

# Freddie Mac

The selected financial data for Freddie Mac (or the "corporation") included in this Supplement should be read in conjunction with the Consolidated Financial Statements and related notes appearing in the Information Statement. Freddie Mac is a federally chartered corporation and its securities are exempt from registration under the federal securities laws.

## FIVE-YEAR SELECTED FINANCIAL DATA

	At or for the Nine Months Ended September 30,		At or for the Year Ended December 31,				
	2001	2000	2000	1999	1998	1997	1996
(dollars in millions, except per share amounts)							
<b>Operating Data(1)</b>							
Operating earnings	\$ 2,301	\$ 1,884	\$ 2,547	\$ 2,223	\$ 1,700	\$ 1,395	\$ 1,243
Operating earnings per common share — diluted	\$ 3.07	\$ 2.51	\$ 3.40	\$ 2.96	\$ 2.31	\$ 1.88	\$ 1.63
Operating return on realized common equity(2)	23.4%	23.1%	22.9%	23.8%	24.6%	23.4%	22.7%
Operating revenues	\$ 4,125	\$ 3,298	\$ 4,457	\$ 4,055	\$ 3,337	\$ 3,029	\$ 2,875
<b>Reported Data(3)</b>							
<b>Balance Sheet</b>							
Retained portfolio(4)	\$ 470,850	\$ 361,624	\$ 385,693	\$ 324,443	\$ 255,009	\$ 164,421	\$ 137,755
Total assets	\$ 571,907	\$ 433,346	\$ 459,297	\$ 386,684	\$ 321,421	\$ 194,597	\$ 173,866
Debt securities, net	\$ 531,312	\$ 406,794	\$ 426,754	\$ 360,581	\$ 287,234	\$ 172,321	\$ 156,491
Total liabilities(5)	\$ 553,812	\$ 419,566	\$ 443,865	\$ 374,602	\$ 309,978	\$ 186,154	\$ 166,271
Summary of Capital Measures:							
Core capital(6)	\$ 17,743	\$ 13,866	\$ 14,381	\$ 12,691	\$ 10,715	\$ 7,375	\$ 6,743
Reserve for mortgage losses(7)	794	780	784	772	768	694	680
Total capital	18,537	14,646	15,165	13,463	11,483	8,069	7,423
Subordinated borrowings	3,122	142	145	130	162	521	490
Adjusted total capital(8)	\$ 21,659	\$ 14,788	\$ 15,310	\$ 13,593	\$ 11,645	\$ 8,590	\$ 7,913
Total PCs	\$ 927,490	\$ 790,891	\$ 822,310	\$ 749,081	\$ 646,459	\$ 579,385	\$ 554,260
Freddie Mac PCs held in the retained portfolio	\$ 291,646	\$ 231,649	\$ 246,209	\$ 211,198	\$ 168,108	\$ 103,400	\$ 81,195
Total mortgage portfolio	\$ 1,106,694	\$ 920,866	\$ 961,794	\$ 862,326	\$ 733,360	\$ 640,406	\$ 610,820
<b>New Business Purchase and Financing Activities</b>							
New business purchases	\$ 332,609	\$ 137,035	\$ 207,423	\$ 272,472	\$ 288,338	\$ 121,490	\$ 128,565
Number of new business purchases (# of loans)	2,005,129	989,705	1,465,280	2,058,330	2,396,651	1,085,046	1,232,540
PC issuances	\$ 268,475	\$ 110,187	\$ 166,901	\$ 233,031	\$ 250,564	\$ 114,258	\$ 119,702
Structured securitizations(9)	\$ 122,363	\$ 34,271	\$ 48,202	\$ 119,565	\$ 135,162	\$ 84,366	\$ 34,145
<b>Income Statement and Ratios</b>							
Net interest income on earning assets	\$ 3,400	\$ 2,100	\$ 2,838	\$ 2,540	\$ 1,927	\$ 1,631	\$ 1,542
Management and guarantee income	\$ 1,206	\$ 1,106	\$ 1,489	\$ 1,405	\$ 1,307	\$ 1,298	\$ 1,249
Total revenues	\$ 4,859	\$ 3,298	\$ 4,457	\$ 4,055	\$ 3,337	\$ 3,029	\$ 2,875
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle	\$ 4,116	\$ 2,610	\$ 3,534	\$ 3,161	\$ 2,356	\$ 1,964	\$ 1,797
Net income	\$ 2,783	\$ 1,884	\$ 2,547	\$ 2,223	\$ 1,700	\$ 1,395	\$ 1,243
Earnings per common share(10)							
Basic	\$ 3.78	\$ 2.52	\$ 3.41	\$ 2.97	\$ 2.32	\$ 1.90	\$ 1.65
Diluted	\$ 3.77	\$ 2.51	\$ 3.40	\$ 2.96	\$ 2.31	\$ 1.88	\$ 1.63
Dividends per common share	\$ 0.60	\$ 0.51	\$ 0.68	\$ 0.60	\$ 0.48	\$ 0.40	\$ 0.35
Dividend payout ratio on common stock(11)	15.97%	20.30%	20.03%	20.14%	20.65%	21.08%	21.26%
Return on total equity(12)	26.8%	20.7%	20.2%	20.3%	19.4%	19.5%	19.7%
Return on average assets(13)	0.72%	0.61%	0.61%	0.64%	0.70%	0.77%	0.80%
Equity to assets ratio(14)	2.68%	2.97%	3.01%	3.16%	3.60%	3.93%	4.05%
Ratio of earnings to fixed charges(15)	1.19:1	1.14:1	1.14:1	1.16:1	1.16:1	1.17:1	1.19:1
Ratio of earnings to combined fixed charges and preferred stock dividends(15)	1.18:1	1.13:1	1.13:1	1.14:1	1.15:1	1.16:1	1.18:1

- (1) Based on Freddie Mac's supplemental performance measure. See "OPERATING EARNINGS" for more information.
- (2) Calculated quarterly as annualized operating net income less preferred stock dividends divided by average realized common stockholders' equity (common stockholders' equity excluding "Accumulated Other Comprehensive Income, Net of Taxes" ("AOCI")). Year-to-date and annual computations reflect the simple average of quarterly returns. 1997 and 1996 ratios are calculated on an annualized basis.
- (3) Based on accounting principles generally accepted in the U.S. ("GAAP").
- (4) Excludes related purchase and sale premiums, discounts and deferred fees, reserve for losses on retained mortgages and net unrealized gain (loss) on available-for-sale guaranteed mortgage securities.
- (5) Excludes "Reserve for Losses on Mortgage Participation Certificates" and "Subordinated borrowings."
- (6) "Stockholders' Equity" excluding AOCI.
- (7) "Reserve for losses on retained mortgages" plus the "Reserve for losses on Mortgage Participation Certificates."
- (8) Prior periods restated to exclude the adjustment for AOCI reflected in the computation of "Core capital."
- (9) Includes issuances of mortgage-related securities in which the cash flows are structured into various classes having a variety of features, the majority of which qualify for treatment as Real Estate Mortgage Investment Conduits ("REMICs") under the Internal Revenue Code.
- (10) "Earnings per common share-basic" are computed based on weighted average common shares outstanding. "Earnings per common share-diluted" are computed based on the total of weighted average common shares outstanding and the effect of dilutive common equivalent shares outstanding.
- (11) Year-to-date and annual computations reflect the simple average of quarterly ratios. Quarterly ratios are computed as dividends paid divided by "Net income available to common stockholders."
- (12) Year-to-date and annual computations reflect the simple average of quarterly returns. Quarterly returns are computed as annualized "Net income" divided by the simple average of the beginning and ending balances of "Stockholders' equity."
- (13) Year-to-date and annual computations reflect the simple average of quarterly returns. Quarterly returns are computed as annualized "Net income" divided by the simple average of the beginning and ending balances of "Total assets."
- (14) Year-to-date and annual computations reflect the simple average of quarterly ratios. Quarterly ratios are computed as the simple average of the beginning and ending "Stockholders' equity" divided by the simple average of the beginning and ending "Total assets."
- (15) Earnings consist of "Income before taxes, extraordinary items and cumulative effect of change in accounting principle" plus fixed charges. Fixed charges include interest (including amounts capitalized) and the portion of net rental expense deemed representative of interest. The ratios of Freddie Mac's earnings to fixed charges and earnings to combined fixed charges and preferred stock dividends were 1.22:1 and 1.20:1, respectively, for the quarter ended September 30, 2001.

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

### **BUSINESS REVIEW**

Freddie Mac participates in the secondary mortgage market primarily by purchasing and guaranteeing residential mortgages originated by mortgage lenders and by purchasing and guaranteeing mortgage-related securities. The corporation finances mortgages by issuing guaranteed mortgage securities backed by pools of mortgages ("securitization financing") and by issuing other financing instruments, principally debt, in the global capital markets ("debt financing").

Freddie Mac generates revenues from its securitization financing activities primarily by charging a management and guarantee fee on the Mortgage Participation Certificates ("PCs") it creates and guarantees. Freddie Mac deducts these amounts from the interest cash flows it receives on securitized mortgages before it passes through the remaining cash flows each month to investors in its mortgage securities. These amounts, which are reported as "Management and guarantee income," enable Freddie Mac to pay the expenses associated with administering its mortgage securities, and they also compensate Freddie Mac for the risk it assumes by guaranteeing to make mortgage security payments to investors in the event of defaults by the borrowers on the underlying mortgages.

Through its debt financing activities, Freddie Mac earns revenues primarily by purchasing mortgages and mortgage securities to hold in its retained portfolio. It finances these investments with a mix of debt securities that bear interest at lower rates than the yields on the mortgage assets being financed. Freddie Mac also maintains a liquidity and contingency investment portfolio to meet various cash management, liquidity and other needs essential to fulfilling its Congressional mission. To manage the interest-rate and other market risks associated with these investments, Freddie Mac enters into interest-rate swaps, options, and other derivative financial instruments. The net revenues earned by Freddie Mac on its debt-financed retained portfolio investments, after taking into account the net benefit or cost of derivative financial instruments, generate "Net interest income on earning assets" for the corporation.

Freddie Mac also earns other types of revenues, including fees earned from the rescuitization of single-class PCs and other mortgage securities into a like amount of multiclass PCs that qualify as REMICs under Internal Revenue Service regulations or into single-class Giant PCs, gains and losses from certain investment activities as well as miscellaneous other sources, which are reported as "Other income, net." The corporation also incurs non-interest expenses in the operation of its business, including credit-related charges, expenses for general and administrative functions, as well as costs related to its investments in housing tax credit partnerships and the payment of income taxes. In addition, Freddie Mac pays dividends on its common and preferred stock.

A detailed discussion of these financing methods is contained in "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ("MD&A") — BUSINESS REVIEW" included in the Information Statement. See "NOTES TO INTERIM FINANCIAL STATEMENTS — Business Segment Reporting" for Freddie Mac's financial results as segmented on the basis of the two methods by which it finances mortgage-related investments. Also see "CONSOLIDATED RESULTS OF OPERATIONS" for a discussion of the corporation's financial results.

### **FORWARD-LOOKING STATEMENTS**

Freddie Mac regularly communicates information concerning its business activities to investors, securities analysts, the news media and others as part of its normal operations. Some of these communications include "forward-looking statements" pertaining to management's current expectations as to Freddie Mac's future business plans, results of operations and/or financial condition. Forward-looking statements are typically accompanied by, and identified with, such terms as "anticipates," "believes," "expects," "intends" and similar phrases. Management's expectations for the corporation's future necessarily involve a number of assumptions and estimates, and various factors could cause actual results to differ materially from these expectations.

Management's discussion and analysis includes several forward-looking statements. Factors that could cause actual results to differ from the expectations expressed in these and other forward-looking statements by management include: substantial changes in interest rates, employment rates, house-price appreciation and the general economy; changes in the corporation's strategies for and results of credit loss mitigation, interest-rate and other market risk management activities, and investment activities; the availability of debt funding in sufficient quantity and at attractive spreads to support continued growth in the retained portfolio; the availability of options, interest-rate and currency swaps, and other derivative financial instruments of the types and in the quantities needed for investment funding and risk management purposes; the availability of equity funding in sufficient quantity to support continued growth of the retained portfolio; the rate of growth in total outstanding U.S. residential mortgage debt; the size of the conforming residential mortgage market; borrower preferences for fixed-rate mortgages or adjustable-rate mortgages ("ARMs")/floating-rate mortgages; preferences of originators to sell mortgages into the secondary market; changes in investor preferences for mortgage-backed securities and debt versus other investments; competition in the purchase of mortgages and sale of mortgage-backed and debt securities; the corporation's ability to implement innovative solutions to business processing systems issues; significant business disruptions resulting from acts of war or terrorism; the occurrence of a major natural or other disaster in a geographic area in which the total mortgage portfolio is heavily concentrated; the degree to which the corporation's business and financial forecasting methods accurately predict actual results; the impact of new accounting standards; and changes in the corporation's legislative or regulatory environment, regulatory capital requirements or Congressional charter, which are described more fully in Freddie Mac's Information Statement.

## **BUSINESS OUTLOOK**

Freddie Mac expects continued growth, reflecting the corporation's ongoing commitment to its key business strategies. During 2001, Freddie Mac expects the growth rate of its total mortgage portfolio to be substantially faster than the growth in outstanding U.S. residential mortgage debt. Additionally, management has increased its expectation for net retained portfolio growth for 2001 to be between \$90 billion and \$105 billion.

In 2001, management expects continued high-quality operating earnings growth (see "OPERATING EARNINGS," for more information about Freddie Mac's supplemental performance measure). Specifically, Freddie Mac anticipates full-year 2001 operating earnings growth of about 23 percent. Management also expects that its average operating fully-tax equivalent ("FTE") net interest yield for full-year 2001 will be about 0.78 percent. In addition, the corporation expects that the average guarantee fee rate on its Total PC portfolio will be about 18.7 basis points in 2001. Freddie Mac anticipates that 2001 credit-related expenses will be lower than previously expected, or less than \$90 million.

In 2002, Freddie Mac expects operating earnings growth in the mid-teens. The corporation also anticipates retained portfolio growth in the mid-teens next year. In addition, Freddie Mac expects its average operating net interest yield for 2002 to be stable, or close to the average for 2001. Finally, the corporation expects credit losses to increase somewhat from their current historical lows, but remain below 2 basis points of its average total mortgage portfolio (excluding non-Freddie Mac mortgage securities).

## **VOLUNTARY COMMITMENTS**

Freddie Mac is providing periodic disclosures relating to the corporation's six voluntary commitments to enhance its risk management, capital and disclosure practices. See "RISK MANAGEMENT" and "LIQUIDITY AND CAPITAL MANAGEMENT" for updates to the credit risk disclosure, interest-rate risk disclosure, periodic issuance of subordinated debt, liquidity and interim risk-based capital stress test commitments.

## RISK MANAGEMENT

Freddie Mac is subject to two primary business risks: (i) credit risk and (ii) interest-rate and other market risks. Freddie Mac is also exposed to operational and other related risks. Management of these risks affects both the level and stability of the corporation's short-term and long-term value.

### Credit Risk

Freddie Mac's primary exposure to credit risk is associated with the mortgages in its total mortgage portfolio ("mortgage credit risk"). The corporation is also subject to credit risk associated with guarantors of non-Freddie Mac mortgage securities held in the retained portfolio and the issuers and guarantors of non-mortgage securities held in the liquidity and contingency investment portfolio, as well as from the institutions with which it conducts business ("institutional credit risk").

#### *Mortgage Credit Risk*

Mortgage credit risk is the risk that the corporation will not receive amounts due from mortgage borrowers because of borrower defaults, potentially resulting in a loss if Freddie Mac is unable to collect amounts due through restructuring of the mortgage, sale of the underlying property or other loss mitigation activities.

