

A Letter From

**Mark Hanson**  
*Vice President of Mortgage Funding*

Since *Gold Perspective's* inaugural issue three months ago, we have been searching for new ways to transform mortgage security cash flows into investments that meet the needs of a diverse range of investors. We are concerned about aberrant prepayment behavior in the conventional market and are committed to maintaining liquidity in the pass-through market. Our research and development professionals are constantly analyzing data to discover creative solutions to alleviate some of these differences. We are also working with our business partners to find solutions in which to enhance the TBA market. Freddie Mac's new Modifiable Mortgage program is a forward step toward achieving this goal.

In response to our lenders' need to reduce mortgage runoff during peak refinancing periods, the Modifiable Mortgage program allows changes to lower note rates on mortgage loans and securitizes them into two new non-TBA prefixes. Loans with this modifiable feature allow lenders to offer borrowers the option to lower the note rates without taking out a new loan or going through a closing. The most significant component of this program is that it provides sellers/servicers with a solution to their need for servicing retention, while protecting the integrity of the TBA market. More about this new program can be found inside this issue.

Freddie Mac's role in the structured mortgage securities market has remained strong in 2002. More than \$77.2 billion in structured products were issued during first quarter 2002. In particular, February marked a significant milestone for Freddie Mac's REMIC program. More than \$26.5 billion

in REMICs were issued—the highest monthly volume ever in the program's 14-year history.

UBS issued the most structured product volume in the first quarter with more than \$15.4 billion, or 20.8% of the total issuance; Credit Suisse First Boston with \$11.8 billion, or 15.9%; Bear Stearns with \$9.8 billion, or 13.3%; Salomon Smith Barney with \$8.6 billion, or 11.6%; and Banc of America with \$5.5 billion, or 7.4%. The success of our REMIC program can be attributed to continued strong mortgage purchase volume and investor demand. Further, our goals for 2002 include enhancing investor awareness and education about structured products, as well as further expanding product offerings customized to meet individual investment needs.

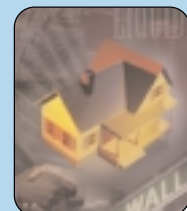
Finally, we want to hear from you. Please feel free to contact *Gold Perspective* if you have any topics you would like to see covered in this publication. This newsletter serves as our information vehicle to you. Please let us know how we can help you further.

Sincerely,



*In This Issue*

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## A Closer Look at Modifiable Mortgages

Freddie Mac recently began a new product— purchasing a fixed-rate home mortgage that, under certain terms, can be modified without a traditional ‘refinance’ transaction. This product was created in an effort to help lenders retain borrowers, change note rates, and reduce the potential for loss of mortgage servicing rights. Lender concern surrounding

*With modifiable mortgages, borrowers will be able to retain their original mortgages, thereby eliminating many of the costs of refinancing.*

*The integrity of Freddie Mac’s existing PCs will be protected since these PCs will not be impacted or modified.*

loans. Existing PCs will not be impacted and cannot be modified.

Available for newly originated and seasoned loans, the modification option will be available to sellers on a negotiated basis. Only the note rate and monthly principal and interest of eligible mortgages may be modified downward. No other mortgage parameters may be modified. When sold to Freddie Mac, the mortgage is pooled under one of two designated guarantor prefixes: 30-year (MM) or 15-year (MN). Upon the exercise of the option to modify a mortgage, that mortgage is purchased (removed) from the applicable MM or MN pool. Subsequently, the mortgage must be resold to Freddie Mac as either a mortgage that has been modified with no further modifications allowed (resold through existing cash or guarantor execu-

portfolio runoff, paperwork backlogs and systems inefficiencies during heavy refinancing periods precipitated Freddie Mac’s decision to provide this option to sellers. Modifiable mortgages will enable borrowers to retain their original mortgage loans. These loans will be pooled separately from TBA-eligible Gold PCs. The integrity of Freddie Mac’s existing PCs will be protected since this program only applies to new

tions) or as a modifiable mortgage (pooled into a new guarantor pool under the MM or MN prefix).

