

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
EXECUTIVE SUMMARY**

Our Business

We generate income through our portfolio investment activities and credit guarantee activities, operating as three reportable segments: Investments, Single-family Guarantee and Multifamily. To achieve our objectives for long-term growth, we focus on three long-term business drivers — the profitability of new business, growth and market share. Competition, other market factors, our housing mission under our charter and the HUD affordable housing goals and subgoals require that we make trade-offs in our business that affect each of these drivers.

Market Overview

The U.S. residential mortgage market weakened considerably during 2007, adversely affecting our financial condition and results of operations. We expect that weakened conditions in the residential mortgage market will continue in 2008.

Home prices declined in 2007. The volume of new and existing home sales continued to decline and increased inventories of unsold homes have undermined property values. Forecasts of nationwide home prices indicate a continued overall decline through 2008. Changes in home prices are an important market indicator for us. When home prices decline, the risk of borrower defaults and the severity of credit losses generally increase.

Credit concerns and resulting liquidity issues affected the financial markets. Recently, the market for mortgage-related securities has been characterized by high levels of volatility and uncertainty, reduced demand and liquidity, significantly wider credit spreads and a lack of price transparency. Mortgage-related securities, particularly those backed by non-traditional mortgage products, have been subject to various rating agency downgrades and price declines. Many lenders tightened credit standards in the second half of 2007 or stopped originating certain types of mortgages for riskier products in the market, such as some types of ARMs, resulting in higher mortgage rates. This response has adversely affected many borrowers seeking to refinance out of ARMs scheduled to reset to higher rates, contributing to higher observed delinquencies.

The credit performance of all mortgage products deteriorated during 2007; however, the performance of subprime, Alt-A loans and other non-traditional mortgage products deteriorated more severely. See “CREDIT RISKS — Mortgage Credit Risk” for additional information regarding mortgage-related securities backed by subprime and Alt-A loans.

Consolidated Results — GAAP

Effective December 31, 2007, we retrospectively changed our method of accounting for our guarantee obligation: a) to a policy of no longer extinguishing our guarantee obligation when we purchase all or a portion of a Freddie Mac-guaranteed security from a policy of effective extinguishment through the recognition of a Participation Certificate residual and b) to a policy that amortizes our guarantee obligation into earnings in a manner that corresponds more closely to our economic release from risk under our guarantee than our former policy, which amortized our guarantee obligation according to the contractual expiration of our guarantee as observed by the decline in the unpaid principal balance of securitized mortgage loans. While our previous accounting is acceptable, we believe the newly adopted method of accounting for our guarantee obligation is preferable because it:

- significantly enhances the transparency and understandability of our financial results;
- promotes uniformity in the accounting model for the credit risk retained in our primary credit guarantee business;
- better aligns revenue recognition to the release from economic risk of loss under our guarantee; and
- increases comparability with other similar financial institutions.

The results of operations for all periods presented in this discussion reflect the retrospective application of our new method of accounting for our guarantee obligation. The net cumulative effect of these changes in accounting principles through December 31, 2007 was an increase to our retained earnings of \$1.3 billion. See “NOTE 20: CHANGES IN ACCOUNTING PRINCIPLES” to our consolidated financial statements for additional information.

In 2007, we reported net losses of \$(3.1) billion, or \$(5.37) per diluted share, compared to net income of \$2.3 billion, or \$3.00 per diluted share, in 2006. Net losses in 2007 were primarily due to higher credit-related expenses and mark-to-market losses on our portfolio of derivatives and guarantee assets. Without giving effect to the changes in accounting method, net losses would have been \$(3.7) billion for the fourth quarter of 2007 and \$(5.2) billion for the year ended December 31, 2007.

Net interest income decreased to \$3.1 billion in 2007 from \$3.4 billion in 2006. The decline in net interest income reflected higher replacement costs associated with the funding of our retained portfolio. Our long-term debt interest costs increased because our lower-rate debt matured and was replaced with higher-rate debt.

In 2007, management and guarantee income increased to \$2.6 billion from \$2.4 billion in 2006, resulting from a 13% increase in the average balance of our PCs and Structured Securities issued. Despite increases in contractual guarantee fees, our total management and guarantee fee rate decreased to 16.6 basis points in 2007 from 17.1 basis points in 2006, primarily attributable to declines in amortization income resulting from slower prepayment projections in 2007.

Other components of non-interest income (loss) totaled \$(2.4) billion in 2007, compared to \$(0.3) billion in 2006. These amounts include \$(4.3) billion of valuation losses in 2007 compared to \$(1.3) billion in 2006. The change in valuation losses was primarily attributable to the impact of decreasing long-term interest rates on our derivatives portfolio. Our valuation losses in 2007 were partially offset by \$0.5 billion of recoveries on loans impaired upon purchase.

Credit-related expenses, which consist of the total of provision for credit losses and real estate owned, or REO, operations expense, were \$3.1 billion and \$0.4 billion in 2007 and 2006, respectively. In 2007, our provision for credit losses increased due to significant credit deterioration in our single-family credit guarantee portfolio.

Other non-interest expense included losses on certain credit guarantees and losses on loans purchased, which totaled \$3.9 billion in 2007, compared to \$0.6 billion in 2006. Increases in losses on certain credit guarantees reflect expectations of higher defaults and severity in the credit market in 2007 which were not fully offset by increases in guarantee and delivery fees due to competitive pressures and contractual fee arrangements. Increases in losses on loans purchased reflect reduced fair values and higher volume of delinquent loans purchased under our guarantees. See ‘CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Expenses — Losses on Certain Credit Guarantees’ for additional information.

We reported income tax expense (benefit) of \$(2.9) billion and \$(45) million in 2007 and 2006 resulting in effective tax rates of 48% and (2)%, respectively. See “NOTE 13: INCOME TAXES” to our consolidated financial statements for additional information.

Segment Results-Adjusted Operating Income

Our operations consist of three reportable segments, which are based on the type of business activities each performs — Investments, Single-family Guarantee and Multifamily. The activities of our business segments are described in “BUSINESS — Business Activities.” Certain activities that are not part of a segment are included in the “All Other” category; this category consists of certain unallocated corporate items, such as remediation and restructuring costs, costs related to the resolution of certain legal matters and certain income tax items. We manage and evaluate performance of the segments and All Other using an Adjusted operating income approach. Adjusted operating income differs significantly from, and should not be used as a substitute for net income (loss) before cumulative effect of change in accounting principle or net income (loss) as determined in accordance with GAAP. There are important limitations to using Adjusted operating income as a measure of our financial performance. Among other things, our regulatory capital requirements are based on our GAAP results. Adjusted operating income adjusts for the effects of certain gains and losses and mark-to-market items which, depending on market circumstances, can significantly affect, positively or negatively, our GAAP results and which, in recent periods, have caused us to record GAAP net losses. GAAP net losses will adversely impact our regulatory capital, regardless of results reflected in Adjusted operating income. See “CONSOLIDATED RESULTS OF OPERATIONS — Segment Measures — Adjusted Operating Income” for a description of “Adjusted operating income” and a discussion of its use as a measure of segment operating performance.

The objective of Adjusted operating income is to present our results on an accrual basis as the cash flows from our segments are earned over time. We are primarily a buy and hold investor in mortgage assets, and given our business objectives, we believe it is meaningful to measure performance of our investment business using long-term returns, not on a short-term fair value basis. The business model for our investment activity is one where we generally hold our investments for the long term, fund the investments with debt and derivatives to minimize interest rate risk, and generate net interest income in line with our return on equity objectives. The business model for our credit guarantee activity is one where we are a long-term guarantor of the conforming mortgage markets, manage credit risk, and generate guarantee and credit fees, net of incurred credit losses. As a result of these business models, we believe that an accrual-based metric is a meaningful way to present the emergence of our results as actual cash flows are realized, net of credit losses and impairments. In summary, Adjusted operating income provides us with a view of our financial results that is more consistent with our business objectives, which helps us better evaluate the performance of our business, both from period to period and over the longer term.

Table 6 presents Adjusted operating income by segment and the All Other category and includes a reconciliation of Adjusted operating income to net income (loss) prepared in accordance with GAAP.

Table 6 — Reconciliation of Adjusted Operating Income to GAAP Net Income (Loss)

	Year Ended December 31,		
	2007	2006	2005
	(in millions)		
Adjusted operating income (loss) after taxes:			
Investments	\$ 2,028	\$ 2,111	\$ 2,284
Single-family Guarantee	(256)	1,289	965
Multifamily	398	434	363
All Other	(103)	19	(437)
Total Adjusted operating income, net of taxes	<u>2,067</u>	<u>3,853</u>	<u>3,175</u>
Reconciliation to GAAP net income (loss):			
Derivative- and foreign currency translation-related adjustments	(5,667)	(2,371)	(1,644)
Credit guarantee-related adjustments	(3,268)	(201)	(458)
Investment sales, debt retirements and fair value-related adjustments	987	231	570
Fully taxable-equivalent adjustments	(388)	(388)	(336)
Total pre-tax adjustments	<u>(8,336)</u>	<u>(2,729)</u>	<u>(1,868)</u>
Tax-related adjustments	<u>3,175</u>	<u>1,203</u>	<u>865</u>
Total reconciling items, net of taxes	<u>(5,161)</u>	<u>(1,526)</u>	<u>(1,003)</u>
Net income (loss) ⁽¹⁾	<u>\$ (3,094)</u>	<u>\$ 2,327</u>	<u>\$ 2,172</u>

(1) Total per consolidated statement of income reflects the impact of the adjustments described in “NOTE 20: CHANGES IN ACCOUNTING PRINCIPLES” to our consolidated financial statements. Additionally, Net income (loss) is presented before the cumulative effect of a change in accounting principle related to 2005.

Investments

Through our Investments segment, we seek to generate attractive returns on our mortgage-related investment portfolio while maintaining a disciplined approach to interest-rate risk and capital management. We seek to accomplish this objective through opportunistic purchases, sales and restructuring of mortgage assets. Although we are primarily a buy and hold investor in mortgage assets, we may sell assets to reduce risk, respond to capital constraints, provide liquidity or structure certain transactions that improve our returns. We estimate our expected investment returns using an OAS approach.

Adjusted operating income for our Investments segment declined in 2007 compared to 2006. We experienced higher funding costs in 2007 for our mortgage-related investment portfolio as our long-term debt interest expense increased, reflecting the replacement of maturing debt.

Performance Highlights of 2007 versus 2006:

- Unpaid principal balance of our mortgage-related investment portfolio increased 1% to \$663 billion at December 31, 2007.
- Adjusted operating net interest yield was flat in 2007, as compared to 2006, due to increased funding costs offset by a decline in amortization expense of our mortgage-related portfolio.
- Capital constraints limited our ability to significantly increase our mortgage-related investment portfolio in order to take advantage of wider mortgage-to-debt OAS.

Single-family Guarantee

Through our Single-family Guarantee segment, we seek to issue guarantees that we believe offer attractive long-term returns relative to anticipated credit costs while fulfilling our mission to provide liquidity, stability and affordability in the residential mortgage market. In addition, we seek to improve our share of the total residential mortgage securitization market by enhancing customer service and expanding our customer base, the types of mortgages we guarantee and the products we offer.

Adjusted operating income for our Single-family Guarantee segment declined in 2007 compared to 2006. In 2007, we experienced an increase in credit costs largely driven by higher volumes of both non-performing loans and foreclosures, higher severity of losses on a per-property basis, a national decline in home prices and declines in regional economic conditions.

Performance Highlights of 2007 versus 2006:

- Credit guarantee portfolio increased by 17.7% for the year ended December 31, 2007, compared to 11.1% for the year ended December 31, 2006.
- Average rates of Adjusted operating management and guarantee fee income for the Single-family Guarantee segment remained unchanged at 18.0 basis points.
- Adjusted operating provision for credit losses for the Single-family Guarantee segment increased to \$3.0 billion for the year ended December 31, 2007 from \$0.3 billion for the year ended December 31, 2006.

- Realized single-family credit losses in 2007 were 3.0 basis points of the average total mortgage portfolio, excluding non-Freddie Mac securities, compared to 1.4 basis points in 2006.
- Announced significant delivery fee increases effective March 2008. Also, in February 2008, we announced an additional increase in delivery fees, effective June 2008, for certain flow transactions.

Multifamily

Through our Multifamily segment, we seek to generate attractive returns on our investments in multifamily mortgage loans while fulfilling our mission to supply affordable rental housing. We also seek to issue guarantees that we believe offer attractive long-term returns relative to anticipated credit costs.

Adjusted operating income for our Multifamily segment decreased in 2007 compared to 2006 as a result of a decrease in net interest income. The decrease in net interest income is primarily attributable to increased debt expense related to higher debt funding costs as well as lower interest yields on the portfolio. Despite market volatility and credit concerns in the single-family market, the multifamily market fundamentals generally continued to display positive trends. Tightened credit standards and reduced liquidity caused many market participants to limit purchases of multifamily mortgages during the second half of 2007, creating investment opportunities for us with higher long-term expected returns and enhancing our ability to meet our affordable housing goals. Despite the investment limitations created by our current capital position, our purchases of multifamily retained mortgages were at record levels in 2007.

Performance Highlights of 2007 versus 2006:

- Mortgage purchases into our multifamily loan portfolio increased approximately 50% in 2007, to \$18.2 billion from \$12.1 billion in 2006.
- Unpaid principal balance of our mortgage loan portfolio increased to \$57.6 billion at December 31, 2007 from \$45.2 billion at December 31, 2006.
- Our provision for credit losses for the Multifamily segment remained low at \$38 million for the year ended December 31, 2007.

Capital Management

Our primary objective in managing capital is preserving our safety and soundness. We also seek to have sufficient capital to support our business and mission. We make investment decisions based on our capital levels. OFHEO monitors our capital adequacy using several capital standards and since 2004 has directed a 30% mandatory target capital surplus above our regulatory minimum capital requirement.

Weakness in the housing market and volatility in the financial markets continue to adversely affect our capital, including our ability to manage to the 30% mandatory target capital surplus. As a result of the impact of GAAP net losses on our regulatory core capital, our estimated capital surplus was below the 30% mandatory target capital surplus at the end of November 2007. In order to manage to the 30% mandatory target capital surplus and improve business flexibility, on December 4, 2007, we issued \$6 billion of non-cumulative, perpetual preferred stock. In addition, during the fourth quarter of 2007, we reduced our common stock dividend by 50% and reduced the size of our cash and investments portfolio. In the future, to help us manage to the 30% mandatory target capital surplus, we may consider additional measures, such as limiting the growth or reducing the size of our retained portfolio, slowing issuances of our credit guarantees, issuing preferred or convertible preferred stock, issuing common stock or further reducing our common stock dividend.

Factors that could adversely affect the adequacy of our capital in future periods include GAAP net losses; continued declines in home prices; changes in our credit and interest-rate risk profiles; adverse changes in interest rates or implied volatility; adverse OAS changes; legislative or regulatory actions that increase capital requirements; or changes in accounting practices or standards.

Other items positively affecting our capital position include: (a) certain operational changes in December 2007 for purchasing delinquent loans from PCs, (b) changes in accounting principles we adopted, which increased core capital by \$1.3 billion at December 31, 2007 and (c) our adoption of SFAS No. 159, “*The Fair Value Option of Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115,*” or SFAS 159, on January 1, 2008, which increased core capital by an estimated \$1.0 billion.

We will submit amended quarterly minimum and critical capital reports to OFHEO that are adjusted to reflect the impacts of the retrospective application of our changes in method of accounting for our guarantee obligation. OFHEO is the authoritative source for our regulatory capital calculations. However, we believe that we remain adequately capitalized for all historical quarters, on an adjusted basis. At December 31, 2007 our estimated regulatory core capital was \$37.9 billion after the effects of the adjustments, which was an estimated \$11.4 billion in excess of our minimum capital requirement and

\$3.5 billion in excess of the 30% mandatory target capital surplus. See “NOTE 9: REGULATORY CAPITAL” to our consolidated financial statements for additional information about our regulatory capital.

Fair Value Results

We use estimates of fair value on a routine basis to make decisions about our business activities. Our attribution of the changes in fair value relies on models, assumptions and other measurement techniques that will evolve over time. Our consolidated fair value measurements are a component of our risk management processes. For information about how we estimate the fair value of financial instruments, see “NOTE 16: FAIR VALUE DISCLOSURES” to our consolidated financial statements.

In 2007, the fair value of net assets attributable to common stockholders, before capital transactions, decreased by \$23.6 billion, compared to a \$2.5 billion increase in 2006. The payment of common dividends and the repurchase of common shares, net of reissuance of treasury stock, reduced total fair value by an additional \$2.1 billion. The fair value of net assets attributable to common stockholders as of December 31, 2007 was \$0.3 billion, compared to \$26.0 billion as of December 31, 2006.

The following attribution of changes in fair value reflects our current estimate of the items presented (on a pre-tax basis) and excludes the effect of returns on capital and administrative expenses.

Our investment activities decreased fair value by approximately \$18.1 billion in 2007. This estimate includes declines in fair value of approximately \$23.8 billion attributable to net mortgage-to-debt OAS widening. Of this amount, approximately \$13.4 billion was related to the impact of the net mortgage-to-debt OAS widening on our portfolio of non-agency mortgage-related securities.

Our investment activities increased fair value by an estimated \$1.3 billion in 2006. This increase in fair value was primarily attributable to the core spread earned on our retained portfolio.

The impact of mortgage-to-debt OAS widening during 2007 increases the likelihood that, in future periods, we will be able to recognize core spread income from our investment activities at a higher spread level. We estimate that we recognized core spread income at a net mortgage-to-debt OAS level of approximately 100 to 105 basis points at December 31, 2007, as compared to approximately 25 to 30 basis points estimated at December 31, 2006. See “CONSOLIDATED FAIR VALUE BALANCE SHEETS ANALYSIS — Discussion of Fair Value Results — *Estimated Impact of Changes in Mortgage-To-Debt OAS on Fair Value Results*” for additional information.

Our credit guarantee activities, including multifamily and single-family whole loan credit exposure, decreased fair value by an estimated \$18.5 billion in 2007. This estimate includes an increase in the single-family guarantee obligation of approximately \$22.2 billion, primarily attributable to higher expected future credit costs and increased uncertainty in the market. This increase in the single-family guarantee obligation was partially offset by a fair value increase in the single-family guarantee asset of approximately \$2.1 billion and cash receipts related to management and guarantee fees and other up-front fees.

During 2006, our credit guarantee activities increased fair value by an estimated \$1.9 billion. This estimate includes a fair value increase related to the single-family guarantee asset of approximately \$0.9 billion and cash receipts related to management and guarantee fees and other up-front fees. These increases were partially offset by an increase in the single-family guarantee obligation of approximately \$1.3 billion.

Business Outlook

We expect that our realized credit losses will continue to increase, which will adversely affect the profitability of our Single-family Guarantee segment. We expect the increase will be largely driven by the credit characteristics of loans originated in 2006 and 2007, which are generally of lower credit quality than loans underlying our issuances in prior years. In addition, the average management and guarantee fees on our 2007 issuances did not keep pace with the increase in expected default costs on the underlying loans. We expect to continue to pursue increases to our guarantee fees and delivery fees on bulk and flow transactions to better reflect our expectations of future default costs.

We expect to continue to experience attractive purchase opportunities for our retained portfolio, due to wider mortgage spreads and continued attractive debt funding levels. As a result of the temporary increase in the conventional conforming loan limits, we expect to purchase mortgages with significantly higher unpaid principal balances. Our ability to purchase these mortgages is subject to certain operational constraints and any conditions that may be imposed by our regulators as well as our ability to manage the additional credit risks associated with such mortgages. In addition, our ability to take full advantage of these and other market opportunities may also be limited by our ability to manage to the 30% mandatory target capital surplus and our voluntary, temporary growth limit.

The turmoil in the credit and mortgage markets is also presenting opportunities to profitably grow our single-family and multifamily portfolios. We expect our share of the mortgage securitization market to grow as mortgage originators have

generally tightened their credit standards during 2007, causing conforming mortgages to be the predominant product in the market.

We expect to begin the process of registering our common stock with the SEC in 2008. As a part of this initiative, we expect to complete the remediation of the material weaknesses in our financial reporting processes. Although we have made substantial progress in the remediation of our control deficiencies, the process of registering with the SEC and meeting our ongoing reporting obligations once our common stock is registered poses significant operational challenges for us.

Over the next two years, we believe we should be able to reduce administrative expenses. We expect to begin this process in 2008, as we complete our financial remediation efforts and benefit from our investments in new technology.

We expect that it will be challenging for us to achieve HUD's affordable housing goals and subgoals for 2008, due to the significant changes in the residential mortgage market that occurred in 2007 and that are likely to continue well into 2008. These changes include a decrease in single-family home sales that began in 2005 and deteriorating conditions in the mortgage credit markets, which have resulted in more rigorous underwriting standards, and greatly reduced originations of subprime and Alt-A mortgages.

CONSOLIDATED RESULTS OF OPERATIONS

The following discussion of our consolidated results of operations should be read in conjunction with our consolidated financial statements, including the accompanying notes. Also see “CRITICAL ACCOUNTING POLICIES AND ESTIMATES” for more information concerning the most significant accounting policies and estimates applied in determining our reported financial position and results of operations.

Effective December 31, 2007, we retrospectively changed our method of accounting for our guarantee obligation: a) to a policy of no longer extinguishing our guarantee obligation when we purchase all or a portion of a Freddie Mac-guaranteed security from a policy of effective extinguishment through the recognition of a Participation Certificate residual and b) to a policy that amortizes our guarantee obligation into earnings in a manner that corresponds more closely to our economic release from risk under our guarantee than our former policy, which amortized our guarantee obligation according to the contractual expiration of our guarantee as observed by the decline in the unpaid principal balance of securitized mortgage loans. While our previous accounting is acceptable, we believe the newly adopted method of accounting for our guarantee obligation is preferable because it:

- significantly enhances the transparency and understandability of our financial results;
- promotes uniformity in the accounting model for the credit risk retained in our primary credit guarantee business;
- better aligns revenue recognition to the release from economic risk of loss under our guarantee; and
- increases comparability with other similar financial institutions.

All of the results of operations discussed below for years ended December 31, 2006 and 2005 are shown as “Adjusted” in the tables to reflect the retrospective application of our new method of accounting for our guarantee obligation. Results for the quarters of 2007 and the twelve months ended 2007 reflect these changes for the full periods presented.

On October 1, 2007, we adopted FASB Interpretation No. 39-1, “*Amendment to FASB Interpretation No. 39*,” or FSP FIN 39-1. See “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Recently Adopted Accounting Standards — *Offsetting of Amounts Related to Certain Contracts*” to our consolidated financial statements for additional information about our adoption of FSP FIN 39-1. The adoption of FSP FIN 39-1 had no effect on our consolidated statements of income.

The net cumulative effect of these changes in accounting principles through December 31, 2007 was an increase to our net income of \$1.3 billion, which includes a net cumulative increase of \$2.2 billion for 2005, 2006 and 2007 and a net cumulative decrease of \$0.9 billion related to periods prior to 2005. See “NOTE 20: CHANGES IN ACCOUNTING PRINCIPLES” to our consolidated financial statements for additional information.

Table 7 — Summary Consolidated Statements of Income — GAAP Results

	Year Ended December 31,		
	2007	Adjusted	
		2006	2005
		(in millions)	
Net interest income	\$ 3,099	\$ 3,412	\$ 4,627
Non-interest income:			
Management and guarantee income	2,635	2,393	2,076
Gains (losses) on guarantee asset	(1,484)	(978)	(1,409)
Income on guarantee obligation	1,905	1,519	1,428
Derivative gains (losses)	(1,904)	(1,173)	(1,321)
Gains (losses) on investment activity	294	(473)	(97)
Gains on debt retirement	345	466	206
Recoveries on loans impaired upon purchase	505	—	—
Foreign-currency gains (losses), net	(2,348)	96	(6)
Other income	246	236	126
Non-interest income	194	2,086	1,003
Non-interest expense:			
Administrative expenses	(1,674)	(1,641)	(1,535)
Other expenses	(7,596)	(1,575)	(1,565)
Non-interest expense	(9,270)	(3,216)	(3,100)
Income (loss) before income tax (expense) benefit and cumulative effect of change in accounting principle	(5,977)	2,282	2,530
Income tax (expense) benefit	2,883	45	(358)
Net income (loss) before cumulative effect of change in accounting principle	(3,094)	2,327	2,172
Cumulative effect of change in accounting principle, net of tax	—	—	(59)
Net income (loss)	<u>\$ (3,094)</u>	<u>\$ 2,327</u>	<u>\$ 2,113</u>

Net Interest Income

Table 8 summarizes our net interest income and net interest yield and provides an attribution of changes in annual results to changes in interest rates or changes in volumes of our interest-earning assets and interest-bearing liabilities. Average balance sheet information is presented because we believe end-of-period balances are not representative of activity throughout the periods presented. For most components of the average balances, a daily weighted average balance was calculated for the period. When daily weighted average balance information was not available, a simple monthly average balance was calculated.

Table 8 — Average Balance, Net Interest Income and Rate/Volume Analysis

	Year Ended December 31,								
	2007			2006			2005		
	Average Balance ⁽¹⁾⁽²⁾	Interest Income (Expense) ⁽¹⁾	Average Rate	Average Balance ⁽¹⁾⁽²⁾	Interest Income (Expense) ⁽¹⁾	Average Rate	Average Balance ⁽¹⁾⁽²⁾	Interest Income (Expense) ⁽¹⁾	Average Rate
	Adjusted								
	(dollars in millions)								
Interest-earning assets:									
Mortgage loans ⁽³⁾⁽⁴⁾	\$ 70,890	\$ 4,449	6.28%	\$ 63,870	\$ 4,152	6.50%	\$ 61,256	\$ 4,010	6.55%
Mortgage-related securities	645,844	34,893	5.40	650,992	33,850	5.20	611,761	28,968	4.74
Total retained portfolio	716,734	39,342	5.49	714,862	38,002	5.32	673,017	32,978	4.90
Investments ⁽⁵⁾	43,910	2,285	5.20	57,705	2,789	4.83	53,252	1,773	3.33
Securities purchased under agreements to resell and federal funds sold	24,469	1,283	5.25	28,577	1,473	5.15	25,344	833	3.28
Total interest-earning assets	\$785,113	\$ 42,910	5.46	\$801,144	\$ 42,264	5.28	\$751,613	\$ 35,584	4.73
Interest-bearing liabilities:									
Short-term debt	\$174,418	\$ (8,916)	(5.11)	\$179,882	\$ (8,665)	(4.82)	\$192,497	\$ (6,102)	(3.17)
Long-term debt ⁽⁶⁾	576,973	(29,148)	(5.05)	587,978	(28,218)	(4.80)	524,270	(23,246)	(4.43)
Total debt securities	751,391	(38,064)	(5.07)	767,860	(36,883)	(4.80)	716,767	(29,348)	(4.09)
Due to PC investors	7,820	(418)	(5.35)	7,475	(387)	(5.18)	10,399	(551)	(5.30)
Total interest-bearing liabilities	759,211	(38,482)	(5.07)	775,335	(37,270)	(4.81)	727,166	(29,899)	(4.11)
Expense related to derivatives		(1,329)	(0.17)		(1,582)	(0.20)		(1,058)	(0.15)
Impact of net non-interest-bearing funding	25,902	—	0.17	25,809	—	0.16	24,447	—	0.14
Total funding of interest-earning assets	\$785,113	\$(39,811)	(5.07)	\$801,144	\$(38,852)	(4.85)	\$751,613	\$(30,957)	(4.12)
Net interest income/yield		\$ 3,099	0.39		\$ 3,412	0.43		\$ 4,627	0.61
Fully taxable-equivalent adjustments ⁽⁷⁾		392	0.05		392	0.04		339	0.05
Net interest income/yield (fully taxable-equivalent basis)		\$ 3,491	0.44%		\$ 3,804	0.47%		\$ 4,966	0.66%
				2007 vs. 2006 Variance			2006 vs. 2005 Variance		
				Due to			Due to		
				Rate ⁽⁸⁾	Volume ⁽⁸⁾	Total Change	Rate ⁽⁸⁾	Volume ⁽⁸⁾	Total Change
				(in millions)					
Interest-earning assets:									
Mortgage loans				\$ (147)	\$ 444	\$ 297	\$ (28)	\$ 170	\$ 142
Mortgage-related securities				1,312	(269)	1,043	2,952	1,930	4,882
Total retained portfolio				1,165	175	1,340	2,924	2,100	5,024
Investments				201	(705)	(504)	857	159	1,016
Securities purchased under agreements to resell and federal funds sold				25	(215)	(190)	523	117	640
Total interest-earning assets				\$ 1,391	\$(745)	\$ 646	\$ 4,304	\$ 2,376	\$ 6,680
Interest-bearing liabilities:									
Short-term debt				\$ (520)	\$ 269	\$ (251)	\$(2,986)	\$ 423	\$(2,563)
Long-term debt				(1,465)	535	(930)	(2,008)	(2,964)	(4,972)
Total debt securities				(1,985)	804	(1,181)	(4,994)	(2,541)	(7,535)
Due to PC investors				(13)	(18)	(31)	12	152	164
Total interest-bearing liabilities				(1,998)	786	(1,212)	(4,982)	(2,389)	(7,371)
Expense related to derivatives				253	—	253	(524)	—	(524)
Total funding of interest-earning assets				\$(1,745)	\$ 786	\$ (959)	\$(5,506)	\$(2,389)	\$(7,895)
Net interest income				\$ (354)	\$ 41	\$ (313)	\$(1,202)	\$ (13)	\$(1,215)
Fully taxable-equivalent adjustments				9	(9)	—	29	24	53
Net interest income (fully taxable-equivalent basis)				\$ (345)	\$ 32	\$ (313)	\$(1,173)	\$ 11	\$(1,162)

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

(2) For securities in our retained and investment portfolios, we calculated average balances based on their unpaid principal balance plus their associated deferred fees and costs (e.g., premiums and discounts), but excluded the effects of mark-to-fair-value changes.

(3) Non-performing loans, where interest income is recognized when collected, are included in average balances.

(4) Loan fees included in mortgage loan interest income were \$290 million, \$280 million and \$371 million for the years ended December 31, 2007, 2006 and 2005, respectively.

(5) Consist of cash and cash equivalents and non-mortgage-related securities.

(6) Includes current portion of long-term debt. See "NOTE 7: DEBT SECURITIES AND SUBORDINATED BORROWINGS" to our consolidated financial statements for a reconciliation of senior debt, due within one year on our consolidated balance sheets.

(7) The determination of net interest income/yield (fully taxable-equivalent basis), which reflects fully taxable-equivalent adjustments to interest income, involves the conversion of tax-exempt sources of interest income to the equivalent amounts of interest income that would be necessary to derive the same net return if the investments had been subject to income taxes using our federal statutory tax rate of 35%.

(8) Rate and volume changes are calculated on the individual financial statement line item level. Combined rate/volume changes were allocated to the individual rate and volume change based on their relative size.

Table 9 summarizes components of our net interest income.

Table 9 — Net Interest Income

	Year Ended December 31,		
	2007	Adjusted	
		2006	2005
		(in millions)	
Contractual amounts of net interest income	\$ 6,038	\$ 7,472	\$ 8,289
Amortization expense, net: ⁽¹⁾			
Asset-related amortization expense, net	(268)	(875)	(1,158)
Long-term debt-related amortization expense, net	(1,342)	(1,603)	(1,446)
Total amortization expense, net	(1,610)	(2,478)	(2,604)
Expense related to derivatives:			
Amortization of deferred balances in AOCI ⁽²⁾	(1,329)	(1,620)	(1,966)
Accrual of periodic settlements of derivatives: ⁽³⁾			
Receive-fixed swaps ⁽⁴⁾	—	502	1,185
Foreign-currency swaps	—	(464)	(277)
Total accrual of periodic settlements of derivatives	—	38	908
Total expense related to derivatives	(1,329)	(1,582)	(1,058)
Net interest income	3,099	3,412	4,627
Fully taxable-equivalent adjustments	392	392	339
Net interest income (fully taxable-equivalent basis)	\$ 3,491	\$ 3,804	\$ 4,966

(1) Represents amortization related to premiums, discounts, deferred fees and other adjustments to the carrying value of our financial instruments and the reclassification of previously deferred balances from accumulated other comprehensive income, or AOCI, for certain derivatives in cash flow hedge relationships related to individual debt issuances and mortgage purchase transactions.

(2) Represents changes in fair value of derivatives in cash flow hedge relationships that were previously deferred in AOCI and have been reclassified to earnings as the associated hedged forecasted issuance of debt and mortgage purchase transactions affect earnings.

(3) Reflects the accrual of periodic cash settlements of all derivatives in qualifying hedge accounting relationships.

(4) Include imputed interest on zero-coupon swaps.

Net interest income and net interest yield on a fully taxable-equivalent basis decreased for the year ended December 31, 2007 compared to the year ended December 31, 2006. During 2007, we experienced higher funding costs for our retained portfolio as our long-term debt interest expense increased, reflecting the replacement of maturing debt that had been issued at lower interest rates to fund our investments in fixed-rate mortgage-related investments. The decrease in net interest income and net interest yield on a fully taxable-equivalent basis was partially offset by a decrease in our mortgage-related securities premium amortization expense as purchases into our retained portfolio in 2007 largely consisted of securities purchased at a discount. In addition, wider mortgage-to-debt OAS due to continued lower demand for mortgage-related securities from depository institutions and foreign investors, along with heightened market uncertainty regarding mortgage-related securities, resulted in favorable investment opportunities. However, to manage to our 30% mandatory target capital surplus, we reduced our average balance of interest earning assets and as a result, we were not able to take full advantage of these opportunities.

Net interest income and net interest yield on a fully taxable-equivalent basis decreased in 2006 as compared to 2005 as spreads on fixed-rate investments continued to narrow, driven by increases in long- and medium-term interest rates. The increase in our long-term debt interest costs reflects the turnover of medium-term debt that we issued in previous years to fund our investments in fixed-rate mortgage-related investments when the yield curve was steep (*i.e.*, short- and medium-term interest rates were low as compared to long-term interest rates). As the yield curve flattened during 2005 and 2006, we experienced increased funding costs associated with replacing maturing lower-cost debt. During 2006, net interest margins declined as a result of changes in interest rates on variable-rate assets acquired in 2004 and 2005. Also, we adjusted our funding mix in 2006 by increasing the proportion of callable debt outstanding, which we use to manage prepayment risk associated with our mortgage-related investments and which generally has a higher interest cost than non-callable debt. In 2006, we considered the issuance of callable debt to be more cost effective than alternative interest-rate risk management strategies, primarily the issuance of non-callable bullet debt combined with the use of derivatives. In addition, the impact of rising short-term interest rates on our funding costs was largely offset by the impact of rising rates on our variable-rate assets in our retained portfolio and cash and investments portfolio.

Net interest income for 2006 also reflected lower net interest income on derivatives in qualifying hedge accounting relationships. Net interest income associated with the accrual of periodic settlements declined as the benchmark London Interbank Offer Rate, or LIBOR, and the Euro Interbank Offered Rate, or Euribor, interest rates increased during the year, adversely affecting net settlements on our receive-fixed and foreign-currency swaps (Euro-denominated). Net interest income was also affected by our decisions in March and December 2006 to discontinue hedge accounting treatment for a significant amount of our receive-fixed and foreign-currency swaps, as discussed in “NOTE 11: DERIVATIVES” to our consolidated financial statements. The net interest expense related to these swaps is no longer a component of net interest

income, after hedge accounting was discontinued, but instead is recognized as a component of derivative gains (losses). By the end of 2006, nearly all of our derivatives were not in hedge accounting relationships.

Enhancements to certain models used to estimate prepayment speeds on mortgage-related securities and our approach for estimating uncollectible interest on single-family mortgages greater than 90 days delinquent resulted in a net decrease in retained portfolio interest income of \$166 million (pre-tax) during the first quarter of 2005.

Non-Interest Income (Loss)

Management and Guarantee Income

The primary drivers affecting management and guarantee income are changes in the average balance of our PCs and Structured Securities issued and changes in guarantee fee rates. Contractual management and guarantee fees include adjustments for buy-ups and buy-downs, whereby the guarantee fee is adjusted for up-front cash payments we make (buy-up) or receive (buy-down) upon issuance of our guarantee. Our average rates of management and guarantee income are affected by the mix of products we issue, competition in the market and customer preference for buy-up and buy-down fees. The majority of our guarantees are issued under customer flow channel contracts. The remainder of our purchase and guarantee securitization of mortgage loans occurs through bulk purchases.

Table 10 provides summary information about management and guarantee income. Management and guarantee income consists of contractual amounts due to us (reflecting buy-ups and buy-downs to base guarantee fees) as well as amortization of certain pre-2003 deferred credit and buy-down fees received by us which are recorded as deferred income as a component of other liabilities. Post-2002 credit fees and buy-down fees are reflected as either increased income on guarantee obligation as the guarantee obligation is amortized or a reduction in losses on certain credit guarantees recorded at the initiation of a guarantee.

Table 10 — Management and Guarantee Income

	Year Ended December 31,					
	2007		2006		2005	
	Amount	Rate	Amount	Rate	Amount	Rate
	Adjusted					
	(dollars in millions, rates in basis points)					
Contractual management and guarantee fees	\$2,591	16.3	\$2,201	15.7	\$1,982	15.8
Amortization of credit and buy-down fees included in other liabilities	44	0.3	192	1.4	94	0.8
Total management and guarantee income	<u>\$2,635</u>	<u>16.6</u>	<u>\$2,393</u>	<u>17.1</u>	<u>\$2,076</u>	<u>16.6</u>
Unamortized balance of credit and buy-down fees included in other liabilities, at period end	\$ 410		\$ 440		\$ 619	

Management and guarantee income increased in 2007 compared to 2006 resulting from a 13% increase in the average balance of our PCs and Structured Securities. The total management and guarantee fee rate decreased in 2007 compared to 2006 due to declines in amortization income resulting from slowing prepayments attributable to increasing interest rate projections. The decline was partially offset by an increase in contractual management and guarantee fee rates as a result of an increase in buy-up activity in 2007.

