

FINAL TRANSCRIPT

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PRESENTATION

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Operator

Ladies and gentlemen, thank you for standing by and welcome to the Freddie Mac third quarter 2007 financial results conference call. At this time, all lines are in a listen-only mode. Later, there will be a question-and-answer session and instructions will be given at that time. (OPERATOR INSTRUCTIONS) As a reminder, today's call is being recorded.

At this time, then, I would like to turn the conference over to the Senior Vice President of Investor Relations, Mr. Ed Golding. Please go ahead, sir.

Ed Golding - Freddie Mac - SVP of IR

Good morning. Welcome to our investor presentation and conference call where we present to you our financial results for the third quarter. Speaking today are Freddie Mac's Chairman and Chief Executive Officer, Dick Syron, our Chief Business Officer, Patti Cook and our Chief Financial Officer, Buddy Pizsel. Our SVP of Credit Risk Oversight, Ray Romano, will join us for Q&As. As we begin, let me make two important points. First, we have posted on our website a slide presentation and tables which include additional information on our results. You may want to have these available as Buddy walks through the numbers.

Second, please note that today we may make certain forward-looking statements regarding our business results. These statements are based on a set of judgments and assumptions about our key business drivers and other factors. Changes in these factors could cause our actual results to vary materially from our expectations. You'll find a full discussion of these factors in today's Information Statement Supplements and the Information Statement in the 2006 Annual Report which are also posted on our website. We strongly encourage you to carefully review these factors. And one final note. We would like as many people as possible to be able to ask a question. Therefore, if you would please limit yourself to one question and a follow-up, I would be grateful. We will come back, time permitting, for a second round. Thanks and now let me introduce our Chairman and CEO, Dick Syron.

Dick Syron - Freddie Mac - Chairman & CEO

Thanks Ed, and good morning to all of you. I know everyone has had a chance to review the press release we posted earlier this morning. As you know, the third quarter continued to represent a very difficult environment as falling housing prices, deteriorating mortgage credit, continued volatility in the fixed income market all contributed to a net loss of \$2 billion. Given the continuation of the same market trends that produced these results through October and November, it is likely that the fourth quarter will prove difficult as well. These results are not surprising, given the vagaries of our accounting that were tied to the housing economy - to the housing economy and we are taking strong steps to improve our business and our future financial results. We do not believe it would be wise to be sanguine about the intermediate term housing market. Thus, we are determined to take strong steps and be in front of whatever happens. We are all very strong believers in both the long-term opportunities for shareholders and in our obligations in times like this to meet our charter by stabilizing markets.

The actions that Buddy and Patti will discuss are aggressive, forward-looking and financially prudent and they will ensure that we are able to fulfill our mission and to meet our responsibilities to our shareholders at the same time. Notwithstanding the extremely tough market in the third quarter, Freddie Mac benefited from our traditional strengths as net interest income and guarantee fees continued to grow. Buddy will discuss these trends when he takes you through our financials. In particular, he will focus on how credit impacted the results. In addition, we have taken sound steps since early 2007 to advance our mission, improve our credit exposure and enhance our long-term profitability. As a result, through the third quarter, our credit position has remained among the strongest in an admittedly troubled industry and the conventional conforming market, where the vast majority of our exposure is, has held up well. Patti will review how we have managed our credit position and will discuss some of the current opportunities we are seeing in the business.

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Before I turn it over to Patti, I want to reiterate to everyone on the call that the GSEs were set up for times like these. Over time, Freddie has prospered by committing capital in these environments, managing credit and interest rate risk to acceptable levels and earning attractive long-term results. Given the current opportunity set in both of our businesses, we feel that we should remain focused on the fundamentals of our business. As a result, the right thing for us to do now is to take steps to bolster our capital position in order to strengthen our franchise and better position us for the future, and that's exactly what we're doing. With that, I'll turn it over to Patti.

Patti Cook - Freddie Mac - Chief Business Officer

Thanks, Dick. These are certainly volatile and challenging times in the U.S. housing and financial markets. I will address how this environment is affecting our current business and the prospect for our future business. I will touch on the credit quality and expected profitability of our guarantee fee business, the credit quality of the asset-backed securities in the retained portfolio, and the outlook for profitability in both. In summary though, I would say that what is "bad" for current profitability is "good" for the longer term prospects of Freddie Mac. As you will hear, we are clearly more relevant and needed today than we were a year ago, which is creating opportunities for us to improve our longer-term profitability.

But first, what have we done to address the current market environment?

We continue to support our customers' liquidity needs and have helped stabilize the conforming mortgage markets. In this period of illiquidity, the GSEs are the primary liquidity provider for mortgages. This is evidenced in our annualized growth rate of 16%, which compares to estimated MDO growth of about 6%. As demand for mortgages has declined, the share of originations being securitized by the GSEs has increased to approximately 65% in the third quarter of '07 from about 40% in 2006. As a result, the agency mortgage market has continued to function relatively well.

Let's turn to the current market environment and its impact on our G-fee business. On slides eight and nine, we have updated the information we provided on our second quarter call. As in June, our current credit position remains relatively strong across our total portfolio. In aggregate, Freddie Mac benefits from a very low current LTV ratio of 60%, high average FICO scores of 724, and a serious delinquency rate of just 51 basis points, a level that is roughly half of the market average. However, our 2006 and 2007 books are expected to realize higher expected default costs than prior books for two reasons. First, the recent weakening in the house price -- of house prices have increased expected default costs for the 2006 and 2007 books compared to prior years. Second, there was an increase with risk layering mortgages. For example, mortgages with FICO scores less than 620 and original LTVs greater than 90, are more concentrated in the 2007 book and represent about 1% of purchases.

On the guarantee fee business, we use market prices to mark all credit related exposures. In the third quarter, the market prices for credit deteriorated significantly and I believe that the market is putting a big risk premium into the price they quote, especially on prime conventional mortgages. Let me put this in perspective. The guarantee obligation including related items was \$16.8 billion at the end of September. For this value to represent the present value of future default costs on our guarantees, we would need to see default rates in the 4 to 5% range and severities around 30%.

A more reasonable assumption might be defaults of 3 to 3.5% and severities of 30%, resulting in total present value of default costs of \$10 billion to \$20 billion over the life of the portfolio. This is with some areas such as California experiencing declines in house prices of 25 to 30%. To put this in perspective, our worst performance was the portfolio we held as of 1991, which went on to experience a 2.6% default rate and a severity of about 30%. So we would need to experience a scenario approximately twice as severe as the 1990s to see the GO realized.

Also a note of caution, when comparing these lifetime numbers to charge-offs, this type of analysis includes not only charge-offs but also REO expense and lost interest. So to summarize, the difference between the \$10 billion to \$12 billion that I quoted and the \$16.8 billion can be thought of as an expression of the market's uncertainty about the future, which manifests itself in wider spreads. So unless the conventional conforming default rate rises to a level of 4 to 5%, we would expect to earn some of the

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GO mark back over time. And remember, as of now, we are seeing single-family serious delinquencies as of September 30, 2007 of 51 basis points.

To address the declining profitability that results from the decline in the housing market, we have taken steps throughout 2007 to increase prices and limit our credit exposure. In our bulk purchase channel, we were able to respond quickly to the changing market dynamics. Early in the year we began restricting the credit terms and increasing prices for purchases through bulk. G-fees in this space have nearly doubled for similar products since the beginning of the year, dramatically improving expected ROEs. While this bulk channel accounts for only about 15% of our total purchases, it accounts for a disproportional share of our lower credit quality purchases. This contributed to the increase on new purchases and our average G-fee up to the mid-20s for the third quarter of 2007. This number includes contractual G-fees and amortization of delivery fees but does not include non-cash items, such as accrual of day one differences.