“Our Modifiable Mortgage program offers Freddie Mac sellers/servicers the option to modify mortgages instead of refinancing them, while protecting the integrity of Freddie Mac’s Gold PC securities that are TBA-eligible,” said Mark Hanson, Vice President of Mortgage Funding. “MM and MN pools will be clearly identified to the mortgage market community, and we do not expect prepayment rates in these prefixes to affect the market calculation of overall prepayment rates in any other Freddie Mac PCs.”

With modifiable mortgages, borrowers will be able to retain their original mortgages, thereby eliminating many of the costs of refinancing. The Modifiable Mortgage program allows sellers/servicers to retain more of their current portfolio by enabling them to offer homeowners a low-cost alternative to refinancing. The seller/servicer must currently service the existing mortgage before they can alter the terms of the modifiable mortgage.

### **Investor Benefits:**

- Assurance that modified mortgages are not in TBA pools
- Modifiable pools are easily identified
- Investor can evaluate the option to modify and price accordingly

### **Lender Benefits:**

- Fastest and easiest way to retain borrowers
- Reduces costs
- Streamlines process
- Builds long term borrower loyalty

### **Borrower Benefits:**

- No new closing costs
- No verifications
- Lower cost than a refinance

*Let's look at an example:*

A lender offers a borrower a new 30-year fixed rate loan that may be modified in the future. The loan can be sold into the new prefix, MM. At a later date, if the borrower and lender agree to modify to a lower rate, the note is modified and the loan is removed from the MM pool. The lender subsequently must resell the modified loan to Freddie Mac either as a non-modifiable loan or as a modifiable into another MM pool. Also, if the lender has seasoned loans in his/her portfolio, then he/she may deliver these loans into the MM prefix if the modifiable feature is added to the note document.

Supplemental disclosure describes the possibility or "risk" of modification to investors in modifiable mortgage pools. When a mortgage is modified, it is purchased out of the guarantor pool, and its balance is passed through to the investor as a prepayment. The investor can price the option to modify the loans and thus value the MM pool.

The MM or MN pools will be clearly identified and distinguishable from TBA-eligible prefixes and will be excluded from any prepayment analysis of Freddie Mac PCs. Consequently, there should be no TBA pool impact from the MM and MN pools. Further, a potential purchaser of an MM or MN security pool will know beforehand of the modification option inherent with the underlying mortgages.

***For more information on this product,  
please contact Investor Inquiry  
at (800) 336-3672.***

### **Moody's Assigns Bank Financial Strength Rating**

*Moody's Investors Service recently assigned Freddie Mac a Bank Financial Strength Rating of A-, a mark of excellence only four other U.S. financial services companies have achieved. Moody's commented that Freddie Mac benefits from strong risk management disciplines and a very sound credit culture. Moody's also noted that the rating reflected Freddie Mac's "deeply ingrained risk conservatism, excellent business franchise, and sophisticated multi-level reporting and governance procedures."*

### **ARM File Layout Change**

*Beginning in May 2002, the fourth business day ARM Factors Transmission will be transmitted with a 60 character legend instead of a 40 character legend and a new Legend 2 field that is 60 characters in length. For more information on the file layout change, please see the Guide to PC, Giant & REMIC OID Disclosure Information at [www.freddiemac.com/mbs/data/disclosure\\_guide\\_new.pdf](http://www.freddiemac.com/mbs/data/disclosure_guide_new.pdf).*

### **Freddie Mac Expands Bloomberg Presence**

*Freddie Mac recently launched a corporate Bloomberg portal at FRE <GO>. Providing links to the FMAC (mortgage-backed securities) and the FREF (debt securities) pages, the FRE main screen expanded to include "Housing and Economic Reports." This new section contains the Primary Mortgage Market Survey, Chief Economist's weekly and monthly commentary, the Conventional Mortgage Home Price Index, and a record of recent and historical refinancing activity. This section significantly enhances the ability for investors and policymakers to access Freddie Mac's extensive housing and economic research.*