Management and guarantee income increased in 2006 compared to 2005 reflecting a 12% increase in the average balance of our PCs and Structured Securities. The total management and guarantee fee rate increased in 2006 compared to 2005, which reflects higher amortization income due to a decrease in interest rates. The contractual management and guarantee fee rate increase was offset by an increase in buy-down activity in 2006.

Gains (Losses) on Guarantee Asset

Upon issuance of a guarantee of securitized assets, we record a guarantee asset on our consolidated balance sheets representing the fair value of the guarantee fees we expect to receive over the life of our PCs or Structured Securities. Subsequent changes in the fair value of the guarantee asset are reported in current period income as gains (losses) on guarantee asset.

The change in fair value of the guarantee asset reflects:

- reductions related to the management and guarantee fees received that are considered a return of our recorded investment in the guarantee asset;
- changes in future management and guarantee fees we expect to receive over the life of the related PCs or Structured Securities, and
- The fair value of future management and guarantee fees is driven by expected changes in interest rates that affect the estimated life of the mortgages underlying our PCs and Structured Securities issued and the related discount rates used to determine the net present value of the cash flows. For example, an increase in interest rates extends the life of the guarantee asset and increases the fair value of future management and guarantee fees. Our valuation

methodology for the guarantee asset uses market-based information, including market values of excess servicing, interest-only securities, to determine the fair value of future cash flows associated with the guarantee asset.

Table 11 — Attribution of Change — Gains (Losses) on Guarantee Asset

	Year Ended December 31,		
	2007	Adjusted	
		2006	2005
	(in millions)		
Management and guarantee fees due	\$ (2,288)	\$ (1,873)	\$ (1,565)
Portion of contractual guarantee fees due related to imputed interest income	549	580	450
Return of investment on guarantee asset	(1,739)	(1,293)	(1,115)
Change in fair value of management and guarantee fees	309	261	(267)
Change in estimate ⁽¹⁾	(54)	54	(27)
Gains (losses) on guarantee asset	<u>\$ (1,484)</u>	<u>\$ (978)</u>	<u>\$ (1,409)</u>

(1) Represents a change in estimate related to gains (losses) on guarantee asset resulting from enhancing our approach for determining the fair value of the guarantee asset.

Management and guarantee fees due represents cash received in the current period related to our PCs and Structured Securities with an established guarantee asset. A portion of management and guarantee fees due is attributed to imputed interest income on the guarantee asset. Management and guarantee fees due increased in both 2007 and 2006, primarily due to increases in the average balance of our PCs and Structured Securities issued.

Gains on fair value of management and guarantee fees in 2007 primarily resulted from an increase in interest rates during the second quarter. The increase in gains on fair value of management and guarantee fees in 2006 was due to an increase in interest rates throughout the year.

Income on Guarantee Obligation

Upon issuance of a guarantee of securitized assets, we record a guarantee obligation on our consolidated balance sheets representing the fair value of our obligation to perform under the terms of the guarantee. Our guarantee obligation is amortized into income using a static effective yield calculated and fixed at inception of the guarantee based on forecasted unpaid principal balances. The static effective yield will be evaluated and adjusted when significant changes in economic events cause a shift in the pattern of our economic release from risk. For example, certain market environments may lead to sharp and sustained changes in home prices or prepayments of mortgages, leading to the need for an adjustment in the static effective yield for specific mortgage pools underlying the guarantee. When a change is required, a cumulative catch-up adjustment, which could be significant in a given period, will be recognized and a new static effective yield will be used to determine our guarantee obligation amortization. Our guarantee obligation consists of:

- performance and other related costs, which consist of: estimated credit costs, including unrecoverable principal and interest over the expected life of the underlying mortgages; estimated foreclosure-related costs; and administrative and other costs related to our guarantee; and
- deferred guarantee income on newly-issued guarantor swap transactions, which represents the excess of compensation, if any, received on issued guarantees and the fair value of our related guarantee asset, compared to the fair value of our corresponding guarantee obligation. Compensation received includes credit and buy-down fees received at the time of securitization. Credit fees vary with the credit quality of the underlying mortgages and buy-down fees vary based on customer compensation payment preferences. Compensation also includes various types of seller-provided credit enhancements related to the underlying mortgage loans.

See “NOTE 20: CHANGES IN ACCOUNTING PRINCIPLES” to our consolidated financial statements for further information regarding our guarantee obligation.

Table 12 — Income on Guarantee Obligation

	Year Ended December 31,		
	2007	Adjusted	
		2006	2005
	(in millions)		
Amortization income related to:			
Performance and other related costs	\$ 1,146	\$ 804	\$ 747
Deferred guarantee income	759	715	681
Total income on guarantee obligation	<u>\$ 1,905</u>	<u>\$1,519</u>	<u>\$1,428</u>
Components of the guarantee obligation, at period end:			
Unamortized balance of performance and other related costs	\$ 9,930	\$5,841	\$4,556
Unamortized balance of deferred guarantee income	3,782	3,641	3,351
Total guarantee obligation	<u>\$13,712</u>	<u>\$9,482</u>	<u>\$7,907</u>

Amortization income increased in 2007 and 2006. These increases reflect the growth of the guarantee obligation associated with newly-issued guarantees, which have higher associated performance costs due to higher expected credit costs than issuances in previous years, as well as higher average balances of our PCs and Structured Securities.

Our amortization method is intended to correlate to our economic release from risk under our guarantee, under changing economic scenarios. In the event of significant and sustained economic changes, we would revise our static effective yield amortization, by recognizing a cumulative, catch-up adjustment. We expect that the decline in national home prices in 2008 will require catch-up adjustments to our static effective yield method. This will result in higher amortization in the first quarter of 2008 than would be recognized under the static effective yield method absent these economic changes.

Derivative Overview

Table 13 presents the effect of derivatives on our consolidated financial statements, including notional or contractual amounts of our derivatives and our hedge accounting classifications.

Table 13 — Summary of the Effect of Derivatives on Selected Consolidated Financial Statement Captions

Description	Consolidated Balance Sheets					
	December 31, 2007			Adjusted December 31, 2006		
	Notional or Contractual Amount ⁽¹⁾	Fair Value (Pre-Tax) ⁽²⁾	AOCI (Net of Taxes) ⁽³⁾	Notional or Contractual Amount ⁽¹⁾	Fair Value (Pre-Tax) ⁽²⁾	AOCI (Net of Taxes) ⁽³⁾
	(in millions)					
Cash flow hedges-open	\$ —	\$ —	\$ —	\$ 70	\$ —	\$ —
No hedge designation	1,322,881	4,790	—	758,039	7,720	—
Subtotal	1,322,881	4,790	—	758,109	7,720	—
Balance related to closed cash flow hedges	—	—	(4,059)	—	—	(5,032)
Total	<u>\$1,322,881</u>	<u>\$4,790</u>	<u>\$(4,059)</u>	<u>\$758,109</u>	<u>\$7,720</u>	<u>\$(5,032)</u>

Description	Consolidated Statements of Income		
	Year Ended December 31,		
	2007	2006	2005
	(in millions)		
Cash flow hedges-open	\$ —	\$ —	\$ (25)
No hedge designation	(1,904)	(1,173)	(1,296)
Total	<u>\$(1,904)</u>	<u>\$(1,173)</u>	<u>\$(1,321)</u>

(1) Notional or contractual amounts are used to calculate the periodic settlement amounts to be received or paid and generally do not represent actual amounts to be exchanged. Notional or contractual amounts are not recorded as assets or liabilities.

(2) The value of derivatives on our consolidated balance sheets is reported as derivative asset, net and derivative liability, net, and includes net derivative interest receivable or payable and cash collateral held or posted. Fair value excludes net derivative interest receivable of \$1.7 billion and net derivative collateral held of \$6.2 billion at December 31, 2007. Fair value excludes net derivative interest receivable of \$2.3 billion and net derivative collateral held of \$9.5 billion at December 31, 2006.

(3) Derivatives that meet specific criteria may be accounted for as cash flow hedges. Changes in the fair value of the effective portion of open cash flow hedges are recorded in AOCI, net of taxes. Net deferred gains and losses on closed cash flow hedges (i.e., where the derivative is either terminated or redesignated) are also included in AOCI, net of taxes, until the related forecasted transaction affects earnings or is determined to be probable of not occurring.

Prior to 2007, we discontinued nearly all of our cash flow hedge and fair value hedge accounting relationships. At December 31, 2007, we did not have any derivatives in hedge accounting relationships. From time to time, we designate as cash flow hedges certain commitments to forward sell mortgage-related securities. See “NOTE 11: DERIVATIVES” to our consolidated financial statements for additional information on our discontinuation of hedge accounting treatment. Derivatives that are not in qualifying hedge accounting relationships generally increase the volatility of reported non-interest income because the fair value gains and losses on the derivatives are recognized in earnings without the offsetting recognition in earnings of the change in value of the economically hedged exposures.

For derivatives designated in cash flow hedge accounting relationships, the effective portion of the change in fair value of the derivative asset or derivative liability is presented in the stockholders’ equity section of our consolidated balance sheets in AOCI, net of taxes. At December 31, 2007 and 2006, the net cumulative change in the fair value of all derivatives designated in cash flow hedge relationships for which the forecasted transactions had not yet affected earnings (net of amounts previously reclassified to earnings through each year-end) was an after-tax loss of approximately \$4.1 billion and \$5.0 billion, respectively. These amounts relate to net deferred losses on closed cash flow hedges. The majority of the closed cash flow hedges relate to hedging the variability of cash flows from forecasted issuances of debt. Fluctuations in prevailing market interest rates have no impact on the deferred portion of AOCI, net of taxes, relating to closed cash flow hedges. The

deferred amounts related to closed cash flow hedges will be recognized into earnings as the hedged forecasted transactions affect earnings, unless it becomes probable that the forecasted transactions will not occur. If it is probable that the forecasted transactions will not occur, then the deferred amount associated with the forecasted transactions will be recognized immediately in earnings.

At December 31, 2007, over 70% and 90% of the \$4.1 billion net deferred losses in AOCI, net of taxes, relating to cash flow hedges were linked to forecasted transactions occurring in the next 5 and 10 years, respectively. Over the next 10 years, the forecasted debt issuance needs associated with these hedges range from approximately \$18.6 billion to \$104.7 billion in any one quarter, with an average of \$58.3 billion per quarter.

Table 14 presents the scheduled amortization of the net deferred losses in AOCI at December 31, 2007 related to closed cash flow hedges. The scheduled amortization is based on a number of assumptions. Actual amortization will differ from the scheduled amortization, perhaps materially, as we make decisions on debt funding levels or as changes in market conditions occur that differ from these assumptions. For example, for the scheduled amortization for cash flow hedges related to future debt issuances, we assume that we will not repurchase the related debt and that no other factors affecting debt issuance probabilities will change.

Table 14 — Scheduled Amortization into Income of Net Deferred Losses in AOCI Related to Closed Cash Flow Hedge Relationships

<u>Period of Scheduled Amortization into Income</u>	<u>December 31, 2007</u>	
	<u>Amount</u>	<u>Amount</u>
	<u>(Pre-tax)</u>	<u>(After-tax)</u>
	(in millions)	
2008	\$(1,331)	\$ (865)
2009	(1,105)	(718)
2010	(910)	(592)
2011	(720)	(468)
2012	(563)	(366)
2013 to 2017	(1,107)	(719)
Thereafter	(509)	(331)
Total net deferred losses in AOCI related to closed cash flow hedge relationships	<u>\$(6,245)</u>	<u>\$(4,059)</u>

Derivative Gains (Losses)

Table 15 provides a summary of the period-end notional amounts and the gains and losses recognized during the year related to derivatives not accounted for in hedge accounting relationships.

Table 15 — Derivatives Not in Hedge Accounting Relationships

	Year Ended December 31,					
	2007		Adjusted			
	Notional or Contractual Amount	Derivative Gains (Losses)	Notional or Contractual Amount	Derivative Gains (Losses)	Notional or Contractual Amount	Derivative Gains (Losses)
	(in millions)					
Call swaptions						
Purchased	\$ 259,272	\$ 2,472	\$194,200	\$(1,128)	\$146,615	\$ (402)
Written	1,900	(121)	—	—	—	—
Put swaptions						
Purchased	18,725	(4)	29,725	(100)	34,675	202
Written	2,650	(72)	—	—	—	—
Receive-fixed swaps	301,649	3,905	222,631	(290)	81,185	(1,535)
Pay-fixed swaps	409,682	(11,362)	217,565	649	181,562	612
Futures	196,270	142	22,400	(248)	86,252	63
Foreign-currency swaps	20,118	2,341	29,234	(92)	197	(9)
Forward purchase and sale commitments	72,662	445	9,942	(95)	21,827	110
Other ⁽¹⁾	39,953	18	32,342	39	15,643	(25)
Subtotal	1,322,881	(2,236)	758,039	(1,265)	567,956	(984)
Accrual of periodic settlements:						
Receive-fixed swaps ⁽²⁾		(327)		(418)		426
Pay-fixed swaps		703		541		(763)
Foreign-currency swaps		(48)		(34)		—
Other		4		3		—
Total accrual of periodic settlements		332		92		(337)
Total	<u>\$1,322,881</u>	<u>\$ (1,904)</u>	<u>\$758,039</u>	<u>\$(1,173)</u>	<u>\$567,956</u>	<u>\$(1,321)</u>

(1) Consists of basis swaps, certain option-based contracts (including written options), interest-rate caps, credit derivatives and swap guarantee derivatives not accounted for in hedge accounting relationships. 2005 also included a prepayment management agreement which was terminated effective December 31, 2005.

(2) Includes imputed interest on zero-coupon swaps.

Derivative gains (losses) reflect the change in the fair value of and the accrual of periodic settlements of all derivatives not in hedge accounting relationships. From 2005 through 2007, we experienced significant periodic income volatility due to changes in the fair values of our derivatives and changes in the composition of our portfolio of derivatives not in hedge accounting relationships.

We use receive- and pay-fixed swaps to adjust the interest rate characteristics of our debt funding in order to more closely match changes in the interest-rate characteristics of our mortgage assets. A receive-fixed swap results in our receipt of a fixed interest-rate payment from our counterparty in exchange for a variable-rate payment to our counterparty. Conversely, a pay-fixed swap requires us to make a fixed interest-rate payment to our counterparty in exchange for a variable-rate payment from our counterparty. Receive-fixed swaps increase in value and pay-fixed swaps decrease in value when interest rates decrease (with the opposite being true when interest rates increase).

We use swaptions and other option-based derivatives to adjust the characteristics of our debt in response to changes in the expected lives of mortgage-related assets in our retained portfolio. Purchased call and put swaptions, where we make premium payments, are options for us to enter into receive- and pay-fixed swaps, respectively. Conversely, written call and put swaptions, where we receive premium payments, are options for our counterparty to enter into receive- and pay-fixed swaps, respectively. The fair values of both purchased and written call and put swaptions are sensitive to changes in interest rates and are also driven by the market's expectation of potential changes in future interest rates (referred to as "implied volatility"). Purchased swaptions generally become more valuable as implied volatility increases and less valuable as implied volatility decreases. Recognized losses on purchased options in any given period are limited to the premium paid to purchase the option plus any unrealized gains previously recorded. Potential losses on written options are unlimited.

In 2007, overall decreases in interest rates across the swap yield curve resulted in fair value losses on our interest-rate swap derivative portfolio that were partially offset by fair value gains on our option-based derivative portfolio. Gains on our option-based derivative portfolio resulted from an overall increase in implied volatility and decreasing interest rates. The overall decline in interest rates resulted in a loss of \$11.4 billion on our pay-fixed swaps that was only partially offset by a \$3.9 billion gain on our receive-fixed swap position. Gains on option-based derivatives, particularly purchased call swaptions, increased in 2007 to \$2.3 billion. We recognized a gain of \$2.3 billion on our foreign-currency swaps as the Euro

continued to strengthen against the dollar. The gains on foreign-currency swaps offset a \$2.3 billion loss on the translation of our foreign-currency denominated debt, which is recorded in foreign-currency gains (losses), net.

The accrual of periodic settlements for derivatives not in qualifying hedge accounting relationships increased in 2007 compared to 2006 due to the increase in our net pay-fixed swap position as we responded to the changing interest rate environment.

During 2006, fair value losses on our swaptions increased as implied volatility declined and both long-term and short-term swap interest rates increased. During 2006 and 2005, fair value changes of our pay-fixed and receive-fixed swaps were driven by increases in long-term swap interest rates. Our discontinuation of hedge accounting treatment resulted in an increase in the notional balance of our receive-fixed swaps not in qualifying hedge accounting relationships, which, combined with fluctuations in swap interest rates throughout the year, reduced fair value losses recognized on our receive-fixed swaps during 2006. See “NOTE 11: DERIVATIVES” to our consolidated financial statements for additional information on our discontinuation of hedge accounting treatment.

The accrual of periodic settlements for derivatives not in qualifying hedge accounting relationships increased during 2006 compared to 2005 as short-term interest rates increased resulting in an increase in income on our pay-fixed swaps.

Gains (Losses) on Investment Activity

Table 16 summarizes the components of gains (losses) on investment activity.

Table 16 — Gains (Losses) on Investment Activity

	Year Ended December 31,		
	2007	Adjusted	
		2006	2005
	(in millions)		
Gains (losses) on trading securities	\$ 540	\$ 1	\$(289)
Gains (losses) on sale of mortgage loans ⁽¹⁾	14	90	124
Gains (losses) on sale of available-for-sale securities	232	(140)	370
Security impairments:			
Interest-only security impairments	(36)	(147)	(71)
Other security impairments	(363)	(257)	(221)
Total security impairments	(399)	(404)	(292)
Lower-of-cost-or-market valuation adjustments	(93)	(20)	(10)
Total gains (losses) on investment activity	<u>\$ 294</u>	<u>\$(473)</u>	<u>\$ (97)</u>

(1) Represent mortgage loans sold in connection with securitization transactions.

Gains (Losses) on Trading Securities

In 2007, the overall decrease in long-term interest rates resulted in gains related to our REMIC securities classified as trading.

In 2006, the increase in long-term interest rates resulted in gains related to our interest-only mortgage related securities classified as trading. These gains were offset by losses on other mortgage-related securities classified as trading as a result of the rise in interest rates. In 2005, increases in long-term interest rates resulted in losses on mortgage-related securities classified as trading.

Gains (Losses) on Sale of Available-For-Sale Securities

We realized net gains on the sale of available-for-sale securities of \$232 million for the year ended December 31, 2007, compared to net losses of \$140 million for the year ended December 31, 2006. During the fourth quarter of 2007, we sold approximately \$27.2 billion of PCs and Structured Securities, classified as available-for-sale, for capital management purposes. These sales generated net gains of approximately \$186 million included in gains (losses) on sale of available-for-sale securities. These gains were partially offset by losses generated by the sale of securities during the second quarter of 2007.

In 2006, losses on sales of available-for-sale securities were primarily driven by resecuritization activity, partially offset by net gains of \$188 million related to the sale of certain commercial mortgage-backed securities, or CMBS, as discussed in “Security Impairments.”

Security Impairments

Security impairments on mortgage-related securities remained flat for the year ended December 31, 2007, compared to the year ended December 31, 2006. Security impairments in 2007 were primarily related to impairments recognized during the second quarter of 2007 on agency securities that we sold in the third quarter of 2007 and thus did not have the intent to hold until the loss would be recovered. In addition, we recognized \$36 million of impairments on our mortgage-related interest-only securities due to the decline in interest rates during the second half of 2007.

For the year ended December 31, 2006 and 2005 security impairments included \$147 million and \$71 million, respectively, related to mortgage-related interest-only securities, primarily due to periodic declines in mortgage interest rates experienced during those years. During the years ended December 31, 2006 and 2005, security impairments also included \$196 million and \$36 million, respectively, of interest-rate related impairments related to mortgage-related securities where we did not have the intent to hold the security until the loss would be recovered. Security impairments during the years ended December 31, 2006 and 2005 also included \$61 million and \$185 million, respectively, related to certain CMBSs backed by cash flows from mixed pools of multifamily and non-residential commercial mortgages. In December 2005, HUD determined that these mixed-pool investments were not authorized under our charter and OFHEO subsequently directed us to divest these investments, which we did in 2006.

Recoveries on Loans Impaired upon Purchase

Recoveries on loans impaired upon purchase represent the recapture into income of previously recognized losses on loans purchased and provision for credit losses associated with purchases of delinquent loans from our PCs and Structured Securities in conjunction with our guarantee activities. Recoveries occur when a non-performing loan is repaid in full or when at the time of foreclosure the estimated fair value of the acquired property, less costs to sell, exceeds the carrying value of the loan. During 2007, we recognized recoveries on loans impaired upon purchase of \$505 million. During 2006, we recaptured \$58 million on impaired loans, which reduced losses on loans purchased. For impaired loans where the borrower has made required payments that return to current status, the basis adjustments are accreted into interest income over time, as periodic payments are received.

Foreign-Currency Gains (Losses), Net

We actively manage the foreign-currency exposure associated with our foreign-currency denominated debt through the use of derivatives. For the year ended December 31, 2007, we recognized net foreign-currency translation losses of \$2.3 billion primarily due to the weakening of the U.S. dollar relative to the Euro. These losses offset an increase in fair value of \$2.3 billion related to foreign-currency-related derivatives during the period, which is recorded in derivative gains (losses).

For the year ended December 31, 2006, we recognized net foreign-currency translation gains related to our foreign-currency denominated debt of \$96 million. These gains offset a decrease in fair value of \$92 million related to foreign-currency-related derivatives during the period, which is recorded in derivative gains (losses).

In December 2006, we voluntarily discontinued hedge accounting for our foreign-currency swaps. See “*Derivative Gains (Losses)*” and “NOTE 11: DERIVATIVES” to our consolidated financial statements for additional information about our derivatives.

Other Income

Other income increased in 2007 compared to 2006 due to \$18 million of trust management income that was related to the establishment of securitization trusts in December 2007 for the underlying assets of our PCs and Structured Securities. Trust management income represents the fees we earn as master servicer, issuer and trustee. These fees are derived from interest earned on principal and interest cash flows between the time they are remitted to the trust by servicers and the date of distribution to our PC and Structured Securities holders.

Other income increased in 2006 compared to 2005, primarily due to \$80 million of expense recorded in 2005 that was related to certain errors not material to our consolidated financial statements with respect to income in previously reported periods.

Non-Interest Expense

Table 17 summarizes the components of non-interest expense.

Table 17 — Non-Interest Expense

	Year Ended December 31,		
	2007	Adjusted	
		2006	2005
	(in millions)		
Administrative Expenses:			
Salaries and employee benefits	\$ 896	\$ 830	\$ 805
Professional services	443	460	386
Occupancy expense	64	61	58
Other administrative expenses	271	290	286
Total administrative expenses	1,674	1,641	1,535
Provision for credit losses	2,854	296	307
REO operations expense	206	60	40
Losses on certain credit guarantees	1,988	406	272
Losses on loans purchased	1,865	148	—
LIHTC partnerships	469	407	320
Minority interests in earnings of consolidated subsidiaries	(8)	58	96
Other expenses	222	200	530
Total non-interest expense	<u>\$9,270</u>	<u>\$3,216</u>	<u>\$3,100</u>

Administrative Expenses

Salaries and employee benefits increased during the past three years as we hired additional employees to support our financial reporting and infrastructure activities. Certain long-term employee incentive compensation costs also increased as we worked to attract and retain key talent to reduce reliance on external resources.

Professional services decreased in 2007 compared to 2006 as we modestly decreased our reliance on consultants and relied more heavily on our employee base to complete certain financial initiatives and our control remediation activities. Professional services increased in 2006 compared to 2005 as we increased the number of consultants utilized to assist in our initiatives to build new financial accounting systems and improve our financial controls.

Despite continued increases in administrative expenses, administrative expenses as a percentage of our average total mortgage portfolio declined to 8.6 basis points for the year ended December 31, 2007 from 9.3 basis points and 9.7 basis points for the years ended 2006 and 2005, respectively.

Provision for Credit Losses

Our credit loss reserves reflect our best estimates of incurred losses. Our reserve estimate includes projections related to strategic loss mitigation initiatives, including a higher rate of loan modifications for troubled borrowers, and projections of recoveries through repurchases by seller/servicers of defaulted loans due to failure to follow contractual underwriting requirements at the time of the loan origination.

Our reserve estimate also reflects our best projection of defaults. However, the unprecedented deterioration in the national housing market and the uncertainty in other macro economic factors makes forecasting of default rates increasingly imprecise.

The inability to realize the benefits of our loss mitigation plans, a lower realized rate of seller/servicer repurchases or default rates that exceed our current projections will cause our losses to be significantly higher than those currently estimated.

The provision for credit losses increased significantly in 2007 compared to 2006, as continued weakening in the housing market affected our single-family portfolio. In 2007, and to a lesser extent in 2006, we recorded additional reserves for credit losses on our single-family portfolio as a result of:

- increased estimates of incurred losses on mortgage loans that are expected to experience higher default rates, particularly for mortgage loans originated during 2006 and 2007, which do not have the benefit of significant home price appreciation;
- an observed increase in delinquency rates and the rates at which loans transition through delinquency to foreclosure; and
- increases in the severity of losses on a per-property basis, driven in part by the declines in home sales and home prices, particularly in the North Central, East and West regions of the U.S.

We expect our loan loss reserves to increase in future periods commensurate with our outlook for future charge-offs. The rate of change will depend on a number of factors including property values, geographic distribution, loan balances and third-party insurance coverage. In 2005, we recorded an additional loss provision of \$128 million for our estimate of

incurred losses for loans affected by Hurricane Katrina. During 2006, we reversed \$82 million of the provision for credit losses recorded in 2005 associated with Hurricane Katrina because the related payment and delinquency experience on affected properties was more favorable than expected. Absent the adjustments related to Hurricane Katrina, the provision for credit losses would have been \$378 million and \$179 million in 2006 and 2005, respectively.

REO Operations Expense

The increase in REO operations expense in 2007, as compared to 2006, was due to a 64% increase in our REO property inventory in 2007 and declining REO property values. The decline in home prices during 2007, combined with our higher REO inventory balance, resulted in an increase in the market-based writedowns of REO, which totaled \$129 million and \$5 million in 2007 and 2006, respectively. The increase in REO expense in 2006, as compared to 2005, was due to higher real estate taxes, maintenance and net losses on sales experienced in 2006.

Losses on Certain Credit Guarantees

We recognize losses on certain credit guarantees when, upon the issuance of PCs in guarantor swap transactions, we determine that the fair value of our guarantee obligation net of other initial compensation exceeds the fair value of our guarantee asset plus buy-up fees and credit enhancement-related assets. Our recognition of losses on guarantee contracts can occur due to any one or a combination of several factors, including long-term contract pricing for our flow business, the difference in overall transaction pricing versus pool-level accounting measurements and, to a lesser extent, efforts to support our affordable housing mission.

We negotiate contracts with our customers based on the volume and types of mortgage loans to be delivered to us, and our estimates of the net present value of related future guarantee fees, credit costs and other associated cash flows. However, the accounting for our guarantee assets and guarantee obligations is not determined at the level at which we negotiate contracts; rather, it is determined separately for each PC-related pool of loans. We determine the initial fair value of the pool-level guarantee assets and guarantee obligations using methodologies that employ direct market-based information. These methodologies differ from the methodologies we use to determine pricing on new contracts.

For each loan pool created, we compare the initial fair value of the related guarantee obligation to the initial fair value of the related guarantee asset and credit enhancement-related assets. If the guarantee obligation is greater than the guarantee asset, we immediately recognize a loss equal to the difference with respect to that pool. If the guarantee obligation is less than the guarantee asset, no initial gain is recorded; rather, guarantee income equal to the difference is deferred as an addition to the guarantee obligation and is recognized as that liability is amortized. Accordingly, a guarantor swap transaction may result in some loan pools for which a loss is recognized immediately in earnings and other loan pools where guarantee income is deferred. We record these losses as losses on certain credit guarantees.

In 2007, 2006 and 2005 we recognized losses of \$2.0 billion, \$0.4 billion and \$0.3 billion, respectively, on certain guarantor swap transactions entered into during those periods. We also deferred income related to newly-issued guarantees of \$0.9 billion, \$1.0 billion and \$1.2 billion in 2007, 2006 and 2005, respectively. Increases in losses on certain credit guarantees reflect expectations of higher defaults and severity in the credit market in 2007 which were not fully offset by increases in guarantee and delivery fees due to competitive pressures and contractual fee arrangements. Increases in losses on loans purchased reflect reduced fair values and higher volume of delinquent loans purchased under our guarantees. Losses on certain credit guarantees are expected to continue to increase until the fair values of our newly-issued obligations return to historical levels or our price increases are sufficient to mitigate the rise in higher expected default costs.

Our guarantee fees with customers are negotiated periodically and remain in effect for an initial contract period of up to one year. We expect most of our guarantor swap transactions under these contracts to generate positive economic returns over the lives of the related PCs. During periods in which conditions in the mortgage credit market deteriorate, such as experienced in 2007, we may incur losses on certain transactions until such time as contract terms are changed or business conditions improve. While we continue to believe the fair value of the guarantee obligation recorded exceeds the losses that we ultimately expect to incur, our expectation of losses on new guarantees have increased significantly.

During the fourth quarter of 2007, we announced increases in delivery fees which are paid at the time of securitization. These increases represent additional fees assessed on all loans issued through flow activity channels, including extra fees for non-traditional and higher risk mortgage loans, that are effective in March 2008. Also, in February 2008, we announced an additional increase in delivery fees, effective in June 2008, for certain flow transactions. We expect that price increases, including the delivery fee increase effective in March and June 2008, will mitigate a portion of the losses on certain credit guarantees.

Losses on Loans Purchased

Losses on non-performing loans purchased from the mortgage pools underlying our PCs and Structured Securities occur when the acquisition basis of the purchased loan exceeds the estimated fair value of the loan on the date of purchase.

In 2007, the market-based valuation of non-performing loans was adversely affected by the market's expectation of higher default costs. The decrease in fair values of these loans, combined with an increase in the volume of purchases of non-performing loans and an increase in the average unpaid principal balance of those loans, resulted in losses of \$1.9 billion and \$0.1 billion for 2007 and 2006, respectively. We expect to recover a portion of the losses on loans purchased over time as these market-based valuations imply future credit losses that are significantly higher than we expect to ultimately incur. See "Non-Interest Income (Loss) — Recoveries on Loans Impaired upon Purchase" for discussion related to recoveries on those previously purchased loans. See "CREDIT RISKS — Table 52 — Changes in Loans Purchased Under Financial Guarantees" for additional information about our purchases of non-performing loans.

Effective December 2007 we made certain operational changes for purchasing delinquent loans from PC pools, which reduced the amount of our losses on loans purchased during the fourth quarter of 2007. We believe that our historical practice of purchasing loans from PC pools once they become 120 days delinquent does not reflect our historical cure rate for most of these delinquent loans. Allowing the loans to remain in PC pools until they become modified, foreclosure occurs or they reach 24 months past due unless we determine it is economically beneficial to purchase the loans sooner, better reflects our expectations for credit losses, because a significant number of these loans reperform. Taking this action is expected to reduce our losses on loans purchased, and result in higher provision for credit losses associated with our PCs and Structured Securities. However, due to the increases in delinquency rates of loans underlying our PCs and Structured Securities in 2007, we expect that the number of loan modifications will increase significantly in 2008, contributing to losses on loans purchased.

Other Expenses

Other expenses increased slightly from 2007 to 2006 and decreased from 2006 to 2005 due to \$339 million of expenses we recorded in 2005 to increase our reserves for legal settlements, net of expected insurance proceeds. See "NOTE 12: LEGAL CONTINGENCIES" to our consolidated financial statements for more information.

Income Tax Expense (Benefit)

For 2007, 2006 and 2005, we reported income tax expense (benefit) of \$(2.9) billion, \$(45) million, and \$358 million, respectively, resulting in effective tax rates of 48%, (2)% and 14%, respectively. The volatility in our effective tax rate over the past three years is primarily the result of fluctuations in pre-tax income. Our effective tax rate continues to be favorably impacted by our investments in LIHTC partnerships and interest earned on tax-exempt housing related securities. Our 2006 effective tax rate also benefited from releases of tax reserves of \$174 million.

For the year ended December 31, 2007, our pre-tax loss exceeded our pre-tax income for years 2005 and 2006. We have not recorded a valuation allowance against our deferred tax assets as we believe that realization is more likely than not. See "NOTE 13: INCOME TAXES" to our consolidated financial statements for additional information.

Segment Measures — Adjusted Operating Income

Adjusted Operating Income

In managing our business, we measure the operating performance of our segments using Adjusted operating income. Adjusted operating income differs significantly from, and should not be used as a substitute for net income (loss) before cumulative effect of change in accounting principle or net income (loss) as determined in accordance with GAAP. There are important limitations to using Adjusted operating income as a measure of our financial performance. Among other things, our regulatory capital requirements are based on our GAAP results. Adjusted operating income adjusts for the effects of certain gains and losses and mark-to-market items which, depending on market circumstances, can significantly affect, positively or negatively, our GAAP results and which, in recent periods, have contributed to GAAP net losses. GAAP net losses will adversely impact our regulatory capital, regardless of results reflected in Adjusted operating income. Also, our definition of Adjusted operating income may differ from similar measures used by other companies. However, we believe that the presentation of Adjusted operating income highlights the results from ongoing operations and the underlying results of the segments in a manner that is useful to the way we manage and evaluate the performance of our business. See "NOTE 15: SEGMENT REPORTING" to our consolidated financial statements for more information regarding segments and Adjusted operating income.

As described below, Adjusted operating income is calculated for the segments by adjusting net income (loss) before cumulative effect of change in accounting principle for certain investment-related activities and credit guarantee-related activities. Adjusted operating income includes certain reclassifications among income and expense categories that have no impact on net income (loss) but provide us with a meaningful metric to assess the performance of each segment and the company as a whole.

Investment Activity-Related Adjustments

We are primarily a buy and hold investor in mortgage assets, although we may sell assets to reduce risk, respond to capital constraints, provide liquidity, or structure transactions that improve our returns. Our measure of Adjusted operating income for our investment-related activities is useful to us because it reflects the way we manage and evaluate the performance of our business.

The most significant inherent risk in our investing activities is interest-rate risk, including duration, convexity and volatility. We actively manage these risks through asset selection and structuring, financing asset purchases with a broad range of both callable and non-callable debt and the use of interest-rate derivatives designed to economically hedge a significant portion of our interest-rate exposure. Our interest rate derivatives include interest-rate swaps, exchange-traded futures, and both purchased and written options (including swaptions). GAAP-basis earnings related to investment activities of our Investments segment, and to a lesser extent, our Multifamily segment, are subject to significant period-to-period variability, which we believe is not necessarily indicative of the risk management techniques that we employ and the performance of these segments.

Our derivative instruments are adjusted to fair value under GAAP with resulting gains or losses recorded in GAAP-basis income. Certain other assets are also adjusted to fair value under GAAP with resulting gains or losses recorded in GAAP-basis income. These assets consist primarily of mortgage-related securities classified as trading and mortgage-related securities classified as available-for-sale when a decline in the fair value of available-for-sale securities is deemed to be other than temporary.

To help us assess the performance of our investment-related activities, we make the following adjustments to earnings as determined under GAAP. We believe this measure of performance, which we call Adjusted operating income, enhances the understanding of operating performance for specific periods, as well as trends in results over multiple periods, as this measure is consistent with assessing our performance against our investment objectives and the related risk-management activities.

- Derivative- and foreign currency translation-related adjustments:
 - Fair value adjustments on derivative positions, recorded pursuant to GAAP, are not recognized in Adjusted operating income as these positions economically hedge our investment activities.
 - Payments or receipts to terminate derivative positions are amortized prospectively into Adjusted operating income on a straight-line basis over the associated term of the derivative instrument.
 - Payments of up-front premiums (*e.g.*, payments made to third parties related to purchased swaptions) are amortized prospectively on a straight-line basis into Adjusted operating income over the contractual life of the instrument. The up-front payments, primarily for option premiums, are amortized to reflect the periodic cost associated with the protection provided by the option contract.
 - Foreign-currency translation gains and losses associated with foreign-currency denominated debt along with the foreign currency derivatives gains and losses are excluded from Adjusted operating income because the fair value adjustments on the foreign-currency swaps that we use to manage foreign-currency exposure are also excluded through the fair value adjustment on derivative positions as described above as the foreign currency exposure is economically hedged.
- Investment sales, debt retirements and fair value-related adjustments:
 - Gains and losses on investment sales and debt retirements that are recognized at the time of the transaction pursuant to GAAP are not immediately recognized in Adjusted operating income. Gains and losses on securities sold out of the retained portfolio and cash and investments portfolio are amortized prospectively into Adjusted operating income on a straight-line basis over five years and three years, respectively. Gains and losses on debt retirements are amortized prospectively into Adjusted operating income on a straight-line basis over the original terms of the repurchased debt.
 - Trading losses or impairments that reflect expected or realized credit losses are realized immediately pursuant to GAAP and in Adjusted operating income since they are not economically hedged. Fair value adjustments to trading securities related to investments that are economically hedged are not included in Adjusted operating income. Similarly, non-credit related impairment losses on securities are not included in Adjusted operating income. These amounts are deferred and amortized prospectively into Adjusted operating income on a straight-line basis over five years for securities in the retained portfolio and over three years for securities in the cash and investments portfolio. GAAP-basis accretion income that may result from impairment adjustments is also not included in Adjusted operating income.

