DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Secretary

24 CFR Part 81

[Docket No. FR–3481–F–03]

RIN 2501–AB56

The Secretary of HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)

AGENCY: Office of the Secretary, HUD.

ACTION: Final rule.

SUMMARY: This final rule implements the Secretary's regulatory authorities respecting the Federal National Mortgage Association (''Fannie Mae'') and the Federal Home Loan Mortgage Corporation (''Freddie Mac'') (collectively the ''Government-Sponsored Enterprises'' or ''GSEs'') under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (''FHEFSSA''). FHEFSSA's purpose is to establish a new regulatory framework for the GSEs that reflects their unique status as shareholder-owned corporations that receive substantial public benefits. FHEFSSA substantially overhauled the regulatory authorities and structure for GSE regulation and required the issuance of this rule.

FHEFSSA directs the Secretary to establish three separate housing goals for the GSEs' mortgage purchases financing: housing for low- and moderate-income families; housing located in central cities, rural areas, and other underserved areas; and special affordable housing to meet the unaddressed needs of low-income families in low-income areas and very-low-income families. Under this rule, the Secretary sets the level of each goal and specifies the requirements for counting mortgage purchases toward meeting the goals. The rule also includes procedures for monitoring and enforcing performance under the goals.

In addition, FHEFSSA requires the Secretary to prohibit discrimination by the GSEs in their mortgage purchases and establishes new responsibilities for the Secretary and the GSEs with respect to the Fair Housing Act and the Equal Credit Opportunity Act. This rule implements these authorities. The rule also sets forth requirements for the Secretary's review and approval of new programs of the GSEs, GSE submission of mortgage purchase data and reports to the Secretary, the Secretary's dissemination of data and protection of proprietary information, and enforcement and other proceedings under this rule.

EFFECTIVE DATE: January 2, 1996, except that § 81.62(c) shall not be effective until April 1, 1996, so that the first mortgage report required to be submitted by the GSEs under that section will cover mortgage purchases through the second quarter of 1996 and will not be due until September 1, 1996.

FOR FURTHER INFORMATION CONTACT: Janet Tasker, Director, Office of Government-Sponsored Enterprises, Room 6154, telephone (202) 708–2224; or, for questions on data or methodology, Harold Bunce, Director, Financial Institutions Regulation, Office of Policy Development and Research, Room 8204, telephone (202) 708–2770; or, for legal questions, Kenneth A. Markison, Assistant General Counsel for Government Sponsored Enterprises/ RESPA, Office of the General Counsel, Room 9262, telephone (202) 708–3137. The address for all of these persons is: Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, D.C. 20410. A telecommunications device for deaf persons (TDD) is available at (202) 708–9300. (The telephone numbers are not toll-free.)

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act Statement

The information collection requirements contained in this rule have been submitted to the Office of Management and Budget (OMB) for review under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520), as implemented by OMB in regulations at 5 CFR part 1320. No person may be required to respond to, or may be subjected to a penalty for failure to comply with, these information collection requirements until they have been approved and HUD has announced the assigned OMB control number. The OMB control number, when assigned, will be announced by separate notice in the Federal Register. In accordance with § 1320.11(h) of the implementing regulations, OMB has 60 days from today's publication date in which to approve, disapprove, or instruct HUD to make a change to the information collection requirements in this rule.

The final rule addresses comments submitted to OMB and HUD on the collection of information requirements in the proposed rule. In addition, HUD has consulted with members of the public and affected agencies regarding these collections of information. In revising the requirements from those that appeared in the proposed rule, HUD has evaluated the necessity and usefulness of the collection of information; reevaluated HUD's estimate of the information collection burden, including the validity of the underlying methodology and assumptions; and minimized the burden on respondents for the information collection requirements, to the extent compatible with the Secretary's responsibilities under the authorizing statute. This final rule provides for the use of electronic collection techniques.

General

Purpose

This final rule establishes new regulations implementing the Secretary of Housing and Urban Development's (''the Secretary's'') authority to regulate the GSEs. The authority exercised by the Secretary is established under:

(1) The Federal National Mortgage Association Charter Act (''Fannie Mae Charter Act''), which is Title III of the National Housing Act, section 301 *et seq.* (12 U.S.C. 1716 *et seq.*);

(2) The Federal Home Loan Mortgage Corporation Act (''Freddie Mac Act''), which is Title III of the Emergency Home Finance Act of 1970, section 301 *et seq.* (12 U.S.C. 1451 *et seq.*); [1] and

(3) FHEFSSA, enacted as Title XIII of the Housing and Community Development Act of 1992 (Pub. L. 102–550, approved October 28, 1992, and codified, generally, at 12 U.S.C. 4501–4641). FHEFSSA substantially changed the Secretary's authorities respecting the GSEs, requiring the Secretary to promulgate new regulations.

This rule implements these authorities and authorities under the Charter Acts, replaces the Secretary's current regulations governing Fannie Mae and, for the first time, establishes regulations governing Freddie Mac.

Background

Fannie Mae and Freddie Mac are congressionally chartered, shareholder-owned corporations that have been regulated by HUD since 1968 and 1989, respectively. The GSEs were chartered by Congress to:

(1) Provide stability in the secondary market for residential mortgages;

(2) Respond appropriately to the private capital market;

(3) Provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a

[1] This rule refers to the Fannie Mae Charter Act and the Freddie Mac Act collectively as the ''Charter Acts.''

reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and

(4) Promote access to mortgage credit throughout the Nation (including central cities, rural areas, and other underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.[2]

In exchange for carrying out their public purposes, the GSEs enjoy substantial public benefits not provided to other private corporations in the secondary mortgage market, which include: (1) Conditional access to a $2.25 billion line of credit from the U.S. Treasury; [3] (2) exemption from securities registration requirements of the Securities and Exchange Commission and the States; [4] and (3) exemption from all State and local taxes, except property taxes.[5] In addition to these benefits, the GSEs enjoy the implicit benefit of the financial market's assumption that, even though no Federal guarantee exists,[6] should a GSE fail to meet its obligations, the Federal Government and, ultimately, the American taxpayer would stand behind the obligations of the GSEs. As a result of their Government-sponsored status, the GSEs borrow at approximately the same rates as the Department of Treasury,[7] and their cost of doing business is less than that of other competitors in the mortgage market. In return for the substantial benefits that the GSEs receive, they are expected to serve certain public purposes, and are subject to congressionally imposed limitations on their undertakings and to HUD's regulation.

Provisions of FHEFSSA

Because Congress perceived a need to increase protection to the taxpayers from any potential financial losses or risks posed by the GSEs, FHEFSSA established an independent financial regulator within HUD—the Office of Federal Housing Enterprise Oversight (OFHEO)—which is responsible for the financial safety and soundness of the GSEs.

At the same time, to assure that the GSEs accomplish their public purposes, Congress clarified and expanded the Secretary's specific powers and authorities respecting the GSEs. FHEFSSA provides that, except for the authority of the Director of OFHEO over all matters related to financial safety and soundness, the Secretary has general regulatory power over the GSEs and is required to make all rules and regulations necessary to ensure that the purposes of FHEFSSA and the Charter Acts are carried out.[8]

FHEFSSA specifically requires the Secretary to establish, monitor, and enforce three separate goals for the GSEs' mortgage purchases on:

(1) Housing for low- and moderate-income families (Low- and Moderate-Income Housing Goal);

(2) Housing located in central cities, rural areas, and other underserved areas (Geographically Targeted Goal); and

(3) Special affordable housing meeting the ''unaddressed housing needs of low-income families in low-income areas and very low-income families'' (Special Affordable Housing Goal).

Under FHEFSSA, the Secretary is to establish each of the housing goals after consideration of certain statutorily prescribed factors relevant to the particular goal. The Secretary's findings concerning each of these factors are set forth in the appendices to this rule, which are published in today's Federal Register after the text of the rule. These appendices will not be codified in the Code of Federal Regulations.

FHEFSSA also establishes new fair lending requirements for the GSEs. Under FHEFSSA, the Secretary must, by regulation, prohibit the GSEs from discriminating in their mortgage purchases because of ''race, color, religion, sex, handicap, familial status, age, or national origin, including any consideration of age or location of the dwelling or the age of the neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect.'' [9] The Secretary must also:

(1) By regulation, require the GSEs to submit data to assist the Secretary in investigating whether a mortgage lender has failed to comply with the Fair Housing Act and the Equal Credit Opportunity Act (''ECOA'');

(2) Obtain and make available to the GSEs information from other regulatory and enforcement agencies on violations by lenders of the Fair Housing Act and ECOA;

(3) Direct the GSEs to take various remedial actions against lenders found to have engaged in discriminatory lending practices in violation of the Fair Housing Act or ECOA; and

(4) Periodically review and comment on the GSEs' underwriting and appraisal guidelines, to ensure that the guidelines are consistent with the Fair Housing Act and FHEFSSA.

FHEFSSA also details the Secretary's authority to review and approve new programs of the GSEs and establishes procedures under which the GSEs may contest determinations on new program requests. FHEFSSA maintains the Secretary's authority to require reports from the GSEs on their activities and requires the GSEs to submit detailed, specific data on their mortgage purchases. FHEFSSA assigns the Secretary other responsibilities, including establishing a public-use database containing data gathered from the GSEs on mortgage purchases, and protecting proprietary information provided by the GSEs. FHEFSSA terminates the former regulations governing Fannie Mae and requires that the Secretary issue new regulations governing both GSEs.

Transition Period

FHEFSSA established a transition period of calendar years 1993 and 1994, to provide time for the Secretary to collect data and implement FHEFSSA's provisions. For the transition period, FHEFSSA established targets for mortgage purchases by the GSEs on housing for low- and moderate-income families and housing located in central cities, rural areas, and other underserved areas. For the transition years, the targets for both of these goals were set at 30 percent of the GSEs' mortgage purchases. The target amounts were the same as the percentage goals established under HUD's Fannie Mae regulations, which were originally promulgated in 1979 and codified under the former Fannie Mae regulations in 24 CFR part 81. During the transition, only mortgages located in central cities, as designated by the Office of Management and Budget (OMB), counted toward the Geographically Targeted Goal. FHEFSSA required that the Secretary establish interim goals to improve the GSEs' performance relative to these targets, so that the GSEs would meet the targets by the end of the transition

[2] Sections 301(b) of the Freddie Mac Act and 301 of the Fannie Mae Charter Act.

[3] Sections 306(c)(2) of the Freddie Mac Act and 304(c) of the Fannie Mae Charter Act.

[4] Sections 306(g) of the Freddie Mac Act and 304(d) of the Fannie Mae Charter Act.

[5] Sections 303(e) of the Freddie Mac Act and 309(c)(2) of the Fannie Mae Charter Act.

[6] The GSEs' obligations are not guaranteed by the United States. See, e.g., sections 1302(4), 1381(f), and 1382(n) of FHEFSSA (requiring each GSE to state in its obligations and securities that such obligations and securities ''are not guaranteed by the United States'').

[7] Congressional Budget Office, *Controlling the Risks of Government-Sponsored Enterprises*, at 10 (April 1991).

[8] Section 1321 of FHEFSSA.

[9] Section 1325(1).

period. FHEFSSA also established specific dollar amounts for purchases by the GSEs of mortgages under the Special Affordable Housing Goal. For the transition years, the legislative history of FHEFSSA indicates that the goal should be higher than the GSEs' 1992 performance.

Interim Notices

As required by FHEFSSA, on October 13, 1993, the Secretary published notices of interim housing goals establishing requirements necessary to implement the transition housing goals;[10] the GSEs reviewed and commented on the notices prior to publication.

The Interim Notice for Fannie Mae established that, of the dwelling units financed by Fannie Mae's mortgage purchases: (1) In 1993 and 1994, 30 percent should be affordable to low- and moderate-income families; (2) in 1993, 28 percent and, in 1994, 30 percent should be located in central cities; and (3) during the 1993–94 period, at least $16.4 billion in mortgages should meet the Special Affordable Housing Goal.

The Interim Notice for Freddie Mac established that, of the dwelling units financed by Freddie Mac's mortgage purchases: (1) In 1993, 28 percent and, in 1994, 30 percent should be affordable to low- and moderate-income families; (2) in 1993, 26 percent and, in 1994, 30 percent should be located in central cities; and (3) during the 1993–94 period, at least $11.9 billion in mortgages should meet the Special Affordable Housing Goal.

In late 1994, when it became apparent that this rulemaking would not be completed in time to establish new housing goals for 1995, the Secretary issued a final regulation extending the 1994 goals for both GSEs into 1995.[11]

The Proposed Rule

On February 16, 1995 (60 FR 9154), HUD published a proposed rule to implement the Secretary's authorities under FHEFSSA and the Charter Acts. The proposed rule raised the level of the goals. It also provided that, in accordance with FHEFSSA, the Geographically Targeted Goal would be expanded to include rural and other underserved areas, and that the goal would be directed to the underserved portions of these areas. The proposal reformulated the categories of the Special Affordable Housing Goal and proposed new counting requirements based on experience gained in the transition period. The proposed rule also would have established procedures for review of new programs, detailed prohibitions against discrimination, scaled back reporting requirements from the former Fannie Mae regulations and the Interim Notices, and included detailed requirements for book entry of GSE securities and procedures under FHEFSSA.

Final Rule

In response to the proposed rule, HUD received 163 comments. The comments came from the GSEs; individuals; representatives of lending institutions, community, and consumer groups; Members of Congress; local and State governments; and others. Following full consideration of the comments and discussions with the GSEs and outside entities, HUD developed this final rule. The final rule is consistent with the approach announced in the proposed rule, but includes significant revisions in light of the comments. The final rule:

(1) Establishes housing goals that are greater than those established under the regulations for the transition and will ensure that the GSEs continue and strengthen their efforts to carry out Congress's intent that the GSEs provide the benefits of a secondary market to families throughout the Nation;

(2) Requires the GSEs to take appropriate steps to facilitate fair housing for all citizens, recognizing the GSEs' leadership role in the lending industry without forcing the GSEs to act in an enforcement capacity better left to the Government;

(3) Establishes conditions and procedures by which the Secretary will exercise his or her statutory authority to review new programs of the GSEs, but in a manner that will not create a disincentive for the GSEs to be innovative in developing new mortgage finance initiatives;

(4) Implements reporting requirements for the GSEs that are not unduly burdensome and will allow the Secretary and Congress to monitor the GSEs' activities appropriately;

(5) Requires dissemination of information on the GSEs' activities to the public, while protecting the GSEs' legitimate commercial interests in proprietary data; and

(6) Establishes fair procedures for enforcement actions and other regulatory procedures under FHEFSSA.

Discussion Of Public Comments

Overview of the Public Comments

Of the 163 comments received, by far the most detailed were the submissions of the two directly affected GSEs—Fannie Mae and Freddie Mac. Each GSE submitted comments of more than 200 pages, supported by numerous appendices, exhibits, and footnotes. Although occasionally voicing approval of provisions of the proposed rule, the GSEs' comments, in the main, registered substantial opposition to key features.

In addition, comments were received from 26 national or regional industry-related groups or associations; 26 nonprofit organizations; 10 Members of Congress; 22 governors and mayors, 10 State and local agencies; 24 banks, lenders, or other real estate professionals; 40 individuals;[12] and 3 legal organizations. HUD reviewed and considered all of these comments in writing the final rule.

The portion of the rule most frequently discussed by the commenters was Subpart B—Housing Goals, some aspect of which attracted comments from 146 of the 163 commenters. Eighty-three of these comments reflected general approval of the proposed rule's approach to the goals. Fifty-three others were in opposition, in whole or in part, while 10 contained mixed statements of support and opposition.

Other major subject areas of the proposed rule (subpart C—Fair Housing, subpart D—New Program Approval,and Subpart E—Access to Information) attracted the attention of only a minority of the commenters. Fifty-five of the 62 commenters who addressed the new program approval provisions opposed them in whole or in part, with only 3 commenters setting out unqualified approval, and 4 others expressing a mixture of favorable and unfavorable comments.

Thirty commenters opposed one or more major elements of the rule's treatment of fair housing concerns, while 11 favored the rule. Two comments featured well-mixed supporting and opposing views. The majority of the institutional commenters and lenders who did address the issues of fair housing stated their opposition to the rule's treatment. Only among the nonprofit organizations did a majority of the commenters addressing the issue express support for the proposed rule's handling of the subject. Commenters often addressed Subpart E, Reporting Requirements, in the context of other statements pertaining to housing goals, fair housing, or both. Accordingly, the commenters' views on reporting are

[10] 58 FR 53048 and 53072.

[11] 59 FR 61504 (November 30, 1994).

[12] The 40 comments from individuals were form letters, signed by persons from several different States but containing identical information except for, in a few instances, written-in additional observations. These comments were limited to housing goals issues and generally favored, and recommended strengthening of, the rule.

largely included in the discussion of subparts B and C.

Only 10 commenters addressed the access to information issue. Of these, six (including the GSEs) were substantially opposed to the rule's provisions, while four supported the rule or urged stronger provisions in favor of broader public disclosure of GSE information.

In all subject areas, the GSEs' expressions of opposition to important features of the rule were backed by a majority of the national or regional industry associations submitting comments, as well as by commenters representing banks and other lenders. On the other hand, several associations expressed notable support for some of the same features.

A higher proportion of the commenting nonprofit organizations supported important aspects of the rule as proposed, although many of these commenters also opposed individual features of the proposal and offered suggestions for modifications or compromises that would accomplish similar aims. A number of nonprofit organizations also recommended further strengthening of the rule, especially as it relates to housing goals.

Comments from Governors and Mayors tended to concentrate on the goals. In general, these comments opposed the definitions in the proposed rule of ''central city,'' ''rural area,'' and other key terms that determine the transactions that count toward achievement of the housing goals. Twelve of the 22 State and local political leaders who commented expressed opposition to the program approval portions of the rule. The 10 comments from State and local governmental agencies focused largely on housing goals issues, but were more diverse in their views, with 5 agencies generally supporting the rule, 4 opposing significant portions of it, and 1 expressing a mixture of favorable and unfavorable comments.

Members of Congress submitting comments mainly addressed housing goals issues, with 6 of the 10 criticizing the rule. Six Members also opposed aspects of the new program approval subpart. Three Members voiced support for the proposed rule's approach to housing goals, and one expressed support for the rule's fair housing provisions.

A discussion of general and specific comments on the rule follows. HUD has read and considered all of the comments received from the public in developing this final rule. Although not all of the comments are addressed explicitly in this preamble, often because HUD's response is implicit in the general discussion of the rule or other comments or because the comments were minor, HUD acknowledges the value of all of the comments submitted in response to the proposed rule.

Other Public Input

In addition to the comments received, HUD sought information from the GSEs and other market participants to verify or revise assumptions and data HUD used in developing the rule. During this rulemaking, HUD held numerous meetings with the GSEs, lenders, developers, nonprofit groups, public-interest representatives, and other Federal agencies to discuss issues related to the rule, including the methodology used to establish market shares, current conditions in rural lending, and current conditions in the multifamily market. Additional information on these meetings is contained in the public docket file of this rule in Room 10276 at HUD Headquarters. HUD also conducted a series of detailed analyses of various technical issues raised in the comment letters. To assist in analyzing these issues, HUD contracted with researchers and academicians in universities and the private sector to carry out independent evaluations of HUD's methodology. HUD also consulted broadly with researchers and economists at other Government agencies, the GSEs, and housing trade groups to critique and refine the underlying analytical work used in establishing the housing goals.

Subpart A—General

Overview

The GSEs commented that various parts of the proposed rule were not legally sustainable because the Secretary's actions were, for example, ''unreasonable,'' ''arbitrary,'' ''capricious,'' ''not supported by a cogent rationale,'' ''in direct conflict with the plain meaning of the Act,'' or ''an improper exercise of the Secretary's discretion.'' HUD has carefully reviewed these concerns and applicable case law,[13] and has concluded that its exercise of regulatory authority in promulgating this final rule is, in all respects, well within the discretion accorded to HUD by Congress under FHEFSSA and is well-supported by ample evidence and considered reasoning.

Section 81.2—Definitions

Many of the definitions remain the same as in the proposed rule or have been modified for purposes of clarity only. This final rule, however, does change some definitions substantially in response to comments. This section of the preamble mainly discusses changes in definitions relating to housing goals. The preamble text concerning subpart D discusses the definition of ''new program'', and the text concerning subpart F discusses the definitions of ''proprietary information'' and ''public data''.

Contract Rent. Freddie Mac asked that the definition of ''contract rent'' be revised to allow the GSEs to decrease contract rent by the amount of any ''rent concessions.'' Supporting, generally, the rule's contract rent definition, Freddie Mac commented that: underwriting determinations are based on post-concession rents; Freddie Mac adheres to that general practice; and allowing rent concessions to be taken into account would materially increase affordability of some units.

Under FHEFSSA, the affordability of housing units and their eligibility for counting towards a goal is based on their rents. Rent concessions are relatively short-term in nature. Their consideration in calculating rents would result in unrealistically low levels of rent, considering that after the rent concession period ends, the rents are increased. Accordingly, it is not appropriate to consider rent concessions in defining or determining rent.

Dwelling unit. Freddie Mac objected to the inclusion of a definition for ''dwelling unit'' in the rule. Freddie Mac asserted that under section 302(h) of the Freddie Mac Act, which defines ''residential mortgage,'' Freddie Mac is authorized to define ''dwelling unit.''

Although Freddie Mac is authorized to define the term ''dwelling unit'' under the Freddie Mac Act, it is appropriate that this final rule define the term under FHEFSSA. The Secretary is charged with measuring the extent of compliance with the housing goals under section 1336 of FHEFSSA. Because FHEFSSA specifically authorizes the Secretary to consider units in formulating the goal, a definition of the term ''unit'' or ''dwelling unit'' is integral to counting GSEs' purchases toward achievement of the goals.

The GSEs also commented that, if ''dwelling unit'' is defined under the rule, the definition of ''dwelling unit'' should include the following types of housing: (1) A single-family dwelling with a home office; (2) dwelling units in an apartment complex with retail space or a day care center; and (3) single-room-occupancy buildings and group homes that may lack separate kitchens

[13] *See, e.g., Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council*, 467 U.S. 837 (1984).

or bathrooms for each unit of residence. In response to this point, the definition of ''dwelling unit'' is changed in the final rule to include single room properties, dwellings that include offices, and dwellings located in mixed-use properties.

Median Income. Freddie Mac, addressing the Low- and Moderate-Income Goal, commented that the definition of ''median income'' should be revised to permit household income in nonmetropolitan areas to be measured against the greater of the county median income or the statewide nonmetropolitan median. Freddie Mac noted that ''the proposed rule would classify a borrower with an income of $12,000 living in a county with median income of $11,000 as 'upper income.''' The final rule (in § 81.15) clarifies that ''median income'' for families outside of metropolitan statistical areas (MSAs) means the greater of the county median income or the statewide nonmetropolitan median income for the area where the property is located.

Mortgages and Interests in Mortgages. The GSEs commented that, in tracking the Freddie Mac Act, the definition of ''mortgage'' appears to have dropped a line relating to interests in mortgages. Freddie Mac suggested adding to the rule's definition ''* * * and includes interests *in mortgages. Such term shall also include a mortgage, lien, or other security interest on* the stock or membership certificate.'' (Emphasis in original.)

FHEFSSA requires the Secretary to establish goals for the ''purchases of mortgages.'' The proposed and final rules specifically allow certain interests in mortgages, such as participations and credit enhancements, to count toward achievement of the goals, because these transactions are essentially the same as mortgage purchases. The final rule provides that ''interests in mortgages'' are mortgages and count toward achievement of the housing goals. Because defining mortgages to include all ''interests in mortgages'' is potentially over-inclusive and may encompass transactions or activities that are not equivalent and should not appropriately count toward achievement of the goals, the counting provisions in § 81.16(b) list specific types of transactions that do not count toward achievement of the goals, including certain ''interests in mortgages.''

Refinancing. Freddie Mac commented that, by excluding from the definition of ''refinancing'' the renegotiation of a multifamily mortgage when a balloon payment is due within one year, it is not clear whether the excluded activity is intended to be treated as a ''mortgage purchase.'' The final rule includes as new mortgages multifamily mortgages that have balloon payments due within 1 year after the date of closing of the renegotiated mortgages.

Very-low-Income. Freddie Mac commented that the term ''very-low-income'' should be defined consistently with certain other HUD regulations and programs. Freddie Mac noted that these programs' formulas for determining eligibility sets the ''very-low-income'' limit above 60 percent of the local area median income in 48 metropolitan areas and 1,502 nonmetropolitan counties with either unusually low income or unusually high housing costs. Freddie Mac urged HUD to create exceptions to the definition of ''very-low-income'' for multifamily projects benefiting from a Federal assistance program, where such projects are located in areas with either unusually low income or unusually high housing costs.

As part of the Special Affordable Housing Goal, Congress specifically required the Secretary to establish a housing subgoal that targets very-low-income families. Section 1303(19) of FHEFSSA defines ''very low-income'' as:

(1) In the case of owner-occupied units, income not in excess of 60 percent of area median income; and

(2) In the case of rental units, income not in excess of 60 percent of area median income, with adjustments for smaller and larger families, as determined by the Secretary.

In certain HUD programs the Secretary has statutory authority to make the type of adjustments that Freddie Mac has requested HUD to make under FHEFSSA. However, FHEFSSA does not provide similar authority. The only adjustments to the definition of ''very-low-income'' that are permissible under FHEFSSA are adjustments for smaller and larger families in the case of rental units.

Subpart B—Housing Goals

Overview

The greatest amount of controversy in the public comments centered on the housing goals. Fannie Mae and a number of commenters focused on the levels of the goals, the concept of ''leading the industry,'' and the methodology used to estimate the size of the conventional market for each of the goals. In its critique of the housing goals portion of the proposed rule, Freddie Mac advanced six major concerns: (1) The market estimates are flawed and will result in infeasible goals over time; (2) the proposed rule does not establish a link between identified housing needs and the housing goals; (3) HUD has not adequately taken market volatility into account in establishing the goals; (4) the GSEs' previous performance is incorrectly assessed; (5) the proposed rule presents too narrow a concept of leading the industry; and (6) the proposed rule does not adequately address the risks posed by increased levels of multifamily purchases. Freddie Mac also expressed concern that in establishing the goals as proposed, HUD would micromanage the type and location of the GSEs' mortgage purchases, severely limiting the GSEs' ability to respond to the market in a timely manner.

General comments on the housing goals are discussed in this section. More detailed analyses of some of these issues are presented in four technical appendices immediately following the text of the rule, as well as in an economic analysis of the rule prepared by HUD.

Levels of the Goals

Fannie Mae requested that the levels of the goals be set lower than in the proposed rule, commenting that the housing goals should be set at a ''reasonable and appropriate share'' of Fannie Mae's business. Fannie Mae also urged HUD to refrain from frequent adjustments in the goals and to avoid increasing the goals if Fannie Mae exceeded them. Similarly, Freddie Mac stressed the necessity of setting ''conservative'' goals that are capable of being met under a variety of economic conditions.

Both GSEs agreed that HUD had not adequately considered the impact that changes in national economic conditions could have on the size of the conventional, conforming market. The GSEs commented that HUD was assuming, in its market estimates, that the unusually favorable economic and housing market conditions of 1993–1994 would continue in the future.

A number of commenters, mainly representing public-interest organizations, asked for more aggressive goal-setting, urging that the levels of the goals were too low, given the benefits provided to the GSEs by virtue of their Federal charters, their current levels of performance, and the scope of the nation's housing problems.

Some commenters, primarily industry representatives, expressed concern with the proposed rule's stated intention to set future goals at higher levels. A number of commenters joined with the GSEs in recommending that goals remain stable over the long term and be imposed at reasonable levels that not only assure the GSEs will increase their support of low- and moderate-income housing, but also reflect that economic conditions may influence the capacity of the GSEs to support such housing in any given year.

The GSEs held differing views on how far into the future the goals should be fixed. Fannie Mae commented that the goals should be fixed for a substantial period of time, to allow the GSEs to incorporate the goals into their long-range business plans and corporate strategies. Freddie Mac expressed serious doubt that meaningful goals could be established for a period more than two years into the future.

Under the rule, the following goals are established: the annual goal for each GSEs' purchases of mortgages on housing for low- and moderate-income families is—for 1996, 40 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1996 and, for each of the years 1997–99, 42 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years; the annual goal for each GSEs' purchases of mortgages on housing located in central cities, rural areas, and other underserved areas is—for 1996, 21 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1996 and, for each of the years 1997–99, 24 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years; and the annual goal for each GSEs' purchases of mortgages on special affordable housing is—for 1996, 12 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1996 and, for each of the years 1997–99, 24 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years; additionally, the special affordable housing goal for each of these years shall include mortgage purchases financing dwelling units in multifamily housing totalling not less than 0.8 percent of the dollar volume of mortgages purchased by the respective GSE in 1994. For 2000 and thereafter the Secretary shall establish new annual goals; pending establishment of goals for 2000 and thereafter, the annual goal for each of those years for each of the three goals shall be the same as the 1999 goals.

The levels of the housing goals established in this final rule meet the following objectives: they are reasonable and appropriate, they reflect consideration of the statutory factors for establishing housing goals, and they are set far enough into the future to allow the GSEs to engage in long-term planning.

First, the levels of the three housing goals are reasonable and appropriate, as summarized below in the discussion of each of the housing goals and detailed further in the appendices. The goals have been set judiciously in relation to reasonable estimates of the market share of the mortgages originated that would qualify under the goals. The levels of the goals also reflect the cyclical nature of the mortgage markets and the need to provide a margin for unforeseen macroeconomic impacts.

Second, the levels of the goals reflect a full consideration of all factors for consideration under FHEFSSA. The GSEs expressed concern that the process used by the Secretary for establishing the levels of the goals was too rigid, driven primarily by the market-share estimates for each of the goals. This concern is unfounded. In establishing the goals, the Secretary carefully considered the factors mandated by FHEFSSA. These factors, which encompass more than just the estimate of the market for each goal, include housing needs, the financial conditions of the GSEs, economic and demographic conditions, previous performance, and the GSEs' leadership role within the industry. The appendices that accompany this rule explain in detail the evaluation of these factors.

The levels of the goals represent a benchmark against which the GSEs' performance can be measured. The levels are designed to be standards, not ceilings. They are not so high that the GSEs are likely to fail to meet the goals. Instead, the levels of the goals represent a reasonable and appropriate share of the GSEs' business that—at a minimum—should be devoted to meeting the needs of lower-income renters and home buyers and of residents of areas underserved by the mortgage markets. The final rule has been revised to allow the GSEs maximum flexibility in choosing how they achieve the goals. The levels of the goals also reflect careful consideration of the concerns expressed by the GSEs and other commenters that economic and demographic conditions be taken into account. The levels of the goals have been set so that they should be attainable in economic conditions more adverse than those experienced in the past few years.

Third, HUD considered carefully the comments expressing concern about the future levels of the goals. To provide the GSEs with the predictability needed to manage their operations, the levels of the goals have been established for the next four years. The Secretary can, by regulation, change the level of the goals for the years 2000 and beyond based on the experience of the previous years. If the Secretary elects not to change them, they will be left at the 1999 levels for future years.

Leading the Industry

The proposed rule asserted that the GSEs have a responsibility because of their Federal charters to lead the industry in expanding housing opportunities for low-income home buyers and renters and for residents of underserved areas. The proposed rule requested comment on how the Secretary should consider ''leading the industry'' in establishing the levels of the housing goals.

Freddie Mac commented that the proposed rule's presentation of ''leading the industry'' was too narrow. Freddie Mac argued that HUD, in suggesting that leading the industry only be judged on percentage terms, ignored the GSEs' non-goal-related activities that provide stability and liquidity to the mortgage markets. Freddie Mac suggested that HUD should view industry leadership to include GSE activities that broaden the entire market, including ''pioneering innovation, the establishment of new business practices and programs, and the generation of market efficiencies.'' Further, HUD should evaluate the GSEs' charge to lead the industry in qualitative, and not just quantitative, terms.

Several industry commenters echoed Freddie Mac's concerns about considering ''leading the industry'' in merely percentage terms. They commented that Congress had included the ability of the GSEs to lead the industry as one of several factors to be considered. Further, they noted that leading the industry can be demonstrated in many ways beyond just the level of mortgage purchases. Reaching reasonable goals would be a component of leadership, the Mortgage Bankers Association (''MBA'') commented, but ''the attainment of steadily increasing benchmarks should not be regarded as a prerequisite for leadership.''

Other commenters differed with this approach. The National Training and Information Center (''NTIC'') commented that the proposed goals were ''too low'' and ''do not ensure that the GSEs will 'lead the market' in the production of affordable housing and housing in underserved areas.'' NTIC stated that, although the GSEs achieved the 1993 goals, the goals and the GSEs ''ha[d] not made a significant presence in these neighborhoods.'' The Los Angeles Housing Department argued that the GSEs ought to purchase ''a higher percentage of mortgages than are originated by the market under each housing goal.''

The GSEs' efforts to create liquidity and stability in the mortgage markets, as well as the introduction of innovative products, technology, and processes, clearly demonstrate their leadership role within the industry. These activities have strengthened the mortgage industry and increased its ability to serve homeowners and renters of all incomes throughout the country. Congress chartered the GSEs to carry out four public purposes: (1) To provide stability; (2) to respond appropriately to the mortgage markets; (3) to assist the residential mortgage market, including serving low- and moderate-income families; and (4) to promote access to mortgage credit throughout the nation. In FHEFSSA, Congress acknowledged, as does HUD, the substantial contributions the GSEs have made and continue to make in creating liquidity and stability in the overall mortgage market. However, in FHEFSSA, Congress developed a mechanism to ensure that the GSEs served lower-income families and underserved areas. HUD, through its focus on the housing goals and performance-based measurements, is carrying out that congressional intent.

Purpose of the Goals

Freddie Mac commented that HUD had premised the proposed rule on the mistaken belief that the GSEs are not fulfilling their statutory purposes. Freddie Mac asserted that its 1993 and 1994 performance under the housing goals ''demonstrate[s] that Freddie Mac is strongly committed to fulfilling its obligation to serve [lower-income households and residents of specific areas].''

Both GSEs commented that a clear connection had not been established between the general housing needs of low- and moderate-income households and those needs that can be addressed by the GSEs. Freddie Mac stated that it is not a problem of availability of mortgage credit that dominates the unaddressed needs of low-income families, but a lack of sufficient incomes or subsidies to support homeownership or rental payments.

Freddie Mac expressed concern that the proposed rule was based upon a ''fundamental misinterpretation'' of what Congress had intended to achieve through FHEFSSA. Freddie Mac denied that FHEFSSA's passage reflected a congressional presumption that the GSEs had failed to serve lower-income households or certain geographic areas adequately.

Both GSEs suggested that the goals amounted to using the GSEs to allocate credit. Fannie Mae also suggested that the goals were being used to assign to the GSEs the responsibility for alleviating specific housing needs. Both GSEs argued that Congress had no such intent.

The GSEs' comments that the housing goals result in credit allocation by the Secretary are difficult to understand. Congress created the GSEs and provided them federally derived benefits to achieve national housing purposes. Congress also required the establishment of explicit goals for the GSEs' purchases of mortgages financing housing for lower-income households and in communities underserved by the mortgage markets. Congress created the GSEs to develop liquidity and stability in the mortgage markets, and Congress specifically charged the GSEs to provide credit to low- and moderate-income households and to all areas. Congress clearly believed that doing so was not inconsistent with the GSEs' operation as profitmaking, shareholder-owned entities.

Criticism that HUD failed to establish a clear connection between identified housing needs and the proposed housing goals reflects a misunderstanding of the requirements placed on the Secretary by FHEFSSA. FHEFSSA directs the Secretary to establish the housing goals after analyzing a number of factors, including national housing needs. HUD's analysis, set forth in the appendices, describes the decline in homeownership rates and the loss of affordable rental stock, and provides background information on the current state of the nation's housing needs. These analyses are not designed as a blueprint for the GSEs' achievement of the housing goals. Nor do they suggest that all those needs identified can or should be met through GSE activities. These analyses do, however, set forth the bases for establishing these goals.

Credit Risk of Multifamily Purchases

Freddie Mac commented that the proposed rule had not adequately addressed the higher credit risk it might face in meeting higher housing goals. Freddie Mac claimed that it would have to purchase ''significantly higher levels'' of multifamily mortgages, a business with a different and higher level of risk than single-family lending. Further, Freddie Mac argued that any additional losses it might experience in order to achieve higher goals would be a direct subsidy on the part of Freddie Mac—something not required by FHEFSSA.

HUD agrees that multifamily financing is a different business than single-family financing, posing a different level of risk. In considering the issue of credit quality in the multifamily market, HUD finds it instructive to compare the levels of activity between the two GSEs. In 1994, Fannie Mae purchased five times as many multifamily mortgages as Freddie Mac. Even after factoring in the relative sizes of the businesses of each GSE—Fannie Mae's overall dollar volume of business is about 25 percent larger than Freddie Mac's—a substantial disparity still exists. Fannie Mae's significantly greater volume of multifamily purchases has not impaired the company's financial health. Further, the economic analysis prepared for this rule does not support the argument that the goals will expose the GSEs to unacceptably high levels of credit risk. Sufficient investment-quality opportunities exist in the marketplace to allow Freddie Mac to achieve all of the housing goals without resorting to the purchase of riskier mortgages.

HUD recognizes that Freddie Mac experienced losses on its multifamily business in the late 1980s, in part because of flawed corporate oversight mechanisms, resulting in Freddie Mac's withdrawal from the multifamily market. However, half a decade has passed since that experience, providing Freddie Mac with sufficient time to develop a multifamily business. Indeed, Freddie Mac has publicly committed itself to this market. Leland Brendsel, Chairman and Chief Executive Officer of Freddie Mac, articulated the GSE's attitude toward this market segment, noting that ''our re-entry into the multifamily market [is] * * * our most important next step in meeting our nation's housing needs. We are committed to having the right people, programs, and systems in place so that our multifamily mortgage purchases will be sustainable over the long term.'' [14] HUD accepts as sincere Freddie Mac's repeated public statements and representations that it is committed to a long-term, meaningful role in the multifamily market; the housing goals take that commitment into account.

[14] Prepared statement of Leland C. Brendsel before the Subcommittee on General Oversight, Investigations, and the Resolution of Failed Financial Institutions of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, April 20, 1994, pp. 4–5.

Market Estimates in Establishing the Goals

In establishing the goals, the Secretary is required to assess, among a number of factors, the size of the conventional market for each goal. HUD developed a straightforward technique for estimating the size of the conventional conforming market for each of the goals. This technique draws on the existing major sources of data on mortgage market activity.

Both GSEs expressed strong criticism of HUD's use of specific data elements in constructing its estimates of market size; for example, estimates of the proportion of 1- to 4-unit rental properties or the levels of multifamily originations. Although both GSEs criticized how data had been interpreted in HUD's market-share models, neither GSE, nor any other commenter, objected to HUD's basic model for calculating the size of the markets relevant to each of the housing goals. However, Freddie Mac provided a detailed set of objections to the use of certain data sources or assumptions, concluding that HUD's market estimates were ''fatally flawed.'' Fannie Mae argued that market estimates employed by HUD ''created an artificial market description based on interpretations of the data available to [HUD], which are not consistent.'' Fannie Mae commented that the Secretary deliberately selected existing data interpretations to yield higher goals. Several other commenters, all industry trade groups, also criticized aspects of HUD's market-share estimates.

Freddie Mac maintained that the flaws in HUD's estimation process would result in goals that were too high, because HUD had overestimated the size of the rental market. Freddie Mac presented a comparison of available market-share estimates, explained deficiencies it believed were present in the data employed by HUD, and claimed that HUD had chosen the least-favorable of the databases that could have been employed in reckoning appropriate goals for the GSEs.

Both GSEs argued that the role of multifamily financing in the mortgage market was consistently overstated in the proposed rule. Freddie Mac provided data to support its assertion that the rule's estimates of multifamily originations overstated both the total amount of originations to be expected and the degree to which multifamily originations are available to the secondary market.

Both GSEs commented that HUD's analysis ignored the impact that changes in national economic conditions can have on the size of the mortgage market. The GSEs noted that their recent efforts to expand the reach of the secondary market in support of lower-income households were assisted by highly favorable interest rates and economic conditions that will likely not persist. Several commenters suggested that HUD consider more fully the impact of changing economic conditions.

In considering the levels of the goals, HUD examined carefully the comments on the methodology used to establish the market share for each of the goals. HUD contracted with the Urban Institute to conduct an independent review that drew upon its resources of well-respected academicians and others in evaluating HUD's methodology. Based on that thorough evaluation, as well as HUD's additional analysis, the basic methodology employed by HUD is a reasonable and valid approach to estimating market share, and Freddie Mac's claim that the methodology is ''fatally flawed'' is without merit.

HUD agrees that a comprehensive source of information on mortgage markets is not available. HUD considered and analyzed a number of data sources for the purpose of estimating market size, because no single source could provide all the data elements needed. In the appendices, HUD has carefully defined the range of uncertainty associated with each of these data sources and has conducted sensitivity analyses to show the effects of various assumptions. Technical papers prepared by the Urban Institute and other academicians support HUD's analysis.

A number of technical changes have been made in response to the comments and the evaluation by outside experts, but the approach for determining market size has not been modified substantially. The detailed evaluations show that the methodology, as modified, produces reasonable estimates of the market share for each goal.

In response to concerns expressed about the volatility of the mortgage markets over time, HUD has taken three steps with regard to the methodology. First, HUD conducted detailed sensitivity analyses for each of the housing goals to reflect economic conditions that are less conducive to homeownership than those that existed during 1993 and 1994. Second, HUD elaborated further on the impact of increased interest rates on long-term affordability and the ability of lower-income households to become homeowners. Third, with regard to volatility in the multifamily market, the Urban Institute, at HUD's request, designed a ''steady-state'' multifamily originations model that produces an alternative means of estimating multifamily originations. This alternative model is designed to generate conservative forecasts of future multifamily loan originations because it omits refinancing activity and balloon loans due to mature in the next several years. This model is less sensitive to year-to-year fluctuations in the historical volume of mortgage originations.

Criticism of the methodology focused, in part, on the estimated size of the multifamily market. The GSEs proposed that HUD use the volume of originations as reported in the Home Mortgage Disclosure Act (''HMDA'') database—$15 billion in 1994—as the accurate number of multifamily originations, as opposed to HUD's $30 billion estimate derived from other data sources. Four of the studies HUD commissioned from the Urban Institute considered various aspects of the multifamily market. HUD also consulted with experts at the Federal Reserve Board, at the Bureau of the Census, and in industry trade groups to assist HUD in carefully evaluating the GSEs' claim that HMDA data provide an accurate number of total multifamily originations.

HUD found a consensus that HMDA data underreports multifamily originations. HMDA, alone, is not an accurate survey of the total market; it was not designed to be one. It includes only information reported by a subset of institutions that originate multifamily loans: large commercial banks, thrifts, and mortgage bankers in metropolitan areas. In addition, HMDA underestimates multifamily lending by both mortgage bankers and commercial banks. The additional analyses conducted in response to the comments support the $30 billion multifamily estimate used by HUD.

Three-Year Rolling Average

Fannie Mae and an industry commenter suggested that HUD measure performance against each goal using a 3-year rolling average. Fannie Mae contended that a 3-year average ''will ameliorate the difficulty that can arise in managing to a specific goal when major factors in the marketplace that are outside of our control can heavily influence our ability to manage to a specific goal level.''

FHEFSSA and the legislative history do not support use of a 3-year rolling average. Instead, they provide a scheme whereby the Secretary is to set goals for each year and performance is to be evaluated during and at the end of each year by the Secretary. FHEFSSA provides that the housing goals are ''annual'' goals. Moreover, if the Secretary determines that there is a substantial probability that the GSE will fail to meet a goal ''*in the current year*'' and a housing plan is required, the housing plan is to describe the actions the GSE will take ''to make such improvements as are reasonable in the remainder of such year.'' [15] Similarly, if the Secretary determines that a GSE has failed to meet a housing goal, the requisite housing plan is to describe the actions the GSE will take ''to achieve the goal for the next calendar year.'' [16] The legislative history also refers to the goals as annual goals.[17]

Interpreting the statute to allow the use of a 3-year rolling average, instead of an annual goal with performance assessed by whether the GSE meets each year's individual goal, would render the statutory provisions insignificant or inoperative. Such a structure would ignore an ''elementary rule of [statutory] construction that effect must be given, if possible, to every word clause and sentence of a statute.'' [18] Accordingly, the Secretary has determined that using a 3-year rolling average was not intended by or permitted under FHEFSSA and, therefore, the final rule contains annual goals. Fannie Mae's root concern—that macroeconomic and other conditions outside its control may render a goal infeasible—is addressed in those provisions of the rule concerning evaluation of GSE performance; these conditions are considered in determining whether a goal was or is feasible. The Secretary can modify a goal, or determine that it was infeasible, if economic conditions change.

Low- and Moderate-Income Goal, Section 81.12

The proposed rule provided that 38 percent of the total number of dwelling units financed by each GSE's 1995 mortgage purchases and 40 percent of their 1996 purchases finance housing for low- and moderate-income families. In 1994, Fannie Mae reported that its performance was 45.83 percent under the Low- and Moderate-Income Goal in the Interim Notice of Housing Goals; Freddie Mac reported its performance as 37.46 percent. As detailed in the appendices, the Secretary determined that the conventional conforming market for this goal is 48–52 percent. This final rule requires that 40 percent of the total number of dwelling units financed by each GSE's mortgage purchases in 1996 and 42 percent in 1997–1999 be affordable to low- and moderate-income families.

Fannie Mae objected to the goal set forth in the proposed rule, recommending a permanent goal of 38 percent, unless and until the economic environment changes significantly. Other commenters stated that the goal was not high enough to challenge the GSEs to increase their mortgage purchases for low- and moderate-income housing. These commenters emphasized the leadership capacity of the GSEs and indicated that an increase in secondary market activity by Fannie Mae and Freddie Mac would help the industry as a whole, because the GSEs' business decisions influence the rest of the market.

The Low- and Moderate-Income Housing Goal established in the final rule is reasonable and appropriate considering the factors set forth in FHEFSSA. HUD addressed the comments on the potential for fluctuations in the market by setting the level of the goal conservatively, relative to market estimates, with the understanding that dramatic changes in the market may require reevaluation of the level of the goal. However, current examination of the size of the market available to the GSEs demonstrates that the number of mortgages secured by housing for low- and moderate-income families is more than sufficient for the GSEs to achieve the goal. Appendices A and D provide extensive detail on the statutory factors considered in establishing the level of the goal.

A number of commenters also requested that the goal include subgoals, targeting a portion of the GSEs' business to multifamily housing and a portion to single-family housing. One commenter also requested the establishment of subgoals to focus a percentage of the GSEs' business on low-income households and another percentage on moderate-income households. Such subgoals would ensure that the GSEs undertake more complex and more time-consuming, and less standard, business to achieve the goal. Subgoals are not established at this time because: (1) The statute provides that subgoals under the Low- and Moderate-Income Goal are unenforceable; (2) subgoals suggest micromanagement of the GSEs' business decisions and unnecessary regulatory interference by HUD; and (3) the Low- and Moderate-Income Goal was designed to focus a portion of the GSEs' business on housing for both low- and moderate-income families, whether that housing is single-family or multifamily, rental or owner-occupied: a unitary goal should achieve this purpose.

Central Cities, Rural Areas, and Other Underserved Areas Goal, Section 81.13

This section of the preamble discusses the public comments on the Central Cities, Rural Areas, and Other Underserved Areas Goal (''Geographically Targeted Goal''), first for urban and then for rural mortgage purchases financing housing in these areas. It also addresses a cross-cutting issue of the legal basis for defining the Geographically Targeted Goal in the manner implemented by this rule.

Level of Geographically Targeted Goal

The Central Cities, Rural Areas, and Other Underserved Areas Goal (''Geographically Targeted Goal'') is established in this rule at 21 percent of GSE business in 1996, and 24 percent in 1997–1999. Under the proposed rule, the Geographically Target Goal would have been established: for 1995, at 18 percent; for 1996, at 21 percent; for 1997 and 1998, a percentage ranging from 21 percent to the proportion or percentage or mortgages qualifying under the goal that are originated in that year's market (''the amount of the market'') or the amount of the market plus an additional percentage; and for each year after 1998, a percentage ranging from 21 percent to the amount of the market or the amount of the market plus an additional percentage or, if HUD does not set an annual goal for those years, the goal for such years shall be the same as the most recent goal established by HUD pending further adjustment by HUD through rulemaking. In Appendix D, HUD estimates that the mortgage market in the areas covered by this goal will account for 25–28 percent of the total number of newly mortgaged dwelling units. In 1994, 29 percent of Fannie Mae's purchases financed dwelling units located in all underserved areas, as defined in the final rule, compared with 24.2 percent of Freddie Mac's purchases.

Mortgage Purchases in Metropolitan Areas, Including Central Cities and Other Underserved Areas

The rule provides that for properties in metropolitan areas, mortgage purchases will count toward the goal when such purchases finance properties that are located in census tracts where either the median income of families in the tract does not exceed 90 percent of the area median income, *or* minorities comprise 30 percent or more of the

[15] Section 1336(c)(2)(B).

[16] Section 1336(c)(2)(A).

[17] *See, e.g.,* S. Rep. No. 282, 102d Cong., 2d Sess, at 5 (1992) (S. Rep.); H.R. Rep. No. 206, 102 Cong., 1st Sess., at 34 and 36 (1991) (H. Rep.); 138 Cong. Rec. S8607 (daily ed. June 23, 1992) (statement of Sen. Riegle); 138 Cong. Rec. S17908 (daily ed. Oct. 8, 1992) (statement of Sen. Cranston).

[18] 2A Norman J. Singer, *Sutherland on Statutory Construction* § 46.06 (5th ed. 1993).

residents and the median income of families in the tract does not exceed 120 percent of the area median income. This definition has been revised from that in the proposed rule which encompassed areas at 80 percent (rather than 90 percent) of median income.

As detailed in Appendix B, this goal emerges from HUD's consideration of the six statutorily mandated factors for establishing the goal, supported by HUD's and other researchers' analyses of mortgage lending data. The final rule's use of a census-tract-based approach to identify underserved metropolitan areas is supported by the legislative history of FHEFSSA.

The final rule's definitions of central cities and other underserved areas, as the underserved census tracts of these areas, encompass 47 percent of metropolitan census tracts and 44 percent of metropolitan residents. The average mortgage denial rate in these tracts is 21 percent—almost twice the denial rate in the non-included tracts. The definition in the final rule adds 3,657 tracts to the definition in the proposed rule. These added tracts also have significant problems with access to mortgage credit, as evidenced by relatively high mortgage denial rates.

The commenters' recommendations for the underserved area definition as it applies to central cities and other underserved areas can be organized into three categories: (1) count all mortgages in OMB-defined central cities; (2) count mortgages in certain census tracts, as in the proposed rule or defined more broadly than under the proposed rule; and (3) modify the list of OMB-defined central cities to include or exclude various cities.

Tract-Based Versus Whole-City Approaches

Fannie Mae strongly objected to HUD's census-tract-based formulation of this goal, insisting that the goal should include ''central cities,'' as defined as such on lists issued periodically by OMB, in addition to high-minority or low-income census tracts in the remaining portions of metropolitan areas as well as rural areas. Fannie Mae's objections were based on both policy and legal arguments; the discussion of the policy issues follows immediately and the legal arguments are considered at the end of this section of the preamble.

Fannie Mae commented that its experience in developing partnerships with central cities demonstrates that including only underserved segments of central cities and rural areas, thereby focusing Fannie Mae's attention especially on low-income or minority communities, would be a mistake. Fannie Mae stated that ''community leaders, Congress, and many national policy makers argue that the health of low-income and minority communities within central cities is tied directly to the overall health of the community.''

A number of commenters also disagreed with the proposed rule's use of a census-tract-based approach, arguing that it did not reflect the manner in which political leaders, real estate professionals, and lenders work in cities. According to the Mortgage Insurance Companies of America, ''rewriting the geographic goals to narrow them substantially is inconsistent with the objective of improving cities.'' The MBA expressed concern that the criteria for the Geographically Targeted Goal would exclude areas that are experiencing or are about to experience ''transitioning minority and low-income demographic patterns''; MBA recommended that HUD broaden the areas covered. The National Association of Realtors (NAR) noted that, conceptually, excluding certain parts of central cities from the definition should not result in less mortgage activity for those cities, because ''such an approach could actually improve overall credit flows by focusing GSE attention on those specific areas most in need.'' However, NAR went on, ''actual marketplace dynamics are more complex than the theory,'' and called for a ''more holistic approach to addressing the mortgage credit needs of the central cities.''

Other commenters supported the idea of targeting by means of census tracts, as proposed. Although Freddie Mac commented that the scope of the goal should be broadened, Freddie Mac ''applaud[ed] the Secretary's general methodological approach in defining what areas should be included'' in the Geographically Targeted Goal. Representative Joseph P. Kennedy ''strongly support[ed] the idea of not using the OMB definition of central cities for this goal, since it is clear that the OMB definition does not identify areas underserved by the mortgage markets.'' The American Bankers Association (ABA) commented that using the OMB list of central cities ''has not done enough to focus the GSEs on the truly underserved portions of urban markets;'' it favored targeting the GSEs' activities on underserved areas, rather than entire cities. The Local Initiatives Support Corporation (LISC) agreed that jurisdictional boundary lines were not particularly useful in identifying places that need better access to mortgage credit and noted with approval that the proposed rule ''dovetails with new regulations implementing the Community Reinvestment Act which also focus on low-income geographies.''

HUD's Analysis of Metropolitan Underserved Areas

Under FHEFSSA, HUD may define the terms ''central cities'', ''rural areas'', and ''other underserved areas''. The research conducted by the GSEs, other mortgage-market economists, and HUD supports the premise that the location of a census tract—whether it is within a central city or not—has minimal impact on whether the tract is underserved. Instead, these studies have found that mortgage availability in a census tract is strongly correlated with the minority concentration or median income of that tract. The most thorough studies available demonstrate that areas with lower incomes and higher shares of minority residents consistently have poorer access to mortgage credit, with higher denial rates and lower origination rates for mortgages. With income, minority composition, and other relevant census tract variables controlled for, differences in credit availability between central cities and suburbs are minimal.

Under its contract with HUD, the Urban Institute evaluated the proposed definition of central cities and underserved areas, as well as the use of various alternatives advanced by commenters. The Urban Institute researchers criticized the use of the OMB definition of central cities—encompassing all areas of designated cities—because that definition treats all areas in central cities as if they have equal mortgage-access problems, when, in fact, areas within central cities are not homogeneous in this regard.[19] Use of the OMB definition of central cities, as advanced by Fannie Mae, would add 8,833 central city tracts to the 13,554 central city tracts included under this final rule's definition. Credit access is not a problem in these added tracts—their mortgage denial rate is 11 percent, or half of the average denial rate in the tracts covered by this final rule. Based on comparisons such as these, HUD has concluded that a targeted approach for defining underserved areas is required, to target the goal and the GSEs' activities to assuring access to mortgage credit in central cities.

HUD considered the comments that this goal should facilitate coordination of GSE outreach with the efforts of city governments to expand investment in

[19] Urban Institute, George Galster, ''Comments on Defining 'Underserved' Areas in Metropolitan Regions,'' prepared for the U.S. Department of Housing and Urban Development, August 15, 1995.

their jurisdictions. The Secretary does not believe the more targeted approach adopted in this rule inhibits such valuable coordination. Many urban revitalization programs and reinvestment efforts, in fact, target specific neighborhoods and areas, rather than an entire city. These programs operate on the common-sense premise that targeting all areas would result in no meaningful targeting. Cities use a neighborhood-based approach, for example, in implementing their Community Development Block Grant programs, defining enterprise communities and empowerment zones, and focusing the activities of redevelopment authorities.

HUD also considered the argument that the lending industry is oriented toward market areas defined in city-wide terms. However, the lending industry does not generally approach lending activity from a city-wide perspective. Lenders generally try to achieve geographic diversification within a city, making distinctions among submarkets. Further, the efforts of lenders to comply with the Community Reinvestment Act [20] are clearly census-tract-based and are targeted to neighborhoods, not to all parts of a city.

Broaden Tract-Based Approach

Freddie Mac's major observation on the scope of the goal was that the definition of underserved areas should be expanded to include census tracts where: (1) the median income of families is not greater than 100 percent of the area median income; or (2) 20 percent or more of the residents in the census tracts are minority.

This alternative definition would add substantially more tracts to the goal, and these tracts have substantially lower denial rates than the tracts included under the final rule. This is noteworthy because it indicates that Freddie Mac believes that access to credit is more limited in more areas throughout the nation than does HUD. The mortgage credit denial rate for the tracts added by the Freddie Mac definition is 15 percent, which is only slightly higher than the denial rate for all metropolitan areas and is significantly less than the 21 percent denial rate in the tracts covered by the goal established in the final rule.

Freddie Mac commented further that if the Secretary increased the scope of the goal to include moderate-income census tracts, a broad, geographically-based goal would be established, which would be consistent with the Low- and Moderate-Income Goal and Congress's intention not to ''force the enterprises to 'target' to meet niche markets.'' HUD does not believe that the final rule's definition, which covers nearly half of all metropolitan residents, defines a niche market.

Finally, HUD notes in response to criticism that the goals overlap, that the three goals established by Congress are distinct. In contrast to the other goals, income of borrowers is not used in the Geographically Targeted Goal as a requirement, but as a proxy for those areas that are underserved by mortgage markets, based on the lower origination and higher denial rates found in low-income census tracts. The Geographically Targeted Goal does not depend on the income or minority status of the individual borrower; the location of the property determines whether units count under the goal. Some overlap, however, among the goals can be expected, given the close relationship between the purposes of serving low- and moderate-income families and promoting ''access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) * * *.'' [21] To the extent that overlap exists, the rule takes this into account, by providing that mortgage purchases may count toward each of the goals.

Modify OMB List of Central Cities

Fannie Mae suggested that HUD could exclude from the OMB ''central cities'' list some central cities that do not qualify, statistically, as underserved. MBA, which recognized problems with the OMB list, and the National Association of Affordable Housing Lenders recommended developing criteria for excluding well-served cities from the OMB list. A large mortgage company commented that the Secretary should use OMB's list of central cities and then add other cities that clearly have underserved needs, but are not on OMB's list. The National Association of Home Builders (NAHB) recommended that HUD develop a formula for excluding from the OMB list the higher-income cities, and then adding ''underserved'' areas of other central cities and certain other non-rural jurisdictions.

The Secretary has carefully considered whether modifying the OMB list of Central Cities will address the fundamental concern with continued use of the OMB definition: is it consistent with the congressional intent to focus a portion of the GSEs' business on communities that are underserved by the mortgage markets? Modifying the OMB list to eliminate well-served cities, or retaining the OMB list and adding distressed non-central cities, does not meet this fundamental concern. In most cities, some parts are not underserved. Retaining the bulk of OMB-defined central cities would include many well-off areas that are not experiencing mortgage credit problems, and it would not appropriately focus the GSEs on those urban neighborhoods that require particular attention from the mortgage markets.

Mortgage Purchases in Nonmetropolitan Areas

The final rule provides that for properties in non-metropolitan areas, mortgage purchases will count toward the Geographically Targeted Goal where such purchases finance properties that are located in counties where: either minorities comprise at least 30 percent of the residents and the median income in the county does not exceed 120 percent of the State nonmetropolitan median income; *or* the median income does not exceed 95 percent of the greater of the State or nationwide nonmetropolitan median income.[22]

This section of the preamble briefly discusses the nature of rural lending, describes the basic characteristics of HUD's definition of rural areas, and provides HUD's responses to comments received on the definition of rural areas.

Problems in Rural Lending

Defining ''rural areas'' requires a different approach than defining ''central cities'' and ''other underserved areas'' because of the lack of mortgage data in nonmetropolitan areas, differences in housing needs between urban and rural areas, and the difficulty of implementing mortgage programs at the census tract-level [23] in rural areas. As discussed in Appendix B, evaluating which rural locations are underserved in terms of access to mortgage credit cannot be done with HMDA data, on which HUD mainly relied in defining urban underserved areas. There are few conclusive studies on access to mortgage credit in rural areas, and the studies that do exist only suggest broad

[20] The Community Reinvestment Act, 12 U.S.C. 2901 *et seq.*, generally requires financial institutions to meet the credit needs of the communities in which the institutions are located.

[21] Sections 1381(a)(4) and 1382(a)(4) of FHEFSSA.

[22] In New England, portions of counties that are outside metropolitan areas are used in place of counties.

[23] Block Numbering Areas (BNAs) in rural areas correspond to census tracts in metropolitan areas. For the sake of simplicity, in this section this rule refers to BNAs as census tracts.

conclusions about credit flows in these areas.

For this reason, HUD consulted with researchers from academia, the Department of Agriculture (USDA), the Census Bureau, and the Housing Assistance Council (HAC). HUD also conducted a series of forums to solicit information on rural mortgage markets from rural lenders, rural housing groups, and the GSEs. The discussions at the forums focused on the unique nature of mortgage lending and the role of the secondary market in rural areas.

Mortgage lending in rural areas is very different from lending in urban areas. The heterogeneity of housing types, the nontraditional and often seasonal incomes of rural borrowers, and the lack of credit history for many rural borrowers make underwriting in rural areas difficult for lenders. Appraisers lack comparable sales data or must rely on comparables over 1-year old or in a nearby town in order to determine the value of a property.

Participation of rural lenders in the secondary market is limited. The low volume of loans originated by rural lenders serving smaller rural communities makes rural lending business less profitable, and thus less attractive, to secondary market firms. Based on 1991 Residential Finance Survey data, which is supported by information from rural lenders and the USDA, rural lenders are more likely than urban lenders to make short-term loans, 3- to 5-year balloon mortgages, or adjustable rate mortgages and to hold mortgages in portfolio. Larger financial institutions, which have experience with the secondary market, often target the larger rural communities and focus less on remote areas.

Some studies report significant barriers to accessing mortgage credit in remote areas and areas with high concentrations of minorities and low-income households. Barriers include lower lender participation in Federal mortgage credit programs such as those of the Rural Housing and Community Development Service, the Federal Housing Administration, and the Department of Veterans Affairs, lack of financial capacity among lenders, lack of private mortgage insurance, and a decreasing number of lending institutions located in rural communities as a result of the savings and loan crisis of the 1980s.

Characteristics of HUD's Rural Areas Definition

Recognizing both the difficulty in defining rural areas and the need to encourage GSE activity in such areas, HUD has chosen a relatively broad, county-based definition of rural areas as the underserved areas outside of a metropolitan area. HUD's definition includes 1,511 of the 2,305 counties in nonmetropolitan areas and accounts for 54 percent of the nonmetropolitan population.

Response to Public Comments

County-Based Definition. Most commenters, including the GSEs, had argued that a definition based on rural census tracts was ill-advised because lenders in rural areas do not understand or lend on the basis of census tracts. Fannie Mae commented that census tracts have ''no practical meaning'' in rural areas from a marketing standpoint and that geographic measurements used in the rule should be ''widely understood, easily measured, and practical from a marketing point of view,'' but that census tracts in rural areas ''fail these tests.''

Freddie Mac joined Fannie Mae in arguing that the use of a rural definition based on census tracts was ill-advised because of geocoding inaccuracies.[24] Freddie Mac added that the rule, as proposed would have automatically excluded single census-tract counties, such as parts of Texas, which, Freddie Mac noted, include some of the poorest counties in the country.[25]

In contrast, some commenters, such as HAC, noted that a county-based definition is not as targeted as a tract definition, because it excludes tracts that could be considered underserved in otherwise-served counties and includes tracts that could be considered adequately served in underserved counties. HAC cited its own analysis of a multitude of data and commented that the appropriate criterion for rural underserved areas would be census tracts with at least 20 percent minority residents and not more than 100 percent of area-wide median income, and that the secondary ''income-only'' criterion should be 90 percent of area-wide median. HAC presented statistical evidence to show that its recommended definitions would: (1) capture a higher percentage of underserved nonmetropolitan areas; and (2) solve the problem of omission of census tracts with predominantly white populations. HAC also recommended supplementing the income and income/minority population criteria with a special rural area criterion related to remoteness (such as the Beale codes[26]) and sparse population.

This final rule uses the county designation, rather than a census tract-based definition. Counties are easy to identify and geocode, which will simplify the reporting process for lenders who provide the GSEs with loan-level data on mortgages. County boundaries in rural areas are commonly recognized by housing industry representatives involved in the loan and marketing process, including lenders and appraisers.

Even though HUD recognizes that a census-tract definition better targets underserved areas, HUD has decided to use a county-based definition in rural areas because the operational difficulties associated with applying census tract boundaries outweigh the benefits of improved targeting of underserved rural areas. HUD recognizes that, under its county-based definition, the GSEs could achieve the goal by purchasing mortgages primarily located in the parts of underserved counties that have higher incomes. Although 21 percent of the homeowners who live in underserved counties under this definition reside in served tracts, these tracts accounted for 39 percent of GSE purchases in 1994. HUD will require the GSEs to continue to report nonmetropolitan mortgage purchases at the tract level as they have done for 1993 and 1994, to enable HUD to assess the desirability of refinement of the definition in the future.

Area for Median Income. Both Freddie Mac's and Fannie Mae's comments on the proposed rule's census tract definition in non-metropolitan areas recommended that tract median income be compared to the greater of county median income or statewide nonmetropolitan median income, to ensure the inclusion of poor tracts in poor counties. Freddie Mac noted that using only county median income could have the result that census tracts ''that would be considered poor by any realistic measure * * * would nonetheless be excluded from the goal's coverage because they happen to be in a very poor county.'' Accordingly, for purposes of the definition of ''rural areas,'' the rule's new definition of ''underserved areas'' provides that the median income for a county is compared to the greater of State or nationwide nonmetropolitan median

[24] Geocoding is the process by which a lender or the GSE identifies the location of a property's address by census tract, postal code, or some other geographic identifier.

[25] Freddie Mac noted that, by definition, these tracts will have median family income equal to 100 percent of the county [tract] median, thus making them, under the proposed rule, ineligible for the Geographically Targeted Goal based on income.

[26] Beale codes are used by the Economic Research Service (ERS) to classify nonmetropolitan counties according to urban population size and adjacency to metropolitan areas.

income. Comparing county median income to the greater of statewide nonmetropolitan or nationwide nonmetropolitan median income ensures that poor counties in poor States will be included in the definition of rural areas.

Moreover, the addition of the nationwide designation of median income addresses a concern expressed by HAC that the proposed definition cover states that have counties with high poverty rates but low minority concentrations. With the nationwide designation, counties in poor States, such as Fulton County, Kentucky, which has a 30 percent poverty rate, will be included as rural areas. The county median income is low relative to national median income, but not low relative to State median income. Without availability of comparison to nationwide income, Fulton County would not be considered a rural area.

Remote Areas. HAC expressed concern that remote rural areas are more likely to be underserved than those closer to urban areas. NAHB also addressed the issue of rural remoteness and recommended that HUD include counties in certain Beale Codes based on their rural character, low urbanization, and non-adjacency to a metropolitan area. The rule's revised nonmetropolitan county definition adequately targets remote counties. The definition picks up 84 percent of the population that reside in remote counties, as determined by Beale Codes.

Geographic Coverage of Rural Areas and Demographic Indicators. HUD uses two demographic indicators—median income and minority concentration—to identify rural areas. These two indicators correlate with the common characteristics of underservedness. Fannie Mae recommended that the rural definition include no demographic indicators, stating ''the geographic goal was not supposed to focus on fractions of geographic areas.'' Fannie Mae's definition of rural areas, therefore, would include all nonmetropolitan counties. As noted below, HUD does not agree that the Geographically Targeted Goal was meant to include all rural areas.

Freddie Mac suggested that HUD use a definition covering rural areas where median income was at or below 100 percent of State median or where 20 percent of the population was minority. Under Freddie Mac's definition, 221 counties in addition to those covered by the definition on the final rule, covering an additional 5.97 million people, would be considered rural areas. Because HUD does not consider these additional counties as being underserved by the mortgage market, HUD is not including these additional counties in its definition of rural areas.

Legal Authority To Limit Goal to Underserved Portions

As noted above, part of Fannie Mae's justification of a definition using whole ''central cities'' as defined by OMB was based on Fannie Mae's interpretation of FHEFSSA. HUD believes that Fannie Mae has interpreted the statutory language too narrowly, and that FHEFSSA did grant HUD latitude to select from among reasonable definitional approaches to establish a goal that is appropriately targeted toward areas underserved by the mortgage lending industry.

Fannie Mae's comments and an opinion prepared for Fannie Mae by the law firm of Arnold and Porter, and submitted with Fannie Mae's comments, raised several legal objections to the proposed rule. One argument was that HUD cannot apply the qualifier ''underserved'' to limit central cities or rural areas to only portions of central cities or rural areas that are underserved.

While FHEFSSA does not refer to ''underserved areas of central cities'' or ''underserved areas in rural areas,'' a general rule of statutory construction provides that, to determine the word or words to which the antecedent applies, one may look to legislative history.[27] ''Where the sense of the entire act requires that a qualifying word or phrase apply to several preceding or even succeeding sections, the word or phrase will not be restricted to its immediate antecedent.''[28]

The legislative history of FHEFSSA makes clear that the goal is to address underserved areas. In explaining the conference bill on the floor of the Congress, then-Chairman Gonzalez stated: ''In establishing the definition of a central city and in determining compliance with such a goal, the Secretary should, to the extent possible, exclude purchases made in non-low income census tracts that happen to otherwise be within the central cities area.''[29] Focusing on ''inner-cities'' rather than entire OMB cities, the legislative history provides that ''[t]he purpose of these goals is * * * to service the mortgage finance needs of low- and moderate-income persons, racial minorities and *inner-city* residents,'' and noted that ''mortgage discrimination and redlining have effectively disadvantaged certain geographic areas, particularly *inner city* and rural areas.''[30]

The ''Plain Meaning''

Fannie Mae commented that the plain meaning of FHEFSSA had been breached by HUD in changing the definition of ''central cities'' from the transition definition and that Congress did not intend that HUD revise that definition in the years following the 2-year transition period. For the transition years of 1993–94, FHEFSSA mandated that the Geographically Targeted Goal be directed only to ''central cities'' as defined by OMB, and HUD extended this approach to 1995 by regulation. However, following the transition, FHEFSSA authorized the Secretary to define central cities and to expand the goal to target ''rural areas'' and ''other underserved areas.'' Fannie Mae commented that Congress intended that only ''other'' underserved areas—that is, areas in addition to central cities and rural areas generally (which, Fannie Mae declared, also were to be considered ''underserved'')—be subject to HUD redefinition in the rule. Fannie Mae commented that ''Congress actually provided the definition of 'central cities' in the subsection on the two-year transition period. . . . There is no indication in the statute that Congress intended the definition of 'central cities' to be restricted or narrowed after the two-year transition period.''

Section 1334(d)(3) of FHEFSSA did define ''central cities'' as the OMB list of central cities. Congress, however, placed that definition in the transitional provisions of the Geographically Targeted Goal and thereby limited it to the transition period (1993–94). Had Congress chosen for HUD to continue using that definition after the transition period, Congress could have placed the definition in the general definition section of FHEFSSA. Congress did not do so.

Fannie Mae's argument that HUD must continue with the transition period definition of central cities would effectively render superfluous the language of the statute that explicitly limits the application of the definition to the transition period. The argument,

[27] *United States v. Brandenburg,* 144 F.2d 656, 660–61 (3d Cir. 1944) (''a clause modifies that antecedent which the draftsman intended it to modify'').

[28] *Sutherland* §§ 47.33 and 47.26. *See also State v. McGee,* 122 Wash.2d 783, 864 P.2d 912, 914 (1993); *Nemzin v. Sinai Hospital,* 143 Mich. App. 798, 372 N.W.2d 667, 668–69 (1985).

[29] 138 Cong. Rec. H11453, H11457 (daily ed. Oct. 5, 1992). Rep. Gonzalez made the identical statement at 138 Cong. Rec. H11077, H11099 (daily ed. Oct. 3, 1992).

[30] S. Rep. at 32, 34, and 41 (emphases added). *See also* 138 Cong. Rec. S8606 (daily ed. June 23, 1992) (statement of Sen. Riegle) (''inner-city lending * * * is a very important part of this legislation'').

thus, would controvert the general rule of statutory construction that effect must be given, if possible, to every word, clause and sentence of a statute.[31] ''A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant, and so that one section will not destroy another unless the provision is the result of obvious mistake or error.''[32]

''Rural Areas'' and ''Central Cities'' Are Not Terms of Art

Fannie Mae also asserted that ''central cities'' is a term of art in housing legislation and that ''rural areas'' has a clear meaning. Fannie Mae commented that OMB has never limited its list of cities in the manner contemplated by the proposed rule. HUD's definition, therefore, is inconsistent with commonly understood meaning and contradicts FHEFSSA's purpose. Fannie Mae argued that the definition of ''central cities'' for the transition period ''is a clear indication of the type of definition that Congress had in mind when considering this goal.''

The terms ''central cities'' and ''rural areas'' are not terms of art and do not have clear meanings. While other statutes and regulations contain definitions of ''central cities'' and ''rural areas,'' these definitions are not uniform. With respect to ''central cities,'' the fact that Congress felt the need to define ''central cities'' for the transition period indicates that the term may have more than one reasonable interpretation. In fact, different Federal agencies define central cities differently.[33]

Fannie Mae's comments concede that the term ''rural areas'' has no established meaning in housing legislation. While other statutes and regulations contain definitions of ''rural areas,'' these are not uniform.[34] Moreover, while the terms ''central cities'' and ''rural areas'' have been used in other statutes, the purposes of those statutes have been very different, *i.e.,* they have not been designed to set goals for providing mortgage credit to such areas. For example, OMB's statutory authority for defining central cities is the Paperwork Reduction Act, and OMB's purpose is to define areas that are ''central'' to a large geographic area. OMB established criteria for central cities which were relevant to this charge. Were HUD to focus on the same criteria, HUD would be taking into account factors that are not directly relevant to determining whether an area is underserved by mortgage credit.

The construction given to a term in one statute is not to be imparted to the construction of the same or similar term in another act, or even another section of the same act, if the purposes of the two acts or sections are different.[35] Given the different purposes of the statutes and regulations defining ''central cities'' and ''rural areas,'' those definitions do not bar HUD from, and in fact mitigate in favor of HUD's, adopting definitions for these terms more consistent with the overall structure and purposes of FHEFSSA and its legislative history.

Special Affordable Housing Goal, Section 81.14

FHEFSSA requires the Secretary to establish Special Affordable Housing Goals for the GSEs' mortgage purchases on rental and owner-occupied housing to meet the then-existing unaddressed needs of, and to be affordable to, low-income families in low-income areas and very-low-income families. Under the proposed rule, the goal was equally divided between rental (single-family and multifamily) and owner-occupied housing. The rental portion of the goal was targeted to very-low-income families while the owner-occupied portion targeted very-low-income families in addition to low-income families in low-income areas.

In response to comments received and upon further consideration by the Secretary, this final rule substantially changes the proposed rule's formulation of the Special Affordable Housing Goal. First, mortgage purchases financing housing for low-income renters in low-income areas now count toward achievement of the goal. Second, the equal division between rental and owner-occupied housing has been removed. Instead, each GSE may choose the type of housing (rental, owner-occupied, single-family, or multifamily) to finance to achieve the goal. However, the goal does require a set minimum of each GSE's purchases to be multifamily mortgages. Finally, the goal allows dwelling units affordable to low-income families in multifamily properties to count where thresholds, based on the LIHTC thresholds, are met.

The final rule provides that the Special Affordable Housing Goal for 1996 is 12 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The goal for 1997–1999 and pending new goals is 14 percent. Of the total Special Affordable Housing Goal, each GSE must annually purchase multifamily mortgages in an amount at least equal to 0.8 percent of the total dollar volume of mortgages purchased by the respective GSE in 1994. In Appendix D, HUD estimates that 20–23 percent of the conventional conforming mortgage market would qualify under the Special Affordable Housing Goal. In 1994, 16.7 percent of Fannie Mae's purchases financed dwelling units that would count toward the achievement of this goal, as defined in the final rule, compared with 11.4 percent of Freddie Mac's purchases. In 1994, Fannie Mae purchased $1.91 billion of mortgages on multifamily housing that would have counted toward the achievement of this goal, or 1.25 percent of its total 1994 business. In 1994, Freddie Mac purchased $425 million of mortgages on multifamily housing that would have counted toward this goal, or 0.36 percent of its total 1994 business.

Rental and Owner Subgoals

Both GSEs' objected to the fact that the proposed rule would have imposed a 50–50 split between rental and owner-occupied housing for the Special Affordable Housing Goal. Fannie Mae commented that the Secretary ''failed to provide an acceptable rationale'' for dividing the Special Affordable Housing Goal equally between rental and owner-occupied dwelling units and provided ''no compelling justification'' for such a split. Freddie Mac also commented that the creation of subgoals for rental and owner-occupied housing made it more difficult to attain the overall goal—even under circumstances in which performance on the owner-occupied subgoal might far surpass the level set by the regulation.

[31] *Sutherland* § 46.06. *See also United States v. Menasche,* 348 U.S. 528, 538–39 (1955); *Moskal v. United States,* 498 U.S. 103, 109–10 (1990).

[32] *Sutherland* § 46.06. *See also United States v. Talley,* 16 F.3d 972, 975–76 (8th Cir. 1994); *Bridger Coal Co./Pacific Minerals, Inc. v. Director, Office of Workers' Compensation Programs, United States Dept. of Labor,* 927 F.2d 1150, 1153 (10th Cir. 1991).

[33] *Compare* 55 Fed. Reg. 12155 (Mar. 30, 1990) (definition of ''central cities'' used by the Statistical Policy Office of OMB) *with* 41 C.F.R. § 101–17.003–35 (General Services Administration's Federal Property Management Regulations).

Related definitions used by the Bureau of the Census, define ''urbanized area central places'' in a manner which indicates that the ''central'' area could be only a portion of a political unit. The Bureau of the Census provides that for extended cities, an ''urbanized area central place'' includes those metropolitan area central cities entirely or partially within the urbanized area, but that only the urban portion of an extended city is classified as central. 55 Fed. Reg. 42593 (Oct. 22, 1993).

[34] *See, e.g.,* 42 U.S.C. 11501(a)(2)(B); 24 CFR 596.3 (definition based on having population of less than 50,000 and being outside of a Metropolitan Statistical Area (MSA)); 12 U.S.C. 2019(b)(3) (definition based simply on having a population of 2500 or less); 42 U.S.C. 294o(e) (definition based simply on being outside of an MSA).

[35] *Laffey v. Northwest Airlines, Inc.,* 567 F.2d 429, 461–62 n. 230 (D.C. Cir. 1976), *cert. denied,* 434 U.S. 1086 (1978).

Fannie Mae also commented that the even split between rental and owner-occupied housing would ''significantly alter'' the basic character of the goal. While Fannie Mae achieved all four subgoals during the transition years 1993–1994, Fannie Mae stated that it had done so by ''significantly larger margins'' in its single-family business, and that this relative ease in meeting subgoals in owner-occupied housing reflected the relative shares of Fannie Mae business represented by single-family and multifamily acquisitions.

Congress intended that the Secretary have broad authority to redesign the sub-categories under the goal. The Senate Report states, ''During a transition period, specific dollar amounts are set for four separate income and housing categories to emphasize that each of these areas needs attention. After the experience of the first two years, the [Secretary] may redesign the categories to target more effectively low-income family needs and reflect any gaps in GSE performance.'' [36] Moreover, FHEFSSA provides that goals should be established for ''rental and owner occupied housing.'' [37] The Secretary considered the statutorily prescribed factors in section 1333(a)(2) prior to establishing the proposed goal and, therefore, the Secretary's actions were neither arbitrary nor capricious. Notwithstanding the fact that the proposed rule would have withstood judicial scrutiny, the Secretary determined for policy reasons to revise the Special Affordable Housing Goal. These revisions include removing the 50–50 split between renter and owner-occupied housing, and replacing it with a more flexible division.

Level of Special Affordable Housing Goal

Freddie Mac commented that the Special Affordable Housing Goals proposed for 1995 and 1996 are ''unrealistically high and very likely infeasible within the meaning of the Act.'' Fannie Mae agreed, arguing that the proposed level of the goal is unreasonable and recommending that the Secretary establish the Special Affordable Housing Goal at no more than 8 percent. Fannie Mae considered the proposed 11 and 12 percent goals ''less unreasonable'' if the Special Affordable Housing Goal included low-income renters in low-income areas. Other commenters, largely nonprofit organizations, felt that the proposed goals both for home ownership and rental housing were too low.

The levels of the Special Affordable Housing Goal in the proposed and final rules are both feasible and reasonable. The Special Affordable Housing Goal is consistent with updated and further refined market share data and analyses, and is reasonable given the GSEs' past performance. While the specifics of the analyses are detailed in Appendices C and D, the major findings supporting this goal level are summarized below.

The proposed rule contained an appendix that analyzed market share data from the American Housing Survey and HMDA. That analysis demonstrated that the GSEs were purchasing much smaller proportions of mortgages of very-low-income families originated by the market than they were purchasing loans of higher-income families. Based on additional and updated analysis of the market data, the original conclusion, discussed in the proposed rule—that there are available mortgages in the very-low-income end of the mortgage market for the GSEs to increase the share of very-low-income mortgage originations they purchase—is unchanged. Additionally, analysis of market share estimates indicates that approximately 20–23 percent of the conventional conforming mortgage market would qualify under the Special Affordable Housing Goal as it is defined in the final rule. This analysis provides further support that the Special Affordable Housing Goal is both feasible and eminently reasonable.

The GSEs' 1994 performance also indicates that the goal is achievable. Using the final rule's conventions for what will count toward the goal, 16.7 percent of Fannie Mae's 1994 business and 11.4 percent of Freddie Mac's would have qualified under the goal.

Authority To Establish Special Affordable Subgoals

Freddie Mac commented that FHEFSSA provides that the Secretary shall establish ''a'' Special Affordable Housing Goal. Freddie Mac argued that the Secretary's proposed approach to implementing the Special Affordable Housing Goal was not authorized by law because, as proposed, it was either two completely separate goals (one for rental housing and one for owner-occupied housing) or one goal with two subgoals.

