FEDERAL HOME LOAN MORTGAGE CORP
Form 10-K
March 11, 2009

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, 2008

Commission File Number: 000-53330

Federal Home Loan Mortgage Corporation

(Exact name of registrant as specified in its charter)

Freddie Mac

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

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

Title of each class:	Name of each exchange on which registered:
Voting Common Stock, no par value per share	New York Stock Exchange
Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
5% Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
5.1% Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
5.79% Non-Cumulative Preferred Stock, par value $1.00 per share	

	New York Stock Exchange
Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
5.81% Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
6% Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
Variable Rate, Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
5.7% Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
Variable Rate, Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share	New York Stock Exchange
6.42% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share	New York Stock Exchange
5.9% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share	New York Stock Exchange
5.57% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share	New York Stock Exchange
5.66% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share	New York Stock Exchange
6.02% Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share	New York Stock Exchange
6.55% Non-Cumulative Preferred Stock, par value $1.00 per share	New York Stock Exchange
Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Stock, par value $1.00 per share	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o   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 o   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 o

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 o Accelerated filer o Non-accelerated filer (Do not check if a smaller reporting company) x Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o 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 30, 2008 (the last business day of the registrant s most recently completed second fiscal quarter) was $10.6 billion.

As of February 25, 2009, there were 647,364,714 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: The information required by Part III (Items 10, 11, 12, 13 and 14) will be filed in an amendment to this annual report on Form 10-K on or before April 30, 2009.

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FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

PART I

ITEM 1. BUSINESS

Our Business and Statutory Mission

Freddie Mac was chartered by Congress in 1970 to stabilize the nation s residential mortgage markets and expand opportunities for homeownership and affordable rental housing. Our statutory mission is to provide liquidity, stability and affordability to the U.S. housing market. We fulfill our mission by purchasing residential mortgages and mortgage-related securities in the secondary mortgage market and securitizing them into mortgage-related securities that can be sold to investors. We purchase single-family and multifamily mortgage-related securities for our mortgage-related investments portfolio, which we previously referred to as our retained portfolio. We also purchase multifamily residential mortgages in the secondary mortgage market and hold those loans either for investment or sale. We finance purchases of our mortgage-related securities and mortgage loans, and manage our interest-rate and other market risks, primarily by issuing a variety of debt instruments and entering into derivative contracts in the capital markets.

Conservatorship

On September 6, 2008, the Director of the Federal Housing Finance Agency, or FHFA, appointed FHFA as our 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. The conservatorship has no specified termination date. There can be no assurance of whether or how the conservatorship will be terminated or what changes may occur to our business structure during or following conservatorship, including whether we will continue to exist. For more information, see Conservatorship and Related Developments.

Operating our business under the conservatorship involves balancing competing objectives. Upon our entry into conservatorship, the Conservator directed us to conduct our business with a focus on maintaining positive stockholders equity in order to reduce the need to draw funds under the Purchase Agreement (described below) and to return to long-term profitability. In addition, the U.S. Department of the Treasury, or Treasury, and the Board of Governors of the Federal Reserve System, or the Federal Reserve, have taken a number of actions to support us in conservatorship, including the following:

- Treasury initially committed to provide us with up to $100 billion in funding under the senior preferred stock purchase agreement, or Purchase Agreement (subsequently, Treasury has announced its commitment to increase the funding available under the Purchase Agreement to $200 billion);

- Treasury established a secured lending facility that is available to us until December 31, 2009 under a Lending Agreement;

- Treasury implemented a program to purchase mortgage-related securities issued by us and the Federal National Mortgage Association, or Fannie Mae, until December 31, 2009; and

- the Federal Reserve implemented a program to purchase up to $100 billion in direct obligations of us, Fannie Mae and the Federal Home Loan Banks, or FHLBs, and up to $500 billion of mortgage-related securities issued by us, Fannie Mae and the Government National Mortgage Association, or Ginnie Mae. The Federal Reserve will purchase these direct obligations and mortgage-related securities from primary dealers.