*Credit Risk Management Strategies:* Freddie Mac's management of mortgage credit risk comprises three broad areas: (i) establishing and enforcing sound underwriting and quality control standards, increasingly through the use of automated underwriting; (ii) obtaining credit enhancements on higher risk mortgages; and (iii) executing loss mitigation activities to resolve non-performing loans.

For most of the mortgages in its total mortgage portfolio (which are either held as whole loans or PCs), Freddie Mac retains the primary risk of loss in the event of default by the borrower on the underlying mortgage loan. Some of these mortgages are higher loan-to-value ("LTV") mortgages, which are required by Freddie Mac's charter to be covered by primary (or loan-level) mortgage insurance (or certain other credit protections) to be eligible for purchase by Freddie Mac. Loans for which loan-level mortgage insurance is the only external protection against credit loss are not classified as credit-enhanced mortgages. Mortgages in this category are included in Freddie Mac's "at-risk" mortgage portfolio.

Table 1 presents the composition of Freddie Mac's total mortgage portfolio.

**Table 1 — Total Mortgage Portfolio by At-Risk and Credit-Enhanced Components**

	September 30, 2001		June 30, 2001		September 30, 2000	
	(dollars in millions)					
Freddie Mac at-risk(1) . . . . .	\$ 768,469	69%	\$ 709,559	68%	\$628,455	68%
Credit-enhanced or guaranteed(2) . . . . .	338,225	31%	338,308	32%	292,411	32%
Total Mortgage Portfolio . . . . .	<u>\$1,106,694</u>	<u>100%</u>	<u>\$1,047,867</u>	<u>100%</u>	<u>\$920,866</u>	<u>100%</u>

- (1) Includes only those mortgages for which Freddie Mac has assumed primary default risk. These mortgages are either held as whole loans or securitized as PCs.
- (2) Includes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default. Also includes securities guaranteed by agencies such as Ginnie Mae or subject to subordination agreements. In some 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.

As shown in Table 1, a significant portion (31 percent) of Freddie Mac's total mortgage portfolio at September 30, 2001 was comprised of credit-enhanced mortgage investments.

#### *Credit Risk Profile*

As part of the corporation's credit risk management practices, Freddie Mac monitors certain loan characteristics such as product mix, LTV ratios and geographic concentration, which may affect the default experience on the corporation's mortgage portfolio.

## Credit Performance

Delinquency rates and credit losses are key indicators of credit performance. *Table 2* and the following discussion address the credit performance of Freddie Mac's single-family and multifamily mortgage portfolios.

**Table 2 — Credit Performance**

	Quarter Ended			Nine Months Ended	
	September 30, 2001	June 30, 2001	September 30, 2000	September 30, 2001	September 30, 2000
	(dollars in millions)				
Delinquencies, end of period(1)					
Single-family:(2)					
At-risk portfolio(3) .....	0.38%	0.36%	0.35%	0.38%	0.35%
Total portfolio .....	0.57%	0.52%	0.45%	0.57%	0.45%
Multifamily:(4)					
Net carrying value .....	\$ 7	\$ 4	\$ 17	\$ 7	\$ 17
Percentage .....	0.03%	0.02%	0.09%	0.03%	0.09%
REO, end of period					
Single-family .....	\$ 375	\$ 363	\$ 363	\$ 375	\$ 363
Multifamily .....	1	3	1	1	1
Total .....	<u>\$ 376</u>	<u>\$ 366</u>	<u>\$ 364</u>	<u>\$ 376</u>	<u>\$ 364</u>
REO activity for period					
Properties in inventory-beginning of period ..	4,758	4,700	5,019	4,564	5,619
Properties acquired .....	2,393	2,401	2,260	7,107	7,288
Properties disposed .....	<u>(2,218)</u>	<u>(2,343)</u>	<u>(2,544)</u>	<u>(6,738)</u>	<u>(8,172)</u>
Properties in inventory-end of period .....	<u>4,933</u>	<u>4,758</u>	<u>4,735</u>	<u>4,933</u>	<u>4,735</u>
Net charge-offs (recoveries)					
Single-family:					
Northeast .....	\$ 3	\$ 3	\$ 5	\$ 13	\$ 16
Southeast .....	2	1	(1)	3	—
North Central .....	—	1	—	(1)	(2)
Southwest .....	—	—	—	(1)	—
West .....	<u>2</u>	<u>3</u>	<u>2</u>	<u>9</u>	<u>9</u>
Total single-family .....	7	8	6	23	23
Multifamily .....	(1)	(2)	—	(3)	(1)
Total .....	<u>\$ 6</u>	<u>\$ 6</u>	<u>\$ 6</u>	<u>\$ 20</u>	<u>\$ 22</u>
Number of single-family foreclosure alternatives settled(5) .....	1,535	1,554	1,083	4,400	3,819
Single-family charge-offs related to foreclosure alternatives .....	\$ 5	\$ 3	\$ 3	\$ 10	\$ 10
Credit-related expenses					
Provision for mortgage losses .....	\$ 10	\$ 10	\$ 10	\$ 30	\$ 30
REO operations expense:					
Single-family .....	7	8	11	29	51
Multifamily .....	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>—</u>
Total .....	8	8	11	30	51
Total credit-related expenses .....	<u>\$ 18</u>	<u>\$ 18</u>	<u>\$ 21</u>	<u>\$ 60</u>	<u>\$ 81</u>
Credit losses(6)					
Single-family .....	\$ 14	\$ 16	\$ 17	\$ 52	\$ 74
Multifamily .....	<u>—</u>	<u>(2)</u>	<u>—</u>	<u>(2)</u>	<u>(1)</u>
Total credit losses .....	<u>\$ 14</u>	<u>\$ 14</u>	<u>\$ 17</u>	<u>\$ 50</u>	<u>\$ 73</u>
Annualized credit losses/average total mortgage portfolio (Excluding non-Freddie Mac mortgage securities) .....	0.6bp	0.6bp	0.8bp	0.7bp	1.2bp
Reserve for mortgage losses, end of period....	\$ 794	\$ 790	\$ 780	\$ 794	\$ 780

(1) Includes mortgages and PCs purchased for the total mortgage portfolio.

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

(3) Includes only those loans for which Freddie Mac has assumed primary default risk. Excludes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies such as Ginnie Mae or subject to subordination agreements. In some 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.

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

(5) Primarily consists of loan modifications and pre-foreclosure sales.

(6) Equal to charge-offs plus REO operations expense.

At September 30, 2001, the delinquency rate for the single-family, at-risk portfolio was 38 basis points, up 2 basis points from June 30, 2001 and up 3 basis points from the same date last year. Total credit losses (which consist of charge-offs and real estate owned (“REO”) operations expense) totaled \$14 million in the third quarter 2001, unchanged from second quarter 2001 and down from \$17 million for third quarter 2000. Annualized credit losses represented 0.6 basis points of the average total mortgage portfolio (excluding non-Freddie Mac mortgage securities) for third quarter 2001, unchanged from second quarter 2001 and down from 0.8 basis points in third quarter 2000. Effective risk management coupled with favorable house-price appreciation, partially offset by the effects of the softening economy, resulted in Freddie Mac’s continued strong credit performance for the current period.

A key element of Freddie Mac’s credit risk management strategy is the continued use of credit enhancements, which reduces the portion of the single-family mortgage portfolio that is classified as at-risk. Mortgages generally reach their peak default years three to five years after origination. As shown in *Table 3*, single-family mortgages originated in 1998 or later, which are approaching their peak default years and have significant credit enhancement protection, represent 71 percent of the corporation’s single-family portfolio at September 30, 2001.

**Table 3 — Single-Family Mortgage Portfolio and At-Risk Delinquencies By Year of Origination**

Year of Origination	September 30, 2001		June 30, 2001		September 30, 2000	
	Percent of Single Family Balance(1)	At-Risk Delinquency Rate(2)	Percent of Single Family Balance(1)	At-Risk Delinquency Rate(2)	Percent of Single Family Balance(1)	At-Risk Delinquency Rate(2)
Pre-1994 .....	13%	1.60%	14%	1.52%	19%	1.51%
1994 .....	3%	0.62%	3%	0.58%	4%	0.56%
1995 .....	3%	0.93%	3%	0.87%	4%	0.81%
1996 .....	4%	0.84%	5%	0.79%	6%	0.72%
1997 .....	6%	0.42%	6%	0.38%	8%	0.30%
1998 .....	21%	0.22%	24%	0.19%	28%	0.13%
1999 .....	17%	0.34%	19%	0.27%	22%	0.15%
2000 .....	10%	0.48%	12%	0.29%	9%	0.06%
2001 .....	23%	0.05%	14%	—	—	—
Total .....	<u>100%</u>	<u>0.38%</u>	<u>100%</u>	<u>0.36%</u>	<u>100%</u>	<u>0.35%</u>

(1) Based on Freddie Mac’s total single-family mortgage portfolio balance, which was \$961 billion, \$910 billion, and \$828 billion at September 30, 2001, June 30, 2001 and September 30, 2000, respectively.

(2) At-risk delinquency statistics are based on loans 90 days or more delinquent plus foreclosures in process and approved, as a percentage of the total number of loans in the year of origination. Includes only those loans for which Freddie Mac has assumed primary default risk. Excludes loans for which a lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies such as Ginnie Mae or subject to subordination agreements. In some 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.

### *Credit Risk Sensitivity*

Changes in house prices are an important factor in determining Freddie Mac’s exposure to mortgage credit risk. A higher rate of appreciation in the value of a residential property is correlated with higher prices obtained in the event of default, resulting in lower levels of credit loss for Freddie Mac. In addition, higher house-price appreciation results in lower LTV ratios and, as a result, lower defaults. Freddie Mac analyzes the sensitivity of expected credit losses on the corporation’s single-family mortgage portfolio to an instantaneous change in house prices. The sensitivity analysis assumes that there is an immediate 5 percent decline in the current level of house prices and that house prices return to trend for 10 years after this initial 5 percent downward shock. Total credit losses over the 10-year period are discounted to present value. Although the credit risk sensitivity model estimates the potential future effect on Freddie Mac’s credit losses that would result from an assumed instantaneous downward movement in house prices, it does not represent an actual current loss to Freddie Mac.

Freddie Mac uses mortgage default and prepayment models estimated by the Office of Federal Housing Enterprise Oversight (“OFHEO”). These models are described at OFHEO’s Web site ([www.ofheo.gov](http://www.ofheo.gov)). The loss severity model used in the credit risk sensitivity analysis is the same model used in the interim risk-based

capital stress test (see “LIQUIDITY AND CAPITAL MANAGEMENT — Capital Management — *Interim Risk-Based Capital Stress Test*”), except that loss severity rates are reduced by half to simulate an economic environment that is more useful in assessing credit risk sensitivity than the extreme assumptions used in the interim stress test. Loss severity rates are then increased by 5 percentage points to reflect the 5 percent decline in house prices when determining the sensitivity of expected credit losses. The sensitivity analysis incorporates the protection provided by primary mortgage insurance and credit enhancements by generating two separate present values for expected credit losses. The values shown in the “Before Receipt” column assume that none of the mortgage insurance and credit enhancements currently covering the mortgages owned by Freddie Mac has any mitigating impact on Freddie Mac’s credit losses, while those in the “After Receipt” column give full effect to Freddie Mac’s mortgage insurance and credit enhancements.

Table 4 sets forth the present value of the increase in credit losses over a 10-year period that Freddie Mac estimates would result from the assumed 5 percent decline in house prices. Credit risk sensitivity results as of September 30, 2001 show a decrease from June 30, 2001 of \$73 million net of mortgage insurance and other credit enhancements.

**Table 4 — Net Present Value of Increase in Credit Losses**

	<b>Before Receipt of Primary Mortgage Insurance and Credit Enhancements</b>	<b>After Receipt of Primary Mortgage Insurance and Credit Enhancements</b>
	(Dollars in Millions)	
As of:		
September 30, 2001 .....	\$859	\$289
June 30, 2001 .....	\$948	\$362

*Institutional Credit Risk*

Freddie Mac is subject to credit risk from institutional counterparties to the extent they do not fulfill their obligations to Freddie Mac under the terms of specific contracts or agreements. Freddie Mac’s institutional credit risk exposure arises primarily from agreements with the following types of counterparties: mortgage servicers, mortgage insurers, guarantors of non-Freddie Mac mortgage securities held in the retained portfolio, issuers and guarantors of investments held in the liquidity and contingency portfolio, and counterparties to derivative financial instruments entered into by the corporation. See “MD&A — Institutional Credit Risk” included in the Information Statement for further discussion.

*Guarantors of Non-Freddie Mac Mortgage Securities*

Freddie Mac’s retained portfolio is exposed to institutional credit risk to the extent that guarantors or the third parties providing credit enhancements on non-Freddie Mac mortgage securities held in this portfolio become insolvent. Non-Freddie Mac mortgage securities consist of both agency and non-agency securities. Agency mortgage securities present minimal institutional credit risk exposure to Freddie Mac due to the high credit quality of issuers and guarantors. Non-agency mortgage securities expose Freddie Mac to both mortgage and institutional credit risk. The corporation mitigates the mortgage credit risk associated with these securities through the use of senior/subordinated bond structures, bond insurance or a combination of both. The potential insolvency of bond insurers that guarantee these securities also poses institutional credit risk.

Agency mortgage securities are generally not separately rated by credit rating agencies, but are viewed as having a level of credit quality at least equivalent to non-agency mortgage securities rated “AAA.” At September 30, 2001, 93 percent of non-agency mortgage securities held by the corporation were rated “AAA” and 7 percent were rated below “AAA.” Freddie Mac manages the institutional credit risk associated with its non-agency mortgage securities by only purchasing securities that meet the corporation’s investment guidelines, performing ongoing analysis to ensure the creditworthiness of the issuers and servicers of non-Freddie Mac mortgage securities and the bond insurers that guarantee those securities, and limiting its investments in the securities of any single issuer.

### *Counterparties to Derivative Financial Instruments*

Freddie Mac uses derivative financial instruments primarily in connection with its interest-rate risk management activities (see “RISK MANAGEMENT — Interest-Rate Risk and Other Market Risks”). Exchange-traded derivative financial instruments, such as futures contracts, do not increase the corporation’s exposure to institutional credit risk since changes in the value of open exchange-traded contracts are settled daily. The use of over-the-counter derivative financial instruments exposes Freddie Mac to institutional credit risk that arises from the possibility that a counterparty will be unable to perform according to the terms of the derivatives contract. Freddie Mac mitigates its exposure to institutional credit risk related to over-the-counter derivative contracts by using master netting agreements, limiting its selection of counterparties and, in many cases, requiring collateral.

The corporation’s aggregate exposure to institutional credit risk for derivative financial instruments can be estimated by calculating the “net replacement value” or replacement cost, of all outstanding non-exchange traded derivative financial instruments for each counterparty with which the corporation was in a net gain or “positive fair value” position, after taking into account the offsets provided by master netting agreements. Net replacement values were \$2.1 billion, \$0.8 billion and \$2.5 billion at September 30, 2001, June 30, 2001 and September 30, 2000, respectively. Freddie Mac’s exposure to institutional credit risk varies from period to period in relation to changes in interest rates, foreign currency exchange rates and the mix and amount of derivatives it holds. At September 30, 2001, of the total estimated \$2.1 billion exposure to institutional credit risk on derivative financial instruments in a net gain position, \$1.9 billion was fully collateralized. At September 30, 2001, counterparties with an independent credit rating of “A” or better accounted for over 99 percent of the notional amount of the corporation’s outstanding over-the-counter derivative financial instruments.

