Freddie Mac CEO and CFO Discuss First Quarter 2023 Financial and Business Results

Remarks by Michael J. DeVito, Chief Executive Officer
and Christian Lown, EVP and Chief Financial Officer

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As Prepared for Delivery

Introduction (Remarks of Mr. DeVito)

Good morning and thank you for joining our first quarter call to review financial results. Today I'd like to cover three topics:

- Our views on the economic environment,
- Actions we've taken to promote liquidity, stability and affordability, and
- Opportunities as Freddie Mac continues to pursue a positive impact on the housing market going forward.

The Economic Environment

Let's start with our view on the overall economy.

We continue to see an elevated risk of a recession over the next 12 months, and two factors largely drive that outlook.

First, inflation remains well above the Federal Reserve's 2 percent target. Despite some cooling, core inflation was 4.6 percent year-over-year, according to the latest figures.

Secondly, uncertainty in the banking sector in March caused some disruption to real estate lending and multifamily construction. The risk of credit tightening remains elevated.

On the bright side, the labor market remains stronger than expected.

The unemployment rate continues to be at close to a 50-year low of 3.5 percent, although job growth is slowing. Not only have we recovered the 21.9 million jobs lost from the early months of the 2020 pandemic, we have added 3.2 million more.

For the overall economy, we agree with other observers that tightening financial conditions are expected to be a drag on 2023 GDP growth.

Higher rates are affecting—and likely will continue to affect—homebuyers and renters.

Our Primary Mortgage Market Survey shows the 30-year fixed at well over 6 percent. That is lower than the November 2022 high of more than 7 percent, but still a full percentage point higher than a year ago.

Due to higher rates, we see significantly fewer refinancing opportunities. That showed up in our first quarter loan acquisition volume. Refinances had been nearly $114 billion, or 55 percent of our acquisitions in first quarter of 2022, compared to just $8.1 billion, or 14 percent, in the most recent quarter.

To understand why rising rates matter, consider that about two in three existing homeowners with mortgages have fixed rates locked in below 4 percent.

Due to the rate lock effect, existing homeowners are less likely to consider selling and moving. In fact, new listings declined almost 35 percent in February compared to the three-year average pre-pandemic, 2016 to 2019.

These factors are aggravating the ongoing supply issue.

While construction picked up in 2022, new housing completions remain below pre-global financial crisis levels. We believe the country still has a deficit of millions of homes.

Factor in migration to more affordable markets and fewer delinquencies to constrained supply, and you can see why house prices have remained elevated even after some moderation. For example, prices fell modestly last fall, but were up month-over-month in February and March.

Longer term, we forecast that house prices will fall roughly 2.9 percent over the next 12 months and possibly another 1.3 percent over the subsequent 12 months.

Most U.S. homeowners have the capacity to weather this decline. They have collectively accumulated roughly $12 trillion in additional equity since 2019.

Our Impact on the Market

Let me turn to some of the actions we have taken to advance our mission in this environment.

We had a solid quarter, earning $2 billion with no significant impact to our earnings or balance sheet from the recent banking industry disruption.

Our earnings enabled us to transfer more than $250 million to Housing and Urban Development's Housing Trust Fund and Treasury's Capital Magnet Fund, to benefit lower-income borrowers and renters.

Solid earnings also increased our net worth by more than $2 billion to $39.1 billion.

Our performance during the quarter was partly the result of steps we've taken these past 15 years to focus on the safety and soundness of our enterprise, particularly with respect to credit risk.

That's enabled us to serve our mission and be a stabilizing force during the recent banking crisis and the pandemic before that. It's also enabled us to be there for families when natural disasters struck across the country.

In the first quarter, we:

- Delivered $65 billion of liquidity to the market;
- Acquired 157,000 purchase loans, down 44 percent year over year;
- Purchased 33,000 refinance loans, down 92 percent year over year;
- Backed a rising share of first-time homebuyers—close to historical highs at 51 percent;
- Helped more than 60,000 renters, with 89 percent of eligible apartments financed affordable to low- and moderate-income families at or below 120 percent of area median income; and
- Completed 24,000 loan workouts to help keep distressed owners in their homes.

Opportunities to Have a Greater Impact Going Forward

All that said, we know there is much more work to be done to bring greater access to affordable and sustainable housing. And those opportunities exist, even in this uncertain economic environment.

For example, there are still opportunities for homeownership. Even with now higher rates, there are millions of mortgage-ready potential homebuyers who could afford a loan near the median home price.

There are still reasons to refinance because there are still homeowners with higher interest rates who could benefit from refinancing.

And, there is still much work to do to create a more equitable housing market. Let me highlight three initiatives.

First, we are currently buying loans from lenders with their own special purpose credit programs. Special purpose credit programs enable lenders to offer special credit terms such as down payment assistance, underwriting or pricing for traditionally underserved borrowers – and can be an important tool in helping to close the homeownership gap.

Second, we rolled out Freddie Mac's special purpose credit program, BorrowSmart Access, across 10 cities with nearly a dozen participating lenders.

More broadly, for those seeking down payment assistance anywhere in the country, our online down payment resource, Freddie Mac DPA One, now contains information on more than 225 lenders and nearly 400 existing down payment assistance programs.