FHEFSSA authorizes the Secretary, both during the transition and thereafter, to establish the goal and define portions thereof. It does not indicate that subgoals are unenforceable or otherwise prevent the Secretary from defining enforceable portions. For the transition period, FHEFSSA itself subdivided the Special Affordable Housing Goal into two separate portions—single-family and multifamily—and went on to define specifically what counted towards each portion. For the period following the transition, FHEFSSA provides that the Secretary ''shall establish a special affordable housing goal.'' [38] FHEFSSA did not define the structure of the goal, but specified that it should meet the then-existing unaddressed needs of low-income families in low-income areas and very-low-income families. The legislative history indicated that, following the transition, the Secretary was to redefine the goal. Under FHEFSSA and legislative intent, the Secretary has adequate flexibility to adjust the goals ''to target more effectively low-income family needs and reflect any gaps in GSE performance.'' [39]

Freddie Mac also commented that section 1333 of FHEFSSA, in establishing the Special Affordable Housing Goal, does not refer to subgoals. Freddie Mac emphasized that, in contrast, section 1332 of FHEFSSA, establishing the Low- and Moderate-Income Housing Goal, and section 1334, establishing the Geographically Targeted Goal, specifically provided that the Secretary may establish subgoals. To Freddie Mac, the omission of a similar provision from section 1333 means that such subgoals are not authorized. Freddie Mac relies on the doctrine of *in pari materia,* which provides that statutes dealing with the same matter or subject shall be construed together. Thus, Freddie Mac argues that sections 1332–34 deal with the same matter, *i.e.,* housing goals, and that the Secretary failed to construe those sections together.

The provisions on subgoals referred to by Freddie Mac at sections 1332 and 1334 concerning the Low- and Moderate-Income Housing Goal and the Geographically Targeted Goal provide that while the Secretary may establish subgoals, they are not enforceable. The omission of a similar provision in section 1333 is not an indication that subgoals or subcategories within the overall goal are prohibited; rather, such omission indicates that to the extent that subgoals or subcategories are promulgated for the Special Affordable Housing Goal, no bar exists to enforcing them. Since section 1333 contemplates the use of enforceable subgoals or subcategories, section 1333 does not include the same type of restriction against enforcing subgoals as do sections 1332 and 1334.

[36] S. Rep. at 37.

[37] Paragraph 1333(a)(1).

[38] Section 1333(a)(1) (emphasis added).

[39] S. Rep. at 37.

Rental Versus Multifamily

A number of commenters, including the MBA, the Enterprise Foundation, the NTIC, the National Low Income Housing Coalition (NLIHC), and the California Reinvestment Committee, expressed concern that the proposed Special Affordable Housing Goal did not have an explicit focus on the multifamily market. They argued that the GSEs should have some explicit regulatory requirement to purchase multifamily mortgages, in order to sustain a secondary market for affordable multifamily loans. These commenters and others recommended that the Secretary establish a subgoal for the purchase of multifamily mortgages. Other commenters, including CANICCOR, the National League of Cities, and the City of Los Angeles, while not recommending an explicit multifamily subgoal, urged the Secretary to require that the GSEs support an active secondary market for multifamily loans.

In light of these comments and additional analysis, the Secretary reconsidered the proposed rule's focus on rental—as opposed to multifamily—mortgages and has revised the goal. The final rule provides that a relatively small portion of the goal must be achieved through the purchase of multifamily mortgages. The remainder of the goal can be achieved through the purchase of multifamily or single-family mortgages—whether owner-occupied or 1- to 4-unit rental properties. A secondary market providing liquidity for financing of 1- to 4-unit rental properties already exists. In the multifamily arena, however, a secondary market for affordable multifamily mortgages is still developing. Given the GSEs' overall experience and financial strength, it is reasonable to expect that they play major roles in the development of a stable secondary market for affordable multifamily mortgages.

Freddie Mac raised concerns that an increased level of multifamily purchases within the Special Affordable Housing Goal could lead to credit risk problems. Freddie Mac argued that a higher level of multifamily purchases may not be possible without relaxing underwriting standards and purchasing higher-risk properties.

It is the Secretary's intention that the goal ensure that the GSEs maintain a consistent focus on the very-low-income portion of the housing market where housing needs are great. Clearly, the intention of the goal is not to promote or encourage the undertaking of unnecessary credit risks on the part of the GSEs. The market data presented and analyzed demonstrates that the level of the Special Affordable Housing Goal is attainable, and the structure of the goal provides the GSEs with adequate flexibility to achieve it without taking unnecessary credit risk. In addition, the Secretary notes that Congress indicated that ''Freddie Mac should be expected to implement strong multifamily programs in the near future. The Committee intends that the [goals] be set at levels consistent with each enterprise having a significant multifamily program.'' [40]

Units Versus Dollars

Freddie Mac argued that the Secretary's decision to express the Special Affordable Housing Goal as a percentage of overall units financed by a GSE is not supported by FHEFSSA and that the statute requires the Special Affordable Housing Goal to be established in dollars of mortgage purchases. NAHB provided a critique of a percent-of-business measurement and urged HUD to retain a dollar-volume target that could be reset each year based on ''assessment of need, subsidy availability, and refined market estimates.'' NAHB's concern grows out of its belief that the Special Affordable Housing Goal, because of its focus on very-low-income mortgages, is tied to the availability of public subsidies, which are not market-driven.

Fannie Mae, on the other hand, did not oppose the change to a percentage-of-business goal and stated that such a goal will ''more accurately reflect contemporaneous market trends because it is 'self-adjusting'. It is a more equitable and sensible approach to a changing, and sometimes volatile, market.'' Other commenters, including the National Council of State Housing Agencies and America's Community Bankers agreed, describing the percentage-of-business approach as a more appropriate way to measure the impact of the GSEs' mortgage purchases.

The Secretary has concluded that the statute permits the Secretary to set the goals as a percentage of units financed by the GSEs, as long as the percentage arrived at exceeds the dollar floor prescribed in FHEFSSA. Section 1333(a)(1) of FHEFSSA provides: ''The special affordable housing goal established under this section for [a GSE] shall *not be less than* one percent of the dollar amount of the mortgage purchases by the [GSE] for the previous year.'' (emphasis added)

When interpreting a statute, a court should only go beyond the text of a statute if the text is ambiguous.[41] Such interpretation of FHEFSSA reveals that it requires the Secretary to: (1) Establish a Special Affordable Housing Goal; and (2) establish the Special Affordable Housing Goal so that it will equal or exceed the one percent dollar amount in section 1333(a)(1). Courts will not reject the literal meaning of a statute unless such an interpretation ''leads to absurd results when applied.'' [42] In this case, the Secretary's interpretation of section 1333(a)(1)—to allow the Secretary to establish the Special Affordable Housing Goal as a percentage of dwelling units financed, while ensuring that the Special Affordable Housing Goal will be set high enough to meet the floor or minimum required under section 1333(a)(1)—is consistent with FHEFSSA and appropriate policy.

The Secretary recognizes the validity of the concerns expressed by Freddie Mac and several other commenters that financing for affordable multifamily units is tied to the availability of public subsidies, which are not market-driven. Therefore, the final rule establishes the multifamily portion of the goal as a percentage of each GSE's business in 1994, rather than for each year. The Secretary believes that 1994 was a reasonable baseline year for the GSEs, given the decline in mortgage originations. Consequently, 1994 represents a reasonable baseline from which to calculate a portion of the Special Affordable Housing Goal that should be devoted to multifamily mortgages.

Low-Income Renters in Low-Income Areas

Under the proposed rule, the Special Affordable Housing Goal would have been directed to rental housing for very-low-income families and to owner-occupied housing for low-income families in low-income areas and very-low-income families. Both GSEs argued that the Special Affordable Housing Goal must also be targeted to mortgage purchases on housing for low-income renters in low-income areas and that this category was improperly excluded from the proposed goal.

The Secretary agrees that the statute requires the inclusion of low-income rental units in low-income areas. Section 1333 of FHEFSSA provides that the goal should address ''the then-existing unaddressed needs of, and affordable to, low-income families in low-income areas and very low-income

[40] S. Rep. at 35–36.

[41] *National Tax* v. *Havlik,* 20 F.3d 705 (7th Cir. 1994).

[42] *Blue Cross* v. *Weitz,* 913 F.2d 1544, 1548 (11th Cir. 1990).

families.'' Inasmuch as there are unaddressed needs of low-income renters in low-income areas and of very-low-income renters, the Secretary has determined that mortgages for low-income renters in low-income areas should be included under the goal. The final rule reflects this change.

Counting of Rental Units

The proposed rule specified that only rental units affordable to very-low-income families (i.e., families whose incomes are 60 percent of area median income or less) would count toward the goal. This altered a convention applicable to the Special Affordable Housing Goal in 1993–1995 that any low-income rental unit in a multifamily property where at least 20 percent of the units are affordable to especially low-income families (i.e., families whose incomes are 50 percent of area median income or less) or where at least 40 percent of the units are affordable to very-low-income families (i.e. families whose incomes are 60 percent of area median income or less) would count toward the goal.

A number of commenters, including both GSEs, the MBA, the Association of Local Housing Finance Agencies, and the Enterprise Foundation, argued that the proposed rule's approach would create a regulatory incentive for the GSEs to focus only on mortgage purchases for buildings that are entirely occupied by very-low-income tenants, at the expense of financing mixed-income buildings. These commenters argued that an exclusive focus on 100-percent very-low-income buildings is contrary to HUD policy established in other contexts emphasizing mixed-income rental developments as more beneficial for residents and communities. The Secretary concluded that the comments have validity and has revised the final rule to use the transition-period convention of counting all low-income units in buildings where the percentage of such units meets the thresholds used during the transition which, in turn, were modeled on the LIHTC.

Refinancings From Portfolio

Under the Interim Notices establishing transition goals, HUD did not allow any credit toward the Special Affordable Housing Goal for the refinancing of mortgages held by the GSEs in portfolio. The proposed rule provided credit for these refinancings—as long as they were economically motivated transactions initiated by the borrower—to count toward the goal. Both Fannie Mae and Freddie Mac supported this approach. Several commenters expressed concern that including refinancings would create a disincentive for the GSEs to focus on new originations for lower-income households.

The exclusion of refinancings, as provided in the Interim Notices, imposed significant compliance burdens on the GSEs in order to identify those purchases of refinanced mortgages that represented mortgages previously purchased by the GSEs. Further, this provision was contrary to the common method of financing multifamily properties using relatively short-term balloon mortgages, which by their nature must be refinanced frequently to maintain project viability. Refinancings in this context serve the goal of continued availability of housing meeting the goals. For these reasons, the final rule maintains that economically motivated, arm's-length refinancings will count toward the Special Affordable Housing Goal.

General Requirements, Section 81.15

Insufficient Information

Performance under each of the housing goals is based on a fraction that is converted into a percentage. The numerator of this fraction is the number of dwelling units that count toward the achievement of a particular housing goal. The denominator is the number of dwelling units (for all mortgages purchased) that could, under appropriate circumstances, count toward achievement of a goal. Under § 81.15(b) of the proposed rule, dwelling units with insufficient information to determine whether the unit scored toward a GSE's goal performance would be excluded from the numerator, but included in the denominator. Freddie Mac objected that this provision was too strict and ''distorts the reports to Congress on * * * purchases of mortgages counted within * * * the goals.'' Freddie Mac recommended that, when a given threshold of completeness of data is met, the GSE be permitted to eliminate from the denominator up to a given percentage of units lacking sufficient data.

HUD is aware that the GSEs have incomplete data for mortgages originated before 1993. Consequently, when a GSE lacks sufficient information to determine whether a mortgage originated before 1993 counts toward achievement of any of the housing goals, the purchase of that mortgage may be excluded from the denominator for purposes of measuring goal performance. However, the goals must be structured in a manner that will create incentives for the GSEs to obtain and provide the data necessary to determine whether the purchase of mortgages originated during or after 1993 count toward the housing goals. Permitting the GSEs to exclude from the denominator, because a GSE lacked complete information, mortgage purchases (of post-1992 originations) that did not meet the goals would create a disincentive to the collection of such information. This result is contrary to the legislative history, which emphasizes the importance of accurate and comprehensive data. Accordingly, the final rule requires all mortgages originated after 1992 to be included in the determination of the GSE's performance under each of the housing goals.

Double-Counting

Some dwelling units financed by a GSE mortgage purchase count toward achievement of one, two, or all three housing goals under § 81.15(d) of the proposed rule. Two commenters objected to permitting double- or triple-counting. One commenter noted that the GSEs may not have to alter their ''programmatic focus to any great extent'' to meet the goals. In the final rule, HUD has allowed counting mortgage purchases toward one or more of the goals, because double counting is consistent with congressional intent. The Senate Report on FHEFSSA [43] provides that the goals be ''overlapping, in that each [GSE] activity counts toward the achievement of each goal, if any, for which the activity qualifies.''

Use of Rent

Freddie Mac commented that § 81.15(f)(5) should be clarified so that use of average rent-by-unit-type continues to be an acceptable means for reporting rent levels and determining affordability of non-owner-occupied units. Freddie Mac claimed that requiring it to obtain individual unit rent data would be a large drain on resources and would place Freddie Mac at a competitive disadvantage relative to its non-GSE competitors. Because the current reporting system has worked satisfactorily and the GSEs' reporting burden is an important consideration, the rule has been changed to conform to Freddie Mac's suggestion.

Seasoned Mortgages

In determining whether mortgages count toward the goals, Freddie Mac asked for revision of §§ 81.15(f)(6) and 81.16(c)(6), to allow the GSEs to use tenant information (for 2- to 4-unit mortgages) and income or rent level information (for single-family

[43] S. Rep. at 63.

mortgages) as of the time of origination, regardless of the age of the mortgages when acquired by the GSE. According to Freddie Mac, the rule would then conform to industry practice and would avoid requiring the modification of data collection and underwriting practices for these types of units. This practice was also allowed under the Notice of Interim Housing Goals published in October 1993, to avoid costly reverification of information. For the same reasons, the final regulation continues this requirement.

Split Areas

Freddie Mac criticized § 81.15(g) of the proposed rule, which would have provided an allocation formula for split census tracts in measuring performance under the Geographically Targeted Goal, as ''cumbersome and inconsistent with HMDA requirements'' in its treatment of determining area median income in census tracts that cross metropolitan area boundaries in New England. Freddie Mac stated that the additional precision in reporting that HUD was apparently seeking was not worth the cost. Freddie Mac recommended that where the ''area'' cannot be determined and the census tract or property lies in a ''split area,'' the GSEs should be permitted to use the convention adopted by the Federal Financial Institutions Examination Council (FFIEC) for HMDA reports. The final rule adopts this suggestion, which uses an allocation that distinguishes only portions of the county within a metropolitan area from those portions outside of a metropolitan area.

Special Counting Requirements, Section 81.16

Low-Income Housing Tax Credit Purchases (LIHTC) and Mortgage Revenue Bonds (MRB)

Fannie Mae objected to §§ 81.16(b) (1) and (2) of the proposed rule, which would have provided that the GSEs' LIHTC equity investments and MRB purchases would not count toward any of the goals, including the Special Affordable Housing Goal. Fannie Mae commented that the Secretary's position on these forms of investment is ''inconsistent and counter-productive.'' Several other commenters agreed with Fannie Mae. One commented that the Secretary should at least give credit for LIHTCs in central cities and underserved areas. Another commenter stated that LIHTC equity investments are not mortgage purchases and, therefore, it might be appropriate to place ''an upper limit on the amount of credit to be taken for such activities.''

The final rule does not change the provision that the purchase of LIHTCs will not count toward the housing goals. The GSEs' support of affordable housing through the provision of equity in exchange for tax benefits is an important activity. Although the legislative history states that equity investments should not count toward the achievement of the Special Affordable Housing Goal, the legislative history indicates that it is the Secretary's decision whether the purchase of LIHTCs should count toward achievement of the other two housing goals.[44] Because the purchase of LIHTCs is not the equivalent of the purchase of a mortgage, equity investments in LIHTCs do not count toward achievement of any of the housing goals.

Freddie Mac commented that the purchase of MRBs should receive full credit. Freddie Mac commented that:

> * * * where revenue bonds are issued that are not supported by any pledge or promise from the state or local issuer of the bonds, or by any other credit enhancement or collateral, other than the payments from the mortgage itself, the purchaser of these bonds would be in the exact same economic position as the purchaser of the mortgage itself.

The final rule allows units financed by a mortgage revenue bond purchased by the GSEs to count under the housing goals with certain restrictions to assure that such MRB purchases are the functional equivalent of mortgage purchases by the GSEs. Under the rule, purchases of MRBs count only where the MRB is to be repaid from the principal and interest of the underlying mortgages originated with funds made available by the MRB. Purchase of an MRB which is either a general obligation of a state or local government or agency or is otherwise credit enhanced, by any government or agency, third party guarantor or surety, will not count.

Risk-Sharing Arrangements

Freddie Mac commented that the exception in § 81.16(b)(3) should be modified so that mortgages purchased by the GSEs under risk-sharing arrangements with HUD or other Federal agencies would receive full credit under the Special Affordable Housing Goal. Freddie Mae stated that such an approach would better comport with the statutory language and would provide an incentive for completing mortgage purchases that may entail greater underwriting risks and a higher level of monitoring. Freddie Mac commented that HUD's rationale in the proposed rule for denying full credit under risk-sharing arrangements of the kind described was ''flawed,'' and that the Secretary lacked authority under FHEFSSA to refuse to give credit, or to provide for only partial credit.

NTIC disagreed with Freddie Mac's comment and with the proposed rule's provision of partial credit for risk-sharing activities. NTIC asserted that the GSEs' risk-sharing activities should supplement affordable housing programs, not replace them. NTIC stated: ''The legislation was enacted to ensure regular, conventional business is available to all citizens and neighborhoods. Allowing Fannie and Freddie to use the government's money to make their goals is unacceptable!''

Under section 1333(b)(1)(A) of FHEFSSA, the Secretary is required to give full credit toward the Special Affordable Housing Goal for the purchase or securitization of federally-insured or guaranteed mortgages where: (1) such mortgages cannot be readily securitized through the Government National Mortgage Association or any other Federal agency; (2) the GSEs' participation substantially enhances the affordability of the housing subject to such mortgages; and (3) the mortgages involved are on housing that otherwise qualifies under the Special Affordable Housing Goal to be considered for purposes of that goal. The Secretary has determined that the GSEs' current risk-sharing activities meet the requirements in (1) and (2). To the extent the third requirement is satisfied, risk-sharing activities will receive full credit toward achievement of the Special Affordable Housing Goal under the final rule, as long as the dwelling units financed meet the other requirements of the goal.

Furthermore, the final rule provides full credit under the Low- and Moderate-Income Goal and the Geographically Targeted Goal for mortgages purchased under risk-sharing arrangements where the GSE assumes substantial risk, which serve to increase available housing opportunities. HUD intends to monitor future GSE purchases under risk-sharing arrangements to assure that providing full credit for such purchases remains warranted.

Forward Commitments

Freddie Mac commented that § 81.16(b)(4) should be revised to permit commitments to purchase mortgages to count as mortgage purchases in the year the commitments were made. Freddie Mac stated that such revision would make the rule consistent with requirements imposed under FHEFSSA, which mandate that Freddie Mac hold

[44] *See, e.g.,* S. Rep. at 38; H. Rep. at 60 and 61.

capital against forward commitments. Freddie Mac added that the rule could add language to ensure against ''double counting.''

Under FHEFSSA, the Secretary is to establish housing goals for mortgage purchases. Section 1303(11) of FHEFSSA defines mortgage purchases to include mortgages purchased for portfolio or securitization. The use of the past tense of the verb, i.e., ''purchased,'' rather than the future tense, i.e., ''purchased or to be purchased,'' indicates that a transaction does not constitute a mortgage purchase simply because a mortgage may be purchased in the future based on a commitment, but that the mortgage must actually have been ''purchased.'' Accordingly, this section of the rule has not been revised.

Second Homes

Freddie Mac commented that § 81.16(b)(5) should be eliminated so that the purchase of mortgages on secondary residences would receive full credit toward the goals. Freddie Mac stated that the majority of secondary residences are located in low- and moderate-income census tracts and ''serve an important role in bolstering local housing markets and providing a supplement to the local housing stock.''

Many second homes, which are frequently owned by affluent families, are located in predominantly low- or moderate-income areas. These second homes provide few, if any, affordable housing opportunities for the permanent residents of areas defined as underserved. Accordingly, the final rule does not provide goal credit for secondary residences.

Credit Enhancements

Freddie Mac expressly supported the Secretary's decision to allow credit enhancements to count toward achievement of the housing goals. However, Freddie Mac commented that certain revisions should be made to § 81.16(c)(1): (1) the requirement that the GSE provide specific mortgages as collateral should be dropped because it does not relate to the economic substance of a credit enhancement or to the rating of the bonds; (2) in a credit enhancement, Freddie Mac does not ''guarantee bonds,'' but ensures that payments are made on the underlying mortgages; thus, the reference to guaranteeing should be omitted; (3) the proposed rule was unclear because it referred to ''State or local housing finance agency'' in one place and ''any entity'' in another place; Freddie Mac commented that ''any entity'' should be used; and (4) the rule should include credit enhancements where a GSE '''reinsures' mortgage insurance provided by a public purpose mortgage insurance entity or fund.'' Freddie Mac provided revised language for this section consistent with its comments.

The National Council of State Housing Agencies stated that it was ''pleased'' that HUD proposed to count the GSEs' credit enhancement transactions, and it opposed the rule's limitation of this credit to transactions in which a GSE provides specific mortgages as collateral.

The counting of a credit enhancement should not depend on whether a GSE's insurance of mortgage payments is provided through collateralizing specific mortgages. This section of the rule has been modified to require the GSE to provide only a specific contractual obligation to ensure mortgage payments. In addition, the Secretary agrees with Freddie Mac that reinsurance of mortgage insurance provided by a public purpose mortgage insurance entity or fund is beneficial to the mortgage markets. Accordingly, the Secretary has decided that, on a case-by-case basis, a GSE may seek the Secretary's approval for counting such transactions toward the achievement of the housing goals.

The Secretary does not want to create a regulatory distortion of corporate decisions on how to develop and initiate credit enhancement transactions. The inconsistency in the proposed rule—limiting credit enhancement transactions to State and local agencies—referred to by Freddie Mac has been removed, and the broader language that it recommended has been adopted.

Real Estate Mortgage Investment Conduits (REMICS)

Freddie Mac commented that § 81.16(c)(2) should be drafted so that purchases of REMICs would count toward fulfillment of all three housing goals ''to the extent that the purchase of the mortgages underlying the REMICs would provide credit under the goals and there is no resulting 'double counting' of these mortgages.'' Freddie Mac stated that this type of transaction increases the liquidity of the mortgage-backed securities market and lowers costs for borrowers.

Fannie Mae commented that the purchase of REMICs should count toward the goals because such activity is functionally equivalent to a mortgage purchase. Fannie Mae commented: ''REMICs that do not contain MBS [Mortgage-Backed Securities] or mortgages purchased by Fannie Mae, Freddie Mac, or a government insured entity do not cause 'double counting' . . . .'' Fannie Mae noted that it has never purchased a REMIC that contained anything other than mortgages and property related to mortgages. (Under the Internal Revenue Service (IRS) Code, 26 CFR 1.860G–2(a)(4) and 1.856–3(c), REMICs may include other interests in real property such as ''options to acquire land or improvements thereon'' and ''timeshare interests.'')

In large measure, HUD agrees with these comments concerning purchases of REMICs. Accordingly, the purchase of REMICs by the GSEs may count toward the goals as long as the underlying mortgages or mortgage-backed securities were not previously purchased or issued by the GSEs or otherwise would result in double counting. Subject to the same restrictions, the guarantee of a REMIC by a GSE may also count toward the goals.

HUD recognizes that the development of new and distinct REMIC structures is dynamic and HUD does not in any manner seek to impede these developments. However, the GSEs are advised that when there is any question about whether a new structure meets these restrictions for counting under the goals, the GSEs should seek the advice of HUD before counting the transaction.

Participations

Instead of counting participations in mortgages toward achievement of the housing goals based on the percentage of the participation purchased by a GSE, as proposed under § 81.16(c)(4), Freddie Mac commented that the rule should provide for full credit whenever the GSE's participation percentage is 50 percent or more and no credit when a participation is below 50 percent.

Freddie Mac's proposal would reduce the reporting and compliance burden, and the final rule adopts this proposal. Participations have played, and are expected to play, a *de minimis* role in the GSEs' purchases, and for that reason the counting approach adopted should have little impact on housing goal performance.

Second Mortgages

In response to the proposed rule's questions concerning whether and how to count second mortgages, Freddie Mac commented that second mortgages should receive full, rather than partial, credit under the goals, because of the difficulty in arriving at an appropriate means of allocating partial credit and because second mortgages frequently fulfill the same purpose as refinancing, at lesser cost to the borrower. Fannie

Mae generally agreed. The Los Angeles Housing Department commented:

> If a second mortgage loan is made to a low income or minority borrower who otherwise would have had to resort to the loan companies which charge exorbitant interest rates and points (''hard money lenders'') the loan should carry full GSE credit. Otherwise, the loan is being made to borrowers who have already shown themselves to be a good risk, and should not generate full credit.

To simplify counting and monitoring for goals purposes and encourage the GSEs to purchase second mortgages, including low- and moderate-income rehabilitation loans, the final rule, by revising the definition of ''mortgage,'' provides that second mortgages will receive full credit toward achievement of the housing goals. This change will be monitored closely by HUD, to assure, for example, that a GSE does not purchase an excessive number of second mortgages with low unpaid principal balances solely to enhance goal performance.

Income Level Definitions—Tenants (Family Size Not Known), Section 81.18

Freddie Mac commented that § 81.18 (determining affordability for rental units where family size is not known) should apply to actual tenants because Freddie Mac normally has data on unit size, instead of family size, for actual tenants.

HUD agrees and has inserted ''actual or'' before the word ''prospective'' where it appears in § 81.18. Unit size serves as an adequate proxy for family size in instances where the data on family size is not readily available, and requiring family size information could, in some cases, impose an unnecessary cost on the GSEs in exchange for very little information.

Rent Level Definitions for Tenants (Income Not Known), Section 81.19

Freddie Mac objected to § 81.19(d), which would have provided that, for purposes of determining whether a rental unit is affordable, units without data on the number of bedrooms must be counted as efficiency units in making affordability calculations. Freddie Mac commented that this assumption would have the effect of understating the GSEs' performance against the goals, and if information is available on the number of bedrooms of a high percentage of units in a property, the GSE should be allowed to apply the known percentages of efficiencies, one-bedrooms, etc., to the unknown units.

The formulation in the proposed rule has been maintained has been maintained in the final rule. It provides an incentive for the GSEs to secure necessary information regarding bedroom size. Freddie Mac's suggestion would increase HUD's burden in monitoring performance without improving accuracy of the data, and this is contrary to the intent in estimating affordability. Therefore, the assumption respecting efficiency units is not changed.

Additional Goals/Subgoals

Several commenters suggested that the Secretary should, in some manner, provide for additional goals and subgoals. One commenter advocated additions to the regulation to ensure that members of minority communities have access to housing finance from the GSEs commensurate with the minority groups' locally determined percentage shares of single-family mortgage purchases. Similarly, several other commenters suggested subgoals for purchases of mortgages on properties occupied by minority households. Another commenter recommended that regional goals be set, taking into account the variation in housing markets from city to city, as well as urban-rural variations. In a similar vein, another commenter suggested that the Secretary ''require the GSEs to increase their . . . purchases in areas of acute need.''

Two commenters recommended that the Secretary establish a goal under which the GSEs would receive full credit toward achievement of the goals for the disposition of real property to nonprofits.

HUD is refraining from establishing a range of subgoals in this final rule. HUD is concerned about micromanaging the GSEs' efforts to achieve the housing goals. In addition, the objectives sought by the commenters can be served through the three existing goals.

Notice and Determination of Failure To Meet Goals, Section 81.21

Although Freddie Mac supported the proposed rule's ''close adherence'' to the language of FHEFSSA in §§ 81.21 and 81.22 of the proposed rule on monitoring and enforcement, Freddie Mac commented on several points. Under the proposed § 81.21(a), the Secretary, in determining whether a GSE has failed or there is a substantial probability that a GSE will fail to meet a housing goal, will consider the GSEs' reports and ''other data available to the Secretary.'' Freddie Mac noted that it did not understand what ''other data'' referred to and Freddie Mac commented that the phrase should be clarified or removed.

In response to this comment and to mirror FHEFSSA, § 81.21 no longer refers to the information that the Secretary will consider in making the determination.

Freddie Mac commented that § 81.21(b)(1) should be revised to track section 1336(b)(2) of FHEFSSA so that a GSE has 30 days from the date of notice to respond to a preliminary determination from the Secretary. The final regulation has been revised to reference the requirement of section 1336(b).

Housing Plans, Section 81.22

In determining feasibility of a housing goal under § 81.22(a), Fannie Mae commented that the final rule should note specifically that the economic environment and fiscal and monetary policies outside Fannie Mae's control will sometimes determine a particular goal's feasibility.

Section 1336(b)(3)(A)(ii) of FHEFSSA provides that, in determining the feasibility of a housing goal, the Secretary must consider market and economic conditions and the GSE's financial condition. The regulation includes this language and the specific reference suggested by Fannie Mae is not needed.

Under § 81.22(b)(4), the proposed rule would have allowed the Secretary to require a GSE's housing plan to address additional matters as required by the Secretary. Freddie Mac objected to the ''any additional matters'' language and insisted that only the statutory description should be used.

The final rule does not make this change because the Secretary may find it necessary and proper to require the GSE to include specific additional matters relevant to achieving the goal in a housing plan.

Citing section 1336(c)(3) of FHEFSSA, which provides that the Secretary shall, by regulation, establish a deadline for submission of housing plans and that such deadline may not be longer than 45 days after notice to the GSE, Freddie Mac asked for 45 days for submission of a housing plan, rather than the 30-day period provided for in § 81.22(c).

FHEFSSA allows the Secretary to establish a time period of less than 45 days and the Secretary has determined that 30 days is necessary to avoid further delay in achieving the housing goal.

Under § 81.22(e), where the first two housing plans submitted by a GSE are disapproved by the Secretary, Freddie Mac commented that the GSEs be granted 30 days to submit a third housing plan, rather that the 15-day period provided for in § 81.22(e).

In the event that a GSE's housing plans are so deficient that the Secretary disapproves the first two submitted by the GSE, the Secretary notes that the GSE will have already had a total of 60 days to develop the first two plans. At that point, the GSE's plan should be sufficiently developed so that an additional 30 days is unnecessary to develop a third plan. Accordingly, this provision has not been changed.

Subpart C—Fair Housing

The GSEs' Role

While expressing their strong commitment to participating in the elimination of discriminatory practices in the mortgage lending process, both GSEs, in similar arguments, objected to certain features of Subpart C—Fair Housing.

Both enterprises outlined their efforts to encourage fair lending practices by primary mortgage lenders through outreach, consumer education, and innovative products. The GSEs stressed their interest in contributing to the elimination of unlawful discrimination in the mortgage finance industry. However, both objected to a fair housing enforcement role which they argued the proposed rule would have imposed on them.

Fannie Mae saw its appropriate role in fair lending as being a provider of outreach, consumer education, and flexible, innovative mortgage products to its customers. Freddie Mac also maintained that its primary role should be to provide a ready source of financing for all creditworthy borrowers and to provide market leadership. Freddie Mac took issue with what it saw as the proposed rule's implication that it should be doing more with respect to fair lending.

Several other commenters endorsed the GSEs' position in this regard and stated that, for the GSEs, the role of regulator is inconsistent with the business partnership relationship that exists between the GSEs and their customers. A major mortgage company commented that GSEs ought not be required to develop fair lending plans, because such plans would, in effect, establish the GSEs as ''primary market regulators.'' Referencing its long established business partnership with both GSEs, the commenter said it did not want these entities ''to also be our regulators.''

On the other hand, the San Diego Housing Commission had no objection to an expanded role for GSEs associated with fair housing:

> The proposed rule essentially requires the GSEs to cooperate with HUD in providing data and other information to assist in the investigation of mortgage discrimination by a lender with which either does business.
> * * *
>
> In general Fannie Mae and Freddie Mac have been successful in expanding the availability of credit, lowering interest rates, and in stabilizing and liquefying the finance market. However, there have been shortcomings in the extent to which they help meet the housing needs of households at the lower end of the housing market. Given their size and the key role they play in housing finance, they are in a position to wield a significant amount of influence.

This final rule follows the clearly expressed intention of Congress that the GSEs comply with the Fair Housing Act and the Equal Credit Opportunity Act (''ECOA'') and aid the efforts of investigators.[45] HUD does not intend that the GSEs will become the Federal government's regulatory or enforcement operation for the primary mortgage market. The Federal fair lending enforcement agencies, not the GSEs, enforce the fair lending laws.

HUD has carefully examined the various points made by the GSEs and other commenters on subpart C of the proposed rule. This final rule contains modifications which respond to the commenters' concerns about the proposed rule's nondiscrimination requirements, assessment of disparate results, and information and recordkeeping requirements. Additionally, many suggestions made by the commenters for language changes and modifications of other aspects of the proposal have been accepted and incorporated. These revisions are discussed elsewhere in this preamble.

Disparate Impact

Freddie Mac argued that section 1325(1) of FHEFSSA reaches only *intentional* discrimination and that application of a disparate impact test is therefore unauthorized. Both GSEs claimed that, even if the disparate impact standard was supported by FHEFSSA, HUD had misstated the standard as articulated by the courts, and had shifted the burden of proof from the plaintiff to the GSE. Other commenters shared this view, although there was little comment in support of Freddie Mac's assertion that FHEFSSA prohibits only intentional discrimination. Fannie Mae claimed that there is no statutory basis and little case law in support of applying a disparate impact analysis to matters arising under ECOA or the Fair Housing Act.

Several other industry commenters joined in this criticism of the proposed rule. The ABA, the MBA, the Western League of Savings Institutions and a major mortgage lender all characterized the application of disparate impact analysis or an ''effects test'' standard in this particular rule as premature and a potential source of marketplace uncertainty.

Both GSEs urged HUD to postpone application of the disparate impact standard in this rule until the issue is addressed in the HUD's broader Fair Housing Act regulations. Adopting the standard in FHEFSSA rules first, the GSEs claimed, would create confusion and increase the likelihood of the development of divergent standards governing mortgage finance. Both GSEs and several major industry organizations argued that subpart C would result in a dual enforcement mechanism, applicable to their operations but not to other segments of the housing marketplace, and would subject them to the application of legal theories that are ''largely untested in mortgage finance.'' The GSEs urged the Secretary not only to delay implementation of a disparate impact standard in advance of a fair lending addition to HUD's Fair Housing regulations, but also to coordinate the development of any such revisions with primary market financial institution regulators and the Department of Justice. Fannie Mae claimed that none of these regulators or enforcers has provided industry-wide guidance to date.

The American Bankers Association questioned the proposed rule's explanation of business necessity, suggesting that it failed to afford the GSEs adequate guidance. It further maintained that HUD's position on the meaning of business necessity was inconsistent with and constituted a more difficult legal test than the understanding of the term reflected in the Interagency Policy Statement on Discrimination in Lending (''Interagency Policy Statement'').[46]

Fannie Mae also claimed that the proposed rule would create a potential ''litigation and enforcement nightmare'' for the GSEs and that the rule would inhibit innovation. Freddie Mac argued that the rule would also inhibit the GSEs' efforts to identify and eradicate barriers in their underwriting guidelines.

Section 1325(1) of FHEFSSA requires the Secretary to prohibit the GSEs from discriminating ''in any manner''—including a prohibition on any consideration of the age or location of a dwelling or neighborhood in a manner that has a ''discriminatory effect.'' The use of the phrases ''in any manner'' and ''discriminatory effect'' in section 1325(1) makes clear Congress's intent

[45] *See* S. Rep. at 43–44.

[46] 59 FR 18266 (1994).

that the statute's prohibitions extend beyond intentional discrimination. The Senate Report states that Congress intended to proscribe ''policies and practices, including inappropriate underwriting guidelines, [which] may *unintentionally* yield discriminatory patterns in mortgage lending.'' [47] The Senate Committee report cited testimony that ''. . .there are other business practices of the enterprises which have the *effect of discriminating* against minorities . . . .'' [48] Examples cited by the Senate Report included differential pricing and fee structures for mortgage products which effectively discouraged lending in minority and low-income communities.[49]

However, HUD has taken into account the considerable comments it received from the GSEs and others, and has determined to track the statutory prohibition as enacted by Congress.

In response to the GSEs' comments regarding a lack of guidance, the disparate impact (or discriminatory effect) theory is firmly established by Fair Housing Act case law. That law is applicable to all segments of the housing marketplace, including the GSEs. All of the circuit courts, except for the D.C. Circuit which has not considered the issue, have held that the Fair Housing Act includes claims based upon the disparate impact theory.[50]

All the Federal financial regulatory and enforcement agencies recognize the role that disparate impact analysis plays in scrutiny of mortgage lending. In the Interagency Policy Statement, the bank, thrift, and credit union regulators, the Justice Department, Treasury, OFHEO, Federal Trade Commission (FTC), and HUD jointly recognized the disparate impact standard as a means of proving lending discrimination under the Fair Housing Act and ECOA. The disparate results assessment requirement included in this final rule mirrors the statutory requirement and is consistent with the Interagency Policy Statement, which explicitly applies a similar ''disparate impact'' standard to proving violations of the Fair Housing Act and ECOA.[51]

Congress, in enacting FHEFSSA, expressly stated that it was concerned with the subtle, often ''*unintentional*'' forms of discrimination that are the hallmark of present-day unlawful conduct, and that the law was enacted to ensure that the enterprises would in no way contribute to the continuance of such discrimination in mortgage lending.[52]

[47] S. Rep. at 43 (emphasis added).

[48] Id. at 31 (emphasis added).

[49] *See id*.

[50] No courts have ever held in Fair Housing Act or ECOA cases that the disparate impact standard does not apply to lenders.

[51] Additionally, the Federal Reserve, in its Regulation B, recognizes the role of disparate impact analysis under ECOA. 12 CFR 202.6(a)(2); Federal Reserve System Handbook at 1–24.

[52] S. Rep. at 42–43.

Prohibitions Against Discrimination

Freddie Mac objected to the use, in § 81.42(b)(1) of the proposed rule, of the term ''*based on* race, color . . .'' (etc.), suggesting that the statutory phrase ''because of'' be substituted. This final rule, which now mirrors the language of the statute, incorporates this suggestion. Section 81.43 of this final rule also follows the language of the statute in requiring assessments ''based on'' protected status. In the context of this rule, HUD considers the terms ''based on'' and ''because of'' to be synonymous.

Appraisals

Freddie Mac found the proposed rule's treatment of age and location troubling, even where the purpose of the rule was to set forth specific exemptions allowing consideration of such factors. Freddie Mac stated that the listed exemptions might be limiting and that the exemption as set out conflicted with the appraisal exemption in the Fair Housing Act. Freddie Mac also asked that the age/location-related exemption be removed from this final rule, asserting that the use of age or location in underwriting is appropriate so long as it is not used to discriminate.

In this final rule, § 81.42 parallels the language of the statute and no longer contains the list of examples of location factors which may properly be considered in an appraisal and in other aspects of the underwriting process. Section 805(c) of the Fair Housing Act, 42 U.S.C. 3605(c) addresses appraisals. The HUD regulation which implements this section provides that ''nothing in this section prohibits a person engaged in the business of making or furnishing appraisals of residential real property from taking into account factors other than race, color, religion, sex, handicap, familial status or national origin.'' 24 CFR 100.135. It is HUD's view that the Fair Housing Act and FHEFSSA allow the consideration of the age or location of a dwelling as long as that consideration is not used in a manner that discriminates unlawfully.

Assessment of Disparate Results

Both GSEs objected to conducting a disparate results assessment as part of the Annual Housing Activities Report (AHAR) required by FHEFSSA, a report further discussed in § 81.63 of subpart E. Both GSEs objected to the manner in which the disparate results assessment would have been implemented by § 81.43 of the proposed rule, insofar as that section would have required the GSEs to set forth fully the basis for their conclusions that a business necessity exists for any policies and practices which yield disparate results. Freddie Mac contended that the Secretary has no authority to require the assessments. Freddie Mac also stated that the business practices assessment requirement would result in a massive diversion of resources from Freddie Mac's core business activities and detract from its abilities to fulfill its mission.

Fannie Mae stated that the proposed rule, as well as HUD administrative law decisions, suggest that Fannie Mae must accompany the demonstration of business necessity with a showing that no less discriminatory alternative exists for serving that business necessity, and that this would involve proving a negative assumption. Similar objections were stated with reference to the provisions requiring the GSEs to assess their underwriting and appraisal guidelines. Fannie Mae also claimed that the proposed rule provided no effective guidance to the GSEs concerning how to apply this test to their operating procedures and how to measure whether facially-neutral policies have a disparate impact on a protected class.

The GSEs further asserted that the business practices assessment and underwriting appraisal guidelines requirements place an excessive burden on the GSEs and that HUD underestimated this burden in its Regulatory Impact Analysis. Fannie Mae and Freddie Mac both objected to what they perceived as a shift in responsibility for analysis of data and enforcement from HUD to the GSEs.

MBA opposed the inclusion of the ''less discriminatory alternative'' prong of the disparate impact analysis set out in the rule, arguing that making it the GSE's burden to establish this prong would be unfair and inconsistent with case law on which the theory is based. Although opposing any requirements for GSEs to develop fair lending plans, and joining the objections to the disparate impact provisions, MBA nevertheless saw it as the proper function of the GSEs to develop a business practices assessment along the lines required by subpart D.

Finally, Freddie Mac claimed that the system of ''self-testing'' required by the business practices assessment conflicts with the clear trend set by the

Department of Justice and federal financial regulatory institutions.

The Fair Housing Act and its implementing regulations, which were promulgated in 1989, apply to the GSEs and include a detailed prohibition against discrimination in the purchasing of loans and set forth the business necessity defense to a disparate impact claim involving the purchasing of loans.[53] Thus, when taken together, the Fair Housing Act regulations and case law, the Civil Rights Act of 1991, and the Interagency Policy Statement provide sufficient guidance concerning the application of the statutorily required assessment of disparate results.

The GSEs' assertions concerning the regulatory burden of compliance with the requirements outlined in § 81.43 of the proposed rule have been given careful consideration. Accordingly, HUD has substantially modified this section of the rule, which, as revised, now largely tracks the statutory language of sections 1381 and 1382 of FHEFSSA. These sections of the statute require the GSEs to include, in their AHAR to the Secretary and Congress, assessments of disparate results of various types of policies and practices. The GSEs are directed specifically to ''assess underwriting standards, business practices, repurchase requirements, pricing, fees, and procedures * * * that may yield disparate results based on the race of the borrower'' in their annual reports.[54]

The disparate results assessment is a statutorily-mandated part of the AHAR under FHEFSSA. This final rule implements that statutory mandate by requiring that the GSEs assess whether their business practices are discriminatory on the bases of race, color, religion, sex, handicap, familial status, age or national origin, since all of these are prohibited bases listed in section 1325(1) of FHEFSSA and the Secretary is charged with prohibiting the GSEs from discriminating in any manner based on all of these prohibited factors. The Secretary is authorized to implement the statute's disparate results assessment requirement in this manner. Sections 1381(p) and 1382(s) of FHEFSSA authorize the Secretary to require the GSEs to submit any other information in their AHARs that the Secretary considers appropriate. However, the Secretary recognizes that data may not be currently available to assess whether certain practices are discriminatory on the bases of handicap, familial status and religion.

[53] 24 CFR 100.125.

[54] Sections 1381(p) and 1382(s) of FHEFSSA.

This rule does not impose a requirement upon the GSEs to ask lenders to report information regarding the religion or handicap of potential borrowers. Nor is it intended, for purposes of this section, that the GSEs ask lenders to report any information other than that which the lenders currently report, or any information which lenders may not inquire about under ECOA or the Fair Housing Act. ECOA regulations generally prohibit creditors from inquiring about an applicant's race, color, religion, or national origin. The Fair Housing Act also generally prohibits inquiries regarding an applicant's race, color, national origin, religion, sex, familial status or handicap. However, ECOA regulations do allow a creditor to collect information regarding an applicant's race, national origin, sex, marital status, and age for monitoring purposes. Additionally, HMDA regulations require lenders to collect information on race or national origin and sex of an applicant or borrower.

These revisions address the GSE's concerns regarding undue regulatory burden. The streamlining of the reporting requirements included in § 81.43 of this final rule reduces the GSEs' compliance burden and requires fewer submissions to HUD. The AHARs under subpart E already require the GSEs to assess the impact of their own decisions with a conscious goal of ensuring that they do not violate the law, and to include, as the statute requires, ''revisions thereto to promote affordable housing and fair lending.''

In developing this final rule, HUD has recognized that regulatory provisions intended as guidance may sometimes become prescriptive and can lead unnecessarily to micromanagement. The GSEs themselves should be afforded the opportunity to use their capabilities to develop a functional assessment method that ensures the fulfillment of the precise statutory directive. The regular assessment by the GSEs of policies and practices to determine whether they may be yielding disparate results, and the evaluation of that assessment by HUD, will carry out FHEFSSA's mandate to prohibit discrimination in any manner.

Additionally, section 1325(6) of FHEFSSA requires review by the Secretary of the GSEs' underwriting and appraisal guidelines to ensure that they are consistent with the Fair Housing Act and that section. The language in § 81.43(b) mirrors the language of the statute.

Data Submission

Freddie Mac raised a series of concerns about the proposed rule's implementation of sections 1325(2) and (3) of FHEFSSA, authorizing the Secretary to require submission of information to assist the Secretary to determine whether a lender with which the enterprise does business has failed to comply with the Fair Housing Act and ECOA. Freddie Mac objected to being required to respond to requests from any agency other than the Secretary, pointing out that § 81.44(b) of the proposed rule suggested that other Federal agencies might make direct requests to the GSEs.

Freddie Mac objected to the rule's suggestion that information could be requested by the Secretary pertaining to the mortgage sales of lenders operating in the ''same or similar areas'' as a lender about whom a request for data had been made. Freddie Mac objected on cost and resources grounds, and requested that the rule be limited to requiring only the provision of data pertaining to lenders (a) against whom a complaint has been filed; (b) where other evidence supports an investigation; and (c) where the data in Freddie Mac's possession is not otherwise publicly available.

Freddie Mac also objected to HUD's characterization, in the proposed rule, of materials to be sought from it as ''information.'' Freddie Mac argued that ''data'' meant facts that were a matter of direct observation, while ''information'' included ''knowledge gained through communication, research, instruction, etc.'' Insisting on the distinction, Freddie Mac objected to the creation of ''an unfettered right of the Secretary to require the enterprises to conduct sophisticated statistical analyses that * * * might be helpful to complete an investigation * * *.'' Fannie Mae asked that the rule be revised to state that GSEs are required to provide only data: (a) owned by the GSE; (b) in response to requests by the Secretary; (c) in connection with an ongoing investigation by the Secretary (rather than other organizations); (d) pertaining only to a particular lender pursuant to specific allegations of discrimination; and (e) that has not already been supplied and is not readily obtainable from other sources.

Other housing industry commenters also requested that investigative data sought by HUD be limited to active investigations already in progress, because requiring the GSEs to produce an analysis of each of their lenders could poison the business relationship between GSEs and their customers, and involve high additional costs for the GSEs. The National Association of Mortgage Brokers (NAMB), the California Association of Realtors, the Western League of Savings Institutions, the ABA, the NAR, and a major mortgage company all joined in protesting what they considered the prospect of excessive information collection, employing GSE resources. NAR raised concerns about ''privileged data on lenders'' and indicated that the organization's concern was ''magnified when the proposed requirement to provide information is coupled with a request that the GSEs conduct an analysis of the data.'' It urged that HUD's requests for data and analysis be limited to situations involving allegations of discrimination.

To address these concerns, § 81.44(b)(1) of this final rule has been modified to clarify that other Federal agencies responsible for ECOA enforcement which wish to request information from the GSEs pursuant to FHEFSSA must do so by submitting that request through the Secretary. The words ''without limitation'' referencing, in the proposed rule, the types of information that may be requested, have been removed in this final rule at § 81.44(b)(1) and (2). Section 81.44(a) also has been modified to make it clear that the GSEs are only required to submit such information under FHEFSSA after it has been requested by the Secretary.

Additionally, in accordance with the President's initiative on regulatory reform, the examples provided in § 81.44(b)(1) and (2) of information which may be requested have been removed from this final rule. By removing those examples, HUD does not intend to limit, in any way, the information it may request pursuant to section 1325 of FHEFSSA and § 81.44 regarding violations by lenders of the Fair Housing Act and ECOA. Requested information may include information on mortgages sold to the GSE by the lender or lenders under investigation, the mortgage sales of lenders operating in the same or similar areas, and information on representations and certifications to the GSEs by the lender or lenders under investigation. Information requested from the GSEs' established data systems may include comparing the loans purchased by the GSE from a particular lender to data on the racial composition of census tracts or providing data on loans sold to the GSE by lenders operating in the same geographical area. In the interests of regulatory reform, the reference to comparative and other data that would be collected under § 81.44(b)(1) and (2) has been removed, but HUD will seek such data when appropriate.

Where comparative data about the performance of other lenders is considered relevant to an ongoing investigation, HUD has the authority under the Fair Housing Act to require anyone, including the GSEs, to provide material or testimony. 24 CFR 103.200, 103.215, 103.220. It is consistent for the GSEs to provide such information pursuant to this section.

Although no other commenters repeated Freddie Mac's distinction between ''data'' and ''information,'' several joined Fannie Mae in arguing that only information about an identified object of investigation, and not available from other sources, should be sought through the GSEs. Freddie Mac also asserted that HUD has grossly underestimated the resource drain on Freddie Mac that § 81.44 would entail. Again referencing the Regulatory Impact Analysis for the proposed rule, Freddie Mac objected that HUD had misstated and oversimplified the work burden associated with the GSE's provision of required data. Several industry commenters echoed Freddie Mac's position on this issue.

Section 1325(3) of FHEFSSA uses the terms ''data'' and ''information'' interchangeably. The legislative history shows that the Congress intended that the GSEs would actively assist HUD by providing data for ''investigative purposes.'' [55] Nor does the statute, or its goals, support Fannie Mae's suggestion that the rule be revised to state that the GSEs are required to provide only information owned by them and not readily available from another source. Congress intended that the GSEs submit information that they are ''privy to and collect,'' and there is no requirement that the GSEs own such information.[56] That language indicates Congress' intent that the Secretary have access, upon request, to information other than that owned by the GSEs.

HUD is sensitive to the need to limit reporting burdens upon both lenders and the GSEs to the minimum level consistent with effectively implementing statutory requirements. As a practical matter, HUD does not anticipate that requests for information from the GSEs pursuant to an investigation will generally require the GSEs to seek additional information from lenders, nor does it expect that it generally will seek information from the GSEs when that information is readily available from other sources. Rather, as mandated by the statute, the GSEs will assist HUD in investigations by providing existing and available data and information upon request by HUD. HUD does not expect that § 81.44 will result in new reporting burdens on lenders, and does not expect that it will impose onerous burdens on the GSEs. Nor does HUD intend for the GSEs to conduct fair lending investigations or otherwise act as an enforcement arm of the Federal government.

For matters involving the Fair Housing Act, the Secretary will only issue requests for information about lender-based data in circumstances involving investigations, as defined by the Fair Housing Act regulations found at 24 CFR part 100, subpart D. For matters involving only ECOA, § 81.44(b)(1) provides that the Secretary will only issue requests for information from the GSEs upon a request from the responsible Federal financial regulatory agency.

In response to comments, the revised § 81.44 omits the provisions in the proposed rule which would have required the GSEs to volunteer information regarding potential violations of the Fair Housing Act or ECOA and which would have required the GSEs to submit other information to HUD or the other lending regulators.[57]

Finally, Freddie Mac objected that HUD ought to revise § 81.44 to assure that any data-providing burdens fall equally on the two competing GSEs.

HUD anticipates that regular reporting and data-provision requirements imposed upon the GSEs will not differ. However, the subject matter of § 81.44 is the provision of information to assist in investigations. The nature of each particular investigation will determine what information is necessary. Because information will only be sought as needed, it would be unnecessarily burdensome, both for the GSEs and HUD, for the Secretary routinely to make duplicate requests for information to both GSEs when it is not otherwise necessary.

Evidentiary Value of Data

Freddie Mac argued strongly that it could not make determinations, in any event, concerning whether its practices produced disparate results among its lenders, since Freddie Mac has no means of collecting data for loans that were declined as a proximate result of Freddie Mac requirements. There was

[55] *See* S. Rep. at 43–44.

[56] *See* S. Rep. at 43–44.

[57] While the requirement to volunteer information about violations has been removed from the rule, this change does not shield the GSEs from potential legal liability if they participate in discrimination. *See* section 1325(1) of FHEFSSA; sections 804 and 805 of the Fair Housing Act, 42 U.S.C. 3604–3605; and 24 CFR 100.125.

support among the other industry commenters concerning what they considered the limited evidentiary value of GSE application data. MBA noted that information solely from the GSEs would ''give a distorted view of a lender's performance since lenders originate loans for other investors and loans with FHA insurance are sold into the secondary market through Ginnie Mae.''

HUD is aware that lender information received from the GSEs generally will include only those transactions in which a GSE has been a participant. However, that is not a basis for concluding that there is no evidentiary value in information provided by the GSEs in accordance with the requirements of FHEFSSA and this final rule. The legislative history of FHEFSSA clearly indicates that Congress considered information possessed by the GSEs to be of potential value in investigations.[58]

Submission of Information to the GSEs

HUD will make information regarding violations of ECOA or the Fair Housing Act available to the GSEs pursuant to § 81.45. Information to be made available regarding violations will include decisions by Administrative Law Judges, Federal courts, the Secretary, or decisions of other courts applying Federal, State or local fair lending laws. HUD recognizes that the information to be made available to the GSEs will be limited by applicable law, memoranda of understanding between the agencies and other arrangements regarding such issues as confidentiality, the right to privacy, and the protection of supervisory information.

HUD recognizes that because the GSEs may take action pursuant to their own policies and agreements, the clause in the proposed rule at § 81.45(b) which authorized them to do so was not necessary. Therefore, the clause has been deleted from this final rule.

In consultations, the federal financial regulators raised concern that § 81.45 of the proposed rule, which directed the Secretary to obtain information from federal financial regulators and others regarding violations of the Fair Housing Act and ECOA, would require the reporting of violations which might be unrelated to mortgage lending discrimination.

In response to these concerns, § 81.45(b) of this final rule limits the information required to be obtained from other Federal regulatory or enforcement agencies to violations by lenders involving discrimination with respect to the availability of credit in a residential real-estate-related-transaction. This change more clearly describes the scope of the data required by this final rule.

In addition, while the rule directs the Secretary to obtain information regarding single violations of the Fair Housing Act in real-estate-related transactions, in response to federal financial regulator concerns involving ECOA violations, the Secretary will obtain information from regulators regarding violations of ECOA by lenders only in circumstances in which there is either more than a single ECOA violation, or the ECOA violation could also be a violation of the Fair Housing Act.

Remedial Actions

Section 1325(5) of FHEFSSA authorizes the Secretary to direct the GSEs to take various remedial actions against lenders that have been found to have engaged in discriminatory lending practices in violation of the Fair Housing Act or ECOA, pursuant to a final adjudication on the record, and after opportunity for an administrative hearing. Freddie Mac commented that HUD had not defined ''final adjudication on the record'' in the proposed rule, and had employed the term ''final determination'' in its place, contrary to section 1325(5) of FHEFSSA. Freddie Mac requested that the term ''final adjudication on the record'' be defined to include recognition that such an adjudication could only result from a United States court or established administrative proceeding, with an unappealable decision on the merits having found a lender to have violated substantive (i.e., not technical or recordkeeping) provisions of ECOA or the Fair Housing Act.

Congress intended that remedial actions would be imposed only on lenders that had been found to have violated the Fair Housing Act or ECOA by a court or administrative law judge, after a trial on the merits, and after that decision was no longer subject to appeal.[59]

Section 81.46(c)(1) provides that the Secretary shall direct a GSE to take remedial action only after a final determination has been made that a lender has violated ECOA or the Fair Housing Act. The term ''final determination'' means, within the context of § 81.46, a final administrative or judicial decision, after hearing or trial on the merits, which is not subject to appeal. For the purposes of finding that there has been a final determination that a lender violated the Fair Housing Act, the implementing regulations at 24 CFR 104.930 and 104.950 establish that a final decision may be made by the Secretary or a HUD Administrative Law Judge, and that a final decision becomes conclusive unless appealed within the statutory period. If a party to the case elects to have that case heard in U.S. District Court pursuant to section 812(o) of the Fair Housing Act, 42 U.S.C. 3612(o), the District Court may decide the case, and that decision becomes conclusive unless appealed within the period established by the Federal Rules of Appellate Procedure. For the purposes of finding a violation of ECOA, a final determination means that a final decision on a complaint must have been made by an appropriate United States District Court or any other court of competent jurisdiction, and that decision must be no longer subject to appeal.

Congress also indicated that after a final determination has been made that a lender violated the Fair Housing Act or ECOA, HUD should conduct a hearing on the record before imposing any remedial action.[60] The term ''final adjudication on the record,'' as used in section 1325(5) of the statute, provides for the use of the formal adjudicative process set forth in §§ 554–557 of the Administrative Procedure Act.

Freddie Mac objected to the phrase ''indefinite suspension'' as used in the rule. Freddie Mac claimed that, as used in the statute, ''suspension'' clearly implied a temporary (and definite) remedial action, and that HUD's use of the term ''indefinite'' suspension constituted a rule-created additional, more severe, form of remedy.

MBA addressed a related concern. In light of the broad scope of remedies outlined in the statute, MBA objected to the rule's use of the phrase ''other remedial action,'' saying that it was inappropriate for the Secretary to assert general discretion to take any other action against lenders without providing

[58] ''In the course of their day-to-day operations the enterprises are privy to and collect certain data which may be instructive regarding the practices of mortgage lenders. The reporting of such data should aid investigative efforts.'' S. Rep. at 43–44; *see also* sections 1325(2) and (3) of FHEFSSA.

[59] ''This section also provides for remedial actions against lenders who have been found to have violated the Fair Housing Act or the Equal Opportunity Act [sic] by the appropriate administrative agency with enforcement responsibility . . . . Any hearing regarding a remedial action should be held only after there has been a final administrative or judicial decision, after hearing or trial on the merits, and not subject to appeal, as provided in the applicable statute.'' S. Rep. at 44.

[60] ''Before imposing any remedial action, HUD shall conduct a hearing on the record in accordance with the Administrative Procedure Act.'' S. Rep. at 44.

the opportunity for notice and comment rulemaking as to what that action might be.

This final rule no longer includes the phrase ''other remedial action.'' However, HUD does not agree with Freddie Mac's assertion that the statutory term ''suspension'' is a limiting one. The terms ''temporary'' and ''indefinite'' clarify the statutory term, which did not provide any time limits for suspensions to be applied. Accordingly, this final rule continues to provide for temporary suspension or indefinite suspension as alternative remedial actions, depending upon the severity of the discriminatory conduct.

Freddie Mac also objected to the fact that the rule does not provide it with a role in connection with any administrative hearing concerning remedial action against a lender. In contrast, the ABA, although supportive of GSE positions on several issues, found no fault with the procedural protections in the proposed rule, and stated its belief that the rule provides necessary and appropriate procedural safeguards for lenders. The statute does not provide a role for the GSEs in connection with an administrative hearing concerning remedial action against a lender.

Additionally, Freddie Mac regarded the list of factors to be considered in determining whether to apply a remedial action, found at § 81.46(c)(3) of the proposed rule, as excessively broad, inclusive of potentially irrelevant considerations, and in contravention of the statute's express intent to limit remedial actions to final adjudications. This final rule provides useful guidance in carrying out the statutory requirement, in section 1325(5), that the Secretary shall direct the GSEs to undertake appropriate remedial actions. The rule states that before giving the GSEs and the lender notice of any remedial action to be taken, the Secretary shall, as a threshold matter, solicit and fully consider the views of the Federal financial regulatory agency responsible for the subject lender. If such responsible Federal financial regulatory agency makes a written determination that a particular remedial action will threaten the financial safety and soundness of the lender, the Secretary shall consider other remedial actions. For the purposes of § 81.46, ''remedial actions'' will include only those actions relating to the business relationship between the GSE and the lender.

The rule provides a list of factors to be considered when directing remedial action. This list has been shortened in this final rule to combine similar factors, in accordance with the President's initiative on regulatory reform. For example, in determining the appropriate remedial action, the Secretary may consider a lender's history with respect to enforcement actions or lawsuits brought against it under ECOA, the Fair Housing Act, or substantially equivalent state or local laws, including cases that are conciliated, settled, or otherwise resolved, as well as private fair housing lawsuits and judgments, settlements, conciliations, or other resolutions. Conciliations and settlements may be considered as mitigating or aggravating factors. For example, a broad class settlement with comprehensive remedial relief may evidence a lender's good faith and affirmative attempts to correct discrimination and may be a mitigating factor when determining whether to impose a remedial action pursuant to § 81.46 against that lender based on an adjudicated finding involving isolated discriminatory acts of a single employee. On the other hand, if a lender enters into a similar settlement, but fails to adhere to it, that may be viewed as an aggravating factor when determining whether to impose a remedial action based on an adjudicated finding that the lender has engaged in discrimination. Similarly, if a GSE has taken action against a lender under its own policies or contractual agreements, such action may also be considered as a mitigating or aggravating factor, depending upon the circumstances and the remedial action under consideration.

HUD recognizes that in selling loans to the secondary market, lenders are required to use the secondary market's underwriting guidelines. Under § 81.46(c)(3)(viii) of this final rule, to the extent that a primary lender is found liable under the Fair Housing Act or ECOA for use of a facially neutral, appropriately applied underwriting guideline that is required in order to sell loans to a secondary mortgage market, the Secretary will take that into account in determining the appropriate sanction, if any, to direct the GSE to impose on the primary lender. In such instances, the Secretary will generally direct a settlement or a reprimand as a remedial action.

The statute did not provide for any special consideration of the effect of remedial actions on the GSEs. However, as provided in § 81.46(c)(3), where warranted, the Secretary shall solicit and fully consider the views of the Director regarding the effect of the action(s) that are contemplated on the safety and soundness of the GSE. In addition, § 81.46(c)(3)(ix) of this final rule provides that ''[a]ny other information deemed relevant by the Secretary'' may be taken into account in determining the level of remedial action, and information concerning the impact on the GSEs may be relevant in particular cases.

Additional Fair Lending Issues

The Western League of Savings Institutions encouraged HUD to approach the task of overseeing fair lending practices from an entirely different perspective. HUD, the commenter said, should be concerned with marketplace entities ''not currently subject'' to Federal regulation, and objected to what it perceived as ''dual oversight'' of some depositary institutions. It also recommended that, since HUD will review and comment on existing and revised GSE underwriting guidelines under the regulation, lenders who rely on those underwriting guidelines should be provided a ''safe harbor'' in the regulation.

Regarding the commenter's concern about ''dual oversight,'' FHEFSSA requires HUD to assume certain enforcement responsibilities, and it does not permit HUD to limit this oversight to particular institutions. In response to the request for a ''safe harbor,'' HUD does not believe this regulation is the appropriate vehicle to address the liability of lenders under the Fair Housing Act. The statute speaks only to the sanctions which the Secretary shall mandate that a GSE impose on a primary lender after an adjudication that the primary lender has discriminated. In directing a sanction under FHEFSSA, the Secretary relies on a prior judicial or administrative determination of a Fair Housing Act or ECOA violation. HUD recognizes that lenders are subject to the investigative and enforcement powers under the fair lending laws of HUD, the Department of Justice, the federal financial regulatory agencies and the FTC. To limit duplicative enforcement activities, HUD will ordinarily ensure that remedial actions the Secretary directs a GSE to take against a lender will not be in the nature of those which could have been, but were not, imposed directly against a lender in the course of an enforcement action by HUD, the Department of Justice, or the lender's primary regulator. HUD will consider, as factors in this determination, whether HUD, the Department of Justice, or the lender's primary regulator took an enforcement action, whether the sanction was a result of private litigation, whether additional facts have come to light, and whether the law has changed.

Industry commenters generally opposed the ''fair lending plan'' suggestion on which HUD sought comment and posed questions. Other commenters asserted that the GSEs should be required to prepare a fair lending plan. In the interest of reducing regulatory burden, HUD has not included a fair lending plan as a requirement in the final rule.

Subpart D—New Program Approval

In General

Section 1322(a) of FHEFSSA charges the Secretary with ''requir[ing] each [GSE] to obtain the approval of the Secretary for any new program of the [GSE] before implementing the program.''

The provisions of the proposed rule which sought to implement this authority met with strong objections from the GSEs and others. In light of the comments, which are detailed below, these provisions have been significantly revised to assure that: (1) the program review process is *not* unnecessarily burdensome; (2) ambiguity in the definition of terms cannot conceivably lead to required HUD approval of undertakings other than those reasonably recognizable as ''new programs''; and (3) constructive innovations by the GSEs, involving variations on existing programs, will be neither delayed nor derailed by HUD review processes. The revision of subpart D consists, in large measure, of conforming its language in key areas with the provisions of the statute with only the addition of necessary housekeeping provisions.

In light of the significant changes in the provisions on new program approval included in this final rule, this preamble summarizes the positions of the GSEs and other commenters in less detail than would be necessary were the proposed rule to have been adopted with only minor alteration. However, all of the comments on the proposal have been thoroughly reviewed by HUD. In general, the comments argued that: (1) HUD did not have statutory authority to promulgate the new program approval provisions of the proposed rule; and (2) these provisions would result in inappropriate micromanagement of the GSEs by HUD, which would inhibit the GSEs' flexibility and ability to adopt new products quickly. The Secretary is confident that: (1) HUD does have the statutory authority to establish new program approval procedures as described in the proposed rule; and (2) these procedures would not have inevitably led to micromanagement. Nonetheless, substantial changes were made to this section to address the concern of the GSEs and other commenters with the proposed procedures. The changes should not be interpreted as reflecting concurrence with the bulk of the comments but rather as an effort toward streamlining the final rule.

The Comments

Both entities read the proposal's definitions of ''new program'' and ''significantly different programs'' as effectively requiring that the Secretary's approval be sought for ''product variations, pilots, and demonstrations'' within existing GSE programs. Based on this expansive interpretation, the GSEs argued that the proposal would exceed the Secretary's authority.[61] Each GSE recommended that the Secretary withdraw the entire subpart,[62] or, in the alternative, simply track the statutory language, without embellishment.

Fannie Mae claimed that these provisions were: (1) arbitrary and capricious, and failed to consider relevant ''business necessities''; (2) an impermissible attempt by the Secretary to ''micro-manage'' the GSEs; (3) inconsistent with expressed congressional intent; (4) not contemplated by FHEFSSA, and unauthorized under the Secretary's general regulatory authority; and (5) inconsistent with the ''general principles'' set out by HUD as governing its own approach to rulemaking in this instance. Fannie Mae also argued that, during its 20 years of experience with HUD's existing program approval process, no evidence exists that a detailed regulation similar to that proposed was necessary.

Freddie Mac's comments were nearly identical. Freddie Mac concluded that the definitions contained in the proposed rule would lead to an enormous expansion of GSE activities subject to Secretarial review. Freddie Mac's comments suggested that: (1) The only threshold for submission of matters for new program review should be whether they are ''significantly different'' from prior programs; (2) only section 305 of the Freddie Mac Charter may serve as a basis for denying a new program approval request; (3) the term ''program'' should be defined to refer only to ''any broad and general plan or course of action for the purchasing, servicing, selling, lending on the security of, or otherwise dealing in conventional mortgages;'' (4) any reference to ''pilot or demonstration program''—the only part of the proposed definition that does not appear in the statute—be stricken; and (5) no attempt should be made to define when a program is ''significantly different,'' relying, instead, on the GSEs' to submit ''truly significant new initiatives'' for prior approval.

Some industry commenters, including the ABA, that joined the GSEs in questioning the scope of subpart D clearly believed that a more carefully tailored version of the approval provisions would be useful. These commenters believed it important that HUD ensure that ''the GSEs' activities are restricted to those activities they were chartered to do—purchase and securitize mortgages.''

Commenters, whether supportive of the GSE position or concerned about restricting the GSEs to Charter Act purposes, consistently argued that flexibility and the ability to move quickly to adopt new products were essential elements of the GSEs' contribution to affordable housing. A few commenters suggested that the Secretary allow the GSEs greater latitude to begin implementation of new programs, but to review the new activity ''as it is being introduced, to determine if it should be curtailed or modified.''

The Secretary's Response

Section 1322—new program approval—is an essential responsibility of HUD and the Federal Government to ensure that the GSEs remain faithful to their statutory purposes and serve the public interest. Accordingly, while significant revisions have been made, the final rule does not diminish the importance of this function. The GSEs argued that no regulation was required to carry out this function. The Secretary believes the final rule properly recognizes this statutory duty and establishes a mechanism for carrying out the responsibility assigned.

The Final Rule

The rule has been streamlined considerably to address the GSEs' apprehension about micromanagement to which the proposed rule apparently

[61] Comments from NAR took a different view: ''We are not contesting the Department's authority to conduct such program approval, since we believe the statute is very clear on this point.'' Nevertheless, NAR believed the proposed rule's new program review authority was ''too broad and ambiguous'' and recommended that the ''parameters for identifying new programs need to be clarified.''

[62] Although many other commenters also were critical of features of the New Program Approvals subpart, only a few joined the GSEs in recommending the subpart's total withdrawal. The MBA, NAMB, and the California Association of Realtors did recommend withdrawal of the subpart. MBA recommended, alternatively, elimination of the New Program Approvals provisions or limiting them to the precise terms of FHEFSSA, which, MBA declared, ''are self-implementing.''

gave rise. The Secretary has removed the definition of ''significantly different programs'' contained in § 81.52(e) of the proposed rule and will use only the statutory definition of new program. Although many believed the proposed definition included virtually all new GSE activities in new products, the definition was intended to clarify that the Secretary's authority extended only to genuinely new programs—and not to new products. Because the definition seems to have added to, not reduced, the confusion, the definition has been dropped.

The final rule also eliminates, in the definition of ''new program'' in § 81.2, the reference to *pilot or demonstration program*(s). The proposed § 81.52(d) has been eliminated. That section provided that ''grandfathered'' programs remained subject to any limitations and requirements included in the Secretary's approval of the new programs. This concept is inherent in FHEFSSA's definition of ''new program'' and was superfluous. For similar reasons, the rule also eliminates specific reference to activities carried out under sections 309(h) of the Fannie Mae Charter Act or 303(d) of the Freddie Mac Act.

In lieu of the proposed requirement that the GSEs submit requests for programs that ''reasonably raise questions'' as to whether they are significantly different, the final rule maintains only, in § 81.52(d), the provision that the Secretary may request information about a program where the Secretary believes that the program may be subject to HUD review. Where, based on the information submitted, the Secretary determines such a request is warranted under the statute, the rule preserves the Secretary's authority to require that the GSE submit a request. This provision is consistent with the legislative intent that a new program that differs significantly ''must be submitted for prior approval.'' [63]

Freddie Mac commented that the GSEs have a ''right * * * not to submit matters for approval that are beyond the scope of * * * the Act.'' Submissions for programs will only be required where the program is within the scope of FHEFSSA's review requirements. In the course of any such submission, the regulation invites the affected GSE to indicate in its response its views respecting whether the program is, in fact, subject to the Secretary's review.

Section 1322(c)(1) of FHEFSSA requires that a GSE ''submit to the Secretary a written request for approval * * * that *describes* the program.'' This final rule sets out the precise information the Secretary regards as necessary for the ''description'' of a new program. The information requested in § 81.53(b) of the final rule is the minimum necessary to carry out the Secretary's statutory duty. These are essential housekeeping requirements; they place no excessive burdens on the GSEs and are tailored to the principal goals of the Secretary's review: assurance that new program initiatives comport with the Charter Acts and are in the public interest. Under FHEFSSA, unless additional information is required, the Secretary must complete a new program review within 45 days. The housekeeping requirements will facilitate the review process and likely obviate the need for additional information.

With the substantial revisions that have been made, the final rule represents an effort to demonstrate that the Secretary will act in the least intrusive manner possible. The Secretary does not want to promulgate a regulation that imposes excessive burdens on the GSEs, or that addresses problems that are not expected to arise. The Secretary believes that new program requests can be acted upon in a less intrusive manner than the procedures set out in the proposed rule may have suggested.

The Secretary has reason to believe, based on experience, that the GSEs will act properly. In the event the Secretary believes that a GSE has undertaken a ''new program'' within the meaning of the statute without prior approval, FHEFSSA and the final rule contain adequate mechanisms for effective inquiry. Furthermore, the Secretary has adequate statutory and regulatory authority to revise this rule in the future, should events prove that a more detailed rule is necessary to carry out the Secretary's mandate.

Subpart E—Reporting Requirements

Sections 309(m) and (n) of the Fannie Mae Charter Act and 307(e) and (f) of the Freddie Mac Act require that the GSEs submit data about their mortgage purchases to the Secretary and submit reports to Congress and the Secretary concerning the GSEs' housing activities. FHEFSSA, at section 1326, mandates that the Secretary require each GSE ''to submit reports on its activities to the Secretary as the Secretary considers appropriate.'' Section 1324 of FHEFSSA requires that the Secretary report to Congress by June 30 of each year on the activities of the GSEs. This final rule implements all of the applicable reporting requirements, to enable the Secretary to monitor the GSEs' activities and report to Congress appropriately.

In promulgating the proposed rule, the Secretary reviewed the reporting requirements for Fannie Mae, contained in the then-existing Fannie Mae regulation, which required Fannie Mae to submit numerous reports to the Secretary. The Secretary determined that a simpler, more effective and less burdensome reporting system should be instituted for both GSEs.

Mortgage Reports, Section 81.62

Although reporting requirements in the proposed rule were streamlined compared to earlier requirements imposed by the Secretary, Freddie Mac found the reporting requirements ''excessive.'' In particular, Freddie Mac objected to submitting loan-level data on a quarterly basis. Freddie Mac asserted that quarterly loan-level data submissions were never contemplated by Congress and that Congress intended that a level of information equivalent only to that obtained from annual reporting under HMDA would be required. Fannie Mae argued that quarterly reports of loan-level data could potentially provide a misleading picture of performance.

Consistent with the Administration's efforts to streamline regulations and reduce reporting requirements, the Secretary has further reduced the frequency and the volume of data submissions. Section 81.62 requires the following information:

- First- and third-quarters reports—tables aggregating loan-level mortgage data; and
- Second- and fourth-quarter reports—tables aggregating loan-level mortgage data as well as loan-level data.

Thus, instead of requiring the submission of the loan-level data with each quarterly report, as proposed, the final rule now requires submission of loan-level data only with the second and fourth quarter reports. (The fourth quarter mortgage report also now serves as the Annual Mortgage Report and is designated as such.) In response to GSE comments, the final rule also clarifies that the quarterly mortgage reports need only include year-to-date data, not quarterly data plus year-to-date data as suggested in the proposed rule.

FHEFSSA charges the Secretary with responsibility for monitoring and enforcing the GSEs' compliance with the housing goals during the course of each year, and requires that the Secretary take action where a GSE fails—or there is a substantial probability that a GSE will fail—to meet any housing goal. The Secretary has determined that quarterly reports, with semiannual reporting of loan-level data, are essential to ensuring that the

[63] S. Rep. at 2.

Secretary has the minimum information needed to carry out these monitoring, compliance, and other regulatory responsibilities.

Requiring quarterly reporting is well within the Secretary's authority under FHEFSSA. The Secretary, under section 1321, has ''general regulatory power over each enterprise and shall make such rules and regulations as shall be necessary and proper to ensure that this part and the purposes of the [Charter Acts] are accomplished.'' Section 1327 mandates that the Secretary require reports on the GSEs' activities ''as appropriate,'' and FHEFSSA's amendments to the Charter Acts specifically require the GSEs to collect, maintain, and provide to the Secretary detailed data on mortgages purchased financing both single-family and multifamily properties ''in a form determined by the Secretary.'' [64]

No convincing indication [65] exists that Congress intended the HMDA schedules or procedures to serve as a controlling model.[66] FHEFSSA did not seek to lessen reporting. Indeed, FHEFSSA required detailed reporting of mortgage data and extensive annual reporting on GSE housing activities to both Congress and the Secretary. In enacting FHEFSSA, Congress was particularly concerned about the lack of information on the GSEs' mortgage purchases. The legislative history describes FHEFSSA's reporting requirements and states:

> * * * an information vacuum has severely impeded Congressional efforts to measure Fannie Mae's compliance with regulatory housing goals that have been in force since 1978. The committee believes that enactment of this bill will fill this vacuum on an expeditious basis by mandating the creation of modern state of the art data systems by both enterprises.[67]

Freddie Mac also expressed concern about the disclosure of mortgage data on less than an annual basis; *e.g.*, if Freddie Mac provided first-quarter loan-level data, it did not want that data released until after the end of the year, and Freddie Mac wanted the data included with all other data from that year so that the timing of its mortgage purchases could not be determined.

It was not intended that quarterly or semi-annual loan-level data be placed in the public-use database. Loan-level data submitted with the second-quarter report are required only so that the Secretary can assess the GSE's current condition under the goals, to facilitate the Secretary's monitoring functions; the final rule so indicates. Because other-than-year-end loan-level data are by nature preliminary, submitted as a condition report, subject to revision, and may cause substantial harm if prematurely released, the inclusion of such data in the public-use database would be inappropriate. Of the mortgage data submitted under section 309(m) of the Fannie Mae Charter Act and section 307(e) of the Freddie Mac Act, the only loan-level mortgage data that shall be placed in the public-use database is year-end data, consistent with subpart F of this rule.

Freddie Mac stated that developing and modifying its systems to comply with these reporting requirements would take some time and, because of this, Freddie Mac requested an exemption from reporting for a reasonable time following the issuance of final regulations. In response, notwithstanding the effective date for other provisions of this rule, the second-quarter mortgage report for 1996 is the first such report required.

Annual Housing Activities Report, Section 81.63

FHEFSSA requires the GSEs to submit an Annual Housing Activities Report (AHAR) to Congress and the Secretary. Under FHEFSSA, the AHAR must, among other things, describe actions that the GSE has undertaken during the preceding year or is planning to undertake to: promote and expand its attainment of its statutory purposes; standardize credit terms and underwriting guidelines for multifamily housing and securitize multifamily housing mortgages; and promote and expand opportunities for first-time home buyers. FHEFSSA also requires that, for the AHAR, the GSEs assess underwriting standards and other business practices and procedures that affect the purchase of mortgages for low- and moderate-income families or that may yield disparate results. The AHAR also must include annual compilations of year-to-date mortgage data (but not loan-level data) and any other information that the Secretary considers necessary for the report and requests in writing.

Fannie Mae objected to the requirement that the AHAR provide information on the extent to which the mortgages purchased ''have been used in conjunction with public subsidy programs.'' Fannie Mae argued that it was only required to report on subsidy programs ''under Federal law'' and that the proposed ''public subsidy'' requirement was too broad, administratively burdensome, time-consuming, and unreliable, because lenders frequently do not report the presence of State/local subsidy programs.

While the Charter Act amendments do specifically require the GSEs to provide information on the extent to which mortgage purchases have been used in conjunction with public subsidy programs under Federal law, the Secretary may require information concerning the presence of non-Federal subsidies under FHEFSSA's authorization to the Secretary to ''request other information [for the AHAR] that the Secretary considers appropriate.'' Nevertheless, HUD has decided to remove this requirement because information on public subsidies is frequently unavailable and often inaccurate, and generally cannot be obtained in sufficient detail to be useful.

The proposed rule would have required each GSE to provide an AHAR within 60 days after the end of each calendar year. Fannie Mae asked that this period be extended to 90 days. Since FHEFSSA requires that the Secretary report to Congress by June 30 of each year on the activities of each GSE, the GSEs' AHARs are needed substantially prior to that date in order to allow sufficient time for HUD to develop the Secretary's report. In an attempt to address the needs of the GSEs and HUD, the final rule provides that AHARs will be due 75 days after the end of the calendar year. The first AHAR required under this rule will be the report covering calendar year 1996 (due in 1997).

Periodic Reports, Section 81.64

Fannie Mae objected to the requirement in § 81.64 of the proposed rule that all releases of information disclosed to entities outside the GSE be submitted to HUD. Fannie Mae argued that the requirement: was excessive, expensive, and of no practical use to HUD; violated the principles of Executive Order 12866; and could compromise the GSE's competitive position and the need for confidentiality. Fannie Mae suggested that the requirement be removed from the regulation or modified to specify that the GSEs need provide to HUD only ''significant announcements'' and could provide those simultaneously with public announcement.

While the burden of compliance with § 81.64 has been exaggerated, no necessity exists for transmittal of

[64] Sections 307(e)(1)(E) of the Freddie Mac Act and 309(m)(1) of the Fannie Mae Charter Act.

[65] The House Bill, H.R. 2900, 102d Cong., 1st Sess., did require ''annual'' reporting in the HMDA manner. However, sections 121(l) and 122(k) of that bill were changed substantially before the law was enacted.

[66] The Senate Report expressed Congressional intent that the Secretary should be more aggressive in monitoring the GSEs' activities. *See* S. Rep. at 33.

[67] S. Rep. at 38–39.

insignificant data. For this reason, HUD has revised § 81.64 to create a self-policing mechanism. The specific categories of information listed in the section—*i.e.*, Housing Advisory Council material, press releases, investor reports, proxy statements, and seller-servicer guides—must all be provided to the Secretary. For all other information released to entities outside the GSE, if the GSE determines that such information is relevant to the Secretary's regulatory responsibilities under FHEFSSA or its Charter Act, the GSE must provide the information to the Secretary. At the same time, the Secretary continues to have the authority to request information on an as-needed basis.

