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Freddie Mac Posts Quarterly Loss Tempered by Accounting Techniques

By [CHARLES DUHIGG](#)

[Freddie Mac](#), one of the nation's largest buyers of home loans, announced a fresh wave of bad news Wednesday, disclosing losses that were smaller than expected only because of accounting tactics that minimized the effects of bad loans.

Yet investors cheered the results anyway, and pushed the company's shares up by more than 9 percent, to close at \$27.25. The company's regulator, which only a month ago chastised Freddie Mac for questionable accounting policies, also recognized the results by reducing the size of the company's financial safety cushion.

Much like its rival [Fannie Mae](#), whose share price rose last week after it reported enormous losses, Freddie Mac's performance on Wednesday reinforced the idea that investors have become convinced that Freddie and Fannie are too important for either to fail.

Put another way, even bad news can be good, as long as the federal government needs to bolster an ailing housing market.

"Both these companies are clearly going to be insolvent by the end of the year, but everyone knows that Congress will do anything to keep them afloat, because if Fannie and Freddie go under, the entire global financial system will melt down," said Christopher Whalen, a founder of Institutional Risk Analytics, an independent research firm. "These companies' earnings don't matter. Their accounting hardly matters. People buy the stock because they believe the federal government will bail them both out if things get really bad."

Freddie Mac, which announced a first-quarter net loss of \$151 million on Wednesday, disputes that it will become insolvent and argued that optimism was warranted because it is positioned to snap up the best and safest loans in the marketplace. (Fannie Mae made similar arguments last week.) Freddie Mac will seek \$5.5 billion in fresh capital from investors, largely to pursue these opportunities, executives said.

"We are confident that the capital we are raising will both allow us to achieve our mission to both the public and to shareholders," Freddie Mac's chief executive, Richard Syron, said in a conference call with analysts. The chief financial officer, Buddy Pizsel, said he expected the company's credit guarantee business to grow by as much as 20 percent this year and other parts of Freddie Mac to grow by more than 30 percent.

But executives also said they expected housing prices to continue to decline, as well as combined credit losses of more than \$6 billion through 2009 from borrowers who do not pay their mortgages on time. Moody's Investors Service downgraded Freddie Mac's financial strength rating on Wednesday, projecting

that the company will have up to \$7.5 billion in losses from bad mortgages over the next two years.

“It’s clear we have not yet hit bottom in the housing market,” Mr. Syron said.

Freddie Mac and Fannie Mae are essential lubricants in the housing marketplace. The companies buy more than 80 percent of all home loans made by banks and lenders, providing fresh financing for more home mortgages.

Because of their importance, the companies have traditionally received much more leniency than other banks and lenders. Their combined financial cushion — \$83 billion at the end of 2007, underpinning \$5 trillion in debt and other financial commitments — is much thinner than at other financial firms.

And some analysts say the cushion at Freddie Mac would be thinner still if it were not for accounting tactics. Executives explained on Wednesday that accounting techniques had allowed the company to reduce its credit losses by \$1.3 billion. Other accounting methods let the company pick and choose which assets and liabilities to measure at market value, adding \$1 billion to retained earnings.

A spokesman for the company, Michael L. Cosgrove, said those accounting methods were proper and withstood the scrutiny of multiple parties, including an auditor.

But last month, the company’s regulator, the [Office of Federal Housing Enterprise Oversight](#), was critical of some of those accounting choices in a report to Congress. That regulator, however, is dependent upon Freddie Mac’s cooperation in helping to combat the unfolding housing crisis.

On Wednesday, the regulator said that it was decreasing the mandatory size of Freddie Mac’s financial cushion by 5 percent and that it would decrease it by another 5 percent in September as long as the company registers with the Securities and Exchange Commission and fulfills other basic requirements.

The company said it planned to register with the S.E.C. by August.

While Freddie Mac’s results seemed not to trouble Wall Street, it is likely they will cause some raised eyebrows in Congress, where lawmakers are debating wide-ranging reforms on how Freddie and Fannie are regulated. Legislation has already passed the House, and on Thursday the Senate Banking Committee is expected to vote on a reform bill.

What the Senate bill will contain, however, is still uncertain, according to people close to the negotiations, who spoke on the condition of anonymity to avoid upstaging their bosses. While Republicans are pushing for legislation that would allow regulators to rein in Freddie and Fannie for a multitude of reasons, Democrats are hoping to place greater restraints on the regulator’s powers.

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