FEDERAL HOME LOAN MORTGAGE CORP
Form 10-K
February 28, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

Commission File Number: 001-34139

Federal Home Loan Mortgage Corporation

(Exact name of registrant as specified in its charter)

Freddie Mac

Federally chartered corporation	**8200 Jones Branch Drive McLean, Virginia 22102-3110**	**52-0904874**	**(703) 903-2000**
(State or other jurisdiction of incorporation or organization)	*(Address of principal executive offices, including zip code)*	*(I.R.S. Employer Identification No.)*	*(Registrant s telephone number, including area code)*

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Voting Common Stock, no par value per share (OTCQB: FMCC)

Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCI)

5% Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCKK)

Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCG)

5.1% Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCH)

5.79% Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCK)

Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCL)

Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCM)

Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCN)

5.81% Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCO)

6% Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCP)

Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCCJ)

5.7% Non-Cumulative Preferred Stock, par value $1.00 per share (OTCQB: FMCKP)

Variable Rate, Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCCS)

6.42% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCCT)

5.9% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCKO)

5.57% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCKM)

5.66% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCKN)

6.02% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCKL)

6.55% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCKI)

Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share (OTCQB: FMCKJ)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [X]

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer (Do not check if a smaller reporting company) [ ]	Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The aggregate market value of the common stock held by non-affiliates computed by reference to the price at which the common equity was last sold on June 29, 2012 (the last business day of the registrant s most recently completed second fiscal quarter) was $162.5 million.

As of February 15, 2013, there were 650,038,674 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None

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PART I

This Annual Report on Form 10-K includes forward-looking statements that are based on current expectations and are subject to significant risks and uncertainties. These forward-looking statements are made as of the date of this Form 10-K and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date of this Form 10-K. Actual results might differ significantly from those described in or implied by such statements due to various factors and uncertainties, including those described in: the BUSINESS Forward-Looking Statements and RISK FACTORS sections of this Form 10-K.

Throughout this Form 10-K, we use certain acronyms and terms that are defined in the GLOSSARY.

ITEM 1. BUSINESS

Conservatorship and Government Support for Our Business

We continue to operate under the direction of FHFA, as our Conservator. We are also subject to certain constraints on our business activities imposed by Treasury due to the terms of, and Treasury s rights under, the Purchase Agreement. We are dependent upon the continued support of Treasury and FHFA in order to continue operating our business. Our ability to access funds from Treasury under the Purchase Agreement is critical to keeping us solvent and avoiding the appointment of a receiver by FHFA under statutory mandatory receivership provisions. The conservatorship and related matters have had a wide-ranging impact on us, including our regulatory supervision, management, business, financial condition, and results of operations.

There is significant uncertainty as to whether or when we will emerge from conservatorship, as it has no specified termination date, and as to what changes may occur to our business structure during or following conservatorship, including whether we will continue to exist. We are not aware of any current plans of our Conservator to significantly change our business model or capital structure in the near-term. Our future structure and role will be determined by the Administration and Congress, and there are likely to be significant changes beyond the near-term. We have no ability to predict the outcome of these deliberations.

As our Conservator, FHFA succeeded to all rights, titles, powers and privileges of Freddie Mac, and of any stockholder, officer or director thereof, with respect to the company and its assets. FHFA, as Conservator, has directed and will continue to direct certain of our business activities and strategies. FHFA has delegated certain authority to our Board of Directors to oversee, and to management to conduct, day-to-day operations. The directors serve on behalf of, and exercise authority as directed by, the Conservator.

In March 2012, FHFA instituted the 2012 conservatorship scorecard, or the Conservatorship Scorecard, for use by both us and Fannie Mae that established business objectives and performance targets and measures, and provided the implementation roadmap for FHFA s strategic plan for Freddie Mac and Fannie Mae. We continue to align our resources and internal business plans to meet the goals and objectives in FHFA s directives. See Regulation and Supervision *Legislative and Regulatory Developments FHFA s Strategic Plan for Freddie Mac and Fannie Mae Conservatorships* and EXECUTIVE COMPENSATION Compensation Discussion and Analysis for further information.

Our current business objectives reflect direction we have received from the Conservator (including the Conservatorship Scorecard), our charter, other legislation, and public statements from FHFA and Treasury officials. Our business objectives have changed considerably since we entered into conservatorship and may continue to change. Certain changes to our business objectives and strategies are designed to provide support for the mortgage market in a manner that serves our public mission and other non-financial objectives. However, these changes to our business objectives and strategies may not contribute to our profitability. Some of these changes increase our expenses, while others require us to forego revenue opportunities.

On February 21, 2012, FHFA sent to Congress a strategic plan for the next phase of the conservatorships of Freddie Mac and Fannie Mae. FHFA stated that the steps envisioned in the plan are consistent with each of the housing finance reform frameworks set forth in the report delivered by the Administration to Congress in February 2011, which is described below, as well as with the leading congressional proposals previously introduced. FHFA s plan provides lawmakers and the

public with an outline of how FHFA as Conservator intends to guide Freddie Mac and Fannie Mae over the next few years, and identifies three strategic goals:

Build. Build a new infrastructure for the secondary mortgage market;

Contract. Gradually contract Freddie Mac and Fannie Mae s dominant presence in the marketplace while simplifying and shrinking their operations; and

Maintain. Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

On February 11, 2011, the Administration delivered a report to Congress that lays out the Administration s plan to reform the U.S. housing finance market, including options for structuring the government s long-term role in a housing finance system in which the private sector is the dominant provider of mortgage credit. The report recommends winding down Freddie Mac and Fannie Mae, and states that the Administration will work with FHFA to determine the best way to responsibly reduce the role of Freddie Mac and Fannie Mae in the market and ultimately wind down both institutions. The report states that these efforts must be undertaken at a deliberate pace, which takes into account the impact that these changes will have on borrowers and the housing market.

The report states that the government is committed to ensuring that Freddie Mac and Fannie Mae have sufficient capital to perform under any guarantees issued now or in the future and the ability to meet any of their debt obligations, and further states that the Administration will not pursue policies or reforms in a way that would impair the ability of Freddie Mac and Fannie Mae to honor their obligations. The report states the Administration s belief that under the companies senior preferred stock purchase agreements with Treasury, there is sufficient funding to ensure the orderly and deliberate wind down of Freddie Mac and Fannie Mae, as described in the Administration s plan.

Based on our Net Worth Amount at December 31, 2012, our dividend obligation to Treasury in March 2013 will be $5.8 billion. On August 17, 2012, Freddie Mac, acting through FHFA, as Conservator, and Treasury entered into an amendment to the Purchase Agreement that, among other items, replaced the fixed 10% dividend rate on the senior preferred stock with a net worth sweep dividend beginning in the first quarter of 2013. Under the net worth sweep dividend provisions, we are required to pay dividends to the extent that our Net Worth Amount exceeds a permitted capital reserve amount (established at $3 billion for 2013 and declining to zero in 2018). This amendment effectively ends the circular practice of taking draws from Treasury to pay dividends to Treasury, thereby helping to preserve remaining funding available to us under the Purchase Agreement. See NOTE 2: CONSERVATORSHIP AND RELATED MATTERS Purchase Agreement for more information.

The aggregate liquidation preference of the senior preferred stock was $72.3 billion and $72.2 billion at December 31, 2012, and 2011, respectively. Beginning January 1, 2013, the remaining funding commitment from Treasury under the Purchase Agreement is $140.5 billion. This amount will be reduced by any future draws. Under the Purchase Agreement, our ability to repay the liquidation preference of the senior preferred stock is limited and we will not be able to do so for the foreseeable future, if at all. The aggregate liquidation preference of the senior preferred stock will increase further if we receive additional draws. For a discussion of factors that could result in additional draws, see RISK FACTORS Conservatorship and Related Matters *We may request additional draws under the Purchase Agreement in future periods.*

For more information on our current business objectives, see Executive Summary *Our Primary Business Objectives.* For more information on the conservatorship and government support for our business, including the Purchase Agreement, see Conservatorship and Related Matters and Treasury Agreements.

Executive Summary

You should read this Executive Summary in conjunction with our MD&A and consolidated financial statements and related notes for the year ended December 31, 2012.

Overview

Freddie Mac is a GSE chartered by Congress in 1970 with a public mission to provide liquidity, stability, and affordability to the U.S. housing market. We have maintained a consistent market presence since our inception, providing mortgage liquidity in a wide range of economic environments. We are working to support the recovery of the housing market and the nation s economy by providing essential liquidity to the

mortgage market and helping to stem the rate of

foreclosures. We believe our actions are helping communities across the country by providing America s families with access to mortgage funding at low rates while helping distressed borrowers keep their homes and avoid foreclosure, where feasible.

Summary of Financial Results

During 2012, we observed certain signs of improvement in the housing market, which contributed positively to our financial results. Our comprehensive income for the year ended December 31, 2012 was $16.0 billion, consisting of $11.0 billion of net income and $5.1 billion of total other comprehensive income. By comparison, our comprehensive income (loss) for the year ended December 31, 2011 was $(1.2) billion, consisting of $(5.3) billion of net income (loss) and $4.0 billion of total other comprehensive income.

Our total equity was $8.8 billion at December 31, 2012, reflecting our total equity balance of $4.9 billion at September 30, 2012, comprehensive income of $5.7 billion for the fourth quarter of 2012 and our dividend payment of $1.8 billion on our senior preferred stock in December 2012. As a result of our positive net worth at December 31, 2012, no draw is being requested from Treasury under the Purchase Agreement for the fourth quarter of 2012.

Our Primary Business Objectives

We are focused on the following primary business objectives: (a) providing credit availability for mortgages and maintaining foreclosure prevention activities; (b) minimizing our credit losses; (c) developing mortgage market enhancements in support of a new infrastructure for the secondary mortgage market; (d) maintaining sound credit quality on the loans we purchase or guarantee; (e) contracting the dominant presence of the GSEs in the marketplace; and (f) strengthening our infrastructure and improving overall efficiency while also focusing on retention of key employees. Our business objectives reflect direction we have received from the Conservator, including the Conservatorship Scorecard. See EXECUTIVE COMPENSATION Compensation Discussion and Analysis for further information.

Providing Credit Availability for Mortgages and Maintaining Foreclosure Prevention Activities

We provide liquidity and support to the U.S. mortgage market in a number of important ways:

- Our support enables borrowers to have access to a variety of conforming mortgage products, including the prepayable 30-year fixed-rate mortgage, which historically has represented the foundation of the mortgage market.

- Our support provides lenders with a constant source of liquidity for conforming mortgage products. We estimate that we, Fannie Mae, and Ginnie Mae collectively guaranteed more than 90% of the single-family conforming mortgages originated during 2012 and 2011.

- Our consistent market presence provides assurance to our customers that there will be a buyer for their conforming loans that meet our credit standards. We believe this liquidity provides our customers with confidence to continue lending in difficult environments.

- We are an important counter-cyclical influence as we stay in the market even when other sources of capital have withdrawn.

During 2012 and 2011, we purchased or issued other guarantee commitments for $426.8 billion and $320.8 billion in UPB of single-family conforming mortgage loans, representing approximately 2.0 million and 1.5 million homes, respectively.

Borrowers typically pay a lower interest rate on loans acquired or guaranteed by Freddie Mac, Fannie Mae, or Ginnie Mae. Mortgage originators are able to offer homebuyers and homeowners lower mortgage rates on conforming loan products, in part because of the value investors place on GSE-guaranteed mortgage-related securities. In December 2012, we estimated that borrowers were paying an average of 43 basis points less on these conforming loans than on non-conforming loans. These estimates were based on data provided by HSH Associates, a third-party provider of mortgage market data.

We are focused on reducing the number of foreclosures and helping to keep families in their homes. In 2012, we continued to introduce new initiatives designed to help eligible borrowers keep their homes and avoid foreclosure. Since 2009, we have helped more than 785,000 borrowers

experiencing hardship complete a loan workout.

Our relief refinance initiative, including HARP (which is the portion of our relief refinance initiative for loans with LTV ratios above 80%), is a significant part of our effort to keep families in their homes. We implemented a number of changes to HARP in late 2011 and 2012. These changes allowed more borrowers to participate in the program and benefit from refinancing their home mortgages, including borrowers whose mortgages have LTV ratios above 125%. Our purchases of HARP loans increased to $86.9 billion in 2012, compared to $39.7 billion in 2011. We have purchased HARP loans provided to nearly 915,000 borrowers since the initiative began in 2009, including more than 434,000 borrowers during 2012.

Under our loan workout programs, our servicers contact borrowers and attempt to help borrowers experiencing hardship stay in their homes or avoid foreclosure. Our servicers seek and also facilitate the completion of foreclosure alternatives when a home retention solution is not possible. Under HAMP and the non-HAMP standard modification, borrowers are required to complete a trial period before the loan modification becomes effective. Based on information provided by the MHA Program administrator, our servicers had completed approximately 217,209 loan modifications under HAMP from the introduction of the initiative in 2009 through December 31, 2012. As of December 31, 2012, approximately 24,000 borrowers were in modification trial periods, including approximately 15,000 borrowers in trial periods for our non-HAMP standard modification. Our new non-HAMP standard loan modification initiative was implemented for all servicers beginning on January 1, 2012. Our completed modification volume during the first half of 2012 was below what otherwise would be expected, as servicers completed the transition to the non-HAMP standard modification initiative; however, the volume of our non-HAMP standard modifications increased in the second half of 2012 compared to the first half of 2012. See Our Business Segments *Single-Family Guarantee Segment* for more information about loss mitigation activities and our efforts to provide credit availability, including through HAMP, and our relief refinance mortgage initiative, which includes HARP.

Short sale activity increased in 2012 compared to 2011. Short sale activity as a percentage of the combined total of short sales and foreclosure transfers increased from 27% in 2011 to 33% in 2012, primarily resulting from our increased focus on this foreclosure alternative. At the direction of FHFA, and as part of the servicing alignment initiative, we announced a new standard short sale process during the third quarter of 2012 designed to help more struggling borrowers use short sales to avoid foreclosure. We believe this new process may lead to an increase in short sales in 2013.

The table below presents our single-family loan workout activities for the last five quarters.

Table 1 Total Single-Family Loan Workout Volumes[1]

	For the Three Months Ended				
	12/31/2012	09/30/2012	06/30/2012	03/31/2012	12/31/2011
	(number of loans)				
Loan modifications	19,898	20,864	15,142	13,677	19,048
Repayment plans	6,964	7,099	8,712	10,575	8,008
Forbearance agreements[2]	2,442	2,190	4,738	3,656	3,867
Short sales and deed in lieu of foreclosure transactions	13,849	14,383	12,531	12,245	12,675
Total single-family loan workouts	43,153	44,536	41,123	40,153	43,598

(1) Based on actions completed with borrowers for loans within our single-family credit guarantee portfolio. Excludes those modification, repayment, and forbearance activities for which the borrower has started the required process, but the actions have not been made permanent or effective, such as loans in modification trial periods. Also excludes certain loan workouts where our single-family seller/servicers have executed agreements in the current or prior periods, but these have not been incorporated into certain of our operational systems, due to delays in processing. These categories are not mutually exclusive and a loan in one category may also be included within another category in the same period.

(2) Excludes loans with long-term forbearance under a completed loan modification. Many borrowers enter into a short-term forbearance agreement before another loan workout is pursued or completed. We only report forbearance activity for a single loan once during each quarterly period; however, a single loan may be included under separate forbearance agreements in separate periods.