Other Information and Analyses, Section 81.65

Freddie Mac opposed § 81.65 of the proposed rule, which stated that ''GSEs shall furnish to the Secretary the data underlying the reports required under this subpart.'' Freddie Mac called such ''open-ended'' requirements burdensome, costly, and not reasonably related to the Secretary's mission. Freddie Mac said that any additional reports the Secretary may wish to require must be related to Charter Act activities of the GSEs. Fannie Mae also objected to this requirement and suggested that ''underlying data'' should instead be requested by HUD on a case-by-case and ''as-needed'' basis.

The Secretary's broad authority to require reports under section 1327 of FHEFSSA encompasses the authority to require additional analyses and reports that the Secretary considers ''appropriate.'' However, requirements in the proposed rule for the GSEs to submit ''underlying data'' were not intended to require that the GSEs submit a massive quantity of data as a matter of course in support of each report. In fact, underlying data will only be sought by the Secretary on a case-by-case basis. Therefore, any required submission of underlying data will be the subject of a specific request from the Secretary to one or both GSEs and will be based on an actual need for supporting data in order to fulfill the Secretary's responsibilities. The final rule has been clarified to this effect.

Other Reporting Issues

Published simultaneously with this final rule is an Appendix E which is a list entitled ''Required Loan-level Data Elements'' which details the reporting formats and the loan-level data elements required to be collected and compiled by each GSE on each single-family and multifamily mortgage purchased. The Secretary may revise the list of loan-level data by notice to the GSEs. Fannie Mae, referencing the proposed rule's loan-level data listings, objected to submitting the following data elements, identified by their numerical listing in the Appendix to the proposed rule:

- For single-family mortgage purchases—Number 24, Refinancing Loan from Own Portfolio; Number 31, Lender Institution; Number 38, Public Subsidy Program; Numbers 45 and 46, Family size of borrower (and co-borrower); and Numbers 54 and 55, Low- and Moderate-Income Goal flag and Special Affordable Housing Goal flag; and
- For multifamily mortgage purchases—Number 26, Lender institution; Number 36, Low and Moderate-Income Goal flag; and Number 37, Special Affordable Housing Goal flag.

Fannie Mae's objections to these data elements were based, variously, on relevancy, unavailability of the data in existing information databases, unreliability of data furnished by lenders, and availability of the data to HUD by other means. In addition, Fannie Mae commented that the furnishing of ''lender institution'' data would violate confidentiality between Fannie Mae and its lenders.

Data Element Number 24, Refinancing Loan from Own Portfolio, is not required in the final rule, because these data were required under the interim notices for technical monitoring purposes that no longer apply.

Data Elements Number 31 (Single-family) and Number 26 (Multifamily), designating Lender Institution (Element Number 27 in Appendix E of this final rule), are important elements for the monitoring of GSE reporting. The name of the lender institution will facilitate the Secretary's verification of loans reported as being sold to the GSEs. Since these data are already reported by lenders under HMDA, disclosing the lender institution would not violate confidentiality between the GSEs and their lenders.

Data Element Number 38, Public Subsidy Program data (for single-family properties), have not been reported by Fannie Mae because it asserts that the data are of such poor quality that the data are not meaningful. Freddie Mac has reported public subsidy data to HUD, but Freddie Mac's data indicates that public subsidies are involved in less than one-quarter of one percent of its single-family mortgage purchases. Given the available data, this data element has been deleted from the list of required data elements.

Data Elements Numbers 45 and 46, Family size of borrower (and co-borrower), are not currently collected by the GSEs, and the final rule does not require the GSEs to collect these data at this time. However, because family size is an important element for determining the affordability of units, the Secretary reserves the right to collect these data at a later date.

Data Elements Numbers 54 and 55 (Single-family) and Numbers 36 and 37 (Multifamily), Low- and Moderate-Income Goal flag and Special Affordable Housing Goal flag, are not required fields under the final rule. The Secretary has determined that this information can be derived from other data elements.

Although HAC commented that the Secretary should use census tracts/BNAs instead of counties, in the definition of rural areas, HAC also commented that, if a county-based definition is used, the Secretary should insist that the GSEs at least report their progress under the Geographically Targeted Goal by census tract/BNA, ''so that HUD can determine the extent to which the GSEs are meeting the goal in purchasing mortgages in 'served' portions of counties.'' Accordingly, although the Secretary has changed the definition of rural areas from a census tract to a county basis (as discussed above), the final rule (at Data Element Number 7) requires the BNA locations for mortgage purchases, to facilitate research and analyses of GSE purchases in non-metropolitan areas. Since 1993, the GSEs have been reporting to HUD BNA locations of mortgages located in non-metropolitan areas.

Subpart F—Access to Information

FHEFSSA requires the Secretary to establish a public-use database and release to the public certain categories of information submitted by the GSEs concerning their mortgage purchases. The statute also requires protection of proprietary information the GSEs submit to the Secretary.

FHEFSSA requires a public-use database so that the public will have access to data and information on the GSEs' performance toward meeting the Charter Act purposes of providing mortgage credit to the broadest range of families throughout the nation. Congress indicated its intent that the GSE public-use database supplement HMDA data.[68] In complying with the public-use database requirements, HUD will make publicly available maximum nonproprietary mortgage purchase data and information to the widest range of

[68] *See, e.g.*, S. Rep. at 39.

housing groups, State and local governmental entities, academicians, and other persons and entities, so that, for example, these entities may monitor the efforts of the GSEs toward meeting their Charter Act purposes.

''Balancing'' Test

The preamble to the proposed rule stated that, in making as much data as possible available, the Secretary would engage in ''balancing the proprietary concerns of the GSEs.'' Freddie Mac commented, however, that Congress did not intend the Secretary to balance the public interest to determine whether information was proprietary; rather Congress encouraged the Secretary to ''be creative in finding ways to release certain types of information—without revealing proprietary information.''

Neither the preamble nor the final rule incorporates a balancing test for determining whether information is proprietary. While the legislative history of FHEFSSA does discuss ''balanc[ing] the sometimes competing interests of the enterprises against the public's interest in access to information,'' it also provides that HUD should ''whenever possible develop disclosure and access methods that take into account any proprietary concerns, while continuing public access to information.'' [69] Therefore, the Secretary has determined that the public interest in knowing about the GSEs' activities must be addressed through the careful and considered design of a public-use database that makes maximum appropriate data and information available to the public in creative ways—including aggregating—while protecting proprietary information.

Definition of ''Proprietary Information''

Section 1326 of FHEFSSA authorizes the Secretary to provide, by regulation or order, that certain information shall be treated as ''proprietary information'' and not subject to disclosure to the public either (1) in the public-use database established pursuant to section 1323 (which consists of mortgage data submitted by the GSEs under section 309(m) of the Fannie Mae Charter Act and section 307(e) of the Freddie Mac Act); or (2) through public dissemination of the AHARs of the GSEs (which the GSEs submit to the Secretary and Congress pursuant to sections 309(n)(3) of the Fannie Mae Charter Act and 307(f)(3) of the Freddie Mac Act). Section 81.2 of the proposed rule defined the term ''proprietary information'' as ''all categories of information and data submitted to the Secretary by a GSE that contain trade secrets or privileged or confidential, commercial or financial information that, if released, would cause the GSE substantial competitive harm.''

Consistent with the statutory language of section 1326 of FHEFSSA and in light of the comments by the GSEs, the final rule clarifies that the designation ''proprietary information'' for purposes of this rule applies only to mortgage data (that the GSEs submit to the Secretary under sections 309(m) of the Fannie Mae Charter Act and 307(e) of the Freddie Mac Act), and AHAR information (that the GSEs submit to the Secretary under sections 309(n) of the Fannie Mae Charter Act and 307(f) of the Freddie Mac Act), since other types of information are not candidates for inclusion in the public-use data base. However, as discussed more fully below, where a GSE seeks to protect from disclosure confidential business information that is not mortgage data that the GSE submits to the Secretary under section 309(m) of the Fannie Mae Charter Act or section 307(e) of the Freddie Mac Act, and is not information that the GSE submits to the Secretary in the AHARs under section 309(n) of the Fannie Mae Charter Act or section 307(f) of the Freddie Mac Act, the GSE may seek protection of such confidential business information under HUD regulations at 24 CFR Part 15. This final rule clarifies and supplements Part 15 with respect to GSE information. FHEFSSA's specific designation of data and information as ''proprietary information'' is designed to distinguish that mortgage data and AHAR information that is to be included in the public-use database and disseminated to the public and data that may be withheld. It is not to be confused with the function that the designation of information as ''confidential business information'' serves under Part 15. (That term distinguishes business information, as defined in 24 CFR 15.54, which a submitter may seek to have withheld from public disclosure under the Freedom of Information Act (FOIA) [70], from other information.)

The issue of the scope of mortgage data that should be treated as ''proprietary'' and withheld from public disclosure drew only limited comment. Only ten of the 163 public comments treated the issue in any level of detail.

Both GSEs commented extensively on this subpart of the rule, recommending protections against the release of certain identified data elements the GSEs considered proprietary. Six of the other ten commenters (including MBA and NAHB) supported the GSEs' position favoring strong controls on release of proprietary information. In contrast, the American Civil Liberties Union Foundation (ACLU), in comments filed on behalf of ACLU, the NAACP Legal Defense and Educational Fund, Inc., the Puerto Rican Legal Defense and Education Fund, and the National Council of La Raza, favored strict limitations on treating information provided by the GSEs under FHEFSSA as proprietary.

The Prospect of Competitive Harm

While Freddie Mac indicated that the definition of proprietary information in the proposed rule was ''generally consistent'' with definitions of the term in similar contexts, Freddie Mac proposed several additions to the scope of the definition. Freddie Mac, citing FHEFSSA's legislative history, contended that it was the intention of Congress that the Secretary withhold data if it ''would be likely to cause the GSE substantial competitive or financial harm, or substantial harm to the GSE's ability to fulfill its statutory purposes.'' In suggesting that the term ''financial harm'' be added, Freddie Mac criticized the use of the term ''competitive harm'' by itself as too narrow. In suggesting that the ability to fulfill statutory purposes be added, Freddie Mac argued that because the GSEs have ''express public purposes,'' it is not merely competitive harm that must be averted, but also the possibility that disclosure of data could ''frustrate the GSEs' ability to fulfill their statutory purposes, by decreasing the liquidity of the secondary mortgage market and [thus] decreasing market stability.''

Fannie Mae pointed out that it had asked for proprietary protection for only 23 of 80 database elements. Fannie Mae, in supplementary comments dated July 24, 1995, urged the adoption of the revisions to the definition of ''proprietary information'' indicated in Freddie Mac's comments.

The final rule adopts the GSEs' comment that the definition include a ''likely to cause competitive harm'' standard. HUD finds this formulation to be consistent with the body of case law interpreting Exemption 4 of FOIA,[71] which focuses on likely competitive harm,[72] as well as related regulations of other Federal financial regulators governing the confidentiality of business information.[73]

[69] S. Rep. at 44.

[70] 5 U.S.C. 552.

[71] 5 U.S.C. 552(b)(4); 24 CFR 15.21(a)(4).

[72] *See Critical Mass Energy Project v. NRC,* 975 F.2d 871 (D.C. Cir. 1992), *cert. denied,* 113 S. Ct. 1579 (1993).

[73] *See, e.g.,* 40 CFR 2.208(e)(1); 19 CFR 201.6(a).

Exemption 4 of FOIA authorizes the withholding of ''trade secrets and commercial or financial information obtained from a person and privileged or confidential.'' Accordingly, the exemption covers material that is substantively very similar to the information protected as proprietary under FHEFSSA. Because the case law interpreting the FOIA exemption is well-developed and FHEFSSA does not define the term ''proprietary,'' HUD has chosen to formulate a definition that largely tracks interpretations of the FOIA exemption, so that interpretation of the term as it applies to mortgage data and AHAR information under FHEFSSA may draw upon the body of FOIA law.

It is not necessary to add a specific reference to ''financial'' harm to the definition of ''proprietary information.'' The exclusion of this term from the definition keeps the definition more consistent with FOIA provisions respecting confidential business information and related law. Section 81.74(b)(1) of the rule provides that the Secretary will consider information on adverse financial consequences that would result from disclosure, in determining what information is proprietary. In general, ''financial'' harm will also involve ''competitive'' harm. Even where the disclosure of information would not harm one GSE relative to the other, the disclosure may nonetheless cause competitive harm, because the GSEs also compete with other private-sector firms, as well as individuals seeking an advantage with respect to the GSEs. The definition, as modified, will protect against financial harm by protecting the GSEs against substantial competitive harm.

It is not necessary to expand the definition to refer specifically to the GSE's ability to fulfill statutory purposes. Again, exclusion of this terminology avoids inconsistency with FOIA and similar definitions. The final rule allows the GSEs to advance arguments, for the Secretary's consideration, regarding any effect that disclosure would have on the GSEs' ability to fulfill statutory purposes.

Plain Meaning

In its original comments—prior to its July 24, 1995, letter endorsing much of Freddie Mac's approach to the definition of ''proprietary''—Fannie Mae's comments on the definition of ''proprietary information'' focused on an assertion that the term ''proprietary'' has a settled ''plain'' meaning which should be incorporated into the rule, i.e., the entire range of business information that a GSE holds closely as an owner of private property. Fannie Mae supported its claim based on the definition in *Webster's* dictionary.

Supreme Court precedent, however, reveals that the established approach under case law is more complicated. The mere fact that a statutory term is defined in a dictionary does not establish the term's plain meaning or deny the agency charged with administration of the statute the authority to provide a reasonable interpretation.[74]

The term ''proprietary'' has several alternative dictionary definitions, depending on the dictionary consulted. Aside from the fact that the designation as ''proprietary information'' for purposes of FHEFSSA only applies to mortgage data and AHAR information, HUD's definition, as revised in this final rule, is similar to the definition Congress has ascribed to the term in other legislation, including statutes enacted just days before FHEFSSA's October 28, 1992, enactment date.[75] In addition, HUD's definition is generally consistent with the definitions of other Federal administrative agencies.[76]

The definition that Fannie Mae advanced is not legally supported and is too broad. If any information obtained and held by a person by virtue of being an owner of property qualifies as proprietary, all such information submitted to HUD would have to be withheld from disclosure. Such a definition would effectively undermine the Secretary's ability to release nonproprietary information; it would allow the GSEs to force proprietary treatment of any information by merely labeling it as such. Such a definition would also improperly apply the specific designation ''proprietary information'' under FHEFSSA to materials other than mortgage data and AHAR information.

Other Comments on Definition

Freddie Mac also asked that § 81.73 be augmented to provide that HUD take into account the extent to which particular information, when taken together with other information, could reveal proprietary information. This final rule has been modified to specify that this is one of the additional facts that the Secretary will consider.[77]

Public-use Database

Consistent with section 1323(a) of FHEFSSA, this final rule establishes a public-use database of mortgage data concerning the characteristics of individual mortgage purchases of the GSEs, including census tract, location, race, and gender of mortgagors.

In accordance with FHEFSSA, this final rule provides that the Secretary may not, by regulation or order, make available to the public information that the Secretary determines is proprietary information. The Secretary, however, may not restrict access to the income, census tract location, race, and gender data of single-family properties. When the Secretary grants a GSE's request for proprietary treatment of mortgage data, the Secretary will issue an order or promulgate a regulation providing that the mortgage data is proprietary and shall not be included in the public-use database.

In addition to mortgage data, the Secretary will make publicly available in the public-use database information in the GSEs' AHARs, which are submitted to the Secretary and Congress, and comprise a detailed picture of the GSEs' activities. Proprietary information in the AHARs may be withheld from the public if the GSE requests, and the Secretary agrees with, designation of the information as proprietary information, pursuant to a regulation or order.

On June 7, 1994, the Secretary published a Temporary Order[78] protecting GSE data and information deemed to be proprietary, pending public comment and further review. Published simultaneously with this final rule and adopted by the Secretary through this rule, is an Appendix 7 containing an Order entitled ''GSE Mortgage Data and AHAR Information: Proprietary Information/Public-use Data'' which Appendix F of this final rule contains the most current listing of data and information deemed proprietary by the Secretary and supersedes the Temporary Order. The Secretary may revise this list by regulation or order.

The public-use database also will not include information the release of which would invade personal privacy,[79]

[74] *See, e.g., National R.R. Passenger Corp.* v. *Boston & Me. Corp.*, 503 U.S. 407, 418–19 (1992).

[75] *See, e.g.*, 42 U.S.C. 13293 (Energy Policy Act of 1992, enacted Oct. 24, 1992); 10 U.S.C. 2506(e)(3) (Defense Conversion Reinvestment and Transition Assistance Act of 1992, enacted Oct. 23, 1992); 15 U.S.C. 5104(a) (Steel and Aluminum Energy Conservation and Technology Competitiveness Act of 1988).

[76] *See, e.g.*, 48 CFR 1805.202(d); 10 CFR 51.16(a); 10 CFR 1504.204(a).

[77] *See* § 81.74(b)(6).

[78] 59 FR 29514.

[79] A bank commented that it was concerned about ''right to privacy issues'' regarding communication between HUD and the GSEs: ''We hope that rights of individual borrowers are not compromised due to creative interpretations of the laws and regulations for the sake of political expediency.''

The Privacy Act of 1974, 5 U.S.C. 552a, and FOIA exemption 6, 5 U.S.C. 552(b)(6), pertain to the disclosure of information on individuals. HUD may

Continued

or information required to be withheld under the Trade Secrets Act.[80]

Availability of ''Public Data''

Section 81.2 of the rule revises the proposed rule's definition of ''public data'' to clarify that it only includes mortgage data submitted to the Secretary by the GSEs (under section 309(m) of the Fannie Mae Charter Act or 307(e) of the Freddie Mac Act) relating to the GSEs' mortgage purchases, and AHAR information (submitted to the Secretary by the GSEs under sections 309(n) of the Fannie Mae Charter Act or 307(f) of the Freddie Mac Act), to the extent that the Secretary determines such mortgage data or AHAR information is not proprietary and should be made publicly available. Freddie Mac was concerned that the definition in the proposed rule could be misconstrued to require HUD to disclose all nonproprietary mortgage data submitted to HUD, including data submitted for reasons unrelated to the rule's reporting requirement in § 81.62. Similarly, Fannie Mae had recommended that the definition be revised to limit its scope.

Under section 1323 of FHEFSSA, HUD has authority to include in the public-use database mortgage data required under section 309(m) of the Fannie Mae Charter Act or section 307(e) of the Freddie Mac Act. In addition, HUD will make publicly available the information in the GSEs' AHARs, except for information the Secretary determines to be proprietary.[81]

HUD's public-use database will only include mortgage data submitted by the GSEs under section 309(m) of the Fannie Mae Charter Act or section 307(e) of the Freddie Mac Act and information in the GSEs' AHARs, except for information the Secretary determines to be proprietary, and only where the Secretary determines that it ''should be made publicly available.'' Since other information or data that the GSEs may submit pursuant to subpart E would not fit the definitions of ''mortgage data'' or ''public data'' used in the rule, that information or data will not be included in the public-use database.

withhold information from the public pursuant to the Privacy Act or FOIA Exemption 6.

[80] 18 U.S.C. 1905.

[81] The GSEs are required by sections 309(n)(3)(B) and 307(f)(3)(B) their Charter Acts to make available publicly reports they provide to HUD pursuant to sections 309(n) and 307(f) of the Charter Acts, unless HUD has determined such information to be proprietary under section 1326 of FHEFSSA. HUD will facilitate this requirement by providing public access to this information.

Timing of Disclosure

In its comments on the proposed rule, Fannie Mae addressed public comments on the June 7, 1994, Temporary Order. Fannie Mae regarded as unpersuasive arguments that competitive harm to the GSEs would not occur because data would be outdated when finally released publicly. Fannie Mae commented that, for single-family products, a time lag of less than 12 months would be insufficient to allow adequate recovery of investment. In the case of multifamily products, Fannie Mae claimed that even the passage of 2 years would be insufficient protection, because competitive harm is caused by affording competitors crucial information allowing them to ''pick the loans off at liquidation, thereby eroding our market share and investment return on the market research and development that preceded our booking the loan initially.''

NAHB strongly supported the creation of a public-use database, but suggested compromise on the question of release of proprietary information. To address the GSEs' concerns regarding confidentiality of data, NAHB suggested that the Secretary grant requests for proprietary treatment for a specified time period, such as two years.

In analyzing whether information is proprietary, the Secretary will, when appropriate, consider the effect of the passage of time in determining if the release of information would likely cause substantial competitive harm.

Requests for Proprietary Treatment

The regulation establishes procedures for the GSEs to request proprietary treatment of mortgage data and AHAR information submitted to the Secretary and clarifies and supplements HUD regulations at 24 CFR Part 15 as they apply to GSE requests for confidential treatment of other business information. When a GSE submits information to the Secretary, the GSE shall designate what part of the information the GSE deems to be mortgage data or AHAR information that is ''proprietary information'' under FHEFSSA or other types of confidential business information for purposes of FOIA. Depending on the type of information submitted, HUD either will process the request in accordance with the procedures in §§ 81.73–81.75, or upon a FOIA request, in accordance with the procedures in 24 CFR Part 15 as clarified and supplemented in this subpart.

Section 81.73(d) of this final rule makes clear that while any request for proprietary treatment is pending, none of the information that is the subject of the request will be disclosed. Part 15 contains a similar protection, which applies to GSE submissions designated as confidential. HUD will not release material marked confidential except in accordance with Part 15 and this final rule.

Fannie Mae objected to the requirement in § 81.73 of the proposed rule that the GSE submit a certification and justification for the Secretary to designate mortgage data or information as ''proprietary information'' under FHEFSSA.

In response to Fannie Mae's comment, HUD has greatly streamlined the regulation. First, under § 81.73, it is now optional for the GSE to submit a statement explaining the bases for the GSE's assertion that mortgage data or AHAR information is proprietary. In instances in which HUD has not previously issued an order or regulation determining the data or information to be proprietary, HUD urges the GSEs to provide such a supporting statement and address in the statement the factors that the Secretary will consider in making determinations of whether data or information is proprietary. Conclusory statements that particular data or information would aid competitors or would impair business dealings, or similar statements, will not provide the kind of views that will be useful to the Secretary.

Second, the final rule eases the requirements by providing that where there is an existing regulation or order designating mortgage data or AHAR information as proprietary, it is sufficient for the GSE to stamp the information as proprietary and reference the order or regulation. When a GSE supports a request for proprietary treatment by citing an existing order or regulation, HUD will determine whether the data or information comes within the order or regulation. If the data or information is proprietary under such order or regulation, it will not be disclosed except in accordance with other provisions in this subpart, *e.g.*, Congressional requests.

The factors the Secretary will apply in making a determination in response to a request for proprietary treatment are identified in § 81.74. The factors in § 81.74(b) will be applied where the request for proprietary treatment pertains to data submitted by the GSEs in the reports required under section 309(m) of the Fannie Mae Charter Act or section 307(e) of the Freddie Mac Act, or AHAR information for which there is no order or regulation covering the materials for which proprietary treatment is requested.

When the Secretary accords proprietary treatment to mortgage data or AHAR information, the rule establishes procedures for the Secretary to issue a temporary order, an order, or a regulation to withhold proprietary information and to inform the public of the withholding. If the Secretary does not determine such mortgage data or AHAR information to be proprietary information, the Secretary will provide the GSE with an opportunity for a meeting on the matter, during which the GSE may provide comments and additional views. After the meeting, the Secretary will determine, in writing, which data or information is proprietary and will notify the GSE 10 working days before the data or information is made available to the public. The rule is now more consistent with HUD FOIA regulations regarding protections for confidential business information in general.[82]

FOIA Requests

Information on the GSEs may be requested by the public pursuant to FOIA. Subpart F of this rule clarifies and supplements HUD's FOIA regulations[83] with respect to information submitted by the GSEs.

FOIA provides that several classes of records are exempt from mandatory disclosure. A memorandum dated October 4, 1993, from the President to Heads of Departments and Agencies, emphasizes the importance of public disclosures under FOIA. The implementing memorandum from the Attorney General, attached to the President's memorandum, instructed agencies to disclose information unless disclosure would harm an interest protected by a FOIA exemption.

Additional Safeguards for Proprietary and Confidential Information

FOIA Exemption 8 protects from mandatory disclosure information ''contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of the Department in connection with its responsibility for the regulation or supervision of financial institutions.''[84] Section 1319F of FHEFSSA specifically provides that HUD is an agency responsible for the regulation and supervision of financial institutions for purposes of this exemption. Accordingly, where appropriate, the Secretary may invoke this exemption to withhold GSE information.

To address comments of Fannie Mae requesting additional safeguards for the protection of information, the rule also has been revised to clarify that while HUD may make information available for the confidential use of other government agencies in their official duties or functions, all such information remains the property of HUD, and unauthorized use or disclosure of information may be subject to the penalties provided in 18 U.S.C. 641.

FOIA Exemption 4 covers ''trade secrets and commercial or financial information obtained from a person and privileged or confidential.''[85] When appropriate, the Secretary may invoke this exemption to withhold GSE information in response to a FOIA request. In addition, the Trade Secrets Act forbids Government officers and employees from releasing trade secrets and other confidential business information. HUD will not disclose information in violation of the Trade Secrets Act, notwithstanding the indication in 24 CFR 15.21 that a requested record will not be withheld under FOIA unless it both comes within one of the FOIA exemptions and there is need in the public interest to withhold the record.

Fannie Mae commented that the Secretary should review the rules of the financial institution regulators governing the confidentiality of materials, and should incorporate the same protections for proprietary information. Fannie Mae commented that OFHEO was adopting its own confidentiality rules to parallel financial institution regulators' protections, and HUD and OFHEO should assure that all submitted materials receive ''consistent protection.''

On March 3, 1995, HUD promulgated new amendments to its FOIA regulations that incorporate explicit protections for business information in accordance with Executive Order 12600.[86] Part 15 regulations are fully applicable to GSE data and information provided to HUD. Indeed, Part 15 applies to a broader range of information that the GSEs submit to HUD, since they are not limited in applicability to mortgage data that the GSEs submit under section 309(m) of the Fannie Mae Charter Act or section 307(e) of the Freddie Mac Act and AHAR information the GSEs submit under section 309(n) of the Fannie Mae Charter Act or section 307(f) of the Freddie Mac Act. HUD has carefully reviewed the safeguards afforded by these new FOIA regulation amendments and this subpart and has concluded that many of the concerns raised by Fannie Mae regarding the protection of proprietary information were previously addressed through those amendments.

As indicated in the preamble to the revised FOIA rules, ''[t]he amendment consolidates the FOIA process under the supervision of a designated officer, which assures more consistent and prompt response to FOIA requests.'' Centralized control also serves to protect against erroneous disclosure. The FOIA amendments state that, except as otherwise provided, HUD officers and employees are prohibited from disclosing business information, except to other HUD officers or employees who are properly entitled to such information for the performance of their official duties.[87] This provision is similar to that of other financial regulators.[88]

In response to another Fannie Mae comment about disclosures by HUD's agents, HUD notes that its amended FOIA rules prohibit HUD officers and employees from directly or indirectly using or allowing the use of business information obtained through or in connection with Government employment that has not been made available to the general public.[89] Also, § 81.76(e) of this final rule includes safeguards against disclosure of GSE data and information by contractors. The FOIA regulations also provide other safeguards consistent with Executive Order 12600, which Fannie Mae commented should be included in HUD's regulations.[90]

When a GSE desires that HUD accord confidential treatment to information other than the mortgage data submitted by the GSEs in the reports required under section 309(m) of the Fannie Mae Charter Act or section 307(e) of the Freddie Mac Act, and other than AHAR information, the GSE should follow the procedures for protection from disclosure of such information in 24 CFR Part 15, as clarified and supplemented by this subpart.

Release of Information to Congress, Comptroller General, or Pursuant to Legal Process

Paragraph 81.76(d) of the proposed rule stipulated that the Secretary would provide information requested by Congress, the Comptroller General, or pursuant to subpoena or other legal process ''without regard to the provisions of this section.'' Both GSEs

[82] *See* 24 CFR 15.54(g).

[83] 24 CFR Part 15.

[84] 5 U.S.C. 552(b)(8); 24 CFR 15.21(a)(8).

[85] 5 U.S.C. 552(b)(4), 24 CFR 15.21(a)(4).

[86] *See* 24 CFR part 15, subpart F.

[87] 24 CFR 15.54(l)(2).

[88] *See, e.g.,* 12 CFR 309.6(b) (FDIC).

[89] 24 CFR 15.54(l)(1).

[90] *See* 24 CFR 15.54(f), (g), (i).

objected to this provision, and were supported by the MBA. Freddie Mac commented that the Secretary has a fiduciary duty to maintain the confidentiality of GSE proprietary information and that duty would be breached by proposed § 81.76(d) to the extent the provision allowed disclosure without any exercise of judgment on the part of the Secretary. Furthermore, Freddie Mac argued that materials disclosed based on a subpoena should be safeguarded to the extent possible against further disclosure to third parties. Freddie Mac asked for provisions, similar to those found in existing HUD regulations,[91] to the effect that the Secretary and his or her counsel would determine whether to honor particular subpoenas or requests. Fannie Mae asserted that HUD's ''unconditional commitment'' to provide congressional access to all committees and subcommittees ''totally conflicts with practices observed by other financial institution regulators.''

The intention of the proposed rule was not that HUD would provide GSE data or information to Congress without any appropriate safeguards; rather, that nothing in this subpart of the rule should be construed to grant authority to the Secretary to withhold information from or to prohibit the disclosure of information to Congress, the Comptroller General, a court of competent jurisdiction pursuant to a subpoena, or where otherwise required by law. HUD safeguards for handling such requests would still apply. Accordingly, § 81.77 of the final rule provides that ''nothing in this subpart F may be construed to grant authority to the Secretary under FHEFSSA to withhold any information from or to prohibit the disclosure of any information'' to Congress, the Comptroller General, or pursuant to a subpoena or legal process. This formulation is in keeping with the practice of other agencies.[92] HUD notes that Congress, the Comptroller General, and the courts all have procedures to safeguard proprietary and confidential information.[93]

This final rule specifies that HUD—in providing data or information in response to requests from Congress, the Comptroller General, and the courts—will, where applicable, include a statement to the effect that the GSE regards the data or information as proprietary or confidential, public disclosure of the information may cause competitive harm to the GSE, and the Secretary has determined that the information is proprietary or confidential. In addition, the rule provides that, to the extent practicable, HUD will provide notice to the GSEs after such a request for proprietary or confidential information is received and before HUD provides information in response to the request.

The revised rule makes clear that HUD's discretion to take additional steps to protect GSE data or information in appropriate circumstances is not precluded. These steps could include, for example, seeking on a GSE's behalf, or supporting a GSE motion for, a protective order when a court subpoenas HUD to produce GSE data or information.

Section 81.77 also clarifies the scope of requests that are to be considered official requests from Congress. This change responds to a specific GSE comment that the request must be from a committee with appropriate jurisdiction, to conform more closely to FOIA procedures and similar authorities. The rule has also been modified to conform language concerning HUD disclosures to the Comptroller General to the language in other HUD regulations.[94]

Furthermore, in response to a comment by Fannie Mae, § 81.77(c) of the final rule now makes clear that safeguards under HUD regulations at 24 CFR 15.71–15.74 apply. These provisions govern the production of documents or testimony when a subpoena, order, or other demand of a court or other authority is issued. The rule extends these protections to situations in which demands are made on non-HUD employees (including contractor employees) who have custody of exempt records, and is modeled after regulations of other financial regulators.[95] The Secretary notes that a recent decision [96], may limit the ability to withhold information pursuant to such a regulation and that case law on this issue is evolving. In response to Fannie Mae's comment that OFHEO and HUD should adopt consistent procedures on this point, the Secretary notes that OFHEO is in the process of promulgating rules applicable to OFHEO employees.[97]

Pro-Disclosure Comments

Comments received from the ACLU, which dealt exclusively with proprietary information issues, advocated more expansive disclosure of GSE data. The ACLU argued that only information elements that both GSEs considered proprietary should even be considered for designation as proprietary. The ACLU commented that, even then, proprietary treatment frequently should be declined in an exercise of the Secretary's discretion. The ACLU asserted the public-interest purposes of the Fair Housing Act, ECOA, and FHEFSSA, and stated:

> Given these factors, we believe that Fannie Mae and Freddie Mac cannot be considered similar to purely private, profit-making enterprises. The true measure of the effectiveness of the GSEs is not their maximization of profit, but their compliance with mandates established by the Congress and the Secretary. ''Proprietary'' for the GSEs should not mean ''will harm competition'' but rather ''will harm the ability to carry out governmental mandates. * * *''

The ACLU favored a presumption that information is not proprietary and suggested a standard for determining whether information is proprietary. Under the ACLU formulation, the burden would be on the GSEs to establish the need for nondisclosure. To meet this burden, the GSEs would have to establish that disclosure would frustrate the goals set by the statute or the Secretary, not ''merely'' that disclosure would hurt the GSEs' competitive positions.

HUD, however, must recognize congressional intent, as expressed through the Charter Acts and legislative history, that the GSEs be self-supporting, profit-making entities. Although the GSEs receive substantial Federal benefits, they are not Government agencies. The GSEs do face competition from each other and from other private sector firms and, accordingly, have legitimate proprietary interests that the Congress explicitly intended to be respected. The ACLU's definition would unjustifiably dismiss any competition-based arguments for withholding sensitive information.

The ACLU also objected to the possibility that the Secretary would make determinations that particular material was proprietary solely on the basis of submissions by the GSEs. Such determinations, the ACLU insisted, should be subjected to public

[91] 24 CFR 15.71–15.74.

[92] *See* 12 CFR 309.6(c)(8) (Federal Deposit Insurance Corporation); *see also* 40 CFR 2.209(b)(1) and 2.209(d); 15 CFR 325.16; 21 CFR 20.86 and 20.87.

[93] *See, e.g., United States v. American Tel. & Tel. Co.*, 551 F.2d 384, 386–87 and nn.2–3 (D.C. Cir. 1976) (discussing congressional rules); 4 CFR Part 81–83 (General Accounting Office regulations governing the disclosure of information); Fed. R. Civ. Proc. 26(c) (judicial protective orders).

[94] *See* 24 CFR 16.11(a)(5).

[95] *See, e.g.*, 12 CFR 792.41 and 792.42.

[96] *In re Bankers Trust Co.*, 61 F.3d 465 (6th Cir. 1995).

[97] *See* 60 FR 25162 (1995) (proposed rule May 11, 1995).

participation and comment before any information is deemed ''proprietary.''

Under FHEFSSA, there is no requirement that any party other than the GSEs be afforded a right to comment before determining that GSE information is proprietary. To the extent that the Secretary employs the rulemaking process in making determinations of the proprietary nature of mortgage data submitted by the GSEs, the Secretary will follow applicable Administrative Procedure Act procedures.

Issues Regarding Specific Data Elements

Freddie Mac commented that information on pricing, fees and other key aspects of business strategy were to be considered proprietary and protected from disclosure to the public. Information on pricing, fees, and other key aspects of business strategy will be withheld to the extent they are proprietary under this rule or otherwise protected from public disclosure under other authorities and HUD regulations.

NAHB suggested that some of the ''data fields'' sought to be protected by the GSEs as proprietary have been provided in HMDA data ''with apparently little harm to either the borrowers or the lending institutions.'' These fields, NAHB added, would be very helpful, in utilizing HUD and HMDA databases together. These fields include: Purpose of Loan; Occupancy Code; Loan Balance at Acquisition.

Additionally, NAHB asserted, certain fields claimed as possibly proprietary were needed for use in research by academicians and governmental entities. NAHB requested, ''at a minimum,'' that the following data fields be included:

For single-family housing:

• Loan to Value Ratio at Origination
• Purpose of Loan, Product Type, and Loan Term
• Occupancy Code, Number of Units.

And for multifamily housing:

• Purpose of Loan, Loan Type, and Loan Term
• Mortgagor Type
• Average Reported Rent OR Rent Plus Utilities OR Rent Affordability Level
• Public Subsidy Program.

With respect to single-family loan-level data, HUD must consider the GSEs' proprietary concerns in determining whether a data element can be released at the census tract level or whether some form of aggregation would be sufficient to protect the proprietary nature of the data in a public release. HUD developed a national-level database file structure that has no geographic identifiers. Certain data elements are recoded into categories to prevent exact identification of specific elements. The national data files are used to supplement census-tract-based public use data files.

For single-family purchases by the GSEs, the national data files contain purpose of the loan, occupancy code, number of units, and the loan-to-value ratio at origination which are recoded into five categories (0–60, 60–80, 80–90, 90–95, and over 95). The census tract and national files do not contain Product Type or Loan Term data since, taken together, these two elements have been deemed proprietary by the Secretary.

For multifamily purchases by the GSEs, a number of elements were deemed proprietary because of the nature of the multifamily market—the size of the market and the way multifamily properties are financed. The fact that these data elements were proprietary led the Secretary to deem Loan Type, Loan Term, Mortgagor Type, and Public Subsidy Program fields as proprietary to protect these data elements. HUD does release the Purpose of the Loan and the affordability of the units, by category, on the national multifamily public use data file.

CANICCOR, an Interfaith Council on Corporate Accountability, urged that, at a minimum, the public be provided all the information that is provided for each loan by primary market lenders under HMDA. This data, CANICCOR said, includes:

• Geocoding to the census tract level;
• Income of borrower;
• Borrower's/Co-borrower's race or national origin;
• Borrower's/Co-borrower's gender or sex;
• Whether owner or non-owner occupancy;
• Purchaser (i.e., which GSE);
• Type of loan (e.g., conventional);
• Purpose (i.e., home purchase, refinance, home improvement);
• Dollar amount of loan; and
• Seller identification.

HUD, in its development of the public-use database, considered the availability of the data to the public through sources outside of the GSE data, including HMDA. The public-use database, either through the census tract file or the national data file, contains all of the above elements.

Subpart G—Procedures for Actions and Review of Action

This subpart establishes procedures for hearings, disclosures of orders and agreements between the Secretary and the GSEs in enforcement actions, and judicial review. Generally, these procedures concern actions by the Secretary to enforce housing goal-related matters under subpart B of the rule and reporting requirements under subpart E. In addition, this portion of the preamble addresses certain procedural issues involving the approval of new programs.

As stated in the proposed rule's preamble, the housing goal requirements of this rule are enforced through the imposition of cease-and-desist orders and civil money penalties. FHEFSSA is prescriptive because of the seriousness of these actions; therefore this final rule often references or restates the statutory requirements. However, in a few instances, which are discussed in more detail throughout this portion of the preamble, the final rule augments the statutory procedures to promote the purposes of the legislation and to better recognize the legitimate interests of the GSEs in these proceedings.

Both GSEs submitted detailed comments on the provisions of subpart G. The arguments and suggestions for change submitted by the two GSEs were markedly similar. On this subject matter, Freddie Mac presented the more detailed objections, so the Freddie Mac comments will be the principal focus of the discussion of the subpart.

Closely Following the Statutory Text

Freddie Mac asserted that this subpart of the regulation should mirror the procedural requirements set forth in FHEFSSA. However, Freddie Mac commented that the proposed rule's provisions ''variously depart from [FHEFSSA], or from the Administrative Procedure Act.'' Additionally, to avoid the ''inefficiencies of litigation,'' Freddie Mac recommended an explicit provision in HUD's enforcement procedures for a HUD/GSE exchange of views before any enforcement action is initiated.

Freddie Mac objected to provisions in §§ 81.82 and 81.83 on the grounds that cease-and-desist orders and imposition of civil penalties were limited to violations of the statute, whereas provisions of the rule could be read as authorizing sanctions for violations of the procedural rule itself. Freddie Mac commented that FHEFSSA permits the Secretary to seek an order only for violations of the statute—not its implementing regulations. Similarly, Freddie Mac urged, the Administrative Procedure Act (APA) requires that no sanction or order may be imposed ''except within jurisdiction delegated to the agency and as authorized by law.'' [98]

While HUD agrees that it is the statute, and not the regulations, that serves as the foundation for any order sought by the Secretary, Freddie Mac's argument suggests that regulatory elaboration may never properly be employed to augment the recitation of statutory authority in connection with an enforcement provision. This is incorrect; it is clear that regulatory references legitimately may be included. Only reference to a regulatory section that exceeds the Secretary's authority would raise a valid legal issue; the references Freddie Mac refers to are reasonably related to the purposes of the enabling legislation. Rather than causing ''confusion,'' these regulatory references help to clarify, and even to limit, the statutory language. The change sought might itself create confusion. Accordingly, the rule retains the regulatory cross-references, and cites both them and the statutory references.

Freddie Mac suggested that the final rule include various procedures to avoid enforcement actions. Freddie Mac cited Executive Order 12778 on Civil Justice Reform in support of its argument that the rule should mandate a preenforcement process, which could include informal discussions, negotiations, and compromise.

HUD expects that, in connection with a pending enforcement action against a GSE, it will frequently be appropriate to solicit the GSE's views in order to explore mutually agreeable resolutions of perceived problems. This option is always available to the Secretary; every reason exists to expect it will be used. However, Freddie Mac's suggestion that the rule should provide expressly for preenforcement procedures in every case—that is, to turn an existing option of the Secretary into a right of the GSEs—is unwarranted. Fact situations may differ too markedly to expect that obligatory preenforcement procedures would always be the proper course. Under § 81.21, the GSE already is afforded an opportunity to respond to the Secretary's preliminary determination that it has failed to meet its housing goals—a response that will precede any HUD requirement for submission of a housing plan. Settlement following the issuance of charges also is permitted under hearing procedures at 24 CFR 30.420. (Part 30 procedures are incorporated by reference into this final rule.)

Given the already-available procedures that will foster the amicable resolution of most disputes, the change Freddie Mac has proposed is unnecessary and is contrary to the spirit of the Administration's efforts to simplify regulations. Potentially, the change could result in institutionalized delay in the hearing process.

Executive Order 12278 is, in relevant part, directed at encouraging techniques to avoid full litigation after charges have been filed. By its own terms, the Executive Order creates no obligation on an agency's part to alter its standards for the acceptance of settlements, or to change existing delegations of settlement or litigation authority. While the Secretary shares the GSEs' interest in minimizing needless litigation, the existing authority to attempt a voluntary pre-charge resolution on a case-by-case basis will accomplish this goal as well as Freddie Mac's suggested procedure.

Freddie Mac also asked for modification of the rule to allow a GSE to recommend and request the appointment (at the GSE's expense and with the Secretary's approval) of ''special expert'' hearing officers to hear all or part of any enforcement action. These special officers would then sit in lieu of, or under the supervision of, a HUD Administrative Law Judge (ALJ).

Freddie Mac commented that these enforcement actions are likely to involve ''highly technical statistical and financial proof on arcane issues * * *.'' While the Secretary hopes and believes that the ALJs will not be called upon to hear these matters often, the ALJs do have experience with handling technical, statistical, and financial matters; there is every reason to believe they will make well-reasoned decisions in any enforcement actions brought under this rule.

Furthermore, the option suggested by Freddie Mac is not available: the person who must preside over the taking of evidence in these proceedings is prescribed by the APA. While procedures authorized under the Alternative Dispute Resolution Act [99] could be used in particular instances—when the parties agreed to their use—a regulatory procedure calling for unilateral Secretarial designation of a special expert at the behest of a GSE would conflict with the APA, as applicable under FHEFSSA. No necessity exists to cite in the rule the existence of alternatives that are available via agreement of the parties.

The Public Interest

Freddie Mac commented that § 81.83(c) (calling for the Secretary's consideration of ''other factors that the Secretary determines in the public interest warrant consideration'' in the course of imposing civil money penalties) cannot be adopted in the manner set out in the proposed rule. Rather, Freddie Mac claimed, FHEFSSA required the Secretary to establish, by rule, following notice and comment, those ''other factors'' to be considered in measuring the conduct of violators.

The reference in the proposed rule to ''other factors * * *'' is too broad, and that formulation has been deleted. However, inasmuch as the Secretary is authorized to consider the nature of the injury to the public in establishing the amount of the penalty and other factors that the Secretary may determine by regulation to be appropriate, the final rule eliminates the ''other factors'' phrase in favor of a ''public interest'' formulation like that contained in FHEFSSA.

Freddie Mac also commented that the statutory language permits the Secretary to consider only ''actual'' injury to the public, and that the use of the term ''nature of the injury to the public'' in the proposed rule is unacceptably subjective. Clearly, under the Secretary's authority to adopt other factors through rulemaking, the rule could include ''nature of the injury to the public'' as a separate factor, if necessary. The final rule, however, returns to the concise statutory formulation, ''injury to the public,'' without regulatory elaboration. HUD does not intend to place narrow limits on the interpretation of the statutory phrase, and will consider, in evaluating a particular fact situation, reasonable application of this factor, including the nature of the injury involved.

Consultation

Freddie Mac also requested that the Secretary limit consultation with the Director of OFHEO concerning any enforcement proceeding against a GSE to consultation before the enforcement proceeding is actually undertaken. Freddie Mac suggested that the proposed rule's formulation allowing the Director's participation in an ongoing enforcement proceeding would be ''inconsistent with the Director's independence from the Secretary, and would be in the nature of a prohibited *ex parte* contact.'' However, Freddie Mac said, *ex parte* problems could be avoided if the consultation (which Freddie Mac favored) took place only before institution of an enforcement proceeding.

Freddie Mac asserted that once an adversary proceeding has commenced, due process requires that any review by the Director be conducted openly, in writing, and included in the

[98] 5 U.S.C. 558(b).

[99] 5 U.S.C. 571–583.

administrative record. Further, the affected GSE should be provided an opportunity to supplement the record and to respond.

Limiting the Secretary's consultations with the Director of OFHEO to communications that occur before the institution of an action would needlessly limit the Secretary's authority in a manner not contemplated by FHEFSSA. Section 81.83(d)(5) of the rule, cited by Freddie Mac as the source of its comments on the subject matter, is, with one minor exception, a recitation of the statutory language.[100]

Freddie Mac's suggestion that these communications between the Secretary and the Director would be ''in the nature of'' *ex parte* communications prohibited by the APA simply is off the mark. Section 1345(c)(1)(C) of FHEFSSA provides that, in establishing standards and procedures governing the imposition of civil money penalties, the Secretary may provide for such review by the Director. Under this provision, Congress intended that open communication between the Secretary and the Director of OFHEO be permitted without implicating the *ex parte* prohibitions in 5 U.S.C. 557(d)(1).

With reference to Freddie Mac's due process concerns, the Secretary is mindful of the need for fairness and openness throughout the process leading to a possible imposition of penalties. An affected GSE would have full access to discovery procedures that will permit review of any decisionmaking process that involves the Director of OFHEO. Accordingly, the final rule does not place limits on Secretary/Director communications.

Standard of Proof

Both GSEs commented on the standard of proof in cease-and-desist and civil money penalty proceedings. Freddie Mac cited *Steadman* v. *SEC*, 450 U.S. 91 (1981) as authority for application of the ''preponderance of the evidence'' standard of proof to both types of proceedings. Fannie Mae stated that the APA's standard of proof is ''substantial evidence,'' and that this standard should be made consistent in provisions governing both cease-and-desist and civil money penalty proceedings.[101]

Under FHEFSSA, the standard of proof to be applied is governed by the APA.[102] As Freddie Mac noted in its comments, the Supreme Court in *Steadman* has found the statutory ''substantial evidence'' phrase to mean a ''preponderance of the evidence'' burden of proof for the proponent of an order, and the final rule reflects this change.

General Procedural Questions

Freddie Mac asked for a variety of other revisions affecting § 81.84 on Hearings:

Freddie Mac requested a ''clarification'' to the effect that the ALJ must modify a hearing schedule at the GSE's request, unless HUD can show good reason why the GSE's request should be denied. Freddie Mac urged that the GSE, rather than the hearing officer, is in the best position to judge the feasibility of a particular hearing schedule. Furthermore, Freddie Mac argued, FHEFSSA ''suggests a congressional determination that such requests should ordinarily be allowed.''

The proposed rule at § 81.84(c) provided that the ALJ would set a hearing schedule ''[u]nless an earlier or later date is requested by a GSE and is granted by the Administrative Law Judge * * *.'' The regulatory formulation is similar to the statute, which provides, at section 1342(a)(2), ''* * * unless an earlier or later date is set by the hearing officer at the request of the enterprise * * *.'' Therefore, on its face, the statute provides for the setting of the date by the ALJ, with an opportunity for the GSE to ''request'' a change. The Secretary sees no basis for limiting the ALJ's discretion, and the rule is unchanged.

Freddie Mac also asked that the rule be modified to provide a procedure for a GSE to request the Secretary to seek enforcement of a subpoena issued and served in connection with a hearing or in discovery proceedings under the rule. The Secretary is sympathetic to the thrust of this comment by Freddie Mac, i.e., that the GSE should have the same right to enforcement of a subpoena as does the Secretary. However, FHEFSSA does not grant a right to subpoenaing parties to apply directly for a judicial order requiring compliance with a subpoena. The Secretary, under FHEFSSA, can only request that the Attorney General bring judicial actions to enforce subpoenas. Because direct judicial enforcement by either party is not specifically provided as a matter of law, HUD has developed an administrative mechanism in the final rule providing for recognition of the GSEs' interest in requesting enforcement action through the Secretary. Consistent with the availability of remedies under the statute, this will improve equity between HUD and the GSEs in discovery.

Freddie Mac asked that the final rule be amended to specify that waiver, by a GSE, of an ALJ hearing on the disapproval of a new program on public interest grounds would not constitute a ''failure to appear'' within the meaning of § 81.84(g). (As proposed, the rule stated that a failure to appear by a GSE shall be taken as consent to the disapproval of a new program.) Freddie Mac said that, in cases involving program disapprovals, a GSE may sometimes wish to expedite judicial review, and urged that the GSE's waiver of an administrative hearing on program disapproval not be treated as a consent to the HUD action.

The final rule does not adopt the change. The statute requires, in section 1322, that HUD provide the GSEs with ''notice of, and opportunity for, a hearing on the record'' after the Secretary submits a report to the Congress to the effect that a new program has been disapproved. The Secretary concludes that this language indicates a preference for providing the GSEs with administrative remedies. Therefore, if the Secretary has refused to approve a new program because the Secretary believes it is not in the public interest, HUD should provide the forum in which appeal of the Secretary's initial disapproval is heard and in which the GSE can offer further evidence on the matter.

Both GSEs requested language indicating more expressly that conduct is only ''alleged'' in notices of charges for cease-and-desist proceedings. (The proposed rule at § 81.82(b)(1)(i), in describing the content of a ''charge'' notification, made reference to a ''* * * concise statement of the facts constituting the conduct upon which the Secretary has relied * * *.'') The final rule includes the word ''alleged'' before ''conduct'' where the reference is to conduct that remains to be proven. However, it is not necessary to reiterate in the rule that the conduct remains to be proven in a hearing.

Fannie Mae recommended revising § 81.84(e) of the rule to increase its specificity regarding how the Secretary will serve notices and filings required under this subpart G. Fannie Mae suggested that HUD follow the Federal Reserve Board rules of service—rules that provide, among other things, details on what types of U.S. mail may be used, and when electronic transmission is acceptable.

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[100] Only a reference to the Notice of Intent—a reference to which Freddie Mac made no objection—contains material not found in the text of FHEFSSA.

[101] The proposed rule set out the preponderance of the evidence standard to govern civil money penalty cases, and the substantial evidence standard for other administrative proceedings under FHEFSSA.

[102] 5 U.S.C. 556(d).

The proposed rule adopted by incorporation the requirements of 24 CFR 30.425(c)(3) governing how service is to be made. The final rule has been revised to accept the GSEs' suggestion and to model the rule governing service after the provisions in the Uniform Rules of Practice and Procedure that have been adopted by the Federal financial regulators.

Closed Proceedings

Freddie Mac requested that the final rule provide explicitly for motions by the GSE to close a hearing, with any ALJ determination on that question to be made reviewable by the Secretary on an interlocutory basis. Freddie Mac argued that the affected GSE is more likely than the ALJ to appreciate how an open hearing would affect its employees, shareholders, customers and borrowers, and its ability to perform its public mission. Freddie Mac proposed that the motion first be made before the ALJ, with discretionary review by the Secretary during an established, brief time period before the hearing is permitted to continue.

FHEFSSA permits the Secretary to determine that a hearing should be closed to the public, or that a document or part of a document should be sealed. The proposed rule implemented this authority in §§ 81.84(h) and 81.85(c), but did not provide additional procedures, beyond those available under the statute or part 30, subpart E, as incorporated.

Under 24 CFR part 30, subpart E, a GSE may move for an order from the ALJ providing for a closed hearing or sealed document. In response to Freddie Mac's comment, the final rule also provides an additional mechanism for interlocutory review by the Secretary of an ALJ's decision in both of these situations. Section 81.84(h) allows a GSE to request the Secretary to review an ALJ's denial of a timely motion for a closed hearing. The hearing is stayed while the Secretary makes a determination on the need to close the hearing. Section 81.85(c) provides that a party may request immediate review by the Secretary of an ALJ's denial of a protective order relating to documents for which disclosure would be contrary to the public interest. However, unless request for protection of the documentary evidence meets specific timing requirements or the Secretary directs otherwise, the obligation to produce the documents at a hearing will not be affected by the request for review by the Secretary of the ALJ's decision on disclosure.

Appeal-Related Issues

Freddie Mac urged that provisions in the final rule ''conform to statutory requirements'' limiting the Secretary to 90 days to decide an appeal of an ALJ ruling. Proposed § 81.84(k) allowed the Secretary an additional 30 days, at his or her discretion, in addition to the statutory 90-day period set out in section 1342(b)(1). Additionally, Freddie Mac objected to the provision in § 81.84(l), permitting remand of a case to an ALJ for additional proceedings, to the extent that remand might have the effect of extending the 90-day time provision established for a final decision. Freddie Mac asked that the Secretary's authority to remand to an ALJ be limited, unless the parties consent to any remand that extends the time for an ultimate decision. The final rule eliminates any reference to a discretionary extension of time triggered by written notice to the parties. However, under the final rule the Secretary's remand of a case to an ALJ for additional proceedings is a ''decision'' within the meaning of FHEFSSA. This approach is consistent with recent case law.[103]

Freddie Mac also commented on the proposed rule's procedural provisions on time-to-file and page limitations on appeals. Freddie Mac stated that procedures set out in § 30.910 for the Secretary's review of ALJ decisions were inadequate in cases involving the GSEs, because of the complex, fact-intensive nature of anticipated cases and the broad public policy implications likely to be involved. Freddie Mac requested that the rule make clear that provisions of § 30.910, including 15-day time and 10-page statement limits for appeals, may be waived by the Secretary upon the motion of a party. Although Freddie Mac agreed that expeditiousness and simplicity are ''generally desirable,'' it asserted that such limits may not be appropriate in cases involving national housing policies.

As a general matter the Secretary has authority to waive HUD regulations, including those provisions to which Freddie Mac has raised objection, as well as other procedural rules from 24 CFR part 30 that are incorporated by reference. Nevertheless, the page-limit, and, in some cases, the time-limit, provisions set out in § 30.910 might be inadequate in cases arising under this rule. For that reason, the final rule makes waiver of those specific provisions easier, by providing that any such waiver of the part 30 page- and time-limits for notices of appeal or any other waivers under this subpart will not trigger publication requirements for general waivers. Waiver requests, when reasonable in light of the subject matter of a particular proceeding and other factors, can be expected to be dealt with suitably by an ALJ or the Secretary.

Freddie Mac asked that, because of the importance of these decisions, the Secretary provide for oral argument on appeal at the request of a GSE. Predicting that cases arising under FHEFSSA will be rare, Freddie Mac argued that providing for oral argument by right would not impose a significant burden on the Secretary.

Nothing in the proposed rule would prevent the Secretary from granting a right to oral argument in connection with a particular appeal of an ALJ decision. A GSE may petition for such an opportunity and the Secretary may, in an appropriate case, agree to it. However, it is unnecessary to provide in the regulation for additional mandatory procedural rights that may be provided in the Secretary's discretion, when necessary.

Freddie Mac commented that the rule need not repeat FHEFSSA's provisions governing judicial review of HUD enforcement actions. For example, Freddie Mac criticized the provisions of proposed § 81.83(e), which detailed the procedures through which the Secretary could seek the aid of the U.S. District Court to collect a civil money penalty. Provisions that only detail functions of the reviewing court have been stricken in the final rule. The final rule now cross-references statutory provisions governing judicial procedures.

Fannie Mae asked for clarification on an ''apparent inconsistency'' between FHEFSSA and the proposed rule concerning who is responsible for filing the record of an administrative proceeding with the appellate court. The statute says the Secretary shall file, while the proposed rule stated the Office of Administrative Law Judges shall file. The provision Fannie Mae questioned is an intentional delegation to the Office of Administrative Law Judges, in the interest of efficiency, and is unchanged in the final rule.

Commenting on § 81.86 of the proposed rule, Freddie Mac said that the rule ignored the fact that FHEFSSA treats enforcement of cease-and-desist orders and civil money penalties orders differently. Freddie Mac argued that the two enforcement actions had been dealt with differently in FHEFSSA to reflect a congressional judgment that fact

[103] *Mountain Side Mobile Estates Partnership v. Secretary of HUD,* 56 F.3d 1243, 1248 (10th Cir. 1993). Furthermore, under the rule, if a decision is remanded for further proceedings, the ALJ is required to issue an initial decision on remand within 60 days of the date of issuance of the final decision, unless it is impractical to do so.

situations involving cease-and-desist orders may require immediate action, while the collection of a civil money penalty might more readily be deferred. The rule has been revised to reflect the statutory language.

Freddie Mac also questioned the inclusion of a provision in § 81.86(c) providing that the Secretary ''may obtain such other relief as may be available, including attorney fees and other expenses * * *.'' FHEFSSA, Freddie Mac asserted, made explicit reference to attorney fees only in instances where a GSE has refused, after adjudication, to pay a civil money penalty. The final rule eliminates, from § 81.86, the reference to attorney fees. The provision more specifically addressing failures to comply with an order imposing a civil money penalty (§ 81.83(e)) cross-references the statutory provision.

New Program Procedures

The proposed rule provided, under the procedures for review of the Secretary's disapproval of a program request on grounds that the program is not authorized, that the GSE may request an opportunity to review and supplement the record, or may request a meeting with the Secretary. The final rule allows the GSE to supplement the record timely in writing and/or through a meeting. Freddie Mac expressed concern in its comments about the procedures outlined in § 81.54. The proposed rule provided that such a meeting ''shall not be on the record * * *.'' Freddie Mac's concern was that materials furnished in response to the invitation to supplement the record—or statements made at the meeting with the Secretary or his designee—might belong on the record, because they might help a court to decided that the Secretary's decision was not arbitrary and capricious, or would otherwise assist in pinpointing the issues in dispute. Additionally, Freddie Mac said, a record would help to avoid arguments about what happened at such a meeting.

Because there is no statutory requirement that any opportunity be provided for a meeting with an affected GSE to review a program disapproval on these grounds, the question of how such a meeting should be conducted is one solely within the Secretary's discretion.[104] The intention of the proposed ''off the record'' provision was to afford GSE representatives some assurance that statements made by them at such a meeting would not be used in a manner adverse to the interests of the GSE.

While the Secretary does not want to reverse the position taken in the proposed rule and provide that all such post-decision meetings will be held on the record, the final rule removes the above-quoted negative declaration from § 81.54(a). Instead, the Secretary will establish procedures for any such meeting on a case-by-case basis.[105]

Subpart H—Book Entry Procedures

Both the GSEs and the Book-Entry Treasury Regulations Task Force of the Investment Securities Subcommittee of the UCC Committee of the Business Law Section of the American Bar Association (''ABA Task Force'') stated that revising book-entry procedures would be premature in light of continuing work on a comprehensive revision of the Treasury Department book-entry regulations.[106] The Federal Reserve Bank of New York—which operates the book-entry system—also urged HUD to delay implementation of new book-entry provisions.

Fannie Mae discussed the book-entry provisions briefly, indicating that the proposed rule's revisions to the book-entry provisions were so minor that any revision was unnecessary. Pending the overhaul of the book-entry system by Treasury, Fannie Mae recommended preserving the current book-entry regulations to ''avoid confusion and certain regulatory inefficiency.'' However, Fannie Mae recommended deleting § 81.45(b) of the current book-entry regulations, consistent with the proposed rule, because without this deletion, Fannie Mae must request a waiver whenever it issues securities in definitive form.

Freddie Mac commented that it ''strongly opposes'' adoption of proposed Subpart H, calling it ''at best premature and at worst potentially destructive.'' Freddie Mac requested that, if HUD determines it is necessary to promulgate subpart H at this time, §§ 81.94(d) and 81.95 be ''recast'' to allow Freddie Mac to maintain its ability to decide whether to allow conversion of its securities to definitive form. Current Freddie Mac regulations allow a depositor to withdraw securities from the book-entry system and convert to definitive form *only* if the securities provide for such conversion pursuant to the offering materials. Since 1985, Freddie Mac's offering materials have not provided such a right of conversion—a practice it comments is in keeping with current market practice. Freddie Mac said that while the proposed HUD rules appear to mirror part O of Treasury's regulations, the Treasury Department has informed Freddie Mac ''that in practice it has not issued its own offerings in definitive form since 1986, notwithstanding the language of Part O, unless the offering circular specifically allows.'' Freddie Mac therefore concluded that the HUD proposal could put the GSEs at a competitive disadvantage respecting other competing issuers, including Treasury.

The GSEs' current book-entry regulations date back to the late 1970s and are codified in separate parts of the CFR.[107] These regulations are essential to permit the GSEs to avail themselves of Federal Reserve book-entry systems. Under HUD's general regulatory power respecting the GSEs, the proposed rule sought to establish a uniform, modern set of book-entry regulations applicable to both Fannie Mae and Freddie Mac modelled on the current book-entry procedures established by the Treasury.[108] Recently, by regulation and at the request of Fannie Mae, the Secretary specifically extended the Fannie Mae book-entry regulations to allow Fannie Mae to continue to use the book-entry system pending the issuance of this comprehensive rule.[109]

Based on the comments, the Secretary has decided to postpone adopting uniform book-entry regulations for the GSEs pending completion of the revised Treasury Department book-entry regulations. For HUD to act now to finalize a complete set of regulations for both GSEs, and then shortly to revise them, would only lead to confusion. HUD will work with the Treasury Department to adopt revised regulations simultaneously. These regulations will be substantively identical for both GSEs and will provide a level playing field. In the interim, Fannie Mae and Freddie Mac book-entry regulations shall remain effective, essentially in their current form. The final rule makes only three changes.

The Fannie Mae book-entry regulations are modified to delete § 81.45(b), as requested by Fannie Mae.

[104] However, written materials submitted at such a meeting, or in lieu of requesting a meeting, are considered as having been submitted with the intention of supplementing the record, as permitted under § 81.54(a)(1).

[105] As a note of further clarification, the final rule continues to permit a GSE freely to supplement the record in writing, either at the meeting with the Secretary or designee, or in a separate submission.

[106] The Treasury Department is revising its book entry regulations to reflect a major revision to Article 8 of the Uniform Commercial Code (UCC). Treasury withdrew proposed changes to its own regulations pending the completion of additional UCC work. *See* 57 FR 12244 (Apr. 9, 1992), and 58 FR 59972 (Nov. 12, 1993).

[107] 24 CFR part 81, subpart E (Fannie Mae) and 1 CFR part 462 (Freddie Mac).

[108] *See* 31 CFR 306.115 *et seq.*

[109] 59 FR 54366 (Oct. 28, 1994).

This provision requires use of book-entry procedures and has necessitated that Fannie Mae formally request a waiver each time definitive certificates are to be issued. Fannie Mae's requests for waivers under this section have always been granted. Nonetheless, work on these requests has frequently tied up both HUD and Fannie Mae staff. In removing this section, HUD recognizes that under Freddie Mac's regulations, securities may be issued in definitive form only where the offering circular so provides. While HUD considered adding this provision to current Fannie Mae regulations, it determined instead to await Treasury Department revisions before addressing the matter.

In addition, the current Fannie Mae book-entry regulations are moved to subpart H and renumbered, using the numbering scheme in the proposed regulation, §§ 81.91–99. HUD explored the possibility of maintaining the book-entry procedures as subpart E, and redesignating and renumbering subparts E through I of the proposed rule, as had been suggested by Fannie Mae. HUD determined, however, that the organization of the regulation was more sensible if the book-entry provisions were placed near the end of the part, because other subparts were of more universal interest. Moreover, moving and redesignating five sections of the proposed rule would be more confusing to the public than moving the book-entry procedures. Finally, in the interest of consistency, the term ''Fannie Mae'' is substituted for the term ''Federal National Mortgage Association'' in this subpart.

Subpart I—Other Provisions

Both GSEs commented on a provision of HUD's proposed rule that provided that the Secretary could conduct regulatory examinations of the GSEs at any time, to determine whether the GSEs were complying with statutory requirements. The primary argument made by both GSEs was that the Secretary does not possess examination authority, because Congress specifically took this authority away from the Secretary under FHEFSSA and gave it to the Director of OFHEO. Freddie Mac also argued that the Secretary does not possess this authority pursuant to FHEFSSA's grant to the Secretary of ''general regulatory authority,'' because examination authority may only be implied if that authority is necessary, indispensable, and essential. Freddie Mac argued that the authority is not necessary, indispensable, or essential, because the Secretary may monitor the GSEs' compliance by using the reports and data that the GSEs provide to HUD.

The section on regulatory examinations has been removed. However another provision, making clear the Secretary's authority to verify information, has been added to the rule at § 81.102. Sections 1381(k) and 1382(e) of FHEFSSA removed the Secretary's explicit statutory authority to ''examine and audit the books and financial transactions'' of the GSEs. However, that elimination of the Secretary's explicit statutory grant of authority to conduct examinations does not mean that the Secretary has no alternative but to accept, as accurate and complete, whatever data, information, or reports the GSEs may provide. Rather, the Secretary may independently verify the accuracy and completeness of the data, information, and reports, including conducting on-site verification, when verification is reasonably related to determining whether the GSEs are complying with the law. The Secretary does not anticipate exercising this authority often, but only where such verification is necessary.

The authority to verify information when necessary is derived from section 1321 of FHEFSSA, which accords the Secretary ''general regulatory power over each enterprise,'' as well as the enumerated powers conferred on the Secretary by FHEFSSA. The Supreme Court has repeatedly held that a grant to an agency of ''general regulatory authority,'' extends to the agency those unenumerated powers that are ''reasonably related to the purposes of the enabling legislation.'' [110] This standard has been accepted by every Federal Court of Appeals.[111] Independent verification of the information provided by the GSEs is reasonably related to the Secretary's performing out his or her statutory duties.

Freddie Mac acknowledged in its comments that ''HUD could have implicit examination authority only if that authority were necessary, indispensable and essential to monitor GSE compliance with'' provisions of the Charter Acts. In support of its ''necessary, indispensable, and essential'' standard, Freddie Mac cited one Circuit Court decision,[112] which involved the authority of bankruptcy judges to conduct jury trials. That case is distinguishable on several grounds and does not represent the correct standard to apply here, in light of Supreme Court holdings adopting a ''reasonably related'' standard, which every Federal Circuit Court has followed.

In a landmark decision, the Supreme Court specifically addressed the scope of an agency's authority to investigate a regulated entity absent an explicit grant of statutory authority to conduct such investigations.[113] In that case, the Court held that the Federal Trade Commission (FTC) possessed authority to require additional reports from a corporation it regulated, even though the FTC did not have specific authority to require such reports under applicable law or the consent decree that it sought to enforce.

In reaching its decision, the Court rejected Morton Salt's argument that enforcing compliance with the decree had to ''rest upon respondents' honor unless evidence of a violation fortuitously comes to the Commission.'' Rather, ''the Commission, in view of its residual duty of enforcement,'' could ''affirmatively satisfy itself that the decree is being observed.'' [114] The Court indicated that the FTC's authority to investigate compliance with consent decrees in this manner derived from its authority to initiate contempt proceedings for the violation of such decrees, concluding that the authority to initiate contempt proceedings ''must have contemplated that the Commission could obtain accurate information from time to time on which to base a responsible conclusion that there was or was not cause for such a proceeding.'' [115]

The Secretary, like the FTC, is charged with the authority to initiate enforcement actions upon determining that the law has been violated. This enforcement responsibility contemplates that the Secretary will obtain accurate information on which to base a responsible conclusion that there is or is not cause for such a proceeding. The Secretary, like the FTC, is accorded a number of investigative functions. For the Secretary, these investigatory functions include the authority to require reports (*e.g.*, FHEFSSA, section 1327), gather data from the GSEs on their mortgage purchases (FHEFSSA, sections 1381(o) and 1382(r)), [116]

[110] *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973) (quoting *Thorpe* v. *Housing Authority of City of Durham*, 393 U.S. 268, 280–81 (1969)).

[111] *See, e.g., Action on Smoking and Health* v. *CAB*, 699 F.2d 1209, 1212 (D.C. Cir. 1983).

[112] *In re United Mo. Bank of Kansas City, N.A.*, 901 F.2d 1449, 1456 (8th Cir. 1990).

[113] *United States* v. *Morton Salt Co.*, 338 U.S. 632 (1950).

[114] 338 U.S. at 640.

[115] *Id.* at 639.

[116] Sections 1381(o) and 1382(r) of FHEFSSA require that the GSEs ''collect, maintain, and provide to the Secretary, in a form determined by the Secretary,'' mortgage data pertaining to single-family and multifamily mortgages. These provisions provide the Secretary with broad discretion to

monitor compliance with the housing goals (FHEFSSA, section 1336), and issue subpoenas (FHEFSSA, section 1348).[117] The Secretary's functions, like the FTC's functions, include making factual determinations. For the Secretary these determinations include: (1) Whether a GSE is complying with the housing goals; (2) whether a GSE has made a good-faith effort to comply with a housing plan; and (3) whether a GSE has submitted the mortgage information and reports required under sections 1381(o), 1382(r), or 1337 of FHEFSSA. Under *Morton Salt*, these functions, along with the Secretary's general regulatory powers, support the Secretary's authority to verify independently the completeness and accuracy of data, information, and reports submitted by the GSEs, including conducting on-site verification when doing so is reasonably related to determining whether the GSEs are complying with the law.

Freddie Mac maintains that the Secretary can sufficiently monitor compliance through the extensive data and reports that the GSEs are required to provide. Freddie Mac points out that the Secretary can use the mortgage purchase data required to be submitted to verify the accuracy of the housing goal performance reported in the annual reports. Freddie Mac asserts, ''If a GSE fails to submit required reports or data required under the Act or its charter, HUD can initiate enforcement proceedings and, incidental to those proceedings, can issue subpoenas for the production of documents and witnesses.''

However, without the authority to verify the completeness and accuracy of the data, information, or reports submitted by each GSE, the Secretary would be hampered in making the determinations that are required. Such a situation could result in the Secretary erroneously concluding that the GSEs are complying with FHEFSSA's requirements when they are not, or that they are not complying with FHEFSSA's requirements when they are. Thus, where the Secretary determines that it is necessary to verify independently the data, information, or reports provided by the GSEs, including conducting on-site verification, such verification is ''reasonably related to the purposes of the enabling legislation.''

Information Collection and Cost/Benefit Analysis

Freddie Mac argued that HUD's estimates of the cost of GSE compliance with the reporting requirements were grossly understated in the analysis provided with the proposed rule. Freddie Mac noted that HUD's estimate of its own costs to review the data was much higher than the costs estimated for the GSEs.

HUD did not act arbitrarily in estimating its own costs to review data as substantially higher than the costs to the GSEs of providing the data. HUD's estimates of costs did not include the GSEs' costs of amassing the data, including systems costs, because the cost estimates were intended to measure the incremental costs associated with compiling the data from the GSEs data systems, i.e., producing the tables, reports, and loan-level data tapes. The estimates also are not intended to reflect costs associated with data elements that the GSEs would collect in the absence of the final rule. Moreover, the costs should not reflect any analytical research conducted by the GSEs with respect to the data or the housing goals.

However, the Secretary does appreciate the GSEs' commitment to diligence in checking the accuracy of the data, and those costs have been accounted for in reviewing the information collection provisions in the final rule. In addition, after reviewing the comments on all areas of the rule in which information collection considerations were a factor, HUD revised its cost estimates to reflect more accurately the costs of producing each of the reports required by the rule. These revised cost estimates have been provided to OMB, and the Economic Analysis that analyzes the costs and benefits associated with the provisions of this final rule is available to the public, as noted under ''Significant Regulatory Action'' in the ''Other Matters'' section of this preamble.

Other Matters

Environmental Impact

In accordance with 40 CFR 1508.4 of the regulations of the Council on Environmental Quality and 24 CFR 50.20 of the HUD regulations, the policies and procedures contained in this rule do not affect a physical structure or property and relate only to statutorily required accounting and reporting procedures, and, therefore, are categorically excluded from the requirements of the National Environmental Policy Act.

Executive Order 12866

This rule constitutes a ''significant regulatory action'' as that term is defined in subsection 3(f) of Executive Order 12866 on Regulatory Planning and Review issued by the President on September 30, 1993. A preliminary review of the rule indicated that it might, as defined in that Order, have an annual effect on the economy of $100 million or more. Accordingly, an economic Analysis was prepared and is available for review and inspection in Room 10276, Rules Docket Clerk, Office of the General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–0500.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that this rule would not have a significant economic impact on a substantial number of small entities. The requirements of the proposed rule are directed toward the accounting procedures used in the mortgage servicing industry and the disclosure to consumers of related information.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under subsection 6(a) of Executive Order 12612, Federalism, has determined that the policies contained in this rule would not have substantial direct effects on States or their political subdivisions, or the relationship between the federal government and the States, or on the distribution of power and responsibilities among the various levels of government. As a result, the rule is not subject to review under the Order. The requirements of the rule are directed toward the accounting procedures used in the mortgage servicing industry and the disclosure to consumers of related information.

Executive Order 12606, The Family

The General Counsel, as the Designated Official under Executive Order 12606, The Family, has determined that this rule does not have the potential for significant impact on family formation, maintenance, and general well-being, and, thus, is not subject to review under the Order. No significant change in existing HUD policies or programs will result from promulgation of this rule, as those

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determine the ''form'' in which the data is to be provided, as well as what information, other than the mortgage characteristics indicated in the statute, the Secretary may also require.

[117] ''Administrative authority to inspect and copy business records was implied as a reasonable projection of a principle reflected in a statutory grant of subpoena power.'' 2B Norman J. Singer, *Sutherland on Statutory Construction* § 55.04 (5th ed. 1992) (citing *Porter* v. *Gantner & Mattern Co.*, 156 F.2d 886 (9th Cir. 1946)).

policies and programs relate to family concerns.

List of Subjects in 24 CFR Part 81

Accounting, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

1. For the reasons set out in the preamble, part 81 of Title 24 of the Code of Federal Regulations is revised to read as follows:

PART 81—THE SECRETARY OF HUD'S REGULATION OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE) AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC)

Subpart A—General

Subpart B—Housing Goals

Subpart C—Fair Housing

Subpart D—New Program Approval

Subpart E—Reporting Requirements

Subpart F—Access to Information

Subpart G—Procedures for Actions and Review of Actions

Subpart H—Book-Entry Procedures

Subpart I—Other Provisions

Authority: 12 U.S.C. 1451 *et seq.*, 1716–1723h, and 4501–4641; 42 U.S.C. 3535(d) and 3601–3619.

Subpart A—General

§ 81.1 Scope of part.

(a) *Authority.* The Secretary has general regulatory power respecting the Federal National Mortgage Association (''Fannie Mae'') and the Federal Home Loan Mortgage Corporation (''Freddie Mac'') (referred to collectively as Government-sponsored enterprises (''GSEs'')) and is required to make such rules and regulations as are necessary and proper to ensure that the provisions of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (''FHEFSSA''), codified generally at 12 U.S.C. 4501–4641; the Fannie Mae Charter Act, 12 U.S.C. 1716–1723h; and the Freddie Mac Act, 12 U.S.C. 1451–59, are accomplished.

(b) *Relation between this part and the authorities of OFHEO.* The Director of the Office of Federal Housing Enterprise Oversight (''OFHEO'') will issue separate regulations implementing the Director's authority respecting the GSEs. In this part, OFHEO and the Director are only referenced when the Director's responsibilities are connected with the Secretary's responsibilities.

§ 81.2 Definitions.

(a) *Statutory terms.* All terms defined in FHEFSSA (12 U.S.C. 4502) are used in accordance with their statutory meaning unless otherwise defined in paragraph (b) of this section.

(b) *Other terms.* As used in this part, the term—

AHAR means the Annual Housing Activities Report that a GSE submits to the Secretary under sections 309(n) of the Fannie Mae Charter Act or 307(f) of the Freddie Mac Act.

AHAR information means data or information contained in the AHAR.

AHS means the American Housing Survey published by HUD and the Department of Commerce.

Balloon mortgage means a mortgage providing for payments at regular intervals, with a final payment (''balloon payment'') that is at least 5 percent more than the periodic payments. The periodic payments may cover some or all of the periodic principal or interest. Typically, the periodic payments are level monthly payments that would fully amortize the mortgage over a stated term and the balloon payment is a single payment due after a specified period (but before the mortgage would fully amortize) and pays off or satisfies the outstanding balance of the mortgage.

Central city means the underserved areas located in any political subdivision designated as a central city by the Office of Management and Budget of the Executive Office of the President.

Charter Act means the Federal National Mortgage Association Charter Act (12 U.S.C. 1716 *et seq.*) or the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451 *et seq.*).

Contract rent means the total rent that is, or is anticipated to be, specified in the rental contract as payable by the tenant to the owner for rental of a dwelling unit, including fees or charges for management and maintenance services and those utility charges that are included in the rental contract. In determining contract rent, rent concessions shall not be considered, *i.e.*, contract rent is not decreased by any rent concessions. Contract rent is rent net of rental subsidies.

Conventional mortgage means a mortgage other than a mortgage as to which a GSE has the benefit of any guaranty, insurance or other obligation by the United States or any of its agencies or instrumentalities.

Day means a calendar day.

Director means the Director of OFHEO.

Dwelling unit means a room or unified combination of rooms intended for use, in whole or in part, as a dwelling by one or more persons, and includes a dwelling unit in a single-family property, multifamily property, or other residential or mixed-use property.

ECOA means the Equal Credit Opportunity Act (15 U.S.C. 1691 *et seq.*).

Familial status has the same definition as is set forth at 24 CFR 100.20.

Family means one or more individuals who occupy the same dwelling unit.

Fannie Mae means the Federal National Mortgage Association and any affiliate thereof.

FHEFSSA means the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, codified generally at 12 U.S.C. 4501–4651.

FOIA means the Freedom of Information Act (5 U.S.C. 552).

Freddie Mac means the Federal Home Loan Mortgage Corporation and any affiliate thereof.

Freddie Mac Act means the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1451 *et seq.*).

Government-sponsored enterprise or *GSE* means Fannie Mae or Freddie Mac.

Handicap has the same definition as is set forth at 24 CFR 100.201.

HUD means the United States Department of Housing and Urban Development.

Lender means any entity that makes, originates, sells, or services mortgages, and includes the secured creditors named in the debt obligation and document creating the mortgage.

Low-income area means a census tract or block numbering area in which the median income does not exceed 80 percent of the area median income.

Median income means, with respect to an area, the unadjusted median family income for the area, as most recently determined and published by the Secretary.

Metropolitan area means a metropolitan statistical area (''MSA''), primary metropolitan statistical area (''PMSA''), or consolidated metropolitan statistical area (''CMSA''), designated by the Office of Management and Budget of the Executive Office of the President.

Minority means any individual who is included within any one of the following racial and ethnic categories:

(1) American Indian or Alaskan Native—a person having origins in any of the original peoples of North America, and who maintains cultural identification through tribal affiliation or community recognition;

(2) Asian or Pacific Islander—a person having origins in any of the original peoples of the Far East, Southeast Asia, the Indian subcontinent, or the Pacific Islands;

(3) African-American—a person having origins in any of the black racial groups of Africa; and

(4) Hispanic—a person of Mexican, Puerto Rican, Cuban, Central or South American, or other Spanish culture or origin, regardless of race.

Mortgage means a member of such classes of liens, including subordinate liens, as are commonly given or are legally effective to secure advances on, or the unpaid purchase price of, real estate under the laws of the State in which the real estate is located, or a manufactured home that is personal property under the laws of the State in which the manufactured home is located, together with the credit instruments, if any, secured thereby, and includes interests in mortgages. ''Mortgage'' includes a mortgage, lien, including a subordinate lien, or other security interest on the stock or membership certificate issued to a tenant-stockholder or resident-member by a cooperative housing corporation, as defined in section 216 of the Internal Revenue Code of 1986, and on the proprietary lease, occupancy agreement, or right of tenancy in the dwelling unit of the tenant-stockholder or resident-member in such cooperative housing corporation.

Mortgage data means data obtained by the Secretary from the GSEs under subsection 309(m) of the Fannie Mae Charter Act and subsection 307(e) of the Freddie Mac Act.

Mortgage purchase means a transaction in which a GSE bought or otherwise acquired with cash or other thing of value, a mortgage for its portfolio or for securitization.

Multifamily housing means a residence consisting of more than 4 dwelling units. The term includes cooperative buildings and condominium projects.

New England means Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont.

OFHEO means the Office of Federal Housing Enterprise Oversight.

Ongoing program means a program that is expected to continue for the foreseeable future.

Other underserved area means any underserved area that is in a metropolitan area, but not in a central city.

Owner-occupied unit means a dwelling unit in single-family housing in which a mortgagor of the unit resides.

Participation means a fractional interest in the principal amount of a mortgage.

Portfolio of loans means 10 or more loans.

Proprietary information means all mortgage data and all AHAR information that the GSEs submit to the Secretary in the AHARs that contain trade secrets or privileged or confidential, commercial, or financial information that, if released, would be likely to cause substantial competitive harm.

Public data means all mortgage data and all AHAR information that the GSEs submit to the Secretary in the AHARs, that the Secretary determines are not proprietary and may appropriately be disclosed consistent with other applicable laws and regulations.

Real estate mortgage investment conduit (REMIC) means multi-class mortgage securities issued by a tax-exempt entity.