## Volumes and Performance Spring 2002

### Freddie Mac Guaranteed Maturity Securities Issuance—1st Quarter 2002

| Series Number | Principle Type | January          | February         | March            | Grand Total      |
|---------------|----------------|------------------|------------------|------------------|------------------|
| 002399        | GMC/PAC        | \$70,641,002.00  |                  |                  | \$70,641,002.00  |
| 002399        | GMC/SUP        | \$94,668,998.00  |                  |                  | \$94,668,998.00  |
| 002411        | GMC/SUP        |                  | \$132,627,000.00 |                  | \$132,627,000.00 |
| 002412        | GMC/PAC        |                  | \$56,416,000.00  |                  | \$56,416,000.00  |
| 002412        | GMC/SEQ        |                  | \$217,005,000.00 |                  | \$217,005,000.00 |
| 002412        | GMC/SUP        |                  | \$28,291,000.00  |                  | \$28,291,000.00  |
| 002418        | GMC/TAC        |                  | \$33,000,000.00  |                  | \$33,000,000.00  |
| 002420        | GMC/PAC        |                  | \$94,776,000.00  |                  | \$94,776,000.00  |
| 002425        | GMC/TAC        |                  |                  | \$30,242,250.00  | \$30,242,250.00  |
| 0024274       | GMC/PAC        |                  |                  | \$112,138,000.00 | \$112,138,000.00 |
| Grand Total   |                | \$165,310,000.00 | \$562,115,000.00 | \$142,380,250.00 | \$869,805,250.00 |

### Primary Mortgage Market Survey

Summary page with all rate types—U.S. averages

| Quarter | U.S.<br>30-yr<br>FRM | 30 yr<br>fees &<br>points | U.S.<br>15-yr<br>FRM | 15-yr<br>fees &<br>points | U.S.<br>1-yr<br>ARM | ARM<br>fees &<br>points | U.S.<br>ARM<br>margin |
|---------|----------------------|---------------------------|----------------------|---------------------------|---------------------|-------------------------|-----------------------|
| Q1:2000 | 8.26                 | 1.0                       | 7.85                 | 1.0                       | 6.68                | 1.0                     | 2.78                  |
| Q2:2000 | 8.32                 | 1.0                       | 7.99                 | 1.0                       | 7.05                | 1.0                     | 2.78                  |
| Q3:2000 | 8.02                 | 1.0                       | 7.73                 | 1.0                       | 7.28                | 0.9                     | 2.78                  |
| Q4:2000 | 7.62                 | 0.9                       | 7.29                 | 0.9                       | 7.17                | 0.9                     | 2.78                  |
| Q1:2001 | 7.01                 | 0.9                       | 6.59                 | 0.9                       | 6.46                | 0.9                     | 2.78                  |
| Q2:2001 | 7.13                 | 0.9                       | 6.66                 | 1.0                       | 5.93                | 0.9                     | 2.78                  |
| Q3:2001 | 6.96                 | 0.9                       | 6.51                 | 0.9                       | 5.67                | 0.9                     | 2.77                  |
| Q4:2001 | 6.77                 | 0.8                       | 6.25                 | 0.8                       | 5.23                | 0.8                     | 2.76                  |
| Q1:2002 | 6.97                 | 0.7                       | 6.46                 | 0.7                       | 5.09                | 0.7                     | 2.78                  |

### Freddie Mac Giant Volume—1st Quarter 2002

| Month    | Total               |
|----------|---------------------|
| January  | \$1,784,696,224.00  |
| February | \$721,634,574.00    |
| March    | \$9,677,250,307.00  |
| Total 1Q | \$12,182,581,105.00 |

### Volume of Structured Products by Month—1st Quarter 2002

| Month    | REMICs              | SPC                | Strips              | Grand Total         |
|----------|---------------------|--------------------|---------------------|---------------------|
| January  | \$17,827,330,788.00 |                    | \$4,175,000,000.00  | \$22,002,330,788.00 |
| February | \$26,530,579,427.00 | \$632,926,000.00   | \$4,275,000,000.00  | \$31,438,505,427.00 |
| March    | \$18,799,568,616.00 | \$2,480,000,000.00 | \$2,500,000,000.00  | \$23,779,568,616.00 |
| Total    | \$63,157,478,831.00 | \$3,112,926,000.00 | \$10,950,000,000.00 | \$77,220,404,831.00 |