- Fully taxable-equivalent adjustment:
 - Interest income on tax-exempt investments is adjusted to reflect its equivalent yield on a fully taxable basis.

We fund our investment assets with debt and derivatives to minimize interest-rate risk as evidenced by our PMVS and duration gap metrics. As a result, in situations where we record gains and losses on derivatives, securities or debt buybacks, these gains and losses are offset by economic hedges that we do not mark-to-market for GAAP purposes. For example, when we realize a gain on the sale of a security, the debt which is funding the security has an embedded loss that is not recognized under GAAP, but instead over time as we realize the interest expense on the debt. As a result, in Adjusted operating income, we defer and amortize the security gain to interest income to match the interest expense on the debt that funded the asset. Because of our risk management strategies, we believe that amortizing gains or losses on economically hedged positions in the same periods as the offsetting gains or losses is a meaningful way to assess performance of our investment activities.

We believe it is useful to measure our performance using long-term returns, not on a short-term fair value basis. Fair value fluctuations in the short-term are not an accurate indication of long-term returns. In calculating Adjusted operating income, we make adjustments to our GAAP-basis results that are designed to provide a more consistent view of our financial results, which helps us better assess the performance of our business segments, both from period to period and over the longer term. The adjustments we make to present our Adjusted operating income results are consistent with the financial objectives of our investment activities and related hedging transactions and provide us with a view of expected investment returns and effectiveness of our risk management strategies that we believe is useful in managing and evaluating our investment-related activities. Although we seek to mitigate the interest-rate risk inherent in our investment-related activities, our hedging and portfolio management activities do not eliminate risk. We believe that a relevant measure of performance should closely reflect the economic impact of our risk management activities. Thus, we amortize the impact of terminated derivatives as well as gains and losses on asset sales and debt retirements into Adjusted operating income. Although our interest-rate risk and asset/liability management processes ordinarily involve active management of derivatives as well as asset sales and debt retirements, we believe that Adjusted operating income, although it differs significantly from, and should not be used as a substitute for GAAP-basis results, is indicative of the longer-term time horizon inherent in our investment-related activities.

Credit Guarantee Activity-Related Adjustments

The credit guarantee activities of our Single-family Guarantee and Multifamily segments consist largely of our guarantee of the payment of principal and interest on mortgages and mortgage-related securities in exchange for guarantee and other fees. Over the longer-term, earnings consist almost entirely of the guarantee fee revenues we receive less related credit costs (*i.e.*, provision for credit losses) and operating expenses. Our measure of Adjusted operating income for these activities consists primarily of these elements of revenue and expense. We believe this measure is a relevant indicator of operating performance for specific periods, as well as trends in results over multiple periods, because it more closely aligns with how we manage and evaluate the performance of the credit guarantee business.

We purchase mortgages from sellers/servicers in order to securitize and issue PCs and Structured Securities. In addition to the components of earnings noted above, GAAP-basis earnings for these activities include gains or losses realized upon the execution of such transactions, subsequent fair value adjustments to the guarantee asset and amortization of the guarantee obligation.

Our credit-guarantee activities also include the purchase of significantly past due mortgage loans from loan pools that underlie our guarantees. Pursuant to GAAP, at the time of our purchase, the loans are recorded at fair value. To the extent the adjustment of a purchased loan to market value exceeds our own estimate of the losses we will ultimately realize on the loan, as reflected in our loan loss reserve, an additional loss is recorded in our GAAP-basis results.

When we determine Adjusted operating income for our credit guarantee-related activities, the adjustments we apply to earnings computed on a GAAP-basis include the following:

- Amortization and valuation adjustments pertaining to the guarantee asset and guarantee obligation are excluded from Adjusted operating income. Cash compensation exchanged at the time of securitization, excluding buy-up and buy-down fees, is amortized into earnings.
- The initial recognition of gains and losses in connection with the execution of either securitization transactions that qualify as sales or guarantor swap transactions, such as losses on certain credit guarantees, is excluded from Adjusted operating income.
- Fair value adjustments recorded upon the purchase of delinquent loans from pools that underlie our guarantees are excluded from Adjusted operating income. However, for Adjusted operating income reporting, our GAAP-basis loan loss provision is adjusted to reflect our own estimate of the losses we will ultimately realize on such items.

Over the long term, Adjusted operating income and GAAP-basis income both capture the aggregate cash flows associated with our guarantee-related activities. Although Adjusted operating income differs significantly from, and should not be used as a substitute for GAAP-basis income, we believe that excluding the impact of changes in the fair value of expected future cash flows from our Adjusted operating income provides a meaningful measure of performance for a given period as well as trends in performance over multiple periods, because it more closely aligns with how we manage and evaluate the performance of the credit guarantee business.

Segment Allocations

Results of each reportable segment include directly attributable revenues and expenses. Administrative expenses that are not directly attributable to a segment are allocated ratably using alternative quantifiable measures such as headcount distribution or system usage if considered semi-direct or on a pre-determined basis if considered indirect. Expenses not allocated to segments consist primarily of costs associated with remediating our internal controls and near-term restructuring costs and are included in the All Other category. Net interest income for each segment includes an allocation related to investments and debt based on each segment's assets and off-balance sheet obligations. The LIHTC tax benefit is allocated to the Multifamily segment. All remaining taxes are calculated based on a 35% federal statutory rate as applied to Adjusted operating income.

We continue to assess the methodologies used for segment reporting and refinements may be made in future periods. See "NOTE 15: SEGMENT REPORTING" to our consolidated financial statements for further discussion of Adjusted operating income as well as the management reporting and allocation process used to generate our segment results.

Segment Results — Adjusted Operating Income

Investments

In this segment, we invest principally in mortgage-related securities and single-family mortgage loans through our mortgage-related investment portfolio. Adjusted operating income consists primarily of the returns on these investments, less the related financing costs and administrative expenses. Within this segment, our activities may include the purchase of mortgage loans and mortgage-related securities with less attractive investment returns and with incremental risk in order to achieve our affordable housing goals and subgoals. We maintain a cash and a non-mortgage-related securities investment portfolio in this segment to help manage our liquidity. We finance these activities primarily through issuances of short- and long-term debt in the public markets. Results also include derivative transactions we enter into to help manage interest-rate and other market risks associated with our debt financing activities and mortgage-related investment portfolio.

Table 18 presents the Adjusted operating income results of our Investments segment.

Table 18 — Adjusted Operating Income Segment Results — Investments

	Year Ended December 31,		
	2007	2006	2005
	(in millions)		
Adjusted operating income results:			
Net interest income	\$ 3,626	\$ 3,736	\$ 4,117
Non-interest income (loss)	40	38	(74)
Non-interest expense:			
Administrative expenses	(515)	(495)	(466)
Other non-interest expense	(31)	(31)	(63)
Total non-interest expense	(546)	(526)	(529)
Adjusted operating income before income tax expense	3,120	3,248	3,514
Income tax expense	(1,092)	(1,137)	(1,230)
Adjusted operating income, net of taxes	2,028	2,111	2,284
Reconciliation to GAAP net income (loss):			
Derivative and foreign currency translation-related adjustments	(5,658)	(2,374)	(1,652)
Credit guarantee-related adjustments	2	1	—
Investment sales, debt retirements and fair value-related adjustments	987	231	570
Fully taxable-equivalent adjustment	(388)	(388)	(336)
Tax-related adjustments	2,026	1,139	717
Total reconciling items, net of taxes	(3,031)	(1,391)	(701)
Net income (loss) ⁽¹⁾	\$ (1,003)	\$ 720	\$ 1,583
Net interest yield — Adjusted operating income basis	0.51%	0.51%	0.60%

(1) Net income (loss) is presented before the cumulative effect of a change in accounting principle related to 2005.

Adjusted operating income for our Investments segment declined slightly in 2007 compared to 2006. In 2007 and 2006, the growth rates of our mortgage-related investment portfolio were 0.7% and (1.6)%, respectively. In 2007, wider mortgage-to-debt OAS resulted in favorable investment opportunities, particularly in the second half of the year. In response to these market conditions, we took advantage of these opportunities by increasing our purchase activities in CMBS and agency

mortgage-related securities. In November 2007, additional widening in OAS levels negatively impacted our GAAP results and lowered our overall capital position. Capital constraints forced us to reduce our balance of interest earning assets, issue \$6 billion of non-cumulative, perpetual preferred stock and reduce our common stock dividend by 50% in the fourth quarter of 2007. As a result, the unpaid principal balance of our mortgage-related investment portfolio increased only slightly from \$658.8 billion at December 31, 2006 to \$663.2 billion at December 31, 2007.

The unpaid principal balance of our mortgage-related investment portfolio declined to \$658.8 billion at December 31, 2006 from \$669.3 billion at December 31, 2005, as relatively tight mortgage-to-debt OASs limited attractive investment opportunities. In addition, we began managing our mortgage-related investment portfolio under a voluntary, temporary growth limit during the second half of 2006.

Our net interest yield remained unchanged for the year ended December 31, 2007 compared to the year ended December 31, 2006; however, our Adjusted operating net interest income declined. This decline is due, in part, to a decrease in the average balance of our mortgage-related investment portfolio. We also experienced higher funding costs as our long-term debt interest expense increased, reflecting the replacement of maturing debt that we issued at lower interest rates during the past few years. Increases in our funding costs were offset by a decline in our mortgage-related securities amortization expense as purchases in 2007 largely consisted of securities purchased at a discount.

During the year ended December 31, 2007, demand for our debt securities remained strong, allowing us to issue our debt securities at rates below those of comparable maturities on the LIBOR yield curve.

Single-Family Guarantee

In this segment, we guarantee the payment of principal and interest on single-family mortgage-related securities, including those held in our retained portfolio, in exchange for guarantee fees received over time and other up-front compensation. Earnings for this segment consist of guarantee fee revenues less the related credit costs (*i.e.*, provision for credit losses) and operating expenses. Also included is the interest earned on assets held in the Investments segment related to single-family guarantee activities, net of allocated funding costs and amounts related to net float benefits. Float arises from timing differences between when the borrower makes principal payments on the loan and the reduction of the PC balance.

Table 19 presents the Adjusted operating income results of our Single-family Guarantee segment.

Table 19 — Adjusted Operating Income Segment Results — Single-Family Guarantee

	Year Ended December 31,		
	2007	2006	2005
	(in millions)		
Adjusted operating income results:			
Net interest income	\$ 703	\$ 556	\$ 349
Non-interest income:			
Management and guarantee income	2,889	2,541	2,341
Other non-interest income	117	159	78
Total non-interest income	3,006	2,700	2,419
Non-interest expense:			
Administrative expenses	(806)	(815)	(767)
Provision for credit losses	(3,014)	(313)	(447)
REO operations expense	(205)	(61)	(40)
Other non-interest expense	(78)	(84)	(30)
Total non-interest expense	(4,103)	(1,273)	(1,284)
Adjusted operating income (loss) before income tax expense	(394)	1,983	1,484
Income tax (expense) benefit	138	(694)	(519)
Adjusted operating income (loss), net of taxes	(256)	1,289	965
Reconciliation to GAAP net income (loss):			
Credit guarantee-related adjustments	(3,270)	(205)	(462)
Tax-related adjustments	1,144	72	161
Total reconciling items, net of taxes	(2,126)	(133)	(301)
Net income (loss)	<u>\$ (2,382)</u>	<u>\$ 1,156</u>	<u>\$ 664</u>

Adjusted operating income for our Single-family Guarantee segment declined in 2007 compared to 2006. This decline reflects an increase in credit costs largely driven by a decline in home prices and other declines in regional economic conditions, partially offset by an increase in management and guarantee income. The increases in management and guarantee income in 2006 and 2007 are primarily due to higher average balances of the single-family credit guarantee portfolio.

Table 20 below provides summary Adjusted operating income information about management and guarantee income for the Single-family Guarantee segment. Management and guarantee income consists of contractual amounts due to us related to our management and guarantee fees as well as amortization of credit fees.

Table 20 — Adjusted Operating Management and Guarantee Income — Single-Family Guarantee

	Year Ended December 31,					
	2007		2006		2005	
	Amount	Rate	Amount	Rate	Amount	Rate
	(dollars in millions, rates in basis points)					
Contractual management and guarantee fees	\$2,514	15.7	\$2,186	15.5	\$1,934	15.4
Amortization of credit fees included in other liabilities	375	2.3	355	2.5	407	3.2
Total Adjusted operating management and guarantee income	<u>2,889</u>	<u>18.0</u>	<u>2,541</u>	<u>18.0</u>	<u>2,341</u>	<u>18.6</u>
Adjustments to reconcile to consolidated GAAP:						
Reclassification between net interest income and guarantee fee ⁽¹⁾⁽²⁾	29		(37)		(9)	
Credit guarantee-related activity adjustments ⁽³⁾	(342)		(172)		(315)	
Multifamily management and guarantee income ⁽⁴⁾	59		61		59	
Management and guarantee income, GAAP	<u>\$2,635</u>		<u>\$2,393</u>		<u>\$2,076</u>	

- (1) Guarantee fees earned on mortgage loans held in our retained portfolio are reclassified from net interest income within the Investments segment to management and guarantee fee within the Single-family Guarantee segment.
- (2) Buy-up and buy-down fees are transferred from the Single-family Guarantee segment to the Investments segment.
- (3) Primarily represents credit fee amortization adjustments.
- (4) Represents management and guarantee income recognized related to our Multifamily segment that is not included in our Single-family Guarantee segment.

In 2007 and 2006, the growth rates of our credit guarantee portfolio were 17.7% and 11.1%, respectively. We estimate the annual growth in total U.S. residential mortgage debt outstanding to be approximately 7.1% in 2007 compared to 11.3% in 2006. Our single-family mortgage purchase and guarantee volumes are impacted by several factors, including origination volumes, mortgage product and underwriting trends, competition, customer-specific behavior and contract terms. Mortgage purchase volumes from individual customers can fluctuate significantly. In 2007, flow and bulk transactions represented approximately 78% and 22%, respectively, of our single-family mortgage purchase and securitization volumes.

The credit markets have been increasingly volatile and the securitization market was extremely competitive. Competitive pressure on flow business guarantee contracts in early 2007 during the renewal periods of some of our longer-term contracts limited our ability to increase flow-business guarantee fees in 2007. As a result, some of our guarantee business in 2007 was acquired below our normal expected return thresholds. At the same time, the expected future credit costs associated with our new credit guarantee business increased.

We negotiated increases in our contractual fee rates for securitization issuances through bulk activity channels throughout 2007 in response to increases in market pricing of mortgage credit risk. We continue to pursue guarantee fee price increases in our flow-business as contracts are renewed. During the fourth quarter of 2007, we announced increases in delivery fees, which are paid at the time of securitization. These increases, which will be effective in March 2008, represent an additional 25 basis points of fees assessed on all loans issued through flow-business channels, as well as extra fees for non-traditional and higher risk mortgage loans. Also, in February 2008, we announced an additional increase in delivery fees for certain flow-business transactions that will be effective in June 2008.

Net interest income increased due to interest earned on cash and investment balances held in the Investments segment related to single-family guarantee activities, net of allocated funding costs. We expect net interest income from cash and investments to decline in 2008, as we begin to recognize trust management income in other non-interest income. The trust management income will be offset by interest expense we incur when a borrower prepays.

Our Adjusted operating provision for credit losses for the Single-family Guarantee segment increased to \$3.0 billion in 2007, compared to \$0.3 billion in 2006, due to continued credit deterioration in our single-family credit guarantee portfolio, primarily related to 2006 and 2007 loan originations. Mortgages in our portfolio originated in 2006 and 2007 have higher transition rates from delinquency to foreclosure, higher delinquency rates as well as higher loss severities on a per-property basis. Our provision is based on our estimate of incurred credit losses inherent in both our retained mortgage loan and our credit guarantee portfolio using recent historical performance, such as the trends in delinquency rates, recent charge-off experience, recoveries from credit enhancements and other loss mitigation activities.

The proportion of higher risk mortgage loans that were originated in the market during the last several years increased significantly. We have increased our securitization volume of non-traditional mortgage products, such as interest-only loans and loans originated with less documentation in the last two years in response to the prevalence of these products within the origination market. Total non-traditional mortgage products, including those designated as Alt-A and interest-only loans, made up approximately 30% and 24% of our single-family mortgage purchase volume in the years ended December 31 2007 and 2006, respectively. Our increased purchases of these mortgages and issuances of guarantees of them expose us to greater

credit risks. In addition, we have increased purchases of mortgages that were underwritten by our seller/servicers using alternative automated underwriting systems or agreed-upon underwriting standards that differ from our system or guidelines.

The delinquency rate on our single-family credit guarantee portfolio, representing those loans which are 90 days or more past due and excluding loans underlying Structured Transactions, increased to 65 basis points as of December 31, 2007 from 42 basis points as of December 31, 2006. Increases in delinquency rates occurred in all product types in 2007, but were most significant for interest-only and option ARM mortgages. Although we believe that our delinquency rates remain low relative to conforming loan delinquency rates of other industry participants, we expect our delinquency rates will rise in 2008. See “CREDIT RISKS — Table 51 — Single-Family — Delinquency Rates — By Product” for further discussion.

Single-family charge-offs, gross, increased 71% in 2007 compared to 2006, primarily due to a considerable increase in the volume of REO properties acquired at foreclosure. In addition, there has been a substantial increase in the average size of the associated unpaid principal balances in 2007, especially for those loans in major metropolitan areas. Higher volumes of foreclosures and higher average loan balances resulted in higher charge-offs, on a per property basis, during 2007.

We experienced increases in delinquency rates and REO activity in the Northeast, North Central, Southeast and West regions during 2007 compared to 2006. The increases in delinquencies and foreclosures have been most evident in the North Central region, where unemployment rates continue to be high. During 2007, we experienced increases in the rate at which loans in our single-family credit guarantee portfolio transitioned from delinquency to foreclosure. The increase in the delinquency transition rates which is the percentage of delinquent loans that proceed to foreclosure or are modified as troubled debt restructurings, compared to our historical experience, has been progressively worse for mortgage loans originated in 2006 and 2007. We believe this trend is, in part, due to the increase of non-traditional mortgage loans, such as interest-only mortgages, as well as an increase in total loan-to-value ratios for mortgage loans originated during these years. In addition, the average size of the unpaid principal balance related to REO properties in our portfolio rose significantly in 2007, especially those REO properties in the Northeast, Southeast and West regions.

Declines in home prices have contributed to the increase in the weighted average estimated current loan-to-value, or LTV, ratio for loans underlying our single-family credit guarantee portfolio to 63% at December 31, 2007 from 57% at December 31, 2006. Approximately 10% of loans in our single-family mortgage portfolio had estimated current LTV ratios above 90% at December 31, 2007, compared to 2% at December 31, 2006. However, as home prices increased during 2006 and prior years, many borrowers used second liens at the time of purchase to potentially reduce the LTV ratio to below 80%, thus avoiding requirements to have private mortgage insurance. Including this secondary financing that our borrowers secured with other financial institutions, we estimate that the percentage of loans underlying our single-family portfolio with total LTV ratios above 90% has risen to approximately 14% at December 31, 2007. In general, higher total LTV ratios indicate that the borrower has less equity in the home and would thus be more susceptible to foreclosure in the event of a financial downturn.

Multifamily

In this segment, we purchase multifamily mortgages for our retained portfolio and guarantee the payment of principal and interest on multifamily mortgage-related securities and mortgages underlying multifamily housing revenue bonds. These activities support our mission to supply financing for affordable rental housing. This segment also includes certain equity investments in various limited partnerships that sponsor low- and moderate-income multifamily rental apartments, which benefit from low-income housing tax credits. Also included is the interest earned on assets held in the Investments segment related to multifamily guarantee activities, net of allocated funding costs.

Table 21 presents the Adjusted operating income results of our Multifamily segment.

Table 21 — Adjusted Operating Income Segment Results — Multifamily

	Year Ended December 31,		
	2007	2006	2005
	(in millions)		
Adjusted operating income results:			
Net interest income	\$ 426	\$ 479	\$ 417
Non-interest income:			
Management and guarantee income	59	61	59
Other non-interest income	24	28	19
Total non-interest income	83	89	78
Non-interest expense:			
Administrative expenses	(189)	(182)	(151)
Provision for credit losses	(38)	(4)	(7)
REO operations expense	(1)	1	—
LIHTC partnerships	(469)	(407)	(320)
Other non-interest expense	(21)	(17)	(20)
Total non-interest expense	(718)	(609)	(498)
Adjusted operating (loss) before income tax benefit	(209)	(41)	(3)
LIHTC partnerships tax benefit	534	461	365
Income tax benefit	73	14	1
Adjusted operating income, net of taxes	398	434	363
Reconciliation to GAAP net income:			
Derivative and foreign currency translation-related adjustments	(9)	3	8
Credit guarantee-related adjustments	—	3	4
Tax-related adjustments	2	(1)	(4)
Total reconciling items, net of taxes	(7)	5	8
Net income	<u>\$ 391</u>	<u>\$ 439</u>	<u>\$ 371</u>

Adjusted operating income for our Multifamily segment decreased \$36 million, or 8%, in 2007 compared to 2006 primarily due to lower net interest income, higher provision for credit losses and higher LIHTC losses.

Net interest income includes interest earned on cash and investment balances held in the Investments segment related to multifamily guarantee activities, net of allocated funding costs. The net interest income of this segment declined slightly in 2007, compared to 2006, as higher funding costs more than offset the increase in our loan portfolio balances. We experienced higher funding costs in 2007 versus 2006, reflecting the replacement of maturing long-term debt that was issued at lower rates in prior years.

Despite market volatility and credit concerns in the single-family market, the multifamily market fundamentals generally continued to display positive trends throughout 2007. Tightened credit standards and reduced liquidity caused many market participants to limit purchases of multifamily mortgages during the second half of 2007, creating investment opportunities for us with higher long-term expected returns and enhancing our ability to meet our affordable housing goals.

Mortgage purchases into our multifamily loan portfolio increased approximately 50% in 2007, to \$18.2 billion from \$12.1 billion in 2006. The balance of our multifamily loan portfolio increased to \$57.6 billion at December 31, 2007 from \$45.2 billion at December 31, 2006. The credit quality of the Multifamily segment remains strong, reflecting a geographically diversified portfolio. While current market developments indicate higher credit losses for most multifamily mortgage investors, we expect a modest impact to our results, as we continued our conservative approach to underwriting multifamily assets throughout the past two years while credit standards for many lenders deteriorated sharply. Our relatively low provision for credit losses and other non-interest expenses in 2007 and 2006 for this segment reflects our disciplined approach.

We increased our LIHTC investment in 2007 compared to 2006. These investments generated losses and tax credits during development and construction phases and income when the properties were placed into service. At December 31, 2007, the unconsolidated LIHTC equity investment portfolio consisted of 268 funds invested in 5,064 properties and had a net investment balance of \$4.6 billion. Our continued investment in LIHTC partnership funds resulted in tax benefits of \$534 million and \$461 million for the years ended December 31, 2007 and 2006, respectively.

CONSOLIDATED BALANCE SHEETS ANALYSIS

The following discussion of our consolidated balance sheets should be read in conjunction with our consolidated financial statements, including the accompanying notes. Also see “CRITICAL ACCOUNTING POLICIES AND ESTIMATES” for more information concerning our significant accounting policies.

On October 1, 2007, we adopted FSP FIN 39-1. See “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Recently Adopted Accounting Standards — *Offsetting of Amounts Related to Certain Contracts*” to our

consolidated financial statements for additional information about adoption of FSP FIN 39-1. The adoption of FSP FIN 39-1 reduced derivative assets, net, derivative liabilities, net and senior debt, due within one year on our consolidated balance sheets.

Effective December 31, 2007, we retrospectively applied changes in our method of accounting for our guarantee obligation. See “NOTE 20: CHANGES IN ACCOUNTING PRINCIPLES” to our consolidated financial statements for additional information regarding these changes and the effect on our consolidated balance sheets. Previously reported consolidated balance sheet amounts as of December 31, 2006 discussed below have been adjusted to reflect the retrospective application of these changes in method.

Retained Portfolio

We refer to our investments in mortgage loans and mortgage-related securities recorded on our consolidated balance sheets as our retained portfolio. See “PORTFOLIO BALANCES AND ACTIVITIES” for further information on the composition of our mortgage portfolios. In response to a request by OFHEO, on August 1, 2006, we voluntarily and temporarily limited the growth of our retained portfolio. For a further discussion of our retained portfolio growth limitation see “REGULATION AND SUPERVISION — Office of Federal Housing Enterprise Oversight — *Voluntary, Temporary Growth Limit.*” The average unpaid principal balance of our retained portfolio for the six months ended December 31, 2007, calculated using cumulative average month-end portfolio balances, was \$26.9 billion below our voluntary growth limit of \$742.4 billion.

Table 22 provides detail regarding the mortgage loans and mortgage-related securities in our retained portfolio.

Table 22 — Characteristics of Mortgage Loans and Mortgage-Related Securities in our Retained Portfolio

	December 31,					
	2007			2006 (Adjusted)		
	Fixed Rate	Variable Rate	Total	Fixed Rate	Variable Rate	Total
	(in millions)					
Mortgage loans:						
Single-family ⁽¹⁾	\$ 21,889	\$ 2,700	\$ 24,589	\$ 19,407	\$ 1,233	\$ 20,640
Multifamily ⁽²⁾	53,114	4,455	57,569	41,866	3,341	45,207
Total mortgage loans	75,003	7,155	82,158	61,273	4,574	65,847
PCs and Structured Securities: ⁽¹⁾⁽³⁾						
Single-family	269,896	84,415	354,311	282,052	71,828	353,880
Multifamily	2,522	137	2,659	241	141	382
Total PCs and Structured Securities	272,418	84,552	356,970	282,293	71,969	354,262
Non-Freddie Mac mortgage-related securities: ⁽¹⁾						
Agency mortgage-related securities: ⁽⁴⁾						
Fannie Mae:						
Single-family	23,140	23,043	46,183	25,779	17,441	43,220
Multifamily	759	163	922	1,013	201	1,214
Government National Mortgage Association, or Ginnie Mae:						
Single-family	537	181	718	707	231	938
Multifamily	13	—	13	13	—	13
Total agency mortgage-related securities	24,449	23,387	47,836	27,512	17,873	45,385
Non-agency mortgage-related securities:						
Single-family:						
Subprime ⁽⁵⁾	498	100,827	101,325	408	121,691	122,099
Alt-A and other ⁽⁶⁾	3,762	47,551	51,313	3,683	52,579	56,262
CMBS	25,709	39,095	64,804	23,517	21,243	44,760
Mortgage revenue bonds ⁽⁷⁾	14,870	65	14,935	13,775	59	13,834
Manufactured housing ⁽⁸⁾	1,250	222	1,472	1,381	129	1,510
Total non-agency mortgage-related securities ⁽⁹⁾	46,089	187,760	233,849	42,764	195,701	238,465
Total unpaid principal balance of retained portfolio	\$417,959	\$302,854	720,813	\$413,842	\$290,117	703,959
Premiums, discounts, deferred fees, impairments of unpaid principal balances and other basis adjustments			(655)			993
Net unrealized gains (losses) on mortgage-related securities, pre-tax			(10,116)			(4,950)
Allowance for loan losses on mortgage loans held-for-investment			(256)			(69)
Total retained portfolio per consolidated balance sheets			\$709,786			\$699,933

- (1) Variable-rate single-family mortgage loans and mortgage-related securities include those with a contractual coupon rate that, prior to contractual maturity, is either scheduled to change or is subject to change based on changes in the composition of the underlying collateral. Single-family mortgage loans also include mortgages with balloon/reset provisions.
- (2) Variable-rate multifamily mortgage loans include only those loans that, as of the reporting date, have a contractual coupon rate that is subject to change.
- (3) For our PCs and Structured Securities, we are subject to the credit risk associated with the underlying mortgage loan collateral.
- (4) Agency mortgage-related securities are generally not separately rated by nationally recognized statistical rating organizations, but are viewed as having a level of credit quality at least equivalent to non-agency mortgage-related securities AAA-rated or equivalent.
- (5) Single-family non-agency mortgage-related securities backed by subprime residential loans include significant credit enhancements, particularly through subordination, and approximately 81% of these securities held at December 31, 2007 were AAA-rated at February 25, 2008.
- (6) Single-family non-agency mortgage-related securities backed by Alt-A and other mortgage loans include significant credit enhancements, particularly through subordination, and approximately 98% of these securities held at December 31, 2007 were AAA-rated at February 25, 2008.
- (7) Consist of obligations of states and political subdivisions. Approximately 67% and 66% of these securities were AAA-rated at December 31, 2007 and 2006, respectively.
- (8) At December 31, 2007 and 2006, 34% and 30%, respectively, of mortgage-related securities backed by manufactured housing were rated BBB- or above. For the same dates, 97% of these securities were supported by third-party credit enhancements (e.g., bond insurance) and other credit enhancements (e.g., deal structure through subordination). Approximately 28% and 23% of these securities were AAA-rated at December 31, 2007 and 2006, respectively.
- (9) Credit ratings for most non-agency mortgage-related securities are designated by no fewer than two nationally recognized statistical rating organizations. At both December 31, 2007 and 2006, approximately 96% of total non-agency mortgage-related securities were AAA-rated.

We invest in agency-issued mortgage-related securities, principally our own, when market conditions offer positive risk-adjusted returns relative to other permitted investments. We have also purchased non-agency mortgage-related securities in support of our affordable housing mission.

Our purchases of non-agency single-family mortgage-related securities, which principally consist of securities backed by subprime and Alt-A mortgage products, have been in highly-rated, senior tranches of securitized mortgage pools. Due to credit concerns in the second half of 2007, new issuances of these securities in the market have declined dramatically. Consequently, our holdings of non-agency single-family mortgage-related securities have decreased in 2007, compared to

2006. We have replaced these investments with purchases of non-agency CMBS securities that meet our investment criteria.

Table 23 provides additional detail regarding the fair value of mortgage-related securities in our retained portfolio.

Table 23 — Fair Value of Available-For-Sale and Trading Mortgage-Related Securities in our Retained Portfolio

	December 31,		
	2007	2006	2005
	(in millions)		
Available-for-sale securities:			
Mortgage-related securities issued by:			
Freddie Mac	\$346,967	\$344,088	\$351,447
Fannie Mae	45,857	43,886	43,306
Ginnie Mae	562	733	1,115
Other	207,701	224,099	231,356
Obligations of states and political subdivisions	14,578	13,925	11,241
Total available-for-sale mortgage-related securities	<u>615,665</u>	<u>626,731</u>	<u>638,465</u>
Trading securities:			
Mortgage-related securities issued by:			
Freddie Mac	12,216	6,573	8,156
Fannie Mae	1,697	802	534
Ginnie Mae	175	222	204
Other	1	—	—
Total trading mortgage-related securities	<u>14,089</u>	<u>7,597</u>	<u>8,894</u>
Total fair value of available-for-sale and trading mortgage-related securities	<u>\$629,754</u>	<u>\$634,328</u>	<u>\$647,359</u>

Upon the adoption of SFAS 159 we increased the number of securities categorized as trading in our retained portfolio on January 1, 2008. See “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Recently Issued Accounting Standards, Not Yet Adopted — *The Fair Value Option for Financial Assets and Financial Liabilities*” to our consolidated financial statements for more information.

Issuers Greater than 10% of Stockholders' Equity

We held Fannie Mae securities in our retained portfolio with a fair value of \$47.6 billion, which represented 178% of total stockholders' equity of \$26.7 billion at December 31, 2007. In addition, we held securities issued by Citi Mortgage Loan Trust 2007-1 in our retained portfolio with a fair value of \$4.0 billion, which represented 15% of total stockholders' equity at December 31, 2007. No other individual issuer at the individual trust level exceeded 10% of total stockholders' equity at December 31, 2007.

Cash and Investments

Table 24 provides additional detail regarding the non-mortgage-related securities in our cash and investments portfolio.

Table 24 — Cash and Investments

	December 31,					
	2007		2006		2005	
	Fair Value	Average Maturity (Months)	Fair Value	Average Maturity (Months)	Fair Value	Average Maturity (Months)
	(dollars in millions)					
Cash and cash equivalents	\$ 8,574	<3	\$11,359	<3	\$10,468	<3
Investments:						
Available-for-sale securities:						
Non-mortgage-related securities:						
Commercial paper	18,513	<3	11,191	<3	5,764	<3
Asset-backed securities ⁽¹⁾	16,588	N/A	32,122	N/A	30,578	N/A
Obligations of states and political subdivisions ⁽¹⁾	—	N/A	2,273	363	5,823	282
Total available-for-sale non-mortgage-related securities ⁽²⁾	<u>35,101</u>		<u>45,586</u>		<u>42,165</u>	
Securities purchased under agreements to resell	6,400	<3	3,250	<3	5,250	<3
Federal funds sold and Eurodollars	162	<3	19,778	<3	9,909	<3
Subtotal	<u>6,562</u>		<u>23,028</u>		<u>15,159</u>	
Total investments	<u>41,663</u>		<u>68,614</u>		<u>57,324</u>	
Total cash and investments per consolidated balance sheets	<u>\$50,237</u>		<u>\$79,973</u>		<u>\$67,792</u>	

(1) Consist primarily of securities that can be prepaid prior to their contractual maturity without penalty.

(2) Credit ratings for most securities are designated by no fewer than two nationally recognized statistical rating organizations. At December 31, 2007, 2006 and 2005, all of our available-for-sale non-mortgage-related securities were rated A or better.

During 2007, we reduced the balance of our cash and investments portfolio in order to take advantage of investment opportunities in mortgage-related securities as OAS widened. In addition, effective in December 2007 we established

securitization trusts for the underlying assets of our PCs and Structured Securities. Consequently, we hold remittances in a segregated account and do not commingle those funds with our general operating funds. The cash owned by the trusts is not reflected in our cash and investment balances on our consolidated balance sheets.

During 2006, we made a decision to maintain higher levels of liquid investments to ensure that we could appropriately service our outstanding debt and PCs and Structured Securities while operating under the Federal Reserve Board's intraday overdraft policy, which was revised effective July 2006. The revised policy restricts the GSEs, among others, from maintaining intraday overdraft positions at the Federal Reserve.

Derivative Assets and Liabilities, Net

See "CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Income (Loss) — *Derivative Gains (Losses)*" for a description of gains (losses) on our derivative positions. Table 25 summarizes the notional or contractual amounts and related fair value of our total derivative portfolio by product type.

Table 25 — Total Derivative Portfolio

	December 31,			
	2007		Adjusted 2006	
	Notional or Contractual Amount ⁽¹⁾	Fair Value ⁽²⁾	Notional or Contractual Amount ⁽¹⁾	Fair Value ⁽²⁾
	(in millions)			
Interest-rate swaps:				
Receive-fixed	\$ 301,649	\$ 3,648	\$222,631	\$ (334)
Pay-fixed	409,682	(11,492)	217,565	(1,352)
Basis (floating to floating)	498	—	683	—
Total interest-rate swaps	<u>711,829</u>	<u>(7,844)</u>	<u>440,879</u>	<u>(1,686)</u>
Option-based:				
Call swaptions				
Purchased	259,272	7,134	194,200	4,034
Written	1,900	(27)	—	—
Put swaptions				
Purchased	18,725	631	29,725	958
Written	2,650	(74)	—	—
Other option-based derivatives ⁽³⁾	30,486	(23)	28,097	(15)
Total option-based	<u>313,033</u>	<u>7,641</u>	<u>252,022</u>	<u>4,977</u>
Futures	196,270	92	22,400	28
Foreign-currency swaps	20,118	4,568	29,234	4,399
Subtotal	<u>1,241,250</u>	<u>4,457</u>	<u>744,535</u>	<u>7,718</u>
Forward purchase and sale commitments	72,662	327	10,012	6
Credit derivatives	7,667	10	2,605	(1)
Swap guarantee derivatives	1,302	(4)	957	(3)
Total derivative portfolio	<u>\$1,322,881</u>	<u>\$ 4,790</u>	<u>\$758,109</u>	<u>\$ 7,720</u>

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

(2) The value of derivatives on our consolidated balance sheets is reported as derivative asset, net and derivative liability, net, and includes net derivative interest receivable or payable and cash collateral held or posted. Fair value excludes net derivative interest receivable of \$1.7 billion and net derivative collateral held of \$6.2 billion at December 31, 2007. Fair value excludes net derivative interest receivable of \$2.3 billion, and net derivative collateral held of \$9.5 billion at December 31, 2006. The fair values for futures are directly derived from quoted market prices. Fair values of other derivatives are derived primarily from valuation models using market data inputs.

(3) Primarily represents written options, including guarantees of stated final maturity of issued Structured Securities and written call options on PCs we issued.

On October 1, 2007, we adopted FSP FIN 39-1. The position amends FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts, an interpretation of APB Opinion No. 10 and FASB Statement No. 105," and permits a reporting entity to offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting agreement. Our adoption resulted in a decrease to total assets and total liabilities of \$8.7 billion. We elected to reclassify net derivative interest receivable or payable and cash collateral held or posted on our consolidated balance sheets to derivative asset, net and derivative liability, net. Prior to adoption, these amounts were recorded in accounts and other receivables, net, accrued interest payable, other assets and senior debt: due within one year, as applicable. FSP FIN 39-1 requires retrospective application and certain amounts in prior periods' consolidated balance sheets have been reclassified to conform to the current presentation. See "NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Derivatives" to our consolidated financial statements for additional information about our derivatives.