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

Disciplined management of interest-rate risk and other market risks is critical to Freddie Mac’s ability to manage its debt financing and securitization financing activities. Successfully managing these risks requires consistently maintaining acceptable levels of risk exposure while meeting the corporation’s thresholds for return on equity and targets for net interest income. Interest-rate risk is the risk that changes in the level of interest rates or changes in the shape of the Treasury yield curve could affect adversely the market value and future earnings of Freddie Mac. Freddie Mac’s interest-rate risk exposure results primarily from the uncertainty as to when borrowers will pay the outstanding principal balance of their mortgages (“prepayment risk”). A mortgage borrower has the option, usually without penalty, to make unscheduled payments of additional principal or to completely pay off a mortgage loan before its scheduled maturity date. A borrower also has the option to make only scheduled principal payments on a mortgage up to its stated maturity, such as 30 years in the case of a 30-year mortgage. This option may cause the mortgage to have a life longer than the expected life of a typical mortgage, which prepays in full before its stated maturity.

A borrower’s ability to shorten the life of a mortgage or hold it until its stated maturity makes the timing and amount of mortgage prepayments very sensitive to changes in interest rates. A significant decline in interest rates may lead to higher prepayments and a shorter expected life for a mortgage than originally projected. Conversely, a significant increase in interest rates could lead to lower than anticipated prepayments and a longer expected life for a mortgage than originally projected. As the mortgage origination process continues to become faster and less expensive for mortgage borrowers, prepayment levels are likely to become increasingly sensitive to changes in interest rates.

### *Measurement of Interest-Rate Risk*

Freddie Mac maintains a disciplined approach to measuring and managing interest-rate risk, with the goal of producing long-term returns that are relatively insensitive to changes in interest rates. On a daily basis, Freddie Mac measures its interest-rate risk exposure due to changes in both the level and shape of the yield curve. Scenario analyses are calculated to estimate the potential percentage loss in Freddie Mac’s market value of equity (referred to as “portfolio market value”) that would result from an adverse parallel shift in the Treasury yield curve and from an adverse change in the slope of the Treasury yield curve. Freddie Mac uses

the results of these two risk measures to gauge the strength and durability of the corporation's projected returns.

#### *Parallel Treasury Yield Curve Shifts*

Freddie Mac measures the risk of a change in the level of interest rates by estimating daily the expected loss in portfolio market value that would result from an immediate, adverse 50 basis point parallel shift (up or down) in the current Treasury yield curve. The use of an immediate shift in interest rates is conservative because it does not allow for any portfolio rebalancing. The risk measure for parallel shifts in the Treasury yield curve, identified as "PMVS" in Freddie Mac's quarterly and annual disclosures prior to first quarter 2001, is now referred to as "PMVS-L" (since it reflects the effect of a change in the *level* of interest rates).

#### *Non-Parallel Treasury Yield Curve Shifts*

Freddie Mac's portfolio market value also may be exposed to non-parallel shifts in the yield curve, such as a flattening or steepening. Changes in the shape, or slope, of the yield curve can, and often do, occur at different points along the yield curve. For this reason, Freddie Mac evaluates its exposure to yield curve risk by examining potential reshaping scenarios at various points along the yield curve. Freddie Mac's exposure to yield curve risk is expressed in terms of the expected loss in portfolio market value resulting from an immediate, adverse 25 basis point shift in the slope of the Treasury yield curve, and is referred to as "PMVS-YC." The use of an immediate shift in interest rates is conservative because it does not allow for any portfolio rebalancing.

#### *Interest-Rate Risk Measurement Methodology*

The PMVS-L and PMVS-YC risk measures take into account all of Freddie Mac's interest-rate sensitive assets and liabilities, including derivative financial instruments and off-balance sheet obligations. In each case, the most adverse change in portfolio market value resulting from the changes in interest rates or yield curve slope under the scenarios discussed below is calculated. Freddie Mac uses proprietary and external business and financial models to measure PMVS-L and PMVS-YC. The scenario analyses Freddie Mac uses to measure interest-rate risk employ mortgage prepayment and other core forecasting models that are reviewed on an ongoing basis and may be adjusted and refined from time to time based on benchmarks of their results against the models of external parties, as well as changes that may occur in the relationship between key variables, including the historical relationship between mortgage interest rates and Treasury and other market rates. Freddie Mac will disclose any changes in risk modeling and assumptions it believes are material to help ensure comparability of the disclosure results over time.

#### *Calculation of PMVS-L*

To calculate PMVS-L, Freddie Mac examines two scenarios: an immediate 50 basis point increase and an immediate 50 basis point decrease in Treasury rates. The 50 basis point shock in Treasury rates is chosen to approximate the effect of a severe tightening or easing of rates. Statistically, it represents the expected change in Treasury rates over a one-month period within a 95 percent confidence interval. This 50 basis point change is applied as a parallel shift, which means that each point along the Treasury yield curve is changed by the same 50 basis points. Given this change in Treasury rates, Freddie Mac calculates the expected change in mortgage and debt rates using information about their historical relationship to Treasury rates and other market information.

#### *Calculation of PMVS-YC*

To calculate PMVS-YC, Freddie Mac also examines two scenarios: an immediate 25 basis point steepening and an immediate 25 basis point flattening in Treasury rates. The calculation of PMVS-YC is based on an assumed reshaping of the yield curve in which the 25 basis point change in slope is obtained by shifting the 2-year and 10-year Treasury rates by an equal amount (12.5 basis points), but in opposite directions. This means that under the yield curve steepening scenario, the 2-year Treasury rate is decreased by 12.5 basis points and the 10-year Treasury rate is increased by 12.5 basis points. Under the yield curve

flattening scenario, the 2-year Treasury rate is increased by 12.5 basis points and the 10-year Treasury rate is decreased by 12.5 basis points. Measuring yield curve risk by shifting the 2-year and 10-year Treasury rates highlights the two sectors of the yield curve that have the greatest effect on mortgage investments: (i) the 2-4 year sector of the yield curve, where expected cash flows from mortgages are concentrated, and (ii) the 10-year sector, which is the benchmark for mortgage rates and which can have a significant effect on prepayments.

#### *Interest-Rate Risk Management Strategies and Results*

Freddie Mac issues many different types of debt and actively rebalances its funding mix to protect its portfolio market value. Derivative financial instruments continue to be important in Freddie Mac's overall strategy for managing interest-rate risk.

#### *Funding Transactions*

Freddie Mac finances retained portfolio investments using a mix of debt and derivative financial instruments that enable it to closely match cash outflows with the cash inflows from the corporation's mortgage investments. Freddie Mac uses various instruments, including short-term debt, callable and non-callable long-term debt and derivative financial instruments, to optimize its ability to reprice debt when mortgages prepay faster than expected. Freddie Mac's ability to maintain this flexibility depends on its ability to issue debt and buy and sell derivative financial instruments at a reasonable cost.

#### *Rebalancing Transactions*

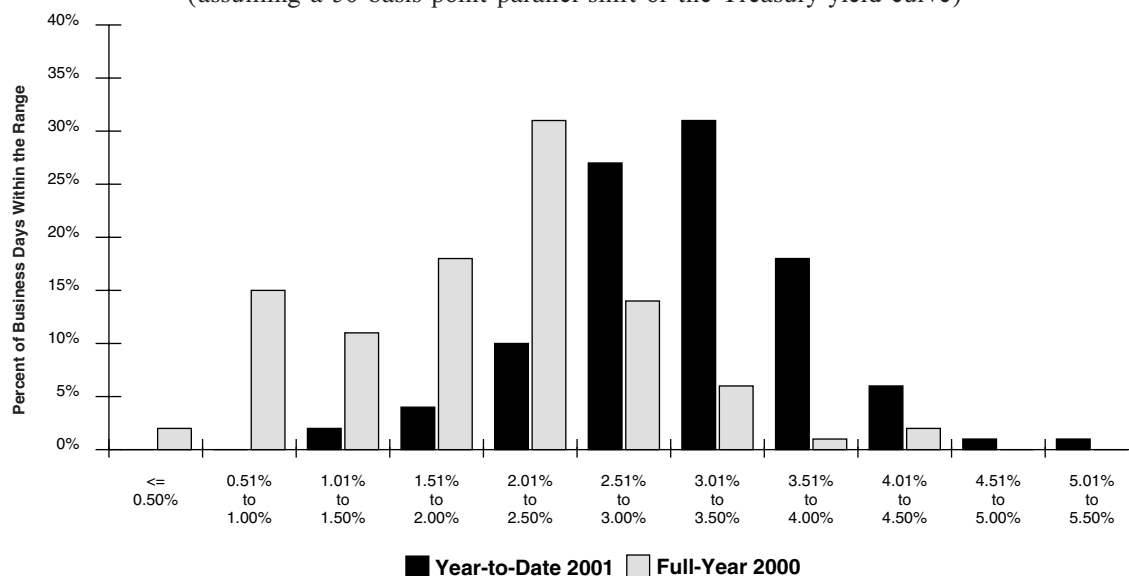
Freddie Mac executes interest-rate risk management (or "rebalancing") transactions to provide protection against both small and large changes in interest rates. To rebalance its portfolio in response to relatively small changes in interest rates, Freddie Mac typically buys or sells derivative financial instruments, such as Treasury futures or interest-rate swaps, to closely match the expected life of its assets and liabilities. In addition, Freddie Mac obtains protection from larger changes in interest rates by purchasing put and call options to offset the risk of the prepayment option embedded in mortgage-related assets. For example, when interest rates are rapidly declining, rebalancing transactions in the form of call options help Freddie Mac to better match the cash flows of the mortgage-related assets, which repay faster than originally expected, to the cash flows of non-callable long-term debt. Similarly, when interest rates are rapidly rising, rebalancing transactions in the form of put options help Freddie Mac to match the cash flow of the mortgage-related assets, which repay slower than originally expected, to the cash flows of non-callable long-term debt.

*Exhibit 1* illustrates the percentage of business days PMVS-L and PMVS-YC were within certain ranges during the nine months ended September 30, 2001 as well as PMVS-L for full-year 2000.

*Exhibit 1 — Risk Management Results*

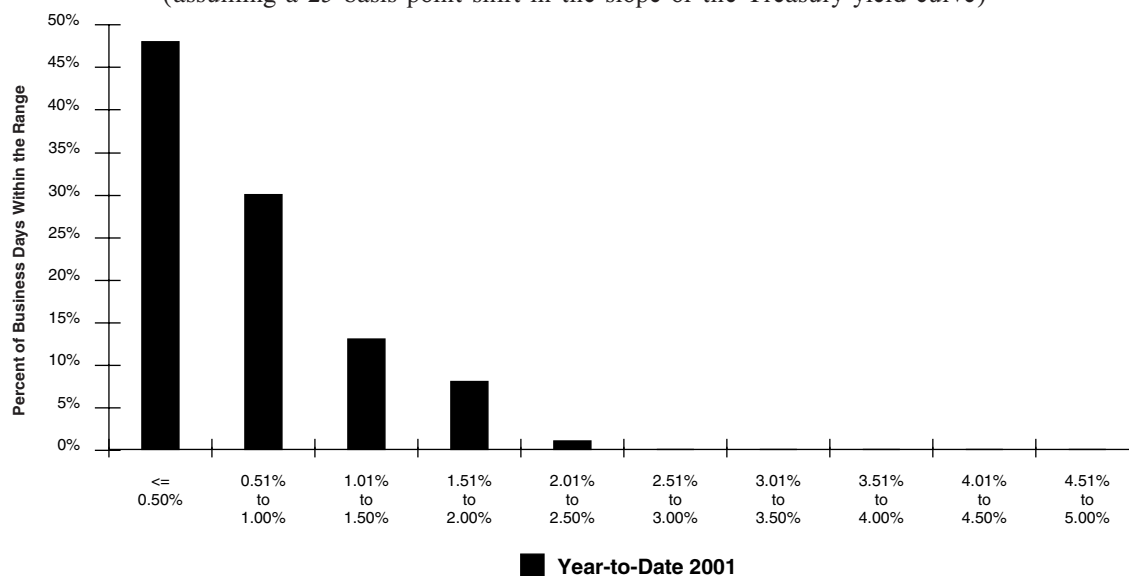
**Portfolio Market Value Sensitivity – Level (PMVS-L)**

(assuming a 50 basis point parallel shift of the Treasury yield curve)



**Portfolio Market Value Sensitivity – Yield Curve (PMVS-YC)**

(assuming a 25 basis point shift in the slope of the Treasury yield curve)



As indicated in *Exhibit 1*, PMVS-L was 4.00 percent or less for nearly 92 percent of the business days during the first nine months of 2001, compared to 98 percent of the business days during full-year 2000. In the days following September 11th, PMVS-L increased as markets reacted to the attacks, but subsequent rebalancing actions quickly lowered PMVS-L to levels similar to those observed in the months before the attacks. PMVS-L tends to increase during periods of declining mortgage interest rates that motivate borrowers to refinance their mortgages. Mortgage rates stayed relatively flat during 2000 and were generally higher than the first nine months of 2001. During the third quarter of 2001, primary mortgage market rates declined significantly. Due to the overall decrease in rates from September 30, 2000 to September 30, 2001, the likelihood of mortgage prepayments in the retained portfolio increased.

Table 5 provides information on average PMVS-YC and PMVS-L for the quarters ended September 30, 2001, June 30, 2001, and September 30, 2000, as well as for the nine months ended September 30, 2001 and September 30, 2000, including average PMVS-L based on a 100 basis point parallel shift in the Treasury yield curve.

**Table 5 — Average Portfolio Market Value Sensitivity**

<u>Average for the Quarter Ended</u>	<u>PMVS-YC</u>	<u>PMVS-L</u>	
	<u>25 bp(1)</u>	<u>50 bp(2)</u>	<u>100 bp(3)</u>
September 30, 2001 .....	0.24%	2.74%	9.30%
June 30, 2001 .....	0.65%	3.12%	10.40%
September 30, 2000 .....	—	2.14%	7.56%
<u>Average for the Nine Months Ended</u>			
September 30, 2001 .....	0.65%	3.09%	10.42%
September 30, 2000 .....	—	1.72%	5.94%

(1) Assuming a 25 basis point shift in the slope of the Treasury yield curve (PMVS-YC disclosure was initiated as of March 31, 2001).

(2) Assuming a 50 basis point parallel shift in the Treasury yield curve.

(3) Assuming a 100 basis point parallel shift in the Treasury yield curve.

See “MD&A — RISK MANAGEMENT — Interest-Rate Risk and Other Market Risks” in the Information Statement for a detailed discussion of Freddie Mac’s other market risks.

## DERIVATIVES PORTFOLIO

Freddie Mac enters into derivatives as an end user in connection with its investment funding and market risk management activities. Derivatives are a critical component in executing funding and other transactions to reduce risk and preserve value. By using derivatives, Freddie Mac is better able to match the expected cash flows of its assets and liabilities and reduce the corporation’s exposure to interest-rate and/or foreign currency risk.

Table 6 summarizes the activity and notional and/or contractual amounts outstanding of derivative instruments.

**Table 6 — Derivative Instrument Activity**

	<u>Quarter Ended</u>			<u>Nine Months Ended</u>	
	<u>Notional or Contractual Amount(1)</u>				
	<u>September 30,</u>	<u>June 30,</u>	<u>September 30,</u>	<u>September 30,</u>	<u>September 30,</u>
	<u>2001</u>	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
	(dollars in millions)				
Change in notional balance					
Beginning balance .....	\$ 692,697	\$ 576,186	\$ 390,488	\$ 474,535	\$ 424,244
New contracts .....	846,639	343,657	174,921	1,503,254	496,023
Maturities and terminations .....	(448,521)	(227,146)	(107,434)	(886,974)	(462,292)
Ending balance .....	<u>\$1,090,815</u>	<u>\$ 692,697</u>	<u>\$ 457,975</u>	<u>\$1,090,815</u>	<u>\$ 457,975</u>

(1) Notional or contractual amounts generally only serve as a factor in determining periodic amounts to be received and paid and do not themselves represent actual amounts to be exchanged or directly reflect the corporation’s exposure to institutional credit risk. Under GAAP, notional or contractual amounts are not recorded as assets and liabilities in the Condensed Consolidated Balance Sheets. Instead, the fair market values of derivative financial instruments (netted by counterparty) are recorded as assets or liabilities.