Refinancing means a transaction in which an existing mortgage is satisfied or replaced by a new mortgage undertaken by the same borrower. The term does not include:

(1) A renewal of a single payment obligation with no change in the original terms;

(2) A reduction in the annual percentage rate of the mortgage as computed under the Truth in Lending Act, with a corresponding change in the payment schedule;

(3) An agreement involving a court proceeding;

(4) A workout agreement, in which a change in the payment schedule or collateral requirements is agreed to as a result of the mortgagor's default or delinquency, unless the rate is increased or the new amount financed exceeds the unpaid balance plus earned finance charges and premiums for the continuation of insurance;

(5) The renewal of optional insurance purchased by the mortgagor and added to an existing mortgage; and

(6) A renegotiated balloon mortgage on a multifamily property where the balloon payment was due within 1 year after the date of the closing of the renegotiated mortgage.

Rent means, for a dwelling unit:

(1) When the contract rent includes all utilities, the contract rent; or

(2) When the contract rent does not include all utilities, the contract rent plus:

(i) The actual cost of utilities not included in the contract rent; or

(ii) A utility allowance.

Rental housing means dwelling units in multifamily housing and dwelling units that are not owner occupied in single-family housing.

Rental unit means a dwelling unit that is not owner-occupied and is rented or available to rent.

Residence means a property where one or more families reside.

Residential mortgage means a mortgage on single-family or multifamily housing.

Rural area means any underserved area located outside of any metropolitan area.

Seasoned mortgage means a mortgage on which the date of the mortgage note is more than 1 year before the GSE purchased the mortgage.

Second mortgage means any mortgage that has a lien position subordinate only to the lien of the first mortgage.

Secondary residence means a dwelling where the mortgagor maintains (or will maintain) a part-time place of abode and typically spends (or will spend) less than the majority of the calendar year. A person may have more than one secondary residence at a time.

Secretary means the Secretary of Housing and Urban Development and, where appropriate, any person designated by the Secretary to perform a particular function for the Secretary, including any HUD officer, employee, or agent.

Single-family housing means a residence consisting of one to four dwelling units. Single-family housing includes condominium dwelling units and dwelling units in cooperative housing projects.

Underserved area means:

(1) For purposes of the definitions of ''central city'' and ''other underserved area,'' a census tract having:

(i) A median income at or below 120 percent of the median income of the metropolitan area and a minority population of 30 percent or greater; or

(ii) A median income at or below 90 percent of median income of the metropolitan area.

(2) For purposes of the definition of ''rural area'':

(i) In areas other than New England, a county having:

(A) A median income at or below 120 percent of the State nonmetropolitan median income and a minority population of 30 percent or greater; or

(B) A median income at or below 95 percent of the greater of the:

(*1*) State non-metropolitan median income; or

(*2*) Nationwide non-metropolitan median income; and

(ii) In New England, an entire county having the characteristics in paragraph (2)(i)(A) or (B) of this definition or the remainder of a county, where a portion of the county is in a metropolitan area and the remainder of the county has the characteristics in paragraph (2)(i)(A) or (B) of this definition.

Utilities means charges for electricity, piped or bottled gas, water, sewage disposal, fuel (oil, coal, kerosene, wood, solar energy, or other), and garbage and trash collection. Utilities do not include charges for telephone service.

Utility allowance means either:

(1) The amount to be added to contract rent when utilities are not included in contract rent (also referred to as the ''AHS-derived utility allowance''), as issued annually by the Secretary; or

(2) The utility allowance established under the HUD Section 8 Program (42 U.S.C. 1437f) for the area where the property is located.

Very-low-income has the same definition as ''very low-income'' has in FHEFSSA.

Wholesale exchange means a transaction in which a GSE buys or otherwise acquires mortgages held in portfolio or securitized by the other GSE, or where both GSEs swap such mortgages.

Working day means a day when HUD is officially open for business.

Subpart B—Housing Goals

§ 81.11 General.

This subpart establishes: three housing goals, as required by FHEFSSA; requirements for measuring performance under the goals; and procedures for monitoring and enforcing the goals.

§ 81.12 Low- and Moderate-Income Housing Goal.

(a) *Purpose of goal.* This annual goal for the purchase by each GSE of mortgages on housing for low- and moderate-income families (''the Low- and Moderate-Income Housing Goal'') is intended to achieve increased purchases by the GSEs of such mortgages.

(b) *Factors.* In establishing the Low- and Moderate-Income Housing Goals, the Secretary considered the factors in 12 U.S.C. 4562(b). A statement documenting the Secretary's considerations and findings with respect to these factors, entitled ''Secretarial Considerations to Establish the Low- and Moderate-Income Housing Goal,'' was published in the Federal Register on December 1, 1995.

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on housing for low- and moderate-income families are:

(1) For 1996, 40 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1996;

(2) For each of the years 1997–99, 42 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years; and

(3) For 2000 and thereafter the Secretary shall establish annual goals; pending establishment of goals for 2000 and thereafter, the annual goal for each of those years shall be 42 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years.

§ 81.13 Central Cities, Rural Areas, and Other Underserved Areas Housing Goal.

(a) *Purpose of the goal.* This annual goal for the purchase by each GSE of mortgages on housing located in central cities, rural areas, and other underserved areas is intended to achieve increased purchases by the GSEs of mortgages financing housing in areas that are underserved in terms of mortgage credit.

(b) *Factors.* In establishing the Central Cities, Rural Areas, and Other Underserved Areas Goals, the Secretary considered the factors in 12 U.S.C. 4564(b). A statement documenting the Secretary's considerations and findings with respect to these factors, entitled ''Secretarial Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal,'' was published in the Federal Register on December 1, 1995.

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on housing located in central cities, rural areas, and other underserved areas are:

(1) For 1996, 21 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1996;

(2) For each of the years 1997–99, 24 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years; and

(3) For 2000 and thereafter the Secretary shall establish annual goals; pending establishment of goals for 2000 and thereafter, the annual goal for each of those years shall be 24 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years.

(d) *Measuring performance.* The GSEs shall determine on a mortgage-by-mortgage basis, through geocoding or any similarly accurate and reliable method, whether a mortgage finances one or more dwelling units located in a central city, rural area, or other underserved area.

§ 81.14 Special Affordable Housing Goal.

(a) *Purpose of the goal.* This goal is intended to achieve increased purchases by the GSEs of mortgages on rental and owner-occupied housing meeting the then-existing unaddressed needs of, and affordable to, low-income families in low-income areas and very-low-income families.

(b) *Factors.* In establishing the Special Affordable Housing Goals, the Secretary considered the factors in 12 U.S.C. 4563(a)(2). A statement documenting the Secretary's considerations and findings with respect to these factors, entitled ''Secretarial Considerations to Establish the Special Affordable Housing Goal,'' was published in the Federal Register on December 1, 1995.

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on rental and owner-occupied housing meeting the then-existing, unaddressed needs of and affordable to low-income families in low-income areas and very-low-income families are:

(1) For 1996, 12 percent of the total number of dwelling units financed by each GSE's mortgage purchases in 1996. The goal shall include mortgage purchases financing dwelling units in multifamily housing totalling not less than 0.8 percent of the dollar volume of mortgages purchased by the respective GSE in 1994;

(2) For each of the years 1997–99, 14 percent of the total number of dwelling units financed by each GSE's mortgage purchases in each of those years. The goal for each year shall include mortgage purchases financing dwelling units in multifamily housing totalling not less than 0.8 percent of the dollar volume of mortgages purchased by the respective GSE in 1994; and

(3) For 2000 and thereafter the Secretary shall establish annual goals. Pending establishment of goals for 2000 and thereafter, the annual goal for each of those years shall be 14 percent of the total number of dwelling units financed by each GSE's mortgages purchases in each of those years; the goal for each such year shall include mortgage purchases financing dwelling units in multifamily housing totalling not less than 0.8 percent of the dollar volume of mortgages purchased by the respective GSE in 1994.

(d) *Counting of multifamily units.* (1) Dwelling units affordable to low-income families and financed by a particular purchase of a mortgage on multifamily housing shall count toward achievement of the Special Affordable Housing Goal where at least:

(i) 20 percent of the dwelling units in the particular multifamily property are affordable to families whose incomes do not exceed 50 percent of the area median income; or

(ii) 40 percent of the dwelling units in the particular multifamily property are affordable to very-low-income families.

(2) Where only some of the units financed by a purchase of a mortgage on multifamily housing count under the multifamily component of the goal, only a portion of the unpaid principal balance of the mortgage attributable to such units shall count toward the multifamily component. The portion of the mortgage counted under the multifamily requirement shall be equal to the ratio of the total units that count to the total number of units in the mortgaged property.

(e) *Full Credit Activities.* (1) For purposes of 12 U.S.C. 4563(b)(1) and this paragraph (e), full credit means that each unit financed by a mortgage purchased by a GSE and meeting the requirements of this section shall count toward achievement of the Special Affordable Housing Goal for that GSE.

(2) Consistent with § 81.16(b)(3)(ii), the Secretary will give full credit toward achievement of the Special Affordable Housing Goals for the activities in 12 U.S.C. 4563(b)(1).

(3) Mortgages under HUD's Home Equity Conversion Mortgage (''HECM'') Insurance Demonstration Program, 12 U.S.C. 1715z-20, and the Farmers Home Administration's Guaranteed Rural Housing Loan Program, 7 U.S.C. 1933, meet the requirements of 12 U.S.C. 4563(b)(1)(A)(i) and (ii).

(4) (i) For purposes of determining whether a seller meets the requirement in 12 U.S.C. 4563(b)(1)(B), a seller must currently operate on its own or actively participate in an ongoing program that will result in originating additional loans that meet the goal. Actively participating in such a program includes actively participating with a qualified housing group that operates a program resulting in the origination of loans that meet the requirements of the goal.

(ii) To determine whether a seller meets the requirement in paragraph (e)(4)(i) of this section, the GSE shall verify and monitor that the seller meets the requirement and develop any necessary mechanisms to ensure compliance with this requirement.

(iii) Where a seller's primary business is originating mortgages on housing that qualifies under this Special Affordable Housing Goal, such seller is presumed to meet the requirements in paragraph (e)(4)(i) of this section.

(f) *No credit activities.* Neither the purchase nor the securitization of mortgages associated with the refinancing of a GSE's existing mortgage or mortgage-backed securities portfolios shall receive credit toward the achievement of the Special Affordable Housing Goal. Refinancings that result from the wholesale exchange of mortgages between the two GSEs shall not count toward the achievement of this goal. Refinancings of individual mortgages shall count toward achievement of this goal when the refinancing is an arms-length transaction that is borrower-driven and the mortgage otherwise counts toward achievement of this goal. For purposes of this paragraph (f), ''mortgage or mortgage-backed securities portfolios'' includes mortgages retained by Fannie Mae or Freddie Mac and mortgages utilized to back mortgage-backed securities.

§ 81.15 General requirements.

(a) *Calculating the numerator and denominator.* Performance under each of the housing goals shall be measured using a fraction that is converted into a percentage. The numerator of each fraction is the number of dwelling units financed by a GSE's mortgage purchases in a particular year that count toward achievement of the housing goal. The denominator of each fraction is, for all mortgages purchased, the number of dwelling units that could count toward achievement of the goal under appropriate circumstances. The denominators shall not include GSE transactions or activities that are not mortgages or mortgage purchases. When a GSE lacks sufficient information to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of a particular housing goal, that mortgage purchase shall be included in the denominator for that housing goal.

(b) *Properties with multiple dwelling units.* For the purposes of counting toward the achievement of the goals, whenever the property securing a mortgage contains more than one dwelling unit, each such dwelling unit shall be counted as a separate dwelling unit financed by a mortgage purchase.

(c) *Credit toward multiple goals.* A mortgage purchase (or dwelling unit financed by such purchase) by a GSE in a particular year shall count toward the achievement of each housing goal for which such purchase (or dwelling unit) qualifies in that year.

(d) *Counting owner-occupied units.* For purposes of counting owner-occupied units toward achievement of the Low- and Moderate-Income Housing

Goal or the Special Affordable Housing Goal, mortgage purchases financing such units shall be evaluated based on the income of the mortgagors and the area median income at the time of origination of the mortgage. To determine whether mortgagors may be counted under a particular family income level, *i.e.*, very-low-, low-, or moderate-income, the income of the mortgagors is compared to the median income for the area at the time of mortgage origination, using the appropriate percentage factor provided under § 81.17.

(e) *Counting rental units.* (1) *Use of income, rent.* (i) *Generally.* For purposes of counting rental units toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, mortgage purchases financing such units shall be evaluated based on the income of actual or prospective tenants where such data is available, *i.e.*, known to a lender.

(ii) *Availability of income information.* (A) Each GSE shall require lenders to provide to the GSE tenant income information under paragraphs (e)(3) and (4) of this section, but only when such information is known to the lender.

(B) When such tenant income information is available for all occupied units, the GSE's performance shall be based on the income of the tenants in the occupied units. For unoccupied units that are vacant and available for rent and for unoccupied units that are under repair or renovation and not available for rent, the GSE shall use the income of prospective tenants, if paragraph (e)(4) of this section is applicable. If paragraph (e)(4) of this section is not applicable, the GSE shall use rent levels for comparable units in the property to determine affordability.

(2) *Model units and rental offices.* A model unit or rental office in a multifamily property may count toward achievement of the housing goals only if a GSE determines that:

(i) It is reasonably expected that the units will be occupied by a family within one year;

(ii) The number of such units is reasonable and minimal considering the size of the multifamily property; and

(iii) Such unit otherwise meets the requirements for the goal.

(3) *Income of actual tenants.* When the income of actual tenants is available, to determine whether a tenant is very-low-, low-, or moderate-income, the income of the tenant shall be compared to the median income for the area, adjusted for family size as provided in § 81.17.

(4) *Income of prospective tenants.* When income for tenants is available to a lender because a project is subject to a Federal housing program that establishes the maximum income for a tenant or a prospective tenant in rental units, the income of prospective tenants may be counted at the maximum income level established under such housing program for that unit. In determining the income of prospective tenants, the income shall be projected based on the types of units and market area involved. Where the income of prospective tenants is projected, each GSE must determine that the income figures are reasonable considering the rents (if any) on the same units in the past and considering current rents on comparable units in the same market area.

(5) *Use of rent.* When the income of the prospective or actual tenants of a dwelling unit is not available, performance under these goals will be evaluated based on rent and whether the rent is affordable to the income group targeted by the housing goal. A rent is affordable if the rent does not exceed 30 percent of the maximum income level of very-low-, low-, or moderate-income families as provided in § 81.19. In determining contract rent for a dwelling unit, the actual rent or average rent by unit type shall be used.

(6) *Timeliness of information.* In determining performance under the housing goals, each GSE shall use tenant and rental information as of the time of mortgage:

(i) Acquisition for mortgages on multifamily housing; and

(ii) Origination for mortgages on single-family housing.

(f) *Application of Median income.* (1) For purposes of determining an area's median income under §§ 81.17 through 81.19 and for the definition of ''low-income area,'' the area is:

(i) The metropolitan area, if the property which is the subject of the mortgage is in a metropolitan area; and

(ii) In all other areas, the county in which the property is located, except that where the State nonmetropolitan median income is higher than the county's median income, the area is the State nonmetropolitan area.

(2) When a GSE cannot precisely determine whether a mortgage is on dwelling unit(s) located in one area, the GSE shall determine the median income for the split area in the manner prescribed by the Federal Financial Institutions Examination Council for reporting under the Home Mortgage Disclosure Act, if the GSE can determine that the mortgage is on dwelling unit(s) located in:

(i) A census tract;

(ii) A census place code;

(iii) A block-group enumeration district;

(iv) A nine-digit zip code; or

(v) Another appropriate geographic segment that is partially located in more than one area (''split area'').

(g) *Sampling not permitted.* Performance under the housing goals for each year shall be based on a complete tabulation of mortgage purchases for that year; a sampling of such purchases is not acceptable.

(h) *Newly available data.* When a GSE uses data to determine whether a mortgage purchase counts toward achievement of any goal and new data is released after the start of a calendar quarter, the GSE need not use the new data until the start of the following quarter.

§ 81.16 Special counting requirements.

(a) *General.* In determining whether a GSE shall receive full credit for a transaction or activity toward achievement of any of the housing goals, the Secretary shall consider whether a transaction or activity of the GSE is substantially equivalent to a mortgage purchase and either creates a new market or adds liquidity to an existing market.

(b) *Not counted.* The following transactions or activities shall not count toward achievement of any of the housing goals and shall not be included in the denominator in calculating either GSE's performance under the housing goals:

(1) Equity investments in housing development projects;

(2) Purchases of State and local government housing bonds except as provided in 81.16(c)(8);

(3) Purchases of non-conventional mortgages except:

(i) Where such mortgages are acquired under a risk-sharing arrangement with a Federal agency; or

(ii) As provided in § 81.14(e)(2);

(4) Commitments to buy mortgages at a later date or time;

(5) Options to acquire mortgages;

(6) Rights of first refusal to acquire mortgages;

(7) Any interests in mortgages that the Secretary determines, in writing, shall not be treated as interests in mortgages;

(8) Mortgage purchases to the extent they finance any dwelling units that are secondary residences; and

(9) Any combination of (1) through (8) above.

(c) *Other special rules*—(1) *Credit enhancements.* (i) Dwelling units financed under a credit enhancement entered into by a GSE shall be treated as mortgage purchases and count toward achievement of the housing goals when:

(A) The GSE provides a specific contractual obligation to ensure timely payment of amounts due under a mortgage or mortgages financed by the issuance of housing bonds (such bonds may be issued by any entity, including a State or local housing finance agency);

(B) The GSE assumes a credit risk in the transaction substantially equivalent to the risk that would have been assumed by the GSE if it had securitized the mortgages financed by such bonds; and

(C) Such dwelling units otherwise qualify under this part.

(ii) When a GSE provides a specific contractual obligation to ensure timely payment of amounts due under any mortgage originally insured by a public purpose mortgage insurance entity or fund, the GSE may, on a case-by-case basis, seek approval from the Secretary for such activities to count toward achievement of the housing goals.

(2) *Real estate mortgage investment conduits (''REMICs'').* (i) A GSE's purchase or guarantee of all or a portion of a REMIC shall be treated as a mortgage purchase and receive credit toward the achievement of the housing goals provided:

(A) The underlying mortgages or mortgage-backed securities for the REMIC were not:

(*1*) Guaranteed by the Government National Mortgage Association; or

(*2*) Previously counted toward any housing goal by the GSE; and

(B) The GSE has the information necessary to support counting the dwelling units financed by the REMIC, or that part of the REMIC purchased or guaranteed by the GSE, toward the achievement of a particular housing goal.

(ii) For REMICs that meet the requirements in paragraph (c)(2)(i) of this section and for which the GSE purchased or guaranteed:

(A) The whole REMIC, all of the units financed by the REMIC shall be treated as a mortgage purchase and count toward achievement of the housing goals; or

(B) A portion of the REMIC, the GSE shall receive partial credit toward achievement of the housing goals. This credit shall be equal to the percentage of the REMIC purchased or guaranteed by the GSE (the dollar amount of the purchase or guarantee divided by the total dollar amount of the REMIC) multiplied by the number of dwelling units that would have counted toward the goal(s) if the GSE had purchased or guaranteed the whole REMIC. In calculating performance under the housing goals, the denominator shall include the number of dwelling units included in the whole REMIC multiplied by the percentage of the REMIC purchased or guaranteed by the GSE.

(3) *Risk-sharing.* Mortgage purchases under risk-sharing arrangements between the GSEs and any Federal agency where the units would otherwise count toward achievement of the housing goal under which the GSE is responsible for a substantial amount (50 percent or more) of the risk shall be treated as mortgage purchases and count toward achievement of the housing goal or goals.

(4) *Participations.* Participations purchased by a GSE shall be treated as mortgage purchases and count toward the achievement of the housing goals, if the GSE's participation in the mortgage is 50 percent or more.

(5) *Cooperative housing and condominium projects.* (i) The purchase of a mortgage on a cooperative housing unit (''a share loan'') or a condominium unit is a mortgage purchase. Such a purchase is counted toward achievement of a housing goal in the same manner as a mortgage purchase of single-family owner-occupied units, *i.e.*, affordability is based on the income of the owner(s).

(ii) The purchase of a mortgage on a cooperative building (''a blanket loan'') or a condominium project is a mortgage purchase and shall count toward achievement of the housing goals. Where a GSE purchases both ''a blanket loan'' and mortgages for units in the same building (''share loans''), both the blanket loan and the share loan(s) are mortgage purchases and shall count toward achievement of the housing goals. Where a GSE purchases both a condominium project mortgage and mortgages on condominium dwelling units in the same project, both the condominium project mortgages and the mortgages on condominium dwelling units are mortgage purchases and shall count toward achievement of the housing goals.

(6) *Seasoned mortgages.* A GSE's purchase of a seasoned mortgage shall be treated as a mortgage purchase for purposes of these goals except:

(i) Where the GSE has already counted the mortgages under a housing goal applicable to 1993 or any subsequent year; or

(ii) As provided in 12 U.S.C. 4563(b)(1)(B).

(7) *Purchase of refinanced mortgages.* Except as provided in § 81.14(f), the purchase of a refinanced mortgage by a GSE is a mortgage purchase and shall count toward achievement of the housing goals to the extent the mortgage qualifies.

(8) *Mortgage revenue bonds.* (i) The purchase of a state or local mortgage revenue bond shall be treated as a mortgage purchase and units financed under such MRB shall count toward achievement of the goals where:

(A) the MRB is to be repaid only from the principal and interest of the underlying mortgages originated with funds made available by the MRB; and

(B) the MRB is not a general obligation of a state or local government or agency or is not credit enchanced by any government or agency, third party guarantor or surety.

(ii) Dwelling units financed by a mortgage revenue bond meeting the requirements of paragraph (c)(8)(i) of this section shall count toward a housing goal to the extent such dwelling units otherwise qualify under this part.

§ 81.17 Affordability—Income level definitions—family size and income known (owner-occupied units, actual tenants, and prospective tenants).

In determining whether a dwelling unit is affordable to very-low-, low-, or moderate-income families, where the unit is owner-occupied or, for rental housing, family size and income information for the dwelling unit is known to the GSE, the affordability of the unit shall be determined as follows:

(a) *Moderate-income* means:

(1) In the case of owner-occupied units, income not in excess of 100 percent of area median income; and

(2) In the case of rental units, where the income of actual or prospective tenants is available, income not in excess of the following percentages of area median income corresponding to the following family sizes:

Number of persons in family	Percentage of area median income
1	70
2	80
3	90
4	100
5 or more	(*)

*100% plus (8% multiplied by the number of persons in excess of 4).

(b) *Low-income* means:

(1) In the case of owner-occupied units, income not in excess of 80 percent of area median income; and

(2) In the case of rental units, where the income of actual or prospective tenants is available, income not in excess of the following percentages of area median income corresponding to the following family sizes:

Number of persons in family	Percentage of area median income
1	56
2	64
3	72
4	80
5 or more	(*)

*80% plus (6.4% multiplied by the number of persons in excess of 4).

(c) *Very-low-income* means:

(1) In the case of owner-occupied units, income not in excess of 60 percent of area median income; and

(2) In the case of rental units, where the income of actual or prospective tenants is available, income not in excess of the following percentages of area median income corresponding to the following family sizes:

Number of persons in family	Percentage of area median income
1	42
2	48
3	54
4	60
5 or more	(*)

*60% plus (4.8% multiplied by the number of persons in excess of 4).

§ 81.18 Affordability—Income level definitions—family size not known (actual or prospective tenants).

In determining whether a rental unit is affordable to very-low, low-, or moderate-income families where family size is not known to the GSE, income will be adjusted using unit size, and affordability determined as follows:

(a) *For moderate-income,* the income of prospective tenants shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	70
1 bedroom	75
2 bedrooms	90
3 bedrooms or more	(*)

*104% plus (12% multiplied by the number of bedrooms in excess of 3).

(b) *For low-income,* income of prospective tenants shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	56
1 bedroom	60
2 bedrooms	72
3 bedrooms or more	(*)

*83.2% plus (9.6% multiplied by the number of bedrooms in excess of 3).

(c) *For very-low-income,* income of prospective tenants shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	42
1 bedroom	45
2 bedrooms	54
3 bedrooms or more	(*)

*62.4% plus (7.2% multiplied by the number of bedrooms in excess of 3).

§ 81.19 Affordability—Rent level definitions—tenant income is not known.

For purposes of determining whether a rental unit is affordable to very-low-, low-, or moderate-income families where the income of the family in the dwelling unit is not known to the GSE, the affordability of the unit is determined based on unit size as follows:

(a) *For moderate-income,* maximum affordable rents to count as housing for moderate-income families shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	21
1 bedroom	22.5
2 bedrooms	27
3 bedrooms or more	(*)

*31.2% plus (3.6% multiplied by the number of bedrooms in excess of 3);

(b) *For low-income,* maximum affordable rents to count as housing for low-income families shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	16.8
1 bedroom	18
2 bedrooms	21.6
3 bedrooms or more	(*)

*24.96% plus (2.88% multiplied by the number of bedrooms in excess of 3); and

(c) *For very-low-income,* maximum affordable rents to count as housing for very-low-income families shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	12.6
1 bedroom	13.5
2 bedrooms	16.2
3 bedrooms or more	(*)

*18.72% plus (2.16% multiplied by the number of bedrooms in excess of 3).

(d) *Missing Information.* Each GSE shall make every effort to obtain the information necessary to make the calculations in this section. If a GSE makes such efforts but cannot obtain data on the number of bedrooms in particular units, in making the calculations on such units, the units shall be assumed to be efficiencies.

§ 81.20 Actions to be taken to meet the goals.

To meet the goals under this rule, each GSE shall operate in accordance with 12 U.S.C. 4565.

§ 81.21 Notice and determination of failure to meet goals.

If the Secretary determines that a GSE has failed or there is a substantial probability that a GSE will fail to meet any housing goal, the Secretary shall follow the procedures at 12 U.S.C. 4566(b).

§ 81.22 Housing plans.

(a) If the Secretary determines, under § 81.21, that a GSE has failed or there is a substantial probability that a GSE will fail to meet any housing goal and that the achievement of the housing goal was or is feasible, the Secretary shall require the GSE to submit a housing plan for approval by the Secretary.

(b) *Nature of plan.* Each housing plan shall:

(1) Be feasible;

(2) Be sufficiently specific to enable the Secretary to monitor compliance periodically;

(3) Describe the specific actions that the GSE will take:

(i) To achieve the goal for the next calendar year; or

(ii) If the Secretary determines that there is substantial probability that the GSE will fail to meet a housing goal in the current year, to make such improvements as are reasonable in the remainder of the year; and

(4) Address any additional matters relevant to the plan as required, in writing, by the Secretary.

(c) *Deadline for submission.* The GSE shall submit a housing plan to the Secretary within 30 days after issuance of a notice under § 81.21 requiring the GSE to submit a housing plan. The Secretary may extend the deadline for submission of a plan, in writing and for a time certain, to the extent the Secretary determines an extension is necessary.

(d) *Review of housing plans.* The Secretary shall review and approve or disapprove housing plans in accordance with 12 U.S.C. 4566(c)(4) and (5).

(e) *Resubmission.* If the Secretary disapproves an initial housing plan submitted by a GSE, the GSE shall submit an amended plan acceptable to the Secretary within 30 days of the Secretary disapproving the initial plan; the Secretary may extend the deadline if the Secretary determines an extension is in the public interest. If the amended plan is not acceptable to the Secretary, the Secretary may afford the GSE 15 days to submit a new plan.

Subpart C—Fair Housing

§ 81.41 General.

In this subpart, the Secretary: prohibits discrimination by the GSEs in their mortgage purchases because of race, color, religion, sex, handicap, familial status, age, or national origin, including any consideration of the age or location of a dwelling or age of the neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect; requires that the GSEs submit information to the Secretary to assist Fair Housing Act and ECOA investigations; provides for advising the GSEs of Fair Housing Act and ECOA violations; provides for reviewing the GSEs' underwriting and appraisal guidelines to ensure compliance with the Fair Housing Act; and requires that the GSEs take actions as directed by the Secretary following Fair Housing Act and ECOA adjudications. Because FHEFSSA provides, generally, that the Director of OFHEO shall enforce violations by the GSEs of FHEFSSA and regulations in this subpart, this subpart also provides for referral of such cases to the Director.

§ 81.42 Prohibitions against discrimination.

Neither GSE shall discriminate in any manner in making any mortgage purchases because of race, color, religion, sex, handicap, familial status, age, or national origin, including any consideration of the age or location of the dwelling or the age of the neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect.

§ 81.43 Reports; underwriting and appraisal guideline review.

(a) *Reports.* Each GSE, in the AHAR required under § 81.63, shall assess underwriting standards, business practices, repurchase requirements, pricing, fees, and procedures that affect the purchase of mortgages for low- and moderate-income families, or that may yield disparate results based on the race, color, religion, sex, handicap, familial status, age, or national origin of the borrower, including revisions thereto to promote affordable housing or fair lending.

(b) *Review of Underwriting and Appraisal Guidelines.* The Secretary shall periodically review and comment on the underwriting and appraisal guidelines of each enterprise to ensure that such guidelines are consistent with the Fair Housing Act and 12 U.S.C. 4545.

§ 81.44 Submission of information to the Secretary.

(a) *General.* Upon request from the Secretary, the GSEs shall submit information and data to the Secretary to assist in investigating whether any mortgage lender with which the GSE does business has failed to comply with the Fair Housing Act or ECOA.

(b) *Information requests and submissions.* (1) *Information requests by the Secretary.* The Secretary may require the GSEs to submit information to assist in Fair Housing Act or ECOA investigations of lenders. Under FHEFSSA, other Federal agencies responsible for the enforcement of ECOA must submit requests for information from the GSEs through the Secretary. For matters involving only ECOA, the Secretary will only issue requests for information upon request from the appropriate Federal agency responsible for ECOA.

(2) *Information from established data systems.* The Secretary may request that a GSE generate information or reports from its data system(s) to assist a Fair Housing Act or ECOA investigation.

(3) *GSE replies.* A GSE receiving any request(s) for information under this section shall reply in a complete and timely manner with any and all information that it is privy to and collects that is responsive to the request.

(c) *Submission to ECOA enforcers.* The Secretary shall submit any information received under paragraph (b) of this section concerning compliance with ECOA to appropriate Federal agencies responsible for ECOA enforcement, as provided in section 704 of ECOA.

§ 81.45 Obtaining and disseminating information.

(a) The Secretary shall obtain information from other regulatory and enforcement agencies of the Federal Government and State and local governments regarding violations by lenders of the Fair Housing Act, ECOA, and/or State or local fair housing/lending laws, and shall make such information available to the GSEs as the Secretary deems appropriate in accordance with applicable law regarding the confidentiality of supervisory information and the right to financial privacy, and subject to the terms of memoranda of understanding and other arrangements between the Secretary and Federal financial regulators and other agencies. In addition, the Secretary shall make information that the Secretary possesses regarding violations of the Fair Housing Act available to the GSEs.

(b) As contemplated in paragraph (a) of this section, the Secretary shall obtain information regarding violations by lenders of the Fair Housing Act or ECOA involving discrimination with respect to the availability of credit in a residential real-estate-related transaction from other Federal regulatory or enforcement agencies. The Secretary will obtain information from regulators regarding violations of ECOA by lenders only in circumstances in which there is either more than a single ECOA violation, or the ECOA violation could also be a violation of the Fair Housing Act.

§ 81.46 Remedial actions.

(a) *General.* The Secretary shall direct the GSEs to take one or more remedial actions, including suspension, probation, reprimand or settlement, against lenders found to have engaged in discriminatory lending practices in violation of the Fair Housing Act or ECOA, pursuant to a final adjudication on the record and an opportunity for a hearing under subchapter II of chapter 5 of title 5, United States Code.

(b) *Definitions.* For purposes of this subpart, the following definitions apply:

Indefinite suspension means that, until directed to do otherwise by the Secretary, the GSEs will refrain from purchasing mortgages from a lender.

Probation means that, for a fixed period of time specified by the Secretary, a lender that has been found to have violated the Fair Housing Act or ECOA will be subject automatically to more severe sanctions than probation, *e.g.*, suspension, if further violations are found.

Remedial action includes a reprimand, probation, temporary suspension, indefinite suspension, or settlement.

Reprimand means a written letter to a lender from a GSE, which has been directed to be sent by the Secretary, stating that the lender has violated the Fair Housing Act or ECOA and warning of the possibility that the Secretary may impose more severe remedial actions than reprimand if any further violation occurs.

Temporary Suspension means that, for a fixed period of time specified by the Secretary, the GSEs will not purchase mortgages from a lender.

(c) *Institution of remedial actions.* (1) The Secretary shall direct the GSE to take remedial action(s) against a lender charged with violating ECOA only after a final determination on the charge has been made by an appropriate United States District Court or any other court of competent jurisdiction. The Secretary shall direct the GSE to take remedial action(s) against a lender charged with violating the Fair Housing Act only after a final determination on the matter has been made by a United States Court, a HUD Administrative Law Judge, or the Secretary.

(2) Following a final determination sustaining a charge against a lender for violating the Fair Housing Act or ECOA, in accordance with paragraph (c)(1) of this section, the Secretary shall determine the remedial action(s) that the GSE is to be directed to take for such violation.

(3) In determining the appropriate remedial action(s), the Secretary shall solicit and fully consider the views of the Federal financial regulator responsible for the subject lender concerning the action(s) that are contemplated to be directed against such lender, prior to directing any such action(s). If such responsible Federal financial regulator makes a written determination that a particular remedial action would threaten the financial safety and soundness of a Federally-insured lender, the Secretary shall consider other remedial actions. Where warranted, the Secretary also shall solicit and fully consider the views of the Director regarding the effect of the action(s) that are contemplated on the safety and soundness of the GSE. In determining what action(s) to direct, the Secretary will also, without limitation, consider the following:

(i) The gravity of the violation;

(ii) The extent to which other action has been taken against the lender for discriminatory activities;

(iii) Whether the lender's actions demonstrate a discriminatory pattern or practice or an individual instance of discrimination;

(iv) The impact or seriousness of the harm;

(v) The number of people affected by the discriminatory act(s);

(vi) Whether the lender operates an effective program of self assessment and correction;

(vii) The extent of any actions or programs by the lender designed to compensate victims and prevent future fair lending violations;

(viii) The extent that a finding of liability against a lender is based on a lender's use of a facially-neutral underwriting guideline of a secondary mortgage market entity applied appropriately by the lender in order to sell loans to that secondary mortgage market entity; and

(ix) Any other information deemed relevant by the Secretary.

(d) *Notice of remedial action(s).* (1) Following the Secretary's decision concerning the appropriate remedial action(s) that the GSE is to be directed to take, the Secretary shall prepare and issue to the GSE and the lender a written notice setting forth the remedial action(s) to be taken and the date such remedial action(s) are to commence. The Notice shall inform the lender of its right to request a hearing on the appropriateness of the proposed remedial action(s), within 20 days of service of the Notice, by filing a request with the Docket Clerk, HUD Office of Administrative Law Judges.

(2) Where a lender does not timely request a hearing on a remedial action, the GSE shall take the action in accordance with the Notice.

(e) *Review and decision on remedial action(s).* (1) Where a lender timely requests a hearing on a remedial action, a hearing shall be conducted before a HUD Administrative Law Judge (ALJ) and a final decision rendered in accordance with the procedures set forth in 24 CFR 30.10, 30.15, and subpart E of part 30 of this title, to the extent such provisions are not inconsistent with this subpart or FHEFSSA. The lender and the Secretary, but not the GSE, shall be parties to the action. At such hearing, the appropriateness of the remedial action for the violation(s) will be the sole matter for review. The validity or appropriateness of the underlying determination on the violation(s) shall not be subject to review at such hearing.

(2) The Secretary shall transmit to the GSEs each final decision by HUD on a remedial action and any dispositive settlement of a proceeding on such action.

(3) The GSE shall take the action(s) set forth in a final decision by HUD on remedial action(s) or any dispositive settlement of such a proceeding setting forth remedial action(s) in accordance with such decision or settlement.

§ 81.47 Violations of provisions by the GSEs.

(a) FHEFSSA empowers the Director of OFHEO to initiate enforcement actions for GSE violations of the provisions of section 1325 of FHEFSSA and these regulations. The Secretary shall refer violations and potential violations of 12 U.S.C. 4545 and this subpart C to the Director.

(b) Where a private complainant or the Secretary is also proceeding against a GSE under the Fair Housing Act, the Assistant Secretary for Fair Housing and Equal Opportunity shall conduct the investigation of the complaint and make the reasonable cause/no reasonable cause determination required by section 810(g) of the Fair Housing Act. Where reasonable cause is found, a charge shall be issued and the matter will proceed to enforcement pursuant to sections 812(b) and (o) of the Fair Housing Act.

Subpart D—New Program Approval

§ 81.51 General.

This subpart details the requirements and procedures for review of requests for new program approval by the Secretary.

§ 81.52 Requirement for program requests.

(a) Before implementing a new program, a GSE shall submit a request for new program approval (''program request'') to the Secretary for the Secretary's review. Submission of a program request is not required where the program that the GSE proposes to implement is not significantly different from:

(1) A program that has already been approved in writing by the Secretary; or

(2) A program that was engaged in by the GSE prior to October 28, 1992.

(b) If a GSE does not submit a program request for a program, the Secretary may request information about the program and require that the GSE submit a program request. The GSE shall comply with the request and may indicate in such response its views respecting whether the program is subject to the Secretary's review.

§ 81.53 Processing of program requests.

(a) Each program request submitted to the Secretary by a GSE shall be in writing and shall be submitted to the Secretary and the Director, Office of

Government-Sponsored Enterprises, Department of Housing and Urban Development, Washington, D.C. For those requests submitted before 1 year after the effective date of the regulations issued by the Director of OFHEO under 12 U.S.C. 4611(e), the GSE shall simultaneously submit the program request to the Director.

(b) Each program request shall include:

(1) An opinion from counsel stating the statutory authority for the new program (Freddie Mac Act section 305(a) (1), (4), or (5), or Fannie Mae Charter Act section 302(b)(2)–(5) or 304);

(2) A good-faith estimate of the anticipated dollar volume of the program over the short- and long-term;

(3) A full description of: (i) The purpose and operation of the proposed program;

(ii) The market targeted by the program;

(iii) The delivery system for the program;

(iv) The effect of the program on the mortgage market; and

(v) Material relevant to the public interest.

(c) Following receipt of a program request, the Secretary and, where a program request is submitted to the Director pursuant to paragraph (a) of this section, the Director shall review the program request.

(d) *Transition standard for approval.* Program requests submitted by the GSEs before the date occurring 1 year after the effective date of the regulations issued by the Director under 12 U.S.C. 4611(e) shall be approved or disapproved by the Secretary as provided in 12 U.S.C. 4542(b)(2).

(e) *Permanent standard for approval by the Secretary.* Program requests submitted after the date occurring one year after the effective date of the regulations issued by the Director under 12 U.S.C. 4611(e) establishing the risk-based capital test shall be approved by the Secretary in accordance with 12 U.S.C. 4542(b)(1).

(f) *Time for review.* Unless the Secretary and, where appropriate, the Director of OFHEO, need additional information, a program request shall be approved or disapproved within 45 days from the date it is received by the Director, Office of Government-Sponsored Enterprises, and, where applicable, the Director of OFHEO. If within 45 days after receiving a request, the Secretary or the Director of OFHEO determine that additional information is necessary to review the matter and request such information from the GSE, the Secretary may extend the time period for consideration for an additional 15 days.

(1) Where additional information is requested, the GSE must provide the requested information to the Secretary and, where appropriate, the Director, within 10 days after the request for additional information.

(2) If the GSE fails to furnish requested information within 10 days after the request for information, the Secretary may deny the GSE's request for approval based on such failure and so report to the Committees of Congress in accordance with paragraph (g) of this section.

(g) *Approval or report.* Within 45 days or, if the period is extended, 60 days following receipt of a program request, the Secretary shall approve the request, in writing, or submit a report to the Committee on Banking and Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, explaining the reasons for not approving the request. If the Secretary does not act within this time period, the GSE's program request will be deemed approved.

§ 81.54 Review of disapproval.

(a) *Programs disapproved as unauthorized.* (1) Where the Secretary disapproves a program request on the grounds that the new program is not authorized, as defined in § 81.53(d) or (e), the GSE may, within 30 days of the date of receipt of the decision on disapproval, request an opportunity to review and supplement the administrative record for the decision, in accordance with paragraphs (a) (2) and (3) of this section.

(2) *Supplementing in writing.* A GSE supplementing the record in writing must submit written materials within 30 days after the date of receipt of the decision on disapproval, but no later than the date of a meeting, if requested, under paragraph (a)(3) of this section.

(3) *Meeting.* Within 10 days of the date of receipt of the decision of disapproval, the GSE may request a meeting. If the request for the meeting is timely, the Secretary shall arrange such a meeting, which shall be conducted by the Secretary or the Secretary's designee within 10 working days after receipt of the request. The GSE may be represented by counsel and may submit relevant written materials to supplement the record.

(4) *Determination.* The Secretary shall:

(i) In writing and within 10 days after submission of any materials under paragraph (a)(2) of this section or the conclusion of any meeting under paragraph (a)(3) of this section, whichever is later, withdraw, modify, or affirm the program disapproval; and

(ii) Provide the GSE with that decision.

(b) *Programs disapproved under public interest determination.* When a program request is disapproved because the Secretary determines that the program is not in the public interest or the Director makes the determination in 12 U.S.C. 4542(b)(2)(B), the Secretary shall provide the GSE with notice of, and opportunity for, a hearing on the record regarding such disapproval. A request for a hearing must be submitted by a GSE within 30 days of the Secretary's submission of a report under § 81.53(g) disapproving a program request or the provision of the notice under this paragraph (b), whichever is later. The procedures for such hearings are provided in subpart G of this part.

Subpart E—Reporting Requirements

§ 81.61 General.

This subpart establishes data submission and reporting requirements to carry out the requirements of the GSEs' Charter Acts and FHEFSSA.

§ 81.62 Mortgage reports.

(a) *Loan-level data elements.* To implement the data collection and submission requirements for mortgage data and to assist the Secretary in monitoring the GSEs' housing goal activities, each GSE shall collect and compile computerized loan-level data on each mortgage purchased in accordance with 12 U.S.C. 1456(e) and 1723a(m). The Secretary may, from time-to-time, issue a list entitled ''Required Loan-level Data Elements'' specifying the loan-level data elements to be collected and maintained by the GSEs and provided to the Secretary. The Secretary may revise the list by written notice to the GSEs.

(b) *Quarterly Mortgage reports.* Each GSE shall submit to the Secretary quarterly a Mortgage Report. The fourth quarter report shall serve as the Annual Mortgage Report and shall be designated as such.

(1) Each Mortgage Report shall include:

(i) Aggregations of the loan-level mortgage data compiled by the GSE under paragraph (a) of this section for year-to-date mortgage purchases, in the format specified in writing by the Secretary; and

(ii) Year-to-date dollar volume, number of units, and number of mortgages on owner-occupied and rental properties purchased by the GSE that do and do not qualify under each housing goal as set forth in this part.

(2) To facilitate the Secretary's monitoring of the GSE's housing goal activities, the Mortgage Report for the second quarter shall include year-to-date computerized loan-level data consisting of the data elements required under paragraph (a) of this section.

(3) To implement the data collection and submission requirements for mortgage data and to assist the Secretary in monitoring the GSE's housing goal activities, each Annual Mortgage Report shall include year-to-date computerized loan-level data consisting of the data elements required by under paragraph (a) of this section.

(c) *Timing of Reports.* The GSEs shall submit the Mortgage Report for each of the first 3 quarters of each year within 60 days of the end of the quarter. Each GSE shall submit its Annual Mortgage Report within 75 days after the end of the calendar year.

(d) *Revisions to Reports.* At any time before submission of its Annual Mortgage Report, a GSE may revise any of its quarterly reports for that year.

(e) *Format.* The GSEs shall submit to the Secretary computerized loan-level data with the Mortgage Report, in the format specified in writing by the Secretary.

§ 81.63 Annual Housing Activities Report.

To comply with the requirements in sections 309(n) of the Fannie Mae Charter Act and 307(f) of the Freddie Mac Act and assist the Secretary in preparing the Secretary's Annual Report to Congress, each GSE shall submit to the Secretary an AHAR including the information listed in those sections of the Charter Acts and as provided in § 81.43(a) of this part. Each GSE shall submit such report within 75 days after the end of each calendar year, to the Secretary the Committee on Banking and Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate. Each GSE shall make its AHAR available to the public at its principal and regional offices. Before making any such report available to the public, the GSE may exclude from the report any information that the Secretary has deemed proprietary under subpart F of this part.

§ 81.64 Periodic reports.

Each GSE shall provide to the Secretary all:

(a) Material distributed to the GSE's Housing Advisory Council;

(b) Press releases;

(c) Investor reports;

(d) Proxy statements;

(e) Seller-servicer guides; and

(f) Other information disclosed by the GSE to entities outside of the GSE, but only where the GSE determines that such information is relevant to the Secretary's regulatory responsibilities.

§ 81.65 Other information and analyses.

When deemed appropriate and requested in writing, on a case by-case basis, by the Secretary, a GSE shall furnish the data underlying any of the reports required under this part and shall conduct additional analyses concerning any such report. A GSE shall submit additional reports or other information concerning its activities when deemed appropriate to carry out the Secretary's responsibilities under FHEFSSA or the Charter Acts and requested in writing by the Secretary.

§ 81.66 Submission of reports.

Each GSE shall submit all hard copy reports or other written information required under this subpart to the Secretary and the Director, Office of Government-Sponsored Enterprises. Each GSE shall submit computerized data required under this subpart to the Director, Financial Institutions Regulations, Office of Policy Development and Research. The address for both of these offices is Department of Housing and Urban Development, 451 7th Street, S.W. Washington, D.C. 20410.

Subpart F—Access to Information

§ 81.71 General.

This subpart:

(a) Provides for the establishment of a public-use database to make available to the public mortgage data that the GSEs submit to the Secretary under subsection 309(m) of the Fannie Mae Charter Act and subsection 307(e) of the Freddie Mac Act, and AHAR information that the GSEs submit to the Secretary in the AHAR under subsection 309(n) of the Fannie Mae Charter Act and subsection 307(f) of the Freddie Mac Act;

(b) Establishes mechanisms for the GSEs to designate mortgage data or AHAR information as proprietary information and for the Secretary to determine whether such mortgage data or AHAR information is proprietary information which should be withheld from disclosure;

(c) Addresses the availability of HUD procedures to protect from public disclosure proprietary information and other types of confidential business information submitted by or relating to the GSEs;

(d) Addresses protections from disclosure when there is a request from Congress for information and sets forth protections for treatment of data or information submitted by or relating to the GSEs by HUD officers, employees, and contractors; and

(e) Provides that data or information submitted by or relating to the GSEs that would constitute a clearly unwarranted invasion of personal privacy shall not be disclosed to the public.

§ 81.72 Public-use database and public information.

(a) *General.* Except as provided in paragraph (c) of this section, the Secretary shall establish and make available for public use, a public-use database containing public data as defined in § 81.2.

(b) *Examination of submissions.* Following receipt of mortgage data and AHAR information from the GSEs, the Secretary shall, as expeditiously as possible, examine the submissions for mortgage data and AHAR information that:

(1) Has been deemed to be proprietary information under this part by a temporary order, final order, or regulation in effect at the time of submission;

(2) Has been designated as proprietary information by the GSE in accordance with § 81.73;

(3) Would constitute a clearly unwarranted invasion of personal privacy if such data or information were released to the public; or

(4) Is required to be withheld or, in the determination of the Secretary, is not appropriate for public disclosure under other applicable laws and regulations, including the Trade Secrets Act (18 U.S.C. 1905) and Executive Order 12600.

(c) *Public data and proprietary data.* The Secretary shall place public data in the public-use database. The Secretary shall exclude from the public-use database and from public disclosure:

(1) All mortgage data and AHAR information within the scope of paragraphs (b)(1), (b)(3), and (b)(4) of this section;

(2) Any other mortgage data and AHAR information under (b)(2) when determined by the Secretary under § 81.74 to be proprietary information; and

(3) Mortgage data that is not year-end data.

(d) *Access.* The Secretary shall provide such means as the Secretary determines are reasonable for the public to gain access to the public-use database. To obtain access to the public-use database, the public should contact the Director, Office of Government-Sponsored Enterprises, Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, D.C.

20410, telephone (202) 708–2224 (this is not a toll-free number).

(e) *Fees.* The Secretary may charge reasonable fees to cover the cost of providing access to the public-use database. These fees will include the costs of system access, computer use, copying fees, and other costs.

§ 81.73 GSE request for proprietary treatment.

(a) *General.* A GSE may request proprietary treatment of any mortgage data or AHAR information that the GSE submits to the Secretary. Such a request does not affect the GSE's responsibility to provide data or information required by the Secretary. Where the Secretary grants a request for proprietary treatment, HUD will not include the data or information in the public-use database or publicly disclose the data or information, except as otherwise provided in accordance with this subpart.

(b) *Request for proprietary treatment of mortgage data and AHAR information.* Except as provided in paragraph (c) of this section, a GSE requesting proprietary treatment of mortgage data or AHAR information shall:

(1) Clearly designate those portions of the mortgage data or AHAR information to be treated as proprietary, with a prominent stamp, typed legend, or other suitable form of notice, stating ''Proprietary Information—Confidential Treatment Requested by [name of GSE]'' on each page or portion of page to which the request applies. If such marking is impractical, the GSE shall attach to the mortgage data or information for which confidential treatment is requested a cover sheet prominently marked ''Proprietary Information—Confidential Treatment Requested by [name of GSE];''

(2) Accompany its request with a certification by an officer or authorized representative of the GSE that the mortgage data or information is proprietary; and

(3) Submit any additional statements in support of proprietary designation that the GSE chooses to provide.

(c) *Alternative procedure available for mortgage data or AHAR information subject to a temporary order, final order, or regulation in effect.* When the request for proprietary treatment pertains to mortgage data or AHAR information that has been deemed proprietary by the Secretary under a temporary order, final order, or regulation in effect, the GSE may reference such temporary order, final order, or regulation in lieu of complying with paragraphs (b)(2) and (3) of this section.

(d) *Nondisclosure during pendency.* Except as may otherwise be required by law, during the time any Request for Proprietary Treatment under § 81.73 is pending determination by the Secretary, the data or information submitted by the GSE that is the subject of the request shall not be disclosed to, or be subject to examination by, the public or any person or representative of any person or agency outside of HUD.

§ 81.74 Secretarial determination on GSE request.

(a) *General.* The Secretary shall review all Requests for Proprietary Treatment from the GSEs, along with any other information that the Secretary may elicit from other sources regarding the Request.

(b) *Factors for proprietary treatment.* Except as provided in paragraph (c) of this section, in making the determination of whether to accord proprietary treatment to mortgage data or AHAR information, the Secretary's considerations shall include, but are not limited to:

(1) The type of data or information involved and the nature of the adverse consequences to the GSE, financial or otherwise, that would result from disclosure, including any adverse effect on the GSE's competitive position;

(2) The existence and applicability of any prior determinations by HUD, any other Federal agency, or a court, concerning similar data or information;

(3) The measures taken by the GSE to protect the confidentiality of the mortgage data or AHAR information in question, and similar data or information, before and after its submission to the Secretary;

(4) The extent to which the mortgage data or AHAR information is publicly available including whether the data or information is available from other entities, from local government offices or records, including deeds, recorded mortgages, and similar documents, or from publicly available data bases;

(5) The difficulty that a competitor, including a seller/servicer, would face in obtaining or compiling the mortgage data or AHAR information; and

(6) Such additional facts and legal and other authorities as the Secretary may consider appropriate, including the extent to which particular mortgage data or AHAR information, when considered together with other information, could reveal proprietary information.

(c) *Alternative criterion for mortgage data or AHAR information subject to a temporary order, final order, or regulation in effect.* Where the request for proprietary treatment pertains to mortgage data or AHAR information that has been deemed proprietary by the Secretary under a temporary order, final order, or regulation in effect, the Secretary shall grant the request with respect to any mortgage data or AHAR information which comes within the order or regulation.

(d) *Determination of proprietary treatment.* The Secretary shall determine, as expeditiously as possible, whether mortgage data or AHAR information designated as proprietary by a GSE is proprietary information, or whether it is not proprietary and subject to inclusion in the public-use database and public release notwithstanding the GSE's request.

(e) *Action when according proprietary treatment to mortgage data and AHAR information.* (1) When the Secretary determines that mortgage data or AHAR information designated as proprietary by a GSE is proprietary, and the mortgage data or AHAR information is not subject to a temporary order, a final order, or a regulation in effect providing that the mortgage data or AHAR information is not subject to public disclosure, the Secretary shall notify the GSE that the request has been granted. In such cases, the Secretary shall issue either a temporary order, a final order, or a regulation providing that the mortgage data or information is not subject to public disclosure. Such a temporary order, final order, or regulation shall:

(i) Document the reasons for the determination; and

(ii) Be provided to the GSE, made available to members of the public, and published in the Federal Register, except that any portions of such order or regulation that would reveal the proprietary information shall be withheld from public disclosure. Publications of temporary orders shall invite public comments when feasible.

(2) Where the Secretary determines that such mortgage data or information is proprietary, the Secretary shall not make it publicly available, except as otherwise provided in accordance with this subpart.

(f) *Determination not to accord proprietary treatment to mortgage data and AHAR information or to seek further information.* When the Secretary determines that such mortgage data or AHAR information designated as proprietary by a GSE may not be proprietary, that the request may be granted only in part, or that questions exist concerning the request, the following procedure shall apply:

(1) The Secretary shall provide the GSE with an opportunity for a meeting with HUD to discuss the matter, for the

purpose of gaining additional information concerning the request.

(2) Following the meeting, based on the Secretary's review of the mortgage data or AHAR information that is the subject of a request and the GSE's objections, if any, to disclosure of such mortgage data or AHAR information, the Secretary shall make a determination:

(i) If the Secretary determines to withhold from the public-use database as proprietary the mortgage data or AHAR information that is the subject of a request, the procedures in paragraph (e) of this section shall apply; or

(ii) If the Secretary determines that any mortgage data or AHAR information that is the subject of a request is not proprietary, the Secretary shall provide notice in writing to the GSE of the reasons for this determination, and such notice shall provide that the Secretary shall not release the mortgage data or AHAR information to the public for 10 working days.

§ 81.75 Proprietary information withheld by order or regulation.

Following a determination by the Secretary that mortgage data or AHAR information is proprietary information under FHEFSSA, the Secretary shall expeditiously issue a temporary order, final order, or regulation withholding the mortgage data or AHAR information from the public-use database and from public disclosure by HUD in accordance with 12 U.S.C. 4546. The Secretary may, from time-to-time, by regulation or order, issue a list entitled ''GSE Mortgage Data and AHAR Information: Proprietary Information/Public-Use Data'' providing that certain information shall be treated as proprietary information. The Secretary may modify the list by regulation or order.

§ 81.76 FOIA requests and protection of GSE information.

(a) *General.* HUD shall process FOIA requests for information submitted to the Secretary by the GSEs in accordance with:

(1) HUD's FOIA and Privacy Act regulations, 24 CFR parts 15 and 16;

(2) 12 U.S.C. 4525, 4543, and 4546 and this subpart; and

(3) Other applicable statutes, regulations, and guidelines, including the Trade Secrets Act, 18 U.S.C. 1905, and Executive Order 12600. In responding to requests for data or information submitted by or relating to the GSEs, the Secretary may invoke provisions of these authorities to protect data or information from disclosure.

(b) *Protection of confidential business information other than mortgage data and AHAR information.* When a GSE seeks to protect from disclosure confidential business information, the GSE may seek protection of such confidential business information pursuant to the provisions of HUD's FOIA regulations at 24 CFR part 15, without regard to whether or not it is mortgage data or AHAR information.

(c) *Processing of FOIA requests*—(1) *FOIA Exemption (b)(4).* HUD will process FOIA requests for confidential business information of the GSEs to which FOIA exemption 4 may apply in accordance with 24 CFR part 15, and the predisclosure notification procedures of Executive Order 12,600.

(2) *FOIA Exemption (b)(8).* Under section 1319F of FHEFSSA, the Secretary may invoke FOIA exemption (b)(8) to withhold from the public any GSE data or information contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of HUD. HUD may make data or information available for the confidential use of other government agencies in their official duties or functions, but all data or information remains the property of HUD and any unauthorized use or disclosure of such data or information may be subject to the penalties of 18 U.S.C. 641.

(3) *Other FOIA exemptions.* Under 24 CFR part 15, the Secretary may invoke other exemptions including, without limitation, exemption (b)(6) (5 U.S.C. 552(b)(6)), to protect data and information that would constitute a clearly unwarranted invasion of personal privacy.

(d) *Protection of information by HUD officers and employees.* The Secretary will institute all reasonable safeguards to protect data or information submitted by or relating to either GSE, including, but not limited to, advising all HUD officers and employees having access to data or information submitted by or relating to either GSE of the legal restrictions against unauthorized disclosure of such data or information under HUD Standards of Conduct regulations, 24 CFR part O; the Government-wide Standards of Ethical Conduct, 5 CFR part 2635; and the Trade Secrets Act, 18 U.S.C. 1905. Officers and employees shall be advised of the penalties for unauthorized disclosure, ranging from disciplinary action under 24 CFR part O and 5 CFR part 2635 to criminal prosecution.

(e) *Protection of information by contractors.* (1) In contracts and agreements entered into by HUD where contractors have access to data or information submitted by or relating to either GSE, HUD shall include detailed provisions specifying that:

(i) Neither the contractor nor any of its officers, employees, agents, or subcontractors may release data submitted by or relating to either GSE without HUD's authorization; and

(ii) Unauthorized disclosure may be a basis for:

(A) Terminating the contract for default;

(B) Suspending or debarring the contractor; and

(C) Criminal prosecution of the contractor, its officers, employees, agents, or subcontractors under the Federal Criminal Code.

(2) Contract provisions shall require safeguards against unauthorized disclosure, including training of contractor and subcontractor agents and employees, and provide that the contractor will indemnify and hold HUD harmless against unauthorized disclosure of data or information belonging to the GSEs or HUD.

§ 81.77 Requests for GSE information on behalf of Congress, the Comptroller General, a subpoena, or other legal process.

(a) *General.* With respect to information submitted by or relating to the GSEs, nothing in this subpart F may be construed to grant authority to the Secretary under FHEFSSA to withhold any information from or to prohibit the disclosure of any information to the following persons or entities:

(1) Either House of Congress or, to the extent of matters within its jurisdiction, any committee or subcommittee thereof, or any joint committee of Congress or subcommittee of any such joint committee;

(2) The Comptroller General, or any of the Comptroller General's authorized representatives, in the course of the performance of the duties of the General Accounting Office;

(3) A court of competent jurisdiction pursuant to a subpoena; or

(4) As otherwise compelled by law.

(b) *Notice of proprietary or confidential nature of GSE information.* (1) In releasing data or information in response to a request as set out in paragraph (a) of this section, the Secretary will, where applicable, include a statement with the data or information to the effect that:

(i) The GSE regards the data or information as proprietary information and/or confidential business information;

(ii) Public disclosure of the data or information may cause competitive harm to the GSE; and

(iii) The Secretary has determined that the data or information is proprietary information and/or confidential business information.

(2) To the extent practicable, the Secretary will provide notice to the GSE after a request from the persons or entities described in paragraphs (a)(1)–(4) of this section for proprietary information or confidential business information is received and before the data or information is provided in response to the request.

(c) *Procedures for requests pursuant to subpoena or other legal process.* The procedures in 24 CFR 15.71–15.74 shall be followed when a subpoena, order, or other demand of a court or other authority is issued for the production or disclosure of any GSE data or information that:

(1) Is contained in HUD's files;

(2) Relates to material contained in HUD's files; or

(3) Was acquired by any person while such person was an employee of HUD, as a part of the performance of the employee's official duties or because of the employee's official status.

(d) *Requests pursuant to subpoena or other legal process not served on HUD.* If an individual who is not a HUD employee or an entity other than HUD is served with a subpoena, order, or other demand of a court or authority for the production or disclosure of HUD data or information relating to a GSE and such data or information may not be disclosed to the public under this subpart or 24 CFR part 15, such individual or entity shall comply with 24 CFR 15.71–15.74 as if the individual or entity is a HUD employee, including immediately notifying HUD in accordance with the procedures set forth in 24 CFR 15.73(a).

(e) *Reservation of additional actions.* Nothing in this section precludes further action by the Secretary, in his or her discretion, to protect data or information submitted by a GSE from unwarranted disclosure in appropriate circumstances.

Subpart G—Procedures for Actions and Review of Actions

§ 81.81 General.

This subpart sets forth procedures for:

(a) The Secretary to issue cease-and-desist orders and impose civil money penalties to enforce the housing goal provisions implemented in subpart B of this part and the information submission and reporting requirements implemented in subpart E of this part; and

(b) Hearings, in accordance with 12 U.S.C. 4542(c)(4)(B), on the Secretary's disapproval of new programs that the Secretary determines are not in the public interest.

§ 81.82. Cease-and-desist proceedings.

(a) *Issuance.* The Secretary may issue and serve upon a GSE a written notice of charges justifying issuance of a cease-and-desist order, if the Secretary determines the GSE:

(1) Has failed to submit, within the time prescribed in § 81.22, a housing plan that substantially complies with 12 U.S.C. 4566(c), as implemented by § 81.22;

(2) Is failing or has failed, or there is reasonable cause to believe that the GSE is about to fail, to make a good-faith effort to comply with a housing plan submitted to and approved by the Secretary; or

(3) Has failed to submit any of the information required under sections 309(m) or (n) of the Fannie Mae Charter Act, sections 307(e) or (f) of the Freddie Mac Act, or subpart E of this part.

(b) *Procedures—(1) Content of notice.* The notice of charges shall provide:

(i) A concise statement of the facts constituting the alleged misconduct and the violations with which the GSE is charged;

(ii) Notice of the GSE's right to a hearing on the record;

(iii) A time and date for a hearing on the record;

(iv) A statement of the consequences of failing to contest the matter; and

(v) The effective date of the order if the GSE does not contest the matter.

(2) *Administrative Law Judge.* A HUD Administrative Law Judge (ALJ) shall preside over any hearing conducted under this section. The hearing shall be conducted in accordance with § 81.84 and, to the extent the provisions are not inconsistent with any of the procedures in this part or FHEFSSA, with §§ 30.10 and 30.15 and subpart E of part 30 of this title.

(3) *Issuance of order.* If the GSE consents to the issuance of the order or the ALJ finds, based on the hearing record, that a preponderance of the evidence established the conduct specified in the notice of charges, the ALJ may issue and serve upon the GSE an order requiring the GSE to:

(i) Submit a housing plan that substantially complies with 12 U.S.C. 4566(c), as implemented by § 81.22;

(ii) Comply with a housing plan; or

(iii) Provide the information required under subpart E of this part.

(4) *Effective date.* An order under this section shall be effective as provided in 12 U.S.C. 4581(c) and § 81.84(m).

§ 81.83 Civil money penalties.

(a) *Imposition.* The Secretary may impose a civil money penalty on a GSE that has failed:

(1) To submit, within the time prescribed in § 81.22, a housing plan that substantially complies with 12 U.S.C. 4566(c), as implemented by § 81.22;

(2) To make a good-faith effort to comply with a housing plan submitted and approved by the Secretary; or

(3) To submit any of the information required under sections 309(m) or (n) of the Fannie Mae Charter Act, sections 307(e) or (f) of the Freddie Mac Act, or subpart E of this part.

(b) *Amount of penalty.* The amount of the penalty shall not exceed:

(1) For any failure described in paragraph (a)(1) of this section, $25,000 for each day that the failure occurs; and

(2) For any failure described in paragraphs (a)(2) or (a)(3) of this section, $10,000 for each day that the failure occurs.

(c) *Factors in determining amount of penalty.* In determining the amount of a penalty under this section, the Secretary shall consider the factors in 12 U.S.C. 4585(c)(2) including the public interest.

(d) *Procedures—(1) Notice of Intent.* The Secretary shall notify the GSE in writing of the Secretary's determination to impose a civil money penalty by issuing a Notice of Intent to Impose Civil Money Penalties (''Notice of Intent''). The Notice of Intent shall provide:

(i) A concise statement of the facts constituting the alleged misconduct;

(ii) The amount of the civil money penalty;

(iii) Notice of the GSE's right to a hearing on the record;

(iv) The procedures to follow to obtain a hearing;

(v) A statement of the consequences of failing to request a hearing; and

(vi) The date the penalty shall be due unless the GSE contests the matter.

(2) To appeal the Secretary's decision to impose a civil money penalty, the GSE shall, within 20 days of service of the Notice of Intent, file a written Answer with the Chief Docket Clerk, Office of Administrative Law Judges, Department of Housing and Urban Development, at the address provided in the Notice of Intent.

(3) *Administrative Law Judge.* A HUD ALJ shall preside over any hearing conducted under this section, in accordance with § 81.84 and, to the extent the provisions are not inconsistent with any of the procedures in this part, FHEFSSA, or §§ 30.10 and 30.15 and subpart E of part 30 of this title.

(4) *Issuance of order.* If the GSE consents to the issuance of the order or the ALJ finds, on the hearing record, that a preponderance of the evidence establishes the conduct specified in the notice of charges, the ALJ may issue an order imposing a civil money penalty.

(5) *Consultation with the Director.* In the Secretary's discretion, the Director of OFHEO may be requested to review any Notice of Intent, determination, order, or interlocutory ruling arising from a hearing.

(e) *Action to collect penalty.* The Secretary may request the Attorney General of the United States to bring an action to collect the penalty, in accordance with 12 U.S.C. 4585(d). Interest on, and other charges for, any unpaid penalty may be assessed in accordance with 31 U.S.C. 3717.

(f) *Settlement by Secretary.* The Secretary may compromise, modify, or remit any civil money penalty that may be, or has been, imposed under this section.

§ 81.84 Hearings.

(a) *Applicability.* The hearing procedures in this section apply to hearings on the record to review cease-and-desist orders, civil money penalties, and new programs disapproved based upon a determination by the Secretary that such programs are not in the public interest, in accordance with 12 U.S.C. 4542(c)(4)(B).

(b) *Hearing requirements.* (1) Hearings shall be held in the District of Columbia.

(2) Hearings shall be conducted by a HUD ALJ authorized to conduct proceedings under 24 CFR part 30.

(c) *Timing.* Unless an earlier or later date is requested by a GSE and the request is granted by the ALJ, a hearing shall be fixed for a date not earlier than 30 days, nor later than 60 days, after:

(1) Service of the notice of charges under § 81.82;

(2) Service of the Notice of Intent to Impose Civil Money Penalty(ies) under § 81.83; or

(3) Filing of a request for a hearing under § 81.54(b).

(d) *Procedure.* Hearings shall be conducted in accordance with the procedures set forth in 24 CFR 30.10, 30.15, and subpart E of part 30 of this title to the extent that such provisions are not inconsistent with any of the procedures in this part or FHEFSSA.

(e) *Service.* (1) *To GSE.* Any service required or authorized to be made by the Secretary under this subpart G may be made to the Chief Executive Officer of a GSE or any other representative as the GSE may designate in writing to the Secretary.

(2) *How service may be made.* A serving party shall use one or more of the following methods of service:

(i) Personal service;

(ii) Delivering the papers to a reliable commercial courier service, overnight delivery service, or the U.S. Post Office for Express Mail Delivery; or

(iii) Transmission by electronic media, only if the parties mutually agree. The serving party shall mail an original of the filing after any proper service using electronic media.

(f) *Subpoena authority*—(1) *General.* In the course of or in connection with any hearing, the Secretary and the ALJ shall have the authority to:

(i) Administer oaths and affirmations;

(ii) Take and preserve testimony under oath;

(iii) Issue subpoenas and subpoenas duces tecum; and

(iv) Revoke, quash, or modify subpoenas and subpoenas duces tecum issued under this paragraph (f).

(2) *Witnesses and documents.* The attendance of witnesses and the production of documents provided for in this section may be required from any place in any State. A witness may be required to appear, and a document may be required to be produced, at:

(i) The hearing; and

(ii) Any place that is designated for attendance at a deposition or production of a document under this section.

(3) *Enforcement.* In accordance with 12 U.S.C. 4588(c), the Secretary may request the Attorney General of the United States to enforce any subpoena or subpoena duces tecum issued pursuant to this section. If a subpoenaed person fails to comply with all or any portion of a subpoena issued pursuant to this paragraph (f), the subpoenaing party or any other aggrieved person may petition the Secretary to seek enforcement of the subpoena. A party's petition to the Secretary for enforcement of a subpoena in no way limits the sanctions that may be imposed by the ALJ on a party who fails to comply with a subpoena issued under this paragraph (f).

(4) *Fees and expenses.* Witnesses subpoenaed under this section shall be paid the same fees and mileage that are paid witnesses in the district courts of the United States and may seek reasonable expenses and attorneys fees in any court having jurisdiction of any proceeding instituted under this section. Such expenses and fees shall be paid by the GSE or from its assets.

(g) *Failure to appear.* If a GSE fails to appear at a hearing through a duly authorized representative, the GSE shall be deemed to have consented to the issuance of the cease-and-desist order, the imposition of the penalty, or the disapproval of the new program, whichever is applicable.

(h) *Public hearings.* (1) All hearings shall be open to the public, unless the ALJ determines that an open hearing would be contrary to the public interest. Where a party makes a timely motion to close a hearing and the ALJ denies the motion, such party may file with the Secretary within 5 working days a request for a closed hearing, and any party may file a reply to such a request within 5 working days of service of such a motion. Such motions, requests, and replies are governed by § 30.515 of this title. When a request for a closed hearing has been filed with the Secretary under this paragraph (h)(1), the hearing shall be stayed until the Secretary has advised the parties and the ALJ, in writing, of the Secretary's decision on whether the hearing should be closed.

(2) Failure to file a timely motion, request or reply is deemed a waiver of any objection regarding whether the hearing will be public or closed. A party must file any motion for a closed hearing within 10 days after:

(i) Service of the notice of charges under § 81.82;

(ii) Service of the Notice of Intent to Impose Civil Money Penalt(ies) under § 81.83; or

(iii) Filing of a request for a hearing under § 81.54(b).

(i) *Decision of ALJ.* After each hearing, the ALJ shall issue an initial decision and serve the initial decision on the GSE, the Secretary, any other parties, and the HUD General Counsel. This service will constitute notification that the case has been submitted to the Secretary.

(j) *Review of initial decision*—(1) *Secretary's discretion.* The Secretary, in the Secretary's discretion, may review any initial decision.

(2) *Requested by a party.* Any party may file a notice of appeal of an initial decision to the Secretary in accordance with § 30.910 of this title. Any waiver of the limitations contained in § 30.910(c) and (d) of this title on the number of pages for notices of appeal and responses, of the time limitation in § 30.910 of this title for filing a notice of appeal of the initial decision, or any other waivers under this subpart shall not be subject to the publication requirements in 42 U.S.C. 3535(q).

(k) *Final decision.* (1) The initial decision will become the final decision unless the Secretary issues a final decision within 90 days after the initial decision is served on the Secretary.

(2) *Issuance of final decision by Secretary.* The Secretary may review any finding of fact, conclusion of law, or order contained in the initial decision of the ALJ and may issue a final decision in the proceeding. Any decision shall include findings of fact upon which the decision is predicated. The Secretary may affirm, modify, or set aside, in whole or in part, the initial

decision or may remand the initial decision for further proceedings. The final decision shall be served on all parties and the ALJ.

(l) *Decisions on remand.* If the initial decision is remanded for further proceedings, the ALJ shall issue an initial decision on remand within 60 days of the date of issuance of the decision to remand, unless it is impractical to do so.

(m) *Modification.* The Secretary may modify, terminate, or set aside any order in accordance with 12 U.S.C. 4582(b)(2).

§ 81.85 Public disclosure of final orders and agreements.

(a) *Disclosure.* Except as provided in paragraph (b) of this section, the Secretary shall make available to the public final orders; written agreements and statements; and modifications and terminations of those orders, agreements, and statements, as set forth in 12 U.S.C. 4586(a) and the implementing regulations in this subpart G. The retention of records of these orders, agreements, and statements, and their modifications and terminations, are governed by 12 U.S.C. 4586(e).

(b) *Exceptions to disclosure.* Exceptions to disclosure will be determined in accordance with 12 U.S.C. 4586 (c), (d), and (f) and paragraph (c) of this section.

(c) *Filing documents under seal*—(1) *Request by party.* Upon the denial by the ALJ of a motion for a protective order, any party may request the Secretary to file any document or part of a document under seal if the party believes that disclosure of the document would be contrary to the public interest. Any other party may file with the Secretary a reply to such a request within 5 working days after a request is made or some other time to be determined by the Secretary. Such requests and replies are governed by § 30.515 of this title.

(2) *Effect of request.* A document or part of a document that is the subject of a timely request to the Secretary to file under seal will not be disclosed under this section until the Secretary has advised the parties and the ALJ, in writing, of the Secretary's decision on whether the document or part of a document should be filed under seal. The ALJ shall take all appropriate steps to preserve the confidentiality of such documents or parts of documents, including closing portions of the hearing to the public.

(3) *Time of request.* Failure to file with the Secretary a timely request or a reply is deemed a waiver of any objection regarding the decision on whether a document is to be disclosed. A party must make its request to file a document under seal at least 10 days before the commencement of the hearing. A request may be filed at any other time before or during the course of the hearing, but the requesting party's obligation to produce the document or parts of the document will not be affected by the party's pending request to the Secretary, unless the Secretary expressly directs the ALJ to treat the document as protected from disclosure until the Secretary makes a final written decision on whether the document should be filed under seal. If the Secretary's direction to the ALJ is made orally, that direction must be reduced to writing and filed with the ALJ within 3 working days of the making of the oral order or the document will then be subject to disclosure pending the Secretary's final written decision on disclosure.

§ 81.86 Enforcement and jurisdiction.

If a GSE fails to comply with a final decision, the Secretary may request the Attorney General of the United States to bring an action in the United States District Court for the District of Columbia for the enforcement of the notice or order. Such request may be made:

(a) *For a cease-and-desist order:*

(1) Upon expiration of the 30-day period beginning on the service of the order on the GSE; or

(2) Upon the effective time specified in an order issued upon consent; and

(b) *For a civil money penalty,* when the order imposing the penalty is no longer subject to review under 12 U.S.C. 4582 and 4583 and the implementing regulations at §§ 81.84 and 81.87.

§ 81.87 Judicial review.

(a) *Commencement.* In a proceeding under 12 U.S.C. 4581 or 4585, as implemented by §§ 81.82 or 81.83, a GSE that is a party to the proceeding may obtain review of any final order issued under § 81.84 by filing in the United States Court of Appeals for the District of Columbia Circuit, within 30 days after the date of service of such order, a written petition praying that the order of the Secretary be modified, terminated, or set aside.

(b) *Filing of record.* Upon receiving a copy of a petition, the Chief Docket Clerk, Office of Administrative Law Judges, shall file in the court the record in the proceeding, as provided in 28 U.S.C. 2112.

(c) *No automatic stay.* The commencement of proceedings for judicial review under this section shall not, unless specifically ordered by the court, operate as a stay of any order issued by the Secretary.

Subpart H—Book-Entry Procedures

§ 81.91 Definitions.

As used in this subpart H, the term—

(a) *Reserve bank* means a Federal Reserve bank and its branches acting as Fiscal Agent of Fannie Mae and, when indicated, acting in its individual capacity or as Fiscal Agent of the United States.

(b) *Fannie Mae security* means any obligation of Fannie Mae (except short-term discount notes and obligations convertible into shares of common stock) issued under 12 U.S.C. 1719 (b), (d), and (e) in the form of a definitive Fannie Mae security or a book-entry Fannie Mae security.

(c) *Definitive Fannie Mae security* means a Fannie Mae security in engraved or printed form.

(d) *Book-entry Fannie Mae security* means a Fannie Mae security in the form of an entry made as prescribed in this part on the records of a Reserve bank.

(e) *Pledge* includes a pledge of, or any other security interest in, Fannie Mae securities as collateral for loans or advances or to secure deposits of public moneys or the performance of an obligation.

(f) *Date of call* is, with respect to Fannie Mae securities issued under 12 U.S.C. 1719 (d) and (e), the date fixed in the authorizing resolution of the Board of Directors of Fannie Mae on which the obligor will make payment of the security before maturity in accordance with its terms, and, with respect to Fannie Mae securities issued under 12 U.S.C. 1719(b), the date fixed in the offering notice issued by Fannie Mae.

(g) *Member bank* means any National bank, State bank, or bank or trust company which is a member of a Reserve bank.

§ 81.92 Authority of Reserve Bank.

Each Reserve bank is hereby authorized, in accordance with the provisions of this part, to:

(a) Issue book-entry Fannie Mae securities by means of entries on its records which shall include the name of the depositor, the amount, the loan title (or series) and maturity date;

(b) Effect conversions between book-entry Fannie Mae securities and definitive Fannie Mae securities;

(c) Otherwise service and maintain book-entry Fannie Mae securities; and

(d) Issue a confirmation of transaction in the form of a written advice (serially numbered or otherwise) which specifies the amount and description of any securities, that is, loan title (or series) and maturity date, sold or transferred, and the date of the transaction.

§ 81.93 Scope and effect of book-entry procedure.

(a) (1) A Reserve bank as Fiscal Agent of Fannie Mae may apply the book-entry procedure provided for in this part to any Fannie Mae securities which have been or are hereafter deposited for any purpose in accounts with it in its individual capacity under terms and conditions which indicate that the Reserve bank will continue to maintain such deposit accounts in its individual capacity, notwithstanding application of the book-entry procedure to such securities. This paragraph (a) is applicable, but not limited, to securities deposited:

(i) As collateral pledged to a Reserve bank (in its individual capacity) for advances by it;

(ii) By a member bank for its sole account;

(iii) By a member bank held for the account of its customers;

(iv) In connection with deposits in a member bank of funds of States, municipalities, or other political subdivisions; or

(v) In connection with the performance of an obligation or duty under Federal, State, municipal, or local law, or judgments or decrees of courts.

(2) The application of the book-entry procedure under this paragraph (a) shall not derogate from or adversely affect the relationships that would otherwise exist between a Reserve bank in its individual capacity and its depositors concerning any deposits under this section. Whenever the book-entry procedure is applied to such Fannie Mae securities, the Reserve bank is authorized to take all action necessary in respect of the book-entry procedure to enable such Reserve bank in its individual capacity to perform its obligations as depositary with respect to such Fannie Mae securities.

(b) A Reserve bank as Fiscal Agent of the corporation may apply the book-entry procedure to Fannie Mae securities deposited as collateral pledged to the United States under Treasury Department Circulars Nos. 92 and 176, both as revised and amended, and may apply the book-entry procedure, with the approval of the Secretary of the Treasury, to any other Fannie Mae securities deposited with a Reserve bank, as Fiscal Agent of the United States.

(c) Any person having an interest in Fannie Mae securities which are deposited with a Reserve bank (in either its individual capacity or as Fiscal Agent of the United States) for any purpose shall be deemed to have consented to their conversion to book-entry Fannie Mae securities pursuant to the provisions of this part, and in the manner and under the procedures prescribed by the Reserve bank.

(d) No deposits shall be accepted under this section on or after the date of maturity or call of the securities.

§ 81.94 Transfer or pledge.

(a) A transfer or pledge of book-entry Fannie Mae securities to a Reserve bank (in its individual capacity or as Fiscal Agent of the United States), or to the United States, or to any transferee or pledgee eligible to maintain an appropriate book-entry account in its name with a Reserve bank under §§ 81.91 through 81.98 is effected and perfected, notwithstanding any provision of law to the contrary, by a Reserve bank making an appropriate entry in its records of the securities transferred or pledged. The making of such an entry in the records of a Reserve bank shall:

(1) Have the effect of a delivery in bearer form of definitive Fannie Mae securities;

(2) Have the effect of a taking of delivery by the transferee or pledgee;

(3) Constitute the transferee or pledgee a holder; and

(4) If a pledge, effect a perfected security interest therein in favor of the pledgee. A transfer or pledge of book-entry Fannie Mae securities effected under this paragraph (a) shall have priority over any transfer, pledge, or other interest, theretofore or thereafter effected or perfected under paragraph (b) of this section or in any other manner.

(b) A transfer or a pledge of transferable Fannie Mae securities, or any interest therein, which is maintained by a Reserve bank (in its individual capacity or as Fiscal Agent of the United States) in a book-entry account under §§ 81.91 through 81.98, including securities in book-entry form under § 81.93(a)(3), is effected, and a pledge is perfected, by any means that would be effective under applicable law to effect a transfer or to effect and perfect a pledge of the Fannie Mae securities, or any interest therein, if the securities were maintained by the Reserve bank in bearer definitive form. For purposes of transfer or pledge hereunder, book-entry Fannie Mae securities maintained by a Reserve bank shall, notwithstanding any provision of law to the contrary, be deemed to be maintained in bearer definitive form. A Reserve bank maintaining book-entry Fannie Mae securities either in its individual capacity or as Fiscal Agent of the United States is not a bailee for purposes of notification of pledges of those securities under this section, or a third person in possession for purposes of acknowledgment of transfer thereof under this section. Where transferable Fannie Mae securities are recorded on the books of a depositary (a bank, banking institution, financial firm, or similar party, which regularly accepts in the course of its business Fannie Mae securities as a custodial service for customers, and maintains accounts in the names of such customers reflecting ownership of or interest in such securities) or account of the pledgor or transferor thereof and such securities are on deposit with a Reserve bank in a book-entry account, hereunder, such depositary shall, for purposes of perfecting a pledge of such securities or affecting delivery of such securities to a purchaser under applicable provisions of law, be the bailee to which notification of the pledge of the securities may be given or the third person in possession from which acknowledgment of the holding of the securities for the purchaser may be obtained. A Reserve bank will not accept notice or advice of a transfer or pledge effected or perfected under this section, and any such notice or advice shall have no effect. A Reserve bank may continue to deal with its depositor in accordance with the provisions of this part, notwithstanding any transfer or pledge effected or perfected under this paragraph (b).

(c) No filing or recording with a public recording office or officer shall be necessary or effective with respect to any transfer or pledge of book-entry Fannie Mae securities or any interest therein.

