Freddie Mac First Quarter 2020 Financial and Business Results

Remarks of David Brickman, Chief Executive Officer
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As Prepared for Delivery

Good morning and welcome to our first quarter earnings conference call.

Today's discussion will cover the following items:

- The company's response to the COVID-19 pandemic
- Freddie Mac's first quarter financial and business results, and
- Our outlook on these uncertain times.

Pandemic Response

I want to start by saying that I hope you and your families are staying safe and remaining positive during these challenging times.

To frame this morning's discussion and highlight both the unprecedented environment in which we are operating and the significant stress in both our country and our markets—I think it is worth reviewing the news we have received just in the last week—a relatively uneventful week I might add, by comparison to past weeks—and the situation we find ourselves in:

- First, as we heard this morning, U.S. weekly jobless claims hit 3.84 million, topping more than 30 million over the past six weeks.
- Second, new home sales fell 15.4 percent to a seasonally adjusted annual rate of 627,000 units last month, the largest percentage decline since July 2013.
- On the rental side, a survey by rental technology company Avail says that 54 percent of renters are out of work.
- And estimates from Amherst Securities and the Joint Center for Housing Studies at Harvard put the potential need for rental support as high as $7 billion per month.

And finally, let me speak generally about forbearance in this time of crisis. We have been working hard to ensure that borrowers and lenders are familiar with the forbearance options that are available to them, and we're seeing the number of forbearance requests increase significantly in both the Single-Family and Multifamily businesses; and we expect those numbers to continue to rise. We are closely watching them and know that many are keenly interested in learning more about where those numbers stand, and we hope to have more to say about them in the near future.

In spite of all this, I'm pleased to report that, so far, our book is generally performing well, and we are withstanding this crisis. We have acted quickly to provide direct relief to millions of homeowners and property owners and indirectly to renters hurt by the pandemic. We are also looking to support our lender partners by making it easier for them to close and sell us loans.

Let me spend a few minutes explaining some of the things we have done.

Homeowners

For homeowners who are unable to pay their mortgages due to pandemic-related financial hardships, we have offered relief designed to help them stay in their homes through and beyond this difficult time.

Here are some of the actions Freddie Mac has taken through its servicers.

- We have suspended all foreclosure actions and evictions of borrowers living in Freddie Mac-financed homes.
- We have provided mortgage payment forbearance for up to 12 months.
- We have instructed servicers to waive all penalties and late fees.
- And, we have offered loan modification options to lower borrowers' payments or keep them the same after forbearance.

Renters

In the rental market, we took action to provide relief to multifamily property owners with as many as 4.2 million renters in more than 27,000 rental properties across the nation. The CARES Act has strengthened this action, now protecting all renters in GSE-backed properties from eviction for nonpayment of rent for 120 days. The forbearance we provide to multifamily owners alleviates some of the cash flow pressure they might otherwise have faced and enables them to more comfortably provide accommodations to their tenants.

While that is good news, the fact remains that our toolbox to help renters in financial distress is limited. Regardless, we are educating renters about their options through various outreach efforts, including a newly-launched consumer website and counseling services.

Lenders

We also have taken action to support lenders so they in turn can help more families either purchase or keep their homes. In short, we quickly made selling loans to us easier and faster, so funds continue to flow through the system to borrowers.

In the single-family business, this includes:

- Allowing potential homebuyers to provide alternative documents in lieu of employment verification, which may be difficult to obtain,
- Allowing appraisal alternatives, which reduces the need for appraisers to inspect the interior of a home,
- Expanding our Automated Collateral Evaluation, which will allow us to conduct more automated appraisals, again, to promote social distancing, and
- Maintaining liquidity to mortgage markets by temporarily purchasing loans from lenders where the borrower has been granted forbearance due to COVID-19.

For our Multifamily lenders, we have announced a number of policy changes that provide unprecedented flexibility, so that appraisal and inspection decisions can be made on a case-by-case basis to protect the safety of landlords, renters and our staff.

Other Market Participants
We are also doing our part to help other market participants. For example, we have taken steps to shore up the vendors that help us keep the mortgage market functioning.

For our suppliers, we have accelerated our payment on invoices, so the more than 200 small and diverse businesses we work with receive payment from us at least 20 days earlier than the standard payment terms. Earlier access to these funds will help cash-strapped businesses make payroll and cover overhead expenses during the crisis. We, as a company, are very proud of this effort.

Freddie Mac
Let me now turn inward and talk a little about Freddie Mac's business continuity efforts. Early in the pandemic, we activated our Crisis Management Team and continuity plans to ensure we will be there day in and day out for our customers, our investors and for the rest of the market while also protecting our staff.

The results of our business resiliency actions to date have been outstanding and we have exceeded our own expectations in terms of our ability to seamlessly maintain continuity in all of our business operations.

So far, Freddie Mac has experienced no significant operational or technology issues associated with the pandemic despite nearly 99 percent of our employees working remotely.

Open for Business
Taking a step back, these efforts highlight an important fact: Freddie Mac is open for business,

both in terms of the extraordinary steps we have taken and in continuing to fulfill our day-to-day mission. We continue to purchase loans in every market, every day.

We are continuing to bring new multifamily security issuances to market. We priced several "K-Deals" over the past month and expect to continue doing so in the weeks ahead. And we have been in the market with new issuances of single-family mortgage-backed securities as well.