## LIQUIDITY AND CAPITAL MANAGEMENT

### Liquidity

Freddie Mac's business activities present liquidity demands driven by maturities of debt, purchases of mortgages, payments of principal and interest to mortgage security holders and general operations. The corporation's sources of cash to meet the needs of its business activities and general operations include issuances of long-term and short-term debt, issuances of common and preferred stock, cash flows from operating activities and repayments of mortgage investments. Because of its financial performance and its regular and significant participation as an issuer in the funding markets, the corporation's sources of funding have remained adequate to meet its liquidity needs.

During the first nine months of 2001, Freddie Mac issued a total of \$150 billion and \$1,594 billion in long-term and short-term debt, respectively, to support its business activities. A significant portion of this debt was issued through the corporation's primary debt financing programs: Reference Notes<sup>®</sup> and Reference Bonds<sup>®</sup> for longer-term financing and Reference Bills<sup>®</sup> for shorter-term financing. These debt-financing programs enable the corporation to sell large issues of long-term and short-term debt that provide investors with high-quality, liquid debt securities. During the first nine months of 2001, Freddie Mac issued \$65 billion of non-callable U.S. dollar-denominated Reference Notes and issued \$431 billion of short-term debt under the corporation's Reference Bill program. Additionally, the corporation issued €10 billion of EuroReference Notes<sup>SM</sup> during the first nine months of 2001. The corporation plans to issue Reference Notes and Reference Bonds totaling \$90 billion in accordance with its previously announced financing calendar for 2001. A Global Reference Note financing calendar for 2002 was announced in May 2001. The financing calendar will continue to provide clarity and transparency with regard to the timing of new debt issues and reopening of prior issues, the anticipated size of individual offerings and settlement dates.

In response to declining interest rates, Freddie Mac called a significant amount, approximately \$103 billion, of its long-term callable debt during the first nine months of 2001. In addition, the corporation announced in April 2001 that it would periodically repurchase a portion of older, off-the-run issues of its Reference Notes and Reference Bonds. During third quarter 2001, Freddie Mac repurchased approximately \$1.4 billion of its outstanding debt under this program, for a year-to-date total of \$2.4 billion. These periodic repurchases, which Freddie Mac expects to conduct at least once each quarter, will assist the corporation in pursuing its asset/liability management strategies while continuing the predictability and liquidity of its Reference program.

*Periodic Issuance of Subordinated Debt:* In first quarter 2001, Freddie Mac completed the initial \$2 billion issuance of its subordinated debt securities, Freddie SUBS<sup>SM</sup>, which is a key component of the corporation's voluntary commitments announced in October 2000. During third quarter 2001, Freddie Mac completed its second Freddie SUBS<sup>SM</sup> offering with a \$1 billion issuance. The amount of Freddie SUBS outstanding is expected to grow to between \$8 billion and \$10 billion over the three-year phase-in period.

During the first nine months of 2001, Freddie Mac completed five preferred stock offerings, providing the corporation approximately \$1.1 billion in net proceeds. On January 26, 2001, Freddie Mac issued variable-rate perpetual non-cumulative preferred stock with a redemption value of \$325 million. On March 23, 2001 Freddie Mac issued variable-rate, perpetual non-cumulative preferred stock with a redemption value of \$230 million and 5.81% perpetual non-cumulative preferred stock with a redemption value of \$172.5 million. In the second quarter, Freddie Mac issued variable-rate, perpetual non-cumulative preferred stock with a redemption value of \$201.3 million and 6% perpetual non-cumulative preferred stock with a redemption value of \$172.5 million. In addition to the five preferred stock offerings completed during the first nine months of 2001, the corporation completed an additional issuance of preferred stock in the fourth quarter 2001. See "RECENT EVENTS" for further information.

Freddie Mac maintains a liquidity and contingency investment portfolio used to manage recurring cash flows and meet other cash management needs, maintain capital reserves to meet mortgage funding needs, provide diverse sources of liquidity and help manage the interest-rate risk inherent in mortgage-related investments. The liquidity and contingency investment portfolio enables Freddie Mac to deploy fully its available capital and fulfill its purpose of providing a stable and reliable supply of mortgage credit nationwide.

This portfolio is important to Freddie Mac's financial management and its ability to provide liquidity and stability to the mortgage market. At September 30, 2001 and June 30, 2001, the liquidity and contingency investment portfolio totaled \$67 billion and \$64 billion, respectively, and consisted principally of cash and cash equivalents, asset-backed securities, corporate debt securities, and other highly rated marketable assets that can be readily converted to cash. The corporation recognizes net interest income on the liquidity and contingency investment portfolio.

*Liquidity Risk Management* — Freddie Mac has committed to maintain more than three months' worth of liquidity, assuming no access to public debt markets, to reduce the possibility that the corporation's operations might be disrupted during a significant financial crisis. To calculate its compliance with this commitment, Freddie Mac forecasts its cash sources and cash needs over a three-month period. Cash sources include certain investments in the liquidity and contingency portfolio, funding available from mortgage repurchase activities, and mortgage asset liquidations. As of September 30, 2001, Freddie Mac met the commitment to maintain more than three months of liquidity.

To facilitate liquidity, Freddie Mac also has committed to maintain at least 5 percent of on-balance sheet assets in liquid, marketable non-mortgage securities. As of September 30, 2001, Freddie Mac also met this commitment.

### Capital Management

Freddie Mac manages its capital resources to provide attractive returns on common equity, maintain sufficient capital to satisfy internal capital adequacy standards and regulatory capital requirements, and absorb unforeseen losses that might arise in fulfilling its mortgage guarantee obligations and conducting its business programs.

Table 7 below sets forth Freddie Mac's capitalization at September 30, 2001.

**Table 7 — Total Capitalization**

	<u>September 30, 2001</u> (dollars in millions)
Debt securities:	
Notes and bonds payable due within one year:	
Discount notes, medium-term notes and securities sold under agreements to repurchase . . . . .	\$225,554
Current portion of long-term debt . . . . .	19,085
	<u>244,639</u>
Notes and bonds payable due after one year . . . . .	286,673
Total debt securities, net . . . . .	531,312
Subordinated borrowings . . . . .	3,122
Stockholders' equity . . . . .	14,506
Total capitalization . . . . .	<u>\$548,940</u>

Table 8 below summarizes the components of Freddie Mac's Core, Total and Adjusted total capital. These measures exclude the AOCI component of "Stockholders' equity," consistent with the corporation's regulatory capital requirements.

**Table 8 — Summary of Capital Measures**

	September 30, 2001	June 30, 2001	September 30, 2000
	(dollars in millions)		
Common stock:			
Par value .....	\$ 152	\$ 152	\$ 152
Additional paid-in capital .....	412	412	438
Preferred stock, at redemption value .....	4,296	4,296	3,195
Retained earnings .....	13,838	13,002	11,129
Treasury stock, at cost .....	(955)	(991)	(1,048)
<b>Core capital</b> .....	<u>17,743</u>	<u>16,871</u>	<u>13,866</u>
Reserve for mortgage losses .....	794	790	780
<b>Total capital</b> .....	<u>18,537</u>	<u>17,661</u>	<u>14,646</u>
Subordinated borrowings .....	3,122	2,130	142
<b>Adjusted total capital</b> .....	<u><u>\$21,659</u></u>	<u><u>\$19,791</u></u>	<u><u>\$14,788</u></u>

During third quarter 2001, the corporation added approximately \$1.9 billion to "Adjusted total capital" due to earnings growth and the issuance of subordinated debt. For the first nine months of 2001, the corporation added approximately \$6.4 billion to "Adjusted total capital" due to earnings growth, five preferred stock issuances and two Freddie SUBS issuances. The increase in Freddie Mac's core capital helped the corporation respond to growth opportunities.

The corporation did not redeem any preferred stock during the first nine months of 2001. At September 30, 2001, preferred stock with redemption values of \$150 million, \$200 million and \$250 million with dividend rates of 5.81 percent, 5.30 percent and a variable rate, respectively are redeemable. The corporation's 6.125 percent preferred stock issue with a redemption value of \$287 million will become redeemable on December 31, 2001 and its 6.14 percent preferred stock issue with a redemption value of \$600 million will become redeemable on June 30, 2002. No other issue of Freddie Mac's preferred stock will become redeemable in 2002. Freddie Mac's capital structure may be influenced by the redemption and replacement of all or part of these preferred stock issuances, which could result in changes in the corporation's mix of common and preferred equity funding. Redemption of preferred stock in future periods will depend primarily on interest-rate levels.

*Interim Risk-Based Capital Stress Test:* During 2000, Freddie Mac committed to disclose the results of an interim risk-based capital stress test that is consistent with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "GSE Act"), pending issuance and implementation of a final risk-based capital standard by OFHEO, and to update that disclosure on a quarterly basis. The two stress test scenarios are defined by large changes in interest rates and house prices. These factors affect the performance of Freddie Mac's portfolio because they affect the level of mortgage defaults and prepayments as well as Freddie Mac's cost of funds. At June 30, 2001 (the most current reporting period for which data are available), Freddie Mac had sufficient capital to satisfy the interim risk-based capital standard under the two stress test scenarios, which are described more fully in the Information Statement and on the corporation's Web site.

In addition to its internal assessment of capital adequacy, Freddie Mac ensures that capital is sufficient to comply with regulatory capital standards under the GSE Act. Freddie Mac and the Federal National Mortgage Association (“Fannie Mae”) are subject to certain minimum, critical and risk-based capital standards issued by OFHEO. At September 30, 2001, Freddie Mac’s estimated minimum capital requirement, as reported to OFHEO, was \$17.3 billion, up from \$16.3 billion and \$13.5 billion at June 30, 2001 and September 30, 2000, respectively. At September 30, 2001, Freddie Mac’s estimated critical capital requirement was \$8.8 billion, up from \$8.3 billion at June 30, 2001. Capital surplus, the excess of Freddie Mac’s regulatory core capital over the minimum capital requirement, was estimated at \$415 million at September 30, 2001, compared to \$567 million and \$340 million at June 30, 2001 and September 30, 2000, respectively. Freddie Mac actively manages its capital surplus by investing in highly rated, short-term instruments. See “MD&A — Regulatory Matters” in the Information Statement for a more detailed discussion of the calculation of minimum, critical and risk-based capital standards. See “RECENT EVENTS” for further discussion of OFHEO’s risk-based capital rule.



Freddie Mac's purchase volume for third quarter 2001 matched second quarter's record high of \$126 billion and represented an increase of 126 percent compared to third quarter 2000. Freddie Mac's purchase volume increased by 143 percent over the nine-month period ended September 30, 2000. Higher purchase volumes in third quarter 2001 and during the first nine months of 2001 reflect increased mortgage refinancing activity as a result of declining interest rates and a strong demand for fixed-rate mortgage products, which loan originators tend to sell to the GSEs. In third quarter 2001, refinanced mortgages, which represented 55 percent of Freddie Mac's total purchases, decreased from 65 percent in second quarter 2001 and increased from 25 percent in third quarter 2000. Fixed-rate mortgages represented 86 percent of Freddie Mac's purchases for third quarter 2001, down from 94 percent for second quarter 2001 and 88 percent for third quarter 2000. The percentage of fixed-rate mortgages purchased during the nine months ended September 30, 2001 was 90 percent, up from 87 percent for the corresponding period in 2000. The percentage of credit-enhanced purchases decreased to 21 percent for third quarter 2001 down from 31 percent for the second quarter of 2001 due primarily to a decline in the number of loans purchased that are covered by pool insurance.

During third quarter 2001, the corporation's market share, as a percentage of combined Freddie Mac and Fannie Mae purchases of both new mortgage originations and mortgage portfolios sold by whole-loan investors (or seasoned portfolios), was 42 percent, compared to 41 percent for second quarter 2001 and 44 percent for third quarter 2000. The corporation's purchase market share relative to Fannie Mae was 41 percent for the nine months ended September 30, 2001, unchanged from the corresponding period of the previous year. Freddie Mac competes for mortgages primarily on the basis of the relative strength of its mortgage purchase programs, security products, customer service, ease of mortgage purchase processing and price.

Third quarter 2001 structured securitization activity was \$51 billion, up from \$48 billion in second quarter 2001 and \$14 billion for third quarter 2000. Structured securitizations totaled \$122 billion during the first nine months of 2001, an increase of \$88 billion from the nine-month period ended September 30, 2000. The increase in structured securitization volume during third quarter 2001 and for the nine months ended September 30, 2001 was affected by the steepening of the yield curve, which has created strong investor demand for REMIC securities.

The annualized liquidation rate on the total mortgage portfolio was 24.8 percent for third quarter 2001 compared to 28.9 percent and 12.7 percent for second quarter 2001 and third quarter 2000, respectively. The annualized liquidation rate increased to 25.6 percent for the nine months ended September 30, 2001 compared to 12.0 percent for the corresponding period in 2000. The increase in liquidations for the nine months ended September 30, 2001 compared to the corresponding period in 2000, reflects accelerated borrower prepayments due to lower interest rates, as evidenced by the increase in the percentage of refinance mortgage purchases period-over-period.

## REVENUE ANALYSIS AND RATE/VOLUME ANALYSIS

Freddie Mac's revenue base consists of "Net interest income on earning assets," "Management and guarantee income" and "Other income, net." *Table 10*, which is prepared in accordance with accounting principles generally accepted in the U.S. ("GAAP"), reflects revenue analysis that presents daily weighted average balances and related yields earned on assets and rates paid on liabilities. *Table 10* also contains a rate/volume analysis that details the changes to "Total revenues." In addition, "Net interest income/yield (fully taxable equivalent basis)" is presented on this table. Taxable-equivalent adjustments to interest income involve 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. The "Operating Net Interest Yield Analysis" table, which is included in the corporation's third quarter 2001 earnings release package and is available at its Web site, is an analysis of net interest yield prepared on an operating earnings basis. See "OPERATING EARNINGS" for a discussion of Freddie Mac's supplemental performance measure.

