively. These securities are excluded because Freddie Mac tends to hold them for a short time period and the geographic information regarding these securities is not available. In fourth quarter 2004, Freddie Mac ceased its PC market-making and support activities accomplished through its Securities Sales & Trading Group business unit and its external Money Manager program, which was a component of the $48,585 million balance at December 31, 2003.

See "NOTE 5: RETAINED PORTFOLIO AND CASH AND INVESTMENTS PORTFOLIO" for more information about the securities Freddie Mac holds.

Table 17.1 — Concentration of Credit Risk

	December 31,			
	2004		2003	
	Amount[1]	Percentage	Amount[1]	Percentage
	(dollars in millions)			
By Region[2]				
Northeast	$ 309,344	24%	$ 288,865	24%
West	296,390	23	295,349	24
North central	280,618	22	271,339	22
Southeast	220,858	18	210,570	17
Southwest	160,249	13	151,486	13
	$1,267,459	100%	$1,217,609	100%
By State				
California	$ 171,209	14%	$ 175,030	14%
Florida	75,879	6	70,970	6
Illinois	65,750	5	63,497	5
New York	65,344	5	56,013	5
All Others	889,277	70	852,099	70
	$1,267,459	100%	$1,217,609	100%

(1) Calculated as Total mortgage portfolio less mortgage-related securities issued by Ginnie Mae that back PCs and Structured Securities as well as agency and non-agency mortgage-related securities held in the Retained portfolio.
(2) Region Designation: West (AK, AZ, CA, GU, HI, ID, MT, NV, OR, UT, WA); Northeast (CT, DE, DC, MA, ME, MD, NH, NJ, NY, PR, PA, RI, VI, VT, VA, WV); North central (IL, IN, IA, MI, MN, ND, OH, SD, WI); Southeast (AL, FL, GA, KY, MS, NC, SC, TN); Southwest (AR, CO, KS, LA, MO, NE, NM, OK, TX, WY).

Mortgage Lenders

A significant portion of Freddie Mac's single-family mortgage purchase volume is generated from several key mortgage lenders that have entered into special business arrangements with Freddie Mac. These individually negotiated arrangements characteristically involve a lender's commitment to sell a high proportion of its conforming mortgage origination volume to Freddie Mac. During 2004, the four most significant of these arrangements together accounted for almost 63 percent of Freddie Mac's volume. Wells Fargo Home Mortgage, Inc. was the largest source and accounted for approximately 33 percent of the company's mortgage purchase volume in 2004 while Chase Home Finance LLC, the second largest source, accounted for approximately 14 percent of the company's mortgage purchase volume. Freddie Mac is exposed to the risk that it could lose purchase volume to the extent these agreements are terminated or modified without replacement from other lenders.

Derivative Portfolio

On an ongoing basis, Freddie Mac reviews the credit fundamentals of all of its 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, and are updated and monitored on a regular basis. Additional reviews are completed when market conditions or events affecting an individual counterparty occur.

Derivative Counterparties. Freddie Mac's use of derivatives exposes the company to counterparty credit risk. Exchange-traded derivatives, such as futures contracts, do not measurably increase the company's 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 the company to counterparty credit risk because transactions are executed and settled between Freddie Mac and the counterparty. Freddie Mac's standards for entering into OTC derivative agreements for interest-rate swaps, option-based derivatives and foreign-currency swaps include rigorous internal credit and legal reviews. Freddie Mac's 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. Freddie Mac uses master netting and collateral agreements to reduce its credit risk exposure to its 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 Freddie Mac's exposure to a single counterparty in the event of default. For example, if Freddie Mac has 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 the company's 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 the company's net credit exposure, which is equal to derivatives in a net gain position by counterparty after giving consideration to collateral posted. Freddie Mac's collateral agreements require most counterparties to post collateral for the amount of the company's 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. Freddie Mac's derivative counterparties typically transfer collateral within one to three business days based on the values of the related derivatives. This time lag in posting collateral can affect Freddie Mac's net uncollateralized exposure to derivative counterparties.

