BRINGING AMERICA HOME

2001 ANNUAL REPORT

Freddie Mac

We Open Doors®

Freddie Mac is a shareholder-owned corporation whose people are

DEDICATED TO

IMPROVING THE QUALITY OF LIFE

by making the American dream of decent, accessible housing a reality. We accomplish this mission by linking Main Street to Wall Street—purchasing, securitizing and investing in home mortgages, and ultimately providing homeowners and renters with lower housing costs and better access to home financing. Since our inception, Freddie Mac has achieved 31 consecutive years of profitability and financed one out of every six homes in America.

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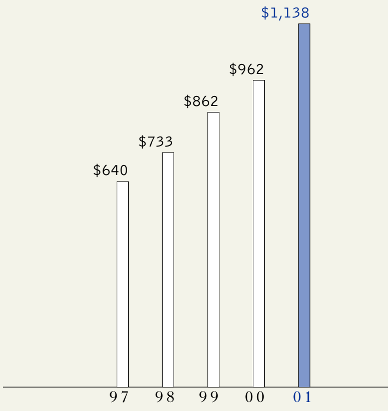
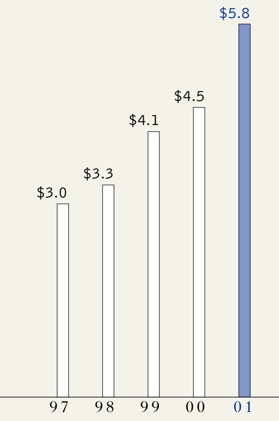
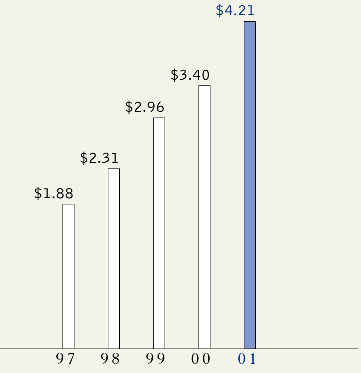


TOTAL MORTGAGE PORTFOLIO
(in billions)



OPERATING REVENUES
(in billions)[1]



OPERATING EARNINGS
PER COMMON SHARE–DILUTED[1]

(1) For more information concerning Freddie Mac's supplemental financial performance measure, see "Management's Discussion and Analysis of Financial Condition and Results of Operations–OPERATING EARNINGS."

SUMMARY OF RESULTS

Year Ended December 31,	2001	2000	% Change
(dollars in millions, except per share amounts)			
REPORTED[1]			
Net interest income on earning assets	$ 5,480	$ 2,838	93%
Management and guarantee income	1,639	1,489	10%
Fair value gains (losses)	(27)	—	100%
Other income, net	273	130	110%
Total Revenues	$ 7,365	$ 4,457	65%
Total non-interest expense	(1,065)	(923)	15%
Income taxes	(1,927)	(995)	94%
Extraordinary (loss) gain on retirement of debt, net of taxes	(231)	8	
Cumulative effect of change in accounting principle, net of taxes	5	—	100%
Net income	$ 4,147	$ 2,547	63%
Preferred stock dividends	$ (217)	$ (180)	21%
Net Income available to common stockholders	$ 3,930	$ 2,367	66%
OPERATING EARNINGS[2]			
Net interest income on earning assets	$ 3,932	$ 2,838	39%
Management and guarantee income	1,639	1,489	10%
Other income, net	273	130	110%
Total Revenues	$ 5,844	$ 4,457	31%
Total non-interest expense	(1,065)	(923)	15%
Income taxes	(1,394)	(995)	40%
Extraordinary (loss) gain on retirement of debt, net of taxes	(231)	8	
Net income	$ 3,154	$ 2,547	24%
Preferred stock dividends	$ (217)	$ (180)	21%
Net income available to common stockholders	$ 2,937	$ 2,367	24%

(1) Presented in conformity with generally accepted accounting principles in the United States.
(2) For more information concerning Freddie Mac's supplemental financial performance measure, see "Management's Discussion and Analysis of Financial Condition and Results of Operations–OPERATING EARNINGS."

TO OUR SHAREHOLDERS

2001 was a great year for Freddie Mac. We financed homes for more than three million families, including record numbers of first-time homebuyers. We delivered strong, high-quality earnings, with operating earnings per share of $4.21, up 24 percent from 2000. Our shareholders enjoyed a return on common equity exceeding 20 percent for the 20th consecutive year.

Freddie Mac achieved record volume in both our single-family and multifamily business in 2001, ensuring that a stable supply of low-cost mortgage money was available to America's housing market. The support we provided to the market last year sustained a strong housing sector and helped buffer the weakening economy.

2001 demonstrated that Freddie Mac's success in serving America's homebuyers and renters, and our ability to deliver strong financial results, go hand in hand. We cannot achieve one without the other.

Freddie Mac is well positioned to continue our growth and maintain our role as the cornerstone of America's housing finance system. Our financial position is rock-solid, well protected from economic volatility, and we stand ready to meet the nation's growing housing finance needs.

KEEPING AMERICA STRONG

Freddie Mac is at the heart of making housing dreams a reality. In 31 years, we have financed homes for 30 million families. By providing an uninterrupted supply of low-cost mortgage money, Freddie Mac has helped make the U.S. housing finance system the envy of the world. Never was our role more evident than in 2001—a year in which housing was a source of significant economic strength.

Last year, Freddie Mac set records in providing mortgage credit for both home purchases and refinances. More than half of our business financed homes for low- and moderate-income families.

Freddie Mac demonstrated our unwavering commitment to bring strength and stability to the mortgage and capital markets. In the wake of the September 11 terrorist attacks, we maintained a continuous flow of capital to America's mortgage market, ensuring that every lender customer who needed financing was served. Freddie Mac also was the first issuer back in the markets for both U.S. dollar and euro-denominated debt with significant financing transactions.

Freddie Mac instituted our "Peace of Mind Plan," providing families directly affected by the attacks assurance that they would not lose their homes to foreclosure. We also joined the nation's housing industry in contributing to the relief efforts, and we supported each other.

While we were not on the front lines that day, as many of our business partners were, we lost a wonderful member of the Freddie Mac family. We recognize a Freddie Mac hero, Mark Schurmeier, who was killed while attending a conference at the World Trade Center. Mark was a devoted father, husband and co-worker, with ten years of exemplary service to the company and our mission. We will miss him.

The events of 2001 underscore the importance of Freddie Mac's role in providing an uninterrupted flow of capital to America's homebuyers. Housing is and will remain a national, bipartisan priority. In his State of the Union address in January, President Bush called for "broader homeownership, especially among minorities." Freddie Mac applauds this vision, and we will continue to make it a reality.

STRONG GROWTH DRIVERS

Freddie Mac is well positioned to serve an ever-growing market of homebuyers. Three key factors will drive our performance in the coming decade:

- A solid foundation—Freddie Mac's market and financial positions are strong.
- Unique core capabilities—Freddie Mac's strong, sustainable capabilities are a powerful force for continued growth.
- A large and growing market—the strong and consistently growing U.S. residential mortgage market provides Freddie Mac with tremendous opportunity.

Solid Foundation

Freddie Mac is committed to being the lowest-cost, most reliable way to finance housing. Ever since the company was created in 1970, Freddie Mac has worked to reduce costs and make it easier for families to get a mortgage loan of choice.

Freddie Mac's record of fulfilling our housing mission is directly related to our record of solid financial performance. Over the past ten years, Freddie Mac's earnings per share have grown an average of 19 percent annually. We produced this exceptional record while carefully managing both credit and interest-rate risk—the two principal risks of investing in and funding mortgage loans—including during the heightened volatility and market dislocation that occurred last fall.

The credit quality of our mortgage portfolio today is the strongest in over a decade. Most of the loans we buy are originated by lenders using our superior automated underwriting system. The estimated current loan-to-value ratio for our mortgage portfolio is about 60 percent. This means we have about $600 billion of homeowner equity protecting us from loss. In addition, about one-third of our portfolio is credit enhanced with third-party insurance and other arrangements that mitigate loss. Our credit portfolio is geographically diversified, which helps protect us from regional downturns. Together, these factors contributed to credit losses on our total mortgage portfolio of less than one basis point in 2001.

Freddie Mac's retained portfolio is well protected against interest-rate volatility. Our primary indicator of interest-rate risk, portfolio market value sensitivity, is low. We use significant amounts of callable debt and other option-embedded instruments. As a result, Freddie Mac has perhaps the lowest interest-rate risk position of any major mortgage investor.

Unique Core Capabilities

Our strong financial position provides great opportunity for growth. Freddie Mac possesses unique core capabilities that will enable us to capitalize on this opportunity.

Our reliable access to low-cost funds enables us to provide competitive bids for mortgages, even during periods of market disruption. Freddie Mac has a wide array of vehicles to finance mortgages. We pioneered mortgage-backed securities, and we were instrumental in developing the market for callable debt—both important for financing long-term fixed-rate mortgages. We continue to find ways to reduce funding costs by broadening and deepening the universe of investors in our Reference Notes® and Bills.

Freddie Mac's security offerings are large, liquid and high quality. They fit extremely well with the investment requirements of an ever-broadening array of investors—domestic and overseas. Five years ago about 5 to 10 percent of our debt was distributed overseas. Now it's more than 35 percent.

Freddie Mac also has world class mortgage expertise. A singular focus on residential mortgages, access to decades of information on 28 million single-family loans and our team of mortgage professionals give us unparalleled understanding of this asset class. This enables us to expertly manage credit and interest-rate risk.

Our expertise gives us an edge in making mortgage investment decisions for our retained portfolio and helps us design and pursue the best hedging strategies. We invest in mortgages only when they meet our return requirements and only when we can prudently manage their interest-rate risk.

Freddie Mac's ability to effectively manage interest-rate risk in the future is supported by the growing variety of techniques available to us. We remain a prudent user of derivative financial instruments, strictly to reduce risk, preserve value and enable families to get fixed-rate mortgage loans. We do business only with highly rated counterparties. We mark-to-market all our derivative positions daily, and we typically require collateral such as cash and Treasury securities to be posted against any risk exposure.

Our expertise in understanding and managing mortgage credit risk also continues to grow and drive innovation. For example, the Loan Prospector® automated underwriting system Freddie Mac introduced to the market in 1995 has now become an integral part of how mortgages are originated. Enhancements to this system are expanding our reach into the mortgage market while maintaining loan quality and helping us continue to carefully control credit costs. In 2001, lenders used Loan Prospector to evaluate nearly two-thirds of the loans sold to us.

Freddie Mac also is using technology to monitor loan performance over time. Today, we can identify the small proportion of loans that become delinquent sooner, and we can act quickly to mitigate risk. A loan that is modified through our loss mitigation process has about 20 percent of the losses of a loan that goes into foreclosure.

Freddie Mac's expertise in understanding and managing loan quality is why our credit performance is among the best in the industry. Freddie Mac's delinquency rates are one-third lower than industry delinquency benchmarks.

In addition to reliable access to low-cost funds and our unparalleled mortgage expertise, the broad scope of Freddie Mac's operations also positions us for growth. The size of our business offers tremendous economies of scale. Freddie Mac's administrative expenses were about 8 basis points of our $1 trillion total mortgage portfolio in 2001. We generated about one and a half million dollars of revenue per employee. Both figures are superior to almost every other major participant in the mortgage market.

Freddie Mac's efficient capital structure also positions us to capture a greater share of the mortgage market. Freddie Mac is in a single, safe business—mortgages for people's homes. Mortgages are high-quality assets, backed by homeowner equity, and we use credit enhancements and other hedging instruments to distribute much of the remaining risk to others.

Our capital requirement—both the standard we hold ourselves to and the state-of-the-art capital requirement now being implemented by our regulator—assures that we hold capital against the risks that we take. We have an efficient capital structure that enables us to effectively compete for mortgage assets in the market and maintain our position as a premier, low-cost funder of residential mortgage credit.

These unique capabilities—reliable access to low-cost funds, unparalleled mortgage expertise, economies of scale and our efficient capital structure—are a powerful force for growth. Freddie Mac will use these capabilities to create value in the growing U.S. mortgage market.

Growing Mortgage Market

Freddie Mac is at the center of the U.S. residential mortgage market—a market that has grown every year since World War II, including times of economic boom and bust. Today, U.S. mortgage debt outstanding is just over $6 trillion. Over the next decade, we expect it to continue to grow between 7 and 9 percent per year.

Mortgage debt will grow because more families will become homeowners, they will continue to buy larger homes with more amenities, and they will finance a greater share of their homes' value.

The nation's homeownership rate currently stands at about 68 percent and is expected to rise above 70 percent by the end of the decade, with the greatest increase for minority and immigrant households. We also expect larger numbers of first-time buyers, who typically borrow a higher proportion of their homes' value. Freddie Mac is well positioned to meet the home financing needs of these new homebuyers.

Rising home prices also will drive increases in mortgage debt outstanding. Nationwide, home prices have increased every year for the past half-century. We expect this trend to continue with home prices growing 4 to 5 percent per year over the next decade.

The mortgage market Freddie Mac serves is exceptionally well poised for sustaining strong, stable growth. We expect mortgage debt outstanding to double to $12 trillion by 2010. There is plenty of room for Freddie Mac to grow our share of this market.

Freddie Mac's retained mortgage portfolio represents only about 9 percent of conforming mortgage debt outstanding. Freddie Mac's relatively small share of a market growing at about 7 to 9 percent annually is a very attractive growth opportunity.

Freddie Mac's securitization business represents about 19 percent of the conforming market. By bringing low-cost financing to new sectors of the mortgage market and lowering the cost of mortgage money through technology, we expect healthy growth here as well.

THE FUTURE

Freddie Mac is in an excellent financial position with a strong business and strong balance sheet. We have unique core capabilities that will enable us to compete in the decade ahead, and we are at the heart of a great market that is growing every year.

As we grow, investors can continue to have confidence in the safety, soundness and transparency of Freddie Mac. We operate in a high-quality business—mortgages for people's homes. We have a simple, clear corporate structure. Freddie Mac has no unconsolidated subsidiaries or affiliates. Freddie Mac also is subject to continuous oversight by regulators and Congress. Freddie Mac meets stringent capital requirements that apply to all mortgages, and all types of financial instruments and obligations.

Freddie Mac is a leader in providing timely, comprehensive and transparent financial disclosure. Our disclosures are in the top tier of corporate America. They include complete information on our financial condition, business activities, interest-rate and credit risk management, corporate credit rating, liquidity and capital strength. They put us at the vanguard of financial disclosure and transparency.

Few companies can match Freddie Mac's record of translating opportunity into results, and we have outstanding opportunities for growth in the decade ahead. Above all, we remain strongly focused on expanding housing opportunities in America. We are committed to bringing America home.

Sincerely,

Leland C Brendsel

Leland C. Brendsel
Chairman and Chief Executive Officer

David W. Glenn
Vice Chairman and President

PROVIDING THE KEYS TO

Homeownership in America has long been linked to the ideals of freedom, prosperity and family. For millions of people, the definition of a better life is having a decent, affordable place to live.

Freddie Mac links Main Street to Wall Street, bringing the nation's homebuyers the best financing available in the global capital markets and expanding opportunities for homeownership and affordable rental housing. As a result, Freddie Mac has helped build the world's best housing finance system and financed homes for 30 million families.

Our mission improves the quality of life for people across America. Without Freddie Mac, the flow of low-cost mortgage funds would be greatly reduced, homeownership rates would be lower, and fewer lower-income and minority families would own a piece of the American dream. More families would have adjustable-rate mortgages and would face greater risk of losing their homes to foreclosure. Because of Freddie Mac, the nation's homeownership rate has increased to the record 68 percent it is today.

At Freddie Mac, we are driven to reduce costs and expand housing opportunities to as many families as possible. We are dedicated to lowering the barriers to homeownership.

A lack of financial literacy can often stand in the way of families obtaining mortgages at a fair price. To address this problem, Freddie Mac has launched a series of community-based educational initiatives.

A prime example is CreditSmart^{SM}, a nationwide education and community-based outreach initiative to help consumers understand, build and maintain good credit. The CreditSmart curriculum, which teaches prospective homebuyers the

Shelia Blockson and Ricky Montgomery are about to conduct a CreditSmart class before a standing-room-only crowd in the bookstore of Chicago's Salem Baptist Church. CreditSmart provides the information people need to get and keep good credit.

THE AMERICAN DREAM

basics of getting and keeping the good credit necessary to buy a home, was developed by Freddie Mac in conjunction with five Historically Black Colleges and Universities, with the assistance of the American Homeowner Education & Counseling Institute.

CreditSmart is part of the award-winning Don't Borrow Trouble℠ campaign that began in Boston and Freddie Mac has taken nationwide. Don't Borrow Trouble provides information to consumers so that they can avoid abusive lending practices and obtain mortgages that suit their needs.

Freddie Mac also provides viable alternatives. One such product enables credit-impaired borrowers to get a mortgage, demonstrate a record of regular payments and then benefit from an interest-rate reduction. Freddie Mac is committed to developing new products and technologies that will make obtaining a mortgage even easier, faster, fairer and less costly.

Over the next decade, America's families will need an additional $6 trillion to finance their homes. Freddie Mac will be there to ensure that mortgage financing is available whenever and wherever it is needed. We are constantly finding new ways to bring America home.

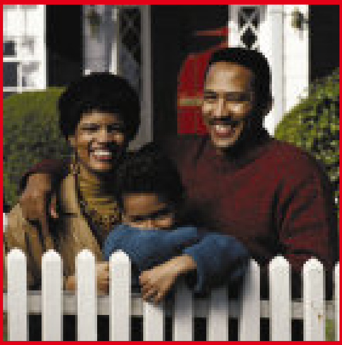
Freddie Mac purchases mortgages from thousands of mortgage lenders serving millions of homebuyers. Freddie Mac is constantly introducing new innovations and new technologies that are increasing the speed and efficiency of this process and bringing lower costs to lenders.

Loan Prospector, our groundbreaking suite of automated underwriting tools, is a great example. Introduced to the market in 1995, Loan Prospector streamlines and reduces the cost of the mortgage process. We keep making it better: Loan Prospector evaluated a record 7 million loans in 2001, including massive numbers of refinancings. The speed and efficiency of automated underwriting enabled our industry to serve a record volume of borrowers in 2001.

Loan Prospector has forever changed mortgage origination from a time-consuming, paper-laden, often anxiety-ridden process into one that can offer the best financing for borrowers in a matter of seconds. More than 15,000 lenders and mortgage brokers nationwide are now using Freddie Mac's Loan Prospector. Today, they can qualify borrowers right at the point of sale, including those with nontraditional credit profiles.

UNLEASHING THE POTENTIAL

Clint Myers and Tracey Anthony of Corporate Investors Mortgage Group in Chapel Hill, North Carolina, winners of Loan Prospector (LP) Service Awards, are just two of the thousands of mortgage industry professionals using Freddie Mac's automated underwriting service nationwide to get more people into more homes. "Before, I was intimidated by the computer and technology advances," said Tracey. "But LP is very user-friendly and my first choice for processing loan applications."

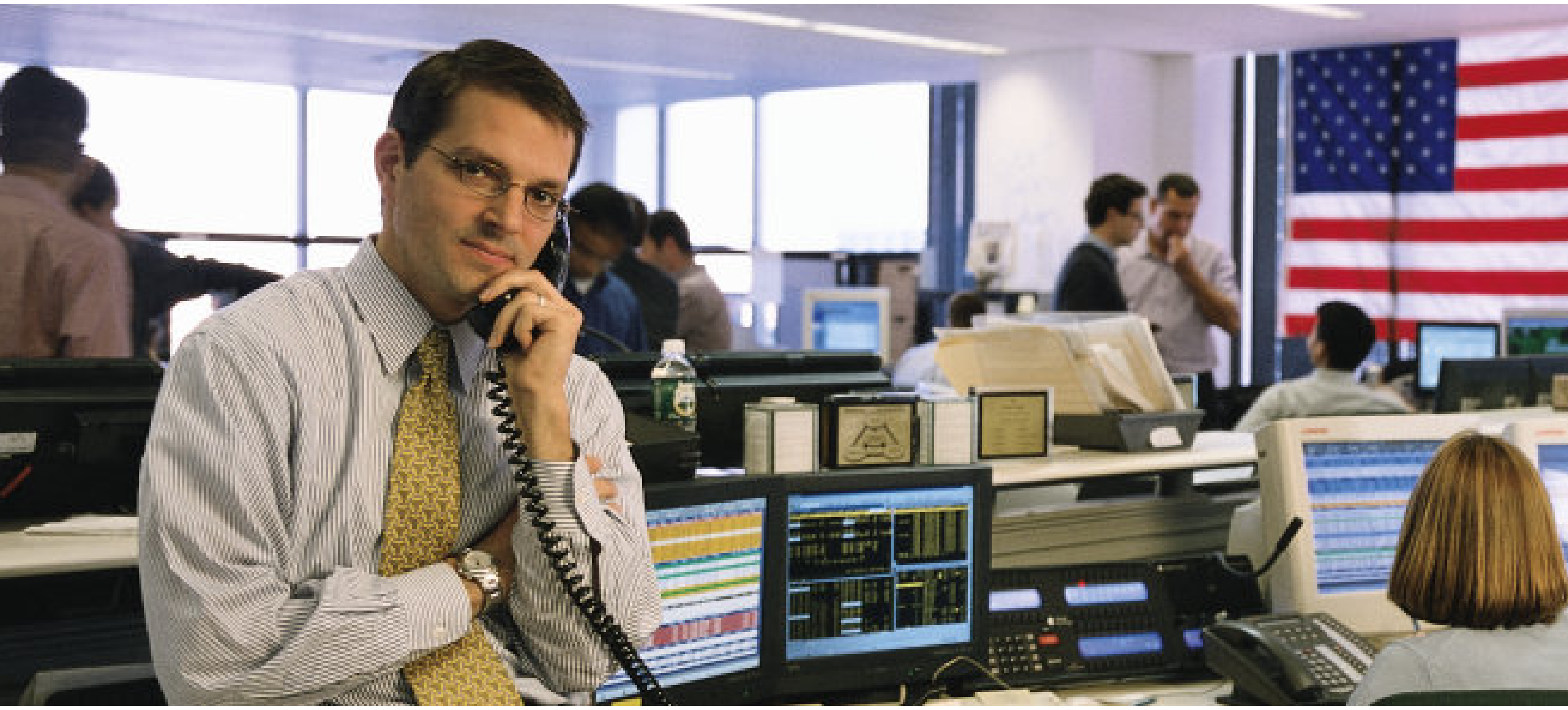


Our technology tools are enabling lenders to make faster, fairer and more accurate decisions and serve the growing diversity of America's borrowers. Our innovations are helping even the smallest lenders to compete.

Freddie Mac's innovations extend to our multifamily business as well. We broke all previous volume records with more than $10 billion in multifamily business in 2001. The growth in this business had a significant impact on the availability of affordable rental housing across the United States: More than 90 percent of the business we funded in 2001, representing almost 300,000 apartment units, is affordable to families of modest means.

Freddie Mac is leading the way with new technologies to bring greater efficiency and lower costs to our lender customers and America's homebuyers. Together, Freddie Mac and our customers are working to bring America home.

OF TECHNOLOGY



OPENING THE DOOR TO THE

Freddie Mac is in a great business: we turn homeownership dreams into reality. We accomplish this by linking America's mortgage markets to the world's capital markets to ensure that lenders have access to a reliable source of low-cost mortgage money.

Freddie Mac has led the market in the development of conventional mortgage-backed and multiclass securities. Our mortgage securities are among the most liquid and widely held in the world.

Freddie Mac also leads the way in the global debt markets. Our Reference suite of products has attracted billions of dollars in low-cost capital from around the world. Our Internet auctions of debt securities provide investors with unparalleled pricing transparency. Freddie Mac introduced the market's first-ever multi-currency debt financing calendar in 2001, giving investors an 18-month view of both our U.S. dollar- and euro-denominated Reference program issuances and providing them critical information for their investment planning.

Freddie Mac's market leadership has not gone unnoticed: In poll results released by *Euromoney*, a leading London-based magazine for the capital markets, respondents named Freddie Mac "Best Borrower" in the world for 2001. This recognition reflects Freddie Mac's growing reputation for innovation in the international investment community.

J.P. Marra, co-head of the Lehman Brothers agency trading desk at its temporary facility in New Jersey. Lehman was one of many firms forced to relocate after their offices in lower Manhattan were severely damaged. By issuing the first large debt offering after September 11, Freddie Mac brought much-needed stability to the capital markets. Reuters reported that the transaction was "a symbol of the U.S. market's resilience and determination to recover."

WORLD'S FINANCIAL MARKETS

Providing liquidity and stability to the mortgage and financial markets is an important element of Freddie Mac's role. The nation's housing market depends on us to ensure mortgage money is always available.

This year our commitment to meet this need was especially evident. Following the September 11 terrorist attacks, Freddie Mac continued to buy mortgages, enabling mortgage lenders to hedge their pipelines and offer rate locks to borrowers. Not a single lender needing funds was turned away throughout this tumultuous time.

Freddie Mac also was the first in the market with a major debt financing transaction—$5 billion in two-year Reference Notes on September 14—bringing much-needed confidence and stability. The international financial community recognized Freddie Mac for its bold action with the presentation of *International Financing Review* magazine's "U.S. Dollar Bond of the Year Award" for 2001.

Our commitment to fulfilling the company's mission remains steadfast. Freddie Mac is attracting the capital that America's housing market needs by bringing liquidity, transparency and predictability to investors worldwide. We will travel the globe to bring America home.

Freddie Mac is a "Great Place to Work," said *Washingtonian* magazine in its latest ranking of area workplaces, and it's easy to see why.

Freddie Mac's mission is to improve the quality of life by making the American dream of decent, accessible housing a reality. The employees of Freddie Mac take that mission to heart and make achieving it possible. Freddie Mac will meet the housing finance needs of future homebuyers only by attracting, retaining and developing talented and dedicated people.

Freddie Mac has been consistently recognized as an employer of choice:

- Freddie Mac is a repeat winner on *Washingtonian* magazine's list of the area's 50 great places to work. Among the Freddie Mac attributes mentioned were family-friendly benefits that include flextime, adoption leave and subsidized back-up childcare.
- *Business Ethics* magazine ranks Freddie Mac 10th on its list of the year's 100 Best Corporate Citizens for 2001.
- *Working Woman* ranks Freddie Mac 8th on its list of 30 U.S. companies with the best track records for buying goods and services from minority- and women-owned businesses.

BUILDING A

The people of Freddie Mac have dedicated thousands of hours to employee volunteerism in efforts from our business/school partnerships to Habitat for Humanity projects. "By volunteering together, we can help brighten the lives of children and families, strengthen communities and increase homeownership opportunities, as well as demonstrate our team spirit," says Corporate Relations Senior Vice President Dwight Robinson as he participates in a Habitat for Humanity build of townhomes in Fairfax, Virginia.

- Freddie Mac rates 17th on *Fortune* magazine's list of the top 50 companies for minority employees and second for corporate giving that benefits minority families.
- Freddie Mac ranks 27th among the top 75 U.S. companies for superior employee benefits, according to *Money* magazine's 2001 benefits survey.

Freddie Mac employees are actively involved in their communities, with about one-third giving their time and talents in company-sponsored volunteer activities. In 2001, the Freddie Mac Foundation celebrated 10 years of opening doors of hope and opportunity to children and their families.

Freddie Mac has financed homes for 30 million families, and along the way we've helped to build a few, too. In 2001, hundreds of Freddie Mac employees joined homebuilding efforts led by Habitat for Humanity International.

The people of Freddie Mac define us. They are proud to work for Freddie Mac and eager to contribute to its success and bring America home.

WINNING TEAM

BOARD OF DIRECTORS *(as of March 15, 2002)*

Leland C. Brendsel
Chairman & Chief Executive Officer
Freddie Mac

David W. Glenn
Vice Chairman & President
Freddie Mac

Cesar B. Cabrera*
President & Owner
Rocca Development Corporation
A real estate development company
San Juan, Puerto Rico

Michelle Engler*
Trustee, Investor Series Trust
& Member, Boards of Managers
JNL Variable Funds
Investment companies
Lansing, Michigan

George D. Gould
Vice Chairman
Klingenstein, Fields & Company, L.P.
An investment management firm
New York, New York

David J. Gribbin III*
Managing Director
Clark and Weinstock
A government affairs firm
Washington, D.C.

Thomas W. Jones
Chairman & Chief Executive Officer
Global Investment Management
and Private Banking Group
A division of Citigroup, Inc. and
Chairman & Chief Executive Officer
Citigroup Asset Management
New York, New York

Henry Kaufman
President
Henry Kaufman & Company, Inc.
An economic and financial consulting
and investment management firm
New York, New York

John B. McCoy
Retired Chairman
& Chief Executive Officer
BANK ONE CORPORATION
A financial institution
Columbus, Ohio

James F. Montgomery
Chairman & Chief Executive Officer
Frontier Bank
A savings and loan company
Park City, Utah

Shaun F. O'Malley
Retired Chairman
Price Waterhouse LLP
An accounting firm
Philadelphia, Pennsylvania

Ronald F. Poe
President
Ronald F. Poe & Associates
A private real estate investment firm
White Plains, New York

William D. Powers*
Principal
Powers, Crane & Company, LLC
A government relations firm
Albany, New York

Stephen A. Ross
Professor
Massachusetts Institute of Technology
Cambridge, Massachusetts
and Co-Chairman
Roll and Ross Asset
Management Corporation
A quantitative financial
management firm
New Haven, Connecticut

Donald J. Schuenke
Retired Chairman
Northwestern Mutual Life Insurance
A life insurance company
Milwaukee, Wisconsin
and Non-Executive Chairman
Allen-Edmonds Shoe Company
A shoe manufacturing company
Port Washington, Wisconsin

Christina Seix
Chairman, Chief Executive Officer
& Chief Investment Officer
Seix Investment Advisors, Inc.
An investment management firm
Woodcliff Lake, New Jersey

Catherine L. Stepp*
Co-owner & Vice President
First Stepp Builders, Inc.
A firm specializing in building
affordable, quality, single-family homes
Racine, Wisconsin

William J. Turner
Co-Manager
Signature Capital, Inc.
A venture capital investment firm
New York, New York
and Chairman & Chief Executive Officer
Turner & Partners, Inc.
A management services
and investment firm
New York, New York

*Appointed by the President of the United States

SENIOR MANAGEMENT *(as of March 15, 2002)*

Leland C. Brendsel
Chairman & Chief Executive Officer

David W. Glenn
Vice Chairman & President

Vaughn A. Clarke
Executive Vice President
& Chief Financial Officer

Maud Mater
Executive Vice President,
General Counsel & Secretary

Paul T. Peterson
Executive Vice President
Single-Family Business

David A. Andrukonis
Senior Vice President
Capital Deployment

Donald J. Bisenius
Senior Vice President
Credit Risk Management

Henry J. Cassidy
Senior Vice President
Single-Family Capital Management

Margaret A. Colon
Senior Vice President
Single-Family Chief Operating Officer

Adrian B. Corbiere
Senior Vice President
Multifamily

Robert C. Dean
Senior Vice President
Market Risk Oversight

R. Mitchell Delk
Senior Vice President
Government Relations

Nazir G. Dossani
Senior Vice President
Investments

Margie Farber
Senior Vice President
Business Area Services

Edward L. Golding
Senior Vice President
Financial Research

Michael W. Hager
Senior Vice President
Human Resources

Melvin M. Kann
Senior Vice President & General Auditor

William I. Ledman
Senior Vice President
Information Systems & Services

Jerome T. Lienhard
Senior Vice President
Debt Funding

Peter F. Maselli
Senior Vice President
General Manager Mortgage Services

Michael C. May
Senior Vice President
Project Enterprise

Milton Moore
Senior Vice President
Technology Infrastructure
& Operations

Gregory J. Parseghian
Senior Vice President &
Chief Investment Officer
Funding & Investments

Gregory E. Reynolds
Senior Vice President
Business Development-Finance

Dwight P. Robinson
Senior Vice President
Corporate Relations

Edmond J. Sannini
Senior Vice President
Corporate Controller

Patrick M. Sheehy
Senior Vice President
General Manager National Lending

David H. Stevens
Senior Vice President
General Manager Community Lending

Robert Y. Tsien
Senior Vice President
Chief Credit Officer

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Five-Year Financial Highlights

December 31,	2001	2000	1999	1998	1997
(dollars in millions, except share-related amounts)					
OPERATING DATA[1][2]					
Operating earnings	$ 3,154	$ 2,547	$ 2,223	$ 1,700	$ 1,395
Operating earnings per common share—diluted	$ 4.21	$ 3.40	$ 2.96	$ 2.31	$ 1.88
Operating return on realized common equity[3]	23.1%	22.9%	23.8%	24.6%	23.7%
Operating revenues	$ 5,844	$ 4,457	$ 4,055	$ 3,337	$ 3,029
REPORTED DATA[4]					
BALANCE SHEET AND CAPITAL MEASURES					
Total assets	$ 617,340	$ 459,297	$ 386,684	$ 321,421	$ 194,597
Debt securities, net	$ 561,946	$ 426,754	$ 360,581	$ 287,234	$ 172,321
Total liabilities[5]	$ 598,367	$ 443,865	$ 374,602	$ 309,978	$ 186,154
Summary of Capital Measures:					
Core capital[6]	$ 19,336	$ 14,381	$ 12,691	$ 10,715	$ 7,375
Reserve for mortgage losses[7]	801	784	772	768	694
Total capital	20,137	15,165	13,463	11,483	8,069
Subordinated borrowings	3,125	145	130	162	521
Adjusted total capital	$ 23,262	$ 15,310	$ 13,593	$ 11,645	$ 8,590
PORTFOLIO BALANCES					
Retained portfolio[8]	$ 491,719	$ 385,693	$ 324,443	$ 255,009	$ 164,421
Total Mortgage Participation Certificates or PCs[9]	$ 948,409	$ 822,310	$ 749,081	$ 646,459	$ 579,385
PCs held in retained portfolio	$ 301,961	$ 246,209	$ 211,198	$ 168,108	$ 103,400
Total mortgage portfolio[10]	$1,138,167	$ 961,794	$ 862,326	$ 733,360	$ 640,406
NEW BUSINESS PURCHASE AND FINANCING ACTIVITIES[2]					
New business purchases	$ 475,091	$ 207,423	$ 272,472	$ 288,338	$ 121,490
Number of new business purchases (# of loans)	2,892,508	1,465,280	2,058,330	2,396,651	1,085,046
PC issuances	$ 389,611	$ 166,901	$ 233,031	$ 250,564	$ 114,258
Structured securitizations[11]	$ 192,437	$ 48,202	$ 119,565	$ 135,162	$ 84,366
INCOME STATEMENT[4]					
Total revenues	$ 7,365	$ 4,457	$ 4,055	$ 3,337	$ 3,029
Net income	$ 4,147	$ 2,547	$ 2,223	$ 1,700	$ 1,395
Earnings per common share-diluted[12]	$ 5.64	$ 3.40	$ 2.96	$ 2.31	$ 1.88
Dividends per common share	$ 0.80	$ 0.68	$ 0.60	$ 0.48	$ 0.40
RATIOS[2]					
Dividend payout ratio on common stock[13]	14.6%	20.0%	20.1%	20.7%	21.1%
Return on common equity[14]	39.2%	23.7%	25.5%	24.1%	23.3%
Return on total equity[15]	29.2%	20.2%	20.3%	19.4%	19.5%
Return on average assets[16]	0.8%	0.6%	0.6%	0.7%	0.8%
Capital to total assets ratio[17]	1.3%	1.3%	1.4%	1.3%	1.1%
Equity to assets ratio[18]	2.6%	3.0%	3.2%	3.6%	3.9%
Ratio of earnings to fixed charges[19]	1.22:1	1.14:1	1.16:1	1.16:1	1.17:1
Ratio of earnings to combined fixed charges and preferred stock dividends[19]	1.20:1	1.13:1	1.14:1	1.15:1	1.16:1

(1) Based on Freddie Mac's supplemental performance measure. See "OPERATING EARNINGS" for more information.
(2) This financial information is unaudited.
(3) Annual computations reflect the simple average of quarterly returns. Quarterly returns are computed as annualized operating net income less preferred stock dividends divided by average realized common stockholders' equity (common stockholders' equity excluding "Accumulated Other Comprehensive Income, Net of Taxes" ("AOCI")).
(4) Based on generally accepted accounting principles in the U.S. ("GAAP").
(5) Excludes "Reserve for losses on Mortgage Participation Certificates" and "Subordinated borrowings."
(6) "Stockholders' equity" excluding AOCI.
(7) "Reserve for losses on retained mortgages" plus the "Reserve for losses on Mortgage Participation Certificates."
(8) The retained portfolio represents mortgages and mortgage-related securities that are held as on-balance sheet assets that Freddie Mac has financed principally with debt securities. This balance excludes related premiums, discounts and deferred fees, reserve for losses on retained mortgages and net unrealized gain (loss) on available-for-sale guaranteed mortgage securities.
(9) Includes all mortgages securitized into PCs including PCs in the "Retained portfolio."
(10) Includes "Total PCs" and non-Freddie Mac securities in the retained portfolio.
(11) Includes issuances of mortgage-related securities in which the cash flows are structured into various classes having a variety of features, the majority of which qualify for treatment as Real Estate Mortgage Investment Conduits ("REMICs") under the Internal Revenue Code.
(12) "Earnings per common share-basic" are computed based on weighted average common shares outstanding. "Earnings per common share-diluted" are computed based on the total of weighted average common shares outstanding and the effect of dilutive common equivalent shares outstanding.
(13) Annual computations reflect the simple average of quarterly ratios. Quarterly ratios are computed as dividends paid divided by "Net income available to common stockholders."
(14) Annual computations reflect the simple average of quarterly returns. Quarterly returns are computed as annualized "Net income available to common stockholders" divided by the simple average of the beginning and ending balances of "Stockholders' equity," net of preferred stock (at redemption value).
(15) Annual computations reflect the simple average of quarterly returns. Quarterly returns are computed as annualized "Net income" divided by the simple average of the beginning and ending balances of "Stockholders' equity."
(16) Annual computations reflect the simple average of quarterly returns. Quarterly returns are computed as annualized "Net income" divided by the simple average of the beginning and ending balances of "Total assets."
(17) Annual computations reflect the simple average of quarterly ratios. Quarterly ratios are computed as the "Core capital" divided by the sum of "Total assets" and "Total PCs" less PCs in the retained portfolio.
(18) Annual computations reflect the simple average of quarterly ratios. Quarterly ratios are computed as the simple average of the beginning and ending "Stockholders' equity" divided by the simple average of the beginning and ending "Total assets."
(19) Earnings consist of "Income before income taxes, extraordinary items and cumulative effect of change in accounting principle" plus fixed charges. Fixed charges include interest (including amounts capitalized) and the portion of net rental expense deemed representative of interest.

Management's Discussion and Analysis of Financial Condition and Results of Operations

FINANCIAL HIGHLIGHTS

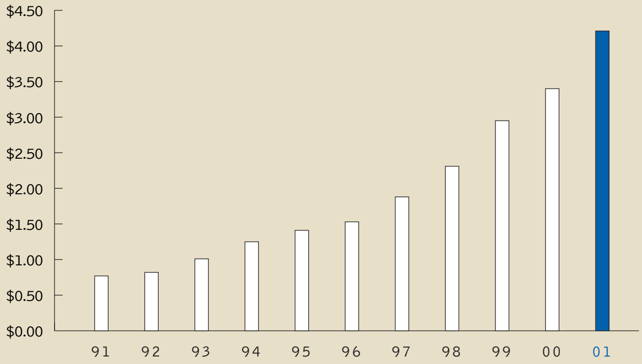
2001 Performance

Freddie Mac (the "corporation") achieved outstanding financial results in 2001, including record revenues and earnings. As reported under generally accepted accounting principles in the U.S. ("GAAP"), Freddie Mac's total revenues grew to $7.4 billion in 2001 compared to $4.5 billion in 2000, while reported net income increased to $4.1 billion in 2001 from $2.5 billion in 2000. Reported diluted earnings per common share equaled $5.64 per share in 2001, up from $3.40 per share in 2000.