### Total Mortgage Participation Certificates (Total PCs)

|               | PC<br>Issuances | Liquidations | Net<br>Additions | Ending<br>Balance | Annualized<br>Growth Rate | PCs Held in<br>Retained<br>Portfolio | Total PCs,<br>Net (1) | Annualized<br>Growth Rate |
|---------------|-----------------|--------------|------------------|-------------------|---------------------------|--------------------------------------|-----------------------|---------------------------|
| February 2001 | 15,549          | \$ (14,457)  | \$ 1,092         | \$ 829,234        | 1.6%                      | \$ 256,834                           | \$ 572,400            | -14.4%                    |
| March         | 23,367          | (18,985)     | 4,382            | 833,616           | 6.3%                      | 261,288                              | 572,328               | -0.2%                     |
| April         | 31,219          | (20,668)     | 10,551           | 844,167           | 15.2%                     | 263,634                              | 580,533               | 17.2%                     |
| May           | 33,670          | (21,883)     | 11,787           | 855,954           | 16.8%                     | 266,749                              | 589,205               | 17.9%                     |
| June          | 38,133          | (20,337)     | 17,796           | 873,750           | 24.9%                     | 269,693                              | 604,057               | 30.2%                     |
| July          | 44,574          | (19,380)     | 25,194           | 898,944           | 34.6%                     | 278,825                              | 620,119               | 31.9%                     |
| August        | 33,933          | (19,060)     | 14,873           | 913,817           | 19.9%                     | 287,521                              | 626,296               | 12.0%                     |
| September     | 32,666          | (18,993)     | 13,673           | 927,490           | 18.0%                     | 291,646                              | 635,844               | 18.3%                     |
| October       | 31,646          | (26,887)     | 4,759            | 932,249           | 6.2%                      | 296,499                              | 635,750               | -0.1%                     |
| November      | 38,958          | (32,077)     | 6,881            | 939,130           | 8.9%                      | 300,806                              | 638,324               | 4.9%                      |
| December      | 50,532          | (41,253)     | 9,279            | 948,409           | 11.9%                     | 301,961                              | 646,448               | 15.3%                     |
| January 2002  | \$ 49,031       | \$ (27,756)  | \$ 21,275        | \$ 969,684        | 26.9%                     | \$ 319,470                           | 650,214               | 7.0%                      |
| February      | 47,473          | (23,419)     | 24,054           | 993,738           | 29.8%                     | 333,950                              | 659,788               | 17.7%                     |
| YTD 2002      | \$ 96,504       | \$ (51,175)  | \$ 45,329        | \$ 993,738        |                           |                                      |                       |                           |

(Total first quarter 2002 figures available online at [www.freddiemac.com/shareholders/volsum](http://www.freddiemac.com/shareholders/volsum).)  
 (1) Equal to ending balance of Total PCs net of PCs held in the retained portfolio U.S. averages

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2002 Economic Outlook

**Frank Nothaft**  
Chief Economist, Freddie Mac  
March 15, 2002

The “recessionette” appears to be over. We believe the economic recovery has started. Federal Reserve Chairman Alan Greenspan said as much in his March 7th testimony before the Senate Banking Committee when he “suggested” that “economic expansion is already well under way.” In harmony with his remarks, February’s payroll employment figures showed a surprising 66,000 gain in payroll employment, the latest of several economic indicators to point toward the recession’s end.

Concern has surrounded the ability of consumer spending to contribute to this year’s expansion. However, consumers don’t appear concerned. Personal consumption expenditures for the fourth quarter 2001 were revised upward, contributing to the hefty upward

*With mortgage rates averaging one-eighth of a percentage point lower in February, the continued vitality of housing demand is assured.*

revision in GDP growth to 1.4% for the final three months. Consumer credit expanded at a 9.3% clip in January, and light vehicle sales were strong in the first two months of this year. Home sales have also remained robust, with home sales (new construction and previously-owned) hitting another record with 6.9 million sales (Seasonally Adjusted at an Annual Rate, “SAAR”) in January. With mortgage rates averaging one-eighth of a percentage point lower in February, the continued vitality of housing demand is assured.