The collateral posted by counterparties serves to protect Freddie Mac 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, Freddie Mac has the right under the agreement to direct the custodian bank to transfer the collateral to the company or, in the case of non-cash collateral, to sell the collateral and transfer the proceeds to the company.

Freddie Mac's uncollateralized exposure to counterparties for OTC interest-rate swaps, option-based derivatives and foreign-currency swaps, after applying netting agreements and collateral, was $601 million and $796 million at December 31, 2004 and 2003, respectively. In the extremely unlikely event that all of Freddie Mac's counterparties for these derivatives were to have defaulted simultaneously on December 31, 2004, the maximum loss to Freddie Mac for accounting purposes would have been approximately $601 million.

Freddie Mac's exposure to counterparties for OTC forward purchase and sale commitments treated as derivatives was $40 million and $101 million as of December 31, 2004 and 2003, respectively. Since the typical maturity for OTC commitments is less than one year, Freddie Mac does not require master netting and collateral agreements for the counterparties of these commitments. Therefore, Freddie Mac's exposure to its OTC commitments counterparties is uncollateralized. Similar to counterparties for its OTC interest-rate swaps, option-based derivatives and foreign-currency swaps, Freddie Mac monitors the credit fundamentals of its OTC commitments counterparties on an ongoing basis to ensure that they continue to meet internal risk-management standards.

NOTE 18: MINORITY INTERESTS

The equity and net earnings attributable to the minority stockholder interests in consolidated subsidiaries are reported in the consolidated balance sheets as Minority interests in consolidated subsidiaries and in the consolidated statements of income as Minority interests in earnings of consolidated subsidiaries, respectively. The majority of the balances in these accounts relate to the company's two majority-owned REITs.

In February 1997, Freddie Mac formed two majority-owned REIT subsidiaries funded through the issuance of common stock (99.9 percent of which is held by Freddie Mac) and a total of $4.0 billion of perpetual, step-down preferred stock issued to outside investors. The dividend rate on the step-down preferred stock is 13.3 percent from initial issuance through 2006 (the "initial term"). Beginning in 2007, the dividend rate will step-down to 1.0 percent. Dividends on this preferred stock accrue in arrears. The balance of the two step-down preferred stock issuances as recorded within Minority interests in consolidated subsidiaries on the consolidated balance sheets totaled $1.5 billion and $1.9 billion at December 31, 2004 and 2003, respectively. The preferred stock is redeemable by the REITs under certain circumstances described in the preferred stock offering documents as a "tax event redemption." Additionally, after an initial period ending December 31, 2006, the REITs may be able to retire the preferred stock under favorable financing terms in accordance with the terms of the preferred stock. The REITs may decide to redeem the preferred stock in the future depending on market conditions and other factors. See "NOTE 14: INCOME TAXES" for more information concerning the REITs.

NOTE 19: EARNINGS PER COMMON SHARE

Basic earnings per common share are computed as Net income available to common stockholders divided by the weighted average common shares outstanding (Weighted average common shares outstanding-basic) for the period. Diluted earnings per common share are computed as Net income available to common stockholders divided by the weighted average common shares outstanding considering the effect of dilutive common equivalent shares outstanding (Weighted average common shares outstanding-diluted) for the period. Dilutive common equivalent shares reflect the assumed issuance of additional common shares pursuant to certain of the company's stock-based compensation plans (see "NOTE 11: STOCK-BASED COMPENSATION") that could potentially reduce or "dilute" earnings per share, based on the treasury stock method.

Table 19.1 provides computations of Freddie Mac's basic and diluted earnings per common share.

