



A letter from:

John Radwanski

Vice President & Assistant Treasurer, Debt Funding

During the first few months of 2006, Freddie Mac continued to carry out our mission in a way that is creating value for both homeowners and our investors. Beginning last year and continuing through this year, we've substantially increased our penetration in the overall market we serve. We've done this by increasing our business volumes in the conforming residential mortgage market in both our credit guarantee and retained portfolio investment businesses. Despite an overall market characterized by persistently tight spreads, we were able to execute on our underlying franchise strengths of excellent credit and interest-rate risk management and low debt funding costs.

While our business fundamentals remain strong, more needs to be done. Our most immediate task is to do everything it takes to ensure that our internal controls and accounting systems are of the same high caliber as our financial risk management and reporting. There is no higher priority for Freddie Mac's senior management than completing this work and becoming timely in our financial reporting. We want to become the standard of excellence not only for managing mortgage risk, but for the accounting and internal controls associated with it.

Our credit and interest-rate risk management record remains a hallmark of the industry. Our ready access to callable debt and specialized mortgage risk expertise are key competitive advantages. We disclose monthly our key measures of interest-rate risk in an effort to be transparent to all who are interested in our results and to demonstrate that we continue to manage risk prudently and consistently in a world of rapidly changing interest rate conditions.

Issuing callable securities serves a mutual purpose by enabling us to reduce our debt obligations in line with prepayments of our mortgage assets while offering high-quality higher yielding securities to our investors. Given our need for optionality across

the yield curve, we offer a diverse range of medium-term notes (MTN), encompassing a variety of first call dates, final maturities and call provisions. The breadth and depth of our structured MTN program reflects its flexibility, allowing investors and underwriters to customize a security to match their appetite for risk. While our structured securities have the same AAA-rating as our bullet debt, investors willing to take additional interest-rate risk often find these structures attractive.

Since structured securities are not for all investors, issuance is currently primarily driven by investor demand. We thought that we would take this opportunity to highlight one type of structured product — callable range accrual notes — that has witnessed strong demand from investors amid an environment of low risk-free rates, tight spreads, flat yield curve and relatively low volatility.

We hope you find this article of interest and look forward to building our relationships with you.

Thank you for your continued interest and support.

Sincerely,



John Radwanski

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➤ Demand for Range Accrual Notes Increases

Freddie Mac issues a variety of debt securities to meet its funding and risk management needs. Our debt securities range in complexity from plain vanilla to highly complex and structured. By definition, a structured note is a debt security that contains one or more embedded components that adjust the security's risk/return profile. In the February 2006 edition of *Reference Point*, we discussed the various types of structured products we issue and how these securities offer potential yield enhancement. Investors who are seeking higher yields are typically willing to take on higher risks and may find securities with certain embedded features attractive. In addition to a simple call or put option, structured notes may contain interest rate caps and floors and coupons contingent on the performance of one or more underlying factors such as interest rate indices, inflation indices, etc. Despite the additional exposure to interest-rate risk, Freddie Mac structured notes retain the same AAA credit rating as our bullet securities, thus offering higher coupon rates without compromising credit risk.

The diversity of structures offered by Freddie Mac is a testament to our program's flexibility, allowing investors and underwriters to customize a security to match their desire for yield, structure, size and maturity. The flexibility of our medium-term notes structured funding platform reflects our need for optionality across the yield curve to manage our interest rate risk exposure amid various market conditions. Given the increased risk embedded in these securities, most structured notes are issued in direct response to investor demand and sold as private placements. Investors originate a "reverse inquiry" with their dealers, expressing their desire for a type of structured product. Dealers, in turn, will purchase these securities from Freddie Mac and sell them to investors.