(d) A Reserve bank shall, upon receipt of appropriate instructions, convert book-entry Fannie Mae securities and deliver them in accordance with such instructions; no such conversion shall affect existing interest in such Fannie Mae securities.

(e) A transfer of book-entry Fannie Mae securities within a Reserve bank shall be made, in accordance with procedures established by the Reserve bank not inconsistent with this part. The transfer of book-entry Fannie Mae securities by a Reserve bank may be made through a telegraphic transfer procedure.

(f) All requests for transfer or withdrawal must be made prior to the maturity or date of call of the securities.

§ 81.95 Withdrawal of Fannie Mae securities.

For all book-entry Fannie Mae securities issued prior to March 10, 1978:

(a) A depositor of book-entry Fannie Mae securities may withdraw them from a Reserve bank by requesting delivery of like definitive Fannie Mae securities to itself or on its order to a transferee.

(b) Fannie Mae securities which are actually to be delivered upon withdrawal may be issued either in registered or in bearer form.

§ 81.96 Delivery of Fannie Mae securities.

A Reserve bank which has received Fannie Mae securities and effected pledges, made entries regarding them, or transferred or delivered them according to the instructions of its depositor is not liable for conversion or for participation in breach of fiduciary duty even though the depositor had no right to dispose of or take other action in respect of the securities. Customers of a member bank or other depositary (other than a Reserve bank) may obtain Fannie Mae securities only by causing the depositor of the Reserve bank to order the withdrawal thereof from the Reserve bank under the conditions set forth in § 81.95.

§ 81.97 Registered bonds and notes.

No formal assignment shall be required for the conversion to book-entry Fannie Mae securities of registered Fannie Mae securities held by a Reserve bank (in either its individual capacity or as Fiscal Agent of the United States) on the effective date of this part for any purpose specified in § 81.93(a). Registered Fannie Mae securities deposited thereafter with a Reserve bank for any purpose specified in § 81.93 shall be assigned for conversion to book-entry Fannie Mae securities. The assignment, which shall be executed in accordance with the provisions of subpart F of 31 CFR part 306, so far as applicable, shall be to ''Federal Reserve Bank of ______________, as Fiscal Agent of the Federal National Mortgage Association, for conversion to book-entry Fannie Mae securities.''

§ 81.98 Servicing book-entry Fannie Mae securities; payment of interest; payment at maturity or upon call.

Interest becoming due on book-entry Fannie Mae securities shall be charged to Fannie Mae's account at the New York Federal Reserve Bank on the interest due date and remitted or credited in accordance with the depositor's instructions. Such securities shall be redeemed and charged to Fannie Mae's account at the New York Federal Reserve Bank on the date of maturity, call or advance refunding, and the redemption proceeds, principal and interest, shall dispose of in accordance with the depositor's instructions.

§ 81.99 Treasury Department regulations; applicability to Fannie Mae.

The provisions of Treasury Department Circular No. 300, 31 CFR part 306 (other than subpart O), as amended from time to time, shall apply, insofar as appropriate, to obligations of Fannie Mae for which a Reserve bank shall act as Fiscal Agent of Fannie Mae and to the extent that such provisions are consistent with agreements between Fannie Mae and the Reserve banks acting as Fiscal Agents of Fannie Mae. Definitions and terms used in Treasury Department Circular No. 300 should read as though modified to effectuate the application of the regulations to Fannie Mae.

Subpart I—Other Provisions

§ 81.101 Equal employment opportunity.

Fannie Mae and Freddie Mac shall comply with sections 1 and 2 of Executive Order 11478 (3 CFR, 1966–1970 Compilation, p. 803), as amended by Executive Order 12106, (3 CFR, 1978, Compilation, p. 263), providing for the adoption and implementation of equal employment opportunity, as required by section 1216 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 1833e).

§ 81.102 Independent verification authority.

The Secretary may independently verify the accuracy and completeness of the data, information, and reports provided by each GSE, including conducting on-site verification, when such steps are reasonably related to determining whether a GSE is complying with 12 U.S.C. 4541–4589 and the GSE's Charter Act.

Dated: November 21, 1995.

Henry G. Cisneros,

Secretary.

2. The following Appendices A through F will not appear in the Code of Federal Regulations.

Appendix A—Secretarial Considerations to Establish the Low- and Moderate-Income Housing Goal

A. Introduction

1. Establishment of Goal

In establishing the annual Low- and Moderate-Income Housing Goal, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the Secretary to consider:

1. National housing needs;
2. Economic, housing, and demographic conditions;
3. The performance and effort of the enterprises toward achieving the Low- and Moderate-Income Housing Goal in previous years;
4. The size of the conventional mortgage market serving low- and moderate-income families relative to the size of the overall conventional mortgage market; [1]
5. The ability of the enterprises to lead the industry in making mortgage credit available for low- and moderate-income families; and
6. The need to maintain the sound financial condition of the enterprises.

2. Underlying Data

In considering the statutory factors in establishing these goals, HUD relied upon data from the American Housing Survey, the 1990 Census of Population and Housing, the 1991 Residential Finance Survey, other government reports, the Home Mortgage Disclosure Act (HMDA) reports, and the GSEs. HUD used data provided by the GSEs to determine their financial condition and their prior performance in meeting the needs of low- and moderate-income families. These data included loan-level information on all mortgages purchased by the GSEs in 1993 and 1994.

Section B responds to comments from the GSEs and other commenters on Appendix A in the proposed rule and Section C presents an updated discussion of each of the factors listed above. Section D summarizes the Secretary's rationale for selecting the levels of the Low- and Moderate-Income Housing Goals for 1996 and 1997–99 and thereafter.

B. Summary and Response to Public Comments

The GSEs and several other commenters furnished comments on Appendix A as it appeared in the proposed rule. Because the GSEs' comments covered all of the points made by other commenters, this appendix refers exclusively to the GSEs' comments. The GSEs took issue with HUD's application of the factors identified in Section A above and the analysis by which HUD determined the levels of the goals. The GSEs commented that Appendix A: (1) confused general housing needs with those for which the GSEs have an

[1] ''Conventional'' mortgages are those which do not carry any government insurance, guarantee, or other obligation. That is, conventional mortgages exclude Federal Housing Administration (FHA), Farmers Home Administration (FmHA), and Veterans Administration (VA) loans.

appropriate responsibility; (2) failed to identify the broad range of economic conditions which might be relevant over the coming years; (3) incorrectly assessed the past performance of the GSEs and postulated a very narrow concept of market leadership; (4) minimized the potential economic impact of higher-risk multifamily mortgage purchases and assumed the GSEs should have equal penetration of single-family and multifamily markets; and (5) used flawed data estimates for calculating the size of the conventional market for the Low- and Moderate-Income Housing Goal.[2]

1. ''Linking'' Housing Needs to GSEs

The GSEs expressed concern that HUD did not distinguish between general housing needs of low- and moderate-income households and those needs that the GSEs could reasonably be expected to address. HUD conducted an analysis of general housing needs to comply with FHEFSSA, which requires the Secretary to consider such needs when establishing the housing goals. HUD's examination of national housing needs does not suggest that the GSEs can or should meet all of those needs. Rather, the analysis was intended to provide background on the evolution and current state of the housing markets for low- and moderate-income households. HUD recognizes that the GSEs can do little to mitigate the more extreme problems, such as homelessness, identified in this analysis (Section C.1 below).

With focused effort the GSEs can assist in addressing problems discussed in the Appendix with regard to single-family and multifamily housing. On the single-family side, the GSEs support of more customized mortgage products and underwriting with greater outreach will likely have mutually beneficial effects for both investors and low- and moderate-income borrowers who have not been served with traditional products, underwriting, and marketing. The GSEs have already embarked on this path and continued efforts are encouraged.

On the multifamily side, with new product development and partnerships the GSEs can reduce the credit gaps in the current market for affordable rental housing—specifically small existing properties, redevelopment projects, housing for the elderly, and new construction in some markets. By sustaining a secondary market in units that meet the low- and moderate-income goal, the GSEs will bring increased liquidity, added stability, and ultimately lower rents for lower-income families in these segments of the market.

Moreover, the GSEs can work to improve overall efficiency and stability of the market for financing multifamily housing by promoting increased standardization, which would allow more direct links to capital markets independent of specific financial intermediaries or investors. The GSEs have been immensely successful in this area with regard to the financing of single-family housing. While HUD recognizes that multifamily finance is different from single-family finance, improvements may well be possible through, for example, creative partnerships and risk-sharing with local institutions.

2. Mortgage Market Volatility

Both GSEs expressed concern that establishing the levels of the housing goals on the basis of experience under the recent unusually favorable mortgage market conditions for financing homeownership could place unreasonable expectations on the GSEs. The GSEs commented that the market for home purchase and finance is very dynamic and susceptible to significant changes in conditions that affect whether home purchase is feasible or accessible to low- and moderate-income households. The current levels of interest rates, home prices, borrower incomes, alternative rental costs, and consumer confidence, as well as expectations about their future levels, play a role in determining whether homeownership is feasible or desirable for any particular household. HUD agrees that forecasting all these factors for upcoming years to obtain a picture of the future climate for home purchase and finance is difficult.

However, setting goals so that they can be met even under the worst of circumstances is unreasonable. If macroeconomic conditions change dramatically, then the levels of the goals can be revised to reflect the changed conditions. FHEFSSA and HUD recognize that conditions could change in ways that would require revised expectations. Thus, HUD is given the statutory discretion: (1) to revise the goals if the need arises and (2) if a GSE fails to meet a housing goal, to determine that the goal was not feasible, and not take further action. Furthermore, as discussed in Appendix D, HUD conducted detailed sensitivity analysis for each of the housing goals to reflect economic conditions that are less conducive to homeownership than those that existed during 1993 and 1994.

3. GSEs Already Innovate and Serve Low- and Moderate-Income Borrowers

The GSEs commented that Appendix A and the proposed rule failed to recognize that the GSEs already make a sizable contribution toward serving the housing needs of a wide range of American families, including low- and moderate-income households, in diverse geographic areas, through their overall operations. Congress chartered the GSEs to carry out four public purposes: (a) provide stability; (b) respond appropriately to the private capital market; (c) provide assistance to the residential mortgage market, including serving low- and moderate-income families; and (d) promote access to mortgage credit throughout the nation. In FHEFSSA, Congress developed a mechanism to ensure that the GSEs finance housing for and provide services to low- and moderate-income families and housing in underserved areas. Congress acknowledged, as does HUD, the substantial contributions the GSEs have made and continue to make in creating liquidity and stability in the overall mortgage market. No additional measures were thought necessary to ensure that such contributions continue to take place. However, in FHEFSSA, Congress focused on enhancing the GSEs' efforts to carry out their other Charter purposes. HUD, through its focus on the goals, is carrying out that Congressional intent.

4. Multifamily Market Is Different

The GSEs commented that the origination and purchase of multifamily mortgages is fundamentally different from the origination and purchase of single-family mortgages. Both GSEs commented that the GSEs do not dominate the multifamily market to the same extent as the single-family market and that they should not be required to obtain the same multifamily market share that they have in the single-family market. Freddie Mac argued that the purchase of creditworthy multifamily loans is far more difficult than for single-family loans.

HUD agrees that the multifamily mortgage business is a different business from single-family finance, posing a different level of risk. Underwriting multifamily mortgages is more like underwriting business loans than underwriting many small and relatively uniform single-family mortgages. However, with regard to the argument that multifamily lending is much more difficult, the evidence is not convincing.

[2] The credit risk criticism is addressed in the Economic Analysis that accompanies this rule and the market share criticism is addressed in Appendix D.

Much of the difficulty with multifamily mortgages in recent years was related to the aftermath of wide swings in the tax treatment of multifamily housing. The tax-driven rather than market-driven overbuilding of the early and mid-1980s was followed by the subsequent withdrawal of tax support and the resulting credit crunch in the late 1980s and the early 1990s. During the early 1990s, underwriting of creditworthy multifamily loans may have been difficult. These conditions have now improved markedly.

Currently, multifamily properties offer less risk of loss than most commercial property classes, according to Moody's Investors Service.[3] In overbuilt markets, vacancies have declined due to depressed construction levels in the early 1990s. Accordingly, competition for multifamily loans has increased and securitization has increased in 1993 and again in 1994. Credit risk remains a concern to investors, but new techniques in multi-class securitization have helped mitigate credit risk on multifamily mortgage pools.

HUD realizes that achievement of the housing goals may require deeper penetration of the multifamily mortgage market than the GSEs have heretofore achieved. As discussed in Section C.2 below, Fannie Mae purchased a large portion (nearly half) of the large multifamily loans (those with balances of $1.0 million or more) that were originated in 1993 and reported in the HMDA data. An alternative to very deep penetration of the large loan market would be for the GSEs to broaden their penetration by shifting their focus toward purchase of smaller multifamily loans. There is no evidence that smaller loans represent higher credit risks. Such a shift may require the GSEs to develop additional capabilities to underwrite smaller loans, such as forming new partnerships with community lenders. This may pose some initial difficulty, but the suggestion that there are long-term fundamental difficulties in the purchase of smaller (less than $1 million) multifamily loans is not consistent with the current market trends toward higher multifamily lending activity and new techniques of credit risk management.

5. HUD's Market Methodology

In establishing the goals, the Secretary is required to assess, among a number of factors, the size of the conventional market for each goal. HUD developed a straightforward technique for estimating the size of the conventional conforming market for each of the goals. This technique draws on the existing major sources of data on mortgage market activity.

Both GSEs expressed strong criticism of HUD's use of specific data elements in constructing its estimates of market size, for example, estimates of the proportion of 1- to 4-unit rental properties or the level of multifamily originations. Although both GSEs criticized how data had been interpreted in HUD's market-share models, neither GSE, nor any other commenter, objected to HUD's basic model for calculating the size of the markets relevant to each of the housing goals. However, Freddie Mac provided a detailed set of objections to the use of certain data sources or assumptions, concluding that HUD's market estimates were ''fatally flawed.'' Fannie Mae argued that market estimates employed by HUD ''created an artificial market description based on interpretations of the data available to [HUD], which are not consistent.'' Fannie Mae commented that the Secretary deliberately selected existing data interpretations to yield higher goals.

Freddie Mac maintained that the flaws in HUD's estimation process would result in goals that were too high, because HUD had overestimated the size of the rental market. Freddie Mac presented a comparison of available market-share estimates, explained deficiencies it believed were present in the data employed by HUD, and claimed that HUD had chosen the least-favorable of the data bases that could have been employed in establishing appropriate goals for the GSEs.

Both GSEs argued that the role of multifamily financing in the mortgage market was consistently overstated in the proposed rule. Freddie Mac provided data to support its assertion that the rule's estimates of multifamily originations overstated both the total amount of originations to be expected and the degree to which multifamily originations are available to the secondary market.

In considering the levels of the goals, HUD examined carefully the comments on the methodology used to establish the market share for each of the goals. HUD contracted with the Urban Institute to conduct an independent review that drew upon its resources of well-respected academics and others in evaluating HUD's methodology. Based on that thorough evaluation, as well as HUD's additional analysis, the basic methodology employed by HUD is a reasonable and valid approach to estimating market share, and Freddie Mac's claim that the methodology is ''fatally flawed'' is without merit.

HUD agrees that a comprehensive source of information on mortgage markets is not available. HUD considered and analyzed a number of data sources for the purpose of estimating market size, because no single source could provide all the data elements needed. In the appendices, HUD has carefully defined the range of uncertainty associated with each of these data sources and has conducted sensitivity analyses to show the effects of various assumptions. Technical papers prepared by the Urban Institute and other academics support HUD's analysis.

A number of technical changes have been made in response to the comments and the evaluation by outside experts and HUD, but the approach for determining market size has not been substantially modified. The detailed evaluations show that the methodology, as modified, produces reasonable estimates of the market share for each goal.

Criticism of the methodology focused, in part, on the estimated size of the multifamily market. The GSEs proposed that HUD use the volume of originations as reported in the Home Mortgage Disclosure Act (HMDA) data base—$15 billion in 1994—as the accurate number of multifamily originations, as opposed to HUD's $30 billion estimate derived from other data sources. Four of the studies HUD commissioned from the Urban Institute considered various aspects of the multifamily market. HUD also consulted with experts at the Federal Reserve Board, the Bureau of the Census, and in industry trade groups to assist HUD in carefully evaluating the GSEs' claim that HMDA data provide an accurate number of total multifamily originations.

HUD found consensus that HMDA data underreport multifamily originations. HMDA, alone, is not an accurate survey of the total market; it was not designed to be one. It includes only information reported by a subset of institutions that originate multifamily loans: large commercial banks, thrifts, and mortgage bankers in metropolitan areas. In addition, HMDA underestimates multifamily lending by both mortgage bankers and commercial banks. The additional analyses conducted in response to the comments support the $30 billion multifamily estimate used by HUD.

c. Consideration of the Factors

Overview of Sections C.1 and C.2. These sections cover a range of topics on housing needs and economic and

[3] ''Moody's: Multifamily Offers Less Loss Risk,'' *National Mortgage News,* May 1, 1995.

demographic trends that are important for understanding mortgage markets. Most of the information, such as trends in refinancing activity, is provided because it describes the market environment in which the GSEs must operate and is therefore useful for gauging the reasonableness of specific levels of the Low- and Moderate-Income Housing Goal. In addition, the severe housing problems faced by lower-income families are discussed.

This information has led the Secretary to the following conclusions:

• The volume of mortgage originations fell from its 1993 record level of one trillion dollars to $773 billion in 1994 and is expected to be about $650 and $700 billion in 1995 and 1996, respectively. Purchase mortgages, including those for first-time homebuyers, have replaced refinance mortgages as the dominant mortgage type.

• The increase in interest rates from the 25-year lows of 1993 could make it more difficult for marginal borrowers to afford homeownership. However, interest rates continue to remain lower and housing more affordable than any previous extended period since 1977. Borrowers also have been helped by the rising incomes that accompany economic growth, which helped to boost the GSEs' purchases of low- and moderate-income mortgages in 1994, beyond levels recorded in 1993.

• Purchasing a home became increasingly difficult for lower-income and younger families during the 1980s. Low-income families with children, who could most benefit from the advantages of ownership, bore the brunt of the decline in ownership rates. The share of the nation's children living in owner-occupied homes fell from 71 percent to 63 percent between 1980 and 1991.

• Very-low-income renters often must pay an unduly high share of their income for rent.

• Several demographic changes will affect the demand for housing over the next few years. The continued influx of immigrants will increase the demand for both rental and owner-occupied housing and help to offset declines due to the aging of the baby-boom generation. Non-traditional households will become more important as overall household formation rates have slowed. With later marriage, divorce, and other non-traditional living arrangements, the fastest-growing household groups will be single-parent and single-person households.

• The multifamily mortgage market is far less integrated into the broader capital markets than the single-family market. Increased liquidity will bring more capital, at lower cost, to fill current and future credit gaps for maintenance of existing affordable stock and construction of affordable units in higher growth markets.

1. National Housing Needs

This section reviews the general housing problems of both low- and moderate-income homeowners and then discusses past and current economic conditions affecting the single-family and multifamily housing markets. HUD recognizes that the GSEs can do little to mitigate many of the more extreme problems discussed in the next sections. These sections are meant to portray the general state of the housing markets for low- and moderate-income households as they exist today and are expected to continue in the near future.

a. Housing Problems Among Low- and Moderate-Income Owners and Renters

Under the income definitions in FHEFSSA, almost three-fifths of U.S. households in 1993 qualified as low- or moderate-income families. Almost half of all homeowners (48 percent) had incomes below their (unadjusted) area median family income, while 76 percent of renters had income below their area's HUD-adjusted median family income.[4]

Housing needs vary with income. In 1993, roughly 21 percent of owners with moderate incomes (income 80 to 100 percent of area median) and 24 percent of moderate-income renters had a housing problem, compared to 25 percent of low-income owners and 36 percent of low-income renters (with income 60 to 80 percent of area median). Moreover, two-thirds of the 14 million households with incomes below 30 percent of median paid more than 30 percent of income for housing or lived in inadequate or crowded housing.[5]

[4] HUD is required by statute to adjust median family income in developing its official income cutoffs for each Metropolitan Statistical Area (MSA) and non-metropolitan county. Income limits based on HUD-Adjusted Area Median Family Incomes (HAMFI) are adjusted 1) with upper and lower caps for areas with low or high ratios of housing costs to income; 2) by setting state nonmetropolitan average income as a floor for nonmetropolitan counties; and 3) by household size. The adjusted annual estimates of area median family income provide the base for the ''50 percent'' and ''80 percent'' of HAMFI cutoffs that are assigned to a household of four. Household size adjustments then range from 70 percent of the base for a 1-person household to 132 percent of the base for an 8-person household.

[5] Tabulations of U.S. Departments of Housing and Urban Development and Commerce, *American Housing Survey for the United States in 1993* (April 1995) performed by HUD Office of Policy Development and Research.

b. Unmet Demands for Homeownership

Homeownership is a key aspiration for most Americans and a basic concern of government. Homeownership fosters family responsibility and self-sufficiency, expands housing choice and economic opportunity, and promotes community stability. Ownership also improves access to the larger homes and better neighborhoods particularly needed by families with children. Children of homeowners are more likely to graduate from high school, less likely to commit crime, and less likely to bear children as teenagers than children of renters.[6] Recent surveys indicate that lower-income and minority families who do not own their homes will make considerable sacrifices to attain this goal.

Ownership rates rose dramatically in the late 1940s and 1950s, increasing from 43.6 percent to 61.9 percent between 1940 and 1960. During the 1960s, homeownership rates rose more slowly, reaching 62.9 percent by 1970, and—after several years of high house price appreciation—an all-time high of 65.6 percent in 1980. In the early 1980s, historically high interest rates, low price appreciation, and a series of deep regional recessions caused the homeownership rate to decline to 63.9 percent by 1985. The rate increased only slightly between 1985 and 1994.[7]

During the 1980s, the goal of homeownership became more elusive for low- and moderate-income families. Declines in ownership rates during the 1980s were most pronounced for younger, lower-income households, particularly those with children:

> Between 1980 and 1992, homeownership among younger households dropped roughly 10 percentage points, from 43.3 percent to 33.1 percent for households with the head aged 25 to 29, and from 61.1 percent to 50.0 percent for households with the head aged 30 to 34. These declines were concentrated among single-parent households and married couples with children.[8]

Homeownership rates fell by 4 percentage points each for moderate-income households and low-income households during the 1980s, and by 3 percentage points for households below 50 percent of area median, adjusted for family size. At each income

[6] These tendencies are especially strong for lower-income households. Children of low-income homeowners are 15 percent more likely to stay in school than children of non-homeowners. Michelle White and Richard Green, ''Measuring the Benefits of Homeowning: Effects on Children,'' University of Chicago, unpublished paper, February 1994.

[7] The stability in ownership after 1985 resulted from increases among elderly households and single individuals, offset by further declines among families with children.

[8] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing*, 1993, Table A–4.

level, declines were greatest for families with children. Among very low-income families with children, homeownership rates dropped by nearly a fourth.[9]

In sum, the families with children who could most benefit from ownership were most adversely affected by declines in ownership. Between 1980 and 1991, the dip in the total ownership rate from 65.6 to 64.2 percent included a fall of seven percentage points among families with children, from 70.4 percent to 63.4 percent.

c. Obstacles to Homeownership

Insufficient income, high debt burdens, and limited savings are obstacles to homeownership for younger families. As home prices skyrocketed during the late 1970s and early 1980s, real incomes stagnated, with earnings growth particularly slow for blue collar and less educated workers. Through most of the 1980s, the combination of slow income growth and increasing rents made saving for home purchase more difficult and relatively high interest rates required larger fractions of family income for homeowner mortgage payments. Thus, fewer households had the financial resources to meet down payment requirements, closing costs, and monthly mortgage payments. One-fifth of first-time homeowners had to rely on their relatives for most of their down payment.[10] One-third of recent first-time homeowners relied on gifts and loans from parents.[11]

In addition to low income, high debts are a primary reason households cannot afford to purchase a home. Nearly 53 percent of renter families have both insufficient income and excessive debt problems that may cause difficulty in financing a home purchase.[12] High debt-to-income ratios frequently make potential borrowers ineligible for mortgages based on the underwriting criteria established in the conventional mortgage market.

d. Affordability Problems and Worst Case Housing Needs

Finding affordable housing is by far the most common housing problem for American families nationwide.[13] Between 1979 and 1991, shares of households paying more than 30 percent of their income for housing fluctuated around 42 percent among renters and rose from 17 percent to 20 percent among owners.[14] Over this period, the number of low-income renter households spending 50 percent or more of their income on housing rose from 4.3 million in 1978 to 6.0 million in 1991.[15] Poor homeowners also paid high proportions of their income for housing costs. Between 1978 and 1989, the share of poor homeowners spending over 60 percent of income on housing rose from 30.6 percent to 33.1 percent.[16]

Although affordability problems affect two-fifths of low-income renters and one-eighth of low-income owners, they are most frequent and severe among the very lowest income owners and renters. In 1991, when the average gross rent/income ratio for renters with incomes above area median income was 23 percent, this ratio was 72 percent for renters with incomes below 30 percent of area median income and 41 percent for renters with incomes between 30 and 49 percent of median.[17]

Priority problems—defined as paying more than half of income for rent and utilities, being displaced, or living in severely inadequate housing—were heavily concentrated among renters with incomes below 50 percent of area median. Half of renters with incomes below 30 percent of median, and one-fourth of those with incomes 31–50 percent of median, had these severe ''worst case'' housing needs.[18]

According to HUD's third Congressionally-mandated study of worst case needs, severe affordability problems were not only the overwhelming cause of worst case needs but often a family's only housing problem.[19] Fully 94 percent of the 5.3 million households with worst case needs reported severe rent burden as a problem, and for almost three-fourths, severe rent burden was their only problem.

The number of households with worst case needs increased by nearly 400,000 between 1989 and 1991, rising most rapidly among families with children. Large families were more likely than smaller ones to have priority problems and to need to move to another housing unit because of crowding or excessive rent burden. Between 1989 and 1991, worst case needs among very-low-income families with three or more children increased from 34.7 percent to 40.2 percent. Elderly households were the least likely to have worst case needs.

2. Economic, Housing, and Demographic Conditions

A number of economic, housing, and demographic considerations have influenced the Secretary's establishment of the Low- and Moderate-Income Housing Goals. Increasing income inequality and changes in household composition suggest that needs for housing affordable to very-low-income families will continue to be most acute, placing additional pressure on the inadequate stock of rental housing affordable to families with incomes below 30 percent of median income. Although volatile interest rates strongly influence both single-family starts and mortgage market activity, rates that are relatively low by historical standards have improved affordability for first-time homebuyers.

a. Underlying Demographic Conditions

(1) *Household Formations.* The demand for housing and mortgages depends heavily on household formations. During the 1970s, as the leading edge of the baby boom generation (born between 1946 and 1964) entered adulthood, household formation surged to an annual average of 1.7 million. Aided by rising incomes and low real interest rates, household heads aged 25–34 purchased homes in record numbers. During the 1980s, annual household growth fell slightly to an average of 1.5 million. Many in the ''housing upgrade'' group (aged 35–44) had benefitted from substantial increases in the prices of their first homes, and were able to afford bigger and higher quality homes during the 1980s. Household formation is expected to drop sharply during the 1990s. The

[9] Kathryn Nelson and Jill Khadduri, ''To Whom Should Limited Housing Resources Be Directed?'' *Housing Policy Debate,* Vol. 3, 1992, pp. 1–55, Table 3.

[10] National Association of Home Builders, *Profile of the New Home Buyer Survey,* 1991.

[11] National Association of Realtors, *Survey of Homeowners and Renters,* 1991.

[12] Howard Savage and Peter Fronczek, *Who Can Afford to Buy A House in 1991?,* U.S. Bureau of the Census, Current Housing Reports H121/93–3, July 1993, p. ix.

[13] ''Affordable housing'' is generally interpreted as housing for which the homeowner or renter pays no more than 30 percent of family income for housing costs, including utilities.

[14] U.S. Departments of Housing and Urban Development and Commerce, *American Housing Survey for the United States in 1991,* April 1993.

[15] 1974–1979 figures from Nelson and Khadduri, ''To Whom Should Limited Housing Resources Be Directed,'' 3 *Housing Policy Debate 1,* 16, 1992. 1991 figure from *Worst Case Needs for Housing Assistance in the United States in 1990 and 1991.* HUD–1481–PDR, June 1994.

[16] Center on Budget and Policy Priorities and Low Income Housing Service, *A Place to Call Home,* April 1989; and U.S. Departments of Housing and Urban Development and Commerce, *American Housing Survey for the United States in 1989,* July 1991.

[17] Tabulations of U.S. Departments of Housing and Urban Development and Commerce, *American Housing Survey for the United States in 1991,* April 1993, performed by HUD Office of Policy Development and Research.

[18] Congress defines ''worst case needs'' for housing assistance as unassisted renters with incomes below 50 percent of area median income who have priority problems.

[19] *Worst Case Needs for Housing Assistance in the United States in 1990 and 1991,* HUD–1481–PDR, June 1994.

Census Bureau projects that the older baby boomers (aged 45 to 54) will be the fastest growing population group during this decade.

The effects of these demographic trends on housing demand have been debated in the economics literature for several years. In 1989, Gregory Mankiw and David Weil predicted that the aging of the baby boomers and the small size of the following ''baby bust'' generation would substantially reduce housing demand and cause housing prices to collapse during the 1990s.[20] Other researchers disagree. Reductions in housing demand due to aging of the baby boom generation could be offset by many factors, including rising incomes, pent-up demand for homeownership by those priced out of the housing market during the 1980s, and high levels of immigration.[21]

(2) *Immigration.* The continued increase in immigration during the 1990s will help offset declines in the demand for housing caused by the aging of the baby boom generation. During the 1980s, 6 million legal immigrants entered the United States, up from 4.2 million during the 1970s and 3.2 million during the 1960s. The Hispanic population residing in the U.S. increased by 50 percent during the 1980s, while the Asian population doubled. About one-quarter of the Hispanics living in the U.S. in 1990 had immigrated during the 1980s. Immigration is projected to add even more new Americans in the 1990s than it did during the 1980s. Asians and Pacific Islanders are expected to be the fastest growing group, with annual growth rates that may exceed 4 percent in the 1990s. Total population is now projected to rise by 25 million in each of the decades from 1991 to 2020. The tendency of immigrants, particularly Hispanics, to locate in certain ''gateway'' cities (e.g., Los Angeles and Miami) will place increased demands on the housing stock in some major urban areas.

(3) *Non-traditional Households.* While overall growth in new households has slowed, non-traditional households have become more important. With later marriages, divorce, and other non-traditional living arrangements, household growth has been fastest among single-parent and single-person households. The number of single parents with one or more children under 18 was 10.5 million in 1992; the vast majority of those single parents were women.[22] About 62 percent of African-American families with children were single-parent families in 1992, compared with 34 percent for Hispanics and 24 percent for Whites. Since only 35 percent of single-parent households are homeowners compared to 74 percent of married couples, their increase should spur demand for rental housing and for affordable ownership opportunities. In addition, HUD's analysis of the nation's worst case housing needs shows that female-headed households suffer some of the most severe housing problems.

(4) *Single Person Households* are playing an increasingly important role in the housing market. Singles accounted for one-fourth of all households in 1990. While one-half owned their own home, many of these were elderly people with little or no mortgage debt and probably no intention of entering the housing market. Never-married singles, on the other hand, have been a significant factor in the homebuying market in large urban areas. Never-married singles rose as a proportion of first-time homebuyers from just over one-quarter in 1990 and 1991 to roughly a third in 1992 and 1993 before declining to about a 30 percent share in 1994.[23] As discussed above, ownership rates among non-elderly single individuals rose steadily during the 1980s. Low interest rates during the past two years apparently enticed even more single renters to become homeowners.

(5) *Growing Income Inequality* in the distribution of income over the last 20 years has made it more difficult for those at the bottom of the income distribution to purchase adequate shelter. The share of the nation's income received by the richest 5 percent of American families rose from 18.6 percent in 1977 to 24.5 percent in 1990, while the share received by the poorest 20 percent fell from 5.7 percent to 4.3 percent. This widening income inequality was due in large part to a widening disparity in earned incomes; as the economy has moved away from manufacturing to more service industry jobs and more advanced computer and technologically-intensive industry jobs, the wages of unskilled, entry-level, and blue collar workers have fallen relative to the wages of professional and technical workers. The result has been an increase in the working poor and a decrease in the middle class.

In addition, higher real interest rates and declining inflation through the 1980s increased the return to capital, raising nonwage incomes of upper and upper middle income families. This too contributed to the increasing inequality in the distribution of income.

b. Economic and Housing Conditions—Single-Family Market

(1) *Interest Rate Trends.* As the 1980s began, mortgage interest rates were above 12 percent and rose quickly to over 15 percent. After 1982, they drifted slowly downward to the 9 percent range in 1987 before rising to over 10 percent in the 1989–1990 period. Rates returned to 9.3 percent in 1991 and then fell further to 8.2 percent in 1992 and 7.2 percent in 1993. The October 1993 rate of 6.80 percent was the lowest level in more than twenty years.[24] Rates rose nearly a full percentage point in 1994, and peaked at 8.3 percent in early 1995, but have since fallen by about 50 basis points.

Volatile interest rates were a principal cause of the housing market volatility of the 1980s and they continue to be a major determinant of housing and mortgage market activity. During 1992 and 1993, homeowners responded to the record low rates by refinancing existing mortgages. While refinancing accounted for less than 25 percent of mortgage originations in 1989–90 when interest rates exceeded 10 percent, the sharp decline in interest rates led refinancings to account for over 50 percent of all mortgage originations in 1992 and 1993.[25] Because of the heavy refinancing activity, single-family mortgage originations surged from less than $500 billion in 1990 to record levels of $894 billion in 1992 and over $1 trillion in 1993. As mortgage rates rebounded from the 1993 lows, refinancing subsided and home purchase returned as the predominant component of mortgage originations. Origination volume totalled $773 billion in 1994 and is projected to be about $650 and $700 billion in 1995 and 1996, respectively.

Single-family housing starts have also responded to interest rates, with record low volumes in 1981 and 1982, peaks in 1986 and 1987, and less severe lows in 1990 and 1991. Low interest rates and economic recovery in 1992 and 1993 made homeownership more affordable

[20] W. Gregory Mankiw and David N. Weil, ''The Baby Boom, the Baby Bust, and the Housing Market,'' *Regional Science and Urban Economics,* May 1989.

[21] See, for example, Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 1994,* 1994.

[22] U.S. Department of Commerce, Bureau of the Census, *How We're Changing: Demographic State of the Nation: 1993.* Special Studies Series, P–23, No. 184, February 1993.

[23] Chicago Title and Trust Family of Insurers, *Who's Buying Homes in America,* 1992, 1993, 1994, and 1995.

[24] Council of Economic Advisers, *Economic Indicators,* August 1995 and *Economic Report of the President,* February 1995.

[25] Monthly average refinancing data obtained from Freddie Mac's *Primary Mortgage Market Survey.*

and helped to turn the housing market around. Single-family starts increased from less than 900,000 during the recessionary years of 1990 and 1991 to 1.03 million in 1992, 1.13 million in 1993, and 1.20 million in 1994. Volume in 1994 was 43 percent higher than 1991's recessionary low of 840,000.

(2) *First-time Homebuyers* have been the driving force in the recovery of the nation's housing market over the past several years. First-time homebuyers are typically people in the 25–34 year-old age group that purchase modestly priced houses. As the post-World War II baby boom generation ages, the percentage of Americans in this age group has shrunk, from 28.3 percent in 1980 to 25.4 percent in 1992.[26] Nonetheless, first-time homebuyers have bucked these demographic trends to increase their share of home sales. During the 1980s, first-time buyers accounted for about 40 percent of home sales; this figure rose to 45 percent in 1991, 48 percent in 1992, receding to 46 percent in 1993, and rebounding to 47 percent in 1994.[27] The 1992 figure was the highest percentage for first-time buyers since the annual Home Buyers Survey was initiated in 1976.

Among the first-time buyers was a record number of single-individual households. The 1992 and 1993 Home Buyers Surveys found that approximately 30 percent of first-time buyers in these years were single, compared to 21 percent in 1991. The more affluent, move-up home buyers, on the other hand, have recently played a smaller role. A sluggish economy, uncertain outlooks for many white-collar jobs, and slow house price appreciation have kept many trade-up buyers out of the housing market.

Reflecting these trends, the average income for recent home buyers has fallen. In 1991, one of every three buyers had a family income of $50,000 or less; in 1993, those earning less than $50,000 accounted for 44 percent of all home buyers. Apparently, two years of low interest rates induced many renters who had previously been priced out of the market to become homeowners. A strong pent-up demand to own a home is not surprising given the large reductions in homeownership rates experienced by several groups during the 1980s (see Section C.1.d above). A recent survey of renters by the National Association of Realtors (NAR) indicated that only one-third prefer to remain renters for the foreseeable future.[28] Thus there are many potential home buyers among the 34 million households that are currently renting.

(3) *Potential Homebuyers.* As noted above, immigration is expected to be a major source of future homebuyers. Fannie Mae's *1995 National Housing Survey* revealed that immigrant renter households are almost 3 times as likely as renter households in general to list home purchase as their ''number-one priority.'' Immigrants as a group are currently more than one-and-two-thirds times as likely to be renters although they appear as financially capable as the population at large.[29] The Joint Center for Housing Studies estimates that if the homebuying potential of immigrant households were realized—i.e., they purchased with the same propensity as non-immigrants with similar characteristics—that the number of homeowners in the largest 40 metropolitan areas would increase by about 900,000. In addition, the Joint Center estimates that another 950,000 native-born minority households in the same metropolitan areas would become homeowners if their rate of homeownership matched that of their native-born white counterparts with similar income and demographic characteristics.[30]

As part of the process of revising the GSE rule, HUD sought information on two key questions: how large is the underserved potential homebuyer market and what are the default risks associated with expanded homeownership among lower-income, underserved households? To help answer these questions, the Urban Institute and HUD developed a logit-based analysis of households in the 1990 Survey of Income and Program Participation (SIPP). The probability of a renter making the transition to homeownership was then estimated directly by applying a logit regression to the mid-1992 sub-sample of white suburban renters and recently-transitioned homeowners. These probabilities were then linked to all the remaining renter SIPP households to identify renters having relatively good prospects for transitioning to homeownership. Of the 20.3 million remaining renter households (i.e., 84 percent of all remaining renters) having low or moderate incomes, roughly 16 percent had a probability of transitioning into homeownership which was greater than that for half of the renter households who actually did become homeowners over the sample period. When one also took into account their likelihood of defaulting relative to the average expected for those actually transitioned to homeownership, 13.4 percent of all remaining low- and moderate-income renters had better-than-median probability of transitioning to homeownership and lower than average probability of default, assuming the purchase of a lower-cost home priced at the 10th percentile of area home prices. The proportion of high-probability, low-risk potential low- and moderate-income homebuyers declines to 10.6 percent if the purchase of homes priced at the median price for the area is assumed for these households.[31] These results indicate the existence of a significant population of lower-risk, potential homebuyer households that might be reached with more aggressive outreach.

(4) *Affordability*. Potential homebuyers in 1992–1994 enjoyed the most affordable market in almost twenty years. The National Association of Realtors (NAR) tracks housing affordability by measuring the degree to which an average family can afford monthly mortgage payments on a typical house, assuming that the family has enough cash for a 20 percent down payment. Specifically, NAR's composite affordability index measures the ratio of median family income to the income required to qualify for a conventional loan on a median-priced house. After averaging slightly over 110 between 1986 and 1991, the index jumped to 125 in 1992 and 133 in 1993, before slipping to 130 in 1994. The 1994 figure indicates that the U.S median family income was 30 percent more than was needed to qualify for a mortgage on the nation's median priced house.[32]

In addition to its overall affordability index, NAR also estimates the ability of first-time home buyers to purchase modestly-priced homes. When this index equals 100, the typical first-time buyer can afford the typical starter home under existing financial conditions with a 10 percent down payment; a score

[26] U.S. Department of Commerce, Bureau of the Census, *Money Income of Households, Families, and Persons in the United States: 1992*, Special Studies Series P–60, No. 184, Table B–25, October 1993.

[27] Chicago Title and Trust Family of Insurers, *Who's Buying Homes in America*, 1992, 1993, 1994, and 1995.

[28] National Association of Realtors, *Survey of Homeowners and Renters*, 1991.

[29] *Fannie Mae National Housing Survey 1995*, pp. 3 and 5.

[30] *State of the Nation's Housing, 1995*, Joint Center for Housing Studies of Harvard University, p. 30, Table A–8.

[31] George Galster and others, ''Estimating the Size, Characteristics, and Risk Profile of Potential Homebuyers,'' (The Urban Institute, September 1995) mimeo.

[32] The South and North Central census regions were the most affordable for homebuyers, with affordability indexes of 141 and 176, respectively, in 1993. Affordability remained much more of a problem in the Northeast and West, where NAR's indexes were 110–117.

below 100 indicates that the monthly mortgage payment places a significant burden on first-time home buyers, even during a period of record low interest rates. NAR's first-time home buyer index ranged from 75 to 86 between 1991 and 1993 (84 in 1994).

(5) *Increased Interest Rates*. The 1994 jump in interest rates reduced housing affordability. According to Freddie Mac's primary market survey, interest rates for conventional, 30-year, fixed rate mortgages increased from a 25-year low of 7.05 percent in the fourth quarter of 1993 to 9.10 percent in the fourth quarter of 1994, with a subsequent decline to 7.95 percent in the second quarter of 1995. The 1994 increase made it more difficult for potential first-time home buyers to qualify for conventional mortgages, as reflected in the decline in NAR's composite affordability index from 142 in the fourth quarter of 1993 to 127 in the fourth quarter of 1994. The first-time home buyer's index dropped from 92.3 to 82.4 during this period. Both indexes would have fallen further if incomes had not risen to partially offset the effects of increased interest rates.[33] However, interest rates continue to remain lower and housing more affordable than was true for any previous extended period since 1977. Moreover, as the economic recovery continues, rising incomes should continue to offset the effects of higher interest rates.

While all of the factors identified above are subject to change, interest rates are perhaps the most volatile. HUD assessed the impact on Fannie Mae's and Freddie Mac's business from a 100- or 200-basis-point increase above actual 1993 and 1994 interest rates, that averaged 7.33 and 8.35 percent, respectively.[34] Table A.1. shows the resulting changes in purchases, assuming no offsetting increases in income or reductions in loan amounts for households with less than median incomes.

Holding everything else constant, a 100-basis-point increase in mortgage interest rates would result in a 2–3 percentage point drop in the GSEs' purchases of lower-income mortgages.[35] While the percentage of business in the lower-income category changes by less than 2 to 3 percentage points, the proportional change relative to its small base is far greater than that on the GSEs' share of higher-income business. This is because the lower the income classification, the greater the concentration of households near the 28 percent limit on the qualifying payment-to-income ratio. As Table A.1 shows, the pattern becomes more exaggerated with a 200 basis point change.

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[33] The qualifying payment-to-income ratio depends essentially on three elements: The interest rate, loan amount, and borrower's income. It can be shown that for every 100 basis point increase in interest rates (one percentage point), payment-to-income ratios rise by approximate 8 percent. However, this effect can be offset with either an 8 percent increase in income or an 8 percent reduction in the loan amount.

[34] The GSE data were limited to long-term, fixed-rate loans for one-unit, owner-occupied properties in metropolitan areas. A payment ratio was estimated for each loan using the Freddie Mac coupon rate prevailing 2 months prior to the origination date, an assumed annual tax and insurance rate of 1.8 percent, acquisition unpaid principal balance, and borrower's income. Estimated payment ratios would be biased upward to the extent the associated monthly Freddie Mac coupon rate or tax and insurance percentages exceed actual loan-specific rates. Because the monthly average of interest rates varied by less than one-half percentage point over any two-month period in 1993 or 1994, the potential bias is likely to be less than 1 percentage point in either direction.

[35] It was assumed that the lower-income, i.e., below-median-income, households whose payment-to-income ratios rose above 28 percent would leave the GSE distribution and either pursue non-GSE conventional or FHA mortgages to maintain their loan amount or defer their home purchase. Above-median-income households whose payment-to-income ratios rose above 28 percent were retained in the subsequent distributions under the expectation that they would either lower their loan amounts, raise their down payments, or switch to an ARM.

Table A.1

Distribution of GSEs' Business by Borrower Income Under Various Interest Rate Scenarios*

Income Class (% of Median)	Actual Rates	+100 Basis Points	+200 Basis Points
Fannie Mae			
Percent of 1993 Business			
Above 100%	64.68	67.28	70.21
80 to 100%	15.68	14.60	13.36
60 to 80%	11.88	10.93	9.87
Under 60%	7.13	6.52	5.95
Percent of 1994 Business			
Above 100%	59.61	62.34	65.33
80 to 100%	16.85	15.84	14.65
60 to 80%	13.61	12.66	11.61
Under 60%	9.12	8.38	7.66
Freddie Mac			
Percent of 1993 Business			
Above 100%	67.09	69.54	72.20
80 to 100%	15.28	14.27	13.11
60 to 80%	11.08	10.19	9.25
Under 60%	6.36	5.84	5.27
Percent of 1994 Business			
Above 100%	66.44	68.93	71.67
80 to 100%	15.43	14.41	13.17
60 to 80%	11.33	10.46	9.51
Under 60%	6.70	6.12	5.55

* Distributions of business by income level for 1993 and 1994 interest rates are limited to 30-year, fixed-rate home purchase mortgages and may differ from distributions reported elsewhere.

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c. Economic and Housing Conditions: Multifamily Market

(1) *The Secondary Mortgage Markets: Multifamily Differs from Single-Family*. Over the past two decades, the single-family mortgage market has evolved from a fragmented set of local markets to an efficient, national market that is well integrated into the broader capital markets. In particular, the development of the secondary market for single-family mortgages has increased the flow of capital available to homeowners and lowered its cost.

The same cannot be said of multifamily rental housing. The secondary market has increased its purchase volume for multifamily mortgages in recent years, but remains much less of a factor in providing capital for multifamily housing than it does for single-family housing. About one-third of multifamily mortgage originations are sold to the secondary market, compared to about three-fourths of single-family mortgages in some years. The GSEs do not dominate the multifamily mortgage market like they dominate the single-family market—the GSE's purchases of multifamily mortgages in 1994 were $5.7 billion out of a total market estimated to be in excess of $30 billion.

(2) *Multifamily Continues to Rely on Portfolio Lenders*. As a result, debt financing for multifamily mortgages remains very dependent on portfolio lenders, many of whom are depository institutions (banks and thrifts). Yet several institutional changes in the past two decades have made it increasingly difficult for depository institutions to originate and hold multifamily mortgages.

These changes include a significant downsizing of the thrift industry after the savings and loan (S&L) debacle of the 1980s, and the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 which imposed new risk standards for depository institutions to prevent a recurrence of the S&L scandal.[36]

(3) *A Role for the GSEs in Multifamily Housing.* In addition to institutional changes, the difficulty with multifamily lending in recent years was also related to market conditions. The tax-driven overbuilding of the early 1980s was followed by a credit crunch due to the Tax Reform Act of 1986, FIRREA, and the soft market conditions for all properties (both new and existing properties) caused by the overbuilding. As a result, underwriting creditworthy multifamily deals was difficult in the early 1990s, especially for portfolio lenders. These conditions have now improved markedly.

Currently, multifamily properties offer less risk of loss than most other commercial property classes according to Moody's Investors Service.[37] In overbuilt markets, vacancies have declined due to depressed construction levels in the early 1990s. Accordingly, competition for multifamily loans has increased and spreads over Treasury rates of these loans have declined in the past year.

Credit risk remains a concern of investors, but new techniques in multiclass securitization have helped mitigate credit risk on multifamily mortgage pools.[38]

Much of the benefit of increased competition for multifamily mortgages results from reduced spreads on these mortgages, which lower capital costs for owners, and ultimately reduce rents for borrowers. As discussed in background section (7) below, the recent market upturn has not been equally beneficial to multifamily properties affordable to lower-income households. Among these are smaller, inner-city properties, which comprise a significant portion of the existing affordable stock, as well as larger redevelopment projects, seniors' housing, and affordable new construction in faster-growing markets.

By sustaining a secondary market for multifamily mortgages, the GSEs can extend the benefits that come from increased mortgage liquidity to many more lower-income families while helping private owners to maintain the quality of the existing affordable housing stock. That is, greater liquidity and stability in the secondary market due to a significant presence by the GSEs will benefit lower-income renters without the need for subsidy—much as the GSEs now provide benefits to homebuyers without subsidies. Providing liquidity and stability is the main role for the GSEs in the multifamily market, just as in the single-family market.

(4) *The Current Availability of Credit is not the Key Issue Regarding the Role of the GSEs.* As described above, an important consideration in determining the appropriate role for the GSEs in the multifamily housing market is the potential benefit from increased liquidity in the long term. The current ''snapshot'' of market conditions and recent trends in the availability of mortgage credit are temporary features of the mortgage market.

Today's ample supply of credit for certain multifamily properties and credit gaps for other classes of properties (see part vi of Section 7 below) are temporary features of a changeable market. For example, the current return to multifamily lending by banks and thrifts may be driven in part by a desire by these institutions to maintain loan volume and fee income following the single-family refinance boom of 1993–1994, and in part by Community Reinvestment Act considerations.

Portfolio lenders may eventually feel the burden of FIRREA standards or other portfolio management pressures and seek to reduce their holdings of multifamily mortgages. This could rather rapidly reverse many of the private investment decisions that have contributed to current market conditions. In such circumstances, the liquidity of an efficient secondary market for multifamily mortgages would help these lenders and other lenders maintain a presence in the primary market during such shifts in investment strategy.

(5) *The Importance of Increased Liquidity*. Anecdotal information available to HUD indicates that lack of liquidity, rather than credit risk, is a major obstacle preventing lenders from holding more affordable housing investments in portfolio. HUD examined the current sources of multifamily capital to determine if mortgages originated were available for purchase by the GSEs, including institutional mortgage originators and holders such as life insurance companies and pension funds.

Investors in multifamily mortgages make their investment decisions based on how well the characteristics of an asset matches their portfolio objectives. Increasing the liquidity of an asset like multifamily mortgages would increase the interest of all investors in holding these assets.

Life insurance companies report, for example, that it is generally true that they buy mortgages with the original intent of holding them. However, life insurance companies do sell multifamily mortgages from time to

[36] Two specific changes instituted by FIRREA that affect multifamily mortgages are risk-based capital requirements under which most multifamily mortgages are assigned 100 percent risk weights (compared to 50 percent risk weights for single-family loans which are not backed by a federal credit agency), and a lending limitation to a single borrower of 15 percent of an institution's unimpaired capital.

[37] ''Moody's: Multifamily Offers Less Loss Risk,'' *National Mortgage News*, May 1, 1995.

[38] For example, Fannie Mae ''swap transactions'' in which Fannie Mae swaps its securities for the top 85 percent, or the ''A'' piece, of a multifamily mortgage pool, leaves the riskier ''B'' piece, which absorbs the first credit losses from the pool, to be sold at discount on the market. Recently there has been considerable investor interest in these higher yielding B pieces.

time, particularly when they need to make adjustments in the composition of their portfolios. These companies would increase their sales of multifamily mortgages if these investments were more liquid. In the current market, absent a highly liquid and efficient secondary market for multifamily mortgages, life companies that wish to sell a mortgage must pay the high transaction costs for a private placement. These companies might even buy and hold more multifamily mortgages, including mortgages on affordable units, in portfolio if there were a more active secondary market for these assets that made them more liquid.

(6) *Increased Liquidity Will Make More Multifamily Mortgages Available for GSE Purchase.* The GSEs have the ability to expand the multifamily secondary market and to bring increased liquidity to multifamily mortgages. The increases in liquidity that their sustained presence in this market would bring would make investments in multifamily mortgages more attractive for all investors. As noted above, even traditional portfolio investors can be a source of mortgages for GSE purchase through sales of existing, seasoned mortgages.[39]

Existing multifamily mortgages currently lack standardization with regard to loan-to-value, debt coverage, and other underwriting ratios, as well as with regard to loan terms, property use restrictions, and other factors. Not all existing mortgages would be suitable for GSE purchase. However, the GSEs can play an important role in bringing basic standards to this market, much as they have done with the single-family market, increasing the supply of seasoned mortgages available for purchase in the future.

(7) *Background on Multifamily Market Conditions.* The following discussion provides a more detailed overview of multifamily market conditions and trends.

(i) *Historical Trend: Decline in Debt Financing.* As mentioned above, the downsizing of the thrift industry in the late 1980s and the FIRREA changes contributed to a credit crunch for multifamily lending. Debt financing for multifamily housing became difficult to obtain in the early 1990s. Conventional multifamily mortgage originations peaked at $41 billion in 1986, and then declined every year to a trough of about $25 billion in 1992. In 1993 the level rose to almost $29 billion, and rose again in 1994 when originations were estimated to be about $33 billion. The recent increases in originations suggest that the credit crunch is effectively over.

The thrift industry's problems played a major role in the decline of the multifamily market. In 1985, thrift institutions originated 42 percent of multifamily mortgages. The thrifts' share of multifamily originations declined every year since that peak. Their holdings have decreased by $41 billion since 1988, due to defaults and write-offs, failure of institutions and refinancing of thrift-held mortgages. Multifamily mortgages remained close to 8.5 percent of total thrift assets from 1985 to 1992, but the high failure rate of these institutions has reduced their total assets. After passage of FIRREA in 1989, multifamily mortgage holdings by thrifts continued to decline.[40]

(ii) *Historical Trend: Decline in New Construction.* Multifamily mortgage construction activity has paralleled the decline in multifamily mortgage originations. Along with the decline in debt financing, the value of new multifamily construction declined for seven consecutive years until it edged up again in 1994 to $12.1 billion.[41] However, peaks and troughs have always characterized multifamily construction starts. The most recent peak year was 1985, in which 576,000 multifamily units were started.[42] The downturn from this peak was particularly severe. Over the next 3 years, multifamily housing production reached the lowest levels recorded since the Government began collecting these data 35 years ago. In 1993, the number of new multifamily units started fell to a low of 132,600. Multifamily starts rose to 223,500 in 1994, but even this level was far below the annual average of 435,000 units from 1964 through 1992.

Much of the current production of affordable multifamily housing is due to Low-Income Housing Tax Credits[43]—about 100,000 units per year since 1992.[44] An increasing share of affordable housing is being produced by non-traditional developers, particularly community-based, nonprofit developers. Although current production levels do not meet the demand for low-cost rental housing, housing affordable to lower-income families is a significant share of the multifamily units that are being produced.

(iii) *Supply and Demand Considerations.* Other market forces besides the thrift industry downsizing and FIRREA contributed to the decline in multifamily lending and construction in the early 1990s. For example, the generous tax treatment allowed by the Economic Recovery Tax Act of 1981 resulted in overbuilding of multifamily housing in many markets. When the Tax Reform Act of 1986 reduced the favorable tax treatment, investment decisions on multifamily mortgages appropriately returned to sound market fundamentals of supply and demand at the local market level. Accordingly, an excess supply of multifamily units in many markets kept the demand for both new construction and debt financing low for many years.

The 1994 upturn in multifamily construction is evidence that local rental markets are now stabilizing. Multifamily production has resumed in these markets, but it has been generally limited to higher-rent luxury units. HUD has anecdotal evidence of this happening throughout the Southeast, for example, and elsewhere.[45]

(iv) *Outlook for New Construction and Debt Financing.* Despite the upturn in starts, the demand for new multifamily construction, but not multifamily mortgage credit, is likely to be weak for the remainder of the decade. The aging of the baby-boom generation means that single-family tradeup homes will dominate the new-construction market, while declines in households under age 35 will limit the demand for new rental housing, except in very fast-growing areas in which migration from other parts of the nation and foreign immigration will offset the decline.[46]

HUD believes that the weak demand for new multifamily construction for the remainder of the decade will not result in a reduction in the overall demand for multifamily mortgage credit. The new

[39] A potential new source of existing multifamily mortgages that may be available for GSE purchase in 1996 and well into the next decade could come from the Department's proposed ''mark-to-market'' solution to reducing the long-term costs of Section 8 project-based assistance programs. If Congress enacts the Department's proposal, several billion dollars of existing mortgages on privately-owned low-income multifamily properties could be sold as current Section 8 assistance contracts expire and are not renewed.

[40] Thrift holdings of multifamily mortgages fell by over one-third between 1989 and 1994, reducing their share of holdings among financial institutions from 34.5 percent to 23.3 percent according to the Federal Reserve Board.

[41] Joint Center for Housing of Harvard University, *State of the Nation's Housing,* 1995.

[42] The record high was 906,200 multifamily units started in 1972.

[43] The Low Income Housing Tax Credit (LIHTC) program was introduced by the Tax Reform Act of 1986.

[44] Exact figures for the LIHTC program are not yet available. The estimate in the text includes existing units under rehabilitation as well as new construction, although the majority are estimated to be new construction. Not all of these units have actually started construction or rehabilitation.

[45] HUD, Office of Policy Development and Research. May 1995. ''U.S. Housing Market Conditions,'' pp. 27–47.

[46] Joint Center for Housing of Harvard University, 1995.

construction weakness will be offset by a growing demand associated with the existing stock. Specifically, mortgage demand in the remainder of the decade will include refinancings of long-term loans to reduce interest rates, rollover of shorter-term balloon loans coming due, refinancings to rehabilitate buildings, and existing property sales. Some observers expect that the $33 billion origination volume in 1994 to increase to over $35–$40 billion in 1996 and 1997.[47]

(v) *Interpreting the Trends.* These trends have been interpreted by some as evidence that the private capital markets in the mid-1990s are capable of providing the necessary liquidity to the multifamily market. However, there are other considerations to be weighed.

Despite the upturn in lending for new construction and the increased participation by banks, private conduits and REITs, there are indications that the private credit markets may not be meeting the full range of multifamily credit needs. The loans most likely to be originated by banks or sold to private conduits and real estate investment trusts (REITs) are not secured by affordable rental units. One market observer noted, ''* * * while Wall Street has recently sought to fill multifamily lending gaps through conduits, these conduits barely nick the surface of affordable housing, concentrating primarily on market-rate multifamily properties.''[48]

There are several reasons for the continued gap in multifamily finance. First, multifamily mortgages, like small business loans, lack standardization. This is particularly true for affordable housing loans because the developments often require a mix of financing sources in order to make the project affordable to low-income households. Second, multifamily loans are also relatively large, making multifamily mortgage pools more difficult to diversify than single-family pools. Third, there is far less information about the performance of multifamily mortgages than there is for single-family mortgages, particularly those secured by affordable developments.

(vi) *Current Credit Gaps: Property Types.* HUD has anecdotal evidence that credit shortages exist currently for certain classes of existing affordable properties: smaller multifamily properties (i.e., 5 to 20 unit properties) in older urban areas, and properties of all sizes in inner cities in need of rehabilitation.[49] While some may consider these to be market ''niches,'' they are not insignificant markets. For example, small multifamily properties actually comprise a major component of the nation's affordable housing stock: the 1991 Residential Finance Survey shows that there were about 470,000 properties in the U.S. with between 5 and 19 units, but only 150,000 with 20 or more units.

Affordable housing for seniors is another class of properties that the conventional market has had difficulty financing. The primary reason for this difficulty appears to be uncertainty by the market over the nature of seniors' housing.[50] Compared to other multifamily rental housing, seniors' housing is more specialized and non-homogeneous. It is a currently evolving product, and investors are especially uncertain of its financial performance.

Finally, there is inadequate capital to finance construction of new affordable units, which usually involve low-income housing tax credits, in higher-growth markets.

(vii) *Current Credit Gaps: Lending Terms.* Terms of conventional financing can also restrict access to credit for units intended for lower-income families. For example, an obstacle to the financing of new construction or substantial rehabilitation of housing for lower-income families is the inability to lock-in an interest rate (without payment of an exorbitant fee) for the permanent loan. Over 60 percent of outstanding multifamily debt either carries a variable interest rate, or will have a balloon payment due in less than 10 years.

The construction financing for most new construction or substantial rehabilitation projects covers both the actual construction and the initial rent-up periods, while the interest rate usually floats until the project has reached the required occupancy level and is ready for permanent loan takeout and possible securitization. The inability to lock-in permanent rates without paying prohibitive lock-in fees, makes it much more difficult to finance affordable housing because a rate increase during construction and rent-up can make an affordable project infeasible.[51] If the GSEs are able to provide new financial instruments that include forward rate commitments at reasonable cost, for example, the credit gaps for affordable units can be reduced.

(viii) *The Impact of Credit Gaps.* A major problem facing low-income households is that low-cost housing units continue to disappear from the existing stock.[52] The ability of the nation to maintain the quality of the affordable housing stock and to stabilize inner city neighborhoods depends on the availability of adequate capital for small existing properties, redevelopment projects, and senior housing.

The current availability of multifamily credit for certain types of multifamily mortgages is not a valid argument that the GSEs are unneeded in the multifamily credit markets. Rather, the current competition for multifamily mortgages on amenity-rich apartments and the tightening spreads between the yields of privately issued multifamily MBS and comparable maturity Treasury bonds demonstrate the benefits that increased liquidity in multifamily markets could provide to the affordable rental housing market. That is, the GSEs' participation in the market can reduce the cost of capital and ultimately improve housing quality and/or decrease rents paid by low-income families.

(ix) *Rentals in 1- to 4-Unit Buildings.* HUD is also aware that a significant portion of the demand for rental housing is satisfied by rental units in properties containing 1 to 4 units. In 1993, about 57 percent of the rental housing in the nation was in buildings with fewer than 5 units. However, there is considerable variation across local markets in the portion of the rental stock that is contained in 1- to 4-unit properties. The New York area, for example, has only 30 percent of its rental units in 1- to 4-unit properties, while Chicago has 46 percent and

[47] Robert Dunsky, James Follain, and Jan Ondrich, ''An Alternative Methodology to Estimate the Volume of Multifamily Mortgage Originations,'' Report prepared for the Department of Housing and Urban Development, September 1995.

[48] Stuart J. Boesky, ''Tax Credits at Work,'' *Mortgage Banking,* September 1995.

[49] Participants at numerous industry forums and working group meetings sponsored by the Department have attested to the existence of these credit gaps.

[50] Campbell, W. Donald. 1995. ''Seniors Housing Finance.'' Paper prepared for AARP/White House Mini-Conference ''Expanding Housing Choices for Older People,'' January 26–27, 1995, in Washington, D.C.

[51] Another example of the terms of conventional financing that restricts access to credit for affordable units is the lack of long-term fixed rate loans. About 60 percent of conventional multifamily loans are adjustable rates or fixed rate balloon loans with terms of 10 years or less. The rollover of a balloon loan generally resets the interest rate. In either case, if the rate increases at a scheduled adjustment period, the higher debt service expense may be more difficult for an affordable property to absorb.

[52] The Joint Center's *State of the Nation's Housing* for 1995 finds that the number of unsubsidized low-cost units in the Northeast has fallen by half since 1974. In the Midwest the addition of new subsidized units has offset the loss of unsubsidized low-cost units, but in every other region the total low-cost stock (subsidized and unsubsidized) is below 1974 levels.

Boston has 56 percent of its rental stock in 1- to 4-unit buildings. The market-specific variations suggest that rental housing in 1- to 4-unit properties is not a perfect substitute for multifamily rental housing. The need for multifamily housing is relatively greater in some cities.

The financing of 1- to 4-unit properties is provided by the standard single-family primary and secondary mortgage markets if one of the units is owner-occupied. This segment is relatively well-served by the existing capital-delivery system. If the 1- to 4-unit property is investor-owned, the single-family market is still used, but with greater restrictions such as tighter underwriting ratios. These restrictions are generally in response to the greater credit risk posed by investor-owned 1- to 4-unit properties. The investor-owned side of the 1- to 4-unit rental market also has access to the liquidity of the single-family secondary market, albeit with restrictions.

(x) *Credit Risk of Affordable Housing.* Credit risk is an important factor to be considered by the GSEs in their participation in the multifamily mortgage markets. Does credit risk pose a major obstacle to the development of an efficient and highly liquid secondary market for multifamily mortgages that addresses the full range of multifamily credit needs? If the GSEs broaden their penetration of the multifamily market to purchase more small (under $1 million) mortgages, will the GSEs be taking on additional risk? Unfortunately, the academic literature is deficient in addressing these questions. However, numerous sources suggest that credit risk is not an insurmountable obstacle.

On a whole loan basis, risk levels of multifamily lending are often higher than for single family. There are four major reasons for this. First, multifamily loans, like small business loans, lack standardization. This is particularly true for affordable housing because the financial package often involves tax credits or local subsidy which complicates the loans. Second, multifamily loans are also relatively large, making multifamily portfolios more difficult to diversify than single-family portfolios. Third, there is far less information about the performance of multifamily mortgages than there is for single-family mortgages, particularly those secured by affordable units. And finally, private mortgage insurance is not generally available for multifamily loans as it is for single-family loans.

However, multifamily investments in today's market often involve mortgage pools rather than whole loans. Credit risk remains a concern of investors, but new techniques in multiclass securitization have helped mitigate credit risk on multifamily mortgage pools. For example, Fannie Mae ''swap transactions'' in which Fannie Mae swaps its securities for the top 85 to 90 percent, or the ''A'' piece, of a multifamily mortgage pool, leaves the riskier ''B'' piece, which absorbs the first credit losses from the pool, to be sold at discount in the market.

The B-piece that absorbs all credit losses up to 15 percent of the total unpaid balance on a typical multiclass multifamily pool provides considerable loss protection. This makes the A-piece highly marketable. Recently there has been considerable investor interest in these higher yielding B-pieces as well.

A source of anecdotal information on the credit risk involved with affordable multifamily housing comes from participants in the low-income housing tax credit (LIHTC) program which was created by the 1986 Tax Reform Act. Tax credits are the only major Federal assistance program for new or rehabilitated low-income housing that is currently active. Detailed data on the composition and performance of tax credit projects are not yet available. However, both academic and industry experts have been observing the tax credit program since its inception, and a number of them have shared their observations with HUD.

These market observers tell HUD that tax credit deals typically are financed with 30 to 40 percent equity obtained from investors receiving the tax credits, first mortgage debt of about 40 to 60 percent, and the remaining amount up to 30 percent comes from local subsidies often in the form of ''soft'' second mortgages. Market observers tell us that the trend in tax credit deals is toward increased equity as a share of the total development cost due to increased competition among tax credit syndicators.

The lenders who provide first mortgage financing for tax credit deals consider their loans on these affordable units to be less risky than loans for market-rate multifamily projects. There are several reasons for this conclusion. First, the loan-to-value ratio on these deals is at most 60 percent, which gives lenders substantial protection from credit risk. If the lender must foreclose, the tax credits stay with the property, giving the lender the ability to attract equity from new investors. Other reasons that first mortgage financing on affordable tax credit deals is considered less risky are the low turnover rates of affordable units which keeps project vacancies low, the high potential for future appreciation of the property, and the close scrutiny to initial underwriting by the equity provider or syndicator.[53] This anecdotal experience suggests that not all mortgages on affordable multifamily loans need be high-credit-risk lending.

Continued achievement of the housing goals in this rule may require the GSEs to develop additional capabilities to underwrite classes of multifamily loans such as smaller existing properties, redevelopment projects, seniors' housing, and tax credit deals. This may pose some initial administrative difficulty for the GSEs, but there are no apparent fundamental difficulties in multifamily mortgage origination and purchase activities, such as unmanageable risks. If there were, such risks would be difficult to explain, given the current market trends toward higher multifamily lending activity and new techniques of risk management.

3. Performance and Effort of the GSEs toward Achieving the Low- and Moderate-Income Goal in Previous Years

Each GSE has submitted data on its 1993 and 1994 performance to the Secretary. This is the first time that such detailed information has been made available on the GSEs' activities, which in 1993 involved the purchase of 2.97 million mortgages on 3.24 million dwelling units by Fannie Mae and the purchase of 2.32 million mortgages on 2.38 million dwelling units by Freddie Mac. In 1994, due to rising interest rates and the decline in mortgage refinancings, aggregate purchase volume (in dwelling units) fell by 43 percent, with Fannie Mae purchasing 1.66 million mortgages on 1.97 million units, and Freddie Mac purchasing 1.25 million mortgages on 1.34 million units.

Each GSE also has submitted detailed loan-level data on each loan it purchased in 1993 and 1994. HUD has done extensive analyses to verify the GSEs' stated performance and to measure aspects of their mortgage purchase activities in 1993–94 not contained in tables submitted to HUD in which the GSEs' aggregate data in various ways.[54]

Fannie Mae's data for 1993 show that 34.3 percent of total units financed by its mortgage purchases were affordable to low- and moderate-income families.

[53] See Stuart J. Boesky, ''Tax Credits at Work,'' *Mortgage Banking,* September 1995.

[54] In the following discussion, the GSEs' performance is measured using the counting rules which will be in effect under the final rule, not those under the Interim Notice, which have been used by the GSEs in reporting performance to HUD. For this reason, in some cases the following data differ slightly from the data reported by the GSEs.

This represented a significant increase in the low- and moderate-income percentage from an estimated 28 percent in 1992, and Fannie Mae's performance substantially exceeded the 30 percent goal established for Fannie Mae by the Secretary.[55] A further gain was recorded in 1994, as 45.4 percent of Fannie Mae's purchases qualified for the Low- and Moderate-Income Housing Goal, which was also 30 percent in 1994.[56]

Freddie Mac's data for 1993 show that 30.0 percent of total units financed by its mortgage purchases were affordable to low- and moderate-income families. There was a significant increase from an estimated 24 percent in 1992, and Freddie Mac's performance exceeded the 28 percent goal established for Freddie Mac by the Secretary. A further gain was also recorded in 1994, when 38.0 percent of total units financed by Freddie Mac's mortgage purchases qualified for the low- and moderate-income goal, which was raised from 28 percent in 1993 to 30 percent in 1994 for Freddie Mac.

Although the GSEs surpassed the low- and moderate-income goals in 1993 and 1994, approximately 50 percent of their one-unit single-family owner-occupied purchases, the bulk of their business, were secured by housing for families with incomes in excess of 120 percent of area median income, as indicated in Table A.2.[57] These results indicate that achievement of the Low- and Moderate-Income Goal in 1993 and 1994 did not impede the GSEs from buying many mortgages on properties purchased by higher-income families.

TABLE A.2.—DISTRIBUTION OF DWELLING UNITS IN GSE SINGLE-FAMILY OWNER-OCCUPIED 1–UNIT PURCHASES BY INCOME CLASS OF MORTGAGOR, 1993–1994

Income of mortgagor(s) relative to area median income (%)	Fannie Mae, 1993 (%)	Fannie Mae, 1994 (%)	Freddie Mac, 1993 (%)	Freddie Mac, 1994 (%)
0–60	6.8	8.8	6.2	6.8
60–80	11.3	13.2	10.8	11.3
80–100	15.0	16.5	14.9	15.2
100–120	15.4	15.8	15.6	16.0
> 120	51.5	45.7	52.5	50.7
Total	100.0	100.0	100.0	100.0

4. Size of the Conventional Conforming Mortgage Market Serving Low- and Moderate-Income Families Relative to the Overall Conventional Conforming Market

The low- and moderate-income share of the mortgage market is estimated to be 48–52 percent. Appendix D presents in detail the underlying analysis for this estimate.

5. GSEs' Ability to Lead the Industry

FHEFSSA requires the Secretary to consider the GSEs' ability to lead the market in determining the level of the Low- and Moderate-Income Goal. The GSEs' ability to lead the industry depends on their dominant role in the mortgage market, their ability—through their underwriting standards and new programs and products—to influence the types of loans that private lenders are willing to make, their utilization of cutting edge technology, their highly competent and well-trained staffs, and their financial resources.

a. Dominant Role in Market

The GSEs purchased 71 percent of all conventional conforming single-family mortgages in 1993—up from 15 percent in 1980, 34 percent in 1985, 50 percent in 1991, and 64 percent in 1992.[63] The GSEs' share of the relevant market fell to 55 percent in 1994. This was due in part to the increase in the adjustable rate mortgage (ARM) share of the mortgage market, from 20 percent in 1993 to 39 percent in 1994.[64] However, the GSEs' market share in 1994 exceeded that in all years except 1992 and 1993.

Most of the mortgages purchased by the GSEs are securitized, but sizable amounts are held in portfolio—in fact Fannie Mae and Freddie Mac have the first- and fourth-largest mortgage portfolios, respectively, of all mortgage holders in the United States. The GSEs now hold or securitize about 30 percent of the total dollar volume of mortgages outstanding, compared to about 7 percent in 1980, and they have accounted for over 40 percent of the net increase in mortgages outstanding between 1980 and 1992 and over 70 percent of the net increase between 1989 and 1992.[65]

The dominant position of the GSEs is reinforced by their relationship to other market institutions. Banks and savings and loans are both their competitors and their customers—they compete as portfolio lenders, but at the same time they sell mortgages to the GSEs and buy mortgage securities from them, and also buy the debt securities that the GSEs use to finance their portfolios.

b. Set Underwriting Standards for Market

The GSEs' underwriting guidelines are followed by virtually all mortgage originators, including lenders who do not sell many of their mortgages to Fannie Mae or Freddie Mac.[66] The guidelines are also commonly followed in underwriting ''jumbo'' mortgages, which exceed the maximum principal amount which can be purchased by the GSEs (the conforming loan limit), because such mortgages eventually

[55] Some mortgage purchases are not eligible for inclusion under the low- and moderate-income goal, such as federally guaranteed mortgages, mortgages on second homes, and mortgages originated prior to January 1, 1993 that were missing relevant borrower income or rent data. Such mortgages were excluded from both the numerator and the denominator in calculating the performance under this goal. These exclusions amounted to 14 percent of Fannie Mae's purchases and 9 percent of Freddie Mac's purchases.

[56] A portion of the increase from 1993 reflects a decline in the share of refinancings, which have been less common among low- and moderate-income families.

[57] Cases with missing data have been excluded from the table.

[63] Estimates provided by Fannie Mae's Economics Department.

[64] Federal Housing Finance Board, ''Rates & Terms on Conventional Home Mortgages,'' Annual Summary, 1994, Table 3. ARMs present less interest rate risk to lenders than fixed-rate mortgages, and therefore are more likely to be retained in portfolio.

[65] John C. Weicher, ''The New Structure of the Housing Finance System,'' *Federal Reserve Bank of St, Louis Review*, July/August 1994, pp. 51–52.

[66] The underwriting guidelines published by the two GSEs are not identical, but they are very similar in most aspects. And since November 30, 1992, Fannie Mae and Freddie Mac have provided lenders the same Uniform Underwriting and Transmittal Summary (Fannie Mae Form 1008/Freddie Mac Form 1077), which is used by originators to collect certain mortgage information that they need for data entry when mortgages are sold to either GSE.

might be sold to the GSEs as the principal balance is amortized or the conforming loan limit is increased. By setting the credit standards against which the mortgage applications of lower-income families will be judged, the GSEs influence the rate at which mortgage funds flow to low-income borrowers and underserved neighborhoods. Congress realized the crucial role played by the GSEs' underwriting guidelines when it required each enterprise to submit a study on its guidelines to the Secretary and to Congress.

c. Leading Edge Technology

Both GSEs are in the forefront of new developments in mortgage industry technology. For example, Fannie Mae has developed FannieMaps®, a computerized mapping service offered to lenders, nonprofit organizations, and state and local governments to help them implement community lending programs. Both GSEs released automated underwriting systems in 1995. The Freddie Mac system is based on credit scoring, which allows explicit consideration of compensating factors, while the Fannie Mae system automates current underwriting standards. Such systems have the potential to reduce the cost of loan origination, particularly for low-risk loans.

d. Staff Resources

Both GSEs are well-known throughout the mortgage industry for the expertise of their staffs in carrying out their current programs, researching and developing improvements in the mortgage market in general, developing innovative new programs, and conducting research that may lead to new programs in the future. Their key executives frequently testify before Congressional committees on a wide range of housing issues, and both GSEs have developed extensive working relationships with a broad spectrum of mortgage market participants, including various nonprofit groups and government housing authorities.

e. Financial Strength

The benefits that accrue to the GSEs because of their GSE status and solid management have made them two of the nation's most profitable businesses. Fannie Mae's net income has increased steadily from $807 million in 1989 to $2.1 billion in 1994, and for the first two quarters of 1995 net income was accruing at an annual rate of $2.3 billion, despite a 46 percent drop in mortgage purchases and a 60 percent drop in MBS issued in comparison with the first half of 1994. Through the second quarter of 1995, Fannie Mae has recorded 30 consecutive quarters of increased net income. Fannie Mae's return on equity averaged 27.5 percent over the 1990–94 period—far above the rates achieved by most financial corporations. In addition, Fannie Mae's dividends per share more than tripled over this period, rising from $0.72 in 1990 to $2.40 in 1994.

Freddie Mac has shown similar trends. Freddie Mac's net income has increased steadily from $414 million in 1990 to $983 million in 1994, and for the first two quarters of 1995 net income was accruing at an annual rate of $1.04 billion, despite declines in business volume similar to those experienced by Fannie Mae. Freddie Mac's return on equity averaged 20.9 percent over the 1990–94 period—also well above the rates achieved by most financial corporations. Freddie Mac's dividends per share nearly doubled over this period, rising from $0.53 in 1990 to $1.04 in 1994.

One measure of the strength of the GSEs was provided by a recent ranking of American corporations. This survey found that Fannie Mae was first of all companies in total assets and Freddie Mac ranked 17th; with regard to total profits, Fannie Mae ranked 20th and Freddie Mac ranked 52nd.[67]

Under FHEFSSA, beginning with the second quarter of 1994, the GSEs must meet fully phased-in minimum core capital requirements of 2.5 percent of on-balance sheet assets and 0.45 percent of outstanding mortgage-backed securities and other off-balance sheet obligations, except as adjusted by the Director of OFHEO.[68] For the transition period from June 30, 1993 through March 31, 1994, the corresponding percentages were 2.25 percent and 0.40 percent respectively. Based on the relation between actual core capital and minimum core capital, a GSE is classified as adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized.

The Director has found both GSEs adequately capitalized for all nine quarters ending June 30, 1993 through June 30, 1995. At the end of the second quarter of 1995, Fannie Mae's core capital of $10.323 billion exceeded its minimum capital requirement of $9.684 billion by $639 million, and Freddie Mac's core capital of $5.538 billion exceeded its minimum capital requirement of $5.256 billion by $282 million.

f. Conclusion About Leading the Market

In light of these factors, the Secretary has determined that the GSEs have the ability to lead the industry in making mortgage credit available for low- and moderate-income families.

6. The Need to Maintain the Sound Financial Condition of the GSEs

HUD has undertaken a separate, detailed economic analysis of this rule, which includes consideration of the financial safety and soundness implications of the housing goals. The analysis considered the likely mortgage default implications of the goals and implications for the profitability of the GSEs under various alternative economic assumptions. Among the conclusions are: that the goals will have, at most, only limited impacts on credit risk, which the GSEs should be able to handle without significant lowering of underwriting standards; that risks associated with increased multifamily mortgage purchase volumes under the goals are manageable, considering the scope of the increases implied by the goals; and that the goals imply no meaningful increase in risk to the sound financial condition of the GSEs' operations. Based on this analysis, HUD concludes that the goals raise minimal, if any, safety and soundness concerns.

D. Determination of the Low- and Moderate-Income Housing Goals

The annual goal for 1996 for each GSE's purchases of mortgages financing housing for low- and moderate-income families is established at 40 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The goal for 1997 and thereafter, unless changed, is 42 percent. These goals represent an increase over the statutorily-mandated 1994 goal of 30 percent, but they are conservative relative to the market share estimates in Appendix D, below Fannie Mae's low-mod performance in 1994, and only slightly above Freddie Mac's performance in 1994. The Secretary's considerations of the six statutory factors led to the choice of these goals.

1. Housing Need

Almost three-fifths of American households qualify as low- and moderate-income under FHEFSSA's definitions—half of owners and 70 percent of renters. Data from the Census and from the American Housing Surveys demonstrate that housing problems and needs for affordable housing are indeed substantial among

[67] *Business Week,* March 27, 1995, p. 154.

[68] Core capital is defined as the sum of the par or stated value of outstanding common or perpetual, noncumulative preferred stock, paid-in capital, and retained earnings.

low- and moderate-income families. These households, particularly those with very-low-incomes, are burdened by high rent payments and will likely continue to face serious housing problems, given the dim prospects for earnings growth in entry-level occupations.

With respect to homeownership, many younger, minority, and lower-income families did not become homeowners during the 1980s due to the slow growth of earnings, high real interest rates, and continued house price increases. Recently, low interest rates and low inflation have improved affordability conditions and first-time homeowners have become a major driving force in the home purchase market. A large pent-up demand for homeownership exists on the part of low-income families closed out of the market during the 1980s, particularly families with children in need of larger units and better neighborhoods.

Several demographic changes will strain the housing finance system during the 1990s. The continued influx of immigrants will increase demand for both rental and owner-occupied housing. Non-traditional households have become more important as overall household formation rates have slowed. With later marriages, divorce, and non-traditional living arrangements, the fastest growing household groups are single-parent and single-person households.

The multifamily mortgage market is far less integrated into the broader capital markets than is the single-family market. The GSEs do not dominate the multifamily secondary mortgage market as they do the single-family market, and they may never dominate the multifamily market to this extent—multifamily loans are more complex than single-family mortgages, and because of the large size of the component loans, multifamily mortgage pools are more difficult to diversify. Portfolio lending may remain a greater factor in multifamily markets.

Current market conditions indicate that the supply of multifamily mortgage credit is adequate for amenity-rich, suburban garden style apartments. However, credit gaps do exist, particularly with regard to the maintenance of the existing affordable stock and construction of affordable units in higher growth markets. Increased liquidity can make investments in affordable multifamily housing more attractive to all investors, including portfolio lenders, which would bring more capital at lower cost to fill current and future multifamily credit gaps. The GSEs' active participation in the market can lead to this needed increase in liquidity.