As part of its 2001 financial disclosures, Freddie Mac introduced a supplemental performance measure known as "operating earnings" (see "OPERATING EARNINGS"). Operating earnings, together with "operating revenues," "operating net interest income" and similar measures, are designed to exclude certain accounting effects associated with the adoption and application of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS 133"), on January 1, 2001, which governs the treatment of derivative financial instruments ("derivatives") on the financial results reported by Freddie Mac under GAAP. Management believes that results presented on an operating basis are beneficial in understanding and analyzing Freddie Mac's financial performance because they better reflect the economic impact of Freddie Mac's risk management activities.

Freddie Mac's total operating revenues increased to $5.8 billion, or 31 percent, from $4.5 billion in 2000, while operating earnings grew to $3.2 billion in 2001, up 24 percent from $2.5 billion in 2000. Diluted operating earnings per common share rose to $4.21 per share in 2001, up 24 percent, from $3.40 per share in 2000. Finally, Freddie Mac's return on common equity exceeded 20 percent for the twentieth consecutive year.

EXHIBIT 1—OPERATING DILUTED EARNINGS PER COMMON SHARE[1]



(1) 2001's reported diluted earnings per common share were $5.64 and operating diluted earnings per common share were $4.21. Prior to 2001, operating and reported diluted earnings per common share were identical.

Freddie Mac's reported and operating revenues grew in 2001 due to strong retained portfolio growth coupled with increased reported and operating net interest income as well as relatively stable guarantee fees. Freddie Mac achieved these results while adhering to its credit and interest-rate risk disciplines.

The retained portfolio growth in 2001 contributed significantly to Freddie Mac's earnings growth during the period. The retained portfolio grew by $106 billion during 2001, increasing to $492 billion at the end of 2001 from $386 billion at the end of 2000. Freddie Mac's total mortgage portfolio grew 18 percent to $1.1 trillion at December 31, 2001, a growth rate that substantially exceeded the estimated 10 percent growth in total outstanding U.S. residential mortgage debt. The corporation's total mortgage portfolio growth in 2001 reflected record new business purchase volume totaling $475 billion, which more than doubled the prior year's purchase volume of $207 billion. Freddie Mac's business volumes increased in 2001 as a result of low mortgage interest rates, which caused a surge in refinance activity, strong home sales and increased mortgage originations. Strong refinance volumes resulted in higher prepayments, which caused Freddie Mac's total portfolio liquidation rate to increase to 31 percent in 2001 from 12 percent in 2000.

Freddie Mac's "Management and guarantee income" and "Other income, net" also contributed to higher operating and reported revenues in 2001 versus 2000. Guarantee fee income rose in 2001 as the average balance of Total PCs increased by $105 billion, or 14 percent, compared to the prior year. The average guarantee fee rate was affected adversely by portfolio turnover and decreased to 18.7 basis points from 19.3 basis points. Resecuritization fees and gains from certain investment activities rose significantly in 2001 resulting in above trend "Other income, net."

The corporation's reported "Net income" and operating earnings grew in 2001 as a result of the increased revenues described above, partially offset by a net increase in non-interest expenses. "Administrative expense" grew 18 percent in 2001, reflecting, among other factors, increased technology-related spending, but remained relatively flat compared to the prior year when viewed as a percentage of the average total mortgage portfolio (approximately 8 basis points). Credit-related expenses declined $22 million, or 21 percent, in 2001, reflecting Freddie Mac's successful credit risk management and continued favorable economic conditions, particularly strong year-over-year house-price appreciation. Additionally, in 2001, as a result of purchases of its outstanding debt, Freddie Mac retired high-cost debt with a par value of $4.7 billion before its scheduled maturity resulting in $231 million in after-tax extraordinary losses, in contrast to the retirement of $0.4 billion of similar debt resulting in an $8 million after-tax extraordinary gain in 2000. Freddie Mac purchased this substantial volume of high-cost debt in response to significant interest-rate declines, reducing future interest expense and helping to accomplish Freddie Mac's risk management objectives (see "CONSOLIDATED RESULTS OF OPERATIONS").

Business Strategies and Activities

Freddie Mac plays a fundamental role in the American housing finance system, linking the domestic mortgage market and the global capital markets. In this role, Freddie Mac focuses on the following business strategies:

- Maintaining the lowest possible cost of financing for its mortgage purchases and investments by creating broader and more liquid markets for its mortgage-backed securities and debt;
- Delivering these low-cost funds to a broader spectrum of America's homeowners by bringing innovation and efficiency to the mortgage market; and
- Managing the credit and interest-rate risks that arise from these business activities.

Freddie Mac participates in the secondary mortgage market primarily by securitizing and purchasing residential mortgages originated by mortgage lenders, and by purchasing mortgage-related securities. The corporation finances mortgages through the issuance of guaranteed mortgage securities backed by pools of mortgages ("mortgage securitization financing") and by issuing other financing instruments, principally debt, in the global capital markets ("debt financing").

Freddie Mac generates revenues from its securitization financing activities primarily by charging a management and guarantee fee on the Mortgage Participation Certificates ("PCs") it creates and guarantees. Freddie Mac deducts these amounts from the interest cash flows it receives on securitized mortgages before it passes through the remaining cash flows each month to investors in its mortgage securities. These amounts, which are classified as "Management and guarantee income," enable Freddie Mac to pay the expenses associated with administering its mortgage securities, and they also compensate Freddie Mac for the credit risk it assumes by guaranteeing to make mortgage security payments to investors in the event of defaults by the borrowers on the underlying mortgages (see "BUSINESS REVIEW—*Mortgage Securitization Financing*" and "CONSOLIDATED RESULTS OF OPERATIONS—*Management and Guarantee Income*").

Freddie Mac earns revenues from its debt financing activities primarily by purchasing mortgages and mortgage-related securities to hold in its retained portfolio. Freddie Mac also maintains a liquidity and contingency investment portfolio to meet various cash management, liquidity and other needs essential to fulfilling its role in the housing finance market. The mortgages, mortgage-related securities and investments are financed with a mix of debt securities that bear interest at lower rates than the yields on the mortgage assets being financed. To manage the interest-rate and other market risks associated with these investments, Freddie Mac enters into interest-rate swaps, options and other derivatives. The net revenues Freddie Mac earns on its debt-financed retained portfolio and investments, after taking into account the effect of most derivatives, are classified "Net interest income on earning assets" (see "BUSINESS REVIEW—*Debt Financing*" and "CONSOLIDATED RESULTS OF OPERATIONS—*Net Interest Income on Earning Assets*").

Freddie Mac also earns other types of revenues, including fees earned from facilitating the resecuritization of single-class PCs and other mortgage securities for investors into a like amount of multiclass PCs that qualify as Real Estate Mortgage Investment Conduits ("REMICs") under Internal Revenue Service regulations or into single-class Giant PCs. These fees, together with gains and losses from certain investment and trading activities and income from other sources, are presented as "Other income, net." The corporation also incurs non-interest expenses in the operation of its business, including credit-related charges, expenses for administrative functions, as well as costs related to its investments in housing tax credit partnerships and the payment of income taxes. In addition, Freddie Mac pays dividends on its common and preferred stock (see "BUSINESS REVIEW" and "CONSOLIDATED RESULTS OF OPERATIONS").

Due to the corporation's financial performance, capital strength, regular issuance of large volumes of high-quality securities in the capital markets, risk management capabilities, public mission and status as a government-sponsored enterprise ("GSE"), Freddie Mac is positioned to create broad and liquid markets for its mortgage-backed securities and debt. This liquidity helps Freddie Mac lower its overall costs of financing, which ultimately benefits mortgage originators and borrowers in the form of lower mortgage interest rates.

By attracting global investors to the domestic housing market, Freddie Mac provides mortgage lenders with continuous access to low-cost financing, which ultimately reduces borrowers' costs. Freddie Mac seeks to enhance the liquidity of its debt securities by increasing the investor base, and ultimately the demand, for its securities in both the domestic and international capital markets.

In addition to lowering the cost of financing, Freddie Mac seeks to streamline the mortgage origination process for lenders, which reduces mortgage origination costs. Through Freddie Mac's automated underwriting service, Loan Prospector® and Loan Prospector on the Internet, mortgage lenders and borrowers benefit from the increased speed, reliability and ease of mortgage underwriting decisions. Since Freddie Mac began offering automated underwriting in 1995, the corporation has processed more than 17 million mortgage loans using these services. Additionally, Freddie Mac offers mortgage lenders other technology-driven tools to assist them in originating loans, evaluating collateral, handling documents electronically as well as in pricing, delivering and servicing loans. Freddie Mac plans to continue to invest in innovative solutions that better assess mortgage credit quality and improve the overall process of originating and servicing residential mortgages as a fundamental means of fulfilling its mission.

FORWARD-LOOKING STATEMENTS

Freddie Mac regularly communicates information concerning its business activities to investors, securities analysts, the news media and others as part of its normal operations. Some of these communications include "forward-looking statements" pertaining to management's current expectations as to Freddie Mac's future business plans, results of operations and/or financial condition. Forward-looking statements are typically accompanied by, and identified with, such terms as "anticipates," "believes," "expects," "intends" and similar phrases. Management's expectations for the corporation's future necessarily involve a number of assumptions and estimates, and various factors that could cause actual results to differ materially from these expectations.

Management's discussion and analysis includes several forward-looking statements. Factors that could cause actual results to differ from the expectations expressed in these and other forward-looking statements by management include: substantial changes in interest rates, house prices, employment rates, and the general economy; changes in the corporation's strategies for and results of credit loss mitigation, interest-rate and other market risk management activities, and investment activities; the availability of debt funding and equity capital in sufficient quantity and at attractive rates to support continued growth in the retained portfolio and to refinance maturing debt; the availability of options, interest-rate and currency swaps, and other derivatives of the types and in the quantities needed for investment funding and risk management purposes; the rate of growth in total outstanding U.S. residential mortgage debt; the size of the conforming residential mortgage market; borrower preferences for fixed-rate mortgages or adjustable-rate mortgages ("ARMs")/floating-rate mortgages; preferences of originators to sell mortgages into the secondary market; changes in investor preferences for mortgage-backed securities and debt versus other investments; competition in the purchase of mortgages and sale of mortgage-backed and debt securities; the corporation's ability to implement innovative solutions to business processing systems issues; significant business disruptions resulting from acts of war or terrorism; the occurrence of a major natural or other disaster in a geographic area in which the total mortgage portfolio is heavily concentrated; the degree to which the corporation's business and financial forecasting methods accurately predict actual results; the impact of new accounting standards; and changes in the corporation's legislative or regulatory environment, regulatory capital requirements or Congressional charter, which are described more fully in Freddie Mac's annual Information Statement (available on the Shareholder page of Freddie Mac's Web site at www.freddiemac.com).

BUSINESS OUTLOOK

Freddie Mac expects continued growth in 2002 and beyond. This performance will be driven by continued growth in the U.S. residential mortgage market as well as the core capabilities in the corporation's two primary business activities—securitization financing of mortgages and debt financing of the retained portfolio.

In 2002, Freddie Mac expects operating earnings per share growth in the mid-teens. The corporation also anticipates retained portfolio growth in the mid-teens. In addition, Freddie Mac expects its average operating net interest yield for 2002 to remain stable, close to 2001's fully tax equivalent ("FTE") operating net interest yield of 0.80 percent (or 80 basis points). Finally, the corporation expects credit losses to increase somewhat from their historical lows in 2001, but remain below 2 basis points of its average total mortgage portfolio (see *Table 8*). The corporation's ability to grow earnings and achieve other financial results is dependent on the rates of growth in the total mortgage portfolio and the retained portfolio, the level of net interest yield, the level of credit losses, trends in prevailing interest rates (in both the mortgage and debt markets) and the general economy, and other factors discussed in "FORWARD-LOOKING STATEMENTS."

MARKET OVERVIEW

Freddie Mac conducts business in two markets—the U.S. residential mortgage market and the global securities market. Freddie Mac's participation in these markets links America's homebuyers and renters with the world's capital markets.

For three decades, the corporation has been a successful competitor in a large and consistently growing market. Freddie Mac estimates that the U.S. residential mortgage market exceeded $6 trillion at the end of 2001. Mortgage debt outstanding has grown every year since World War II and grew by an estimated 10 percent in 2001, even while the economy slowed. Freddie Mac estimates that the residential mortgage market will average 7 percent to 9 percent growth annually through 2010, driven by strong demand for housing, continued house-price appreciation and an increase in the amount of housing stock funded with debt.

In general terms, the residential mortgage market consists of a primary mortgage market and a secondary mortgage market that link homebuyers and investors. In the primary market, residential mortgage lenders originate mortgages and generally include mortgage banking companies, commercial banks, savings institutions, credit unions and other institutions. They obtain the funds they lend to mortgage borrowers in a variety of ways, including selling mortgages into the secondary market. Mortgage brokers advise prospective borrowers about mortgage products and lending rates, and they connect borrowers with lenders.

Freddie Mac operates in the secondary mortgage market. The secondary market encompasses institutions engaged in buying and selling mortgages in the form of whole loans and mortgage-related securities. Freddie Mac obtains the funds for these activities in a variety of ways, including issuing mortgage-backed and debt securities in the capital markets. The magnitude of investment and trading activity in the secondary mortgage market supports a continuous flow of funds to the primary market. This stable flow of funds helps moderate cyclical swings in the housing market and ensure that mortgage funds are available at all times in all communities.

Various other business entities also play significant roles in the residential mortgage market. Mortgage servicers administer mortgage loans, collecting payments of principal and interest from borrowers as well as amounts related to property taxes and insurance. Principal and interest payments are ultimately passed through to mortgage investors. In addition, private mortgage insurance companies and other financial institutions sometimes provide third-party insurance for mortgage loans. Third-party insurance or other credit protections are required by law on certain loans sold to Freddie Mac and the Federal National Mortgage Association ("Fannie Mae").

Secondary market participants include Freddie Mac and Fannie Mae, investment banking firms and others who trade and invest in mortgages and mortgage-related securities. Freddie Mac and Fannie Mae are the largest participants in the U.S. secondary mortgage market. Both companies are stockholder-owned, congressionally chartered corporations with the public purpose of increasing the supply and availability of home mortgage financing. Both Freddie Mac and Fannie Mae have charter purposes that limit them to providing lenders with a steady source of low-cost mortgage funds in the conforming residential mortgage market. They are required by their statutory mission to participate in this market, at all times regardless of market conditions. By contrast, non-GSE market participants are free to enter and exit the mortgage market as part of business strategies that allow them to pursue multiple lines of business in a variety of markets.

Freddie Mac competes primarily with Fannie Mae for the purchase or guarantee of conventional residential mortgages—home loans that are not insured or guaranteed by agencies of the U.S. government. The corporation's business is limited by law to the conforming mortgage market, which means that Freddie Mac may not purchase mortgages with unpaid principal balances above prescribed dollar limits. Freddie Mac and Fannie Mae adjust these limits annually to reflect changes in the average purchase price of single-family conventionally financed homes, as reported by the Federal Housing Finance Board ("FHFB"). Effective January 1, 2002, the one-unit, single-family loan limit increased 9.3 percent to $300,700 from $275,000 in 2001. Freddie Mac estimates that approximately $1.3 trillion of conventional conforming single-family mortgages were originated in 2001. Of that amount, $813 billion, or 64 percent, were sold to Freddie Mac and Fannie Mae compared to $325 billion, or 45 percent, of the conventional, conforming originations in 2000. The GSEs' higher market share in 2001 as compared to 2000 was due to the high level of refinance activity in 2001, which resulted from declining interest rates and a strong demand for fixed-rate mortgage products, which loan originators tend to sell to the GSEs.

Freddie Mac also competes with other financial institutions that retain or securitize mortgages, such as depository institutions, so-called "private-label" issuers and Federal Home Loan Banks participating in FHFB-approved programs. Competition from these entities can vary as a result of economic, financial market and regulatory factors. Among other things, these factors may affect the degree to which depository and other institutions sell mortgages in the secondary market rather than retaining them in their own portfolios.

Freddie Mac competes in the global securities market as an issuer of mortgage-backed securities and debt. Freddie Mac securities have a number of attributes that help the corporation operate efficiently and on a large scale in both its mortgage securitization and debt financing activities. These include the high quality and liquidity of Freddie Mac securities as well as attributes under Freddie Mac's Congressional charter and other federal laws and regulations. These attributes, which facilitate Freddie Mac's development and maintenance of the liquid markets that are essential to fulfilling its Congressional mandate, include the following:

- Exemption from U.S. Securities and Exchange Commission registration and reporting requirements (although Freddie Mac is fully subject to the antifraud provisions of the securities laws);
- Access to the Federal Reserve's book-entry system for the issuance, transfer and payment of most mortgage-backed and debt securities; and
- The ability of many institutions to invest in Freddie Mac mortgage-backed and debt securities essentially without limit.

Freddie Mac intends to grow profitably by lowering the cost of mortgage financing and facilitating access to mortgage credit. The corporation will continue to grow by helping lenders make sound, profitable mortgage loans that they know Freddie Mac stands ready to purchase and that meet the needs of their customers. By bringing innovation to the mortgage origination process and the securities markets, applying technology and extending its reach to more borrowers who can be served profitably, Freddie Mac intends to expand its mortgage purchases and to simplify the lending process, reducing costs in accordance with its mission.

BUSINESS REVIEW

Freddie Mac participates in the secondary mortgage market primarily by securitizing and purchasing residential mortgages originated by mortgage lenders and by purchasing mortgage-related securities. Freddie Mac uses two principal methods to finance its mortgage-related investments:

- **Mortgage Securitization Financing.** Under this method of financing, mortgages are securitized in the form of PCs issued to investors by Freddie Mac. Although Freddie Mac guarantees payments on its PCs, the mortgages underlying PCs are owned by PC investors. Accordingly, mortgage investments financed by the issuance of PCs are an off-balance sheet contingency, referred to as Total PCs.
- **Debt Financing.** Under this method of financing, mortgages and mortgage-related securities are held as on-balance sheet assets that Freddie Mac has financed principally with debt securities. These assets are referred to as the retained portfolio.

Freddie Mac's total mortgage portfolio, composed of mortgages financed by mortgage securitization and debt financing, grew 18 percent from $962 billion at the end of 2000 to $1.1 trillion at the end of 2001.

Freddie Mac's public mission requires it to provide a continuous supply of mortgage credit for U.S. homebuyers in all economic environments. Freddie Mac flexibly employs both of its financing methods to ensure that it fulfills its mission. Each of these methods of financing mortgage investments generates different sources and types of revenue, exposes the corporation to different types and degrees of risk and requires the commitment of different levels of capital.

Mortgage Securitization Financing

Each PC represents an undivided interest in a pool of mortgages. Principal and interest payments on the mortgages in the pool underlying the PCs are passed through to PC holders by Freddie Mac on a monthly basis. Freddie Mac typically assumes the mortgage credit risk on the underlying mortgages (the risk that mortgage borrowers will default on their payment obligations) by guaranteeing the timely payment of principal and interest to holders of its PCs, although it shares this risk in certain cases with third parties through the use of primary loan-level mortgage insurance, pool insurance and other credit enhancements. The strength of Freddie Mac's credit guarantee on its PCs offers investor appeal and provides liquidity in the mortgage securities market.

Payments on the mortgages underlying a PC pool are remitted to Freddie Mac by mortgage servicers approved by the corporation. Any interest payable by the borrowers on mortgages in a PC pool that exceeds the mortgage servicer's required remittance to Freddie Mac is retained by the servicer as compensation for servicing the mortgages. Generally, the rate of interest payable by servicers to Freddie Mac on the mortgages in any PC pool will exceed the coupon rate of the related PCs that Freddie Mac pays to investors, with the difference compensating Freddie Mac for assuming mortgage credit risk and administering the mortgage securities. This fee income, recorded as "Management and guarantee income" over the PC's life, provides Freddie Mac with a steady source of revenue. The balance of Total PCs grew $126 billion, or 15 percent, from $822 billion at the end of 2000 to $948 billion at the end of 2001 with associated "Management and guarantee fee income" of $1,639 million and $1,489 million for 2001 and 2000, respectively.

The costs of securitization financing and Freddie Mac's ability to compete for mortgage purchases may be affected by the price difference, or "spread," between PCs and competing securities. Freddie Mac supports the liquidity and depth of the market for its PCs through various activities, which include actively trading PCs through its Securities Sales and Trading Group ("SS&TG"), participating with external money management firms to buy and sell PCs, marketing to dealers and investors the relative merits of trading and investing in PCs, participating in various financial markets, and introducing new mortgage-related securities products and related initiatives. Freddie Mac may increase, reduce or discontinue these or other related activities at any time.

Debt Financing

Freddie Mac issues debt principally to finance mortgage-related investments held in the retained portfolio. In so doing, Freddie Mac issues a mixture of short-term debt and long-term callable and non-callable debt. This funding mix enables Freddie Mac to manage its interest-rate risk by giving it the flexibility to closely match the interest-rate characteristics from debt financing with the expected cash inflows from its mortgage-related investments. Freddie Mac uses derivatives to hedge interest-rate, cash flow and prepayment risks associated with its mortgage related investments and debt financing. (see "RISK MANAGEMENT—*Interest-Rate Risk and Other Market Risks*—Interest-Rate Risk Management Strategies—Hedging Strategies").

The corporation earns net interest income on its retained portfolio, which is the interest income earned on these investments less the interest expense on the interest-bearing liabilities funding them, taking into account the benefit or cost of any associated derivatives.

Freddie Mac's strategy of funding mortgage purchases with a mix of short- and long-term debt results in debt costs that vary over the lives of the mortgage assets as normally lower-cost, short-term debt matures and higher-cost, long-term debt remains outstanding. Mortgage investments funded in a steep yield curve environment, such as that experienced during much of 2001, will generally have higher initial net yields (the spread between the interest income on the mortgage and interest expense on the debt) that decline over time as short-term debt matures and is replaced with more costly debt instruments. In a flatter yield curve environment, Freddie Mac's funding strategy generally results in net yields that are lower initially but that are more stable over the lives of the mortgage investments.

Mortgage-related investments comprising the retained portfolio are primarily PCs, but also include unsecuritized mortgage loans ("Mortgages") and non-Freddie Mac mortgage securities. The retained portfolio grew 27 percent to $492 billion at the end of 2001 from $386 billion at the end of 2000. At December 31, 2001, the retained portfolio consisted of $63 billion in "Mortgages" and $429 billion in "Guaranteed mortgage securities" (including $302 billion of PCs held in the retained portfolio and $127 billion of non-Freddie Mac mortgage securities).

Maintaining access to low-cost debt financing and to derivatives used for hedging interest-rate risk is essential to future growth of the retained portfolio. The corporation's premier programs for intermediate- and long-term debt are its Reference Notes and its Reference Bonds^{SM} financing programs. Under these programs, Freddie Mac regularly sells large issues of primarily non-callable debt to provide investors with high-quality, liquid debt securities. Freddie Mac also has a Reference Bills^{SM} financing program, under which large issues of short-term debt are auctioned on a regular schedule. Reference Bills with one-, two- and three-month maturities are auctioned weekly. Reference Bills with six- and twelve-month maturities are sold every four weeks. Freddie Mac also issues Reference Notes denominated in Euros, which are sold to institutional investors that include European, Asian and other international finance institutions, through its EuroReference Note^{SM} Programme.

CRITICAL ACCOUNTING POLICIES

The Consolidated Financial Statements are prepared in accordance with GAAP, which requires the corporation to make estimates and assumptions that affect its reported results (see Note 1 to the Consolidated Financial Statements). The corporation believes that some of the more significant accounting policies it uses to present its financial results in accordance with GAAP, discussed below, involve a relatively high degree of judgment and complexity.

Loan Loss Reserves: Freddie Mac maintains reserves for losses on its PCs and retained mortgages at levels management believes to be adequate to absorb estimated losses inherent in the total mortgage portfolio at the balance sheet date. Loan loss reserves totaled $801 million at December 31, 2001. Reserves are increased through periodic provisions charged to expense and decreased by charge-offs, net of recoveries. Setting the level of reserves requires significant judgment, which are regularly evaluated by management. Many factors, including delinquency rates, credit enhancements, size of the portfolio, year of loan origination, geographic location and house price performance are important assumptions in estimating mortgage losses. The use of different estimates or assumptions as well as changes in external factors could produce materially different provisions and reserve levels.

Securitizations: Freddie Mac resecuritizes PCs and other mortgage securities it owns, primarily into REMICs or Giant PCs, and frequently retains an interest in those assets. Freddie Mac estimates and records a gain or loss on the portion sold by allocating the previous carrying value of the assets involved in the transfer between the assets sold and the interests retained, based on their relative fair value at the date of transfer. Freddie Mac uses the sales proceeds to determine the value of the assets sold and primarily uses quoted market prices in estimating the value of retained interests, which totaled $65 billion at December 31, 2001.

Fair Values: As of December 31, 2001, a substantial portion of Freddie Mac's financial assets and liabilities, including all derivatives, are presented in the Consolidated Balance Sheets at fair value. Under GAAP, the fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, other than in a liquidation. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, other than in a liquidation. Fair values play an important role in the valuation of Freddie Mac's assets and liabilities and its hedging strategies (see "Hedging Activities" below). Fair values are based on market prices when they are available. If market quotes are not available, fair values are based on discounted cash flows using market estimates of interest rates and volatility or on dealer prices and prices of similar instruments. Pricing models and their underlying assumptions are based on management's best estimates for discount rates, market volatility, prepayments, and other factors. These assumptions may have a significant effect on the reported fair values of assets and liabilities (including derivatives) and related revenue and expenses. The use of different models and assumptions as well as changes in market conditions could result in materially different net income and stockholders' equity amounts.

As of December 31, 2001, $270 billion of securities classified as available-for-sale securities ("AFS") and $5 billion of securities classified as "trading" are presented at fair value. Changes in the fair value of AFS and trading securities are presented in "Accumulated other comprehensive income" ("AOCI") on the Consolidated Statements of Stockholders' Equity and the "Other income, net" caption on the Consolidated Statements of Income, respectively. Changes in the fair values of all derivatives, and of those assets and liabilities linked to derivatives and designated as fair value hedges in accordance with SFAS 133, are reported in income (see the discussion of fair value hedges in "Hedging Activities," below). At December 31, 2001, "Derivative assets, at fair value" totaled $1.6 billion and "Derivative liabilities, at fair value" totaled $2.5 billion.

Hedging Activities: SFAS 133 specifies criteria for when derivatives may be accounted for as fair value hedges or cash flow hedges. All derivatives must be assigned to fair value, cash flow, or "no hedge" designation categories at the time of execution and throughout the period they are owned, although a derivative's specific hedge designation may change.

In analyzing the expected effectiveness of hedge relationships (i.e., the extent to which changes in the fair value of derivatives offset changes in the fair value of hedged items relating to the hedged risk), Freddie Mac uses market data relating to the value of derivatives and hedged items. It also uses proprietary models, which consider market prepayment estimates, to value the borrower's prepayment option that is embedded in mortgages underlying hedged PCs held by Freddie

Mac (see "RISK MANAGEMENT—*Interest-Rate Risk and Other Market Risks*—Interest-Rate Risk"). As further discussed below, the effectiveness and application of Freddie Mac's hedging strategies can materially affect the amount and timing of reported earnings and levels of stockholders' equity.

Fair Value Hedges—A fair value hedge must hedge exposure to changes in the fair value of a fixed-rate asset, liability or firm commitment attributable to a particular risk (see "Fair Values" above regarding the determination of fair values). When a derivative meets the SFAS 133 fair value hedge criteria, changes in the fair values of the derivative are offset by changes in the value of the hedged assets or liabilities relating to the hedged risk. The net change in fair value is presented in the "Fair value gain (losses)" caption on the Consolidated Statements of Income.

Cash Flow Hedges—A cash flow hedge must hedge exposure to the variability of expected future cash flows relating to floating-rate assets, floating-rate liabilities or forecasted transactions (e.g., anticipated future issuances of debt). When a derivative meets the SFAS 133 criteria for a cash flow hedge, the effective portion of changes in the fair value of the derivative is captured in AOCI, and any ineffectiveness arising from changes in the derivative fair value in excess of the fair value of the hedged risk is presented in the "Fair value gains (losses)" caption on the Consolidated Statements of Income.

No-Hedge Designation—A relatively small portion of Freddie Mac's derivatives (approximately one percent of the outstanding notional balance as of December 31, 2001), although entered into for risk management purposes, are not designated as fair value or cash flow hedges either because they do not satisfy SFAS 133's hedge criteria or because hedge accounting has not been elected. For example, Freddie Mac at times enters into derivative transactions to hedge interest-rate risk relating to securities held in its trading portfolios. Because changes in the value of trading securities are always recognized through income and trading securities cannot be designated as hedged items under SFAS 133, Freddie Mac enters into derivatives that are classified as "no hedge" designations in order to hedge these securities. In that case, changes in the fair value of both the trading assets and the derivative are reported in income. When a derivative is not designated as either a fair value or cash flow hedge, changes in the derivative's fair value are presented in "Other income, net."

Redesignation of Hedges and Amortization of Basis Adjustments—Changes in the fair values of hedged assets and liabilities (see "Fair Values" above regarding the determination of fair values) also result in adjustments to their carrying basis. These basis adjustments are amortized into reported net interest income over the lives of the hedged items. Amortization of fair value basis adjustments must begin no later than when a hedging relationship is terminated, which is deemed to occur when the hedge no longer meets the SFAS 133 hedging criteria, when hedge accounting is no longer elected, when the derivative is sold or terminated, or when the derivative is redesignated to another hedge relationship. The magnitude and timing of this amortization are affected by the size of the fair value basis adjustments, the frequency of hedge redesignations, and changes in the estimated lives of the hedged assets or liabilities (caused, in large part, by changes in interest rates and prepayment patterns).

EFFECT OF DERIVATIVE ACCOUNTING ON REPORTED FINANCIAL RESULTS AND OPERATING EARNINGS

Freddie Mac's principal hedging strategies employ derivatives, primarily purchased options and interest-rate swaps. The accounting treatment of these derivatives and of the hedged assets and liabilities was significantly revised by SFAS 133 and may cause Freddie Mac's reported earnings and reported "Stockholders' equity" to be significantly more volatile than was the case prior to SFAS 133's implementation on January 1, 2001. In management's opinion, the revised accounting treatment for Freddie Mac's derivative transactions under SFAS 133 does not necessarily reflect their economic substance or the results of the corporation's risk management activities. Accordingly, as an aid to understanding and analyzing its financial performance, Freddie Mac provides information regarding its supplemental reporting measure, "operating earnings" (see "OPERATING EARNINGS" for more information).

RISK MANAGEMENT

Freddie Mac is subject to three main business risks: *(i)* credit risk, *(ii)* interest-rate and other market risks and *(iii)* operational risks. Management of these risks affects both the level and stability of the corporation's short-term earnings and long-term value.

Credit Risk

Freddie Mac's primary exposure to credit risk is associated with the mortgages in its total mortgage portfolio ("mortgage credit risk"). The corporation is also subject to "institutional credit risk" associated with various third parties including guarantors of non-Freddie Mac mortgage securities held in the retained portfolio, issuers and guarantors of securities held in the liquidity and contingency investment portfolio and institutions with which it conducts business, including counterparties to derivatives.

Mortgage Credit Risk

Mortgage credit risk is the risk that the corporation will not receive amounts due from mortgage borrowers because of borrower defaults, potentially resulting in a loss if Freddie Mac is unable to collect amounts due through restructuring of the mortgage, sale of the underlying property or other loss mitigation activities.

Oversight of Mortgage Credit Risk: Freddie Mac's Board of Directors oversees the corporation's management of credit risk. Under the Board's oversight, senior management is responsible for the day-to-day management of the corporation's activities related to credit risk. Freddie Mac also maintains a credit risk oversight function that reports directly to the Vice Chairman and President.

Mortgage Credit Risk Management Strategies: Freddie Mac's management of mortgage credit risk comprises three broad areas:

- Establishing and enforcing sound underwriting and quality control standards through the use of automated underwriting;
- Obtaining credit enhancements on higher-risk mortgages; and
- Executing loss mitigation activities to resolve non-performing loans.

Freddie Mac manages mortgage credit risk by using automated underwriting systems and other tools to evaluate the credit quality of the mortgages it securitizes and purchases. It secures partial protection against the risk of default through the use of primary mortgage insurance and various forms of credit enhancement, and it seeks to reduce the corporation's overall exposure to credit losses by using a variety of loss mitigation techniques to prevent non-performing mortgages from proceeding to foreclosure, as part of its ongoing effort to manage mortgage credit risk. In addition, Freddie Mac monitors a number of factors relating to type, location and other mortgage characteristics, as well as the sensitivity of credit losses to changes in house prices.

Freddie Mac has been gradually expanding its efforts to serve market segments in which it guarantees securities backed by conforming mortgage loans with relatively higher risk characteristics than mortgages traditionally securitized and purchased by Freddie Mac. At December 31, 2001, Freddie Mac had guaranteed approximately $15 billion of such securities, representing less than two percent of the total portfolio. These mortgage securities are significantly credit-enhanced and highly rated by at least one nationally recognized credit rating agency, reducing Freddie Mac's credit exposure.

Underwriting Standards and Quality Control— Freddie Mac seeks to ensure that the mortgages it securitizes and purchases are protected by the borrower's willingness and ability to repay the mortgage obligation and by adequate equity in the underlying property. Automated underwriting tools such as Loan Prospector® and other quantitative credit risk management tools are used to evaluate and monitor credit risk for single-family mortgages. During 2001, 62 percent of Freddie Mac's single-family purchase volume was evaluated prior to purchase using Loan Prospector, compared with 56 percent in 2000. Loan Prospector combines loan-to-value ("LTV") ratios and other loan and borrower characteristics to generate credit risk classifications that enable Freddie Mac and lenders to evaluate overall loan risk. These statistically based risk assessments increase the ability of Freddie Mac and mortgage lenders to distinguish among single-family loans based on their likelihood of default.

The corporation also manages the quality of its single-family mortgage purchases by monitoring seller/servicers' compliance with its underwriting standards through quality control reviews and on-site audits and investigating situations involving possible fraud.

As part of its post-purchase quality control review process, Freddie Mac uses Loan Prospector tools to evaluate the credit quality of virtually all single-family mortgages that were not evaluated by Loan Prospector prior to purchase. Particular focus is placed on performing quality control reviews of purchases identified as high-risk mortgages.

For multifamily mortgages, Freddie Mac manages risk primarily using a combination of intensive underwriting and strict requirements on the mortgage lenders eligible to participate in Freddie Mac's multifamily programs.

Credit Enhancements— For most of the mortgages in its total mortgage portfolio, Freddie Mac retains the primary risk of loss in the event of default by the borrower on the underlying mortgage loan. The corporation's charter requires that mortgages with LTV ratios above 80 percent at time of origination be covered by primary mortgage insurance (or certain other credit protections) to be eligible for purchase by Freddie Mac. Loans for which loan-level, primary mortgage insurance is the only external protection against credit loss are not classified as credit-enhanced mortgages even though Freddie Mac has partially transferred credit risk on these loans. Mortgages in this category are included in Freddie Mac's "at-risk" mortgage portfolio.

For certain other mortgages, Freddie Mac shares the default risk by transferring a portion of that risk to various third parties through a variety of credit enhancement vehicles, other than primary mortgage insurance (see "RISK MANAGEMENT—*Credit Risk*—Institutional Credit Risk"). Mortgages in this category are referred to as "credit-enhanced" mortgages. Pool insurance is the most prevalent type of credit enhancement protecting Freddie Mac's mortgage portfolio. Pool insurance covers a large group of similar loans, in contrast to loan-level mortgage insurance, which is obtained for individual loans. Pool insurance contracts expire after no fewer than eight years, and typically cover losses ranging between 0.80 percent and 1.50 percent of the aggregate original unpaid principal balance of the pooled loans at the time of purchase. Freddie Mac uses the proceeds from pool insurance to offset credit losses (defined as principal and interest charge-offs plus real estate owned ("REO") operations expense) related to individual loans within the pools that default. For those pool insurance contracts that expire before the completion of the contractual mortgage term, Freddie Mac arranges for the contracts to cover the period of time during which management believes the mortgages are most likely to default. In addition to pool-insured loans, Freddie Mac's credit-enhanced mortgages include loans protected by reinsurance, collateral (including cash or high-quality marketable securities) pledged by a lender, or recourse agreements under which the lender repurchases loans that default. Freddie Mac may receive collateral or cash proceeds that offset credit losses when these mortgages default. In exchange for this potential future benefit, Freddie Mac receives a lower guarantee fee on securitized mortgages that are credit-enhanced.

A portion of the corporation's total mortgage portfolio consists of mortgage securities issued or guaranteed by entities other than Freddie Mac. These investments, referred to as "non-Freddie Mac mortgage-related securities," include *(i)* agency mortgage securities, *(ii)* mortgage revenue bonds and *(iii)* other mortgage-related securities. They are included as credit-enhanced or guaranteed in the table below.

Table 1 presents the composition of Freddie Mac's total mortgage portfolio.

TABLE 1 - TOTAL MORTGAGE PORTFOLIO BY AT-RISK AND CREDIT-ENHANCED COMPONENTS

December 31,	2001		2000	
(dollars in millions)				
Freddie Mac at-risk[1]	$ 804,334	71%	$ 656,282	68%
Credit-enhanced or guaranteed[2]	333,833	29%	305,512	32%
Total mortgage portfolio	$ 1,138,167	100%	$ 961,794	100%

(1) Includes only those mortgages for which Freddie Mac has assumed primary default risk. These mortgages are either held as whole loans or securitized as PCs.

(2) Includes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default. Also includes securities guaranteed by agencies or subject to subordination agreements. In some cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

The percentage of the corporation's total mortgage portfolio that was credit-enhanced or guaranteed declined to 29 percent at December 31, 2001, down from 32 percent at December 31, 2000, primarily due to a decline in the number of loans purchased that are covered by pool insurance. Freddie Mac's ability and desire to continue to expand the credit-enhanced portion of its total mortgage portfolio will depend on management's evaluation of the credit quality of new business purchases and the future availability of effective credit enhancements at prices that permit an attractive return on credit-enhanced mortgage investments.

While the use of credit enhancements reduces Freddie Mac's exposure to mortgage credit risk, it increases the corporation's exposure to institutional credit risk, that is, the risk that the provider of the credit enhancement may not perform its contractual responsibility (see "RISK MANAGEMENT—*Credit Risk*—Institutional Credit Risk").

***Loss Mitigation Activities*—**Despite the corporation's underwriting standards, mortgages may become non-performing due to changes in general economic conditions, changes in the financial status of individual borrowers or other factors. *Table 2* summarizes the corporation's non-performing, restructured and seriously delinquent loans and assets.