For our flow purchases, given the prevalence of long-term contracts that govern our purchases in that space, implementing credit and price changes is more challenging. However, we have taken two significant steps. In August, we raised prices for loans with higher risk characteristics. And last week we expanded our delivery fees to include fees on LTVs greater than 70% and FICO scores below 680. This would have the effect of increasing fees on our current deliveries by 3 to 5 basis points, depending on delivery mix. We are also discontinuing the purchase of no income, no asset (or NINA loans) and reinforcing our declining market's requirements. We will continue to review all of our pricing on an ongoing basis. In sum, while the housing market remains challenging, we are comfortable with our ability to adjust prices and terms of business, to enhance the profitability of our securitization business going forward.

Let's turn to a discussion of the risk profile and profit outlook for the retained portfolio. The credit profile of our retained portfolio remains of the highest credit quality with 57% in agency mortgages and 33% in non-agency securities, of which 97% is AAA rated and does not include any CDOs. These asset-backs are critical to our ability to meet our affordable lending objectives and allowed us to invest in non-prime markets with substantial credit enhancements. Despite the continued deterioration of the housing market and increases in non-prime delinquencies, we remain comfortable with our risk position on these assets. For the subprime securities, while we have experienced some downgrades, we have high levels of subordination that support these investments, as shown on slide ten. Even at a 50% cumulative default rate and 50% severity assumption, no losses are projected on these securities. There are also about \$26 billion of Alt-A and \$21 billion of MTA asset-backed securities in the portfolio, which we have grouped together in this slide with an average suborder -- with average subordination levels of 16% and 22% respectively. While the overall book should have sufficient subordination to withstand continued deterioration in housing and performance, there are some chances of losses, although unlikely, on a few individual bonds, given the variation in subordination levels.

Let me turn to OAS and fair value. Despite its high credit quality, the retained portfolio has experienced significant spread widening during 2007. In the third quarter alone, the portfolio was marked down by \$8 billion on a fair value basis as spreads widened, bringing the year-to-date write-down to about \$9 billion. This represents about a 40 basis point widening on the entire portfolio. There is always some good news and bad news in these markdowns. The bad news is the fair value mark-to-market write-down it creates. The good news is the higher spread income that will accrue going forward, coupled with improved opportunities. At the beginning of the year, the spread in the portfolio was about 25 to 30 basis points. At the end of September, it was about 65 to 70 basis points. Thus, the spread the portfolio was earning going forward is about 2.5 times higher.

While capital constraints are currently restricting our purchase activities, we are optimizing our purchases and select sales against runoff to maximize the OAS on the portfolio. Two examples during the third quarter were, first, the purchase of AAA bonds against the sale of agency pass-throughs and, second, the purchase of cheap agency ARMs in August against fixed-rate pass-throughs. Both transactions resulted in significant option-adjusted spread pick-up. We will continue to look for these kinds of opportunities and also add responsibly to the portfolio as we address our capital situation.

So there you have it. From a business perspective, even in this difficult business environment, we continue to benefit from a relatively strong credit position. We will have higher core spread income in the retained portfolio. We have taken steps to

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continue our mission and improve our business and we are experiencing significant growth and pricing power in our G-fee business. All of these business drivers will contribute to improved returns over the long-term. With that, I'll turn it over to Buddy.

Buddy Pizsel - *Freddie Mac - CFO*

Thanks Patti, and good morning everyone. I'm going to take a few minutes to provide a high level review of our third quarter 2007 GAAP and fair value results, shown on slide two. I'll keep this brief, because I want to focus most of my comments on credit. Let's begin with the GAAP results. The key take-aways here are that while we've continued to experience improvements in net interest income and guarantee fees, the combination of negative marks in our derivatives and credit related items, as well as higher provisions for credit losses produced a quarterly net loss of \$2 billion or \$3.29 per share. Let's look first at net interest income. As you can see here on line one, for the third quarter, we continued to benefit from improved net interest income. The combination of improved contractual spreads between our assets and debt, continued yield curve steepening and the diminishing effect of the 2006 debt refinancings lifted our net interest income to \$987 million or 52 basis points of net interest margin, up from \$973 million or 51 basis points in the second quarter.

Moving to our management and guarantee income, line two shows that we experienced good growth in revenues on third-party owned PCs, which brought our top line guarantee revenues to \$520 million or 16.6 basis points, up from \$474 million or 15.7 basis points in the second quarter. This line includes only contractual G-fees on third-party PCs. Amortization of deferred fees would have added 1.4 basis points, yielding an overall G-fee of 18 bps. As a reminder, we do not include any contribution from non-cash accretion of day one losses in our guarantee fees. During the third quarter, we recorded \$1.5 billion in interest-rate related mark-to-market losses, shown here on line three. Remember, we manage our interest rate exposures to very low levels. The reported losses on derivatives are economically offset by gains on our debt funding programs and retained portfolio securities. These offsetting gains are not reflected in the GAAP income statement. So again, for another quarter, our reported results have been significantly depressed by mark-to-market effects.

This GAAP accounting depresses our regulatory core capital, which is necessary for growth. It's also made it more difficult to communicate our results externally. While the work isn't complete, I can tell you that we're taking two steps to address this problem. First, I've asked my team to start building a framework for reinitiating hedge accounting on our portfolio of driver derivatives. That, plus selective adoption of the fair value option will dampen some, not all, of this noise. Second, as we have discussed with many of you, we have also made good progress on developing segment reporting and an adjusted GAAP measure that will present our Company's results more clearly. As part of this presentation, we are currently planning to adjust out unrealized derivative mark-to-market items and simply recognize realized gains and losses as they would emerge over the life of the portfolio. Delivering this presentation requires a re-measurement of past results, with an accompanying MD&A. We're doing our utmost to roll out this presentation by year-end. But if this work jeopardizes our release of results in 60 days, it will be provided after the year-end release. We will meet our 60-day year-end commitment.

Moving to lines four and five, the total credit impact on our GAAP results in the third quarter totaled \$3.5 billion. On a year-to-date basis, we have absorbed \$4.9 billion of total credit costs. I will discuss that thoroughly in a minute. Let me now turn to our fair value results on line six. You can see we recorded a net reduction in our fair value of common equity before capital transactions of \$8.1 billion after tax in the third quarter. Included in this result was OAS widening in the retained portfolio, which contributed a pretax reduction of approximately \$8 billion, \$3.5 billion of which was associated with a widening of OASs on our portfolio of ABS securities. As Patti discussed, we believe that little, if any, of this fair value loss will result in cash losses. So we expect most of this mark will be timing differences, as improved core spread income in the retained portfolio during the quarter and going forward will reverse these losses.

Our guarantee fee business experienced a \$7 billion pretax reduction in value, due to significant declines in the market value of the net guarantee asset and guarantee obligation and widening credit spreads and the lower market prices on our portfolio of delinquent loans. This resulted in a GO that Patti referred to of approximately \$17 billion, which overstates what we expect to become realized credit losses. A more reasonable outcome is \$10 billion to \$12 billion. I think there was a glitch in Patti's

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script when she gave \$10 to \$20 billion. She meant \$10 to \$12 billion. Having given a high level review of our GAAP and fair value results, let me now turn to credit, beginning with slide three. This slide frames the way the Company currently accounts for credit costs. In the upper box, line one is our credit provision, which for the most, part addresses our off-balance sheet single-family credit exposure. Year-to-date, we took approximately \$1.7 billion in provision expense, with the bulk of that recorded in the third quarter. I'll explain that third quarter increase in a minute.