On September 18, 2008, we entered into a lending agreement with Treasury, or Lending Agreement, pursuant to which Treasury established a new secured lending credit facility that is available to us until December 31, 2009 as a liquidity backstop. In order to borrow pursuant to the Lending Agreement, we are required to post collateral in the form of Freddie Mac or Fannie Mae mortgage-related securities to secure all borrowings under the facility. The terms of any borrowings under the Lending Agreement, including the interest rate payable on the loan and the amount of collateral we will need to provide as security for the loan, will be determined by Treasury. Treasury is not obligated under the Lending Agreement to make any loan to us. Treasury does not have authority to extend the term of this credit facility beyond December 31, 2009, which is when Treasury s temporary authority to purchase our obligations and other securities, granted by the Federal Housing Finance Regulatory Reform Act of 2008, or Reform Act, expires. After December 31, 2009, Treasury still may purchase up to $2.25 billion of our obligations under its permanent authority, as set forth in our charter.

In the second half of 2008, we experienced less consistent demand for our debt securities as reflected in wider spreads on our term and callable debt. This reflected overall deterioration in our access to unsecured medium and long-term debt markets. There were many factors contributing to the reduced demand for our debt securities in the capital markets, including continued severe market disruptions, market concerns about our capital position and the future of our business (including its future profitability, future structure, regulatory actions and agency status) and the extent of U.S. government support for our debt securities. In addition, various U.S. government programs were still being absorbed by market participants creating uncertainty as to whether competing obligations of other companies were more attractive investments than our debt securities. An inability to issue debt securities at attractive rates in amounts sufficient to fund our business activities and meet our obligations could have an adverse effect on our liquidity, financial condition and results of operations.

As our ability to issue long-term debt has been limited, we have relied increasingly on short-term debt to fund our purchases of mortgage assets and to refinance maturing debt. As a result, we are required to refinance our debt on a more frequent basis, exposing us to an increased risk of insufficient demand, increasing interest rates and adverse credit market conditions. On November 25, 2008, the Federal Reserve announced that it would purchase up to $100 billion in direct obligations of us, Fannie Mae and the FHLBs and up to $500 billion of mortgage-related securities issued by Freddie Mac, Fannie Mae and Ginnie Mae by the end of the second quarter of 2009. Since that time, we have experienced improved demand for our issuances of long-term debt, indicating that these conditions are beginning to improve and demonstrating greater ability for us to access the long-term debt markets. We do not currently have plans to use the Lending Agreement and are uncertain as to the impact, if any, its expiration might have on our operations or liquidity.

We believe we will continue to have adequate access to the short and medium-term debt markets for the purpose of refinancing our debt obligations as they become due. We also continue to have undisrupted access to the derivatives markets, as necessary, for the purposes of entering into derivatives to manage our duration risk.

In November 2008, we received $13.8 billion from Treasury under the Purchase Agreement, and we expect to receive $30.8 billion in March 2009 pursuant to a draw request that FHFA submitted to Treasury on our behalf. Upon funding of the $30.8 billion draw request, the aggregate liquidation preference on the senior preferred stock owned by Treasury will increase from $1.0 billion as of September 8, 2008 to $45.6 billion. The amount remaining under the announced funding commitment from Treasury will be $155.4 billion, which does not include the initial liquidation preference of $1 billion reflecting the cost of the initial funding commitment (as no cash was received). The corresponding annual dividends payable to Treasury will increase to $4.6 billion. This dividend obligation exceeds our annual historical earnings in most periods, and will contribute to increasingly negative cash flows in future periods, if we pay the dividends in cash. See Conservatorship and Related Developments *Overview of Treasury Agreements*. In addition, the continuing deterioration in the financial and housing markets and further net losses in accordance with generally accepted accounting principles, or GAAP, will make it more likely that we will continue to have additional large draws under the Purchase Agreement in future periods, which will make it significantly more difficult to pay senior preferred dividends in cash in the future. Additional draws would also diminish the amount of Treasury s remaining commitment available to us under the Purchase Agreement. As a result of additional draws and other factors, our cash flow from operations and earnings will likely be negative for the foreseeable future, there is significant uncertainty as to our future capital structure and long-term financial sustainability, and there are likely to be significant changes to our capital structure and business model beyond the near-term that we expect to be decided by the U.S. Congress, or Congress, and the Executive Branch.