2. Past Performance and Ability to Lead the Industry

The GSEs have been assisting the overall secondary market, increasing their share of purchases of conventional conforming single-family mortgage origination from 42 percent in 1989 to 70 percent in 1993 before dropping to 55 percent in 1994. In fact, most industry observers would agree that the recent growth in the secondary market was the reason the decline of the thrift industry had only minor effects on the nation's housing finance system.

The GSEs' performance on the low- and moderate-income goal has also been improving. Fannie Mae's performance increased from 34.3 percent in 1993 to 45.4 percent in 1994. Freddie Mac's performance also increased from 30.0 to 38.0 percent during this period.

Single-family Market. The Secretary is concerned about the GSEs' assistance to the lower-income end of the market. Figure A.1 presents the distribution of the GSEs' single-family mortgage purchases by income category. In 1994, homeowners with incomes less than 60 percent of median represented roughly 7 percent of GSE purchases, and those with incomes less than 80 percent of median represented no more than 19 percent of GSE purchases. Families with incomes over 120 percent of median, on the other hand, accounted for approximately 50 percent of single-family mortgages purchased by the GSEs.

While the GSEs have improved their performance, they continue to purchase a smaller proportion of mortgages for very-low-income homebuyers than do portfolio lenders operating in the conforming market. According to the AHS, about 10 percent of conforming loans were originated for very-low-income homebuyers in 1993, compared to about 5 percent of GSE purchases in 1993. Figure A.2 uses HMDA data to compare the GSEs with the non-GSE portion of the conforming market. In 1993 and 1994, very-low-income loans accounted for a higher percentage of the business of portfolio (non-GSE) lenders than they did of GSE business. The 1993 and 1994 HMDA data suggest that there is room for the GSEs to improve their performance in purchasing loans at the lower-income end of the market.

Moreover, there is evidence that there is a significant population of potential homebuyers who might well respond to aggressive outreach. As mentioned above, both Fannie Mae and the Joint Center expect immigration to be a major source of future homebuyers. Furthermore, analysis by The Urban Institute indicates the existence of a large untapped potential. Indeed, the GSE's recent experience with new outreach and affordable housing initiatives is important confirmation of this potential.

Multifamily Market. The Secretary is particularly concerned about the level of Freddie Mac's activity in the multifamily area. In 1994, Freddie Mac purchased $913 million in multifamily mortgages, which was an increase over its purchase of $191 million in 1993. Given the affordability problems faced by renters and the need for a well-functioning secondary market for multifamily loans, it is imperative that Freddie Mac's multifamily business be increased. By sustaining a secondary market in units that meet the special affordable goal, the GSEs will bring increased liquidity, added stability, and ultimately lower rents for lower-income families in these segments of the market. In addition, their promotion of increased standardization in multifamily finance would allow for more direct links to capital markets and improve overall market efficiency and stability. The 1996 and 1997–99 goals are intended to encourage a minimum level of multifamily activity by Freddie Mac.

3. Market Feasibility and Changing Market Conditions

As detailed in Appendix D, the low- and moderate-income mortgage market is quite large, accounting for 48 to 52 percent of dwelling units financed by conventional conforming mortgages. Figure A.3 compares recent GSE performance, the 1996 and 1997–1999 goals, and the size of the low- and moderate-income market. Having considered the projected market and economic and demographic conditions for 1996–1999 and the GSEs' recent performance, HUD has determined that goals for low- and moderate-income purchases of 40 percent for 1996, 42 percent for 1997–1999, and 42 percent thereafter pending establishment of a new goal, are feasible.

In estimating the size of the market, HUD also used assumptions about future economic and market conditions that were less favorable than those that existed over the last two years. HUD is well aware of the volatility of mortgage markets and the possible impacts on the GSE's ability to meet the housing goals. Should conditions change such that the goals are no longer reasonable or feasible, the Secretary has the authority to revise the goals.

4. Parity Between the GSEs

The Secretary is establishing identical goals for both Fannie Mae and Freddie Mac. Freddie Mac consistently lags behind Fannie Mae on the housing goals. In part, this is due to Freddie Mac's limited multifamily activity—their 1994 multifamily mortgage purchases accounted for only 8.9 percent of their overall performance under this housing goal (versus 23.8 percent for Fannie Mae). Freddie Mac has used the past four years to rebuild its multifamily operations and has recently brought on new staff, developed new systems, and is pursuing an aggressive acquisition strategy. On the single-family side, Freddie Mac serves the same lenders and offers the same products as Fannie Mae. Therefore, Freddie Mac should be able to match Fannie Mae's performance in achieving the single-family goals. Moreover, the legislative history supports the idea of parity after the transition period, noting that ''because the enterprises have essentially equal opportunities, their respective annual goals should generally be set at comparable levels.'' [69]

5. Conclusions

The Secretary has determined that the 1996 and 1997–1999 goals set forth above address national housing needs and current economic, housing, and demographic conditions, and that they take into account the GSEs' performance in the past in purchasing low- and moderate-income mortgages, as well as the size of the conventional mortgage market serving low- and moderate-income families. Moreover, the Secretary has considered the GSEs' ability to lead the industry as well as the GSEs' financial condition. The Secretary has determined that the goals are necessary and achievable.

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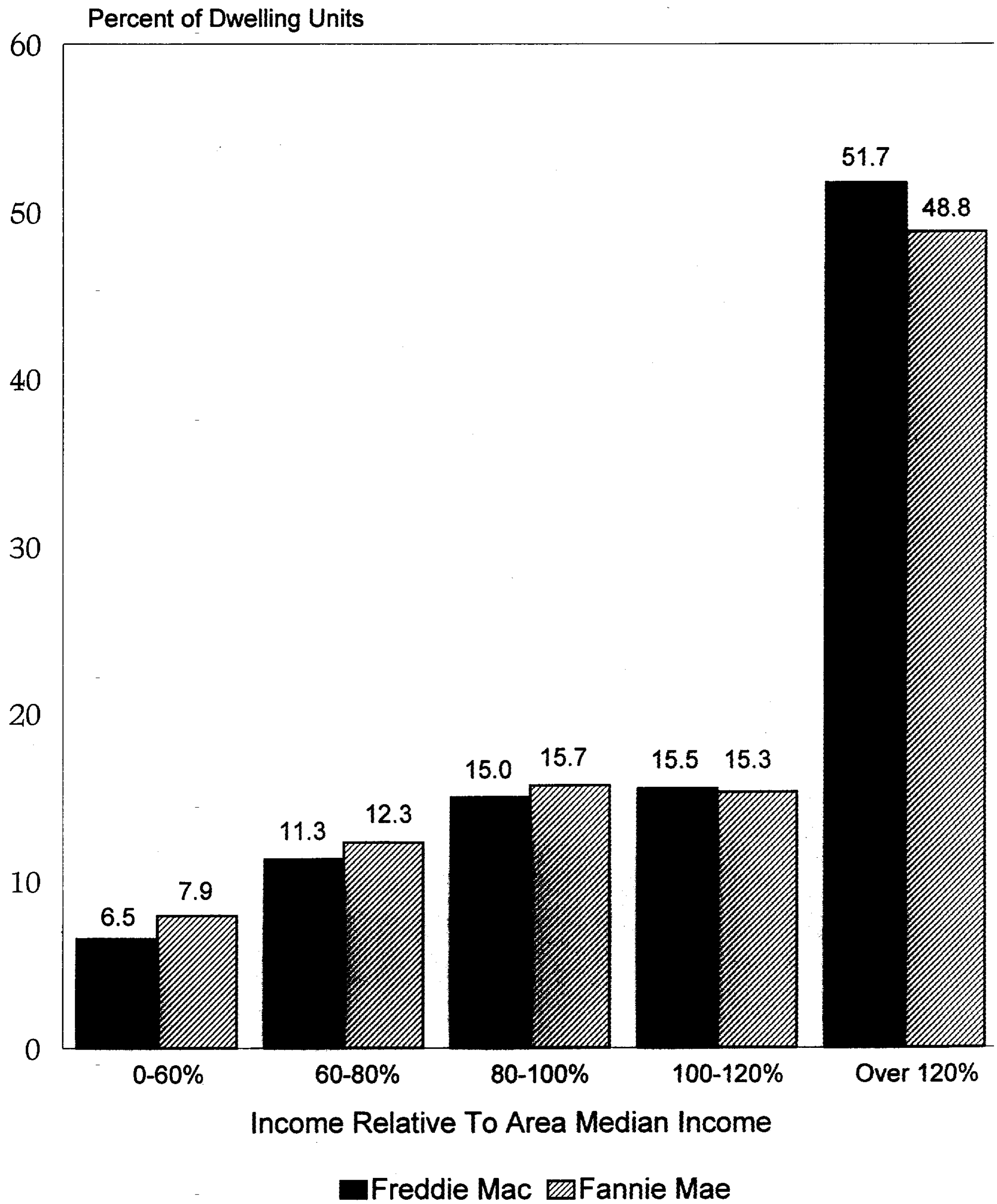
[69] Senate Report 102–282, p. 36.

FIGURE A.1

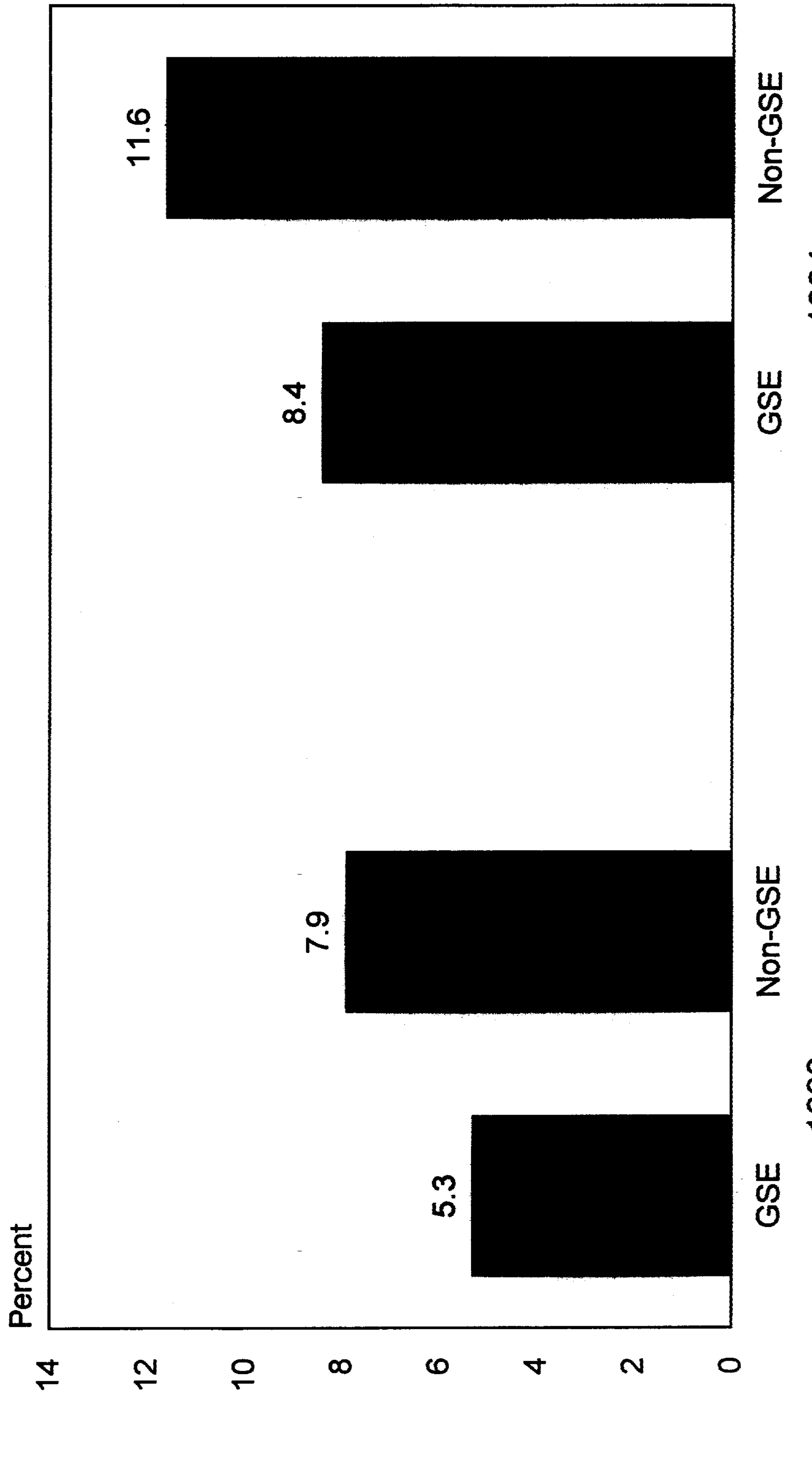
Distribution Of Total GSE Purchases Of Single-Family Owner-Occupied Dwelling Units By Income Class of Mortgagor For 1994



* Performances based on assumptions in final rule.

FIGURE A.2

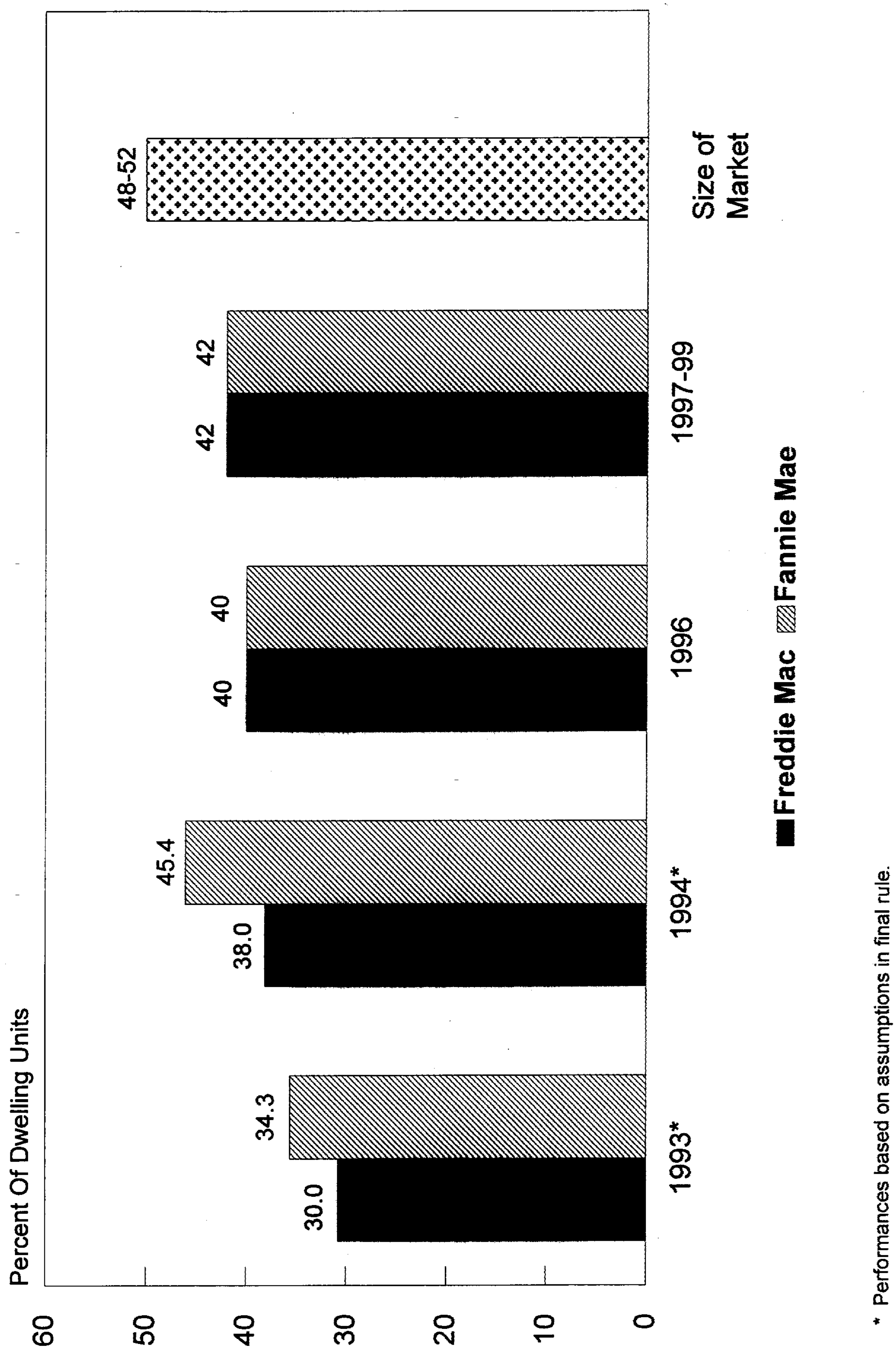
The Share Of GSE And Non-GSE Mortgages To Very-Low-Income Borrowers 1993 and 1994



Source: 1993 and 1994 HMDA Data

FIGURE A.3

Low- And Moderate-Income Activity And Goals For Freddie Mac And Fannie Mae, 1993-99



* Performances based on assumptions in final rule.

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Appendix B—Secretarial Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Goal

A. Establishment of Goal

1. Introduction

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) requires the Secretary to establish an annual goal for the purchase of mortgages on housing located in central cities, rural areas, and other underserved areas (the ''Geographically Targeted Goal'').

In establishing this annual housing goal, FHEFSSA requires the Secretary to consider:

1. Urban and rural housing needs and the housing needs of underserved areas;
2. Economic, housing, and demographic conditions;
3. The performance and effort of the GSEs toward achieving the Geographically Targeted Goal in previous years;
4. The size of the conventional mortgage market for central cities, rural areas, and other underserved areas relative to the size of the overall conventional mortgage market;
5. The ability of the GSEs to lead the industry in making mortgage credit available throughout the United States, including central cities, rural areas, and other underserved areas; and
6. The need to maintain the sound financial condition of the GSEs.

Organization of Appendix. Section A defines the goal and summarizes HUD's assessment of other proposed definitions of the Geographically Targeted Goal. Section B reports findings on access to mortgage credit and Section C addresses the factors listed above. Section D summarizes the Secretary's rationale for setting the level for the Geographically Targeted Goal.

2. HUD's Geographically Targeted Goal

As required by FHEFSSA, during 1993–1995 only mortgages located in central cities, as designated by the Office of Management and Budget (OMB), counted toward the Geographically Targeted Goal. FHEFSSA directed the Secretary to expand the Geographically Targeted Goal to include rural areas and other underserved areas.

HUD's definition of the Geographically Targeted Goal is based on studies of mortgage lending and mortgage credit flows conducted by academic researchers, community groups, the GSEs, HUD and other government agencies. While more research must be done before mortgage access for different types of people and neighborhoods is fully understood, one finding from the existing research literature stands out—minority and low-income neighborhoods have higher mortgage denial rates and lower mortgage origination rates than other neighborhoods. A neighborhood's minority composition and its level of income are useful proxies for measuring access to mortgage credit.

Metropolitan Areas. The rule provides that within metropolitan areas, mortgage purchases will count toward the goal when those mortgage purchases finance properties that are located in census tracts where either the median income of families in the tract does not exceed 90 percent of the area median income, or minorities comprise 30 percent or more of the residents and the median income of families in the tract does not exceed 120 percent of the area median income.

The final rule's definition includes 20,326 of the 43,232 census tracts (47 percent) in metropolitan areas and accounts for 44 percent of the metropolitan population.[1] The tracts included in this definition suffer from poor mortgage access and depressed socioeconomic conditions. The average mortgage denial rate in these tracts is 21 percent, almost twice the denial rate in non-included tracts.

The definition in the final rule adds 3,657 additional tracts to the definition in the proposed rule. These tracts have significant problems with access to credit, as evidenced by relatively high mortgage denial rates and low origination rates.

Nonmetropolitan Areas. The final rule provides that in non-metropolitan areas, mortgage purchases that finance properties that are located in counties will count toward the Geographically Targeted Goal where: minorities comprise 30 percent or more of the residents and the median income of families does not exceed 120 percent of the state nonmetropolitan median income; *or* the median income of families does not exceed 95 percent of the greater of the state nonmetropolitan median income or the nationwide nonmetropolitan median income.

Two important factors influenced HUD's definition of nonmetropolitan underserved areas—lack of available data for measuring mortgage availability in rural areas and the difficulty in operating mortgage programs at the census-tract level in rural areas. Because of these factors, the final rule uses a more inclusive, county-based definition of underservedness in rural areas. HUD's definition includes 1,511 of the 2,305 counties (66 percent) in nonmetropolitan areas and accounts for 54 percent of the nonmetropolitan population.

Goal Levels. The Geographically Targeted Goal is 21 percent in 1996 and 24 percent in 1997 and thereafter. HUD estimates that the mortgage market in areas included in the Geographically Targeted Goal accounts for 25–28 percent of the total number of newly-mortgaged dwelling units. In 1994, 29 percent of Fannie Mae's purchases financed dwelling units located in these areas, compared with 24 percent of Freddie Mac's purchases.

3. Alternative Definitions

Fannie Mae and Freddie Mac each proposed alternative definitions of underserved areas. Several other commenters suggested alternative definitions similar to those proposed by the GSEs. Fannie Mae would define all central city and nonmetropolitan census tracts as underserved; a suburban or non-central city tract would be considered underserved if minorities comprise 50 percent or more of the residents; or if the median income of families does not exceed 80 percent of the area median income. Freddie Mac would define a tract as underserved if minorities comprise 20 percent or more of the residents; or if the median income of families does not exceed 100 percent of the area median income.

HUD conducted extensive analysis of these and other alternative definitions of underserved areas. HUD also contracted with the Urban Institute to evaluate the alternative definitions of underserved areas.[2] That analysis, which is reported in Section B of this appendix, concluded that HUD's definitions in both the proposed rule and this final rule provide much better measures of mortgage access problems.

Fannie Mae Definition. The research conducted by the GSEs, other mortgage

[1] Tracts are excluded from the analysis if median income is suppressed or there are no population or owner-occupied 1–4 unit properties. There are 2,033 of these tracts. When reporting denial, origination, and application rates, tracts are excluded from the analysis if there are no purchase or refinance applications. Tracts are also excluded from the analysis if: (1) group quarters constitute more than 50 percent of housing units or (2) there are less than 15 home purchase applications in the tract and the tract denial rates equal 0 or 100 percent. Excluded tracts account for a small percentage of mortgage applications (1.4 percent). These tracts are not excluded from HUD's underserved areas if they meet the income and minority thresholds. Rather, the tracts are excluded to remove the effects of outliers from the analysis.

[2] George Galster, ''Comments on Defining 'Underserved' Areas in Metropolitan Regions,'' Urban Institute, prepared for the U.S. Department of Housing and Urban Development, August 15, 1995.

market economists, and HUD supports the premise that the location of a census tract—whether within a central city or a suburb—has minimal relationship to whether the tract is underserved. Instead, these studies have found that mortgage flows in a census tract are strongly correlated with the minority concentration or median income of that tract. The Urban Institute criticized the continued use of OMB-designated central cities in the goal because it treats all areas in central cities as if they have access problems. However, substantial evidence shows that mortgage access problems are not the same across central city neighborhoods.

Use of the definition advanced by Fannie Mae would add 8,833 central-city tracts to 13,554 central city tracts under this rule's definition. Credit access is not a problem in these added tracts—their average mortgage denial rate is 11 percent, which is one-half of the 22 percent denial rate for central city tracts covered by this final rule.

Freddie Mac Definition. Use of the definition proposed by Freddie Mac would add substantially more tracts and tracts that have lower denial rates than the definition in the final rule. Credit access does not appear to be a problem in the 5,367 tracts added by the Freddie Mac definition. The denial rate for the added tracts is 15 percent, which is only slightly above the 13 percent denial rate for all metropolitan tracts and significantly less than the 21 percent denial rate for metropolitan area tracts covered by this final rule.

B. Underlying Data and Identifying Underserved Areas

1. Introduction and Overview

Data on mortgage credit flows are far from perfect, and issues regarding the identification of areas with inadequate access to credit are both complex and controversial. For this reason, before considering housing needs and past GSE performance, it is essential to define ''underserved areas'' as accurately as possible from existing data. To provide essential background for understanding the final rule's definition of underserved areas for this goal, this section carefully reviews the literature investigating access to credit and reports findings from HUD's analysis of 1993 and 1994 HMDA and Census data bases. The first part of this section discusses research and data analysis in urban areas; the latter part discusses rural areas.

Three main points are made in this section:

- The existence of substantial geographic disparities in mortgage credit is well documented for metropolitan areas. Research has demonstrated that areas with lower incomes and higher shares of minority population consistently have poorer access to mortgage credit, with higher mortgage denial rates and lower origination rates for mortgages. Thus, the income and minority composition of an area is a good method of determining whether that area is being underserved by the mortgage market.
- The research supports a targeted definition. Studies conclude that characteristics of the applicant and the neighborhood where the property is located are the major determinants of mortgage denials and origination rates. Once these characteristics are accounted for, other influences such as location in an OMB-designated central city play only a minor role in explaining disparities in mortgage lending.[3]
- Research on mortgage credit needs in rural areas is not extensive because of the lack of mortgage data. The available research does suggest that income and minority composition identify rural areas that experience housing and mortgage access problems. The lack of mortgage data, however, suggests the use of a broader underserved definition than in metropolitan areas.

2. Evidence About Access to Credit in Urban Areas

The viability of neighborhoods—whether urban, rural, or suburban—depends on the access of their residents to mortgage capital to purchase and improve their homes. While neighborhood problems are caused by a wide range of factors, including substantial inequalities in the distribution of the nation's income and wealth, there is increasing agreement that imperfections in the nation's housing and mortgage markets are hastening the decline of distressed neighborhoods. Disparate denial of credit based on geographic criteria can lead to disinvestment and neighborhood decline. Discrimination and other factors, such as inflexible and restrictive underwriting guidelines, limit access to mortgage credit and leave potential borrowers in certain areas underserved.

a. Early Credit Flow Studies

Most studies of geographical disparities have used Home Mortgage Disclosure Act (HMDA) data. A number of studies using the early HMDA data sought to test for the existence of geographical redlining, which is the refusal of lenders to make loans in certain neighborhoods regardless of the creditworthiness of the individual applicant.[4] Consistent with the redlining hypothesis, these studies found lower volumes of loans going to low-income and high-minority neighborhoods.[5] However, such analyses were criticized because they did not distinguish between demand and supply effects[6]—that is, whether loan volume was low because people in high-minority and low-income areas were unable to afford home ownership and therefore were not applying for mortgage loans, *or* because lenders refused to make loans in these areas. Moreover, the early HMDA data were incomplete because non-depository lenders (e.g., mortgage bankers, who originate most FHA loans) were not included.

Like early HMDA studies, an analysis of deed transfer data in Boston found lower rates of mortgage activity in minority neighborhoods.[7] The discrepancies held even after controlling for income, house values and other economic and non-racial factors that might explain differences in demand and housing market activity.[8]

[3] For the sake of brevity, in the remainder of this appendix, the term ''central city'' is used to mean ''OMB-designated central city.''

[4] Prior to 1990, HMDA data showed only the total number and aggregate dollar volume of loans made in each census tract for depository institutions; no information was reported on individual borrowers or on applications denied.

[5] These studies, which were conducted at the census tract level, typically involved regressing the number of mortgage originations (relative to the number of properties in the census tract) on characteristics of the census tract including its minority composition. A negative coefficient estimate for the minority composition variable was often interpreted as suggesting redlining. For a discussion of these models, see Eugene Perle, Kathryn Lynch, and Jeffrey Horner, ''Model Specification and Local Mortgage Market Behavior,'' *Journal of Housing Research,* Volume 4, Issue 2, 1993, pp. 225–243.

[6] For critiques of the early HMDA studies, see Andrew Holmes and Paul Horvitz, ''Mortgage Redlining: Race, Risk, and Demand,'' *The Journal of Finance,* Volume 49, No. 1, March 1994, pp. 81–99; and Michael H. Schill and Susan M. Wachter, ''A Tale of Two Cities: Racial and Ethnic Geographic Disparities in Home Mortgage Lending in Boston and Philadelphia,'' *Journal of Housing Research,* Volume 4, Issue 2, 1993, pp. 245–276.

[7] Katherine L. Bradbury, Karl E. Case, and Constance R. Dunham, ''Geographic Patterns of Mortgage Lending in Boston, 1982–1987,'' *New England Economic Review,* September/October 1989, pp. 3–30.

[8] Using an analytical approach similar to that of Bradbury, Case, and Dunham, Anne Shlay found evidence of fewer mortgage loans originated in black census tracts in Chicago and Baltimore. See Anne Shlay, ''Not in That Neighborhood: The Effects of Population and Housing on the Distribution of Mortgage Finance within the Chicago SMSA,'' *Social Science Research,* Volume 17, No. 2, 1988, pp. 137–163; and ''Financing Community: Methods for Assessing Residential Credit Disparities, Market Barriers, and Institutional Reinvestment Performance in the Metropolis,'' *Journal of Urban Affairs,* Volume 11, No. 3, 1989, pp. 201–223.

In addition, a larger percentage of transactions in such neighborhoods were financed by the seller or other non-traditional institutional lenders (e.g., credit unions, governments, universities, business leaders, real estate trusts, and pension funds). Greater seller financing may suggest unmet demand for mortgages, since it is not likely that minority sellers prefer, more than whites, to finance the sale of their homes rather than being paid in cash.[9] The study concluded that ''the housing market and the credit market together are functioning in a way that has hurt African American neighborhoods in the city of Boston.''

b. Improved HMDA Data—Wider Coverage and Mortgage Denial Rates

HMDA reporting was expanded in 1990 to provide information on the disposition of loan applications (originated, approved but not accepted by the borrower, denied, withdrawn, or not completed), to include the activity of large independent mortgage companies, and to provide information on the race and income of individual loan applicants. An additional expansion in 1993 covered mortgage companies that originated 100 or more home purchase loans in the preceding calendar year. HUD's analysis using the expanded HMDA data for 1993 and 1994 shows that high-minority and low-income census tracts have both higher loan application denial rates and lower loan origination rates.[10]

Table B.1 presents mortgage denial and origination rates by the minority composition and median income of census tracts for metropolitan areas. Two patterns are clear:

- Census tracts with higher percentages of minority residents have higher mortgage denial rates and lower mortgage origination rates than all-white or substantially-white tracts. For example, the denial rate for census tracts that are over 90 percent minority is over two-and-a-half times that for census tracts with less than 10 percent minority.
- Census tracts with lower incomes have higher denial rates and lower origination rates than higher income tracts. The average number of 1993 mortgage originations in the highest-income census tracts (i.e., tracts with a median income over 150 percent of area median) was 20.0 per 100 owner-occupants; this compares with a range of 4.4 to 9.0 originations for the census tract deciles with income less than 90 percent of area median.[11]

Denial rates in 1993 increased from 10.7 to 29.3 percent as minority concentration changes from low-minority to 90-percent-minority tracts.[12] They declined from 24.2 to 7.8 percent as tract income increases from 60 percent of area median to over 150 percent of area median. Similar patterns arose in 1994.

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[9] Analysis of 1985 American Housing Survey data also showed a greater reliance on non-institutional financing by low- and moderate-income owners in both metropolitan and rural areas. See the Urban Institute, ''The Availability and Use of Mortgage Credit in Rural Areas,'' 1990.

[10] HUD's previous analysis of 1992 HMDA produced comparable results. For a similar analysis based on 1992 HMDA data, see Glenn B. Canner, Wayne Passmore, and Dolores S. Smith, ''Residential Lending to Low-Income and Minority Families: Evidence from the 1992 HMDA Data,'' *Federal Reserve Bulletin,* Volume 80, February 1994, pp. 79–108.

[11] Origination rates in 1994 are lower than origination rates in 1993 for all income and minority levels because of the lower number of refinance mortgages.

[12] The denial rates in Table B.1 are for purchase mortgages. Denial rates are several percentage points lower for refinance loans than for purchase loans, but denial rates follow the same pattern for both types of loans: rising with minority concentration and falling with increasing income.

Table B.1

Origination and Denial Rates for Conventional Mortgages

Minority Percentage	Originations Per 100 Owner-Occupied Units (Purchases and Refinances) 1993	Originations Per 100 Owner-Occupied Units (Purchases and Refinances) 1994	Denial Rates (Purchases) 1993	Denial Rates (Purchases) 1994
Less than 10%	14.6	8.2	10.7 %	10.9 %
10-20	13.7	8.0	13.2	13.7
20-30	11.9	7.3	16.2	16.7
30-40	11.1	6.8	18.4	18.5
40-50	10.1	6.5	20.1	20.2
50-60	9.4	6.4	22.0	21.1
60-70	9.2	6.3	22.7	21.6
70-80	8.5	6.3	23.2	22.1
80-90	7.0	5.6	25.3	23.9
90-100	4.1	3.9	29.3	27.3

Tract Income Relative to MSA Median	Originations Per 100 Owner-Occupied Units (Purchases and Refinances) 1993	Originations Per 100 Owner-Occupied Units (Purchases and Refinances) 1994	Denial Rates (Purchases) 1993	Denial Rates (Purchases) 1994
Less than 20%	5.9	1.4	30.6 %	28.7 %
20-30	6.3	4.2	25.8	28.4
30-40	4.4	3.9	28.2	27.9
40-50	4.7	4.4	28.0	26.8
50-60	5.1	4.4	25.8	26.0
60-70	6.2	5.0	24.2	23.8
70-80	7.3	5.5	21.6	21.4
80-90	9.0	6.2	18.7	19.3
90-100	10.7	6.8	15.9	16.3
100-110	12.7	7.6	13.3	13.6
110-120	14.9	8.5	11.3	11.3
120-150	18.1	9.6	9.4	9.3
150+	20.0	9.9	7.8	7.5

Source: HUD Analysis of 1993 and 1994 HMDA Data

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Table B.2 aggregates the data in Table B.1 into six minority and income combinations that exhibit very different credit flows. The low-minority (less than 30 percent minority), high-income (over 120 percent of area median) group has a denial rate of 8 percent and an origination rate of 19 per 100 owner occupants. The high-minority (over 50 percent), low-income (under 90 percent of area median) group has a denial rate of 27 percent and an origination rate of only 6 per 100 owner occupants. The other groupings fall between these two extremes.

The advantages of HUD's underserved area definition can be seen by examining the minority-income combinations highlighted in Table B.2. The sharp differences in denial rates and origination rates between the underserved and remaining served categories illustrate that HUD's definition delineates areas that have significantly less success in receiving mortgage credit. Underserved areas have almost twice the average denial rate of served areas (21 percent versus 11 percent) and half the average origination rate per 100 owner occupants (8 versus 16). HUD's definition does not include high-income (over 120 percent of area median) census tracts even if they meet the minority threshold. The mortgage origination rate per 100 owner occupants (15) for high-income tracts with a minority share of population over 30 percent is about the same as the average (16) for all served areas.

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Table B.2

Mortgage Denial and Origination Rates By Minority and Income Characteristics of the Census Tract

Denial Rates (Purchase Mortgages Only)				
	Minority Composition			
Tract Income	< 30%	30 - 50%	50 - 100%	Total
Less Than 90%	19.0%	22.1%	26.9%	21.3%
90 - 120%	12.8%	18.1%	21.6%	13.5%
120+	8.4%	15.1%	16.7%	8.9%
Total	11.8%	19.1%	24.4%	13.3%

Origination Rates per 100 owner occupants (Purchase and Refinance Mortgages)				
	Minority Composition			
Tract Income	< 30%	30 - 50%	50 - 100%	Total
Less Than 90%	8.3%	8.0%	5.7%	7.5%
90 - 120%	12.9%	11.3%	9.7%	12.6%
120+	19.1%	15.9%	13.8%	18.8%
Total	14.1%	10.7%	7.2%	13.1%

Source: HUD Analysis of 1993 HMDA Data

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c. Recent HMDA Studies—Controlling for Applicant Credit Risk

An important question is whether variations in denial rates reflect lender bias against certain kinds of neighborhoods and borrowers, or simply the credit quality of the potential borrower (as indicated by the applicant's available assets, credit rating, employment history, etc.). The technical improvements offered by recent studies of credit disparities have attempted to control for credit risk factors that might influence a lender's decision to approve a loan. Without fully accounting for the creditworthiness of the borrower, racial differences in denial rates cannot be attributed to lender bias. The best example of accounting for credit risk is the study by researchers at the Federal Reserve Bank of Boston, which analyzed mortgage denial rates.[13] To control for credit risk, the Boston Fed researchers included 38 borrower and loan variables indicated by lenders to be critical to loan decisions. The study found that minorities' higher denial rates could not be explained fully by income and credit risk factors. African Americans and Hispanics were about 60 percent more likely to be denied credit than Whites, even after controlling for credit risk characteristics such as credit history, employment stability, liquid assets, self-employment, age, and family status and composition. Although almost all highly-qualified applicants of all races were approved, differential treatment was observed among borrowers with lesser qualifications.[14]

A recent HUD study also found mortgage denial rates for minorities to be higher in ten metropolitan areas, even after controlling for credit risk.[15] In addition, the higher denial rates observed in minority neighborhoods were not purely a reflection of the higher denial rates experienced by minorities. Whites experienced higher denial rates in some minority neighborhoods than in some predominantly white neighborhoods.

A more recent reassessment and refinement of the data used by the Federal Reserve Bank of Boston has confirmed the findings of that study.[16] William C. Hunter of the Federal Reserve Bank of Chicago also found that race was a factor in denial rates of marginal applicants. While denial rates were comparable for borrowers of all races with ''good'' credit ratings, among those with ''bad'' credit ratings or high debt ratios, minorities were significantly more likely to be denied than similarly-situated whites. The study concludes that the racial differences in denial rates are due to a cultural gap between white loan officers and minority applicants, and conversely, a cultural affinity with white applicants.

The two Fed studies and the HUD study concluded that the effect of borrower race on mortgage rejections persists even after controlling for legitimate determinants of lenders' credit decisions. Thus, they give some legitimacy to denial rate comparisons such as those in Tables B.1 and B.2. However, the independent race effect identified in these studies is still difficult to interpret. In addition to lender bias, access to credit can be limited by loan characteristics that reduce profitability[17] and by underwriting standards that have disparate effects on minority and lower income borrowers and neighborhoods.[18]

d. Recent HMDA Studies—Controlling for Neighborhood Risk and Demand and Tests of the Redlining Hypothesis

Two recent statistical studies sought to test the redlining hypothesis by more completely controlling for differences in neighborhood risk and demand. These studies do not support claims of racially induced mortgage redlining—the explanatory power of neighborhood race is reduced to the extent that the effects of neighborhood risk and demand are accounted for. However, these studies cannot reach definitive conclusions about redlining because of the correlation of neighborhood race with other explanatory variables included in their models.

First, Andrew Holmes and Paul Horvitz used 1988–1991 HMDA data to examine the flow of conventional mortgage originations across census tracts in Houston.[19] Their regression model included as explanatory variables the economic viability of the loan and characteristics of residents of the tract (e.g., house value, income, age distribution and education level), measures of demand (e.g., recent movers and change in owner-occupied units between 1980 and 1990), and measures of credit risk (defaults on government-insured loans and change in tract house values between 1980 and 1990). To determine the existence of racial redlining, the model also included as explanatory variables the percentages of African American and Hispanic residents in the tract and the increase in the tract's minority percentage between 1980 and 1990. Most of the neighborhood risk and demand variables were significant determinants of the flow of conventional loans in Houston. The coefficients of the racial composition variables were insignificant which, led Holmes and Horvitz to conclude that allegations of redlining could not be supported, at least in the Houston market.

One of their more interesting findings, however, was that the racial composition variables became significant and negative, thus suggesting the existence of redlining, when they re-estimated their model twice, once without the credit risk variables and once without the demand variables. This finding is consistent with earlier credit flow studies that concluded that redlining exists. Holmes and Horvitz caution against relying on findings from these earlier studies because they did not adequately account for differences in neighborhood risk and demand. The authors conclude that ''a claim of racially based geographic discrimination in mortgage lending must be based on a consideration of race *after* taking

[13] Alicia H. Munnell, Lynn E. Browne, James McEneaney, and Geoffrey M. B. Tootell, ''Mortgage Lending in Boston: Interpreting HMDA Data,'' Federal Reserve Bank of Boston, Working Paper Series, No. 92–7, October 1992.

[14] This study was the subject of substantial criticism with regard to data quality and model specification, but even after accounting for these problems, the race conclusions were found to persist in a re-estimation of the model by Fannie Mae. See James H. Carr and Isaac F. Megbolugbe, ''The Federal Reserve Bank of Boston Study on Mortgage Lending Revisited,'' *Journal of Housing Research,* Volume 4, Issue 2, 1993, pp. 277–313. Other criticisms, however, have also been mentioned. For instance, the fact that the credit risk variables included in the model are correlated with the minority variable suggests that the latter may be picking up the effects of still other credit risk variables omitted from the model. See John Straka, ''Boston Federal Reserve Study of Mortgage Discrimination,'' *Secondary Mortgage Markets,* Volume 10, No. 1, Winter 1993, pp. 8–9, for a useful discussion of other aspects of the Boston Fed study.

[15] Ann B. Schnare and Stuart A. Gabriel, ''The Role of FHA in the Provision of Credit to Minorities,'' ICF Incorporated, prepared for the U.S. Department of Housing and Urban Development, April 25, 1994.

[16] William C. Hunter, ''The Cultural Affinity Hypothesis and Mortgage Lending Decisions,'' WP–95–8, Federal Reserve Bank of Chicago, 1995.

[17] Lenders are discouraged from making smaller loans in older neighborhoods. Since upfront loan fees are frequently determined as a percentage of the loan amount, such loans generate lower revenue and thus are less profitable to lenders.

[18] Standard underwriting practices may exclude lower income families that are, in fact, creditworthy. Such families tend to pay cash, leaving them without a credit history. In addition, the usual front-end and back-end ratios applied to applicants' housing expenditures and other on-going costs may be too stringent for lower income households, who typically pay higher shares of their income for housing than higher income households.

[19] Holmes and Horvitz also analyzed the flow of government-insured loans and obtained what are now standard results in the literature—compared with conventional loans, government-insured loans are more targeted to lower income and risky neighborhoods.

account of variables that are rationally connected with the economics of the mortgage lending process.'' [20]

In the second study, Michael Schill and Susan Wachter attempt to improve on earlier studies of redlining by examining whether mortgage denials are related to neighborhood racial composition.[21] Schill and Wachter argue that HMDA data on mortgage rejections, first released in 1990, allow researchers to address perhaps the major shortcoming of earlier credit flow studies—the inability to separate demand influences from supply influences. Analyzing information on whether lenders accept or reject individual loan applicants permits Schill and Wachter to study the determinants of the supply decision separately.[22]

In their empirical work, Schill and Wachter focused on loan acceptances rather than denials. Their model posits that the probability that a lender will accept a specific mortgage application depends on characteristics of the individual loan application [23] and characteristics of the neighborhood where the property collateralizing the loan is located. Because they rely on public data, Schill and Wachter did not have information on several loan and property risk variables, such as loan-to-value ratio, that are known to affect the mortgage decision. To compensate for the lack of these variables, the study includes neighborhood risk proxies that are likely to affect the future value of the properties.[24] Finally, to test for the existence of racially-induced lending patterns across census tracts, Schill and Wachter included the percentage of persons in the census tract that were African American and Hispanic.

The authors tested their model for conventional mortgages in Philadelphia and Boston. They first estimated their model including as explanatory variables only the individual loan and racial composition variables. The applicant race variables—whether the applicant was African American or Hispanic—showed significant negative effects on the probability that a loan would be accepted. Schill and Wachter stated that this finding does not provide evidence of individual race discrimination because applicant race is most likely serving as a proxy for credit risk variables omitted from their model (e.g., credit history, wealth and liquid assets). In this first analysis, the percentage of the census tract that was African American also showed a significant and negative coefficient, a result that is consistent with redlining. However, when the neighborhood risk proxies were included in the model along with the individual loan variables, the percentage of the census tract that was African American becomes insignificant. Thus, similar to Holmes and Horvitz, Schill and Wachter stated that ''once the set of independent variables is expanded to include measures that act as proxies for neighborhood risk, the results do not reveal a pattern of redlining.'' [25]

In their conclusion, however, Schill and Wachter stated that while their results did not support the hypothesis of redlining, they could not say definitively that neighborhood race is unrelated to lenders' decisions to accept or reject loan applications. One reason for their hesitancy is that many of their individual loan variables (as well as their neighborhood risk variables) are correlated with the racial composition of the census tract. For instance, the applicant's race variable (i.e., whether the applicant is African American or Hispanic) remained highly significant and negative in all their estimations. Because of the high degree of racial segregation that exists in urban areas, the applicant race variable was positively correlated with the census tract race variable. It may be that the applicant race variable was picking up effects that should properly be attributed to the census tract race variable.[26] If this were the case, Schill and Wachter's conclusions about the existence of racially induced redlining would necessarily change.

e. Geographic Dimensions of Underserved Areas—Targeted versus Broad Approaches

An important issue for the GSE regulations is whether geographic areas under this goal should be broadly or narrowly defined. Is central city location an adequate proxy for lack of access to mortgage credit? What is gained by more targeted neighborhood-based definitions? This section reports findings from three studies that address these questions. All three support defining underserved areas in terms of the minority and/or income characteristics of census tracts, rather than in terms of a broad definition such as all areas of all central cities.

HUD's Analysis. Tables B.1 and B.2 documented the relatively high denial rates and low mortgage origination rates in underserved areas as defined by HUD. This section extends that analysis by comparing underserved and served areas within central cities and suburbs. Figure B.1 shows that HUD's definition targets central city neighborhoods that are experiencing problems obtaining mortgage credit. The 22 percent denial rate in these neighborhoods is twice the 11 percent denial rate in the remaining areas of central cities. Similarly, the average mortgage origination rate (per 100 owner occupants) in HUD-defined underserved areas of central cities is 7, much lower than the average of 15 for the remaining areas of central cities.

A broad, inclusive definition of ''central city'' that includes all areas of all OMB-designated central cities would include the ''remaining'' portions of these cities. Figure B.1 shows that these

[20] Holmes and Horvitz, page 97 (emphasis added). The authors recognize that many of the risk and demand variables in their model are rather highly correlated with the racial composition variables also included in their model. Thus, one could argue that their risk and demand variables are serving, to a certain extent, as proxies for race, which would mean that their results suggest a high degree of redlining in the Houston market. Holmes and Horvitz dismiss this argument by stating that several of their non-racial variables are reasonable proxies for other prudent lending variables such as wealth and job stability for which they did not have direct data.

[21] Schill and Wachter. Although their methodology and findings are similar to those of studies discussed in the next section, it is informative to review Schill and Wachter's study in detail because it illustrates issues that must be dealt with before definitive conclusions can be reached about redlining.

[22] Perle also agrees that micro-based models of mortgage denial rates are more appropriate for studying redlining than macro-based credit flow models that fail to separate demand and supply effects.

[23] Individual loan characteristics include loan size (economies of scale cause lenders to prefer large loans to small loans) and all individual borrower variables included in the HMDA data (the applicant's income, sex, and race).

[24] Their neighborhood risk proxies include median income and house value (inverse indicators of risk), percent of households receiving welfare, median age of houses, homeownership rate (an inverse indicator), vacancy rate, and the rent-to-value ratio (an inverse indicator). A high rent-to-value ratio suggests lower expectations of capital gains on properties in the neighborhood.

[25] Schill and Wachter, page 271. Munnell, *et al.* reached similar conclusions in their study of Boston. They found that the race of the individual mattered, but that once individual characteristics were controlled, racial composition of the neighborhood was insignificant.

[26] In their study of individual loan denial rates, Avery, Beeson, and Sniderman obtain significant and positive coefficients for the individual applicant's race. Unlike Schill and Wachter, they found that denial rates were higher in low-income tracts even after controlling for the effects of the applicant's race and income. Although denial rates were not higher overall for purchase and refinance loans in minority tracts after controlling for the race of the applicant, denial rates were higher in minority tracts for white applicants. In other words, minorities have higher denial rates wherever they attempt to borrow, but whites face higher denials when they attempt to borrow in areas dominated by minorities. In addition, denial rates were higher in minority areas for home-improvement loans. See Robert B. Avery, Patricia E. Beeson, and Mark S. Sniderman, ''Underserved Mortgage Markets: Evidence from HMDA Data,'' Working Paper Series 94–16, Federal Reserve Bank of Cleveland, October 18, 1994.

areas, which account for approximately 42 percent of the population in OMB-designated central cities, appear to be well served by the mortgage market. They are not experiencing problems obtaining access to mortgage credit.[27]

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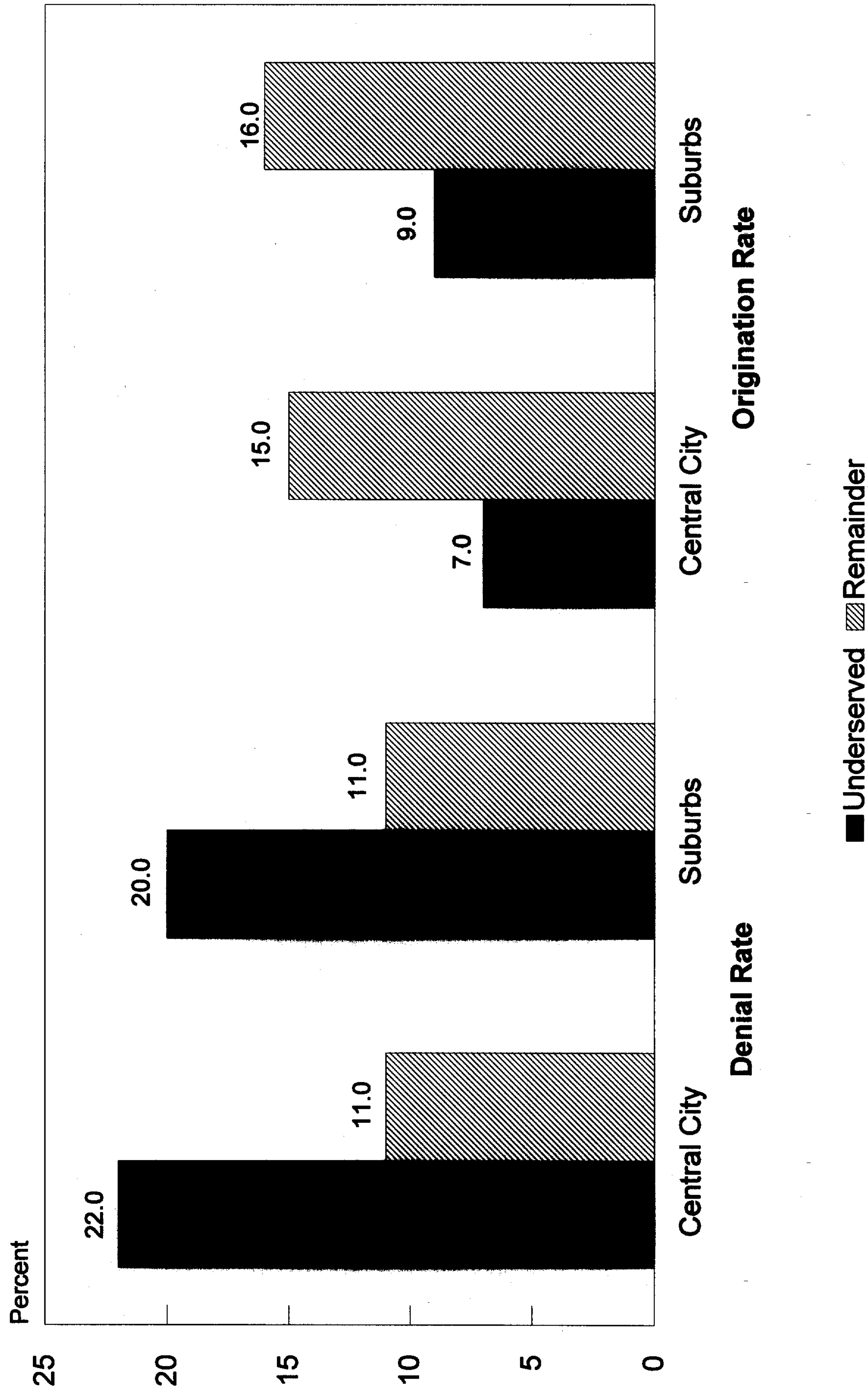
[27] The Preamble to this rule provides additional reasons why central city location should not be used as a proxy for underserved areas.

FIGURE B.1

1993 Denial And Origination Rates
Underserved Areas And Remainder
By Central Cities And Suburbs



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HUD's definition also targets in the suburbs as well as in central cities—for example, the average denial rate in underserved suburban areas is almost twice that in the remaining served areas of the suburbs. Low-income and high-minority suburban tracts appear to have credit problems similar to their central city counterparts. These suburban tracts, which account for 31 percent of the suburban population, are encompassed by the definition of other underserved areas. Thus, the advantage of HUD's targeted definition of underserved areas is illustrated by sharp differences in measures of mortgage access between served and underserved areas within both central cities and suburbs.

William Shear, James Berkovec, Ann Dougherty, and Frank Nothaft, economists at Freddie Mac, recently completed an analysis of mortgage flows and application acceptance rates in 32 metropolitan areas that also supported a targeted definition of underserved areas.[28] These researchers regressed the number of mortgage originations per 100 properties in the census tract on several independent variables that are intended to account for some, but admittedly not all, of the demand and supply (i.e., credit risk) influences at the census tract level. Examples of the demand and supply variables at the census tract level include: tract income relative to the area median income, the increase in house values between 1980 and 1990, the percentage of units boarded up, and the age distributions of households and housing units. The tract's minority composition and central city location were included to test if these characteristics are associated with underserved neighborhoods after controlling for the demand and supply variables. Several of their findings relate to the issue of defining underserved areas:

- Census tracts with high concentrations of African American and Hispanic families have lower rates of applications, originations, and acceptance rates. For instance, the regression estimates suggest that all-White census tracts would have an average 10.5 originations per 100 properties, while all-African American and all-Hispanic census tracts would have about 7 originations per 100 properties.
- Tract income influences mortgage flows—tracts at 80 percent of median income are estimated to have 8.6 originations per 100 owners as compared with 10.8 originations for tracts over 120 percent of median income.
- Once census tract influences are accounted for, central city location has only a minimal effect on credit flows.

Shear, Berkovec, Dougherty, and Nothaft recognized that it is difficult to interpret their estimated minority effects—the effects may indicate lender discrimination, supply and demand effects not included in their model but correlated with minority status, or some combination of these factors. They explain the implications of their results for measuring underserved areas as follows:

> * * * While it is not at all clear how we might rigorously define, let alone measure, what it means to be underserved, it is clear that there are important housing-related problems associated with certain location characteristics, and it is possible that, in the second or third best world in which we live, mortgage markets might be useful in helping to solve some of these problems. We then might use these data to help single out important areas or at least eliminate some bad choices. * * * The regression results indicate that income and minority status are better indicators of areas with special needs than central city location.[29]

HUD Analysis. HUD used 1993 HMDA data to update the analysis of Shear *et al.* HUD focused on denial and origination rates for conforming conventional applications and included all metropolitan areas in the analysis.[30] HUD's analysis also supports a targeted underserved definition. Lower-income census tracts and census tracts with concentrations of African American and Hispanic families have lower origination rates and higher denial rates. For example, the regression estimates suggest that all-White census tracts would have an average 13.7 percent denial rate and 13.4 originations per 100 properties, while census tracts that are 50 percent African American (Hispanic) would have an average 22.3 (19.7) percent denial rate and 9.8 (12.0) originations per 100 properties. Furthermore, the regression analysis indicates central-city location has a minimal effect on denial and origination rates, after controlling for census tract effects.[31]

Robert Avery, Patricia Beeson, and Mark Sniderman of the Federal Reserve Bank of Cleveland recently presented a paper specifically addressing the issue of underserved areas in the context of the GSE legislation.[32] Their study examines variations in application rates and denial rates for all individuals and census tracts included in the 1990 and 1991 HMDA data base. They seek to isolate the differences that stem from the characteristics of the neighborhood itself rather than the characteristics of the individuals that apply for loans in the neighborhood or lenders that happen to serve them. Similar to the two studies of redlining reviewed in the previous section, Avery, Beeson and Sniderman hypothesize that variations in mortgage application and denial rates will be a function of several risk variables such as the income of the applicant and changes in neighborhood house values; they test for independent racial effects by adding to their model the applicant's race and the racial composition of the census tract. Econometrics are used to separate individual applicant effects from neighborhood effects.

Based on their empirical work, Avery, Beeson and Sniderman reach the following conclusions:

- The individual applicant's race exerts a strong influence on mortgage application and denial rates. African American applicants, in particular, have unexplainably high denial rates.
- Once individual applicant and other neighborhood characteristics are controlled for, overall denial rates for purchase and refinance loans were only slightly higher in minority census tracts than non-minority census tracts.[33] For white applicants, on the other hand, denial rates were significantly higher in minority tracts.[34] That is, minorities

[28] William Shear, James Berkovec, Ann Dougherty, and Frank Nothaft, ''Unmet Housing Needs: The Role of Mortgage Markets,'' presented at mid-year meeting of the American Real Estate and Urban Economics Association, June 1, 1994. See also Susan Wharton Gates, ''Defining the Underserved,'' *Secondary Mortgage Markets,* 1994 Mortgage Market Review Issue, pp. 34–48.

[29] Shear *et al.,* p. 18.

[30] Including FHA applications in the analysis—as in Shear *et al.*—does not significantly change the results reported in this section.

[31] Central city location had no significant effect on origination rates. For denial rates, the difference between the average central city denial rate and the average suburban denial rate was .56 percent.

[32] See Avery, *et al.*

[33] Avery *et al.* find very large unadjusted differences in denial rates between white and minority neighborhoods, and although the gap is greatly reduced by controlling for applicant characteristics (such as race and income) and other census tract characteristics (such as house price and income level), a significant difference between white and minority tracts remains (for purchase loans, the denial rate difference falls from an unadjusted level of 16.7 percent to 4.4 percent after controlling for applicant and other census tract characteristics, and for refinance loans, the denial rate difference falls from 21.3 percent to 6.4 percent). However, when between-MSA differences are removed, the gap drops to 1.5 percent and 1.6 percent for purchase and refinance loans, respectively. See Avery, *et al.,* p. 16.

[34] Avery, *et al.,* page 19, note that, other things equal, a black applicant for a home purchase loan is 3.7 percent more likely to have his/her application denied in an all-minority tract than in an all-white tract, while a white applicant from an all-minority tract would be 11.5 percent more likely to be denied.

have higher denial rates wherever they attempt to borrow but whites face higher denials when they attempt to borrow in minority neighborhoods. In addition, Avery *et al.* found that home improvement loans had significantly higher denial rates in minority neighborhoods. Given the very strong effect of the individual applicant's race on denial rates, Avery *et al.* note that since minorities tend to live in segregated communities, a policy of targeting minority neighborhoods may be warranted.

- The median income of the census tract had strong effects on both application and denial rates of purchase and refinance loans, even after other variables were accounted for.
- There is little difference in overall denial rates between central cities and suburbs, once individual applicant and census tract characteristics are controlled for.

Avery, Beeson and Sniderman conclude that a tract-level definition would be a more effective way to define underserved areas in the GSE regulation than using the list of OMB-designated central cities as a proxy.

The next section will also document that there are equally widespread and pervasive differences in socioeconomic conditions across neighborhoods.

f. Conclusions From HUD's Analysis and the Economics Literature About Urban Underserved Areas

The implications of studies by HUD and others for defining underserved areas can be summarized briefly. First, the existence of large geographic disparities in mortgage credit is well documented. HUD's analysis of 1993 and 1994 HMDA data shows that low-income and high minority neighborhoods receive substantially less credit than other neighborhoods and, by most reasonable criteria, fit the definition of being underserved by the nation's credit markets.

Second, researchers are testing models that more fully account for the various risk, demand, and supply factors that determine the flow of credit to urban neighborhoods. The studies by Holmes and Horvitz and Schill and Wachter are good examples of this recent research. Their attempts to test the redlining hypothesis show the analytical insights that can be gained by more rigorous modeling of this issue. However, as those two studies show, the fact that our urban areas are highly segregated means that the various loan, applicant, and neighborhood characteristics currently being used to explain credit flows are often highly correlated with each other which makes it difficult to reach definitive conclusions about the relative importance of any single variable such as neighborhood racial composition. Thus, the need continues for further research on the underlying determinants of geographic disparities in mortgage lending.[35]

Finally, much research strongly supports a targeted definition of underserved areas. Studies by Shear, *et al.* and Avery, Beeson, and Sniderman conclude that characteristics of both the applicant and the neighborhood where the property is located are the major determinants of mortgage denials and origination rates—once these characteristics are controlled for, other influences such as central city location play only a minor role in explaining disparities in mortgage lending. HUD's analysis shows that both credit and socioeconomic problems are highly concentrated in underserved areas within central cities and suburbs. The remaining, high-income portions of central cities and suburbs appear to be well served by the mortgage market.

HUD recognizes that the mortgage origination and denial rates forming the basis for the research mentioned in the preceding paragraph, as well as for HUD's definition of underserved areas, are the result of the interaction of individual risk, demand and supply factors that analysts have yet to disentangle and interpret. The need continues for further research addressing this problem. HUD believes, however, that the economics literature is consistent with a targeted rather than a broad approach for defining underserved areas.

3. Alternative Underserved Area Definitions for Urban Areas[36]

This section compares the final rule's underserved definition to the alternative definitions advanced by Freddie Mac and Fannie Mae. Other comments were essentially variations on the two distinct approaches suggested by the GSEs. Therefore, rather than analyzing all variants, this section analyzes the two major alternative definitions—using all central cities and all rural areas, or expanding on the proposed rule's tract-based approach. The tracts added by these two alternative definitions have lower denial rates and higher origination rates than the tracts covered by the final rule. A study by the Urban Institute, summarized below, criticized both alternative definitions for being too broad in coverage.

a. The Fannie Mae Definition

Fannie Mae urged that HUD use the following definition for the geographically targeted goal: All central cities as defined by OMB, all non-metropolitan areas, *and all other* metropolitan census tracts that are more than 50 percent minority *or* that have an income less than 80 percent of area median income. The alternative definition proposed by Fannie Mae includes central city tracts that are substantially better off and have fewer problems accessing credit than underserved tracts covered by the final rule's definition. In suburban areas, the Fannie Mae definition excludes suburban tracts that appear to have mortgage access problems.

Table B.3 reports mortgage denial and origination rates and socioeconomic characteristics of served and underserved census tracts under the Fannie Mae definition. Credit access does not appear to be a problem in the added tracts—mortgage denial rates are one-half of mortgage denial rates in central city tracts covered by HUD's underserved definition. Moreover, the added central city census tracts appear substantially better off than the central-city census tracts covered by HUD's definition. The 7 percent poverty rate for the central city tracts added by Fannie Mae's underserved definition is only about one-third the 22 poverty rate for tracts included in central cities under the final rule.

The suburban tracts excluded from Fannie Mae's definition do not appear as distressed as other suburban underserved tracts covered by the final rule. For example, the 10 percent poverty rate in the excluded tracts is lower than the 14 percent poverty rate in all HUD suburban underserved tracts. But these tracts do appear to have problems accessing mortgage credit as evidenced by their high denial rates. The denial rate in the excluded tracts is 18 percent compared to the 20 percent denial rate in all underserved suburban tracts covered by the final rule.

[35] Methodological and econometric challenges that researchers will have to deal with are discussed in Mitchell Rachlis and Anthony Yezer, ''Serious Flaws in Statistical Tests for Discrimination in Mortgage Markets,'' *Journal of Housing Research,* Volume 4, 1993, pp. 315–336.

[36] The analysis in this section relies on 1993 HMDA data.

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Table B.3

Characteristics of HUD's and Fannie Mae's Underserved Areas In Metropolitan Areas

	Denial Rate	Tract Income/ MSA Income	Relative Median House Value*	Minority Percentage	Poverty Rate
Central City					
HUD (Base)	21.5%	69.7	71.7	51.6%	21.9%
Additional Fannie Mae Tracts	10.8%	130.2	128.2	13.4%	7.1%
Suburbs					
HUD (Base)	20.4%	80.8	78.5	34.4%	14.0%
Tracts Excluded from Fannie Mae Definition	18.4%	88.8	86.3	18.8%	10.1%
Metropolitan Areas					
HUD (Base)	21.0%	70.9	72.3	46.9%	20.0%
Fannie Mae Definition	15.5%	89.2	89.7	39.0%	16.6%

* Median house value in tract relative to median house value in metropolitan area.

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b. The Freddie Mac Definition

A tract is underserved, according to Freddie Mac, if minorities comprise 20 percent or more of the residents *or* the median income of families does not exceed 100 percent of area median income. Freddie Mac's definition includes areas covered by the Geographically Targeted Goal as well as 5,367 additional tracts where median family income is between 90 and 100 percent of area median income or minorities comprise 20–30 percent of tract population.

Table B.4 reports characteristics of the census tracts added by Freddie Mac's underserved area definition. Mortgage credit access does not appear to be a major problem in these added tracts. Their 15 percent mortgage denial rate is only slightly above average and much lower than the 21 percent denial rate for tracts included in the Geographically Targeted Goal. Mortgage origination patterns in these tracts show a similar disparity.

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Table B.4

Characteristics of HUD's and Freddie Mac's Underserved Areas In Metropolitan Areas

	Denial Rate	Tract Income/ MSA Income	Relative Median House Value*	Minority Percentage	Poverty Rate
Central City					
HUD (Base)	21.5%	66.3	69.0	54.4%	23.6%
Added Freddie Mac Tracts	14.5%	98.1	96.2	14.6%	9.5%
Suburbs					
HUD (Base)	20.4%	80.0	78.5	34.4%	14.0%
Added Freddie Mac Tracts	15.3%	97.0	95.4	10.7%	7.7%
Metropolitan Areas					
HUD (Base)	21.0%	70.9	72.3	46.9%	20.0%
Added Freddie Mac Tracts	15.0%	97.4	95.7	12.1%	8.3%

* Median house value in tract relative to median house value in metropolitan area.

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c. The Urban Institute Study.

HUD commissioned the Urban Institute to evaluate the Department's effort to define underserved metropolitan areas. The Urban Institute analysis examined how HUD's, Fannie Mae's, and Freddie Mac's underserved definitions are related to a measure of credit flow problems. An underserved definition can be judged on how accurately it predicts the ''credit flow measure.'' In its analysis, the Urban Institute used mortgage denial rates as the credit flow measure.

The Urban Institute tested each of the definitions using a denial rate threshold of 22 percent.[37] The proposed rule's definitions correctly predict the credit flow measure for 71 percent of the tracts, while the Freddie Mac definition correctly predicts only 63 percent of the tracts, and the Fannie Mae definition only 58 percent of the tracts. Moreover, the HUD definition is not sensitive to changes in the threshold that defines credit flow problems. The Urban Institute also concluded that the final rule's definition is superior to the Freddie Mac and Fannie Mae definitions when the tract denial rate threshold is reduced to 17 percent.

4. Identifying Underserved Locations in Rural Areas [38]

This section discusses the final rule's definition of rural underserved areas, reviews the existing literature on rural housing needs and rural mortgage credit problems, and summarizes discussions held with rural lenders, rural housing developers, public interest groups, and the GSEs at forums on rural lending sponsored by HUD.[39] In addition, this section explains why defining underservedness in rural areas is more difficult than in metropolitan areas.

a. Basic Characteristics of Rural Areas

Identifying underserved rural areas is more difficult than identifying underserved metropolitan areas. In part, this difficulty results from the use of multiple definitions of ''rural'' by researchers, policy makers, and Federal agencies. The Census Bureau defines rural as communities with fewer than 2,500 residents. The Department of Agriculture's Rural Housing and Community Development Service (formerly the Farmers Home Administration) uses several definitions of rural, each specific to one of its housing programs. Maps outlining the areas covered by the various RHCDS programs are available only at local agriculture field offices.[40]

For the purposes of the final rule, HUD defines rural to be any area that lies outside of metropolitan boundaries established by OMB. The OMB nonmetropolitan definition is easily understood by lenders and the GSEs. Approximately 21 percent of the United States population lives in nonmetropolitan areas, with 75 percent of the nonmetropolitan population concentrated in the South and Midwest.

Proportionately more poor people and fewer minorities live in nonmetropolitan areas than in metropolitan areas. The poverty rate in nonmetropolitan areas is 17 percent, compared to 12 percent in metropolitan areas; minorities make up 15 percent of the population in nonmetropolitan areas compared to 27 percent in metropolitan areas. The South and West nonmetropolitan regions have the highest poverty rates and minority percentages. The South, for example, has a 21 percent poverty rate and a 23 percent minority concentration. Poverty rates are highest in remote counties that are not adjacent to a metropolitan area and have less than 2,500 in urban areas. These remote counties account for 12 percent of nonmetropolitan population.

b. Data Issues and Previous Research

Defining rural underserved areas requires a different approach than in metropolitan areas because of the lack of mortgage flow data, differences in housing needs between urban and rural areas, and the difficulty of implementing mortgage programs at the census tract level in rural areas. Evaluating which rural areas are underserved in terms of access to mortgage credit cannot be done with HMDA data, the source used for most studies of credit needs, because HMDA does not provide geographic identifiers on mortgage activity outside of metropolitan statistical areas.[41]

There are few conclusive studies on access to mortgage credit in rural areas because of the lack of adequate data.[42] The studies that do exist only suggest broad conclusions about credit flows in rural areas. Recognizing this lack of research on credit flows in rural areas, the Department consulted with researchers from academia, the Department of Agriculture, the Census Bureau, the Housing Assistance Council, and the Congressional Budget Office. The Department also conducted a series of forums to solicit information on rural mortgage markets from lenders, rural housing groups, and the GSEs. The following section summarizes the existing research on rural credit flows and describes further analysis conducted by HUD.

The Urban Institute Study (''The Availability and Use of Mortgage Credit in Rural Areas'' 1990) concludes that while little data on mortgage credit in rural areas is available, evidence suggests that there is no rural credit shortage that would warrant changes in federal mortgage credit policy. Symptoms of credit shortage identified by the Urban Institute include low homeownership rates, limited borrowing to finance home purchase, adverse credit terms for qualified borrowers, and larger portions of income spent on housing. Because these symptoms do not exist in the majority of rural areas, the Urban Institute concluded that most rural areas suffering from inactive local mortgage markets have weak economies in which demand for home mortgages is low.

The Urban Institute's indicators of a credit shortage and their focus on fixed-rate conventional mortgages could have led to the wrong conclusions about mortgage credit availability in rural areas. Higher homeownership rates in rural areas, for example, are not necessarily indicative of the lack of a credit shortage. Although nonmetropolitan households are more likely to own their homes than metropolitan households—the homeownership rate is 73 and 62 percent, respectively, in nonmetropolitan and metropolitan areas—the higher homeownership rate likely reflects the lack of rental

[37] The unweighted average of denial rates across metropolitan census tracts is 17 percent. The weighted average, which takes into account the number of applications in a tract, is 13 percent.

[38] In this Appendix definition, ''rural'' is used synonymously with ''nonmetropolitan,'' which differs from the terminology employed by the Census Bureau.

[39] Records of these forums are part of the public docket for this rule, and are available for public inspection at the HUD Headquarters Building, Room 10276.

[40] For example, the Rural Housing and Community Development Service (RHCDS) defines rural for its Rural Guaranteed Housing Program as any community with less than 10,000 people in a metropolitan area and less than 20,000 outside an MSA.

[41] Lenders are not required to report under HMDA the location of those mortgage applications for properties outside MSA boundaries. Moreover, a large portion of the data compiled by banking regulators does not distinguish between mortgage activity of rural branches of large regional banks and mortgage activity of the bank's metropolitan headquarters.

[42] Studies include: ''Analysis of Underserved Rural Areas,'' Housing Assistance Council, 1995; ''Effect of Federal Home Loan Bank System District Banks on the Housing Finance System in Rural Areas,'' ICF Incorporated, 1993; ''The Availability and Use of Mortgage Credit in Rural Areas,'' The Urban Institute, 1990; and ''Location, Location, Location: Report on Residential Mortgage Credit Availability in Rural Areas,'' The Center for Community Change, 1990.

opportunities and the high percentage of mobile homes in rural areas. Mobile homes account for 15 percent of owner-occupied units in nonmetropolitan areas, compared with only 6 percent in metropolitan areas. Mobile homes are starter homes for many rural households because of their affordability and the availability of dealer financing. The homeownership rate, exclusive of mobile homes, is approximately equal in metropolitan and nonmetropolitan areas indicating that nonmetropolitan households who buy mobile homes are the counterparts of metropolitan households who live in rental housing.

Furthermore, it is not surprising that studies that focus on fixed-rate home purchase mortgages lead to the conclusion that credit terms in rural areas do not differ significantly from credit terms in urban areas.[43] Properties that meet the underwriting criteria for fixed-rate mortgages are similar to urban properties that meet these criteria. Many rural properties, however, do not satisfy the criteria designed for mortgages underwritten in urban areas.

The Center for Community Change Study (''Location, Location, Location'', 1990) suggests that financing of housing in rural areas is made difficult by underwriting standards designed for urban areas: ''Interviews with bankers and realtors indicate that federal mortgage assistance programs and secondary market underwriting criteria continue to be geared to an urban market with a fire hydrant on every block and hard surface roads throughout.'' Moreover, the Center for Community Change reports that in many remote areas and areas with high concentrations of minorities and low-income households, a number of barriers prevent borrowers from accessing mortgage credit. These barriers include lower lender participation in federal mortgage assistance programs, lack of financial expertise among rural lenders, lack of private mortgage insurance, and a decreasing number of lending institutions located in rural communities as a result of the savings and loan crisis of the 1980s.

Housing Assistance Council Study. The connection between high-minority, low-income populations and poor access to mortgage credit was examined in a 1995 study conducted by the Housing Assistance Council (HAC) for HUD. HAC focused on the impact of alternative combinations of HUD's proxies of underserved areas—minority concentration and median income. The HAC study reiterated the difficulty of establishing an underserved areas definition that balances the priority of targeting those areas with the most severe credit problems with the priority of including enough areas so that the GSEs could build an infrastructure to facilitate and stimulate mortgage lending in rural areas. HAC suggested that the income criteria be high enough to include persistent poverty areas with low minority concentrations.

USDA's Economic Research Service. ''Rural Conditions and Trends'', a periodic research publication, shows that urban proximity is important: Economic conditions and housing problems tend to be worse in counties most remote from metropolitan areas or smaller cities.[44] In particular, counties with ''persistent low-income,'' which are disproportionately more rural and remote, have had little recent economic activity, stagnation in real family income during the 1980s, and continue to have the highest incidence of housing lacking complete plumbing. These high poverty counties are concentrated in Appalachia and in areas with high proportions of minority residents.

The ICF Study. Prepared for the Federal Housing Finance Board, this 1993 study examines the effect of the Federal Home Loan Bank System (FHLBS) District Banks on the housing financing system in rural areas. The study concluded that nonmetropolitan commercial banks and savings and loans are more likely than their metropolitan counterparts to hold loans in portfolio than to participate in the secondary market. Banks and savings and loans are the largest holders of fixed-rate mortgages in nonmetropolitan communities. In metropolitan areas, however, conventional mortgages are more often held or securitized by GSEs. Membership in the FHLBS is beneficial to commercial banks, savings and loans, and thrifts because the Bank System can provide them with capital, in the form of advances secured by the portfolio loans, to originate additional mortgage loans.[45] The importance of the FHLBS to rural lenders suggests that increased access to the secondary market would also be important for rural lenders.

RFS Analysis. HUD's analysis of the Residential Finance Survey shows that 17 percent of all mortgages originated between 1989 and 1991 were in nonmetropolitan areas. This percentage is consistent with the overall percentage of owner-occupied units in nonmetropolitan areas, especially after taking into account the lower mobility of nonmetropolitan residents and the fact that more households use cash and other non-bank sources to finance home purchases.[46]

Nonmetropolitan households are less likely to hold FHA mortgages than their metropolitan counterparts. According to RFS data, FHA's share of mortgages originated in nonmetropolitan areas is approximately half its share of mortgages in metropolitan areas. In part, the lower FHA share is attributable to the presence of the Rural Housing and Community Development Service (formerly the Farmers Home Administration) in nonmetropolitan areas. According to RFS data, the RHCDS 502 Direct Loan Program accounted for 5 percent of rural home purchase mortgages between 1989 and 1991.[47] The funds for this program, however, have been dwindling from $1.8 billion dollars in 1994 to $900 million in 1995. In 1991, the RHCDS created the 502 Guaranteed Rural Housing Loan Program, which guarantees losses up to 90 percent of the loan amount on 100-percent loan-to-value loans. The borrower's income cannot exceed 115% of county median income to qualify for these loans. Having to hold a 30-year fixed-rate mortgage in portfolio and being subject to recourse on the loan prevents many lenders from participating in the program.

According to the RFS, conventional mortgages held by financial institutions differ in metropolitan and nonmetropolitan areas. First, fewer nonmetropolitan mortgages are privately insured—16 percent of mortgages in nonmetropolitan areas are insured compared to 22 percent of mortgages in metropolitan areas.[48] Second,

[43] The ICF study also concludes that credit terms do not differ significantly between metropolitan and nonmetropolitan mortgages but their focus is only on fixed-rate and adjustable rate conventional mortgages.

[44] *Rural Conditions and Trends*, Volume 4, No. 3, Fall 1993, a special 1990 census issue, documents differences among counties in population, education, employment, income, poverty, and housing.

[45] ICF Incorporated, ''Effect of Federal Home Loan Bank System District Banks on the Housing Finance System in Rural Areas,'' p.30.

[46] Using 1989 AHS data, ICF reports that the mobility rate of nonmetropolitan owners is 18 percent lower than the mobility rate of metropolitan owners. Data from the Residential Finance Survey show that 10 percent of metropolitan households and 18 percent of nonmetropolitan households use cash to acquire their homes.

[47] This Program offers 100-percent loan-to-value (including closing costs) fixed-rate mortgages for 30 years at subsidized interest rates; it is targeted to rural households at 80 percent of area median income or less. To make Program funds go further, the RHCDS created the Rural Direct Leveraging Program where the lender and the RHCDS each make a 50-percent loan-to-value loan.

[48] According to the Center for Community Change study, the higher percentage of uninsured conventional mortgages could imply that

Continued

nonmetropolitan households rely more on short-term loans with balloon payments than their metropolitan counterparts.[49] Finally, the mortgage term for conventional fixed-rate mortgages is shorter for nonmetropolitan households.[50]

Rural Forums. In addition to examining available research, HUD convened three forums on rural housing issues with rural lenders, rural housing groups, housing industry organizations, the Department of Agriculture's Economic Research Service and Rural Housing and Community Development Service, the Congressional Budget Office, and the GSEs, which focused on the unique nature of mortgage lending and the role of the secondary market in rural areas. Participants agreed that some of the difficulty associated with financing housing in rural areas results from inappropriate underwriting and appraisal standards, inadequate resources, and the lack of access to government programs and secondary mortgage funds.

Participants emphasized that mortgage lending in rural areas is very different from lending in urban areas. The heterogeneity of housing types, nontraditional and often seasonal incomes of rural borrowers, and lack of credit history for many rural borrowers make underwriting in rural areas difficult for urban-oriented lenders. Appraisers may lack comparable sales or must rely on comparables over one year old or in a nearby town in order to determine a property's value.

Participation of rural lenders in the secondary market is limited. The low volume of loans originated by rural lenders serving smaller nonmetropolitan communities makes this business less profitable, and thus less attractive, to the secondary marketing firms.[51] Rural lenders are more likely to make short-term loans, 3-to-5 year balloons or adjustable rate mortgages, and hold them in portfolio. Many rural lenders do not participate in federal housing programs because they do not want to deal with the ''red tape'' of government or they are unaware of how the programs work and do not have the resources necessary to train staff. Moreover, some small rural banks may not be equipped to do the kind of labor-intensive loans that are required to qualify low-income borrowers.

Larger financial institutions, which do have experience with government programs and the secondary market, target more urbanized nonmetropolitan communities because of the higher demand for loans and lower costs of business. These lenders concentrate on loans with larger loan amounts and lower servicing costs, focus less on remote areas, and originate loans that are more easily sold to the secondary market.

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nonmetropolitan residents make higher down payments than metro residents because private market insurance is unavailable.

[49] In nonmetropolitan areas with fewer than 10,000 people, for example, 63 percent of conventional mortgages are fixed-rate, 16 percent are short-term with balloon payments, and 21 percent are adjustable rate mortgages. In nonmetropolitan areas with more than 10,000 people, 68 percent of conventional mortgages are fixed rate, 11 percent are short-term with balloon payments, and 20 percent are adjustable rate. In metro areas, however, 75 percent are fixed-rate, 5 percent are short-term balloons, and 19 percent are adjustable rate.

[50] In metro areas, 72 percent of fixed-rate mortgages have mortgage terms greater than 20 years, compared with only 33 percent in nonmetropolitan communities with less than 10,000 population and 59 percent in nonmetropolitan communities with more than 10,000 population. A similar story can be told for adjustable rate mortgages although the differential in percentages between metro and nonmetropolitan is not as pronounced. In particular, nonmetropolitan areas with more than 10,000 people have similar terms as metro areas. Nonmetropolitan areas with fewer than 10,000 people have shorter mortgage terms than other in nonmetropolitan and metropolitan areas.

[51] Twenty-nine percent of commercial banks (including the branches of banks headquartered elsewhere) are community banks. Fifty percent of these banks are in towns with 2,500 or fewer residents. The average community bank has only $50 million in assets.

Efforts have been made to overcome housing finance difficulties in rural areas. For example, the Farm Credit System, Farmer Mac, and Fannie Mae recently created a conduit to provide affordable loans to residents of rural communities with populations under 2,500.[52] The underwriting provisions of the program accommodate the unique features of rural housing, such as large lot sizes and few comparable sales for appraisal. In 1994, Fannie Mae established new, more flexible, underwriting guidelines for rural areas. These changes in the industry could contribute to increased secondary market activity and account for the increase in the proportion of Fannie Mae's business in rural areas. In 1994, Fannie Mae's purchases in rural areas increased to 9.3 percent of its total business, compared to 8.3 percent in 1993. Rural areas accounted for about 12.5 percent of Freddie Mac's business in both 1993 and 1994.

c. HUD's Definition of Underserved Counties

The Secretary has determined that in nonmetropolitan areas ''underserved areas'' are defined as counties where: minorities comprise 30 percent or more of the residents and the median income of families does not exceed 120 percent of the state nonmetropolitan median income; *or* the median income of families does not exceed 95 percent of the greater of the state nonmetropolitan median income or the nationwide nonmetropolitan median income. Comparing county median income to state nonmetropolitan median income ensures that poor counties in high-income states are included as underserved rural areas and comparing county median income to national nonmetropolitan median income ensures that poor counties in poor states are included as underserved rural areas.