**Table 10 — Revenue Analysis and Rate/Volume Analysis**

	Quarter Ended								
	September 30, 2001			June 30, 2001			September 30, 2000		
	Average Balance	Interest Income/Expense	Average Rate	Average Balance	Interest Income/Expense	Average Rate	Average Balance	Interest Income/Expense	Average Rate
	(dollars in millions)								
<b>Interest-earning assets:</b>									
Mortgages	\$ 60,891	\$ 1,103	7.24%	\$ 60,183	\$ 1,099	7.31%	\$ 56,698	\$ 1,047	7.39%
Guaranteed mortgage securities(1)	397,263	6,592	6.64%	376,110	6,284	6.68%	296,148	5,088	6.87%
Total retained portfolio	458,154	7,695	6.72%	436,293	7,383	6.77%	352,846	6,135	6.95%
Investments(2)	81,885	889	4.27%	77,432	968	4.96%	68,584	1,131	6.50%
Net benefit (cost) of derivatives		98			114			(2)	
<b>Total interest-earning assets</b>	<b>\$540,039</b>	<b>\$ 8,682</b>	<b>6.42%</b>	<b>\$513,725</b>	<b>\$ 8,465</b>	<b>6.58%</b>	<b>\$421,430</b>	<b>\$ 7,264</b>	<b>6.88%</b>
<b>Interest-bearing liabilities:</b>									
Short-term debt	\$213,016	\$(2,166)	3.98%	\$198,637	\$(2,404)	4.79%	\$162,336	\$(2,679)	6.46%
Long-term debt	300,031	(4,657)	6.21%	282,901	(4,391)	6.21%	238,619	(3,839)	6.43%
Total debt securities	513,047	(6,823)	5.28%	481,538	(6,795)	5.62%	400,955	(6,518)	6.44%
PC variance:									
Due to prepayments(3)	11,600	(206)	7.11%	16,443	(295)	7.18%	5,949	(103)	6.88%
Due to ARM/floating rate adjustments(4)	—	(9)	—%	—	(7)	—%	—	7	—%
Net cost of PC variance	11,600	(215)	7.42%	16,443	(302)	7.36%	5,949	(96)	6.43%
Net benefit (cost) of derivatives		(324)			(264)			87	
<b>Total interest-bearing liabilities</b>	<b>524,647</b>	<b>(7,362)</b>	<b>5.59%</b>	<b>497,981</b>	<b>(7,361)</b>	<b>5.89%</b>	<b>406,904</b>	<b>(6,527)</b>	<b>6.38%</b>
Net non-interest-bearing funding	15,392	—	—	15,744	—	—	14,526	—	—
<b>Total funding of interest-earning assets</b>	<b>\$540,039</b>	<b>\$(7,362)</b>	<b>5.43%</b>	<b>\$513,725</b>	<b>\$(7,361)</b>	<b>5.71%</b>	<b>\$421,430</b>	<b>\$(6,527)</b>	<b>6.16%</b>
Net interest income/yield		\$ 1,320	0.99%		\$ 1,104	0.87%		\$ 737	0.72%
Management and guarantee income	\$899,574	\$ 416	18.5bp	\$847,974	\$ 398	18.8bp	\$773,398	\$ 372	19.2bp
Fair value gains (losses)		\$ 33			\$ 22			\$ —	
Other income, net(5)		\$ 68			\$ 77			\$ 16	
<b>Total revenues</b>		<b>\$ 1,837</b>			<b>\$ 1,601</b>			<b>\$ 1,125</b>	
<b>Net interest income/yield (fully taxable equivalent basis)</b>		<b>\$ 1,375</b>	<b>1.03%</b>		<b>\$ 1,168</b>	<b>0.92%</b>		<b>\$ 787</b>	<b>0.77%</b>

	3rd Quarter 2001 vs. 2nd Quarter 2001 Increase or (Decrease) Due to				3rd Quarter 2001 vs. 3rd Quarter 2000 Increase or (Decrease) Due to			
	Rate	Volume	Total \$ Change	Total % Change	Rate	Volume	Total \$ Change	Total % Change
		(dollars in millions)						
<b>Interest-earning assets:</b>								
Mortgages	\$ (9)	\$ 13	\$ 4	— %	\$ (21)	\$ 77	\$ 56	5 %
Guaranteed mortgage securities	(45)	353	308	5 %	(233)	1,737	1,504	30 %
Total retained portfolio	(54)	366	312	4 %	(254)	1,814	1,560	25 %
Investments	(135)	56	(79)	(8)%	(463)	221	(242)	(21)%
Net benefit (cost) of derivatives	(16)	—	(16)		100	—	100	
<b>Total interest-earning assets</b>	<b>\$(205)</b>	<b>\$ 422</b>	<b>\$ 217</b>	<b>3 %</b>	<b>\$(617)</b>	<b>\$ 2,035</b>	<b>\$1,418</b>	<b>20 %</b>
<b>Interest-bearing liabilities:</b>								
Short-term debt	\$ 414	\$(176)	\$ 238	10 %	\$1,350	\$(837)	\$ 513	19 %
Long-term debt	—	(266)	(266)	(6)%	169	(987)	(818)	(21)%
Total debt securities	414	(442)	(28)	— %	1,519	(1,824)	(305)	(5)%
PC variance	(2)	89	87	29 %	(28)	(91)	(119)	(124)%
Net benefit (cost) of derivatives	(60)	—	(60)		(411)	—	(411)	
<b>Total interest-bearing liabilities</b>	<b>\$ 352</b>	<b>\$(353)</b>	<b>\$ (1)</b>	<b>— %</b>	<b>\$1,080</b>	<b>\$(1,915)</b>	<b>\$(835)</b>	<b>(13)%</b>
Net interest income	\$ 147	\$ 69	\$ 216	20 %	\$ 463	\$ 120	\$ 583	79 %
Management and guarantee income	\$ (6)	\$ 24	\$ 18	5 %	\$ (17)	\$ 61	\$ 44	12 %
Fair value gains (losses)			\$ 11	50 %			\$ 33	100 %
Other income, net			\$ (9)	(12)%			\$ 52	325 %
<b>Total revenues</b>			<b>\$ 236</b>	<b>15 %</b>			<b>\$ 712</b>	<b>63 %</b>

**Table 10 — Revenue Analysis and Rate/Volume Analysis (continued)**

	Nine Months Ended					
	September 30, 2001			September 30, 2000		
	Average Balance	Interest Income/Expense	Average Rate	Average Balance	Interest Income/Expense	Average Rate
<b>Interest-earning assets:</b>						
Mortgages	\$ 60,126	\$ 3,293	7.30%	\$ 56,635	\$ 3,126	7.36%
Guaranteed mortgage securities (6)	371,784	18,795	6.74%	283,555	14,418	6.78%
Total retained portfolio	431,910	22,088	6.82%	340,190	17,544	6.88%
Investments (7)	76,129	2,908	5.05%	68,216	3,172	6.16%
Net benefit (cost) of derivatives		234			(9)	
<b>Total interest-earning assets</b>	<b>\$508,039</b>	<b>\$ 25,230</b>	<b>6.62%</b>	<b>\$408,406</b>	<b>\$ 20,707</b>	<b>6.75%</b>
<b>Interest-bearing liabilities:</b>						
Short-term debt	\$195,280	\$ (7,100)	4.80%	\$166,895	\$ (7,741)	6.09%
Long-term debt	285,369	(13,389)	6.25%	221,493	(10,565)	6.36%
Total debt securities	480,649	(20,489)	5.66%	388,388	(18,306)	6.25%
PC variance:						
Due to prepayments (3)	12,410	(666)	7.16%	5,260	(272)	6.88%
Due to ARM/floating rate adjustments (4)	—	(16)	—	—	19	—
Net cost of PC variance	12,410	(682)	7.34%	5,260	(253)	6.41%
Net benefit (cost) of derivatives		(659)			(48)	
<b>Total interest-bearing liabilities</b>	<b>493,059</b>	<b>(21,830)</b>	<b>5.88%</b>	<b>393,648</b>	<b>(18,607)</b>	<b>6.26%</b>
Net non-interest-bearing funding	14,980	—	—	14,758	—	—
<b>Total funding of interest-earning assets</b>	<b>\$508,039</b>	<b>\$ (21,830)</b>	<b>5.71%</b>	<b>\$408,406</b>	<b>\$ (18,607)</b>	<b>6.04%</b>
Net interest income/yield		\$ 3,400	0.90%		\$ 2,100	0.71%
Management and guarantee income	\$858,079	\$ 1,206	18.7bp	\$762,050	\$ 1,106	19.3bp
Fair value gains (losses)		\$ 72			\$ —	
Other income, net (8)		\$ 181			\$ 92	
<b>Total revenues</b>		<b>\$ 4,859</b>			<b>\$ 3,298</b>	
Net interest income/yield (fully taxable equivalent basis)		\$ 3,578	0.95%		\$ 2,260	0.76%

	Nine months ended September 30, 2001 vs. Nine months ended September 30, 2000			
	Increase or (Decrease) Due to			
	Rate	Volume	Total \$ Change	Total % Change
(dollars in millions)				
<b>Interest-earning assets:</b>				
Mortgages	\$ (26)	\$ 193	\$ 167	5 %
Guaranteed mortgage securities	(109)	4,486	4,377	30 %
Total retained portfolio	(135)	4,679	4,544	26 %
Investments	(634)	370	(264)	(8) %
Net benefit (cost) of derivatives	243	—	243	
<b>Total interest-earning assets</b>	<b>\$ (526)</b>	<b>\$ 5,049</b>	<b>\$ 4,523</b>	<b>22 %</b>
<b>Interest-bearing liabilities:</b>				
Effective short-term debt	\$1,952	\$ (1,311)	\$ 641	8 %
Effective long-term debt	223	(3,047)	(2,824)	(27) %
Total debt securities	2,175	(4,358)	(2,183)	(12) %
PC variance	(85)	(344)	(429)	(170) %
Net benefit (cost) of derivatives	(611)	—	(611)	
<b>Total interest-bearing liabilities</b>	<b>\$1,479</b>	<b>\$ (4,702)</b>	<b>\$ (3,223)</b>	<b>(17) %</b>
Net interest income	\$ 953	\$ (347)	\$ 1,300	62 %
Management and guarantee income	\$ (39)	\$ 139	\$ 100	9 %
Fair value gains (losses)			\$ 72	100 %
Other income, net			\$ 89	97 %
<b>Total revenues</b>			<b>\$ 1,561</b>	<b>47 %</b>

- (1) Rates calculated on a fully taxable equivalent basis were 6.69%, 6.74%, and 6.93% for quarters ended September 30, 2001, June 30, 2001 and September 30, 2000, respectively, based upon related income of \$6,643 million, \$6,334 million, and \$5,128 million, respectively.
- (2) Rates calculated on a fully taxable equivalent basis were 4.32%, 5.03%, and 6.56% for quarters ended September 30, 2001, June 30, 2001 and September 30, 2000, respectively, based upon related income of \$898 million, \$982 million, and \$1,141 million, respectively.
- (3) Mortgage liquidations on which interest continues accruing to the security holder.
- (4) Rate changes on ARMs/floating rate mortgages for which the related security rate changes one month later.
- (5) Includes recognized net gains on certain hedging transactions totaling \$2 million for third quarter 2000.
- (6) Rates calculated on a fully taxable equivalent basis were 6.80% and 6.85% for the nine months ended September 30, 2001 and September 30, 2000, respectively, based upon related income of \$18,949 million and \$14,559 million, respectively.
- (7) Rates calculated on a fully taxable equivalent basis were 5.10% and 6.23% for nine months ended September 30, 2001 and September 30, 2000, respectively, based upon related income of \$2,937 million and \$3,221 million, respectively.
- (8) Includes recognized net gains on certain hedging transactions totaling \$58 million for the nine months ended September 30, 2000.

## OPERATING EARNINGS

On January 1, 2001, Freddie Mac implemented Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS 133"), which required the corporation to recognize on balance sheet all derivatives as either assets or liabilities (see "NOTES TO INTERIM FINANCIAL STATEMENTS"). Beginning with its first quarter 2001 reporting, Freddie Mac began providing a supplemental performance measure known as "operating earnings." Management believes that results presented on an operating basis are beneficial in understanding and analyzing Freddie Mac's financial performance because they better reflect the economic impact of the corporation's risk management activities. Results presented on an operating basis are also useful because they are comparable with reported results for periods prior to the adoption of SFAS 133.

Operating earnings, along with corresponding ratios, reflect adjustments to reported results to exclude certain accounting effects associated with SFAS 133. These adjustments include the elimination of the "Cumulative change in accounting principle, net of taxes" and "Fair value gains (losses)," which are included in earnings prepared in accordance with GAAP, as well as the recognition of straight-line amortization expense on purchased option premiums, which differs from how these premiums are amortized for reported earnings. Freddie Mac's operating earnings may not be comparable to supplemental performance measures with similar titles that are used by other companies.

Table 11 reconciles reported GAAP net income, which is presented in the corporation's Condensed Consolidated Statements of Income, to its operating earnings.

**Table 11 — Operating Earnings Reconciliation**

	Quarter Ended					
	September 30, 2001			June 30, 2001		
	Reported	Operating	Adjustment	Reported	Operating	Adjustment
	(Dollars in millions, except per share amounts)					
Net interest income on earning assets	\$ 1,320	\$ 1,015	\$ (305)	\$ 1,104	\$ 904	\$ (200)
Management and guarantee income	416	416	—	398	398	—
Fair value gains (losses)	33	—	(33)	22	—	(22)
Other income, net	68	68	—	77	77	—
<b>Total revenues</b>	<b>\$ 1,837</b>	<b>\$ 1,499</b>	<b>\$ (338)</b>	<b>\$ 1,601</b>	<b>\$ 1,379</b>	<b>\$ (222)</b>
Total non-interest expense	(253)	(253)	—	(244)	(244)	—
Income taxes	(487)	(368)	119	(408)	(331)	77
Extraordinary gain (loss) on retirement of debt, net of taxes	(65)	(65)	—	(35)	(35)	—
Cumulative effect of change in accounting principle, net of taxes	—	—	—	—	—	—
<b>Net income</b>	<b>\$ 1,032</b>	<b>\$ 813</b>	<b>\$ (219)</b>	<b>\$ 914</b>	<b>\$ 769</b>	<b>\$ (145)</b>
Preferred stock dividends	(58)	(58)	—	(53)	(53)	—
Net income available to common shareholders	974	755	(219)	861	716	(145)
Weighted average common shares outstanding — diluted (thousands)	697,203	697,203	—	696,657	696,657	—
<b>Earnings per common share — diluted</b>	<b>\$ 1.40</b>	<b>\$ 1.08</b>	<b>\$(0.32)</b>	<b>\$ 1.24</b>	<b>\$ 1.03</b>	<b>\$(0.21)</b>
	Nine Months Ended					
	September 30, 2001					
	Reported	Operating	Adjustment			
	(Dollars in millions, except per share amounts)					
Net interest income on earning assets	\$ 3,400	\$ 2,738	\$ (662)			
Management and guarantee income	1,206	1,206	—			
Fair value gains (losses)	72	—	(72)			
Other income, net	181	181	—			
<b>Total revenues</b>	<b>\$ 4,859</b>	<b>\$ 4,125</b>	<b>\$ (734)</b>			
Total non-interest expense	(743)	(743)	—			
Income taxes	(1,238)	(981)	257			
Extraordinary gain (loss) on retirement of debt, net of taxes	(100)	(100)	—			
Cumulative effect of change in accounting principle, net of taxes	5	—	(5)			
<b>Net income</b>	<b>\$ 2,783</b>	<b>\$ 2,301</b>	<b>\$ (482)</b>			
Preferred stock dividends	(158)	(158)	—			
Net income available to common shareholders	2,625	2,143	(482)			
Weighted average common shares outstanding — diluted (thousands)	696,849	696,849	—			
<b>Earnings per common share — diluted</b>	<b>\$ 3.77</b>	<b>\$ 3.07</b>	<b>\$(0.70)</b>			

Table 12 summarizes Freddie Mac's financial performance, prepared on the basis of operating earnings, for the third quarter 2001 as compared to second quarter 2001 and third quarter 2000 and for the nine months ended September 30, 2001 compared to the nine months ended September 30, 2000.

**Table 12 — Operating Results of Operations**

	Third Quarter 2001	Second Quarter 2001	Dollar Change	Percent Change	Third Quarter 2000	Dollar Change	Percent Change
	(dollars in millions, except per share amounts)						
Operating revenue .....	\$1,499	\$1,379	\$ 120	9%	\$1,125	\$ 374	33%
Total non-interest expense .....	(253)	(244)	9	4%	(227)	26	11%
Operating income before income taxes ..	1,246	1,135	111	10%	898	348	39%
Operating income taxes .....	(368)	(331)	37	11%	(256)	112	44%
Extraordinary gain (loss) on retirement of debt, net of taxes .....	(65)	(35)	30		3	68	
Operating earnings .....	<u>\$ 813</u>	<u>\$ 769</u>	<u>\$ 44</u>	6%	<u>\$ 645</u>	<u>\$ 168</u>	26%
Operating earnings per common share — diluted (1) .....	\$ 1.08	\$ 1.03	\$0.05	5%	\$ 0.86	\$0.22	26%
Operating net interest income on earning assets (fully taxable equivalent basis) (2) .....	\$1,070	\$ 968	\$ 102	11%	\$ 789	\$ 281	36%
Operating net interest yield on earning assets (fully taxable equivalent basis) (2) .....	0.80%	0.77%			0.77%		
Operating effective tax rate (3) .....	29.5%	29.2%			28.5%		

(1) After preferred stock dividends of \$58 million, \$53 million and \$45 million for the quarters ended September 30, 2001, June 30, 2001 and September 30, 2000, respectively.