A Stabilizing Force, a Transformed Company

Our response to the pandemic shows how far we have come as a company from the 2008 Financial Crisis.

Throughout the recent events, Freddie Mac has been a stabilizing force in the U.S. housing finance system – demonstrating that we are a very different company than the one that entered conservatorship 12 years ago.

Financial and Business Results

Now, let's turn to our first quarter financial results.

We earned comprehensive income of $0.6 billion, a decrease of $1.8 billion compared with the fourth quarter 2019.

The decrease from the prior quarter was driven by:

- Higher credit-related expense of $1.1 billion, or $0.9 billion, after-tax, due to higher expected credit losses as a result of the pandemic;
- Lower gains on single-family asset disposition activity of $0.5 billion, after-tax; and
- Higher market-related losses of $0.3 billion, after-tax, primarily driven by spread widening due to COVID-19.

The impact from interest rate changes this quarter was minimal due to our effective use of hedge accounting, and while our expected credit losses are higher due to COVID-19, they are being partially offset by expected recoveries from credit enhancements, like STACR and ACIS. As of March, CRT transactions, including STACR and ACIS, covered 51 percent of the single-family credit guarantee portfolio.

And although our GAAP net interest income was down from the prior quarter, our adjusted measures for net interest income and guarantee fee income, which more clearly reflect our sources of revenue, remained strong, both increasing slightly from the prior quarter.

Our total equity now stands at $9.5 billion, compared with $9.1 billion at December 31. The added capital strengthens our balance sheet in the face of this crisis, and it advances our goal of responsibly exiting conservatorship.

You'll note that the increase in total equity, which typically tracks with our comprehensive income, was less than the $0.6 billion we earned. This is due to an adjustment to retained earnings made on January 1 related to our adoption of CECL, which totaled approximately $240 million.

Returning to CRT for a moment, Single-Family continued to transfer credit risk in the first quarter, completing CRT transactions that protect more than $140 billion of unpaid principal balance with maximum coverage of more than $5 billion.

Risk distribution also continued in Multifamily—our K-deal program was tested in the quarter and passed. In fact, Freddie Mac Multifamily successfully sold "unguaranteed" subordinate securities that did not benefit from our own guarantee or even the prospect of support from the government during a period of significant dislocation.

We also have maintained high levels of liquidity on our own balance sheet and we are positioning ourselves to be well prepared for challenges ahead related to underlying economic stress. We were able to access both short-term and long-term debt markets as needed. In the month of March, we issued approximately $55 billion of debt, with about $33 billion of it having maturities greater than one year.

We followed that up with an issuance of our Reference Notes in April, the second of the year so far, with the first in February.

These issuances demonstrate that our access to funding markets remains intact and that we have the wherewithal to meet our financial obligations and meet the funding needs of customers.

Looking to our business results, we executed on our mission of providing liquidity, stability and affordability to the housing market.

In the first quarter:

- We helped more than 630,000 families own or rent a home by providing nearly $152 billion in funding to the mortgage market.
- We purchased 526,000 home loans, including loans to nearly 87,000 first-time homebuyers.
- We financed 111,000 rental units, 96 percent of which were affordable to families earning at-or-below 120 percent of area median income.

- And, all of this is beyond the borrowers and renters we helped keep in their homes through the extraordinary measures I discussed earlier.

The challenge now becomes keeping up that momentum through deeply uncertain times.

Outlook

Which brings me to our outlook for the housing market for the rest of the year.

We expect the COVID-19 pandemic to have a significant effect on our business into 2021, and perhaps beyond.

With large parts of the U.S. economy shut down to fight the pandemic, the housing market faces its greatest challenge in more than a decade.

Based on current assumptions, we expect home sales to fall significantly this quarter and then begin to recover over the next year. While home prices increased in the first quarter, the future effect of the COVID-19 pandemic is highly uncertain and dependent on the pace of economic recovery. The decline in home prices could be significant if forbearance and foreclosure mitigation do not limit the effect on home prices.

In addition, the Federal Reserve's purchases of mortgage securities have helped stabilize mortgage markets and lower mortgage rates.

We expect rates to remain low over the next two years and result in an increase in mortgage refinance activity that largely offsets the decline in purchase money mortgages.

We expect serious delinquency rates and the volume of loss mitigation activity to increase significantly in the near-term due to the pandemic; and while we believe the forbearance programs that we announced represent effective loss mitigation in the short term, we will likely see higher delinquencies and defaults in the future as the underlying forbearance agreements end. This is in large part why our loan loss reserves have increased.

Conclusion

Clearly, we have some difficult and uncertain times ahead.

But we remain steadfast, well managed and committed to our important role in the U.S. housing finance system and the U.S. economy.

I want to thank everyone we work with who has pulled together through this crisis. That includes not only the tireless team at FHFA, but also our customers, our investors and countless other market participants—like real estate professionals, home builders and housing counselors.

I also want to thank the millions of homeowners and renters who put their faith in Freddie Mac, its lenders and servicers, as they struggled—and in some cases continue to struggle—through the hardship brought about by this crisis.

Finally, I want to thank the thousands of Freddie Mac staff who have soldiered on during an unprecedented time to ensure Freddie Mac remains … open for business.

I will now take your questions.