Table B.5 compares the final rule's definition with Freddie Mac's and Fannie Mae's definitions of rural underserved areas as well as with a 90/30 definition that is analogous to HUD's metropolitan underserved areas definition.[53] HUD, however, chose the broader 95/30 definition for rural areas because the 90/30 definition did not include a significant number of persistent poverty counties.[54]

The final rule's definition of rural underserved areas balances the competing priorities of a targeted definition that provides greater mortgage opportunities to counties experiencing the worst problems and of a broad definition that encourages the GSEs to provide a secondary market infrastructure that encourages mortgage lending in all nonmetropolitan areas. The final rule's definition covers 54 percent of the nonmetropolitan population, 67 percent of poor persons, and 75 percent of the minority population.[55] The counties included have poverty rates (21 percent) and minority percentages (21 percent) well above the average poverty rate (17 percent) and minority percentage (15 percent) for all nonmetropolitan areas. Thus, HUD's definition encompasses 66 percent of all nonmetropolitan counties, including the most distressed nonmetropolitan counties.

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[52] Conduits provide assistance to smaller lenders so that they have access to secondary market funds. Moreover, conduits can provide guarantees and recourse to secondary market investors that low volume lenders cannot provide.

[53] Freddie Mac's definition includes counties as underserved if county median income does not exceed state nonmetropolitan median income or minority composition exceeds 20 percent. Fannie Mae's underserved definition includes all nonmetropolitan counties.

[54] A county experiences persistent poverty if its poverty rate is at least 20 percent over the last 3 decades.

[55] The 54 percent coverage rate in nonmetropolitan areas is similar to the 58 percent coverage rate in central cities.

Table B.5

Nonmetropolitan Counties

	All Nonmetropolitan Areas	Coverage Rates In Underserved Rural Counties			
		90/30	95/30 Absolute	Freddie Mac	Fannie Mae
Counties	2,305	42.7 %	**66.0 %**	75.0 %	100 %
Population	50,860,983	33.3	**54.0**	66.0	100
Poor	8,421,751	45.3	**67.0**	76.0	100
Minority Population	7,495,007	63.5	**75.0**	83.0	100
Substandard Housing Units	915,866	51.3	**69.0**	78.0	100
Mobile Homes	2,033,730	39.7	**62.0**	73.0	100

	All Nonmetropolitan Areas	Rates In Underserved Rural Counties			
				Added by	
		90/30	95/30 Absolute (Base)	Freddie Mac	Fannie Mae
Poverty Rate	17.0 %	23.3 %	**21.0 %**	14.0 %	12.0 %
Minority Percentage	15.0	28.1	**21.0**	9.0	8.0
Substandard Housing	5.0	7.7	**6.0**	4.0	3.0
Mobile Homes	15.0	18.1	**17.0**	14.0	12.0

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Counties not included under the final rule's definition but included by the broader Freddie Mac or Fannie Mae definitions have relatively low poverty rates and low minority percentages. The Freddie Mac definition includes an additional 221 counties and approximately 6 million additional people. These additional counties have a 14 percent poverty rate and minorities comprise 9 percent of the population. The Fannie Mae definition includes an additional 794 counties and approximately 23 million people. These additional counties have a 12 percent poverty rate and minorities comprise 8 percent of the population.

The HUD definition also targets specific geographic areas with high poverty and minority concentrations. For example, 71 percent of the nonmetropolitan population in the South is covered by HUD's definition. Similarly, HUD's definition includes 84 percent of the population that reside in remote counties that are not adjacent to metropolitan areas and have fewer than 2,500 residents in towns.

d. Tract Versus County Definition

A number of commenters, including the GSEs, argued that a definition based on rural census tracts was ill-advised because lenders in rural areas do not understand or lend on the basis of census tracts. Fannie Mae commented that use of census tract data was inappropriate because census tracts have ''no practical meaning'' in rural areas from a marketing standpoint; that geographic measurements used in the rule should be ''widely understood, easily measured, and practical from a marketing point of view;'' and that census tracts in rural areas ''fail these tests.''

In contrast, some commenters, such as HAC, noted that a county-based definition is not as targeted as a tract definition since it excludes tracts which could be considered underserved in served counties and includes tracts which could be considered adequately served in underserved counties.

The final rule uses the county designation, as opposed to a census tract-based definition. Counties are easy to identify and geocode, which will simplify the reporting process for the GSEs and for the lenders who provide the GSEs with loan level data. County boundaries are commonly recognized by housing industry representatives involved in the loan and marketing process, including lenders and appraisers.

Under this county-based definition, the GSEs may have an incentive to buy mortgages in the parts of underserved counties that have higher incomes. Although 21 percent of the homeowners that live in underserved rural areas reside in served tracts, these tracts accounted for 39 percent of GSE purchases. Even though HUD recognizes that a census tract definition better targets underserved areas, HUD decided to use a county-based definition because the operational difficulties associated with census tract and Block Numbering Area (BNA) boundaries outweigh the benefits of improved targeting of underserved areas.

C. Consideration of the Housing, Economic, and Demographic Factors

As Section B shows, the most thorough studies available provide strong evidence that in metropolitan areas low income and minority composition identify neighborhoods that are underserved by the mortgage market. As this section discusses, geographical differentials in housing, social, and economic problems and past discrimination against minorities confirm that problems are greater throughout the nation in the areas covered by the Geographically Targeted Goal. Section C.1. briefly describes housing, social, and economic problems of distressed neighborhoods. Section C.2. discusses discrimination and other housing problems faced by minorities. Although few studies have yet analyzed the specific geographic areas targeted by the final rule, the segregation of minorities within the nation's inner cities and poorer rural counties makes this information pertinent to analysis of underserved areas and to the goal set by the Secretary.

1. Urban and Rural Housing Needs and the Housing Needs of Underserved Areas

Over the past three decades evidence of growing poverty concentrations has increased concern about poor living conditions in the nation's distressed neighborhoods. John Kasarda has focused on trends in the neighborhood concentration of poverty and measures of the ''underclass'' population such as school dropouts, unemployed and underemployed adult males, single-parent families, and families dependent upon welfare.[56] Kasarda has not only documented the extreme deprivation that exists in minority and low-income neighborhoods throughout our major urban areas, but he has also shown that neighborhood distress and concentrations of lower-income residents in tracts with high poverty worsened during the 1980s.

Analysis within 44 major metropolitan areas showed that in the late 1980s renters were most likely to have worst case needs in the poorest neighborhoods.[57] Although only one-tenth of households lived in neighborhoods with poverty rates above 20 percent, those poorest neighborhoods housed almost one-fourth of worst case renters. These poorest zones closely resemble tracts identified as poor ghettos or underclass areas. They contained older, smaller units that were more often physically inadequate and crowded than other housing in the metropolitan areas studied.[58] Additional discussion of housing needs is contained in Appendix A.

2. Economic, Housing, and Demographic Conditions

Appendix A includes detailed discussion of economic, housing, and demographic conditions. That discussion was considered in establishing the Geographically Targeted Goal. This section discusses other conditions.

a. Discrimination in the Housing Market

In addition to discrimination in the lending market, substantial evidence exists of discrimination in the housing market. The 1989 Housing Discrimination Study sponsored by HUD found that minority home buyers encounter some form of discrimination about half the time when they visit a rental or sales agent to ask about advertised housing.[59] The incidence of discrimination was higher for African Americans than for Hispanics and for homebuyers than for renters. For renters, the incidence of discrimination was 46 percent for Hispanics and 53 percent for African Americans. The incidence among buyers was 56 percent for Hispanics and 59 percent for African Americans.

While discrimination is rarely overt, minorities are more often told the unit of interest is unavailable, shown fewer properties, offered less attractive terms, offered less financing assistance, or provided less information than similarly situated non-minority homeseekers.

[56] ''Inner-City Concentrated Poverty and Neighborhood Distress: 1970 to 1990.'' *Housing Policy Debate,* 4(3): 253–302.

[57] U.S. Dept. of Housing and Urban Development, 1992. *The Location of Worst Case Needs in the Late 1980s: A Report to Congress.* HUD–1387–PDR.

[58] Kathryn P. Nelson, 1993. ''Intra-urban Mobility and Location Choice in the 1980s,'' pp. 53–95 in Thomas Kingsley and Margery Turner, eds., *Housing Markets and Residential Mobility,* Washington, DC: The Urban Institute Press.

[59] Margery A. Turner, Raymond J. Struyk, and John Yinger. *Housing Discrimination Study: Synthesis,* Washington, D.C., U.S. Department of Housing and Urban Development: 1991.

Some evidence indicates that properties in minority and racially-diverse neighborhoods are marketed differently from those in White neighborhoods. Houses for sale in non-White neighborhoods are rarely advertised in metropolitan newspapers, open houses are rarely held, and listing real estate agents are less often associated with a multiple listing service.[60]

b. Housing Problems of Minorities and their Neighborhoods

Because they face discrimination in access to housing or lending, minorities and their neighborhoods face severe housing problems:

- Discrimination in the housing and lending markets is evidenced by racial disparities in homeownership. In 1991, the homeownership rate was 68 percent for Whites, 43 percent for African Americans, and 39 percent for Hispanics. Although differences in income, wealth, and family structure explain much of the differences, racial disparities persist after accounting for these factors.[61]
- Discrimination, while not the only cause, contributes to the pervasive level of segregation that persists between African Americans and Whites in our urban areas.
- Hispanics are the group most likely to have worst case needs for housing assistance, but least likely to receive assistance; in 1991, only 21 percent of very low-income Hispanics lived in public or assisted housing. The 1989 to 1991 increase in worst case needs was the largest for Hispanic households, rising from 39.2 to 44.4 percent of very low-income Hispanic renters.

Homeownership rates vary consistently by neighborhood characteristics. As Table B.6 shows, on average homeownership rates decrease as the minority concentration in census tracts increases, and as income falls relative to the area median. These patterns are consistent with the demographic patterns described earlier, that minorities and low-income households have lower homeownership rates. An exception to this pattern occurs in tracts with incomes below 50 percent of the area median, in which homeownership rates rise with minority concentration in some cases. However, only a very small proportion of households live in these tracts.

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[60] Margery A. Turner, ''Discrimination in Urban Housing Markets: Lessons from Fair Housing Audits,'' *Housing Policy Debate*, Vol. 3, Issue 2, 1992, pp. 185–215.

[61] Susan M. Wachter and Isaac F. Megbolugbe, ''Racial and Ethnic Disparities in Homeownership,'' *Housing Policy Debate*, Vol. 3, Issue 2, 1992, pp. 333–370.

Table B.6

Homeownership Rates for Metropolitan Census Tracts

Tract Median Income as a Percentage of Area Median Income	Percentage of Minority Households in Census Tracts										
	LT 10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-90%	90-100%	Total
30% or Less	27%	23%	34%	34%	37%	33%	35%	37%	33%	35%	35%
30-40%	35%	26%	38%	40%	39%	38%	40%	38%	40%	43%	41%
40-50%	45%	44%	43%	44%	44%	44%	43%	45%	45%	48%	46%
50-60%	63%	49%	51%	47%	48%	51%	52%	50%	53%	54%	52%
60-90%	74%	66%	63%	62%	60%	62%	63%	64%	63%	65%	67%
90-100%	80%	74%	72%	70%	69%	71%	70%	71%	74%	79%	77%
100-120%	84%	78%	76%	75%	73%	77%	78%	77%	79%	75%	81%
Greater than 120%	88%	83%	81%	82%	81%	80%	84%	84%	82%	78%	86%
Total	83%	76%	71%	68%	65%	65%	64%	63%	60%	56%	75%

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3. Previous Performance and Effort of the GSEs In Connection With the Central Cities, Rural Areas and Other Underserved Areas Goal

Table B.7 summarizes GSE acquisitions in underserved areas during 1993 and 1994. Fannie Mae's performance in underserved metropolitan areas increased from 23 percent in 1993 to 29 percent in 1994, and Freddie Mac's performance increased from 21 percent to 24 percent. Table B.7 also shows the level of the GSEs' purchases in rural underserved areas. Slightly more than 25 percent of their 1994 purchases in rural areas were in underserved areas.

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Table B.7

Fannie Mae and Freddie Mac Acquisitions of Single-Family and Multifamily Units in Underserved Metro and Nonmetro Areas in 1993 and 1994

	Fannie Mae		Freddie Mac	
	1993	1994	1993	1994
Metropolitan				
Number Of Units	642,843	502,270	429,313	275,276
Percent of Total Metro	22.6%	29.2%	20.9%	23.9%
Total Eligible	2,839,471	1,721,417	2,049,807	1,153,010
Nonmetropolitan				
Number Of Units	76,547	47,945	69,110	42,718
Percent of Total Metro	24.8%	26.9%	23.6%	26.3%
Total Eligible	308,088	177,965	292,802	162,462
Overall				
Number Of Units	719,390	550,215	498,423	317,994
Percent of Total Metro	22.9%	29.0%	21.3%	24.2%
Total Eligible	3,147,559	1,899,382	2,342,609	1,315,472

Source: HUD\ Policy Development and Research

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4. Size of the Conventional Conforming Mortgage Market for Underserved Areas

HUD estimates that underserved areas account for 25–28 percent of the conventional conforming mortgage market. The analysis underlying this estimate is detailed in Appendix D.

5. Ability to Lead the Industry

This factor is the same as the fifth factor considered under the goal for mortgage purchases on housing for low- and moderate-income families. Accordingly, see Section C.5 of Appendix A for discussion of this factor.

6. Need to Maintain the Sound Financial Condition of the Enterprises

HUD has undertaken a separate, detailed economic analysis of this rule, which includes consideration of the financial safety and soundness implications of the housing goals. The analysis considered the likely mortgage default implications of the goals and implications for the profitability of the GSEs under various alternative economic assumptions. Among the conclusions are: that the goals will have, at most, only limited impacts on credit risk, which the GSEs should be able to handle without significant lowering of underwriting standards; that risks associated with increased multifamily mortgage purchase volumes under the goals are manageable, considering the scope of the increases implied by the goals; and that the goals imply no meaningful increase in risk to the sound financial condition of the GSEs' operations. Based on this analysis, HUD concludes that the goals raise minimal, if any, safety and soundness concerns.

D. Determination of the 1995 and 1996 Central Cities, Rural Areas, and Other Underserved Areas Goal

This section summarizes the Secretary's rationale for choosing targeted definitions of central cities, rural areas, and other underserved areas, compares the characteristics of served and underserved areas, and addresses other issues related to determining the goal. The section draws heavily from earlier sections which have reported findings from HUD's analyses of mortgage credit needs as well as findings from other research studies investigating access to mortgage credit.

1. Market Failure

The nation's housing finance market is a highly efficient system where most homebuyers can put down relatively small amounts of cash and obtain long-term funding at relatively small spreads above the lender's borrowing costs. Indeed, the growth of the secondary mortgage market during the 1980s integrated a previously thrift-dominated mortgage market with the nation's capital markets so that mortgage funds are more readily available and mortgage costs are more closely tied to movements in Treasury interest rates.

Unfortunately, this highly efficient financing system does not work everywhere or for everyone. Access to credit often depends on improper evaluation of characteristics of the mortgage applicant and the neighborhood in which the applicant wishes to buy. HUD's analysis of 1993 and 1994 HMDA data shows that mortgage credit flows are substantially lower in minority and low-income neighborhoods and mortgage denial rates are much higher for minority applicants.

Admittedly, disagreement exists in the economics literature regarding the underlying causes of these disparities in access to mortgage credit, particularly as related to the roles of discrimination, ''redlining'' of specific neighborhoods, and the barriers posed by underwriting guidelines to potential minority and low-income borrowers. Because the mortgage system is quite complex and involves numerous participants, it will take more data and research to gain a fuller understanding of why these disparities exist. Still, studies reviewed in Section B of this Appendix found that the individual's race and the racial and income composition of neighborhoods influence mortgage access even after accounting for demand and risk factors that may influence borrowers' decisions to apply for loans and lenders' decisions to make those loans. Therefore, the Secretary concludes that minority and low-income communities are underserved by the mortgage system.

2. Identifying Urban Underserved Areas

To identify areas underserved by the mortgage market, HUD focused on two traditional measures used in a number of HMDA studies: [62] application denial rates and mortgage origination rates per 100 owner-occupied units. [63] Tables B.1 and B.2 in Section B presented detailed data on denial and origination rates by the racial composition and median income of census tracts for metropolitan areas.[64] Aggregating those data is useful for examining denial and origination rates for broader groupings of census tracts:

[62] HMDA data have been expanded in 1993 to cover independent mortgage companies that originated 100 or more home purchase loans in the preceding calendar year. HMDA provides no useful information on rural areas. In addition, although HMDA data now include applications to provide some measure of overall loan demand, pre-screening discrimination can discourage would-be homebuyers from applying for a mortgage, leading to an underestimation of demand. Nevertheless, the HMDA data, while not necessarily definitive, are still useful in helping to define underserved areas.

[63] Analysis of application rates are not reported here. Although application rates are sometimes used as a measure of mortgage demand, they provide no additional information beyond that provided by looking at both denial and origination rates. The patterns observed for application rates are still very similar to those observed for origination rates.

[64] As shown in Table B.1, no sharp breaks occur in the denial and origination rates across the minority and income deciles—mostly, the increments are somewhat similar as one moves across the various deciles that account for the major portions of mortgage activity.

Minority composition (percent)	Denial rate (percent)	Origination rate	Tract income (percent)	Denial rate (percent)	Origination rate
0–30	11.8	14.1	Less than 90	21.3	7.5
30–50	19.1	10.7	90—120	13.5	12.6
50–100	24.4	7.2	Greater than 120	8.9	18.8

Two points stand out from these data. First, census tracts with higher percentages of minority residents have higher denial and lower origination rates. Tracts that are over 50 percent minority have twice the denial rate and half the origination rate of tracts that are under 30 percent minority.[65] Second, census tracts with lower incomes have higher denial rates and lower origination rates than higher income tracts. Tracts with income less than or equal to 90 percent of area median have more than two times the denial rate and less than one-half the origination rate of tracts with income over 120 percent of area median.

HUD chose over 30-percent minority and under 90-percent of area median income as the thresholds for defining metropolitan underserved areas. There are two advantages to HUD's definition. First, the cutoffs produce sharp differentials in denial and origination rates between served and underserved areas. For instance, the overall denial rate (21 percent) in underserved areas is almost double that (11 percent) in served areas. Thus, an advantage of a targeted definition of underserved areas is illustrated by sharp differences in mortgage access between served and underserved areas.[66]

A second advantage is that the minority and income cutoffs are useful for defining mortgage problems in the suburbs as well as in OMB-defined central cities. Underserved areas account for 31 percent of the suburban population, compared with 58 percent of the central city population. The average denial rate in underserved suburban areas is almost twice that in the remaining areas of the suburbs. (See Figure B.1 in Section B.) Thus, the minority and income thresholds in HUD's definition identify those suburban tracts that seem to be experiencing mortgage credit problems.

3. Characteristics of Urban Underserved Areas

The final rule's definition of metropolitan underserved areas includes 20,326 of the 43,232 census tracts in metropolitan areas, covering 44 percent of the metropolitan population, 58 percent of the OMB-defined central city population, and 31 percent of the suburban population. As shown in Table B.8, the final rule's definition covers most of the population of the nation's most distressed OMB-defined central cities: Newark (99 percent), Detroit (96 percent), Hartford (97 percent), Baltimore (90 percent), and Cleveland (90 percent). The nation's five largest cities also contain large concentrations of underserved areas: New York (62 percent), Los Angeles (69 percent), Chicago (77 percent), Houston (67 percent), and Philadelphia (80 percent).

High-Income-Minority Tracts. It should be noted that the final rule's definition of underserved areas excludes high minority tracts with median income above 120 percent of area median income. As shown in Table B.9, these tracts, which represent about two percent of metropolitan area population, appear to be relatively well off: they have low levels of poverty (7 percent), and high relative house values (122 percent). The high-income-minority tracts are concentrated in a few metropolitan areas: 7 percent of Los Angeles' population lives in them; the corresponding figures are 7 percent for New York, 5 percent for Miami, 25 percent for Honolulu, and 12 percent for San Antonio. By contrast, most relatively distressed metropolitan areas have few households in such areas—for example, Cleveland (1 percent), Detroit (2 percent), Memphis (1 percent), Milwaukee (0 percent), and Philadelphia (1 percent).

Income Threshold. Among other issues considered in setting the underserved definition for metropolitan areas included raising the area income threshold, to include more moderate-income census tracts. This alternative would add tracts with incomes between 90 and 100 percent of the area median. However, it should be noted that high-minority tracts (over 30 percent minority) at this income level are already included in HUD's underserved areas definition, and that raising the income limit to 100 percent would add only tracts with low-minority concentration (below 30 percent). These areas represent 4,486 census tracts, and comprise 11 percent of metropolitan population.[67]

These low-minority moderate-income tracts have denial rates almost 30 percent below the tracts that meet HUD's underserved definition (15 versus 21 percent). By contrast, high-minority moderate-income tracts have a denial rate almost identical to the overall underserved denial rate. The origination rate in moderate-income low-minority tracts (11 per 100 owner occupants) is noticeably higher than that in underserved tracts (8 per 100 owner occupants).

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[65] The differentials in denial rates are due, in part, to differing risk characteristics of the prospective borrowers in different areas. However, use of denial rates is supported by the findings in the Boston Fed study which found that denial rate differentials persist, even after controlling for risk of the borrower. See Section B for a review of that study.

[66] The Final Rule changed the income threshold from 80 percent to 90 percent. This added 3,645 tracts with a denial rate of 18 percent.

[67] In addition to including tracts with income between 90 and 100 percent of area median as underserved, the Freddie Mac definition includes tracts between 20 and 30 percent minority concentration; this would add an additional 881 tracts. Table B.4 compares the HUD and Freddie Mac definitions.

Table B.8

Needy Areas in Central Cities Would Be Covered

Large Cities with High Concentrations of Tracts Included in the Geographically Targeted Goal (Percent of Population)			
Newark			99%
Hartford			97%
Gary			96%
Detroit			96%
Jersey City			92%
Miami			91%
Baltimore			90%
Cleveland			90%
St. Louis			85%
Five Largest Cities			
New York			62%
Los Angeles			69%
Chicago			77%
Houston			67%
Philadelphia			80%
Central Cities with Small Concentrations			
Large Cities		**Small Cities**	
Raleigh	33%	Appleton, WI	6%
Tulsa	38%	Cedar Falls, IA	8%
Nashville-Davidson	41%	Scottsdale, AZ	11%
Oklahoma City	42%	Naples, FL	13%
Wichita	43%	Orem, UT	14%
Colorado Springs	44%	Wheeling, WV	20%
Columbus	46%	Salem. OR	19%
Phoenix	51%	Elkhart, IN	20%

Table B.9

Characteristics of High Income Minority Tracts (HIMTS) and Moderate Income Tracts

	Served Tracts			
	HIMTS	90- 100% of Area Median Income	Remaining Served Tracts	Underserved Tracts
Unemployment Rate	4.9 %	5.1 %	3.9 %	8.9 %
Denial Rate	15.7	15.1	9.7	21.0
Tract/MSA Income	145.2	95.2	133.2	70.9
Relative Median House Value*	122.2	93.4	136.0	72.3
Poverty Rate	7.0	8.4	5.1	20.0
African American	16.2	3.8	2.9	23.9
Hispanic	21.8	3.5	3.4	17.9
Asian	12.7	1.5	2.4	4.3

Note: High-income minority tracts (HIMTS) are census tracts with income greater than 120 percent of area median and minority percentage greater than 30 percent. Moderate-income tracts are census tracts with income between 90 and 100 percent of area median and minority percentage less than 30 percent. Tracts with zero population, zero owner-occupied units, or suppressed income are not included.

* Median house value in tract relative to median house value in metropolitan area.

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4. Rural Underserved Areas

Recognizing both the difficulty of defining rural underserved areas and the need to encourage GSE activity in such areas, HUD has chosen a rather broad, county-based definition of underservedness in rural areas. Its definition includes 1,511 of the 2,305 counties in nonmetropolitan areas and covers 54 percent of the nonmetropolitan population. Still, HUD's definition targets the most disadvantaged rural counties. It covers 67 percent of the nonmetropolitan poor and 75 percent of nonmetropolitan minorities. The average poverty rate of underserved counties is 21 percent, significantly greater than the 12 percent poverty rate in counties designated as ''served''.

The HUD definition also targets specific geographic areas with high poverty and minority concentrations. For example, HUD's definition includes 84 percent of the population that reside in remote counties that are not adjacent to metropolitan areas and have fewer than 2,500 residents in towns.

5. GSE Activity in Underserved Areas

Figure B.2 uses 1993 and 1994 HMDA data for single-family mortgages to compare GSE and non-GSE funding in underserved areas. The non-GSE part of the conventional conforming market consists mainly of bank and thrift portfolio lenders. The share of funding going to underserved areas increased between 1993 and 1994 for both GSEs and non-GSEs. A larger proportion of non-GSE mortgages finance properties in underserved areas than do mortgages purchased by the GSEs. This was particularly the case for Freddie Mac in 1994—22 percent of Freddie Mac's single-family business was in underserved areas, compared with 27 percent of non-GSE business.[68]

In terms of overall business, 29 percent of Fannie Mae's 1994 business was in underserved areas as was 24 percent of Freddie Mac's. The fact that underserved areas have much lower incomes than other areas does not mean that GSE purchase activity in underserved areas derives totally from lower income families. In 1993, above-median income households accounted for 48 percent of the mortgages that the GSEs purchased in underserved areas and in 1994, they accounted for 37 percent. This suggests these areas are quite diverse.

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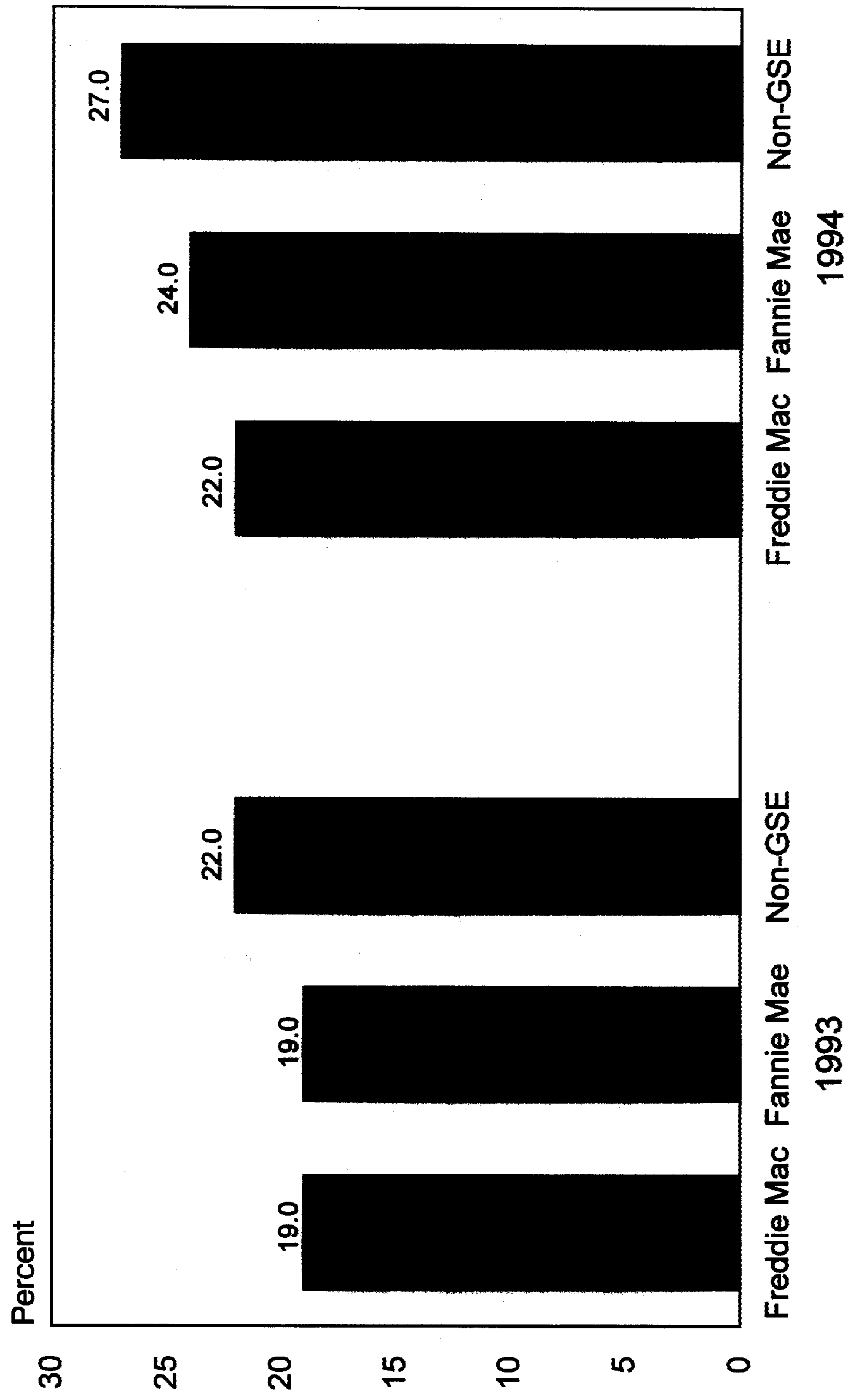
[68] The HMDA data has been adjusted for 100,000 mobile homes along the lines discussed in Appendix D.

FIGURE B.2

The Share Of GSE And Non-GSE Mortgages in Areas Included in the Geographically Targeted Goal, 1993 and 1994



Source: 1993 and 1994 HMDA Data

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6. Market Feasibility and Changing Market Conditions

As detailed in Appendix D, the market for mortgages in underserved areas accounts for 25 to 28 percent of dwelling units financed by conventional conforming mortgages. Figure B.3 compares recent GSE performance, the 1996 and 1997–1999 goals, and the size of the market. Having considered the projected market and economic and demographic conditions for 1996–1999 and the GSEs' recent performance, HUD has determined that goals for mortgage purchases in central cities, rural areas, and other underserved areas 21 percent for 1996, 24 percent for 1997–1999, and 24 percent thereafter pending establishment of a new goal, are feasible.

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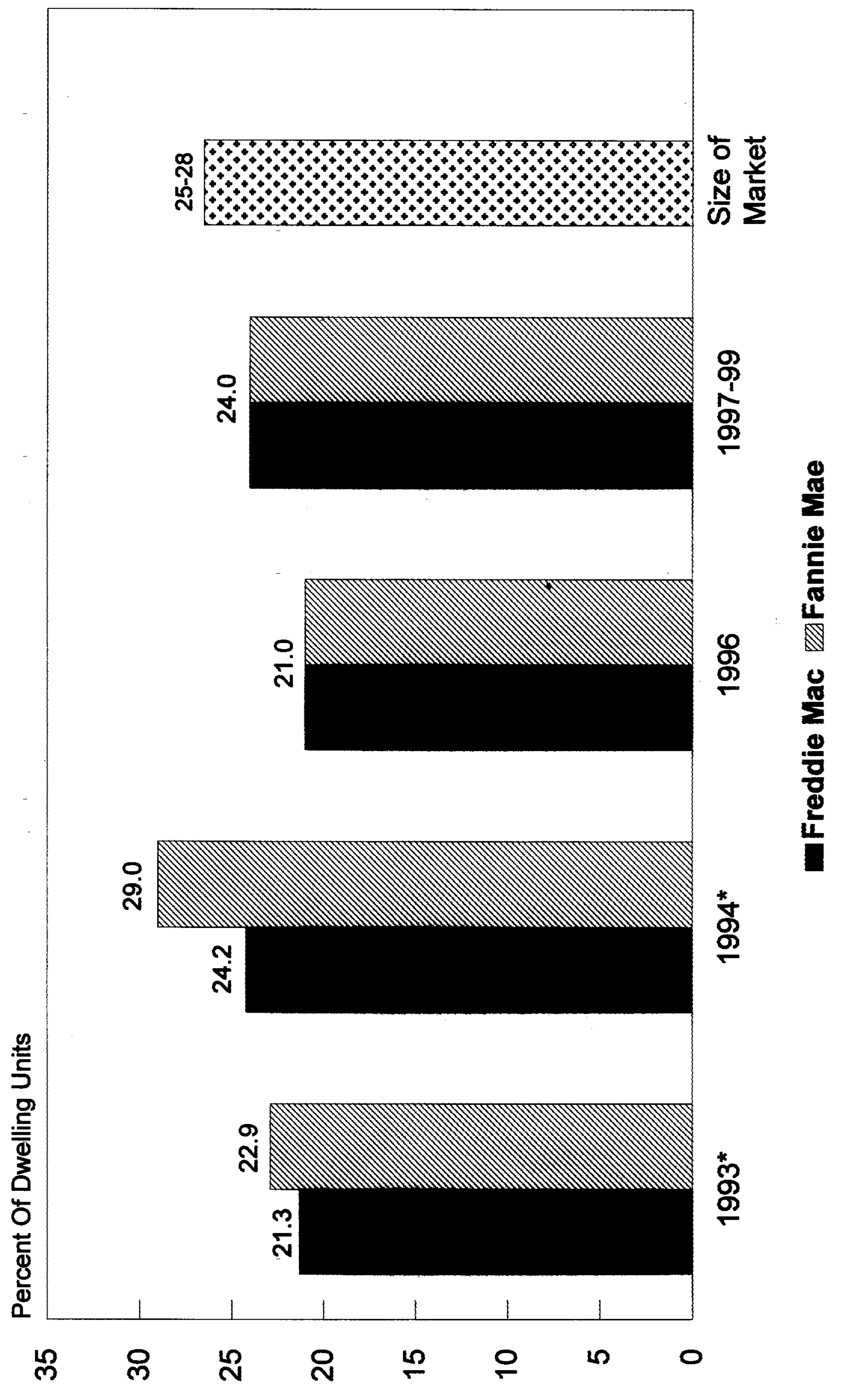
FIGURE B.3

Previous Performance and Goals in Central Cities, Rural Areas, and Other Underserved Areas For Freddie Mac And Fannie Mae, 1993-99



* Performances based on assumptions in final rule.

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7. Conclusion

The Secretary has determined that the goals of 21 percent in 1996 and 24 percent in 1997 and thereafter are necessary and feasible.

Appendix C—Secretarial Considerations To Establish the Special Affordable Housing Goal

A. Introduction

1. Establishment of the Goal

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) requires the Secretary to establish a special annual goal designed to adjust the purchase by each GSE of mortgages on rental and owner-occupied housing to meet the unaddressed needs of, and affordable to, low-income families in low-income areas and very-low-income families (the Special Affordable Housing Goal).

In establishing the Special Affordable Housing Goal, FHEFSSA requires the Secretary to consider:

(1) Data submitted to the Secretary in connection with the Special Affordable Housing Goal for previous years;

(2) The performance and efforts of the GSEs toward achieving the Special Affordable Housing Goal in previous years;

(3) National housing needs of targeted families;

(4) The ability of the GSEs to lead the industry in making mortgage credit available for low-income and very-low-income families; and

(5) The need to maintain the sound financial condition of the enterprises.

2. The Goal

The final rule provides that the Special Affordable Housing Goal for 1996 is 12 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The goal for 1997 and subsequent years is 14 percent. Of the total Special Affordable Housing Goal for each year, each GSE must purchase multifamily mortgages in an amount at least equal to 0.8 percent of the total dollar volume of mortgages purchased by the GSE in 1994.

Approximately 20–23 percent of the conventional conforming mortgage market would qualify under the Special Affordable Housing Goal as defined in the final rule. Using the final rule's conventions for what will count toward the goal, 16.7 percent of Fannie Mae's 1994 business and 11.4 percent of Freddie Mac's would have qualified toward the goal.

Units that count toward the goal: Subject to further provisions specified below, units that count toward the Special Affordable Housing Goal include units occupied by low-income owners and renters in low-income areas, and very-low-income owners and renters. Low-income rental units in multifamily properties where at least 20 percent of the units are affordable to families whose incomes are 50 percent of area median income or less or where at least 40 percent of the units are affordable to families whose incomes are 60 percent or less of area median income count toward the goal.

B. Underlying Data

In considering the factors under FHEFSSA to establish the Special Affordable Housing Goal, HUD relied upon data gathered from the American Housing Survey, the Census Bureau's 1991 Residential Finance Survey, the 1990 Census of Population and Housing, other government reports, Home Mortgage Disclosure Act (HMDA) data and reports, and the GSEs. Among other new data resources, full-year 1994 data from the GSEs, as well as HMDA data for 1994, became available to HUD since publication of the proposed rule. Appendix D discusses in detail how these data resources were used and how the size of the conventional conforming market for this goal was estimated.

Section C discusses the factors listed above, and Section D provides the Secretary's rationale for establishing the special affordable goal.

C. Consideration of the Factors

1 and 2. Data Submitted to the Secretary in Connection With the Special Affordable Housing Goal for Previous Years, and the Performance and Efforts of the Enterprises Toward Achieving the Special Affordable Housing Goal in Previous Years

The discussions of these two factors have been combined because they overlap to a significant degree.

a. GSE Performance Relative to the 1993–94 Goals

For the 1993–94 transition period the Special Affordable Housing Goal was established in dollar terms. FHEFSSA called for special affordable purchases of $2.0 billion by Fannie Mae and $1.5 billion by Freddie Mac, and the legislative history made it clear that such purchases should be ''above and beyond their existing performance and commitments.'' [1] The specified amounts of the goals were evenly divided between multifamily and single family housing.

The Special Affordable Housing Goals for 1993–94 were $12.7 billion single family and $3.6 billion multifamily for Fannie Mae, and $11.1 billion single family and $0.8 billion multifamily for Freddie Mac.[2]

[1] Senate Report, p. 36.

[2] The 1993–94 dollar-based goals were extended on a pro-rated basis for 1995.

Fannie Mae's qualifying mortgage purchases in 1993 and 1994 together amounted to $16.7 billion single-family and $4.5 billion multifamily. Thus Fannie Mae surpassed the 1993–94 single-family and multifamily portions of the goal by 32 percent and 26 percent, respectively.

Freddie Mac's qualifying mortgage purchases in 1993 and 1994 together amounted to $12.2 billion single-family and $495 million multifamily. Thus Freddie Mac surpassed the 1993–94 single-family goal by 10 percent but fell short on the multifamily portion of the goal by 38 percent.

b. 1993–94 GSE Performance Relative to Final Rule Special Affordable Housing Goals for 1996–1999

Owner-occupied housing. Between 1993 and 1994, both GSEs increased significantly the purchase of mortgages on owner-occupied housing that would qualify under this goal. (See Table C.1.)

Rental housing. As in the case of owner-occupied housing, between 1993 and 1994 both GSEs increased significantly the purchase of mortgages financing rental units affordable to very-low-income families. (See Table C.2.)

In this final rule, the Special Affordable Housing Goal has been broadened relative to the proposed rule, to include low-income renters in low-income areas. This change increases the number of qualifying mortgages by 8.5 percent for Fannie Mae in 1993 and 10.2 percent in 1994, and 6.1 percent for Freddie Mac in 1993 and 6.5 percent in 1994. (See Table C.3.)

This final rule also includes as eligible all rental units affordable to low-income families in properties where at least 40 percent of the units qualify as very-low-income, or where at least 20 percent of the units qualify as especially-low-income. (Especially-low-income means no more than 50 percent of area median.) This provision makes a difference of approximately 5,100 units in Fannie Mae's 1993 performance, and 11,600 in 1994. For Freddie Mac, there is no effect for 1993, and approximately 1,300 units for 1994. (See Table C.4.)

Summary. Table C.5 summarizes the GSEs' purchases in 1993 and 1994 that would qualify under the final rule's Special Affordable Housing Goal: Fannie Mae's and Freddie Mac's qualifying purchases in 1994 were 16.7 percent and 11.4 percent of total eligible purchases, respectively. Thus Fannie Mae would have achieved both the 1996 goal and the goal for 1997 and thereafter, and Freddie Mac would nearly have achieved the 1996 goal.

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Table C.1
GSEs' Purchases Qualifying as Special Affordable Under the Final Rule:
Single-Family Owner-Occupied Units*

	Fannie Mae		Freddie Mac	
	1993	1994	1993	1994
Low-Income Families in Low-Income Areas				
Number of Units	27,258	24,538	21,408	15,460
Percent	0.9%	1.3%	1.0%	1.2%
Very-Low-Income Families				
Number of Units	135,364	119,253	97,053	76,279
Percent	4.7%	6.5%	4.5%	5.9%
Subtotal				
Number of Units	162,622	143,791	118,461	91,739
Percent	5.6%	7.9%	5.5%	7.1%
Total Eligible	2,905,406	1,827,584	2,167,994	1,291,275

*Includes owner-occupied units in 2-4 unit properties

Table C.2

GSEs' Purchases Qualifying as Special Affordable Under the Final Rule: Rental Units Affordable To Very-Low-Income Families

	Fannie Mae		Freddie Mac	
	1993	1994	1993	1994
Units in 2-4 Unit Owner-Occupied Properties				
Number of Units	12,890	13,556	7,787	8,151
Percent	0.4%	0.7%	0.4%	0.6%
Units in 1-4 Unit Investor-Owned Properties				
Number of Units	19,296	24,309	13,005	13,925
Percent	0.7%	1.3%	0.6%	1.1%
Units in Multifamily Properties				
Number of Units	67,437	84,561	7,683	22,770
Percent	2.3%	4.6%	0.4%	1.8%
Subtotal				
Number of Units	99,623	122,426	28,475	44,846
Percent	3.4%	6.7%	1.3%	3.5%
Total Eligible	2,905,406	1,827,584	2,167,994	1,291,275

Table C.3

GSEs' Purchases Qualifying as Special Affordable Under the Final Rule:

Rental Units Affordable To Low-Income Families in Low-Income Areas*

		Fannie Mae		Freddie Mac	
		1993	1994	1993	1994
Units in 2-4 Unit Owner-occupied Properties					
	Number of Units	3,918	4,241	2,667	2,351
	Percent	0.1%	0.2%	0.1%	0.2%
Units in 1-4 Unit Investor-Owned Properties					
	Number of Units	7,681	7,953	5,740	3,960
	Percent	0.3%	0.4%	0.3%	0.3%
Units in Multifamily Properties					
	Number of Units	10,764	15,022	577	2,609
	Percent	0.4%	0.8%	0.0%	0.2%
Subtotal					
	Number of Units	22,363	27,216	8,984	8,920
	Percent	0.8%	1.5%	0.4%	0.7%
Total Eligible		2,905,406	1,827,584	2,167,994	1,291,275

*Other than units affordable to very-low-income families counted in Table C.2.

Table C.4

GSEs' Purchases Qualifying as Special Affordable Under the Final Rule: Rental Units Affordable to Low-Income Families Outside Low-Income Areas*

	Fannie Mae		Freddie Mac	
	1993	1994	1993	1994
Number of Units	5,122	11,631	0	1,316
Percent	0.2%	0.6%	0%	0.1%
Total Eligible	2,905,406	1,827,584	2,167,994	1,291,275

*Units affordable to low-income families in properties where at least 40 percent of the units are affordable to very-low-income families or at least 20 percent of the units are affordable to especially low-income families, other than units counted in Table C.2 or C.3.

Table C.5

GSEs' Purchases Qualifying as Special Affordable Under the Final Rule: Summary Table Showing All Single-Family and Multifamily Units

	Fannie Mae		Freddie Mac	
	1993	1994	1993	1994
Number of Units	289,729	305,065	155,921	146,821
Percent	10.0%	16.7%	7.2%	11.4%
Total Eligible	2,905,406	1,827,584	2,167,994	1,291,275

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3. National Housing Needs of Low-Income Families in Low-Income Areas and Very-Low-Income Families

The following discussion closely follows HUD's analysis of national housing needs in Appendix C of the proposed rule, which has been updated in various respects. As in the proposed rule, this discussion concentrates on very-low-income families with the greatest needs, because Section C of Appendix A presents detailed analyses of housing problems and demographic trends for lower-income families.

a. Housing Problems Among Very-low-income Families

Data from the 1990 Census and from the 1989, 1991, and 1993 American Housing Surveys demonstrate that housing problems and needs for affordable housing are more pressing in the lowest-income categories than among moderate-income families. Analyses of special tabulations of the 1990 Census prepared for use in developing Comprehensive Housing Affordability Strategies (the CHAS database), which have been updated to 1993 using American Housing Survey Data, show clearly that sharp differentials by income characterized all regions of the nation as well as their city, suburban, and nonmetropolitan portions. Nationally, approximately one-fourth of moderate-income renters and owners experienced one or more housing problems, compared to nearly three-fourths of very-low-income renters and nearly half of very-low-income owners.[3] Severe cost burdens—paying more than half of income for housing and utilities—varied even more markedly by income, involving less than 2 percent of moderate-income households, but nearly two-fifths of the 10.5 million owners with incomes below 30 percent of area median income.

The CHAS tabulations are based on HUD-adjusted median income for both owners and renters, rather than on unadjusted median income for owners, as FHEFSSA specifies for mortgages counted toward the housing goals.[4] But tabulations of the 1993 AHS using the GSE income definitions reveal the same pattern of problems for lower-income families. As the following table details, for both owners and renters, housing problems are much more frequent for the lowest-income groups.[5] Priority problems of severe cost burden or severely inadequate housing are noticeably concentrated among renters and owners with incomes below 35 percent of area median income.

Income as % of area median income (percent)	Renters		Owners	
	Any problems (percent)	Priority problems (percent)	Any problems (percent)	Priority problems (percent)
Less than 35 ...	89	44	62	36
36–50	78	17	40	13
51–80	48	5	29	7
81–100 .	24	1	21	4

Comparisons by income reveal that owners and renters (with incomes between 50 and 80 percent of area median) resemble moderate-income households in seldom having priority problems. Priority problems are heavily concentrated among households with incomes below 50 percent of median.[6] In 1991, 5.3 million unassisted renter households with incomes below 50 percent of area median income had ''worst case'' housing needs.[7] This total does not include homeless persons and families, although they also qualify for preference. For three-fourths of the renter families with worst case problems, the only problem was affordability—they do not have problems with housing adequacy or crowding.

b. Needs for Housing Affordable to Very-Low-Income Families

The existing housing stock satisfies the physical needs of most very-low-income renters. In most cases families are able to find adequate housing. The problem is that much of this housing is not affordable to very-low-income families—i.e., these families must pay more than 30 percent of their income for housing. The main exception to this generalization occurs among extremely-low-income families (defined as families below 30 percent of area median income) with three or more children. The 1993 American Housing Survey shows that 47 percent of these families live in crowded housing. A certain amount of variation in need exists, by region and degree of urbanization. Although 22 percent of worst case renters experience crowding or severe inadequacy, this figure varies from 11 percent in the Northeastern suburbs to 35 percent in the South's nonmetropolitan areas. Shortages of affordable housing units continued to be greatest and vacancy rates lowest in California.

The relative decline in inexpensive dwelling units has been concentrated among the least expensive rental units—those with rents affordable to families with incomes below 30 percent of area median income. In 1979, the number of units in this rent range was 28 percent less than the number of renters with incomes below 30 percent of area median income; by 1989, the gap had widened to 39 percent, a shortage of 2.7 million units.[8] This shortage is a problem particularly at the extremely low end of the rent distribution. Both nationally and in most states, there are surpluses of rental housing affordable to families with incomes between 30 and 50 percent of area median income and to those in the 50–80 percent range.[9] Furthermore, in most states, vacancy rates were high in 1990 among units with rents affordable to families with incomes at or below 50 percent of median.[10] Thus, like housing problems, unmet needs for affordable housing are heavily concentrated in rent ranges affordable to renters with incomes below 30 percent of area median income.

[3] The problems covered by the Census include paying over 30 percent of income for housing, lacking complete kitchen or plumbing, and overcrowding. See Appendix Tables 18A and 19A of Amy Bogdon, Joshua Silver, and Margery A. Turner, *National Analysis of Housing Affordability, Adequacy, and Availability: A Framework for Local Housing Strategies,* HUD–1448–PDR, 1994.

[4] To determine eligibility for Section 8 and other HUD programs, HUD adjusts income limits derived from the median family income for household size. The ''very low'' and ''low'' income limits at 50 percent and 80 percent of median apply to 4-person households. Relative to the income limits for a 4-person household, the limit is 70 percent for a 1-person household, 80 percent for a 2-person household, 90 percent for a 3-person household, 108 percent for a 5-person household, 116 percent for a 6-person household, etc.

[5] Tabulations of the 1993 American Housing Survey by HUD's Office of Policy Development and Research. The results in the table categorize renters reporting housing assistance as having no housing problems. Almost one-third of renters with incomes 0–30 percent of median and one-fifth of those with incomes 30–50 percent of median are assisted.

[6] For all housing programs of HUD (other than the GSE goals) and the Department of Agriculture, ''very-low-income'' is defined as not exceeding 50 percent of area median income.

[7] ''Worst case housing needs'' for housing assistance are defined as unassisted renters with income below 50 percent of area median income who meet a Federal preference for admission to rental assistance because they pay more than half of income for rent and utilities, have been displaced, or live in severely substandard housing (which includes being homeless).

[8] Tabulations by HUD's Office of Policy Development and Research, based on U.S. Departments of Housing and Urban Development and Commerce, *American Housing Survey for the United States in 1989,* July 1991.

[9] HUD's Office of Policy Development and Research, *Worst Case Needs for Housing Assistance in the United States in 1990 and 1991,* 1994, Table 8.

[10] Id., Table 6.

4. The Ability of the Enterprises to Lead the Industry in Making Mortgage Credit Available for Low-Income and Very-Low-Income Families

The discussion of the ability of Fannie Mae and Freddie Mac to lead the industry in Section C.5 of Appendix A is relevant to this factor—the GSEs' dominant role in the market, their role in establishing widely-applied underwriting standards, their role in the development of new technology for mortgage origination, their strong staff resources, and their financial strength. Additional analysis on the potential ability of the enterprises to lead the industry in the low- and very-low-income market appears below—in Section D.2 generally, and in Section D.3 with respect to multifamily housing.

The ability of the GSEs to lead the industry in the special affordable market is best demonstrated by the significant gains both enterprises have made in this market. As a percentage of total units in the properties whose mortgages they purchased, the special affordable share for the GSEs combined rose from 7.7 percent in 1993 to 13.9 percent in 1994 and 16.4 percent for the first half of 1995. The 1994 increase was truly impressive, as special affordable units rose by 6 percent while total units declined by 41 percent.

5. The Need to Maintain the Sound Financial Condition of the GSEs

HUD has undertaken a separate, detailed economic analysis of this rule, which includes consideration of the financial safety and soundness implications of the housing goals. The analysis considered the likely mortgage default implications of the goals and implications for the profitability of the GSEs under various alternative economic assumptions. Among the conclusions are: that the goals will have, at most, only limited impacts on credit risk, which the GSEs should be able to handle without significant lowering of underwriting standards; that risks associated with increased multifamily mortgage purchase volumes under the goals are manageable, considering the scope of the increases implied by the goals; and that the goals imply no meaningful increase in risk to the sound financial condition of the GSEs' operations. Based on this analysis, HUD concludes that the goals raise minimal, if any, safety and soundness concerns.

D. Determination of the Goal

Several considerations, many of which have been reviewed in earlier sections of this Appendix, led to the determination of the Special Affordable Housing Goal.

1. Severe Housing Problems

The data presented in Section C.3 demonstrate that housing problems and needs for affordable housing are much more pressing in the lowest-income categories than among moderate-income families. The high incidence of severe problems among the lowest-income renters reflects severe shortages of units affordable to those renters. At incomes below 30 percent of median, two-thirds of owners and 70 percent of renters pay more than 30 percent of their income for housing, live in inadequate housing, or are crowded. As the analysis presented above shows, priority problems—paying more than half of income for housing or living in severely inadequate housing—are heavily concentrated among renters with incomes below 50 percent of median. Housing and affordability problems are particularly acute for renters with income below 30 percent of area median income.

2. GSE Performance and the Market

The Special Affordable Housing Goal is designed, in part, to ensure that the GSEs maintain a consistent focus on serving the very-low-income portion of the housing market where housing needs are greatest. The bulk of the GSEs' low- and moderate-income mortgage purchases are for the higher-income portion of the low- and moderate-income category. The lowest-income borrowers accounted for a very small percentage of each GSEs' purchases. Five percent of the GSEs' 1993 mortgage purchases financed homes for single-family homeowners with incomes below 60 percent of area median, and 7 percent in 1994. (See Figure A.1 in Appendix A.)

Specification of the goal. The Special Affordable Housing Goal is established as percentages of the GSEs' total business for the 1996–99 period. This kind of specification is preferable to a fixed, dollar-based specification because: (1) The size of the market for housing eligible to count toward the Special Affordable Housing Goal fluctuates with the size of the overall market rather than remaining at any fixed dollar level (as shown by analysis of HMDA data); and (2) fixed-dollar goals, if based on a high-volume year, could be unattainable in a low-volume year; if based on a low-volume year, could represent insufficient support by the GSEs for the special affordable market in a high-volume year; and if based on an average-volume year, could alternate between being unattainable in some years and insufficient in other years.

GSEs' Performance Relative to the Market. Analysis of American Housing Survey and HMDA data shows that the GSEs are purchasing a smaller proportion of loans for very-low-income homebuyers than are portfolio lenders operating in the conforming market (see the discussion of Figure A.2 in Appendix A). That analysis suggests that there is room in the very-low-income end of the homebuyer market for the GSEs to improve their performance.

A reasonable estimate of the size of the market for both single family and multifamily mortgages that would be eligible to count toward the Special Affordable Housing Goal is 20–23 percent of the overall conventional conforming market, as explained in Section H.2 of Appendix D.

Under the final rule's counting conventions 16.7 percent (7.9 percent owner-occupied and 8.8 percent rental) of units covered by Fannie Mae's mortgage purchases in 1994 would have been eligible to count toward this goal, and 11.4 percent (7.1 percent owner-occupied and 4.3 percent rental) of units covered by Freddie Mac's mortgage purchases would have been eligible to count toward this goal. Figure C.1 compares recent GSE performance, the 1996 and 1997–99 Special Affordable Housing Goals, and the size of the market.

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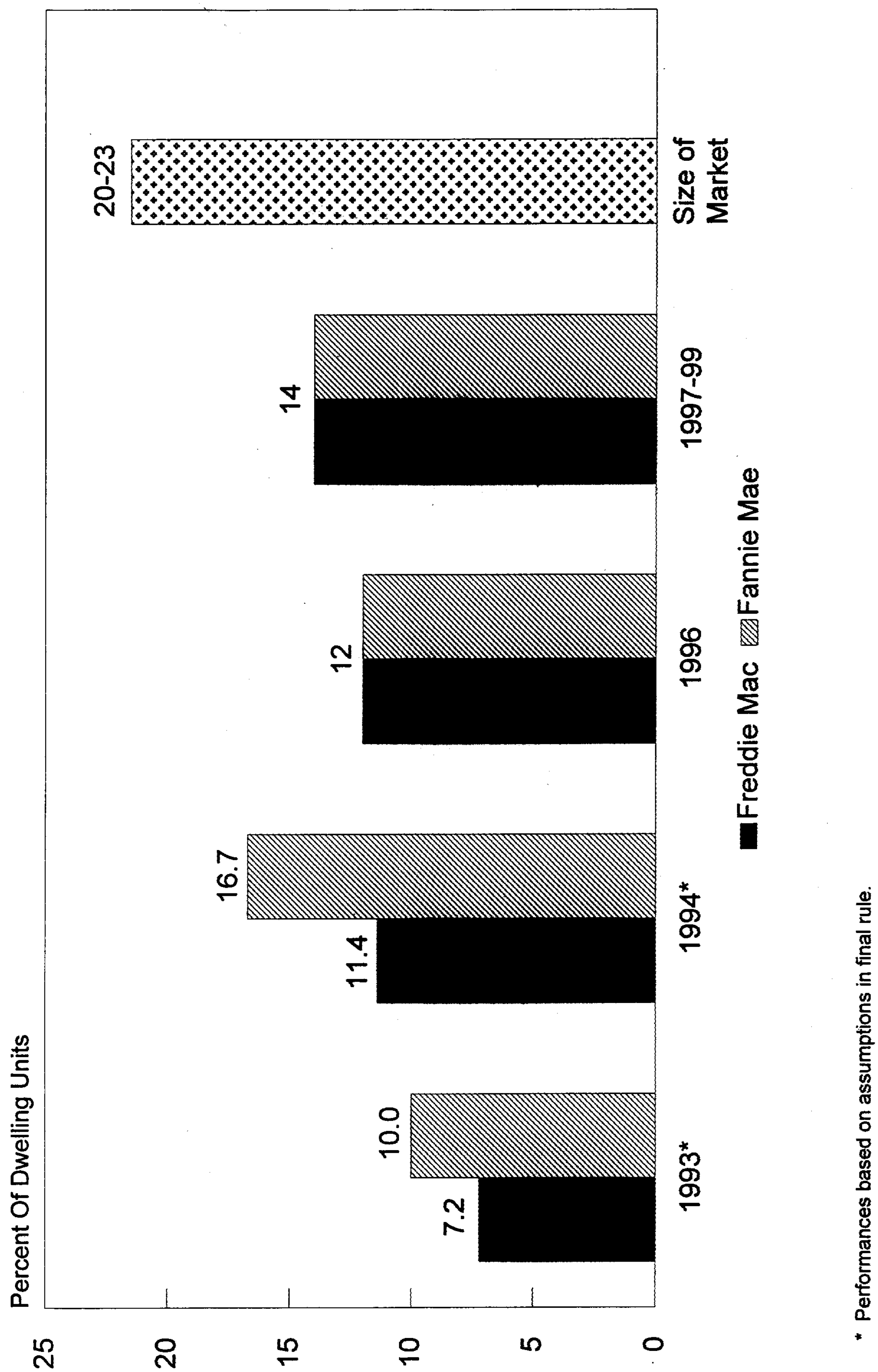
FIGURE C.1

Special Affordable Activity And Goals For Freddie Mac and Fannie Mae, 1993-99



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3. Multifamily Purchases

The GSEs can bring an important benefit to the multifamily market in the form of long-term liquidity. In the multifamily arena, however, a secondary market is only in its infancy (see Section C.2.c in Appendix A). Given the GSEs' overall experience and financial strength, it is reasonable to expect that they would play major roles in this development.

Recent tightening of interest rate spreads for ''better'' multifamily mortgage originations demonstrates that increased liquidity can lower spreads. This suggests that participation by the GSEs can lower financing costs and ultimately rents across the broad range of multifamily properties, including properties occupied by low- and very-low-income tenants. (Section C.2.c of Appendix A elaborates on these themes.)

A minimum multifamily special affordable volume of 0.8 percent of total 1994 volume of business is reasonable, both relative to the size of the market and relative to the GSEs' recent volume of qualifying multifamily purchases. The implied volumes are $950 million for Freddie Mac (relative to $118.8 billion total volume) and $1.22 billion for Fannie Mae (relative to $153.0 billion total volume). Their 1994 volumes of multifamily business that would have qualified as special affordable under this final rule were $425 million for Freddie Mac (0.36 percent of 1994 business), or half of the necessary volume for 1996, and $1.91 billion for Fannie Mae (1.25 percent of 1994 business), or $690 million more than necessary for 1996. The size of the total multifamily market that would qualify under the Special Affordable Housing Goal is approximately $10 billion annually.

Expressing the multifamily subgoals for every year covered by this rule as percentages of total 1994 purchases is a reasonable approach, since multifamily subgoals expressed as percentages of current-year total business could be difficult to achieve in some years. Total volume is driven by the single-family business, which is subject to wide swings due to refinancing waves, as in 1992–93, and to changes in the ARM share of the market.

The Secretary selected 0.8 percent of total 1994 business volume after careful review of the GSEs' past performance and consideration of the need to maintain a minimum level of attention to multifamily housing. This percentage may seem small, but that is because the multifamily market (measured in dollar terms) comprises only a fraction of the total mortgage market, and the special affordable share of the GSEs' multifamily purchases in 1994 was just above 50 percent.[11] For this same reason, changes in this subgoal of even 0.1 percent are significant.

These subgoals are below recent levels of special affordable multifamily purchases by Fannie Mae, but above recent levels of such purchases by Freddie Mac. It should be emphasized that these are minimum purchase amounts; thus HUD in no way is encouraging Fannie Mae to reduce its volume of multifamily business, which is important in its overall efforts to meet the Special Affordable Housing Goal and Low- and Moderate-Income Housing Goals. HUD very much supports Freddie Mac's actions to rebuild its multifamily business, and encourages further efforts in this area. To date Freddie Mac has had no delinquencies on its multifamily business since it reentered this market, and the GSE's multifamily business has been creditworthy and profitable.[12]

4. Conclusion

HUD has determined that the Special Affordable Housing Goal established in the final rule addresses national housing needs within the income categories specified for this goal, while accounting for the GSEs' performance in the past in purchasing mortgages meeting the needs of very-low-income families and low-income families in low-income areas. HUD has also considered the size of the conventional mortgage market serving very-low-income families and low-income families in low-income areas. Moreover, HUD has considered the GSEs' ability to lead the industry as well as their financial condition. HUD has determined that goals of 12 percent in 1996, 14 percent in 1997–1999, and 14 percent thereafter pending establishment of a new goal, with fixed multifamily subgoals of 0.8 percent of 1994 volumes of business, are both necessary and achievable.

Appendix D—Estimating the Size of the Conventional Conforming Market for Each Housing Goal

In establishing the three housing goals, the Secretary is required to assess, among a number of factors, the size of the conventional market for each goal. This Appendix explains HUD's methodology for estimating the size of the conventional market for each of the three housing goals. Section A provides an overview of public comments on the methodology described in the proposed rule. Section B describes the main components of HUD's market-share model and identifies those parameters that have a large effect on the relative market shares. Sections C and D discuss two particularly important market parameters—the size of the multifamily market and the share of the single-family mortgage market accounted for by rental properties. With this as background, Section E provides a more systematic presentation of the model's equations and main assumptions. Sections F, G, and H report HUD's estimates for the Low- and Moderate-Income Goal, the Central Cities, Rural Areas, and other Underserved Areas Goal, and the Special Affordable Housing Goal, respectively.

A. Overview of Comments on Market Methodology

1. Overall Issue

Both GSEs expressed strong criticism of HUD's use of specific data elements in constructing its estimates of market size. Although both GSEs criticized how data had been interpreted in the proposed rule's market share model, neither GSE, nor any commenter, objected to HUD's basic model for calculating the size of the markets relevant to each of the goals. However, Freddie Mac presented a detailed set of objections to the use of certain data sources or assumptions, concluding that HUD's market estimates were ''fatally flawed.'' Freddie Mac commented that ''the Proposed Rule uses a combination of data sources and a set of arbitrary assumptions in order to estimate the size of the current conforming, conventional market,'' adding that ''in nearly every case, HUD has chosen an estimate at the highest end of calculable estimates.''

Freddie Mac proposed a number of revisions to the assumptions or data sets used in the proposed rule, for example—using HMDA data to estimate the size of the multifamily and single-family rental markets, using American Housing Survey rent data on recently-completed properties to estimate the affordability of the newly-mortgaged rental properties, using discount factors to reduce the size of the rental and low-income owner markets, etc. HUD has carefully considered these comments in revising the market estimates for each of the goals. However, HUD disagrees with Freddie Mac's overarching comment that because data are not always available in the form and format desired, HUD should use minimal estimates of market activity. Such an

[11] Multifamily properties account for a much higher percentage of dwelling units financed by mortgages than their percentage of total dollar mortgage volume.

[12] *American Banker*, October 12, 1995, p. 12.

approach does not take advantage of the wealth of information currently available on mortgage activity.

In revising the rule, HUD has carefully reviewed existing information on mortgage activity in order to understand the weakness of various data sources, has conducted sensitivity analyses to show the effects of alternative parameter assumptions, and has hired independent researchers to assist in determining best estimates for the more important determinants of the housing goal market shares. HUD is well aware of uncertainties with some of the data and much of this Appendix is spent discussing the effects of these uncertainties on the market estimates.

The remainder of this section responds to several major comments about the market share methodology made by Freddie Mac and others. But with respect to Freddie Mac's statements that HUD's methodology is ''fatally flawed'' and based on ''arbitrary assumptions,'' HUD has three specific comments here:

(A) HUD contracted with Urban Institute researchers to independently evaluate its methodology for estimating market shares for the various goals. They concluded that HUD's conceptual approach is ''a reasonable approach to determining the size of the low- and moderate-income, underserved areas, and special affordable markets relative to the size of the overall conventional, conforming mortgage market.'' [1] They also concluded that Freddie Mac's approach for measuring mortgage market property shares was the wrong approach (see discussion below).

(B) Freddie Mac commissioned Abt Associates to evaluate HUD's methodology for the proposed rule. Abt Associates concluded that ''the point is not that HUD misused the data. On the contrary, HUD made reasonable attempts to arrive at plausible estimates.'' [2] (Emphasis added.)

(C) HUD has set conservative goals. For example, the Low- and Moderate-Income Goal is 40 percent for 1996 and 42 percent for 1997 and subsequent years. These goals are well below the market shares projected by HUD and the Urban Institute. In addition, the Abt study estimated that the low- and moderate-income market was 41–57 percent, placing the Low- and Moderate-Income Goal for 1997 and subsequent years at the bottom of Abt's range of estimates of market size. It should further be noted that Abt's estimates were made based on the proposed rule. A number of liberalizations in the counting rules have been made in the final rule, which mean that market estimates should be revised upward in light of these changes.

It also should be emphasized that neither GSE objected to HUD's basic model for calculating the size of the markets relevant to each of the housing goals, which involves estimating (1) the share of the market (in dwelling units) by type of property (single-family-owner, single-family-rental, and multifamily), (2) the proportion of dwelling units financed by mortgages for each type of property meeting each goal, and (3) projecting the size of the market by weighting each such goal share by the corresponding market share. The GSEs' comments focused on how the underlying estimates were derived and the resulting impacts on the size of the market for each goal. As noted above, HUD recognizes the uncertainty regarding some of these estimates, which led the Department to undertake a number of sensitivity analyses and to contract with Urban Institute researchers to reduce some of this uncertainty.

2. Major Issues

(1) Market volatility. Freddie Mac commented that HUD's analysis ignores the impact that changes in national economic conditions can have on the size of the market, stating that its recent efforts to expand the reach of the secondary market in support of low- and moderate-income people ''were aided by very favorable interest rates and macroeconomic conditions that made housing extraordinarily affordable.'' However, Freddie Mac observed, fluctuations of interest rates of approximately 250 basis points in the past year have demonstrated that housing can become much less affordable in a short period, but ''HUD's market estimates assume that the favorable conditions of 1993 and 1994 will continue indefinitely.''

HUD response. HUD has addressed the concerns about market volatility in two major ways:

(A) HUD has conducted detailed sensitivity analyses for each of the housing goals. These analyses present different estimates of market size by varying key assumptions: the size of the multifamily market; the low- and moderate-income shares of single-family owner-occupied homes [3], single-family rental homes, and multifamily units; the breakdown of the single-family market between owner-occupied units and rental units; and the multifamily loan amount per unit. These analyses support the feasibility of the goals under a wide range of conditions.

(B) With regard to volatility in the multifamily market, Freddie Mac stated the HUD's use of Residential Finance Survey (RFS) data is inappropriate, because they draw on a period when multifamily lending was unusually high. HUD did not use the RFS data in its baseline model. As the proposed rule noted, the RFS, based on a period with a high level of multifamily originations, overstates the probable level of multifamily originations in the 1996–97 period.

HUD recognizes that there is volatility in the multifamily market, and for this reason contracted with Urban Institute researchers to develop a ''steady-state'' multifamily originations model which abstracts from the volatility of interest rates, refinancings, and waves of maturing balloon mortgages.[4] This model generated projections of multifamily activity no less than, and in some cases substantially greater than, those used by HUD in this rule.

(2) Size of the multifamily market. Both GSEs commented that in the proposed rule the role of multifamily financing is consistently overstated. In particular, both GSEs advocated the use of data from the Home Mortgage Disclosure Act (HMDA) reports, rather than the Survey of Mortgage Lending Activity (SMLA), used by HUD in the proposed rule.

HUD response. HUD addressed this comment in two ways:

(A) HUD commissioned four papers on the multifamily market by Urban Institute researchers [5] and held two seminars on this topic with a wide range of participants, including the GSEs. These papers compared and evaluated

[1] Dixie M. Blackley and James R. Follain, ''A Critique of the Methodology Used to Determine Affordable Housing Goals for the Government-Sponsored Housing Enterprises,'' October 1995, p. 21.

[2] Abt Associates, ''Evaluation of HUD-Proposed Housing Goals for the GSEs,'' February 6, 1995, p. 12.

[3] The GSEs have generally advocated use of the HMDA data. In a number of the sensitivity analyses, the percentages of single-family owner-occupied homes which qualify for the low-mod goal have been reduced below the levels reported by the 1993 and 1994 HMDA data.

[4] Robert Dunsky, James R. Follain, and Jan Ondrich, ''An Alternative Methodology to Estimate the Volume of Multifamily Mortgage Originations,'' September 1995.

[5] These are: The previously cited papers by Blackely and Follain (1995) and Dunsky, Follain, and Ondrich (1995); ''Estimating the Volume of Multifamily Mortgage Originations by Commercial Banks Using the Survey of Mortgage Lending Activity and Home Mortgage Disclosure Act data,'' by Amy D. Crews, Robert Dunsky, and James Follain (October 1995); and ''What We Know About Multifamily Mortgage Originations,'' by Amy D. Crews, Robert M. Dunsky, and James R. Follain (October 1995).

information about the size of the multifamily market in detail. They supported HUD's projections of the size of the market, and at least one of their analyses suggested that higher estimates were reasonable. They concluded that the HMDA data base underreports multifamily originations. Details are presented in section C.2, below.

(B) In its sensitivity analyses, HUD has used lower estimates of the size of the multifamily market than the base case in the proposed rule.

Section C below provides a more detailed response to the GSEs' comments about the size of the multifamily market.

(3) Size of the single-family rental market. Freddie Mac stated that HUD's use of the Survey of Mortgage Lending Activity (SMLA) caused it to overstate the size of the single-family rental market, arguing that a more accurate estimate is derived from HMDA.

HUD response. HUD did not use the SMLA to estimate the rental share of the single-family market—rather, it closely analyzed data from the Residential Finance Survey (RFS) and the HMDA reports. In its base case HUD projected the investor share of the single-family market at 10.0 percent, well below the 17.3 percent reported by the RFS, but slightly above the 8.0 percent reported by the 1994 HMDA data. Again, the Urban Institute researchers concluded that the HMDA estimate was too low and a 10–12 percent estimate was reasonable. At the same time, HUD has acknowledged that there is some uncertainty about the rental share of the single-family market, and has reflected this in its sensitivity analyses (Table D.3).

(4) Multifamily market penetration. Fannie Mae stated that the multifamily lending industry is fundamentally different from the single-family industry and that the GSEs do not dominate the multifamily market to the degree that they dominate the single-family market. Fannie Mae concluded that ''origination volumes in multifamily lending are not a reliable indicator of what is available to either Fannie Mae or Freddie Mac in the secondary market.'' Freddie Mac concurred with this view.

HUD response. The GSEs are able to purchase loans from any multifamily lender. Explicitly considering only multifamily loans originated by certain lenders in the estimate of market size would implicitly amount to intervention in the GSEs' mortgage purchase decisions, and be tantamount to ''micromanagement'' of the GSEs' operations, which both HUD and the GSEs wish to avoid. (Appendix A discusses HUD's response to this issue in more detail.)

At the same time, HUD realizes that the GSEs have been and are likely to continue to be less active in the multifamily market than in the single-family market. It is also true that multifamily originations play a significant role in estimating the size of the Low- and Moderate-Income and Special Affordable Housing Goals. For these reasons, both of these goals have been conservatively set in relation to HUD's estimates of the size of these markets, including all multifamily originations.

Other Issues

(5) Distortions caused by mobile home loans in the HMDA data. Fannie Mae commented that the HMDA data used in HUD's analysis included mobile home loans, which ''are an important source of affordable housing for low- and moderate-income families, but which are not a significant product line for either Fannie Mae or Freddie Mac,'' adding that if mobile home originations are eliminated, ''the amount of mortgages meeting this [low- and moderate-income] goal available to Fannie Mae and Freddie Mac is significantly reduced.'' Freddie Mac was in general agreement with this view.

HUD response. HUD has undertaken discussions with industry representatives and mobile home lenders and has examined the effects of adjusting the HMDA data for mobile homes.[6] However, as Section F discusses in detail, it is not clear how many mobile home loans are included in the HMDA data. Thus, HUD also uses American Housing Survey data that does not include mobile homes. To a certain extent, HUD had anticipated this issue in its proposed rule by excluding small loans from its analysis of HMDA data.

(6) American Housing Survey (AHS) data on housing affordability. Freddie Mac stated that HUD's use of the AHS led to an overstatement of housing affordability, because ''it is well known that income reported in the AHS [is] lower than other independent estimates of income.''

HUD response. This issue requires distinguishing between owner-occupied and rental units using special 1990 Census tabulations. HUD compared data on household income to official HUD estimates of area median income for each location in the country. These Census tabulations should be more accurate than the AHS in two ways—because the Census income data are better, and because the Census income data were compared to accurate median family income data for each metro area or nonmetro county in the country. The AHS estimates of the income of very-low-, low-, and moderate-income homeowners are about two percentage points higher than the corresponding Census data. However, these comparisons fail to take into account the changes which were made in the AHS in 1993, which has reduced income underreporting by the AHS. (See Section F.1.c below.) Thus, it appears that income underreporting is not a serious problem with the recent AHS data. As noted above, one advantage of the AHS data is that it excludes mobile home loans.

The Census tabulations show that the AHS and the Census data are remarkably similar with regard to renters' incomes. But the Department used rent data, not income data, in measuring affordability of rental units. The AHS asks more questions about rent components than any other survey and it is the only source of information on gross rent (contract rent plus the cost of utilities), thus it is the best source of information about rents.

(7) Use of rent levels inflates rental housing importance. Freddie Mac stated that the proposed rule uses rent levels to qualify rental units as serving low- or moderate-income levels. They added that ''This is reasonable, but has the effect of increasing the importance of rental housing in meeting goals,'' because ''many higher income households live in lower cost rental units.''

HUD response. It is true that many higher-income households live in lower-rent units, but this is irrelevant. If the GSEs undertook a concerted effort to gather comprehensive data on renter income, as allowed (but not required) by the FHEFSSA, HUD would base its low- and moderate-income rental share on renters' income data. But in fact both GSEs have repeatedly said that data on tenant income is not generally available, and HUD has therefore allowed the GSEs to use data on rents in determining affordability. To be consistent with this practice, HUD has used rents in estimating the size of the market related to the various goals. This procedure does not inflate the importance of rental housing relative to what is available for purchase by the GSEs.

[6] These adjustments involved identifying all loans originated by four mobile home lenders, examining borrower income data for these loans, extrapolating from this data to estimate the size of the total mobile home market by income level in the HMDA data, and deducting the resulting estimates from the HMDA data.

B. Overview of HUD's Market Share Methodology

1. Definition

The size of the market for each housing goal is one of the factors that the Secretary is required to consider when setting the level of each housing goal.[7] Using the Low- and Moderate-Income Housing Goal as an example, the market share in a particular year is defined as follows:

Low- and Moderate-Income Share of Market: The number of dwelling units financed by the primary mortgage market in a particular calendar year that are occupied by (or affordable to, in the case of rental units) families with incomes less than the area median income *divided by* the total number of dwelling units financed in the conforming conventional primary mortgage market.

There are three important aspects to this definition. First, the market is defined in terms of ''dwelling units'' rather than, for example, ''value of mortgages'' or ''number of properties.'' Second, the units are ''financed'' units rather than the entire stock of all mortgaged dwelling units; that is, the market-share concept is based on the mortgage flow in a particular year, which will be smaller than total outstanding mortgage debt. Third, the low- and moderate-income market is expressed relative to the overall conforming conventional market, which is the relevant market for the GSEs.[8] The low- and moderate-income market is defined as a percentage of the conforming market; this percentage approach maintains consistency with the method for computing each GSE's performance under the low- and moderate-income goal (that is, the number of low- and moderate-income dwelling units financed by GSE mortgage purchases relative to the overall number of dwelling units financed by GSE mortgage purchases).

2. Three-Step Procedure

Ideally, computing the low- and moderate-income market share would be straightforward, consisting of three steps:

(Step 1) Projecting the market shares of the four major property types included in the conventional conforming mortgage market:

(a) Single-family owner-occupied dwelling units (SF-O units);

(b) Rental units in 2–4 unit properties where the owner occupies one unit (SF 2–4 units);[9]

(c) Rental units in one-to-four unit investor-owned properties (SF investor units); and,

(d) Rental units in multifamily (5 or more units) properties (MF units).[10]

(Step 2) Projecting the ''goal percentage'' for each of the above four property types (for example, the ''low- and moderate-income goal percentage for single-family owner-occupied properties'' is the percentage of those dwelling units financed by mortgages in a particular year that are occupied by households with incomes below the area median).

(Step 3) Multiplying the four percentages in (2) by their corresponding market shares in (1), and summing the results to arrive at an estimate (weighted average) of the overall share of dwelling units financed by mortgages that are occupied by low- and moderate-income families.

The four property types are analyzed separately because of their differences in low- and moderate-income occupancy. Rental properties have substantially higher percentages of low- and moderate-income occupants than owner-occupied properties. This can be seen by the following illustration of Step 3's basic formula for calculating the size of the low- and moderate-income market:[11]

Property type	(Step 1) share of market (percent)	(Step 2) low-mod share (percent)	(Step 3) multiply (1) x (2) (percent)
(a) SF–O	71.0	36	25.6
(b) SF 2–4	2.0	85	1.7
(c) SF Investor	10.6	85	9.1
(d) MF	16.4	90	14.8
Total Market	100.0	....	51.2

In this example, low- and moderate-income dwelling units are estimated to account for slightly over 51 percent of the total number of dwelling units financed in the conforming mortgage market. To examine the other housing goals, the ''goal percentages'' in Step 2 would be changed and the new ''goal percentages'' would be multiplied by Step 1's property distribution, which remains constant.

3. Data Issues

Unfortunately, complete and consistent mortgage data are not readily available for carrying out the above three steps. A single data set for calculating either the property shares or the housing goal percentages does not exist. However, there are several major data bases that provide a wealth of useful information on the mortgage market. HUD combined information from the following sources: the Home Mortgage Disclosure Act (HMDA) reports, the American Housing Survey (AHS), HUD's Survey of Mortgage Lending Activity (SMLA), and the Census Bureau's Residential Finance Survey (RFS).

Property Shares. To derive the property shares, HUD started with forecasts of single-family mortgage originations. These forecasts, which are readily available from industry groups and the GSEs, are based on HUD's SMLA. The SMLA does not provide information on conforming mortgages, on owner versus renter mortgages, or on the number of units financed. Thus, to estimate the number of single-family units financed in the conforming conventional market, HUD had to project certain market parameters based on its judgment about the reliability of different data sources. Sections D and E report HUD's findings related to the single-family market.

Total market originations are obtained by adding multifamily originations to the single-family estimate. Because of the wide range of estimates available, the size of the multifamily mortgage market turned out to be one of the most controversial issues raised in the public comments. In 1994, HMDA reported about $15 billion in conventional multifamily originations while the SMLA reported double that amount ($30 billion). Because most renters qualify under the low- and moderate-income goal, the chosen market size for multifamily can have a substantial effect on the overall estimate of the low- and moderate-income market (as well as on the estimate of the special affordable market). Thus, it is important to have a reliable estimate of the size of the multifamily market. Section C discusses this issue in detail.

Goal Percentages. To derive the goal percentages for each property type, HUD relied heavily on HMDA and AHS data. For single-family owner originations, HMDA provides comprehensive information on borrower incomes and

[7] Sections 1332(b)(4), 1333(a)(2), and 1334(b)(4).

[8] So-called ''jumbo'' mortgages, greater than $203,150 for 1-unit properties, are excluded in defining the conforming market. There is some overlap of loans eligible for purchase by the GSEs with loans insured by the FHA and guaranteed by the Veterans Administration.

[9] The owner of the SF 2–4 property is counted in (a).

[10] Property types (b), (c), and (d) consist of rental units. Property types (b) and (c) must sometimes be combined due to data limitations; in this case, they are referred to as ''single-family rental units'' (SF-R units).

[11] The property shares and low-mod percentages reported here are based on one set of model assumptions; other sets of assumptions are discussed in Section E.

census tract locations for metropolitan areas. Unfortunately, it provides no information on the incomes of renters living in mortgaged properties (either single-family or multifamily) or on the affordability of rental units in mortgaged properties. The AHS, however, does provide a wealth of information on the affordability of rental properties. Thus, an important issue here concerns whether affordability data from rental properties can serve as a proxy for the affordability of newly-mortgaged rental properties. This issue as well as other technical issues related to the goal percentages (such as the need to exclude mobile homes from HMDA data) are discussed in Sections F, G, and H.

4. Conclusions

HUD has attempted to reduce the range of uncertainty around its market estimates by carefully reviewing all known major mortgage data sources and by conducting numerous sensitivity analyses to show the effects of alternative assumptions. The remainder of this Appendix reports findings from the additional analyses that HUD has conducted in response to public comments received. Sections C, D, and E report findings related to the property share distributions called for in Step 1, while Sections F, G, and H report findings related to the goal-specific market parameters called for in Step 2. These latter sections also report the overall market estimates for each housing goal calculated in Step 3.

HUD contracted with the Urban Institute to comment on the reasonableness of its market share approach and to conduct analyses related to specific comments received from the public about its market share methodology. Findings from several Urban Institute reports will be discussed throughout this Appendix.