(2) Income and yields for periods prior to 1Q 2001 include net gains on hedging activities reported in "Other Income, Net."

(3) Includes the tax effect of adjustments necessary to derive "Operating earnings."

	Nine Months Ended			
	September 30, 2001	September 30, 2000	Dollar Change	Percent Change
	(dollars in millions, except per share amounts)			
Operating revenue .....	\$4,125	\$3,298	\$ 827	25%
Total non-interest expense .....	(743)	(688)	55	8%
Operating income before income taxes ..	3,382	2,610	772	30%
Operating income taxes .....	(981)	(734)	247	34%
Extraordinary gain (loss) on retirement of debt, net of taxes .....	(100)	8	108	
Operating earnings .....	<u>\$2,301</u>	<u>\$1,884</u>	<u>\$ 417</u>	22%
Operating earnings per common share — diluted (1) .....	\$ 3.07	\$ 2.51	\$0.56	22%
Operating net interest income on earning assets (fully taxable equivalent basis) (2) .....	\$2,916	\$2,318	\$ 598	26%
Operating net interest yield on earning assets (fully taxable equivalent basis) (2) .....	0.78%	0.78%		
Operating effective tax rate (3) .....	29.0%	28.1%		

(1) After preferred stock dividends of \$158 million, \$135 million for the nine months ended September 30, 2001 and September 30, 2000, respectively.

(2) Income and yields for periods prior to 1Q 2001 include net gains on hedging activities reported in "Other Income, Net."

(3) Includes the tax effect of adjustments necessary to derive "Operating earnings."

## CONSOLIDATED RESULTS OF OPERATIONS

Table 13 summarizes Freddie Mac's financial performance, prepared in accordance with GAAP, for third quarter 2001 as compared to second quarter 2001 and third quarter 2000 and for the nine months ended September 30, 2001, as compared to the nine months ended September 30, 2000.

**Table 13 — Results of Operations**

	Third Quarter 2001	Second Quarter 2001	Dollar Change	Percent Change	Third Quarter 2000	Dollar Change	Percent Change
(dollars in millions, except per share amounts)							
Net interest income on earning assets	\$ 1,320	\$ 1,104	\$ 216	20 %	\$ 737	\$ 583	79 %
Management and guarantee income	416	398	18	5 %	372	44	12 %
Fair value gains (losses)	33	22	11	50 %	—	33	100 %
Other income, net(1)	68	77	(9)	(12)%	16	52	325 %
Total revenues	<u>1,837</u>	<u>1,601</u>	<u>236</u>	<u>15 %</u>	<u>1,125</u>	<u>712</u>	<u>63 %</u>
Credit-related expenses	(18)	(18)	—	— %	(21)	(3)	(14)%
Administrative expenses	(201)	(194)	7	4 %	(180)	21	12 %
Housing tax credit partnerships(2)	(34)	(32)	2	6 %	(26)	8	31 %
Total non-interest expense	<u>(253)</u>	<u>(244)</u>	<u>9</u>	<u>4 %</u>	<u>(227)</u>	<u>26</u>	<u>11 %</u>
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle	1,584	1,357	227	17 %	898	686	76 %
Income taxes	(487)	(408)	79	19 %	(256)	231	90 %
Extraordinary gain (loss) on retirement of debt, net of taxes	(65)	(35)	30		3	68	
Net income	<u>\$ 1,032</u>	<u>\$ 914</u>	<u>\$ 118</u>	<u>13 %</u>	<u>\$ 645</u>	<u>\$ 387</u>	<u>60 %</u>
Earnings per common share(3)							
Basic	\$ 1.40	\$ 1.24	\$0.16	13 %	\$ 0.87	\$ 0.53	61 %
Diluted	\$ 1.40	\$ 1.24	\$0.16	13 %	\$ 0.86	\$ 0.54	63 %
Net interest income on earning assets (fully taxable equivalent basis)	\$ 1,375	\$ 1,168	\$ 207	18 %	\$ 787	\$ 588	75 %
Net interest yield on earning assets (fully taxable equivalent basis)	1.03%	0.92%			0.77%		
Effective tax rate	30.7%	30.1%			28.5%		
Retained portfolio (in billions)	\$ 470.9	\$ 443.8	\$27.1	6 %	\$ 361.6	\$109.3	30 %
Total mortgage portfolio (in billions)(4)	\$1,106.7	\$1,047.9	\$58.8	6 %	\$ 920.9	\$185.8	20 %

	Nine Months Ended			
	September 2001	September 2000	Dollar Change	Percent Change
(dollars in millions, except per share amounts)				
Net interest income on earning assets	\$ 3,400	\$ 2,100	\$1,300	62 %
Management and guarantee income	1,206	1,106	100	9 %
Fair value gains (losses)	72	—	72	100 %
Other income, net(5)	181	92	89	97 %
Total revenues	<u>4,859</u>	<u>3,298</u>	<u>1,561</u>	<u>47 %</u>
Credit-related expenses	(60)	(81)	(21)	(26)%
Administrative expenses	(585)	(529)	56	11 %
Housing tax credit partnerships(2)	(98)	(78)	20	26 %
Total non-interest expense	<u>(743)</u>	<u>(688)</u>	<u>55</u>	<u>8 %</u>
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle	4,116	2,610	1,506	58 %
Income taxes	(1,238)	(734)	504	69 %
Extraordinary gain (loss) on retirement of debt, net of taxes	(100)	8	108	
Cumulative effect of change in accounting principle, net of taxes	5	—	5	100 %
Net income	<u>\$ 2,783</u>	<u>\$ 1,884</u>	<u>\$ 899</u>	<u>48 %</u>
Earnings per common share(6)				
Basic	\$ 3.78	\$ 2.52	\$ 1.26	50 %
Diluted	\$ 3.77	\$ 2.51	\$ 1.26	50 %
Net interest income on earning assets (fully taxable equivalent basis)	\$ 3,578	\$ 2,260	\$1,318	58 %
Net interest yield on earning assets (fully taxable equivalent basis)	0.95%	0.76%		
Effective tax rate	30.1%	28.1%		
Retained portfolio (in billions)	\$ 470.9	\$ 361.6	\$109.3	30 %
Total mortgage portfolio (in billions)(4)	\$1,106.7	\$ 920.9	\$185.8	20 %

(1) Includes recognized net gains on hedging activities totaling \$2 million for the quarter ended September 30, 2000.

(2) Represents costs associated with Freddie Mac's investment in housing tax credit partnerships. Tax credits generated by these investments reduce the corporation's tax liability.

(3) After preferred stock dividends of \$58 million, \$53 million and \$45 million for the quarters ended September 30, 2001, June 30, 2001, and September 30, 2000, respectively.

(4) Equal to the retained portfolio plus Total PCs, net of Freddie Mac PCs held in the retained portfolio.

(5) Includes recognized gains on hedging transactions totaling \$58 million for the nine months ended September 30, 2000.

(6) After preferred stock dividends of \$158 million and \$135 million for the nine months ended September 30, 2001 and September 30, 2000, respectively.

## Net Interest Income on Earning Assets

Freddie Mac's "Operating net interest income on earning assets" and reported "net interest income on earnings assets" performed well during the third quarter 2001 as well as for the first nine months of 2001. The Federal Reserve reduced short-term rates nine times during the first nine months of 2001, causing the yield curve to reach its steepest level since 1994. The steep yield curve resulted in wider initial spreads on Freddie Mac's substantial retained portfolio purchases during the first nine months of the year and also improved the spread on the corporation's existing interest-earning assets. The benefit of higher spreads on portfolio assets more than offset the effect of increased costs associated with derivatives. In addition, Freddie Mac experienced lower PC variance expense in third quarter 2001 as a result of declining prepayments and the effect of the corporation's recently adopted remittance cycle change (see "RECENT EVENTS").

2001's operating and reported FTE net interest income and yields differ due primarily to the treatment of the cost to enter into options. For operating purposes, the cost to enter into options is recognized into income on a straight-line basis over the life of the options, while for reported purposes, the amount recognized into income will fluctuate from period to period based on the mark-to-market value of the derivatives and the life of the underlying hedged items.

For third quarter 2001, "Operating net interest income on earning assets" totaled \$1,015 million compared to \$904 million for second quarter 2001 and \$737 million in third quarter 2000. Third quarter 2001, operating FTE net interest income, totaled \$1,070 million compared to \$968 million in second quarter 2001 and \$789 million in third quarter 2000. Growth in operating FTE net interest income from the second quarter 2001 reflects a 5 percent increase in the operating average balance of interest-earning assets coupled with a 3 basis point increase in operating FTE net interest yield on earning assets (0.80 percent for third quarter 2001 versus 0.77 percent for second quarter 2001). Growth in operating FTE net interest income from the third quarter 2000 reflects a 28 percent increase in the operating average balance of interest-earning assets coupled with a 3 basis point increase in operating FTE net interest yield on earning assets (0.80 percent for third quarter 2001 versus 0.77 percent for third quarter 2000).

For third quarter 2001, reported "Net interest income on earning assets" totaled \$1,320 million compared to \$1,104 million for second quarter 2001 and \$737 million for third quarter 2000. For third quarter 2001, reported FTE net interest income totaled \$1,375 million compared to \$1,168 million second quarter 2001 and \$787 million for third quarter 2000. Growth in reported FTE net interest income from second quarter 2001 reflects a 5 percent increase in the reported average balance of interest-earning assets coupled with a 11 basis point increase in reported FTE net interest yield on earning assets (1.03 percent for third quarter 2001 versus 0.92 percent for second quarter 2001). Growth in reported FTE net interest income from third quarter 2000 reflects a 28 percent increase in the reported average balance of interest-earning assets coupled with a 26 basis point increase in reported FTE net interest yield on earning assets (1.03 percent for third quarter 2001 versus 0.77 percent for third quarter 2000).

For the nine months ended September 30, 2001, "Operating net interest income on earning assets" totaled \$2,738 million compared to \$2,100 million for the nine months ended September 30, 2000. Operating FTE net interest income on earning assets was \$2,916 million for the nine months ended September 30, 2001, an increase of 26 percent over operating FTE net interest income of \$2,318 million for the comparable 2000 period. Growth in operating FTE net interest income reflects an increase of 26 percent in the operating average balance of interest-earning assets from the nine months ended September 30, 2000.

For the nine months ended September 30, 2001, reported "Net interest income on earning assets" totaled \$3,400 million compared to \$2,100 million for the nine months ended September 30, 2000. Reported FTE net interest income was \$3,578 million for the nine months ended September 30, 2001 compared to \$2,260 million for the same period during 2000. Growth in reported FTE net interest income reflects an increase of 24 percent in the reported average balance of interest-earning assets from the nine months ended September 30, 2000 coupled with a 19 basis point increase in reported FTE net interest yield on earning assets (0.95 percent for the nine months ended September 30, 2001 versus 0.76 percent for the nine months ended September 30, 2000).

## Management and Guarantee Income

For third quarter 2001, “Management and guarantee income” increased \$18 million and \$44 million compared to second quarter 2001 and third quarter 2000, respectively, due to increases in the average balance of Total PCs, partially offset by a 0.3 and 0.7 basis point declines, respectively, in average guarantee fee rates.

For the nine months ended September 30, 2001, “Management and guarantee income” increased \$100 million compared to the nine months ending September 30, 2000 primarily due to a \$96 billion increase in the average balance of Total PCs, partially offset by a 0.6 basis point decline in the average guarantee fee rate.

The average guarantee fee rate continued to be affected by portfolio turnover, with fee rates on new PC issuances typically below the average fee rate of the Total PC portfolio. Lower rates reflect a number of factors, including continued competitive pricing pressures, Freddie Mac’s reduced exposure to mortgage credit risk (because a higher proportion of the mortgages that underlie PCs are credit-enhanced), and changes in Freddie Mac’s exposure to other risk factors such as the mix of mortgages that underlie PCs. The impact of portfolio turnover was higher in third quarter 2001 compared to third quarter 2000 due to the increase in mortgage prepayments experienced during a declining interest-rate environment.

## Fair Value Gains (Losses)

Freddie Mac began recording “Fair value gains (losses)” on its Condensed Consolidated Statements of Income in 2001 upon adoption of SFAS 133. Hedge ineffectiveness arises when the fair value change of a derivative is not exactly offset by the fair value change in the hedged item. Hedge ineffectiveness on fair value hedges, reported as “Fair value gains (losses),” totaled \$33 million for third quarter 2001 compared to \$22 million for second quarter 2001. On a year-to-date basis, hedge ineffectiveness on fair value hedges totaled \$72 million.

## Other Income, Net

“Other income, net,” which tends to fluctuate from period to period, consists primarily of fees earned from resecuritization and technology programs and gains and losses from investment and other activities. During the third quarter 2001, “Other income, net” decreased \$9 million from second quarter 2001 and increased \$52 million compared to third quarter 2000 both primarily driven by fees generated by resecuritization activity. On a year-to-date basis, “Other income, net” increased \$89 million over the nine months ended September 30, 2000 primarily due to a \$74 million increase in resecuritization fees.

## Credit-Related Expenses

On a quarterly basis, credit-related expenses (which consist of the “Provision for mortgage losses” and “REO operations expense”) of \$18 million remained consistent with second quarter 2001 and decreased \$3 million, or 14 percent compared to third quarter 2000. A \$4 million reduction in single-family “REO Operations Expense” drove the decline from third quarter 2000, respectively. On a year-to-date basis, “Credit-related expenses” decreased \$21 million, or 26 percent, compared to the first nine months of 2000. Freddie Mac’s loss mitigation activities, consistently strong house-price appreciation and the on-going use of credit enhancements continued to have a favorable impact on credit expenses (see “RISK MANAGEMENT — Mortgage Credit Risk — *Credit Performance*”).

## Administrative Expenses

“Administrative expenses” totaled \$201 million during the third quarter 2001, an increase from second quarter of \$7 million, or 4 percent, and an increase from third quarter 2000 of \$21 million, or 12 percent. Annualized administrative expenses as percentage of the average total mortgage portfolio equaled 7.5 basis points for the third quarter 2001 compared to 7.6 basis points for second quarter 2001 and 8.0 basis points for the third quarter 2000.

“Administrative expenses” increased \$56 million, or 11 percent, over the nine months ended September 30, 2000. Annualized administrative expenses for the nine-month period, as a percentage of the average total mortgage portfolio, totaled 7.6 basis points in 2001 compared to 8.0 basis points in 2000.

### **Housing Tax Credit Partnerships**

The costs associated with Freddie Mac’s investment in “Housing tax credit partnerships” during third quarter 2001 of \$34 million increased from second quarter 2001 by \$2 million and increased by \$8 million from third quarter 2000. For the nine months ended September 30, 2001, the cost associated with Freddie Mac’s investment in housing tax credit partnerships increased \$20 million over the nine months ended September 30, 2000. While these investments, which are used to develop multifamily low-income rental properties, create operating losses, they also generate tax credits that reduce the corporation’s federal income tax liability.