Minimizing Our Credit Losses

To help minimize the credit losses related to our guarantee activities, we are focused on:

pursuing a variety of loan workouts, including foreclosure alternatives, in an effort to reduce the severity of losses we experience over time;

managing foreclosure timelines to the extent possible, given the lengthy foreclosure process in many states;

managing our inventory of foreclosed properties to reduce costs and maximize proceeds; and

pursuing contractual remedies against originators, lenders, servicers, and insurers, as appropriate.

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We establish guidelines for our servicers to follow and provide them default management tools to use, in part, in determining which type of loan workout would be expected to provide the best opportunity for minimizing our credit losses. We require our single-family seller/servicers to first evaluate problem loans for a repayment or forbearance plan before considering modification. If a borrower is not eligible for a modification, our seller/servicers pursue foreclosure alternatives (e.g., short sales) before considering foreclosure.

During 2012, we continued to implement the FHFA-directed servicing alignment initiative, under which we and Fannie Mae are aligning certain standards for servicing non-performing loans owned or guaranteed by the companies. We have provided standards to our servicers under this initiative that require them to initiate earlier and more frequent communication with delinquent borrowers, employ consistent requirements for collecting documents from borrowers, and follow consistent timelines for responding to borrowers and for processing foreclosures. Under these new servicing standards, we pay incentives to servicers that exceed certain performance standards with respect to servicing delinquent loans. We also assess compensatory fees from servicers if they do not achieve minimum performance benchmarks with respect to servicing delinquent loans, including foreclosure timelines.

Our servicers pursue repayment plans and loan modifications for borrowers facing financial or other hardships since the level of recovery (if a loan reperforms) may often be much higher than with foreclosure or foreclosure alternatives. In cases where these alternatives are not possible or successful, a short sale transaction typically provides us with a comparable or higher level of recovery than what we would receive through property sales from our REO inventory. In large part, the benefit of short sales arises from the avoidance of costs we would otherwise incur to complete the foreclosure and dispose of the property, including maintenance and other property expenses associated with holding REO property. The foreclosure process is a lengthy one in many jurisdictions with significant associated costs to complete, including, in times of declining home values, foregone recovery we might receive from an earlier sale.

We have contractual arrangements with our seller/servicers under which they agree to sell us mortgage loans, and represent and warrant that those loans have been originated under specified underwriting standards. In addition, our servicers represent and warrant to us that those loans will be serviced in accordance with our servicing contract. If we subsequently discover that the representations and warranties were breached (i.e., contractual standards were not followed), we can exercise certain contractual remedies to mitigate our actual or potential credit losses. These contractual remedies include the ability to require the seller/servicer to repurchase the loan at its current UPB and/or to make us whole for losses realized with respect to the loan, after consideration of other recoveries, if any. The amount we expect to collect on outstanding repurchase requests is significantly less than the UPB of the loans subject to the repurchase requests primarily because many of these requests will likely be satisfied by the seller/servicers reimbursing us for realized credit losses. Some of these requests also may be rescinded in the course of the contractual appeals process. As of December 31, 2012, the UPB of loans subject to repurchase requests issued to our single-family seller/servicers was approximately $3.0 billion, and approximately 41% of these requests were outstanding for more than four months since issuance of our initial repurchase request (this figure includes repurchase requests for which appeals were pending). Of the total amount of repurchase requests outstanding at December 31, 2012, approximately $1.2 billion were issued due to mortgage insurance rescission or mortgage insurance claim denial.

Historically, we have used a process of reviewing a sample of the loans we purchase to validate compliance with our standards. In addition, we review many delinquent loans and loans that have resulted in credit losses, such as through foreclosure or short sale. Beginning in 2012, we made revisions to our selection approach for these loans that expanded the coverage of our loan reviews. Certain of these changes are designed to increase our loss recoveries. We expect that the changes made to our loan review process will increase our repurchase request volumes with our seller/servicers in the future.

We, together with Fannie Mae, also launched a new representation and warranty framework for conventional loans purchased by the GSEs on or after January 1, 2013. The objective of the new framework is to clarify lenders repurchase exposures and liability on future sales of mortgage loans to Freddie Mac and Fannie Mae and, under the new framework, lenders will be relieved of certain repurchase obligations in specific cases, such as for loans that perform for 36 consecutive months (subject to certain exclusions). As a result, if we are unable to identify breaches in representations and warranties timely, we may face greater exposure to credit and other losses under this new framework, as our ability to seek recovery or repurchase from the seller is more limited. The new framework does not affect seller/servicers obligations under their contracts with us with respect to loans sold to us prior to January 1, 2013. The new framework also does not affect their obligation to service these loans in accordance with our servicing standards. For more information, see Our Business

Segments *Single-Family Guarantee Segment New Representation and Warranty Framework* and MD&A RISK MANAGEMENT Credit Risk *Institutional Credit Risk Single-Family Mortgage Seller/Servicers*.

Our credit loss exposure is also partially mitigated by mortgage insurance, which is a form of credit enhancement. Primary mortgage insurance is generally required to be purchased, typically at the borrower s expense, for certain mortgages with higher LTV ratios. Although we received payments under primary and other mortgage insurance of $2.0 billion and $2.5 billion in 2012 and 2011, respectively, which helped to mitigate our credit losses, many of our mortgage insurers remain financially weak. As a result, we expect to receive substantially less than full payment of our claims from three of our mortgage insurance counterparties that are currently partially paying claims under orders of their state regulators. We believe that certain other of our mortgage insurance counterparties lack sufficient ability to meet all their expected lifetime claims paying obligations to us as those claims emerge. See NOTE 4: MORTGAGE LOANS AND LOAN LOSS RESERVES Table 4.5 Recourse and Other Forms of Credit Protection for information about credit enhancements of our single-family credit guarantee portfolio.

Developing Mortgage Market Enhancements in Support of a New Infrastructure for the Secondary Mortgage Market

We continue efforts that we believe will create value for the industry by building the infrastructure for a future housing finance system. These efforts include the implementation of the UMDP, which provides us with the ability to collect additional data that we believe will improve our risk management practices. In the first quarter of 2012, we completed a key milestone of the UMDP with the launch of the Uniform Collateral Data Portal for the electronic submission of appraisal reports for conventional mortgages. The implementation of the portal was effective for mortgages with application dates after November 30, 2011 that were delivered to us after March 18, 2012. In the second quarter of 2012, we implemented the ULDD, which provides for the efficient collection and use of consistent information about loan terms, collateral, and borrowers. The implementation of ULDD was effective for mortgages with application dates after November 30, 2011 that were delivered to us after July 22, 2012, with a transition period allowing for optional usage of ULDD for mortgages delivered to us between April 23, 2012 and July 22, 2012.

We are also working with FHFA and others to develop a plan for the design and development of a securitization platform that can be used in a future secondary mortgage market. In October 2012, FHFA released a white paper for industry comment that described a proposed framework for a new securitization platform and a model pooling and servicing agreement. FHFA has stated that it anticipates that Freddie Mac and Fannie Mae will each maintain its own distinct securitization operations and continue to issue its own securities.

We are continuing to work with FHFA and Fannie Mae to develop recommendations to align certain of the terms of the contracts we and Fannie Mae use with our respective single-family seller/servicers, as well as certain practices we follow in managing our remedies and our respective business relationships with these companies. In October 2012, we announced, pursuant to a directive by FHFA, changes to requirements in certain areas related to loan servicing, including a process and criteria for evaluating servicer performance. These changes align our and Fannie Mae s requirements in these areas. See MD&A RISK MANAGEMENT Credit Risk *Institutional Credit Risk Single-Family Mortgage Seller/Servicers* for additional information.

Maintaining Sound Credit Quality on the Loans We Purchase or Guarantee

We continue to focus on maintaining credit policies, including our underwriting standards, that allow us to purchase and guarantee loans made to qualified borrowers that we believe will provide management and guarantee fee income (excluding the amounts associated with the Temporary Payroll Tax Cut Continuation Act of 2011), over the long-term, that exceeds our expected credit-related and administrative expenses on such loans.

The credit quality of the single-family loans we acquired beginning in 2009 (excluding HARP and other relief refinance mortgages) is significantly better than that of loans we acquired from 2005 to 2008, as measured by original LTV ratios, FICO scores, and the proportion of loans underwritten with fully documented income. The improvement in credit quality of loans we have purchased since 2008 (excluding HARP and other relief refinance mortgages) is primarily the result of: (a) changes in our credit policies, including changes in our underwriting standards; (b) fewer purchases of loans with higher risk characteristics; and (c) changes in mortgage insurers and lenders underwriting practices.

Underwriting procedures for relief refinance mortgages are limited in many cases, and such procedures generally do not include all of the changes in underwriting standards we have implemented since 2008. As a result, relief refinance mortgages

generally reflect many of the credit risk attributes of the original loans. However, borrower participation in our relief refinance mortgage initiative may help reduce our exposure to credit risk in cases where the borrowers payments under their mortgages are reduced, thereby strengthening the borrowers potential to make their mortgage payments. Relief refinance mortgages of all LTV ratios comprised approximately 18% and 11% of the UPB in our total single-family credit guarantee portfolio at December 31, 2012 and 2011, respectively.

HARP loans represented 11% and 6% of the UPB of our single-family credit guarantee portfolio as of December 31, 2012 and 2011, respectively. Mortgages originated after 2008, including HARP loans, represented 63% and 51% of the UPB of our single-family credit guarantee portfolio as of December 31, 2012 and 2011, respectively, while the single-family loans originated from 2005 through 2008 represented 24% and 32% of this portfolio at these dates, respectively.

Approximately 96% and 92% of the single-family mortgages we purchased in 2012 and 2011, respectively, were fixed-rate, first lien amortizing mortgages, based on UPB. Approximately 82% and 78% of the single-family mortgages we purchased in 2012 and 2011, respectively, were refinance mortgages, and approximately 24% and 16%, respectively, of these refinance mortgages were HARP loans, based on UPB. HARP loans comprised approximately 20% and 12% of our single-family purchase volume in 2012 and 2011, respectively.

Due to our participation in HARP, we purchase a significant number of loans that have original LTV ratios over 100%. The proportion of loans we purchased with LTV ratios over 100% increased from approximately 4% of our single-family mortgage purchases (including HARP loans) in 2011 to 12% of our single-family mortgage purchases in 2012. This increase was mainly due to the changes in HARP announced in the fourth quarter of 2011, which allow borrowers (whose loans we already hold in our single-family credit guarantee portfolio) with higher LTV ratios to refinance. Over time, HARP loans may not perform as well as other refinance mortgages because the continued high LTV ratios and reduced underwriting standards of these loans increase the probability of default. In addition, HARP loans may not be covered by mortgage insurance for the full excess of their UPB over 80%. See Our Business *Relief Refinance Mortgage Initiative and the Home Affordable Refinance Program* for further information about our relief refinance initiative and HARP.

The table below presents the composition and certain other information about loans in our single-family credit guarantee portfolio, by year of origination at December 31, 2012 and 2011, and for the years ended December 31, 2012 and 2011.

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Table 2 Single-Family Credit Guarantee Portfolio Summary[1]

	At December 31, 2012					Year Ended December 31, 2012
	Percent of Portfolio	Average Credit Score[2]	Current LTV Ratio[3]	Current LTV Ratio >100%[3][4]	Serious Delinquency Rate[5]	Percent of Credit Losses[6]
Loans originated 2009 to 2012:						
Relief refinance loans:						
HARP loans	11%	735	100%	43%	1.06%	2.1%
Other relief refinance loans	7	749	58		0.29	0.1
All other loans	45	757	66	1	0.27	1.5
Subtotal 2009 to 2012 originations	63	753	71	7	0.39	3.7
Loans originated 2005 to 2008	24	708	98	42	9.56	87.2
Loans originated 2004 and prior	13	715	56	6	3.20	9.1
Total	100%	737	75	15	3.25	100.0%

	At December 31, 2011					Year Ended December 31, 2011
	Percent of Portfolio	Average Credit Score[2]	Current LTV Ratio[3]	Current LTV Ratio >100%[3][4]	Serious Delinquency Rate[5]	Percent of Credit Losses[6]
Loans originated 2009 to 2011:						
Relief refinance loans:						
HARP loans	6%	737	97%	35%	1.08%	1.0%
Other relief refinance loans	5	751	61		0.17	0.1
All other loans	40	757	69	2	0.21	0.8
Subtotal- 2009 to 2011 originations	51	754	71	5	0.30	1.9
Loans originated 2005 to 2008	32	713	104	48	8.75	89.5
Loans originated 2004 and prior	17	719	61	9	2.83	8.6
Total	100%	735	80	20	3.58	100.0%

(1) Based on the loans remaining in the portfolio at December 31, 2012 and 2011, which totaled $1.6 trillion and $1.7 trillion, respectively, rather than all loans originally guaranteed by us and originated in the respective year. Includes loans acquired under our relief refinance initiative, which began in 2009. For credit scores, LTV ratios, serious delinquency rates, and other information about the loans in our single-family credit guarantee portfolio, see RISK MANAGEMENT Credit Risk *Mortgage Credit Risk Single-Family Mortgage Credit Risk*.
(2) Credit score data is based on FICO scores, which are ranked on a scale of approximately 300 to 850 points. Although we obtain updated credit information on certain borrowers after the origination of a mortgage, such as those borrowers seeking a modification, the scores presented in this table represent the credit score of the borrower at the time of loan origination and may not be indicative of the borrowers creditworthiness at December 31, 2012.
(3) We estimate current market values by adjusting the value of the property at origination based on changes in the market value of homes in the same geographical area since origination. See endnote (4) to Table 41 Characteristics of the Single-Family Credit Guarantee Portfolio for information on our calculation of current LTV ratios.
(4) Calculated as a percentage of the aggregate UPB of loans with LTV ratios greater than 100% in relation to the total UPB of loans in the category.
(5)

See RISK MANAGEMENT Credit Risk *Mortgage Credit Risk* *Single-family Mortgage Credit Risk* *Delinquencies* for further information about our reported serious delinquency rates.
(6) Historical credit losses for each origination year may not be representative of future results.

Contracting the Dominant Presence of the GSEs in the Marketplace

We continue to take steps toward the goal of gradually shifting mortgage credit risk from Freddie Mac to private investors, while simplifying and shrinking certain of our operations. In the case of single-family credit guarantees, we are exploring several ways to accomplish this goal, including increasing guarantee fees and evaluating new risk-sharing transactions beyond the traditional charter-required mortgage insurance coverage. Two across-the-board increases in guarantee fees occurred in 2012, and FHFA has proposed additional fee adjustments, as discussed in BUSINESS Our Business Segments *Single-Family Guarantee Segment* *Overview of the Securitization Process*.

In the Investments segment, under the terms of the Purchase Agreement, as amended on August 17, 2012, and FHFA regulation, the UPB of our mortgage-related investments portfolio: (a) could not exceed $650 billion on December 31, 2012; and (b) on December 31 of each year thereafter, may not exceed 85% of the aggregate amount of the UPB we were permitted to own as of December 31 of the immediately preceding calendar year, until the portfolio reaches $250 billion. This strategy is designed to reduce the portfolio and provide the best return to the taxpayer while minimizing market disruption.

