



In the *IFR Review of the Year 2000*, Freddie Mac is named winner of *North American Borrower of the Year* and *Agency Borrower of the Year*

A Letter From

Jerome Lienhard

Debt Issuance Highlights in 2000

The millennial year marked one of the most active periods in Freddie Mac's debt funding history. We broke new ground in innovation and leadership and successfully tapped new sources of capital in foreign currencies. In the *IFR Review of the Year 2000*, Freddie Mac was named winner in two separate categories: **North American Borrower of the Year** and **Agency Borrower of the Year**. The IFR cited Freddie Mac's achievement in establishing the cReference NotesSM Programme and its announced plans to sell 2- and 3-year Reference NotesSM via Dutch auction as outstanding developments in global capital markets. In addition, the new Funding and Investments management team is credited with the positive change in the market's perception of Freddie Mac.

One of the major highlights of 2000 was the introduction in January of Reference BillsSM sold via Dutch auction using an internet-based platform. Reference Bills are offered in 1-, 2-, 3-, 6- and 12-month maturities making Freddie Mac the first corporation to issue bills over the full yield curve according to a financing calendar. In the program's inaugural year, we issued over \$615 billion through our twenty-two member dealer group. Building on the success of our Reference Bills auctions, we will

launch Dutch auctions of our 2- and 3-year Reference NotesSM early in 2001.

In other highlights of the year, cReference NotesSM have rapidly become the most actively traded, non-sovereign issues in the Euro bond market. This programme is filling the gap in the declining supply of government issuance in Euros and the lack of truly liquid bellwether securities. The first issue, the 5.75% of September 2010, quickly became the third most active issue on the EuroMTS of 119 issues among all participating countries. These issues are also being used as hedging vehicles and are key contributors in developing a growing, viable repo market in Euros. Notably in US dollar-denominated debt, Freddie Mac became the first corporate borrower to use an internet-based book-building process, with the 6-7/8% January 2005 Reference Note issue.

On October 19th, Freddie Mac undertook voluntary actions to achieve greater financial transparency, capital adequacy and market discipline. We announced a subordinated debt program, Freddie SUBSSM, as one of six separate initiatives stated in the Enhancements to Capital Strength, Disclosure and Market Discipline. The first Freddie SUBS coming to market in the first quarter of 2001 will be a 10-year bullet issue in a minimum size of \$1 billion. Over a three-year phase-in period, we expect to issue Freddie SUBS at least twice a year in 2- through 30-year maturities, resulting in a total outstanding range of \$8 billion to \$10 billion either through new issuances or by reopening existing issues. Freddie SUBS will be issued in an amount such that the sum of core capital and outstanding subordinated debt will equal or exceed 4 percent of on-balance sheet assets and 0.45 percent of off-balance sheet mortgage securities following the three-year

(continued on page 2)

This Issue

Letter from Jerome Lienhard, Senior Vice President, Global Funding

Commentary on the Fed's changing investment practices by Lou Crandall of Wrightson Associates

Historical data on Freddie Mac's debt securities

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Market Talk

The US Federal Reserve's Changing Investment Practices

Lou Crandall
Wrightson Associates

2001 will see another massive reduction in the supply of Treasury debt. Attention in the months ahead will be focused on the effects of the cyclical slowdown and the new fiscal initiatives proposed by the Bush administration, but these will not wipe away all — or even most — of the budget surplus expected for the coming year. The Treasury would retire nearly \$200 billion of marketable debt this year even if the current slowdown were to turn into a full-fledged recession. If the Fed succeeds in engineering a soft landing, the paydown for the year is likely to exceed \$250 billion.

The contraction in the public debt has reached the point where the single largest holder of Treasury securities — the Federal Reserve — must lay the groundwork for diversifying its portfolio. At the end of 2000, the Fed's \$533 billion portfolio of marketable Treasury securities accounted for 18% of the \$3 trillion total. The Fed is still adding \$30 billion to \$40 billion to its portfolio annually while the overall supply is shrinking by more than \$200 billion per year. If the Fed's balance sheet continues to grow at its long-term average of 6% to 7% and

if the budget surplus from 2002 onward is only half as large as OMB now projects, the Fed will be the proud owner of every single Treasury security in existence before the end of the decade.