TABLE 2 – NON-PERFORMING ASSETS, TROUBLED DEBT RESTRUCTURINGS AND SERIOUS DELINQUENCIES

December 31,	2001	2000
(dollars in millions)		
Non-accrual loans[1]	$ 776	$ 729
Real estate owned	442	348
Total non-performing assets	1,218	1,077
Troubled debt restructurings[2]	853	747
Serious delinquencies[3]	3,568	2,506
Total	$ 5,639	$ 4,330

(1) Includes loans for which interest income is recognized on a cash basis. For single-family loans, this population is determined using statistically based models. For multifamily loans, the population includes all loans 90 days or more delinquent.

(2) Includes previously delinquent loans that have been modified and are performing in accordance with the modified terms.

(3) Includes single-family loans 90 days or more delinquent, excluding all loans disclosed as non-accrual. For multifamily loans, the population includes all loans 60 days or more delinquent but less than 90 days delinquent.

Loss mitigation activities are a key component of Freddie Mac's strategy for managing and resolving non-performing assets and lowering credit losses. These activities influence the amounts recovered by the corporation on delinquent mortgages and REO. Freddie Mac emphasizes early intervention in delinquencies and alternatives to foreclosure. Foreclosure alternatives are intended to reduce the number of delinquent mortgages proceeding to foreclosure and, ultimately, reduce Freddie Mac's total losses by eliminating a portion of the costs related to foreclosed properties.

Loan modifications and pre-foreclosure sales are the two foreclosure alternatives most often carried out by servicers on behalf of Freddie Mac. A loan modification is an agreement that changes one or more of the original terms of a mortgage for qualifying borrowers, usually the loan's interest rate or payment period. A pre-foreclosure sale is a transaction in which Freddie Mac accepts less than full payment of the amount owed on a defaulted mortgage in exchange for the sale of a home prior to foreclosure. In 2001, Freddie Mac executed foreclosure alternatives on a total of 6,364 loans, consisting of 5,142 loan modifications and 1,222 pre-foreclosure sales, as compared to foreclosure alternatives in 2000 on a total of 5,157 loans, consisting of 3,851 loan modifications and 1,306 pre-foreclosure sales.

Over the years, Freddie Mac has developed innovations that help servicers manage non-performing loans more effectively. These innovations include Early Indicator^{SM}, a system that estimates the probability that delinquent loans will continue through to foreclosure, and Servicer Performance Profiles^{SM}, which are confidential reports by which Freddie Mac evaluates the performance of its mortgage servicers based on their management of performing and non-performing loans.

Credit Risk Profile: As part of the corporation's credit risk management practices, Freddie Mac monitors certain loan characteristics such as product mix, LTV ratios and geographic concentration, which may affect the default experience on the corporation's mortgage portfolio.

***Product Mix*—**Product mix affects the credit risk profile of Freddie Mac's total mortgage portfolio. *Table 3* presents the distribution of Freddie Mac's total mortgage portfolio by mortgage product type.

TABLE 3 – TOTAL MORTGAGE PORTFOLIO

December 31,	2001		2000	
(dollars in millions)				
30-year single-family fixed-rate[1]	$ 812,878	71%	$ 697,450	73%
15-year single-family fixed-rate	209,823	19	165,885	17
ARMs/floating-rate[2]	69,522	6	63,630	7
Balloon/resets	14,303	1	11,726	1
Total single-family	1,106,526	97	938,691	98
Multifamily	31,641	3	23,103	2
Total mortgage portfolio[3]	$ 1,138,167	100%	$ 961,794	100%

Average single-family loan balance	$ 99,317	$ 92,383

(1) Also includes 20-year fixed-rate mortgages, second mortgages and mobile home loans.
(2) Includes 1-, 3-, 5-, 7- and 10-year ARMs.
(3) Excludes related unamortized premiums, discounts and deferred fees, loan loss reserves and net unrealized gain (loss) on AFS GMS.

In general, 15-year fixed-rate mortgages exhibit the lowest default rate among the types of single-family mortgages owned or insured by Freddie Mac, due to the accelerated rate of principal amortization on these mortgages and the credit profiles of borrowers who seek and qualify for them. The next lowest rate of default is associated with 30-year fixed-rate mortgages. Balloon/reset mortgages typically default at a higher rate than fixed-rate mortgages. ARMs generally have the highest default rate among single-family mortgages, although default rates for different types of ARMs may vary. While ARMs are typically originated with interest rates that are initially lower than those available for fixed-rate mortgages, their interest rates also change over time based on changes in an index or reference interest rate. As a result, the borrower's payments may rise or fall, within limits, as interest rates change. As payments increase, the risk of default also increases.

LTV Ratios—Freddie Mac's principal safeguard against credit losses for mortgages in its at-risk portfolio is provided by the borrower's equity in the underlying properties. The likelihood of single-family mortgage default depends not only on the initial credit quality of the loan, but also on events that occur after origination. Accordingly, Freddie Mac monitors the LTV ratio at the date of mortgage origination, as well as the estimated current LTV ratio, which reflects estimated house-price appreciation or depreciation occurring after origination. The estimated current LTV ratio compares the current unpaid principal balance of the mortgage to the estimated current market value of the property securing the mortgage. Historical experience has shown that defaults are less likely to occur on mortgages with low estimated current LTV ratios. To the extent that Freddie Mac is able to sell a property for an amount that equals or exceeds the unpaid balance of a defaulted mortgage loan (plus amounts incurred as carrying and disposition costs), it can avoid credit losses in the event of a default on an at-risk mortgage. Additional protection against credit loss on its at-risk mortgages with higher original LTV ratios is provided by loan-level primary mortgage insurance.

The distribution of Freddie Mac's single-family portfolio by original and estimated current LTV ratio range is presented in *Tables 4* and *5*, respectively.

TABLE 4 – ORIGINAL LTV RATIO RANGE

December 31,	2001	2000	1999
0% to 70%	32%	31%	32%
Above 70% to 80%	44	42	42
Above 80% to 90%	13	14	15
Above 90% to 95%	10	11	10
Above 95%	1	2	1
Total	100%	100%	100%

TABLE 5 – ESTIMATED CURRENT LTV RATIO RANGE[1]

December 31,	2001	2000	1999
0% to 70%	63%	65%	59%
Above 70% to 80%	24	16	19
Above 80% to 90%	8	13	16
Above 90% to 95%	4	2	2
Above 95%	1	4	4
Total	100%	100%	100%
Average estimated current LTV ratio	61%	61%	64%

(1) Current market values are estimated by adjusting the value of the property at origination based on changes in the market value of house prices since origination.

Geographic Concentration—Freddie Mac mitigates the potential adverse effect of changing local and regional economic conditions on its credit results by maintaining a geographically diverse mortgage portfolio. The geographic distribution of Freddie Mac's portfolio generally reflects the distribution of outstanding U.S. residential mortgage debt.

Tables 6 and *7* present at-risk delinquencies and foreclosure percentages and net loan loss charge-offs for Freddie Mac's single-family portfolio by geographic region.

TABLE 6 – SINGLE-FAMILY AT-RISK DELINQUENCIES AND FORECLOSURES BY REGION[1][2]

December 31,	2001	2000	1999
Northeast	0.46%	0.44%	0.51%
Southeast	0.47	0.40	0.39
North Central	0.38	0.30	0.28
Southwest	0.37	0.30	0.30
West	0.38	0.36	0.40
Total	0.41%	0.37%	0.39%

(1) *Based on the number of mortgages 90 days or more delinquent and includes mortgages and PCs.*

(2) *Includes only those loans for which Freddie Mac has assumed primary default risk. Excludes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies or subject to subordination agreements. In some cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.*

TABLE 7 – SINGLE-FAMILY NET LOAN LOSS CHARGE-OFFS (RECOVERIES) BY REGION

December 31,	2001	2000	1999
(dollars in millions)			
Northeast	$ 17	$ 20	$ 46
Southeast	4	2	—
North Central	(3)	(3)	(4)
Southwest	—	—	(6)
West	13	13	23
Total	$ 31	$ 32	$ 59

Credit Performance: The effectiveness of Freddie Mac's credit risk management is reflected primarily in the level of defaulted mortgages and the level of credit losses relative to the total mortgage portfolio, after the effect of primary mortgage insurance and credit enhancements. Freddie Mac continued to demonstrate very strong credit performance during 2001, driven by effective risk management and favorable economic conditions (particularly house-price appreciation). *Table 8* and the following discussion address the credit performance of Freddie Mac's single-family and multifamily mortgage portfolios.

TABLE 8 – CREDIT PERFORMANCE

Year Ended December 31,	2001	2000	1999
(dollars in millions)			
Delinquencies, end of period[1]			
Single-family:[2]			
At-risk portfolio[3]	0.41%	0.37%	0.39%
Total portfolio	0.65%	0.50%	0.43%
Multifamily:[4]			
Net carrying value	$ 44	$ 9	$ 23
Percentage	0.15%	0.04%	0.14%
REO, end of period			
Single-family	$ 441	$ 346	$ 437
Multifamily	1	2	1
Total	$ 442	$ 348	$ 438
REO activity			
Properties in inventory-beginning of period	4,564	5,619	6,781
Properties acquired	10,091	9,532	11,474
Properties disposed	(8,942)	(10,587)	(12,636)
Properties in inventory-end of period	5,713	4,564	5,619
Net charge-offs (recoveries)			
Single-family:			
Foreclosure alternatives[5]	$ 12	$ 11	$ 14
REO acquisitions	19	21	45
Total single-family	31	32	59
Multifamily	(3)	(4)	(3)
Total	$ 28	$ 28	$ 56
Number of single-family foreclosure alternatives settled[5]	6,364	5,157	5,517
Credit-related expenses			
Provision for mortgage losses	$ 45	$ 40	$ 60
REO operations expense:			
Single-family	38	66	99
Multifamily	1	—	—
Total	39	66	99
Total credit-related expenses	$ 84	$ 106	$ 159
Credit losses[6]			
Single-family	$ 69	$ 98	$ 158
Multifamily	(2)	(4)	(3)
Total credit losses	$ 67	$ 94	$ 155
Total credit losses/average total mortgage portfolio[7]	0.7 bp	1.1 bp	2.0 bp
Reserve for mortgage losses, end of period	$ 801	$ 784	$ 772

(1) *Includes mortgages and PCs.*

(2) *Based on the number of mortgages 90 days or more delinquent.*

(3) *Includes only those loans for which Freddie Mac has assumed primary default risk. Excludes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies or subject to subordination agreements. In some cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.*

(4) *Based on net carrying value of mortgages 60 days or more delinquent.*

(5) *Primarily consists of loan modifications and pre-foreclosure sales.*

(6) *Equal to charge-offs plus REO operations expense.*

(7) *Average total mortgage portfolio excluding non-Freddie Mac mortgage securities.*

Single-family—The single-family at-risk delinquency rate increased 4 basis points from year-end 2000 to 41 basis points at December 31, 2001. The single-family total portfolio delinquency rate increased 15 basis points from year-end 2000 to 65 basis points at December 31, 2001. The weakening economy drove the increase in single-family delinquencies, along with the fact that a considerable portion of the mortgages in Freddie Mac's total portfolio reached their peak default years (generally, three to five years after origination) in 2001.

REO properties in inventory increased in 2001 both in terms of dollar amount and number of properties held. The single-family REO balance was $441 million at December 31, 2001, up from $346 million and $437 million at December 31, 2000 and 1999, respectively. The increase in the single-family REO balance during 2001 was due primarily to a softening economy. The average holding period for REO properties declined modestly in 2001 from 2000, reflecting Freddie Mac's ability to dispose of properties quickly.

Single-family credit losses totaled $69 million in 2001, a decline of 30 percent and 56 percent from losses experienced in 2000 and 1999, respectively. The decline in credit losses was due primarily to lower loss severity rates on defaulted mortgages. Lower loss severities reflect continued strong home prices, effective loss mitigation activities and the expanded use of credit enhancements on new purchases in recent years.

Table 9 presents the distribution of the single-family mortgage portfolio and at-risk delinquencies by year of origination.

TABLE 9 – SINGLE-FAMILY MORTGAGE PORTFOLIO AND AT-RISK DELINQUENCIES BY YEAR OF ORIGINATION

December 31,	2001		2000	
Year of Origination	Percent of Single Family Balance[1]	At-Risk Delinquency Rate[2]	Percent of Single Family Balance[1]	At-Risk Delinquency Rate[2]
Pre-1994	11%	0.53%	17%	0.49%
1994	3%	0.70%	4%	0.60%
1995	2%	1.08%	4%	0.84%
1996	4%	0.97%	6%	0.77%
1997	5%	0.52%	8%	0.34%
1998	19%	0.27%	27%	0.17%
1999	15%	0.43%	21%	0.20%
2000	8%	0.74%	13%	0.11%
2001	33%	0.08%	—	—
Total	100%	0.41%	100%	0.37%

(1) Based on Freddie Mac's total single-family mortgage portfolio balance, which was $981 billion and $859 billion at December 31, 2001 and 2000, respectively.

(2) At-risk delinquency statistics are based on loans 90 days or more delinquent plus foreclosures in process and approved, as a percentage of the total number of loans in the year of origination. Includes only those loans for which Freddie Mac has assumed primary default risk. Excludes loans for which a lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies or subject to subordination agreements. In some cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

As shown in *Table 9*, mortgages originated in 1998 or later represented more than 75 percent of the corporation's single-family portfolio at December 31, 2001. About half of these mortgages, which have significant credit enhancement protection, are approaching their peak default years.

Multifamily—The multifamily delinquency rate was 0.15 percent at December 31, 2001, up from 0.04 percent at December 31, 2000. The net carrying value of non-performing multifamily mortgages totaled $44 million at December 31, 2001, an increase of $35 million from December 31, 2000 primarily due to one property in New York City indirectly affected by the attacks on the U.S. on September 11, 2001. Multifamily recoveries totaled $3 million in 2001, compared to recoveries of $4 million in 2000. Recoveries in 2001 and 2000 resulted from the collection of certain amounts previously deemed uncollectible. The corporation has not experienced losses on loans purchased or insured after 1993 in its multifamily loan portfolio.

Credit Risk Sensitivity: Freddie Mac's commitments to enhance risk management, capital and disclosure practices include the quarterly disclosure of credit risk sensitivity (see "VOLUNTARY COMMITMENTS" for more information). This disclosure illustrates the extent to which the corporation's credit risk loss exposure is sensitive to a sudden decline in house prices.

Changes in house prices are an important factor in determining Freddie Mac's exposure to mortgage credit risk. A higher rate of appreciation in the value of a residential property generally results in lower rates of borrower default and lower credit losses for Freddie Mac.

Freddie Mac analyzes the sensitivity of credit losses on the corporation's single-family mortgage portfolio to an instantaneous change in house prices. The sensitivity analysis compares expected single-family credit losses under two economic scenarios that make different assumptions about future increases in house prices over a 10-year period. The first scenario assumes that house prices will increase at a constant rate of 3 percent per year over the 10-year period; the second scenario assumes that there is an immediate 5 percent decline in the level of house prices and that after this initial downward shock house prices grow 3 percent per year for the next 10 years. Interest rates are assumed to remain unchanged in both scenarios. Total credit losses over the 10-year period are then discounted to present value.

To determine expected credit losses for use in this credit risk sensitivity analysis, Freddie Mac deploys Office of Federal Housing Enterprise Oversight's ("OFHEO") mortgage default and prepayment models, which are described in OFHEO's April 1999 risk-based capital ("RBC") proposal. The loss severity model used in the credit risk sensitivity analysis is the same model Freddie Mac uses in the interim risk-based capital stress test (see "LIQUIDITY AND CAPITAL MANAGEMENT—*Capital Management*—Interim Risk-Based Capital Stress Test"), except that loss severity rates are initially reduced by half to simulate an economic environment that, while significantly stressful by recent historical standards, is more useful in assessing credit risk sensitivity than the extreme assumptions used in the interim stress test. Loss severity rates are then increased by 5 percentage points to reflect additional credit losses due to the 5 percent decline in house prices.

The sensitivity analysis incorporates the protection provided by primary mortgage insurance and credit enhancements by generating two separate present values for expected credit losses. The values shown in *Table 10* in the "Before Receipt" column assume that none of the mortgage insurance and credit enhancements currently covering the mortgages owned by Freddie Mac has any mitigating impact on Freddie Mac's credit losses, while those in the "After Receipt" column assume Freddie Mac will collect amounts due from mortgage insurers and the counterparties that provide credit enhancements (after giving effect to certain assumptions about counterparty default rates).

Table 10 sets forth the present value of the increase in credit losses over a 10-year period that Freddie Mac estimates would result from the assumed 5 percent decline in house prices. Credit risk sensitivity results as of December 31, 2001 show an increase in credit losses of $301 million net of mortgage insurance and other credit enhancements. This represents a decrease of $48 million compared to December 31, 2000.

TABLE 10 – NET PRESENT VALUE OF INCREASE IN CREDIT LOSSES

(dollars in millions)	Before Receipt of Primary Mortgage Insurance and Credit Enhancements	After Receipt of Primary Mortgage Insurance and Credit Enhancements
As of		
December 31, 2001	$ 940	$ 301
December 31, 2000[1]	$ 971	$ 349

[1] As a result of model modifications adopted during first quarter 2001 that reflect a more conservative application of default and loss severity assumptions, data as of December 31, 2000 have been restated to present data comparable to December 31, 2001 figures. Data originally reported as of December 31, 2000 were as follows: Before Receipt, $710 million; After Receipt, $215 million.

The credit risk sensitivity analysis is provided as additional information concerning the mortgages securitized and purchased in the total mortgage portfolio. Freddie Mac's process for estimating loan loss reserves for these mortgages is discussed in Notes 1 and 4 to the Consolidated Financial Statements.

Institutional Credit Risk

Freddie Mac is subject to credit risk from institutional counterparties to the extent they do not fulfill their obligations to Freddie Mac under the terms of specific contracts or agreements. Freddie Mac's primary institutional credit risk exposure (other than counterparty credit risk exposure relating to derivatives, which is discussed in "*Derivative Counterparty Credit Risk*") arises from agreements with the following counterparties:

- Mortgage servicers;
- Mortgage insurers and reinsurers;
- Guarantors of non-Freddie Mac mortgage securities held in the retained portfolio; and
- Issuers and guarantors of investments held in the liquidity and contingency portfolio.

Freddie Mac is exposed to institutional credit risk arising from the insolvency of mortgage servicers that remit monthly principal and interest payments on mortgages to Freddie Mac or that guarantee the performance of certain mortgages. To protect itself against this risk, Freddie Mac requires servicers to meet minimum net worth, insurance and other eligibility requirements, and institutes remedial actions against seller/servicers that fail to comply with its standards. These actions include transferring mortgage servicing to other qualified servicers and/or terminating Freddie Mac's relationship with the seller/servicers.

Freddie Mac also bears institutional credit risk relating to the nonperformance of mortgage insurers that insure purchased or guaranteed mortgages. Freddie Mac manages this risk by regularly monitoring its exposure to individual mortgage insurers. Freddie Mac also performs periodic on-site audits of mortgage insurers to ensure compliance with its eligibility requirements and to evaluate their management and control practices. Substantially all mortgage insurers providing primary mortgage insurance coverage on single-family mortgages purchased during 2001 were rated "AA" or better by S&P. In addition, state insurance authorities regulate mortgage insurers.

Freddie Mac also is exposed to institutional credit risk to the extent that the guarantors or the third parties providing credit enhancements on the non-Freddie Mac mortgage securities held in the retained portfolio become insolvent. Non-Freddie Mac mortgage securities consist of agency and non-agency mortgage securities. Agency mortgage securities present minimal institutional credit risk exposure to Freddie Mac due to the high credit quality of the issuers and guarantors. Non-agency mortgage securities expose Freddie Mac to institutional credit risk. The corporation mitigates the risk associated with these securities through credit enhancements such as senior/subordinated bond structures, bond insurance or a combination of both. Substantially all of the bond insurers providing coverage for non-agency mortgage securities held by Freddie Mac were rated "AAA" by one or more rating agencies. Furthermore, Freddie Mac manages institutional credit risk by only purchasing securities that meet the corporation's stringent investment guidelines and performing ongoing analysis to evaluate the creditworthiness of the issuers and servicers of non-Freddie Mac mortgage securities and the bond insurers that guarantee those securities. To assess the creditworthiness of non-agency securities, the corporation may perform additional analysis, including on-site visits, review of financial information, verification of loan documentation, review of underwriting or servicing processes and similar due diligence measures. In addition, management regularly evaluates these investments to determine if any impairment in fair value requires a write-down of the asset's carrying value and/or warrants divestiture.

TABLE 11 – CREDIT CHARACTERISTICS OF NON-FREDDIE MAC MORTGAGE SECURITIES

December 31,	2001			2000		
	Dollars in Millions	Percent of Total	% AAA Rated[1]	Dollars in Millions	Percent of Total	% AAA Rated[1]
Agency mortgage securities	$ 77,302	61%	100%	$ 37,294	46%	100%
Non-agency securities:						
Mortgage revenue bonds[2]	7,299	6%	80%	6,953	9%	83%
Other mortgage-related securities[3]	42,365	33%	96%	35,997	45%	96%
Total non-agency securities	49,664	39%	94%	42,950	54%	94%
Total	$ 126,966	100%	97%	$ 80,244	100%	97%

(1) Rated AAA or equivalent. Credit rating of non-agency mortgage securities is designated by at least two nationally recognized statistical rating agencies.
(2) Consists of obligations of state and political subdivisions.
(3) Includes home equity securities, commercial mortgage securities backed by pools of loans that include significant amounts of multifamily mortgages, manufactured housing securities and other mortgage-related securities.

Approximately 61 percent of the non-Freddie Mac mortgage securities owned by the corporation consist of agency mortgage securities, which typically are not separately rated by credit agencies but generally are viewed as having a level of credit quality at least equivalent to non-agency mortgage securities rated "AAA." The remaining 39 percent, or $49.7 billion in principal amount of the corporation's non-Freddie Mac mortgage securities consist of the specific types of non-agency mortgage securities shown in *Table 11*. Of this amount, 94 percent are rated "AAA." A relatively small portion of the securities in each non-agency category is rated below "AAA."

Institutional credit risk also arises from the insolvency of issuers or guarantors of investments held in Freddie Mac's liquidity and contingency investment portfolio, which is used to meet both anticipated and unanticipated liquidity and working capital requirements (see "LIQUIDITY AND CAPITAL MANAGEMENT—*Liquidity*"). Instruments in this portfolio are investment grade at the time of purchase and primarily short-term in nature, thereby mitigating to a significant extent the institutional credit risk inherent in this portfolio. Similar to its GMS holdings, management regularly evaluates these investments to determine if any impairment in fair value requires a write-down of the asset's carrying value and/or warrants divestiture.

Interest-Rate Risk and Other Market Risks

Disciplined risk management is critical to Freddie Mac's ability to maintain long-term value that is relatively insensitive to changes in interest-rate and other market risks. Interest-rate risk and other market risks associated with Freddie Mac's business could have an adverse impact on its net income, the strength and stability of its earnings growth and the future value of the corporation. Successfully managing interest-rate and other market risks requires consistently maintaining acceptable levels of risk exposure while meeting the corporation's return on equity thresholds and earnings objectives.

Oversight of Interest-Rate and Other Market Risks

Freddie Mac's Board of Directors oversees the corporation's management of interest-rate and other market risks. Under the Board's oversight, senior management is responsible for day-to-day management of the corporation's activities relating to interest-rate and other market risks. Freddie Mac also maintains a market risk oversight function that reports directly to the Chief Financial Officer.

Interest-Rate Risk

Interest-rate risk is the risk that changes in the level of interest rates or changes in the shape of yield curves could affect adversely the market value and future earnings of Freddie Mac. Freddie Mac's interest-rate risk exposure results primarily from the uncertainty as to when borrowers will pay the outstanding principal balance of their mortgages ("prepayment risk"). A mortgage borrower has the option, usually without penalty, to make unscheduled payments of additional principal or to completely pay off a mortgage loan at any time before its scheduled maturity date or to hold the mortgage to its stated maturity. The borrower's option makes the timing and amount of mortgage prepayments very sensitive to changes in interest rates, among other factors.

Prepayment levels have become increasingly sensitive to changes in interest rates as greater efficiency in the mortgage origination process has made refinancing a mortgage faster and less expensive for borrowers. Prepayments tend to increase when interest rates fall due to the benefits of refinancing a mortgage at a lower interest rate. A significant decline in interest rates may lead to higher prepayments and a shorter expected life for a mortgage than originally projected. Conversely, a significant increase in interest rates could lead to lower than anticipated prepayments and a longer expected life for a mortgage than originally projected. The sensitivity of prepayment levels on a mortgage portfolio to changes in interest rates is heightened when the coupon rates on mortgage assets in the portfolio are concentrated within a relatively narrow range.

Sources of Interest-Rate Risk

Retained Portfolio: Freddie Mac is exposed to higher levels of interest-rate risk when it uses debt rather than mortgage securitizations to finance mortgage purchases. In a mortgage securitization financing transaction, Freddie Mac transfers most of the interest-rate risk to PC investors. In a debt financing transaction, Freddie Mac retains most of the interest-rate risk. The retained portfolio is comprised of mortgage investments with a range of different characteristics, including different stated maturities, underlying collateral, principal and interest payment structures and prepayment patterns. To manage this variety of mortgage-related investments, Freddie Mac employs a risk management strategy that seeks to match the interest-rate characteristics of its liabilities and derivatives with the prepayment option embedded in mortgage assets.

Prepayment risk associated with the retained portfolio can affect adversely net interest income in both rising and falling interest-rate environments and can be significant when rates change suddenly. Freddie Mac uses various instruments, including short-term debt, callable and non-callable long-term debt and derivatives to enhance its ability to reprice debt when mortgages prepay faster or slower than expected. When interest rates move up or down, mismatches between Freddie Mac's interest income and interest expense may arise and may affect adversely net interest income. When interest rates fall, net interest income may be reduced if borrowers prepay their mortgage loans faster than anticipated and Freddie Mac is only able to reinvest the proceeds in lower-yielding investments. When interest rates rise, net interest income may be reduced if mortgages remain outstanding longer than anticipated and Freddie Mac must refinance maturing debt at higher rates.

Securitization Financing: Changes in interest rates may affect adversely the future cash flows that Freddie Mac receives from securitization financing, and thus affect the corporation's market value and future earnings. Income received from securitization financing is reported in "Management and guarantee income." A change in interest rates that causes mortgage prepayments to increase may cause Freddie Mac's guarantee fees to decrease if prepayments exceed the volume of new mortgage securitizations. In this case, fee income generally would decline because of the contraction in the amount of outstanding PCs on which fee income is earned. In addition, the average guarantee fee on securitized mortgages would decline if new mortgage purchases were securitized at lower fee levels than existing mortgages and/or the mortgages that prepay. Securitization-related earnings are affected by, among other factors, guarantee fee levels and credit-related expenses. Therefore, to the extent that new mortgages are of higher credit quality than the mortgages that prepay, lower future default costs may fully or partially offset the effect of lower average guarantee fees.

Securitized mortgages also expose Freddie Mac to interest-rate risk because of timing differences between Freddie Mac's receipt of payments from mortgage borrowers and its subsequent pass-through of those payments to PC investors. These timing differences can lead to significant interest expense, particularly in a rapidly declining interest-rate environment. If the interest rate paid to a PC investor is higher than the reinvestment rate on payments received from mortgage borrowers, Freddie Mac bears the cost difference, recognized as interest expense, for the time period between when the borrower pays Freddie Mac and when Freddie Mac pays the PC investor. Beginning in July 2001, Freddie Mac implemented a change in its prepayment accounting cycle for certain Gold and ARM PCs to pass through mortgage prepayments to PC investors more quickly. This change conforms the corporation's prepayment cycle to industry practice. The benefit of this change will be a shorter time period for which Freddie Mac owes payments to PC investors at the PC coupon rate. Furthermore, in most market environments this change should result in lower interest expense, with greater benefit to Freddie Mac occurring in periods when prepayment speeds accelerate and/or the yield curve steepens, as was the case in 2001.

Trading Portfolios: Freddie Mac's mortgage securities dealer unit, SS&TG, and external money managers actively trade mortgage-related securities to support the market for Gold PCs. The primary goal of these activities is to improve the liquidity of Gold PCs and strengthen relationships with mortgage security investors. Revenue earned from these activities includes interest income from mortgage securities in these trading portfolios, and realized or unrealized gains or losses on those securities. These trading portfolios are subject to Freddie Mac's risk measurement and management standards, which helps to minimize losses when there are significant changes in interest rates. The interest-rate risk exposure arising from the trading portfolios is smaller than the interest-rate risk associated with the much larger retained portfolio.

Premiums and Discounts: An increase or decrease in mortgage prepayments will change the rate of amortization of certain premium and discount amounts, which can affect Freddie Mac's income and portfolio market value. Changes in interest rates affect the market prices of mortgage-related assets and debt obligations, frequently causing them to trade at a premium or discount to their par value. The purchase of mortgage-related assets and issuance of debt at amounts above or below par value give rise to premiums and discounts. In addition, changes in the market values of financial assets and liabilities accounted for as hedged items under SFAS 133 also result in adjustments to the hedged item's carrying basis. Purchase premiums, discounts and basis adjustments on mortgage investments are amortized over the expected lives of the investments. If a mortgage purchased at a premium prepays more quickly than originally expected, the investment yield is reduced because the premium is amortized into expense more quickly. Conversely, prepayments that are slower than anticipated on a premium investment cause yields to be higher than originally expected because the premium is amortized into expense more slowly. For mortgages purchased at a discount, faster prepayments result in increased yields and slower prepayments reduce them.

Interest-Rate Risk Management Strategies

Freddie Mac issues many different types of debt and actively adjusts its funding mix to protect its portfolio market value. Derivatives and asset-related strategies are also extremely important in Freddie Mac's overall strategy for managing interest-rate risk.

Funding Transactions

Freddie Mac's disciplined risk management strategy includes issuance of different debt products. Freddie Mac finances its retained portfolio using a mix of debt and derivatives that enable it to closely match expected cash outflows with the expected cash inflows from the corporation's mortgage investments and to manage the uncertainty of these cash flows. Freddie Mac uses various instruments, including short-term debt, callable and non-callable long-term debt and derivatives, to optimize its ability to reprice debt when mortgages prepay faster or slower than expected. Freddie Mac's repricing flexibility depends on continued market demand for large volumes of its callable and non-callable debt and access to a derivatives market that is large and liquid enough to permit Freddie Mac to enter into derivatives at a reasonable cost (see "RISK MANAGEMENT—*Interest-Rate Risk and Other Market Risks*—Other Market Risks—Liquidity").

Asset-Related Strategies

Freddie Mac's asset purchase strategies are an important part of its overall interest-rate risk management. When Freddie Mac invests in mortgages that are less sensitive to prepayment risk, it can reduce the amount of future rebalancing actions that are needed. These strategies can be product- or loan-level based, or involve structured transactions. For example, the 15-year fixed-rate mortgage product is less sensitive to prepayments than the 30-year mortgage product. When Freddie Mac executes a structured transaction as part of its interest-rate risk management activities, it creates multiclass securities using PCs in the retained portfolio as the underlying collateral and retains the tranches that help optimize the portfolio's risk profile.

Derivative Transactions

Purpose of Derivatives—Freddie Mac enters into derivative transactions as an end user to obtain low-cost financing, reduce risk, and protect market value. It does not engage in such transactions for speculative purposes. Freddie Mac primarily uses interest-rate swaps and foreign currency swaps, options to enter into interest-rate swaps ("swaptions"), interest rate caps and floors, and futures contracts.

Freddie Mac uses only derivatives that are common in the financial markets to conduct its risk management activities. Substantially all of Freddie Mac's derivative positions fall into one of four categories: LIBOR-based interest-rate swaps, LIBOR and Treasury-based exchange-traded futures, LIBOR and Treasury-based options, and foreign currency swaps.

Freddie Mac enters into derivative transactions: (i) when mortgage assets are purchased, to provide a component of the funding mix that contributes to lower debt costs; (ii) when debt is issued or forecast to be issued, to reduce interest-rate and other market risks; and (iii) when changes in interest rates require it to dynamically adjust (or "rebalance") its funding mix in order to more closely match changes in the interest-rate characteristics of its mortgage assets (see "*Derivative-Related Benefits*" and "*Derivative-Related Risks*" below).

Accounting for Derivatives—SFAS 133, which Freddie Mac implemented on January 1, 2001, significantly revised the accounting treatment of derivatives. Among other things, the new standard requires derivatives to be recorded at their fair value and to be presented on the balance sheet as either "Derivative assets", when the fair value of the derivative is a gain, or "Derivative liabilities," when the fair value of the derivative is a loss (see "CRITICAL ACCOUNTING POLICIES—Fair Values").

Substantially all interest-rate swaps, swaptions and other derivatives are accounted for under SFAS 133 in either fair value or cash flow hedge relationships. A relatively small proportion of derivatives, totaling $13 billion notional amount at December 31, 2001 (approximately 1 percent of Freddie Mac's total notional amount outstanding as of that date), although executed for risk management purposes, are not designated as hedges for accounting purposes.

In accordance with GAAP, Freddie Mac estimates the fair value of its derivatives based on quoted market prices, if such prices are available. Freddie Mac uses market quotes to determine the fair value of its exchange-traded derivatives (exchange-traded futures and options). For its over-the-counter ("OTC") derivatives (primarily swaps and swaptions), for which market prices are not available, Freddie Mac estimates fair value based on discounted cash flow models that rely on external market estimates of interest rates, volatility and other factors.

When derivatives are designated in fair value hedge relationships, changes in the fair values of both the derivative and the hedged items are reported in "Fair value gains (losses)." When derivatives are designated in cash flow hedge relationships, the effective portion of the change in derivative fair value is reported in AOCI. In the case of "no hedge" designation, the changes in fair value of the derivative is reported in "Other income, net" (see "CRITICAL ACCOUNTING POLICIES" and Note 1 to the Consolidated Financial Statements). In addition, changes in hedged item fair values are reported as part of the hedged item's carrying value and amortized as a component of net interest income consistent with the treatment of premiums, discounts and deferred fees. These changes may cause reported earnings and GAAP-based stockholders' equity to be significantly more volatile than was the case prior to implementation of SFAS 133.

Under SFAS 133, the amortization of hedged item basis adjustments occurs over the life of the hedged item (for example, the estimated mortgage life in the case of hedged PCs) and must begin no later than when the hedge relationship ends. A hedge relationship is deemed to be terminated when (i) the hedging relationship is no longer effective (i.e. it no longer satisfies the SFAS 133 criteria for hedge accounting) or desired, (ii) the derivative is sold or terminated or (iii) the derivative is redesignated from one hedge relationship to another. Freddie Mac frequently adjusts its hedging relationships in order to maximize the effectiveness of its hedging strategies in response to changing interest rates and other market factors, asset and liability pay downs, and changes in the composition of its derivatives, mortgage assets and debt obligations. The hedge amortization must begin at the time of redesignation regardless of whether the derivative is part of a new hedge relationship. Therefore, a substantial portion of Freddie Mac's hedged item basis adjustments commences amortization as a component of net interest income on a monthly basis. The effect of this amortization on "Net Interest Income" may differ significantly from the actual derivative cash flows realized in income over the period the derivatives are held (see "OPERATING EARNINGS" for more information).

Hedging Strategies

Table 12 and the accompanying discussion describe Freddie Mac's principal hedging strategies and associated derivatives transactions, and provide year-end 2001 data on the notional amounts of derivatives designated to those principal hedging relationships. The corporation uses these and other derivatives in fair value and cash flow hedging relationships designated in accordance with SFAS 133. *Table 13* provides additional detail regarding Freddie Mac's derivatives, notional balances and fair values as of December 31, 2001.

TABLE 12 – PRINCIPAL HEDGING STRATEGIES

Hedged Item	Principal Derivatives Used	Hedge Type	Hedged Risk
Forecasted Debt issuances	Pay-fixed swaps, LIBOR futures and options on LIBOR futures	Cash Flow	Increase in future funding costs caused by increases in benchmark interest rate
Existing Long-Term Fixed-Rate Debt	Receive-fixed swaps	Fair Value	Change in debt value caused by changes in benchmark interest rate
Prepayment Options Embedded in Retained PCs	Swaptions, and Receive- and Pay-fixed swaps	Fair Value	Change in value of embedded prepayment option in mortgage assets
Foreign-Currency Exposure	Receive-fixed foreign/pay-floating foreign swaps, and Receive- floating foreign/pay-floating US dollar basis swaps	Fair Value	Change in value of foreign-denominated debt due to changes in interest and foreign exchange rates

Hedges of Forecasted Debt Issuances: Freddie Mac frequently issues discount notes and other short-term or medium-term fixed-rate debt when funding the retained portfolio, with the expectation that a substantial portion of that debt will mature and be replaced by subsequent debt issuances. This funding strategy can provide a lower cost of funds and greater repricing flexibility than long-term non-callable debt. Because the contractual maturities of these debt instruments commonly are shorter than the expected lives of the mortgage investments, the corporation is exposed to the risk of increasing interest rates to the extent that maturing debt is refunded at higher interest costs. To protect against this risk, Freddie Mac commonly executes interest-rate swaps, in which Freddie Mac contractually agrees to pay a fixed interest rate and receive a variable interest rate—typically indexed to the London Inter-Bank Offered Rate ("LIBOR")—based on a fixed notional amount and term ("pay-fixed interest-rate swaps"). In this case, the floating-rate amounts the corporation receives from the swap offset the interest payments Freddie Mac expects to make on its forecasted future debt issuances, effectively "fixing" net funding costs over the swap period. At December 31, 2001, $213 billion notional amount of pay-fixed swaps was designated as cash flow hedges of the variability of future interest payments and carried at fair value. In addition, a combined $346 billion notional amount of short-term LIBOR futures contracts and short-term purchased options on such contracts, which provide interest-rate protection in combination with pay-fixed swaps, was designated in cash flow hedge relationships.

Hedges of Existing Long-Term Fixed-Rate Debt: Freddie Mac also issues long-term debt to finance the retained portfolio. This exposes the corporation to the risk that a decline in interest rates prior to the debt's maturity will result in mortgages that prepay and are replaced by lower-yielding mortgage investments, while the associated debt remains outstanding and cannot be replaced by debt with lower market interest rates. To hedge against this risk, the corporation commonly executes interest-rate swaps in which Freddie Mac contractually agrees to pay a variable interest rate and receive a fixed interest rate based on a fixed notional amount and term ("receive-fixed interest-rate swaps"). In this case, the fixed interest rate received on the swap serves to offset the debt's fixed interest cost, effectively altering the corporation's debt from long-term, fixed-rate to short-term, floating-rate debt. At December 31, 2001, $67 billion notional amount of receive-fixed swaps was designated as fair value hedges of the changes in a specified benchmark rate of interest (LIBOR) on existing long-term debt.

Hedges of Prepayment Options Embedded in Retained PCs: Freddie Mac uses a mix of call swaptions, put swaptions and receive-fixed and pay-fixed swaps to hedge the borrower prepayment option embedded in retained PCs. A swaption is an option to enter into an interest-rate swap in the future on terms that are established when the option contract is initiated. A "call swaption" entitles the option buyer to execute a receive-fixed swap, while a "put swaption" entitles the option buyer to execute a pay-fixed swap. The swaption buyer pays a premium for the right to enter into the interest-rate swap at some future date. Depending on interest-rate conditions, the holder of the option may or may not exercise the swaption and enter into the underlying swap.