Table 19.1 — Earnings Per Common Share — Basic and Diluted

	Year Ended December 31,		
	2004	2003	2002
	(dollars in millions and shares in thousands)		
Net income	$ 2,937	$ 4,816	$ 10,090
Preferred stock dividends and issuance costs on redeemed preferred stock (including $0, $0 and $5 of issuance costs on redeemed preferred stock)	(210)	(216)	(239)
Net income available to common stockholders[1]	$ 2,727	$ 4,600	$ 9,851
Weighted average common shares outstanding — basic	689,282	687,094	692,727
Dilutive potential common shares[2]	2,239	1,581	2,389
Weighted average common shares outstanding — diluted	691,521	688,675	695,116
Basic earnings per common share	$ 3.96	$ 6.69	$ 14.22
Diluted earnings per common share	$ 3.94	$ 6.68	$ 14.17

(1) Net income available to common stockholders is not affected by dilutive potential common shares for the years ended December 31, 2004, 2003 and 2002.
(2) The effect of dilutive common equivalent shares outstanding includes: (a) the weighted average shares related to stock options (including the ESPP) that have an exercise price lower than the average market price during the period; (b) the weighted average of non-vested restricted shares; and (c) all restricted stock units. Such items are excluded from weighted average common shares outstanding — basic.

Options to purchase 2.4 million, 3.4 million and 2.5 million shares of common stock were excluded from the computation of Diluted earnings per common share at December 31, 2004, 2003 and 2002, respectively, because the options' exercise price exceeded the average market price of the common stock for the years ended December 31, 2004, 2003 and 2002, respectively.

DIRECTORS AND EXECUTIVE OFFICERS

Directors

Information on our Directors is set forth under "Proposal 1: Election of Directors — Nominees for Election" of our Proxy Statement for our annual meeting to be held on July 15, 2005, and is incorporated herein by reference.

Executive Officers

As of June 1, 2005, our executive officers are as follows:

Name	Age	Year of Affiliation	Position
Richard F. Syron	61	2003	Chairman and Chief Executive Officer
Eugene M. McQuade	56	2004	President and Chief Operating Officer
Martin F. Baumann	57	2003	Executive Vice President, Finance and Chief Financial Officer
Ralph F. Boyd, Jr.	48	2004	Executive Vice President, Community Relations
Patricia L. Cook	52	2004	Executive Vice President, Investments
Joseph A. Smialowski	56	2004	Executive Vice President, Operations and Technology
David A. Andrukonis	47	1980	Senior Vice President and Chief Enterprise Risk Officer*
Margaret A. Colon	47	1983	Senior Vice President and Chief Administrative Officer
Adrian B. Corbiere	60	1999	Senior Vice President, Multifamily Sourcing
Joan E. Donoghue	48	2001	Senior Vice President, General Counsel and Corporate Secretary
Stanley J.D. Martin	58	2004	Senior Vice President and General Auditor
Timothy J. McBride	46	2005	Senior Vice President, Government and Industry Relations
Hollis S. McLoughlin	54	2004	Senior Vice President and Chief of Staff
Robert Y. Tsien	52	2000	Senior Vice President, Mission Oversight and Development
Jerry Weiss	47	2003	Senior Vice President and Chief Compliance Officer
John F. Woods	40	2002	Senior Vice President, Corporate Controller and Principal Accounting Officer

* Mr. Andrukonis announced his intention to leave Freddie Mac effective at the end of June 2005.

The following is a brief biographical description of each of our executive officers.

Richard F. Syron was appointed Chairman and Chief Executive Officer in December 2003. Prior to joining us, Mr. Syron was Executive Chairman of Thermo Electron Corporation, a position he assumed in November 2002. He joined Thermo Electron in June 1999 as its Chief Executive Officer and became its Chairman of the Board in January 2000. Prior to that, he was Chairman and Chief Executive Officer of the American Stock Exchange for five years, President of the Federal Reserve Bank of Boston for five years and President of the Federal Home Loan Bank of Boston for three years.