Faced with this prospect, the FOMC last year requested a staff study of alternative investment options. That study is due to be presented at the January 30-31 FOMC meeting, and the summary conclusions should be made public shortly thereafter. Fed officials have indicated that any changes in their investment patterns will be evolutionary and that the report itself will not trigger any sudden shifts in Fed holdings. Even so, the report's conclusions should provide some sense of the direction in which the Fed's balance sheet will move over the next year or two. The odds are good that the FOMC report will endorse increased reliance on tri-party Repurchase Agreements backed by a combination of Treasury, Agency and mortgage-backed securities. The report may also point the way toward an even broader Federal Reserve financing facility in the future that would accept other collateral classes ranging from commercial paper to corporate bonds and asset-backed securities.

First, a little background on Fed investment practices in the past. Despite the impression left by some economics textbooks, the Fed has never invested solely in Treasury securities. For the first ten years of its existence (1918-28), bank obligations outweighed Treasuries on its balance sheet. In the

“The odds are good that the FOMC report will endorse increased reliance on tri-party Repurchase Agreements backed by a combination of Treasury, Agency and mortgage-backed securities.”

Letter continued from cover

period. We will be requesting ratings from both Moody's Investor Services and Standard and Poor's, and anticipate that Freddie SUBS will be represented in all appropriate Agency/Government bond indices.

We are entering 2001 with a continuing focus on transparency, regularity and liquidity. As pioneers of the first-ever corporate financing calendar, we have published our user-friendly Reference BillsSM, Reference NotesSM and Reference BondsSM financing calendars on our website, enabling investors to plan their activities across the full yield curve. To further foster a term repo market, we will continue to accept Reference Notes and Bonds as collateral for our own cash management activities.

Most importantly, we will commence our internet-based Dutch auctions of 2- and 3-year Reference

Notes in February 2001 in order to add increased transparency to the pricing process. The 2- and 3-year issues will have a \$3 billion minimum and \$5 billion target size with no reopenings. Offered through a Dealer Group, these issues will mark the first time new term debt global issues have been priced and distributed by a GSE through Dutch auction. Freddie Mac is committed to our customer-focused approach to funding decent, accessible housing for American families. We are excited about the innovations we brought forth in 2000 and expect to bring to the market in 2001. We look forward to a successful New Year and wish you the same.

Jerome Lienhard
Senior Vice President, Global Funding



1960s, the Fed's Open Market Desk began to buy bankers acceptances in order to help develop the market for those instruments. In the 1970s, it added Agency securities to its portfolio for similar reasons. And all along, it has supplemented its outright purchases with temporary injections in the form of Repurchase Agreements (RPs).

The Fed's two objectives in assembling a portfolio are to minimize credit risk and, most importantly, to maximize liquidity. The special emphasis on liquidity might seem odd in light of the fact that the Fed has been a buy-and-hold investor for most of its history, but it is a central element of the Fed's contingency planning. If the Fed were forced by a banking crisis to provide support as the lender of last resort, it would need to liquidate existing assets quickly in order to make room on its balance sheet for an increased volume of discount window advances. The Desk will restrict its portfolio to assets for which there would be a ready market even in the event of a financial crisis or assets with maturities short enough to make them self-liquidating. As one Fed official put it in a recent Bond Market Association interview, the ideal Fed portfolio would consist entirely of bills.

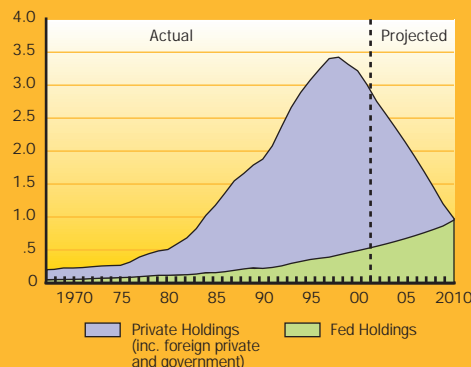
In practice, of course, the Desk hasn't been able to limit itself to bills, but has had to buy Treasury notes and bonds as well to meet its investment needs. If it is forced to diversify into non-Treasury investments, the Desk will emphasize shorter maturities. The Desk is willing to extend out along either the yield curve or the credit curve, but is wary of doing both at once.