Because we expect many of our differing and potentially competing objectives will result in significant costs, and the extent to which we will be compensated or receive additional support for implementation of these actions is unclear, there is significant uncertainty as to the ultimate impact they will have on our future capital or liquidity needs. However, we believe that the increased level of support provided by Treasury and FHFA, as described above, is sufficient in the near-term to ensure we have adequate capital and liquidity to continue to conduct our normal business activities. Management is in the process of identifying and considering various actions that could be taken to reduce the significant uncertainties surrounding the business, as well as the level of future draws under the Purchase Agreement; however, our ability to pursue such actions may be limited based on market conditions and other factors. Any actions we take will likely require approval by FHFA and Treasury before they are implemented. In addition, FHFA, Treasury or Congress may direct us to focus our efforts on supporting the mortgage markets in ways that make it more difficult for us to implement any such actions.

Recent Developments Impacting our Business

On February 18, 2009, Treasury Secretary Geithner issued a statement outlining further efforts by Treasury to strengthen its commitment to us by increasing the funding available under the Purchase Agreement from $100 billion to $200 billion, affirming Treasury s plans to continue purchasing Freddie Mac mortgage-related securities and increasing the limit on our mortgage-related investments portfolio by $50 billion to $900 billion with a corresponding increase in the amount of allowable debt outstanding. As of the filing of this annual report on Form 10-K, the Purchase Agreement has not been amended to reflect the increase in Treasury s commitment. For additional information on our Purchase Agreement, see Conservatorship and Related Developments *Overview of Treasury Agreements Senior Preferred Stock 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.

We have worked with our Conservator to, among other things, help distressed homeowners and we have implemented a number of steps that include extending foreclosure timelines and additional efforts to modify and restructure loans. On February 18, 2009 President Obama announced the Homeowner Affordability and Stability Plan, or HASP. The HASP is designed to help in the housing recovery, to promote liquidity and housing affordability, to expand our foreclosure prevention efforts and to set market standards. The Obama administration announced that the key components of the plan are providing access to low-cost refinancing for responsible homeowners suffering from falling house prices, creating a $75 billion homeowner stability initiative to reach up to three to four million at-risk homeowners and supporting low mortgage rates by strengthening confidence in Freddie Mac and Fannie Mae. Freddie Mac will carry out initiatives to enable a large number of homeowners to refinance mortgages and to encourage modifications of mortgages for both homeowners who are in default and those who are at risk of imminent default.

HASP specifically includes (a) an initiative to allow mortgages currently owned or guaranteed by us to be refinanced without obtaining additional credit enhancement beyond that already in place for that loan; and (b) an initiative to encourage modifications of mortgages for both homeowners who are in default and those who are at risk of imminent default, through various government incentives to servicers, mortgage holders and homeowners. At present, it is difficult for us to predict the full extent of our activities under these initiatives and assess their impact on us. However, to the extent that our servicers and borrowers participate in these programs in large numbers, it is likely that the costs we incur associated with modifications of loans, the costs associated with servicer and borrower incentive fees and the related accounting impacts, will be substantial.

HASP will require us, in some cases, to modify loans when default is imminent even though the borrower s mortgage payments are current. If current loans are modified and are purchased from mortgage participation certificate, or PC, pools, our guarantee may no longer be eligible for an exception from derivative accounting under Statement of Financial Standards, or SFAS, No. 133, *Accounting for Derivative Instruments and Hedging Activities*, or SFAS 133, thereby requiring us, pursuant to our current accounting policy, to account for our guarantee as a derivative instrument. Management is working internally and with regulatory agencies to consider potential changes to our modification practices or current accounting policy to maintain the SFAS 133 exemption. If our efforts to maintain our exemption from derivative accounting for our guarantee are unsuccessful, our entire guarantee may be accounted for as a derivative instrument as early as the second quarter of 2009; however, the precise timing remains uncertain. We currently estimate the initial impact of accounting for our guarantee as a derivative instrument at fair value, less credit reserves, to be an initial pre-tax charge of approximately $30 billion based on balances at December 31, 2008. Accounting for the guarantee as a derivative instrument would require us to recognize subsequent guarantee fair value changes through earnings in future periods and, as a result, no longer recognize credit losses associated with the guarantee as they are incurred and no longer recognize revenue through amortization of the guarantee obligation, as these amounts would be reflected in the fair value changes. As such, these initiatives are likely to have a significant adverse effect on our financial results or condition.

