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**Research Update:**

# Freddie Mac 'AA-' Rating Placed On Credit Watch Negative; Senior Unsecured Debt Rating Affirmed

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## Rationale

On May 6, 2008, Standard & Poor's Ratings Services affirmed its 'AAA/Stable/A-1+' senior unsecured debt rating on Freddie Mac and placed its 'AA-' risk to the government, subordinated debt, and preferred stock ratings on Freddie Mac on CreditWatch Negative.

The action was a result of expected lower earnings for 2008 and 2009 and quarterly earnings volatility that is reaching beyond the tolerance for the 'AA-' rating. The weak residential mortgage cycle has now lasted much longer than originally anticipated, pushing the expectation for credit-related expenses higher.

Freddie Mac's lower core earnings performance, driven primarily by rising credit-related expenses, will continue to pressure capital measures. Credit-related expenses are fast approaching a new peak for Freddie Mac. Its core earnings capacity to withstand the higher credit costs for 2008 and 2009 is significantly lower, given its narrower net interest margin.

Freddie Mac's capital position remains under pressure given the quarterly GAAP losses recently recorded, the expectation for credit-related expenses to remain high, and the strong growth expectations for its core mortgage business. The level of capital commitment to support the core business, regardless of the continued reduction in the original 30% regulatory capital surplus requirement (which for Freddie Mac is now a 20% surplus requirement) remains a key rating factor.

We assess Freddie Mac's capital level on a managed-assets basis, given the credit guarantee it provides to its off-balance-sheet mortgage-backed securities (MBS). So although Freddie Mac operated with a capital surplus position above its regulatory minimum requirement at year-end 2007, our view of capital is less positive.

The ratings on Freddie Mac's senior unsecured debt reflect the company's very strong business franchise, its status as a government-sponsored enterprise (GSE), its status as a public-policy institution under our government-related criteria, and its key role regarding liquidity in the U.S. mortgage capital markets. The ratings also reflect the implicit U.S. government support of these securities, as it relates to Freddie Mac's charter and governing legislation. This support has been strengthened recently given the more prominent liquidity role Freddie Mac has in the current dislocation of mortgage liquidity in the secondary markets. As a result, its market share of new MBS issuance has soared during the past three quarters and the U.S. Treasury has made the GSEs central to its economic policies.

The CreditWatch will be resolved shortly after Freddie Mac releases its first-quarter operating results on May 14. At this time we will factor in the

key positive and negative trends affecting Freddie Mac's credit profile. This will include a review of its first-quarter results and our expectation for future quarterly earnings volatility. This review will also assess Freddie Mac's capital strength and its commitment to capital as well as the core earnings and credit performance outlook for the next year. The outcome will either be an affirmation of the 'AA-' ratings or a one-notch downgrade to 'A+.'

## Ratings List

Ratings Affirmed

Freddie Mac

Senior Unsecured Debt	AAA/Stable/A-1+	
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CreditWatch/Outlook Action

	To	From
Freddie Mac		
Subordinated		
Local Currency	AA-/Watch Neg	AA-
Preferred Stock		
Local Currency	AA-/Watch Neg	AA-
Risk To The Government		
Local Currency	AA-/Watch Neg/--	AA-/Negative/--

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