Repurchase Agreements are the obvious alternative to bills. As collateralized investments, they offer greater credit protection than other money market instruments. Moreover, a portfolio of overlapping term agreements would provide the Fed with the liquidity it craves by ensuring that a large volume of assets would come due each week. The Desk has been experimenting with this approach for several months by doing \$2 billion to \$3 billion of four-week tri-party RPs on Mondays and Thursdays, using a mixture of Treasury, Agency and mortgage-backed collateral. If the Desk were to double the size of its individual operations and extend their terms from one month to two, the rolling stock of RPs would rise to \$100 billion or more, satisfying the Fed's net investment needs for the next two to three years.

The Fed's current tri-party RP program began as an experiment in late 1999 as part of the Desk's Y2K preparations. The Desk questioned whether its existing tools would allow it to meet banks'

Private and Federal Reserve Holdings of Marketable Treasury Debt: 1975-2010

Projections from 2001 onward assume unchanged Fed investment patterns and budget surpluses half as large as current official forecasts
Levels in Trillions of US Dollars



extraordinary year-end reserve needs smoothly. By the time the century date change rolled around, the Desk had used its new tri-party facility to amass more than \$140 billion of RPs. The level of Fed RPs fell back to a daily average of roughly \$20 billion in 2000, but the Y2K experience demonstrates that there is room for expansion in the program. The Fed's internal review of open market operations is likely to identify Open Market Repurchase Agreements as the most efficient alternative to Treasury purchases in the near term. If so, the Desk will become a more substantial source of short-run financing for the Agency and MBS markets over the coming year.

Over the longer run, the tri-party RP program may prove to be nothing more than a stopgap measure. If current trends in the U.S. Treasury market persist and the Fed is forced to turn to private-sector assets, the Fed will find itself extending \$1 trillion of short-term credit to the financial system by the end of this decade. Lending on that scale obviously cannot be funneled through the dwindling group of primary dealers. The logical next step for the Fed is to consider a more ambitious financing facility similar to that used by the ECB, in which a wide range of financial institutions can bid directly for term funding from the central bank. The upcoming report, however, is unlikely to provide more than a preliminary assessment of the principles that would guide such a system. For at least the next couple of years, the Fed is likely to build on its successful tri-party RP program to meet its net investment needs.

Mr. Crandall is chief economist of Wrightson Associates and is the principal author of its market-leading newsletter, "The Money Market Observer" (www.wrightson.com).

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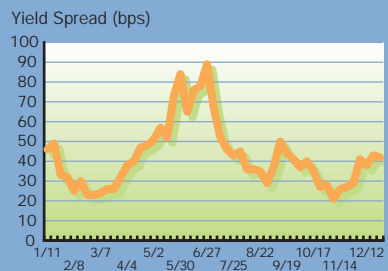
Reference Point

January 2001



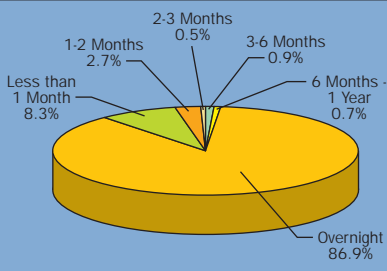
Data Bank

Reference BillsSM Spread to Treasuries (3-month) January 1 - December 31, 2000



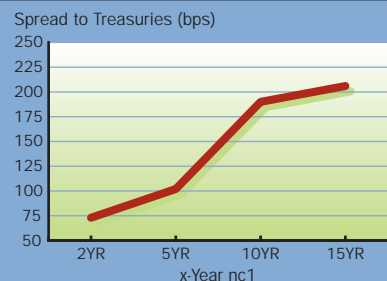
| Maturity | Par Amount (billions) |
|--------------|-----------------------|
| 1 Month | 236.0 |
| 2 Month | 177.0 |
| 3 Month | 158.5 |
| 6 Month | 20.2 |
| 12 Month | 25.5 |
| TOTAL | 617.2 |

Discount Note Issuance January 1 - December 31, 2000



| Maturity | Par Amount (billions) |
|-----------------|-----------------------|
| Overnight | 1,268.0 |
| < 1 Month | 121.0 |
| 1-2 Months | 39.0 |
| 2-3 Months | 7.0 |
| 3-6 Months | 14.0 |
| 6 Months - 1 YR | 11.0 |
| TOTAL | 1,459.0 |