See Conservatorship and Related Developments *Impact of Conservatorship and Related Actions on Our Business,* RISK FACTORS and NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Conservatorship and Related Developments to our consolidated financial statements for additional information.

Our Charter and Statutory Mission

The Federal Home Loan Mortgage Corporation Act, which we refer to as our charter, forms the framework for our business activities, the products 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, as described in *Our Business Segments* *Single-Family Guarantee Segment* and *Multifamily Segment.*

Our statutory mission as defined in our charter is:

- to provide stability in the secondary market for residential mortgages;

to respond appropriately to the private capital market;

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

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

Our business objectives continue to evolve under conservatorship. For more information, see Conservatorship and Related Developments *Impact of Conservatorship and Related Actions on Our Business.*

Our Market and Mortgage Securitizations

We conduct business in the U.S. residential mortgage market and the global securities market under the direction of our Conservator. These markets experienced substantial deterioration during 2008, which has continued into early 2009, as discussed in MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, or MD&A, EXECUTIVE SUMMARY. The size of the U.S. residential mortgage market is affected by many factors, including changes in interest rates, homeownership 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

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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 and the mortgage purchase and securitization activity of other financial institutions.

At December 31, 2008, our total mortgage portfolio, which includes our mortgage-related investments portfolio and the unpaid principal balance of all other loans and securities that we guarantee, was $2.2 trillion, while the total U.S. residential mortgage debt outstanding, which includes single-family and multifamily loans, was approximately $12.1 trillion. See MD&A PORTFOLIO BALANCES AND ACTIVITIES for further information on the composition of our mortgage portfolios.

Table 1 provides important indicators for the U.S. residential mortgage market.

Table 1 Mortgage Market Indicators

	Year Ended December 31,		
	2008	**2007**	**2006**
Home sale units (in thousands)(1)	4,833	5,715	6,728
Home price appreciation (depreciation)(2)	(12.1)%	(4.3)%	2.2%
Single-family originations (in billions)(3)	$ 1,485	$ 2,430	$ 2,980
Adjustable-rate mortgage share(4)	7%	10%	22%
Refinance share(5)	49%	46%	43%
U.S. single-family mortgage debt outstanding (in billions)(6)	$ 11,167	$ 11,168	$ 10,456
U.S. multifamily mortgage debt outstanding (in billions)(6)	$ 890	$ 840	$ 743

(1) Includes sales of new and existing homes in the U.S. and excludes condos/co-ops. Source: National Association of Realtors news release dated February 25, 2009 (sales of existing homes) and U.S. Census Bureau news release dated February 26, 2009 (sales of new homes).
(2) Calculated internally using estimates of changes in single-family home prices by state, which are weighted using the property values underlying our single-family mortgage portfolio to obtain a national index. The appreciation or depreciation rate for each year presented incorporates property value information on loans purchased by both Freddie Mac and Fannie Mae through December 31, 2008 and will be subject to change based on more recent purchase information.
(3) Source: Inside Mortgage Finance estimates of originations of single-family first-and second liens dated January 30, 2009.
(4) Based on the number of conventional one-family home purchase mortgages and represents the annual averages of monthly figures using data provided by FHFA.
(5) Refinance share of the number of conventional mortgage applications. Source: Mortgage Bankers Association s Mortgage Applications Survey. Data reflect annual average of weekly figures.
(6) Source: Federal Reserve Flow of Funds Accounts of the United States dated December 11, 2008. The outstanding amounts for 2008 presented above reflect balances as of September 30, 2008.