Manufacturing appears poised for a rebound, which will complement growth in other sectors of the

economy. Factory orders were up for a second straight month in January, and the Institute for Supply Management’s manufacturing index jumped in February, the first gain in 19 months. As further confirmation, the Fed announced that industrial production was up for a second straight month in February. Productivity grew at a much faster rate during the fourth quarter than had been anticipated, suggesting productivity rose by 2% for the year as a whole. If strong productivity growth continues, then labor cost pressures will be contained and the inflation outlook will continue to be good. We project inflation, as measured by the Consumer Price Index, to grow only 2.0% over this year.

2002 Economic Forecast

|   |                |
|---|----------------|
| GDP Growth .....                          | 3.3%           |
| Inflation (CPI) .....                     | 2.0%           |
| Unemployment Rate .....                   | 5.5%           |
| Conforming Mortgage Rate .....            | 7.0%           |
| Housing Starts .....                      | 1.6 million    |
| Single-Family Home Sales .....            | 6.1 million    |
| House Price Appreciation.....             | 3.0%           |
| Single-Family Mortgage Originations ..... | \$1.4 trillion |

Details

- We have revised upward our projection of economic growth for 2002 based on the strength in recent economic indicators. Real GDP is forecast to expand 2.5% in the first quarter and 3.3% for the year.
- Inflation will remain low, with price increases of 2.0% this year and a longer-term trend of 2.5% annually.

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- The unemployment rate may edge above February's 5.5% before gradually easing lower. For 2002, the rate is forecast to average 5.5%, declining to 5.0% in 2003.
- With low inflation expected, long-term interest rates should also remain low. Thirty-year fixed-rate mortgages have hovered within a narrow 0.5% band centered at 7% since mid-November, and this pattern should continue. The rate on conforming loans is expected to average 7.0% for 2002.
- Housing starts have remained vibrant, hitting 1.68 million (SAAR) in January. We think that level cannot be sustained, however, and February starts should come in lower. For the year, starts are forecast at 1.60 million, the same as 2001.
- Likewise, a sales pace of close to 7 million for single-family houses, as indicated in the January data, cannot be sustained. Sales should slip down toward a 6 million (SAAR) pace and come in about 2% below 2001's record level of 6.2 million sales.
- House price appreciation slowed dramatically in the fourth quarter, but an upward revision in appreciation (as measured by Freddie Mac's Conventional Mortgage Home Price Index<sup>1</sup>) is likely. Much of the initial estimate is based on home purchase contracts signed in September

and October, and home values are likely to have firmed subsequently. Look for appreciation of 3% for 2002.

- Single-family mortgage originations will be about 20% lower in 2002 because of an anticipated drop in refinancing, coming in around \$1.4 trillion in new production. Refinancing will slow because mortgage rates are likely to inch a bit higher in the second half of the year (especially for ARMs as the Fed pushes the Federal Funds rate up) and because the bulk of families with a financial incentive to refinance will have done so by mid-year. The ARM share of originations will continue to remain low, averaging 16% in 2002.

<sup>1</sup>Freddie Mac's Conventional Mortgage Home Price Index and Frank Nothaft's Housing and Economic Reports are available on Bloomberg at [FRE<GO>](#).

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*Frank Nothaft is Freddie Mac's Chief Economist. He is responsible for primary and secondary mortgage market analysis and research, macroeconomic analysis and forecasting. Prior to being named chief economist, Nothaft served as deputy chief economist for Freddie Mac since 1988 and as a senior economist from November 1986. Nothaft was an economist with the Board of Governors of the Federal Reserve System from 1983 until 1986, where he served in the mortgage and consumer finance section and as the assistant to Governor Henry C. Wallich.*