The value of a swaption primarily reflects expected changes in the level and volatility of interest rates. Since borrower prepayments are also driven largely by changes in current and expected interest rates, swaptions provide an appropriate means of hedging the prepayment option. As part of this hedging strategy, Freddie Mac also enters into receive-fixed and pay-fixed swaps, and frequently alters the composition of the derivatives comprising this strategy as market factors and mortgage portfolio attributes change. At December 31, 2001, $180 billion notional amount of call and put swaptions, $98 billion notional amount of receive-fixed swaps and $35 billion notional amount of pay-fixed swaps were designated as fair value hedges of the embedded borrower prepayment options.

Hedges of Foreign Currency Exposure: As part of issuing foreign-denominated debt, Freddie Mac executes interest-rate and foreign-currency swaps in order to mitigate interest-rate and foreign-currency risk. These derivative transactions have served to effectively convert long-term fixed-rate foreign-denominated debt to U.S. dollar-denominated, floating-rate debt. A combined $44 billion notional amount of interest-rate and currency swaps was designated as fair value hedges at December 31, 2001.

Management believes that financial results reported under SFAS 133 do not necessarily convey the underlying economics of Freddie Mac's business and risk management activities. Accordingly, in first quarter 2001, Freddie Mac began providing a supplemental performance measure known as "operating earnings" as an alternative means of evaluating Freddie Mac's business results and risk management activities (for additional information see "OPERATING EARNINGS").

Summary of Derivatives Positions

Table 13 summarizes the notional amounts and fair values of Freddie Mac's derivatives by instrument type as well as derivative activity for 2001 and 2000 (see Note 10 to the Consolidated Financial Statements for more information). A positive fair value in *Table 13* for a derivative product category is the estimated amount, prior to netting by counterparty, that Freddie Mac would be entitled to receive if it terminated those transactions. A negative fair value is the estimated amount, prior to netting by counterparty, that Freddie Mac would owe if it terminated the derivatives in that product category.

TABLE 13 – DERIVATIVES

December 31,	2001		2000	
	Notional Amount [1]	Net Fair Value [2]	Notional Amount [1]	Net Fair Value [2]
(dollars in millions)				
Interest-rate swaps				
Pay-fixed	$ 249,204	$ (10,013)	$ 141,637	$ (5,346)
Receive-fixed	186,956	4,156	129,208	2,609
Basis (floating-to-floating)	6,609	(158)	7,043	(8)
Option-based derivatives[3]	408,189	5,210	125,529	2,131
Futures	174,639	13	25,071	145
Foreign-currency swaps	23,995	(64)	10,208	539
Forward sales	2,802	(28)	35,839	(327)
Total	$ 1,052,394	$ (884)	$ 474,535	$ (257)

Notional or Contractual Amount [1]	2001	2000
(dollars in millions)		
Change in notional balance		
Beginning balance	$ 474,535	$ 424,244
New contracts	1,958,849	668,852
Maturities and terminations[4]	(1,380,990)	(618,561)
Ending balance	$ 1,052,394	$ 474,535

[1] Notional amounts serve as a factor in determining periodic amounts to be received and paid and generally do not represent actual amounts to be exchanged or directly reflect the corporation's exposure to institutional credit risk. In accordance with GAAP, notional amounts are not recorded as assets or liabilities in the Consolidated Balance Sheets.

[2] The fair market values of derivatives (netted by counterparty) are presented as "Derivative assets, at fair value" ($1,598 million at December 31, 2001) and "Derivative liabilities, at fair value" ($2,482 million at December 31, 2001) on the Consolidated Balance Sheets. Substantially all of the counterparty credit risk embedded in the "Derivative assets, at fair value" was collateralized (see Table 15). In 2000 (prior to the adoption and application of SFAS 133), derivative fair values were generally not recorded on the Consolidated Balance Sheets. This table presents derivatives by instrument type. As a result, fair values are not netted by counterparty as they are when computing counterparty credit risk exposure.

[3] Consists of options, swaptions and interest-rate caps and floors.

[4] The majority of this activity represents maturities and closing out of certain derivatives positions. Maturities are in accordance with the derivative's contractual terms while close outs prior to contractual expiration are typical for exchange-traded derivatives.

The total notional amount of Freddie Mac's derivatives increased by $578 billion from December 31, 2000 to December 31, 2001. This increase is directly attributable to rebalancing actions taken to mitigate the interest-rate risk associated with large changes in both long-term and short-term interest rates during 2001. Large changes in interest-rates generally cause the interest-rate characteristics of Freddie Mac's mortgage assets to change more than the interest-rate characteristics of its debt. In this environment, derivatives provided Freddie Mac with the ability to rapidly adjust the interest-rate characteristics of the retained portfolio. During 2001, derivatives activity was primarily in option-based derivatives, interest-rate swaps, and exchange-traded futures. The net fair value of all derivatives declined by $627 million from December 31, 2000 to December 31, 2001. Relatively low interest rates during most of 2001 produced declines in the fair value of pay-fixed swaps that exceeded gains on receive-fixed swaps and option-based derivatives.

Derivatives entered into for risk management purposes also may significantly affect Freddie Mac's net income due to expenses incurred to enter into such transactions, changes in their fair value and their potential impact on the timing of interest income and expense.

Derivative-related Benefits

Freddie Mac uses derivatives in its interest-rate risk management strategy to reduce interest-rate risk from its mortgage assets and the liabilities that fund them. Management believes that the benefits derivatives provide greatly exceed the risks inherent in using derivatives. The principal benefit is that derivatives have enabled Freddie Mac to keep its interest-rate risk exposure at consistently low levels, regardless of the market environment.

Freddie Mac measures and manages its interest-rate risk by estimating on a daily basis the potential percentage loss in its market value of equity (also referred to as "portfolio market value") that would arise under multiple interest-rate scenarios. This estimate of the potential percentage loss in portfolio market value is referred to as the corporation's Portfolio Market Value Sensitivity ("PMVS"). *Table 14* shows the effect of derivatives on Freddie Mac's two principal interest-rate risk measures: "PMVS-L and PMVS-YC" (see the detailed description of these two measures in "RISK MANAGEMENT—*Interest-Rate Risk and Other Market Risks*—Measurement of Interest-Rate Risk"). In summary, this table shows that the PMVS-L and PMVS-YC average risk levels for 2001, which remained low consistent with prior periods, would have been appreciably higher if Freddie Mac had not used derivatives to reduce its risk from the large changes in the level and volatility of interest rates.

TABLE 14 – DERIVATIVE IMPACT ON AVERAGE PMVS

	Before Derivatives	After Derivatives	Benefit from Derivatives
2001 Average PMVS-L	9.74%	3.13%	6.61%
2001 Average PMVS-YC	1.03%	0.62%	0.41%

By keeping PMVS-L and PMVS-YC low, Freddie Mac has been able to protect the fair value of its "Stockholders' equity" from large changes in interest rates.

Derivative-Related Risks

The primary derivative-related risks that Freddie Mac incurs are counterparty credit risk resulting from credit exposure to derivative counterparties and liquidity risk. Freddie Mac ensures that its use of derivatives is consistent with its strict risk management discipline, and has implemented measures that seek to minimize these risks.

Derivative Counterparty Credit Risk—Exchange-traded derivatives, such as futures contracts, do not measurably increase the corporation's exposure to counterparty credit risk because changes in the value of open exchange-traded contracts are settled daily through a financial clearinghouse established by each exchange. However, OTC derivatives expose Freddie Mac to counterparty credit risk because the transactions are executed and settled between the two parties. When an OTC derivative has a market value above zero (i.e. a gain reported as "Derivative assets, at fair value" in the Consolidated Balance Sheets), then the counterparty owes the value of the derivative to Freddie Mac. Credit risk arises from the possibility that the counterparty will not be able to pay the amount owed.

Derivative Counterparty Credit Risk Standards and Quality Control—Freddie Mac uses several tools to manage and minimize counterparty credit risk: (i) strict standards for approving new OTC derivative counterparties; (ii) master netting agreements and the posting of collateral by counterparties; (iii) continuous monitoring of counterparties; and (iv) stress-testing to evaluate potential exposure under adverse market scenarios.

Standards for Derivative Counterparties—Freddie Mac's standards for entering into derivative agreements include rigorous internal credit and legal reviews, encompassing quantitative and qualitative analysis of key financial measures, and counterparty credit ratings among the highest available from the major rating agencies. Freddie Mac works actively with a diversified group of 28 OTC derivative counterparties. Most of these counterparties are major financial institutions that act as market makers in the OTC derivatives market. As of December 31, 2001, based on notional amounts outstanding, OTC counterparties with an independent credit rating of "AA-" or better accounted for 74 percent of Freddie Mac's OTC derivatives. In addition, over the past two years several new OTC derivative counterparties have been approved, helping to diversify Freddie Mac's counterparty credit risk exposure.

In order that derivative transactions can be replaced if a counterparty defaults, Freddie Mac limits the amount of exposure to each counterparty. As of December 31, 2001, the five largest counterparties, based on notional amount outstanding, each with an independent credit rating of "A" or better, represented 58 percent of Freddie Mac's OTC derivatives.

Master Netting and Collateral Agreements—Freddie Mac uses master netting and collateral agreements to reduce its risk exposure to its OTC derivative counterparties. Master netting agreements provide for the netting of amounts receivable and payable from an individual counterparty, which reduces Freddie Mac's exposure to a single counterparty in the event of default. For example, if Freddie Mac has a gain position on one derivative and a loss position on another derivative with the same counterparty, then the loss can be netted with the gain to determine the amount of net exposure to Freddie Mac. On a daily basis, the market value of each counterparty's derivatives outstanding is calculated to determine the amount of the current exposure. Freddie Mac's collateral agreements require non-AAA-rated counterparties to post collateral for the amount of money they owe to Freddie Mac, taking into consideration posting thresholds. Under the collateral agreements, counterparties are required to post collateral on at least a weekly basis if Freddie Mac has net exposure to them. Freddie Mac also has the right to request that additional collateral be posted on a more frequent basis if Freddie Mac's net exposure has increased. Similarly, counterparties have the right to request return of excess collateral to them if Freddie Mac's net exposure has decreased. In certain cases, counterparties also must post additional collateral if they experience a decline in credit ratings.

To date, Freddie Mac has not incurred any credit losses on its OTC derivative transactions. The collateral posted by counterparties serves to protect Freddie Mac against the risk of such losses. Collateral posted by a derivative counterparty is deposited with a custodian bank which holds the collateral deposits for Freddie Mac. Acceptable forms of collateral are limited to Treasury securities, agency debt securities, agency mortgage-backed securities and cash. If a counterparty were to default on its obligations under the derivative agreement and the default was not remedied in the manner prescribed in the transaction agreement, Freddie Mac would have the right under those agreements to direct the custodian bank to transfer the collateral to Freddie Mac or, in the case of non-cash collateral, to direct that the collateral be sold and the proceeds paid to Freddie Mac.

Table 15 summarizes Freddie Mac's counterparty credit exposure as of December 31, 2001.

TABLE 15 – DERIVATIVE COUNTERPARTY CREDIT EXPOSURE

December 31, 2001				
Rating[1]	Number of Counterparties[2]	Notional[3]	Total Exposure at Fair Value[4]	Exposure, Net of Collateral[5]
(dollars in millions)				
AAA	2	$ 62,274	$ —	$ —
AA+	1	615	80	3
AA	5	168,730	393	26
AA-	13	260,599	558	40
A+	2	76,945	5	—
A	3	92,332	655	—
A-	1	190	—	—
BBB+	1	96	2	—
Total OTC derivatives	28	$ 661,781	$ 1,693	$ 69
Other derivatives[6]	N/A	390,613		
Total derivatives	N/A	$ 1,052,394		

(1) Freddie Mac uses the lower of Standard & Poor's ("S&P") and Moody's ratings to manage collateral requirements. In this table, the rating is stated in terms of the S&P equivalent.
(2) Based on legal entities. Affiliated legal entities are reported separately.
(3) Notional amounts serve as a factor in determining periodic amounts to be received and paid and generally do not represent actual amounts to be exchanged or directly reflect the corporation's exposure to institutional credit risk.
(4) For each counterparty, this amount includes derivatives with a net positive market value plus the related accrued interest receivable/payable (net).
(5) "Total Exposure at Fair Value" less collateral held as determined at the counterparty level.
(6) Consists primarily of exchange-traded derivatives, which do not measurably increase the corporation's exposure to counterparty credit risk because changes in value of open exchange-traded contracts are settled daily through a financial clearinghouse established by each exchange.

Freddie Mac's exposure to OTC derivative counterparties varies from period to period depending on changes in interest rates, foreign-currency exchange rates and the amount of derivatives it holds. As noted in *Table 15*, Freddie Mac's exposure to OTC derivative counterparties, after applying netting agreements and collateral, was only $69 million as of December 31, 2001. Approximately 90 percent of Freddie Mac's counterparty credit exposure was collateralized by cash at December 31, 2001. In the extremely unlikely event that all of Freddie Mac's OTC derivative counterparties were to default on all of their December 31, 2001 obligations at once, the maximum loss to Freddie Mac is estimated to be $69 million. This amount is approximately two percent of Freddie Mac's reported net income for 2001, and represents less than one week of earnings.

Continuous Monitoring of OTC Derivative Counterparties—On an ongoing basis, Freddie Mac reviews the credit fundamentals of all of its OTC derivative counterparties to ensure that they continue to meet its standards. In addition to external ratings, internal ratings are given to each counterparty based on quantitative and qualitative analysis, and are updated on a regular basis. Additional reviews are completed when market conditions or events affecting an individual counterparty occur.

Derivative Portfolio Stress-Testing—Market values of derivatives can change significantly when market conditions change. As a result, Freddie Mac monitors the risk that its exposure, net of collateral, to its OTC derivative counterparties will increase under certain adverse market conditions. Freddie Mac regularly performs severe market stress tests to evaluate the potential exposure, net of collateral, to each of its OTC derivative counterparties and the potential losses that Freddie Mac might incur.

To date, Freddie Mac has not set aside specific reserves for institutional credit risk exposure. Management does not believe such reserves are necessary, given the corporation's counterparty policies and collateral requirements.

Derivative Market Liquidity Risk—Derivative market liquidity risk refers to Freddie Mac's ability to enter into derivative transactions at a reasonable cost, and to replace them if a counterparty defaults. To protect its continuous access to these markets, Freddie Mac uses a variety of products and a variety of OTC derivative counterparties. Transaction costs are a factor considered in the risk management process, given the effect of these costs on net interest income. Freddie Mac controls its derivative costs by managing the timing, amount, and choice of derivative instruments deployed for interest-rate risk management. In addition to OTC derivatives, Freddie Mac also uses exchange-traded derivatives, asset-related strategies, callable debt, and Reference Notes to manage interest-rate risk.

Increases in the costs incurred by Freddie Mac in order to enter into risk management transactions (whether resulting from credit downgrades by rating agencies, legislative or regulatory events that temporarily increase transaction costs, or other factors) could also affect the level of Freddie Mac's risk management activities and/or lower its net interest income.

Measurement of Interest-Rate Risk

Freddie Mac maintains a disciplined approach to measuring and managing interest-rate risk. On a daily basis, the corporation measures its interest-rate risk exposure due to changes in both the level and shape of the Treasury yield curve, a standard benchmark yield curve based on the interest rates for Treasury securities, which are viewed by the market as being free of credit risk and providing a convenient means of comparing the credit quality of other debt securities. Scenario analyses are calculated to estimate the potential loss in Freddie Mac's market value of equity that would result from an increase or decrease in the (i) level of interest rates and (ii) slope of the yield curve. Under both scenario analyses, the corporation uses whichever change (increase or decrease) results in the larger potential loss to estimate the potential percentage loss in portfolio market value.

Freddie Mac uses its PMVS-L and PMVS-YC risk measures to gauge the strength and durability of the corporation's projected returns. The PMVS-L and PMVS-YC risk measures take into account all of Freddie Mac's interest-rate sensitive assets and liabilities (including derivatives) and PC guarantee obligations. In each case, Freddie Mac calculates the most adverse change in portfolio market value resulting from the changes in interest rates or yield curve slope under the scenarios discussed below. Freddie Mac uses proprietary and external business and financial models to measure PMVS-L and PMVS-YC. The scenario analyses Freddie Mac uses to measure interest-rate risk employ mortgage prepayment and other core forecasting models that are reviewed on an ongoing basis. The models may be adjusted and refined from time to time based on benchmarks of their results against the models of external parties, as well as changes that may occur in the relationship between key variables, including the historical relationship between mortgage interest rates and Treasury, LIBOR and other market rates. Freddie Mac mitigates operational risk related to this and other valuation models by benchmarking model results to market estimates of external parties.

Freddie Mac supplements its PMVS-L and PMVS-YC risk measurements with other interest-rate modeling and tools, including stress tests, that measure the effect on the corporation of more severe interest-rate and credit environments for purposes of evaluating the adequacy of the corporation's capital (see "LIQUIDITY AND CAPITAL MANAGEMENT—*Capital Management*—Capital Adequacy"). Freddie Mac uses proprietary and external financial and risk models to estimate interest-rate risk. The use of financial models to measure interest-rate risk exposes the corporation to certain operational and other related risks (see "RISK MANAGEMENT—*Operational Risks*").

Parallel Treasury Yield Curve Shifts: Freddie Mac's most significant market risk exposure arises from changes in the level of interest rates, which it measures using PMVS-L. To calculate PMVS-L, Freddie Mac examines two scenarios: an immediate 50 basis point increase and an immediate 50 basis point decrease in Treasury rates. In each case, the 50 basis point change is applied as a parallel shift, which means that each point along the Treasury yield curve is changed by the same 50 basis points. Given this assumed change in Treasury rates, Freddie Mac calculates the expected change in mortgage and debt rates using information about their historical relationship to Treasury securities as well as other rates and market information. Statistically, the 50 basis point shock represents the most significant expected change in Treasury rates over a one-month period within a 95 percent confidence interval. Management believes the use of an immediate 50 basis point shift in interest rates is a conservative way to measure this risk because it represents a large shift in the level of Treasury rates that rarely occurs and does not take into account any rebalancing actions that Freddie Mac would normally take to reduce risk exposure.

Non-Parallel Treasury Yield Curve Shifts: Freddie Mac's portfolio market value also is exposed to interest-rate risk arising from non-parallel shifts in the yield curve (such as a flattening or steepening) when the cash flows of its assets and liabilities are not exactly matched. This risk exposure is referred to as yield curve risk. Because future mortgage prepayments are impossible to predict with certainty, some degree of cash flow mismatch exists at all times. Changes in the shape, or slope, of the yield curve can, and often do, arise due to changes in interest rates at different points along the yield curve. For this reason, Freddie Mac evaluates its exposure to yield curve risk by examining potential reshaping scenarios at various points along the yield curve.

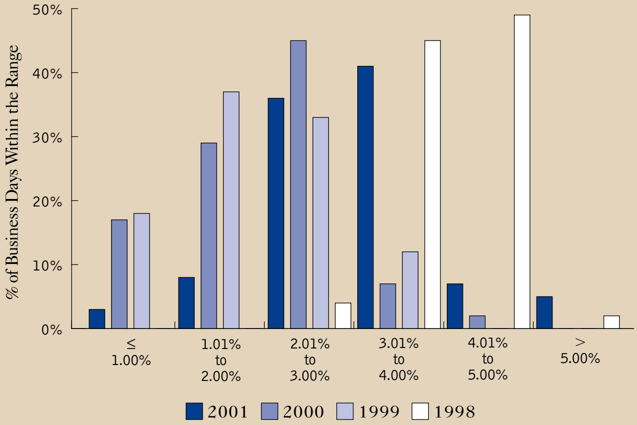
To calculate PMVS-YC, Freddie Mac also examines two scenarios: an immediate 25 basis point steepening and an immediate 25 basis point flattening in Treasury rates. The calculation of PMVS-YC is based on an assumed reshaping of the yield curve in which the 25 basis point change in slope is obtained by shifting the 2-year and 10-year Treasury rates by an equal amount (12.5 basis points), but in opposite directions. Accordingly, under the yield curve steepening scenario, the 2-year Treasury rate is decreased by 12.5 basis points and the 10-year Treasury rate is increased by 12.5 basis points. Under the yield curve flattening scenario, the 2-year Treasury rate is increased by 12.5 basis points and the 10-year Treasury rate is decreased by 12.5 basis points. Measuring yield curve risk by shifting the 2-year and 10-year Treasury rates highlights the two sectors of the yield curve that have the greatest effect on mortgage investments: (i) the 2- to 4-year sector of the yield curve, where expected cash flows from mortgages are concentrated; and (ii) the 10-year sector, which is the benchmark for mortgage rates and which can have a significant effect on prepayments. Statistically, the 25 basis point shock represents the most significant expected change in the yield curve in the 2- to 10-year sectors over a one-month period within a 95 percent confidence interval. Management believes the use of an immediate 25 basis point shift in the slope of the Treasury yield curve is a conservative way to measure this risk because it represents a severe change in slope that rarely occurs and does not take into account any rebalancing actions in response to such changes in risk exposure.

Risk Management Results

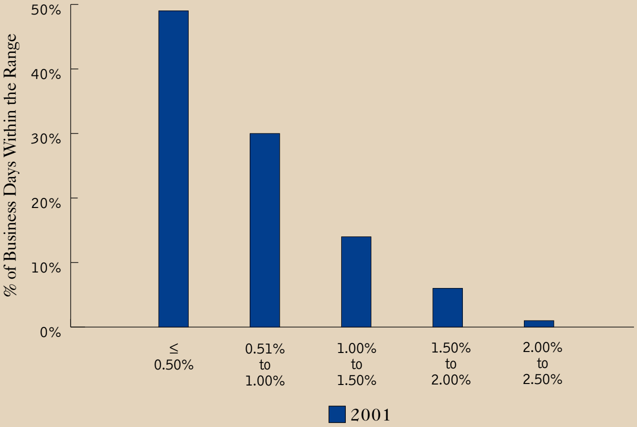
PMVS-L and PMVS-YC will vary over time depending on a variety of factors, including the current level of interest rates relative to the average coupon of portfolio assets, liquidity in the derivatives market and the cost of purchasing interest-rate protection in the derivatives and callable debt markets. Monitoring and managing PMVS-L and PMVS-YC are key elements of Freddie Mac's overall investment management strategy. *Exhibit 2* illustrates the percentage of business days PMVS-L was within certain ranges during 2001 as compared to 2000, 1999 and 1998 and the percentage of business days PMVS-YC was within certain ranges for 2001.

EXHIBIT 2—RISK MANAGEMENT RESULTS

Portfolio Market Value Sensitivity - Level (PMVS-L)
(Assuming a 50 basis point parallel shift of the Treasury yield curve)



Portfolio Market Value Sensitivity - Yield Curve (PMVS-YC)
(Assuming a 25 basis point shift in the slope of the Treasury yield curve)



As indicated in *Exhibit 2*, PMVS-L was 4.0 percent or less for approximately 88 percent of the business days in 2001, compared to 98 percent, 100 percent and 49 percent of the business days in 2000, 1999 and 1998, respectively. Additionally, PMVS-YC was 2.0 percent or less for more than 99 percent of the business days in 2001. At December 31, 2001, each 1.0 percent of portfolio market value was equal to a potential dollar value loss of approximately $120 million. PMVS-L and PMVS-YC are estimates of the potential future loss in portfolio market value arising from assumed changes in the interest-rate environment. It is important to recognize that they do not represent actual current losses to Freddie Mac because they are only projections of estimated losses in value based on assumed extreme rate shocks. If rate changes of this magnitude were actually to occur, their effect on portfolio market value could be mitigated through rebalancing activities.

Table 16 provides estimated PMVS-L as of December 31, 2001, 2000, 1999 and 1998 and an estimate of PMVS-YC as of December 31, 2001. To supplement the PMVS-L results based on an assumed 50 basis point shift in Treasury rates, *Table 16* also provides year-end PMVS-L estimates assuming a 100 basis point shift in Treasury rates.

TABLE 16 – PORTFOLIO MARKET VALUE SENSITIVITY ASSUMING SHIFTS OF THE TREASURY YIELD CURVE

	Portfolio Market Value Sensitivity			Potential Dollar Value Loss in Equity (millions)		
	PMVS-YC	PMVS-L		PMVS-YC	PMVS-L	
As of	25 bp[1]	50 bp[2]	100 bp[3]	25 bp[1]	50 bp[2]	100 bp[3]
December 31, 2001	0.3%	2.2%	8.8%	$ 36	$ 262	$ 1,031
December 31, 2000	—	2.5%	8.5%	—	$ 272	$ 924
December 31, 1999	—	0.8%	2.9%	—	$ 102	$ 366
December 31, 1998	—	3.9%	14.0%	—	$ 362	$ 1,300

(1) Assuming a 25 bp shift in the slope of the Treasury yield curve (PMVS-YC disclosure was initiated as of March 31, 2001).
(2) Assuming a 50 bp parallel shift in the Treasury yield curve.
(3) Assuming a 100 bp parallel shift in the Treasury yield curve.

PMVS-L and PMVS-YC measure the estimated effect on Freddie Mac's portfolio market value that would arise from significant changes in the level and slope of the Treasury yield curve. Because interest rate events of this magnitude are very rare, actual daily changes in Freddie Mac's market value of equity are generally far less than the estimated changes under the extreme PMVS-L and PMVS-YC scenarios. During 2001, Freddie Mac's actual daily change in estimated market value of equity for PMVS-L was less than 1.0 percent of equity 98 percent of the business days, and never exceeded 2.6 percent of equity. Similarly, for PMVS-YC, the actual daily change in estimated market value of equity was less than 1.0 percent of equity 98 percent of the business days, and never exceeded 2.0 percent of equity. These actual results reflect both the effect of rebalancing actions and the fact that the actual daily change in interest rates never exceeded 50 basis points.

There have been wide fluctuations in interest rates in each of the past two years. In 2000, interest rates were volatile, with the 10-year Treasury rate declining 170 basis points from its peak early in the year. By the end of 2001, the 10-year Treasury rate had changed by only 7 basis points from its level at the beginning of the year, although it fluctuated in a 130 basis point range during the year. Even though the market was extremely volatile, the corporation's risk levels, as measured by PMVS-L and PMVS-YC, remained consistently low due to disciplined execution of Freddie Mac's funding and hedging strategies. Historical levels of PMVS-L and PMVS-YC will not necessarily be indicative of future results.

Other Market Risks

Freddie Mac monitors and manages its exposure to other market risks.

Mortgage/Debt Spread: Mortgage/debt spread risk is the risk that portfolio market value and earnings will decline as a result of an increase in the spread between the interest rate on mortgage assets and debt used to finance these investments. Mortgage/debt spread risk is inherent to any mortgage investor that uses non-mortgage debt to finance mortgage purchases. To the extent that new debt must be issued on an existing mortgage investment, any adverse change in the mortgage/debt spread will cause funding costs to increase. Freddie Mac's balanced funding strategies limit the amount of new debt that must be issued. Since Freddie Mac retains the majority of its mortgage assets to maturity, temporary fluctuations in this spread do not significantly affect its portfolio market value over the long term.

Agency/Treasury and Agency/Swap Basis: Freddie Mac principally uses swaps and Treasury securities to effect its rebalancing actions. Interest rates on swaps and Treasury instruments are based on the LIBOR and Treasury indices, whereas Freddie Mac debt is based on the Agency curve. Agency/Treasury and Agency/Swap basis risk is the risk that changes in the interest-rate spread between different financial instruments and indices could result in a loss. For example, when Freddie Mac executes interest-rate swaps (generally based on LIBOR) to effectively lengthen the maturity of the portfolio, it is exposed to the risk of adverse changes in the relationship between the LIBOR curve and the Agency curve until the swap is replaced with agency debt. Freddie Mac monitors basis risk by measuring exposure levels on a daily basis and maintains internal operating limits on the amount of basis risk exposure.

Volatility: Volatility risk is the risk that changes in market expectations regarding the volatility of future interest rates could affect adversely the corporation's portfolio market value. The market's expectation about the future volatility of interest rates, known as implied volatility, is embedded in option prices. The volatility risk of the options embedded in Freddie Mac's mortgage investments is mitigated by the options purchased through callable debt or derivatives. However, the volatility risk in the mortgages is not fully offset because the volatility of mortgage investments and options is not exactly the same. Freddie Mac monitors volatility risk by measuring exposure levels on a daily basis and maintains internal operating limits on the amount of volatility risk exposure.

Liquidity: Liquidity risk is the risk that market liquidity is not sufficient to execute transactions needed to maintain its interest-rate risk management strategies. Freddie Mac is exposed to liquidity risk in its ability to enter into derivative instruments when needed at a reasonable price, and in its ability to issue short-term debt, typically Reference Bills and discount notes, when funding is needed. A lack of sufficient capacity or liquidity in the derivatives market could limit Freddie Mac's risk management activities, increasing its exposure to interest-rate risk. Limited liquidity or capacity in the derivatives market could make derivatives that Freddie Mac needs for risk management purposes either unavailable or prohibitively expensive. An increase in the costs Freddie Mac must incur to enter into risk management transactions could lower Freddie Mac's net interest income. In addition, if Freddie Mac is unable to enter into derivatives transactions at reasonable prices, its ability to rebalance its portfolio in response to changes in interest rates and to optimize its funding mix when it purchases mortgage assets could be impaired significantly. To manage these risks, Freddie Mac monitors market capacity and liquidity in the derivatives markets and debt markets on a daily basis, uses a variety of derivative instruments, and monitors cash flow needs on a daily basis (see "LIQUIDITY AND CAPITAL MANAGEMENT—*Liquidity*").

Foreign Currency: Freddie Mac is potentially exposed to the risk that fluctuations in currency-exchange rates (e.g., foreign currencies to the U.S. dollar) could affect adversely the corporation's portfolio market value or future earnings. Freddie Mac's exposure arises primarily because it issues debt denominated in currencies other than the U.S. dollar, the corporation's functional currency. In the case of Freddie Mac's EuroReference Note Programme, Freddie Mac is obligated to make periodic interest and principal payments in Euros. Freddie Mac mitigates the risk associated with fluctuations in currency-exchange rates by entering into swap transactions that effectively convert foreign-denominated obligations into U.S. dollar denominated obligations. The exchange rate risk is completely hedged when the debt's principal and the swap's notional amounts and the timing of the payments are identical. In some market conditions, Freddie Mac uses short-term currency hedges until permanent hedges are secured. Freddie Mac's exposure to foreign currency risk is minimal because only a small percentage of its debt is denominated in foreign currencies (less than 4.2 percent as of December 31, 2001) and because the currency-risk exposure arising from debt issuances is eliminated when hedges are established for the entire debt maturity. Foreign currency swaps expose Freddie Mac to institutional credit risk (see "RISK MANAGEMENT—*Credit Risk*—Institutional Credit Risk").

Operational Risks

Operational risk is the risk that financial loss, increased regulatory risk or damage to Freddie Mac's reputation could result from failed internal processes and/or systems, human factors and environmental events. These include accounting, operational, reporting, legal and human resource related processes. Operational risk is inherent in all business and support groups and processes are in place to manage these risks from a business-, department- and firm-wide perspective. In individual business areas, managers are responsible for managing the operating risks in their respective area. Firm-wide tools are available to accumulate and report issues across the organization.

Management mitigates the risk of process and system failures and significant business disruptions by implementing controls designed to provide assurance that system-generated data are reconciled to source documentation in a timely fashion, performing reasonableness and validity tests to ensure the accuracy of its financial information, and maintaining certain backup facilities. In addition, Freddie Mac maintains a continuity plan for critical business processes and systems in the event of disasters.

Management maintains an internal control framework designed to identify, measure, monitor and manage all significant operational risks on an ongoing basis. Freddie Mac continuously assesses its operational and financial reporting infrastructure to ensure it is adequate to handle emerging business and financial reporting developments. In 2001, complexities associated with the implementation of SFAS 133 gave rise to increased operating risk resulting from the processing requirements associated with hedge re-designations and the resulting income and expense amortization, as well as derivative and hedged item valuations and effectiveness assessments (see "CRITICAL ACCOUNTING POLICIES" for more information). In addition, the introduction of Freddie Mac's supplemental operating earnings measure in 2001 also created new accounting and processing requirements. The new processes associated with the implementation of SFAS 133 and the introduction of operating earnings, as well as enhancements to existing processes, involved changes to various automated systems and other internal control mechanisms to manage and control these risks.

Freddie Mac's use of business and financial models expose the corporation to the risk that they may produce incorrect results that are used by management to make inappropriate business decisions, adversely affecting the corporation's value. Freddie Mac mitigates operational risk related to this and other valuation models by benchmarking model results to market estimates of external parties. In the case of forecasting models, Freddie Mac mitigates operational risk by performing periodic comparisons of actual results to forecasted results and adjusting forecast models and assumptions accordingly. The corporation's use of external models also exposes the corporation to the risk that the models might become unavailable and that Freddie Mac would not be able to find suitable replacements in a timely fashion.

The corporation mitigates the risk of human error by adequately training employees, hiring experienced personnel, documenting and adhering to comprehensive policies and procedures as well as by regularly evaluating the effectiveness of its internal control structure. The corporation's Internal Audit Division regularly monitors Freddie Mac's compliance with established policies and procedures, and evaluates Freddie Mac's internal control structure.

LIQUIDITY AND CAPITAL MANAGEMENT

Liquidity

Freddie Mac's business activities present liquidity demands driven by maturities of debt, purchases of mortgages, payments of principal and interest to PC holders and general operations. The corporation's sources of cash to meet the needs of its business activities and general operations include issuances of long-term and short-term debt, issuances of common and preferred stock, cash flows from operating activities as well as repayments and sales of mortgage assets. Depending on market conditions and the mix of the corporation's derivatives due to on-going risk management strategies, Freddie Mac's derivatives portfolio can be either a net source or use of cash. Because of its financial performance and its regular and significant participation as an issuer in the funding markets, the corporation's sources of liquidity have remained adequate to meet its needs and management anticipates that they will continue to do so.

During 2001, Freddie Mac issued a total of $208 billion and $2.0 trillion in long-term and short-term debt, respectively, to support its business activities. A significant portion of debt issued in 2001 occurred through the corporation's primary debt financing programs: Reference Notes and Reference Bonds for longer-term financing and Reference Bills for shorter-term financing. These debt financing programs enable the corporation to sell large issues of long-term and short-term debt that provide investors with high-quality, liquid debt securities. During 2001, Freddie Mac issued $84 billion of non-callable U.S. dollar-denominated Reference Notes and Reference Bonds and $569 billion of short-term debt under the corporation's Reference Bill program. Additionally, under the corporation's EuroReference Note^{SM} Programme, the corporation issued €15 billion (equal to a total of $13.5 billion) in 2001 of EuroReference Notes^{SM}. The EuroReference Notes are traded on the Euro MTS (the Euro government trading system), which facilitates more transparent secondary market prices and narrower spreads between the price offered to purchase the Notes and the price offered to sell the Notes. Freddie Mac plans to issue Reference Notes, Reference Bonds and EuroReference Notes totaling over $100 billion in accordance with its previously announced financing calendar for 2002. The financing calendar will continue to provide clarity and transparency with regard to the timing of Internet auctions for new debt issues and reopening of prior issues, the anticipated size of individual offerings and settlement dates.

In response to declining interest rates, Freddie Mac called a significant amount, approximately $127 billion, of its long-term callable debt during 2001. In addition, Freddie Mac announced in April 2001 that it would repurchase periodically a portion of certain older issues of its Reference Notes and Reference Bonds. During 2001, Freddie Mac repurchased approximately $4 billion of its outstanding debt under this program. These periodic repurchases, which Freddie Mac expects to conduct at least once each quarter, will assist the corporation in pursuing its risk management strategies while continuing the predictability and liquidity of its Reference program.

During 2001, Freddie Mac completed six preferred stock offerings providing the corporation approximately $1.4 billion in net proceeds, and two Freddie SUBS^{SM} subordinated debt offerings providing approximately $3 billion in net proceeds.

As noted above, Freddie Mac has been able to maintain access to capital markets, even in highly volatile market environments, to secure the funding and the derivative financial instruments it needs to execute its business strategies. The liquidity crisis in the fourth quarter of 1998, which sharply reduced liquidity in major markets for corporate bonds and other securities, demonstrated that the ability of issuers to access those markets quickly and in large volumes cannot be assumed in corporate funding strategies. In addition to market-driven events, other factors relating to Freddie Mac (such as potential credit downgrades by one or more rating agencies, or legislative or regulatory developments perceived by the market as potentially adverse to GSEs) could impair its ability to access the capital markets for these purposes.

To protect itself against temporary dislocations or contractions in its ability to obtain funding for its business operations, Freddie Mac maintains a liquidity and contingency investment portfolio. The liquid assets held in this portfolio can be sold or financed to manage recurring cash flows and meet other cash management needs, maintain capital reserves to meet mortgage funding needs, provide diverse sources of liquidity and help manage the interest-rate risk inherent in mortgage-related assets. The liquidity and contingency investment portfolio also enables Freddie Mac to deploy fully its available capital. This portfolio is important to Freddie Mac's financial management and its ability to provide liquidity and stability to the mortgage market. At December 31, 2001 and 2000, the liquidity and contingency investment portfolio totaled $83 billion and $49 billion, respectively, and consisted principally of cash and cash equivalents, asset-backed securities, corporate debt securities, and other highly rated marketable assets that can be readily converted to cash.

See "VOLUNTARY COMMITMENTS—Liquidity Management and Contingency Planning" for more information.

Capital Management

Freddie Mac manages its capital resources to provide attractive returns on common equity, maintain sufficient capital to satisfy internal capital adequacy standards as well as regulatory capital requirements, absorb unforeseen losses that might arise in fulfilling its obligations and conduct its business programs.

Capital Transactions

Table 17 summarizes the components of Freddie Mac's Core, Total and Adjusted total capital. These measures exclude the AOCI component of "Stockholders' equity," consistent with the corporation's regulatory capital requirements.

TABLE 17 – SUMMARY OF CAPITAL MEASURES

December 31, *(dollars in millions)*	2001	2000	1999
Common stock:			
Par value	$ 152	$ 152	$ 152
Additional paid-in capital	532	429	474
Preferred stock (at redemption value)	4,596	3,195	3,195
Retained earnings	15,004	11,629	9,736
Treasury stock, at cost	(948)	(1,024)	(866)
Core capital	19,336	14,381	12,691
Reserve for mortgage losses	801	784	772
Total capital	20,137	15,165	13,463
Subordinated borrowings[1]	3,125	145	130
Adjusted total capital	$ 23,262	$ 15,310	$ 13,593

(1) Includes Freddie SUBS and the corporation's other outstanding series of subordinated debt.

During 2001, the corporation added approximately $8 billion to "Adjusted total capital" from retained earnings, six preferred stock issuances and two Freddie SUBS issuances, partially offset by payment of common and preferred stock dividends. The increase in Freddie Mac's core capital helped the corporation respond to growth opportunities during 2001.

The corporation did not redeem any preferred stock during 2001. At December 31, 2001, preferred stock with redemption values of $150 million, $200 million, $250 million and $287 million with dividend rates of 5.81 percent, 5.30 percent, a variable rate and 6.125 percent, respectively were redeemable. The corporation redeemed the $287 million of 6.125 percent preferred stock in February 2002 following the January 2002 issuance of 5.81 percent perpetual non-cumulative preferred stock with a redemption value of $300 million. The corporation's 6.14 percent preferred stock issue with a redemption value of $600 million will become redeemable on June 30, 2002. No other issue of Freddie Mac's preferred stock will become redeemable in 2002. Freddie Mac's capital structure may be influenced by the redemption and replacement of all or part of these preferred stock issuances, which could result in changes in the corporation's mix of common and preferred equity funding. Redemption of preferred stock in future periods will depend primarily on interest-rate levels.

