



2006 Annual Report



Freddie Mac Facts

- Since 1970, Freddie Mac has made home possible more than 50 million times.
- More than half of all Freddie Mac mortgage purchases support housing for low- to moderate-income families. More than 90% of all the apartment units financed by Freddie Mac are for low- to moderate-income families.
- **Corporate Responsibility Officer Magazine** has named Freddie Mac to its list of “100 Best Corporate Citizens” for 2007, putting our company near the top of America’s corporations based on environmental responsibility, corporate governance and ethics, fairness toward employees, accountability to local community, providing responsible products and service to customers and maintaining a healthy rate of return for investors.
- Since December 2003, we have increased the dividend on our common stock by 92%.
- Freddie Mac Foundation celebrated its 15th anniversary last year.
- Freddie Mac’s annual *Hoops for the Homeless* event raised more than \$900,000 for homeless families in 2006.
- Freddie Mac 2006 workplace awards:
 - Fortune Magazine**
“Best Companies for Minorities”
 - Latina Style Magazine**
“Best Places for Women—Honorary”
 - Hispanic Business Inc.**
“Top Companies for Diversity”
 - Business Ethics Magazine**
“100 Best Corporate Citizens”
 - Washington Business Journal**
“Top Local Corporate Philanthropists”

Company Overview

Congress chartered Freddie Mac in 1970 with the mission of bringing liquidity, stability and affordability to the nation's mortgage markets and expanding homeownership and affordable rental housing opportunities. Since then, Freddie Mac has made home possible more than 50 million times.

As one of the largest purchasers of mortgage loans in the United States, Freddie Mac provides a vital link between mortgage lenders and investors. We don't make mortgage loans directly to homebuyers. Rather, we benefit consumers by providing lenders across the country with a steady flow of low-cost mortgage funding in good times and bad. Because Freddie Mac also provides assistance for affordable rental housing, we've helped make home possible for more than 4 million renters.

Our mission of expanding affordable housing opportunities is the foundation of our business. It forms the framework for our business activities, shapes the products we bring to market and drives the services we provide to the nation's housing and mortgage industry. Everything we do comes back to making America's mortgage markets liquid and stable and increasing opportunities for homeownership and affordable rental housing across America. ■



A Message from the Chairman

2006 was a challenging year in the U.S. housing and mortgage markets, and Freddie Mac shared in those challenges. But even though housing weakened last year, Freddie Mac gained some strength.

Housing starts tumbled by 13 percent in 2006. Home purchases fell 10 percent. Mortgage originations dropped and home prices began to decline in a number of local markets. And the possibility of further weakness in the sector remains a leading concern for economic growth in 2007 — particularly if accompanied by widespread loan defaults or a severe tightening of credit standards.

At this writing, defaults and late payments have remained relatively low on prime mortgages, which are made to lower-risk borrowers and account for the lion's share of home loans. But late payments have risen swiftly over the past year on subprime mortgages, those made to borrowers having spottier credit histories and posing higher risks.

Yet despite last year's many challenges—which included reduced housing affordability, rising mission demands, tight spreads, intense competition and voluntary limits on our retained portfolio—Freddie Mac made continued progress. We increased our earnings, served our vital public mission and strengthened our franchise.

We did not meet all our 2006 objectives, particularly as to financial reporting and internal controls. This was very disappointing to me and to your entire management team. But we have implemented a sound, comprehensive plan to make the needed improvements and are moving ahead briskly. The timing of this annual report is itself one small sign of progress. Our plan should allow us to resume quarterly reporting in the second half of 2007.

Key Accomplishments

Building Shareholder Value

I'll begin by summarizing Freddie Mac's improved business and financial performance. Our net income grew last year to approximately \$2.2 billion, up roughly 4 percent from 2005. Return on common equity was 8.6 percent, up from 7.7 percent for 2005. Fair value, another very important measure of our performance, grew before capital transactions by approximately \$2.5 billion last year, compared to a \$1.0 billion increase in 2005. Fair value return on equity was approximately 9.5 percent, rebounding from 3.7 percent the previous year.

This improved performance was based on several factors. For starters, we achieved strong growth of 10.6 percent in our credit guarantee portfolio—slightly outpacing the overall market. By earning high marks for customer satisfaction and purchasing a broader range of loans, we were able to buy not only a larger volume but also a more representative mix of mortgages in 2006. This performance reflected the company's enhanced responsiveness and the efforts of our sales force. We ended the year with a total of \$1.5 trillion in mortgage securities issued—up from less than \$1 trillion in 2001.