In the Multifamily segment, our primary business model is to purchase held-for-sale multifamily loans for aggregation and then securitization through multifamily K Certificates, which are considered Other Guarantee Transactions. In substantially all of these transactions we guarantee only the most senior tranches of the securities. As a result, a significant portion of our expected credit risk associated with these loans is sold in subordinated tranches to third party investors.

Strengthening Our Infrastructure and Improving Overall Efficiency While Also Focusing On Retention of Key Employees

We continue to work to both enhance the quality of our infrastructure and to improve our efficiency to preserve the taxpayers investment. We are focusing our resources primarily on key projects, many of which are related to FHFA-mandated strategic initiatives that will likely take several years to fully implement. We are also focused on making significant improvements to our systems infrastructure in order to: (a) replace legacy hardware or software systems at the end of their useful lives and to strengthen our disaster recovery capabilities; and (b) improve our data collection and administration capabilities as well as our ability to assist in the servicing of loans.

We continue to actively manage our general and administrative expenses, while also continuing to focus on retaining key talent. In the first half of 2012, we introduced a new compensation program for employees to help mitigate the uncertainty surrounding compensation. Under the program, the majority of employees have a more predictable income, as the program either reduces or eliminates the amount of compensation that is subject to variability. The variable elements of compensation for our senior executives are subject only to reduction based on the company s and their individual performance, with no upside potential. While employee turnover moderated in 2012 compared to 2011, we are continuing to explore various strategic arrangements with outside firms to provide operational capability and staffing for key functions, as needed.

Our general and administrative expenses increased in 2012 compared to 2011, largely due to an increase in spending for FHFA-mandated strategic initiatives. We believe the various FHFA-mandated strategic initiatives will likely continue to require significant resources and thus continue to affect our level of administrative expenses going forward.

Single-Family Credit Guarantee Portfolio

The UPB of our single-family credit guarantee portfolio declined approximately 6.2% and 3.5% during 2012 and 2011, respectively, as the amount of single-family loan liquidations exceeded new loan purchase and guarantee activity. We believe this is due, in part, to declines in the amount of single-family mortgage debt outstanding in the market and a decline in our single-family competitive position compared to other market participants (primarily Fannie Mae and Ginnie Mae). See RISK FACTORS Competitive and Market Risks *A significant decline in the price performance of or demand for our PCs could have an adverse effect on the volume and/or profitability of our new single-family guarantee business* for further information on our competitive position in the single-family mortgage market.

The table below provides certain credit statistics for our single-family credit guarantee portfolio.

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Table 3 Credit Statistics, Single-Family Credit Guarantee Portfolio

	As of				
	12/31/2012	9/30/2012	6/30/2012	3/31/2012	12/31/2011
Payment status					
One month past due	1.85%	2.02%	1.79%	1.63%	2.02%
Two months past due	0.66%	0.66%	0.60%	0.57%	0.70%
Seriously delinquent(1)	3.25%	3.37%	3.45%	3.51%	3.58%
Non-performing loans (in millions)(2)	$ 128,599	$ 131,106	$ 118,463	$ 119,599	$ 120,514
Single-family loan loss reserve (in millions)(3)	$ 30,508	$ 33,298	$ 35,298	$ 37,771	$ 38,916
REO inventory (in properties)	49,071	50,913	53,271	59,307	60,535
REO assets, net carrying value (in millions)	$ 4,314	$ 4,459	$ 4,715	$ 5,333	$ 5,548

	For the Three Months Ended				
	12/31/2012	9/30/2012	6/30/2012	3/31/2012	12/31/2011
	(in units, unless noted)				
Seriously delinquent loan additions(1)	72,626	76,104	75,904	80,815	95,661
Loan modifications(4)	19,898	20,864	15,142	13,677	19,048
REO acquisitions	18,672	20,302	20,033	23,805	24,758
REO disposition severity ratio:(5)					
California	34.4%	37.7%	41.6%	44.2%	44.6%
Arizona	35.9%	36.3%	40.4%	45.0%	46.7%
Florida	42.6%	44.7%	46.2%	48.6%	50.1%
Nevada	45.6%	50.6%	54.3%	56.5%	54.2%
Illinois	46.5%	47.7%	47.8%	49.3%	51.2%
Total U.S	35.2%	36.2%	37.9%	40.3%	41.2%
Single-family provision (benefit) for credit losses (in millions)	$ (658)	$ 650	$ 177	$ 1,844	$ 2,664
Single-family credit losses (in millions)	$ 2,396	$ 2,936	$ 2,858	$ 3,435	$ 3,209

(1) See MD&A RISK MANAGEMENT Credit Risk *Mortgage Credit Risk Single-Family Mortgage Credit Risk Delinquencies* for further information about our reported serious delinquency rates.
(2) Consists of the UPB of loans in our single-family credit guarantee portfolio that have undergone a TDR or that are seriously delinquent. During the third quarter of 2012, we changed the treatment of single-family loans discharged in Chapter 7 bankruptcy to classify these loans as TDRs, regardless of the borrowers payment status. As a result, we newly classified approximately $19.5 billion in UPB of loans discharged in Chapter 7 bankruptcy as TDRs in the third quarter of 2012. As of December 31, 2012 and 2011, approximately $65.8 billion and $44.4 billion in UPB of TDR loans, respectively, were no longer seriously delinquent.
(3) Consists of the combination of: (a) our allowance for loan losses on mortgage loans held for investment; and (b) our reserve for guarantee losses associated with non-consolidated single-family mortgage securitization trusts and other guarantee commitments.
(4) Represents the number of modification agreements with borrowers completed during the quarter. Excludes forbearance agreements, repayment plans, and loans in modification trial periods.
(5) States presented represent the five states where our credit losses were greatest during 2012. Calculated as the amount of our losses recorded on disposition of REO properties during the respective quarterly period, excluding those subject to repurchase requests made to our seller/servicers, divided by the aggregate UPB of the related loans. The amount of losses recognized on disposition of the properties is equal to the amount by which the UPB of the loans exceeds the amount of sales proceeds from disposition of the properties. Excludes sales commissions and other expenses, such as property maintenance and costs, as well as applicable recoveries from credit enhancements, such as mortgage insurance.

In discussing our credit performance, we often use the terms credit losses and credit-related expenses. These terms are significantly different. Our credit losses consist of charge-offs and REO operations expense, while our credit-related expenses consist of our provision for credit losses and REO operations expense.

Since the beginning of 2008, on an aggregate basis, we have recorded provision for credit losses associated with single-family loans of approximately $75.2 billion, and have recorded an additional $3.9 billion in losses on loans purchased from PC trusts, net of recoveries. The majority of these losses are associated with loans originated in 2005 through 2008. While loans originated in 2005 through 2008 will give rise to additional credit losses that have not yet been incurred and, thus, have not yet been provisioned for, we believe that, as of December 31, 2012, we have reserved for or charged-off the majority of the total expected credit losses for these loans. Nevertheless, various factors, such as continued high unemployment rates or future declines in home prices, could require us to provide for losses on these loans beyond our current

expectations.

Our loan loss reserves declined in every quarter of 2012, which reflects improvement in both borrower payment performance and lower severity ratios for both REO dispositions and short sale transactions due to the improvements in home prices in most areas during 2012. Our REO inventory also declined in every quarter of 2012, which reflects that our sales of REO properties exceeded the volume of our REO acquisitions due to lower foreclosure activity as well as an increase in the volume of short sales prior to foreclosure.

Our average REO disposition severity ratio improved to 35.2% for the fourth quarter of 2012 compared to 41.2% for the fourth quarter of 2011. Although this ratio improved for each quarter of 2012, it remains high as compared to our experience in periods before 2007.

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The serious delinquency rate for our single-family credit guarantee portfolio improved at December 31, 2012, compared to December 31, 2011. Excluding relief refinance loans, the improvement in borrower payment performance during 2012 reflects an improved credit profile of borrowers with loans originated since 2008. However, several factors, including the lengthening of the foreclosure process, have resulted in loans remaining in serious delinquency for longer periods than experienced prior to 2008, particularly in states that require a judicial foreclosure process. As of December 31, 2012 and 2011, the percentage of seriously delinquent loans that have been delinquent for more than six months was 72% and 70%, respectively.

The balance of our non-performing loans increased during the third quarter of 2012, due to a change in the treatment of single-family loans discharged in Chapter 7 bankruptcy to classify these loans as TDRs (unless they were already classified as TDRs for other reasons), regardless of the borrowers payment status. Except for this change in classification, which resulted in approximately $19.5 billion in UPB of loans being newly classified as TDRs in the third quarter of 2012, the balance of our non-performing loans would have declined in every quarter of 2012. Although we experienced improvement in the amount of our non-performing loans during the year, this balance remained high at the end of 2012, compared to periods prior to 2009.

The credit losses and loan loss reserves associated with our single-family credit guarantee portfolio remained elevated in 2012, due, in part, to:

- Losses associated with the continued high volume of foreclosures and foreclosure alternatives. These actions relate to the continued efforts of our servicers to resolve our large inventory of seriously delinquent loans. Due to the length of time necessary for servicers either to complete the foreclosure process or pursue foreclosure alternatives on seriously delinquent loans in our portfolio, we expect our credit losses will continue to remain elevated even if the volume of new serious delinquencies declines.

- Continued negative effect of certain loan groups within the single-family credit guarantee portfolio, such as: (a) loans originated in 2005 through 2008; and (b) loans with higher-risk characteristics (such as those underwritten with certain lower documentation standards and interest-only loans), a significant portion of which were originated in 2005 through 2008. These groups continue to be large contributors to our credit losses.

- Cumulative decline in national home prices of 22% since June 2006, based on our own index. As a result of this price decline, approximately 15% of loans in our single-family credit guarantee portfolio, based on UPB, had estimated current LTV ratios in excess of 100% (i.e., underwater loans) as of December 31, 2012.

- Weak financial condition of many of our mortgage insurers, which has reduced our actual recoveries from these counterparties as well as our estimates of expected recoveries.

Some of our loss mitigation activities create fluctuations in our delinquency statistics. See MD&A RISK MANAGEMENT Credit Risk *Mortgage Credit Risk Single-family Mortgage Credit Risk Credit Performance Delinquencies* for further information about factors affecting our reported delinquency rates.

Consolidated Financial Results 2012 versus 2011

Net income was $11.0 billion for 2012 compared to net income (loss) of $(5.3) billion for 2011. Key highlights of our financial results include:

- Net interest income for 2012 decreased to $17.6 billion from $18.4 billion for 2011, mainly due to the impact of a reduction in the balance of our higher-yielding mortgage-related assets, partially offset by lower funding costs.

- Provision for credit losses for 2012 declined to $1.9 billion, compared to $10.7 billion for 2011. The significant reduction in provision for credit losses in 2012 primarily reflects declines in the volume of newly delinquent loans (largely due to a decline in the portion of our single-family credit guarantee portfolio originated in 2005 through 2008), and lower estimates of incurred loss due to the positive

impact of an increase in national home prices.

Non-interest income (loss) was $(4.1) billion for 2012, compared to $(10.9) billion for 2011. The improvement was largely driven by a decrease in derivative losses during 2012 compared to 2011.

Non-interest expense declined to $2.2 billion for 2012, from $2.5 billion for 2011, primarily due to a decrease in REO operations expense during 2012 compared to 2011 as a result of improving home prices in certain geographical areas with significant REO activity.

Comprehensive income was $16.0 billion for 2012 compared to comprehensive income (loss) of $(1.2) billion for 2011. Comprehensive income for 2012 consisted of $11.0 billion of net income and $5.1 billion of other comprehensive income, primarily due to a reduction in net unrealized losses on our available-for-sale securities.

Our Business

We conduct business in the U.S. residential mortgage market and the global securities market, subject to the direction of our Conservator, FHFA, and under regulatory supervision of FHFA, the SEC, HUD, and Treasury. The size of the U.S. residential mortgage market is affected by many factors, including changes in interest rates, home ownership rates, home prices, the supply of housing and lender preferences regarding credit risk and borrower preferences regarding mortgage debt. The amount of residential mortgage debt available for us to purchase and the mix of available loan products are also affected by several factors, including the volume of mortgages meeting the requirements of our charter (which is affected by changes in the conforming loan limit determined by FHFA), our own preference for credit risk reflected in our purchase standards and the mortgage purchase and securitization activity of other financial institutions. We conduct our business operations solely in the U.S. and its territories.

In addition to the directives given us by our Conservator, our charter forms the framework for our business activities, the initiatives we bring to market and the services we provide to the nation s residential housing and mortgage industries. Our charter also determines the types of mortgage loans that we are permitted to purchase. Our statutory mission as defined in our charter is to:

provide stability in the secondary market for residential mortgages;

respond appropriately to the private capital market;

provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages for low- and moderate-income families, involving a reasonable economic return that may be less than the return earned on other activities); and

promote access to mortgage credit throughout the U.S. (including central cities, rural areas, and other underserved areas).

Our charter does not permit us to originate mortgage loans or lend money directly to consumers in the primary mortgage market. We provide liquidity, stability and affordability to the U.S. housing market primarily by providing our credit guarantee for residential mortgages originated by mortgage lenders and investing in mortgage loans and mortgage-related securities. We use mortgage securitization as an integral part of our activities. Mortgage securitization is a process by which we purchase mortgage loans that lenders originate, and pool these loans into guaranteed mortgage securities that are sold in global capital markets, generating proceeds that support future loan origination activity by lenders. The primary Freddie Mac guaranteed mortgage-related security is the single-class PC. We also aggregate and resecuritize mortgage-related securities that are issued by us, other GSEs, HFAs, or private (non-agency) entities, and issue other single-class and multiclass mortgage-related securities to third-party investors. We also enter into certain other guarantee commitments for mortgage loans, HFA bonds under the HFA initiative, and multifamily housing revenue bonds held by third parties.

Our charter limits our purchases of single-family loans to the conforming loan market. The conforming loan market is defined by loans originated with UPBs at or below limits determined annually based on changes in FHFA s housing price index, a method established and maintained by FHFA for determining the national average single-family home price. Since 2006, the base conforming loan limit for a one-family residence has been set at $417,000, and higher limits have been established in certain high-cost areas (currently, up to $625,500 for a one-family residence). Higher limits also apply to two- to four-family residences and for mortgages secured by properties in Alaska, Guam, Hawaii, and the U.S. Virgin Islands.

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Our charter generally prohibits us from purchasing first-lien single-family mortgages if the outstanding UPB of the mortgage at the time of our purchase exceeds 80% of the value of the property securing the mortgage unless we have one of the following credit protections:

- mortgage insurance from a mortgage insurer that we determine is qualified on the portion of the UPB of the mortgage that exceeds 80%;
- a seller s agreement to repurchase or replace any mortgage that has defaulted; or
- retention by the seller of at least a 10% participation interest in the mortgage.

Under our charter, our mortgage purchase operations are confined, so far as practicable, to mortgages that we deem to be of such quality, type and class as to meet generally the purchase standards of other private institutional mortgage investors. This is a general marketability standard.

Our charter requirement for credit protection on mortgages with LTV ratios greater than 80% does not apply to multifamily mortgages or to mortgages that have the benefit of any guarantee, insurance or other obligation by the U.S. or any of its agencies or instrumentalities (e.g., the FHA, the VA or the USDA Rural Development). Additionally, as part of HARP, we may purchase single-family mortgages that refinance borrowers whose mortgages we currently own or guarantee without obtaining additional credit enhancement in excess of that already in place for any such loan, even if the LTV ratio of the new loan is above 80%.

