Freddie Mac CEO David Brickman Discusses Fourth Quarter and Full Year 2019 Financial Results

As Prepared for Delivery

Good morning and welcome to our fourth quarter and full-year earnings call. I'm excited to recap the significant progress our company made in 2019 and share with you some of the big developments we're working toward in the year ahead.

Today I will touch on three topics:

- First, our financial performance over the course of 2019,
- Second, the progress we have made to further Freddie Mac's role as the leader in housing, and
- Third, our current thinking about the housing market in 2020.

I'll conclude by discussing how all this relates to our primary focus: preparing to responsibly exit conservatorship.

Financial and Business Results

We ended 2019 with a very strong fourth quarter, recording $2.4 billion of comprehensive income. This was a $0.6 billion increase over the prior quarter.

For the year overall, Freddie Mac saw continued solid earnings, with strong returns and a decline in the amount of capital necessary to manage our risks.

Specifically, our comprehensive income in 2019 was $7.8 billion, down $0.8 billion from 2018. The company's modest drop in income is largely attributable to three factors:

1. **First, the low interest rate environment** reduced net interest income on our investments portfolio,
2. **Second, guarantee portfolio amortization income decreased—a product of timing differences between when we receive the proceeds from loan prepayments and the remittance of those proceeds to security holders.** This partially offset otherwise strong business revenue,
3. **And third, the investments we made to reduce our risks and make our business more efficient increased our costs**. I will elaborate on some of those investments later in my remarks.

In addition to these factors, I note that other income was lower in 2019. This is due, in part, to a $0.3 billion judgment we obtained in 2018.

Our return on conservatorship capital remained relatively unchanged from 2018 at a strong 15 percent. This proxy for return-on-equity is a good indication that our company is maintaining a consistent and stable risk-adjusted return. It is also evidence of our strength as a well-managed financial institution that is making good decisions in the best interest of taxpayers.

In addition, we continue to demonstrate our core strength as a risk manager, most notably through the decline of $4.8 billion in the amount of conservatorship capital needed to support our business. This can largely be attributed to credit risk transfer activity, home price appreciation, and the disposition of legacy assets—as well as a decrease in deferred tax assets.

This reduction, combined with the continued strong and stable credit performance in our mortgage business, illustrates the strength of our risk culture.

Let me note one additional item in terms of financial performance related to the implementation of the Financial Accounting Standard Board's new Current Expected Credit Loss accounting – known as CECL. I can report that we expect to recognize a non-material decrease to retained earnings of $0.2 billion upon CECL's adoption on January 1, 2020.

Finally, in 2019 we executed on what matters most at Freddie Mac—our mission of providing liquidity, stability and affordability to the housing market. In fact, over the course of the year:

- We helped nearly 2.6 million families to own or rent a home by providing nearly $558 billion in funding to the mortgage market.
- We served approximately 950 regional and community-oriented single-family lenders.
- We purchased nearly 1.8 million home loans, including loans to nearly 395,000 first-time homebuyers.
- And we financed 809,000 rental units, 94 percent of which were affordable to families earning at-or-below 120 percent of area median income.

Leadership in Housing

Beyond these numbers, 2019 also marked a year of evolution as we continued to transform our company to be the leader in housing across a number of dimensions. That evolution includes the successful launch of the Uniform Mortgage Backed Security, or UMBS, our continually evolving credit risk transfer programs and advancements in our internally- and externally-focused technology.

Uniform Mortgage Backed Security

Launched in June, the UMBS is one of the most important developments in housing finance since our founding. In a short time, we have seen more than $27 trillion of securities trade in the combined to-be-announced, or TBA, market. The tremendous volume of trading on the new UMBS has enhanced secondary market liquidity, which should ultimately lower mortgage costs for homebuyers.

Improvements in Credit Risk Transfer

Our pioneering credit risk transfer, or CRT, programs achieved new heights in 2019 surpassing $50 billion of Single-Family credit risk transferred from Freddie Mac to investors. The percentage of our Single-Family credit guarantee portfolio and the percentage of our Multifamily mortgage portfolio covered by credit enhancements increased to 56 percent and 89 percent, respectively, as of December 31. And we continued to find new and innovative ways to move more risk to the private sector last year.