The composition of our derivative portfolio will change from period to period as a result of derivative purchases, terminations or assignments prior to contractual maturity and expiration of the derivatives at their contractual maturity. We record changes in fair values of our derivatives in current income or, to the extent our accounting hedge relationships are effective, we defer those changes in AOCI or offset them with basis adjustments to the related hedged item.

As interest rates fluctuate, we use derivatives to adjust the contractual funding of our debt in response to changes in the expected lives of mortgage-related assets in our retained portfolio. Notional or contractual amount increased year-over-year as we responded to the changing interest rate environment. It is often operationally more efficient to enter new derivative positions even though the same economic result can be achieved by terminating existing positions.

The fair value of the total derivative portfolio decreased in 2007 due to net interest rate decreases across the yield curve that negatively impacted the fair value of our interest-rate swap portfolio. These fair values losses were partially offset by fair value increases on our purchased call swaption derivative portfolio that resulted from a net increase in implied volatility and net interest rate decreases.

As interest rates decreased, the fair value of our pay-fixed swap portfolio decreased by \$10.1 billion in 2007. This was partially offset by increases in the fair value of our receive-fixed swap portfolio of approximately \$4.0 billion and our purchased call swaption portfolio of \$3.1 billion. In 2007, we added to our portfolio of purchased call swaptions to manage convexity risk associated with the prepayment option in a decreasing interest rate environment. The notional amount of our pay-fixed swap portfolio increased because we enter into forward-starting pay-fixed swaps to mitigate the duration risk created when we enter into purchased call swaptions and to manage steepening yield curve effects on mortgage duration.

Table 26 summarizes the changes in derivative fair values.

Table 26 — Changes in Derivative Fair Values

	2007 ⁽¹⁾	Adjusted 2006 ⁽¹⁾
	(in millions)	
Beginning balance, at January 1 — Net asset (liability)	\$ 7,720	\$ 6,517
Net change in:		
Forward purchase and sale commitments	321	40
Credit derivatives	11	—
Swap guarantee derivatives	(1)	(1)
Other derivatives: ⁽²⁾		
Changes in fair value	(2,688)	2,008
Fair value of new contracts entered into during the period ⁽³⁾	1,146	2,577
Contracts realized or otherwise settled during the period	(1,719)	(3,421)
Ending balance, at December 31 — Net asset (liability)	<u>\$ 4,790</u>	<u>\$ 7,720</u>

(1) The value of derivatives on our consolidated balance sheets is reported as derivative asset, net and derivative liability, net, and includes net derivative interest receivable or payable and cash collateral held or posted. Fair value excludes net derivative interest receivable of \$1.7 billion and net derivative collateral held of \$6.2 billion at December 31, 2007. Fair value excludes net derivative interest receivable of \$2.3 billion and net derivative collateral held of \$9.5 billion at December 31, 2006. Fair value excludes net derivative interest receivable of \$1.8 billion and net derivative collateral held of \$8.5 billion at January 1, 2006.

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

(3) Consists primarily of cash premiums paid or received on options.

Table 27 provides information on our outstanding written and purchased swaption and option premiums at December 31, 2007 and 2006, based on the original premium receipts or payments. We use written options primarily to mitigate convexity risk and reduce our overall hedging costs. See “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks — Sources of Interest-Rate Risk and Other Market Risks — Duration Risk and Convexity Risk” for further discussion related to convexity risk.

Table 27 — Outstanding Written and Purchased Swaption and Option Premiums

	Original Premium Amount (Paid) Received	Original Weighted Average Life to Expiration	Remaining Weighted Average Life
	(dollars in millions)		
Purchased: ⁽¹⁾			
At December 31, 2007	\$(5,478)	7.8 years	6.0 years
At December 31, 2006	\$(5,316)	7.5 years	6.1 years
Written: ⁽²⁾			
At December 31, 2007	\$ 87	3.0 years	2.6 years
At December 31, 2006	\$ 21	0.2 years	0.1 years

(1) Purchased options exclude callable swaps.

(2) Excludes written options on guarantees of stated final maturity of Structured Securities.

Table 28 shows the fair value for each derivative type and the maturity profile of our derivative positions. A positive fair value in Table 28 for each derivative type is the estimated amount, prior to netting by counterparty, that we would be

entitled to receive if we terminated the derivatives of that type. A negative fair value for a derivative type is the estimated amount, prior to netting by counterparty, that we would owe if we terminated the derivatives of that type. See “Table 44 — Derivative Counterparty Credit Exposure” under “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks” for additional information regarding derivative counterparty credit exposure. Table 28 also provides the weighted average fixed rate of our pay-fixed and receive-fixed swaps.

Table 28 — Derivative Fair Values and Maturities

	December 31, 2007					
	Notional or Contractual Amount	Total Fair Value ⁽²⁾	Fair Value ⁽¹⁾			
			Less than 1 Year	1 to 3 Years	Greater than 3 and up to 5 Years	In Excess of 5 Years
(dollars in millions)						
Interest-rate swaps:						
Receive-fixed:						
Swaps	\$ 282,504	\$ 3,266	\$ 27	\$ 1,557	\$ 785	\$ 897
Weighted-average fixed rate ⁽³⁾			4.61%	4.46%	4.54%	5.47%
Forward-starting swaps ⁽⁴⁾	19,145	382	—	5	19	358
Weighted-average fixed rate ⁽³⁾			—	4.78%	5.02%	5.34%
Total receive-fixed	<u>301,649</u>	<u>3,648</u>	<u>27</u>	<u>1,562</u>	<u>804</u>	<u>1,255</u>
Basis (floating to floating)	498	—	—	—	—	—
Pay-fixed:						
Swaps	322,316	(8,517)	(92)	(2,216)	(1,849)	(4,360)
Weighted-average fixed rate ⁽³⁾			5.10%	4.77%	4.92%	5.15%
Forward-starting swaps ⁽⁴⁾	87,366	(2,975)	—	—	(4)	(2,971)
Weighted-average fixed rate ⁽³⁾			—	—	5.25%	5.66%
Total pay-fixed	<u>409,682</u>	<u>(11,492)</u>	<u>(92)</u>	<u>(2,216)</u>	<u>(1,853)</u>	<u>(7,331)</u>
Total interest-rate swaps	<u>711,829</u>	<u>(7,844)</u>	<u>(65)</u>	<u>(654)</u>	<u>(1,049)</u>	<u>(6,076)</u>
Option-based:						
Call swaptions						
Purchased	259,272	7,134	406	1,533	1,940	3,255
Written	1,900	(27)	—	—	(27)	—
Put swaptions						
Purchased	18,725	631	31	68	61	471
Written	2,650	(74)	(4)	(49)	(21)	—
Other option-based derivatives ⁽⁵⁾	30,486	(23)	—	—	(1)	(22)
Total option-based	<u>313,033</u>	<u>7,641</u>	<u>433</u>	<u>1,552</u>	<u>1,952</u>	<u>3,704</u>
Futures	196,270	92	93	(1)	—	—
Foreign-currency swaps	20,118	4,568	1,173	2,047	544	804
Forward purchase and sale commitments	72,662	327	327	—	—	—
Swap guarantee derivatives	1,302	(4)	—	—	—	(4)
Subtotal	<u>1,315,214</u>	<u>4,780</u>	<u>\$1,961</u>	<u>\$ 2,944</u>	<u>\$ 1,447</u>	<u>\$(1,572)</u>
Credit derivatives	7,667	10	—	—	—	—
Total	<u>\$1,322,881</u>	<u>\$ 4,790</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

(1) Fair value is categorized based on the period from December 31, 2007 until the contractual maturity of the derivative.

(2) The value of derivatives on our consolidated balance sheets is reported as derivative asset, net and derivative liability, net, and includes net derivative interest receivable or payable and cash collateral held or posted. Fair value excludes net derivative interest receivable of \$1.7 billion and net derivative collateral held of \$6.2 billion at December 31, 2007.

(3) Represents the notional weighted average rate for the fixed leg of the swaps.

(4) Represents interest-rate swap agreements that are scheduled to begin on future dates ranging from less than one year to ten years.

(5) Primarily represents written options, including guarantees of stated final maturity of issued Structured Securities and written call options on PCs we issued.

Guarantee Asset

Table 29 summarizes changes in the guarantee asset balance.

Table 29 — Changes in Guarantee Asset

	December 31,	
	2007	Adjusted 2006
(in millions)		
Beginning balance	\$ 7,389	\$ 6,264
Additions, net	3,686	2,103
Return of investment on guarantee asset	(1,739)	(1,293)
Change in fair value of future management and guarantee fees	309	261
Change in estimate	(54)	54
Gains (losses) on guarantee asset	(1,484)	(978)
Ending balance	<u>\$ 9,591</u>	<u>\$ 7,389</u>

The increase in additions, net, in 2007, as compared to 2006, is due to an increase in our guarantee fee rates for both adjustable rate and fixed rate products, and to a lesser extent, the increase in our issuance volume in 2007.

The losses on guarantee assets in 2007 increased as compared to 2006. This increase is due to the return of investment associated with a higher guarantee asset balance. Gains on fair value of management and guarantee fees in 2007 resulted from an increase in interest rates during the second quarter. The increase in gains on fair value of management and guarantee fees in 2006 was due to an increase in interest rates throughout the year. See “CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Income (Loss) — *Gains (Losses) on Guarantee Asset*” for further discussion of gains (losses) on our guarantee asset.

Total Debt Securities, Net

Table 30 reconciles the par value of our debt securities to the amounts shown on our consolidated balance sheets. See “LIQUIDITY AND CAPITAL RESOURCES” for further discussion of our debt management activities.

Table 30 — Reconciliation of the Par Value of Total Debt Securities to Our Consolidated Balance Sheets

	December 31,	
	2007	2006
(in millions)		
Total debt securities:		
Par value ⁽¹⁾	\$775,847	\$778,418
Unamortized balance of discounts and premiums ⁽²⁾	(43,540)	(41,814)
Foreign-currency-related and hedging-related basis adjustments ⁽³⁾	6,250	7,737
Total debt securities, net	<u>\$738,557</u>	<u>\$744,341</u>

(1) Includes securities sold under agreements to repurchase and federal funds purchased.

(2) Primarily represents unamortized discounts on zero-coupon debt securities.

(3) Primarily represent deferrals related to the translation gain (loss) on foreign-currency denominated debt that was in hedge accounting relationships.

changes in our guarantee obligation balances for 2007 and 2006, as well as the balances of the components of our guarantee obligation at December 31, 2007 and 2006.

Table 32 — Changes in Guarantee Obligation

	December 31,	
	2007	Adjusted 2006
	(in millions)	
Beginning balance	\$ 9,482	\$ 7,907
Transfer-out to the loan loss reserve ⁽¹⁾	(7)	(7)
Additions, net:		
Fair value of performance and other related costs of newly-issued guarantees	5,241	2,097
Deferred guarantee income of newly-issued guarantees	901	1,004
Amortization income:		
Performance and other related costs	(1,146)	(804)
Deferred guarantee income	(759)	(715)
Income on guarantee obligation	(1,905)	(1,519)
Ending balance	<u>\$13,712</u>	<u>\$ 9,482</u>
Components of the guarantee obligation, at period end:		
Unamortized balance of performance and other related costs	\$ 9,930	\$ 5,841
Unamortized balance of deferred guarantee income	3,782	3,641
Ending balance	<u>\$13,712</u>	<u>\$ 9,482</u>

(1) Represents portions of the guarantee obligation that correspond to incurred credit losses reclassified to reserve for guarantee losses on PCs.

The primary drivers affecting our guarantee obligation balances are our credit guarantee business volumes, fair values of performance obligations on new guarantees and expected profitability of new guarantee business at origination. Additions related to the performance obligations of our newly-issued PCs and Structured Securities increased in 2007, as compared to 2006, due to widening credit spreads of both fixed-rate and adjustable-rate products and higher volume of credit guarantee business. We issued \$471 billion and \$360 billion of our PCs and Structured Securities in 2007 and 2006, respectively. Deferred guarantee income related to newly-issued guarantees declined in 2007, as compared to 2006, due to a decrease in profitability expected on guarantees issued in 2007.

The increase in amortization income attributable to the performance and other related costs is primarily due to an increase in the guarantee obligation caused by higher expected default costs on newly-issued guarantees as well as a higher volume of credit guarantee business. See “CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Income (Loss) — Income on Guarantee Obligation” for additional discussion related to our guarantee obligation.

Total Stockholders' Equity

Total stockholders' equity decreased \$0.2 billion during 2007. This decrease was primarily a result of a net loss of \$3.1 billion, a \$2.7 billion net increase in the AOCI loss, the repurchase of \$1.0 billion of common stock and \$1.6 billion of common and preferred stock dividends declared. These reductions were partially offset by a net increase of \$8.0 billion in non-cumulative, perpetual preferred stock. We issued \$8.6 billion of non-cumulative, perpetual preferred stock, consisting of \$1.5 billion in connection with the planned replacement of common stock with an equal amount of preferred stock and \$600 million to replace higher-cost preferred stock that we redeemed and additional issuances of \$6.5 billion in the aggregate to bolster our capital base and for general corporate purposes. See “LIQUIDITY AND CAPITAL RESOURCES — Capital Resources — *Core Capital*” for additional information.

The balance of AOCI at December 31, 2007 was a net loss of approximately \$11.1 billion, net of taxes, compared to a net loss of \$8.5 billion, net of taxes, at December 31, 2006. The increase in the net loss in AOCI was primarily attributable to unrealized losses on our single-family non-agency mortgage-related securities backed by subprime loans and Alt-A loans with net unrealized losses, net of taxes, recorded in AOCI of \$5.6 billion and \$1.7 billion, respectively, at December 31, 2007. The increase in the net loss in AOCI was partially offset by an increase in the value of available-for-sale securities as medium- and long-term rates declined since December 31, 2006 and the reclassification to earnings of deferred losses related to closed cash flow hedge relationships. See “CREDIT RISKS — Mortgage Credit Risk” for more information regarding mortgage-related securities backed by subprime loans and Alt-A loans.

CONSOLIDATED FAIR VALUE BALANCE SHEETS ANALYSIS

Our consolidated fair value balance sheets include the estimated fair values of financial instruments recorded on our consolidated balance sheets prepared in accordance with GAAP, as well as off-balance sheet financial instruments that represent our assets or liabilities that are not recorded on our GAAP consolidated balance sheets. These off-balance sheet items predominantly consist of: (a) the unrecognized guarantee asset and guarantee obligation associated with our PCs

issued through our Guarantor Swap program prior to the implementation of FIN 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and rescission of FASB Interpretation No. 34,” (b) certain commitments to purchase mortgage loans and (c) certain credit enhancements on manufactured housing asset-backed securities. The fair value balance sheets also include certain assets and liabilities that are not financial instruments (such as property and equipment and real estate owned, which are included in other assets) at their carrying value in accordance with GAAP. During 2007 and 2006, our fair value results were impacted by several improvements in our approach for estimating the fair value of certain financial instruments. See “OFF-BALANCE SHEET ARRANGEMENTS” and “CRITICAL ACCOUNTING POLICIES AND ESTIMATES” as well as “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” and “NOTE 16: FAIR VALUE DISCLOSURES” to our consolidated financial statements for more information on fair values.

In conjunction with the preparation of our consolidated fair value balance sheets, we use a number of financial models. See “OPERATIONAL RISKS” and “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks” for information concerning the risks associated with these models.

Key Components of Changes in Fair Value of Net Assets

Our attribution of changes in the fair value of net assets relies on models, assumptions, and other measurement techniques that will evolve over time. Changes in the fair value of net assets from period to period result from returns (measured on a fair value basis) and capital transactions and are primarily attributable to changes in a number of key components:

Core Spread Income

Core spread income on our retained portfolio is a fair value estimate of the net current period accrual of income from the spread between mortgage-related investments and debt, calculated on an option-adjusted basis. OAS is an estimate of the yield spread between a given financial instrument and a benchmark (LIBOR, agency or Treasury) yield curve, after consideration of potential variability in the instrument’s cash flows resulting from any options embedded in the instrument, such as prepayment options.

Changes in Mortgage-To-Debt OAS

The fair value of our net assets can be significantly affected from period to period by changes in the net OAS between the mortgage and agency debt sectors. The fair value impact of changes in OAS for a given period represents an estimate of the net unrealized increase or decrease in fair value of net assets arising from net fluctuations in OAS during that period. We do not attempt to hedge or actively manage the basis risk represented by the impact of changes in mortgage-to-debt OAS because we generally hold a substantial portion of our mortgage assets for the long term and we do not believe that periodic increases or decreases in the fair value of net assets arising from fluctuations in OAS will significantly affect the long-term value of our retained portfolio. Our estimate of the effect of changes in OAS excludes the impact of other market risk factors we actively manage, or economically hedge, to keep interest-rate risk exposure within prescribed limits.

Asset-Liability Management Return

Asset-liability management return represents the estimated net increase or decrease in the fair value of net assets resulting from net exposures related to the market risks we actively manage. We do not hedge all of the interest-rate risk that exists at the time a mortgage is purchased or that arises over its life. The market risks to which we are exposed as a result of our retained portfolio activities that we actively manage include duration and convexity risks, yield curve risk and volatility risk. We seek to manage these risk exposures within prescribed limits as part of our overall portfolio management strategy. Taking these risk positions and managing them within prudent limits is an integral part of our strategy to optimize the risk/return profile of our investment activity and generate fair value growth. We expect that the net exposures related to market risks we actively manage will generate fair value returns that contribute to meeting our long-term growth objectives, although those positions may result in a net increase or decrease in fair value for a given period. See “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks” for more information.

Core Guarantee Fees, Net

Core guarantee fees, net represents a fair value estimate of the annual income of the credit guarantee portfolio, based on current portfolio characteristics and market conditions. This estimate considers both contractual guarantee fees collected over the life of the credit guarantee portfolio and credit-related delivery fees collected up-front when pools are formed, and associated costs and obligations, which include default costs.

Change in the Fair Value of the Credit Guarantee Portfolio

Change in the fair value of the credit guarantee portfolio represents the estimated impact on the fair value of the credit guarantee business resulting from additions to the portfolio (net difference between the fair values of the guarantee asset and guarantee obligation recorded when pools are formed) plus the effect of changes in interest rates, projections of the future credit outlook and other market factors (e.g., impact of the passage of time on cash flow discounting).

We generally do not hedge changes in the fair value of our existing credit guarantee portfolio, with two exceptions discussed below. While periodic changes in the fair value of the credit guarantee portfolio may have a significant impact on the fair value of net assets, we believe that changes in the fair value of our existing credit guarantee portfolio are not the best indication of long-term fair value expectations because such changes do not reflect our expectation that, over time, replacement business will largely replenish guarantee fee income lost because of prepayments. However, to the extent that projections of the future credit outlook are realized our fair value results may be affected.

We hedge interest-rate exposure related to net buy-ups (up-front payments we made that increase the guarantee fee that we will receive over the life of the pool) and float (expected gains or losses resulting from our mortgage security program remittance cycles). These value changes are excluded from our estimate of the changes in fair value of the credit guarantee portfolio, so that it reflects only the impact of changes in interest rates and other market factors on the unhedged portion of the projected cash flows from the credit guarantee business. The fair value changes associated with net buy-ups and float are considered in asset-liability management return (described above) because they relate to hedged positions.

Fee Income

Fee income includes miscellaneous fees, such as resecuritization fees, fees generated by our automated underwriting service and delivery fees on some mortgage purchases.

Discussion of Fair Value Results

In 2007, the fair value of net assets attributable to common stockholders, before capital transactions, decreased by \$23.6 billion compared to a \$2.5 billion increase in 2006. The payment of common dividends and the repurchase of common shares, net of reissuance of treasury stock, reduced total fair value by \$2.1 billion in 2007. The fair value of net assets attributable to common stockholders as of December 31, 2007 was \$0.3 billion, compared to \$26.0 billion as of December 31, 2006.

Table 33 summarizes the change in the fair value of net assets attributable to common stockholders for 2007 and 2006.

Table 33 — Summary of Change in the Fair Value of Net Assets Attributable to Common Stockholders

	<u>2007</u>	<u>2006</u>
	(in billions)	
Beginning balance	\$ 26.0	\$26.8
Changes in fair value of net assets attributable to common stockholders, before capital transactions	(23.6)	2.5
Capital transactions:		
Common dividends, common share repurchases and issuances, net	<u>(2.1)</u>	<u>(3.3)</u>
Ending balance	<u>\$ 0.3</u>	<u>\$26.0</u>

Estimated Impact of Changes in Mortgage-To-Debt OAS on Fair Value Results

For the years ended December 31, 2007 and 2006, we estimate that on a pre-tax basis the changes in the fair value of net assets attributable to common stockholders, before capital transactions, included decreases of approximately \$23.8 billion and \$0.9 billion, respectively, due to a net widening of mortgage-to-debt OAS.

We believe disclosing the estimated impact of changes in mortgage-to-debt OAS on the fair value of net assets is helpful to understanding our current period fair value results in the context of our long-term fair value return objective. Due to the significant challenges that exist in the current market, we will not, in the near-term, achieve our objective of long-term returns, before capital transactions, on the average fair value of net assets attributable to common stockholders in the low-to mid-teens. Given the current level of uncertainty in the residential mortgage credit market, volatility in interest rates and our current capital constraints, we will not achieve our long-term objective until market conditions improve.

How We Estimate the Impact of Changes in Mortgage-To-Debt OAS on Fair Value Results

The impact of changes in OAS on fair value should be understood as an estimate rather than a precise measurement. To estimate the impact of OAS changes, we use models that involve the forecast of interest rates and prepayment behavior and other inputs. We also make assumptions about a variety of factors, including macroeconomic and security-specific data, interest-rate paths, cash flows and prepayment rates. We use these models and assumptions in running our business, and we rely on many of the models in producing our financial statements and measuring, managing and reporting interest-rate and other market risks. The use of different estimation methods or the application of different assumptions could result in a materially different estimate of OAS impact.

An integral part of this framework includes the attribution of fair value changes to assess the performance of our investment activities. On a daily basis, all interest rate sensitive assets, liabilities and derivatives are modeled using our proprietary prepayment and interest rate models. Management uses interest-rate risk statistics generated from this process, along with daily market movements, coupon accruals and price changes, to estimate and attribute returns into various risk factors commonly used in the fixed income industry to quantify and understand sources of fair value return. One important risk factor is the change in fair value due to changes in mortgage-to-debt OAS.

Understanding Our Estimate of the Impact of Changes in Mortgage-To-Debt OAS on Fair Value Results

A number of important qualifications apply to our disclosed estimates. The estimated impact of the change in option-adjusted spreads on the fair value of our net assets in any given period does not depend on other components of the change in fair value. Although the fair values of our financial instruments will generally move toward their par values as the instruments approach maturity, investors should not expect that the effect of past changes in OAS will necessarily reverse through future changes in OAS. To the extent that actual prepayment or interest rate distributions differ from the forecasts contemplated in our models, changes in values reflected in mortgage-to-debt OAS may not be recovered in fair value returns at a later date.

When the OAS on a given asset widens, the fair value of that asset will typically decline, all other things being equal. However, we believe such OAS widening has the effect of increasing the likelihood that, in future periods, we will recognize income at a higher spread on this existing asset. The reverse is true when the OAS on a given asset tightens — current period fair values for that asset typically increase due to the tightening in OAS, while future income recognized on the asset is more likely to be earned at a reduced spread. Although a widening of OAS is generally accompanied by lower current period fair values, it can also provide us with greater opportunity to purchase new assets for our retained portfolio at the wider mortgage-to-debt OAS.

For these reasons, our estimate of the impact of the change in OAS provides information regarding one component of the change in fair value for the particular period being evaluated. However, results for a single period should not be used to extrapolate long-term fair value returns. We believe the potential fair value return of our business over the long term depends primarily on our ability to add new assets at attractive mortgage-to-debt OAS and to effectively manage over time the risks associated with these assets, as well as the risks of our existing portfolio. In other words, to capture the fair value returns we expect, we have to apply accurate estimates of future prepayment rates and other performance characteristics at the time we purchase assets, and then manage successfully the range of market risks associated with a debt-funded mortgage portfolio over the life of these assets.

Estimated Impact of Credit Guarantee on Fair Value Results

Our credit guarantee activities, including multifamily and single-family whole loan credit exposure, decreased pre-tax fair value by an estimated \$18.5 billion in 2007. This estimate includes an increase in the single-family guarantee obligation of approximately \$22.2 billion, primarily attributable to the market's pricing of mortgage credit. Wider credit spreads on CMBS and whole loans also negatively impacted our multifamily guarantee obligation. These increases were partially offset by a fair value increase in the single-family guarantee asset of approximately \$2.1 billion and cash receipts related to management and guarantee fees and other up-front fees.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Our business activities require that we maintain adequate liquidity to make payments upon the maturity, redemption or repurchase of our debt securities; purchase mortgage loans, mortgage-related securities and other investments; make payments of principal and interest on our debt securities and on our PCs and Structured Securities; make net payments on derivative instruments; fund our general operations; and pay dividends on and repurchase our preferred and common stock.

We fund our cash requirements primarily by issuing short-term and long-term debt. Other sources of cash include:

- receipts of principal and interest payments on securities or mortgage loans we hold;
- sales of securities we hold;
- borrowings against mortgage-related securities and other investment securities we hold;
- other cash flows from operating activities, including guarantee activities; and
- issuances of common and preferred stock.

We measure our cash position on a daily basis, netting uses of cash with sources of cash. We manage the net cash position over a rolling forecasted 120-day period, with the goal of providing the amount of debt funding needed to cover expected net cash outflows without adversely affecting our overall funding levels. We maintain alternative sources of liquidity

to allow normal operations for 120 days without relying upon the issuance of unsecured debt consistent with industry practices of sound liquidity management. Our daily liquidity management activities are consistent with the liquidity component of our commitment with OFHEO to maintain alternative sources of liquidity to allow normal operations for 90 days without relying upon issuance of unsecured debt. See “RISK MANAGEMENT AND DISCLOSURE COMMITMENTS” for further information.

Effective December 2007, we established securitization trusts for the underlying assets of our PCs and Structured Securities. Consequently, we hold remittances in a segregated account and do not commingle those funds with our general operating funds. We now receive trust management income, which represents the fees we earn as master servicer, issuer and trustee for our PCs and Structured Securities. These fees are derived from interest earned on principal and interest cash flows between the time remitted to the trust by servicers and the date of distribution to our PC and Structured Securities holders.

Effective in July 2006, the Federal Reserve Board revised its payments system risk policy to restrict or eliminate daylight overdrafts by GSEs in connection with their use of the Fedwire system. The revised policy also includes a requirement that the GSEs fully fund their accounts in the system to the extent necessary to cover payments on their debt and mortgage-related securities each day, before the Federal Reserve Bank of New York, acting as fiscal agent for the GSEs, will initiate such payments. We have taken actions to fully fund our account as necessary, such as opening lines of credit with third parties. Certain of these lines of credit require that we post collateral that, in certain limited circumstances, the secured party has the right to repledge to other third parties, including the Federal Reserve Bank. As of December 31, 2007, we pledged approximately \$16.8 billion of securities to these secured parties. These lines of credit, which provide additional intraday liquidity to fund our activities through the Fedwire system, are uncommitted intraday loan facilities. As a result, while we expect to continue to use these facilities, we may not be able to draw on them if and when needed. See “NOTE 4: RETAINED PORTFOLIO AND CASH AND INVESTMENTS PORTFOLIO” to our consolidated financial statements for further information.

To fund our business activities, we depend on the continuing willingness of investors to purchase our debt securities. Any change in applicable legislative or regulatory exemptions, including those described in “REGULATION AND SUPERVISION,” could adversely affect our access to some debt investors, thereby potentially increasing our debt funding costs. However, because of our financial performance and our regular and significant participation as an issuer in the capital markets, our sources of liquidity have remained adequate to meet our needs and we anticipate that they will continue to be so.

Under our charter, the Secretary of the Treasury has discretionary authority to purchase our obligations up to a maximum of \$2.25 billion principal balance outstanding at any one time. However, we do not rely on this authority as a source of liquidity to meet our obligations.

Depending on market conditions and the mix of derivatives we employ in connection with our ongoing risk management activities, our derivative portfolio can be either a net source or a net use of cash. For example, depending on the prevailing interest-rate environment, interest-rate swap agreements could cause us either to make interest payments to counterparties or to receive interest payments from counterparties. Purchased options require us to pay a premium while written options allow us to receive a premium.

We are required to pledge collateral to third parties in connection with secured financing and daily trade activities. In accordance with contracts with certain derivative counterparties, we post collateral to those counterparties for derivatives in a net loss position, after netting by counterparty, above agreed-upon posting thresholds. See “NOTE 4: RETAINED PORTFOLIO AND CASH AND INVESTMENTS PORTFOLIO” to our consolidated financial statements for information about assets we pledge as collateral.

We are involved in various legal proceedings, including those discussed in “LEGAL PROCEEDINGS,” which may result in a use of cash.

Debt Securities

Because of our GSE status and the special attributes granted to us under our charter, our debt securities and those of other GSE issuers trade in the so-called “agency sector” of the debt markets. This highly liquid market segment exhibits its own yield curve reflecting our ability to borrow at lower rates than many other corporate debt issuers. As a result, we mainly compete for funds in the debt issuance markets with Fannie Mae and the Federal Home Loan Banks, which issue debt securities of comparable quality and ratings. However, we also compete for funding with other debt issuers. The demand for, and liquidity of, our debt securities benefit from their status as permitted investments for banks, investment companies and other financial institutions under their statutory and regulatory framework. Competition for funding can vary with economic, financial market and regulatory environments.

We fund our business activities primarily through the issuance of short- and long-term debt. Table 34 summarizes the par value of the debt securities we issued, based on settlement dates, during 2007 and 2006. We seek to maintain a variety of consistent, active funding programs that promote high-quality coverage by market makers and reach a broad group of institutional and retail investors. By diversifying our investor base and the types of debt securities we offer, we believe we enhance our ability to maintain continuous access to the debt markets under a variety of market conditions.

Table 34 — Debt Security Issuances by Product, at Par Value⁽¹⁾

	Year Ended December 31,	
	2007	2006
	(in millions)	
Short-term debt:		
Reference Bills [®] securities and discount notes	\$597,587	\$593,444
Medium-term notes — callable	4,100	8,532
Medium-term notes — non-callable	202	1,550
Total short-term debt	<u>601,889</u>	<u>603,526</u>
Long-term debt:		
Medium-term notes — callable ⁽²⁾	112,452	106,777
Medium-term notes — non-callable ⁽³⁾	25,096	17,721
U.S. dollar Reference Notes [®] securities — non-callable	51,000	55,000
Freddie SUBS [®] securities ⁽⁴⁾	—	3,299
Total long-term debt	<u>188,548</u>	<u>182,797</u>
Total debt securities issued	<u>\$790,437</u>	<u>\$786,323</u>

(1) Exclude securities sold under agreements to repurchase and federal funds purchased, lines of credit and securities sold but not yet purchased.

(2) Include \$145 million and \$100 million of medium-term notes — callable issued for the years ended December 31, 2007 and 2006, respectively, which were accounted for as debt exchanges.

(3) Include \$— and \$1.0 billion of medium-term notes — non-callable issued for the years ended December 31, 2007 and 2006, respectively, which were accounted for as debt exchanges.

(4) Include \$— and \$1.5 billion of Freddie SUBS[®] securities issued for the years ended December 31, 2007 and 2006, respectively, which were accounted for as debt exchanges.

Short-Term Debt

We fund our operating cash needs, in part, by issuing Reference Bills[®] securities and other discount notes, which are short-term instruments with maturities of one year or less that are sold on a discounted basis, paying only principal at maturity. Our Reference Bills[®] securities program consists of large issues of short-term debt that we auction to dealers on a regular schedule. We issue discount notes with maturities ranging from one day to one year in response to investor demand and our cash needs. Short-term debt also includes certain medium-term notes that have original maturities of one year or less.

Long-Term Debt

We issue debt with maturities greater than one year primarily through our medium-term notes program and our Reference Notes[®] securities program.

Medium-term Notes

We issue a variety of fixed- and variable-rate medium-term notes, including callable and non-callable fixed-rate securities, zero-coupon securities and variable-rate securities, with various maturities ranging up to 30 years. Medium-term notes with original maturities of one year or less are classified as short-term debt. Medium-term notes typically contain call provisions, effective as early as three months or as distant as ten years after the securities are issued.

Reference Notes[®] Securities

Through our Reference Notes[®] securities program, we sell large issues of long-term debt that provide investors worldwide with a high-quality, liquid investment vehicle. Reference Notes[®] securities are regularly issued, U.S. dollar denominated, non-callable fixed-rate securities, which we currently issue with original maturities ranging from two through ten years. We have also issued €Reference Notes[®] securities denominated in Euros, but did not issue any such securities in 2007 or 2006. We hedge our exposure to changes in foreign-currency exchange rates by entering into swap transactions that convert foreign-currency denominated obligations to U.S. dollar-denominated obligations. See “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks — Sources of Interest-Rate Risk and Other Market Risks” for more information.

The investor base for our debt is predominantly institutional. However, we also conduct weekly offerings of FreddieNotes[®] securities, a medium-term notes program designed to meet the investment needs of retail investors.

Subordinated Debt

During the year ended December 31, 2007, we called \$1.9 billion of higher-cost Freddie SUBS® securities, while not issuing any new securities. During the year ended December 31, 2006, we issued approximately \$3.3 billion of Freddie SUBS® securities. In addition, we called approximately \$1.0 billion of previously issued Freddie SUBS® securities in August 2006. At December 31, 2007 and 2006, the balance of our subordinated debt outstanding was \$4.5 billion and \$6.4 billion, respectively. Our subordinated debt in the form of Freddie SUBS® securities is a component of our risk management and disclosure commitments with OFHEO (described in “RISK MANAGEMENT AND DISCLOSURE COMMITMENTS”).

Debt Retirement Activities

We repurchase or call our outstanding debt securities from time to time to help support the liquidity and predictability of the market for our debt securities and to manage interest-rate risk associated with our assets and liabilities. When our debt securities become seasoned or one-time call options on our debt securities expire, they may become less liquid, which could cause their price to decline. By repurchasing debt securities, we help preserve the liquidity of our debt securities and improve their price performance, which helps to reduce our funding costs over the long-term. Our repurchase activities also help us manage the funding mismatch, or duration gap, created by changes in interest rates. For example, when interest rates decline, the expected lives of the mortgage-related securities held in our retained portfolio decrease, reducing the need for long-term debt. We use a number of different means to shorten the effective weighted average lives of our outstanding debt securities and thereby manage the duration gap, including retiring long-term debt through repurchases or calls; changing our debt funding mix between short- and long-term debt; or using derivative instruments, such as entering into receive-fixed swaps or terminating or assigning pay-fixed swaps. From time to time, we may also enter into transactions in which we exchange newly issued debt securities for similar outstanding debt securities held by investors. These transactions are accounted for as debt exchanges.

Table 35 provides the par value, based on settlement dates, of debt securities we repurchased, called and exchanged during 2007 and 2006.

Table 35 — Debt Security Repurchases, Calls and Exchanges

	Year Ended December 31,	
	2007	2006
	(in millions)	
Repurchases of outstanding €Reference Notes® securities	\$ 3,965	\$ 5,210
Repurchases of outstanding medium-term notes	10,986	28,560
Calls of callable medium-term notes	95,317	26,559
Calls of callable Freddie SUBS® securities	1,930	1,000
Exchanges of medium-term notes	145	1,074
Exchanges of Freddie SUBS® securities	—	1,480

Credit Ratings

Our ability to access the capital markets and other sources of funding, as well as our cost of funds, are highly dependent upon our credit ratings. Table 36 indicates our credit ratings at February 1, 2008.

Table 36 — Freddie Mac Credit Ratings

	Nationally Recognized Statistical Rating Organization		
	S&P	Moody's	Fitch
Senior long-term debt ⁽¹⁾	AAA	Aaa	AAA
Short-term debt ⁽²⁾	A-1+	P-1	F-1+
Subordinated debt ⁽³⁾	AA-/Negative	Aa2	AA-
Preferred stock	AA-/Negative	Aa3	A+

(1) Includes medium-term notes, U.S. dollar Reference Notes® securities and €Reference Notes® securities.

(2) Includes Reference Bills® securities and discount notes.

(3) Includes Freddie SUBS® securities only.

In addition to the ratings described in Table 36, S&P provides a “Risk-To-The-Government” rating that measures our ability to meet our debt obligations and the value of our franchise in the absence of any implied government support. Our “Risk-To-The-Government” rating was AA- with a negative outlook at February 1, 2008. See “RISK MANAGEMENT AND DISCLOSURE COMMITMENTS.” A S&P rating outlook assesses the potential direction of a long-term credit rating over the intermediate term (typically six months to two years). A modifier of “negative” means that a rating may be lowered.

Moody's also provides a “Bank Financial Strength” rating that represents Moody's opinion of our intrinsic safety and soundness and, as such, excludes certain external credit risks and credit support elements. Ratings under this measure range

from A, the highest, to E, the lowest rating. On January 9, 2008, Moody's placed our "Bank Financial Strength" rating on review for possible downgrade. Our "Bank Financial Strength" rating remained at A- as of February 1, 2008.

Equity Securities

See "Capital Resources — *Core Capital*" and "MARKET FOR THE COMPANY'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES" for information about issuances and repurchases of our equity securities.