Our Business Segments

Our operations consist of three reportable segments, which are based on the type of business activities each performs Single-family Guarantee, Investments, and Multifamily. Certain activities that are not part of a reportable segment are included in the All Other category.

We evaluate segment performance and allocate resources based on a Segment Earnings approach. For more information on our segments, including financial information, see MD&A CONSOLIDATED RESULTS OF OPERATIONS Segment Earnings and NOTE 13: SEGMENT REPORTING.

Single-Family Guarantee Segment

The Single-family Guarantee segment reflects results from our single-family credit guarantee activities. In our Single-family Guarantee segment, we purchase single-family mortgage loans originated by our seller/servicers in the primary mortgage market. In most instances, we use the mortgage securitization process to package the mortgage loans into guaranteed mortgage-related securities. We guarantee the payment of principal and interest on the mortgage-related security in exchange for management and guarantee fees.

Our Customers

Our customers are predominantly lenders in the primary mortgage market that originate mortgages for homeowners. These lenders include mortgage banking companies, commercial banks, savings banks, community banks, credit unions, HFAs, and savings and loan associations.

We acquire a significant portion of our mortgages from several large lenders. These lenders are among the largest mortgage loan originators in the U.S. During 2012, three mortgage lenders, Wells Fargo Bank, N.A, U.S. Bank, N.A., and JPMorgan Chase Bank, N.A., each accounted for 10% or more of our single-family mortgage purchase volume and collectively accounted for approximately 49% of our single-family mortgage purchase volume. In the last two years, a number of our largest mortgage seller/servicers have reduced or eliminated their purchases of mortgage loans from mortgage brokers and correspondent lenders. As a result, we are acquiring an increasing portion of our business volume directly from smaller lenders. Our top ten lenders accounted for approximately 73% and 82% of our single-family mortgage purchase volume during 2012 and 2011, respectively.

We are the master servicer for the loans we purchase, and delegate the primary servicing function to our customers. A significant portion of our single-family mortgage loans are serviced by several of our large customers. If our servicers lack appropriate process controls, experience a failure in their controls, or experience an operating disruption in their ability to service mortgage loans, our business and financial results could be adversely affected. For additional information about our

relationships with our customers, see MD&A RISK MANAGEMENT Credit Risk *Institutional Credit Risk Single-Family Mortgage Seller/Servicers.*

Our Competition

Historically, our principal competitors have been Fannie Mae, Ginnie Mae and FHA/VA, and other financial institutions that retain or securitize mortgages, such as commercial and investment banks, dealers, and thrift institutions. Since 2008, most of our competitors, other than Fannie Mae and Ginnie Mae, have ceased their activities in the residential mortgage securitization business or severely curtailed these activities relative to their previous levels. We compete on the basis of price, products, the structure of our securities, and service. Competition to acquire single-family mortgages can also be significantly affected by changes in our credit standards.

Ginnie Mae, which became a more significant competitor beginning in 2009, guarantees the timely payment of principal and interest on mortgage-related securities backed by federally insured or guaranteed loans, primarily those insured by FHA or guaranteed by VA. Ginnie Mae maintained a significant market share in 2012 and 2011, in large part due to favorable pricing of loans insured by FHA, the increase in the FHA loan limit and the availability, through FHA, of a mortgage product for borrowers seeking greater than 80% financing who could not otherwise qualify for a conventional mortgage.

The conservatorship, including direction provided to us by our Conservator, and the restrictions on our activities under the Purchase Agreement may affect our ability to compete. FHFA, through its strategic plan activities, has required that we and Fannie Mae adopt uniform approaches in a number of areas. Through the servicing alignment initiative, we and Fannie Mae have aligned many of our policies and procedures with respect to the servicing of single-family loans. We are also aligning certain terms of the contracts we and Fannie Mae use with our respective single-family customers, and are working with Fannie Mae on a new securitization platform. For more information, see RISK FACTORS Conservatorship and Related Matters *FHFA directives that we and Fannie Mae adopt uniform approaches in some areas could have an adverse impact on our business or on our competitive position with respect to Fannie Mae.*

Overview of the Mortgage Securitization Process

Mortgage securitization is a process by which we purchase mortgage loans that lenders originate, and pool these loans into mortgage securities that are sold in global capital markets. The following diagram illustrates how we support mortgage market liquidity when we create PCs through mortgage securitizations. These PCs can be sold to investors or held by us or our customers.

The U.S. residential mortgage market consists of a primary mortgage market that links homebuyers and lenders and a secondary mortgage market that links lenders and investors. We participate in the secondary mortgage market by purchasing mortgage loans and mortgage-related securities for investment and by issuing guaranteed mortgage-related securities. In the Single-family Guarantee segment, we purchase and securitize single-family mortgages, which are mortgages that are secured by one- to four-family properties.

In general, the securitization and Freddie Mac guarantee process works as follows: (a) a lender originates a mortgage loan to a borrower purchasing a home or refinancing an existing mortgage loan; (b) we purchase the loan from the lender and place it with other mortgages into a security that is sold to investors (this process is referred to as pooling); (c) the lender may then use the proceeds from the sale of the loan or security to originate another mortgage loan; (d) we provide a credit guarantee, for a fee (generally a portion of the interest collected on the mortgage loan), to those who invest in the security; (e) the borrower s monthly payment of mortgage principal and interest (net of a servicing fee and our management and guarantee fee) is passed through to the investors in the security; and (f) if the borrower stops making monthly payments because a family member loses a job, for example we step in and, pursuant to our guarantee, make the applicable payments to investors in the security. In the event a borrower defaults on the mortgage, our servicer works with the borrower to find a solution to help them stay in the home, or sell the property and avoid foreclosure, through our many different workout options. If this is not possible, we ultimately foreclose and sell the home.

The terms of single-family mortgages that we purchase or guarantee allow borrowers to prepay these loans, thereby allowing borrowers to refinance their loans when mortgage rates decline. Because of the nature of long-term, fixed-rate mortgages, borrowers with these mortgages are protected against rising interest rates, but are able to take advantage of

declining rates through refinancing. When a borrower prepays a mortgage that we have securitized, the outstanding balance of the security owned by investors is reduced by the amount of the prepayment. Unscheduled reductions in loan principal, regardless of whether they are voluntary or involuntary, result in prepayments of security balances. Consequently, the owners of our guaranteed securities are subject to prepayment risk on the related mortgage loans, which is principally that the investor will receive an unscheduled return of the principal, and therefore may not earn the rate of return originally expected on the investment.

We guarantee these mortgage-related securities in exchange for compensation, which consists primarily of a combination of management and guarantee fees paid on a monthly basis as a percentage of the UPB of the underlying loans (referred to as base fees), and initial upfront payments (referred to as delivery fees). We may also make upfront payments to buy-up the monthly management and guarantee fee rate, or receive upfront payments to buy-down the monthly management and guarantee fee rate. These fees are paid in conjunction with the formation of a PC to provide for a uniform coupon rate for the mortgage pool underlying the issued PC.

We enter into mortgage purchase volume commitments with many of our single-family customers. These commitments provide for the lenders to deliver to us a certain volume of mortgages during a specified period of time. Some commitments may also provide for the lender to deliver to us a minimum percentage of their total sales of conforming loans. The purchase and securitization of mortgage loans from customers under these contracts have pricing schedules for our management and guarantee fees that are negotiated at the outset of the contract with initial terms that may range from one month to one year. We call these transactions flow activity and they represent the majority of our purchase volumes. The remainder of our purchases and securitizations of mortgage loans occurs in bulk transactions for which purchase prices and management and guarantee fees are negotiated on an individual transaction basis. Mortgage purchase volumes from individual customers can fluctuate significantly. If a mortgage lender fails to meet its contractual commitment, we have a variety of contractual remedies, which may include the right to assess certain fees. Our mortgage purchase contracts contain no penalty or liquidated damages clauses based on our inability to take delivery of presented mortgage loans. However, if we were to fail to meet our contractual commitment, we could be deemed to be in breach of our contract and could be liable for damages in a lawsuit. Given the uncertainty of the housing market in recent years, since 2009 we have entered into arrangements with certain existing customers at their renewal dates that allow us to change credit and pricing terms more quickly than in the past, including the ability to change our base management and guarantee fees upon 90 days or less notice to customers, if directed to do so by FHFA.

We seek to issue guarantees with fee terms that we believe will, over the long-term, provide management and guarantee fee income that exceeds our anticipated credit-related and administrative expenses on the underlying loans. To compensate us for higher levels of risk in some mortgage products, we charge upfront delivery fees above the base management and guarantee fee, which are calculated based on credit risk factors such as the mortgage product type, loan purpose, LTV ratio and other loan or borrower characteristics. Historically, we have varied our guarantee and delivery fee pricing for different customers, mortgage products, and mortgage or borrower underwriting characteristics based on our assessment of credit risk and loss mitigation related to single-family loans.

We implemented several increases in delivery fees in recent years that are applicable to single-family mortgages with certain higher-risk loan characteristics. Certain of these fee increases do not apply to relief refinance mortgages with LTV ratios greater than 80% and with settlement dates on or after July 1, 2011. We have established maximum limits on the amount of delivery fees that are imposed for relief refinance mortgages, regardless of the LTV ratio of the loan.

We also implemented two across-the-board increases in guarantee fees in 2012. Effective April 1, 2012, at the direction of FHFA, both we and Fannie Mae increased the guarantee fee on single-family residential mortgages sold to us by 10 basis points. Under the Temporary Payroll Tax Cut Continuation Act of 2011, the proceeds from this increase are being remitted to Treasury to fund the payroll tax cut. We pay these fees to Treasury on a quarterly basis and refer to this fee increase as the legislated 10 basis point increase in guarantee fees. In the fourth quarter of 2012, both we and Fannie Mae implemented, at FHFA s direction, a further increase in guarantee fees on single-family mortgages of an average of 10 basis points. In announcing this increase, FHFA stated that the changes to the guarantee fee pricing represent a step toward encouraging greater participation in the mortgage market by private firms.

In September 2012, FHFA also requested public comment on a proposed approach under which we and Fannie Mae would adjust our delivery fees charged on single-family mortgages in states where costs related to foreclosures are statistically higher than the national average. FHFA stated in its September 2012 announcement that it expects to direct us and Fannie Mae to implement the pricing adjustments in 2013.

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Securitization Activities

The types of mortgage-related securities we issue and guarantee include the following:

- PCs;
- REMICs and Other Structured Securities; and
- Other Guarantee Transactions.

For information about the amount of mortgage-related securities we have issued, see Table 35 Freddie Mac Mortgage-Related Securities. For information about the relative performance of mortgages underlying these securities, see MD&A RISK MANAGEMENT Credit Risk.

PCs

Our PCs are single-class pass-through securities that represent undivided beneficial interests in trusts that hold pools of mortgages we have purchased. Holding investments in single-family loans in the form of PCs rather than as unsecuritized loans gives us greater flexibility in managing the composition of our mortgage-related investments portfolio, as it is generally easier to purchase and sell PCs than unsecuritized mortgage loans, and allows more cost effective interest-rate risk management. For our fixed-rate PCs, we guarantee the timely payment of principal and interest. For our single-family ARM PCs, we guarantee the timely payment of the weighted average coupon interest rate for the underlying mortgage loans. We also guarantee the full and final payment of principal for ARM PCs; however, we do not guarantee the timely payment of principal on ARM PCs. We issue most of our single-family PCs in transactions in which our customers provide us with mortgage loans in exchange for PCs. We refer to these transactions as guarantor swaps. The following diagram illustrates a guarantor swap transaction:

Guarantor Swap

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We also issue PCs in exchange for cash. The following diagram illustrates an exchange for cash in a cash auction of PCs:

Cash Auction of PCs

Institutional and other fixed-income investors, including pension funds, insurance companies, securities dealers, money managers, REITs, and commercial banks, purchase our PCs. For the past several years, the Federal Reserve has purchased significant amounts of mortgage-related securities issued by us, Fannie Mae and Ginnie Mae. These purchases, which are ongoing, have affected mortgage spreads (positively and, in some periods, negatively) and the demand for and values of our PCs.

PCs differ from most other fixed-income securities in several ways. For example, and most significantly, single-family PCs can be partially or fully prepaid at any time. Homeowners have the right to prepay their mortgage at any time (known as the prepayment option), and homeowner mortgage prepayments are passed through to the PC holder. Consequently, mortgage-related securities implicitly have a call option that significantly reduces the average life of the security from the contractual loan maturity. As a result, our PCs generally provide a higher nominal yield than certain other fixed-income products. In addition, in contrast to U.S. Treasury securities, PCs are not backed by the full faith and credit of the United States and are instead backed by interests in real estate, in addition to our own guarantee.

From time to time we undertake actions in an effort to support the liquidity and the relative price performance of our PCs to comparable Fannie Mae securities through a variety of activities, including the resecuritization of PCs into REMICs and Other Structured Securities. Other strategies may include: (a) encouraging sellers to pool mortgages that they deliver to us into PC pools with a larger and more diverse population of mortgages; (b) influencing the volume and characteristics of mortgages delivered to us by tailoring our loan eligibility guidelines and other means; and (c) engaging in portfolio purchase and retention activities. See *Investments Segment PC Support Activities* and RISK FACTORS Competitive and Market Risks *A significant decline in the price performance of or demand for our PCs could have an adverse effect on the volume and/or profitability of our new single-family guarantee business* for additional information about our effort to support the liquidity and relative price performance of our PCs.

REMICs and Other Structured Securities

We issue single-class and multiclass securities. Single-class securities (e.g., PCs) involve the straight pass-through of all of the cash flows of the underlying collateral to holders of the beneficial interests. Our primary multiclass securities qualify for tax treatment as REMICs. Multiclass securities divide all of the cash flows of the underlying mortgage-related assets into two or more classes designed to meet the investment criteria and portfolio needs of different investors by creating classes of securities with varying maturities, payment priorities and coupons, each of which represents a beneficial ownership interest in a separate portion of the cash flows of the underlying collateral. Usually, the cash flows are divided to modify the relative exposure of different classes to interest-rate risk, or to create various coupon structures. The simplest division of cash flows is into principal-only and interest-only classes. Other securities we issue can involve the creation of sequential payment and planned or targeted amortization classes. In a sequential payment class structure, one or more classes receive all or a disproportionate percentage of the principal payments on the underlying mortgage assets for a period of time until that class or classes are retired, following which the principal payments are directed to other classes. Planned or targeted amortization

classes involve the creation of classes that have relatively more predictable amortization schedules across different prepayment scenarios, thus reducing prepayment risk, extension risk, or both.

Our REMICs and Other Structured Securities represent beneficial interests in pools of PCs and/or certain other types of mortgage-related assets. We create these securities primarily by using PCs or previously issued REMICs and Other Structured Securities as the underlying collateral. Similar to our PCs, we guarantee the payment of principal and interest to the holders of tranches of our REMICs and Other Structured Securities. We do not charge a management and guarantee fee for these securities if the underlying collateral is already guaranteed by us since no additional credit risk is introduced. Because the collateral underlying nearly all of our single-family REMICs and Other Structured Securities consists of other mortgage-related securities that we guarantee, there are no economic residual interests in the related securitization trust. We do not issue tranches of securities in these transactions that have concentrations of credit risk beyond those embedded in the underlying assets. The following diagram provides a general example of how we create REMICs and Other Structured Securities.