GAAP allows you to provide for incurred losses that have already manifested themselves in delinquencies, as well as an estimate for losses related to credit events which have occurred, such as job loss, that will emerge as delinquencies within the foreseeable future. For us that foreseeable future is one year. GAAP does not allow you to expense your projected ultimate default cost, nor does it allow you to expense future REO cost or lost interest. These are recognized on a "pay as you go" basis. In the lower box is our mark-to-market credit cost. That covers two situations. First, in general, when assets are moved on balance sheet, we record our credit exposure by booking -looking to the market's view of how they would price credit risk for these investments and then booking that. That market price is a much different measure of credit. It not only covers ultimate expected default but also covers REO and lost interest as well as a significantly - a significant uncertainty premium. So that measure has all the potential overshooting issues that Patti covered in discussing the fair value of the GO.

Year-to-date, on line six, we recorded approximately \$2.2 billion of net market write-downs. When we think about the core earnings of the business, we believe a provisioning approach better measures the emergence of credit costs, as opposed to the mark-to-market approach and we will be presenting our results on the provisioning basis in our adjusted GAAP framework. What we presented on this slide is the provision we would have incurred in lieu of these mark-to-market items. On the upper right box, you can see that year-to-date provisioning for these essentially on-balance sheet credit costs would have resulted in an additional provision expense of \$494 million, as opposed to a market price adjustment of \$2.2 billion. For the third quarter stand alone, the additional provision expense was \$263 million, as opposed to a market price adjustment of \$1.7 billion. So adding that on balance sheet provision to our off balance sheet provision generates an adjusted provision, in total, of approximately \$2.2 billion year-to-date and establishes an adjusted gross reserve of \$2.6 billion.

The last mark-to-market item on this page is line eight, which are losses we record when the market's pricing of the value of loan guarantees for an individual pool exceeds the value of the fees. When this happens, we report a loss today and at the same time defer revenue of an equal amount that will amortize into the P&L over time. When amortization is complete, there's a zero impact on results. However, as the market view of credit worsens, initial reported losses have increased, more revenue is deferred and that's what's happening. That said, we don't think of this as an incremental credit cost of credit over the long-term. So I know that that's a complicated explanation but I hope it's clear. In summary, we have taken \$4.6 billion of credit costs year-to-date through our P&L. We believe an adjusted provision of approximately \$2.2 billion is a more reasonable measure of credit costs. On a provisioning basis, our credit costs have gone up significantly in the third quarter and the next two slides get at what's behind this.

We have said in past calls that our 2006 and 2007 books have worse credit attributes than previous year vintages and, right out of the blocks, were hit by negative price declines. As a result, early delinquency and transition rates on these recent books are outsized compared to historical patterns. We have chosen to give credibility to these observed trends and have made a number of changes to our reserving methodology in response. These changes for the 2006 and 2007 books are the biggest driver in our provision increase. On slide four, you can see that our year-to-date charge-offs, which are the most lagging credit indicator, include a small percentage from the '06 and '07 books. However, for our serious delinquencies, the '06 and '07 books account for 23% of the total, which is much higher than historical early performance. We've experienced down cycles before in the credit markets and in hindsight you always wish you would have reacted more quickly. We've done that. As a result, 67% of our adjusted reserve is attributable to our 2006 and 2007 books.

On slide five, we give you a forward look of charge-offs. Remember, at the end of the day, no matter what the bookkeeping method, our credit losses emerge in this charge-off line. The total credit costs in dollars shown here assume that the '08, '09 purchases do not contribute to losses in '08 or in '09. So on line one, you can see charge-offs continuing to rise through the end of the year and end the year at approximately \$350 million. Adding REO expense, that equates to a full-year total credit cost of

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roughly \$500 million or 3 basis points of the portfolio, in line with our expectations. For projecting forward, we are using the less severe realization and severity rates and house price paths Patti referred to earlier, which equate to about \$10 billion of total expected future GAAP credit costs for this book.

For 2008 and 2009, total credit losses grow significantly, rising from 8 basis points in '08 to 11 basis points in 2009. We have not provided the out years, but I can tell you that 2009 is the peak charge-off year for the closed book and then charge-offs start sloping downward. What's important here is that when we think about our adjusted reserve, it's based on our view of the forward-looking charge-offs for incurred losses. You can see here that at \$2.6 billion, our adjusted reserve will cover roughly the next two years of charge-offs. Let me close the credit story on slide six with a discussion of our losses on loans purchased or LIA loans. When we buy 120-day delinquent loans out of our securities, we put them on the balance sheet at the market's view of fair value. We have always used the market's view versus our model's view. And you can see that, as credit conditions have worsened, the market's pricing for these loans have declined dramatically. These prices again reflect the severe market sentiment that Patti discussed.

Down below, we show you what the historical trend has been for the way these loans have played out and roughly speaking, in the past, around 60 to 65% cure, which means they resume payments on the mortgage or they pay it off. Now, the older books did benefit from rising house price paths, so the more recent books could behave worse. But so far, the '06 book looks in line with our long-term experience. Since we started this accounting last year, we have recaptured a cumulative 53% of the total dollar discounts on loans purchased out of the securities during 2006. At this point, we have no reason to believe that the '07 LIA purchases will behave any differently. The last points on LIA are for the roughly 35% of LIA loans that go to foreclosure, one, it takes a number of years to get there, and two, today's LIA prices overshoot the charge-off amount. So let me summarize our credit story. Credit has clearly worsened. We have taken over \$4.6 billion in credit costs year-to-date, which is almost 50% of the \$10 billion we expect to ultimately incur. The mark-to-market items have been extreme. We believe an adjusted provision is the right way to look at credit and our actions there have been responsive to what we have seen and prudent.

Before I turn to capital, let me provide some insight into the fourth quarter. And as Dick said, so far in the quarter, market conditions are working against us. Loan rates have rallied and OAS and credit spreads have continued to widen. So unless market conditions improve, fair value returns will be negative and with no changes in our accounting, our GAAP results will also be negative. At this point, we're projecting fourth quarter performance about in line with the third quarter. Which brings me to capital. As of September 30th, we had \$8.5 billion of capital over the statutory minimum capital, but only \$600 million over the 30% mandatory capital surplus target.

Given the opportunities to deploy capital, and uncertainty of our GAAP results and credit conditions, as well as uncertainties on the relief of the 30%, we are planning on taking several actions to bolster our capital. First, we have engaged Lehman Brothers and Goldman Sachs to help us consider capital raising alternatives in the very near term. Second, we are seriously considering a 50% reduction in our common dividend. These actions, coupled with other management steps, should provide sufficient capital flexibility for us to manage the Company for our shareholders and meet our charter through the balance of this credit downturn. When things return to normal, we are committed to returning the excess capital to our shareholders. With that, let me turn things back to Dick.

Dick Syron - Freddie Mac - Chairman & CEO

Thanks, Buddy. We've given you a lot of information today in context. I just want to leave you with a couple of very short comments that are hopefully straightforward. Our situation is we have a 30% mandatory capital requirement and we are committed to meeting that. At the same time, our accounting is volatile, to say the least. And that drives much of what we have been talking about. Having said that, one, we're taking the challenges that Freddie places extremely seriously, as I know you believe we are, and we're focused on them intensely and, we believe, very realistically. Two, we're putting in place a very active capital management plan that will allow us to manage our business consistent with the needs of the market environment, benefit our shareholders and put this situation behind us. Three, we have identified a clear path to improve our financial results

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and we're moving down that path very aggressively. Clearly, the most important part of this call is your questions and let's turn to those.