AOCI consists of unrealized gains or losses, net of tax, related to certain derivatives and the corporation's AFS portfolio. In 2001, AOCI decreased $4.4 billion, although this decrease does not affect the corporation's adjusted total capital or core capital. The initial adoption of SFAS 133 resulted in a reduction to AOCI of approximately $2.5 billion as of January 1, 2001 due to SFAS 133's requirement to recognize the corporation's cash flow hedges on the balance sheet at fair value, which was partially offset by gains resulting from securities that were transferred from the held-to-maturity portfolio to the AFS portfolio. Declining benchmark swap rates in 2001 caused the fair value of certain derivatives (particularly pay-fixed interest-rate swaps) to decrease by approximately $3.3 billion, further reducing AOCI. These declines in AOCI were partially offset by a $1.4 billion increase in the net unrealized gain (loss) on AFS securities, driven by declining mortgage rates in 2001.

Freddie Mac actively manages capital to provide attractive returns on common equity, to satisfy obligations under its stock-based compensation plans (see Note 9 to the Consolidated Financial Statements) and to return capital to shareholders through common stock repurchases, when appropriate. The amount of capital actually available to repurchase common stock will be affected primarily by mortgage portfolio growth opportunities, Freddie Mac's assessment of the adequacy of its capital, as well as the implementation of regulatory risk-based capital standards. During 2001, Freddie Mac did not repurchase shares; during 2000, Freddie Mac returned $258 million to shareholders through common stock repurchases pursuant to the corporation's stock repurchase program.

Capital Adequacy

Freddie Mac regularly assesses the adequacy of its capital. Management believes that Freddie Mac should hold capital sufficient to satisfy its financial obligations, even if economic circumstances deteriorate unexpectedly and severely. Freddie Mac uses a stress test methodology to assess its capital adequacy.

The stress test methodology for assessing capital adequacy is a type of scenario analysis used by many firms to evaluate their financial strength under adverse business conditions. The focus of Freddie Mac's stress tests is on the risks embedded in the current book of business and current capital levels supporting this book of business; accordingly, these stress tests assume a "wind-down" in which no new business or capital is added to the firm. This assumption is exceedingly conservative because Freddie Mac has the ability to engage in new mortgage business activities, change its risk profile or raise capital as economic conditions change.

Interim Risk-Based Capital Stress Test

In October 2000, Freddie Mac committed to disclose whether the corporation passed an interim risk-based capital stress test that is consistent with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "GSE Act"). Freddie Mac intends to discontinue this interim disclosure when OFHEO begins to officially classify Freddie Mac's capital under the risk-based capital regulation (see "VOLUNTARY COMMITMENTS" for more information).

The interim risk-based capital stress test used by Freddie Mac is based on the comment letter, available at Freddie Mac's Web site, that Freddie Mac submitted in response to OFHEO's proposed risk-based capital rule (see "REGULATORY MATTERS—*Capital Standards*"). The interim stress test estimates the amount of capital Freddie Mac would need to satisfy its current obligations over a 10-year period of extreme economic conditions, assuming no new business or capital as required by the GSE Act.

Freddie Mac simulates its financial performance under these stressful economic conditions using mortgage behavioral models proposed by OFHEO, with adjustments to correct for data issues as discussed in the comment letter, to predict mortgage cash flows. Freddie Mac then uses an accounting model to translate the predicted mortgage cash flows, as well as simulated cash flows of liabilities and off-balance sheet obligations, into income statements and balance sheets for each of the 10 years of the stress period. The comment letter provides a more detailed discussion of the methodology underlying the interim risk-based capital stress test. The capital needed to satisfy the interim standard is equal to 130 percent of the amount necessary to satisfy all of Freddie Mac's financial obligations under each of the two stress test scenarios. The 30 percent additional capital beyond what is required to cover credit risk and interest-rate risk captured by the stress test is an additional cushion for management and operations risk.

The two stress test scenarios are defined by large changes in interest rates and house prices. These factors affect the performance of Freddie Mac's portfolio because they affect the level of mortgage defaults and prepayments as well as Freddie Mac's cost of funds. *Table 18* describes these two scenarios relative to a baseline in which interest rates do not change and house prices appreciate at an average annual rate of 3 percent. At December 31, 2001, Freddie Mac had sufficient capital to satisfy the interim risk-based capital standard under both stress test scenarios.

TABLE 18 – STRESS TEST ECONOMIC SCENARIOS

Economic Scenario	Interest-Rate Change[1]	House-Price Change[2]
Rising-rate environment	75%	(15%)
Falling-rate environment	(50%)	(28%)

(1) The change in the general level of interest rates as represented by the change in the 10-year Constant Maturity Treasury rate relative to recent historical levels as given by the GSE Act. The interest rate shock occurs in the first 12 months of the simulation, with rates remaining at their new levels for the rest of the stress period.

(2) The house-price change is the difference in the level of house prices at the end of the fifth year of the stress scenario relative to the baseline scenario. Since defaults occur with a lag relative to the house-price changes, house-price changes in the early years of the stress periods are most relevant for default behavior. The rising-rate environment includes an inflation adjustment relative to the falling-rate environment as stated in the comment letter.

VOLUME STATISTICS

Table 19 summarizes Freddie Mac's purchase and securitization activity for the years ended December 31, 2001, 2000 and 1999.

TABLE 19 – VOLUME STATISTICS

Year Ended December 31,	2001		2000		1999	
(dollars in millions)						
30-year fixed-rate	$ 330,963	70%	$ 152,492	73%	$ 195,974	72%
15-year fixed-rate	93,431	19%	20,935	10%	48,320	18%
ARMs/floating-rate	31,851	7%	26,848	13%	16,524	6%
Balloon/resets	8,575	2%	1,118	1%	4,473	1%
Total single-family	464,820	98%	201,393	97%	265,291	97%
Multifamily	10,271	2%	6,030	3%	7,181	3%
Total new business volume[1]	$ 475,091	100%	$ 207,423	100%	$ 272,472	100%
Credit risk distribution of purchases						
Freddie Mac at-risk[2]	$ 345,616	73%	$ 116,971	56%	$ 175,842	65%
Credit-enhanced or guaranteed[3]	$ 129,475	27%	$ 90,452	44%	$ 96,630	35%
Purchase market share[4]	41%		42%		43%	
Percentage of refinance mortgage purchases	62%		28%		50%	
Average LTV of purchases						
Refinance mortgages	70%		70%		70%	
Purchase money mortgages	80%		81%		81%	
Total purchases	74%		78%		75%	
Mortgage liquidations[5]	$ 298,718		$ 107,956		$ 143,508	
Mortgage liquidation rate[6]	31%		12%		20%	
Original-issue securities settlements						
Single-family PCs	$ 387,255		$ 165,115		$ 230,986	
Multifamily PCs	2,356		1,786		2,045	
Total	$ 389,611		$ 166,901		$ 233,031	
Structured securitizations[7]	$ 192,437		$ 48,202		$ 119,565	

(1) Includes mortgages exchanged for Freddie Mac PCs or purchased for cash, and non-Freddie Mac mortgage securities. Excludes market purchases of Freddie Mac PCs since purchases do not affect the unpaid principal balance of the total mortgage portfolio.

(2) Includes only those mortgages for which Freddie Mac has assumed primary default risk.

(3) Includes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default. Also includes securities guaranteed by agencies or subject to subordination agreements. In some cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

(4) Based on mortgage purchase and PC issuance activity relative to Fannie Mae.

(5) Includes mortgage-related securities held in the retained portfolio that have been sold.

(6) The liquidation rate reflects principal payments only and excludes mortgage-related securities held in the retained portfolio that have been sold.

(7) Includes issuances of mortgage-related securities in which the cash flows are structured into various classes having a variety of features, the majority of which qualify for treatment as Real Estate Mortgage Investment Conduits ("REMICs") under the Internal Revenue Code.

Freddie Mac's 2001 business volume was the highest in the corporation's history. Interest rates for fixed-rate mortgages reached 30-year lows in 2001, resulting in a surge of mortgage refinancing activity which included a particularly strong demand for fixed-rate mortgage products. As a result of these market trends, purchase volume more than doubled in 2001 compared to 2000. This exceptional purchase volume is unlikely to be repeated in 2002. Mortgage lenders tend to sell or securitize fixed-rate residential mortgages to the GSEs as opposed to ARM/floating-rate products, which tend to better match the cash flows of their liabilities. Fixed-rate mortgages represented 89 percent of Freddie Mac's purchases for 2001, up from 83 percent in 2000. Refinanced mortgages represented 62 percent of Freddie Mac's total 2001 purchases, up from 28 percent in 2000. The lower purchase volume in 2000 relative to 1999 reflected decreased mortgage refinancing activity as a result of a rising trend in mortgage interest rates during a significant portion of 2000. Fixed-rate mortgages represented 83 percent of Freddie Mac's purchases for 2000, down from 90 percent in 1999. Refinanced mortgages represented 28 percent of Freddie Mac's total 2000 purchases, down from 50 percent in 1999.

The liquidation rate on the total mortgage portfolio increased to 31 percent for 2001, compared to 12 percent and 20 percent for 2000 and 1999, respectively. The higher liquidation rate in 2001 compared to 2000 reflects accelerated borrower prepayments due to declining interest rates, as evidenced by the significant increase in the percentage of refinance mortgage purchases in 2001 compared to 2000. Conversely, a rising trend in mortgage interest rates in 2000 compared to 1999 resulted in slower borrower prepayments as evidenced by a decrease in the percent of refinanced business purchases in 2000.

The percentage of credit-enhanced purchases decreased to 27 percent for 2001 compared to 44 percent for 2000 and 35 percent for 1999, due primarily to a decline in the number of loans purchased that are covered by pool insurance.

The corporation's market share, as a percentage of the combined Freddie Mac and Fannie Mae purchases of both new mortgage originations and seasoned portfolios, was 41 percent, 42 percent and 43 percent for 2001, 2000 and 1999, respectively. Freddie Mac competes for mortgages primarily on the basis of the relative strength of its mortgage purchase programs, security products, customer service, ease of mortgage purchase processing and price.

A significant portion of Freddie Mac's mortgage purchase volume is generated from several key mortgage lenders that have entered into special business arrangements with Freddie Mac. These individually negotiated relationships characteristically involve a commitment by the lender to sell a high proportion of its conforming mortgage origination volume to Freddie Mac. The four most significant of these arrangements accounted for approximately 55 percent of Freddie Mac's conforming mortgage origination volume in 2001; the largest of the agreements is with Wells Fargo Home Mortgage, Inc. Freddie Mac is exposed to the risk that it will lose significant purchase volume that it may be unable to replace if, when the agreements terminate, one or more of these key lenders chooses to significantly reduce the volume of mortgages it sells to Freddie Mac.

Given the highly concentrated nature of Freddie Mac's mortgage purchase business, the loss of any one of its major lender customers would adversely affect its market share, revenues and/or technology adoption and usage. Freddie Mac believes that it would be able to recover the loss of revenues and market share that would accompany a significant decrease in or loss of business volume from one or more of its largest customers, through such means as strengthening its relationships with other major lenders and servicers and/or modifying its business strategies, but there can be no assurance as to whether or how quickly this recovery would occur.

Structured securitization volumes vary based on market conditions that affect demand by Freddie Mac and other investors for REMIC securities. Freddie Mac's structured securitization activity was a record $192 billion in 2001, compared to $48 billion and $120 billion in 2000 and 1999, respectively. The increase in structured securitization volume in 2001 compared to 2000 was affected by the steepening of the yield curve, which created strong investor demand for REMIC securities. The decrease in structured securitization volume in 2000 compared to 1999 reflected market conditions prevailing at that time.

AVERAGE BALANCE SHEETS AND RATE/VOLUME ANALYSIS

Table 20 reflects an analysis of reported revenue and presents daily weighted average balances and related yields earned on assets and rates paid on liabilities. When daily weighted average balance information is not available, a simple month-to-month average balance is calculated. *Table 20* also contains a rate/volume analysis that details the changes to "Total revenues." In addition, "Net interest income/yield (fully taxable equivalent basis)" is presented on this table. Taxable equivalent adjustments to interest income involve the conversion of tax-exempt sources of interest income to the equivalent amounts of interest income that would be necessary to derive the same net return if the investments had been subject to income taxes.

TABLE 20 – REPORTED REVENUE ANALYSIS AND RATE/VOLUME ANALYSIS

Year Ended December 31,		2001			2000			1999	
(dollars in millions)		Interest			Interest			Interest	
	Average	Income/	Average	Average	Income/	Average	Average	Income/	Average
	Balance	Expense	Rate	Balance	Expense	Rate	Balance	Expense	Rate
INTEREST-EARNING ASSETS:									
Mortgages	$ 60,484	$ 4,394	7.26%	$ 56,814	$ 4,187	7.37%	$ 54,577	$ 3,967	7.27%
GMS[1]	383,520	25,786	6.72%	290,498	19,805	6.82%	239,173	15,784	6.60%
Total retained portfolio	444,004	30,180	6.80%	347,312	23,992	6.91%	293,750	19,751	6.72%
Investments[2]	80,016	3,669	4.54%	69,193	4,389	6.27%	58,267	3,041	5.17%
Net benefit (cost) of derivatives		439			(31)			(39)	
Total interest-earning assets	$ 524,020	$ 34,288	6.54%	$ 416,505	$ 28,350	6.79%	$ 352,017	$ 22,753	6.46%
INTEREST-BEARING LIABILITIES:									
Short-term debt	$ 202,247	$ (8,805)	4.30%	$ 164,104	$ (10,314)	6.18%	$ 176,364	$ (9,072)	5.07%
Long-term debt	291,775	(17,485)	5.99%	232,038	(14,837)	6.40%	154,193	(9,582)	6.21%
Subordinated borrowings	2,213	(133)	6.04%	140	(14)	9.93%	147	(14)	9.36%
Total debt securities	496,235	(26,423)	5.30%	396,282	(25,165)	6.31%	330,704	(18,668)	5.61%
PC Variance:									
Due to prepayments[3]	13,570	(963)	7.10%	5,396	(374)	6.92%	9,299	(661)	7.11%
Due to ARM/floating rate adjustments[4]	—	(24)	—	—	22	—	—	(5)	—
Net cost of PC variance	13,570	(987)	7.28%	5,396	(352)	6.50%	9,299	(666)	7.16%
Net benefit (cost) of derivatives		(1,398)			5			(879)	
Total interest-bearing liabilities	509,805	(28,808)	5.63%	401,678	(25,512)	6.31%	340,003	(20,213)	5.91%
Net non-interest bearing funding	14,215	—	—	14,827	—	—	12,014	—	—
Total funding of interest-earning assets	$ 524,020	$ (28,808)	5.48%	$ 416,505	$ (25,512)	6.09%	$ 352,017	$(20,213)	5.71%
Net interest income/yield		$ 5,480	1.06%		$ 2,838	0.70%		$ 2,540	0.75%
Management and guarantee income	$ 876,630	$ 1,639	18.7 bp	$ 772,048	$ 1,489	19.3 bp	$ 710,009	$ 1,405	19.8 bp
Fair value gains (losses)		$ (27)			$ —			$ —	
Other income, net[5]		$ 273			$ 130			$ 110	
Total reported revenues		$ 7,365			$ 4,457			$ 4,055	
Net interest income/yield (fully taxable equivalent basis)		$ 5,709	1.10%		$ 3,057	0.75%		$ 2,721	0.80%

TABLE 20 – REPORTED REVENUE ANALYSIS AND RATE/VOLUME ANALYSIS CONTINUED

	2001 vs. 2000 Variance Due to				2000 vs. 1999 Variance Due to			
(dollars in millions)	Rate	Volume	Total Change	Total % Change	Rate	Volume	Total Change	Total % Change
INTEREST-EARNING ASSETS:								
Mortgages	$ (63)	$ 270	$ 207	5%	$ 57	$ 163	$ 220	6%
GMS	(363)	6,344	5,981	30%	634	3,387	4,021	25%
Total retained portfolio	(426)	6,614	6,188	26%	691	3,550	4,241	21%
Investments	(1,389)	669	(720)	(16%)	791	557	1,348	44%
Net benefit (cost) of derivatives	470		470		8		8	
Total interest-earning assets	$ (1,345)	$ 7,283	$ 5,938	21%	$ 1,490	$ 4,107	$ 5,597	25%
INTEREST-BEARING LIABILITIES:								
Short-term debt	$ 3,834	$ (2,325)	$ 1,509	15%	$ (1,855)	$ 613	$ (1,242)	(14%)
Long-term debt	1,189	(3,956)	(2,767)	(19%)	(413)	(4,842)	(5,255)	(55%)
Total debt securities	5,023	(6,281)	(1,258)	(5%)	(2,268)	(4,229)	(6,497)	(35%)
PC variance	(104)	(531)	(635)	(180%)	35	279	314	47%
Net benefit (cost) of derivatives	(1,403)		(1,403)		884		884	
Total interest-bearing liabilities	$ 3,516	$ (6,812)	$ (3,296)	(13%)	$ (1,349)	$ (3,950)	$ (5,299)	(26%)
Net interest income	$ 2,171	$ 471	$ 2,642	93%	$ 141	$ 157	$ 298	12%
Management and guarantee income	$ (52)	$ 202	$ 150	10%	$ (39)	$ 123	$ 84	6%
Fair value gains (losses)			$ (27)				$ —	
Other income, net			$ 143	110%			$ 20	18%
Total reported revenues			$ 2,908	65%			$ 402	10%

(1) Rates calculated on a fully taxable equivalent basis were 6.78%, 6.88% and 6.66% for the years ended December 31, 2001, 2000 and 1999, respectively, based on related income of $25,993 million, $19,995 million, and $15,930 million, respectively.

(2) Rates calculated on a fully taxable equivalent basis were 4.59%, 6.34% and 5.29% for the years ended December 31, 2001, 2000 and 1999, respectively, based on related income of $3,711 million, $4,436 million, and $3,110 million, respectively.

(3) Mortgage liquidations on which interest continues accruing to the security holder.

(4) Rate changes on ARMs/floating-rate mortgages for which the related security rate changes one month later.

(5) Includes recognized net gains on certain derivative transactions totaling $71 million and $22 million for the years ended December 31, 2000 and 1999, respectively.

OPERATING EARNINGS

On January 1, 2001, Freddie Mac implemented SFAS 133, which requires the corporation to recognize on the balance sheet all derivatives as either assets or liabilities measured at their fair value (see Note 1 to the Consolidated Financial Statements). Beginning with its first quarter 2001 reporting, Freddie Mac began providing a supplemental performance measure known as "operating earnings." Management believes that results presented on an operating basis, while not a defined term within GAAP nor comparable in many cases to supplemental performance measures used by other companies, are beneficial in understanding and analyzing Freddie Mac's financial performance because they better reflect the economic effect of Freddie Mac's risk management activities.

Freddie Mac's operating earnings, along with corresponding ratios, reflect adjustments for certain income statement effects of SFAS 133. These adjustments relate primarily to the timing of derivative income and expense recognition. *Table 21* and the discussion that follows address the differences between GAAP net income (i.e., reported net income) and operating earnings for 2001.

TABLE 21 – OPERATING EARNINGS RECONCILIATION

For the Year ended December 31,

(dollars in millions)

		Adjustments						
	Reported	A	B	C	D	E	Total	Operating
Net interest income on earning assets	$5,480	$ (519)	$ (1,029)				$(1,548)	$3,932
Management and guarantee income	1,639						—	1,639
Fair value gains (losses)	(27)			27			27	—
Other income, net	273						—	273
Total revenues	$7,365	$ (519)	$ (1,029)	$ 27	$ —	$ —	$(1,521)	$5,844
Total non-interest expense	(1,065)						—	(1,065)
Income taxes	(1,927)				533		533	(1,394)
Extraordinary (loss) gain on retirement of debt, net of taxes	(231)						—	(231)
Cumulative effect of change in accounting principle, net of taxes	5					(5)	(5)	—
Net income	$4,147	$ (519)	$ (1,029)	$ 27	$ 533	$ (5)	$ (993)	$3,154

A *Remove certain SFAS 133 hedged item amortization.*
B *Include straight-line option premium amortization.*
C *Remove SFAS 133 "Fair value gains (losses)."*
D *Apply federal income tax effect (35%) to adjustments necessary to derive "Operating earnings."*
E *Remove SFAS 133 "Cumulative effect of change in accounting principle, net taxes."*

As shown in *Table 21*, there are three primary adjustments to reported net income in deriving operating earnings. These adjustments are as follows:

- The removal of certain SFAS 133 hedged item amortization (Column A)
- The inclusion of straight-line option premium amortization (Column B)
- The removal of SFAS 133 "Fair value gains (losses)" (Column C)

In addition to these three adjustments, operating earnings reflects the Federal income tax effect on these items (Column D) and the exclusion of the one-time effect of adopting SFAS 133 on January 1, 2001 (Column E) (see Note 1 to the Consolidated Financial Statements for more information on the implementation effect of SFAS 133). In the following paragraphs, the primary adjustments to reported net income in deriving operating earnings (Columns A, B and C of *Table 21*) are more fully described.

As previously discussed, Freddie Mac's principal hedging strategies include the use of purchased options and interest-rate swaps. While these derivatives produce effective hedges, the required accounting treatment for these derivatives and their related hedged items is not always reflective of their economic substance or Freddie Mac's risk management activities. For instance, under SFAS 133, changes in hedged item fair values are reported as part of the hedged item's carrying value and amortized as a component of reported net interest income over the life of the hedged item. In the case of Freddie Mac's options, this amortization process results in the recognition of the cost of options in an uneven manner over the estimated life of the hedged mortgage securities (as opposed to evenly over the life of the option, as described below). In addition, in the case of Freddie Mac's interest-rate swaps, this amortization process results in the recognition in reported net interest income of hedged item fair value changes that will reverse themselves if the related derivative is held to its maturity. Accordingly, amortization of these hedged item fair value changes associated with options and outstanding interest-rate swaps is not included in Freddie Mac's operating earnings. As shown in Column A of *Table 21*, amortization of fair value net gains removed from GAAP net income in deriving operating earnings totaled $519 million in 2001.

From an economic perspective, Freddie Mac views the premium paid for an option as a fixed cost that should be recognized evenly over the life of the option. SFAS 133 requires mark-to-market of the option position and thus its cost is instead recognized over the estimated life of the hedged mortgage securities. Straight-line amortization better presents the cost of hedging with options—a cost that is known at the inception of the hedge and does not change over the life of the hedge. As shown in Column B of *Table 21*, 2001's reported net income is adjusted to include $1,029 million of straight-line option premium amortization expense in Freddie Mac's operating earnings.

Under SFAS 133, Freddie Mac is required to recognize in earnings any change in the fair value of a derivative that is not exactly offset by the change in fair value of the hedged item. Freddie Mac's reported net income will be more volatile because it is unlikely that changes in the market value of individual derivative contracts will perfectly match changes in hedged item values in all periods. Because these amounts are not realized until a derivative is terminated and will result in no income statement effect if these derivatives are held to their expiration, they are removed from reported net income in deriving Freddie Mac's operating earnings. As shown in Column C of *Table 21*, fair value net losses removed from 2001's reported income totaled $27 million.

As discussed above, the differences between Freddie Mac's GAAP net income and operating earnings relate to interim fair value changes and the time period over which certain derivative income and expense is recognized. These differences will reverse over time, resulting in cumulative GAAP net income and cumulative operating earnings that are equal.

TABLE 22 – OPERATING RESULTS OF OPERATIONS

			2001 vs. 2000	
Year Ended December 31,	2001	2000	Dollar Change	Percent Change
(dollars in millions, except per share amounts)				
Operating revenue[1]	$ 5,844	$ 4,457	$ 1,387	31%
Total non-interest expense	(1,065)	(923)	(142)	15%
Operating income before income taxes	4,779	3,534	1,245	35%
Operating income taxes	(1,394)	(995)	(399)	40%
Extraordinary gain (loss) on retirement of debt, net of taxes	(231)	8	(239)	
Operating earnings	$ 3,154	$ 2,547	$ 607	24%
Operating earnings per common share—diluted[2]	$ 4.21	$ 3.40	$ 0.81	24%
Operating net interest income on earning assets	$ 3,932	$ 2,838	$ 1,094	39%
Operating net interest income on earning assets (fully taxable equivalent basis)[3]	$ 4,161	$ 3,128	$ 1,033	33%
Operating average balance of interest earning assets	$ 525,494	$ 416,505	$ 108,989	26%
Operating net interest yield on earning assets (fully taxable equivalent basis)[3]	0.80%	0.77%		
Operating effective tax rate[4]	29.2%	28.2%		

[1] Increased derivative costs in 2001 are partially offset by increases in "Fair value gains (losses)," which will be reflected in operating earnings over time.
[2] After preferred stock dividends of $217 million and $180 million for the years ended 2001 and 2000, respectively.
[3] Income and yields for periods prior to 2001 include net gains on hedging activities reported in "Other income, net."
[4] Includes the tax effect of adjustments necessary to derive "Operating earnings."

CONSOLIDATED RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Notes to the Consolidated Financial Statements.

Table 23 summarizes Freddie Mac's financial performance, prepared in accordance with GAAP, for 2001 as compared to 2000, and 2000 as compared to 1999.

TABLE 23 – SUMMARY OF REPORTED RESULTS

	2001 vs. 2000				2000 vs. 1999		
Year Ended December 31,	2001	2000	Dollar Change	Percent Change	1999	Dollar Change	Percent Change
(dollars in millions, except share-related amounts)							
Net interest income on earning assets	$ 5,480	$ 2,838	$ 2,642	93%	$ 2,540	$ 298	12%
Management and guarantee income	1,639	1,489	150	10%	1,405	84	6%
Fair value (losses) gains	(27)	—	(27)	100%	—	—	—%
Other income, net[1]	273	130	143	110%	110	20	18%
Total revenues	$ 7,365	$ 4,457	$ 2,908	65%	$ 4,055	$ 402	10%
Credit-related expenses	$ (84)	$ (106)	$ 22	21%	$ (159)	$ 53	33%
Administrative expenses	(844)	(713)	(131)	18%	(655)	(58)	9%
Housing tax credit partnerships	(137)	(104)	(33)	32%	(80)	(24)	30%
Total non-interest expense	$ (1,065)	$ (923)	$ (142)	15%	$ (894)	$ (29)	3%
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle	$ 6,300	$ 3,534	$ 2,766	78%	$ 3,161	$ 373	12%
Income taxes	(1,927)	(995)	(932)	94%	(943)	(52)	6%
Income before extraordinary items and cumulative effect of change in accounting principle, net of taxes	$ 4,373	$ 2,539	$ 1,834	72%	$ 2,218	$ 321	14%
Extraordinary (loss) gain on retirement of debt, net of taxes	(231)	8	(239)		5	3	60%
Cumulative effect of change in accounting principle, net of taxes	5	—	5	100%	—	—	—%
Net income	$ 4,147	$ 2,547	$ 1,600	63%	$ 2,223	$ 324	15%
Earnings per common share[2]							
Basic	$ 5.66	$ 3.41	$ 2.25	66%	$ 2.97	$ 0.44	15%
Diluted	$ 5.64	$ 3.40	$ 2.24	66%	$ 2.96	$ 0.44	15%
Net interest income on earning assets (fully taxable equivalent basis)	$ 5,709	$ 3,057	$ 2,652	87%	$ 2,721	$ 336	12%
Net interest yield on earning assets (fully taxable equivalent basis)	1.10%	0.75%			0.80%		
Effective tax rate	30.6%	28.2%			29.8%		
Retained portfolio (in billions)	$ 491.7	$ 385.7	$ 106.0	27%	$ 324.4	$ 61.3	19%
Total mortgage portfolio (in billions)	$ 1,138.2	$ 961.8	$ 176.4	18%	$ 862.3	$ 99.5	12%

(1) Includes recognized net gains on derivatives activities totaling $71 million and $22 million for the years ended December 31, 2000 and 1999, respectively.
(2) After preferred stock dividends of $217 million, $180 million and $153 million for the years ended December 31, 2001, 2000 and 1999, respectively.

Net Interest Income on Earning Assets

Freddie Mac's "Net interest income on earning assets" grew significantly during 2001. The Federal Reserve reduced short-term rates 11 times during 2001, causing the yield curve to reach its steepest level since the early 1990s. The steep yield curve resulted in wider initial spreads on Freddie Mac's substantial retained portfolio purchases during the year and also improved the spread on the corporation's existing interest-earning assets. The benefit of higher spreads on portfolio assets more than offset the effect of higher net cost of derivatives in 2001.

For 2001, reported "Net interest income on earning assets" increased $2.642 billion, or 93 percent, from $2.838 billion in 2000 to $5.480 billion in 2001. Reported FTE net interest income increased $2.652 billion, or 87 percent, from $3.057 billion in 2000 to $5.709 billion in 2001. Growth in reported FTE net interest income reflects a $108 billion, or 26 percent, increase in the reported average balance of interest-earning assets from 2000 coupled with a 35 basis point increase in reported FTE net interest yield on earning assets (1.10 percent in 2001 versus 0.75 percent in 2000).

A significant factor affecting the year-over-year increase in reported FTE net interest yield on earning assets relates to the revised accounting for derivatives and hedging activities upon adoption of SFAS 133 in 2001. For example, prior to the implementation of SFAS 133, the upfront premium paid for an option-based derivative was amortized as a reduction in reported "Net interest income on earning assets" over the life of the option-based derivative. In 2001, however, derivatives included in fair value hedge relationships are marked-to-market though "Fair value gains (losses)" and hedged item basis adjustments are amortized to reported "Net interest income on earning assets." FTE net interest yield in 2001 increased due to a significant amount of hedged item amortization income and the absence of straight-line amortization expense related to option-based derivative premiums that had been reflected in 2000's FTE net interest yield (see Note 1 to the Consolidated Financial Statements for more information).

Reported FTE net interest income increased $336 million, or 12 percent, from $2.721 billion in 1999 to $3.057 billion in 2000. Growth in reported FTE net interest income reflects an increase of $64 billion, or 18 percent, in the reported average balance of interest-earning assets from 1999 partially offset by a 5 basis point decrease in reported FTE net interest yield on earning assets (0.75 percent in 2000 versus 0.80 percent in 1999). The 5 basis point decline in the reported FTE net interest yield from 1999 primarily reflects the net effect of funding and rebalancing actions taken by Freddie Mac to protect the corporation's portfolio market value as interest rates changed over the course of 2000.

Operating net interest income on earning assets increased $1.094 billion, or 39 percent, from $2.838 billion in 2000 to $3.932 billion in 2001. Operating FTE net interest income increased $1.033 billion, or 33 percent, from $3.128 billion in 2000, which includes net gains on certain derivative transactions, to $4.161 billion in 2001. Operating FTE net interest yield on earning assets was 0.80 percent for 2001 compared to 0.77 percent for 2000. Growth in operating FTE net interest income reflects a $109 billion, or 26 percent, increase in the operating average balance of interest-earning assets from 2000 (see "OPERATING EARNINGS").

Management and Guarantee Income

"Management and guarantee income" increased $150 million, or 10 percent, from $1.489 billion in 2000 to $1.639 billion in 2001. This increase was due to a $105 billion, or 14 percent, increase in the average balance of Total PCs, partially offset by a 0.6 basis point decrease in the average guarantee fee rate compared to 2000. "Management and guarantee income" increased $84 million, or 6 percent, from $1.405 billion in 1999 to $1.489 billion in 2000. This increase was due to a $62 billion, or 9 percent, increase in the average balance of Total PCs, partially offset by a 0.5 basis point decrease in the average guarantee fee rate compared to 1999.

The average guarantee fees in 2001, 2000 and 1999 were affected adversely by portfolio turnover, with fees on new PC issuances typically below the average fee of the Total PC portfolio, combined with liquidations of existing PC balances generally having comparatively higher fees than on new PC issuances. During the latter part of 2001, however, the guarantee fee rate on new business purchases increased modestly in conjunction with changes in customer mix. On a full-year basis, the lower average guarantee fees reflect a number of factors, including continued competitive pricing pressures and changes in Freddie Mac's exposure to other risk factors such as the mix of mortgages that underlie PCs. The impact of portfolio turnover was higher in 2001 compared to 2000 due to the increase in mortgage prepayments experienced during a lower interest-rate environment. Average guarantee fees are increasingly influenced by product mix, customer concentrations, the use of credit enhancements and the competitive environment (see "RISK MANAGEMENT—*Credit Risk*—Mortgage Credit Risk—Mortgage Credit Risk Management Strategies—*Credit Enhancements*").

Fair Value Gains (Losses)

Freddie Mac began recording "Fair value gains (losses)," or hedge ineffectiveness, on its Consolidated Statements of Income in conjunction with the application of SFAS 133 in 2001. Hedge ineffectiveness arises when the fair value change of a derivative does not exactly offset the fair value change of the hedged risk and was a $27 million loss in 2001. Freddie Mac manages its asset and liability position to provide long-term returns that are relatively insensitive to changes in interest rates. Even in situations where hedges are highly effective for economic purposes, accounting hedge ineffectiveness may vary significantly from period to period.

Other Income, Net

The primary components of "Other income, net," which fluctuates from period to period, include fees earned from resecuritization activity (fees paid by underwriters for Freddie Mac's issuance and management of structured securitizations, including REMICs), gains and losses on asset sales, SS&TG's trading activities, changes in the fair value of derivatives that do not qualify for hedge accounting treatment and other revenues, such as fees earned for automated underwriting (Loan Prospector) and electronic network (GoldWorks®) services.

"Other income, net" for 2001 was $273 million, an increase of $143 million compared to 2000. This increase primarily reflects a $115 million increase in resecuritization fees, which fluctuate with investor demand for REMIC securities, gains on a higher volume of asset sales and SS&TG's trading activities.

"Other income, net" increased $20 million from 1999 to 2000 primarily due to a $49 million increase in gains from certain hedging transactions, partially offset by a $34 million decrease in resecuritization fees.

Credit-Related Expenses

Credit-related expenses (which consist of the "Provision for mortgage losses" and "REO operations expense") decreased $22 million, or 21 percent, to $84 million in 2001 from $106 million in 2000. From 1999 to 2000, credit-related expenses decreased $53 million, or 33 percent, from $159 million in 1999. These decreases were primarily due to declines in single-family "REO operations expense." Freddie Mac's loss mitigation activities, continued strong house-price appreciation and the on-going use of credit enhancements on mortgage investments had a favorable impact on credit expenses. The "Provision for mortgage losses" of $45 million in 2001 represented an increase from $40 million in 2000 and a decrease from $60 million in 1999. Although the overall mortgage portfolio has increased, the reserve as a percentage of the total portfolio has declined due to the favorable trends in at-risk delinquencies and house-price appreciation.

Administrative Expenses

"Administrative expenses" increased $131 million, or 18 percent, from $713 million in 2000 to $844 million in 2001, and increased $58 million, or 9 percent, from 1999 to 2000. The increase for all years presented was due to investments to streamline the mortgage process and to enhance Freddie Mac's technology and related infrastructure, among other factors. "Administrative expenses" as a percentage of the average total mortgage portfolio increased to 8.1 basis points in 2001 from 8.0 basis points in 2000 and were unchanged from 8.1 basis points in 1999.

Housing Tax Credit Partnerships

The costs associated with Freddie Mac's investment in "Housing tax credit partnerships" totaled $137 million in 2001, a $33 million and $57 million increase from 2000 and 1999, respectively. "Housing tax credit partnerships" develop or rehabilitate low-income multifamily rental properties. While these investments create losses, they also generate tax credits that reduce the corporation's federal income tax expense and liability.

Income Taxes

In 2001, the operating provision for income taxes increased $399 million, or 40 percent, from $995 million in 2000 to $1,394 million in 2001. The operating effective income tax rate for 2001 was 29.2 percent, up from 28.2 percent in 2000, primarily due to income growth outpacing the growth in certain tax credits and adjustments.

Reported "Provision for income taxes," increased $932 million, or 94 percent, from $995 million in 2000 to $1,927 million in 2001. The reported effective income tax rate for 2001 was 30.6 percent, up from 28.2 percent in 2000 primarily due to income growth outpacing the growth in certain tax credits and adjustments. Reported "Provision for income taxes," increased $52 million, or 6 percent, during 2000 from $943 million in 1999. The reported effective income tax rate of 28.2 percent in 2000 decreased from 29.8 percent in 1999.

Reported "Provision for income taxes" and operating provision for income taxes as well as effective income tax rates exclude the tax effects related to the cumulative effect of change in accounting principle and extraordinary gain (loss) on retirement of debt.

Extraordinary Gain (Loss) on Retirement of Debt, Net of Taxes

Freddie Mac repurchases high-cost debt prior to scheduled maturity, depending on market conditions and portfolio objectives. Freddie Mac incurred a $231 million after-tax loss on the retirement of $4.7 billion par value of debt during 2001. During 2000, Freddie Mac incurred an $8 million after-tax gain on the retirement of $0.4 billion of par debt. In 1999, Freddie Mac incurred a $5 million after-tax gain on the retirement of $0.8 billion par value of debt.

Cumulative Effect of Change in Accounting Principle, Net of Taxes

On January 1, 2001, Freddie Mac implemented SFAS 133, which required the corporation to recognize on balance sheet all derivatives as either assets or liabilities measured at their fair value. The one-time, net cumulative after-tax adjustments required by SFAS 133 resulted in an increase to first quarter 2001 reported "Net income" of $5 million. The increase to reported "Net income" primarily resulted from gains recognized in measuring certain derivatives at fair value, substantially offset by losses resulting from transferring securities from the held-to-maturity portfolio.

REGULATORY MATTERS

Capital Standards

In addition to its internal assessment of capital adequacy (see "LIQUIDITY AND CAPITAL MANAGEMENT—*Capital Adequacy*"), Freddie Mac ensures that capital is sufficient to comply with regulatory capital standards under the GSE Act. Freddie Mac and Fannie Mae are subject to certain minimum, critical and risk-based capital standards issued by OFHEO.

On September 13, 2001, OFHEO published its risk-based capital rule in the Federal Register. On December 11, 2001, OFHEO published proposed amendments to the risk-based capital rule that would affect capital charges for counterparty risk and certain other aspects of the rule. Freddie Mac and other parties submitted comments on the proposed amendments. The amendments to the risk-based capital rule were published on OFHEO's Web site on February 20, 2002.

OFHEO's release publishing the final risk-based capital rule on September 13, 2001 stated that the publication triggered a one-year implementation period after which the risk-based capital standard may be incorporated into OFHEO's classification of the capital adequacy of Freddie Mac and Fannie Mae. Prior to the end of the implementation period, Freddie Mac and Fannie Mae are to be classified as adequately capitalized, the highest capital classification, so long as they meet the minimum capital standard. Freddie Mac expects that when the risk-based capital rule becomes operative at the end of the one-year implementation period, Freddie Mac will continue to be classified as adequately capitalized, as it has since OFHEO began classifying Freddie Mac in 1993.

After the risk-based capital rule has been in effect for one year, if Freddie Mac does not meet the risk-based capital standard (but meets the minimum capital standard), the corporation would be required to submit and obtain OFHEO's approval of a capital restoration plan and would be subject to restrictions on certain dividend payments and other capital distributions. If Freddie Mac does not meet the minimum capital standard, the corporation would be required to submit and obtain OFHEO's approval of a capital restoration plan; it also would have to obtain OFHEO's approval of certain dividend payments and other capital distributions. Additionally, OFHEO would be authorized to limit Freddie Mac's growth, require it to obtain additional capital or restrict it from undertaking activities that present excessive risk.