REMICs and Other Structured Securities

We issue many of our REMICs and Other Structured Securities in transactions in which securities dealers or investors sell us mortgage-related assets or we use our own mortgage-related assets (e.g., PCs and REMICs and Other Structured Securities) in exchange for the REMICs and Other Structured Securities. The creation of REMICs and Other Structured Securities allows for setting differing terms for specific classes of investors, and our issuance of these securities can expand the range of investors in our mortgage-related securities to include those seeking specific security attributes. For REMICs and Other Structured Securities that we issue to third parties, we typically receive a transaction, or resecuritization, fee. This transaction fee is compensation for facilitating the transaction, as well as future administrative responsibilities.

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Other Guarantee Transactions

We also issue mortgage-related securities to third parties in exchange for non-Freddie Mac mortgage-related securities. We refer to these as Other Guarantee Transactions. The non-Freddie Mac mortgage-related securities are transferred to trusts that were specifically created for the purpose of issuing securities, or certificates, in the Other Guarantee Transactions. The following diagram illustrates an example of an Other Guarantee Transaction:

Other Guarantee Transaction

Other Guarantee Transactions can generally be segregated into two different types. In one type, we purchase only senior tranches from a non-Freddie Mac senior-subordinated securitization, place the senior tranches into securitization trusts, and issue Other Guarantee Transaction certificates guaranteeing the principal and interest payments on those certificates. In this type of transaction, our credit risk is reduced by the structural credit protections from the related subordinated tranches, which we do not guarantee. In the second type, we purchase single-class pass-through securities, place them in securitization trusts, and issue Other Guarantee Transaction certificates guaranteeing the principal and interest payments on those certificates. Our Other Guarantee Transactions backed by single-class pass-through securities do not benefit from structural or other credit enhancement protections.

Although Other Guarantee Transactions generally have underlying mortgage loans with varying risk characteristics, we do not issue tranches that have concentrations of credit risk beyond those embedded in the underlying assets, as all cash flows of the underlying collateral are passed through to the holders of the securities and there are no economic residual interests in the securitization trusts. Additionally, there may be other credit enhancements and structural features retained by the seller, such as excess interest or overcollateralization, that provide credit protection to our interests, and reduce the likelihood that we will have to perform under our guarantee of the senior tranches. In exchange for providing our guarantee, we may receive a management and guarantee fee or other delivery fees, if the underlying collateral is not already guaranteed by us.

In 2010 and 2009, we entered into transactions under Treasury s NIBP with HFAs, for the partial guarantee of certain single-family and multifamily HFA bonds, which were Other Guarantee Transactions with significant credit enhancement provided by Treasury. While we have not engaged in any of these transactions since 2010, we continue to participate in and support this program and these guarantees remain outstanding. The securities issued by us pursuant to the NIBP were purchased by Treasury. See NOTE 2: CONSERVATORSHIP AND RELATED MATTERS Housing Finance Agency Initiative for further information.

Single-Family PC Trust Documents

We establish trusts for all of our issued PCs pursuant to our PC master trust agreement. In accordance with the terms of our PC trust documents, we have the option, and in some instances the requirement, to remove specified mortgage loans from the applicable trust. To remove these loans, we pay the trust an amount equal to the current UPB of the mortgage, less any outstanding advances of principal that have been distributed to PC holders. Our payments to the trust are distributed to the PC holders at the next scheduled payment date.

We have the option to remove a mortgage loan from a PC trust under certain circumstances to resolve an existing or impending delinquency or default. Since 2010, our practice generally has been to remove substantially all single-family mortgage loans that are 120 days or more delinquent from our issued PCs. From time to time, we reevaluate our practice of removing delinquent loans from PCs and alter it if circumstances warrant.

We are required to remove a mortgage loan (or, in some cases, substitute a comparable mortgage loan) from a PC trust in the following situations:

- if a court of competent jurisdiction or a federal government agency, duly authorized to oversee or regulate our mortgage purchase business, determines that our purchase of the mortgage was unauthorized and a cure is not practicable without unreasonable effort or expense, or if such a court or government agency requires us to repurchase the mortgage;

- if a borrower exercises its option to convert the interest rate from an adjustable-rate to a fixed-rate on a convertible ARM; and

- in the case of balloon-reset loans, shortly before the mortgage reaches its scheduled balloon-reset date.

The To Be Announced Market

Because our fixed-rate single-family PCs are considered to be homogeneous, and are issued in high volume and are highly liquid, they generally trade on a generic basis by PC coupon rate, also referred to as trading in the TBA market. A TBA trade in Freddie Mac securities represents a contract for the purchase or sale of PCs to be delivered at a future date; however, the specific PCs that will be delivered to fulfill the trade obligation, and thus the specific characteristics of the mortgages underlying those PCs, are not known (i.e., announced) at the time of the trade, but only shortly before the trade is settled. The use of the TBA market increases the liquidity of mortgage investments and improves the distribution of investment capital available for residential mortgage financing, thereby helping us to accomplish our statutory mission. The Securities Industry and Financial Markets Association publishes guidelines pertaining to the types of mortgages that are eligible for TBA trades. Certain of our PC securities are not eligible for TBA trades, such as those backed by relief refinance mortgages with LTV ratios greater than 105%.

Other Guarantee Commitments

In certain circumstances, we provide our guarantee of mortgage-related assets held by third parties, in exchange for a management and guarantee fee, without our securitization of the related assets. For example, we provide long-term standby commitments to certain of our single-family customers, which obligate us to purchase seriously delinquent loans that are covered by those agreements. In addition, during 2010 and 2009, we issued guarantees under the TCLFP on securities backed by HFA bonds as part of the HFA Initiative. See NOTE 2: CONSERVATORSHIP AND RELATED MATTERS Housing Finance Agency Initiative for further information.

Underwriting Requirements and Quality Control Standards

We use a process of delegated underwriting for the single-family mortgages we purchase or securitize. In this process, our contracts with seller/servicers describe mortgage underwriting standards and the seller/servicers represent and warrant to us that the mortgages sold to us meet these standards. In our contracts with individual seller/servicers, we may waive or modify selected underwriting standards. Through our delegated underwriting process, mortgage loans and the borrowers ability to repay the loans are evaluated using a number of critical risk characteristics, including, but not limited to, the borrower s credit score and credit history, the borrower s monthly income relative to debt payments (or DTI), the original LTV ratio, the type of mortgage product, the property type and market value, and the occupancy type of the loan. Our single-family loans are generally underwritten with a requirement for a maximum original LTV ratio of 95% (excluding jumbo

conforming, cash-out refinance, and HARP mortgages). We prescribe maximum LTV ratio limits of 80% for cash-out refinance loans and 90% for jumbo conforming mortgages.

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Due to adverse market and economic conditions, and based in part on our reviews of the underwriting quality for loans originated in 2005 through 2007, we implemented several credit limits since 2008. These credit limits are defined by specified criteria such as the LTV ratio, credit score and DTI ratio. For documentation to substantiate assets and income, we require the borrower to provide at least one paystub, one IRS Form W-2, and one current bank statement. FICO scores are the most commonly used credit scores today. FICO scores are ranked on a scale of approximately 300 to 850 points. Statistically, borrowers with higher credit scores are more likely to repay or have the ability to refinance than those with lower scores. We obtain credit scores of borrowers at the time of origination and do not typically receive updated data on borrower credit scores after origination.

The majority of our single-family mortgage purchase volume is evaluated using automated underwriting software, either our proprietary software (Loan Prospector), the seller/servicers own software, or Fannie Mae s proprietary software. The percentage of our single-family mortgage purchase flow activity volume evaluated by the loan originator using Loan Prospector prior to being purchased by us was 45%, 41%, and 39% during 2012, 2011, and 2010, respectively. Beginning in 2009, we added a number of additional credit standards for loans evaluated by other underwriting software to improve the quality of loans we purchase that are evaluated using such other software. Consequently, we do not currently believe that the use of an automated underwriting software other than Loan Prospector significantly increases our loan performance risk.

As part of our quality control process, we review the underwriting documentation for certain loans we have purchased for compliance with our standards. In recent years, we have worked actively with our seller/servicers to improve loan underwriting quality. As a result, we observed improved quality control results for loans funded during 2011 as compared to 2010. As of December 31, 2012, the average aggregate underwriting deficiency rate across all seller/servicers for loans funded during 2011 and 2010 was approximately 5% and 13%, respectively. These rates may change in the future as our seller/servicers may appeal our findings. We have not yet sufficiently compiled our 2012 results for loan reviews due to the normal processing time to complete such reviews. The most common underwriting deficiencies found in the review of loans purchased during 2011 related to insufficient income and inadequate or missing documentation to support borrower qualification. The next most common deficiency was inaccurate data entered into Loan Prospector. We give our seller/servicers an opportunity to appeal ineligible loan determinations in response to our request for the repurchase of the loan. Beginning in the latter half of 2011, we required certain of our larger seller/servicers to maintain ineligible loan rates below a stated threshold (generally 5%), with financial consequences for non-compliance, as part of the renewals of our contracts with them. We expect these changes in seller/servicer contracts to positively impact ineligible loan rates. In addition, for all of our largest seller/servicers, we actively manage the current quality of loan originations by providing monthly written and oral communications regarding loan defect rates and the drivers of those defects as identified in our performing loan quality control sampling reviews. If necessary, we work with seller/servicers to develop an appropriate plan of corrective action.

Through 2012, for loans with identified underwriting deficiencies, we required either immediate repurchase or allowed performing loans to remain in our portfolio subject to our continued right to issue a repurchase request to the seller/servicers at a later date. Beginning January 1, 2013, our practice for lender repurchases is based upon the new framework discussed below. Our right to request repurchase by seller/servicers is intended to protect us against deficiencies in underwriting by our seller/servicers. For more information on our seller/servicers repurchase obligations, including recent performance under those obligations, see MD&A RISK MANAGEMENT Credit Risk *Institutional Credit Risk Single-family Mortgage Seller/Servicers*.

New Representation and Warranty Framework

At the direction of FHFA, we and Fannie Mae launched a new representation and warranty framework for conventional loans purchased by the GSEs on or after January 1, 2013. The objective of the new framework is to clarify lenders repurchase exposures and liability on future sales of mortgage loans to Freddie Mac and Fannie Mae and, under this new framework, lenders will be relieved of certain repurchase obligations for loans that meet specific payment requirements. Examples, subject to certain exclusions, include:

- loans with 36 months of consecutive, on-time payments after we purchase them; and
- relief refinance mortgages with 12 months of consecutive, on-time payments after we purchase them.

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Under the new framework, Freddie Mac and Fannie Mae, under the supervision of FHFA, have established consistent standards for:

- conducting quality control reviews earlier in the loan process, generally between 30 to 120 days after loan purchase;
- requiring lenders to submit requested loan files for review within specified timelines;
- evaluating loan files on a more comprehensive basis to ensure a focus on identifying significant deficiencies; and
- making available more transparent appeals processes for lenders to appeal repurchase requests.

Additionally, we will use our tools and available data to enable earlier identification of potentially defective loans prior to their purchase and delivery. The changes to the representation and warranty process are key elements of the seller/servicer contract harmonization project that supports FHFA s strategic plan for the Freddie Mac and Fannie Mae conservatorships announced in 2012.

The new framework does not affect seller/servicers obligations under their contracts with us with respect to loans sold to us prior to January 1, 2013. The new framework also does not affect their obligation to service these loans in accordance with our servicing standards. Freddie Mac will continue to work with lenders to resolve contractual claims on loans delivered prior to January 1, 2013.

Credit Enhancements

Our charter requires that single-family mortgages with LTV ratios above 80% at the time of purchase be covered by specified credit enhancements or participation interests. However, we may purchase single-family mortgages under HARP that refinance mortgages we currently own or guarantee without obtaining additional credit enhancement in excess of that already in place, even if the LTV ratio of the new loan is above 80%. Primary mortgage insurance is the most prevalent type of credit enhancement protecting our single-family credit guarantee portfolio, and is typically provided on a loan-level basis. Generally, in order to file a claim under a primary mortgage insurance policy, the insured loan must be in default and the borrower s interest in the underlying property must have been extinguished, such as through a short sale or foreclosure action. The mortgage insurer has a prescribed period of time within which to process a claim and make a determination as to its validity and amount.

For some mortgage loans, we elect to share the default risk by transferring a portion of that risk to various third parties through a variety of other credit enhancements. Other types of credit enhancements that we use are lender recourse (under which we may require a lender to repurchase a loan upon default), indemnification agreements (under which we may require a lender to reimburse us for credit losses realized on mortgages), collateral pledged by lenders, and subordinated security structures. Lender recourse and indemnification agreements are typically entered into contemporaneously with the purchase of a mortgage loan as an alternative to requiring primary mortgage insurance on the loan or in exchange for a lower guarantee fee on the loan.

We also use pool insurance, although we have not purchased pool insurance on single-family loans since March 2008. Pool insurance provides insurance on a pool of loans up to a stated aggregate loss limit. In addition to a pool-level loss coverage limit, some pool insurance contracts may have limits on coverage at the loan level. During 2012, we reached the maximum limit of loss on certain pool insurance contracts before their maturity dates. In order to file a claim under a pool insurance policy, we generally must have finalized the primary mortgage claim, disposed of the foreclosed property, and quantified our net loss with respect to the insured loan to determine the amount due under the pool insurance policy. Certain pool insurance policies have specified loss deductibles that must be met before we are entitled to recover under the policy.

Our use of credit enhancements to reduce our exposure to mortgage credit risk increases our exposure to institutional credit risk. See MD&A RISK MANAGEMENT Credit Risk *Institutional Credit Risk* for information about our counterparties that provide credit enhancement on loans in our single-family credit guarantee portfolio, including information about pool insurance coverage and our mortgage loan insurers.

Loss Mitigation and Loan Workout Activities

Loan workout activities are a key component of our loss mitigation strategy for managing and resolving troubled assets and lowering credit losses. Our single-family loss mitigation strategy emphasizes early intervention by servicers in delinquent mortgages and provides alternatives to foreclosure. Our single-family loss mitigation activities include providing our single-family servicers with default management tools designed to help them manage non-performing loans more

effectively and to assist borrowers in maintaining home ownership where possible, or facilitate foreclosure alternatives when continued homeownership is not an option. We require our single-family seller/servicers to first evaluate problem loans for a repayment or forbearance plan before considering modification. If a borrower is not eligible for a modification, our seller/servicers pursue other workout options before considering foreclosure.

Our loan workouts include:

- Forbearance agreements, where reduced payments or no payments are required during a defined period, generally less than one year. They provide additional time for the borrower to return to compliance with the original terms of the mortgage or to implement another loan workout. During 2012, the average time period granted for completed short-term forbearance agreements was between two and three months.

- Repayment plans, which are contractual plans to make up past due amounts. These plans assist borrowers in returning to compliance with the original terms of their mortgages. During 2012, the average time period granted for completed repayment plans was between two and six months.

- Loan modifications, which may involve changing the terms of the loan, or adding outstanding indebtedness, such as delinquent interest, to the UPB of the loan, or a combination of both. We require our servicers to examine the borrower s capacity to make payments under the new terms by reviewing the borrower s qualifications, including income. During 2012, we granted principal forbearance but did not utilize principal forgiveness for our loan modifications. Principal forbearance is a change to a loan s terms to designate a portion of the principal as non-interest-bearing and non-amortizing. A borrower may only receive one HAMP modification; however, a loan may be modified twice under our standard loan modification program. Generally, a borrower may only receive one standard modification during a 12 month period. However, we reserve the right to approve additional non-HAMP loan modifications to the same borrower, based on the borrower s individual facts and circumstances.