Eugene M. McQuade was appointed President and Chief Operating Officer effective September 1, 2004. Before joining us, Mr. McQuade was President of Bank of America Corporation. He also served as President and Chief Operating Officer of FleetBoston Financial Corp., which merged with Bank of America on April 1, 2004. Mr. McQuade joined Fleet in 1992 and became Chief Financial Officer in 1993, Vice Chairman in 1997, and President and Chief Operating Officer in 2002. Prior to joining Fleet, Mr. McQuade was Executive Vice President and Controller of Manufacturers Hanover Corp.

Martin F. Baumann was appointed Executive Vice President, Finance in April 2003 and Chief Financial Officer in June 2003. Prior to joining us, Mr. Baumann worked at PricewaterhouseCoopers since 1969, where he was a partner from 1980. At PricewaterhouseCoopers, he performed a variety of functions, including serving as the Deputy Chairman — World Financial Services Practice and as the Global Banking Leader. He also served on PricewaterhouseCoopers U.S. and World Financial Services Executive Committees.

Ralph F. Boyd, Jr. was appointed Executive Vice President, Community Relations in February 2005. Prior to holding his current position, he served as our Executive Vice President, General Counsel and Corporate Secretary. Prior to joining us, Mr. Boyd was a senior partner with the law firm Alston & Bird LLP since August 2003 and was U.S. assistant attorney general and head of the Justice Department's Civil Rights Division from July 2001 through July 2003. From 1997 to 2001, Mr. Boyd was a trial partner with Goodwin Procter LLP, and before that, he served for six years as an Assistant U.S. Attorney in Boston. He also was an associate at the law firm of Ropes & Gray in Boston from 1987 to 1991.

Patricia L. Cook was appointed Executive Vice President, Investments, effective August 2, 2004. Prior to joining us, Ms. Cook was Managing Director and Chief Investment Officer, Global Fixed Income at JPMorgan Fleming Asset Management ("JP Morgan Fleming") since May 2003. Prior to joining JP Morgan Fleming, she was Managing Director and Chief Investment Officer, Fixed Income at Prudential Investment Management. From June 1991 to July 2001, Ms. Cook was Managing Director at Fisher Francis Trees and Watts. Prior to that, she worked in various management positions at Salomon Brothers, Inc. from January 1979 to June 1991.

Joseph A. Smialowski was named Freddie Mac's Executive Vice President of Operations and Technology in December 2004. Before joining Freddie Mac, Mr. Smialowski was Executive Vice President at Fleet Boston Financial from December 1998. Prior to that, he was Chief Information Officer at Sears, Roebuck and Co. from September 1993. Early in his career, Mr. Smialowski held increasingly responsible management, technology and operations positions at Dennison Manufacturing, Xerox and The Hartford.

David A. Andrukonis was appointed Senior Vice President and Chief Enterprise Risk Officer in October 2003. Prior to that he served as Senior Vice President of Single-Family Capital Deployment from September 2001 through October 2003. He also served as Senior Vice President and Chief Credit Officer from August 1998 through September 2001. Prior to that, he held various positions at our company since joining us in 1980, including Senior Vice President and General Manager of the Seller Division, Vice President of Mortgage Finance, Manager of Product Development and Pricing and Senior Economist.

Margaret A. Colon was named Senior Vice President and Chief Administrative Officer in October 2003. Prior to that, Ms. Colon served as Senior Vice President of Infrastructure Initiatives Program Management from July 2002 to October 2003 and as Senior Vice President and Single-Family Chief Operating Officer from June 2000 through June 2002. Prior to June 2000, she also has served in various other positions at our company, including Senior Vice President — Servicer, Vice President of Corporate Finance Operations, Vice President and Assistant to the President, Vice President and Multifamily Controller. Prior to joining us in 1983, Ms. Colon was a senior auditor with Deloitte Haskins and Sells.