In general terms, 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. In the primary mortgage market, residential mortgage lenders such as mortgage banking companies, commercial banks, savings institutions, credit unions and other financial institutions originate or provide mortgages to borrowers. They obtain the funds they lend to mortgage borrowers in a variety of ways, including by selling mortgages or mortgage-related securities into the secondary mortgage market. Our charter does not permit us to originate loans in the primary mortgage market.

The secondary mortgage market consists of institutions engaged in buying and selling mortgages in the form of whole loans (*i.e.*, mortgages that have not been securitized) and mortgage-related securities. We participate in the secondary mortgage market by purchasing mortgage loans and mortgage-related securities for investment and by issuing guaranteed mortgage-related securities, principally those we call PCs. We do not lend money directly to homeowners.

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The following diagram illustrates how we create PCs through mortgage securitizations that can be sold to investors or held by us to provide liquidity to the mortgage market:

We guarantee the payment of principal and interest of PCs created in this process in exchange for a combination of monthly management and guarantee fees and initial upfront cash payments referred to as delivery fees. Our guarantee increases the marketability of the PCs, providing liquidity to the mortgage market. Various other participants also play significant roles in the residential mortgage market. Mortgage brokers advise prospective borrowers about mortgage products and lending rates, and they connect borrowers with lenders. Mortgage servicers administer mortgage loans by collecting payments of principal and interest from borrowers as well as amounts related to property taxes and insurance. They remit the principal and interest payments to us, less a servicing fee, and we pass these payments through to mortgage investors, less a fee we charge to provide our guarantee (*i.e.*, the management and guarantee fee). In addition, private mortgage insurance companies and other financial institutions sometimes provide third-party insurance for mortgage loans or pools of loans. Our charter generally requires third-party insurance or other credit protections on some loans that we purchase. Most mortgage insurers increased premiums and tightened underwriting standards during 2008. These actions may impair our ability to purchase loans made to borrowers who do not make a down payment at least equal to 20% of the value of the property at the time of loan origination.

Our charter generally prohibits us from purchasing first-lien conventional (not guaranteed or insured by any agency or instrumentality of the U.S. government) single-family mortgages if the outstanding principal balance at the time of 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 outstanding principal balance above 80%;

a seller s agreement to repurchase or replace (for periods and under conditions as we may determine) any mortgage that has defaulted; or

retention by the seller of at least a 10% participation interest in the mortgages.

In addition, on February 18, 2009, the Obama Administration announced the HASP, which includes an initiative pursuant to which FHFA allowed mortgages currently owned or guaranteed by us to be refinanced without obtaining additional credit enhancement in excess of that already in place for that loan. For more information, see Conservatorship and Related Developments *Homeownership Affordability and Stability Plan.*

Our charter requirement for credit protection does not apply to multifamily mortgages or to mortgages insured by the Federal Housing Administration, or FHA, or partially guaranteed by the Department of Veterans Affairs, or VA, or the U.S. Department of Agriculture, or USDA, Rural Development.

Under our charter, so far as practicable, we may only purchase mortgages that are of a quality, type and class that generally meet the purchase standards of private institutional mortgage investors. This means the mortgages we purchase must be readily marketable to institutional mortgage investors.

Our Customers

Our customers are predominantly lenders in the primary mortgage market that originate mortgages for homeowners and apartment owners. These lenders include mortgage banking companies, commercial banks, savings banks, community banks, credit unions, state and local housing finance agencies 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. We have mortgage purchase volume commitments with a number of mortgage lenders that provide for a minimum level of mortgage volume or specified dollar amount that these customers will deliver to us. If a mortgage lender fails to meet its contractual commitment, we have a variety of contractual remedies, including 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. As the mortgage industry has been consolidating and certain large lenders have failed, we, as well as our competitors, have been seeking business from a decreasing number of key lenders. In addition, many of our customers are experiencing financial and liquidity problems that may affect the volume of business they are able to generate. During 2008, three mortgage lenders each accounted for more than 10% of our single-family mortgage purchase volume. These three lenders collectively accounted for approximately 59% of our single-family mortgage purchase volume for 2008 and our top ten lenders represented approximately 84% of our single-family mortgage purchase volume for the same period. Further, our top three multifamily lenders each accounted for more than 10%, and collectively represented approximately 40%, of our multifamily purchase volume during 2008. See RISK FACTORS Competitive and Market Risks for additional information.

