Freddie Mac CEO Discusses Second Quarter 2020 Financial and Business Results

Remarks of David Brickman, Chief Executive Officer
July 30, 2020

As Prepared for Delivery

Good morning and thank you for joining our second quarter earnings call.

Today, we will cover three topics in addition to our financial and business results:

- First, I'll provide an update on our work to help stabilize markets during the pandemic,
- I'll then discuss recent key developments on the road to exiting conservatorship, and
- I'll finish with our outlook for the months ahead.

PANDEMIC RESPONSE

Let's start with our response to the pandemic still disrupting hundreds of millions of American lives.

In our last call, I provided an update on Freddie Mac's leadership in helping to stabilize the housing market and the economy through our support to consumers, lenders and others impacted by COVID-19.

As many of you know, we created forbearance programs for single-family and multifamily borrowers, implemented tenant protections and created flexibilities to ensure social distancing.

In the second quarter, we extended the timelines on those programs and introduced a new payment deferral solution, which returns a homeowner's post-forbearance monthly mortgage payment to its pre-COVID amount. We also introduced a look-up tool for renters so they can determine whether their property is backed by Freddie Mac.

I'm proud of the work we've done. We fulfilled our mission and played the counter-cyclical role the GSEs are called on to play in times of crisis.

Forbearance

Our actions—combined with other direct relief from the CARES Act—appear to be having a positive impact. While much uncertainty remains, particularly as significant portions of the CARES Act have expired, the overall trend in forbearances has been down since their peak in late May.

Black Knight estimates that as of the May 26 peak, approximately 4.76 million single-family borrowers were in forbearance, representing 9 percent of all loans.

The percentage of GSE loans in forbearance was 7.2. By last week, those figures had improved, with approximately 7.8 percent of all loans and 5.8 percent of GSE-backed loans in forbearance.

Our assessment, based on reporting from servicers, is consistent with those numbers. We estimate more than 115,000 borrowers exited forbearance in the second quarter to end the period at 426,000. Approximately 3.75 percent of Freddie Mac's single-family loans were in forbearance and at least one month past due based on the loan's original contractual terms at June 30.

In Multifamily, the percentage of forborne Freddie Mac loans is even lower. As of June 30, 2.4 percent of the loans by unpaid principal balance in our multifamily mortgage portfolio were in forbearance, approximately 83.5 percent of which are included in securitizations with credit enhancement provided by subordination.

While these numbers are better than expected, this crisis is far from over. In fact, despite the overall downward trend, Black Knight's latest weekly forbearance report represented a slight increase from the week before. We will continue to monitor these indicators and further adjust our policies and practices as necessary.

EXITING CONSERVATORSHIP

The hard work we have done to support liquidity, stability and affordability in the market while blunting the worst effects of the coronavirus have not distracted us from our top strategic priority: Responsibly exiting conservatorship.

Many of you are aware of the milestones we have already passed on our way toward that goal:

- FHFA and Treasury's announcement of a plan to end the conservatorship
- Suspension of the "net worth sweep," as a first major step toward building capital, and
- FHFA's retention of an investment advisor

In the second quarter we reached two additional key milestones.

First, we selected J.P. Morgan as financial advisor to help facilitate Freddie Mac's recapitalization. We chose J.P. Morgan as our financial advisor based on its track record and expertise in managing complex equity and capital markets transactions. They will provide strategic counsel and perform a range of tasks including advice and assistance on valuation analysis, consideration of potential capital structures and assessment of capital raising alternatives.

Second, in May FHFA re-proposed its GSE capital rule. The comment period for that rule remains open. We look forward to a final rule that ensures we can continue to fulfill our mission in a safe and sound way and that provides an attainable target for exiting conservatorship.

I also want to mention that we were very pleased to hire our new chief financial officer, Chris Lown, in the second quarter. Chris joined us in June from Navient, where he spent the last three years as CFO after two decades in banking. He is a strong addition to our management team and his experience will be invaluable as we begin to consider an eventual capital raise.

FINANCIAL AND BUSINESS RESULTS

Turning to our results, Freddie Mac earned $1.9 billion dollars of comprehensive income in the second quarter. The $1.3 billion dollar increase compared with the first quarter was driven by:

- Higher investment gains of $1.2 billion dollars, after-tax, primarily due to higher quoted spreads in the Multifamily business resulting in higher margins combined with fair value gains due to improved spreads;
- Also, lower credit-related expense of $0.3 billion dollars, after-tax, primarily reflecting updated estimates of current expected credit losses in the second quarter; and
- Higher net interest income and guarantee fee income of $0.1 billion dollars, after-tax

Looking at capital, the company's total equity increased to $11.4 billion dollars at June 30, compared with $9.5 billion at March 31.

Our Single-Family segment achieved new business activity of $232 billion dollars in the quarter, the most since the third quarter 2003 and the second highest ever. Multifamily also saw a significant increase with $20 billion dollars of new business activity.