- Short sale and deed in lieu of foreclosure transactions.

We also participate in the MHA Program, which is designed to help in the housing recovery, promote liquidity and housing affordability, expand foreclosure prevention efforts, and set market standards. Participation in the MHA Program is an integral part of our mission of providing stability to the housing market. Through our participation in this program, we help borrowers maintain home ownership. Some of the key initiatives of this program include HAMP and HARP, which are discussed below.

Home Affordable Modification Program

HAMP commits U.S. government, Freddie Mac, and Fannie Mae funds to help eligible homeowners avoid foreclosures and keep their homes through mortgage modifications, where possible. HAMP applies to loans originated on or before January 1, 2009. The program is scheduled to end on December 31, 2013.

Under this program, we offer loan modifications to financially struggling homeowners with mortgages on their primary residences that reduce the monthly principal and interest payments on their mortgages. HAMP requires that each borrower complete a trial period during which the borrower will make monthly payments based on the estimated amount of the modification payments. Trial periods are required to be at least three months. After the final trial-period payment is received by our servicer the borrower and servicer will enter into the modification.

To address documentation issues experienced when the program began, guidelines for HAMP provide that, for trial periods that became effective on or after June 1, 2010, borrowers must provide income documentation before entering into the trial period. Prior to the June 1, 2010 changes to HAMP, we experienced approximately a 38% modification completion rate under the program. Subsequent to the June 1, 2010 changes, we have experienced a modification completion rate in excess of 75%. When a borrower s trial period is cancelled, the loan is considered for our other workout activities.

HAMP includes the following features:

Under HAMP, the goal is to reduce the borrower s monthly mortgage payments to 31% of gross monthly income, which may be achieved through a combination of methods, including interest rate reductions, term extensions, and principal forbearance. Although HAMP contemplates that some servicers will also make use of principal reduction to achieve reduced payments for borrowers, we have only used forbearance and have not used principal reduction in modifying our loans. Borrowers whose loans are modified through HAMP accrue monthly incentive payments (in the

form of credits) that are applied annually to reduce up to $1,000 of their principal per year, for five years, as long as they are making timely payments under the modified loan terms.

Servicers are paid incentive fees for each completed HAMP modification. Servicers receive additional incentive fees for any modification that reduces a borrower s monthly payment by 6% or more, in each of the first three years after the modification, as long as the modified loan remains current.

Except in limited instances, each borrower s reduced payment will remain in effect for a minimum of five years, and borrowers whose interest rates were adjusted below market levels will have their interest rate and payment gradually increased after the fifth year to a rate consistent with the market rate at the time of modification. Although mortgage investors under the MHA Program are entitled to certain subsidies from Treasury for reducing the borrowers monthly payments from 38% to 31% of the borrower s income, we do not receive such subsidies on modified mortgages owned or guaranteed by us. We also bear the costs of borrower incentive payments and servicer incentive fees for our HAMP loans, without reimbursement of such costs from Treasury.

Trial periods are required to be at least three months in duration. Our servicers are permitted to add an interim month, which will be reported as a fourth trial period month. In addition, our servicers are authorized to extend a trial period for up to an additional two months when the borrower is in bankruptcy in order to provide additional time to have the mortgage removed from the bankruptcy plan, which is a prerequisite to a modification under HAMP.

We are the compliance agent for Treasury for certain foreclosure avoidance activities under HAMP by mortgage holders other than Freddie Mac and Fannie Mae. Among other duties, as the program compliance agent, we conduct examinations and review servicer compliance with the published requirements for the program. Some of these examinations are on-site, and others involve off-site documentation reviews. We report the results of our examination findings to Treasury. Based on the examinations, we may also provide Treasury with advice, guidance and lessons learned to improve operation of the program.

Relief Refinance Mortgage Initiative and the Home Affordable Refinance Program

Our relief refinance opportunities, including HARP (which is the portion of our relief refinance initiative for loans with LTV ratios above 80%), are a significant part of our effort to keep families in their homes. Only borrowers with Freddie Mac-owned or guaranteed mortgages are eligible for our relief refinance mortgage initiative. Our relief refinance initiative began in 2009 and is designed to provide eligible homeowners with existing loans owned or guaranteed by us an opportunity to refinance their mortgage without obtaining new mortgage insurance in excess of what was already in place. Our relief refinance initiative enables us to assist homeowners by making their mortgage payments more affordable through one or more of the following ways: (a) a reduction in payment; (b) a reduction in interest rate; (c) movement to a more stable mortgage product type (i.e., from an adjustable-rate mortgage to a fixed-rate mortgage); or (d) a reduction in amortization term.

HARP and the relief refinance mortgage initiative originally permitted eligible borrowers with Freddie Mac mortgages (that were sold to us on or before May 31, 2009) and LTVs up to 125% to refinance their mortgages. In October 2011, FHFA, Freddie Mac, and Fannie Mae announced a series of FHFA-directed changes to HARP, in an effort to attract more eligible borrowers who can benefit from refinancing their home mortgages. We subsequently made similar changes to the relief refinance mortgage initiative for loans with LTV ratios of 80% and less. The enhancements to HARP and the relief refinance mortgage initiative included:

- removing the 125% LTV ratio ceiling for fixed-rate mortgages;
- relieving the lenders of certain underwriting and borrower eligibility representations and warranties on the original mortgage being refinanced;
- eliminating the need for a new property appraisal where there is a reliable automated valuation model estimate provided by the purchasing GSE; and
- extending the last application date for HARP loans to December 31, 2013.

We began purchasing HARP loans under the revised program in January 2012. In September 2012, we announced additional changes to our relief refinance process that are intended to reduce the seller/servicers   operational complexities associated with originating these loans.

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Underwriting procedures for relief refinance mortgages are limited in many cases, and such procedures generally do not include all of the changes in underwriting standards we have implemented since 2008. As a result, relief refinance mortgages generally reflect many of the credit risk attributes of the original loans. However, borrower participation in our relief refinance mortgage initiative may help reduce our exposure to credit risk in cases where the borrowers payments under their mortgages are reduced, thereby strengthening the borrowers potential to make their mortgage payments. See MD&A RISK MANAGEMENT Credit Risk *Mortgage Credit Risk Single-family Mortgage Credit Risk Single-Family Loan Workouts and the MHA Program* for additional information about HARP and our relief refinance mortgage initiative.

Non-HAMP Standard Modifications

In late 2011, as part of the servicing alignment initiative (described below), we implemented a new non-HAMP standard loan modification initiative, replacing our previous non-HAMP modification initiative. The standard modification requires a three-month trial period (our previous non-HAMP modification program did not require a trial period). The standard modification provides an extension of the loan s term to 480 months. In addition, the standard modification initiative currently provides for a standard modified interest rate of 4% (though the rate could change in the future). This initiative also provides for a servicer incentive fee schedule for non-HAMP modifications, comparable to the current HAMP servicer incentive fee structure. The incentive fees are intended to provide greater incentives to our servicers to modify loans earlier in the delinquency. Unlike with HAMP modifications, our non-HAMP standard modification does not provide for borrower incentive payments or recurring servicer incentive fees after the initial servicer incentive payment.

Servicing Alignment Initiative

During 2012, we continued to implement the FHFA-directed servicing alignment initiative, under which we and Fannie Mae are aligning certain standards for servicing non-performing loans owned or guaranteed by the companies. We believe that the servicing alignment initiative will continue to: (a) change, among other things, the way servicers communicate and work with troubled borrowers; (b) bring greater consistency and accountability to the servicing industry; and (c) help more distressed homeowners avoid foreclosure. We have provided standards to our servicers under this initiative that require them to initiate earlier and more frequent communication with delinquent borrowers, employ consistent requirements for collecting documents from borrowers, and follow consistent timelines for responding to borrowers and for processing foreclosures. These standards have resulted in greater alignment of servicer processes for both HAMP and most non-HAMP workouts.

Under these new servicing standards, we pay incentives to servicers that exceed certain performance standards with respect to servicing delinquent loans. We also assess compensatory fees if servicers do not achieve a minimum performance benchmark with respect to servicing delinquent loans. Incentive fees paid to servicers and compensatory fees received from servicers are recorded in other expenses and other income, respectively, within our consolidated statements of comprehensive income. These incentives may result in our payment of increased fees to our seller/servicers, the cost of which may be partially mitigated by the compensatory fees paid to us by our servicers that do not perform as required.

In August 2012, as part of the servicing alignment initiative we announced a new standard short sale process, aligned with Fannie Mae, which is designed to help more struggling borrowers use short sales to avoid foreclosure. This new process became effective November 1, 2012, and changes many of the operational procedures required to complete a transaction, including: (a) expanding the eligibility for borrowers to qualify for these transactions; (b) delegating the authority to complete these transactions to our seller/servicers in most cases; and (c) providing for a standardized and simplified method for seller/servicers to value the property and evaluate the transaction on a more timely basis.

In addition, in November 2012 we announced a new process, aligned with Fannie Mae, for deed in lieu of foreclosure transactions. This new process will become effective on March 1, 2013.

For more information regarding credit risk, see MD&A RISK MANAGEMENT Credit Risk, NOTE 4: MORTGAGE LOANS AND LOAN LOSS RESERVES, and NOTE 5: INDIVIDUALLY IMPAIRED AND NON-PERFORMING LOANS.

Investments Segment

The Investments segment reflects results from our investment, funding and hedging activities. In our Investments segment, we invest principally in mortgage-related securities and single-family performing mortgage loans, which are funded by other debt issuances and hedged using derivatives. In our Investments segment, we also provide funding and hedging

management services to the Single-family Guarantee and Multifamily segments. In the Investments segment, we are not currently a substantial buyer or seller of mortgage assets.

Our Customers

Our customers for our debt securities predominantly include insurance companies, money managers, central banks, depository institutions, and pension funds. Within the Investments segment, we buy securities and single-family mortgage loans through various market sources. We purchase a significant portion of these loans from a variety of lenders, as discussed in *Single-Family Guarantee Segment Our Customers*.

Our Competition

Historically, our principal competitors have been Fannie Mae and other financial institutions that invest in mortgage-related securities and mortgage loans, such as commercial and investment banks, dealers, thrift institutions, REITs, and insurance companies. The conservatorship, including direction provided to us by our Conservator and the restrictions on our activities under the Purchase Agreement, has affected and will continue to affect our ability to compete in the business of investing in mortgage-related securities and mortgage loans.

We compete for debt funding with Fannie Mae, the FHLBs and other institutions. Competition for debt funding from these entities can vary with changes in economic, financial market and regulatory environments.

Assets

Historically, we have primarily been a buy-and-hold investor in mortgage-related securities and single-family performing mortgage loans. We purchase these assets to improve profitability, support our customers, and support the liquidity and price performance of our PCs. We may sell assets to reduce risk, provide liquidity, and improve our returns. However, due to limitations under the Purchase Agreement and those imposed by FHFA, our ability to acquire and sell mortgage assets is significantly constrained. For more information, see Conservatorship and Related Matters *Limits on Investment Activity and Our Mortgage-Related Investments Portfolio* and MD&A CONSOLIDATED RESULTS OF OPERATIONS Segment Earnings *Segment Earnings-Results Investments.*

We may enter into a variety of transactions to improve investment returns, including: (a) dollar roll transactions; (b) purchases of agency securities (including agency REMICs); and (c) purchases of performing single-family mortgage loans. In addition, we may create REMICs from existing agency securities and sell tranches that are in demand by investors to reduce our asset balance, while conserving value for the taxpayer. We estimate our expected investment returns using an OAS approach, which is an estimate of the yield spread between a given financial instrument and a benchmark (LIBOR, agency or Treasury) yield curve. In this approach, we consider potential variability in the instrument s cash flows resulting from any options embedded in the instrument, such as the prepayment option. Additionally, in this segment we hold reperforming and modified single-family mortgage loans related to our single-family business. For our liquidity needs, we maintain a portfolio comprised primarily of cash and cash equivalents, non-mortgage-related securities (primarily Treasury securities), and securities purchased under agreements to resell.

Debt Financing

We fund our investment activities by issuing short-term and long-term debt. The conservatorship, and the resulting support we receive from Treasury, has enabled us to access debt funding on terms sufficient for our needs. While we believe that the support provided by Treasury pursuant to the Purchase Agreement currently enables us to maintain our access to the debt markets and to have adequate liquidity to conduct our normal business activities, the costs of our debt funding could vary for a number of reasons, including the uncertainty about the future of the GSEs. Additionally, the Purchase Agreement limits the amount of indebtedness we can incur.

For more information, see Conservatorship and Related Matters and MD&A LIQUIDITY AND CAPITAL RESOURCES Liquidity.

Risk Management

Our Investments segment has responsibility for managing our interest rate risk and certain liquidity risks. Derivatives are an important part of our risk management strategy. We use derivatives primarily to: (a) hedge forecasted issuances of debt; (b) synthetically create callable and non-callable funding; (c) adjust or rebalance our funding mix in response to

changes in the interest-rate characteristics of our mortgage-related assets; and (d) hedge foreign-currency exposure. For more information regarding our use of derivatives, see QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK and NOTE 10: DERIVATIVES. For information regarding our liquidity management, see MD&A LIQUIDITY AND CAPITAL RESOURCES.

PC Support Activities

Our PCs are an integral part of our mortgage purchase program. Our Single-family Guarantee segment purchases many of our mortgages by issuing PCs in exchange for those mortgage loans in guarantor swap transactions. We also issue PCs backed by mortgage loans that we purchased for cash. The relative price performance of our PCs and comparable Fannie Mae securities can directly affect the volume and/or profitability of our new single-family guarantee business.

From time to time, we undertake actions in an effort to support the liquidity and the relative price performance of our PCs to comparable Fannie Mae securities through a variety of activities. These activities can include the purchase and sale of Freddie Mac mortgage-related securities, purchases of loans, and dollar roll transactions, as well as the issuance of REMICs and Other Structured Securities. Our purchases and sales of mortgage-related securities and our issuances of REMICs and Other Structured Securities influence the relative supply and demand (i.e., liquidity) for these securities, helping to support the price performance of our PCs. Depending upon market conditions, including the relative prices, supply and demand for our PCs and comparable Fannie Mae securities, as well as other factors, there may be substantial variability in any period in the total amount of securities we purchase or sell, and in the success of our efforts to support the liquidity and price performance of our PCs. In the first half of 2012, we curtailed mortgage-related investments portfolio purchase and retention activities that were undertaken primarily in an effort to support the liquidity and price performance of our PCs. However, due to a decline in our single-family competitive position compared to other market participants (primarily Fannie Mae and Ginnie Mae) in the first half of 2012, we resumed certain of the activities noted above during the second half of 2012 in an effort to support the price performance of our PCs while minimizing market disruption. For more information about our efforts to support the liquidity and relative price performance for PCs, see *Single-Family Credit Guarantee Segment Securitization Activities*.