QUESTIONS AND ANSWERS

Operator

Great. Thank you very much. (OPERATOR INSTRUCTIONS) And our first question then comes this morning from the line of Paul Miller with FBR Capital Markets. Please go ahead.

Paul Miller - Friedman Billings Ramsey - Analyst

This is a question for Patricia Cook. On the \$17 billion, can you go over the GA/GO write-down? I think there's a lot of numbers thrown out there, that you said that you expect a \$10 billion to \$12 billion of losses, but you've written down that asset by \$17 billion and to realize that loss you would need to double the severity rate which we saw in the early '90s. Could you just go over some of that a little more slowly.

Patti Cook - Freddie Mac - Chief Business Officer

Sure. Although, it sounds like you pretty much got it. The total value of the GO on the balance sheet as of September 30th was \$16.4 billion. All right. That is the -- that is a present value estimate of total future default costs. Now, when we evaluate that number against what we think are some reasonable expectations, call it 3 to 3.5% default and severities 28 to 30%, we would only expect to realize on a present value basis \$10 billion to \$12 billion of that \$16 billion. And even that, I want to put it in historical context and say the 3 to 3.5% default and the 28 to 30% severities are high numbers. They are much higher than our 1991 book of business realized.

Having said that, if we are right about that number, the 10 to 12, it means the difference, the 16.4 minus that number, would accrue back to us in the form of income or increased fair value over time. I want to go a step further and say that behind the 3 to 3.5% defaults are pretty significant house price declines, call it peak to trough nationally of something like 5 or 6% and various regions that are experiencing some deterioration in house prices, lows of 25 to 30%. So I hope that's helpful.

Paul Miller - Friedman Billings Ramsey - Analyst

And just one quick follow-up. You know, 5 to 6% national decline, what if we get 10% declines? I mean, is that what's factored into that \$16 billion number?

Patti Cook - Freddie Mac - Chief Business Officer

You know what? Rather than think about it from just a house price decline, because there's a lot of ways to nuance the house price decline, after would be if you thought a 10% national house price decline led to 4 to 5% defaults and 30% plus severities in our conventional conforming space, then you could realize \$16 billion. So I would encourage you to connect the house price outlook with what you think that means in terms of default and severities and, to put it in historical context, go back and look at what Freddie experienced with their 1990, 1991 book of business.

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Paul Miller - *Friedman Billings Ramsey - Analyst*

Okay. Thank you very much, Patricia.

Dick Syron - *Freddie Mac - Chairman & CEO*

This is Dick Syron. Can I just add quickly onto this. There's a lot of housing price decline numbers thrown around. There are four major different indices that we use. In - the index that we're using tends to understate compared to other areas. In other words, it would be worse, if you were to put it in the same basis as other indices, because it's a repeat sales index that has to do with the space that we sell in. So it's important to understand that and it has no jumbos in it.

Paul Miller - *Friedman Billings Ramsey - Analyst*

Okay. Thank you very much.

Operator

Thanks. And we have a question then from the line of Gary Gordon with Portales Partners. Please go ahead.

Gary Gordon - *Portales Partners - Analyst*

Okay. Thank you. Just the definitions of these accounting charges are mind-boggling. But on page three, credit-related items, the second and third items, losses and loans purchased and PC residuals, maybe you could just add a little color to what they are. I understand on new business charges in line eight, what are two and three?

Buddy Pizel - *Freddie Mac - CFO*

Losses on loan purchase is what I referred to as the LIA loans. And these are situations where we purchase a delinquent loan, greater than 120 days delinquent, out of the portfolio and put it on the balance sheet at the market's view of fair value. The next line, which is the PC residual, that's a big number and this gets to the current accounting model, where when we -- if we have an off-balance sheet guarantee, we're provisioning for it. If we buy that security, so we buy a Freddie security and put it on our balance sheet, we stop provisioning and we mark the credit to market. So it has the same measurement underpinnings as the GO that Patti just spoke to and creates a much more radical view of the measurements of credit.

Gary Gordon - *Portales Partners - Analyst*

Okay. Following up on then line eight, losses and certain credit guarantees, basically as we speak, you put on new business, you take a hit to earnings and therefore to capital.

Buddy Pizel - *Freddie Mac - CFO*

Right.

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Gary Gordon - Portales Partners - Analyst

You've just re-priced a lot of your product. If we're looking at the fourth quarter, has the re-pricing - considering where credit spreads have changed, has the re-pricing allowed you to offset this or do you basically continue to lose business - lose money every time you add a new piece of business.

Buddy Pizel - Freddie Mac - CFO

Remember, this is a timing difference. When we book that loss today, I defer more income and amortize it. So it does stress our GAAP capital but it's not a long-term capital issue for the Company. Secondly, the price increases that we have announced go effective in April. So you really won't see the improvement on the day one difference for new purchases until that point in time. We think that those price increases will tend to mute some of the day one loss. It also depends on where the markets are pricing credit at that point in time, because we use the markets to price that day one difference.

Gary Gordon - Portales Partners - Analyst

Okay. I guess the reason it's of issue today is, as you put on new business, you lose money and now you've got issues with capital, potentially cutting the dividend, having to raise capital. So there would be I think a trade-off, as we speak, of do I go out and raise new equity or do I do that next piece of business. And how would you think -- how are you making these -- thinking about these trade-offs.

Buddy Pizel - Freddie Mac - CFO

See, unfortunately, the way this is done, the -- we would contract with one of our originators in total and we know in total that that business is profitable. But in the way they deliver individual pools, our accounting has to react to individual pools, even when in total there's a profitable overall contract. So it's unfortunate the way the accounting model works, but we don't see it as a trade-off in doing new business because we can, at this point, determine which of these pools are delivered with a gain and which are delivered with a loss.

Gary Gordon - Portales Partners - Analyst

Okay. So you just literally just have to take the new business, even if it means being forced to raise capital to finance it?

Patti Cook - Freddie Mac - Chief Business Officer

One thing I would add about it, I mean, we believe that the long-term returns on the G-fee business are attractive. And to echo some of Buddy's discussion, we are looking at ways to mute the effect of that day one difference.

Gary Gordon - Portales Partners - Analyst

Okay.

Patti Cook - Freddie Mac - Chief Business Officer

So the way we would actually pool those loans into securities.

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Gary Gordon - Portales Partners - Analyst

Okay. Thank you.

Operator

Thanks. Our next question then comes from the line of Mike Nannizzi with Bear Stearns.

David Hochstim - Bear Stearns - Analyst

Hi. It's actually David Hochstim. Could you just address the idea that you're briefly suffering from wider credit spreads through reductions in GAAP capital. You can't take advantage of those wider spreads fully because your capital has been eroded, so you can't buy those high return assets. And yet, you've got \$8.5 billion of surplus capital above the statutory minimum. Why isn't the best thing for shareholders to get relief from that arbitrary 30% cushion that the regulators impose. You're virtually compliant with the agreement. In fact, you've been in compliance with the written agreement you had in June. So why shouldn't there be some adjustment to that supposedly temporary capital restriction?

Dick Syron - Freddie Mac - Chairman & CEO

Well, David, you have addressed a very key issue, obviously, and the issue you have addressed has underneath it that we have the opportunity now to put profitable business on the books, but we're constrained by capital. And that is a major factor. Look, I mean, we don't think this is very pleasant thing to say, what we're doing here, in terms of major capital actions, considering dividend reductions. But we wouldn't be doing it unless we thought we were going to make money on it. And that's the motivation for it. With respect to the 30% itself, the 30% is the decision of the regulator. This is, as you know, the GSE sector as a whole, a highly regulated business and they're the ones that have to determine that.