Callable MTNs Yield Spreads of x-Year nc1 to Treasuries on December 31, 2000



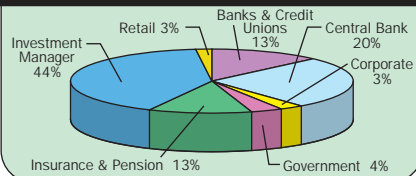
| Maturity | Non-Callable MTN O/S (billions) | Callable MTN O/S (billions) |
|--------------|---------------------------------|-----------------------------|
| 1-3 YRS | 18.6 | 28.0 |
| 3-5 YRS | 2.5 | 28.7 |
| 5-10 YRS | 7.9 | 42.1 |
| > 10 YRS | 5.7 | 32.5 |
| TOTAL | 34.8 | 131.3 |

through December 31, 2000

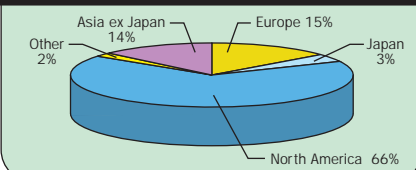
Reference NotesSM and Reference BondsSM Outstandings

| Maturity | Structure | CUSIP | Issued (billions) |
|--------------|-----------|-----------|-------------------|
| 15-Feb-01 | 2 YR | 3134A25Q7 | 4.00 |
| 15-Jun-01 | 2 YR | 3134A3UO7 | 5.00 |
| 15-Aug-02 | 2 YR | 3134A35B8 | 4.00 |
| 14-Dec-01 | 3 YR | 3134A2ZJ0 | 3.00 |
| 15-May-02 | 3 YR | 3134A3RE8 | 5.50 |
| 15-Oct-02 | 3 YR | 3134A3T48 | 5.00 |
| 15-Feb-03 | 3 YR | 3134A33D6 | 5.00 |
| 15-May-03 | 3 YR | 3134A34H6 | 5.00 |
| 15-Nov-03 | 3 YR | 3134A4C05 | 6.00 |
| 15-Jul-03 | 5 YR | 3134A2KZ0 | 5.00 |
| 15-Jan-04 | 5 YR | 3134A2T99 | 6.00 |
| 15-Jul-04 | 5 YR | 3134A3YM2 | 6.00 |
| 15-Jan-05 | 5 YR | 3134A32S4 | 8.00 |
| 15-Jul-05 | 5 YR | 3134A34O6 | 9.00 |
| 15-Apr-08 | 10 YR | 3134A2DT2 | 5.00 |
| 15-Oct-08 | 10 YR | 3134A2UJ5 | 7.00 |
| 15-Mar-09 | 10 YR | 3134A3EM4 | 7.00 |
| 15-Sep-09 | 10 YR | 3134A3M78 | 9.00 |
| 15-Mar-10 | 10 YR | 3134A33L8 | 5.00 |
| 15-Sep-10 | 10 YR | 3134A35H5 | 6.00 |
| 15-Sep-29 | 30 YR | 3134A3U46 | 3.00 |
| 15-Mar-31 | 30 YR | 3134A4AA2 | 2.00 |
| TOTAL | | | 127.50 |

Reference NotesSM & Reference BondsSM Issuance Investor Distribution

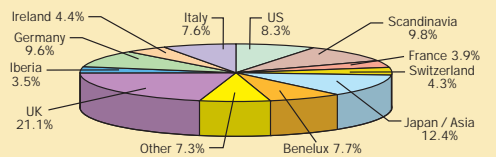


Reference NotesSM & Reference BondsSM Issuance Geographic Distribution

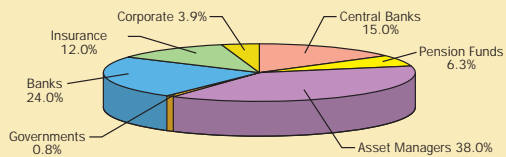


cReference NotesSM

Geographic Distribution



Investor Distribution



c5 Billion
ISIN Number
XS0117858323
Structure
5-3/4% of 9/15/2010

c5 Billion
ISIN Number
XS0121336266
Structure
5-1/4% of 1/15/2006

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