For example, in Single-Family, we introduced a new offering that transfers additional first-loss risk that our company previously retained.

And in Multifamily, we launched our first-ever K-Deal with a class of securities tied to the new Structured Overnight Finance Rate, or SOFR, the index which is expected to replace LIBOR over the next two years.

Our Digital Evolution

We also made progress in our ongoing digital transformation in 2019, helping to improve our efficiency and decrease our operational risk. We have made significant investments in improving our technology, adding new collaboration and productivity tools that have changed the way we work as a company.

We also have adopted an "agile" environment for product development that brings IT and business together to be faster, smarter and more collaborative.

The results include integrated software applications such as Single-Family's Asset and Income Modeler, or AIM, which automates the process of borrower data verification. AIM makes it possible for lenders to close loans faster and creates a better financing experience for homebuyers. The automation of this process also helps remove subjectivity from borrower asset and income assessments, reduces errors and allows us to calculate risk more easily and accurately.

Our Multifamily business is also driving toward a digital platform. We recently introduced a digital inspection application that allows inspectors to use a mobile device to digitally record inspection observations, including photos, decreasing potential operational and credit risk for Freddie Mac.

Thought Leadership

In addition, we've ramped up our industry leading research to help more families. Our efforts range from economic outlooks and insightful articles on nearly every aspect of the housing market to attitudinal research on the changing preferences of today's renters and owners. In fact, we recently released a landmark study on Generation Z—the large population cohort born since the mid-1990s, the generation after the Millennials—which will profoundly influence our industry over the next few decades, and which I find particularly interesting given that I am the parent of three Generation Z'ers.

A Look Ahead To 2020

Looking ahead, the actions we took in 2019 helped to prepare us for the environment we expect in 2020 and beyond. So, what do we see coming?

We expect mortgage rates to remain low over the next two years, which will continue to fuel purchase demand and bring modest market growth.

We project home sales will increase steadily from 6 million in 2019 to 6.3 million in 2021. While home price growth should decelerate, we believe it will continue to climb at an annual rate of 2.8 percent in 2020.

The optimistic outlook for growth of the market and home price appreciation unfortunately comes with a downside, as supply continues to tighten. The nation's housing stock is suffering. The United States added 9.8 million housing units in the last decade, compared to an average of 18 million per decade over the last 50 years. Even the 10-year high of 1.3 million units delivered in 2019 fell short of annual housing demand by about 300,000 units, exacerbating an already significant supply deficit from prior years and contributing to the growing affordability crisis.

These economic factors underscore the urgency of our top strategic priority as a company: exiting conservatorship responsibly.

I will also note that in 2020 we, as a company, will be expanding our focus on sustainability and ESG issues more broadly. You will see some commentary about this in our 10-K. And look for us to have more to discuss over the course of the year.

Let us close with that topic of our preparations to exit conservatorship.

Preparing to Exit Conservatorship

FHFA Director Calabria has said that ending conservatorship will move us toward a mortgage finance system that meets the housing needs of American families, protects the American taxpayer and supports financial stability.

We support those goals. Like Director Calabria, we believe that exiting conservatorship will help us identify new opportunities to lower the barriers to creating, preserving and financing quality housing. We also believe it will enable us to identify market opportunities to incentivize private capital to invest in affordable housing solutions.

We took some significant steps in 2019 to help prepare for our exit. Importantly, we built an additional $4.6 billion in total equity, bringing our capital buffer to $9.1 billion as of December 31.

FHFA took another a significant step in the past few days, announcing it has selected a firm to advise it on a potential capital raise. We hope to actively begin a search for our own financial adviser in the coming weeks, and we hope to report our progress on that in the near future.

We also look forward to FHFA finalizing a capital rule that will provide guidance on our target capital level and set yet another milestone on the path to exiting conservatorship.

I want to close by reiterating something I mentioned in the last earnings call: FHFA will set out the milestones on the path to exit from conservatorship, but how fast we achieve them is up to us. As a company and as individuals, we at Freddie Mac are committed to that goal, and achieving it responsibly. We believe our mission requires it.

That concludes my prepared remarks.

I thank you for your time, and I am happy to take your questions.