Now, looking forward, we are making strong progress towards our compliance plan. As our compliance plan is completed, and we have a 60-day time frame on that, we would expect -- and we get some other things done -- to become more aggressive and we do expect to get the 30% back over time, which will obviously both give us more opportunities and put us in a situation where the capital that we have raised now won't be as necessary to hold onto.

David Hochstim - Bear Stearns - Analyst

Okay. Follow-up question for Buddy. Your guidance on the fourth quarter looking similar to the third quarter from a GAAP earnings standpoint, does that suggest that some of the accounting changes that you have talked about implementing, that would reduce some of this GAAP noise and distortions in capital, won't be effective for the fourth quarter or could they be and that would kind of help diminish the effect of this?

Buddy Pizel - Freddie Mac - CFO

They may well could be, David, and we're doing everything that we can to get those implemented and they would certainly mute things and probably the biggest thing they would mute is that PCR mark that we take which is in effect the GO mark for the on-balance sheet Freddie securities. We're trying to do a number of things. But we're trying to do everything and we don't want to make a commitment at this point that we can deliver all of it. So my guidance was on the same basis as we reported third quarter. Fourth quarter would look the same. We're working to get the accounting changes. If we do, the fourth quarter will improve.

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Operator

Our next question comes from the line of Howard Shapiro with Fox-Pitt Kelton. Please go ahead.

Howard Shapiro - *Fox-Pitt Kelton - Analyst*

Hi. I just wanted to follow up on David's question and ask you point blank, did you go to OFHEO and ask for relief on the 30% capital surcharge? You are proposing to dilute shareholders, so please don't tell us that it's a question you do not want to answer on a public call.

Dick Syron - *Freddie Mac - Chairman & CEO*

Well, we respect and abide by our regulators, which isn't how we deal with these things. We have had discussions with them on the 30%. That obviously is a key issue and I would expect that we would be having those discussions as time goes forward.

Howard Shapiro - *Fox-Pitt Kelton - Analyst*

Did they say no?

Dick Syron - *Freddie Mac - Chairman & CEO*

You can interpret the answer, I think.

Howard Shapiro - *Fox-Pitt Kelton - Analyst*

So the regulators said no. Okay. Great. Next question. I guess it would be for Patti. On your subprime exposure, the securities where you've got somewhere between 29% and plus subordination, can you tell us how those securities might differ from the subprime collateral that's in the marketplace as a whole, specifically the subprime collateral that's in the ABX index, that's marked at substantial discounts to par?

Patti Cook - *Freddie Mac - Chief Business Officer*

Sure. The biggest difference between our subprime ABS and the ABX index is around the average life of the securities. So the ABSs that back the ABX index are much longer and that has several implications. The first of which, as spreads widen, the DVO1 is greater so the price goes down harder. And maybe more importantly, they don't benefit like we do on the increased subordination and the early cash flows going to increase the subordination of the shorter ABSs that we own. That's the primary difference.

Howard Shapiro - *Fox-Pitt Kelton - Analyst*

Okay. Great. Thank you very much.

Operator

Thanks. Our next question then comes from the line of Eric Wasserstrom with UBS. Please go ahead.

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Eric Wasserstrom - UBS - Analyst

Thanks. Just to circle back to some of the things that have been said, I mean, given that there's a very, very high likelihood that the trends we have seen so far through the quarter will cause you to violate the 30% excess capital standard in the absence of any other exogenous factor, could you help us prioritize what course of action you would take and put some magnitude around that?

Dick Syron - Freddie Mac - Chairman & CEO

Well, at the time the 30% was first put into place, it was put into place with the idea that this is something that one could go through and then come back above and manage on an average basis. So we are not handling this on the basis of, gee, we want to avoid being 29.98% at the end of one month. But our cushion -- and as you know, we have talked about this extensively and our regulator has commented on it extensively, the need for a cushion above the 30% is sufficiently thin now, that when you combine that with the opportunities that would be foregone, not to be undertaking business, we think the course that we're considering and discussing with our directors on capital is the right one. One quick point. All right? There are two basic approaches we could take now. We could sort of go to fortress Freddie, shrink the business, which I don't think would be in the interest of the shareholders and certainly not in our interest of our obligation, statutorily under our charter to the U.S. mortgage market, but we could do that. We could not do anything on stock and just shrink the business and wait for it through. Or we could take these actions, which we think are consistent with the best interests of the mortgage market, and with the interest of the shareholders and do it quickly, get in front of the situation, and do it with a magnitude that we think we can get behind us.

Eric Wasserstrom - UBS - Analyst

Okay. And in terms -- I mean, given that the -- I mean, Dick, I respect that and I understand that. I'm just trying to get a sense.

Dick Syron - Freddie Mac - Chairman & CEO

I'm sorry if I'm too intense about it.

Eric Wasserstrom - UBS - Analyst

I can understand why. But I guess given that the dividend cut is actually in the scheme of things a very small number, I'm trying to get a sense of how else you would prioritize the actions and what the potential magnitude of them could be?

Dick Syron - Freddie Mac - Chairman & CEO

You know, we have -- I think we have indicated we're talking about doing things in the preferred space. Okay? We have not talked this fully through with our Board. We have obviously talked to our Board, but we haven't gone through the full governing process in a formal sense. So in all due respect, I don't want to get too precise about this. Let me put it this way. We are -- we're not happy about this. We don't expect you to be happy about this. But we are trying to do this in a way that's either least worst or most friendly to our existing common shareholders.

Eric Wasserstrom - UBS - Analyst

All right. Thanks very much.

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Operator

Thank you. We have a question then from the line of Moshe Orenbuch with Credit Suisse.

Moshe Orenbuch - *Credit Suisse - Analyst*

Thanks. I guess I was trying to understand the context of how we should think about the potential from write-downs in the fourth quarter and it wasn't clear. You said similar size to the third quarter, but are they driven by the same factors and do those abate in the first quarter then? Presuming that the two factors, number one, that home price declines are continuing and both the rate of increase in delinquencies is continuing, it would seem that that would continue. And also, could you address whether the subprime securities will have to be written down through earnings on an other than temporary impairment basis and how that would affect the capital that you would need to a raise.

Buddy Pizel - *Freddie Mac - CFO*

Moshe, let me take that in two pieces. On the credit side, if you think about our reserve covers about roughly two years out of charge-offs and we said that beyond '09, charge-offs start to decline. Assuming that our house price path and assumptions hold, you would have some decline of the provision that would start to happen. And it really depends on what those out-year charge-offs look like. But it would, based on the way we're looking at things, as '10 and 2011 decline, the provisioning will be declining also. In regards to the marks that we're taking, there's two factors there. How much gets purchased out of the portfolios and at what price. And that's the biggest wild card in trying to project forward. So we're assuming for the fourth quarter purchases are going to continue to rise and prices are going to be holding.

They're not going to be going up. Now, the other factor is the reversal of the pro -- of the markdowns we've already taken for LIA. You can see that's starting to play into the results and again it's the pace at which LIA performance unwinds and those are the three determining factors. So that would imply that '08 would continue to be a difficult credit year. It's hard to estimate at this point relative to '07 where that will be. And then things should clearly abate when we get to 2009.

Patti Cook - *Freddie Mac - Chief Business Officer*

I want to add on the subprime, in terms of impairments, because of the view, it's our expectation that we don't realize losses on that portfolio. We therefore don't need to impair them.

Buddy Pizel - *Freddie Mac - CFO*

Right. We can tell you, Moshe, we've done significant cash flow testing. We've actually got very little of the portfolio that even gets into the impairment calculation because it has to go below \$0.90 on the dollar before we would consider it for the impairment. For the little bit that's gotten there, it's roughly \$150 million, there are no losses that we would expect taking.