Cash and Investments Portfolio

We maintain a cash and investments portfolio that is important to our financial management and our ability to provide liquidity and stability to the mortgage market. At December 31, 2007, this portfolio consisted primarily of cash equivalents and non-mortgage-related securities, such as commercial paper and asset-backed securities, that we could sell or finance to provide us with an additional source of liquidity to fund our business operations. We also use the portfolio to help manage recurring cash flows and meet our other cash management needs. In addition, we use the portfolio to hold capital on a temporary basis until we can deploy it into retained portfolio investments or credit guarantee opportunities. We may also sell or finance the securities in this portfolio to maintain capital reserves to meet mortgage funding needs, provide diverse sources of liquidity or help manage the interest-rate risk inherent in mortgage-related assets.

For additional information on our cash and investments portfolio, see "CONSOLIDATED BALANCE SHEETS ANALYSIS — Cash and Investments." The non-mortgage-related investments in this portfolio may expose us to institutional credit risk and the risk that the investments could decline in value due to market-driven events such as credit downgrades or changes in interest rates and other market conditions. See "CREDIT RISKS — Institutional Credit Risk" for more information.

Cash Flows

Our cash and cash equivalents decreased \$2.8 billion to \$8.6 billion for the year ended December 31, 2007. Cash flows used for operating activities in 2007 were \$7.4 billion, which reflected a reduction in cash due to a net loss of \$3.1 billion and a decrease in liabilities to PC investors as a result of a change in our PC issuance process. See "NOTE 20: CHANGES IN ACCOUNTING PRINCIPLES" to our consolidated financial statements for additional information. Net cash used was primarily provided by net interest income, management and guarantee fees and changes in other operating assets and liabilities. Cash flows provided by investing activities in 2007 were \$9.6 billion, primarily due to a net increase in cash flows as we reduced our balance of federal funds sold and eurodollars. See "CONSOLIDATED BALANCE SHEETS ANALYSIS — Cash and Investments" for additional information. This was partially offset by an increase in cash used to purchase mortgage loans under financial guarantees as a result of increasing delinquencies. See "CREDIT RISKS — Mortgage Credit Risk — *Performing and Non-Performing Assets*" and "*— Delinquencies*" for additional information. Cash flows used for financing activities in 2007 were \$5.0 billion and resulted from a decrease in debt securities, net, preferred and common stock repurchases and dividends paid. Cash used was partially offset by proceeds from the issuance of preferred stock. See "NOTE 8: STOCKHOLDERS' EQUITY" to our consolidated financial statements for more information.

Our cash and cash equivalents increased \$0.9 billion to \$11.4 billion for the year ended December 31, 2006. Cash flows provided by operating activities in 2006 were \$8.7 billion, which primarily reflected cash flows provided by net interest income, management and guarantee fees and changes in other operating assets and liabilities, partially offset by non-interest expenses. Cash flows used for investing activities in 2006 were \$4.9 billion, primarily resulting from purchases of held-for-investment mortgages and available-for-sale securities, as well as a net decrease in cash flows from securities purchased under agreements to resell and federal funds sold, partially offset by proceeds from sales and maturities of available-for-sale securities and repayments of held-for-investment mortgages. Cash flows used for financing activities in 2006 were \$2.9 billion and were primarily due to repayments of debt securities, repurchases of common stock, payment of cash dividends on preferred stock and common stock, and payments of housing tax credit partnerships notes payable, partially offset by proceeds from issuance of debt securities.

Our cash and cash equivalents decreased \$24.8 billion to \$10.5 billion for the year ended December 31, 2005. Cash flows provided by operating activities in 2005 were approximately \$6.2 billion, which primarily reflected cash flows provided by net interest income, management and guarantee fees and changes to other operating assets and liabilities, partially offset by non-interest expenses as well as net cash flows used in purchases of held-for-sale mortgages. Cash flows used for investing activities were \$58.4 billion, primarily resulting from purchases of held-for-investment mortgages and available-for-sale securities as we increased our retained portfolio in 2005 and the repayment of swap collateral obligations. These outflows were partially offset by proceeds from sales and maturities of available-for-sale securities and repayments of held-for-investment mortgages, as well as cash flows from securities purchased under agreements to resell and federal funds sold.

Cash flows provided by financing activities in 2005 were \$27.4 billion and were primarily due to proceeds from issuance of debt securities, partially offset by net cash flows used in repayments of debt securities, payment of cash dividends on preferred stock and common stock, and payments of housing tax credit partnerships notes payable.

Capital Resources

Capital Management

Our primary objective in managing capital is preserving our safety and soundness. We also seek to have sufficient capital to support our business and mission at attractive long-term returns. See “NOTE 9: REGULATORY CAPITAL” to our consolidated financial statements for more information regarding our regulatory capital requirements and OFHEO’s capital monitoring framework. When appropriate, we will consider opportunities to return excess capital to shareholders (through dividends and share repurchases) and optimize our capital structure to lower our cost of capital.

We assess and project our capital adequacy relative to our regulatory requirements as well as our economic risks. This includes targeting a level of additional capital above each of our capital requirements, as well as the 30% mandatory target capital surplus to help support ongoing compliance and to accommodate future uncertainties. We evaluate the adequacy of our targeted additional capital in light of changes in our business, risk and economic environment.

We develop an annual capital plan that is approved by our board of directors and updated periodically. This plan provides projections of capital adequacy, taking into consideration our business plans, forecasted earnings, economic risks and regulatory requirements.

Capital Adequacy

We estimate at December 31, 2007 that we exceeded each of our regulatory capital requirements, in addition to the 30% mandatory target capital surplus. However, weakness in the housing market and volatility in the financial markets continue to adversely affect our capital, including our ability to manage to the 30% mandatory target capital surplus. Factors that could adversely affect the adequacy of our capital in future periods include GAAP net losses; continued declines in home prices; changes in our credit and interest-rate risk profiles; adverse changes in interest-rate or implied volatility; adverse OAS changes; legislative or regulatory actions that increase capital requirements; or changes in accounting practices or standards.

As a result of the impact of GAAP net losses on our core capital, we did not meet the 30% mandatory target capital surplus at the end of November 2007. In order to manage to the 30% mandatory target capital surplus and improve business flexibility, on December 4, 2007, we issued \$6 billion of non-cumulative, perpetual preferred stock. In addition, during the fourth quarter of 2007, we reduced our common stock dividend by 50% and reduced the size of our cash and investments portfolio. If these measures are not sufficient to help us manage to the 30% mandatory target capital surplus, then we will consider additional measures in the future, such as limiting growth or reducing the size of our retained portfolio, slowing issuances of our credit guarantees, issuing preferred or convertible preferred stock, issuing common stock or further reducing our common stock dividend.

Other items positively affecting our capital position include: (a) certain operational changes in December 2007 for purchasing delinquent loans from our PCs, (b) changes in accounting principles we adopted, which increased core capital by \$1.3 billion at December 31, 2007 and (c) our adoption of SFAS 159 on January 1, 2008, which increased core capital by an estimated \$1.0 billion.

Our ability to execute additional actions or their effectiveness may be limited and we might not be able to manage to the 30% mandatory target capital surplus. If we are not able to manage to the 30% mandatory target capital surplus, OFHEO may, among other things, seek to require us to (a) submit a plan for remediation or (b) take other remedial steps. In addition, OFHEO has discretion to reduce our capital classification by one level if OFHEO determines that we are engaging in conduct OFHEO did not approve that could result in a rapid depletion of core capital or determines that the value of property subject to mortgage loans we hold or guarantee has decreased significantly. See “REGULATION AND SUPERVISION — Office of Federal Housing Enterprise Oversight — *Capital Standards and Dividend Restrictions*” and “NOTE 9: REGULATORY CAPITAL — Classification” to our consolidated financial statements for information regarding additional potential actions OFHEO may seek to take against us.

Core Capital

During 2007 and 2006, our core capital increased approximately \$2.5 billion and \$0.3 billion, respectively. The increase in 2007 was primarily due to a net increase in the balance of our non-cumulative, perpetual preferred stock of \$8.0 billion and the cumulative effect of a change in accounting principle of \$181 million, partially offset by a net loss of \$3.1 billion, common stock repurchases of \$1.0 billion, and common and preferred stock dividends declared of \$1.6 billion. The increase in our core capital in 2006 was primarily from net income of \$2.3 billion and a net increase in the balance of our non-cumulative, perpetual preferred stock of \$1.5 billion, partially offset by common stock repurchases of \$2.0 billion and the

payment of common stock and preferred stock dividends totaling \$1.6 billion. See “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Recently Adopted Accounting Standards — *Accounting for Uncertainty in Income Taxes*” to our consolidated financial statements for further information regarding the cumulative effect of a change in accounting principle.

We completed five non-cumulative, perpetual preferred stock offerings during 2007. In these offerings, we issued an aggregate of \$8.6 billion of non-cumulative, perpetual preferred stock, consisting of \$1.5 billion in connection with the planned replacement of common stock with an equal amount of preferred stock and \$600 million to replace higher-cost preferred stock that we redeemed and additional issuances of \$6.5 billion in the aggregate to bolster our capital base and for general corporate purposes. We purchased a total of approximately 16.1 million shares of our outstanding common stock under the stock repurchase plan authorized in March 2007 at an average cost of \$62.04 per share.

Our board of directors approved a dividend per common share of \$0.25 for the fourth quarter of 2007, a decrease from the \$0.50 per share common dividend that was paid for each of the first three quarters of 2007 and the fourth quarter of 2006. Our common dividend per share was \$0.47 for each of the first three quarters of 2006 and the fourth quarter of 2005. Our board of directors will determine the amount of future dividends, if any, after considering factors such as our capital position and our earnings and growth prospects. Our board of directors also approved an increase in the number of authorized shares of common stock from 726 million to 806 million in November 2007.

For the fourth quarter of 2005 through the fourth quarter of 2007, our board of directors also approved quarterly preferred stock dividends that were consistent with the contractual rates and terms of the preferred stock. See “NOTE 8: STOCKHOLDERS’ EQUITY” to our consolidated financial statements for information regarding our outstanding issuances of preferred stock.

PORTFOLIO BALANCES AND ACTIVITIES

Total Mortgage Portfolio

Our total mortgage portfolio includes mortgage loans and mortgage-related securities held in our retained portfolio as well as the balances of PCs and Structured Securities held by third parties. Guaranteed PCs and Structured Securities held by third parties are not included on our consolidated balance sheets.

Table 37 provides information about our total mortgage portfolio at December 31, 2007, 2006 and 2005.

Table 37 — Total Mortgage Portfolio and Segment Portfolio Composition⁽¹⁾⁽²⁾

	December 31,		
	2007	2006	2005
	(in millions)		
Total mortgage portfolio:			
<i>Retained portfolio:</i>			
Single-family mortgage loans	\$ 24,589	\$ 20,640	\$ 20,396
Multifamily mortgage loans	57,569	45,207	41,085
Total mortgage loans	<u>82,158</u>	<u>65,847</u>	<u>61,481</u>
Guaranteed PCs and Structured Securities in the retained portfolio	356,970	354,262	361,324
Non-Freddie Mac mortgage-related securities, agency	47,836	45,385	44,626
Non-Freddie Mac mortgage-related securities, non-agency	233,849	238,465	242,915
Total non-Freddie Mac mortgage-related securities	<u>281,685</u>	<u>283,850</u>	<u>287,541</u>
Total retained portfolio ⁽³⁾	<u>720,813</u>	<u>703,959</u>	<u>710,346</u>
<i>Guaranteed PCs and Structured Securities held by third parties:</i>			
Single-family Structured Transactions	9,351	8,424	10,489
Multifamily Structured Transactions	900	867	—
Single-family PCs and other Structured Securities	1,363,613	1,105,437	949,599
Multifamily PCs and other Structured Securities	7,999	8,033	14,112
Total guaranteed PCs and Structured Securities held by third parties	<u>1,381,863</u>	<u>1,122,761</u>	<u>974,200</u>
Total mortgage portfolio	<u>\$2,102,676</u>	<u>\$1,826,720</u>	<u>\$1,684,546</u>
	December 31,		
	2007	2006	2005
	(in millions)		
Segment portfolios:			
<i>Investments — Mortgage-related investment portfolio:</i>			
Single-family mortgage loans	\$ 24,589	\$ 20,640	\$ 20,396
Guaranteed PCs and Structured Securities in the retained portfolio	356,970	354,262	361,324
Non-Freddie Mac mortgage-related securities in the retained portfolio	281,685	283,850	287,541
Total Investments — Mortgage-related investment portfolio ⁽⁴⁾	<u>\$ 663,244</u>	<u>\$ 658,752</u>	<u>\$ 669,261</u>
<i>Single-family Guarantee — Credit guarantee portfolio:</i>			
Guaranteed PCs and Structured Securities in the retained portfolio	\$ 343,071	\$ 336,869	\$ 344,922
Guaranteed PCs and Structured Securities held by third parties	1,363,613	1,105,437	949,599
Single-family Structured Transactions in the retained portfolio	11,240	17,011	16,011
Single-family Structured Transactions held by third parties	9,351	8,424	10,489
Total Single-family Guarantee — Credit guarantee portfolio	<u>\$1,727,275</u>	<u>\$1,467,741</u>	<u>\$1,321,021</u>
<i>Multifamily — Guarantee and loan portfolios:</i>			
Multifamily loan portfolio	\$ 57,569	\$ 45,207	\$ 41,085
Multifamily Structured Transactions	900	867	—
Multifamily PCs and other Structured Securities ⁽⁵⁾	10,658	8,415	14,503
Total multifamily guarantee portfolio	<u>11,558</u>	<u>9,282</u>	<u>14,503</u>
Total Multifamily — Guarantee and loan portfolios	<u>\$ 69,127</u>	<u>\$ 54,489</u>	<u>\$ 55,588</u>
Less: Guaranteed PCs and Structured Securities in the retained portfolio ⁽⁶⁾	<u>(356,970)</u>	<u>(354,262)</u>	<u>(361,324)</u>
Total mortgage portfolio	<u>\$2,102,676</u>	<u>\$1,826,720</u>	<u>\$1,684,546</u>

(1) Based on unpaid principal balance and excludes mortgage loans and mortgage-related securities traded, but not yet settled.

(2) Effective December 2007, we established securitization trusts for the underlying assets of our PCs and Structured Securities issued. As a result, we adjusted the reported balance of our mortgage portfolios to reflect the publicly-available security balances of our PCs and Structured Securities. Previously these balances were based on the unpaid principal balance of the underlying mortgage loans.

(3) See “CONSOLIDATED BALANCE SHEETS ANALYSIS — Table 22 — Characteristics of Mortgage Loans and Mortgage-Related Securities in our Retained Portfolio” for a reconciliation of the retained portfolio amounts shown in this table to the amounts shown under such caption in conformity with GAAP on our consolidated balance sheets.

(4) Includes certain assets related to Single-family Guarantee activities and Multifamily activities.

(5) Includes multifamily PCs and other Structured Securities both in the retained portfolio and held by third parties.

(6) The amount of our PCs and Structured Securities in the retained portfolio is included in both our segments’ mortgage-related and guarantee portfolios and thus deducted in order to reconcile to our total mortgage portfolio. These securities are managed by the Investments segment, which receives related interest income; however, the Single-family and Multifamily segments manage and receive associated guarantee fees.

In 2007 and 2006, our total mortgage portfolio grew at a rate of 15% and 8%, respectively. Our new business purchases consist of mortgage loans and non-Freddie Mac mortgage-related securities that are purchased for our retained portfolio or serve as collateral for our issued PCs and Structured Securities. We generate a significant portion of our mortgage purchase volume through several key mortgage lenders. See “BUSINESS — Our Charter and Mission — Types of Mortgages We Purchase” for information about these relationships and consequent risks. Table 38 summarizes purchases into our total mortgage portfolio.

Table 38 — Total Mortgage Portfolio Activity Detail⁽¹⁾

	Year Ended December 31,					
	2007		2006		2005	
	Amount	% of Purchase Amounts	Amount	% of Purchase Amounts	Amount	% of Purchase Amounts
(dollars in millions)						
New business purchases:						
Single-family mortgage purchases:						
Conventional:						
30-year amortizing fixed-rate ⁽²⁾	\$326,455	66%	\$251,143	67%	\$272,702	67%
15-year amortizing fixed-rate	28,910	6	21,556	6	40,963	10
ARMs/adjustable-rate ⁽³⁾	12,465	3	18,854	5	35,677	9
Interest-only ⁽⁴⁾	97,778	20	58,176	16	26,516	7
Option ARMs	—	—	—	—	3,918	1
Balloon/resets ⁽⁵⁾	125	—	419	—	1,720	—
FHA/VA ⁽⁶⁾	157	—	946	—	—	—
Rural Housing Service and other federally guaranteed loans	176	—	176	—	177	—
Total single-family	466,066	95	351,270	94	381,673	94
Multifamily:						
Conventional and other	21,645	4	13,031	4	11,172	3
Total multifamily	21,645	4	13,031	4	11,172	3
Total mortgage purchases	487,711	99	364,301	98	392,845	97
Non-Freddie Mac mortgage-related securities purchased for Structured Securities:						
Ginnie Mac Certificates	48	—	48	—	37	—
Structured Transactions ⁽⁷⁾	3,431	1	8,592	2	14,331	3
Total Non-Freddie Mac mortgage-related securities purchased for Structured Securities	3,479	1	8,640	2	14,368	3
Total single-family and multifamily mortgage purchases and total non-Freddie Mac mortgage-related securities purchased for Structured Securities	\$491,190	100%	\$372,941	100%	\$407,213	100%
Non-Freddie Mac mortgage-related securities purchased into the retained portfolio:						
Agency securities:						
<i>Fannie Mae:</i>						
Single-family:						
Fixed-rate	\$ 2,170		\$ 4,259		\$ 2,854	
Variable-rate	9,863		8,014		3,368	
Total Fannie Mae	12,033		12,273		6,222	
<i>Ginnie Mae:</i>						
Single-family:						
Fixed-rate	—		—		64	
Total Ginnie Mae	—		—		64	
Total agency mortgage-related securities	12,033		12,273		6,286	
Non-agency securities:						
<i>Single-family</i>						
Single-family:						
Fixed-rate	881		718		2,154	
Variable-rate	49,563		96,906		148,600	
Total single-family	50,444		97,624		150,754	
<i>Commercial mortgage-backed securities:</i>						
Fixed-rate	3,558		2,534		10,343	
Variable-rate	18,526		13,432		4,497	
Total commercial mortgage-backed securities	22,084		15,966		14,840	
<i>Mortgage revenue bonds:</i>						
Single-family:						
Fixed-rate	1,813		3,062		2,374	
Variable-rate	—		—		27	
Multifamily:						
Fixed-rate	—		116		434	
Variable-rate	—		—		5	
Total mortgage revenue bonds	1,813		3,178		2,840	
<i>Manufactured Housing:</i>						
Single-family:						
Variable-rate	127		—		—	
Total Manufactured Housing	127		—		—	
Total non-agency mortgage-related securities	74,468		116,768		168,434	
Total non-Freddie Mac mortgage-related securities purchased into the retained portfolio	86,501		129,041		174,720	
Total new business purchases	\$577,691		\$501,982		\$581,933	
Mortgage purchases with credit enhancements		21%		17%		17%
Mortgage liquidations ⁽⁸⁾	\$298,089		\$339,814		\$384,674	
Mortgage liquidations rate ⁽⁸⁾		16%		20%		26%
Freddie Mac securities repurchased into the retained portfolio:						
Single-family:						
Fixed-rate	\$111,976		\$ 76,378		\$106,682	
Variable-rate	26,800		27,146		29,805	
Multifamily:						
Fixed-rate	2,283		—		—	
Total Freddie Mac securities repurchased into the retained portfolio	\$141,059		\$103,524		\$136,487	

(1) Based on unpaid principal balances. Excludes mortgage loans and mortgage-related securities traded but not yet settled. Also excludes net additions to the retained portfolio for delinquent mortgage loans and balloon reset mortgages purchased out of PC pools.
(2) Includes 40-year and 20-year fixed-rate mortgages.
(3) Includes ARMs with 1-, 3-, 5-, 7- and 10-year initial fixed-rate periods.
(4) Represents loans where the borrower pays interest only for a period of time before the borrower begins making principal payments.
(5) Represents mortgages whose terms require lump sum principal payments on contractually determined future dates unless the borrower qualifies for and elects an extension of the maturity date at an adjusted interest-rate.
(6) Excludes FHA/Department of Veterans Affairs, or VA, loans that back Structured Transactions.
(7) Includes \$312 million, \$6,908 million and \$14,331 million of option ARM loans purchased for Structured Transactions in 2007, 2006 and 2005, respectively.
(8) Based on total mortgage portfolio.

Guaranteed PCs and Structured Securities

Guaranteed PCs and Structured Securities represent the unpaid principal balances of the mortgage-related securities we issue or otherwise guarantee. Table 39 presents the distribution of underlying mortgage assets for our PCs and Structured Securities.

Table 39 — Guaranteed PCs and Structured Securities⁽¹⁾⁽²⁾

	December 31,		
	2007	2006 (in millions)	2005
Single-family:			
Conventional:			
30-year fixed rate ⁽³⁾	\$1,091,212	\$ 882,398	\$ 741,913
20-year fixed-rate	72,225	66,777	67,937
15-year fixed rate	272,490	290,314	321,176
ARMs/adjustable-rate	91,219	100,808	106,644
Option ARMs	1,853	2,808	3,830
Interest-only ⁽⁴⁾	159,028	76,114	25,697
Balloon/resets	17,242	21,551	26,321
FHA/VA	1,283	1,398	849
Rural Housing Service and other federally guaranteed loans	132	138	154
<i>Total single-family</i>	<u>1,706,684</u>	<u>1,442,306</u>	<u>1,294,521</u>
Multifamily:			
Conventional and other	10,658	8,415	14,503
<i>Total multifamily</i>	<u>10,658</u>	<u>8,415</u>	<u>14,503</u>
Structured Securities backed by non-Freddie Mac mortgage-related securities:			
Ginnie Mae Certificates ⁽⁵⁾	1,268	1,510	2,021
Structured Transactions ⁽⁶⁾	20,223	24,792	24,479
<i>Total Structured Securities backed by non-Freddie Mac mortgage-related securities</i>	<u>21,491</u>	<u>26,302</u>	<u>26,500</u>
Total guaranteed PCs and Structured Securities	<u>\$1,738,833</u>	<u>\$1,477,023</u>	<u>\$1,335,524</u>

(1) Based on unpaid principal balances and excludes mortgage-related securities traded, but not yet settled.

(2) Effective December 2007, we established securitization trusts for the underlying assets of our PCs and Structured Securities. As a result, we adjusted the reported balance of our mortgage portfolios to reflect the publicly-available security balances of our PCs and Structured Securities. Previously we reported these balances based on the unpaid principal balance of the underlying mortgage loans.

(3) Portfolio balances include \$1,762 million, \$42 million and \$— of 40-year fixed-rate mortgages at December 31, 2007, 2006 and 2005, respectively.

(4) Includes both fixed and variable-rate interest only loans.

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

(6) Represents Structured Securities backed by non-agency securities that include prime, FHA/VA and subprime mortgage loan issuances.

Our guarantees of non-traditional mortgage products, including lower documentation loans, have increased in the last two years in response to newer products in the mortgage origination market. Interest-only loans represented approximately 20% and 16% of our securitization volume in 2007 and 2006, respectively. Other non-traditional mortgage products, including those designated as Alt-A loans, made up approximately 10% and 8% of our mortgage purchase volume in 2007 and 2006, respectively. We impose risk management thresholds on purchases of certain new products for which we have limited historical experience. See “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK” and “CREDIT RISKS” for additional information regarding our non-traditional mortgage loans, including delinquency rate information.

Table 40 provides additional detail regarding our PCs and Structured Securities.

Table 40 — Single-Class and Multi-Class PCs and Structured Securities⁽¹⁾

<u>December 31, 2007</u>	<u>Retained Portfolio</u>	<u>Held by Third Parties (in millions)</u>	<u>Total Guaranteed PCs and Structured Securities⁽⁶⁾</u>
PCs and Structured Securities:			
Single-class ⁽²⁾	\$219,702	\$ 817,353	\$1,037,055
Multi-class ⁽³⁾⁽⁴⁾	137,268	526,604	663,872
Other ⁽⁵⁾	—	37,906	37,906
Total PCs and Structured Securities ⁽⁷⁾	<u>\$356,970</u>	<u>\$1,381,863</u>	<u>\$1,738,833</u>
 <u>December 31, 2006</u>			
PCs and Structured Securities:			
Single-class ⁽²⁾	\$194,057	\$ 624,383	\$ 818,440
Multi-class ⁽³⁾⁽⁴⁾	160,205	491,696	651,901
Other ⁽⁵⁾	—	6,682	6,682
Total PCs and Structured Securities	<u>\$354,262</u>	<u>\$1,122,761</u>	<u>\$1,477,023</u>

(1) Based on unpaid principal balances, and excludes Freddie Mac mortgage-related securities traded, but not yet settled.

(2) Includes single-class Structured Securities backed by PCs and Ginnie Mae Certificates.

(3) Includes multi-class Structured Securities that are backed by PCs, Ginnie Mae Certificates and non-agency mortgage-related securities.

(4) Principal-only strips backed by our PCs and held in the retained portfolio are classified as multi-class for the purpose of this table.

(5) See “NOTE 2: FINANCIAL GUARANTEES AND TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS” to our consolidated financial statements for a discussion of our other mortgage guarantees.

(6) Total PCs and Structured Securities exclude \$1,519 billion and \$1,240 billion at December 31, 2007 and 2006, respectively, of Structured Securities backed by securitized PCs and other previously issued Structured Securities. These excluded Structured Securities which do not increase our credit related exposure, consist of single-class Structured Securities backed by PCs, REMICs, and principal-only strips. The notional balances of interest-only strips are excluded because this table is based on unpaid principal balances. Also excluded are modifiable and combinable REMIC tranches and interest and principal classes, where the holder has the option to exchange the security tranches for other pre-defined security tranches.

(7) Effective December 2007, we established securitization trusts for the underlying assets of our PCs and Structured Securities issued. As a result, we adjusted the reported balance of our mortgage portfolios to reflect the publicly-available security balances of our PCs and Structured Securities. Previously, we reported these balances based on the unpaid principal balance of the underlying mortgage loans.

OFF-BALANCE SHEET ARRANGEMENTS

We enter into certain business arrangements that are not recorded on our consolidated balance sheets or may be recorded in amounts that differ from the full contract or notional amount of the transaction. Most of these arrangements relate to our financial guarantee and securitization activity for which we record guarantee assets and obligations, but the related securitized assets are owned by third parties. These off-balance sheet arrangements may expose us to potential losses in excess of the amounts recorded on our consolidated balance sheets.

Guarantee of PCs and Structured Securities

As discussed in “BUSINESS — Types of Mortgages We Purchase,” we guarantee the payment of principal and interest on PCs and Structured Securities we issue. Mortgage-related assets that back PCs and Structured Securities held by third parties are not reflected as assets on our consolidated balance sheets.

We manage the risks of our credit guarantee activity carefully, sharing the risk in some cases with third parties through the use of primary mortgage insurance, pool insurance and other credit enhancements. “NOTE 2: FINANCIAL GUARANTEES AND TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS” to our consolidated financial statements provides information about our guarantees, including details related to credit protections and maximum coverages that we obtain through credit enhancements. Also, see “CREDIT RISKS” for more information.

Our credit guarantee activities principally occur through our guarantor swap program in the form of mortgage swap transactions. In a mortgage swap transaction, a mortgage lender delivers mortgages to us in exchange for our PCs that represent undivided interests in those same mortgages. We receive various forms of consideration in exchange for providing our guarantee on issued PCs, including (a) the contractual right to receive a management and guarantee fee, (b) delivery or credit fees for higher-risk mortgages and (c) other forms of credit enhancements received from counterparties or mortgage loan insurers.

Credit guarantee activity also occurs through our cash window and our multilender swap program. Single-family mortgage loans we purchase for cash through the cash window are typically either retained by us in our retained portfolio or pooled together with other single-family mortgage loans we purchase in connection with PC swap-based transactions in our multilender program executed with various lenders. We may issue such PCs to these lenders in exchange for the mortgage loans we purchase from them or, to the extent these loans are pooled with loans purchased for cash, we may sell them to third parties for cash consideration through an auction.

We also sell PCs from our retained portfolio in resecuritized form. We issue single- and multi-class Structured Securities that are backed by securities held in our retained portfolio and subsequently transfer such Structured Securities to third parties in exchange for cash, PCs or other mortgage-related securities. We earn resecuritization fees in connection with the creation of certain Structured Securities. We resecuritized a total of \$456.9 billion and \$388.9 billion of single and multiclass Structured Securities during the year ended December 31, 2007 and 2006, respectively. The increase of our principal credit risk exposure on Structured Securities relates only to that portion of resecuritized assets that consists of non-Freddie Mac mortgage-related securities. For information about our purchase and securitization activities, see “PORTFOLIO BALANCES AND ACTIVITIES.”

In addition, we also enter into long-term standby commitments for mortgage assets held by third parties that require that we purchase loans from lenders when the loans subject to these commitments meet certain delinquency criteria. We have included these transactions in the reported activity and balances of our PCs and Structured Securities. Long-term standby commitments represented approximately 2% and less than 1% of the balance of our PCs and Structured Securities as of December 31, 2007 and 2006, respectively.

Our maximum potential off-balance sheet exposure to credit losses relating to our PCs and Structured Securities is primarily represented by the unpaid principal balance of those securities held by third parties, which was \$1,382 billion and \$1,123 billion at December 31, 2007 and 2006, respectively. Based on our historical credit losses, which in 2007 averaged approximately 3.0 basis points of the aggregate unpaid principal balance of our PCs and Structured Securities, we do not believe that the maximum exposure is representative of our actual exposure on these guarantees. The maximum exposure does not take into consideration the recovery we would receive through exercising our rights to the collateral backing the underlying loans nor the available credit enhancements, which include recourse and primary insurance with third parties.

The accounting policies and fair value estimation methodologies we apply to our credit guarantee activities significantly affect the volatility of our reported earnings. See “CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Income (Loss)” for an analysis of the effects on our consolidated statements of income related to our credit guarantee activities. See “CONSOLIDATED BALANCE SHEETS ANALYSIS” for a description of our guarantee asset and guarantee obligation. The accounting for our securitization transactions and the significant assumptions used to determine the gains or losses from such transfers that are accounted for as sales are discussed in “NOTE 2: FINANCIAL GUARANTEES AND TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS” to our consolidated financial statements.

Other

We extend other guarantees and provide indemnification to counterparties for breaches of standard representations and warranties in contracts entered into in the normal course of business based on an assessment that the risk of loss would be remote. See “NOTE 2: FINANCIAL GUARANTEES AND TRANSFERS OF SECURITIZED INTERESTS IN MORTGAGE-RELATED ASSETS” to our consolidated financial statements for additional information.

We are a party to numerous entities that are considered to be variable interest entities, or VIEs, in accordance with FASB Interpretation No. 46 (Revised December 2003), “*Consolidation of Variable Interest Entities (revised December 2003)*,” an interpretation of APB No. 51,” or FIN 46(R). These variable interest entities include low-income multifamily housing tax credit partnerships, certain Structured Transactions and certain asset-backed investment trusts. See “NOTE 3: VARIABLE INTEREST ENTITIES” to our consolidated financial statements for additional information related to our significant variable interests in these VIEs.

As part of our credit guarantee business, we routinely enter into forward purchase and sale commitments for mortgage loans and mortgage-related securities. Some of these commitments are accounted for as derivatives. Their fair values are reported as either Derivative assets, net at fair value or Derivative liabilities, net at fair value on our consolidated balance sheets. See “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks” for further information. Our non-derivative commitments are primarily related to commitments arising from mortgage swap transactions and, to a lesser extent, commitments to purchase certain multifamily mortgage loans that will be classified as held-for-investment. These non-derivative commitments totaled \$173.4 billion and \$264.4 billion at December 31, 2007 and 2006, respectively. Such commitments are not accounted for as derivatives and are not recorded on our consolidated balance sheets.

Effective December 2007 we established securitization trusts for the administration of cash remittances received on the underlying assets of our PCs and Structured Securities. We receive trust management income, which represents the fees we earn as master servicer, issuer, trustee and administrator for our PCs and Structured Securities. These fees, which are included in our non-interest income, are derived from interest earned on principal and interest cash flows between the time funds are remitted to the trust by servicers and the date of distribution to our PC and Structured Securities holders. The trust management income will be offset by interest expense we incur when a borrower prepays.

CONTRACTUAL OBLIGATIONS

Table 41 provides aggregated information about the listed categories of our contractual obligations as of December 31, 2007. These contractual obligations affect our short- and long-term liquidity and capital resource needs. The table includes information about undiscounted future cash payments due under these contractual obligations, aggregated by type of contractual obligation, including the contractual maturity profile of our debt securities and other liabilities reported on our consolidated balance sheet and our operating leases at December 31, 2007. The timing of actual future payments may differ from those presented due to a number of factors, including discretionary debt repurchases. Our contractual obligations include other purchase obligations that are enforceable and legally binding. For purposes of this table, purchase obligations are included through the termination date specified in the respective agreements, even if the contract is renewable. Many of our purchase agreements for goods or services include clauses that would allow us to cancel the agreement prior to the expiration of the contract within a specified notice period; however, this table includes such obligations without regard to such termination clauses (unless we have provided the counterparty with actual notice of our intention to terminate the agreement).

In Table 41, the amounts of future interest payments on debt securities outstanding at December 31, 2007 are based on the contractual terms of our debt securities at that date. These amounts were determined using the key assumptions that (a) variable-rate debt continues to accrue interest at the contractual rates in effect at December 31, 2007 until maturity and (b) callable debt continues to accrue interest until its contractual maturity. The amounts of future interest payments on debt securities presented do not reflect certain factors that will change the amounts of interest payments on our debt securities after December 31, 2007, such as (a) changes in interest rates, (b) the call or retirement of any debt securities and (c) the issuance of new debt securities. Accordingly, the amounts presented in the table do not represent a forecast of our future cash interest payments or interest expense.

Table 41 excludes the following items:

- future payments related to our guarantee obligation, because the amount and timing of such payments are generally contingent upon the occurrence of future events and are therefore uncertain;
- future contributions to our Pension Plan, as we have not yet determined whether a contribution is required for 2008. See “NOTE 14: EMPLOYEE BENEFITS” to our consolidated financial statements for additional information about contributions to our Pension Plan;
- future cash settlements on derivative agreements not yet accrued, because the amount and timing of such payments are dependent upon changes in the underlying financial instruments and are therefore uncertain; and
- future dividends on the preferred stock we issued, because dividends on these securities are non-cumulative. In addition, the classes of preferred stock issued by our two consolidated real estate investment trust, or REIT, subsidiaries pay dividends that are cumulative. However, dividends on the REIT preferred stock are excluded because the timing of these payments is dependent upon declaration by the boards of directors of the REITs.

Table 41 — Contractual Obligations by Year at December 31, 2007

	Total	2008	2009	2010	2011	2012	Thereafter
	(in millions)						
Long-term debt securities ⁽¹⁾	\$576,349	\$ 97,262	\$ 79,316	\$63,911	\$45,966	\$52,317	\$237,577
Short-term debt securities ⁽¹⁾	199,498	199,498	—	—	—	—	—
Interest payable ⁽²⁾	144,405	25,181	20,806	17,606	14,279	12,073	54,460
Other liabilities reflected on our consolidated balance sheet:							
Other contractual liabilities ⁽³⁾⁽⁴⁾⁽⁵⁾	2,912	2,293	300	104	66	12	137
Purchase obligations:							
Purchase commitments ⁽⁶⁾	38,013	38,013	—	—	—	—	—
Other purchase obligations	401	262	54	27	21	18	19
Operating lease obligations	107	19	19	14	8	7	40
Capital lease obligations	1	1	—	—	—	—	—
Total specified contractual obligations	\$961,686	\$362,529	\$100,495	\$81,662	\$60,340	\$64,427	\$292,233

- (1) Represent par value. Callable debt is included in this table at its contractual maturity. For additional information about our debt securities, see “NOTE 7: DEBT SECURITIES AND SUBORDINATED BORROWINGS” to our consolidated financial statements.
- (2) Includes estimated future interest payments on our short-term and long-term debt securities. Also includes accrued interest payable recorded on our consolidated balance sheet, which consists primarily of the accrual of interest on short-term and long-term debt as well as the accrual of periodic cash settlements of derivatives, netted by counterparty.
- (3) Other contractual liabilities primarily represent future cash payments due under our contractual obligations to make delayed equity contributions to LIHTC partnerships and payables to the trust established for the administration of cash remittances received related to the underlying assets of our PCs and Structured Securities issued.
- (4) Accrued obligations related to our defined benefit plans, defined contribution plans and executive deferred compensation plan are included in the Total and 2008 columns. However, the timing of payments due under these obligations is uncertain. See “NOTE 14: EMPLOYEE BENEFITS” to our consolidated financial statements for additional information.
- (5) As of December 31, 2007, we have recorded tax liabilities for unrecognized tax benefits totaling \$563 million and allocated interest of \$137 million. These amounts have been excluded from this table because we cannot estimate the years in which these liabilities may be settled. See “NOTE 13: INCOME TAXES” to our consolidated financial statements for additional information.
- (6) Purchase commitments represent our obligations to purchase mortgage loans and mortgage-related securities from third parties. The majority of purchase commitments included in this caption are accounted for as derivatives in accordance with SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” or SFAS 133.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires us to make a number of judgments, estimates and assumptions that affect the reported amounts of our assets, liabilities, income, and expenses. Certain of our accounting policies, as well as estimates we make, are critical to the presentation of our financial condition and results of operations. They often require management to make difficult, complex or subjective judgments and estimates, at times, regarding matters that are inherently uncertain. The accounting policies discussed in this section are particularly critical to understanding our consolidated financial statements. Actual results could differ from our estimates and different judgments and assumptions related to these policies and estimates could have a material impact on our consolidated financial statements.