Adrian B. Corbiere was named Senior Vice President, Multifamily Sourcing in August 1999. Before joining Freddie Mac, Mr. Corbiere was a managing director at Allstate Insurance Corp., responsible for all real estate, mortgage and CMBS investments. Prior to his position at Allstate, he was Senior Vice President of fixed-income investments, including mortgages and private placement bonds, at New England Mutual Life Insurance Company and held various real estate finance positions at both Cigna and Phoenix Mutual Insurance Companies.

Joan E. Donoghue was named Freddie Mac's Senior Vice President, General Counsel and Corporate Secretary in February 2005. Ms. Donoghue had previously served as Senior Vice President and Principal Deputy General Counsel since April 2004. She joined Freddie Mac in 2001 as Associate General Counsel and later served as Vice President and Acting General Counsel. Prior to joining Freddie Mac, Ms. Donoghue held positions of increasing importance with the U.S. Department of State including Deputy Legal Adviser. She also served as deputy general counsel at the U.S. Department of the Treasury. She also served as visiting professor at Boalt Hall School of Law, University of California at Berkeley, where she was a Council on Foreign Relations International Affairs Fellow. She began her legal career as an associate attorney with Covington and Burling.

Stanley J.D. Martin was appointed Senior Vice President and General Auditor in June 2004. Immediately prior to his appointment, Mr. Martin had served as interim General Auditor since February 2004. Before that, Mr. Martin served as Executive Vice President and then as a consultant to HSBC Bank USA from 2000

to April 2003. From 1998 to 2000, he was Chief Financial Officer and Executive Vice President of Republic New York Corporation. Prior to that, Mr. Martin was a Partner at KPMG LLP from 1982 to 1998.

Timothy J. McBride was appointed Freddie Mac's Senior Vice President, Government and Industry Relations in January 2005. Prior to Freddie Mac, Mr. McBride served as Vice President, External Affairs/ Public Policy for Daimler Chrysler Corporation, where he was responsible for directing Chrysler's federal lobbying and formulating public policy on a variety of issues. Before that, he worked at Sun Company, Incorporated as director of communications. Mr. McBride also held key positions with the Administration of former president George H.W. Bush where he served as Assistant to the President and Director of White House Management and Administration. During his tenure, he also held the positions of Assistant Secretary of Commerce for Trade Development and Special Assistant to the President. He also worked for a number of years in the Office of the Vice President of the United States for George H. W. Bush.

Hollis S. McLoughlin was named Senior Vice President and Chief of Staff in April 2004. Since 1998, Mr. McLoughlin has been Chief Operating Officer of two private equity-backed operating companies. Before that, he was one of the founding partners of Darby Overseas, a private equity partner based in Washington, D.C. He has also been a senior executive at Purolator Courier, the overnight delivery company and a privately held transportation company. From 1989 through 1992, Mr. McLoughlin served as Assistant Secretary of the Treasury under former president George H. W. Bush. He served as Chief of Staff to Sen. Nicholas Brady, R-N.J., in 1982 and to Rep. Millicent Fenwick, R-N.J., from 1975 to 1979.

Robert Y. Tsien was appointed Senior Vice President, Mission Oversight and Development in April 2004. Prior to that, he served as Senior Vice President, Production in the Multifamily Division from October 2003, and as our Chief Credit Officer from September 2001 to October 2003. Mr. Tsien joined us as Vice President of Multifamily Risk Management in April 2000. Prior to joining us, Mr. Tsien was director of risk management and securitization pricing at Titanium Investment Company.

Jerry Weiss was appointed Senior Vice President and Chief Compliance Officer in October 2003. Prior to joining us, Mr. Weiss worked from 1990 at Merrill Lynch Investment Managers, most recently as First Vice President and Global Head of Compliance. From 1982 to 1990, Mr. Weiss was with a national law practice in Washington, D.C., where he specialized in securities regulation and corporate finance matters.