The critical capital standard determines whether Freddie Mac is critically undercapitalized. If Freddie Mac does not meet the critical capital standard, OFHEO would be required to perform supervisory actions, in most cases including appointing a conservator.

At December 31, 2001, Freddie Mac's estimated minimum capital requirement, as reported to OFHEO, was $18.5 billion, compared to $14.2 billion at December 31, 2000. Capital surplus, the excess of Freddie Mac's core capital over the minimum capital requirement, was estimated at $821 million at December 31, 2001, compared to $202 million at December 31, 2000. At December 31, 2001, Freddie Mac's estimated critical capital requirement, as reported to OFHEO, was $9.4 billion, compared to $7.2 billion at December 31, 2000. Critical capital surplus, the excess of Freddie Mac's core capital over the critical capital requirement, was estimated at $9.9 billion at December 31, 2001, compared to $7.1 billion at December 31, 2000. OFHEO classified Freddie Mac as adequately capitalized in each quarter of 2001. See Note 9 to the Consolidated Financial Statements for further information on the corporation's capital standards.

Housing Goals

The GSE Act requires the Secretary of the Department of Housing and Urban Development to establish three mortgage purchase goals for Freddie Mac and Fannie Mae: (i) a goal for the purchase of mortgages on housing for low- and moderate-income borrowers (the "Low- and Moderate-Income Goal"); (ii) a goal for the purchase of mortgages on housing located in central cities, rural areas and other underserved areas (the "Underserved Areas Goal"); and (iii) a special affordable housing goal for the purchase of mortgages on housing for low-income borrowers in low-income areas and for very low-income borrowers, including purchases of multifamily mortgages (the "Special Affordable Goal").

In October 2000, the Secretary issued final regulations establishing new affordable mortgage purchase goals for Freddie Mac and Fannie Mae for calendar years 2001 through 2003, which increased the affordable mortgage purchase goals in place relative to calendar years 1997 through 2000. The final rule increased the Low- and Moderate-Income Goal from the previous 42 percent to 50 percent; increased the Underserved Areas Goal from the previous 24 percent to 31 percent; and increased the Special Affordable Goal from the previous 14 percent to 20 percent, including an increase in the target for qualifying multifamily mortgage purchases from the previous $0.99 billion to $2.11 billion.

Freddie Mac met each of these goals in 2001 and 2000 as shown in *Table 24* below.

TABLE 24 – HOUSING GOALS

Year Ended December 31,	2001		2000	
	Goal	Result	Goal	Result
(dollars in billions)				
Low- and Moderate-Income Goal	50%	53%	42%	50%
Underserved Areas Goal	31%	32%	24%	29%
Special Affordable Goal	20%	23%	14%	21%
Qualifying Multifamily	$ 2.11	$ 4.72	$ 0.99	$ 2.40

Management views the purchase of mortgages benefiting low- and moderate-income families and neighborhoods as an integral part of Freddie Mac's mission and business, and remains committed to fulfilling the needs of underserved borrowers and markets. Accordingly, Freddie Mac expects that it will continue to purchase the majority of the single-family and multifamily mortgages counted toward its performance under the housing goals through its standard purchase programs, in conformity with its customary mortgage underwriting standards.

TAX MATTERS

In February 1997, Freddie Mac formed two real estate investment trust ("REIT") subsidiaries that issued a total of $4 billion in step-down preferred stock to investors. Under IRS regulations, which were in effect when the REITs were formed, dividend payments to holders of the REITs' step-down preferred stock are tax deductible. In 1997, subsequent to the formation of Freddie Mac's REIT subsidiaries, the Department of the Treasury announced its intention to propose regulations that would effectively eliminate the tax advantages of REITs that issue step-down preferred stock. On January 7, 2000, the Treasury issued final regulations. These regulations deny certain tax benefits attributable to Freddie Mac's REIT preferred stock for tax years ending on or after February 27, 1997. Accordingly, Freddie Mac has elected not to treat such dividends as fully tax deductible in its Consolidated Financial Statements. This treatment is subject to change once uncertainties related to the tax treatment of such dividends are adequately clarified. The preferred stock is redeemable by the REITs under certain circumstances where changes in applicable tax law could adversely affect the tax treatment of the REITs or preferred stock.

VOLUNTARY COMMITMENTS

The following provides updated information on the six Voluntary Commitments made by Freddie Mac in October 2000. Additional information about Freddie Mac's Voluntary Commitments is available on its Web site (www.freddiemac.com).

Description

2001 Results

1. Periodic Issuance of Subordinated Debt: Freddie Mac will issue publicly traded and externally rated subordinated debt ("Freddie SUBS$^{\text{SM}}$") on a semi-annual basis. Freddie SUBS will be issued in an amount such that the ratio of "Voluntary Commitments' total capital" to on-balance sheet assets will equal or exceed 4 percent by October 2003. Voluntary Commitments' total capital is defined as the sum of core capital, loan loss reserves and Freddie SUBS outstanding, reduced by 0.45 percent of off-balance sheet mortgage securities.

During 2001, Freddie Mac completed two Freddie SUBS issuances with par values totaling $3 billion. The ratio of Voluntary Commitments' total capital to total assets was 3.3 percent at December 31, 2001.

2. Liquidity Management and Contingency Planning: Freddie Mac will comply with principles of sound liquidity management set forth by the Basel Committee on Banking Supervision, will maintain more than three months' worth of liquidity (based on internal forecasts) assuming it has no access to public debt markets and will maintain at least 5 percent of total assets in liquid, marketable, non-mortgage securities.

Freddie Mac has met this commitment for each quarter since inception of the Voluntary Commitments up to and including fourth quarter 2001.

3. Interim Implementation of Risk-Based Capital Stress Test: Freddie Mac will implement an interim risk-based capital stress test and disclose the results on a quarterly basis, pending final promulgation of a risk-based capital standard by OFHEO. Specifically, the corporation will disclose whether it has sufficient capital to withstand 10 years of extremely adverse interest-rate and credit conditions.

Freddie Mac has had sufficient capital to withstand 10 years of extremely adverse interest-rate and credit conditions for each quarter since inception of the Voluntary Commitments up to and including fourth quarter 2001.

4. New Interest-Rate Risk Disclosures: Freddie Mac will initiate public disclosure of interest-rate risk sensitivity results on a monthly basis. Specifically, the Portfolio Market Value Sensitivity to Changes in the Level of Interest Rate ("PMVS-L") shows the expected impact on Freddie Mac's portfolio market value from an immediate, adverse 50 basis point ("bp") parallel shift in the Treasury yield curve. The Portfolio Market Value Sensitivity to Changes in the Slope of the Yield Curve ("PMVS-YC") shows the same impact from an immediate, adverse 25 bp change in the slope of the Treasury yield curve.

Monthly results are reported on Freddie Mac's Web site. Freddie Mac's quarterly average interest-rate risk sensitivity results for 2001 are as follows:

Quarter ended	PMVS-L (50bp)	PMVS-YC (25bp)
December 31, 2001	3.24%	0.58%
September 30, 2001	2.74%	0.24%
June 30, 2001	3.12%	0.65%
March 31, 2001	3.42%	1.03%

5. New Credit Risk Disclosures: Freddie Mac will initiate public disclosure of credit risk sensitivity results on a quarterly basis. These disclosures show the present value of the estimated increase in credit losses to Freddie Mac over a 10-year period assuming an immediate 5 percent decline in house prices.

Freddie Mac's quarterly credit risk sensitivity results for 2001 are as follows:

(dollars in millions)	Before Receipt of Primary Mortgage Insurance and Credit Enhancements	After Receipt of Primary Mortgage Insurance and Credit Enhancements
As of		
December 31, 2001	$940	$301
September 30, 2001	$859	$289
June 30, 2001	$948	$362
March 31, 2001	$884	$312

6. Public Disclosure of Annual Rating: Freddie Mac will obtain an annual credit rating from a nationally recognized statistical rating organization and disclose this rating to the public.

Freddie Mac has a "risk-to-the-government" credit rating of "AA-" from S&P. This rating will be maintained by S&P on a "surveillance" basis, which means that S&P will be obligated to notify the public if the rating is ever affected by a change in Freddie Mac's financial condition.

Consolidated Financial Statements

FREDDIE MAC CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31,	2001	2000	1999
(dollars in millions, except share-related amounts)			
Interest income			
Mortgages	$ 4,394	$ 4,187	$ 3,967
Guaranteed mortgage securities	25,786	19,805	15,784
Investments and securities purchased under agreements to resell	3,669	4,389	3,041
Net benefit (cost) of derivatives	439	(31)	(39)
Total interest income	34,288	28,350	22,753
Interest expense on debt securities			
Short-term debt	(8,805)	(10,314)	(9,072)
Long-term debt	(17,618)	(14,851)	(9,596)
Total interest expense on debt securities	(26,423)	(25,165)	(18,668)
Interest expense due to security program cycles	(987)	(352)	(666)
Net (cost) benefit of derivatives	(1,398)	5	(879)
Total interest expense	(28,808)	(25,512)	(20,213)
Net interest income on earning assets	5,480	2,838	2,540
Management and guarantee income	1,639	1,489	1,405
Fair value gains (losses)	(27)	—	—
Other income, net	273	130	110
Total revenues	7,365	4,457	4,055
Provision for mortgage losses	(45)	(40)	(60)
REO operations expense	(39)	(66)	(99)
Administrative expenses	(844)	(713)	(655)
Housing tax credit partnerships	(137)	(104)	(80)
Total non-interest expense	(1,065)	(923)	(894)
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle	6,300	3,534	3,161
Provision for income taxes	(1,927)	(995)	(943)
Income before extraordinary items and cumulative effect of change in accounting principle, net of taxes	4,373	2,539	2,218
Extraordinary (loss) gain on retirement of debt, net of taxes	(231)	8	5
Cumulative effect of change in accounting principle, net of taxes	5	—	—
Net income	$ 4,147	$ 2,547	$ 2,223
Preferred stock dividends	(217)	(180)	(153)
Net income available to common stockholders	$ 3,930	$ 2,367	$ 2,070
Basic earnings per common share before extraordinary items and cumulative effect of change in accounting principle	$ 5.98	$ 3.40	$ 2.97
Extraordinary (loss) gain on retirement of debt, net of taxes	(0.33)	0.01	—
Cumulative effect of change in accounting principle, net of taxes	0.01	—	—
Basic earnings per common share after extraordinary items and cumulative effect of change in accounting principle	$ 5.66	$ 3.41	$ 2.97
Diluted earnings per common share before extraordinary items and cumulative effect of change in accounting principle	$ 5.96	$ 3.39	$ 2.95
Extraordinary (loss) gain on retirement of debt, net of taxes	(0.33)	0.01	0.01
Cumulative effect of change in accounting principle, net of taxes	0.01	—	—
Diluted earnings per common share after extraordinary items and cumulative effect of change in accounting principle	$ 5.64	$ 3.40	$ 2.96
Weighted average common shares outstanding (in thousands)			
Basic	694,096	693,555	696,042
Diluted	696,876	696,448	700,211

See accompanying Notes to Consolidated Financial Statements.

FREDDIE MAC CONSOLIDATED BALANCE SHEETS

December 31,	2001	2000
(dollars in millions, except share-related amounts)		
ASSETS		
Retained portfolio		
Mortgages	$ 62,792	$ 59,240
Reserve for losses on retained mortgages	(326)	(334)
Mortgages, net	62,466	58,906
Guaranteed mortgage securities (GMS)	428,927	326,453
Premiums, discounts and deferred fees	(56)	(843)
Net unrealized gain on available-for-sale securities	2,922	601
Retained portfolio, net	494,259	385,117
Cash and cash equivalents	1,508	366
Investments	75,894	40,718
Securities purchased under agreements to resell	5,531	7,488
Accounts and trading receivables	33,073	21,102
Real estate owned (REO), net	442	348
Derivative assets, at fair value	1,598	—
Other assets	5,035	4,158
Total assets	$ 617,340	$ 459,297
LIABILITIES AND STOCKHOLDERS' EQUITY		
Debt securities, net		
Due within one year	$ 250,338	$ 183,576
Due after one year	311,608	243,178
Total debt securities, net	561,946	426,754
Principal and interest due to Mortgage Participation Certificate (PC) investors	25,628	7,495
Derivative liabilities, at fair value	2,482	—
Other liabilities	8,311	9,616
	598,367	443,865
Reserve for losses on Mortgage Participation Certificates	475	450
Guarantees		
Total Mortgage Participation Certificates (Total PCs)	948,409	822,310
Less underlying mortgages	(948,409)	(822,310)
Total guarantees, net	—	—
Subordinated borrowings	3,125	145
Stockholders' equity		
Preferred stock, at redemption value	4,596	3,195
Common stock, $0.21 par value, 726,000,000 shares authorized, 725,882,280 shares issued	152	152
Additional paid-in capital	532	429
Retained earnings	15,004	11,629
Accumulated other comprehensive income (loss), net of taxes	(3,963)	456
Treasury stock, at cost, 30,578,510 and 33,298,078 shares, respectively	(948)	(1,024)
Total stockholders' equity	15,373	14,837
Total liabilities and stockholders' equity	$ 617,340	$ 459,297

See accompanying Notes to Consolidated Financial Statements.

FREDDIE MAC CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31, *(dollars in millions)*	2001	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 4,147	$ 2,547	$ 2,223
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Cumulative effect of change in accounting principle (pre-tax)	(8)	—	—
Fair value gains (losses)	27	—	—
Amortization of mortgage premiums, discounts and deferred fees	(95)	(74)	106
Amortization of discounts on short-term debt	8,144	10,423	8,847
Amortization of discounts on long-term debt	284	791	354
Extraordinary loss (gain) on debt retirement (pre-tax)	355	(13)	(8)
Provision for mortgage losses	45	40	60
Provision for REO disposition losses	62	54	66
Amortization of deferred compensation	24	18	8
(Gain) loss on sale of investments	(108)	40	28
(Decrease) increase in deferred income taxes	(606)	33	344
Net change in other receivables and payables	5,503	768	(13,499)
Net cash provided by (used in) operating activities	17,774	14,627	(1,471)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of mortgages and mortgage investments	(269,089)	(104,497)	(128,009)
Repayments and sales of mortgage investments	160,864	42,382	57,533
Proceeds from sales of REO	754	889	1,111
Net (increase) decrease in investments	(34,780)	(8,688)	12,743
Net decrease (increase) in securities purchased under agreements to resell	1,957	(2,527)	(3,205)
Derivative premiums, net	(1,716)	—	—
Net cash used in investing activities	(142,010)	(72,441)	(59,827)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of short-term debt	2,047,352	2,243,103	1,677,833
Repayments of short-term debt	(1,977,967)	(2,269,037)	(1,703,733)
Proceeds from issuance of long-term debt	207,569	93,275	113,600
Repayments of long-term debt	(152,236)	(13,430)	(23,568)
Proceeds from issuance of preferred stock	1,389	—	681
Redemption of preferred stock	—	—	(300)
Proceeds from issuance of common stock	43	37	26
Repurchases of common stock	—	(258)	(92)
Payment of cash dividends on preferred and common stock	(772)	(654)	(570)
Net cash provided by financing activities	125,378	53,036	63,877
Net increase (decrease) in cash and cash equivalents	1,142	(4,778)	2,579
Cash and cash equivalents at beginning of period	366	5,144	2,565
Cash and cash equivalents at end of period	$ 1,508	$ 366	$ 5,144
SUPPLEMENTAL CASH FLOW INFORMATION			
Cash paid for:			
Interest	$ 28,505	$ 22,693	$ 19,193
Income taxes	957	977	1,249
Non-cash financing activities:			
Transfers to REO	910	853	1,041

See accompanying Notes to Consolidated Financial Statements.

FREDDIE MAC CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Year Ended December 31, 2001, 2000, and 1999

(dollars in millions)	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Taxes	Treasury Stock, at Cost	Total Stockholders' Equity
Balance, December 31, 1998	$ 2,807	$ 152	$ 494	$ 8,083	$ 120	$ (821)	$ 10,835
Net income				2,223			2,223
Change in net unrealized (loss) gain on certain investments reported at fair value					(1,286)		(1,286)
Comprehensive income (loss)							937
Cash dividends declared:							
Preferred stock				(153)			(153)
Common stock				(417)			(417)
Common stock issuance			(7)			47	40
Common stock repurchase						(92)	(92)
Preferred stock issuance	688		(7)				681
Preferred stock redemption	(300)						(300)
Unearned deferred compensation, net			(6)				(6)
Balance, December 31, 1999	$ 3,195	$ 152	$ 474	$ 9,736	$ (1,166)	$ (866)	$ 11,525
Net income				2,547			2,547
Change in net unrealized gain (loss) on certain investments reported at fair value					1,622		1,622
Comprehensive income (loss)							4,169
Cash dividends declared:							
Preferred stock				(180)			(180)
Common stock				(474)			(474)
Common stock issuance			(17)			100	83
Common stock repurchase						(258)	(258)
Unearned deferred compensation, net			(28)				(28)
Balance, December 31, 2000	$ 3,195	$ 152	$ 429	$ 11,629	$ 456	$ (1,024)	$ 14,837
Net income				4,147			4,147
Cumulative effect of change in accounting principle					(2,450)		(2,450)
Change in:							
Net unrealized (loss) gain on certain derivative instruments					(3,340)		(3,340)
Net unrealized gain (loss) on certain investments reported at fair value					1,371		1,371
Comprehensive income (loss)							(272)
Cash dividends declared:							
Preferred stock				(217)			(217)
Common stock				(555)			(555)
Common stock issuance			(7)			76	69
Preferred stock issuance	1,401		(12)				1,389
Unearned deferred compensation, net			(1)				(1)
Income tax benefit from employee stock option exercises			123				123
Balance, December 31, 2001	$ 4,596	$ 152	$ 532	$ 15,004	$ (3,963)	$ (948)	$ 15,373

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Freddie Mac (the "corporation") is a stockholder-owned, government-sponsored enterprise ("GSE") established by Congress in 1970 to provide a continuous flow of funds for residential mortgages. Freddie Mac's obligations are not insured or guaranteed by the United States ("U.S.") or any agency or instrumentality of the U.S. other than Freddie Mac.

Freddie Mac issues guaranteed mortgage passthrough securities (referred to as "Mortgage Participation Certificates" or "PCs"). By guaranteeing payment on its PCs, Freddie Mac assumes mortgage credit risk on the mortgages underlying the PCs, which are owned by PC investors. The portfolio of mortgages underlying PCs is an off-balance sheet contingency (referred to as "Total Mortgage Participation Certificates" or "Total PCs"). As compensation for assuming credit risk and administering principal and interest payments, Freddie Mac receives fee income that is recognized as "Management and guarantee income." Guarantee fees are earned over the lives of the mortgages underlying the PCs.

The corporation's retained portfolio consists of "Guaranteed mortgage securities" ("GMS") as well as unsecuritized mortgages. GMS primarily consists of PCs and non-Freddie Mac mortgage securities, which include agency and non-agency securities. Freddie Mac's investment portfolio primarily consists of non-mortgage securities. The corporation recognizes "Net interest income on earning assets" on both portfolios, which is the interest income earned on these investments less the interest expense from the interest-bearing liabilities funding them, adjusted for the "Net benefit (cost) of derivatives."

Freddie Mac's financial reporting and accounting policies conform to generally accepted accounting principles in the U.S. ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to the current year presentation. The following is a summary of the corporation's significant accounting policies.

Consolidation

The Consolidated Financial Statements include the accounts of the corporation and its four subsidiaries. All material intercompany transactions have been eliminated in consolidation. Freddie Mac has no unconsolidated subsidiaries.

The Consolidated Financial Statements include the accounts of its two majority-owned real estate investment trust ("REIT") subsidiaries: Home Ownership Funding Corporation and Home Ownership Funding Corporation II. In 1997, Home Ownership Funding Corporation and Home Ownership Funding Corporation II issued a total of $4 billion in step-down preferred stock to investors to finance the purchase of mortgage-related investments. The investors' preferred stock ownership interest in the REIT subsidiaries is reported in "Debt securities, net," and the related dividends paid by the REIT subsidiaries are reported in interest expense on long-term debt.

The Consolidated Financial Statements also include the accounts of its two other subsidiaries: the majority-owned subsidiary West*Mac Associates Limited Partnership ("West*Mac"), which is the owner and developer of Freddie Mac's corporate headquarters, as well as the wholly-owned subsidiary Ignition Mortgage Technology Solutions, Inc.

Mortgages and Guaranteed Mortgage Securities

Mortgages and certain GMS held in the retained portfolio are classified as held-for-investment and held-to-maturity, respectively. These investments are reported at their amortized cost when the corporation has the intent and ability to hold them to maturity. Other GMS are classified as available-for-sale and are reported at fair value, with unrealized gains and losses reported in the "Accumulated other comprehensive income, net of taxes" ("AOCI") component of "Stockholders' equity." The final component of the retained portfolio is classified as trading and is reported at fair value with unrealized gains and losses recognized as a component of "Other Income, net." Freddie Mac recognized $48 million of net unrealized gains related to trading securities held at December 31, 2001. No GMS securities were classified as trading at December 31, 2000 and December 31, 1999.

Interest income on mortgages is recognized on an accrual basis unless the collection of interest income is considered doubtful. For single-family mortgages, estimates of uncollectible interest are based on statistical models. For multifamily mortgages, interest income is recognized on a cash basis when a mortgage is 90 days or more delinquent.

PCs owned by Freddie Mac are included on the Consolidated Balance Sheets in the retained portfolio as GMS and are also included in Total PCs. Guarantee fee income on these PCs is recorded as part of "Management and guarantee income." The "Total Mortgage Portfolio" is the sum of the mortgages, GMS and Total PCs (excluding PCs held in the retained portfolio).

PC Issuance and Securitization

Freddie Mac issues single-class PCs representing undivided interests in conforming single-family and multifamily mortgages. The underlying mortgages and PCs are not assets or direct liabilities of Freddie Mac. Freddie Mac recognizes fee income over the lives of mortgages that underlie the PCs as "Management and guarantee income." Freddie Mac enters into certain securitization transactions using assets in the retained portfolio.

Premiums, Discounts and Deferred Fees

"Premiums, discounts and deferred fees," include premiums, discounts, fair value basis adjustments on hedged mortgage securities as well as deferred fees and costs associated with PC issuances. These amounts are amortized principally to interest income over the estimated weighted average lives of the underlying mortgages using the effective interest method. The corporation uses actual prepayment experience and estimates of future prepayments to determine the constant yield needed to apply the effective interest method.

Freddie Mac frequently redesignates its hedging relationships on its mortgage-related investments to reflect, among other things, market factors and paydowns. Amortization of hedging- related basis adjustments is initiated and affects net income on a monthly basis.

Reserve for Mortgage Losses

Management maintains the corporation's "Reserve for losses on retained mortgages" and "Reserve for losses on Mortgage Participation Certificates" (collectively, "reserve for mortgage losses") at levels it deems adequate to absorb estimated losses inherent in the total mortgage portfolio at the balance sheet date. Reserves are adjusted through periodic provisions charged to expense and decreased by charge-offs, net of recoveries. Charge-offs are recognized when a mortgage is modified in a troubled debt restructuring or foreclosed, and are equal to the cost basis of the mortgage less the fair value of the mortgage or property acquired.

In estimating losses incurred on the single-family mortgage portfolio, management utilizes a statistically based model that evaluates numerous factors including, but not limited to, general and regional economic conditions, expected future default experience (including the effect of credit enhancements), size of the portfolio, year of loan origination, geographic location and house-price performance of the property securing the mortgage. Multifamily mortgages are individually evaluated for losses, with reserves established to cover collateral deficiencies based on the current market value of the properties securing the mortgage, less estimated costs to sell and repair the properties. Management also considers uncertainties related to estimations in the reserve setting process.

Cash and Cash Equivalents

Freddie Mac considers highly liquid investment securities, generally with original maturities of three months or less and used for cash management purposes, to be cash equivalents. Cash equivalents are reported at cost, which approximates their fair value.

Investments

Freddie Mac classifies all investment securities as either available-for-sale or trading. Available-for-sale securities are reported at fair value, with unrealized gains and losses reported in AOCI. Securities held for trading purposes are reported at fair value, with unrealized gains and losses recognized in current period income as a component of "Other income, net."

Real Estate Owned

Real estate owned ("REO") is carried at the lower of cost or fair value less estimated selling costs. Accordingly, provisions for estimated REO selling costs and for losses occurring subsequent to foreclosure due to changes in the fair value of the property are recognized through the REO valuation allowance, with a corresponding charge to "REO operations expense." REO-related expenses incurred and income earned during the holding period are also included as part of "REO operations expense."

Debt Securities

Debt securities are classified as either "Due within one year" or "Due after one year" based on their remaining contractual maturity. The classification of interest expense on debt securities as either short-term or long-term is based on the their original contractual maturity.

Debt securities denominated in a foreign currency are translated into U.S. dollars using foreign exchange spot rates as of the date of the balance sheet. The corporation uses foreign currency swaps to hedge against the risk of changes in foreign currency exchange rates.

Debt issuance costs are deferred and amortized using the effective interest method over the period during which the related indebtedness is outstanding or, for callable debt, the period during which the related indebtedness is expected to be outstanding.

Amortization of hedging-related basis adjustments on existing debt is generally initiated on a monthly basis.

Security Program Variances

Timing differences between Freddie Mac's receipt of principal and interest payments from seller/servicers and subsequent passthrough to PC investors results in the liability "Principal and interest due to Mortgage Participation Certificate (PC) investors" ("P&I due"). Mortgage prepayments received by Freddie Mac are generally invested in short-term investments by the corporation over the period from prepayment to payment to the PC investor. However, these prepayment amounts are interest-bearing to the PC investor at the PC coupon rate only from the date of prepayment until the date the PC security balance is reduced and non-interest-bearing from the date the PC security balance is reduced to the date of payment to the PC investor. Both the interest expense resulting from P&I due balances, which is reported as "Interest expense due to security program cycles," and the investment income earned on the prepayment proceeds are recognized over the period between the date of mortgage prepayment and the date of payment to the PC investor.

Income Taxes

Freddie Mac uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized based upon the expected future tax consequences of existing temporary differences between the financial reporting and the tax reporting basis of assets and liabilities using enacted statutory tax rates. To the extent tax rates change, deferred tax assets and liabilities are adjusted in the period the tax change is enacted. Deferred tax expense represents the net change in the deferred tax asset or liability balance during the year. This amount, together with income taxes payable for the current year, represents the total "Provision for income taxes" for the year.

Derivative Financial Instruments

Derivative financial instruments ("derivatives") are financial instruments whose value is based upon an underlying asset, index or reference rate. Over-the-counter derivatives are privately negotiated contractual agreements that can be customized to meet specific needs. Exchange-traded derivatives are standardized contracts executed through organized exchanges.

Freddie Mac enters into derivatives as an end user to obtain lower-cost financing, reduce risk and protect market value. Freddie Mac does not engage in such transactions for speculative purposes. By using derivatives, Freddie Mac is better able to match the expected cash flows of its assets and liabilities and reduce the corporation's exposure to interest-rate and/or foreign-currency risk.

Accounting for Derivatives in 2001

On January 1, 2001, Freddie Mac implemented Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS 133"), which requires the corporation to recognize all derivatives on its balance sheet as either assets or liabilities measured at their fair value. The adoption of this standard did not affect the corporation's previously issued financial statements up to and including the December 31, 2000 financial results. The one-time, net cumulative after-tax adjustments required upon adoption of SFAS 133 resulted in a $5 million increase to "Net income" and a $2.5 billion reduction to AOCI. The reduction to AOCI primarily resulted from SFAS 133's requirement to recognize the derivatives designated as cash flow hedges, principally pay fixed swaps, on the balance sheet at fair value. Consistent with other GAAP-based equity valuation adjustments, changes in GAAP-based equity due to SFAS 133 AOCI adjustments do not affect Freddie Mac's regulatory core capital, which is equal to "Stockholders' equity," excluding AOCI.

When derivatives meet specific criteria, they are accounted for as either fair value hedges or cash flow hedges. Although Freddie Mac does not execute derivatives for trading or speculative purposes, in some cases, certain derivatives either do not satisfy SFAS 133's hedge criteria or because hedge accounting has not been elected. Changes in fair value of those derivatives are reported in "Other income, net."

The amortization of hedged item basis adjustments occurs over the life of the hedged item (for example, the estimated mortgage life in the case of hedged PCs), and must begin no later than when the hedge relationship terminates. A hedge relationship is deemed to be terminated when (i) the hedge no longer meets the SFAS 133 hedging criteria, (ii) hedge accounting is no longer elected, (iii) the derivative is sold or terminated, or (iv) the derivative is redesignated to another hedge relationship. Freddie Mac frequently redesignates derivatives from one hedge relationship to another or otherwise adjusts its hedging relationships in order to maximize the effectiveness of its hedging strategies in response to changing interest rates and other market factors, asset and liability paydowns, and changes in the composition of its derivatives, mortgage assets and debt obligations. Accordingly, the amortization of basis adjustments as a component of net interest income is begun each month for a substantial portion of Freddie Mac's hedging relationships.

Accounting for Derivatives in 2000 and 1999

Prior to the adoption of SFAS 133, when derivatives met specific criteria, they were accounted for either as synthetic instruments or as hedges. When these financial instruments failed to meet such criteria, they were reported at fair value, with related gains or losses reported in "Other income, net."

When derivatives were accounted for as synthetic instruments, generally applicable to interest-rate contracts, the net differential received or paid was recognized on an accrual basis and recorded in "Net benefit (cost) of derivatives." Net premiums paid to enter into derivatives, as well as gains and losses on terminated derivatives, were deferred and amortized to interest income or expense.

When derivatives qualified for hedge accounting treatment, related fair value gains or losses were deferred as an adjustment to the carrying value of the hedged asset or liability. Upon termination of a hedge relationship, the deferred gain or loss was amortized over the remaining effective life of the asset or liability. Interest payments received or paid under derivatives qualifying as hedges were recognized on an accrual basis and recorded in "Net benefit (cost) of derivatives."

For foreign-currency swaps, amounts received or paid, together with the hedged assets and liabilities that were also denominated in a foreign currency, were translated into U.S. dollars using foreign exchange spot rates as of the date of the balance sheet. Transaction gains and losses for both foreign-currency swaps and foreign denominated assets and liabilities were reported in "Other income, net."

Earnings Per Common Share

"Earnings per common share-basic" are computed as net income available to common stockholders divided by the weighted average common shares outstanding ("Weighted average common shares outstanding-basic") for the period. "Earnings per common share-diluted" are computed as net income available to common stockholders divided by the total of weighted average common shares outstanding and the effect of dilutive common equivalent shares outstanding ("Weighted average common shares outstanding-diluted") for the period. Dilutive common equivalent shares reflect the assumed issuance of additional common shares pursuant to certain of the corporation's stock-based compensation plans (see Note 9) that could potentially reduce or "dilute" earnings per share, based on the treasury stock method.

Table 1.1 provides a reconciliation of "Weighted average common shares outstanding-basic" to "Weighted average common shares outstanding-diluted."

TABLE 1.1

Year Ended December 31,	2001	2000	1999
(shares in thousands)			
Weighted average common shares outstanding-basic	694,096	693,555	696,042
Effect of dilutive common equivalent shares outstanding	2,780	2,893	4,169
Weighted average common shares outstanding-diluted	696,876	696,448	700,211

At December 31, 2001, options to purchase 1,276,032 shares of common stock were excluded from the computation of diluted EPS because the options' exercise price exceeded the average market price of the common shares as of the balance sheet date. Of this amount, options to purchase 1,229,482 shares and 46,550 shares expire on March 1, 2006 and May 30, 2006, respectively.

NOTE 2

COMPREHENSIVE INCOME

Comprehensive income represents net income plus changes in the fair value of investments classified as available for sale ("AFS") and certain derivatives.

Table 2.1 presents the changes in the components of comprehensive income.

TABLE 2.1

Year Ended December 31,	2001	2000	1999
(dollars in millions)			
Net gains (losses) on derivative instruments during the period:			
Net unrealized losses, net of tax benefit of $2,792	$(5,186)	$ —	$ —
Reclassification adjustment for realized losses included in net income, net of tax benefit of $994[1]	1,846	—	—
Net losses on certain derivative instruments	$(3,340)	$ —	$ —
Net unrealized investment gains (losses) during the period:			
Unrealized holding gains (losses), net of tax expense (benefit) of $753, $855 and $(702), respectively	$ 1,399	$ 1,588	$ (1,303)
Reclassification adjustment for realized (gains) losses included in net income, net of tax (expense) benefit of $(15), $18, and $9, respectively	(28)	34	17
Net unrealized gains (losses) on AFS investments	$ 1,371	$ 1,622	$ (1,286)

(1) Represents amounts related to derivatives designated as cash flow ledges that are included in the "Net interest income on earning assets" caption on the Consolidated Statements of Income.

NOTE 3

MORTGAGES AND GUARANTEED MORTGAGE SECURITIES

Table 3.1 summarizes the retained portfolio by mortgage product type.

TABLE 3.1

December 31,	2001	2000
(dollars in millions)		
Single-family:		
30-year fixed-rate[1]	$ 350,910	$ 285,940
15-year fixed-rate	82,071	54,206
Adjustable-rate mortgages/floating-rate[2]	33,670	27,364
Balloon/resets	903	788
Multifamily	24,165	17,395
Retained portfolio[3]	$ 491,719	$ 385,693

(1) Also includes 20-year fixed-rate mortgages, second mortgages and mobile home loans.
(2) Includes 1-,3-,5-,7- and 10-year adjustable rate mortgages.
(3) Excludes related unamortized premiums, discounts and deferred fees, reserve for losses on retained mortgages and net unrealized gain (loss) on AFS GMS.

At December 31, 2001 and 2000, mortgages totaled $62.8 billion and $59.2 billion, respectively, of which $2.7 billion and $0.2 billion, respectively, were classified as held-for-sale. The fair value of mortgages held-for-sale at December 31, 2001 and 2000 approximate their carrying value.

Table 3.2 summarizes GMS by major security product type.

TABLE 3.2

December 31,	2001	2000
(dollars in millions)		
PCs	$ 301,961	$ 246,209
Agency mortgage securities	77,302	37,294
Mortgage revenue bonds[1]	7,299	6,953
Other mortgage-related securities[2]	42,365	35,997
GMS[3]	$ 428,927	$ 326,453

(1) Consists of obligations of state and political subdivisions.
(2) Includes home equity securities, commercial mortgage securities backed by pools of loans that include significant amounts of multifamily mortgages, manufactured housing securities and other mortgage-related securities.
(3) Excludes related unamortized premiums, discounts and deferred fees and net unrealized gain (loss) on AFS GMS.

Table 3.3 summarizes the estimated fair value and corresponding gross unrealized gains and losses for AFS and held-to-maturity GMS in the retained portfolio.

TABLE 3.3

December 31,	2001				2000			
		Gross	Gross	Estimated		Gains	Losses	Estimated
	Amortized	Unrealized	Unrealized	Fair	Amortized	Gross	Gross	Fair
	Cost	Gains	Losses	Value	Cost	Unrealized	Unrealized	Value
(dollars in millions)								
Available-for-sale	222,713	2,869	(16)	225,566	65,213	680	(132)	65,761
Held-to-maturity	$203,359	$3,586	$(118)	$206,827	$260,626	$ 666	$(426)	$260,866
Total	$426,072	$6,455	$(134)	$432,393	$325,839	$1,346	$(558)	$326,627

At December 31, 2001 and 2000, AOCI included net unrealized gains (losses) on AFS GMS, net of tax, totaling $2 billion and $356 million, respectively. In 2001, 2000 and 1999, Freddie Mac sold $32 billion, $3 billion and $1 billion, respectively, of GMS from its AFS portfolio, resulting in net realized gains (losses) included in income of approximately $27 million, $(14) million and $1 million, respectively.

The cost basis of the AFS securities sold was determined using the specific identification method. On January 1, 2001, Freddie Mac transferred approximately $36 billion of PCs from the held-to-maturity portfolio to the trading portfolio, generating a $708 million loss reflected as a component of the SFAS 133's cumulative change in accounting principle. Additionally, as part of the SFAS 133 transition adjustment, Freddie Mac transferred $59 billion of PCs from the held-to-maturity portfolio to the AFS portfolio, resulting in a $419 million gain in AOCI ($272 million, net of tax).

NOTE 4

RESERVE FOR MORTGAGE LOSSES

Table 4.1 summarizes the activity in the reserve for mortgage losses.

TABLE 4.1

Year Ended December 31,	2001	2000	1999
(dollars in millions)			
Reserve for mortgage losses:			
Beginning balance	$ 784	$ 772	$ 768
Provision	45	40	60
Charge-offs, net of recoveries	(28)	(28)	(56)
Ending balance	$ 801	$ 784	$ 772

Impaired Loans

The reserve for mortgage losses consists of a specific valuation allowance related to impaired loans and an additional reserve for other probable losses. The population of impaired loans includes multifamily loans for which it is probable that the corporation will not receive all amounts contractually due, as well as all troubled debt restructurings (both single-family and multifamily). The corporation's recorded investment in impaired loans and the related valuation allowance are summarized in *Table 4.2*.

TABLE 4.2

December 31,	2001			2000		
	Recorded Investment	Specific Reserve	Net Investment	Recorded Investment	Specific Reserve	Net Investment
(dollars in millions)						
Impaired loans having:						
Related valuation allowance	$ 18	$ (3)	$ 15	$ 28	$ (4)	$ 24
No related valuation allowance	883	—	883	747	—	747
Total	$ 901	$ (3)	$ 898	$ 775	$ (4)	$ 771

For the years ended December 31, 2001, 2000 and 1999 the average recorded investment in impaired loans was $824 million, $725 million and $670 million, respectively. Interest income on impaired loans is recognized on a cash basis and totaled approximately $60 million, $50 million and $48 million for the years ended December 31, 2001, 2000 and 1999, respectively. Interest income on completed troubled debt restructurings is accrued when collectibility becomes probable.

Delinquency Rates

Table 4.3 summarizes the delinquency rates for Freddie Mac's total mortgage portfolio, excluding non-Freddie Mac mortgage-related securities, at December 31, 2001, 2000 and 1999.

TABLE 4.3

Year Ended December 31,	2001	2000	1999
(dollars in millions)			
Delinquencies, end of period			
Single-family:[1]			
At-risk portfolio[2]	0.41%	0.37%	0.39%
Total portfolio	0.65%	0.50%	0.43%
Multifamily[3]	0.15%	0.04%	0.14%

(1) Based on the number of mortgages 90 days or more delinquent.

(2) Includes only those loans for which Freddie Mac has assumed primary default risk. Excludes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies or subject to subordination agreements. In some cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

(3) Based on net carrying value of mortgages 60 days or more delinquent.

NOTE 5

INVESTMENTS

Table 5.1 summarizes the carrying value of Freddie Mac's "Investments."

TABLE 5.1

December 31,	2001				2000			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value[1]	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value[1]
(dollars in millions)								
Asset-backed securities	$ 25,994	$288	$ (29)	$26,253	$18,961	$ 116	$ (14)	$19,063
Corporate debt securities	9,417	160	(53)	$ 9,524	5,877	52	(35)	$ 5,894
Obligations of states and political subdivisions	4,284	1	(1)	$ 4,284	679	1	(1)	$ 679
Auction-rate preferred stock	942	3	—	$ 945	464	1	(4)	$ 461
Other available-for-sale securities	2,911	27	—	$ 2,938	6,022	38	—	$ 6,060
Total available-for-sale investments	$ 43,548	$479	$ (83)	$43,944	$32,003	$ 208	$ (54)	$32,157
Commercial paper				11,900				1,408
Eurodollar time deposits				9,226				900
Federal funds sold				6,620				1,367
Mutual funds, managed accounts and other trading assets[2]				4,204				4,886
Total investments				$75,894				$40,718

(1) The carrying value for Federal funds sold, Eurodollar time deposits and commercial paper is amortized cost, which approximates their fair value.