Our critical accounting policies and estimates relate to: (a) valuation of financial instruments; (b) derivative instruments and hedging activities; (c) allowances for loan losses and reserve for guarantee losses; (d) application of the static effective yield method guarantee obligation; (e) application of the effective interest method; and (f) impairment recognition on investments in securities. For additional information about these and other significant accounting policies, including recently issued accounting pronouncements, see “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” to our consolidated financial statements.

Valuation of Financial Instruments

A significant portion of our assets and liabilities consists of financial instruments that are measured at fair value on our consolidated financial statements. For instruments that are complex in nature, the measurement of fair value requires significant management judgments and assumptions. These judgments and assumptions, as well as changes in market conditions, may have a material effect on our GAAP consolidated balance sheets and statements of income as well as our consolidated fair value balance sheets.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in a transaction between market participants at the measurement date. The selection of a technique to measure fair value for each type of financial instrument depends on both the reliability and the availability of relevant market data. The amount of judgment involved in measuring the fair value of a financial instrument is affected by a number of factors, such as the type of

instrument, the liquidity of the markets for the instrument and the contractual characteristics of the instrument. We measure fair value according to the following fair value hierarchy of inputs to valuation techniques:

- quoted market prices for identical and similar instruments;
- industry standard models that consider market inputs such as yield curves, duration, volatility factors and prepayment speeds; and
- internally developed models that consider inputs based on management's judgment of market-based assumptions.

Financial instruments with active markets and readily available market prices are valued based on independent price quotations obtained from third party sources, such as pricing services, dealer quotes or direct market observations. During the second half of 2007, the market for non-agency securities has become significantly less liquid, which has resulted in lower transaction volumes, wider credit spreads and less transparency with pricing for these assets. In addition, we have observed more variability in the quotations received from dealers and third-party pricing services. However we believe that these quotations provide reasonable estimates of fair value. Independent price quotations obtained from pricing services are valuations estimated by a service provider using available market information. Dealer quotes are prices obtained from dealers that generally make markets in the relevant products and are an indication of the price at which the dealer would consider transacting in normal market conditions. Market observable prices are prices that are retrieved from sources in which market trades are executed, such as electronic trading platforms. When quoted prices are not readily available, we utilize models, including industry standard models and internally-developed models. These models use observable market inputs such as interest rate curves, market volatilities and pricing spreads. We maximize the use of observable inputs to the extent available. Certain complex financial instruments have significant data inputs that cannot be validated by reference to the market. These instruments are typically illiquid or unique in nature and require the use of management's judgment of market-based assumptions. The use of different pricing models or assumptions could produce materially different measurements of fair value.

Fair value affects our statement of income in the following ways:

- For certain financial instruments that are recorded in the GAAP consolidated balance sheets at fair value, changes in fair value are recognized in current period earnings. These include:
 - securities classified as trading, which are recorded in gains (losses) on investment activity;
 - derivatives with no hedge designation, which are recorded in derivative gains (losses); and
 - the guarantee asset, which is recorded in gains (losses) on guarantee asset.
- For other financial instruments that are recorded in the GAAP consolidated balance sheets at fair value, changes in fair value are deferred, net of tax, in AOCI. These include:
 - securities classified as available-for-sale, which are initially measured at fair value with deferred gains and losses recognized in AOCI. These deferred gains and losses affect earnings over time through amortization, sale or impairment recognition; and
 - changes in derivatives that are designated in cash flow hedge accounting relationships.
- Our guarantee obligation is initially measured at fair value, but is not remeasured at fair value on a periodic basis. This initial estimate results in losses on certain guarantees when the fair value of the guarantee obligation exceeds the fair value of the related guarantee asset and credit enhancement-related assets at issuance. This obligation also affects earnings over time through amortization to income on guarantee obligation.
- Mortgage loans purchased under our financial guarantees result in recognition of losses on loans purchased when fair values are less than our acquisition basis at the date of purchase.
- Mortgage loans that are held-for-sale are recorded at the lower-of-cost-or-market with changes in fair value recorded through earnings in gains (losses) on investment activity.

We periodically evaluate our valuation techniques and may change them to improve our fair value estimates, to accommodate market developments or to compensate for changes in data availability and reliability or other operational constraints.

At December 31, 2007 and 2006, the fair values for approximately 99% of our mortgage-related securities were based on prices obtained from third parties or were determined using models with significant observable inputs. The fair values for the remainder of our mortgage-related securities were obtained from internal models with few or no observable inputs. All of the fair values for our non-mortgage-related securities at December 31, 2007, and the majority of them at December 31, 2006, were based on prices obtained from third parties. The majority of our derivative positions were valued using internally developed models that used market inputs because few of the derivative contracts we used were listed on exchanges. At December 31, 2007 and 2006, approximately 71% and 65%, respectively, of the gross fair value of our derivative portfolio

related to interest-rate and foreign-currency swaps that did not have embedded options. These derivatives were valued using a discounted cash flow model that projects future cash flows and discounts them at the spot rate related to each cash flow. The remaining 29% and 35%, respectively, of our derivatives portfolio was valued based on prices obtained from third parties or using models with significant observable inputs.

See “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks” for discussion of market risks and our interest-rate sensitivity measures, Portfolio Market Value Sensitivity or PMVS, and duration gap.

Derivative Instruments and Hedging Activities

We discontinued substantially all of our hedge accounting relationships by December 31, 2006. During 2006 and 2005, our hedge accounting relationships primarily consisted of hedging benchmark interest-rate risk related to the forecasted issuances of debt that were designated as cash flow hedges, and fair value hedges of benchmark interest-rate risk and/or foreign currency risk on existing fixed-rate debt.

The changes in fair value of the derivatives in these cash flow hedge relationships were recorded as a separate component of AOCI to the extent the hedge relationships were effective, and amounts are reclassified to earnings when the forecasted transaction affects earnings.

When a cash flow hedge is discontinued, the net derivative gain or loss remains in AOCI unless it is probable that the hedged transaction will not occur. This requires estimates based on our expectation of future funding needs and the composition of future debt issuances. Our expectations about future funding needs are based upon projected growth and historical activity.

We believe that the forecasted issuances of debt previously hedged in cash flow hedging relationships have not become probable of not occurring; therefore, we may continue to include previously deferred amounts in AOCI. In the event that these forecasted issuances of debt do not occur or become probable of not occurring, potentially material amounts that are currently deferred and reported in AOCI would then be immediately recognized in our consolidated statements of income under derivative gains (losses).

The change in fair value of the derivatives in fair value hedge relationships were recorded in earnings along with the change in fair value of the hedged debt. Any difference was reflected as hedge ineffectiveness in other income.

For additional discussion of our use of derivatives and summaries of derivative positions, see “CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Income (Loss) — *Derivative Overview*” and “NOTE 11: DERIVATIVES” to our consolidated financial statements.

Allowance for Loan Losses and Reserve for Guarantee Losses

We maintain an allowance for loan losses on mortgage loans held-for-investment and a reserve for guarantee losses on PCs, collectively referred to as our loan loss reserves, to provide for credit losses when it is probable that a loss has been incurred. We use the same methodology to determine our allowance for loan losses and reserve for guarantee losses, as the relevant factors affecting credit risk are the same.

To calculate the loan loss reserves for the single-family loan portfolio, we aggregate homogenous loans into pools based on common underlying characteristics, using statistically based models to evaluate relevant factors affecting loan collectibility, and determine the best estimate of loss. To calculate loan loss reserves for the multifamily loan portfolio, we also use models, evaluate certain larger loans for impairment, and review repayment prospects and collateral values underlying individual loans.

We regularly evaluate the underlying estimates and models we use when determining the loan loss reserves and update our assumptions to reflect our historical experience and current view of economic factors.

Determining the adequacy of the loan loss reserves is a complex process that is subject to numerous estimates and assumptions requiring significant judgment. Key estimates and assumptions that impact our loan loss reserves include:

- loss severity trends;
- default experience;
- expected proceeds from credit enhancements;
- collateral valuation; and
- identification and impact assessment of macroeconomic factors.

No single statistic or measurement determines the adequacy of the loan loss reserves. Changes in one or more of the estimates or assumptions used to calculate the loan loss reserves could have a material impact on the loan loss reserves and provisions for credit losses.

We believe the level of our loan loss reserves is reasonable based on internal reviews of the factors and methodologies used. A management committee reviews the overall level of loan loss reserves, as well as the factors and methodologies that give rise to the estimate, and submits the best point estimate for review by senior management.

Application of the Static Effective Yield Method

We amortize our guarantee obligation under the static effective yield method. The static effective yield will be calculated and fixed at inception of the guarantee based on forecasted unpaid principal balances. The static effective yield will be evaluated and adjusted when significant changes in economic events cause a shift in the pattern of our economic release from risk. For example, certain market environments may lead to sharp and sustained changes in home prices or prepayments of mortgages, leading to the need for an adjustment in the static effective yield for specific mortgage pools underlying the guarantee. When a change is required, a cumulative catch-up adjustment, which could be significant in a given period, will be recognized and a new static effective yield will be used to determine our guarantee obligation amortization. See “NOTE 20: CHANGES IN ACCOUNTING PRINCIPLES” to our consolidated financial statements for further information.

Application of the Effective Interest Method

As described in “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” to our consolidated financial statements, we use the effective interest method to: (a) recognize interest income on our investments in debt securities; and (b) amortize related deferred items into interest income. The application of the effective interest method requires us to estimate the effective yield at each period end using our current estimate of future prepayments. Determination of these estimates requires significant judgment, as expected prepayment behavior is inherently uncertain. Estimates of future prepayments are derived from market sources and our internal prepayment models. Judgment is involved in making initial determinations about prepayment expectations and in updating those expectations over time in response to changes in market conditions, such as interest rates and other macroeconomic factors. See the discussion of market risks and our interest-rate sensitivity measures under “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — Interest-Rate Risk and Other Market Risks.” We believe that our current estimates of future prepayments are reasonable and comparable to those used by other market participants.

Impairment Recognition on Investments in Securities

We recognize impairment losses on available-for-sale securities through the income statement when we have concluded that a decrease in the fair value of a security is not temporary. For securities accounted for under Emerging Issues Task Force 99-20, “*Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*,” or EITF 99-20, an impairment loss is recognized when there is both a decline in fair value below the carrying amount and an adverse change in expected cash flows. Determination of whether an adverse change has occurred involves judgment about expected prepayments and credit events. We review securities not accounted for under EITF 99-20 for potential impairment whenever the security’s fair value is less than its amortized cost to determine whether we have the intent and ability to hold the investments until a forecasted recovery. This review considers a number of factors, including the severity of the decline in fair value, credit ratings, the length of time the investment has been in an unrealized loss position, and the likelihood of sale in the near term. While market prices and rating agency actions are factors that are considered in the impairment analysis, cash flow analysis based on default and prepayment assumptions serves as an important factor in determining if an other than temporary impairment has occurred. We recognize impairment losses when quantitative and qualitative factors indicate that it is probable that the security will suffer a contractual principal loss or interest shortfall. We apply significant judgment in determining whether impairment loss recognition is appropriate. We believe our judgments are reasonable. However, different judgments could have resulted in materially different impairment loss recognition. See “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” to our consolidated financial statements for more information on impairment recognition on securities.

Accounting Changes and Recently Issued Accounting Pronouncements

See “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” to our consolidated financial statements for more information concerning our accounting policies and recently issued accounting pronouncements, including those that we have not yet adopted and that will likely affect our consolidated financial statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to risks that include interest-rate and other market risks, including those described in “RISK FACTORS.” While we consider both our day-to-day and long-term management of interest-rate and other market risks to be satisfactory, we identified weaknesses in prior years in our overall risk governance framework. We created an executive

management enterprise risk committee to provide a company-wide view of risk and have formed five subcommittees to focus on credit, market, models, operational and regulatory risks. Our board of directors has also assigned primary responsibility for oversight of enterprise risk management to the Governance, Nominating and Risk Oversight Committee of the board of directors.

Interest-Rate Risk and Other Market Risks

Our interest-rate risk management objective is to serve our mission by protecting shareholder value in all interest-rate environments. Our disciplined approach to interest-rate risk management is essential to maintaining a strong and durable capital base and uninterrupted access to debt and equity capital markets.

Sources of Interest-Rate Risk and Other Market Risks

Our retained portfolio activities expose us to interest-rate risk and other market risks arising primarily from the uncertainty as to when borrowers will pay the outstanding principal balance of mortgage loans and mortgage-related securities held in our retained portfolio, known as prepayment risk, and the resulting potential mismatch in the timing of our receipt of cash flows related to our assets versus the timing of payment of cash flows related to our liabilities. For the vast majority of our mortgage-related investments, the mortgage borrower has the option to make unscheduled payments of additional principal or to completely pay off a mortgage loan at any time before its scheduled maturity date (without having to pay a prepayment penalty) or make principal payments in accordance with their contractual obligation.

Our credit guarantee activities also expose us to interest-rate risk because changes in interest rates can cause fluctuations in the fair value of our existing credit guarantee portfolio. We generally do not hedge these changes in fair value except for interest-rate exposure related to net buy-ups and float. Float, which arises from timing differences between when the borrower makes principal payments on the loan and the reduction of the PC balance, can lead to significant interest expense if the interest rate paid to a PC investor is higher than the reinvestment rate earned by the securitization trusts on payments received from mortgage borrowers and paid to us as trust management income.

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

Duration Risk and Convexity Risk

Duration is a measure of a financial instrument's price sensitivity to changes in interest rates. Convexity is a measure of how much a financial instrument's duration changes as interest rates change. Our convexity risk primarily results from prepayment risk. We actively manage duration risk and convexity risk through asset selection and structuring (that is, by identifying or structuring mortgage-related securities with attractive prepayment and other characteristics), by issuing a broad range of both callable and non-callable debt instruments and by using interest-rate derivatives and written options. Managing the impact of duration risk and convexity risk is the principal focus of our daily market risk management activities. These risks are encompassed in our PMVS and duration gap risk measures, discussed in greater detail below. We use prepayment models to determine the estimated duration and convexity of mortgage assets for our PMVS and duration gap measures. Expected results can be affected by differences between prepayments forecasted by the models and actual prepayments.

Yield Curve Risk

Yield curve risk is the risk that non-parallel shifts in the yield curve (such as a flattening or steepening) will adversely affect shareholder value. Because changes in the shape, or slope, of the yield curve often arise due to changes in the market's expectation of future interest rates at different points along the yield curve, we evaluate our exposure to yield curve risk by examining potential reshaping scenarios at various points along the yield curve. Our yield curve risk under a specified yield curve scenario is reflected in our PMVS-Yield Curve, or PMVS-YC, disclosure.

Volatility Risk

Volatility risk is the risk that changes in the market's expectation of the magnitude of future variations in interest rates will adversely affect shareholder value. Implied volatility is a key determinant of the value of an interest-rate option. Since prepayment risk is generally inherent in mortgage assets, changes in implied volatility affect the value of mortgage assets. We manage volatility risk through asset selection and by maintaining a consistently high percentage of option-embedded liabilities relative to our mortgage assets. We monitor volatility risk by measuring exposure levels on a daily basis and we maintain internal limits on the amount of volatility risk exposure that is acceptable to us.

Basis Risk

Basis risk is the risk that interest rates in different market sectors will not move in tandem and will adversely affect shareholder value. This risk arises principally because we generally hedge mortgage-related investments with debt securities. We do not actively manage the basis risk arising from funding retained portfolio investments with our debt securities, also referred to as mortgage-to-debt OAS risk. See "MD&A — CONSOLIDATED FAIR VALUE BALANCE SHEETS

ANALYSIS — Key Components of Changes in Fair Value of Net Assets — *Changes in Mortgage-To-Debt OAS*” for additional information. We also incur basis risk when we use LIBOR- or Treasury-based instruments in our risk management activities.

Foreign-Currency Risk

Foreign-currency risk is the risk that fluctuations in currency exchange rates (e.g., foreign currencies to the U.S. dollar) will adversely affect shareholder value. We are exposed to foreign-currency risk because we have debt denominated in currencies other than the U.S. dollar, our functional currency. We eliminate virtually all of our foreign-currency risk by entering into swap transactions that effectively convert foreign-currency denominated obligations into U.S. dollar-denominated obligations.

Portfolio Market Value Sensitivity and Measurement of Interest-Rate Risk

We employ a risk management strategy that seeks to substantially match the duration characteristics of our assets and liabilities. To accomplish this, we employ an integrated strategy encompassing asset selection and structuring and asset and liability management.

Through our asset selection process, we seek to purchase mortgage assets with desirable prepayment expectations based on our evaluation of their yield-to-maturity, option-adjusted spreads and credit characteristics. Through this selection process and the restructuring of mortgage assets, we seek to retain cash flows with more stable risk and investment return characteristics while selling off the cash flows that do not meet our investment profile.

Through our asset and liability management process, we mitigate interest-rate risk by issuing a wide variety of debt products. The prepayment option held by mortgage borrowers drives the fair value of our mortgage assets such that the combined fair value of our mortgage assets and non-callable debt will decline if interest rates move significantly in either direction. We mitigate much of our exposure to changes in interest rates by funding a significant portion of our mortgage portfolio with callable debt. When interest rates change, our option to redeem this debt offsets a large portion of the fair value change driven by the mortgage prepayment option. At December 31, 2007, approximately 44% of our fixed-rate mortgage assets were funded and economically hedged with callable debt. However, because the mortgage prepayment option is not fully hedged by callable debt, the combined fair value of our mortgage assets and debt will be affected by changes in interest rates.

To further reduce our exposure to changes in interest rates, we hedge a significant portion of the remaining prepayment risk with option-based derivatives. These derivatives primarily consist of call swaptions, which tend to increase in value as interest rates decline, and put swaptions, which tend to increase in value as interest rates increase. With the addition of these option-based derivatives, a greater portion of our prepayment risk has been hedged. We also manage interest-rate risk by rebalancing the portfolio, primarily using interest-rate swaps. Although we do not hedge all of our exposure to changes in interest rates, these exposures are generally well understood, are subject to established limits, and are monitored and controlled through our disciplined risk management process. These limits are refined and updated from time to time. See “MD&A — CONSOLIDATED FAIR VALUE BALANCE SHEETS ANALYSIS — Key Components of Changes in Fair Value of Net Assets — *Changes in Mortgage-To-Debt OAS*” for further information.

PMVS and Duration Gap

Our primary interest-rate risk measures are PMVS and duration gap. PMVS is measured in two ways, one measuring the estimated sensitivity of our portfolio market value (as defined below) to parallel moves in interest rates (Portfolio Market Value Sensitivity-Level or (PMVS-L)) and the other to nonparallel movements (PMVS-YC). In December 2007, we changed our PMVS reporting to represent estimated dollars-at-risk, rather than expressed as a percentage of fair value to common equity. We believe this change provides more relevant information and better represents our overall level and loss exposure to adverse interest-rate movements given the substantial reduction in the fair value of common equity that occurred during 2007.

Our PMVS and duration gap estimates are determined using models that involve our best judgment of interest-rate and prepayment assumptions. Accordingly, while we believe that PMVS and duration gap are useful risk management tools, they should be understood as estimates rather than as precise measurements.

While PMVS and duration gap estimate the exposure to changes in interest rates, they do not capture the potential impact of certain other market risks, such as changes in volatility, basis, prepayment model, mortgage-to-debt option-adjusted spreads and foreign-currency risk. The impact of these other market risks can be significant. See “*Sources of*

Interest-Rate Risk and Other Market Risks” discussed above for further information. Definitions of our primary interest rate risk measures follow:

- PMVS-L shows the estimated loss in pre-tax portfolio market value from an immediate adverse 50 basis point parallel shift in the level of LIBOR rates (*i.e.*, when the yield at each point on the LIBOR yield curve increases or decreases by 50 basis points).
- PMVS-YC shows the estimated loss in pre-tax portfolio market value from an immediate adverse 25 basis point change in the slope (up and down) of the LIBOR yield curve. The 25 basis point change in slope for the PMVS-YC measure is obtained by shifting the two-year and ten-year LIBOR rates by an equal amount (12.5 basis points), but in opposite directions. LIBOR rate shifts between the two-year and ten-year points are interpolated.
- Duration gap estimates the net sensitivity of the fair value of our financial instruments to movements in interest rates. Duration gap is presented in units expressed as months. A duration gap of zero implies that the change in value of assets from an instantaneous rate move will be accompanied by an equal and offsetting move in the value of debt and derivatives thus leaving the net fair value of equity unchanged. However, because duration does not capture convexity exposure (the amount by which duration itself changes as rates move), actual changes in fair value from interest-rate changes may differ from those implied by duration gap alone. For that reason, we believe duration gap is most useful when used in conjunction with PMVS.

The 50 basis point shift and 25 basis point change in slope of the LIBOR yield curve used for our PMVS measures represent events that are expected to have an approximately 5% probability of occurring over a one-month time horizon. We believe that our PMVS measures represent conservative measures of interest-rate risk because these assumed scenarios are unlikely and because the scenarios assume instantaneous shocks. Therefore, these PMVS measures do not consider the effects on fair value of any rebalancing actions that we would typically take to reduce our risk exposure.

The expected loss in portfolio market value is an estimate of the sensitivity to changes in interest rates of the fair value of all interest-earning assets, interest-bearing liabilities and derivatives on a pre-tax basis. When we calculate the expected loss in portfolio market value and duration gap, we also take into account the cash flows related to certain credit guarantee-related items, including net buy-ups and expected gains or losses due to net interest from float. In making these calculations, we do not consider the sensitivity to interest-rate changes of the following assets and liabilities:

- *Credit guarantee portfolio.* We do not consider the sensitivity of the fair value of the credit guarantee portfolio to changes in interest rates except for the guarantee-related items mentioned above (*i.e.*, net buy-ups and float), because we believe the expected benefits from replacement business provide an adequate hedge against interest-rate changes over time.
- *Other assets with minimal interest-rate sensitivity.* We do not include other assets, primarily non-financial instruments such as fixed assets and REO, because we estimate their impact on PMVS and duration gap to be minimal.

PMVS Results

Table 42 provides estimated point-in-time PMVS-L and PMVS-YC results at December 31, 2007 and 2006. Table 42 also provides PMVS-L estimates assuming an immediate 100 basis point shift in the LIBOR yield curve. Because we do not hedge all prepayment option risk, the duration of our mortgage assets changes more rapidly as changes in interest rates increase. Accordingly, as shown in Table 42, the PMVS-L results based on a 100 basis point shift in the LIBOR curve are disproportionately higher than the PMVS-L results based on a 50 basis point shift in the LIBOR curve.

Table 42 — PMVS Assuming Shifts of the LIBOR Yield Curve

	Potential Pre-Tax Loss in Portfolio Market Value		
	PMVS-YC	PMVS-L	
	25 bps	50 bps	100 bps
		(in millions)	
At:			
December 31, 2007	\$42	\$533	\$1,681
December 31, 2006	\$27	\$146	\$ 560

Derivatives have enabled us to keep our interest-rate risk exposure at consistently low levels in a wide range of interest-rate environments. Table 43 shows that the low PMVS-L risk levels for the periods presented would generally have been higher if we had not used derivatives to manage our interest-rate risk exposure.

Table 43 — Derivative Impact on PMVS-L (50 bps)

	<u>Before Derivatives</u>	<u>After Derivatives</u> (in millions)	<u>Effect of Derivatives</u>
At:			
December 31, 2007	\$1,371	\$533	\$(838)
December 31, 2006	\$ 541	\$146	\$(395)

Duration Gap Results

Our estimated average duration gap for the months of December 2007 and 2006 was zero months.

The disclosure in our Monthly Volume Summary reports, which are available on our website at www.freddiemac.com, reflects the average of the daily PMVS-L, PMVS-YC and duration gap estimates for a given reporting period (a month, quarter or year).

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

We use derivatives primarily to:

- hedge forecasted issuances of debt and synthetically create callable and non-callable funding;
- regularly adjust or rebalance our funding mix in order to more closely match changes in the interest-rate characteristics of our mortgage assets; and
- hedge foreign-currency exposure (see “*Sources of Interest-Rate Risk and Other Market Risks — Foreign-Currency Risk.*”)

Hedge Forecasted Debt Issuances and Create Synthetic Funding

We typically commit to purchase mortgage investments on an opportunistic basis for a future settlement, typically ranging from two weeks to three months after the date of the commitment. To facilitate larger and more predictable debt issuances that contribute to lower funding costs, we use interest-rate derivatives to economically hedge the interest-rate risk exposure from the time we commit to purchase a mortgage to the time the related debt is issued. We also use derivatives to synthetically create the substantive economic equivalent of various debt funding structures. For example, the combination of a series of short-term debt issuances over a defined period and a pay-fixed swap with the same maturity as the last debt issuance is the substantive economic equivalent of a long-term fixed-rate debt instrument of comparable maturity. Similarly, the combination of non-callable debt and a call swaption, or option to enter into a receive-fixed swap, with the same maturity as the non-callable debt, is the substantive economic equivalent of callable debt. These derivatives strategies increase our funding flexibility and allow us to better match asset and liability cash flows, often reducing overall funding costs.

Adjust Funding Mix

We generally use interest-rate swaps to mitigate contractual funding mismatches between our assets and liabilities. We also use swaptions and other option-based derivatives to adjust the contractual funding of our debt in response to changes in the expected lives of mortgage-related assets in our retained portfolio. As market conditions dictate, we take rebalancing actions to keep our interest-rate risk exposure within management-set limits. In a declining interest-rate environment, we typically enter into receive-fixed swaps or purchase Treasury-based derivatives to shorten the duration of our funding to offset the declining duration of our mortgage assets. In a rising interest-rate environment, we typically enter into pay-fixed swaps or sell Treasury-based derivatives in order to lengthen the duration of our funding to offset the increasing duration of our mortgage assets.

Types of Derivatives

The derivatives we use to hedge interest-rate and foreign-currency risk are common in the financial markets. We principally use the following types of derivatives:

- LIBOR- and the Euro Interbank Offered Rate, or Euribor-, based interest-rate swaps;
- LIBOR- and Treasury-based options (including swaptions);
- LIBOR- and Treasury-based exchange-traded futures; and
- Foreign-currency swaps.

In addition to swaps, futures and purchased options, our derivative positions include the following:

Written Options and Swaptions

Written call and put swaptions are sold to counterparties allowing them the option to enter into receive- and pay-fixed swaps, respectively. Written call and put options on mortgage-related securities give the counterparty the right to execute a

contract under specified terms, which generally occurs when we are in a liability position. We use these written options and swaptions to manage convexity risk over a wide range of interest rates. Written options lower our overall hedging costs, allow us to hedge the same economic risk we assume when selling guaranteed final maturity REMICs with a more liquid instrument and allow us to rebalance the options in our callable debt and REMIC portfolios. We may, from time to time, write other derivative contracts such as caps, floors, interest-rate futures and options on buy-up and buy-down commitments.

Forward Purchase and Sale Commitments

We routinely enter into forward purchase and sale commitments for mortgage loans and mortgage-related securities. Most of these commitments are derivatives subject to the requirements of SFAS 133.

Swap Guarantee Derivatives

We issue swap guarantee derivatives that guarantee the payments on (a) multifamily mortgage loans that are originated and held by state and municipal housing finance agencies to support tax-exempt multifamily housing revenue bonds and (b) Freddie Mac pass-through certificates which are backed by tax-exempt multifamily housing revenue bonds and related taxable bonds and/or loans. In connection with some of these guarantees, we may also guarantee the sponsor's or the borrower's performance as a counterparty on any related interest-rate swaps used to mitigate interest-rate risk.

Credit Derivatives

We entered into credit derivatives during 2007, including risk-sharing agreements. Under these risk-sharing agreements, default losses on specific mortgage loans delivered by sellers are compared to default losses on reference pools of mortgage loans with similar characteristics. Based upon the results of that comparison, we remit or receive payments based upon the default performance of the referenced pools of mortgage loans. In addition, we entered into an agreement whereby we assume credit risk for mortgage loans held by third parties for up to a 90-day period in exchange for a monthly fee. Should the mortgage loans become delinquent we are obligated to purchase the loans.

In addition, we have also purchased mortgage loans containing debt cancellation contracts, which provide mortgage debt or payment cancellation for borrowers who experience unanticipated losses of income dependent on a covered event. The rights and obligations under these agreements have been assigned to the servicers. However, in the event the servicer does not perform as required by contract, under our guarantee, we would be obligated to make the required contractual payments.

Derivative-Related Risks

Our use of derivatives exposes us to derivative market liquidity risk and counterparty credit risk.

Derivative Market Liquidity Risk

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

We limit our duration and convexity exposure to each counterparty. At December 31, 2007, the largest single uncollateralized exposure of our 27 approved OTC counterparties listed in "Table 44 — Derivative Counterparty Credit Exposure" was related to a AAA-rated counterparty, constituting \$174 million, or 51%, of the total uncollateralized exposure of our OTC interest-rate swaps, option-based derivatives and foreign-currency swaps.

Derivative Counterparty Credit Risk

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

We actively manage our exposure to counterparty credit risk using several tools, including:

- review of external rating analyses;
- strict standards for approving new derivative counterparties;

- ongoing monitoring of our positions with each counterparty;
- managing diversification mix among counterparties;
- master netting agreements and collateral agreements; and
- stress-testing to evaluate potential exposure under possible adverse market scenarios.

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

Derivative Counterparties

Our use of OTC interest-rate swaps, option-based derivatives and foreign-currency swaps is subject to rigorous internal credit and legal reviews. Our derivative counterparties carry external credit ratings among the highest available from major rating agencies. All of these counterparties are major financial institutions and are experienced participants in the OTC derivatives market.

Master Netting and Collateral Agreements

We use master netting and collateral agreements to reduce our credit risk exposure to our active OTC derivative counterparties for interest-rate swaps, option-based derivatives and foreign-currency swaps. See “NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS” to our consolidated financial statements for additional information.

Table 44 summarizes our exposure to counterparty credit risk in our derivatives, which represents the net positive fair value of derivative contracts, related accrued interest and collateral held by us from our counterparties, after netting by counterparty as applicable (*i.e.*, net amounts due to us under derivative contracts). This table is useful in understanding the counterparty credit risk related to our derivative portfolio.

Table 44 — Derivative Counterparty Credit Exposure

December 31, 2007						
Rating ⁽¹⁾	Number of Counterparties ⁽²⁾	Notional Amount	Total Exposure at Fair Value ⁽³⁾	Exposure, Net of Collateral ⁽⁴⁾	Weighted Average Contractual Maturity (in years)	Collateral Posting Threshold
(dollars in millions)						
AAA	2	\$ 1,173	\$ 174	\$174	3.4	Mutually agreed upon
AA+	3	180,939	945	—	4.4	\$10 million or less
AA	9	463,163	1,347	62	5.3	\$10 million or less
AA-	6	160,678	2,230	30	5.8	\$10 million or less
A+	5	168,680	1,770	54	6.1	\$1 million or less
A	2	35,391	239	19	5.7	\$1 million or less
Subtotal ⁽⁵⁾	27	1,010,024	6,705	339	5.4	
Other derivatives ⁽⁶⁾		238,893	—	—		
Forward purchase and sale commitments		72,662	465	465		
Swap guarantee derivatives		1,302	—	—		
Total derivatives		<u>\$1,322,881</u>	<u>\$7,170</u>	<u>\$804</u>		

December 31, 2006						
Rating ⁽¹⁾	Number of Counterparties ⁽²⁾	Notional Amount	Adjusted Total Exposure at Fair Value ⁽³⁾	Exposure, Net of Collateral ⁽⁴⁾	Weighted Average Contractual Maturity (in years)	Collateral Posting Threshold
(dollars in millions)						
AAA	2	\$ 3,408	\$ 411	\$411	1.6	Mutually agreed upon
AA	8	269,126	2,134	92	4.7	\$10 million or less
AA-	12	278,993	6,264	161	5.2	\$10 million or less
A+	4	142,332	1,393	7	6.1	\$1 million or less
A-	1	210	1	1	5.0	\$1 million or less
Subtotal ⁽⁵⁾	27	694,069	10,203	672	5.2	
Other derivatives ⁽⁶⁾		53,071	—	—		
Forward purchase and sale commitments		10,012	18	18		
Swap guarantee derivatives		957	—	—		
Total derivatives		<u>\$758,109</u>	<u>\$10,221</u>	<u>\$690</u>		

(1) We use the lower of S&P and Moody's ratings to manage collateral requirements. In this table, the rating of the legal entity is stated in terms of the S&P equivalent.

(2) Based on legal entities. Affiliated legal entities are reported separately.

(3) For each counterparty, this amount includes derivatives with a net positive fair value (recorded as derivative assets, net), including the related accrued interest receivable/payable (net).

(4) Total Exposure at Fair Value less collateral held as determined at the counterparty level.

(5) Consists of OTC derivative agreements for interest-rate swaps, option-based derivatives (excluding written options), foreign-currency swaps and purchased interest-rate caps. Written options do not present counterparty credit exposure, because we receive a one-time up-front premium in exchange for giving the holder the right to execute a contract under specified terms, which generally puts us in a liability position.

(6) Consists primarily of exchange-traded contracts, certain written options and certain credit derivatives.

Over time, our exposure to individual counterparties for OTC interest-rate swaps, option-based derivatives and foreign-currency swaps varies depending on changes in fair values, which are affected by changes in period-end interest rates, the implied volatility of interest rates, foreign-currency exchange rates and the amount of derivatives held. Our uncollateralized exposure to counterparties for these derivatives, after applying netting agreements and collateral, decreased to \$339 million at December 31, 2007 from \$672 million at December 31, 2006. This decrease was primarily due to a significant decrease in uncollateralized exposure to AAA-rated counterparties, which typically are not required to post collateral given their low risk profile.

At December 31, 2007, the uncollateralized exposure to non-AAA-rated counterparties was primarily due to exposure amounts below the applicable counterparty collateral posting threshold as well as market movements during the time period between when a derivative was marked to fair value and the date we received the related collateral. Collateral is typically transferred within one business day based on the values of the related derivatives.

As indicated in Table 44, approximately 95% of our counterparty credit exposure for OTC interest-rate swaps, option-based derivatives and foreign-currency swaps was collateralized at December 31, 2007. If all of our counterparties for these derivatives had defaulted simultaneously on December 31, 2007, our maximum loss for accounting purposes would have been approximately \$339 million.

In the event of counterparty default our economic loss may be higher than the uncollateralized exposure of our derivatives if we were not able to replace the defaulted derivatives in a timely fashion. We monitor the risk that our uncollateralized exposure to each of our OTC counterparties for interest-rate swaps, option-based derivatives and foreign-currency swaps will increase under certain adverse market conditions by performing daily market stress tests. These tests

evaluate the potential additional uncollateralized exposure we would have to each of these derivative counterparties assuming changes in the level and implied volatility of interest rates and changes in foreign-currency exchange rates over a brief time period.

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

As indicated in Table 44, the total exposure to our forward purchase and sale commitments of \$465 million and \$18 million at December 31, 2007 and 2006, respectively, was uncollateralized. Because the typical maturity of our forward purchase and sale commitments is less than one year, we do not require master netting and collateral agreements for the counterparties of these commitments. However, we monitor the credit fundamentals of the counterparties to our forward purchase and sale commitments on an ongoing basis to ensure that they continue to meet our internal risk-management standards. At December 31, 2007, we had a large volume of purchase and sale commitments related to our retained portfolio that increased our exposure to the counterparties to our forward purchase and sale commitment. These commitments settled in January 2008.

CREDIT RISKS

Our credit guarantee portfolio is subject primarily to two types of credit risk: mortgage credit risk and institutional credit risk. Mortgage credit risk is the risk that a borrower will fail to make timely payments on a mortgage or security we own or guarantee. We are exposed to mortgage credit risk on our total mortgage portfolio because we either hold the mortgage assets or have guaranteed mortgages in connection with the issuance of a PC, Structured Security or other borrower performance commitment. Institutional credit risk is the risk that a counterparty that has entered into a business contract or arrangement with us will fail to meet its obligations.

Mortgage and credit market conditions deteriorated rapidly in the second half of 2007 and have continued in 2008. These conditions were brought about by several factors, which increased our exposure to both mortgage credit and institutional credit risks. Factors negatively affecting the mortgage and credit markets in recent months include:

- significant volatility;
- lower levels of liquidity;
- wider credit spreads;
- rating agency downgrades of mortgage-related securities or counterparties;
- declines in home prices nationally;
- higher incidence of institutional insolvencies; and
- higher levels of foreclosures and delinquencies, particularly with respect to non-traditional and subprime mortgage loans.

Mortgage Credit Risk

Mortgage Credit Risk Management Strategies

Mortgage credit risk is primarily influenced by the credit profile of the borrower on the mortgage, the features of the mortgage itself, the type of property securing the mortgage, home price trends, apartment demand in the area, the number of competing properties in the area (including properties under construction) and the general economy. To manage our mortgage credit risk, we focus on three key areas: underwriting requirements and quality control standards; portfolio diversification; and portfolio management activities, including loss mitigation and the use of credit enhancements.

Underwriting Requirements and Quality Control Standards

All mortgages that we purchase for our retained portfolio or our credit guarantee portfolio have an inherent risk of default. We seek to manage the underlying risk by using our underwriting and quality control processes and adequately pricing for the risk.