Another key to Freddie Mac's success in 2006 was our disciplined management of interest-rate risk. One of the many reasons was our extensive use of callable debt—which we use more than most mortgage investors and believe gives us a real comparative advantage in managing risk. As a result, we came through a challenging year well positioned to deal with a broad range of interest-rate conditions, and with the value of our shareholders' equity well protected from interest rate swings.

On the credit risk side, Freddie Mac's exposures remained well controlled and our total single-family 90-day delinquencies actually declined during the year. At year's end, only 6 percent of our total mortgage portfolio was in nontraditional mortgages and the portfolio's average loan-to-value ratio was 57 percent. Experience and recent market developments tell us to be careful, however, and we are keeping a watchful eye on our 2006 book of business. While we are in better position than many, we have set aside increased loan loss reserves, as our credit portfolio remains vulnerable to significant declines in house prices.

Low funding costs were another building block of our success in 2006, with improvements across the yield curve. As an example, our funding cost advantage relative to LIBOR for our 10-year Reference Notes[®] securities increased in 2005 and 2006 by almost 20 basis points. We've said before that when spreads are tight, we may lose some return on the asset side, but we can often make up ground on the debt side. That is exactly what we did last year, by capitalizing on our improved funding costs.

Capital management remains a priority for us. Freddie Mac increased our common dividend again in 2006 to \$2.00 per share annually, bringing the total increase in our dividend to 92 percent since the end of 2003. Moreover, we returned \$2 billion to our common shareholders in a preferred-for-common restructuring. All told, we returned some \$3.3 billion to common shareholders last year—the most in Freddie Mac history.

Going forward, Freddie Mac remains strongly capitalized. With a strong balance sheet, our estimated regulatory core capital grew in 2006 to over \$36 billion. As we complete our financial reporting and internal controls remediation, I hope we will be in a better position to return some of the capital in excess of our statutory minimum that we have accumulated over the past several years. And I'm pleased to report that, consistent with discussions with our regulator, our board has approved an additional \$1 billion in common repurchases and preferred offerings this year.

Serving Our Mission

As a government-sponsored enterprise (GSE), Freddie Mac faced mounting mission challenges in 2006: reduced affordability, rising concerns about credit quality and predatory lending, a housing sector losing momentum, and HUD affordable housing goals of unprecedented difficulty. Despite these challenges, we served our mission well—providing liquidity, affordability and stability to the housing finance market, and to a broader economy hoping to see a “soft landing” for housing.

I am proud that Freddie Mac's affordable performance in 2006 was among our strongest ever. We believe we met the most demanding affordable housing goals in the company's history, pending determination by the U.S. Department of Housing and Urban Development. Of the nearly 3.3 million homes we financed last year, almost 56 percent were affordable to low- or moderate-income families. We served 300,000 first-time homebuyers. And in another record year for our growing multifamily business, we financed almost half a million affordable apartment homes.

We also believe we achieved two of our three subgoals, although we reported to HUD that we just missed one of the extremely challenging subgoals by less than 700 loans out of more than 900,000 eligible mortgage purchases. The difficulty of this challenge was magnified by market forces affecting the entire housing sector that made the average home less affordable in 2006. It also highlighted the GSEs' need to strike a balance between striving to achieve demanding housing goals and ensuring that we do not encourage imprudent lending.

When Hurricane Katrina riveted the nation's attention in 2005, Freddie Mac was there to help. In 2006, long after most television cameras were gone, Freddie Mac stayed actively involved in rebuilding the Gulf Coast region. After the hurricanes struck, we pledged to

buy \$1 billion in mortgage revenue bonds (MRBs) from state and local housing finance agencies in the Gulf. We fully met that commitment in 2006, less than 12 months later. The MRBs we have purchased will provide low-cost financing for more than 10,000 families. In addition, Freddie Mac provided well over \$700 million in mortgage funding last year for multifamily properties along the Gulf Coast.

Freddie Mac acted last year to ease the increasing strains on housing affordability. We supported our lenders by introducing an innovative 40-year product that combines the advantages of a fixed-rate loan with lower monthly costs. And we expanded our special workforce housing initiative to include military families, as well as police, firefighters, teachers and nurses. Those who defend us from harm, teach our children and care for our sick should be able to live in the communities they serve.

This February, in order to protect consumers and raise underwriting standards, Freddie Mac took the lead in announcing that after September 1, we will not buy subprime mortgages that pose an unacceptable risk of excessive payment shock and possible foreclosure. As a GSE, we feel a responsibility not only to help families *buy* their own homes, but to help them *keep* their homes, as well.