John F. Woods was named Senior Vice President and Principal Accounting Officer in October 2003 and Corporate Controller in February 2005. Prior to that, Mr. Woods served as Senior Vice President, Control and Accounting in Funding and Investments from April 2002 to October 2003. Prior to joining us, Mr. Woods was a consulting partner at Arthur Andersen.

EXECUTIVE COMPENSATION

Information regarding executive compensation is set forth under the section titled "Executive Compensation" of our Proxy Statement for our annual meeting of stockholders to be held on July 15, 2005 and is incorporated by reference into this Information Statement.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Security Ownership of Management

Information regarding the beneficial ownership of our common stock by each of our directors, certain executive officers and by all directors and executive officers as a group is set forth under the section titled "Corporate Governance — Stock Ownership by Directors and Officers" of our Proxy Statement for our annual meeting of stockholders to be held on July 15, 2005 and is incorporated by reference into this Information Statement.

Security Ownership of Certain Beneficial Owners

Information regarding the beneficial ownership of our common stock by each director nominee and certain beneficial owners is set forth under the section titled "Corporate Governance — Stock Ownership by Directors and Officers" of our Proxy Statement for our annual meeting of stockholders to be held on July 15, 2005 and is incorporated by reference into this Information Statement.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information regarding certain relationships and related transactions is set forth under the section titled "Proposal 1: Election of Directors — Transactions with Institutions Related to Directors" of our Proxy Statement for our annual meeting of stockholders to be held on July 15, 2005 and is incorporated by reference into this Information Statement.

INDEMNIFICATION AND OTHER REIMBURSEMENTS OF DIRECTORS, OFFICERS AND EMPLOYEES

Information concerning indemnification and reimbursement arrangements is set forth under the section titled "Proposal 1: Election of Directors — Indemnification and Other Reimbursements of Directors, Officers and Employees" of our Proxy Statement for our annual meeting of stockholders to be held on July 15, 2005 and is incorporated by reference into this Information Statement.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information regarding principal accountant fees and services is set forth under the section titled "Proposal 2: Ratification of Appointment of Independent Auditors" of our Proxy Statement for our annual meeting of stockholders to be held on July 15, 2005 and is incorporated by reference into this Information Statement.

CERTIFICATION*

I, Richard F. Syron, certify that:

1. I have reviewed this Information Statement of Freddie Mac;

2. Based on my knowledge, this Information Statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Information Statement; and

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this Information Statement, fairly present in all material respects the financial condition, results of operations and cash flows of Freddie Mac as of, and for, the periods presented in this Information Statement.

Date: June 14, 2005

/s/ RICHARD F. SYRON

Richard F. Syron
Chairman and Chief Executive Officer

CERTIFICATION*

I, Martin F. Baumann, certify that:

1. I have reviewed this Information Statement of Freddie Mac;

2. Based on my knowledge, this Information Statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Information Statement; and

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this Information Statement, fairly present in all material respects the financial condition, results of operations and cash flows of Freddie Mac as of, and for, the periods presented in this Information Statement.

Date: June 14, 2005

/s/ MARTIN F. BAUMANN

Martin F. Baumann
Executive Vice President and Chief Financial Officer

* These certifications do not address our internal control over financial reporting or disclosure controls and procedures because a comprehensive evaluation of the effectiveness of these controls and procedures was not performed as of December 31, 2004.

RATIO OF EARNINGS TO FIXED CHARGES

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(dollars in millions)				
Income before cumulative effect of change in accounting principles, net of taxes	$ 2,937	$ 4,816	$10,090	$ 3,115	$ 3,666
Add:					
Income tax expense	790	2,202	4,713	1,339	1,504
Minority interests in earnings of consolidated subsidiaries	129	157	184	208	231
Total interest expense	26,566	26,509	26,876	27,577	25,483
Interest factor in rental expenses	6	5	5	5	5
Capitalized interest[1]	1	—	1	1	1
Earnings, as adjusted	$30,429	$33,689	$41,869	$32,245	$30,890
Fixed charges:					
Total interest expense	$26,566	$26,509	$26,876	$27,577	$25,483
Interest factor in rental expenses	6	5	5	5	5
Capitalized interest[1]	1	—	1	1	1
Total fixed charges	$26,573	$26,514	$26,882	$27,583	$25,489
Ratio of earnings to fixed charges[2]	1.15	1.27	1.56	1.17	1.21