Serious delinquencies increased in the quarter to 2.48 percent in Single-Family. Importantly this includes loans in forbearance for which the borrower has requested and been provided the right to suspend monthly payments.

Multifamily delinquencies effectively held near-zero at 0.1 percent. However, it is important to note that our Multifamily loans in forbearance are not considered delinquent as long as the borrower is in compliance with the forbearance agreement, including the agreed upon repayment plan. Consequently, our reported multifamily delinquency rates exclude these loans.

We continued to deliver on our mission in the second quarter. Freddie Mac provided funding for 827,000 single-family homes, including 609,000 refinancings. Approximately 48 percent of home sales we made possible were to first-time homebuyers.

On the Multifamily side, we financed 202,000 rental units, 95 percent of which were affordable to families making 120 percent or less of area median income.

Overall, we supported the U.S. housing finance system with $253.5 billion dollars of funding in the quarter.

OUTLOOK ON THE ECONOMIC ENVIRONMENT AND STATE OF HOUSING

Looking ahead at the state of the economy and housing, the impact of the pandemic has been unprecedented, and as a result, our economic and business forecasts are more uncertain than usual. A lot depends on the course of the virus and the pace of recovery, especially as some states reintroduce pandemic-related restrictions and relief programs expire. But right now, data suggests that the dramatic economic contraction caused by the pandemic bottomed out in mid-April, and the economy appears to be slowly improving. However, we may indeed see slower growth for a sustained period.

Despite the slow recovery, the housing market appears to be relatively healthy and has recovered faster than the rest of the economy.

In the single-family market, we have seen purchase applications rebound—likely triggered by the lowest average interest rates since Freddie Mac began tracking them in 1971. To give you an idea about how remarkable the recovery in homebuying has been: It took ten years for purchase demand to fully recover from the Great Recession. In this crisis, it did so in ten weeks.

As you might expect with very low interest rates, we have seen a dramatic rise in refinancings, and our economists expect refinance activity to stay at high levels through the end of the year.

We expect home sales to fall to 4.8 million in 2020 and then rebound to 5.6 million in 2021, which is still slightly below the 6 million sales we saw in 2019. We expect full-year house price growth to slow in 2020 and 2021.

In the Multifamily market, we see an uptick in inflows, which indicates there has been some recent acceleration in transaction activity, largely being driven by low interest rates.

We saw rents decline and vacancy rates increase over the second quarter. However, an increase in tenants staying in place and renewing their leases somewhat limited the impact of declining demand on occupancy levels.

Long-run supply shortfalls and strong multifamily fundamentals tell us the drop in demand is a temporary circumstance driven by COVID-19. Largely due to supply shortages, affordable housing was already in crisis pre-pandemic, and pandemic-related unemployment and reductions in income are disproportionately affecting renters, low-income families and families of color.

The disproportionate impact to the Black community especially has been obvious. While Black Americans represent 13 percent of the population, they account for about 23 percent of deaths from COVID-19, due to conditions largely created by unequal economic, housing, environmental and health care systems. Specifically, with regard to housing, the Census Bureau reports the Black homeownership rate is more than 20 percentage points lower than the national average and nearly 30 percentage points lower than the white home ownership rate.

Clearly, there is much work to be done, and we at Freddie Mac believe we have an obligation to do it.

Our heightened awareness of racial injustice is giving rise to a renewed focus on not just access to credit, but on driving meaningful outcomes and addressing the deplorable gap between white and Black homeownership rates. As a majority-minority company, and one so critical to the nation's housing landscape, Freddie Mac is recommitting to its mission of expanding homeownership opportunities and access to rental housing, including for families of color, across the United States. You can expect to hear more from us on our commitments to affordable housing and inclusion and diversity, as well as other environmental, social and governance matters in the near future.

CONCLUSION

Finally, let me end with this: Last week, Freddie Mac reached the fiftieth anniversary of our founding. Rather than celebrate in this challenging time, we chose to reflect on our past and the power we have to change the future. I urge you to visit our recently launched Fifty Years of Home website to see the profound impact Freddie Mac has had on U.S. housing since its founding in 1970, a year in which we purchased a grand total of eight loans.

Today, the number of single-family homes and quality rental units we've made possible is closer to 80 million.

Of those, 20 million homes and 5.4 million rental units were affordable to low- and moderate-income borrowers and renters, respectively. And, we've helped 5.6 million families achieve the American Dream by purchasing their very first home.

Throughout our journey, we've established a record as an innovator, from our very first mortgage backed security in 1971 to today's thriving multifamily and single-family credit risk transfer markets.

That is a legacy we are rightly proud of, and it is a base on which we can build toward a better future, both for this company and for the country that gave us our start 50 short years ago.

Thank you, and now I will take your questions.

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