(2) Net gains totaled $114 million, $68 million and $21 million for the years ended December 31, 2001, 2000 and 1999, respectively.

The remaining contractual maturities of AFS investments are summarized in *Table 5.2*.

TABLE 5.2

December 31,	2001		2000	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(dollars in millions)				
Due within one year	$ 5,329	$ 5,438	$ 6,733	$ 6,769
Due after one year through five years	7,827	7,843	4,649	4,684
Due after five years through 10 years	4,398	4,410	1,660	1,641
	17,554	17,691	13,042	13,094
Asset-backed securities[1]	25,994	26,253	18,961	19,063
Total available-for-sale investments	$ 43,548	$ 43,944	$ 32,003	$ 32,157

(1) The contractual maturities of asset-backed securities may not represent their expected lives as obligations underlying these securities may be prepaid at any time without penalty.

Included in AOCI at December 31, 2001 and 2000, respectively, were net unrealized gains (losses) on AFS investments, net of tax, totaling $257 million and $100 million, respectively. Sales of AFS investments for the years ended December 31, 2001, 2000 and 1999 were approximately $23 billion, $7 billion and $18 billion, respectively, resulting in net realized gains (losses) of $81 million, $(26) million and $3 million, respectively.

At December 31, 2001, Freddie Mac held securities issued by eight highly-rated entities that individually exceed 10 percent of Freddie Mac's "Stockholders' equity." The estimated fair value of these holdings, which approximates amortized cost, ranged from $1.6 billion to $2.6 billion and totaled approximately $15 billion.

NOTE 6

SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

Securities purchased under agreements to resell (reverse repurchase agreements) are effectively collateralized lending transactions in that Freddie Mac purchases a security with an agreement to sell back the same or substantially the same security. *Table 6.1* summarizes information regarding the balances and maturities of reverse repurchase agreements.

TABLE 6.1

December 31,	2001	2000
(dollars in millions)		
Average outstanding balance during the year	$ 6,733	$ 5,235
Maximum month-end outstanding balance	$ 6,753	$ 7,814
Balance, due within one year	$ 5,531	$ 7,488

The amount a Freddie Mac customer can borrow under a reverse repurchase agreement is generally limited to a maximum of 99 percent of the initial fair value of the securities collateralizing the agreement, depending on the type of collateral and/or the credit quality of the customer. The master agreements governing reverse repurchase agreement transactions provide for the delivery of securities collateralizing the agreements to Freddie Mac (or its custodian bank) and provide that Freddie Mac has the right to sell the collateral in the event of borrower default. All reverse repurchase agreements permit Freddie Mac to obtain additional collateral as margin if the fair value of the securities subject to the reverse repurchase agreement declines.

NOTE 7

REAL ESTATE OWNED

Table 7.1 provides a summary of Freddie Mac's REO activity.

TABLE 7.1

	REO, Gross	Valuation Allowance	REO, Net
(dollars in millions)			
Balance, December 31, 1998	$ 632	$ (58)	$ 574
Additions	1,041	(66)	975
Dispositions and write-downs	(1,185)	74	(1,111)
Balance, December 31, 1999	$ 488	$ (50)	$ 438
Additions	853	(54)	799
Dispositions and write-downs	(948)	59	(889)
Balance, December 31, 2000	$ 393	$ (45)	$ 348
Additions	910	(62)	848
Dispositions and write-downs	(798)	44	(754)
Balance, December 31, 2001	$ 505	$ (63)	$ 442

NOTE 8 *Contractual Debt*

DEBT SECURITIES AND SUBORDINATED BORROWINGS

Table 8.1 provides information relating to debt securities and subordinated borrowings. *Table 8.2* provides additional information related to amounts with original maturities of one year or less.

TABLE 8.1

December 31,	2001		2000	
	Balance, Net	Effective Rate[1]	Balance, Net	Effective Rate[1]
(dollars in millions)				
Due within one year				
Discount notes, medium-term notes and securities sold under agreements to repurchase	$ 229,255	2.44%	$ 150,782	6.41%
Current portion of long-term debt	21,083	5.95%	32,794	5.90%
Total due within one year	250,338	2.74%	183,576	6.32%
Due after one year[2]	314,733	5.70%	243,323	6.52%
Total	$ 565,071		$ 426,899	

(1) *Represents the weighted average effective rate at the end of the period, and includes the amortization of discounts or premiums, hedging gains or losses and debt issuance costs.*

(2) *Includes subordinated borrowings of $3,125 million (6.35 percent effective rate) and $145 million (9.96 percent effective rate) at December 31, 2001 and 2000, respectively, net of unamortized discounts totaling $428 million and $400 million at December 31, 2001 and 2000.*

TABLE 8.2

December 31,	2001			
	Balance, Net	Average Balance Outstanding During the Year	Effective Rate[1]	Maximum Balance Outstanding at Any Month End
(dollars in millions)				
Discount notes	$ 222,468	$ 192,856	2.42%	$ 222,468
Medium-term notes	6,730	9,102	2.91%	13,638
Securities sold under agreements to repurchase	57	289	6.04%	1,175
Total	$ 229,255	$ 202,247	2.44%	

December 31,	2000			
	Balance, Net	Average Balance Outstanding During the Year	Effective Rate[1]	Maximum Balance Outstanding at Any Month End
(dollars in millions)				
Discount notes	$ 132,744	$ 145,092	6.39%	$ 155,016
Medium-term notes	17,980	19,006	6.56%	23,201
Securities sold under agreements to repurchase	58	6	4.01%	58
Total	$ 150,782	$ 164,104	6.41%	

(1) *Represents the weighted average effective rate at the end of the period, and includes the amortization of discounts or premiums, hedging gains or losses and debt issuance costs.*

Discount notes and medium-term notes are unsecured general obligations. Securities sold under agreements to repurchase are effectively collateralized borrowing transactions in that Freddie Mac sells PCs with an agreement to repurchase PCs that are substantially the same. These agreements require the underlying PCs to be delivered to the dealers who arranged the transactions.

Subordinated borrowings, which are reported net of their unamortized discount, consist of capital debentures and zero-coupon capital debentures subordinate to all obligations, including obligations of others guaranteed by Freddie Mac, whether existing at the date of issuance or thereafter.

A portion of Freddie Mac's long-term debt is callable. Callable debt gives Freddie Mac the option to redeem the debt security in whole or in part at either a specified call date or at any time on or after a specified call date. *Table 8.3* summarizes the maturities, balances and effective interest rates at December 31, 2001 for contractually callable debt by call period.

TABLE 8.3

Call Period Inception Date	Maturity	Balance, Net of Discount	Effective Rate
(dollars in millions)			
2002	2002-2031	$ 78,601	5.46%
2003	2004-2026	11,413	6.05%
2004	2006-2022	3,341	6.27%
2005	2008-2021	875	6.62%
2006	2011-2021	1,251	6.75%
Thereafter	2012-2029	996	6.93%
Total		$ 96,477	5.60%

Table 8.4 summarizes the contractual maturities of short- and long-term debt securities and subordinated borrowings outstanding at December 31, 2001, assuming callable debt is *(i)* paid at scheduled maturity and *(ii)* redeemed at the initial call date.

TABLE 8.4

Year	Scheduled Maturity	Assuming Callable Debt is Redeemed at Initial Call Date
(dollars in millions)		
2002	$ 247,751	$ 325,215
2003	52,244	52,233
2004	59,132	43,651
2005	25,357	17,526
2006	47,018	30,891
2007	6,199	2,349
2008	16,385	13,059
2009	20,646	15,290
2010	24,294	23,045
2011	30,990	25,366
Thereafter	35,055	16,446
Total	$ 565,071	$ 565,071

Freddie Mac extinguished $4,701 million, $398 million, and $814 million of par value debt before scheduled maturities in 2001, 2000, and 1999, respectively. As a result, Freddie Mac recognized extraordinary after-tax (losses) gains totaling $(231) million, $8 million, and $5 million for 2001, 2000, and 1999, respectively.

NOTE 9 *Preferred Stock*

STOCKHOLDERS' EQUITY

During 2001, Freddie Mac completed six preferred stock offerings, raising approximately $1.4 billion (see *Table 9.1* for more information). All 17 classes of preferred stock outstanding at December 31, 2001 have a par value of $1 per share, and are redeemable, on specified dates, at the corporation's option at their redemption price (or redemption value) plus dividends accrued through the redemption date. In addition, all 17 classes of preferred stock are perpetual and non-cumulative, and carry no significant voting rights or rights to purchase additional Freddie Mac stock or securities. Costs incurred in connection with the issuance of preferred stock are charged to "Additional paid-in capital."

Table 9.1 provides a summary of Freddie Mac's preferred stock outstanding at December 31, 2001.

TABLE 9.1

						Total	
	Issue	Shares	Shares	Total	Redemption	Outstanding	Redeemable
	Date	Authorized	Outstanding	Par Value	Price per Share	Balance[1]	On or After
(shares and dollars in millions, except redemption price per share)							
1996 Variable-rate[2]	April 26, 1996	5.00	5.00	$ 5.00	$ 50.00	$ 250	June 30, 2001
6.125%	November 1, 1996	5.75	5.75	5.75	50.00	287	December 31, 2001
6.14%	June 3, 1997	12.00	12.00	12.00	50.00	600	June 30, 2002
5.81% (1997 issue)	October 27, 1997	3.00	3.00	3.00	50.00	150	October 27, 1998
5%	March 23, 1998	8.00	8.00	8.00	50.00	400	March 31, 2003
1998 Variable-rate[3]	September 23, 1998	4.40	4.40	4.40	50.00	220	September 30, 2003
5.1% (1998 issue)	September 23, 1998	8.00	8.00	8.00	50.00	400	September 30, 2003
5.3%	October 28, 1998	4.00	4.00	4.00	50.00	200	October 30, 2000
5.1% (1999 issue)	March 19, 1999	3.00	3.00	3.00	50.00	150	March 31, 2004
5.79%	July 21, 1999	5.00	5.00	5.00	50.00	250	June 30, 2009
1999 Variable-rate[4]	November 5, 1999	5.75	5.75	5.75	50.00	288	December 31, 2004
2001 Variable-rate[5]	January 26, 2001	6.50	6.50	6.50	50.00	325	March 31, 2003
2001 Variable-rate[6]	March 23, 2001	4.60	4.60	4.60	50.00	230	March 31, 2003
5.81% (2001 issue)	March 23, 2001	3.45	3.45	3.45	50.00	172	March 31, 2011
6.0%	May 30, 2001	3.45	3.45	3.45	50.00	173	June 30, 2006
2001 Variable-rate[7]	May 30, 2001	4.02	4.02	4.02	50.00	201	June 30, 2003
5.7%	October 30, 2001	6.00	6.00	6.00	50.00	300	December 31, 2006
Total		91.92	91.92	$ 91.92		$ 4,596	

(1) Amounts stated at redemption value.

(2) The dividend rate resets quarterly and is equal to the sum of the three-month London Inter-Bank Offered Rate ("LIBOR") plus one percent divided by 1.377, and is capped at 9.00 percent.

(3) Includes 1.4 million shares subsequently issued on September 29, 1998. The dividend rate resets quarterly and is equal to the sum of three-month LIBOR plus one percent divided by 1.377, and is capped at 7.50 percent.

(4) Initial dividend rate is 5.97 percent per annum through December 31, 2004. Dividend rate resets on January 1, 2005 and on January 1st every five years thereafter based on a five-year constant maturity Treasury ("CMT") rate which is capped at 11.00 percent. Optional redemption on December 31, 2004 and on December 31 every five years thereafter.

(5) Initial dividend rate is 4.817 percent per annum through March 31, 2003. Dividend rate resets on April 1, 2003 and as of April 1st every two years thereafter based on the 2-year CMT rate plus .10 percent and is capped at 11.00 percent. Optional redemption on March 31, 2003 and on March 31 every two years thereafter.

(6) Initial dividend rate is 4.50 percent per annum through March 31, 2002. Dividend rate resets on April 1, 2002 and as of April 1st every year thereafter based on 12-month LIBOR minus .20 percent and is capped at 11.00 percent. Optional redemption on March 31, 2003 and on March 31 every year thereafter.

(7) Initial dividend rate is 4.48 percent per annum through June 30, 2003. Dividend rate resets on July 1, 2003 and as of July 1st every two years thereafter based on the 2-year CMT rate plus .20 percent and is capped at 11.00 percent. Optional redemption on June 30, 2003 and on June 30th every two years thereafter.

If the Internal Revenue Code of 1986 ("Code") is amended to reduce the dividends-received deduction from the current 70 percent rate, the dividend rate on certain issues of preferred stock will increase. The increase to the dividend rate will be equal to the amount necessary to adjust for the effect of the reduction in the dividends-received deduction. No additional adjustment will be made, however, to the extent that the dividends-received deduction is reduced below 50 percent. Such adjustment may result in a dividend rate in excess of the specified rate caps on the variable-rate issues.

Dividends Declared

Table 9.2 summarizes the cash dividends declared per share on Freddie Mac's common and preferred stock.

TABLE 9.2

Year Ended December 31,	2001	2000	1999
Common:	$ 0.80	$ 0.68	$ 0.60
Preferred:			
1996 Variable-rate	1.98	2.76	2.35
6.125%	3.06	3.06	3.06
6.14%	3.07	3.07	3.07
5.81% (1997 issue)	2.91	2.91	2.91
5%	2.50	2.50	2.50
1998 Variable-rate	1.98	2.76	2.35
5.1% (1998 issue)	2.55	2.55	2.55
5.3%	2.65	2.65	2.65
5.1% (1999 issue)	2.55	2.55	1.99
5.79%	2.90	2.90	1.28
1999 Variable-rate	2.99	2.99	0.46
2001 Variable-rate	2.23	—	—
2001 Variable-rate	1.77	—	—
5.81% (2001 issue)	2.24	—	—
6%	1.75	—	—
2001 Variable-rate	1.31	—	—
5.7%	0.48	—	—

Common Stock Repurchase Program

In March 2001, Freddie Mac's Board of Directors ("Board") reaffirmed authority granted to management in 1997 to repurchase up to five percent, or approximately 34 million shares, of its common stock outstanding as of September 5, 1997. Under this authorization, Freddie Mac repurchased no outstanding shares in 2001 and 5.9 million of outstanding common shares in 2000.

Stock-Based Compensation

Freddie Mac has three stock-based compensation plans: the Employee Stock Purchase Plan ("ESPP"), the 1995 Stock Compensation Plan ("Employee Plan") and the 1995 Directors' Stock Compensation Plan ("Directors' Plan"). Freddie Mac applies Accounting Principles Board Opinion 25 and SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS 123") as appropriate.

Employee Stock Purchase Plan ("ESPP"): Freddie Mac has established an ESPP under which shares of common stock may be purchased by full-time and part-time employees who have continuously worked 20 or more hours per week or taken certain types of approved paid or unpaid leave. The maximum market value of stock available for annual purchase is $20,000 per employee. The purchase price under the ESPP in 2002 will be equal to 85 percent of the average price of the stock on the subscription (grant) date, August 1, 2001, or the exercise date, July 31, 2002, whichever is lower. The ESPP is qualified under the Code, and thus is a non-compensatory plan. As a result, no compensation expense is recognized for stock purchase options granted under the ESPP.

On August 1, 2001 and August 2, 2000, employees pledged to purchase up to 799,654 shares on July 31, 2002 and 1,020,850 shares on July 31, 2001, respectively. Employees purchased 914,167 and 177,678 shares for the years ended December 31, 2001 and 2000, respectively.

The per-share weighted average fair value of stock purchase options granted under the ESPP in 2001 and 2000 as of the grant date was $23.81 and $13.43, respectively.

1995 Stock Compensation Plan ("Employee Plan"): Under the Employee Plan, Freddie Mac is permitted to grant to employees stock-based awards, including stock options with dividend rights, restricted stock and stock appreciation rights ("SARs"). All such awards are forfeitable for at least one year after the date of grant, and Freddie Mac has the right to impose performance conditions with respect to any awards under the Employee Plan. To date, no SARs have been granted under the Employee Plan.

Stock options granted under the Employee Plan generally allow for the purchase of Freddie Mac's common stock at a price equal to the fair value of the common stock on the grant date. Options generally may be exercised for a period of 10 years from the grant date, subject to a vesting schedule commencing on the grant date. The grant or exercise of such options does not result in compensation expense since the exercise price is equal to the fair value of the stock on the grant date.

Dividend rights provide participants with the right to receive, at the time stock options are exercised or upon expiration, an amount equal to the dividends paid on the stock from the date the options were granted. Compensation expense associated with dividend rights is recognized when dividends are declared, based on the amount of dividends declared.

Restricted stock entitles participants to all the rights of a stockholder including dividends, except that the shares awarded are subject to a risk of forfeiture and may not be disposed of by the participant until the end of the restricted period established by the corporation. The value of restricted shares awarded is amortized to compensation expense over the restricted or vesting period. During 2001 and 2000, 367,902 and 1,101,050 shares of restricted stock, respectively, were granted under the Employee Plan. The number of outstanding shares of restricted stock granted under the Employee Plan was 1,478,873 and 1,561,397 at December 31, 2001 and 2000, respectively.

1995 Directors' Stock Compensation Plan ("Directors' Plan"): Under the Directors' Plan, Freddie Mac is permitted to grant stock options with dividend rights, restricted stock and restricted stock units ("RSU") to non-employee members of the Board of Directors ("Directors"). The accounting for stock options with dividend rights and restricted stock granted under the Directors' Plan is identical to that described above for the Employee Plan. RSUs represent a contractual right to receive one share of common stock at a specified future date for each restricted stock unit and do not have voting rights. The accounting for RSUs is identical to that of restricted stock, except related to the dividend rights feature and their effect on earnings per share-basic. During 2001 and 2000, 28,289 and 23,733 RSUs, respectively, were granted under the Directors' Plan. At December 31, 2001 and 2000, remaining outstanding shares of restricted stock and RSUs granted under the Directors' Plan totaled 51,538 and 51,417, respectively.

Directors are granted stock options valued at $125,000 ($250,000 in the case of a newly elected or appointed Director). These options have an exercise price equal to the fair value of the common stock at the date of grant, and may be exercised for a period of 10 years from the grant date, subject to a five-year vesting period. The Directors' Plan also provides for annual awards of restricted stock or RSUs valued at $65,000 ($130,000 in the case of a newly elected or appointed Director) on the date of grant. Awards of both stock options and RSUs stock units become exercisable at the rate of 20 percent for each of five years following the grant date. Newly elected or appointed Directors who were granted the larger amount of stock options and RSUs in their first year of service do not receive grants of stock options or RSUs during their second year of service.

Compensation Expense: Actual compensation expense related to stock-based compensation plans charged to income was $30.7 million, $23.8 million and $14.7 million for the years ended December 31, 2001, 2000 and 1999, respectively. Compensation expense is recognized for dividend rights, restricted stock, and RSUs for all plans.

Table 9.3 summarizes the pro forma net income and related basic and diluted earnings per common share, had compensation expense for stock options granted under the ESPP, Employee Plan and Directors' Plan been determined based on their fair value at the grant dates (the fair value method as described in SFAS 123).

TABLE 9.3

Year Ended December 31,	2001	2000	1999
(dollars in millions, except share-related amounts)			
Net income			
As reported	$ 4,147	$ 2,547	$ 2,223
Pro forma	$ 4,121	$ 2,528	$ 2,211
Basic earnings per common share before extraordinary items and cumulative effect of change in accounting principle	$ 5.98	$ 3.40	$ 2.97
Basic earnings per common share after extraordinary items and cumulative effect of change in accounting principle	$ 5.66	$ 3.41	$ 2.97
Pro forma basic earnings per common share before extraordinary items and cumulative effect of change in accounting principle	$ 5.94	$ 3.38	$ 2.96
Pro forma basic earnings per common share after extraordinary items and cumulative effect of change in accounting principle	$ 5.62	$ 3.39	$ 2.96
Diluted earnings per common share before extraordinary items and cumulative effect of change in accounting principle	$ 5.96	$ 3.39	$ 2.95
Diluted earnings per common share after extraordinary items and cumulative effect of change in accounting principle	$ 5.64	$ 3.40	$ 2.96
Pro forma diluted earnings per common share before extraordinary items and cumulative effect of change in accounting principle	$ 5.92	$ 3.36	$ 2.93
Pro forma diluted earnings per common share after extraordinary items and cumulative effect of change in accounting principle	$ 5.60	$ 3.37	$ 2.94

For pro forma disclosure purposes, compensation expense was calculated as the fair value of the stock option awards issued as of the grant date, which was estimated using the Black-Scholes model. *Table 9.4* summarizes the assumptions used in determining the fair value of options granted under Freddie Mac's three stock-based compensation plans.

TABLE 9.4

	ESPP			Employee and Directors' Stock Compensation Plans		
	2001	2000	1999	2001	2000	1999
Dividend yield[1]	1.16%	1.74%	1.23%	—	—	—
Expected life	1 year	1 year	1 year	10 years	10 years	10 years
Expected volatility	39.70%	38.87%	37.56%	40.40%	36.22%	37.80%
Risk-free interest rate	3.62%	6.18%	5.20%	5.16%	6.28%	5.34%

[1] The dividend yield assumption is not used for the Employee and Directors' Stock Compensation Plan since these plans feature the accrual of dividend equivalents included in reported net income.

Other Stock-Based Compensation Information: The maximum number of shares of common stock that may be granted to employees under the Employee Plan is 33.6 million shares. The maximum number of shares of common stock that may be granted under the Directors' Plan is 2.4 million shares.

At December 31, 2001, a total of 25.1 million shares and 0.7 million shares had been issued under the Employee Plan and Directors' Plan, respectively. At December 31, 2001, a total of 10.2 million shares remained available for grant under both the Employee Plan and the Directors' Plan. The maximum number of shares of common stock that may be granted to employees under the ESPP is 12 million shares. At December 31, 2001, 7.8 million shares had been issued under the ESPP and 4.2 million shares remained available for grant.

Common stock delivered under these plans may be shares currently held by Freddie Mac as treasury stock (stock previously issued and subsequently purchased by Freddie Mac) or shares purchased by Freddie Mac in the open market. No awards may be made under the ESPP or Employee Plan after December 31, 2004. No awards may be made under the Directors' Plan after May 2008.

Table 9.5 provides a summary of activity related to stock options under the Employee Plan and the Directors' Plan.

TABLE 9.5

Year Ended December 31,	2001		2000		1999	
	Stock Options	Weighted Average Exercise Price	Stock Options	Weighted Average Exercise Price	Stock Options	Weighted Average Exercise Price
Outstanding, beginning of year	9,035,859	$ 29.23	9,841,126	$ 23.11	10,181,384	$ 18.75
Granted	1,444,846	$ 67.18	2,016,305	$ 42.75	1,075,290	$ 58.64
Exercised	(1,588,118)	$ 16.18	(2,338,494)	$ 12.53	(1,180,572)	$ 12.27
Canceled	(170,625)	$ 46.31	(483,078)	$ 41.92	(234,976)	$ 51.53
Outstanding, end of year	8,721,962	$ 37.56	9,035,859	$ 29.23	9,841,126	$ 23.11
Options exercisable at year-end	4,532,265	$ 23.29	5,212,961	$ 18.38	7,069,515	$ 14.89
Weighted-average fair value of options granted during year		$ 25.54		$ 16.24		$ 26.18

Table 9.6 provides additional information for stock options outstanding under the Employee Plan and the Directors' Plan at December 31, 2001 by range of exercise prices.

TABLE 9.6

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding at December 31, 2001	Weighted Average Remaining Contract Life in Years	Weighted Average Exercise Price	Exercisable at December 31, 2001	Weighted Average Exercise Price
$ 9.00 to 14.99	993,228	1.26	$ 11.80	993,228	$ 11.80
15.00 to 24.99	2,375,008	3.60	18.10	2,375,008	18.10
25.00 to 34.99	666,836	5.43	34.16	507,242	34.08
35.00 to 44.99	1,565,219	8.11	41.54	62,541	43.07
45.00 to 54.99	1,020,887	7.18	47.33	383,913	47.30
55.00 to 64.99	824,752	7.64	60.95	208,225	60.40
65.00 to 67.99	1,276,032	9.16	67.78	2,108	67.85
	8,721,962	5.90	$ 37.56	4,532,265	$ 23.29

Regulatory Capital

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("GSE Act") established risk-based, minimum and critical capital standards for Freddie Mac and Fannie Mae. On September 13, 2001, OFHEO published a risk-based capital rule in the Federal Register. On December 11, 2001, OFHEO published proposed amendments to the risk-based capital rule that would affect capital charges for counterparty risk and certain other aspects of the rule. Freddie Mac and other parties submitted comments on the proposed amendments. The amendments to the risk-based capital rule were published on OFHEO's Web site on February 20, 2002.

OFHEO's release publishing the final risk-based capital rule on September 13, 2001 stated that the publication triggered a one-year implementation period after which the risk-based capital standard may be incorporated into OFHEO's classification of the capital adequacy of Freddie Mac and Fannie Mae. Prior to the end of the implementation period, Freddie Mac and Fannie Mae are to be classified as adequately capitalized, the highest capital classification, so long as they meet the minimum capital standard. Freddie Mac expects that when the risk-based capital rule becomes operative at the end of the one-year implementation period, Freddie Mac will continue to be classified as adequately capitalized, as it has been since OFHEO began classifying Freddie Mac in 1993.

After the risk-based capital rule has been in effect for one year, if Freddie Mac does not meet the risk-based capital standard (but meets the minimum capital standard), the corporation would be required to submit and obtain OFHEO's approval of a capital restoration plan and would be subject to restrictions on certain dividend payments and other capital distributions. If Freddie Mac does not meet the minimum capital standard, the corporation would be required to submit and obtain OFHEO's approval of a capital restoration plan; it also would have to obtain OFHEO's approval of certain dividend payments and other capital distributions. Additionally, OFHEO would be authorized to limit Freddie Mac's growth, require it to obtain additional capital or restrict it from undertaking activities that present excessive risk.

The minimum capital standard generally requires Freddie Mac to hold an amount of core capital computed as follows: the sum of 2.50 percent of aggregate on-balance sheet assets, as measured under GAAP and 0.45 percent of other aggregate off-balance sheet obligations. If Freddie Mac does not meet the minimum capital standard, the corporation would be required to submit and obtain OFHEO's approval of a capital restoration plan as well as seek and obtain OFHEO's approval to authorize dividend payments and other capital distributions. Additionally, OFHEO would be authorized to limit Freddie Mac's growth, require it to acquire new capital or restrict it from activities that create excessive risk.

The critical capital level generally is equal to the sum of 1.25 percent of aggregate on-balance sheet assets, as measured under GAAP and 0.25 percent of other aggregate off-balance sheet obligations. If Freddie Mac does not meet the critical capital standard, OFHEO would be required to perform supervisory duties in most cases including conservatorship of the corporation's assets.

At December 31, 2001 and 2000, Freddie Mac's core capital totaled approximately $19.3 billion and $14.4 billion, respectively, which exceeded the minimum and critical capital requirements under the GSE Act.

NOTE 10

DERIVATIVE FINANCIAL INSTRUMENTS

Freddie Mac principally uses the following types of derivatives:

Interest-Rate Swaps: Interest-rate swaps are contractual agreements between two parties for the exchange of periodic payments based on a pre-determined amount ("notional") and agreed-upon fixed and floating interest rates.

Futures Contracts: Futures contracts are exchange-traded agreements that obligate one party to sell and another party to purchase a specified amount of a designated financial instrument at a specified price and date.

Options and Swaptions: Options are exchange-traded or over-the-counter agreements that give the holder the right, but not the obligation, to buy or sell a specified asset or enter into a contract at a specified price during a specified period of time. Option holders will generally exercise their options only if there is an economic advantage in doing so. Swaptions are options to execute an interest-rate swap at a specific date and specific rates.

Interest-Rate Caps and Floors: Interest-rate caps and floors are agreements in which the holder pays a one-time up-front premium to another party in exchange for the right to receive interest payments based on a particular notional amount and the amount, if any, by which the agreed-upon index rate exceeds a specified maximum ("cap") or by which the agreed upon index is below a specified minimum ("floor") rate.

Forward Sales: Forward sales are over-the-counter agreements that obligate one party to sell and another party to purchase a specified amount of a designated financial instrument at a specified price and date.

Foreign-Currency Swaps: Currency swaps are contractual agreements between two parties for the exchange of a specified amount of a designated foreign currency for a specified amount of U.S. dollars at the inception and termination of the contract. Each party will also make periodic interest payments on the currency it receives in the swap at agreed-upon fixed or floating interest rates.

2001 Hedging Activity

Fair value hedges represent hedges of exposure to changes in the fair value of a recognized fixed-rate asset, liability or firm commitment. Freddie Mac uses interest-rate swaps, futures and forward contracts to hedge against the changes in fair value of fixed-rate debt due to changes in benchmark interest rates, either the rate on U.S. Treasury obligations or LIBOR, and/or foreign currency fluctuations. At December 31, 2001, $67 billion notional amount of receive-fixed swaps was designated as fair value hedges of the changes in a specified benchmark rate of interest (LIBOR) on existing long-term debt. Freddie Mac also uses interest-rate swaps and swaptions to hedge against changes in fair value of borrower prepayment options embedded in the PCs held in the retained portfolio. At December 31, 2001, $180 billion notional amount of call and put swaptions, $98 billion notional amount of receive-fixed swaps and $35 billion notional amount of pay-fixed swaps were designated as fair value hedges of the embedded borrower prepayment options. In addition, the corporation executes foreign-currency and interest-rate swaps to hedge against foreign currency fluctuations. A combined $44 billion notional amount of interest-rate and currency swaps was designated as fair value hedges at December 31, 2001.

Derivatives designated as fair value hedges are reported at their fair value, netted by counterparty where right of offset and other criteria are met, as either "Derivative assets" or "Derivative liabilities," with changes in fair value reported as "Fair value gains (losses)." Similarly, the carrying amount of the hedged asset or liability also reflects changes in its fair value related to the hedged risk, with fair value changes also recorded to "Fair value gains (losses)." Hedge ineffectiveness arises when the fair value change of the derivative does not equal the fair value change of the hedged risk. For 2001, hedge ineffectiveness related to fair value hedges was a net $13 million loss. No amounts have been excluded from the assessment of effectiveness for derivatives designated as fair value hedges. Freddie Mac has not recognized gains or losses related to hedged firm commitments.

Cash flow hedges represent hedges of exposure to the variability in the cash flows of a recognized floating-rate asset or liability or a forecasted transaction. Freddie Mac uses interest-rate swaps, futures, options on futures, foreign-currency swaps and forward contracts to hedge the changes in cash flows of variable-rate debt, forecasted issuances of debt and foreign currency fluctuations. Cash flow hedges also include hedges of certain forecasted transactions up to a maximum economic life of thirty years. At December 31, 2001, $213 billion notional amount of pay-fixed swaps were designated as cash flow hedges of the variability of future interest payments and carried at fair value. In addition, a combined $346 billion notional amount of short-term LIBOR futures contracts and short-term purchased options on such contracts, which provide interest-rate protection in combination with pay-fixed swaps, were designated in cash flow hedge relationships.

Derivatives designated as cash flow hedges are reported at their fair value, netted by counterparty where the right to offset and other criteria are met, as either "Derivative assets" or "Derivative liabilities" with changes in fair value generally reported in AOCI. The change in fair value of the derivative from inception of the hedge is compared to the cumulative change in the fair value of expected future cash flows on the hedged transaction. Any excess of the change in fair value of the derivative over the change in value of the hedged forecasted cash flows is reflected as hedge ineffectiveness and reported in "Fair value gains (losses)." For 2001, hedge ineffectiveness related to cash flow hedges was a net $14 million loss. No amounts have been excluded from the assessment of effectiveness for derivatives designated as cash flow hedges. The corporation has not discontinued cash flow hedge designations due to a change in the probability of a forecasted transaction.

Interest received or paid for derivatives qualifying as fair value or cash flow hedges are recognized on an accrual basis and recorded in "Net benefit (cost) of derivatives" according to the contractual terms of the agreement. Upon termination or redesignation of the hedge relationship, basis adjustments related to the hedged asset or liability that arise due to the fair value changes during the period hedged are amortized to net interest income or expense, similar to the treatment of premiums, discounts and deferred fees. The fair value determination described above excludes the interest accrued, which is recorded in "Other assets" and/or "Other liabilities."

Under SFAS 133, AOCI amounts are reclassified to "Net interest income on earning assets" as the associated hedged forecasted items affect earnings. These reclassifications represent the cash flows received or paid related to derivatives designated as cash flow hedges, for example, the interest income and expense in the case of pay-fixed swaps designated as cash flow hedges. Assuming no changes in interest rates or other factors affecting derivative valuations, the corporation estimates that approximately $3.9 billion of the balance of AOCI at December 31, 2001 will be reclassified to "Net interest income on earning assets" over the next 12 months. Although changes in interest rates may cause significant fluctuations in AOCI, due primarily to changes in the value of pay-fixed swaps hedging forecasted debt issuances, such interest rate changes should have minimal effect on the corporation's effective funding costs (i.e., interest expense adjusted for the effect of associated swaps and other derivatives). Freddie Mac's "Net interest income on earning assets" includes the cash flows on all interest-earning assets, debt securities, and derivatives.

Occasionally, derivatives do not qualify for hedge accounting treatment under SFAS 133. These derivatives are reported at their fair value as either "Derivative assets" or "Derivative liabilities" with changes in fair value reported in "Other income, net."

At December 31, 2000, the fair value of all derivatives was not required to be recorded on the balance sheet. The net carrying amount of options totaled $1.8 billion and was recorded in "Other assets."

NOTE 11

CONCENTRATIONS OF CREDIT RISK, CONTINGENCIES AND COMMITMENTS

Mortgage Participation Certificates

Freddie Mac guarantees PC holders the timely payment of interest at the PC coupon rate, and the timely payment of scheduled principal on mortgages underlying Gold PCs or the ultimate payment of principal on mortgages underlying 75-day PCs. Several types of credit risk are associated with Total PCs, net. These include the risk of loss from: *(i)* borrower default on the mortgage; *(ii)* the failure of institutions holding monthly remittances payable to Freddie Mac and *(iii)* mortgage fraud. These credit risks are mitigated through Freddie Mac's uniform underwriting and servicing criteria and, in certain circumstances, warranties obtained from sellers. Freddie Mac also requires mortgage insurance or other credit protections for mortgages with loan-to-value ratios ("LTV") that exceed certain levels. Some transactions may also include various forms of credit enhancements provided by third parties. Management monitors the corporation's credit exposure and provides for probable losses incurred through the "Reserve for losses on Mortgage Participation Certificates."

As part of administering its PC programs, Freddie Mac purchases the mortgages backing PCs when certain events occur. Specifically, Freddie Mac may be required to purchase certain mortgages in case of default, as defined in the security offering documents.

Concentrations of Credit Risk

Table 11.1 summarizes the total mortgage portfolio by geographical concentration. Excluded from the total mortgage portfolio at December 31, 2001 and 2000 are $127.0 billion and $80.2 billion, respectively, of non-Freddie Mac mortgage securities held in the retained portfolio.

TABLE 11.1

December 31,	2001		2000	
	Amount	Percentage	Amount	Percentage
(dollars in millions)				
BY REGION[1]				
West	$ 264,861	26%	$ 236,922	27%
Northeast	235,539	23	208,156	23
North Central	210,284	21	175,371	20
Southeast	180,058	18	156,796	18
Southwest	120,459	12	104,305	12
	$ 1,011,201	100%	$ 881,550	100%
BY STATE				
California	$ 161,370	16%	$ 141,630	16%
Florida	58,312	6	49,715	5
Illinois	51,405	5	43,200	5
Texas	48,033	5	41,210	5
All Others	692,081	68	605,795	69
	$ 1,011,201	100%	$ 881,550	100%

[1] *Region Designation: West (AK, AZ, CA, GU, HI, ID, MT, NV, OR, UT, WA); Northeast (CT, DE, DC, MA, ME, MD, NH, NJ, NY, PA, RI, VT, VA, WV); North Central (IL, IN, IA, MI, MN, ND, OH, SD, WI); Southeast (AL, FL, GA, KY, MS, NC, PR, SC, TN, VI); Southwest (AR, CO, KS, LA, MO, NE, NM, OK, TX, WY).*

A significant portion of Freddie Mac's mortgage purchase volume is generated from several key mortgage lenders that have entered into special business arrangements with Freddie Mac. These individually negotiated arrangements characteristically involve a lender's commitment to sell a high proportion of its conforming mortgage origination volume to Freddie Mac. The four most significant of these arrangements accounted for almost 55 percent of Freddie Mac's volume; the largest of which is with Wells Fargo Home Mortgage, Inc. Freddie Mac is exposed to the risk that it could lose purchase volume to the extent these agreements are terminated, or modified without replacement from other lenders.

Contingencies

From time to time, Freddie Mac may be involved as a party to certain legal proceedings arising in the normal course of its business. While litigation and claims resolution are subject to many uncertainties and cannot be predicted with assurance, it is management's opinion that any resulting losses would not have a material effect on Freddie Mac's Consolidated Financial Statements.

Commitments

A master commitment is a contract between Freddie Mac and a mortgage lender that sets forth the terms and conditions under which Freddie Mac will securitize or purchase mortgages from approved seller/servicers. A master commitment, either optional or mandatory, may provide for the securitization or purchase of mortgages under one or more purchase programs with various product attributes, such as conventional fixed-rate or conventional ARMs. At the time a commitment to purchase is entered into, Freddie Mac is subject to credit risk similar to that described previously in "Mortgage Participation Certificates." Mortgage commitments under these programs totaled $84.6 billion and $35.7 billion at December 31, 2001 and 2000 respectively.

NOTE 12 INCOME TAXES

Freddie Mac is exempt from state and local taxes, with the exception of real estate taxes.

Table 12.1 presents the components of the corporation's "Provision for income taxes."

TABLE 12.1

Year Ended December 31,	2001	2000	1999
(dollars in millions)			
Current tax provision	$ 1,321	$ 1,028	$ 1,287
Deferred tax provision	606	(33)	(344)
Total provision for income taxes	$ 1,927	$ 995	$ 943

Deferred tax assets and liabilities reflect the tax effect of temporary differences between the book basis of assets and liabilities for financial reporting purposes and the tax basis of those assets and liabilities. The net deferred tax asset is included in "Other assets." Included in the net deferred tax asset is tax (benefit) expense on the net unrealized gain (loss) on certain investments and net gain (loss) on certain derivatives during the period that are reported in AOCI. Management believes that it is more likely than not that the total deferred tax asset will be realized in future periods.

Table 12.2 summarizes the deferred tax asset and liability.

TABLE 12.2

December 31,	2001	2000
(dollars in millions)		
Deferred tax assets:		
Premiums, discounts and deferred fees	$ 575	$ 655
Reserve for credit losses	280	274
Other items, net	134	253
Net unrealized loss on certain investments and derivatives reported at fair value	2,134	—
Total deferred tax asset	3,123	1,182
Deferred tax liabilities:		
Debt costs	323	253
Investments and derivatives, net	479	154
Other items, net	91	73
Net unrealized gain on certain investments reported at fair value	—	245
Total deferred tax liability	893	725
Net deferred tax asset	$ 2,230	$ 457

Table 12.3 reconciles the expected federal statutory tax provision to the effective provision for income taxes.