We use a process of delegated underwriting for the single-family mortgages we purchase or securitize. In this process, we provide originators with a series of mortgage underwriting standards and the originators represent and warrant to us that the mortgages sold to us meet these requirements. We subsequently review a sample of these loans and, if we determine that any loan is not in compliance with our contractual standards, we may require the seller/servicer to repurchase that mortgage or make us whole in the event of a default. We provide originators with written standards and/or automated underwriting software tools, such as Loan Prospector.[®] We use other quantitative credit risk management tools that are designed to evaluate single-family mortgages and monitor the related mortgage credit risk for loans we may purchase. Loan Prospector[®] generates a credit risk classification by evaluating information on significant indicators of mortgage default risk,

such as LTV ratios, credit scores and other mortgage and borrower characteristics. These statistically-based risk assessment tools increase our ability to distinguish among single-family loans based on their expected risk, return and importance to our mission. In many cases, underwriting standards are tailored under contracts with individual customers. We have been expanding the share of mortgages we purchase that were underwritten by our seller/servicers using alternative automated underwriting systems or agreed-upon underwriting standards that differ from our system or guidelines, which may increase our credit risk and may result in increased losses. We regularly monitor the performance of mortgages purchased using these systems and standards, and if they underperform mortgages originated using Loan Prospector®, we may seek additional guarantee fee compensation for future purchases of similar mortgages.

The percentage of our single-family mortgage purchase volume evaluated using Loan Prospector® prior to purchase has declined over the last three years. As part of our post-purchase quality control review process, we use Loan Prospector® to evaluate the credit quality of virtually all single-family mortgages that were not evaluated by Loan Prospector® prior to purchase. Loan Prospector® risk classifications influence both the price we charge to guarantee loans and the loans we review in quality control.

For multifamily mortgage loans, we use an intensive pre-purchase underwriting process for the mortgages we purchase, unless the mortgage loans have significant credit enhancements. Our underwriting process includes assessments of the local market, the borrower, the property manager, the property's historical and projected financial performance and the property's physical condition, which may include a physical inspection of the property. In addition to our own inspections, we rely on third-party appraisals and environmental and engineering reports. We have also engaged third-party underwriters to underwrite mortgages on our behalf. During 2007, we also began a program of delegated underwriting for certain multifamily mortgages we purchase or securitize.

Credit Enhancements

Our charter requires that single-family mortgages with LTV ratios above 80% at the time of purchase must be covered by one or more of the following: (a) primary mortgage insurance on the portion above 80% guaranteed or insured by a qualified insurer as we determined; (b) a seller's agreement to repurchase or replace any mortgage in default (for such period and under such circumstances as we may require); or (c) retention by the seller of at least a 10% participation interest in the mortgages. In addition, for some mortgage loans, we elect to share the default risk by transferring a portion of that risk to various third parties through a variety of other credit enhancements. In many cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

At December 31, 2007 and 2006, credit-enhanced single-family mortgages and mortgage-related securities represented approximately 17% and 16% of the \$1,819 billion and \$1,541 billion, respectively, unpaid principal balance of the total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities and that portion of issued Structured Securities that is backed by Ginnie Mae Certificates. We exclude non-Freddie Mac mortgage-related securities because they expose us primarily to institutional credit risk. We exclude that portion of Structured Securities backed by Ginnie Mae Certificates because the incremental credit risk to which we are exposed is considered insignificant. See "MD&A — CONSOLIDATED BALANCE SHEETS ANALYSIS — Table 22 — Characteristics of Mortgage Loans and Mortgage-Related Securities in our Retained Portfolio" for additional information about our non-Freddie Mac mortgage-related securities. Our ability and desire to expand or reduce the portion of our total mortgage portfolio with credit enhancements will depend on our evaluation of the credit quality of new business purchase opportunities, the risk profile of our portfolio and the future availability of effective credit enhancements at prices that permit an attractive return. While the use of credit enhancements reduces our exposure to mortgage credit risk, it increases our exposure to institutional credit risk.

Primary mortgage insurance is the most prevalent type of credit enhancement protecting our total mortgage portfolio and is typically provided on a loan-level basis for certain single-family mortgages. Primary mortgage insurance transfers varying portions of the credit risk associated with a mortgage to a third-party insurer. The amount of insurance we obtain on any mortgage depends on our requirements and our assessment of risk. We may, from time to time, agree with the insurer to reduce the amount of coverage that is in excess of our charter's minimum requirement and may also furnish certain services to the insurer in exchange for fees paid by the insurer. As is the case with credit enhancement agreements generally, these agreements often improve the overall value of purchased mortgages and thus may allow us to offer lower guarantee fees to sellers. As of December 31, 2007 and 2006, in connection with PCs and Structured Securities backed by single-family mortgage loans, excluding the loans that are underlying Structured Transactions, we had maximum coverage totaling \$51.9 billion and \$40.2 billion, respectively, in primary mortgage insurance.

Other prevalent types of credit enhancement that we use are lender recourse and indemnification agreements (under which we may require a lender to reimburse us for credit losses realized on mortgages), as well as pool insurance. Pool insurance provides insurance on a pool of loans up to a stated aggregate loss limit. In addition to a pool-level loss coverage limit, some pool insurance contracts may have limits on coverage at the loan level. For pool insurance contracts that expire

before the completion of the contractual term of the mortgage loan, we seek to ensure that the contracts cover the period of time during which we believe the mortgage loans are most likely to default. At December 31, 2007 and 2006, in connection with PCs and Structured Securities backed by single-family mortgage loans, excluding the loans that are underlying Structured Transactions, we had maximum coverage totaling \$12.1 billion, and \$10.5 billion, respectively, in lender recourse and indemnification agreements; and \$3.8 billion and \$3.7 billion, respectively, in pool insurance. See “Institutional Credit Risk — *Mortgage Insurers*” for further discussion about our mortgage loan insurers.

Other forms of credit enhancements on single-family mortgage loans include government guarantees, collateral (including cash or high-quality marketable securities) pledged by a lender, excess interest and subordinated security structures. As of December 31, 2007 and 2006, in connection with PCs and Structured Securities backed by single-family mortgage loans, excluding the loans that are underlying Structured Transactions, we had maximum coverage totaling \$0.5 billion and \$0.8 billion, respectively, in other credit enhancements.

We occasionally use credit enhancements to mitigate risk on multifamily mortgages. These mortgages are in almost all cases without recourse to the borrower, absent borrower misconduct. The types of credit enhancements used for multifamily mortgage loans include recourse to the mortgage seller, third-party guarantees or letters of credit, cash escrows, subordinated participations in mortgage loans or structured pools, sharing of losses with sellers, and cross-default and cross-collateralization provisions. Cross-default and cross-collateralization provisions typically work in tandem. With a cross-default provision, if the loan on a property goes into default, we have the right to declare specified other mortgage loans of the same borrower or certain of its affiliates to be in default and to foreclose those other mortgages. In cases where the borrower agrees to cross-collateralization, we have the additional right to apply excess proceeds from the foreclosure of one mortgage to amounts owed to us by the same borrower or its specified affiliates relating to other multifamily mortgage loans we own. We also receive similar credit enhancements for multifamily PC Guarantor Swaps; for tax-exempt multifamily housing revenue bonds that support pass-through certificates issued by third parties for which we provide our guarantee of the payment of principal and interest; for Freddie Mac pass-through certificates that are backed by tax-exempt multifamily housing revenue bonds and related taxable bonds and/or loans; and for multifamily mortgage loans that are originated and held by state and municipal agencies to support tax-exempt multifamily housing revenue bonds for which we provide our guarantee of the payment of principal and interest. As of December 31, 2007 and 2006, in connection with PCs and Structured Securities backed by multifamily mortgage loans, excluding the loans that are underlying Structured Transactions, we had maximum coverage totaling \$1.2 billion and \$1.1 billion, respectively.

Other Credit Risk Management Activities

To compensate us for unusual levels of risk in some mortgage products, we may charge incremental fees above a base guarantee fee calculated based on credit risk factors such as the mortgage product type, loan purpose, LTV ratio, and other loan or borrower attributes. In addition, we occasionally use financial incentives and credit derivatives, as described below, in situations where we believe they will benefit our credit risk management strategy. These arrangements are intended to reduce our credit-related expenses, thereby improving our overall returns.

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

We have also entered into credit derivatives. All credit derivatives were classified as no hedge designation. The fair value of these credit derivatives was not material at either December 31, 2007 or 2006. See “QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK — *Use of Derivatives and Interest-Rate Risk Management — Credit Derivatives*” for further discussion.

Although these arrangements are part of our overall credit risk management strategy, we have not treated them as credit enhancements for purposes of describing our total mortgage portfolio characteristics because the risk-sharing and credit derivative agreements may require us to make payments to the seller/servicer.

Portfolio Diversification

A key characteristic of our credit risk portfolio is diversification along a number of critical risk dimensions. We continually monitor a variety of mortgage loan characteristics such as product mix, LTV ratios and geographic concentrations, which may affect the default experience on our overall mortgage portfolio. As part of our risk management practices, we have adopted a set of limits on our purchases and holdings of certain types of non-traditional mortgage products that are deemed to have higher risks or lack sufficient historical experience to confidently forecast performance expectations over a full housing cycle. These loan products include option ARMs and loans with high LTV ratios, and mortgages originated with limited or no underwriting documentation.

Product mix affects the credit risk profile of our total mortgage portfolio. In general, 15-year amortizing fixed-rate mortgages exhibit the lowest default rate among the types of mortgage loans we securitize and purchase, due to the accelerated rate of principal amortization on these mortgages and the credit profiles of borrowers who seek and qualify for them. In a rising interest rate environment, balloon/reset mortgages and ARMs typically default at a higher rate than fixed-rate mortgages, although default rates for different types of ARMs may vary.

The primary mortgage products within our mortgage loan and guaranteed PC and Structured Securities portfolios are conventional fixed-rate loans. However, during the past several years, there was a rapid proliferation of non-traditional mortgage product types designed to address a variety of borrower and lender needs, including issues of affordability and reduced income documentation requirements. While features of these products have been on the market for some time, their prevalence in the market and our total mortgage portfolio increased in 2007 and 2006. See “REGULATION AND SUPERVISION — Office of Federal Housing Enterprise Oversight — *Guidance on Non-traditional Mortgage Product Risks and Subprime Lending*” and “RISK FACTORS — Legal and Regulatory Risks” for more information on these products. Despite an increase in the purchase of adjustable-rate mortgages in the last few years, single-family traditional long-term fixed-rate mortgages comprised approximately 80% and 82% of our mortgage loans and loans underlying our PCs and Structured Securities at December 31, 2007 and 2006, respectively.

Adjustable-Rate, Interest-Only and Option ARM Loans

These mortgages are designed to offer borrowers greater choices in their payment terms. Interest-only mortgages allow the borrower to pay only interest for a fixed period of time before the loan begins to amortize. Option ARM loans permit a variety of repayment options, which include minimum, interest only, fully amortizing 30-year and fully amortizing 15-year payments. Minimum payment option loans allow the borrower to make monthly payments that are less than the interest accrued for the period. The unpaid interest, known as negative amortization, is added to the principal balance of the loan, which increases the outstanding loan balance. Our purchases of interest-only mortgage products increased in 2007, representing approximately 20% of our total mortgage portfolio purchases as compared to approximately 16% in 2006. Our purchase of option ARM mortgage products decreased in 2007, representing less than 1% and approximately 2% of our total mortgage portfolio purchases in 2007 and 2006, respectively. Interest-only and option ARM loans are considered non-traditional mortgage products as defined by the October 2006 Guidance on Non-traditional Mortgage Product Risks. At December 31, 2007 and 2006, interest-only and option ARM loans collectively represented approximately 10% and 6%, respectively, of the unpaid principal balance of the total mortgage portfolio. We will continue to monitor the growth of these products in our portfolio and, if appropriate, may seek credit enhancements to further manage the incremental risk.

Table 45 presents scheduled reset information for single-family mortgage loans underlying our PCs and Structured Securities, excluding Structured Transactions, at December 31, 2007 that contain adjustable payment terms. The reported balances in the table are based on the unpaid principal balances of these loans, aggregated by adjustable-rate loan product type and categorized by year of the next scheduled contractual reset date. The timing of the actual reset dates may differ from those presented due to a number of factors, including refinancing or exercising of other provisions within the terms of the mortgage.

Table 45 — Single-Family Scheduled Adjustable-Rate Resets by Year at December 31, 2007⁽¹⁾

	2008	2009	2010	2011	2012	Thereafter	Total
	(in millions)						
ARMs/amortizing	\$20,258	\$17,945	\$16,751	\$12,420	\$ 8,516	\$14,437	\$ 90,327
ARMs/interest-only	2,382	3,529	18,822	30,105	32,909	33,857	121,604
Balloon/resets	3,236	3,004	6,863	2,821	880	318	17,122
Adjustable-rate loans ⁽²⁾	<u>\$25,876</u>	<u>\$24,478</u>	<u>\$42,436</u>	<u>\$45,346</u>	<u>\$42,305</u>	<u>\$48,612</u>	<u>\$229,053</u>

(1) Based on the unpaid principal balances of mortgage products that contain adjustable-rate interest provisions, excluding \$1.9 billion of option ARM loans, as of December 31, 2007. These reported balances are based on the unpaid principal balance of the underlying mortgage loans and do not reflect the publicly-available security balances we use to report the composition of our PCs and Structured Securities.

(2) Represents the portion of the unpaid principal balances that are scheduled to reset during the period specified above.

Adjustable-rate mortgages typically have initial periods during which the interest rate is fixed. After this initial period, which can typically range from two to ten years, the interest rate on the loan will then periodically reset based on a current market rate. As of December 31, 2007, approximately 22% of the adjustable-rate single-family mortgage loans within our PCs and Structured Securities are scheduled to have interest rates that reset in 2008 or 2009.

Subprime Loans

Participants in the mortgage market often characterize single-family loans based upon their overall credit quality at the time of origination, generally considering them to be prime or subprime. There is no universally accepted definition of subprime. The subprime segment of the mortgage market primarily serves borrowers with poorer credit payment histories

and such loans typically have a mix of credit characteristics that indicate a higher likelihood of default and higher loss severities than prime loans. Such characteristics might include a combination of high LTV ratios, low credit scores or originations using lower underwriting standards such as limited or no documentation of a borrower's income. The subprime market helps certain borrowers by broadening the availability of mortgage credit.

While we have not historically characterized the single-family loans underlying our PCs and Structured Securities as either prime or subprime, we do monitor the amount of loans we have guaranteed with characteristics that indicate a higher degree of credit risk. See "*Mortgage Portfolio Characteristics — Higher Risk Combinations*" for further information. We estimate that approximately \$6 billion and \$3 billion of loans underlying our Structured Transactions at December 31, 2007 and 2006, respectively, were classified as subprime mortgage loans. To support our mission, we announced in April 2007 that we will purchase up to \$20 billion in fixed-rate and hybrid ARM products that will provide lenders with more choices to offer subprime borrowers. The products are intended to be consumer-friendly mortgages for borrowers that will limit payment shock by offering reduced adjustable-rate margins, longer fixed-rate terms and longer reset periods than existing similar products. Subsequent to our announcement, we have entered into purchase commitments of \$207 million of mortgages on primary residence, single-family properties specifically pursuant to this commitment. We also fulfill this commitment through purchases of refinance mortgages made to credit challenged borrowers, who may have previously been served by the subprime mortgage market. As of December 31, 2007, we have purchased approximately \$43 billion of conventional mortgages made to borrowers who otherwise might have been limited to subprime products, including approximately \$23 billion of refinance mortgages meeting our criteria.

With respect to our retained portfolio, at December 31, 2007 and 2006, we held investments of approximately \$101 billion and \$122 billion, respectively, of non-agency mortgage-related securities backed by subprime loans. These securities include significant credit enhancement, particularly through subordination, and 81% of these securities were AAA-rated at February 25, 2008. During 2007, we recognized \$10 million of credit losses as impairment expense on these securities related to four positions that were below AAA-rated at acquisition. The net unrealized losses, net of tax, on the remaining securities that are below AAA-rated are included in AOCI and totaled \$504 million as of December 31, 2007. Between December 31, 2007 and February 25, 2008, credit ratings for mortgage-related securities backed by subprime loans with an aggregate unpaid principal balance of \$16 billion were downgraded by at least one nationally recognized statistical rating organization. In addition, there were \$5 billion of unrealized losses, net of tax, associated with AAA-rated, non-agency mortgage-related securities backed by subprime collateral that are principally a result of decreased liquidity in the subprime market. The extent and duration of the decline in fair value of these securities relative to our cost have met our criteria that indicate the impairment of these securities is temporary. However, if market conditions continue to deteriorate, further credit downgrades to our non-agency mortgage-related securities backed by subprime loans could occur and may result in additional declines in their fair value.

Alt-A Loans

Many mortgage market participants classify single-family loans with credit characteristics that range between their prime and subprime categories as Alt-A because these loans have a combination of characteristics of each category or may be underwritten with lower or alternative documentation than a full documentation mortgage loan. Although there is no universally accepted definition of Alt-A, industry participants have used this classification principally to describe loans for which the underwriting process has been streamlined in order to reduce the documentation requirements of the borrower or allow alternative documentation.

We principally acquire Alt-A mortgage loans from our traditional lenders that largely specialize in originating prime mortgage loans. These lenders typically originate Alt-A loans as a complementary product offering and generally follow an origination path similar to that used for their prime origination process. In determining our exposure to Alt-A loans in our PC and Structured Securities portfolio, we have classified mortgage loans as Alt-A if the lender that delivers them to us has classified the loans as Alt-A, or if the loans had reduced documentation requirements which indicate that the loans should be classified as Alt-A. We estimate that approximately \$154 billion, or 9%, of our single-family PCs and Structured Securities at December 31, 2007 were backed by Alt-A mortgage loans. For these loans, our average credit score was 719, our estimated current average LTV ratio was 72% and our delinquency rate, excluding certain Structured Transactions, was 1.86% at December 31, 2007.

We also invest in non-agency mortgage-related securities backed by Alt-A loans in our retained portfolio. We have classified these securities as Alt-A if the securities were labeled as Alt-A when sold to us or we believe the underlying collateral includes a significant amount of Alt-A loans. We believe that \$51 billion and \$56 billion of our single-family non-agency mortgage-related securities that are not backed by subprime loans are generally backed by Alt-A mortgage loans at December 31, 2007 and 2006, respectively. We have focused our purchases on credit-enhanced, senior tranches of these securities and more than 99% of these securities were AAA-rated as of December 31, 2007. Between December 31, 2007

and February 25, 2008, credit ratings for mortgage-related securities backed by Alt-A loans with an aggregate unpaid principal balance of \$1.1 billion were downgraded from AAA by at least one nationally recognized statistical rating organization.

Guidance on Non-traditional Mortgage Product Risks and Subprime Mortgage Lending

In October 2006, five federal financial institution regulatory agencies jointly issued Interagency Guidance that clarified how financial institutions should offer non-traditional mortgage products in a safe and sound manner and in a way that clearly discloses the risks that borrowers may assume. In June 2007, the same financial institution regulatory agencies published the final interagency Subprime Statement, which addressed risks relating to subprime short-term hybrid ARMs. The Interagency Guidance and the Subprime Statement set forth principles that regulate financial institutions originating certain non-traditional mortgages and subprime short-term hybrid ARMs with respect to their underwriting practices. These principles included providing borrowers with clear and balanced information about the relative benefits and risks of these products sufficiently early in the process to enable them to make informed decisions.

OFHEO has directed us to adopt practices consistent with the risk management, underwriting and consumer protection guidelines of the Interagency Guidance and the Subprime Statement. These principles apply to our purchase of non-traditional mortgages and subprime short-term hybrid ARMs and our related investment activities. In response, in July 2007, we informed our customers of new underwriting and disclosure requirements for non-traditional mortgages. In September 2007, we informed our customers and other counterparties of similar new requirements for subprime short-term hybrid ARMs. These new requirements are consistent with our announcement in February 2007 that we would implement stricter investment standards for certain subprime ARMs originated after September 1, 2007, and develop new mortgage products providing lenders with more choices to offer subprime borrowers. See “RISK FACTORS — Legal and Regulatory Risks” for further discussion

Mortgage Portfolio Characteristics

As previously noted, all mortgages that we purchase for our retained portfolio or that we guarantee have an inherent risk of default. We seek to manage the underlying risk by adequately pricing for the risk we assume using our underwriting and quality control processes. Our underwriting process evaluates mortgage loans using several critical risk characteristics, such as credit score, LTV ratio and occupancy type. Table 46 provides characteristics of our single-family new business purchases in 2007 and 2006, and of our single-family mortgage portfolio at December 31, 2007 and 2006.

Table 46 — Characteristics of Single-Family Mortgage Portfolio⁽¹⁾

	Purchases During the Year Ended December 31,			Portfolio at December 31,		
	2007	2006	2005	2007	2006	2005
Original LTV Ratio Range⁽²⁾						
Less than 60%	18%	19%	21%	22%	24%	25%
Above 60% to 70%	14	14	16	16	16	17
Above 70% to 80%	49	54	50	47	46	44
Above 80% to 90%	8	7	7	8	7	8
Above 90% to 100%	11	6	6	7	7	6
Above 100%	—	—	—	—	—	—
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Weighted average original ratio	74%	73%	71%	71%	70%	70%
Estimated Current LTV Ratio Range⁽³⁾						
Less than 60%				41%	52%	56%
Above 60% to 70%				15	18	18
Above 70% to 80%				19	20	18
Above 80% to 90%				15	8	6
Above 90% to 100%				7	2	2
Above 100%				3	—	—
Total				<u>100%</u>	<u>100%</u>	<u>100%</u>
Weighted average estimated current LTV ratio				63%	57%	56%
Credit Score⁽⁴⁾						
740 and above	42%	42%	44%	45%	45%	45%
700 to 739	22	24	23	23	23	23
660 to 699	19	19	19	18	18	18
620 to 659	11	10	10	9	9	9
Less than 620	6	5	4	4	4	4
Not available	—	—	—	1	1	1
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Weighted average credit score	718	720	722	723	725	725
Loan Purpose						
Purchase	47%	53%	44%	40%	37%	32%
Cash-out refinance	32	32	35	30	29	29
Other refinance	21	15	21	30	34	39
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Property Type						
1 unit	97%	97%	97%	97%	97%	97%
2-4 units	3	3	3	3	3	3
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Occupancy Type						
Primary residence	89%	89%	91%	91%	92%	93%
Second/vacation home	5	6	5	5	5	4
Investment	6	5	4	4	3	3
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

(1) Purchases and ending balances are based on the unpaid principal balance of the single-family mortgage portfolio (excluding certain Structured Transactions). Purchases included in the data totaled \$467 billion, \$358 billion and \$396 billion in 2007, 2006 and 2005, respectively. Ending balances included in the data totaled \$1,718 billion, \$1,482 billion and \$1,333 billion at December 31, 2007, 2006 and 2005, respectively.

(2) Original LTV ratios are calculated as the amount of the mortgage we guarantee divided by the lesser of the appraised value of the property at time of mortgage origination or the mortgage borrower's purchase price.

(3) Current market values are estimated by adjusting the value of the property at origination based on changes in the market value of homes since origination. Estimated current LTV excludes Structured Transactions and option ARMs. Estimated current LTV ratio range is not applicable to purchases made during the year and excludes any secondary financing.

(4) Credit score data is as of mortgage loan origination for all loans within mortgage pools underlying our issued PCs and Structured Securities, as well as mortgage loans held in our retained portfolio, and is based on the rating system scale developed by Fair, Isaac and Co., Inc., or FICO®, scores.

Loan-to-Value Ratios. An important safeguard against credit losses for mortgage loans in our single-family non-credit-enhanced portfolio is provided by the borrowers' equity in the underlying properties. Our charter requires that single-family mortgages with LTV ratios above 80% at the time of purchase be covered by one or more of the following: (a) mortgage insurance for mortgage amounts above the 80% threshold; (b) a seller's agreement to repurchase or replace any mortgage upon default; or (c) retention by the seller of at least a 10% participation interest in the mortgages. In addition, we employ other types of credit enhancements, including pool insurance, indemnification agreements, collateral pledged by lenders and subordinated security structures.

The likelihood of single-family mortgage default depends not only on the initial credit quality of the loan, but also on events that occur after origination. Accordingly, we monitor changes in home prices across the country and the impact of these home price changes on the underlying LTV ratio of mortgages in our portfolio. While home prices rose significantly during the years prior to 2006, growth slowed significantly during 2006 and home prices generally declined in 2007 across the United States. We monitor regional geographic markets for changes in these trends, particularly with respect to new loans originated in regional markets that have had significant home price appreciation, and we may seek to reinsure a portion of our risk. Historical experience has shown that defaults are less likely to occur on mortgages with lower estimated current LTV ratios. At December 31, 2007, 2006 and 2005, single-family mortgage portfolio loans with 80% or less in estimated current LTV ratio, totaled 75%, 90% and 92%, respectively, which indicates an increase in our exposure to losses in the event of default.

Credit Score. Credit scores are a useful measure for assessing the credit quality of a borrower. Credit scores are numbers reported by credit repositories, based on statistical models, that summarize an individual's credit record and predict the likelihood that a borrower will repay future obligations as expected. FICO scores are the most commonly used credit scores today. FICO scores are ranked on a scale of approximately 300 to 850 points. Statistically, consumers with higher credit scores are more likely to repay their debts as expected than those with lower scores. At December 31, 2007, 2006 and 2005, the weighted average credit score for single-family mortgage portfolio (based on the credit score at origination) remained high at 723, 725 and 725, respectively, indicating borrowers with strong credit quality.

Loan Purpose. Mortgage loan purpose indicates how the borrower intends to use the funds from a mortgage loan. The three general categories are purchase, cash-out refinance and other refinance. In a purchase transaction, funds are used to acquire a property. In a cash-out refinance transaction, in addition to paying off an existing first mortgage lien, the borrower obtains additional funds that may be used for other purposes, including paying off subordinate mortgage liens and providing unrestricted cash proceeds to the borrower. In other refinance transactions, the funds are used to pay off an existing first mortgage lien and may be used in limited amounts for certain specified purposes; such refinances are generally referred to as "no cash-out" or "rate and term" refinances. Other refinance transactions also include refinance mortgages for which the delivery data provided was not sufficient for us to determine whether the mortgage was a cash-out or a no cash-out refinance transaction. Given similar loan characteristics (e.g., LTV ratios), purchase transactions have the lowest likelihood of default followed by no cash-out refinances and then cash-out refinances. The amount of purchase mortgages in our single-family mortgage portfolio has been increasing in each of the last three years as homeownership rates in the U.S. have also increased.

Property Type. Single-family mortgage loans are defined as mortgages secured by housing with up to four living units. Mortgages on one-unit properties tend to have lower credit risk than mortgages on multiple-unit properties.

Occupancy Type. Borrowers may purchase a home as a primary residence, second/vacation home or investment property that is typically a rental property. Mortgage loans on properties occupied by the borrower as a primary or secondary residence tend to have a lower credit risk than mortgages on investment properties.

Geographic Concentration. Because our business involves purchasing mortgages from every geographic region in the U.S., we maintain a geographically diverse single-family mortgage portfolio. This diversification generally mitigates credit risks arising from changing local economic conditions. Our single-family mortgage portfolio's geographic distribution was relatively stable from 2005 to 2007, and remains broadly diversified across these regions. See "NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS" to our consolidated financial statements for more information concerning the distribution of our single-family mortgage portfolio by geographic region.

Higher Risk Combinations. Combining certain loan characteristics often can indicate a higher degree of credit risk. For example, mortgages with both high LTV ratios and borrowers who have lower credit scores typically experience higher rates of delinquency, default and credit losses. As of December 31, 2007, approximately 1% of single-family mortgage loans we have guaranteed were made to borrowers with credit scores below 620 and had original LTV ratios above 90% at the time of mortgage origination. In addition, as of December 31, 2007, 4% of Alt-A and interest-only single-family loans we have guaranteed have been made to borrowers with credit scores below 620 at mortgage origination. These combinations of loans represent categories that have inherently greater credit risk, but reflect our efforts to meet increasingly demanding affordable housing goals. For the 25% of single-family mortgage loans with greater than 80% estimated current LTV ratios, the borrowers had a weighted average credit score at origination of 708 and 705 at December 31, 2007 and 2006, respectively. Similarly, for the 14% of single-family mortgage loans where the average credit score at origination was less than 660, the average estimated current LTV ratios were 71% and 63% at December 31, 2007 and 2006, respectively. As home prices increased during 2006 and prior years, many borrowers used second liens at the time of purchase to potentially reduce their LTV ratio to below 80%. Including this secondary financing, we estimate that the percentage of loans we have guaranteed with total LTV ratios above 90% has risen to 14% as of December 31, 2007.

Loss Mitigation Activities

Loss mitigation activities are a key component of our strategy for managing and resolving troubled assets and lowering credit losses. Our single-family loss mitigation strategy emphasizes early intervention in delinquent mortgages and providing alternatives to foreclosure. Other single-family loss mitigation activities include providing our single-family servicers with default management tools designed to help them manage non-performing loans more effectively and support fulfillment of our mission by assisting borrowers in retaining homeownership. Foreclosure alternatives are intended to reduce the number of delinquent mortgages that proceed to foreclosure and, ultimately, mitigate our total credit losses by reducing or eliminating a portion of the costs related to foreclosed properties and avoiding the credit loss in REO.

Our foreclosure alternatives include:

- Repayment plans are contractual plans to make up past due amounts. They mitigate our credit losses because they assist borrowers in returning to compliance with the original terms of their mortgages.
- Loan modifications, which involve adding delinquent interest to the original unpaid principal balance of the loan or changing other terms of a mortgage as an alternative to foreclosure. We examine the borrower's capacity to make payments under the new terms by reviewing the borrower's qualifications, including income and other indebtedness.
- Forbearance agreements, under which reduced payments or no payments are required during a defined period. They provide a temporary suspension of the foreclosure process to allow additional time for the borrower to return to compliance with the original terms of the borrower's mortgage or to implement another foreclosure alternative.
- Pre-foreclosure sales, in which the borrower, working with the servicer, sells the home and pays off all or part of the outstanding loan, accrued interest and other expenses from the sale proceeds.

The table below presents the number of loans with foreclosure alternatives for the years ended December 31, 2007, 2006 and 2005.

Table 47 — Single-Family Foreclosure Alternatives⁽¹⁾

	December 31,		
	2007	2006	2005
	(number of loans)		
Repayment plans	38,809	36,996	38,740
Loan modifications	8,105	9,348	6,232
Forbearance agreements	3,108	11,152	13,403
Pre-foreclosure sales	2,009	1,575	1,672
Foreclosure alternatives	<u>52,031</u>	<u>59,071</u>	<u>60,047</u>

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

The total number of loans with foreclosure alternatives decreased in 2007, as compared to 2006 and 2005, due to a significant reduction in the number of forbearance agreements that were extended to single-family borrowers affected by Hurricane Katrina in 2005 and 2006. Absent the impact of Hurricane Katrina, the number of foreclosure alternatives increased slightly due to the deterioration of the residential mortgage market during 2007.

We require multifamily seller/servicers to closely manage mortgage loans they have sold us in order to mitigate potential losses. For loans over \$1 million, servicers must generally submit an annual assessment of the mortgaged property to us based on the servicer's analysis of financial and other information about the property and, except for certain higher performing loans, an inspection of the property. We evaluate these assessments internally and may direct the servicer to take specific actions to reduce the likelihood of delinquency or default. If a loan defaults despite these actions, we may offer a foreclosure alternative to the borrower. For example, we may modify the terms of a multifamily mortgage loan, which gives the borrower an opportunity to bring the loan current and retain ownership of the property. Because the activities of multifamily seller/servicers are an important part of our loss mitigation process, we rate their performance regularly and conduct on-site reviews of their servicing operations to confirm compliance with our standards.

Performing and Non-Performing Assets

We have classified loans in our single-family mortgage portfolio that are past due for 90 days or more (seriously delinquent) or whose contractual terms have been modified due to the financial difficulties of the borrower as non-performing assets. Similarly, multifamily loans are classified as non-performing assets if they are 60 days or more past due (seriously delinquent), if collectibility of principal and interest is not reasonably assured based on an individual loan level assessment, or if their contractual terms have been modified due to financial difficulties of the borrower. Table 48 provides detail on performing and non-performing assets in our total mortgage portfolio.

Table 48 — Performing and Non-Performing Assets⁽¹⁾

	December 31, 2007			
	Performing Assets ⁽²⁾	Non-Performing Assets		Total
		Less Than 90 Days Past Due ⁽³⁾	Seriously Delinquent ⁽⁴⁾	
	(in millions)			
<i>Mortgage loans in retained portfolio</i>				
Multifamily	\$ 57,295	\$ —	\$ 3	\$ 57,298
Multifamily troubled debt restructurings	—	264	7	271
Subtotal, mortgage loans in retained portfolio, multifamily	<u>57,295</u>	<u>264</u>	<u>10</u>	<u>57,569</u>
Single-family	13,591	—	698	14,289
Single-family loans purchased under financial guarantees ⁽⁵⁾	2,399	—	4,602	7,001
Single-family troubled debt restructurings	—	2,690	609	3,299
Subtotal, mortgage loans in retained portfolio, single-family	<u>15,990</u>	<u>2,690</u>	<u>5,909</u>	<u>24,589</u>
Subtotal, mortgage loans in retained portfolio	<u>73,285</u>	<u>2,954</u>	<u>5,919</u>	<u>82,158</u>
<i>Guaranteed PCs and Structured Securities</i>				
Multifamily	10,607	—	—	10,607
Multifamily troubled debt restructurings	—	51	—	51
Single-family ⁽⁶⁾	1,700,543	—	6,141	1,706,684
Structured Securities backed by non-Freddie Mac mortgage-related securities ⁽⁷⁾	19,846	—	1,645	21,491
Subtotal, guaranteed PCs and Structured Securities	<u>1,730,996</u>	<u>51</u>	<u>7,786</u>	<u>1,738,833</u>
<i>REO, Net</i>	—	—	1,736	1,736
Totals	<u>\$1,804,281</u>	<u>\$3,005</u>	<u>\$15,441</u>	<u>\$1,822,727</u>
	December 31, 2006 (Adjusted)			
	Performing Assets ⁽²⁾	Non-Performing Assets		Total
		Less Than 90 Days Past Due ⁽³⁾	Seriously Delinquent ⁽⁴⁾	
	(in millions)			
<i>Mortgage loans in retained portfolio</i>				
Multifamily	\$ 44,845	\$ —	\$ —	\$ 44,845
Multifamily troubled debt restructurings	—	362	—	362
Subtotal, mortgage loans in retained portfolio, multifamily	<u>44,845</u>	<u>362</u>	<u>—</u>	<u>45,207</u>
Single-family	13,843	—	1,125	14,968
Single-family loans purchased under financial guarantees ⁽⁵⁾	1,156	—	1,827	2,983
Single-family troubled debt restructurings	—	2,219	470	2,689
Subtotal, mortgage loans in retained portfolio, single-family	<u>14,999</u>	<u>2,219</u>	<u>3,422</u>	<u>20,640</u>
Subtotal, mortgage loans in retained portfolio	<u>59,844</u>	<u>2,581</u>	<u>3,422</u>	<u>65,847</u>
<i>Guaranteed PCs and Structured Securities</i>				
Multifamily	8,333	—	30	8,363
Multifamily troubled debt restructurings	—	52	—	52
Single-family ⁽⁶⁾	1,440,585	—	1,721	1,442,306
Structured Securities backed by non-Freddie Mac mortgage-related securities ⁽⁷⁾	25,305	—	997	26,302
Subtotal, guaranteed PCs and Structured Securities	<u>1,474,223</u>	<u>52</u>	<u>2,748</u>	<u>1,477,023</u>
<i>REO, Net</i>	—	—	743	743
Totals	<u>\$1,534,067</u>	<u>\$2,633</u>	<u>\$ 6,913</u>	<u>\$1,543,613</u>

(1) Based on unpaid principal balance. Effective December 2007, we established securitization trusts for the underlying assets of our PCs and Structured Securities issued. As a result, we adjusted the reported balance of our mortgage portfolios to reflect the publicly-available security balances of our PCs and Structured Securities. Previously we reported these balances based on the unpaid principal balance of the underlying mortgage loans.

(2) Consists of single-family loans that are less than 90 days past due and multifamily loans less than 60 days past due under the original terms of the mortgage as of period end and have not had loan terms modified.

(3) Includes single-family loans that were previously reported as seriously delinquent and for which the original loan terms have been modified.

(4) Consists of single-family loans 90 days or more delinquent or in foreclosure and multifamily loans 60 days or more delinquent at period end. Delinquency status does not apply to REO; however, REO is included in non-performing assets.

(5) Represents those loans purchased from the mortgage pools underlying our PCs, Structured Securities or long-term standby agreements due to the borrower's delinquency. Once we purchase a loan under our financial guarantee it is placed on non-accrual status as long as it remains greater than 90 days past due. Through November 2007, our general practice was to purchase the mortgage loans out of PCs after the loans became 120 days delinquent. Effective December 2007, our practice changed to purchase these impaired loans out of our PC pools when the loans have been modified, foreclosure sales occur, or when the loans have been delinquent for 24 months, unless we determine it is economically beneficial to do so sooner.

(6) Excludes our Structured Securities that we classify separately as Structured Transactions.

(7) Consists of our Structured Transactions and that portion of Structured Securities that are backed by Ginnie Mae Certificates.