(1) Subsequent to the issuance of our Information Statement dated September 24, 2004, we revised the capitalized interest to conform to 2004 presentation for 2003, 2002, 2001 and 2000. This resulted in a $2 million, $2 million and $1 million decrease in capitalized interest for 2003, 2002 and 2001, respectively.
(2) Ratio of earnings to fixed charges is computed by dividing Earnings, as adjusted by Total fixed charges.

RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED STOCK DIVIDENDS

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(dollars in millions)				
Income before cumulative effect of change in accounting principles, net of taxes	$ 2,937	$ 4,816	$10,090	$ 3,115	$ 3,666
Add:					
Income tax expense	790	2,202	4,713	1,339	1,504
Minority interests in earnings of consolidated subsidiaries	129	157	184	208	231
Total interest expense	26,566	26,509	26,876	27,577	25,483
Interest factor in rental expenses	6	5	5	5	5
Capitalized interest[1]	1	—	1	1	1
Earnings, as adjusted	$30,429	$33,689	$41,869	$32,245	$30,890
Fixed charges:					
Total interest expense	$26,566	$26,509	$26,876	$27,577	$25,483
Interest factor in rental expenses	6	5	5	5	5
Capitalized interest[1]	1	—	1	1	1
Preferred stock dividends[2]	266	315	351	310	252
Total fixed charges including preferred stock dividends	$26,839	$26,829	$27,233	$27,893	$25,741
Ratio of earnings to combined fixed charges and preferred stock dividends[3]	1.13	1.26	1.54	1.16	1.20

(1) Subsequent to the issuance of our Information Statement dated September 24, 2004, we revised the capitalized interest to conform to 2004 presentation for 2003, 2002, 2001 and 2000. This resulted in a $2 million, $2 million and $1 million decrease in capitalized interest for 2003, 2002 and 2001, respectively.
(2) Preferred stock dividends represent pre-tax earnings required to cover any preferred stock dividend requirements using our effective tax rate for the relevant periods.
(3) Ratio of earnings to combined fixed charges and preferred stock dividends is computed by dividing Earnings, as adjusted by Total fixed charges including preferred stock dividends.

ADDITIONAL FINANCIAL INFORMATION

For more information about Freddie Mac stock contact:

Freddie Mac
Mailstop D4O
1551 Park Run Drive
McLean, Virginia 22102-3110
Investor Relations: (571) 382-4732
Toll Free: (800) FREDDIE
On the Internet: http://www.FreddieMac.com/investors

ANNUAL MEETING

The annual meeting of Freddie Mac's stockholders will be held:

July 15, 2005
9:00 a.m. eastern time
8000 Jones Branch Drive
McLean, Virginia 22102

Proxy material will be mailed to stockholders of record by the company's transfer agent in accordance with Freddie Mac's bylaws and New York Stock Exchange requirements.

DIVIDEND PAYMENT

Approved by Freddie Mac's Board of Directors, dividends on the company's common stock and non-cumulative preferred stock in 2004 and the first five months of 2005 were paid on:

March 31, 2004
June 30, 2004
September 30, 2004
December 31, 2004
March 31, 2005

Subject to approval by Freddie Mac's Board of Directors, dividends on the company's common stock and non-cumulative preferred stock in the last seven months of 2005 are expected to be paid on:

June 30, 2005
September 30, 2005
December 31, 2005

CORPORATE HEADQUARTERS

8200 Jones Branch Drive
McLean, Virginia 22102-3110
(703) 903-2000

NEW YORK CITY OFFICE

575 Lexington Avenue, Suite 1800
New York, New York 10022-6102
(212) 418-8900

NORTH CENTRAL REGION

333 West Wacker Drive, Suite 2500
Chicago, Illinois 60606-1287
(312) 407-7400

NORTHEAST REGION

1410 Spring Hill Road, Suite 600
Post Office Box 50122
McLean, Virginia 22102-8922
(703) 902-7700

SOUTHEAST REGION

North Tower, Suite 200
2300 Windy Ridge Parkway SE
Atlanta, Georgia 30339-5665
(770) 857-8800

SOUTHWEST REGION

5000 Plano Parkway
Carrollton, Texas 75010-4902
(972) 395-4000

WESTERN REGION

21700 Oxnard Street, Suite 1900
Woodland Hills, California 91367-3642
(818) 710-3000

INDEX OF ACRONYMS

We are providing this index of acronyms used in this Information Statement for the convenience of the reader. All of the acronyms listed below are defined at their first use in this document.

ABO	Accumulated benefit obligation
AICPA	American Institute of Certified Public Accountants
AOCI	Accumulated other comprehensive income (loss), net of taxes
APB	Accounting Principles Board
ARM	Adjustable-Rate Mortgage
CMT	Constant Maturity Treasury
CON	Statements of Financial Accounting Concepts
DOL	Department of Labor
EITF	Emerging Issues Task Force
ERISA	Employee Retirement Income Security Act
ESPP	Employee Stock Purchase Plan
Fannie Mae	Federal National Mortgage Association
FASB	Financial Accounting Standards Board
FHA	Federal Housing Administration
FICO	Credit scores initially developed by Fair, Issac and Co., Inc.
FIN	Financial Accounting Standards Board Interpretation
Freddie SUBS	Subordinated debt securities issued by Freddie Mac
FSP	Financial Accounting Standards Board Staff Position
GA	Guarantee Asset
GAAP	Generally Accepted Accounting Principles
Ginnie Mae	Government National Mortgage Association
GO	Guarantee Obligation
GSE	Government-Sponsored Enterprise
GSE ACT	The Federal Housing Enterprises Financial Safety and Soundness Act of 1992
HUD	Department of Housing and Urban Development
IRC	Internal Revenue Code
IRR	Internal Rates of Return
IRS	Internal Revenue Service
LIBOR	London Interbank Offered Rate
LIHTC	Low-Income Housing Tax Credit
LTV	Loan-to-Value
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
NPV	Net Present Value
NYSE	New York Stock Exchange
OFHEO	Office of Federal Housing Enterprise Oversight
OTC	Over-the-Counter
PBO	Projected benefit obligation
PC	Mortgage Participation Certificate
PMI	Primary Mortgage Insurance
PMVS	Portfolio Market Value Sensitivity
PMVS-L	Portfolio Market Value Sensitivity Level
PMVS-YC	Portfolio Market Value Sensitivity Yield Curve
PwC	PricewaterhouseCoopers LLP
REIT	Real Estate Investment Trust
REMIC	Real Estate Mortgage Investment Conduit
REO	Real Estate Owned
RHS	Rural Housing Service
RSU	Restricted Stock Units
QFA	Quarterly Funding Announcement

QSPE	Qualifying Special Purpose Entities
S&P	Standard & Poor's
SAR	Stock Appreciation Rights
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SOP	The AICPA's Statement of Position
TBA	To Be Announced
TDR	Troubled Debt Restructuring
U.S.	United States
VA	Department of Veterans Affairs
VIE	Variable Interest Entity

DESIGN HC Creative Communications LLC | www.hccreative.com

CORPORATE HEADQUARTERS
8200 Jones Branch Drive | McLean, VA 22102-3110
703-903-2000 | 800-424-5401 | www.FreddieMac.com