Moshe Orenbuch - *Credit Suisse - Analyst*

That 90% is a Freddie Mac policy? It's not consistent with the way I understood it.

Buddy Pizel - *Freddie Mac - CFO*

That is our internal policy, that before we consider things for impairment, especially because we hold our portfolio, it has to move below 90% and then we're subject to whatever the cash flow test would indicate, whether there's a loss to be realized.

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Moshe Orenbuch - *Credit Suisse - Analyst*

Okay. Thank you. And in terms of -- I guess just to get -- concentrate back on the first part then, because it doesn't seem like it would flip completely around by the first quarter. It would seem that there's going to be additional -- in other words, the capital plan is going to have to encompass more than just the loss in the fourth quarter.

Buddy Pizel - *Freddie Mac - CFO*

Our capital plan does contemplate a difficult credit environment in our reported results for 2008. This does not abate in the first quarter of 2008.

Moshe Orenbuch - *Credit Suisse - Analyst*

Okay. Thanks.

Operator

Thank you. Our next question then comes from the line of Robert Lacoursiere with Banc of America Securities. Please go ahead.

Robert Lacoursiere - *Banc of America Securities - Analyst*

Yeah, I just wonder if you could just help me understand how you come up with these -- the valuations for the LIA loans. There's obviously not a market. So what are you using, like a level two approach and where do you get the inputs from?

Patti Cook - *Freddie Mac - Chief Business Officer*

Actually, we do get LIA marks from the street and you're right, and part of that is probably reflected in the price. It is an illiquid market. It's certainly not trading as many of the other securities that we own trade. But we do go to the street for an independent mark.

Robert Lacoursiere - *Banc of America Securities - Analyst*

But they never actually trade. You don't actually sell these things, right. You're just asking them to quote you a figure, right.

Patti Cook - *Freddie Mac - Chief Business Officer*

Right. You're on to a good point, Robert. Because I think the same thing is in evidence when we price the overall GO. You know, if you think about it, our -- the mortgages that we're guaranteeing in our G-fee business really don't trade in securitized -- in a triple-A senior sub sort of structure. So even there, the fact that we take that structure, we go to the market and we ask for a price on something that really doesn't trade I think supports the notion that the uncertainty in the credit risk premium that's embedded in those marks is likely to overshoot in a cautious credit environment.

Robert Lacoursiere - *Banc of America Securities - Analyst*

That is precisely my point. I'm wondering why you have to rely on those quotes when there's no market. Why can't you do a level three approach and put your own assumptions in like other institutions do?

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Patti Cook - *Freddie Mac - Chief Business Officer*

This is -- you want to take it?

Buddy Pizel - *Freddie Mac - CFO*

We have been there in the past and the feedback that we have received from our auditors is the market is a more reliable source of pricing and accordingly, even in thin markets, that should be our first line of defense, whether it contradicts our models or not. And we have -- since we made this change, we've only looked to the market wherever possible and we've always been able to get market prices. Whether we like them or not, they are out there. And if they're out there, we're using them to measure. Because the accounting literally says that you're suppose to use -- that what someone would pay you to take the obligation off your hands and if there's a market price out there, that is an indicator of the price that you would have to pay to have it taken off your hands.

Robert Lacoursiere - *Banc of America Securities - Analyst*

If I could just bother you with one follow-up, if they're quoting -- if these institutions are quoting you those prices, are they not obligated to reflect those valuations on their own positions on their own books?

Buddy Pizel - *Freddie Mac - CFO*

That's an interesting question but we're not going to go there.

Robert Lacoursiere - *Banc of America Securities - Analyst*

Thank you.

Operator

Thanks. Our next question comes from the line of Fred Cannon with KBW. Please go ahead.

Fred Cannon - *Keefe, Bruyette & Woods - Analyst*

Oh, thanks. A follow-up on a couple of issues. One is when you said earlier the results in the fourth quarter would be in line with the third quarter, does that include the fair value loss that we saw in the third quarter? Are you projecting a similar fair value decline in the fourth quarter?

Buddy Pizel - *Freddie Mac - CFO*

It's hard to project. I mean, the month of October was not a good month when that closed out. The fair value results are highly subject to where the mark is at the end of the quarter. Through November, things haven't improved much as far as credit spreads or where OASs have gone. So this assumes that nothing improves. If nothing improves, it may not be as bad as the third quarter, but it's not going to be pretty.

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Fred Cannon - Keefe, Bruyette & Woods - Analyst

Okay. So it could be again a \$10 or so hit. Just a follow-up too. Obviously, a number of us are trying to get a handle on the size of the capital raise. And I know it's difficult for you guys to discuss that directly. I was wondering, though, in terms of just my math, if I'm off in magnitude. I was thinking that if we have a similar loss and you don't get the accounting change in the fourth quarter, you had about \$600 million over your 30% cap number. If you had a \$2 billion loss, you would probably want to make that up and then add another \$1 billion or so for potential growth. So would I be off in a huge magnitude if I was thinking in the \$2 billion to \$4 billion in terms of the capital needs of the Company.

Buddy Pizel - Freddie Mac - CFO

Let me just say a couple things without giving you a number, Fred. We are looking to raise capital to get beyond the first quarter, really to get through '08 and to the end of the credit cycle. And secondly, this will be a large transaction. Third, we're not looking to do common. And fourth we will be doing something, assuming our board supports it, in the very, very near term.

Fred Cannon - Keefe, Bruyette & Woods - Analyst

Okay. Great, thanks very much. I know you can't say exactly. So that's helpful.

Operator

Great. Thank you. Our next question then comes from the line of Brad Ball with Citi. Please go ahead.

Brad Ball - Citigroup - Analyst

Thanks, Buddy. I just had a follow-up on the question about your reserve relative to your guidance. So you're looking for 8 basis points of losses in '08, another 11 basis points in '09 and it peaks in '09. You've got \$2.6 billion of reserves today and you're projecting something like \$2.9 billion of losses over that time frame, the '08/'09. On that basis it looks like there isn't a significant need for increased provisioning or is there? Where am I wrong? At the end of '09 when credit begins to improve, what level of reserving do you expect to hold into the future? In other words, what do you expect your normalized loss rate to be, could we get back to the sort of mid single digits or do we get back as low as 3 basis points? Thanks.

Buddy Pizel - Freddie Mac - CFO

Remember the way this works, Brad, is you are provisioning based on a forward look of incurred losses. So you're right, at this moment the reserve covers most of the '08/'09 charge-offs. But as we're provisioning on a going forward basis, we're looking into 2010 and those charge-offs will be coming down on a going forward basis. And so that would imply that, assuming that our assumptions are right, our provisioning would be going down accordingly. So that's the way that works. I think I -- I believe I said that we're trying to cover in total some \$10 billion of total credit costs that could go through the GAAP numbers. So if we provided right now with the mark-to-market, we've gotten a long way there. A think we're almost 50% of the way there already through this year. But on a provisioning basis that will emerge over time, something on the six to seven years.

Brad Ball - Citigroup - Analyst

Yep. And what about normalized loss rates?

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Buddy Pizel - Freddie Mac - CFO

Normalized loss rates, as we get through the rest of this, should return to something in the 4 to 6 range, than 3. If you look back historically, we were expecting about 4 to 6, and assuming stable times, what we're realizing is what we would be provisioning for and that's the way to think about the business.

Patti Cook - Freddie Mac - Chief Business Officer

One thing to add and remind ourselves, when we talk about the 10 to 12, that includes REO expense and lost interest. And not just charge-offs.

Brad Ball - Citigroup - Analyst

Okay. Thank you.

Operator

Thanks. Our next question then comes from the line of [Vivian Wang] with Morgan Stanley. Please go ahead.