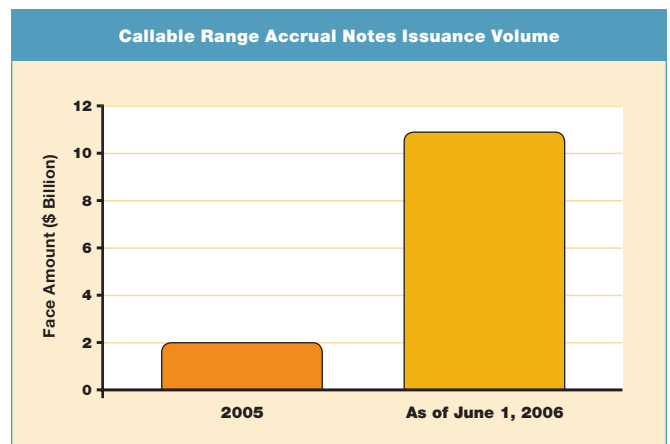
Of these products, the most popular among investors this year has been the callable range accrual note. For the first half of 2006, the agency market has issued nearly \$11 billion of callable range accrual notes, dwarfing the total volume issued in 2005 (see Chart 1). Range accrual notes offer investors the opportunity to express their expectations for short-term rates

to remain within a certain range. Expectations that the Fed is nearing the end of its tightening cycle may be prompting some increased demand for these securities.

Range accrual notes offer investors the opportunity to express their expectations for short-term rates to remain within a certain range.

Callable range accrual notes allow investors to earn a fixed coupon rate (or specified floating coupon rate based on a formula) when an index remains within a pre-specified range. This stated fixed or floating coupon rate is typically greater than an investor would earn on a standard fixed-rate (or floating rate) security to compensate the investor for additional interest rate risk.

Chart 1 – GSE issuance of callable range accrual notes surge compared to 2005



Source: Bloomberg

To demonstrate the potential yield pickup, we compare several different structured securities (see Table 1). As the interest rate risk embedded in these securities rises, the yield to maturity increases to compensate for the higher risk profile. As can be seen from the table, one can amplify the fixed rate coupon (or floating rate spread) by compressing the range within which the indexed rate must remain for the coupon to accrue interest. It is important for investors to understand that the security only accrues interest on days when the index is within the pre-specified range.

The table also shows the amount of duration, and perhaps more importantly, negative convexity Freddie Mac obtains from various structured products with Bermudan call options, compared to a bullet security of comparable maturity. Given that mortgage assets tend to lose value as rates go down because of the increased likelihood of being prepaid, Freddie Mac is exposed to negative convexity. Issuing callable debt, including range accrual notes, allows us to reduce our liabilities in line with our mortgage assets, enabling us to better match the durations of our assets with our liabilities and to lower our debt funding costs. Importantly, the amount of callable debt outstanding covers over 50 percent of our fixed-rate mortgage portfolio.

Freddie Mac has more than 1,000 different institutional investors — more than one-third overseas — investing in our callable debt, helping to diversify our sourcing of convexity. Many of these investors do not purchase or are forbidden to purchase over-the-counter derivative instruments, but

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can take similar risk exposures by investing in our structured securities, which helps to broaden the pool of end-holders of mortgage interest-rate risk exposure.

In the current market environment of relatively low risk free rates, tight spreads, flat yield curve and relatively low volatility, callable range accrual notes have offered investors willing to take on structured product risk attractive alternatives to express their investment views while earning higher coupons. Freddie Mac continues to strive to find the right balance between our need to manage our own interest-rate risk and the needs of these global investors by issuing structured notes. Attracting global capital to the U.S. housing finance system enables us to fulfill our mission of providing liquidity, stability and affordability to the U.S. housing market.

Table 1

	10-Year Bermudan* Callable Range Accrual Note				
	10-Year Bullet Security	10-Year Bermudan* Callable Security	Index Range Between 0% and 9%	Index Range Between 0% and 8%	Index Range Between 0% and 7%
Coupon	5.58%	6.74%	7.35%	8.15%	9.95%
Duration	7.58	1.98	3.24	4.61	7.81
Convexity	0.71	(2.28)	(3.99)	(5.66)	(10.25)

*A Bermudan callable security has a call option that can be exercised by Freddie Mac at regular periodic intervals, such as every six months.