### **Income Taxes**

Quarterly “Operating income taxes,” increased \$37 million, or 11 percent, compared to second quarter 2001 and increased \$112 million, or 44 percent, compared to third quarter 2000. The operating effective income tax rate for the third quarter 2001, was 29.5 percent, up from 29.2 percent and 28.5 percent in the second quarter 2001 and the third quarter 2000, respectively. For the nine months ended September 30, 2001, “Operating income taxes” increased \$247 million from the same period in 2000. The operating effective income tax rate for the nine months ended September 30, 2001, was 29.0 percent, up from 28.1 percent for the nine months ended September 30, 2000.

Reported “Income taxes,” increased \$79 million during the third quarter of 2001, or 19 percent, compared to second quarter 2001 and increased \$231 million, or 90 percent compared to third quarter 2000. The reported effective income tax rate for the third quarter 2001 was 30.7 percent, up from 30.1 percent in second quarter 2001 and 28.5 percent in third quarter 2000. For the nine months ended September 30, 2001, reported “Income taxes” increased \$504 million from the same period in 2000. The reported effective income tax rate for the nine months ended September 30, 2001, was 30.1 percent, up from 28.1 percent for the nine months ended September 30, 2000.

Reported “Income taxes” and “Operating income taxes” as well as effective income tax rates exclude the tax effects related to the cumulative effect of change in accounting principle and extraordinary gain (loss) on retirement of debt.

### **Extraordinary Gain (Loss) on Retirement of Debt, Net of Taxes**

From time to time Freddie Mac repurchases high cost debt, depending on market conditions and portfolio objectives. Freddie Mac incurred a \$65 million after-tax loss on the repurchase of \$1.5 billion in debt and a \$35 million after-tax loss on the repurchase of \$1.1 billion in debt during third quarter 2001 and second quarter 2001, respectively. During third quarter 2000, Freddie Mac incurred a \$3 million after-tax gain on the repurchase of debt in the amount of \$0.3 billion. For the nine months ended September 30, 2001, Freddie Mac incurred a \$100 million after-tax loss on the repurchase of debt in the amount of \$2.6 billion versus an \$8 million after-tax gain on the repurchase of debt in the amount of \$0.4 billion for the same period in 2000.

### **Cumulative Effect of Change in Accounting Principle, Net of Taxes**

On January 1, 2001, Freddie Mac implemented SFAS 133, which required the corporation to recognize on balance sheet all derivatives as either assets or liabilities measured at their fair value. The one-time, net cumulative after-tax adjustments required by SFAS 133 resulted in an increase to first quarter 2001 “Net income” of \$5 million. The increase to “Net income” primarily resulted from gains recognized in measuring certain derivatives at fair value, partially offset by losses resulting from a portfolio restructuring related to certain securities transferred from held-to-maturity.

## RECENT EVENTS

### Board of Directors

On September 7, 2001, the Board of Directors appointed Shaun F. O'Malley to the Board for a term expiring on the date of the next annual meeting of shareholders. Maud Mater, who continues to serve as Executive Vice President — General Counsel and Secretary of Freddie Mac, served on the Board until Mr. O'Malley's appointment.

### Regulation and Governmental Relationships

On September 13, 2001, OFHEO published its final risk-based capital rule in the Federal Register. That publication triggered a one-year period before the risk-based capital rule may be incorporated into OFHEO's classification of the capital adequacy of Freddie Mac and Fannie Mae. OFHEO has indicated publicly its intent to publish a notice of proposed rulemaking that would amend certain aspects of the final rule, including capital charges for counterparty risk ("haircuts"). We do not anticipate that such amendments, if adopted, would have a materially adverse impact on Freddie Mac. During the implementation period, Freddie Mac and Fannie Mae are to be classified as adequately capitalized, the highest capital classification, so long as they meet the minimum capital standard. Freddie Mac anticipates that when the risk-based capital rule becomes operative at the end of the one-year implementation period Freddie Mac will continue to be classified at the highest possible classification, as it has been since OFHEO began classifying Freddie Mac in 1993. Management believes that the risk-based capital rule is flexible enough for Freddie Mac to use many strategies to meet the rule's capital requirements.

### Equity Securities

On October 30, 2001, Freddie Mac issued 6 million shares of 5.7% Non-Cumulative Preferred Stock (the "Non-Cumulative Preferred Stock") at a price of \$50 per share. The Non-Cumulative Preferred Stock has a liquidation preference of \$50 per share, is redeemable beginning on December 31, 2006 and at any time thereafter and ranks on a parity, both as to dividends and upon liquidation, with other currently outstanding series of Freddie Mac preferred stock.

### Management

Michael Hager was appointed Senior Vice President-Human Resources, effective September 7, 2001. Before joining Freddie Mac, Mr. Hager was Senior Vice President, Human Resources at the Russell Corporation for two years. Prior to that, he was Chief Human Resources Officer and Senior Vice President at BANC ONE CORPORATION.

David Andrukonis was appointed as Senior Vice President-Capital Deployment, effective September 24, 2001. Mr. Andrukonis has previously served as Senior Vice President-Chief Credit Officer.

Robert Tsien was appointed Senior Vice President – Chief Credit Officer, effective September 24, 2001. Mr. Tsien has previously served as Vice President – Multifamily Risk Management.

### Events of September 11, 2001

After the attacks on the United States on September 11, 2001, Freddie Mac provided uninterrupted service to its customers in the mortgage origination industry and continued to fulfill its mission of maintaining the flow of affordable funds to America's mortgage borrowers. Freddie Mac continued to buy mortgages and mortgage securities and was the first large issuer of term debt in the global capital markets following September 11th. Freddie Mac also extended assistance to the victims of the attacks, their families and those involved in the ongoing relief efforts. On September 14, Freddie Mac announced its "Peace of Mind Plan" to ensure that no directly affected borrowers lose their homes as a result of the attacks. In addition, Freddie Mac

pledged \$10 million as part of a larger industry commitment to support general relief for the victims' survivors and rebuilding efforts.

#### **PC Accounting Cycle Change**

Beginning in July 2001, Freddie Mac implemented a change in its prepayment accounting cycle for certain Gold and ARM PCs from a "mid-month" accounting cycle to a conventional calendar month accounting cycle. This change enabled Freddie Mac to pass through mortgage prepayments to PC investors more efficiently and standardized Freddie Mac's process to conform with industry practice.

### **CUSTOMER AND MARKET SUPPORT ACTIVITIES**

#### **Market Support for PCs**

Freddie Mac supports the market for its PCs through various activities, including the securities trading activities of its Securities Sales and Trading Group, participating with external money management firms to buy and sell PCs, marketing to dealers and investors the relative merits of trading and investing in PCs, participating in various financial markets, and introducing new mortgage-related securities products and related initiatives. Freddie Mac may increase, reduce or discontinue these or other related activities at any time.

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(unaudited)**

	Quarter Ended			Nine Months Ended	
	September 30, 2001	June 30, 2001	September 30, 2000	September 30, 2001	September 30, 2000
	(dollars in millions, except per share amounts)				
Interest income .....	\$ 8,682	\$ 8,465	\$ 7,264	\$ 25,230	\$ 20,707
Interest expense .....	(7,362)	(7,361)	(6,527)	(21,830)	(18,607)
Net interest income on earning assets .....	1,320	1,104	737	3,400	2,100
Management and guarantee income .....	416	398	372	1,206	1,106
Fair value gains (losses) .....	33	22	—	72	—
Other income, net .....	68	77	16	181	92
Total revenues .....	1,837	1,601	1,125	4,859	3,298
Provision for mortgage losses .....	(10)	(10)	(10)	(30)	(30)
REO operations expense .....	(8)	(8)	(11)	(30)	(51)
Administrative expenses .....	(201)	(194)	(180)	(585)	(529)
Housing tax credit partnerships .....	(34)	(32)	(26)	(98)	(78)
Total non-interest expense .....	(253)	(244)	(227)	(743)	(688)
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle .....	1,584	1,357	898	4,116	2,610
Income taxes .....	(487)	(408)	(256)	(1,238)	(734)
Income before extraordinary items and cumulative effect of change in accounting principle, net of taxes .....	1,097	949	642	2,878	1,876
Extraordinary gain (loss) on retirement of debt, net of taxes .....	(65)	(35)	3	(100)	8
Cumulative effect of change in accounting principle, net of taxes .....	—	—	—	5	—
Net income .....	<u>\$ 1,032</u>	<u>\$ 914</u>	<u>\$ 645</u>	<u>\$ 2,783</u>	<u>\$ 1,884</u>
Preferred stock dividends .....	(58)	(53)	(45)	(158)	(135)
Net income available to common stockholders .....	<u>\$ 974</u>	<u>\$ 861</u>	<u>\$ 600</u>	<u>\$ 2,625</u>	<u>\$ 1,749</u>
Basic earnings per common share before extraordinary items and cumulative effect of change in accounting principle .....	\$ 1.49	\$ 1.29	\$ 0.86	\$ 3.91	\$ 2.51
Extraordinary gain (loss) on retirement of debt, net of taxes .....	(0.09)	(0.05)	0.01	(0.14)	0.01
Cumulative effect of change in accounting principle, net of taxes .....	—	—	—	0.01	—
Basic earnings per common share after extraordinary items and cumulative effect of change in accounting principle .....	<u>\$ 1.40</u>	<u>\$ 1.24</u>	<u>\$ 0.87</u>	<u>\$ 3.78</u>	<u>\$ 2.52</u>
Diluted earnings per common share before extraordinary items and cumulative effect of change in accounting principle .....	\$ 1.49	\$ 1.29	\$ 0.86	\$ 3.90	\$ 2.50
Extraordinary gain (loss) on retirement of debt, net of taxes .....	(0.09)	(0.05)	—	(0.14)	0.01
Cumulative effect of change in accounting principle, net of taxes .....	—	—	—	0.01	—
Diluted earnings per common share after extraordinary items and cumulative effect of change in accounting principle .....	<u>\$ 1.40</u>	<u>\$ 1.24</u>	<u>\$ 0.86</u>	<u>\$ 3.77</u>	<u>\$ 2.51</u>
Weighted average common shares outstanding (thousands)					
Basic .....	694,661	693,726	691,543	693,826	693,984
Diluted .....	697,203	696,657	693,719	696,849	696,643
Dividends per common share .....	\$ 0.20	\$ 0.20	\$ 0.17	\$ 0.60	\$ 0.51

**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(unaudited)

	September 30, 2001	June 30, 2001	December 31, 2000	September 30, 2000
	(dollars in millions)			
<b>Assets</b>				
Mortgages, net .....	\$ 59,311	\$ 61,213	\$ 58,906	\$ 56,712
Guaranteed mortgage securities (GMS) .....	419,309	381,990	327,054	303,636
Purchase and sale premiums, discounts and deferred fees .....	(3,734)	(654)	(843)	(1,044)
Retained portfolio, net .....	474,886	442,549	385,117	359,304
Cash and cash equivalents .....	583	973	366	224
Investments .....	65,964	63,323	48,206	48,593
Other assets .....	30,474	30,745	25,608	25,225
<b>Total assets</b> .....	<b>\$ 571,907</b>	<b>\$ 537,590</b>	<b>\$ 459,297</b>	<b>\$ 433,346</b>
<b>Liabilities and Stockholders' Equity</b>				
Debt securities, net				
Due within one year .....	\$ 244,639	\$ 223,509	\$ 183,576	\$ 180,652
Due after one year .....	286,673	271,073	243,178	226,142
Total debt securities, net .....	531,312	494,582	426,754	406,794
Other liabilities .....	22,967	26,898	17,561	13,218
Total Mortgage Participation Certificates (Total PCs) .....	927,490	873,750	822,310	790,891
Less—Underlying mortgages .....	(927,490)	(873,750)	(822,310)	(790,891)
Total guarantees, net .....	—	—	—	—
Subordinated borrowings .....	3,122	2,130	145	142
Stockholders' equity .....	14,506	13,980	14,837	13,192
<b>Total liabilities and stockholders' equity</b> .....	<b>\$ 571,907</b>	<b>\$ 537,590</b>	<b>\$ 459,297</b>	<b>\$ 433,346</b>

**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(unaudited)

	Nine Months Ended September 30, 2001						
	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Treasury Stock, at Cost	Stockholders' Equity
	(dollars in millions)						
Balance, December 31, 2000 .....	\$3,195	\$152	\$429	\$11,629	\$ 456	\$(1,024)	\$14,837
Net income .....				2,783			2,783
Change in accumulated other comprehensive income, net of taxes .....					(3,693)		(3,693)
Cash dividends declared:							
Preferred stock .....				(158)			(158)
Common stock .....				(416)			(416)
Preferred stock issuance, net .....	1,101		(10)				1,091
Common stock issuance, net .....			(7)			69	62
Balance, September 30, 2001 .....	\$4,296	\$152	\$412	\$13,838	\$(3,237)	\$ (955)	\$14,506

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited)

	Quarter Ended			Nine Months Ended	
	September 30, 2001	June 30, 2001	September 30, 2000	September 30, 2001	September 30, 2000
	(dollars in millions)				
<b>Net Cash Provided By Operating Activities</b>	\$ 1,068	\$ 1,752	\$ 1,529	\$ 9,234	\$ 7,968
<b>Cash Flows From Investing Activities:</b>					
Purchases of mortgages and mortgage investments	(62,477)	(66,158)	(22,998)	(190,259)	(68,528)
Repayment and sale of mortgage investments	31,120	37,496	10,633	91,408	27,223
PC issuances under Cash Program	4,111	6,274	1,375	13,055	3,461
Proceeds from sales of REO	179	216	219	576	696
Net decrease (increase) in investments	(3,426)	(13,922)	(8,802)	(19,736)	(12,293)
Net decrease (increase) in securities purchased under agreements to resell	1,255	31	(1,296)	2,569	521
<b>Net cash used in investing activities</b>	<u>(29,238)</u>	<u>(36,063)</u>	<u>(20,869)</u>	<u>(102,387)</u>	<u>(48,920)</u>
<b>Cash Flows From Financing Activities:</b>					
Proceeds from issuance of short-term debt	550,187	488,973	658,486	1,594,088	1,925,987
Repayments of short-term debt	(534,880)	(461,216)	(661,914)	(1,526,773)	(1,947,127)
Proceeds from issuance of long-term debt	49,191	49,431	24,227	150,135	63,720
Repayments of long-term debt	(35,634)	(42,024)	(1,606)	(122,727)	(5,839)
Proceeds from issuance of preferred stock	—	370	—	1,091	—
Other	(1,084)	(858)	(147)	(2,444)	(709)
<b>Net cash provided by financing activities</b>	<u>27,780</u>	<u>34,676</u>	<u>19,046</u>	<u>93,370</u>	<u>36,032</u>
Net increase (decrease) in cash and cash equivalents	(390)	365	(294)	217	(4,920)
Cash and cash equivalents at beginning of period	<u>973</u>	<u>608</u>	<u>518</u>	<u>366</u>	<u>5,144</u>
Cash and cash equivalents at end of period	<u>\$ 583</u>	<u>\$ 973</u>	<u>\$ 224</u>	<u>\$ 583</u>	<u>\$ 224</u>
<b>Supplemental Cash Flow Information</b>					
Cash paid for:					
Interest	\$ 8,248	\$ 6,041	\$ 7,050	\$ 23,040	\$ 18,462
Income taxes	—	142	148	374	544
Non-cash financing activities:					
Transfers to REO	206	233	202	639	663

## NOTES TO INTERIM FINANCIAL STATEMENTS

### Basis of Presentation

In the opinion of Freddie Mac, the preceding unaudited Condensed Consolidated Financial Statements, prepared from the corporation's books and records, contain all adjustments necessary for a fair presentation of the corporation's financial condition as of September 30, 2001, June 30, 2001, December 31, 2000 and September 30, 2000, and the results of operations and its cash flows for each of the three-month periods ended September 30, 2001, June 30, 2001 and September 30, 2000 and nine month periods ended September 30, 2001 and September 30, 2000. Freddie Mac's financial reporting and accounting policies conform to accounting principles generally accepted in the U.S. ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Adjustments included herein are of a normal and recurring nature. Certain previously reported amounts have been reclassified to conform with the current period presentation. Results of operations reported for interim periods are not necessarily indicative of results for the entire year. These unaudited financial statements should be read in conjunction with the audited financial statements included in the Information Statement dated March 26, 2001. These unaudited financial statements are stated on a basis substantially consistent with that of the December 31, 2000 audited financial statements, with the exception of the adoption and application of Statement of Financial Accounting Standard No. 133 ("SFAS 133") on January 1, 2001. See "Accounting Change".