Our Business Segments

We manage our business, under the direction of the Conservator, through three reportable segments:

- Investments;
- Single-family Guarantee; and
- Multifamily.

For a summary and description of our financial performance and financial condition on a consolidated as well as segment basis, see MD&A and FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA and the accompanying notes to our consolidated financial statements.

As described below in Conservatorship and Related Developments *Managing Our Business During Conservatorship*, we are subject to a variety of different, and potentially competing, objectives in managing our business. These objectives create conflicts in strategic and day-to-day decision making that will likely lead to suboptimal outcomes for one or more, or possibly all, of these objectives. For example, to the extent we increase activities to assist the mortgage market, our financial results are likely to suffer.

Investments Segment

Our Investments business is responsible for investment activity in mortgages and mortgage-related securities, other investments, debt financing, and managing our interest rate risk, liquidity and capital positions. We invest principally in mortgage-related securities and single-family mortgages through our mortgage-related investments portfolio.

Although we are primarily a buy-and-hold investor in mortgage assets, we may sell assets that are no longer expected to produce desired returns, to reduce risk, provide liquidity or structure certain transactions that are designed to improve our returns. We estimate our expected investment returns using an option-adjusted spread, or OAS, approach, which is an estimate of the yield spread between a given financial instrument and a benchmark (London Interbank Offered Rate, or LIBOR, agency or Treasury) yield curve, after consideration of potential variability in the instrument s cash flows resulting from any options embedded in the instrument, such as prepayment options. Our Investments segment activities may include the purchase of mortgages and mortgage-related securities with less attractive investment returns and with incremental risk in order to achieve our affordable housing goals and subgoals or to pursue other objectives under our conservatorship. Our statutory mission as defined in our charter includes providing ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages for low- and moderate-income families, involving an economic return that may be less than the return earned on other activities). Additionally, in this segment we maintain a cash and other investments portfolio, comprised primarily of cash and cash equivalents, non-mortgage-related securities, federal funds sold and securities purchased under agreements to resell, to help manage our liquidity needs.

Debt Financing

We fund our investment activities in our Investments and Multifamily segments by issuing short-term and long-term debt. Competition for funding in the capital markets can vary with economic and financial market conditions and regulatory environments. For example, under the recent Federal Deposit Insurance Corporation, or FDIC, temporary liquidity guarantee program, participating banks and holding companies may issue senior, short-term unsecured debt that is guaranteed by the U.S. government, which improves their ability to compete with us for debt funding. In the second half of 2008, we experienced less demand for our debt securities, as reflected in wider spreads on our term and callable debt. This reflected overall deterioration in our access to unsecured medium and long-term debt markets to fund our purchases of mortgage assets and to refinance maturing debt. As a result, we have been required to refinance our debt on a more frequent basis, exposing us to an increased risk of insufficient demand and adverse credit market conditions. However, the Federal Reserve has been an active purchaser in the secondary market of our long-term debt under its purchase program as discussed below, and spreads on our debt and our access to the debt markets have improved in early 2009 as a result of this activity.

Subsequent to our entry into conservatorship, Treasury and the Federal Reserve took certain actions affecting our access to debt financing, including the following:

- on September 18, 2008, we entered into the Lending Agreement with Treasury, pursuant to which Treasury established a secured lending credit facility that is available to us until December 31, 2009 as a liquidity backstop (after December 31, 2009, Treasury still may purchase up to $2.25 billion of our obligations under its permanent authority, as set forth in our charter); and

- on November 25, 2008, the Federal Reserve announced a program to purchase up to $100 billion in direct obligations of Freddie Mac, Fannie Mae and the FHLBs.