The amount of non-performing assets increased 93% at December 31, 2007, to approximately \$18.4 billion, from \$9.5 billion at December 31, 2006, due to the continued deterioration in single-family housing market fundamentals which has resulted in higher delinquency transition rates in 2007. This rate increased in 2007, compared to 2006. The changes in

these delinquency transition rates, as compared to our historical experience, have been progressively worse for loans originated in 2006 and 2007. We believe this trend is, in part, due to greater origination volume of non-traditional loans, such as interest-only mortgages, as well as an increase in total LTV ratios for mortgage loans originated in those years. In addition, the average size of the unpaid principal balance related to non-performing assets in our portfolio rose in 2007. As a result, the balance of our REO, net, increased 134% in 2007. Until nationwide home prices return to historical appreciation rates or selected regional economies improve, we expect to continue to experience higher delinquency transition rates than those experienced in 2006 and an increase in non-performing assets.

Delinquencies

We report single-family delinquency information based on the number of loans that are 90 days or more past due or in foreclosure. For multifamily loans, we report the delinquency when payment is 60 days or more past due. We include all the single-family loans that we own and those that are collateral for our PCs and Structured Securities, including those with significant credit enhancement, in the calculation of delinquency information; however, we exclude that portion of our Structured Securities that is backed by Ginnie Mae Certificates and our Structured Transactions. Structured Transactions represented 1%, 2% and 2% of our total mortgage portfolio at December 31, 2007, 2006 and 2005, respectively. Multifamily delinquencies may include mortgage loans where the borrowers are not paying as agreed, but principal and interest are being paid to us under the terms of a credit enhancement agreement. Table 49 presents delinquency information for the single-family loans underlying our total mortgage portfolio.

Table 49 — Single-Family — Delinquency Rates, Excluding Structured Transactions — by Region

	December 31, 2007		December 31, 2006		December 31, 2005	
	Percent of Unpaid Principal Balance ⁽²⁾	Delinquency Rate ⁽³⁾	Percent of Unpaid Principal Balance ⁽²⁾	Delinquency Rate ⁽³⁾	Percent of Unpaid Principal Balance ⁽²⁾	Delinquency Rate ⁽³⁾
Northeast ⁽¹⁾	24%	0.39%	24%	0.24%	24%	0.22%
Southeast ⁽¹⁾	18	0.59	18	0.30	18	0.38
North Central ⁽¹⁾	20	0.48	21	0.32	22	0.30
Southwest ⁽¹⁾	13	0.32	13	0.26	13	0.64
West ⁽¹⁾	25	0.42	24	0.12	23	0.11
	<u>100%</u>		<u>100%</u>		<u>100%</u>	
Total non-credit-enhanced — all regions		0.45		0.25		0.30
Total credit-enhanced — all regions		1.62		1.30		1.61
Total single-family portfolio		0.65		0.42		0.53

(1) Presentation of non-credit-enhanced delinquency rates with the following regional designation: West (AK, AZ, CA, GU, HI, ID, MT, NV, OR, UT, WA); Northeast (CT, DE, DC, MA, ME, MD, NH, NJ, NY, PA, RI, VT, VA, WV); North Central (IL, IN, IA, MI, MN, ND, OH, SD, WI); Southeast (AL, FL, GA, KY, MS, NC, PR, SC, TN, VI); and Southwest (AR, CO, KS, LA, MO, NE, NM, OK, TX, WY).

(2) Percentages are based on mortgage loans in the retained portfolio and total PCs and Structured Securities issued, excluding that portion of our Structured Securities that is backed by Ginnie Mae Certificates.

(3) Percentages are based on number of loans and excluding Structured Transactions.

During 2007 and continuing into 2008, home prices have continued to decline. In some geographical areas, particularly in the North Central region, this decline has been combined with increased rates of unemployment and weakness in home sales, which has resulted in increases in delinquency rates throughout 2007. We have also experienced increases in delinquency rates in the Northeast, Southeast and West regions in 2007.

Although Structured Transactions generally have underlying mortgage loans with a variety of risk characteristics, many of them may afford us credit protection from losses due to the underlying structure employed and additional credit enhancement features. Delinquency rates on Structured Transactions were 9.86%, 8.36% and 12.34% at December 31, 2007, 2006 and 2005, respectively. The delinquency rate of the total single-family portfolio, including Structured Transactions, was 0.76%, 0.54% and 0.71% at December 31, 2007, 2006 and 2005, respectively.

Table 50 — Single-Family Mortgages by Year of Origination — Percentage of Mortgage Portfolio and Non-Credit-Enhanced Delinquency Rates⁽¹⁾

Year of Origination	December 31,					
	2007		2006		2005	
	Percent of Single-Family Unpaid Principal Balance	Non-Credit-Enhanced Delinquency Rate	Percent of Single-Family Unpaid Principal Balance	Non-Credit-Enhanced Delinquency Rate	Percent of Single-Family Unpaid Principal Balance	Non-Credit-Enhanced Delinquency Rate
Pre-2000	3%	0.64%	4%	0.58%	6%	0.73%
2000	<1	1.63	<1	1.83	<1	2.09
2001	2	0.60	3	0.60	4	0.75
2002	6	0.37	9	0.32	11	0.38
2003	20	0.20	26	0.15	34	0.17
2004	13	0.35	16	0.22	21	0.21
2005	18	0.51	23	0.19	24	0.08
2006	18	0.89	19	0.09	—	—
2007	20	0.35	—	—	—	—
Total	<u>100%</u>	0.45	<u>100%</u>	0.25	<u>100%</u>	0.30

(1) Excludes Structured Transactions.

Our single-family mortgage portfolio was affected by heavy refinance volumes, which have contributed to higher liquidation rates during the last five years. At December 31, 2007, approximately 56% of our single-family mortgage portfolio consisted of mortgage loans originated in 2007, 2006 or 2005. The single-family loans in our retained portfolio and underlying our PCs and Structured Securities that were originated in 2007, 2006 and 2005 have experienced higher rates of delinquency in the earlier years of their terms as compared to our historical experience for newer originations. We attribute this increase to a number of factors, including the expansion of credit terms under which loans are underwritten and an increase in our purchases of adjustable-rate and non-traditional mortgage products that have higher inherent credit risk than traditional fixed-rate mortgage products. Table 51 presents the delinquency rates of our single-family retained mortgages and those that underlie our PCs and Structured Securities categorized by product type.

Table 51 — Single-Family — Delinquency Rates — By Product

	Non-Credit-Enhanced, December 31,					
	2007		2006		2005	
	Percent of Number of Single-Family Loans	Delinquency Rate	Percent of Number of Single-Family Loans	Delinquency Rate	Percent of Number of Single-Family Loans	Delinquency Rate
Conventional:						
30-year amortizing fixed-rate ⁽¹⁾	60%	0.46%	55%	0.31%	52%	0.40%
15-year amortizing fixed-rate	29	0.18	34	0.14	38	0.19
ARMs/adjustable-rate	4	0.36	6	0.26	6	0.22
Interest-only	5	1.85	3	0.30	1	0.04
Balloon/resets	1	0.33	1	0.19	2	0.19
Total mortgage loans, PCs and Structured Securities	99	0.45	99	0.25	99	0.30
Structured Transactions ⁽²⁾	1	1.88	1	0.22	1	0.10
Total mortgage portfolio	100%	0.45	100%	0.25	100%	0.30
Number of single-family loans (in millions)	10.10		9.23		8.67	
	Credit-Enhanced ⁽⁴⁾ , December 31,					
	2007		2006		2005	
	Percent of Number of Single-Family Loans	Delinquency Rate	Percent of Number of Single-Family Loans	Delinquency Rate	Percent of Number of Single-Family Loans	Delinquency Rate
Conventional:						
30-year amortizing fixed-rate ⁽¹⁾	80%	1.60%	75%	1.32%	72%	1.74%
15-year amortizing fixed-rate	5	0.63	7	0.64	9	0.81
ARMs/adjustable-rate	4	1.14	6	1.21	8	1.05
Interest-only	4	3.11	3	1.05	2	0.23
Balloon/resets	< 1	1.55	1	0.98	1	0.91
FHA/VA	2	2.96	2	2.99	2	4.03
Rural Housing Service and other federally guaranteed loans	1	2.85	1	2.65	1	3.34
Total mortgage loans, PCs and Structured Securities	96	1.62	95	1.30	95	1.61
Structured Transactions ⁽²⁾	4	13.79	5	14.43	5	19.65
Total mortgage portfolio	100%	2.14	100%	1.93	100%	2.54
Number of single-family loans (in millions)	2.23		1.95		1.92	
	Total, December 31,					
	2007		2006		2005	
	Percent of Number of Single-Family Loans	Delinquency Rate	Percent of Number of Single-Family Loans	Delinquency Rate	Percent of Number of Single-Family Loans	Delinquency Rate
Conventional:						
30-year amortizing fixed-rate ⁽¹⁾	64%	0.72%	60%	0.54%	56%	0.72%
15-year amortizing fixed-rate	25	0.20	29	0.16	33	0.22
ARMs/adjustable-rate	4	0.50	6	0.44	7	0.39
Interest-only	5	2.03	3	0.44	1	0.10
Balloon/resets	1	0.41	1	0.25	2	0.25
FHA/VA	< 1	2.96	< 1	2.99	< 1	4.03
Rural Housing Service and other federally guaranteed loans	< 1	2.85	< 1	2.65	< 1	3.34
Total mortgage loans, PCs and Structured Securities	99	0.65	99	0.42	99	0.53
Structured Transactions ⁽²⁾⁽³⁾	1	9.86	1	8.36	1	12.34
Total mortgage portfolio	100%	0.76	100%	0.54	100%	0.71
Number of single-family loans (in millions)	12.33		11.18		10.59	
Net charge-offs (dollars in millions)						
Mortgage loans, PCs and Structured Securities	\$289		\$141		\$101	
Structured Transactions ⁽²⁾⁽³⁾⁽⁵⁾	1		1		—	
Total mortgage portfolio	\$290		\$142		\$101	

(1) Includes 40-year and 20-year fixed-rate mortgages.

(2) Structured Transactions generally have underlying mortgage loans with a variety of risk characteristics but many provide inherent credit protection from losses due to the structure employed, including subordination, excess interest, overcollateralization and other features.

(3) Includes \$13 billion, \$19 billion and \$18 billion of option ARM loans that are underlying our Structured Transactions as of December 31, 2007, 2006 and 2005, respectively.

(4) Credit-enhanced loans are primarily those mortgage loans for which a third party has primary default risk. The total credit-enhanced unpaid principal balance as of December 31, 2007, 2006 and 2005 was \$326 billion, \$266 billion and \$253 billion, respectively, for which the maximum coverage of third party primary liability was \$55 billion, \$58 billion and \$53 billion, respectively.

(5) Does not include credit losses related to Structured Transactions that were held in our retained portfolio.

Increases in delinquency rates occurred in all product types in 2007, but were most significant for interest-only and option ARM mortgages. Delinquency rates for interest-only and option ARM products, increased to 203 and 224 basis points, respectively, compared to 44 and 31 basis points at December 31, 2006, respectively. The delinquency rate on our total single-family portfolio, excluding that portion of Structured Securities that is backed by Ginnie Mae Certificates and Structured Transactions, was 65 basis points at December 31, 2007, as compared to 42 basis points as of December 31, 2006. Although we believe our delinquency rates have remained low relative to conforming loan delinquency rates of other industry participants, we expect our delinquency rates to continue to rise in 2008. Our multifamily delinquency rate remained very low at 0.02%, 0.06% and —% at the end of 2007, 2006 and 2005, respectively.

Table 52 presents activities related to loans acquired under financial guarantees in 2007.

Table 52 — Changes in Loans Purchased Under Financial Guarantees⁽¹⁾

	2007			Net Investment
	Unpaid Principal Balance	Purchase Discount	Loan Loss Reserves	
				(in millions)
Beginning balance	\$ 2,983	\$ (220)	\$ —	\$ 2,763
Purchases of loans	8,833	(2,364)	—	6,469
Provision for credit losses	—	—	(12)	(12)
Principal repayments	(1,486)	197	4	(1,285)
Troubled debt restructurings ⁽²⁾	(694)	129	—	(565)
Foreclosures, transferred to REO	(2,635)	491	6	(2,138)
Ending balance ⁽³⁾	<u>\$ 7,001</u>	<u>\$(1,767)</u>	<u>\$ (2)</u>	<u>\$ 5,232</u>

(1) Consists of seriously delinquent loans purchased in performance of our financial guarantees since January 1, 2006.

(2) Consist of loans that have transitioned into troubled debt restructurings during the stated period.

(3) Includes loans that have subsequently returned to current status under the original loan terms at December 31, 2007.

We have the right to purchase mortgages that back our PCs and Structured Securities from the underlying loan pools when they are significantly past due. This right to repurchase collateral is known as our repurchase option. Through November 2007, our general practice was to purchase the mortgage loans out of PCs after the loans became 120 days delinquent. Effective December 2007, our practice changed to purchase these loans out of our PCs when the loans have been modified, foreclosure sales occur, or when the loans have been delinquent for 24 months, unless we determine it is economically beneficial to do so sooner. Consequently, we purchased relatively few impaired loans under our repurchase option in December 2007. We record at fair value loans that we purchase out of our guaranteed PCs and Structured Securities in connection with our repurchase option. We record losses on loans purchased on our consolidated statements of income in order to reduce our net investment in acquired loans to their fair value.

The unpaid principal balance of non-performing loans that have been purchased under our financial guarantees and that have not been modified under troubled debt restructurings increased approximately 135% in 2007. This increase is attributable to an increase in the volume of delinquent loans in 2007 as well as an increase in the average size of the unpaid principal balance of those loans. We purchased approximately \$8.8 billion in unpaid principal balances of these loans with a fair value at acquisition of \$6.5 billion.

Loans acquired in 2007 added approximately \$2.4 billion of purchase discount, which is comprised of \$0.5 billion that was previously recorded on our consolidated balance sheets as loan loss reserve and \$1.9 billion of losses on loans purchased as shown on our consolidated statements of income during 2007. We expect that we will continue to incur losses on the purchase of non-performing loans in 2008. However, the volume and severity of these losses is dependent on many factors, including the effects of our change in practice for repurchases and regional changes in home prices.

Recoveries on loans impaired upon purchase represent the recapture into income of previously recognized losses on loans purchased and provision for credit losses associated with purchases of delinquent loans from our PCs and Structured Securities in conjunction with our guarantee activities. Recoveries occur when a non-performing loan is repaid in full or when at the time of foreclosure the estimated fair value of the acquired property, less costs to sell, exceeds the carrying value of the loan. During 2007, we recognized recoveries on loans impaired upon purchase of \$505 million. For impaired loans where the borrower has made required payments that return to current status, the basis adjustments are accreted into interest income over time as periodic payments are received. We classify loans repaid in full and those returning to current status, including those with modified terms, as cured loans and the cumulative percentage of impaired loans that have cured since our purchase out of our PCs as a cure rate. As of December 31, 2007, the cure rate for non-performing loans purchased out of PCs during 2007 and 2006 was approximately 34% and 56%, respectively. We believe, based on the cure rate experienced on these loans, as well as our access to credit enhancement remedies that we will continue to recognize recoveries on loans impaired upon purchase in 2008.

Credit Loss Performance

Table 53 provides detail on our credit loss performance associated with mortgage loans in our retained portfolio, including those purchased out of PCs and Structured Securities.

Table 53 — Credit Loss Performance

	December 31,		
	2007	2006	2005
(dollars in millions)			
REO			
REO balances:			
Single-family	\$ 1,736	\$ 734	\$ 611
Multifamily	—	9	18
Total	<u>\$ 1,736</u>	<u>\$ 743</u>	<u>\$ 629</u>
REO activity (number of properties): ⁽¹⁾			
Beginning property inventory	8,785	8,070	9,604
Properties acquired	22,840	16,387	15,861
Properties disposed	<u>(17,231)</u>	<u>(15,672)</u>	<u>(17,395)</u>
Ending property inventory	<u>14,394</u>	<u>8,785</u>	<u>8,070</u>
Average holding period (in days) ⁽²⁾	167	175	186
REO operations income (expense):			
Single-family	\$ (205)	\$ (61)	\$ (40)
Multifamily	<u>(1)</u>	<u>1</u>	<u>—</u>
Total	<u>\$ (206)</u>	<u>\$ (60)</u>	<u>\$ (40)</u>
CHARGE-OFFS			
Single-family:			
Foreclosure alternatives, gross	\$ (57)	\$ (50)	\$ (44)
Recoveries ⁽³⁾	<u>19</u>	<u>11</u>	<u>23</u>
Foreclosure alternatives, net	(38)	(39)	(21)
REO acquisitions, gross	(471)	(258)	(242)
Recoveries ⁽³⁾	<u>219</u>	<u>155</u>	<u>162</u>
REO acquisitions, net	(252)	(103)	(80)
Single-family totals:			
Charge-offs, gross ⁽⁴⁾ (including \$372 million, \$308 million and \$286 million relating to loan loss reserves, respectively)	(528)	(308)	(286)
Recoveries ⁽³⁾	<u>238</u>	<u>166</u>	<u>185</u>
Single-family charge-offs, net	<u>(290)</u>	<u>(142)</u>	<u>(101)</u>
Multifamily:			
Charge-offs, gross ⁽⁴⁾ (including \$4 million, \$5 million and \$8 million relating to loan loss reserves, respectively)	(4)	(5)	(8)
Recoveries ⁽³⁾	<u>1</u>	<u>—</u>	<u>—</u>
Multifamily charge-offs, net	<u>(3)</u>	<u>(5)</u>	<u>(8)</u>
Total Charge-offs:			
Charge-offs, gross ⁽⁴⁾ (including \$376 million, \$313 million and \$294 million relating to loan loss reserves, respectively)	(532)	(313)	(294)
Recoveries:			
Related to primary mortgage insurance	156	112	119
Related to other credit enhancements	<u>83</u>	<u>54</u>	<u>66</u>
Total recoveries ⁽³⁾	<u>239</u>	<u>166</u>	<u>185</u>
Charge-offs, net	<u>\$ (293)</u>	<u>\$ (147)</u>	<u>\$ (109)</u>
CREDIT LOSSES⁽⁵⁾			
Single-family	\$ (495)	\$ (203)	\$ (141)
Multifamily	<u>(4)</u>	<u>(4)</u>	<u>(8)</u>
Total	<u>\$ (499)</u>	<u>\$ (207)</u>	<u>\$ (149)</u>
In basis points ⁽⁶⁾			
Single-family	(3.0)	(1.4)	(1.1)
Multifamily	<u>—</u>	<u>—</u>	<u>—</u>
Total	<u>(3.0)</u>	<u>(1.4)</u>	<u>(1.1)</u>

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

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

(3) Includes recoveries of charge-offs primarily resulting from foreclosure alternatives and REO acquisitions on loans where a share of default risk has been assumed by mortgage insurers, servicers, or other third parties through credit enhancements.

(4) Charge-offs represent the amount of the unpaid principal balance of a loan that has been discharged in order to remove the loan from our retained portfolio at the time of resolution, regardless of when the impact of the credit loss was recorded on our consolidated statements of income through the provision for credit losses or losses on loans purchased. The amount of charge-offs for credit loss performance is generally derived as the contractual balance of a loan at the date it is discharged less the estimated value in final disposition.

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

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

Our credit loss performance is a historic metric that measures losses at the conclusion of the loan resolution process. Our credit loss performance does not include our provision for credit losses and losses on loans purchased. We expect our credit losses to continue to increase in 2008, especially if market conditions, such as home prices and the rate of home sales, continue to deteriorate.

Table 54 and Table 55 provide detail by region for two credit performance statistics, REO activity and charge-offs. Regional REO acquisition and charge-off trends generally follow a pattern that is similar to, but lags, that of regional delinquency trends.

Table 54 — REO Activity by Region⁽¹⁾

	December 31,		
	2007	2006	2005
	(number of properties)		
REO Inventory			
Beginning property inventory	8,785	8,070	9,604
Properties acquired by region:			
Northeast	2,336	1,253	1,306
Southeast	4,942	3,970	4,504
North Central	9,175	7,236	5,790
Southwest	3,977	3,498	3,412
West	2,410	430	849
Total properties acquired	<u>22,840</u>	<u>16,387</u>	<u>15,861</u>
Properties disposed by region:			
Northeast	(1,484)	(1,260)	(1,384)
Southeast	(4,009)	(4,132)	(5,221)
North Central	(7,520)	(6,294)	(5,715)
Southwest	(3,488)	(3,441)	(3,820)
West	(730)	(545)	(1,255)
Total properties disposed	<u>(17,231)</u>	<u>(15,672)</u>	<u>(17,395)</u>
Ending property inventory	<u>14,394</u>	<u>8,785</u>	<u>8,070</u>

(1) See “Table 49 — Single-Family — Delinquency Rates, Excluding Structured Transactions — By Region” for a description of these regions.

Our REO property inventories increased 64% in 2007 reflecting the impact of the weakening housing market and tightening credit standards. In addition, the impact of a national decline in home prices and a decrease in the volume of home sales activity during 2007 lessens the alternatives to foreclosure for homeowners exposed to temporary deterioration in their financial condition. Increases in our REO inventories have been most severe in areas of the country where unemployment rates continue to be high, such as the North Central region. The East and West coastal areas of the country also experienced significant increases in REO in 2007.

Table 55 — Single-Family Charge-offs and Recoveries by Region⁽¹⁾⁽²⁾

	Year Ended December 31,								
	2007			2006			2005		
	Charge-offs, gross	Recoveries	Charge-offs, net	Charge-offs, gross	Recoveries	Charge-offs, net	Charge-offs, gross	Recoveries	Charge-offs, net
	(in millions)								
Northeast	\$ 50	\$ (21)	\$ 29	\$ 22	\$ (9)	\$ 13	\$ 21	\$ (10)	\$ 11
Southeast	112	(60)	52	72	(42)	30	76	(54)	22
North Central	219	(92)	127	133	(66)	67	102	(66)	36
Southwest	90	(45)	45	73	(44)	29	68	(44)	24
West	57	(20)	37	8	(5)	3	19	(11)	8
Total	<u>\$528</u>	<u>\$(238)</u>	<u>\$290</u>	<u>\$308</u>	<u>\$(166)</u>	<u>\$142</u>	<u>\$286</u>	<u>\$(185)</u>	<u>\$101</u>

(1) See “Table 49 — Single-Family — Delinquency Rates, Excluding Structured Transactions — By Region” for a description of these regions.

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

Single-family charge-offs, gross, increased 71% in 2007 compared to 2006, primarily due to a considerable increase in the volume of REO properties acquired at foreclosure. We expect that the volume of our REO properties will continue to increase if the economic condition of the residential mortgage market does not improve. Higher volumes of foreclosures and higher average loan balances resulted in higher charge-offs, on a per property basis, during 2007.

We maintain two loan loss reserves — reserve for losses on mortgage loans held-for-investment and reserve for guarantee losses on Participation Certificates — at levels we deem adequate to absorb probable incurred losses on mortgage loans held-for-investment in the retained portfolio and mortgages underlying our PCs and Structured Securities. See “MD&A — CRITICAL ACCOUNTING POLICIES AND ESTIMATES — Allowance for Loan Losses and Reserve for Guarantee Losses,” “NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES” and “NOTE 5:

MORTGAGE LOANS AND LOAN LOSS RESERVES” to our consolidated financial statements for further information. Table 56 summarizes our loan loss reserves activity for both reserves in total.

Table 56 — Loan Loss Reserves Activity

	Year Ended December 31,				
	2007	Adjusted			
		2006	2005	2004	2003
	(in millions)				
Total loan loss reserves: ⁽¹⁾					
Beginning balance	\$ 619	\$ 548	\$ 355	\$ 356	\$ 439
Provision (benefit) for credit losses	2,854	296	307	164	(35)
Charge-offs, gross ⁽²⁾	(376)	(313)	(294)	(300)	(224)
Recoveries ⁽³⁾	239	166	185	160	145
Charge-offs, net	(137)	(147)	(109)	(140)	(79)
Adjustment for change in accounting ⁽⁴⁾	—	—	—	—	42
Transfers, net ⁽⁵⁾	(514)	(78)	(5)	(25)	(11)
Ending balance	<u>\$2,822</u>	<u>\$ 619</u>	<u>\$ 548</u>	<u>\$ 355</u>	<u>\$ 356</u>

- (1) Includes reserves for loans held for investment in the retained portfolio and reserves for guarantee losses on Participation Certificates.
- (2) Charge-offs related to retained mortgages represent the amount of the unpaid principal balance of a loan that has been discharged using the reserve balance to remove the loan from our retained portfolio at the time of resolution. Charge-offs exclude \$156 million in 2007 related to reserve amounts previously transferred to reduce the carrying value of loans purchased under financial guarantees.
- (3) Includes recoveries of charge-offs primarily resulting from foreclosure alternatives and REO acquisitions on loans where a share of default risk has been assumed by mortgage insurers, servicers or third parties through credit enhancements. Recoveries of charge-offs through credit enhancements are limited in some instances to amounts less than the full amount of the loss.
- (4) On January 1, 2003, \$42 million of recognized guarantee obligation attributable to estimated incurred losses on outstanding PCs or Structured Securities was reclassified to reserve for guarantee losses on Participation Certificates.
- (5) Consist of: (a) the transfer of reserves associated with non-performing loans purchased from mortgage pools underlying our PCs, Structured Securities and long-term standby agreements to establish the initial recorded investment in these loans at the date of our purchase; (b) amounts attributable to uncollectible interest on PCs and Structured Securities in our retained portfolio; and (c) other transfers, net.

Our total loan loss reserves increased in 2007 as we recorded additional reserves to reflect increased estimates of incurred losses, an observed increase in delinquency rate and increases in the expected severity of losses on a per-property basis related to our single-family portfolio. In addition, in 2006, we reversed \$82 million of our provision for credit losses recorded in 2005 associated with Hurricane Katrina because the related payment and delinquency experience on affected properties was more favorable than expected. See “MD&A — CONSOLIDATED RESULTS OF OPERATIONS — Non-Interest Expense — *Provision for Credit Losses*,” for additional information.

Credit Risk Sensitivity

Our credit risk sensitivity analysis assesses the assumed increase in the present value of expected single-family mortgage portfolio credit losses over ten years as the result of an estimated immediate 5% decline in home prices nationwide, followed by a return to more normal growth in home prices based on historical experience. We use an internally developed Monte Carlo simulation-based model to generate our credit risk sensitivity analyses. The Monte Carlo model uses a simulation program to generate numerous potential interest-rate paths that, in conjunction with a prepayment model, are used to estimate mortgage cash flows along each path. In the credit risk sensitivity analysis, we adjust the home-price assumption used in the base case to estimate the level and sensitivity of potential credit costs resulting from a sudden decline in home prices. Our credit risk sensitivity results are presented in “RISK MANAGEMENT AND DISCLOSURE COMMITMENTS.”

Institutional Credit Risk

Our primary institutional credit risk exposure, other than counterparty credit risk relating to derivatives, arises from agreements with:

- mortgage insurers;
- mortgage seller/servicers;
- issuers, guarantors or third-party providers of credit enhancements (including bond insurers);
- mortgage investors;
- multifamily mortgage guarantors,
- issuers, guarantors and insurers of investments held in both our retained portfolio and cash and investments portfolio; and
- derivative counterparties.

A significant failure by a major entity in one of these categories to perform could have a material adverse effect on our retained portfolio, cash and investments portfolio or credit guarantee activities. The recent challenging market conditions

have adversely affected, and are expected to continue to adversely affect, the liquidity and financial condition of a number of our counterparties. For example, some of our largest mortgage seller/servicers have experienced ratings downgrades and liquidity constraints and other of our counterparties may also experience these concerns. The weakened financial condition and liquidity position of some of our counterparties may adversely affect their ability to perform their obligations to us, or the quality of the services that they provide to us. During 2007, we terminated our arrangements with certain mortgage seller/servicers due to their failure to meet our eligibility requirements and we continue to closely monitor the eligibility of mortgage seller/servicers under our standards. The failure of any of our primary counterparties to meet their obligations to us could have a material adverse effect on our results of operations and financial condition.

Investments in our retained portfolio expose us to institutional credit risk on non-Freddie Mac mortgage-related securities to the extent that servicers, issuers, guarantors, or third parties providing credit enhancements become insolvent or do not perform. Our non-Freddie Mac mortgage-related securities portfolio consists of both agency and non-agency mortgage-related securities. Agency securities present minimal institutional credit risk due to the prevailing view that these securities have a credit quality at least equivalent to non-agency securities rated AAA (based on the S&P or equivalent rating scale of other nationally recognized statistical rating organizations). We seek to manage institutional credit risk on non-Freddie Mac mortgage-related securities by only purchasing securities that meet our investment guidelines and performing ongoing analysis to evaluate the creditworthiness of the issuers and servicers of these securities and the bond insurers that guarantee them. See “MD&A — CONSOLIDATED BALANCE SHEETS ANALYSIS — Table 22 — Characteristics of Mortgage Loans and Mortgage-Related Securities in our Retained Portfolio” for more information regarding the non-Freddie Mac securities in our retained portfolio.

Mortgage Insurers

We have institutional credit risk relating to the potential insolvency or non-performance of mortgage insurers that insure mortgages we purchase or guarantee. We manage this risk by establishing eligibility standards for mortgage insurers and by regularly monitoring our exposure to individual mortgage insurers. Our monitoring includes regularly performing analysis of the estimated financial capacity of mortgage insurers under different adverse economic conditions. We also monitor the mortgage insurers’ credit ratings, as provided by nationally recognized statistical rating organizations, and we periodically review the methods used by the nationally recognized statistical rating organizations. Recently the mortgage insurance industry has been subject to increased public and regulatory scrutiny. In addition, certain large insurers have been downgraded by nationally recognized rating agencies.

We announced that effective June 1, 2008, our private mortgage insurer counterparties may not cede new risk if the gross risk or gross premium ceded to captive reinsurers is greater than 25%. We also announced that we are temporarily suspending certain requirements for our mortgage insurance counterparties that are downgraded below AA– or Aa3 by any one of the rating agencies, provided the mortgage insurer commits to providing a remediation plan for our approval within 90 days of the downgrade. We periodically perform on-site reviews of mortgage insurers to confirm compliance with our eligibility requirements and to evaluate their management and control practices. In addition, state insurance authorities regulate mortgage insurers. In the event one of our mortgage insurers were to become insolvent, the insurer’s future premiums would be used to pay claims. See “NOTE 17: CONCENTRATION OF CREDIT AND OTHER RISKS” to our consolidated financial statements for additional information.

Mortgage Seller/Servicers

We are exposed to institutional credit risk arising from the insolvency or non-performance by our mortgage seller/servicers, including non-performance of their repurchase obligations arising from the representations and warranties made to us for loans they underwrote and sold to us. The servicing fee charged by mortgage servicers varies by mortgage product. We generally require our single-family servicers to retain a minimum percentage fee for mortgages serviced on our behalf, typically 0.25% of the unpaid principal balance of the mortgage loans. However, on an exception basis, we allow a lower or no minimum servicing amount. The credit risk associated with servicing fees relates to whether we could transfer the applicable servicing rights to a successor servicer and recover amounts owed to us by the defaulting servicer in the event the defaulting servicer is unable to fulfill its responsibilities.

In order to manage the credit risk associated with our mortgage seller/servicers, we require them to meet minimum financial capacity standards, insurance and other eligibility requirements. We institute remedial actions against seller/servicers that fail to comply with our standards. These actions may include transferring mortgage servicing to other qualified servicers or terminating our relationship with the seller/servicer. We conduct periodic operational reviews of our single-family mortgage seller/servicers to help us better understand their control environment and its impact on the quality of loans sold to us. We use this information to determine the terms of business we conduct with a particular seller/servicer. We do not believe we have any significant exposure to seller/servicers identified as primarily subprime lenders that are not currently in compliance with our financial monitoring standards.

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

Non-Freddie Mac Mortgage-Related Securities

Investments in our retained portfolio expose us to institutional credit risk related to non-Freddie Mac mortgage-related securities to the extent that servicers, issuers, guarantors, or third parties providing credit enhancements become insolvent or do not perform. See “MD&A — CONSOLIDATED BALANCE SHEETS ANALYSIS — Table 22 — Characteristics of Mortgage Loans and Mortgage-Related Securities in our Retained Portfolio” for more information concerning our retained portfolio.

Our non-Freddie Mac mortgage-related securities portfolio consists of both agency and non-agency mortgage-related securities. Agency mortgage-related securities, which are securities issued or guaranteed by Fannie Mae or Ginnie Mae, present minimal institutional credit risk due to the high credit quality of Fannie Mae and Ginnie Mae. Ginnie Mae securities are backed by the full faith and credit of the U.S. Agency mortgage-related securities are generally not separately rated by nationally recognized statistical rating organizations, but are viewed as having a level of credit quality at least equivalent to non-agency mortgage-related securities rated AAA (based on the S&P rating scale or an equivalent rating from other nationally recognized statistical rating organizations). At December 31, 2007, we held approximately \$48 billion of agency securities, representing approximately 2% of our total mortgage portfolio.

Non-agency mortgage-related securities expose us to institutional credit risk if the nature of the credit enhancement relies on a third party to cover potential losses. However, most of our non-agency mortgage-related securities rely primarily on subordinated tranches to provide credit loss protection and therefore expose us to limited counterparty risk. In those instances where we desire further protection, we may choose to mitigate our exposure with bond insurance or by purchasing additional subordination. Bond insurance exposes us to the risks related to the bond insurer’s ability to satisfy claims. As of December 31, 2007, we had insurance coverage, including secondary policies, on securities totaling \$17.9 billion of unpaid principal balance, consisting of \$16.1 billion and \$1.8 billion, of coverage for bonds in our retained and investment portfolios, respectively. As of December 31, 2007, the top three of our bond insurers, each accounting for more than 20% of our overall bond insurance coverage (including secondary policies), collectively represented approximately 80% of our bond insurance coverage.

At December 31, 2007, all of the bond insurers providing coverage for non-agency mortgage-related securities held by us were rated AAA or equivalent by at least one nationally recognized statistical rating organization. However, the bond insurance industry has been adversely affected by the increased volatility in the credit and mortgage markets. Consequently, certain large insurers have been downgraded by nationally recognized statistical rating agencies. Subsequent to December 31, 2007, three of those bond insurers, representing approximately 62% of our total bond insurer coverage, have been downgraded below AAA by at least one rating agency.

We manage institutional credit risk on non-Freddie Mac mortgage-related securities by only purchasing securities that meet our investment guidelines and performing ongoing analysis to evaluate the creditworthiness of the issuers and servicers of these securities and the bond insurers that guarantee them. To assess the creditworthiness of these entities, we may perform additional analysis, including on-site visits, verification of loan documentation, review of underwriting or servicing processes and similar due diligence measures. In addition, we regularly evaluate our investments to determine if any impairment in fair value requires an impairment loss recognition in earnings, warrants divestiture or requires a combination of both. See “RISK FACTORS — Legal and Regulatory Risks” for more information.

Mortgage Investors and Originators

We are exposed to pre-settlement risk through the purchase, sale and financing of mortgage loans and mortgage-related securities with mortgage investors and originators. The probability of such a default is generally remote over the short time horizon between the trade and settlement date. We manage this risk by evaluating the creditworthiness of our counterparties and monitoring and managing our exposures. In some instances, we may require these counterparties to post collateral.

Cash and Investments Portfolio

Institutional credit risk also arises from the potential insolvency or non-performance of issuers or guarantors of investments held in our cash and investments portfolio. Instruments in this portfolio are investment grade at the time of purchase and primarily short-term in nature, thereby substantially mitigating institutional credit risk in this portfolio. We regularly evaluate these investments to determine if any impairment in fair value requires an impairment loss recognition in earnings, warrants divestiture or requires a combination of both.

OPERATIONAL RISKS

Operational risks are inherent in all of our business activities and can become apparent in various ways, including accounting or operational errors, business interruptions, fraud, failures of the technology used to support our business activities and other operational challenges from failed or inadequate internal controls. These operational risks may expose us to financial loss, interfere with our ability to sustain timely financial reporting, or result in other adverse consequences. Governance over the management of our operational risks takes place through the enterprise risk management framework. Business areas retain primary responsibility for identifying, assessing and reporting their operational risks.

Our business processes are highly dependent on our use of technology and business and financial models. While we believe that we have remediated material weaknesses in our information technology general controls, we continue to face challenges in ensuring that the new controls will operate effectively (see “CONTROLS AND PROCEDURES — Internal Control Over Financial Reporting” for more information). Although we have strengthened our model oversight and governance processes to validate model assumptions, code, theory and the system applications that utilize our models, the complexity of the models and the impact of the recent turmoil in the housing and credit markets create additional risk regarding the reliability of our models.

We continue to make significant investments to build new financial accounting systems and move to more effective and efficient business processing systems. Until those systems are fully implemented, we continue to remain more reliant on end-user computing systems than is desirable. We are also challenged to effectively and timely deliver integrated production systems. Reliance on certain of these end-user computing systems increases the risk of errors in some of our core operational processes and increases our dependency on monitoring controls. We are mitigating this risk by improving our documentation and process controls over these end-user computing systems and implementing more rigorous change management controls over certain key end-user systems using change management controls over tools which are subject to our information technology general controls.

In recognition of the importance of the accuracy and reliability of our valuation of financial instruments, we engage in an ongoing internal review of our valuations. We perform analysis of internal valuations on a monthly basis to confirm the reasonableness of the valuations. This analysis is performed by a group that is independent of the business area responsible for valuing the positions. Our verification and validation procedures depend on the nature of the security and valuation methodology being reviewed and may include: comparisons with external pricing sources, comparisons with observed trades, independent verification of key valuation model inputs and independent security modeling. Results of the monthly verification process, as well as any changes in our valuation methodologies, are reported to a management committee that is responsible for reviewing and approving the approaches used in our valuations to ensure that they are well controlled and effective, and result in reasonable fair values.