Source: Freddie Mac

Freddie Mac Funding Summary

2006 Quarter 2

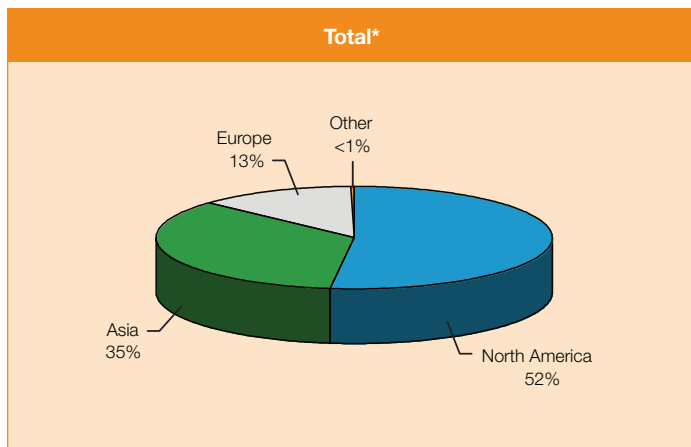
Estimated issuance, redemption and balances - unaudited (1, 2, 3)

	Outstanding 3/31/2006	Gross Issuance (4)	Matured	Called	Repurchased (4)	Net Issuance (5)	Outstanding 6/30/2006
Reference Bills & Discount Notes	\$ 176.7	162.2	(170.7)	—	—	(8.5)	\$ 168.2
Medium Term Notes							
Global Floating Rate	\$0.0	—	—	—	—	—	\$0.0
Syndicated Callable	22.5	—	—	—	(2.7)	(2.7)	19.8
MTN Callable	271.9	37.0	(11.7)	(0.1)	(6.8)	18.3	290.2
MTN Other	57.2	5.6	(0.9)	—	—	4.7	61.9
FreddieNotes	19.2	0.6	—	(0.1)	—	0.5	19.7
Total Medium Term Notes	\$ 370.8	43.2	(12.7)	(0.2)	(9.5)	20.8	\$ 391.6
Reference Notes							
USD Reference Notes	\$ 218.6	19.0	(4.0)	—	—	15.0	\$ 233.6
€Reference Notes (6)	25.6	—	—	—	—	—	25.6
Total Reference Notes	\$ 244.2	19.0	(4.0)	—	—	15.0	\$ 259.2
Subordinated Debt	\$5.9	1.3	—	—	—	1.3	\$ 7.1
Total Debt	\$ 797.5	225.7	(187.4)	(0.2)	(9.5)	28.6	\$ 826.1

Disclaimer: (1) All figures are estimates based on Freddie Mac's unaudited internal reports and are subject to change. Totals may not recalculate due to rounding. (2) All figures represent face amounts in USD billions. These figures could differ significantly from proceeds, amortized principal amount and book value figures, particularly for zero-coupon securities. (3) Effective date for inclusion in the reported period is trade date. (4) "Gross Issuance" and "Repurchased" amounts include transactions that may be considered exchanges for financial reporting purposes under generally accepted accounting principles, or GAAP. (5) Represents the sum of the "Gross Issuance", "Matured", "Called" and "Repurchased" columns. (6) The US dollar amounts reflected for non-dollar debt are based on the exchange rate at issuance.

Geographical Distribution

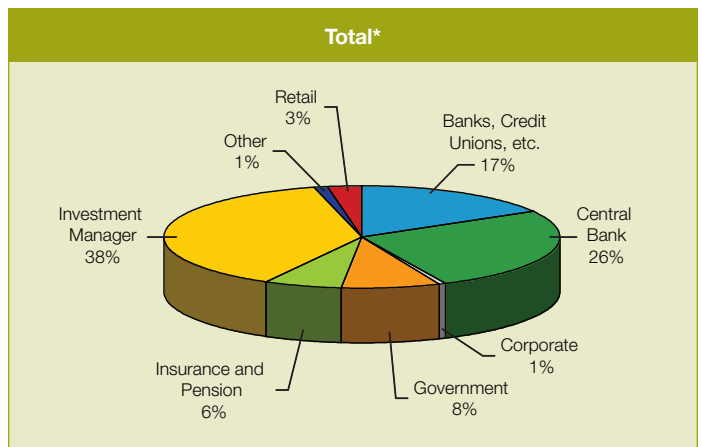
Last 12 Months through June 30, 2006



*Includes exchanged securities' cash portion only.

Investor Type Distribution

Last 12 Months through June 30, 2006



*Includes exchanged securities' cash portion only.

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