The support of the Federal Reserve has helped to improve spreads on our debt and our access to the debt markets.

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

Risk Management

Our Investments segment has responsibility for managing our interest rate and liquidity risks. We use derivatives to: (a) regularly adjust or rebalance our funding mix in order to more closely match changes in the interest rate characteristics of our mortgage-related assets; (b) economically hedge forecasted issuances of debt and synthetically create callable and non-callable funding; and (c) economically hedge foreign-currency exposure. For more information regarding our derivatives, see QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK and NOTE 12: DERIVATIVES to our consolidated financial statements.

PC and Structured Securities Support Activities

We support the liquidity of the market for PCs through a variety of activities, including educating dealers and investors about the merits of trading and investing in PCs, enhancing disclosure related to the collateral underlying our securities and introducing new mortgage-related securities products and initiatives. We support the price performance of our PCs through a variety of strategies, including the purchase and sale of PCs and other agency securities, as well as through the issuance of Structured Securities. Agency securities refer to securities issued by Freddie Mac, Fannie Mae, a similarly chartered government-sponsored enterprise, or GSE, and Ginnie Mae. As discussed in *Single-Family Guarantee Segment,* our Structured Securities represent beneficial interests in pools of PCs and certain other types of mortgage-related assets. Our purchases and sales of mortgage securities influence the relative supply and demand for these securities, and the issuance of Structured Securities increases demand for our PCs. Increasing demand for our PCs helps support the price performance of our PCs. This in turn helps our competitiveness in purchasing mortgages from our lender customers. Depending upon market conditions, including the relative prices, supply of and demand for 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. We may increase, reduce or discontinue these or other related activities at any time, which could affect the liquidity of the market for PCs.

Single-Family Guarantee Segment

In our Single-family Guarantee segment, we purchase single-family mortgages originated by our lender customers in the primary mortgage market, primarily through our guarantor swap program. We securitize mortgages we have purchased and issue mortgage-related securities that can be sold to investors or held by us in our Investments segment. Earnings for this segment consist primarily of management and guarantee fee revenues, including amortization of upfront payments we receive, less related credit costs and operating expenses. Earnings for this segment also include the interest earned on assets held in the Investments segment related to single-family guarantee activities, net of allocated funding costs and amounts related to net float benefits.

Loan and Security Purchases

Our charter establishes requirements for and limitations on the mortgages and mortgage-related securities we may purchase, as described below. 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. The primary types of single-family mortgages we purchase are 30-year, 20-year, and 15-year fixed-rate mortgages, interest-only mortgages, adjustable rate mortgages, or ARMs, and balloon/reset mortgages.

Our charter places an upper limitation, called the conforming loan limit, on the original principal balance of single-family mortgage loans we purchase. No comparable limits apply to our purchases of multifamily mortgages. The conforming loan limit is determined annually based on changes in FHFA s housing price index. Any decreases in the housing price index are accumulated and used to offset any future increases in the housing price index so that loan limits do not decrease from year-to-year. For 2006 to 2008, the base conforming loan limit for a one-family residence was set at $417,000. As discussed below, the base conforming loan limit for a one-family residence for 2009 will remain at $417,000, with higher limits in certain high-cost areas. Higher limits apply to two- to four-family residences.

As part of the Economic Stimulus Act of 2008, the conforming loan limits were increased for mortgages originated in certain high-cost areas from July 1, 2007 through December 31, 2008 to the higher of the applicable 2008 conforming loan limits, ($417,000 for a one-family residence), or 125% of the median house price for a geographic area, not to exceed $729,750 for a one-family residence. We began accepting these conforming jumbo mortgages for securitization as PCs and purchase into our mortgage-related investments portfolio in April 2008.

Pursuant to the Reform Act beginning in 2009, the conforming loan limits are permanently increased for mortgages originated in high-cost areas where 115% of the median house price exceeds the otherwise applicable conforming loan limit to the lesser of (i) 115% of the median house price or (ii) 150% of the conforming loan limit (currently $625,500 for a one-family residence).

FHFA has announced that the base conforming lo