Ken Posner - Morgan Stanley - Analyst

Hi. It's actually Ken Posner. I wanted to ask a clarifying question about the 30% capital surcharge. Rationale for that surcharge has to do with a variety of operating and control issues. And I'm wondering if you can give us sort of a punch list of things to be checked off at which point -- I know you can't speak for OFHEO, but at which point you could go to OFHEO and say we have corrected everything that you have pretty much pointed to.

Dick Syron - Freddie Mac - Chairman & CEO

Well, we know that the critical things that are on the path are the -- getting back the timely reporting, which we keep on closing the distance every quarter, we're pleased that we got this quarter out in the time frames that we have and we've been taking that time in every quarter. Year-end, we will be on time and we will be trying to continue -- we will be continuing that in 2008. So timeliness is one. Secondly, it's remediating our material weaknesses and that goes with the execution of the comprehensive plan. We're in good -- on track to have substantial remediation of our material weaknesses and our significant deficiencies by the end of the year. It will take a little time I think for someone to observe that, in fact, these are working as well as we would assert. But we are on track to get the bulk of this done by the end of the year.

The third is becoming an SEC registrant. We said that we would be a SEC registrant by mid-2008. We have actually started the engagement with the SEC, as we speak. Those are three clear points. There could be a question -- clearly, the regulator has discretion here and we have not gotten a clear statement that if you do these things, the 30% comes off. So we are in discussions about what other considerations could be made. But at least those three points, without getting those done, we know that there's really no discussion.

Ken Posner - Morgan Stanley - Analyst

Thank you.

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Operator

Thanks. Our next question then comes from the line of Bruce Harting with Lehman Brothers. Please go ahead.

Bruce Harting - *Lehman Brothers - Analyst*

I guess I'm not completely clear on the difference between, Patti, what you were talking about on the GO markup in terms of expectations and the assumptions underlying that at say, 4 to 5% versus the more realistic scenario and then overlaying that on top of the language, the graph on 11% -- 11 basis points of loss. So is the 11 basis points out to '09 the actual cash incurred loss and the GO is more of a marking process that will be realized over time or is one a component of the other? And then, in the exercise we try to do each quarter in reconciling GAAP to operating, I'll leave some of those alone, but it sounds like if OAS, which is sort of gapped out here from, say, 30, 40 basis points to almost 70 in the space of the last quarter, continues to worsen, that will obviously impact fourth quarter. But at some point in say '08 or '09, will there be a windfall as OAS tightens, where the GAAP numbers will be going dramatically in the other direction on both the OAS adjustment, as well as the guarantee obligation adjustment that you're talking about?

Patti Cook - *Freddie Mac - Chief Business Officer*

All right. We're going to go backwards and answer the OAS question first. You know, there are two observations about the substantial widening in OAS. One is, we start to realize, if you will, core spread income over the retained portfolio at a much higher rate when the whole portfolio's marked at 70 basis points versus 30. That in-and-of itself gives you more cushion, if you will, around subsequent widening.

So for example, if you had a 40 basis point widening this year and it resulted in X amount of fair value loss, a 40 basis point widening next year on much higher core spread income has a very different outlook. So my point would be, even if spreads just stayed the same, you have the wind at your back from a fair value perspective. Now, if you're right and the market were to correct, then you would have -- you referred to it as a windfall. You would have a substantial mark-to-market gain in fair value that would support returns from that perspective.

Buddy Pizel - *Freddie Mac - CFO*

But the OAS widening has a less impact on the GAAP results. Because GAAP is a (inaudible) -- it deals with a different emergence of profits. It's not as big a driver and you don't get a windfall in the way GAAP emerges compared to fair value, if in fact, OAS is starting to tighten. Bruce, I think the question on how do you toggle between the GO conversation and the table that we showed on expected defaults, I think you're right when you say that the expected defaults are a component of the GO. We're using in underlying data the same expected defaults emerging in the measurement of the GO base cap of \$10 billion to \$12 billion as we reflected on this table. But the difference is that when you measure the GO, you're running out through the end of time and then you present value it.

The other two elements that the GO has in it is an REO cost which again goes through measured out in time and present valued and it also has lost interest, which is strung out and PV'ed. So the numbers are by themselves different, but if you call Ed Golding, he can walk you through that, because we are able to move between the two models at this point and the information we disclosed is a subcomponent of the GO.

Ed Golding - *Freddie Mac - SVP of IR*

Next question, please.

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Operator

Great. Thank you. Your next question comes from the line of Claudia McPherson with HSBC.

Claudia McPherson - HSBC - Analyst

Good morning. Thank you for taking my call. I'm trying to figure out what all the news that's in the press right now around bond insurers and mortgage insurers and the potential for downgrades and then just negative readings, pressure on these types of companies. Can you help us understand what a downgrade or a potential failure of a company like this would mean for Freddie Mac and around what kind of capital call would you face, maybe charges and then just give us the sense of the impact of just downgrades versus maybe an absolute failure of a company. Thank you.

Ray Romano - Freddie Mac - SVP, Credit Risk Oversight

Yes. This is Ray Romano. Let me first say that we aggressively manage our counterparty risk and have a long track record of being proactive in managing these risks. Having said that, we have examined all of our mortgage insurance providers as well as our financial guarantors on an individual basis and on call. And we are comfortable with our exposure to these sectors. At the same time, we do have within our tool chest, at our disposal, ways in which we can manage those risks and we have executed on that throughout 2007. We'll continue to do so to manage that exposure.

Operator

Did you have any further questions?

Claudia McPherson - HSBC - Analyst

Can you give us a sense of what exactly are these tools that you're utilizing?

Ray Romano - Freddie Mac - SVP, Credit Risk Oversight

Yes, so for example, in some of the financial guarantors, we have actually taken proactive steps to receive premium payments or recoveries now, versus expected losses at some time in the future for weaker identified counterparties. And that's just some examples. We do have other tools as well. We maintain a very aggressive set of standards for all of our mortgage insurance providers. We're very clear what happens in the event of a downgrade and what actions we could take, such as requiring a plan for returning to a healthy position, measuring their remediation progress and also impose other restrictions to firm up their capital positions.

Claudia McPherson - HSBC - Analyst

Okay. Thank you.

Operator

Thanks. Our next question then comes from the line of George Sacco with JPMorgan. Please go ahead.

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George Sacco - JPMorgan - Analyst

Hi. First, with regards to the loans purchased from your PCs, do the market values reflect credit enhancement you purchased on those loans?

Buddy Pizel - Freddie Mac - CFO

I do not believe so.

George Sacco - JPMorgan - Analyst

Okay.

Buddy Pizel - Freddie Mac - CFO

That's a straight price.

George Sacco - JPMorgan - Analyst

Okay. And so mortgage insurance, any pool insurance that you may have purchased would actually be an offsetting recovery against some of that at some point.

Buddy Pizel - Freddie Mac - CFO

Yes.

Ray Romano - Freddie Mac - SVP, Credit Risk Oversight

Yes. I would just add also, we have other contractual obligations associated with our purchasing of loans. So those are also available.

George Sacco - JPMorgan - Analyst

Okay. And just a second question, as relates to the accounting changes you talked about, the different things you're looking at to potentially smooth out the GAAP earnings a little bit, is there -- are any of these changes contingent on a trigger event such as SEC registration or, in theory, could you implement all of the changes you're looking at as soon as you had the systems in place and are comfortable that you're prepared to do it.

Buddy Pizel - Freddie Mac - CFO

Well, it's a mix. Some of the changes we would be able to do because we think they're clearly preferable and that's the guideline for making a change. Some of them we think are -- we're doing more for comparability and ease of understanding of the results and they do require approval and permission by the SEC and we have begun that dialogue with them.