### Accounting Change

On January 1, 2001, Freddie Mac implemented SFAS 133, which required the corporation to recognize on its balance sheet all derivatives as either assets or liabilities measured at their fair value. The adoption of this standard did not affect the corporation's previously issued financial statements up to and including the December 31, 2000 financial results. The one-time, net cumulative after-tax adjustments required by SFAS 133 resulted in an increase to "Net income" of \$5 million and a \$2.5 billion reduction to "Accumulated Other Comprehensive Income, Net of Taxes" ("AOCI"), a component of "Stockholders' equity." The increase to "Net income" primarily resulted from gains recognized in measuring certain derivatives at fair value, partially offset by losses resulting from portfolio restructurings that transferred certain securities from the held-to-maturity portfolio. The reduction to AOCI primarily resulted from SFAS 133's requirement to recognize the corporation's cash flow hedges on the balance sheet at fair value, partially offset by gains resulting from portfolio restructurings that transferred certain securities from the held-to-maturity portfolio. Consistent with other GAAP-based equity valuation adjustments, the change in GAAP-based equity due to SFAS 133 does not affect Freddie Mac's regulatory core capital, which is equal to "Stockholders' equity," excluding certain mark-to-market adjustments.

Freddie Mac enters into derivatives as an end user in connection with its investment funding and market risk management activities. Derivatives are a critical component in executing funding and other transactions to reduce risk and preserve value. By using derivatives, Freddie Mac is better able to match the expected cash flows of its assets and liabilities and reduce the corporation's exposure to interest-rate and/or foreign currency risk (see "MD&A — RISK MANAGEMENT — Interest-Rate Risk and Other Market Risks.")

When derivatives meet specific hedge criteria, they are accounted for as either fair value hedges or cash flow hedges. Although Freddie Mac executes derivatives as a method of reducing risk or otherwise preserving economic value, in some cases certain derivatives do not satisfy SFAS 133's hedge criteria and thus are not accounted for as hedges. Those derivatives are reported at fair value through "Other income."

Fair value hedges represent hedges of exposure to changes in the fair value of a recognized fixed-rate asset, liability or firm commitment. Freddie Mac uses interest-rate swaps, futures, and other Treasury-based and agency-based instruments to hedge against the changes in fair value of fixed rate debt due to changes in benchmark interest-rates and/or foreign currency fluctuations. Freddie Mac also uses swaps and options to hedge against changes in fair value of prepayment options embedded in the PCs held in the retained portfolio.

Fair value hedges are reported at their fair value as either “Other assets” or “Other liabilities,” with changes in fair value reported as “Fair value gains (losses).” The hedged item also reflects changes in fair value related to the hedged risk, with the offset being recorded to “Fair value gains (losses).” Hedge ineffectiveness arises when the fair value change of the derivative does not exactly offset the change in fair value of the hedged risk. For the first nine months of 2001, hedge ineffectiveness related to fair value hedges was a net \$72 million gain.

Cash flow hedges represent hedges of exposure to the variability in the cash flows of a recognized floating-rate asset or liability or a forecasted transaction. Freddie Mac uses interest-rate swaps, futures, and other Treasury-based and agency-based derivative instruments to hedge the changes in cash flows of short-term debt and forecasted issuances of debt. Freddie Mac hedges its exposure to the variability in future cash flows of forecasted transactions for a maximum of 30 years, although a substantial majority of the economic value associated with these hedges will be reflected in the corporation’s financial statements over the next 6 years. Cash flow hedges are reported at their fair value as either “Other assets” or “Other liabilities” with changes in fair value reported in AOCI. The change in fair value of the derivative from inception of the hedge is compared to the cumulative change in expected future cash flows on the hedged transaction, with any resulting ineffectiveness recorded to “Fair value gains (losses).” For the first nine months of 2001, there was no hedge ineffectiveness related to cash flow hedges.

As noted above, the adoption of SFAS 133 resulted in a \$2.5 billion after-tax reduction to AOCI on January 1, 2001. This adjustment to AOCI was primarily due to SFAS 133’s requirement to record the corporation’s cash flow hedges to fair market value, with an offsetting entry to AOCI. As a result of declines in market interest rates during the first nine months of 2001, Freddie Mac recorded an additional after-tax reduction to AOCI of \$6.4 billion due to SFAS 133. Assuming no changes in interest rates or other factors affecting derivative valuations, the corporation expects that approximately \$2.9 billion of the balance of AOCI at September 30, 2001 will be reclassified to “Net interest income on earning assets” over the next 12 months. These reclassifications represent cash flows on the related derivative instruments and affect “Net interest income on earning assets” in a manner consistent with the treatment for such derivatives prior to the adoption of SFAS 133. Although changes in interest rates may cause significant fluctuations in AOCI, they will have minimal effect on the corporation’s effective funding costs associated with hedged transactions. Freddie Mac’s “Net interest income on earning assets” includes the cash flows on all interest-earning assets, debt securities, and derivative instruments.

## Business Segment Reporting

Management assesses corporate performance and allocates capital principally on the basis of the two methods by which it finances mortgages and mortgage-related investments: mortgage securitization and debt financing activities. The table below presents each segment's financial performance for interim periods. See Note 12 to the Consolidated Financial Statements included in the Information Statement for further discussion of the methods used to allocate revenues and expenses to each segment.

Quarter Ended September 30, 2001						
Mortgage Securitization Financing	Debt Financing	Elimination(1)	Reported Consolidated	Adjustments(2)	Operating Consolidated	
(dollars in millions)						
Net interest income on earning assets(3)	\$ 34	\$1,240	\$46	\$1,320	\$(305)	\$1,015
Management and guarantee income	462	—	(46)	416	—	416
Fair value gains	—	33	—	33	(33)	—
Other income, net	118	(50)	—	68	—	68
<b>Total revenues</b>	<b>614</b>	<b>1,223</b>	<b>—</b>	<b>1,837</b>	<b>(338)</b>	<b>1,499</b>
Credit-related expenses	(18)	—	—	(18)	—	(18)
Administrative expenses	(154)	(47)	—	(201)	—	(201)
Housing tax credit partnerships	(34)	—	—	(34)	—	(34)
Income before income taxes	408	1,176	—	1,584	(338)	1,246
Provision for income taxes	(110)	(377)	—	(487)	119	(368)
Income before extraordinary items, net of taxes	298	799	—	1,097	(219)	878
Extraordinary loss on retirement of debt, net of taxes	—	(65)	—	(65)	—	(65)
<b>Net income</b>	<b>\$ 298</b>	<b>\$ 734</b>	<b>\$—</b>	<b>\$1,032</b>	<b>\$(219)</b>	<b>\$ 813</b>

Quarter Ended June 30, 2001						
Mortgage Securitization Financing	Debt Financing	Elimination(1)	Reported Consolidated	Adjustments(2)	Operating Consolidated	
(dollars in millions)						
Net interest income on earning assets (3)	\$ 26	\$1,032	\$ 46	\$1,104	\$(200)	\$ 904
Management and guarantee income	444	—	(46)	398	—	398
Fair value gains	—	22	—	22	(22)	—
Other income, net	96	(19)	—	77	—	77
<b>Total revenues</b>	<b>566</b>	<b>1,035</b>	<b>—</b>	<b>1,601</b>	<b>(222)</b>	<b>1,379</b>
Credit-related expenses	(18)	—	—	(18)	—	(18)
Administrative expenses	(146)	(48)	—	(194)	—	(194)
Housing tax credit partnerships	(32)	—	—	(32)	—	(32)
Income before income taxes	370	987	—	1,357	(222)	1,135
Provision for income taxes	(100)	(308)	—	(408)	77	(331)
Income before extraordinary items, net of taxes	270	679	—	949	(145)	804
Extraordinary loss on retirement of debt, net of taxes	—	(35)	—	(35)	—	(35)
<b>Net income</b>	<b>\$ 270</b>	<b>\$ 644</b>	<b>\$ —</b>	<b>\$ 914</b>	<b>\$(145)</b>	<b>\$ 769</b>

Quarter Ended September 30, 2000						
Mortgage Securitization Financing	Debt Financing	Elimination(1)	Reported Consolidated	Adjustments(2)	Operating Consolidated	
(dollars in millions)						
Net interest income on earning assets (3)	\$ 58	\$ 638	\$ 41	\$ 737	\$—	\$ 737
Management and guarantee income	413	—	(41)	372	—	372
Other income, net	45	(29)	—	16	—	16
<b>Total revenues</b>	<b>516</b>	<b>609</b>	<b>—</b>	<b>1,125</b>	<b>—</b>	<b>1,125</b>
Credit-related expenses	(21)	—	—	(21)	—	(21)
Administrative expenses	(150)	(30)	—	(180)	—	(180)
Housing tax credit partnerships	(26)	—	—	(26)	—	(26)
Income before income taxes	319	579	—	898	—	898
Provision for income taxes	(85)	(171)	—	(256)	—	(256)
Income before extraordinary items, net of taxes	234	408	—	642	—	642
Extraordinary gain on retirement of debt, net of taxes	—	3	—	3	—	3
<b>Net income</b>	<b>\$ 234</b>	<b>\$ 411</b>	<b>\$ —</b>	<b>\$ 645</b>	<b>\$—</b>	<b>\$ 645</b>

Nine Months Ended September 30, 2001

	Mortgage Securitization Financing	Debt Financing	Elimination (1)	Reported Consolidated	Adjustments (2)	Operating Consolidated
	(dollars in millions)					
Net interest income on earning assets(3)	\$ 120	\$3,144	\$ 136	\$3,400	\$(662)	\$2,738
Management and guarantee income	1,342	—	(136)	1,206	—	1,206
Fair value gains	—	72	—	72	(72)	—
Other income, net	295	(114)	—	181	—	181
<b>Total revenues</b>	<u>1,757</u>	<u>3,102</u>	<u>—</u>	<u>4,859</u>	<u>(734)</u>	<u>4,125</u>
Credit-related expenses	(60)	—	—	(60)	—	(60)
Administrative expenses	(447)	(138)	—	(585)	—	(585)
Housing tax credit partnerships	(98)	—	—	(98)	—	(98)
Income before income taxes	1,152	2,964	—	4,116	(734)	3,382
Provision for income taxes	(309)	(929)	—	(1,238)	257	(981)
Income before extraordinary items and cumulative effect of change in accounting principle, net of taxes	843	2,035	—	2,878	(477)	2,401
Extraordinary loss on retirement of debt, net of taxes	—	(100)	—	(100)	—	(100)
Cumulative effect of change in accounting principle, net of taxes(4)	—	5	—	5	(5)	—
<b>Net income</b>	<u>\$ 843</u>	<u>\$1,940</u>	<u>\$ —</u>	<u>\$2,783</u>	<u>\$(482)</u>	<u>\$2,301</u>

Nine Months Ended September 30, 2000

	Mortgage Securitization Financing	Debt Financing	Elimination (1)	Reported Consolidated	Adjustments (2)	Operating Consolidated
	(dollars in millions)					
Net interest income on earning assets(3)	\$ 206	\$1,771	\$ 123	\$2,100	\$ —	\$2,100
Management and guarantee income	1,229	—	(123)	1,106	—	1,106
Other income, net	78	14	—	92	—	92
<b>Total revenues</b>	<u>1,513</u>	<u>1,785</u>	<u>—</u>	<u>3,298</u>	<u>—</u>	<u>3,298</u>
Credit-related expenses	(81)	—	—	(81)	—	(81)
Administrative expenses	(442)	(87)	—	(529)	—	(529)
Housing tax credit partnerships	(78)	—	—	(78)	—	(78)
Income before income taxes	912	1,698	—	2,610	—	2,610
Provision for income taxes	(240)	(494)	—	(734)	—	(734)
Income before extraordinary items, net of taxes	672	1,204	—	1,876	—	1,876
Extraordinary gain on retirement of debt, net of taxes	—	8	—	8	—	8
<b>Net income</b>	<u>\$ 672</u>	<u>\$1,212</u>	<u>\$ —</u>	<u>\$1,884</u>	<u>\$ —</u>	<u>\$1,884</u>

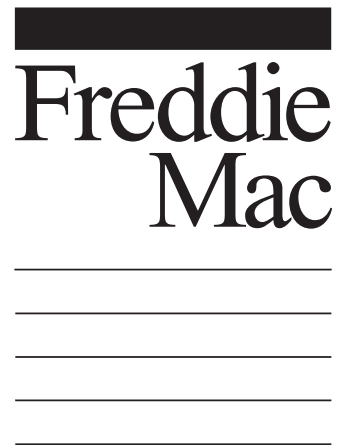
- (1) Reflects the elimination of fees earned by the Mortgage Securitization Financing Segment for the credit guarantee it provides on unsecuritized mortgages retained by the Debt Financing segment, and a corresponding elimination of the cost of this credit guarantee charged to the Debt Financing Segment for purposes of deriving consolidated amounts.
- (2) These adjustments to the Debt Financing Segment reconcile reported earnings to operating earnings. See "MD&A-OPERATING EARNINGS" for more information.
- (3) Net interest income for the Debt Financing Segment includes interest expense on debt securities and other liabilities that finance mortgage-related investments. Included in interest expense on debt securities is non-cash amortization of debt discounts totaling \$2.263 billion, \$2.430 billion and \$2.809 billion for the quarters ended September 30, 2001, June 30, 2001 and September 30, 2000, respectively, as well as \$7.214 billion and \$8.685 billion for the nine months ended September 30, 2001 and September 30, 2000, respectively, which principally represents the contractual cost of funds associated with issuing short-term debt at a discount.
- (4) Adoption of SFAS 133 on January 1, 2001.

**Earnings per Common Share**

“Earnings per common share-basic” are computed as net income available to common stockholders divided by the weighted average common shares outstanding for the period. “Earnings per common share-diluted” are computed as net income available to common stockholders divided by the total of weighted average common shares outstanding and the effect of dilutive common equivalent shares outstanding for the period. The table below provides a reconciliation of “Weighted average common shares outstanding — basic” to “Weighted average common shares outstanding — diluted.”

	<u>Quarter Ended</u>			<u>Nine Months Ended</u>	
	<u>September 30, 2001</u>	<u>June 30, 2001</u>	<u>September 30, 2000</u>	<u>September 30, 2001</u>	<u>September 30, 2000</u>
	(shares in thousands)				
Weighted average common shares outstanding — basic .....	694,661	693,726	691,543	693,826	693,984
Effect of dilutive common equivalent shares .....	<u>2,542</u>	<u>2,931</u>	<u>2,176</u>	<u>3,023</u>	<u>2,659</u>
Weighted average common shares outstanding — diluted .....	<u>697,203</u>	<u>696,657</u>	<u>693,719</u>	<u>696,849</u>	<u>696,643</u>

See notes 1, 7 and 8 to the Consolidated Financial Statements included in the Information Statement for further information about Freddie Mac’s debt securities, subordinated borrowings, stockholders’ equity and common equivalent shares pursuant to the corporation’s stock-based compensation plans.



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