We incur costs in connection with our efforts to support the liquidity and price performance of our PCs, including engaging in transactions that yield less than our target rate of return. We may increase, reduce or discontinue these or other related activities at any time, which could affect the liquidity and price performance of our PCs. For more information, see RISK FACTORS Competitive and Market Risks *A significant decline in the price performance of or demand for our PCs could have an adverse effect on the volume and/or profitability of our new single-family guarantee business.*

Multifamily Segment

The Multifamily segment reflects results from our investment (both purchases and sales), securitization, and guarantee activities in multifamily mortgage loans and securities. Although historically we were primarily a buy and hold investor in multifamily mortgage assets (both loans held for investment and investment securities, primarily CMBS), since 2009 our primary business model is to purchase held-for-sale multifamily loans for aggregation and then securitization through multifamily K Certificates, which are considered Other Guarantee Transactions. In substantially all of these transactions we guarantee only the most senior tranches of the securities. As a result, a significant portion of our expected credit risk associated with these loans is sold in subordinated tranches to third party investors. With this model, we utilize securitization to substantially reduce our credit risk while providing liquidity to the multifamily market. See *Single-Family Guarantee Segment Securitization Activities Other Guarantee Transactions* for a diagram that illustrates these transactions.

To a lesser extent, we provide guarantees of the payment of principal and interest on tax-exempt multifamily pass-through certificates backed by multifamily housing revenue bonds. These housing revenue bonds are collateralized by mortgage loans on low- and moderate-income multifamily housing developments. In addition, we guarantee the payment of principal and interest on tax-exempt multifamily housing revenue bonds secured by low- and moderate-income multifamily mortgage loans.

The multifamily property market is affected by local and regional economic factors, such as employment rates, construction cycles, and relative affordability of single-family home prices, all of which influence the supply and demand for multifamily properties and pricing for apartment rentals. Our multifamily loan volume is largely sourced through established institutional channels where we are generally providing post-construction financing to larger apartment project operators with established performance records.

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Our lending decisions are largely based on the assessment of the property s ability to provide rents that will generate sufficient operating cash flows to support payment of debt service obligations (both principal and interest) as measured by the expected DSCR and the loan amount relative to the value of the property as measured by the LTV ratio. Multifamily mortgages generally are without recourse to the borrower (i.e., the borrower is not personally liable for any deficiency remaining after foreclosure and sale of the property), except in the event of fraud or certain other specified types of default. Therefore, repayment of the mortgage depends on the ability of the underlying property to generate cash flows sufficient to cover the related debt obligations. That, in turn, depends on conditions in the local rental market, local and regional economic conditions, the physical condition of the property, the quality of property management, and the level of operating expenses.

Our Customers

We acquire a significant portion of our multifamily mortgage loans from several large seller/servicers. For 2012, our top two multifamily sellers, CBRE Capital Markets, Inc. and Berkadia Commercial Mortgage, LLC, each accounted for more than 10% of our multifamily purchase volume, and together accounted for approximately 34% of our multifamily purchase volume. Our top 10 multifamily lenders represented an aggregate of approximately 80% of our multifamily purchase volume for 2012.

A significant portion of our multifamily mortgage loans are serviced by several of our large customers. See MD&A RISK MANAGEMENT Credit Risk *Institutional Credit Risk Seller/Servicers* for additional information.

Our Competition

We compete on the basis of: (a) price; (b) products, including our use of certain securitization structuring; and (c) service. Historically, our principal competitors have been Fannie Mae, FHA, and other financial institutions that retain or securitize multifamily mortgages, such as commercial and investment banks, dealers, thrift institutions, and insurance companies. During the period of significant market volatility (primarily during 2008 and 2009), many of our competitors, other than Fannie Mae and FHA, significantly curtailed their activities in the multifamily mortgage business relative to their previous levels. Beginning in 2010, as multifamily fundamentals were improving, more market participants began to re-emerge in the multifamily market, and we have faced increased competition.

Underwriting Requirements and Quality Control Standards

Our process and standards for underwriting multifamily mortgages differ from those used for single-family mortgages. Unlike single-family mortgages, we currently do not use a delegated underwriting process for the newly-originated multifamily mortgages we purchase or securitize. Instead, we typically underwrite and evaluate each mortgage prior to purchase or providing our guarantee. This process includes review of third-party appraisals and cash flow analysis. Our underwriting standards focus on loan quality measurement based, in part, on the LTV ratio and DSCR. The DSCR estimates a multifamily borrower s ability to service its mortgage obligation using the secured property s cash flow, after deducting non-mortgage expenses from income. The higher the DSCR, the more likely a multifamily borrower will be able to continue servicing its mortgage obligation. Our standards for multifamily loans specify maximum original LTV ratio and minimum DSCR that vary based on the loan characteristics, such as loan type (new acquisition or supplemental financing), loan term (intermediate or longer-term), and loan features (interest-only or amortizing, fixed- or variable-rate). Our multifamily loans are generally underwritten with requirements for a maximum original LTV ratio of 80% and a DSCR of greater than 1.25 (which for interest-only and partial interest-only loans is based on an assumed monthly payment that reflects amortization of principal). In certain circumstances, our standards for multifamily loans allow for certain types of loans to have an original LTV ratio over 80% and/or a DSCR of less than 1.25, typically where this will serve our mission and contribute to achieving our affordable housing goals. In cases where we commit to purchase or guarantee a permanent loan upon completion of construction or rehabilitation, we generally require additional credit enhancements, because underwriting for these loans typically requires estimates of future cash flows for calculating the DSCR that is expected after construction or rehabilitation is completed.

Multifamily seller/servicers make representations and warranties to us about the mortgage and about certain information submitted to us in the underwriting process. We have the right to require that a seller/servicer repurchase a multifamily mortgage for which there has been a breach of representation or warranty. However, because of our evaluation of underwriting information for most multifamily properties prior to purchase, repurchases have been rare.

We generally require multifamily seller/servicers to service mortgage loans they have sold to us in order to mitigate potential losses. This includes property monitoring tasks beyond those typically performed by single-family servicers. We

are not the master servicer for multifamily loans we have securitized (i.e., K Certificates) since we transfer the master servicing responsibilities to the trustees on behalf of the bondholders in accordance with the securitization and trust documents. For loans over $1 million where we own the servicing rights, servicers must generally submit an annual assessment of the mortgaged property to us based on the servicer s analysis of the property as well as the borrower s quarterly financial statements. In situations where a borrower or property is in distress, the frequency of communications with the borrower may be increased. Because the activities of multifamily seller/servicers are an important part of our loss mitigation process, we rate their performance regularly and may conduct on-site reviews of their servicing operations in an effort to confirm compliance with our standards.

For loans for which we are the master servicer, if a borrower is in distress, we may offer a workout option to the borrower. For example, we may modify the terms of a multifamily mortgage loan, which gives the borrower an opportunity to bring the loan current and retain ownership of the property. These arrangements are made with the expectation that we will recover our initial investment or minimize our losses. We do not enter into these arrangements in situations where we believe we would experience a loss in the future that is greater than or equal to the loss we would experience if we foreclosed on the property at the time of the agreement.

Conservatorship and Related Matters

Overview and Entry into Conservatorship

We have been operating under conservatorship, with FHFA acting as our conservator, since September 6, 2008. The conservatorship and related matters have had a wide-ranging impact on us, including our regulatory supervision, management, business, financial condition and results of operations.

On September 7, 2008, the then Secretary of the Treasury and the then Director of FHFA announced several actions taken by Treasury and FHFA regarding Freddie Mac and Fannie Mae. These actions included the execution of the Purchase Agreement, pursuant to which we issued to Treasury both senior preferred stock and a warrant to purchase common stock. At that time, FHFA set forth the purpose and goals of the conservatorship as follows: The purpose of appointing the Conservator is to preserve and conserve the company s assets and property and to put the company in a sound and solvent condition. The goals of the conservatorship are to help restore confidence in Fannie Mae and Freddie Mac, enhance their capacity to fulfill their mission, and mitigate the systemic risk that has contributed directly to the instability in the current market. We refer to the Purchase Agreement and the warrant as the Treasury Agreements.

There is significant uncertainty as to whether or when we will emerge from conservatorship, as it has no specified termination date, and as to what changes may occur to our business structure during or following conservatorship, including whether we will continue to exist. We are not aware of any current plans of our Conservator to significantly change our business model or capital structure in the near-term. Our future structure and role will be determined by the Administration and Congress, and there are likely to be significant changes beyond the near-term. We have no ability to predict the outcome of these deliberations.

On February 21, 2012, FHFA sent to Congress a strategic plan for the next phase of the conservatorships of Freddie Mac and Fannie Mae. The plan outlines how FHFA, as Conservator, intends to guide us and Fannie Mae over the next few years, and identifies the strategic goals of (a) building a new infrastructure for the secondary mortgage market; (b) gradually contracting Freddie Mac and Fannie Mae s dominant presence in the marketplace while simplifying and shrinking their operations; and (c) maintaining foreclosure prevention activities and credit availability for new and refinanced mortgages. In March 2012, FHFA instituted the Conservatorship Scorecard that established objectives, performance targets and measures, and provided the implementation roadmap for FHFA s strategic plan.

We receive substantial support from Treasury and FHFA, as our Conservator and regulator, and are dependent upon their continued support in order to continue operating our business. This support includes our ability to access funds from Treasury under the Purchase Agreement, which is critical to: (a) keeping us solvent; (b) allowing us to focus on our primary business objectives under conservatorship; and (c) avoiding the appointment of a receiver by FHFA under statutory mandatory receivership provisions. For the past several years, the Federal Reserve has purchased significant amounts of mortgage-related securities issued by us, Fannie Mae, and Ginnie Mae. These purchases, which are ongoing, have affected mortgage spreads (positively and, in some periods, negatively) and the demand for and value of our PCs.

For a description of certain risks to our business relating to the conservatorship and Treasury Agreements, see RISK FACTORS.

Supervision of Our Company During Conservatorship

Upon its appointment, FHFA, as Conservator, immediately succeeded to all rights, titles, powers and privileges of Freddie Mac, and of any stockholder, officer or director of Freddie Mac with respect to Freddie Mac and its assets, and succeeded to the title to all books, records and assets of Freddie Mac held by any other legal custodian or third party. Under conservatorship, we have additional heightened supervision and direction from our regulator, FHFA, which is also acting as our Conservator.

During the conservatorship, the Conservator has delegated certain authority to the Board of Directors to oversee, and to management to conduct, day-to-day operations so that the company can continue to operate in the ordinary course of business. The directors serve on behalf of, and exercise authority as directed by, the Conservator. The Conservator retains the authority to withdraw or revise its delegations of authority at any time. The Conservator also retained certain significant authorities for itself, and did not delegate them to the Board. For more information on limitations on the Board s authority during conservatorship, see DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE Authority of the Board and Board Committees.

Because the Conservator succeeded to the powers, including voting rights, of our stockholders, who therefore do not currently have voting rights of their own, we do not expect to hold stockholders meetings during the conservatorship, nor will we prepare or provide proxy statements for the solicitation of proxies.

We describe the powers of our Conservator in detail below under Powers of the Conservator.

Impact of Conservatorship and Related Actions on Our Business

We conduct our business subject to the direction of FHFA as our Conservator. While the conservatorship has benefited us through, for example, improved access to the debt markets because of the support we receive from Treasury, we are also subject to certain constraints on our business activities by Treasury due to the terms of, and Treasury s rights under, the Purchase Agreement.

The Conservator continues to determine, and direct the efforts of the Board of Directors and management to address, the strategic direction for the company. While the Conservator has delegated certain authority to management to conduct day-to-day operations, many management decisions are subject to review and approval by FHFA and Treasury. In addition, management frequently receives directions from FHFA on various matters involving day-to-day operations.

Our current business objectives reflect direction we received from the Conservator (including the Conservatorship Scorecard). Our business objectives changed considerably since we entered into conservatorship. See Executive Summary *Our Primary Business Objectives* for more information. At the direction of the Conservator, we made changes to certain business practices that are designed to provide support for the mortgage market in a manner that serves our public mission and other non-financial objectives but may not contribute to our profitability. Certain of these objectives are intended to help homeowners and the mortgage market and may help to mitigate future credit losses. However, some of our initiatives are expected to have an adverse impact on our near- and long-term financial results. The Conservator stated that it is taking actions in support of the objectives of a gradual transition to greater private capital participation in housing finance and greater distribution of risk to participants other than the government. The Conservator also stated that it is focusing on retaining value in the business operations of Freddie Mac and Fannie Mae, overseeing remediation of identified weaknesses in corporate operations and risk management, and ensuring that sound corporate governance principles are followed. Given the important role the Administration and our Conservator have placed on Freddie Mac in addressing housing and mortgage market conditions and our public mission, we may be required to take additional actions that could have a negative impact on our business, operating results or financial condition, and thus could contribute to a need for additional draws under the Purchase Agreement.

These actions and objectives create risks and uncertainties that we discuss in RISK FACTORS Conservatorship and Related Matters. For more information on the impact of conservatorship and our current business objectives, see NOTE 2: CONSERVATORSHIP AND RELATED MATTERS.

Limits on Investment Activity and Our Mortgage-Related Investments Portfolio

The conservatorship has significantly affected our investment activity. FHFA has stated that we will not be a substantial buyer or seller of mortgages for our mortgage-related investments portfolio. Under the terms of the Purchase Agreement, as amended on August 17, 2012, and FHFA regulation, the UPB of our mortgage-related investments portfolio: (a) could not

exceed $650 billion on December 31, 2012; and (b) on December 31 of each year thereafter, may not exceed 85% of the aggregate amount of the UPB we were permitted to own as of December 31 of the immediately preceding calendar year, until the portfolio reaches $250 billion. As a result, the UPB of our mortgage-related investments portfolio may not exceed $553 billion as of December 31, 2013. FHFA has indicated that such portfolio reduction targets should be viewed as minimum reductions and has encouraged us to reduce the mortgage-related investments portfolio at a faster rate than required, while indicating that the pace of reducing the portfolio may be moderated by conditions in the housing and financial markets. This strategy is designed to reduce the portfolio and provide the best return to the taxpayer while minimizing market disruption.

The table below presents the UPB of our mortgage-related investments portfolio, for purposes of the limit imposed by the Purchase Agreement and FHFA regulation.

Table 4 Mortgage-Related Investments Portfolio[1]

	December 31, 2012	December 31, 2011
	(in millions)	
Investments segment Mortgage investments portfolio	$ 375,924	$ 449,273
Single-family Guarantee segment Single-family unsecuritized mortgage loans[2]	53,333	62,469
Multifamily segment Mortgage investments portfolio	128,287	141,571
Total mortgage-related investments portfolio	$ 557,544	$ 653,313

(1) Based on UPB and excludes mortgage loans and mortgage-related securities traded, but not yet settled.
(2) Represents unsecuritized seriously delinquent single-family loans managed by the Single-family Guarantee segment.

The UPB of our mortgage-related investments portfolio at December 31, 2012 was $557.5 billion, a decline of $95.8 billion compared to $653.3 billion at December 31, 2011. The reduction in UPB resulted primarily from liquidations and is consistent with our efforts to reduce the size of our mortgage-related investments portfolio as described above. The mortgage-related investments portfolio is comprised of agency securities, single-family non-agency mortgage-related securities, CMBS, housing revenue bonds, and single-family and multifamily unsecuritized mortgage loans.