Freddie Mac also exerted responsible leadership in 2006 by addressing concerns about credit quality and practices in the housing finance market. For instance, we developed and instituted workout policies that can significantly reduce the odds of home loss through foreclosure. We also continued educating consumers on how to avoid predatory practices, and maintained our pioneering policies that led the industry in recent years to reject abusive loans that limit consumers' rights.

Strengthening Our Team

We strengthened Freddie Mac last year by building out the company's executive team in several areas vital to our success. Of great interest to our investors is the addition of Buddy Pizsel as Chief Financial Officer. Buddy brings experience and zeal to the task of making Freddie Mac's financials more transparent, accessible and useful to investors. Other key additions included our new head of Enterprise Operational Risk, Gareth Davies; General Auditor, Kirk Die; Corporate Controller, Jim Egan; Chief Information Officer, Jim Hughes; Senior Vice President for Market Risk Oversight, Manoj Singh; and Vice President for Internal Controls, Jim Larkin, among others.

Of course, the strength of our team goes far beyond its executives. Freddie Mac's greatest asset is its skilled and dedicated employees, and their efforts are critical to our success. So we were gratified by our enhanced employee engagement in 2006, and we thank all our employees for their hard work.

Challenges to be Addressed

While Freddie Mac reached many of our goals last year, some major challenges remained unmet. Foremost among them was the essential task of getting current in our financials and strengthening our internal controls. There's no question this has taken longer than any of us expected.

Fortunately, we have developed and are carrying out a comprehensive plan that embodies our detailed blueprint for completing this job. We have first-rate teams and project leaders implementing this plan and they are making good progress. Our goal is to return to quarterly financial reporting this year. And we are working assiduously to improve our internal controls systems and infrastructure. As I said in last year's letter to stockholders, Freddie Mac must become the standard of excellence not only for managing mortgage risk, but for the accounting and internal controls associated with it.

The highly competitive, tight-spread environment we faced last year is another ongoing challenge for us in 2007. Our improved funding costs are part of the answer, as I mentioned. More broadly, we must continue to take other steps going forward—as with our expanded use of structured securities, for example—to generate acceptable returns in spite of tight margins.

Freddie Mac worked hard to hold its own in market share last year. While last year's 43 percent share was marginally below our 2005 figure, we consciously turned away some business that would not have served our mission or return objectives, rather than pursue additional share for share's sake. Looking ahead, we are focused on pricing issues as well as strong customer relationships.

Senior management is also keenly focused on Freddie Mac's expenses. Although these rose modestly last year—mostly in professional services related to our financial remediation—their rate of growth still was exceeded by the rate of growth in our business. This was in keeping with our long-term goal of managing administrative expenses to be a decreasing percentage of our mortgage portfolio, subject to the near-term imperative that we complete our needed investments in financial reporting and internal controls.

Building a stronger future for this company includes building support for the GSE model. Freddie Mac continues to strongly support an appropriate legislative solution that would strengthen our oversight and enable us to fulfill our vital housing mission. And we are playing a constructive role toward that end. Throughout 2006, we worked closely with our regulators at OFHEO and HUD, with the Administration and with Congress, to achieve balanced legislative and regulatory solutions that address the concerns of the past but are consistent with the growing demands of the future. This will remain a focus for me, and for this company, until the job is done.

Our guiding principle in this is that we support an independent regulatory structure modeled on that for banks. Once legislation is enacted, it is likely to remain in place for a very long time. Accordingly, we feel we have a responsibility to housing, our shareholders and the country at large to make our views known.

That's why I have explained publicly how the GSEs will become even more important in the years to come. And that, in turn, is why I have asked decision-makers not to unduly hamper the GSEs, just as the nation is about to need us most.

Conclusion

Looking at 2006 as a whole—from our growing guarantee volumes and earnings, to our vital housing mission, to our internal and external progress—one overarching fact emerges. While we did not accomplish everything we wanted to, Freddie Mac ended the year in a stronger position than we began it.

Our challenge is to put enough years like that back to back and become a high performer. All my experience makes me confident that this is what is happening at Freddie Mac—and our trajectory is clear.

However, it is *your* confidence in this company that truly matters. For it is what allows us to make home possible for America's families; to exert responsible leadership; and to lower costs for homeowners and renters alike. The congressional genius in designing the GSEs was to accomplish a public mission not with federal expenditures, but using private capital.

So thank you for your confidence in this franchise. It is what makes the GSE model work. And our aim every day is to earn it. ■

Sincerely,

A handwritten signature in black ink that reads "Dick Syron". The signature is written in a cursive, flowing style.

Richard F. Syron
Chairman and Chief Executive Officer

2006 Annual Report to Stockholders