TABLE 12.3

Year Ended December 31,	2001	2000	1999
(dollars in millions)			
Provision for income taxes at the statutory rate	$ 2,205	$ 1,237	$ 1,106
Tax-exempt interest and dividends-received deductions	(148)	(140)	(79)
Tax credits	(130)	(102)	(84)
Total provision for income taxes	$ 1,927	$ 995	$ 943
Statutory tax rate	35.0%	35.0%	35.0%
Effective tax rate	30.6%	28.2%	29.8%

In 1998, the IRS issued Freddie Mac a Statutory Notice, which asserts income tax deficiencies, for the corporation's first two tax years, 1985 and 1986. In first quarter 1999, Freddie Mac filed a petition in the U.S. Tax Court ("Court") to contest the deficiencies. In third quarter 1999, the IRS issued a Statutory Notice for Freddie Mac's tax years 1987 to 1990, and Freddie Mac filed a petition in the Court on September 29, 1999. Subsequently, the Court combined the 1985 to 1990 tax years into one case.

The IRS examination of Freddie Mac's federal income tax returns for the years 1991 through 1993 has been completed. In December 2001, the IRS issued a Statutory Notice for these years. The IRS is currently examining Freddie Mac's federal income tax returns for the years 1994 through 1997. In management's opinion, adequate provision has been made for all income taxes and related interest. Management believes that any additional tax liability that may arise for prior periods as a result of IRS adjustments will not have a material adverse impact on Freddie Mac's financial condition or results of operations.

In February 1997, Freddie Mac formed two REIT subsidiaries that issued a total of $4 billion in step-down preferred stock to investors. Under IRS regulations, which were in effect when the REITs were formed, dividend payments to holders of the REITs' step-down preferred stock are tax deductible. In 1997, subsequent to the formation of Freddie Mac's REIT subsidiaries, the Department of Treasury announced its intention to propose regulations that would effectively eliminate the tax advantages of REITs that issue step-down preferred stock. On January 7, 2000 the Treasury issued final regulations. These regulations deny certain tax benefits attributable to Freddie Mac's REIT preferred stock for tax years ending on or after February 27, 1997. Accordingly, Freddie Mac has elected not to treat such dividends as fully tax deductible in its Consolidated Financial Statements. This treatment is subject to change once uncertainties related to the tax treatment of such dividends are adequately clarified. The preferred stock is redeemable by the REITs under certain circumstances where changes in applicable tax law could adversely affect the tax treatment of the REITs or preferred stock.

NOTE 13

EMPLOYEE BENEFITS

Freddie Mac maintains a tax-qualified defined benefit pension plan ("Pension Plan") covering substantially all of its employees. Pension Plan benefits are based on years of service and the employee's highest average compensation (up to legal plan limits) over any three consecutive years of employment. It is Freddie Mac's general practice to contribute to the Pension Plan an amount up to the maximum amount deductible for federal income tax purposes each year. Pension Plan assets consist primarily of corporate bonds and listed stocks. In addition to the Pension Plan, Freddie Mac maintains nonqualified, unfunded defined benefit pension plans for officers of the corporation. The related retirement benefits for the nonqualified plans are paid from Freddie Mac's general assets.

The corporation is required to accrue the estimated cost of retiree benefits as employees render the services necessary to earn their post-retirement benefits. Freddie Mac maintains a defined benefit post-retirement health care plan that provides post-retirement health care benefits on a contributory basis to retired employees age 55 or older who rendered at least five years of service after age 35 and who, upon separation or termination, immediately elected to commence benefits under the pension plan in the form of an annuity. The corporation's post-retirement health care plan currently is not funded and therefore has no plan assets.

Table 13.1 summarizes the components of consolidated net periodic benefit costs related to Freddie Mac's defined benefit pension plans and post-retirement health care plan.

TABLE 13.1

	Pension Benefits			Post-Retirement Benefits		
Year Ended December 31,	2001	2000	1999	2001	2000	1999
(dollars in thousands)						
Service cost of current period	$ 11,646	$ 9,970	$10,747	$ 2,415	$ 2,601	$ 2,444
Interest cost on benefit obligation	12,483	10,519	9,721	1,682	1,488	1,315
Expected return on plan assets	(13,557)	(12,279)	(10,685)	—	—	—
Recognized net actuarial (gain) loss	(887)	(856)	292	(329)	(144)	—
Recognized prior service cost	77	14	14	—	—	—
Recognized initial net asset being amortized over 17 years	43	43	43	—	—	—
Net periodic benefit costs	$ 9,805	$ 7,411	$10,132	$ 3,768	$ 3,945	$ 3,759

Table 13.2 summarizes the changes in the projected benefit obligation and plan assets for the defined benefit pension plans, and the change in the accumulated benefit obligation for the post-retirement health care plan. The Amendment referred to below relates to the corporation's change in the death benefit effective January 1, 2001 to provide pre-retirement death benefits for all participants.

TABLE 13.2

	Pension Benefits		Post-Retirement Benefits	
December 31,	2001	2000	2001	2000
(dollars in thousands)				
CHANGE IN BENEFIT OBLIGATION:				
Benefit obligation—beginning balance	$ 161,519	$ 141,525	$ 21,784	$ 19,916
Amendment	832	—	—	—
Service cost of current period	11,646	9,970	2,415	2,601
Interest cost on benefit obligation	12,483	10,519	1,682	1,488
Net actuarial (gain) loss	(4,914)	1,640	2,027	(2,075)
Benefits paid	(2,612)	(2,135)	(154)	(146)
Benefit obligation—ending balance	$ 178,954	$ 161,519	$ 27,754	$ 21,784
CHANGE IN PLAN ASSETS:				
Plan assets at fair value—beginning balance	$ 151,884	$ 137,680		
Actual (loss) return on plan assets	(20,585)	16,289		
Employer contributions	10,419	50		
Benefits paid	(2,612)	(2,135)		
Plan assets at fair value—ending balance	$ 139,106	$ 151,884		

Freddie Mac's pension and post-retirement health care costs and the funded status of these plans for 2001, 2000, and 1999 were calculated using assumptions as of September 30, 2001, 2000, and 1999, respectively. *Table 13.3* sets forth the funded status of the defined benefit pension plans and post-retirement health care plan, the assumptions used to calculate the funded status and amounts recognized in the Consolidated Balance Sheets.

TABLE 13.3

	Pension Benefits		Post-Retirement Benefits	
December 31,	2001	2000	2001	2000
(dollars in thousands)				
Benefit obligation in excess of plan assets	$ 39,848	$ 9,635	$ 27,754	$ 21,784
Unrecognized net actuarial (loss) gain	(3,440)	26,676	3,179	5,534
Unrecognized prior service cost	(1,214)	(459)	—	—
Initial unrecognized net asset being recognized over 17 years	(1,091)	(1,134)	—	—
Contributions made subsequent to measurement date	—	—	(41)	(38)
Net liability included in other liabilities	$ 34,103	$ 34,718	$ 30,892	$ 27,280
MAJOR ASSUMPTIONS:				
Assumed discount rate	7.50%	7.75%	7.50%	7.75%
Rate of increase in compensation levels	4.50%	4.50%	—	—
Consumer price index	3.50%	3.50%	—	—
Expected long-term rate of return on plan assets	9.00%	9.00%	—	—

The assumed health care cost trend rate used in measuring the accumulated post-retirement benefit obligation was 8.0 percent in 2001, gradually declining to 5.0 percent in the year 2006 and remaining at that level thereafter. *Table 13.4* sets forth the effect on the accumulated post-retirement benefit obligation and the sum of the service cost and interest cost components of the net periodic post-retirement benefit costs that would result from a 1 percent increase or decrease in the assumed health care cost trend rate.

TABLE 13.4

	One Percent Increase	One Percent Decrease
Effect on the accumulated post-retirement benefit obligation for health care benefits	24%	(19)%
Effect on the net periodic post-retirement benefit cost components	26%	(20)%

Freddie Mac also offers a tax-qualified defined contribution pension plan (the "Savings Plan") to all eligible employees. Employees were permitted to contribute from 1 percent to 15 percent of their annual salaries to the Savings Plan, up to $14,500 ($10,500 pre-tax and $4,000 after tax) in 2001 and 2000 and up to $12,500 ($10,000 pre-tax and $2,500 after tax) in 1999. Freddie Mac matches employees' contributions up to 6 percent of their salaries; the actual percentage of the match depends upon the length of service. In addition, Freddie Mac is authorized to make discretionary contributions to a profit sharing account in the Savings Plan on behalf of each eligible employee, based on salary level. Freddie Mac made contributions to the Savings Plan totaling $21.1 million, $16.1 million, and $15.3 million for 2001, 2000, and 1999, respectively.

NOTE 14

BUSINESS SEGMENT REPORTING

Management assesses corporate performance and allocates capital principally on the basis of the two methods by which it finances mortgages and mortgage-related assets: mortgage securitization and debt financing activities. Freddie Mac separately manages these two business activities which generate different sources and types of revenue, expose the corporation to different types and degrees of risk and require commitment of different levels of capital.

Mortgage securitization (the "Securitization Segment") involves securitizing mortgages in the form of PCs. Freddie Mac generates "Management and guarantee income," representing the fee it receives as compensation for, among other things, assuming the credit risk on Freddie Mac's total mortgage portfolio. The Securitization Segment incurs all credit-related expenses as a consequence of assuming this credit risk. Since credit risk is also the primary exposure of multifamily mortgage-related investments, the revenues and expenses generated from these investments are included in the Securitization Segment where this risk is managed. Through other activities related to securitization, Freddie Mac earns fees through the REMIC and Giant PC Programs as well as seller/servicer-related fees. In addition, income is earned from trading activities conducted in support of the market for PCs. Income generated from fee-for-service and trading activities is recorded as part of "Other income, net" or "Net interest income on earnings assets." "Net interest income on earnings assets" for the Securitization Segment also reflects interest earned on investments of capital allocated to this business segment and interest expense related to the security program variances, net of interest income from the temporary reinvestment of these balances.

Debt financing of mortgage-related assets (the "Debt Financing Segment") involves issuing debt securities (and, to a lesser extent, equity and other liabilities) to finance the retained portfolio and investment portfolios as well as executing derivative transactions. Most of the corporation's consolidated total assets are financed with debt and other liabilities. Similar to PCs held in the retained portfolio, purchases of mortgages reflect management's decision to assume the credit risk on these mortgages and to retain such mortgages as portfolio investments. Accordingly, income earned on mortgages is allocated between the corporation's two segments. "Net interest income on earnings assets" of the Debt Financing Segment is reduced by the cost of this credit guarantee.

Revenues and direct expenses are allocated among the corporation's two segments, as noted above, and overhead expenses, such as administrative expenses, are allocated either directly to each segment or through estimates, based on factors such as revenues or portfolio volume, as applicable.

Table 14.1 details the corporation's GAAP-based financial performance by segment for the years ended December 31, 2001, 2000 and 1999, respectively.

TABLE 14.1

Year Ended December 31,	2001			
	Mortgage Securitization Financing	Debt Financing	Elimination[1]	Consolidated
(dollar in millions)				
Net interest income on earning assets[2]	$ 132	$ 5,170	$ 178	$ 5,480
Management and guarantee income	1,817	—	(178)	1,639
Fair value gains (losses)	—	(27)	—	(27)
Other income, net	425	(152)	—	273
Total revenues	2,374	4,991	—	7,365
Credit-related expenses	(84)	—	—	(84)
Administrative expenses	(645)	(199)	—	(844)
Housing tax credit partnerships	(137)	—	—	(137)
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle	1,508	4,792	—	6,300
Provision for income taxes	(397)	(1,530)	—	(1,927)
Income before extraordinary items and cumulative effect of change in accounting principle, net of taxes	1,111	3,262	—	4,373
Extraordinary loss on retirement of debt, net of taxes	—	(231)	—	(231)
Cumulative effect of change in accounting principle, net of taxes[3]	—	5	—	5
Net income	$ 1,111	$ 3,036	$ —	$ 4,147

Year Ended December 31,	2000			
	Mortgage			
	Securitization	Debt		
	Financing	Financing	Elimination[1]	Consolidated
(dollar in millions)				
Net interest income on earning assets[2]	$ 283	$ 2,392	$ 163	$ 2,838
Management and guarantee income	1,652	—	(163)	1,489
Other income, net	140	(10)	—	130
Total revenues	2,075	2,382	—	4,457
Credit-related expenses	(106)	—	—	(106)
Administrative expenses	(590)	(123)	—	(713)
Housing tax credit partnerships	(104)	—	—	(104)
Income before income taxes and extraordinary items	1,275	2,259	—	3,534
Provision for income taxes	(341)	(654)	—	(995)
Income before extraordinary items, net of taxes	934	1,605	—	2,539
Extraordinary gain on retirement of debt, net of taxes	—	8	—	8
Net income	$ 934	$ 1,613	$ —	$ 2,547

Year Ended December 31,	1999			
	Mortgage			
	Securitization	Debt		
	Financing	Financing	Elimination[1]	Consolidated
(dollar in millions)				
Net interest income on earning assets[2]	$ 214	$ 2,173	$ 153	$ 2,540
Management and guarantee income	1,558	—	(153)	1,405
Other income, net	135	(25)	—	110
Total revenues	1,907	2,148	—	4,055
Credit-related expenses	(159)	—	—	(159)
Administrative expenses	(547)	(108)	—	(655)
Housing tax credit partnerships	(80)	—	—	(80)
Income before income taxes and extraordinary items	1,121	2,040	—	3,161
Provision for income taxes	(313)	(630)	—	(943)
Income before extraordinary items, net of taxes	808	1,410	—	2,218
Extraordinary gain on retirement of debt, net of taxes	—	5	—	5
Net income	$ 808	$ 1,415	$ —	$ 2,223

(1) Reflects the elimination of fees earned by the Mortgage Securitization Financing Segment for the credit guarantee it provides on mortgages retained by the Debt Financing segment, and a corresponding elimination of the cost of this credit guarantee charged to the Debt Financing Segment for purposes of deriving consolidated amounts.

(2) Net interest income for the Debt Financing Segment includes interest expense on debt securities and other liabilities that finance mortgage-related assets.

(3) Adoption of SFAS 133 on January 1, 2001.

NOTE 15

FAIR VALUE DISCLOSURES

The Consolidated Fair Value Balance Sheets in *Table 15.1* present Freddie Mac's estimates of the fair value of the corporation's assets, liabilities, derivatives and other obligations as of December 31, 2001 and 2000. These balance sheets were prepared on the fair value basis of accounting, which is a basis of accounting other than GAAP, to provide relevant financial information that is not provided by the GAAP financial statements. These disclosures satisfy the guidelines of SFAS 107, "Disclosures About Fair Value of Financial Instruments."

TABLE 15.1

December 31,	2001		2000	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(dollars in billions)				
ASSETS				
Mortgages, net	$ 62.5	$ 63.8	$ 58.9	$ 59.7
Guaranteed mortgage securities, net	431.8	435.5	326.2	326.7
Retained portfolio, net	494.3	499.3	385.1	386.4
Cash and cash equivalents	1.5	1.5	0.4	0.4
Investments	81.4	81.4	48.2	48.2
Other assets	38.5	38.6	25.6	24.4
Derivatives	1.6	1.6	—	—
Off-balance sheet items:				
Guarantee fees on Total PCs	(0.5)	2.1	(0.5)	2.9
	$ 616.8	$ 624.5	$ 458.8	$ 462.3
LIABILITIES AND NET FAIR VALUE				
Total debt securities, net	$ 565.0	$ 569.1	$ 428.3	$ 429.4
Other liabilities	33.9	33.9	17.1	16.8
Derivatives	2.5	2.5	(1.4)	0.3
	601.4	605.5	444.0	446.5
Estimated income taxes on differences between fair values and GAAP values	—	1.3	—	0.4
Preferred stock	4.6	4.5	3.2	3.0
Common stockholders' equity, net of taxes	10.8	13.2	11.6	12.4
	$ 616.8	$ 624.5	$ 458.8	$ 462.3

Limitations

The fair value of "Common stockholders' equity, net of taxes" represents the difference between the estimated fair value of assets and liabilities reduced by the tax effect of the difference between the fair value and GAAP value of equity. This estimate does not attempt to present Freddie Mac's value as a going concern or present the value of anticipated future business. Therefore, net fair value does not represent an estimate of the aggregate fair value of Freddie Mac's common stock or the corporation as a whole.

Valuation Methods and Assumptions

The following methods and assumptions were used to estimate the fair value of assets and liabilities at December 31, 2001 and 2000.

Mortgages, Net

Freddie Mac values mortgages based on comparisons to actively traded PCs with similar characteristics.

Guaranteed Mortgage Securities (GMS), Net

The fair value of GMS, net is based on quoted market prices for each security in the portfolio. The fair value of available-for-sale securities equals the value used on the GAAP balance sheets.

Cash and Cash Equivalents and Investments

These assets are generally short-term in nature. Therefore, the carrying amount on the GAAP balance sheet is a reasonable estimate of fair value.

Other Assets and Other Liabilities

These amounts are generally short-term in nature. Therefore, the carrying amount on the GAAP balance sheet is a reasonable estimate of fair value.

Derivatives

The fair value of derivatives is based on market prices or, to the extent that market quotes are not available, on discounted cash flows using market estimates of interest rates and volatility.

Guarantee Fees on Total PCs

The fair value of guarantee fees on Total PCs includes the expected guarantee fee income on Total PCs, net of the expected default costs on the underlying mortgages, float costs from remittance cycle cash flows, and servicing-related administrative costs. The present value of guarantee fee cash flows and expected future default costs on the underlying mortgages is estimated using proprietary models. The fair value of the costs from remittance cycle cash flows is based on the estimated reinvestment income earned during the period between the remittance of mortgage principal and interest to Freddie Mac, and the disbursement of these funds to PC investors. The carrying amount at December 31, 2001 and 2000 represents the “Reserve for Losses on Mortgage Participation Certificates” which is reported as part of total assets for purposes of this presentation.

Total Debt Securities, Net and Preferred Stock

The fair value of these amounts is based on quoted market prices.

Estimated Income Taxes on Differences Between Fair Values and GAAP Values

The fair value balance sheet includes an estimate of federal income taxes on the difference between the carrying value and the fair value of “Common stockholders’ equity, net of taxes” by applying the statutory federal tax rate of 35 percent to the excess of net fair value over “Common stockholders’ equity” measured under GAAP. This adjustment is made to the fair value of equity based on the assumption that income taxes will be paid on future earnings.

NOTE 16

RETAINED INTERESTS RESULTING FROM THE RESECURITIZATION OF MORTGAGE-BACKED SECURITIES

Freddie Mac resecuritizes PCs and other mortgage securities it owns primarily into REMICs or Giant PCs, and frequently retains an interest in these assets. Freddie Mac accounts for these resecuritizations under SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The initial carrying value of the retained interest in resecuritizations is measured by allocating the previous carrying amount of the financial assets involved in the transfer between the assets sold and the retained interests based on their relative fair value at the date of transfer. Freddie Mac estimates the fair value of retained interests primarily using quoted market prices. Gain or loss is recognized on the portion of assets sold.

Proceeds from resecuritizations of PCs and mortgage securities the corporation owned were $23 billion for 2001. Cash flows received on retained interests were $11 billion for 2001. Freddie Mac recognized net gains for the year ended December 31, 2001 totaling $23 million. Prior to 2001, resecuritizations by Freddie Mac of PCs and mortgage securities it owns were insignificant.

Freddie Mac uses external models to determine the market value and potential change in value due to variations in two primary key assumptions: discount rate and prepayment speed. These models use a range of interest-rate scenarios to estimate future prepayments on the underlying mortgages. The effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumptions; however, changes in one factor may result in variation in another, which may magnify or counteract the sensitivities. These sensitivities are hypothetical and should be used with caution. In addition, these sensitivities only measure the change in value of the retained interests while ignoring offsetting changes in the values of associated debt funding (which would normally be expected to offset, fully or partially, the changes in retained interest values).

For measuring the fair value of the retained interests at the date of resecuritization, the discount rate assumption ranged from 4.9 percent to 27.3 percent (the high end of the range applies to retained interest-only securities, which account for less than 1 percent of total retained interests) and the annual prepayment speed assumption on the underlying mortgages ranged from 9 percent to 30 percent. At December 31, 2001, the key assumptions used in valuing retained interests at the end of the latest period and the sensitivity of the fair value of retained interests to immediate 10 percent and 20 percent adverse changes in those assumptions are as follows:

TABLE 16.1

December 31,	2001
(dollars in millions)	
Fair value of retained interests	$ 64,507
Weighted average discount rate assumption	6.0%
Impact on fair value of 10% adverse change	$ (1,480)
Impact on fair value of 20% adverse change	$ (2,959)
Weighted average life (in years)	6.7
Weighted average prepayment speed assumption	13.7%
Impact on fair value of 10% adverse change	$ (85)
Impact on fair value of 20% adverse change	$ (146)

Management's Report on Consolidated Financial Statements and Internal Control Structure

The management of Freddie Mac (or the "corporation") is responsible for the preparation, integrity and fair presentation of the corporation's annual Consolidated Financial Statements. The annual Consolidated Financial Statements presented have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and, as such, include amounts based on judgments and estimates made by management. Management also has prepared the other information included in this annual report, and is responsible for its accuracy and consistency with the Consolidated Financial Statements.

The annual Consolidated Financial Statements referred to above have been audited by Arthur Andersen LLP, independent public accountants, who have been given unrestricted access to all financial records and related data, including minutes of all meetings of stockholders, the Board of Directors (the "Board") and committees of the Board. Management believes that all representations made to Arthur Andersen LLP during the audit were valid and appropriate.

In addition, management is responsible for establishing and maintaining an internal control structure over financial reporting, including controls over the safeguarding of assets. The objective of the internal control structure is to provide reasonable assurance to management and the Board as to the preparation of the financial statements in accordance with GAAP.

Management has made its own assessment of the effectiveness of the corporation's internal control structure over financial reporting, including controls over the safeguarding of assets, as of December 31, 2001, in relation to the criteria described in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2001, the corporation's internal control structure was effective in achieving the objective stated above.

There are inherent limitations in the effectiveness of any internal control structure, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control structure can provide only reasonable assurance with respect to the reliability of the financial statements. Furthermore, the effectiveness of any internal control structure can change with changes in circumstances.

Management also recognizes its responsibility for fostering a strong ethical climate so that Freddie Mac's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in Freddie Mac's Code of Conduct, which is publicized throughout the corporation. The Code of Conduct addresses, among other things, potential conflicts of interest, acceptable employee activities conducted outside of Freddie Mac, acceptable financial activities, confidentiality of proprietary information, ethical business conduct and compliance with the Code of Conduct. Freddie Mac maintains a systematic program to assess compliance with the Code of Conduct.

The corporation has an Internal Audit Department whose responsibilities include monitoring compliance with established policies and procedures and evaluating Freddie Mac's internal control structure. The Internal Audit Department is independent of the activities it reviews. Operational and special audits are conducted, and internal audit reports are submitted to appropriate management and the Audit Committee of Freddie Mac's Board.

The Audit Committee of the Board meets periodically with management, internal auditors and Freddie Mac's independent public accountants to review matters relating to financial accounting and reporting policies and control procedures. Both Arthur Andersen LLP and the Internal Audit Department have full and free access, with and without management present, to the Audit Committee.

Leland C Brendsel

Leland C. Brendsel
Chairman and Chief Executive Officer

Vaughn A. Clarke
Executive Vice President and Chief Financial Officer

Report of Independent Public Accountants on Consolidated Financial Statements

To the Board of Directors and Stockholders of Freddie Mac:

We have audited the accompanying Consolidated Balance Sheets of Freddie Mac, a federally chartered corporation (the "corporation"), and subsidiaries as of December 31, 2001 and 2000, and the related Consolidated Statements of Income, Stockholders' Equity and Cash Flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Freddie Mac and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

As discussed in Notes 1 and 10 to the consolidated financial statements, effective January 1, 2001, the corporation changed its method of accounting for derivatives.

We have also audited, in accordance with auditing standards generally accepted in the United States, the supplemental Consolidated Fair Value Balance Sheets of Freddie Mac as of December 31, 2001 and 2000. As described in Note 15, the supplemental Consolidated Fair Value Balance Sheets have been prepared by management to present relevant financial information that is not provided by the Consolidated Balance Sheets referred to above and are not intended to be a presentation in conformity with accounting principles generally accepted in the United States. In addition, the supplemental Consolidated Fair Value Balance Sheets do not purport to present the net realizable, liquidation or market value of the corporation as a whole. Furthermore, amounts ultimately realized by the corporation from the disposal of assets and settlement of liabilities may vary significantly from the fair values presented. In our opinion, the supplemental Consolidated Fair Value Balance Sheets referred to above present fairly, in all material respects, the information set forth therein as described in Note 15.

Arthur Andersen LLP

Vienna, Virginia
January 18, 2002

Report of Independent Public Accountants on Management's Assertion About the Effectiveness of the Internal Control Structure Over Financial Reporting

To the Board of Directors and Stockholders of Freddie Mac:

We have examined management's assertion that Freddie Mac maintained effective internal control over financial reporting, as of December 31, 2001, based on criteria established in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission, included in the accompanying Management's Report on Consolidated Financial Statements and Internal Control Structure. Management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of internal control based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any system of internal control, errors or irregularities may occur and not be detected. Also, projections of any evaluation of the system to future periods are subject to the risk that the system of internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that Freddie Mac maintained effective internal control over financial reporting, as of December 31, 2001, is fairly stated, in all material respects, based upon criteria established in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Arthur Andersen LLP

Vienna, Virginia
January 18, 2002

Additional Financial Information (unaudited)

QUARTERLY RESULTS OF OPERATIONS

	2001				2000			
	4th	3rd[1]	2nd[1]	1st	4th	3rd	2nd	1st
(dollars in millions)								
Interest income	$ 9,031	$ 8,709	$ 8,465	$ 8,083	$ 7,643	$ 7,264	$ 6,912	$ 6,531
Interest expense	(7,155)	(7,271)	(7,275)	(7,107)	(6,905)	(6,527)	(6,216)	(5,864)
Net interest income on earning assets	1,876	1,438	1,190	976	738	737	696	667
Management and guarantee income	433	416	398	392	383	372	368	366
Fair value gains (losses)	105	(85)	(64)	17	—	—	—	—
Other income, net	92	68	77	36	38	16	43	33
Total revenues	2,506	1,837	1,601	1,421	1,159	1,125	1,107	1,066
Provision for mortgage losses	(15)	(10)	(10)	(10)	(10)	(10)	(10)	(10)
REO operations expense	(9)	(8)	(8)	(14)	(15)	(11)	(19)	(21)
Administrative expenses	(259)	(201)	(194)	(190)	(184)	(180)	(180)	(169)
Housing tax credit partnerships	(39)	(34)	(32)	(32)	(26)	(26)	(26)	(26)
Income before income taxes, extraordinary items and cumulative effect of change in accounting principle	2,184	1,584	1,357	1,175	924	898	872	840
Provision for income taxes	(689)	(487)	(408)	(343)	(261)	(256)	(246)	(232)
Income before extraordinary items and cumulative effect of change in accounting principle, net of taxes	1,495	1,097	949	832	663	642	626	608
Extraordinary (loss) gain on retirement of debt, net of taxes	(131)	(65)	(35)	—	—	3	5	—
Cumulative effect of change in accounting principle, net of taxes	—	—	—	5	—	—	—	—
Net income	$ 1,364	$ 1,032	$ 914	$ 837	$ 663	$ 645	$ 631	$ 608
Net income available to common stockholders	$ 1,305	$ 974	$ 861	$ 790	$ 618	$ 600	$ 586	$ 563
EARNINGS PER COMMON SHARE BEFORE EXTRAORDINARY ITEMS AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE[2]								
Basic	$ 2.07	$ 1.49	$ 1.29	$ 1.13	$ 0.89	$ 0.86	$ 0.84	$ 0.81
Diluted	$ 2.06	$ 1.49	$ 1.29	$ 1.12	$ 0.89	$ 0.86	$ 0.83	$ 0.81
EARNINGS PER COMMON SHARE[2]								
Basic	$ 1.88	$ 1.40	$ 1.24	$ 1.14	$ 0.89	$ 0.87	$ 0.84	$ 0.81
Diluted	$ 1.87	$ 1.40	$ 1.24	$ 1.13	$ 0.89	$ 0.86	$ 0.84	$ 0.81

[1] In fourth quarter 2001, Freddie Mac revised its reporting for certain income and expense associated with SFAS 133, which the corporation adopted on January 1, 2001. This change represents a reclassification between "Fair value gains (losses)" and "Net interest income on earning assets." This reclassification has been retroactively applied to previous quarters in 2001 for comparability purposes.

[2] "Earnings per common share-basic" are computed based on weighted average common shares outstanding. "Earnings per common share-diluted" are computed based on the total of weighted average common shares outstanding and the effect of dilutive common equivalent shares outstanding.

Additional Financial Information (unaudited)

TOTAL MORTGAGE PORTFOLIO LIQUIDATION ACTIVITY (ANNUALIZED)

	Quarter Ended				
Year	March 31	June 30	September 30	December 31	Annual
2001	19.8%	28.9%	24.8%	39.8%	30.6%
2000	10.3%	12.2%	12.7%	12.4%	12.3%
1999	25.8%	20.8%	15.3%	11.6%	19.6%
1998	26.7%	27.8%	26.1%	35.8%	30.5%
1997	11.7%	13.4%	16.0%	18.0%	14.7%

MORTGAGE DELINQUENCY STATISTICS

SINGLE-FAMILY MORTGAGES (based on number of mortgages)

Date	Total Number of Mortgages[1]	Delinquent Three or More Payments[1]	Foreclosures Approved and in Process[1]	At-risk Portfolio[1]	Total Portfolio
12/01	7,985,083	0.19%	0.22%	0.41%	0.65%
12/00	7,296,319	0.18%	0.19%	0.37%	0.50%
12/99	6,879,620	0.16%	0.23%	0.39%	0.43%
12/98	6,420,915	0.23%	0.27%	0.50%	0.49%
12/97	6,668,745	0.22%	0.33%	0.55%	0.56%

(1) Includes only loans for which Freddie Mac has assumed primary default risk. Excludes loans for which the lender or a third party has retained primary default risk by pledging collateral or agreeing to accept losses on loans that default and securities guaranteed by agencies such as Ginnie Mae or subject to subordination agreements. In some cases, the lender's or third party's risk is limited to a specific level of losses at the time the credit enhancement becomes effective.

MULTIFAMILY MORTGAGES (based on net carrying value of mortgages)

Date	Total Dollars of Mortgages	Delinquent Two or More Payments	Foreclosures Approved and in Process	Total	Net Carrying Value of Non-Performing Mortgages
(dollars in millions)					
12/01	$ 29,959	0.15%	0.00%	0.15%	$ 44
12/00	$ 22,077	0.03%	0.01%	0.04%	$ 9
12/99	$ 16,817	0.12%	0.02%	0.14%	$ 23
12/98	$ 10,972	0.18%	0.19%	0.37%	$ 40
12/97	$ 8,364	0.52%	0.44%	0.96%	$ 80

Eleven-Year Financial Highlights

December 31, *(dollars in millions, except per share amounts)*	2001	2000	1999
Total mortgage portfolio	$1,138,167	$ 961,794	$ 862,326
Retained portfolio	$ 491,719	$ 385,693	$ 324,443
Total PCs	$ 948,409	$ 822,310	$ 749,081
Total assets	$ 617,340	$ 459,297	$ 386,684
Total capital[1]	$ 20,137	$ 15,165	$ 13,463
Adjusted total capital[2]	$ 23,262	$ 15,310	$ 13,593
New business purchases	$ 475,091	$ 207,423	$ 272,472
Number of new business purchases	2,892,508	1,465,280	2,058,330
PC issuances	$ 389,611	$ 166,901	$ 233,031
Operating net interest income on earning assets [3]	$ 3,932	$ 2,838	$ 2,540
Management and guarantee income	$ 1,639	$ 1,489	$ 1,405
Operating total revenues[3]	$ 5,844	$ 4,457	$ 4,055
Operating earnings[3]	$ 3,154	$ 2,547	$ 2,223
Operating earnings per common share—diluted[3][4]	$ 4.21	$ 3.40	$ 2.96
Dividends per common share[4]	$ 0.80	$ 0.68	$ 0.60
Operating return on realized common equity[3]	23.1%	22.9%	23.8%

(1) Stockholders' equity excluding Accumulated Other Comprehensive Income ("Core capital"), plus the sum of "Reserve for losses on retained mortgages" and "Reserve for losses on Mortgage Participation Certificates."

(2) "Total capital" plus "Subordinated borrowings."

(3) See "Management's Discussion and Analysis of Financial Condition and Results of Operations–OPERATING EARNINGS." Prior to 2001, operating and reported diluted earnings per common share were identical.

(4) "Operating Earnings per common share" and "Dividends per common share" reflect a three-for-one stock split effective March 1992 and a four-for-one stock split effective December 1996.

See also Five-Year Financial Highlights.

1998	1997	1996	1995	1994	1993	1992	1991
$ 733,360	$ 640,406	$ 610,820	$ 566,469	$ 533,484	$ 494,727	$ 441,410	$ 386,209
$ 255,009	$ 164,421	$ 137,755	$ 107,424	$ 72,828	$ 55,698	$ 33,896	$ 27,046
$ 646,459	$ 579,385	$ 554,260	$ 515,051	$ 491,325	$ 454,906	$ 407,514	$ 359,163
$ 321,421	$ 194,597	$ 173,866	$ 137,181	$ 106,199	$ 83,880	$ 59,502	$ 46,860
$ 11,483	$ 8,069	$ 7,423	$ 6,513	$ 5,902	$ 5,197	$ 4,355	$ 3,303
$ 11,645	$ 8,590	$ 7,913	$ 7,146	$ 7,128	$ 6,680	$ 5,813	$ 5,265
$ 288,338	$ 121,490	$ 128,565	$ 98,386	$ 124,246	$ 229,706	$ 191,126	$ 99,965
2,396,651	1,085,046	1,232,540	934,890	1,256,566	2,315,162	1,969,851	1,061,942
$ 250,564	$ 114,258	$ 119,702	$ 85,877	$ 117,110	$ 208,724	$ 179,207	$ 92,479
$ 1,927	$ 1,631	$ 1,542	$ 1,298	$ 1,047	$ 808	$ 695	$ 683
$ 1,307	$ 1,298	$ 1,249	$ 1,185	$ 1,173	$ 1,077	$ 936	$ 792
$ 3,337	$ 3,029	$ 2,875	$ 2,541	$ 2,300	$ 2,023	$ 1,695	$ 1,511
$ 1,700	$ 1,395	$ 1,243	$ 1,091	$ 983	$ 786	$ 622	$ 555
$ 2.31	$ 1.88	$ 1.63	$ 1.41	$ 1.26	$ 1.01	$ 0.82	$ 0.77
$ 0.48	$ 0.40	$ 0.35	$ 0.30	$ 0.26	$ 0.22	$ 0.19	$ 0.17
24.6%	23.4%	22.2%	21.9%	23.2%	22.3%	21.2%	23.6%

Shareholder Information

QUARTERLY COMMON STOCK INFORMATION

	2001				2000				1999			
	4th	3rd	2nd	1st	4th	3rd	2nd	1st	4th	3rd	2nd	1st
Closing Trading Prices												
High	$ 70.79	$ 69.57	$ 69.89	$ 67.68	$ 69.00	$ 54.13	$ 51.00	$ 50.44	$ 55.75	$ 61.06	$ 64.63	$ 61.19
Low	63.31	60.80	60.15	60.00	50.75	38.94	40.13	37.69	45.75	49.75	53.56	55.00
Dividends Declared	0.20	0.20	0.20	0.20	0.17	0.17	0.17	0.17	0.15	0.15	0.15	0.15

ABOUT FREDDIE MAC'S EQUITY CAPITAL

As of December 31, 2001, Freddie Mac had two types of stock outstanding: common stock, having a par value of $0.21 per share, and seventeen classes of non-cumulative preferred stock, having a par value of $1.00 per share.

Freddie Mac's common stock is listed on the New York and Pacific Stock Exchanges. As of December 31, 2001, there were 695,132,394 shares outstanding of common stock. Options on Freddie Mac's common stock are traded on U.S. option exchanges.

The following table summarizes Freddie Mac's outstanding non-cumulative preferred stock as of December 31, 2001.

Description	Shares Outstanding	NYSE Symbol[1]
(shares in millions)		
1996 Variable-rate	5.00	FRE.prB
6.125%	5.75	FRE.prC
6.14%	12.00	FRE.prD
5.81% (1997 issue)	3.00	(2)
5%	8.00	FRE.prF
1998 Variable-rate	4.395	FRE.prG
5.1% (1998 issue)	8.00	FRE.prH
5.3%	4.00	(2)
5.1% (1999 issue)	3.00	(2)
5.79%	5.00	FRE.prK
1999 Variable-rate	5.75	FRE.prL
2001 Variable-rate	6.50	FRE.prM
2001 Variable-rate	4.60	FRE.prN
5.81% (2001 issue)	3.45	FRE.prO
6.0%	3.45	FRE.prP
2001 Variable-rate	4.02	FRE.prQ
5.7%	6.00	FRE.prR

(1) Preferred stock is listed on the New York Stock Exchange, unless otherwise noted.
(2) Not listed on any exchange.

On January 29, 2002, Freddie Mac issued 6,000,000 shares of 5.81% Non-Cumulative Preferred Stock ("2002 5.81% Issue") at a price of $50 per share. The 2002 5.81% Issue has a liquidation preference of $50 per share, is redeemable on March 31, 2007 and thereafter and ranks on a parity, both as to dividends and upon liquidation, with other currently outstanding series of Freddie Mac preferred stock. The 2002 5.81% Issue is not listed on the New York Stock Exchange. Freddie Mac redeemed the 6.125% non-cumulative preferred stock with a redemption value of $287 million on February 24, 2002.

As of February 28, 2002, Freddie Mac had approximately 5,627 common stockholders of record. Freddie Mac estimates that approximately 201,000 additional common stockholders hold shares through banks, brokers and nominees.

STOCK TRANSFER AGENT

Inquiries concerning lost stock certificates, dividend payments, change of address and account status should be directed to Freddie Mac's stock transfer agent:

EquiServe Trust Company, N.A.
P.O. Box 2500
Jersey City, New Jersey 07303-2500
Toll Free: (800) 519-3111

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ADDITIONAL FINANCIAL INFORMATION

For more information about Freddie Mac stock or to obtain a copy of the latest Information Statement (prepared in lieu of a Form 10-K), contact:

Freddie Mac
Mailstop A57
8250 Jones Branch Drive
McLean, Virginia 22102
Toll Free: (800) FREDDIE
On the Internet: http://www.freddiemac.com

ANNUAL MEETING

The annual meeting of Freddie Mac's shareholders will be held:
Thursday, May 2, 2002
9:00 a.m. Eastern Time
McLean Hilton Hotel
7920 Jones Branch Drive
McLean, Virginia 22102

Proxy material will be mailed to shareholders of record on or about April 2, 2002.

DIVIDEND PAYMENT

Subject to approval by Freddie Mac's Board of Directors, dividends on the corporation's common stock and non-cumulative preferred stock in 2002 are expected to be paid on or about:

March 31, 2002
June 30, 2002
September 30, 2002
December 31, 2002

Freddie Mac

We Open Doors®

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