We consider the liquidity of the assets in our mortgage-related investments portfolio based on three categories: (a) agency securities; (b) assets that are less liquid than agency securities; and (c) illiquid assets. Assets that are less liquid than agency securities include unsecuritized performing single-family mortgage loans, multifamily mortgage loans, CMBS, and housing revenue bonds. Our less liquid assets collectively represented approximately 28% of the UPB of the portfolio at December 31, 2012, compared to 32% as of December 31, 2011. Illiquid assets include unsecuritized seriously delinquent and modified single-family mortgage loans which we removed from PC trusts, and our investments in non-agency mortgage-related securities backed by subprime, option ARM, and Alt-A and other loans. Our illiquid assets collectively represented approximately 35% of the UPB of the portfolio at December 31, 2012, as compared to 29% as of December 31, 2011. The increase in the percentage of illiquid assets at December 31, 2012 compared to December 31, 2011 is primarily due to our agency securities balance decreasing at a faster rate than our assets that are less liquid than agency securities and illiquid assets.

Powers of the Conservator

Under the GSE Act, the conservatorship provisions applicable to Freddie Mac are based generally on federal banking law. As discussed below, FHFA has broad powers when acting as our conservator. For more information on the GSE Act, see Regulation and Supervision.

General Powers of the Conservator

Upon its appointment, the Conservator immediately succeeded to all rights, titles, powers and privileges of Freddie Mac, and of any stockholder, officer or director of Freddie Mac with respect to Freddie Mac and its assets. The Conservator also succeeded to the title to all books, records and assets of Freddie Mac held by any other legal custodian or third party.

Under the GSE Act, the Conservator may take any actions it determines are necessary and appropriate to carry on our business, support public mission objectives, and preserve and conserve our assets and property. The Conservator s powers include the ability to transfer or sell any of our assets or liabilities (subject to certain limitations and post-transfer notice provisions for transfers of qualified financial contracts, as defined below under Special Powers of the Conservator Security Interests Protected; Exercise of Rights Under Qualified Financial Contracts) without any approval, assignment of

rights or consent of any party. The GSE Act, however, provides that mortgage loans and mortgage-related assets that have been transferred to a Freddie Mac securitization trust must be held for the beneficial owners of the trust and cannot be used to satisfy our general creditors.

Under the GSE Act, in connection with any sale or disposition of our assets, the Conservator must conduct its operations to maximize the NPV return from the sale or disposition of such assets, to minimize the amount of any loss realized in the resolution of cases, and to ensure adequate competition and fair and consistent treatment of offerors. The Conservator is required to maintain a full accounting of the conservatorship and make its reports available upon request to stockholders and members of the public.

We remain liable for all of our obligations relating to our outstanding debt and mortgage-related securities. FHFA has stated that our obligations will be paid in the normal course of business during the conservatorship.

Special Powers of the Conservator

Disaffirmance and Repudiation of Contracts

Under the GSE Act, the Conservator may disaffirm or repudiate contracts (subject to certain limitations for qualified financial contracts) that we entered into prior to its appointment as Conservator if it determines, in its sole discretion, that performance of the contract is burdensome and that disaffirmance or repudiation of the contract promotes the orderly administration of our affairs. The GSE Act requires FHFA to exercise its right to disaffirm or repudiate most contracts within a reasonable period of time after its appointment as Conservator. In a final rule published in June 2011, FHFA defines a reasonable period of time following appointment of a conservator or receiver to be 18 months. The Conservator has advised us that it has no intention of repudiating any guarantee obligation relating to Freddie Mac s mortgage-related securities because it views repudiation as incompatible with the goals of the conservatorship. We can, and have continued to, enter into, perform and enforce contracts with third parties.

Limitations on Enforcement of Contractual Rights by Counterparties

The GSE Act provides that the Conservator may enforce most contracts entered into by us, notwithstanding any provision of the contract that provides for termination, default, acceleration, or exercise of rights upon the appointment of, or the exercise of rights or powers by, a conservator.

Security Interests Protected; Exercise of Rights Under Qualified Financial Contracts

Notwithstanding the Conservator s powers under the GSE Act described above, the Conservator must recognize legally enforceable or perfected security interests, except where such an interest is taken in contemplation of our insolvency or with the intent to hinder, delay or defraud us or our creditors. In addition, the GSE Act provides that no person will be stayed or prohibited from exercising specified rights in connection with qualified financial contracts, including termination or acceleration (other than solely by reason of, or incidental to, the appointment of the Conservator), rights of offset, and rights under any security agreement or arrangement or other credit enhancement relating to such contract. Such rights in connection with qualified financial contracts that arise solely by reason of, or incidental to, the appointment of a receiver may be exercised only after: (a) 5:00 p.m. on the business day following the receiver s appointment; or (b) notice to such person that such contract has been transferred by the receiver to another person. The term qualified financial contract means any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement as determined by FHFA by regulation, resolution or order.

Avoidance of Fraudulent Transfers

Under the GSE Act, the Conservator may avoid, or refuse to recognize, a transfer of any property interest of Freddie Mac or of any of our debtors, and also may avoid any obligation incurred by Freddie Mac or by any debtor of Freddie Mac, if the transfer or obligation was made: (a) within five years of September 6, 2008; and (b) with the intent to hinder, delay, or defraud Freddie Mac, FHFA, the Conservator or, in the case of a transfer in connection with a qualified financial contract, our creditors. To the extent a transfer is avoided, the Conservator may recover, for our benefit, the property or, by court order, the value of that property from the initial or subsequent transferee, other than certain transfers that were made for value, including satisfaction or security of a present or antecedent debt, and in good faith. These rights are superior to any rights of a trustee or any other party, other than a federal agency, under the U.S. bankruptcy code.

Modification of Statutes of Limitations

Under the GSE Act, notwithstanding any provision of any contract, the statute of limitations with regard to any action brought by the Conservator is: (a) for claims relating to a contract, the longer of six years or the applicable period under state law; and (b) for tort claims, the longer of three years or the applicable period under state law, in each case, from the later of September 6, 2008 or the date on which the cause of action accrues. In addition, notwithstanding the state law statute of limitation for tort claims, the Conservator may bring an action for any tort claim that arises from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to us, if the state s statute of limitations expired not more than five years before September 6, 2008.

Suspension of Legal Actions

Under the GSE Act, in any judicial action or proceeding to which we are or become a party, the Conservator may request, and the applicable court must grant, a stay for a period not to exceed 45 days.

Treatment of Breach of Contract Claims

Under the GSE Act, any final and unappealable judgment for monetary damages against the Conservator for breach of an agreement executed or approved in writing by the Conservator will be paid as an administrative expense of the Conservator.

Attachment of Assets and Other Injunctive Relief

Under the GSE Act, the Conservator may seek to attach assets or obtain other injunctive relief without being required to show that any injury, loss or damage is irreparable and immediate.

Subpoena Power

The GSE Act provides the Conservator, with the approval of the Director of FHFA, with subpoena power for purposes of carrying out any power, authority or duty with respect to Freddie Mac.

Treasury Agreements

Treasury entered into several agreements with us in connection with our entry into conservatorship, as described below.

Purchase Agreement, Senior Preferred Stock, and Common Stock Warrant

Purchase Agreement

On September 7, 2008, we, through FHFA, in its capacity as Conservator, and Treasury entered into the Purchase Agreement. The Purchase Agreement was subsequently amended and restated on September 26, 2008, and further amended on May 6, 2009, December 24, 2009, and August 17, 2012. Pursuant to the Purchase Agreement, on September 8, 2008 we issued to Treasury: (a) one million shares of Variable Liquidation Preference Senior Preferred Stock (with an initial liquidation preference of $1 billion), which we refer to as the senior preferred stock; and (b) a warrant to purchase, for a nominal price, shares of our common stock equal to 79.9% of the total number of shares of our common stock outstanding on a fully diluted basis at the time the warrant is exercised, which we refer to as the warrant. The terms of the senior preferred stock and warrant are summarized in separate sections below. We did not receive any cash proceeds from Treasury as a result of issuing the senior preferred stock or the warrant. However, deficits in our net worth have made it necessary for us to make substantial draws on Treasury s funding commitment under the Purchase Agreement. As a result, the aggregate liquidation preference of the senior preferred stock has increased from $1.0 billion as of September 8, 2008 to $72.3 billion at December 31, 2012. Under the Purchase Agreement, our ability to repay the liquidation preference of the senior preferred stock is limited and we will not be able to do so for the foreseeable future, if at all.

The senior preferred stock and warrant were issued to Treasury as an initial commitment fee in consideration of the initial commitment from Treasury to provide up to $100 billion (subsequently increased to $200 billion and further increased as necessary to accommodate any cumulative reduction in our net worth during 2010, 2011, and 2012) in funds to us under the terms and conditions set forth in the Purchase Agreement. Beginning January 1, 2013, the amount of available funding remaining under the Purchase Agreement is $140.5 billion. This amount will be reduced by any future draws. The provisions of the Purchase Agreement whereby Treasury s funding commitment would increase as necessary to accommodate any cumulative reduction in our net worth during 2010, 2011, and 2012 no longer apply.

In addition to the issuance of the senior preferred stock and warrant, we are required under the Purchase Agreement to pay a quarterly commitment fee to Treasury. Under the Purchase Agreement, the fee is to be determined in an amount mutually agreed to by us and Treasury with reference to the market value of Treasury s funding commitment as then in effect. However, pursuant to the August 2012 amendment to the Purchase Agreement, for each quarter commencing January 1, 2013, and for as long as the net worth sweep dividend provisions remain in form and content substantially the same, no periodic commitment fee under the Purchase Agreement will be set, accrue or be payable. Treasury had waived the fee for all applicable quarters prior to that date.

The Purchase Agreement provides that, on a quarterly basis, we generally may draw funds up to the amount, if any, by which our total liabilities exceed our total assets, as reflected on our GAAP balance sheet for the applicable fiscal quarter (referred to as the deficiency amount), provided that the aggregate amount funded under the Purchase Agreement may not exceed Treasury s commitment. The Purchase Agreement provides that the deficiency amount will be calculated differently if we become subject to receivership or other liquidation process. The deficiency amount may be increased above the otherwise applicable amount upon our mutual written agreement with Treasury. In addition, if the Director of FHFA determines that the Director will be mandated by law to appoint a receiver for us unless our capital is increased by receiving funds under the commitment in an amount up to the deficiency amount (subject to the maximum amount that may be funded under the agreement), then FHFA, in its capacity as our Conservator, may request that Treasury provide funds to us in such amount. The Purchase Agreement also provides that, if we have a deficiency amount as of the date of completion of the liquidation of our assets, we may request funds from Treasury in an amount up to the deficiency amount (subject to the maximum amount that may be funded under the agreement). Any amounts that we draw under the Purchase Agreement will be added to the liquidation preference of the senior preferred stock. No additional shares of senior preferred stock are required to be issued under the Purchase Agreement.

The Purchase Agreement provides that the Treasury s funding commitment will terminate under any of the following circumstances: (a) the completion of our liquidation and fulfillment of Treasury s obligations under its funding commitment at that time; (b) the payment in full of, or reasonable provision for, all of our liabilities (whether or not contingent, including mortgage guarantee obligations); and (c) the funding by Treasury of the maximum amount of the commitment under the Purchase Agreement. In addition, Treasury may terminate its funding commitment and declare the Purchase Agreement null and void if a court vacates, modifies, amends, conditions, enjoins, stays or otherwise affects the appointment of the Conservator or otherwise curtails the Conservator s powers. Treasury may not terminate its funding commitment under the Purchase Agreement solely by reason of our being in conservatorship, receivership or other insolvency proceeding, or due to our financial condition or any adverse change in our financial condition.

The Purchase Agreement provides that most provisions of the agreement may be waived or amended by mutual written agreement of the parties; however, no waiver or amendment of the agreement is permitted that would decrease Treasury s aggregate funding commitment or add conditions to Treasury s funding commitment if the waiver or amendment would adversely affect in any material respect the holders of our debt securities or Freddie Mac mortgage guarantee obligations.

In the event of our default on payments with respect to our debt securities or Freddie Mac mortgage guarantee obligations, if Treasury fails to perform its obligations under its funding commitment and if we and/or the Conservator are not diligently pursuing remedies in respect of that failure, the holders of these debt securities or Freddie Mac mortgage guarantee obligations may file a claim in the United States Court of Federal Claims for relief requiring Treasury to fund to us the lesser of: (a) the amount necessary to cure the payment defaults on our debt and Freddie Mac mortgage guarantee obligations; and (b) the lesser of: (i) the deficiency amount; and (ii) the maximum amount of the commitment less the aggregate amount of funding previously provided under the commitment. Any payment that Treasury makes under those circumstances will be treated for all purposes as a draw under the Purchase Agreement that will increase the liquidation preference of the senior preferred stock.

The Purchase Agreement has an indefinite term and can terminate only in limited circumstances, which do not include the end of the conservatorship. The Purchase Agreement therefore could continue after the conservatorship ends.

Senior Preferred Stock

Shares of the senior preferred stock have a par value of $1, and have a stated value and initial liquidation preference equal to $1,000 per share. The liquidation preference of the senior preferred stock is subject to adjustment. Dividends that are not paid in cash for any dividend period will accrue and be added to the liquidation preference of the senior preferred stock. In addition, any amounts Treasury pays to us pursuant to its funding commitment under the Purchase Agreement and any

quarterly commitment fees that are not paid in cash to Treasury nor waived by Treasury will be added to the liquidation preference of the senior preferred stock. As described below, we may make payments to reduce the liquidation preference of the senior preferred stock in limited circumstances.

Treasury, as the holder of the senior preferred stock, is entitled to receive quarterly cash dividends, when, as and if declared by our Board of Directors. Through December 31, 2012, the senior preferred stock accrued quarterly cumulative dividends at a rate of 10% per year. However, under the August 2012 amendment to the Purchase Agreement, the fixed dividend rate was replaced with a net worth sweep dividend beginning in the first quarter of 2013. For more information regarding our net worth sweep dividend, see NOTE 2: CONSERVATORSHIP AND RELATED MATTERS.

The senior preferred stock is senior to our common stock and all other outstanding series of our preferred stock, as well as any capital stock we issue in the future, as to both dividends and rights upon liquidation. The senior preferred stock provides that we may not, at any time, declare or pay dividends on, make distributions with respect to, or redeem, purchase or acquire, or make a liquidation payment with respect to, any common stock or other securities ranking junior to the senior preferred stock unless: (a) full cumulative dividends on the outstanding senior preferred stock (including any unpaid dividends added to the liquidation preference) have been declared and paid in cash; and (b) all amounts required to be paid with the net proceeds of any issuance of capital stock for cash (as described in the following paragraph) have been paid in cash. Shares of the senior preferred stock are not convertible. Shares of the senior preferred stock have no general or special voting rights, other than those set forth in the certificate of designation for the senior preferred stock or otherwise required by law. The consent of holders of at least two-thirds of all outstanding shares of senior preferred stock is generally required to amend the terms of the senior preferred stock or to create any class or series of stock that ranks prior to or on parity with the senior preferred stock.

We are not permitted to redeem the senior preferred stock prior to the termination of Treasury s funding commitment set forth in the Purchase Agreement; however, we are permitted to pay down the liquidation preference of the outstanding shares of senior preferred stock to the extent of: (a) accrued and unpaid dividends previously added to the liquidation preference and not previously paid down; and (b) quarterly commitment fees previously added to the liquidation preference and not previously paid down. In addition, if we issue any shares of capital stock for cash while the senior preferred stock is outstanding, the net proceeds of the issuance must be used to pay down the liquidation preference of the senior preferred stock; however, the liquidation preference of each