For those of you interested in these and the many other things we're doing to support sustainable homeownership and affordable rental opportunities, you can find all of our updated information on FreddieMac.com.

With that, I'll turn to our CFO Chris Lown to review our financial results.

Business and Financial Results (Remarks of Mr. Lown)

Thank you, Michael, and good morning.

We earned net income of $2 billion this quarter, a decline of $1.8 billion, or 47 percent, year-over-year. This decline was primarily driven by lower fair value gains and a credit reserve build this quarter versus a credit reserve release in the prior year quarter.

First quarter net interest income was $4.5 billion, a 10 percent year-over-year increase, a result of 4 percent growth in the Single-Family mortgage portfolio and a 1 basis point increase in the average Single-Family guarantee fee rate. Higher investment income benefiting from higher interest rates also contributed to the increase in net interest income. These positive drivers were partially offset by lower deferred fee income recognition resulting from slower prepayments due to higher mortgage rates.

Non-interest income for the first quarter was $326 million, down $1.4 billion from the prior year quarter, primarily due to a decline in net investment gains in Single-Family. In the first quarter last year, we recorded large gains from forward sales of guaranteed mortgage-related securities.

Our provision for credit losses was $395 million for this quarter, driven by modest credit reserve builds in both business segments, compared to a benefit of $837 million for the prior year quarter, which was primarily the result of a credit reserve release due to higher estimated house prices and an improvement in forecast economic conditions.

Our total mortgage portfolio at the end of this quarter was $3.4 trillion, a four percent increase year-over-year.

Single-Family Business Segment

Turning to our individual business segments, the Single-Family segment reported net income of $1.7 billion for the quarter, down 51 percent year-over-year.

Net interest income of $4.3 billion was up 13 percent year-over-year as the Single-Family mortgage portfolio grew four percent from the prior year and the average guarantee fee rate increased from 47 to 48 basis points. Investment net interest income also increased due to higher interest rates. These increases were partially offset by lower deferred fee income due to slower prepayments as a result of higher mortgage rates.

Non-interest income for Single-Family was a loss of $93 million this quarter compared to income of $1.4 billion in the prior year quarter. In 1Q 2022, Single-Family's non-interest income was primarily driven by gains on commitments to hedge the securitization pipeline due to spread widening on agency mortgage-related securities.

Our provision for single-family credit losses was $318 million this quarter, primarily due to a credit reserve build for new acquisitions. The $831 million benefit for credit losses in the prior year quarter was driven by a credit reserve release due to higher estimated house prices and improved forecasted economic conditions. The Single-Family allowance for credit losses coverage ratio at the end of this quarter was 26 basis points, up from 15 basis points a year earlier.

The Single-Family serious delinquency rate continued to decline to 62 basis points at the end of the first quarter, down 30 basis points from First Quarter 2022 and 4 basis points from 4Q 2022. In the first quarter, we helped approximately 24,000 families remain in their homes through loan workouts.

Our Single-Family portfolio credit characteristics remained strong, with the weighted average current Loan-to-Value ratio at 55 percent and the weighted average current credit score at 755. At the end of the quarter, 62 percent of our Single-Family portfolio had some form of credit enhancement.

New business activity totaled $59 billion this quarter, a decline of $148 billion, or 71 percent, year-over-year, as refinance activity declined significantly due to increases in mortgage interest rates. Home purchase volume made up 86 percent of our total new business activity this quarter vs. 45 percent in 1Q 2022. The average guarantee fee rate charged on new business increased by 6 basis points, from 49 basis points a year ago to 55 basis points this quarter.

Multifamily Business Segment

Moving on to Multifamily, the segment reported net income of $318 million, down $69 million, or 18 percent, from the prior year quarter. This decline was primarily driven by lower net interest income, offset in part by higher non-interest income, and by a provision for credit losses this period versus a benefit for credit losses in the prior year period.

Net interest income of $205 million was down 31 percent year-over-year as the high interest rate environment led to lower security prepayment income compared to last year. Non-interest income of $419 million was up 25 percent year-over-year on a positive fair value impact to our guarantee asset as long-term interest rates declined during the first quarter.

The Multifamily provision for credit losses was $77 million this quarter versus a small benefit in the first quarter of 2022, primarily due to increased uncertainty in forecasted economic conditions.

Our Multifamily new business activity was $6 billions for the first quarter, down 60 percent from a year ago, as higher interest rates have reduced demand for multifamily mortgage financing. The Multifamily mortgage portfolio increased 3 percent year-over-year to $426 billion.

The Multifamily delinquency rate was 13 basis points at the end of the quarter, up slightly from 12 basis points last quarter and up from 8 basis points at the end of March 2022. This increase was primarily driven by an increase in delinquent loans in our senior housing and small balance loan portfolios.

Approximately 93 percent of the Multifamily mortgage portfolio was covered by credit enhancements at the end of the first quarter.

Capital

On the capital front, our net worth increased to $39.1 billion at the end of the quarter, representing a 23 percent increase year-over-year.

With that, I will turn it back over to Michael.

Conclusion (Remarks of Mr. DeVito)

Thank you, Chris.

Freddie Mac's solid performance in the first quarter helped promote sustainable homeownership and rental opportunities across the nation…but there's a lot more work to be done. In an uncertain economic environment, we remain focused on our mission and will continue to serve as a stabilizing force for the housing finance system.