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George Sacco - JPMorgan - Analyst

Okay. And would you be applying or have you at least had discussions about applying any of these changes retroactively or (inaudible) prospective.

Buddy Pizel - Freddie Mac - CFO

The changes -- yes, the changes that we would be making, if we're successful, would be applied retroactively so that we would have a consistent comparability of future results against historical results.

George Sacco - JPMorgan - Analyst

Great. Thank you.

Operator

Thanks. Our next question then comes from the line of Thomas Mitchell with Miller Tabak. Please go ahead.

Thomas Mitchell - Miller Tabak - Analyst

In sort of marking this out, I guess one way to look at your loss provision for the third quarter was that you were getting ahead of the curve and you put up a 25 basis point provision. Just in the short term, in the next two or three quarters, can we expect you to continue trying to push to get ahead of the curve or would we expect the provision to move closer to the actual expected losses that you described of 8 and 11 basis points in 2008 and 2009?

Buddy Pizel - Freddie Mac - CFO

Well, I wouldn't say we were pushing to get ahead of the curve. What we were doing is responding to what we have observed in the '06, '07 book. So there was in the current provision a certain amount of catch-up for the '07 book and the '06 book, as we changed the way our methodology responded to the emerging trends. So we would not expect in the next quarters to be, again, making further tightening. Because I think we've tightened as much as you are allowed to go in giving recognition to what your observable patterns are. As far as the long-term 8 to 11 basis points, the provisioning generally will lead your default costs so we're not going to give guidance yet as to when that will occur and at what degree it will occur in '08, but in general, provisions are going to come first, defaults are going to come second.

Thomas Mitchell - Miller Tabak - Analyst

And then in terms of this immediate mark-down kind of business, is there any sense that you have -- I'm trying to think how to phrase it. Are there any mechanisms in the marketplace that indicate to you that that changes any time soon? And then the second question goes to this other thing about OAS, if treasury bond yields stay the same, they just stop moving, and if the OAS stops moving, then all these marks go away. Is that true or not?

Patti Cook - Freddie Mac - Chief Business Officer

Actually, there's two aspects, two answers, whether you're talking about GAAP or fair value. In GAAP space, because of mark-to-market, there is an interest rate component to our GAAP results that doesn't have any economic component and you're right, if rates didn't change, it would eliminate that volatility from GAAP. On an option-adjusted spread basis, the fair value

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change is a direct function of those changes in OAS. A one basis point change in the overall portfolio could be as worth as much as \$300 million plus. So stabilization in both interest rates and in spreads would mute the volatility of both GAAP and fair value in different ways.

Thomas Mitchell - *Miller Tabak - Analyst*

Thank you.

Ed Golding - *Freddie Mac - SVP of IR*

Operator, can we take two more questions, please.

Operator

Certainly. The first of those two will be from the line of Paul Miller with FBR. Please go ahead.

Paul Miller - *Friedman Billings Ramsey - Analyst*

Yeah, thank you very much. I know a lot of you have been talking about these credit spreads widening out. We know in the fourth quarter, it's just getting worse. But do you think that that after the new year that these credit spreads are starting to come back? Is a lot of this -- you hear a lot of these \$400 billion of SIV assets sitting out there, that there's a buyer strike out there relative to anybody buying any of these assets. Can you just give some market color on where do you think credit spreads are going to go into the new year?

Patti Cook - *Freddie Mac - Chief Business Officer*

If I had a crystal ball and I could speak to that conclusively we would all be in sort of great shape. You know, if you look at where spreads are today and how wide they are and how far they've moved, I mean, I know I'm an optimist but I would certainly hope that we would see some stability as we begin the new year. Having said that, though, if house prices were to continue to decline and capital for a lot of large financial institutions remains dear, it's hard for me to put my finger on when the turnaround actually occurs.

Dick Syron - *Freddie Mac - Chairman & CEO*

Paul, this is Dick, just a quick addition to what Patti says. We purposely have as a policy in the Company that we do not try to engage in any element of a market timing.

Paul Miller - *Friedman Billings Ramsey - Analyst*

Okay. And then in the other -- the other question I had in these OAS spreads that are -- I think you published in the graph on your table that it's 60 to 70 basis points. You also talked about your NIM almost doubling in the quarter. What's the new product you're bringing on? Are you getting close to 100 basis points now on new product that you're able to bring onto your books?

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Patti Cook - Freddie Mac - Chief Business Officer

That's a good question. The OAS in the portfolio in part reflects substantial widening on the triple-A asset-backs backed by subprime that we have alluded to several times in the call. Unfortunately, because of those wide spreads, not much is being originated. So at the margin, our ability to add those types of securities to the portfolio really does not exist. Having said that, there was one trade that we did in the third quarter that took advantage of those spreads. But maybe more importantly, even on the agency side, we're seeing enough widening in option-adjusted spreads that the returns to deployed capital into that market are very attractive.

Paul Miller - Friedman Billings Ramsey - Analyst

When you say attractive, can you just give me a feeling on the agency stuff, where can you put the new stuff on?

Patti Cook - Freddie Mac - Chief Business Officer

From an economic perspective, ROEs that are above our long-term expectations.

Paul Miller - Friedman Billings Ramsey - Analyst

Okay. Thank you very much.

Operator

Thanks. And our last question then comes from the line of Howard Shapiro with Fox-Pitt Kelton. Please go ahead.

Howard Shapiro - Fox-Pitt Kelton - Analyst

Hi. Dick, I was wondering if I could ask you maybe a more general question on kind of the implications of all this for the mortgage market. You've sold almost \$50 billion of your portfolio into the marketplace in the last two months, which, by my understanding means that's \$50 billion less of liquidity available for borrowers out there. If you couldn't raise money or if it was too expensive to raise money or if you were growth constrained in general, what would you say the general implications are for the downturn we're seeing in the mortgage market right now?

Dick Syron - Freddie Mac - Chairman & CEO

Actually, you raised a very, very important point that's kind of dear to my heart as an exFed person and regulator. Clearly, it is not productive in this market for the mortgage markets or the macro economy for us to be selling into the markets. And I think that's implicit in your question. And that is why we have made the decision, painful as it may be, that we want to be able to both satisfy our shareholders, more satisfy, and to address our charter responsibility to provide stability and liquidity. Given the capital requirements we have, the only way we can do that is not by necessarily shrinking the organization, but by going out and taking the steps that we'll be talking to you about in the almost immediate future and being able to be a valuable contributor to the market.

Howard Shapiro - Fox-Pitt Kelton - Analyst

Thanks.

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Dick Syron - *Freddie Mac - Chairman & CEO*

Let me just finish my saying, look, this is a very, very difficult time. These are not -- this is not happy news. We realize that. But let me finish on this note. We will work through this. We have a difficult situation in front of us. But we are confident and we're committed that we can work through it in a way that benefits both our shareholders and our mission for the mortgage market in the U.S. economy and thank you very much for all the time that you've taken.

Operator

Thank you.

Ed Golding - *Freddie Mac - SVP of IR*

Operator, if you could give us the replay number, please.

Operator

I certainly can. Thank you. And ladies and gentlemen, this conference will be available for replay starting today, Tuesday, November 20th at 1:30 p.m. eastern time and it will be available through Monday, December 3rd at midnight eastern time. You may access the executive playback service by dialing 1-800-475-6701 from within the United States or Canada or from outside the U.S. or Canada please dial 320-365-3844, and then enter the access code of 891911. That does conclude our conference for today. Thanks for your participation and for using AT&T's executive teleconference. You may now disconnect.

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