C. Size of the Multifamily Mortgage Market

This section derives projections of multifamily mortgage originations, in dollars and in numbers of units in mortgaged properties.

The multifamily sector is especially important in the establishment of housing goals for Fannie Mae and Freddie Mac because multifamily properties are overwhelmingly occupied by low- and moderate-income families. For example, in 1994 11 percent of units financed by Fannie Mae were multifamily, but 93 percent of those units were low- and moderate-income units, accounting for 23 percent of all of Fannie Mae's low- and moderate-income purchases for that year.

This discussion is organized as follows: Section 1 reviews the proposed rule's approach to multifamily market estimation, the public comments on the methodology, and HUD's approach to resolve various questions raised. Section 2 identifies and evaluates available historical data resources. Section 3 undertakes an analysis of projected aggregate origination volume for 1996 and 1997 for the entire multifamily market and then considers the portion of the market relevant as a basis for establishing housing goals for Fannie Mae and Freddie Mac.

1. The Proposed Rule, Public Comments, and HUD's Approach to Resolving Issues Raised

Proposed rule. The proposed rule presented two projections of the size of the multifamily market. The first, based on the Bureau of the Census's 1991 Survey of Residential Finance (RFS), was $35 billion of conventional multifamily originations, which was projected to be 7 percent of the total dollar volume of conventional originations. The second, based on HUD's Survey of Mortgage Lending Activity (SMLA), was $33 billion of conventional multifamily originations, which was projected to be 5 percent of the total dollar volume of conventional originations.

Public comments. Both GSEs maintained that in deriving market-share estimates for all three of the statutory goals, HUD had made projections of the size of the multifamily market that were unreasonably high. They claimed that HUD had chosen the poorest and least-favorable of the data bases that could have been employed for this purpose.

The following points were made by the GSEs in support of this general criticism:

a. HUD's reliance on the Survey of Mortgage Lending Activity (SMLA): The GSEs commented that this survey's estimates of multifamily lending volumes in the early 1990s are based on data for a sample of commercial banks that is known to be out-of-date and too small, yet this survey is the one on which HUD relied most heavily.

b. HUD's use of the Residential Finance Survey (RFS): The GSEs commented that HUD used mortgage assumptions data that should have been excluded in estimating mortgage origination volumes; that HUD improperly ignored the nature of RFS as a survey of outstanding mortgages still outstanding after a period of time had passed since their origination and did not adequately allow for differential prepayment rates between multifamily and single-family mortgages over that passage of time; that HUD had relied on RFS data for mortgages originated over a longer-than-necessary time interval (1987–1991, when 1989–91 could have been used); that HUD had not recognized the decline in origination rates that occurred in the early 1990s, after the end of the period reflected in RFS and after a period of turmoil in the market in 1990–91; that HUD had failed to recognize that originations in 1990–91 included significant numbers of multifamily loan restructurings that would have been reported as new loans in RFS (as well as SMLA) but would not have been available for GSE purchase.

c. HUD's neglect of evidence on the multifamily market in the Home Mortgage Disclosure Act (HMDA) data base: The GSEs stated their belief that HMDA covers nearly 100 percent of the relevant lender base; and that commercial banks are known to file HMDA reports reliably, making this a better source of information on banks than SMLA. As a general matter, Fannie Mae and Freddie Mac contended that the HMDA figure for 1993 mortgage originations is the more accurate one, based on what they understood to be methodological deficiencies in SMLA and limited applicability of RFS.

Activities to resolve issues. HUD contracted with the Urban Institute for a wide-ranging evaluation of data sources and exploration of factors that could potentially affect multifamily originations in the next few years. This work included analyses of RFS, SMLA, and HMDA data, investigations of the methodologies used to construct these three data sources, and discussions with knowledgeable individuals in the lending community. This was supplemented by HUD in-house analyses of RFS, HMDA, SMLA, and GSE data on multifamily volumes. In addition, HUD convened two meetings with experts involved in the collection and compilation of RFS, SMLA, and HMDA data and other experts on mortgage originations. HUD also organized a discussion of affordable multifamily development and the secondary market involving a diverse group of lenders, with Urban Institute researchers. Representatives of Fannie Mae and Freddie Mac were present at all of these meetings. The results of these analyses are summarized below.

2. Multifamily Origination Volumes, 1987–1994

The principal sources of evidence on historical multifamily origination volumes are RFS, SMLA, and HMDA. RFS data show the aggregate face value of mortgage loans by year of origination (in groups of years in the public use RFS data base) which were still outstanding as of the spring 1991 survey date. SMLA and HMDA data represent annual aggregate dollar volumes of loan originations. Table D.1 presents figures for 1987 through 1994.

TABLE D.1.—MULTIFAMILY MARKET ESTIMATES

[Billions of dollars]

Origination year	RFS mortgages outstanding, spring 1991	SMLA originations	HMDA originations
1987	35.7 (avg.) ...	45.1	....
1988	35.7 (avg.) ...	38.2	....
1989	37.4 (avg.) ...	31.1	....
1990	37.4 (avg.) ...	23.6	....
1991	37.4 (avg.) ...	25.5	....
1992	37.4 (avg.) ...	25.7	10.2
1993	37.4 (avg.) ...	31.7	13.3
1994	37.4 (avg.) ...	31.3	15.2

The RFS figures in Table D.1 are expressed on an annualized basis, i.e., value of mortgages originated in 1987 and 1988 (and still outstanding as of 1991) divided by 2, and value originated in 1989–1991 (similarly), divided by 2⅓ (based on the survey date approximately one-third of the way through 1991).

To address the public comments, it is necessary to understand the methods used to compile each of these sources. Findings from HUD's comparative analysis will then be presented.

RFS begins with a sample of properties based on the lists of properties constructed for the decennial censuses of population and housing. The owner of each property is then located and interviewed—whether an owner-occupant or an absentee owner of a property that contains entirely rental or vacant units. The survey instrument includes questions on the mortgage(s) that apply to the property, as well as on property and owner characteristics. Each owner is asked to identify the holder or servicer of any applicable mortgage loans, and a separate lender survey instrument is administered. Responses from the owner questionnaires are linked to responses from the lender questionnaires in the data base as released by the Census Bureau. The strength of this survey is that it presents a highly comprehensive picture of residential financing, since it is based on a property sample rather than on a survey of lenders. Consistent and rigorous statistical and operational quality control procedures are applied throughout.

The data that enter into SMLA are compiled by HUD from source materials generated in various ways from the different institutional types of mortgage lenders. Data on savings associations are collected for HUD by the Office of Thrift Supervision; these data cover all thrifts, not a sample. Mortgage company and life insurance company data are collected through sample surveys conducted by the Mortgage Bankers Association of America and the American Council of Life Insurance, respectively. Data on commercial banks and mutual savings banks are collected on a HUD form from samples of such lenders. The Federal credit agencies and State credit agencies report their data directly to HUD. Local credit agency data are collected by HUD staff from a publication that lists their mortgage financing activities. HUD contracted with ICF, Inc., in 1994 to evaluate the methodology used in constructing the SMLA.[12] ICF concluded that, with respect to the survey of commercial banks and mutual savings banks, ''while there do not appear to be any significant problems with the sampling plan, the sample has never been redrawn since the origination of the [SMLA], and . . . has very likely become seriously outdated . . ..''[13] With respect to mortgage bankers, ICF said that MBA staff had expressed ''concern that estimated data on multifamily . . . originations may not be as reliable as corresponding data on single-family mortgage originations.'' Subsequently, MBA has stopped reporting multifamily originations data to HUD and has begun work to revise its survey procedures. With these two exceptions, ICF concluded that no efforts to improve data collection methodologies appeared warranted.

HMDA data are collected by lending institutions and reported to their respective regulators as required by law. HMDA was enacted as a mechanism to permit the public to determine locations of properties on which local depository institutions make mortgage loans, ''to enable them to determine whether depository institutions are filling their obligations to serve the housing needs of the communities and neighborhoods in which they are located . . .'' (12 USC 2801). HMDA reporting requirements apply to lenders which have offices in Metropolitan Statistical Areas and which have more than $10 million in total assets. (For mortgage bankers, the $10 million includes assets of any parent corporations, reporting is required only if home purchase loan originations exceed 10 percent of total loan originations, and reporting since 1993 has been required only if the institution's annual home purchase loan origination volume is at least 100.) Reporting is required for all loans closed in the name of the lending institution and loans approved and later acquired by the lending institution, including multifamily loans. Thus, the HMDA data base concentrates on lending by depository institutions in metropolitan areas but, unlike SMLA and RFS, it is not a sample survey; it is intended to include loan-level data on all loans made by the institutions that are required to file reports.

The Urban Institute researchers concluded, based on comparison of the methodologies used in the three surveys and on reported problems with SMLA and HMDA (reviewed above), and on direct analyses of each data base (discussed below) that the RFS is ''an excellent survey which represents a good source of information about multifamily originations in the years just prior to the survey, i.e., 1989–1991''.[14] They infer from RFS an estimate of at least $30 billion per year of multifamily originations in 1987–1991.

With this in mind, we proceed to an examination of origination volumes reported by the three data sources by type of lender. Table D.2 shows the basic figures. The column headed ''RFS'' shows the annualized aggregate face value of multifamily loans outstanding as of the 1991 survey date that were originated in the indicated years, as in Table D.1, but disaggregated in table D.2 by category of loan servicer as of the 1991 survey date. The columns headed ''SMLA'' and ''HMDA'' show aggregate dollar volumes of loan originations by category of originator in the indicated years.

In addition to category of loan servicer, RFS also reports the category of holder. Use of data from the servicer category, as in Table D.2, produces the more reliable comparison with the other surveys because multifamily loans that are sold into the secondary market tend to remain serviced by the same category of originating lender. There are several major differences between the servicer and holder breakdowns in RFS. Commercial banks hold 20–30 percent more loans for each origination period than they service. Mortgage bankers hold about one-quarter of the value of loans that they service—one would expect even fewer. Since independent mortgage banking companies are not

[12] Evaluation of Design and Implementation of the Gross Flows Survey of Mortgage Lending Activity, Final Report submitted to HUD, July 31, 1994.

[13] HUD's Office of Housing has issued a Request for Proposals for help with improving the commercial banks component of SMLA.

[14] ''What We Know About Multifamily Mortgage Originations'', p. 5.

chartered to hold loans, these holdings presumably reflect a mis-categorization problem such as loans held by depository institutions of which the mortgage bankers are affiliates. Life insurance companies, pension funds, and REITs hold more than double the value of loans than they service. Federally-sponsored secondary market agencies and pools, and to a lesser extent conventional pools, are significant non-servicing holders of mortgages.

The total SMLA figure for 1987–88 is greater than the corresponding total RFS figure, consistent with attrition from the inventory of multifamily mortgages outstanding before the date of administration of the RFS. SMLA figures are also greater than RFS figures for lender categories, except for mortgage bankers.

The total RFS figure for 1989–91 is greater than the corresponding SMLA figure. To a significant extent, the difference reflects categories of lenders that SMLA does not cover: finance companies, individuals and estates, and ''other'' lenders—these include trust accounts administered by banks, nonprofit organizations, and insurance companies other than life insurance companies.

The main question raised by this comparison is why SMLA and HMDA report such different multifamily estimates for 1993. SMLA reports $31.7 billion while HMDA reports $13.3 billion. The Urban Institute conducted extensive analysis to answer this question. The researchers concluded both that the SMLA multifamily origination volume was too high and the HMDA estimate was too low, creating the large gap in reported 1993 multifamily originations. They concluded that the 1993 lending volume was actually in the range of $25–30 billion, i.e., the SMLA figure may be as much as $7 billion too high and the 1993 HMDA figure is likely at least $12 billion too low. This conclusion is supported by the following analyses:

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Table D.2
Comparison of RFS, SMLA, and HMDA Figures
(billions of dollars)

	1987-88		1989-91		1993	
Type of lender	SMLA	RFS	SMLA	RFS	SMLA	HMDA
Commercial banks	7.6	5.5	9.7	7.8	18.8	4.8
Savings & loans; mutual savings banks	21.6	13.6	11.4	9.5	7.3	6.5
Credit unions	--	0.06	--	0.01	--	0.01
Finance companies	--	0.6	--	3.0	--	--
Mortgage companies	3.5	7.2	4.6	8.6	2.0	1.9
Life insurance companies	3.6	2.5	2.4	2.3	1.5	--
Pension funds (including State & local governments)	0.07	0.08	0.04	0.2	0.2	--
Real estate investment trusts	--	0.09	--	0.2	--	--
State and local government credit agencies	4.1	0.6	1.5	0.3	1.0	--
Federal credit agencies	1.1	1.4	1.3	0.7	0.9	--
Federally sponsored secondary market agencies & pools and private conduits	0	0.3	0	0.1	--	--
Individuals and estates	--	0.9	--	0.9	--	--
Other	--	1.5	--	1.3	--	--
Not reported	--	4.4	--	4.3	--	--
TOTAL	41.6	38.6	30.9	39.1	31.7	13.3

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(a) A commercial banks figure of $7–8 billion is more plausible than SMLA's $18.8 billion for 1993. Comparison of HMDA and SMLA data on loans purchased in 1993 indicates that HMDA missed a significant volume of multifamily loan originations; thus the $4.8 billion HMDA figure is too low. A $7–8 billion figure is implied by combining the HMDA and SMLA data.[15]

(b) The SMLA overestimate for banks is offset by underestimation of multifamily loans for some lender categories, particularly mortgage bankers, loans by individuals, and life insurance companies.[16]

(c) A conclusion that HMDA underreports multifamily originations is supported by a comparison between HMDA and Fannie Mae data. Loans reported in HMDA as sold to Fannie Mae in 1993 tend to be smaller in size than Fannie Mae's 1993 multifamily originations as shown in the Fannie Mae data base. In addition, 41 percent of Fannie Mae's 1993 multifamily mortgage purchases were found to be in tracts where HMDA reported no multifamily originations. It appears that larger multifamily loans tend not to be reported in HMDA. Further evidence of the poor quality of the HMDA multifamily data is the fact that it reported that in 1993 more multifamily loans were sold to Freddie Mac than to Fannie Mae, when in fact Freddie Mac's purchases were only a small fraction of Fannie Mae's purchases.

(d) In addition, the HMDA data base does not cover a number of important categories of multifamily lenders such as life insurance companies and State housing finance agencies, providing another reason that the HMDA data understates the size of the multifamily market.

(e) The conclusion regarding HMDA is further supported by an analysis of RFS data, projecting loan terminations for to 1993 based on RFS's estimates of loans outstanding by maturity in 1991, using a hazard modeling framework.[17]

The SMLA figures, with the adjustments for 1993 discussed above, indicate a volume of multifamily mortgage originations of at least $30 billion around 1990, dropping to around $25 billion in the early 1990s. The inconsistency between the revised SMLA estimate and the HMDA 1993 estimate is the result of HMDA's underestimation for commercial banks and mortgage companies, and omission of several important lending categories shown in SMLA and RFS.

The estimate of $25–30 billion annual lending volume for 1993 and other years in the early 1990s represents around 10 percent of the aggregate value of multifamily mortgage debt outstanding, which was estimated by RFS at $329 billion as of Spring 1991.[18] Such an originations-to-outstanding debt ratio is consistent with the value of this ratio during the preceding several years, which provides further support both for the conclusion regarding 1993 and for HUD's extrapolation to 1996 and beyond.

3. Projections for 1996 and Beyond

Of the three data bases described above, the greatest confidence appears warranted for the RFS. The Urban Institute researchers therefore developed a model to project multifamily origination volumes from the 1991 survey date forward, based on RFS data on mortgages by year since origination. They applied a statistical model of mortgage terminations based on Freddie Mac's experience from the mid-1970s to around 1990. While mortgage characteristics in 1990 are not wholly similar to the characteristics of these historical mortgages financed by Freddie Mac, nevertheless the prepayment propensities of contemporary mortgages may at least be approximated by the prepayment experience of these historical mortgages. The research methodology took account of the influence of interest rate fluctuations on prepayments of the historical mortgages; the projections assumed that prepayments are motivated mainly by property sales.[19]

The analysis began with the $273 billion of outstanding first mortgage debt shown by RFS for 1991. Forecast mortgage origination volumes based on mortgages existing in 1991 were: $27 billion for 1993 (providing a useful point of comparison with the HMDA and SMLA figures referenced earlier), $37 billion for 1996 and $40 billion for 1997, the years to which this rulemaking applies. New construction was projected to add slightly less than $7 billion of mortgage lending volume each year to these figures.

These analyses imply an aggregate volume approaching $40 billion for the whole multifamily market in 1996. To derive an estimate of the market relevant to Fannie Mae and Freddie Mac, we exclude (a) FHA-insured loans, and (b) loans insured by State bonding agencies and held by State and local credit agencies. Other categories of mortgages, considering the type of insurer, servicer, or holder, do not tend to have mortgage characteristics that differ substantially from the multifamily mortgages that are purchased by Fannie Mae and Freddie Mac. There is thus no particular basis for excluding them.

Based on this analysis, $30-$35 billion per year are reasonable projections of multifamily mortgage origination volumes for 1996. Urban Institute analysis indicates an increasing level in 1997 and beyond.[20]

D. Single-Family Owner and Rental Mortgage Market Shares

1. Available Data

HUD projects that originations for single-family properties will total $700 billion in 1996. Because this projection is based on HUD's Survey of Mortgage Lending Activity, it combines mortgage originations for the three different types of single-family properties: owner-occupied, one-unit properties (SF-O); 2–4 unit rental properties (SF 2–4); and 1–4 unit rental properties owned by investors (SF-Investor). The fact that the goal percentages are much higher for the two rental categories argues strongly for disaggregating single-family mortgage originations by property type. This section discusses available data for estimating the relative size of the single-family rental mortgage market.

The RFS and HMDA are the two data sources for estimating the relative size of the single-family rental market. The RFS provides mortgage origination estimates for each of the three single-family property types. HMDA divides single-family mortgage originations into two property types:[21]

(1) Owner-occupied originations, which include both SF–O and SF 2–4.

(2) Non-owner-occupied mortgage originations, which include SF Investor.

The percentage distributions of mortgages from these data sources are as follows:

[15] ''Estimating the Volume of Multifamily Mortgage Originations for Commercial Banks.''

[16] ''What We Know About Mortgage Originations,'' p. 20.

[17] ''An Alternative Methodology to Estimate the Volume of Multifamily Mortgage Originations.''

[18] SMLA's figure is $245 billion as of the end of 1992. SMLA's coverage is less than RFS's. This figure is based on call reports and not subject to the methodological comments concerning SMLA's bank origination volume estimates.

[19] This is the methodology used to construct the 1993 RFS-based estimate cited above.

[20] ''An Alternative Methodology to Estimate the Volume of Multifamily Mortgage Originations.''

[21] This ignores the HMDA loans with ''non-applicable'' for owner type.

	1993 HMDA (percent)	1994 HMDA (percent)	1987–91 [22] RFS (percent)	HUD's proposed rule (percent)
SF–O	94.3	92.0	80.4	88.0
SF 2–4	(Included above).	....	2.3	2.0
SF Investor	5.7	8.0	17.3	10.0
Total	100.0	100.0	100.0	100.0

Because HMDA combines the first two categories, the comparisons between the data bases must necessarily focus on the SF investor category. The RFS estimate of 17.3 percent is over twice HMDA's highest estimate. In its proposed rule, HUD projected a 10.0 percent share for the SF investor group, only two percentage points higher than the 1994 HMDA figure. In fact, HUD's projection appears quite conservative relative to the RFS estimate of 17.3 percent.

2. Urban Institute Analysis—Investor Market Share

HUD asked the Urban Institute to analyze the differences between the RFS and HMDA investor shares and determine which was the more reasonable. The Urban Institute's analysis of this issue is contained in a report by Dixie Blackley and James Follain.[23] Blackley and Follain provide reasons why HMDA should be adjusted upward as well as reasons why the RFS should be adjusted downward. One reason for adjusting HMDA's investor share upward is that the investor share of mortgage originations as reported by HMDA is much lower that the investor share of the single-family rental stock as reported by the AHS. The fact that investor loans prepay at a faster rate than other single-family loans suggests to Blackley and Follain that the investor share of single-family mortgage originations should be higher—not lower—than the investor share of the single-family housing stock. Follain and Blackley conclude that ''this brings into question the investor share based upon HMDA data'' (page 15).

The RFS's investor share should be adjusted downward in part because the RFS assigns all vacant properties to the rental group, but some of these are likely intended for the owner market, especially among one-unit properties. Blackley and Follain's analysis of this issue suggests lowering the investor share from 17.3 percent to about 14–15 percent.

Blackley and Follain note that a conservative estimate of the SF investor share is advisable because of the difficulty of measuring the magnitudes of the various effects that they analyzed.[24] They conclude that 10 percent and 12 percent are reasonable estimates of the investor share of single-family mortgage originations.[25] As noted earlier, HUD projected an investor share of 10 percent in its proposed rule. Blackley and Follain caution that uncertainty exists around these estimates because data bases needed to estimate these parameters do not provide precise measures of their size.

3. Single-Family Market in Terms of Unit Shares

The market share estimates for the housing goals need to be expressed as percentages of units rather than as percentages of mortgages. Thus, it is necessary to compare unit-based distributions of the single-family mortgage market under the alternative estimates discussed so far. The mortgage-based distributions given above in Section D.1 were adjusted in two ways. First, the owner-occupied HMDA data were disaggregated between SF–O and SF 2–4 mortgages based on RFS data, which show that SF 2–4 mortgages represent approximately 2 percent of all single-family mortgages. Second, the resulting mortgage-based distributions were shifted to unit-based distributions by applying the unit-per-mortgage assumptions in HUD's proposed rule. HUD assumed 2.25 units per SF 2–4 property and 1.35 units per SF investor property; both figures were derived from the 1991 RFS.[26]

[22] The year-by-year distributions from the RFS were not too different from the average distribution given in the text.

[23] Dixie M. Blackley and James R. Follain, ''A Critique of the Methodology Used to Determine Affordable Housing Goals for the Government Sponsored Housing Enterprises,'' October 1995.

[24] For example, they note that discussions with some lenders suggest that because of higher mortgage rates on investor properties, some HMDA-reported owner-occupants may in fact be ''hidden'' investors; however, it would be difficult to quantify this effect. They also note that some properties may switch from owner to renter properties soon after the mortgage is originated. While such loans would be classified by HMDA as owner-occupied at the time of mortgage origination, they could be classified by the RFS as rental mortgages. Again, it would be difficult to quantify this effect given available data.

[25] *Ibid.*, page 22.

[26] The unit-per-mortgage data from the 1991 RFS match closely the GSE purchase data for 1993 and 1994. Blackley and Follain show that an adjustment for vacant investor properties would raise the average units per mortgage to 1.4; however, this increase is so small that it has little effect on the overall market estimates.

	1994 HMDA (percent)	1987–91 RFS (percent)	HUD's proposed rule (percent)	Blackley/ Follain alternative (percent)
SF–O	85.4	73.8	83.0	80.6
SF–2–4 Owner [27]	1.9 (est.)	2.1	1.9	1.9
SF 2–4 Renter	2.4 (est.)	2.7	2.4	2.3
SF Investor	10.3	21.4	12.7	15.2
Total	100.0	100.0	100.0	100.0
SF-Rental	12.7	24.1	15.1	17.5

Three points should be made about these data. First, notice that the ''SF-Rental'' row highlights the share of the single-family mortgage market accounted for by all rental units.

Second, notice that the rental categories represent a larger share of the unit-based market than they did of the mortgage-based market reported earlier. This, of course, follows directly from applying the loan-per-unit expansion factors.

Third, notice that the rental share under HMDA's unit-based distribution is again about one-half of the rental share under the RFS's distribution. The rental share in HUD's proposed rule is slightly larger than that reported by HMDA. The rental share in the ''Blackley-Follain'' alternative is slightly above that in HUD's proposed rule.[28]

4. Conclusions

This section has reviewed data and analyses related to determining the rental share of the single-family mortgage market. There are two main conclusions:

(1) The analytical findings do not support public commenters who argued that HUD had overestimated the single-family rental market in its proposed rule. While there is uncertainty concerning the relative size of this market, the projections made by HUD appear reasonable and, in fact, are below one set of the ''best estimates'' provided by Blackley and Follain.

(2) HMDA likely underestimates the single-family rental mortgage market. Thus, this part of the HMDA data are not considered reliable enough to use in computing the market shares for the housing goals. HMDA's rental data are included, however, in various sensitivity analyses of the market shares conducted in Sections F, G, and H. These analyses will show the effects on the overall market estimates of the different projections about the size of the single-family rental market.

E. HUD's Market Share Model

This section integrates findings from the previous two sections about the absolute size of the multifamily mortgage market and the relative distribution of single-family owner and rental mortgages into a single model of the mortgage market. The section provides the basic equations for HUD's market share model and identifies the remaining parameters that must be estimated.

The output of this section is a unit-based distribution for the four property types discussed in Section B.[29] Sections F–H will apply goal percentages to this property distribution in order to determine the size of the mortgage market for each of the three housing goals.

1. Basic Equations for Determining Units Financed in the Mortgage Market

The model first estimates the number of dwelling units financed by conventional conforming mortgage originations for each of the four property types. It then determines each property type's share of the total number of dwelling units financed.

a. Single-Family Units

This section estimates that 5.11 million single-family units will be financed in the conventional conforming market in 1996, where single-family units (SF–UNITS) are defined as:

SF–UNITS = SF–O + SF 2–4 + SF–INVESTOR

First, we estimate the dollar volume of conventional conforming single-family mortgages (CCSFM$):

(1) CCSFM$ = CONF% * CONV% * SFORIG$

Where:

CONF% = conforming mortgage originations as a percent (measured in dollars) of conventional single-family originations; estimated to be 83%.[30]

CONV% = conventional mortgage originations as a percent of total mortgage originations; forecasted to 78% by industry and GSEs.[31]

SFORIG$ = dollar volume of single-family one-to-four unit mortgages; projected to be $700 billion [32] in 1996 based on industry and GSE market forecasts.[33]

Substituting these values into (1) yields an estimate for CCSFM$ of $453 billion.

[27] Notice that the SF 2–4 category has been divided into its owner and renter subcomponents. This is easily done based on the assumption of 2.25 units per SF 2–4 mortgage. For each mortgage, one unit represents the owner occupant and 1.25 additional units represent renter occupants. The owner-occupant is included in the SF–O category in this Appendix. This is necessary because different data sources are used to estimate the owner's income and the affordability of the rental units. The income of owners of 2–4 properties are included in the borrower income data reported by HMDA. The AHS will be used to estimate the affordability of the rental units.

[28] Blackley and Follain say that 10 or 12 percent are reasonable estimates. Since HUD's proposed rule was approximately 10 percent, the ''Blackley-Follain'' alternative assumes that investors account for 12 percent of all single-family mortgages.

[29] The property distribution reported in Section A is an example of the output of the market share model. Thus, this section completes Step 1 of the three-step procedure outlined in Section A.

[30] The model projects that the conventional market share will increase slightly over its 81.4 percent of total mortgage originations in 1994.

[31] Data provided by Fannie Mae show that conforming loans have been about 78 percent of total conventional loans over the past few years.

[32] Single-family mortgage originations are estimated to be $700 billion in 1996, a reduction of $310 billion from the record setting $1,010 billion in 1993 and a reduction of $70 billion from the $770 billion in 1994. These reductions are due to the decline in refinance activity which is projected to fall from almost 60 percent of originations in 1993 to 25 percent in 1996.

[33] Fannie Mae, Freddie Mac, and the Mortgage Bankers Association have provided HUD with projections of 1996 single-family originations. Because the 1997 market is expected to be similar to the 1996 market, the discussion focuses on the 1996 market. The various market estimates reported in Sections E, F, and G for the 1996 market serve as a proxy for the 1997 market.

Second, we estimate the number of conventional conforming single-family mortgages (CCSFM#):

(2) CCSFM# = CCSFM$/SFLOAN$

Where:

SFLOAN$ = the average conventional conforming mortgage amount for single-family properties; estimated to be $94,000.[34]

Substituting this value into (2) yields an estimate of 4.82 million mortgages in 1996.

Third, we estimate the total number of single-family mortgages among the three single-family property types. Using the 88/2/10 percentage distribution for single-family mortgages from HUD's proposed rule (see Section C), the following results are obtained:

(3a) SF–OM# = .88 * CCSFM# = number of owner-occupied, one-unit mortgages = 4.24 million.

(3b) SF–2–4M# = .02 * CCSFM# = number of owner-occupied, two-to-four unit mortgages = .10 million.

(3c) SF–INVM# = .10 * CCSFM# = number of one-to-four unit investor mortgages = .48 million.

Fourth, we determine the number of dwelling units financed by these single-family mortgages:

(4a) SF–O = SF–OM# + SF–2–4M# = number of owner-occupied dwelling units financed = 4.34 million.

(4b) SF 2–4 = 1.25 * SF–2–4M# = number of rental units in 2–4 properties where a owner occupies one of the units = .12 million.[35]

(4c) SF–INVESTOR = 1.35 * SF–INVM# = number of single-family investor dwelling units financed = .65 million.

Summing equations 4a–4c gives 5.11 million for the projected number of newly-mortgaged single-family units (SF–UNITS).

b. Multifamily Units

The number of dwelling units financed by conventional conforming multifamily originations is:

(5) MF–UNITS = CCMFM$/MFLOAN$

Where:

CCMFM$ = conventional conforming mortgage originations, which are projected to be $30 billion; as discussed in Section C, alternative estimates of the multifamily market will be included in the analysis.

MFLOAN$ = average loan amount per housing unit in multifamily properties = $30,000.[36]

Substituting these values into (5) yields a projection for MF–UNITS of 1.0 million.

c. Total Units Financed

The total number of dwelling units financed by the conventional conforming mortgage market (TOTAL) can be expressed in three useful ways:

(6a) TOTAL = SF–UNITS + MF–UNITS = 6.11 million

(6b) TOTAL = SF–O + SF 2–4 + SF–INVESTOR + MF–UNITS

(6c) TOTAL = SF–O + SF–RENTAL + MF–UNITS

Where SF–RENTAL equals SF–2–4 plus SF–INVESTOR.

2. Property Distributions

The next step is to express the number of dwelling units financed for each property type as a percentage of the total number of units financed by conventional conforming mortgage originations.[37]

The projections used above in equations (1)–(6) produce the following distributions of financed units by property type:

	Percent share		Percent share
SF–O	71.0		
SF 2–4	2.0	SF–O	[38] 71.8
SF INVESTOR.	10.6	SF–RENTER.	12.6
MF–UNITS	16.4	MF–UNITS	16.4
Total	100.0	....	100.0

Sections C and D discussed alternative projections for the volume of the multifamily originations and the investor share of single-family mortgages. The analysis in this appendix will consider three multifamily origination levels—$23 billion, $30 billion, and $35 billion—and three projections about the investor share of single-family mortgages—7 percent, 10 percent, and 12 percent. The middle values ($30 billion and 10 percent) will be considered the ''baseline'' projections throughout the Appendix.

Table D.3 reports the unit-based distributions produced by HUD's market share model for different combinations of these projections. The effects of the different projections can best be seen by examining the owner category which varies by 9 percentage points, from a low of 67.2 percent (multifamily originations of $35 billion coupled with an investor mortgage share of 12 percent) to a high of 76.0 percent (multifamily originations of $23 billion coupled with an investor mortgage share of 7 percent). The owner share under the baseline projections ($30 billion and 10 percent) is 71.0 percent.

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[34] The Federal Housing Finance Board's 1994 Mortgage Interest Rate Survey (MIRS) reported an average loan size of $109,900 for one-unit, owner-occupied conventional mortgages. Assuming that 78 percent of the dollar volume of conventional single-family originations is conforming and that 90 percent of the number of conventional originations are conforming, the average loan amount for one-unit, owner-occupied mortgages in the conforming market is obtained by multiplying $109,900 by (.78/.90); this produces $95,246. A small adjustment (based on GSE data) is applied to this figure to reflect the fact that SFORIG$ includes a relatively small volume of mortgages for two-to-four-unit and investor properties (see Section C above). This produces an average loan size of about $94,000 for the conventional conforming market.

[35] Based on the RFS, there is an average of 2.25 housing units per mortgage for 2–4 properties. 1.25 is used here because one (i.e., the owner occupant) of the 2.25 units is allocated to the SF–O category. The RFS is also the source of the 1.35 used in (4c).

[36] Blackley and Follain, *op. cit.*, p. 10.

[37] The share of the mortgage market accounted for by owner occupants is (SF–O)/TOTAL; the share of the market accounted for by all single-family rental units is SF–RENTAL/TOTAL; and so on.

[38] Owners of 2–4 properties account for 1.6 percentage points of the 71.0 percent for SF–O.

Table D-3
Distribution of Financed Dwelling Units by Property Type For Different Projections of Multifamily and Single-Family Investor Originations

Investor Share Percentage Single-Family Mortgage Market	Size of Multifamily Market		
	$23 Billion	$30 Billion	$35 Billion
10 Percent			
Single-Family Owner-Occupied	73.0 %	71.0 %	69.1 %
Single-Family Rental	12.9	12.6	12.3
Multifamily	14.1	16.4	18.6
Total	100.0	100.0	100.0
7 Percent			
Single-Family Owner-Occupied	76.0 %	74.0 %	72.0 %
Single-Family Rental	9.8	9.5	9.3
Multifamily	14.2	16.5	18.7
Total	100.0	100.0	100.0
12 Percent			
Single-Family Owner-Occupied	70.9 %	69.1 %	67.2 %
Single-Family Rental	15.1	14.7	14.3
Multifamily	14.0	16.3	18.5
Total	100.0	100.0	100.0

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Comparison with the RFS. The Residential Finance Survey is the only mortgage data source that provides unit-based property distributions similar to those reported in Table D.3. Based on RFS data for 1987 to 1991, HUD estimated that, of total dwelling units in properties financed by recently acquired conventional conforming mortgages, 56.5 percent were owner-occupied units, 17.9 percent were single-family rental units, and 25.6 percent were multifamily rental units.[39] Thus, the RFS presents a much lower owner share than does HUD's model. This difference is due mainly to the relatively high level of multifamily originations during the mid- to late-1980s, which is the period covered by the RFS.[40]

3. Sensitivity of Property Distributions to Changes in Other Model Parameters

The multifamily and single-family rental markets are not the only areas where some degree of uncertainty exists about their magnitudes. HUD examined the sensitivity of the property distributions given in Table D.3 to changes in several other model parameters. Most of these sensitivity analyses will be reported when discussing the market estimates for each of the housing goals. Suffice it to say here that any changes that reduce the owner category—such as reducing the overall level of single-family origination activity or raising the per unit loan amounts for single-family mortgages—tend to increase the market estimates for each of the housing goals. This occurs because the goal percentages for owner mortgages are lower than those for rental housing.

F. Size of the Conventional Conforming Mortgage Market Serving Low- and Moderate-Income Families

This section estimates the size of the low- and moderate-income market by applying low- and moderate-income percentages to the property shares given in Table D.3. This section essentially accomplishes Steps 2 and 3 of the three-step procedure discussed in Section B.

Technical issues and data adjustments related to the low- and moderate-income percentages for owners and renters are discussed in the first two subsections. Then, estimates of the size of the low- and moderate-income market are presented along with several sensitivity analyses. Based on these analyses, HUD concludes that 48–52 percent is a reasonable estimate of the mortgage market's low- and moderate-income share for 1996 and 1997. It is assumed that similar shares will exist following 1997.

The final rule establishes the Low- and Moderate-Income Goal for 1996 at 40 percent of the total number of dwelling units financed by the GSE's mortgage purchases for 1996. The level of the goal for 1997 and subsequent years is 42 percent of each year's mortgage purchases.

1. Low- and Moderate-Income Percentage for Single-Family Owner Mortgages

a. HMDA Data

The most important determinant of the low- and moderate-income share of the mortgage market is the income distribution of single-family borrowers. HMDA reports annual income data for families living in metropolitan areas who purchase a home or refinance their existing mortgage.[41] Table D.4 gives the percentage of mortgages taken out by low- and moderate-income families for the years 1992, 1993, and 1994. For each year, an unadjusted low- and moderate-income percentage is reported as well as one based on the adjustments that HUD made in its proposed rule, that is, excluding loans less than $15,000 and excluding loans where the loan-to-income ratio was greater than six.[42] The additional adjustments reported for 1993 and 1994 will be discussed below.

Table D.4 also reports similar data for very-low-income families (that is, families with incomes less than 60 percent of area median income). These data will be used in Section H to estimate the special affordable mortgage market.

Two trends in the income data should be mentioned. First, the percentage of borrowers with less than area median income has increased significantly over the past three years—borrowers with less than median income increased from 33.5 percent of the home purchase market in 1992 to 42.6 percent of that market in 1994. This jump in low-income lending has been attributed to historically low interest rates during this period and to affordable lending initiatives and outreach efforts on the part of lenders, private mortgage insurers, and the GSEs. Second, the characteristics of borrowers refinancing mortgages appears to have changed between 1993 and 1994. During the refinancing waves of 1992 and 1993, refinancing borrowers had much higher incomes than borrowers purchasing homes. But during 1994 these two groups exhibited practically the same income distributions.

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[39] Restricting the RFS analysis to 1991 resulted in only minor changes to the market shares.

[40] Between 1987 and 1991, annual multifamily mortgage originations averaged $32 billion, representing 7.2 percent of conventional mortgage originations. In 1994, conventional multifamily originations stood at $30 billion but because of the increase in single-family originations since the late 1980s, the multifamily share of total originations had dropped to 4.5 percent. In HUD's projection model, the $30 billion in multifamily originations represents 4.9 percent of total conventional originations for 1996.

[41] As noted earlier, HMDA data are expressed in terms of number of loans rather than number of units. In addition, HMDA data do not distinguish between owner-occupied one-unit properties and owner-occupied 2–4 properties. This is not a particular problem for this section's analysis of owner incomes.

[42] The purpose of the first adjustment was to drop from the analysis small loans (such as mobile home loans) which the GSEs do not typically purchase; the purpose of the second adjustment was to cleanse the data base of outliers and likely coding errors. As discussed below, a more direct adjustment for mobile homes is made in this final rule.

Table D-4

Single-Family Owner-Occupied Mortgage Market by Borrower Income

	Low- and Moderate- Income			Very- Low- Income		
	Purchase	Refinance	Total	Purchase	Refinance	Total
1992 HMDA						
A. All Loans	35.0%	26.2%	29.0%	9.4%	5.4%	6.7%
B. Proposed Rule	33.5%	25.1%	27.8%	7.8%	4.2%	5.4%
1993 HMDA						
A. All Loans	39.6%	30.1%	32.9%	11.5%	6.4%	7.9%
B. Proposed Rule	38.2%	29.3%	32.0%	10.0%	5.6%	6.9%
C. All Without Mobile Homes						
(1) 75,000	37.9%	30.1%	32.3%	10.3%	6.4%	7.5%
(2) 100,000	37.3%	30.0%	32.1%	9.9%	6.4%	7.3%
(3) 125,000	36.6%	30.0%	31.9%	9.4%	6.3%	7.2%
(4) 150,000	36.0%	30.0%	31.7%	9.0%	6.3%	7.1%
D. C Plus Additional Adjustments						
(1) 75,000	36.9%	29.4%	31.5%	9.1%	5.6%	6.6%
(2) 100,000	36.4%	29.4%	31.3%	8.8%	5.6%	6.5%
1994 HMDA						
A. All Loans	42.6%	40.4%	41.6%	13.1%	11.8%	12.5%
B. Proposed Rule Method	41.1%	39.1%	40.2%	11.2%	10.4%	10.9%
C. All Without Mobile Homes						
(1) 100,000	40.8%	40.3%	40.6%	11.9%	11.7%	11.8%
(2) 125,000	40.3%	40.3%	40.3%	11.5%	11.7%	11.6%
(3) 150,000	39.8%	40.3%	40.0%	11.2%	11.7%	11.4%
(4) 200,000	38.7%	40.2%	39.4%	10.5%	11.7%	11.1%
D. C Plus Additional Adjustments						
(1) 100,000	39.6%	39.1%	39.4%	10.3%	10.4%	10.2%
(2) 125,000	39.2%	39.1%	39.1%	10.1%	10.4%	10.4%
American Housing Survey						
1985			27.0%			9.0%
1987			32.0%			10.0%
1989			34.0%			11.0%
1991			36.0%			14.0%
1993	38.7%	28.6%	33.0%	12.9%	8.1%	10.1%
Average(1985-93)			32.3%			10.6%

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b. Adjustment for Mobile Home Loans

The GSEs do not purchase mobile home loans under their seller/servicer guidelines unless they are real estate loans, that is, the home must have a permanent foundation and the site must be either purchased as part of the transaction or already owned by the borrower. A 1993 study estimated that only 10 percent of existing mobile homes could qualify under GSE guidelines, but industry trends (more homes on private lots and on concrete foundations) suggest that this percentage has grown in the past few years.[43] Mobile home loans present a problem for this analysis because an unknown number of them are included in the HMDA data. Since mobile homes are disproportionately occupied by lower-income families, their inclusion in HMDA data overstates the number of low-income loans eligible for GSE purchase under their seller/servicer guidelines. In other words, the 42.6 percent share for less-than-median-income home purchasers given in Table D.4 overstates the low- and moderate-income share of home purchase loans available to the GSEs in 1994.

According to industry representatives, it is unclear how many mobile home lenders report to HMDA, and for those that do report to HMDA, how many provide information on their non-real estate loans. HUD was able to identify four lenders in the HMDA data that primarily originate mobile home loans.[44] According to HMDA, these lenders originated 101,493 owner-occupied loans in 1993 and 124,251 in 1994. Reflecting the fact that over half of all mobile homes are sold in nonmetropolitan areas, only 33,813 (33 percent) of the four lenders' 1993 loans and 48,400 (39 percent) of their 1994 loans had geocode information (such as census tract or MSA code) indicating that the loans were for properties located in metropolitan areas.

With this information, ''ineligible'' mobile home loans under the GSE seller/servicer guidelines could be deducted from the unadjusted HMDA data in three steps. First, the percentage income distribution of the above-mentioned geocoded mobile home loans[45] could be applied to an ''estimate'' of the total number of geocoded mobile home loans included in the HMDA data base. (As discussed below, obtaining this ''estimate'' is the difficult part.) This would produce numbers of projected mobile home loans by income category. Next, the projected mobile home loans could be deducted from HMDA's unadjusted numbers for each income category. This would produce estimates of HMDA-reported, non-mobile-home loans by income category. Finally, a percentage income distribution could be calculated from these adjusted HMDA data.

HUD examined other data on the size of the mortgage market for mobile homes in order to determine some upper bounds for the ''estimate'' required in the first step. According to the American Housing Survey, there were 235,000 newly-constructed mobile homes in 1993, and 99,300 of these were located in metropolitan areas. About 85,000 of the newly-constructed mobile homes in metropolitan areas were financed with a mortgage or installment contract, rather than purchased ''free and clear.'' The other major category of mobile home lending involves purchases of existing mobile homes.[46] According to the AHS, 95,000 existing mobile homes located in metropolitan areas were sold and purchased using a mortgage or installment contract during 1993. Thus, the AHS estimates that there were about 180,000 owner-occupied mobile homes purchased and financed during 1993.[47] Assuming that 10–15 percent of these 180,000 loans are ''eligible'' under the GSE guidelines would reduce the estimate of ineligible loans to the 155,000–165,000 range.

Adjusted HMDA Data. Table D.4 shows the effects of a series of estimates of the size of the mobile home loan market included in HMDA. Adjusting HMDA data in the manner described earlier reduces the low- and moderate-income percentage for 1993 home purchase loans from the unadjusted HMDA figure of 39.6 percent to 37.9 percent if one assumes that 75,000 ineligible mobile home loans are included in HMDA income data, and to 37.3 percent if one assumes 100,000.[48] Increasing the assumptions to 125,000 and 150,000 ineligible mobile home loans reduces the low- and moderate-income percentage further to 36.6 percent and 36.0 percent, respectively.

As shown in Table D.4, the market share for very-low-income families is proportionately more affected by the adjustment than is the market share for less-than-median-income families. For instance, the home purchase share for very-low-income home purchase borrowers falls from 11.5 percent to 10.3 percent assuming that 75,000 mobile home loans are included in the 1993 HMDA data, and to 9.0 percent assuming that 150,000 mobile home loans are included in the HMDA data.

Mobile home loans were excluded from the AHS income data reported in Table D.4. For home purchase loans, that data show a 38.7 percent low- and moderate-income percentage and a 12.9 percent very-low-income percentage for 1993. Thus, the AHS income data suggest that the larger deductions for mobile homes (125,000 and 150,000) are probably too high.[49] In addition, when the 150,000 ''estimate'' was applied in the above three-step procedure, mobile homes accounted for all of the low- and moderate-income loans less than $15,000 included in the 1993 HMDA data base.[50] While the appropriate deduction of mobile home loans from HMDA data is not known, it appears to be much less than the higher estimates reported in Table D.4.

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[43] See the study conducted by The Hamilton Securities Group (dated September 1993) for the National Commission on Manufactured Housing. Data supporting the 10 percent estimate for existing mobile homes was not provided by Hamilton.

[44] These lenders were Green Tree Acceptance, Vanderbilt Mortgage, The CIT Group, and Oakwood. Green Tree is estimated to account for 20–30 percent of the mobile home market.

[45] The income distribution for the 48,400 loans included in the 1994 HMDA data is: 34.5% had income less than 60% of AMI, 23.6% had income 60–80% of AMI, 17.2% had income 80–100% of AMI, and 24.7% had income greater than 100% of AMI. This can be compared with the income distribution for all HMDA loans reported in Table D.4. A mobile home loan borrower is almost three times more likely to have a very low income than the typical borrower (34.5% versus 12.5%). (Similar results were obtained for 1993 HMDA data.)

[46] Only about 5 percent of the identified mobile home loans were refinance loans. This explains why the income percentages for refinance loans in Table D.4 do not change very much, and why the change in total loans is much less than the change in home purchase loans. Manufactured Housing Insurance staff tell us that mobile home refinance loans are uncommon. Even if mobile home refinance loans were important, the 25 percent refinance share for 1996 loans in HUD's model would reduce the importance of this issue.

[47] It should be noted that the AHS sample for recent movers purchasing mobile homes was small which means that this estimate is subject to some degree of uncertainty.

[48] It should be noted that the adjustments made in HUD's proposed rule produce about the same effects as the mobile home adjustments discussed above; this can be seen by comparing percentages in row B with those in rows C(1) and C(2) of Table D.4. One reason for this similarity is that many mobile home loans are less than $15,000 and these were excluded from HUD's analysis in the proposed rule.

[49] Even adjusting the 12.9 percent figure for possible underreporting of income in the AHS (see discussion below) would not affect this conclusion. The AHS estimate of the very-low-income percentage would remain much higher than the 9.4 (9.0) percent figure associated with deducting 125,000 (150,000) mobile home loans from the 1993 HMDA data.

[50] This also happened when the 200,000 ''estimate'' was applied to 1994 HMDA data. Table D.4 gives higher ''estimates'' for 1994 HMDA because the U.S. Census reports that newly-constructed mobile homes increased by 50,000 (on a nationwide basis) between 1993 and 1994. Whether purchases of existing mobile homes also increased, or even declined, is not known.

c. Additional Adjustments to HMDA Data

Proposed Rule Adjustments. After deducting estimates of ineligible mobile home loans, HUD made the same deductions as in its proposed rule—that is, from the remaining estimate of non-mobile-home loans, HUD deducted loans less than $15,000 and loans with a loan-to-income ratio greater than six. The effects of these adjustments are shown in rows D(1) and D(2) of Table D.4. For instance, the low- and moderate-income percentage for 1994 home purchase loans falls from 42.6 percent (unadjusted HMDA) to 40.8 percent (due to dropping 100,000 mobile homes) to 39.6 percent (due to the proposed rule adjustments). In this case, the 1994 market share for very-low-income borrowers falls from 13.1 percent to 11.9 percent to 10.3 percent—a reduction of over 20 percent. When the AHS percentages given in Table D.4 are adjusted for loans less than $15,000 and for loans with a loan-to-income ratio greater than six, the low- and moderate-income percentage for home purchase loans falls from 38.7 to 37.2, while the very-low-income percentage for home purchase loans falls from 12.9 to 11.1.

Possible Bias in HMDA Data. There is evidence that HMDA may be over-reporting lower-income loans relative to higher-income loans. Jim Berkovec and Peter Zorn compared loans that were reported by HMDA as being sold to Freddie Mac with loans that Freddie Mac's own records show as being purchased by Freddie Mac.[51] Their major conclusion was that 1992 and 1993 HMDA data contain only 65–70 percent of conventional mortgage loans. They also found that HMDA's coverage varied across census tracts, with coverage being higher in lower-income census tracts.[52] While there was some correlation with the percent minority population in the census tract, it largely disappeared when controlling for income.

For a census tract configuration approximating the underserved area definition in HUD's proposed rule, Berkovec and Zorn's simulations suggest that the market share for these tracts should be adjusted by a factor of 90%-95% in 1992 and by 85%-95% in 1993.[53] However, Berkovec and Zorn caution that their analysis does not look at the whole mortgage market; rather, it looks only at HMDA loans reported as being sold to Freddie Mac. Loans sold to Fannie Mae are not included in Berkovec and Zorn's analysis. Thus, systematic over-reporting of low income loans sold to Freddie Mac could also explain their findings.

The low- and moderate-income goal is defined in terms of borrower incomes, not census tract incomes as analyzed by Berkovec and Zorn. Thus, HUD compared income distributions of loans that HMDA reports were originated in 1993 and 1994 and sold to one of the GSEs in the year of origination with income distributions of loans that the GSEs report were purchased by them in 1993 and 1994 in the same year as origination. The results were consistent with Berkovec and Zorn's findings that HMDA may be over-reporting lower-income loans and that the over-reporting may be greater the lower the income. In 1993, the low- and moderate-income share of loans reported by HMDA as being sold to the GSEs was 1.7 percentage points greater than the low- and moderate-income share of loans that the GSEs report they purchased in 1993 (34.2 percent versus 32.5 percent); this translates into a five percent rate of over-reporting. The corresponding very-low-income shares, on the other, differed by almost ten percent (7.1 percent based on HMDA data versus 6.5 percent based on GSE data). But as noted by Berkovec and Zorn, the absolute difference (0.6 percent in this case) is not so great because of the relatively small number of loans originated for very-low-income borrowers. Similar results were obtained when comparing 1994 HMDA and GSE data.

The above comparisons suggest that low- and moderate-income percentages reported in row D of Table D.4 may need a slight further adjustment for HMDA's over-reporting of lower income loans. But, as noted earlier, 1993 AHS data suggest that HMDA data does not need to be adjusted downward. Because of this uncertainty, HUD considers several possible values of the low- and moderate-income percentage for owners when computing the low- and moderate-income market share estimates in Section F.3 below.

d. American Housing Survey Data

Borrower income data from the American Housing Survey are included in Table D.4.[54] The low- and moderate-income percentages from the 1993 AHS are similar to those reported by 1993 HMDA data. According to the AHS, 38.7 percent of those families who recently purchased their homes, and who obtained conventional mortgages below the conforming loan limit, had incomes below the area median; this compares with 37.3 percent based on 1993 HMDA data that excludes 100,000 mobile homes.

A longer-term perspective of the mortgage market can be gained by examining income data from the last five American Housing Surveys, conducted in 1985, 1987, 1989, 1991, and 1993. The low- and moderate-income share was in the 32–34 percent range except for 1985 (27 percent) and 1991 (36 percent). The overall average during the 1985–93 period was 32.3 percent.

AHS Under-Reporting of Income. In commenting on the proposed rule, the GSEs criticized HUD's reliance on AHS data on the grounds that income reported in the AHS is lower than other independent estimates of income,[55] and questioned AHS estimates that 60 percent of all households qualify as low- or moderate-income under definitions of the Act.[56] The reported discrepancy is

[51] Jim Berkovec and Peter Zorn, ''How Complete is HMDA?: HMDA Coverage of Freddie Mac Purchases,'' Freddie Mac, January 4, 1995.

[52] Berkovec and Zorn offer two possible reasons for why HMDA reporting may be better in low-income areas. First, regulatory and CRA pressure is greater on larger banks and thrifts and all of these are required to report to HMDA. Smaller suburban lenders making loans in higher income tracts are not all required to report to HMDA and less likely to encounter intense regulatory pressure. Second, lenders have more incentive to report lower-income loans and thus are more careful in reporting these loans.

[53] These percentages were derived from their Tables 8 and 9 by comparing market shares under the three adjustment methods with the market share actually reported by HMDA. To approximate the underserved definition in HUD's proposed rule, high-minority tracts (31–100 percent) with incomes between 100 and 120 percent of area median income were assigned one-half of the market share of the high-minority tracts with income greater than area median income.

[54] The AHS data reported in this final rule were derived using different methods than the corresponding data reported in HUD's proposed rule. The differences will be explained below when discussing AHS data on rent affordability.

[55] See *Codebook for the American Housing Survey Data Base: 1973–1993*, at page 1–11.

[56] Claiming that 50 percent of the country's households are ''below the true median by definition,'' Freddie Mac proposed adjusting for AHS underreporting of income by inflating incomes of all households until 50 percent of AHS households are ''above median income.'' This suggestion has a major flaw: it fails to distinguish between median household income and the Act's definition of ''median income'' as: the unadjusted median family income for the area, as determined and published annually by the Secretary. [Sec. 1303 (9), emphasis added.] Because more than 30 percent of households are occupied by single persons or unrelated individuals and families often have more earners than households, median family income is appreciably higher than median household income. In 1990, for example, U.S. median family income was $35,353, 18 percent above the median household income of $29,943. Interpolating from the household income distribution, in 1990 58.3 percent of households had income less than national median family income. Table 695 of the 1992 Statistical Abstract gives the 1990 household income distribution in dollars with $35,000 as one cutoff. It shows that 57.9% of households had

Continued

based on a comparison with sources such as Gross Domestic Product (GDP) and the Social Security Administration, and relates to specific sources of income, such as interest income and assistance income, which are more significant portions of the incomes of households at the upper and lower ends of the spectrum. AHS estimates of wage and salary income are quite comparable to these aggregate sources. It is unclear how these discrepancies affect the percentages of interest here.

A more relevant issue is a comparison of AHS sample data with special tabulations of 1990 Census data, which has more accurate income data, since it explicitly asks amounts of income by source for each individual. Moreover, decennial Census data on median family income are the basic source of HUD's official estimates of area median income that define ''median income'' for this rule.[57]

In special Comprehensive Housing Affordability Strategy (CHAS) tabulations, 1990 Census data on household income were compared to official HUD estimates of area median income for each location in the country. These CHAS tabulations should be more accurate than the AHS in two ways—because the Census income data are better, and because the CHAS income data were compared to accurate median family income data for each metro area or nonmetro county in the country.

Comparison between the 1989 AHS income distribution (which, taken in fall of 1989, is the closest in time to the April 1, 1990 Census) and the CHAS tabulations shows that two income distributions are remarkably similar for renters:

Income cutoff	Percent of total below cutoff	
	CHAS	AHS
50% of median	38.7%	38.5%
80% of median	59.0%	59.0%
95% of median	68.0%	67.5%

For owners, shares appear to differ by about 2 percentage points throughout the very low- to moderate-income range.[58]:

Income cutoff	Percent of total below cutoff	
	CHAS	AHS
50% of median	15.5%	17.6%
80% of median	29.7%	32.2%
95% of median	37.8%	40.1%

This suggests that reducing the 1989 AHS estimates for owners by no more than 2 percentage points would appropriately adjust for income underreporting.

Improvements to the 1993 Survey. Income underreporting in the AHS was reduced after changes were made in the questionnaire for the 1993 Survey. Formerly, the AHS reported dividend and interest income for a household only if it exceeded $400. Now the Survey reports all dividend and interest income, regardless of the amount, and various sources of interest are specified. In addition to unemployment and worker's compensation and ''any other income,'' Survey respondents were explicitly asked about ''other disability payments,'' and ''veterans' payments.'' As a result, the percentage of respondents reporting income in this category rose from 9.6 percent in 1991 to 13.8 percent in 1993. In general, the percentage of AHS households reporting income other than wages or salaries rose sharply, from 63 percent in 1991 to 79 percent in 1993.

income below $35,000 in 1990 and 17.5% had income in the $35,000–$49,999 category.

[57] Note that in setting the median family income for an MSA, HUD compares the Census estimate to the AHS estimate. The Census estimate is used, unless it falls outside the confidence interval for the AHS estimate, in which case the AHS estimate is used. Currently, the Census estimate is used for all MSAs.

[58] These estimates of income are adjusted for family size, and therefore should not be taken as direct estimates of shares of owners qualifying as ''low or moderate income'' under GSE income definitions. The comparison should however provide a valid estimate of the effect of income underreporting on the AHS estimates of low or moderate income made without family size adjustments.

Thus, it is not clear that AHS underreporting of income is a major problem, especially since the 1993 improvement. In any event, there does not appear to be a need for an adjustment of more than a couple of percentage points for owner-occupied units surveyed prior to 1993, and no adjustment is needed for rental units.

2. Low- and Moderate-Income Percentage for Renter Mortgages

a. American Housing Survey Data

The American Housing Survey does not include data on mortgages for rental properties; rather, it includes data on the characteristics of the existing rental housing stock and recently completed rental properties. Current data on the income of prospective or actual tenants has also not been readily available for rental properties. Where such income information is not available, FHEFSSA provides that a rent level is affordable if it does not exceed 30 percent of the maximum income level for the low- and moderate-income category, with appropriate adjustments for family size as measured by the number of bedrooms. The GSEs' performance under the housing goals is measured in terms of the affordability of the rental dwelling units that are financed by mortgages that the GSEs purchase; the income of the occupants of these rental units is generally not considered in the calculation of goals' performance. Thus, it is appropriate to base estimates of market size on rent affordability data rather than on renter income data.[59]

Table D.5 presents AHS data on the affordability of the rental housing stock for the survey years between 1985 and 1993. The 1993 AHS shows that for 1–4 unit unsubsidized rental properties, 98 percent of all units, and 92 percent of units constructed in the preceding three years had gross rent (contract rent plus the cost of all utilities) less than or equal to 30 percent of area median income. For multifamily unsubsidized rental properties, the corresponding figures are 96 percent of all units, and 88 percent of units constructed in the preceding three years. The AHS data for 1989 and 1991 are similar to the 1993 data.

Several commenters expressed concern about using affordability data from the outstanding rental stock to proxy affordability data for mortgage flows. Some have argued that data based on the recently completed stock would be a better proxy for mortgage flows. In the above case, there is not a large difference between the affordability percentages for the recently constructed stock and those for the outstanding stock of rental properties. But this is not the case when affordability is defined at the very-low-income level. As shown in Table D.5, the recently completed stock houses substantially fewer very-low-income renters than does the existing stock. Because this issue is important for the special affordable goal, it will be further analyzed in Section H when that goal is considered.

For purposes of the Low- and Moderate-Income Goal, the analysis in Section H concludes that the existing stock is an adequate proxy for the mortgage flow when rent affordability is defined in terms of less than 30 percent of area median income. More specifically, that analysis suggests that 85 percent of single-family rental units and 90 percent of multifamily units are reasonable estimates for projecting the percentage of financed units affordable at the low- and moderate-income level.[60]

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[59] Because the ''low- and moderate-income share'' of rental units is based on rents rather than incomes, Freddie Mac's comment on the proposed rule, that estimates of the low-mod share for rental units should be adjusted for AHS income underreporting, is not valid.

[60] In 1994, 87 percent of GSE purchases of single-family investor rental units and 95 percent of their purchases of multifamily units qualified under the low-mod goal.

Table D-5

Rental Market By Affordability of Dwelling Unit: American Housing Survey, 1985-1993

Units Affordable at 100% of Area Median Income	Recently Constructed Stock(a)	Stock 4 Years Or Older	Existing Stock
1-4 Properties			
1985	75%	94%	93%
1987	80%	93%	92%
1989	90%	97%	97%
1991	92%	97%	97%
1993	92%	98%	98%
Average (1985-93)	84%	96%	95%
Multifamily (5+) Properties			
1985	88%	94%	93%
1987	86%	93%	92%
1989	88%	96%	95%
1991	88%	97%	96%
1993	88%	96%	96%
Average (1985-93)	87%	95%	95%
Units Affordable at 60% of Area Median Income			
1-4 Properties			
1985	8%	56%	54%
1987	17%	54%	52%
1989	24%	60%	59%
1991	26%	64%	63%
1993	37%	61%	61%
Average (1985-93)	20%	59%	58%
Multifamily (5+) Properties			
1985	14%	44%	41%
1987	18%	43%	40%
1989	13%	51%	47%
1991	18%	54%	51%
1993	12%	53%	51%
Average (1985-93)	15%	49%	46%

Source: American Housing Surveys, 1985, 1987, 1989,1991, 1993
a. Constructed in last 3 years.

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b. Improvements to AHS Analysis

The AHS data for both owners and renters differ from those reported in HUD's proposed rule due to several improvements in HUD's methodology. The major changes are as follows:

- The income limits for the 1989–93 surveys are now based on 1990 Census results, and those for the 1985 and 1987 survey are now based on 1980 Census results. Previous versions had used income limits from 1970 Census data for 1985, and from 1980 Census data for all other years. These changes basically use income limits that are more ''correct'' for each year than was the case in the earlier analysis. The newly available income limits based on 1990 Census data should more accurately describe income distributions in 1989 and 1991 than the ones extrapolated from 1980 Census data.
- A bedroom-size adjustment factor used by HUD for units with four or more bedrooms has been added; this is important because these large-bedroom units represent almost one-fourth of rental units with three or more bedrooms. This change increases accuracy because earlier, the 3-plus bedroom adjustment factor was used for all units with more than three bedrooms.
- Utility payments in the 1985 and 1987 surveys are constrained to independent (lower) estimates so that they are comparable with procedures begun by the Census Bureau for the 1989 AHS. The new Census Bureau procedures were instituted to correct errors in reported utility payments that were known to cause upward bias. This change should also increase accuracy.

The main effects of these changes are higher affordability estimates than reported in the proposed rule. The portion of the outstanding stock that is affordable at less than area median income goes up by only 3–6 percentage points across the five survey years; however, the portion of the recently completed stock shows increases from 5 to 20 percentage points. The portion of the outstanding stock affordable at the very-low-income level rises from 4 to 14 percent in four of the survey years and declines in the other one.[61]

3. Size of the Low- and Moderate-Income Mortgage Market

a. Market Estimates

This section provides estimates for the size of the low- and moderate-income mortgage market. Three alternative sets of projections about property shares and property low- and moderate-income percentages are given in Table D.6. Case 1 projections represent the baseline and intermediate case; it assumes that investors account for 10 percent of the single-family mortgage market. Case 2 assumes a lower investor share (7 percent) based on HMDA data and slightly more conservative low- and moderate-income percentages for single-family rental and multifamily properties (80 percent and 85 percent, respectively). Case 3 assumes a higher investor share (12 percent) consistent with Follain and Blackley's suggestions.

The low- and moderate-income percentage for owners is the most important determinant of the market estimates. Thus, Table D.7 provides market estimates for different owner percentages as well as for different sizes of the multifamily market—the $30 billion baseline projection bracketed by $23 and $35 billion. Most low- and moderate-income estimates reported for the baseline projections are around 50 percent. The market estimate is 53 percent if the owner percentage is at its 1994 level (40 percent), and it is 51 percent if the owner percentage is at its 1993 level (37 percent). If the low- and moderate-income percentage for owners falls to 32 percent (about its 1992 level), the overall market estimate falls to 48 percent. Under HUD's baseline projections, the owner percentage can fall to as low as 30 percent—about ten (seven) percentage points lower than its 1994 (1993) level—and the low- and moderate-income market share would still be at 46 percent.

The size of the multifamily market is also an important determinant of the low- and moderate-income market share. The market estimates increase by about a percentage point as multifamily volume moves from $23 billion to $35 billion. The market estimates for Case 2 and Case 3 bracket those for Case 1. The smaller rental market and lower low- and moderate-income percentages for rental properties result in the Case 2 estimates being almost three percentage points below the Case 1 estimates.

The various market estimates presented in Table D.7 are not all equally likely. Most of them equal or exceed 48 percent, suggesting that this is a reasonable lower bound for the size of the low- and moderate-income market.

[61] Except for 1991, which showed an increase from 31 to 36 percent in the percentage of borrowers with less than median income, the income percentages for owners showed only slight increases or no increases at all.

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Table D-6

Alternative Assumptions for Single-Family Rental Mortgage Shares and other Variables

	Case 1	Case 2	Case 3
1. Single-Family Mortgage Shares			
Single-Family Owner-Occupied	88.0%	91.0%	86.0%
Single-Family 2-4	2.0%	2.0%	2.0%
Single-Family 1-4 Investor	10.0%	7.0%	12.0%
2. Units Per Single-Family Mortgage			
Single-Family 2-4	2.25	2.25	2.25
Single-Family 1-4 Investor	1.35	1.35	1.40
3. Multifamily Loan Per Unit			
$23 Billion	$27,500	$27,500	$27,500
$30-$35 Billion	$30,000	$30,000	$30,000
4. Percentage Affordable at Area Median Income (AMI):			
Single-Family Rental	85.0%	80.0%	85.0%
Multifamily	90.0%	85.0%	90.0%
5. Percentage Underserved			
Single-Family Rental	37.5%	35.0%	40.0%
Multifamily	42.5%	40.0%	45.0%
6. Percentage Affordable at 60% of AMI			
Single-Family Rental	45.0%	40.0%	50.0%
Multifamily	42.0%	40.0%	45.0%
7. Percentage Low-Income in Low-Income Areas:			
Single-Family Rental	10.0%	8.0%	10.0%
Multifamily	10.0%	8.0%	10.0%

Table D-7

Low- and Moderate- Income Mortgage Market: Sensitivity Analysis

Case 1 with Different Percentages for Single-Family Owner-Occupied's With Incomes less than AMI:		Size of Multifamily Market		
		$23 Billion	$30 Billion	$35 Billion
Single-Family: [a]	40% (1994 HMDA adjusted)	52.1 %	53.2 %	54.1 %
	38%	50.7	51.7	52.7
	37% (1993 HMDA adjusted)	50.0	51.1	52.1
	36%	49.2	50.3	51.4
	34%	47.8	48.9	50.0
	32%	46.3	47.5	48.6
	30%	44.9	46.1	47.2
	28%	43.4	44.6	45.8
Single-Family:	36% With:			
	Case 1	49.2 %	50.3 %	51.4 %
	Case 2	46.5	47.5	48.5
	Case 3	50.4	51.4	52.5
Single-Family:	34% With:			
	Case 1 (above)	47.8 %	48.9 %	50.0 %
	Case 2	45.0	46.0	47.1
	Case 3	49.0	50.1	51.1

[a] These percentages are used for home purchase loans. Refinanced loans were assumed to be 4 percentage points less for each alternative .

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b. Economic Conditions, Market Estimates, and the Feasibility of the Low- and Moderate-Income Housing Goal

The public comments indicated a concern that the market share estimates and the housing goals failed to recognize the volatility of housing markets and the existence of macroeconomic cycles. There was particular concern that the market shares and housing goals were based on a period of record low interest rates and high affordability. This section discusses these issues, noting that the Secretary can consider shifts in economic conditions when evaluating the performance of the GSEs on the goals, and noting further that the market share estimates can be examined in terms of less favorable market conditions than existed during 1993 and 1994.

Volatility of Market. Industry forecasts of the 1996 mortgage market are the starting point for HUD's estimates of market share for each housing goal. HUD projected $700 billion in single-family originations for 1996 based on forecasts of $720 billion by the Mortgage Bankers Association and $700 billion by Fannie Mae. These industry forecasts are based on certain underlying economic conditions. Unanticipated shifts in economic activity will obviously affect the degree to which these forecasts are borne out. Thus, changing economic conditions can affect the validity of HUD's market estimates as well as the feasibility of accomplishing the housing goals.

One only has to recall the volatile nature of the mortgage market in the past few years to appreciate the uncertainty around projections of that market. Large swings in refinancing, consumers switching between adjustable-rate mortgages and fixed-rate mortgages, increased first-time homebuyer activity due to record low interest rates, and shifts in FHA activity have all characterized the recent mortgage market. These conditions are beyond the control of the GSEs but they would affect their performance on the housing goals. A mortgage market dominated by heavy refinancing on the part of middle-income homeowners would reduce the GSEs' ability to reach a specific target on the low- and moderate-income goal, for example. A jump in interest rates would reduce the availability of very-low-income mortgages for the GSEs to purchase. But on the other hand, the next few years may be highly favorable to achieving the goals because of the high refinancing activity in 1993. A period of low interest rates would sustain affordability levels without causing the rush to refinance seen in 1993. A high percentage of potential refinancers have already done so, and are less likely to do so again. Year-to-date 1995 data support this argument.

Feasibility Determination. HUD is well aware of the volatility of mortgage markets and the possible impacts on the GSEs' ability to meet the housing goals. FHEFSSA allows for changing market conditions.[62] If HUD has set a goal for a given year and market conditions change dramatically during or prior to the year, making it infeasible for the GSE to attain the goal, HUD must determine "whether (taking into consideration market and economic conditions and the financial condition of the enterprise) the achievement of the housing goal was or is feasible." This provision of FHEFSSA clearly allows for a finding by HUD that a goal was not feasible due to market conditions, and no subsequent actions would be taken.

Affordability and Market Estimates. The market share estimates rely on 1993 and 1994 HMDA data for the percentage of low- and moderate-income borrowers. As discussed earlier, record low interest rates and affordability initiatives of the private sector encouraged first-time buyers and low-income borrowers to enter the market during this period. A significant increase in interest rates over their 1993–94 levels would reduce the presence of low-income families in the mortgage market and the availability of low-income mortgages for purchase by the GSEs.

HUD simulated the effects of a two-percentage point increase in interest rates on the payment-to-income ratios of 1993 and 1994 GSE borrowers (see Appendix A). Lower-income borrowers started with higher payment ratios and were thus disproportionately affected by the simulated increase in interest rates. Dropping from the GSE data all less-than-median income borrowers whose payment-to-income ratios increased to above 28 percent reduced the low- and moderate-income percentage of GSE business by 15 percent (about 5 percentage points) and the very-low-income percentage by 17 percent (about 1.25 percentage points). While this is only a partial look at the effects of higher interest rates, it indicates that the effects will be concentrated at the lower-income end of the market. A counter-balancing effect would be that a rise in interest rates reduces the refinance rate. In 1993, refinance borrowers had higher incomes than home purchase borrowers, but in 1994, purchase and refinance mortgage borrowers had more similar incomes.

As discussed in Appendix A, the effects of higher interest rates on affordability have to be considered in the context of other market changes. Rising employment, incomes, and consumer confidence, for example, can mitigate the effects of higher rates on the demand for mortgage credit. Unfortunately, it is difficult to quantify the impacts of these economic changes on the market estimates for the housing goals. What one can do, however, is examine the sensitivity of the market estimates to changes in the percentage of borrowers that have an income less than area median income. As noted earlier, reducing that percentage to 30 percent from its 1993–94 level of 37–40 percent drops the overall low- and moderate-income estimate to 46 percent under the baseline projections.

The market model was re-estimated assuming an even higher interest rate environment—lower origination volumes ($535 billion for single-family and $23 billion for multifamily) and an owner low- and moderate-income percentage (26) that was only two-thirds of the 1994 level.[63] In this case, the market estimate of 44 percent remains above HUD's goals of 40 percent for 1996 and 42 percent for 1997. Obviously, there are combinations of projections that would drive the low- and moderate-income market estimate even lower; however, setting the goals to ensure their feasibility under the most pessimistic of economic conditions is not appropriate, given that the Secretary can re-evaluate goal feasibility if market conditions change dramatically.

c. Conclusions About the Size of Low- and Moderate-Income Market

Based on the above findings as well as numerous sensitivity analyses, HUD concludes that 48–52 percent is a reasonable estimate of the mortgage market's low- and moderate-income share for 1996 and beyond. HUD recognizes that shifts in economic conditions could increase or decrease the size of the low- and moderate-income market during that period.

4. Further Considerations—Factors Not Taken Into Account in Developing the Market Estimates

The 48–52 percent low- and moderate-income market estimate does not take into account several factors which could enhance the GSEs' performance with regard to the goals.

[62] Section 1336(b)(3)(A).

[63] The $535 billion is a lower bound estimate provided by Freddie Mac.

a. Purchases of Seasoned Mortgages

Both GSEs buy a number of seasoned mortgages, where the date of the mortgage note is more than one year before the date the GSE purchased the mortgage. HUD's market share estimates are based on current mortgage originations, thus there is no way for HUD to take into account the availability of seasoned mortgages. But many such mortgages would qualify for one or more of the goals.

b. Small Second Loans

The final rule will allow the GSEs to count second mortgages for full credit toward the housing goals. In 1993, the GSEs purchased only a small number of second mortgages: Fannie Mae purchased 658 seconds, totalling $28.1 million, and Freddie Mac purchased 27 seconds, totalling $1.4 million. In 1994, the GSEs purchased both fewer such loans and smaller loans. Fannie Mae's second mortgage purchases fell to 207 loans, totalling $7.8 million, while Freddie Mac's purchases of second mortgages fell to 1, in the amount of $24,000.

It is unclear how the GSEs will react to the fact that seconds will be eligible under the goals. One scenario might involve a substantial increase in their purchases of small home improvement loans in inner-city areas which would increase their performance under the goals. Another scenario might involve only incremental changes to their current business which would only marginally increase their performance under the goals. It is also unclear how to delineate the overall market in which the GSEs might be operating, because their past purchases have been so small. Admittedly, they could purchase second mortgages in all segments of the market (from inner city low-income loans to suburban high-income loans); however, given their current small share of the overall market, it might not be appropriate to assume their purchases would cover the entire market. In any case, HUD has made no adjustments in its market estimate to allow for the possible effects of making second mortgages eligible under the goals.

The HMDA data do include information on home improvement loans (HILs). In 1993, 620,000 home improvement loans were originated, with an average loan amount of $20,700. Using RFS data, for the period 1989–1991, the average loan amount for HILs was $26,700. The loan distribution for all HILs shows that 59 percent of these loans were for amounts less than $15,000. Compared with purchase mortgages, HILs are more targeted to lower-income borrowers. Almost 47 percent of conforming conventional owner-occupied HILs went to low- and moderate-income borrowers.

G. Size of the Conventional Conforming Market Serving Central Cities, Rural Areas, and Other Underserved Areas

The following discussion presents the estimates of the size of the conventional conforming market for the Central City, Rural Areas, and other Underserved Areas Goal (Geographically-Targeted Goal). The first two sections focus on central cities and other underserved areas. Section 1 presents area percentages for different property types while section 2 presents market estimates for these areas. Section 3 discusses rural areas.

The final rule establishes the Central Cities, Rural Areas, and other Underserved Areas Goal for 1996 at 21 percent of the total number of dwelling units financed by the GSE's mortgage purchases. The level of the goal for 1997 and subsequent years is 24 percent.

1. Central City and Other Underserved Area Shares by Property Type

For purposes of the definitions of central cities and other underserved areas, underserved areas are defined as census tracts with:

(a) Tract median income at or below 90 percent of the MSA median income; or

(b) A minority composition equal to 30 percent or more and a tract median income no more than 120 percent of MSA median income.

Table D.8 presents central cities and other underserved areas percentages for mortgages on owner, single-family rental, and multifamily properties. In 1994, 24.6 percent of home purchase loans financed properties located in these areas; this represents an increase from 22.4 percent for 1993.[64] In 1994, refinance loans were slightly more likely than home purchase loans to be located in these areas (27.7 versus 24.6 percent) while in 1993 the situation was reversed (20.1 versus 22.4 percent). As table D.8 shows, the adjustments for mobile home loans are not nearly as large as those reported earlier for the borrower income data. The possibility that HMDA over-reports loans in low-income areas suggests that these percentages should be adjusted by another percent or two (see discussion of the Berkovec-Zorn paper in section F.1.c). Because of the importance of owner properties, the sensitivity analyses will examine a range of values for this variable.

Based on 1993 and 1994 HMDA data, the central cities and other underserved areas percentage for single-family rental units is 41–43 percent while that for multifamily properties is 48–51 percent. Thus, rental mortgages are about twice as likely as owner mortgages to finance properties located in these areas.

2. Market Estimates for Central Cities and Other Underserved Areas

Table D.9 presents estimates for the central cities and other underserved areas market for the same combinations of projections used to analyze the Low- and Moderate-Income Goal. Table D.6 in Section F.3 defines Cases 1, 2, and 3; Case 1 (the baseline) projects a 37.5 percent share for single-family rentals and a 42.5 percent share for multifamily properties while the more conservative Case 2 projects 35.0 percent and 40.0 percent, respectively.

The single-family owner percentages are the driving force in the market for the estimate, even more so than in the low- and moderate-income analysis. Table D.9 reports results under the baseline projections but for owner percentages ranging from 25 percent (1994 HMDA without mobile homes) to 20 percent (1993 HMDA) to 17 percent. The market share estimates are mostly in the 25–28 percent range if the single-family owner central cities and other underserved areas percentage is 18 percent or more. If the owner percentage is at the 1994 HMDA level of 25 percent, the market share estimate is as high as 29 percent.

At the lower extreme, the single-family owner percentage can go as low as 17 percent, which is 8 percentage points lower than the 1994 HMDA value, and the market estimate is still 24 percent in the base case. Thus, the Geographically Targeted Goal allows for a market not as affordable as the 1993–94 period.

Unlike the low- and moderate-income goal, the market estimates differ only slightly as one moves from Case 1 to Case 3 and from $23 billion to $35 billion in the size of the multifamily market. This is because the central cities and other underserved areas differentials between the owner and rental properties are not as large as the low- and moderate-income differentials reported earlier.

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[64] The corresponding percentages for the definitions in the proposed rule are 15.4 percent for 1993 and 17.1 percent in 1994. Thus, the effect of the additional 3,657 census tracts is to increase the home purchase percentage by 7.0 percent in 1993 and by 7.5 percent in 1994.

Table D-8

Central Cities and Other Underserved Areas Mortgage Market: 1993 and 1994 HMDA Data

	Purchase	Refinance	Total
Single-Family Owner-Occupied			
1993 HMDA			
A. All Loans	22.4%	20.1%	20.8%
B. Without Mobile Homes			
(1) 75,000	21.4%	20.1%	20.5%
(2) 100,000	21.1%	20.1%	20.4%
(3) 150,000	20.4%	20.1%	20.2%
1994 HMDA			
A. All Loans	24.6%	27.7%	26.0%
B. Without Mobile Homes			
(1) 100,000	23.5%	27.7%	25.4%
(2) 125,000	23.2%	27.7%	25.3%
(3) 150,000	22.9%	27.7%	25.1%
(4) 200,000	22.3%	27.7%	24.8%
Non-owner			
1993 HMDA	39.6%	41.3%	41.0%
1994 HMDA	39.8%	46.7%	43.1%
Multifamily			
1993 HMDA			47.7%
1994 HMDA			50.6%

Table D-9

Central Cities and Other Underserved Areas Market Estimates: Sensitivity Analysis

Case 1 With Different Central Cities and Other Underserved Area Percentages for Single-Family Owner-Occupied's:		Size of Multifamily Market $23 Billion	$30 Billion	$35 Billion
Single-Family Owner-Occupied: [a]	25% (1994 HMDA adjusted)	29.1 %	29.4 %	29.8 %
	23%	27.6	28.0	28.4
	21%	26.2	26.6	27.0
	20% (1993 HMDA adjusted)	25.4	25.9	26.3
	19%	24.7	25.2	25.6
	18%	24.0	24.5	24.9
	17%	23.2	23.8	24.3
Single-Family Owner-Occupied:	21% With:			
	Case 1 (above)	26.2 %	26.6 %	27.0 %
	Case 2	25.1	25.5	25.9
	Case 3	27.3	27.8	28.2
Single-Family Owner-Occupied:	19% With:			
	Case 1 (above)	24.7 %	25.2 %	25.6 %
	Case 2	23.5	24.0	24.4
	Case 3	25.9	26.4	26.9

[a] These percentages are used for both purchase and refinance loans.

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3. Size of Rural Underserved Area Market

Rural areas are nonmetropolitan counties with:

(a) County median income at or below 95 percent of the greater of statewide nonmetropolitan median income or nationwide nonmetropolitan income; or

(b) A minority composition equal to 30 percent or more and a county median income no more that 120 percent of statewide nonmetropolitan median income.

HMDA does not provide mortgage data for nonmetropolitan counties, which makes it impossible to estimate the size of the mortgage market in rural areas. However, all indicators suggest that counties in rural areas comprise a larger share of the nonmetropolitan mortgage market than the census tracts in central cities and other underserved areas comprise of the metropolitan mortgage market. Counties within rural areas include 54 percent of nonmetropolitan residents as well as 54 percent of nonmetropolitan homeowners. Central cities and other underserved census tracts, on the other hand, account for 44 percent of metropolitan population and 34 percent of metropolitan homeowners.

In 1994, 26.9 percent of Fannie Mae's total purchases in nonmetropolitan areas were in rural areas while 29.2 percent of Fannie Mae's purchases in metropolitan areas were in central cities and other underserved areas. The corresponding percentages for Freddie Mac were 26.3 and 23.9, respectively. These data suggest that if the market share for counties in rural areas were available, it would be similar to the market share for census tracts in central cities and other underserved areas. Thus, HUD will use the metropolitan estimate to proxy the overall market for this goal, including rural areas.

4. Conclusions

Based on the above findings as well as numerous sensitivity analyses, HUD concludes that 25–28 percent is a reasonable estimate of mortgage market originations that would qualify toward achievement of the Geographically Targeted Goal if purchased by a GSE. HUD recognizes that shifts in economic and housing market conditions could affect the size of this market; however, the market estimate allows for the possibility that adverse economic conditions can make housing less affordable than it has been in the last two years.

H. Size of the Conventional Conforming Market for the Special Affordable Housing Goal

This section presents estimates of the conventional conforming mortgage market for the Special Affordable Housing Goal. The special affordable market consists of owner and rental dwelling units which are occupied by: (a) very-low-income families; *or* (b) low-income families in low-income census tracts[65]; *or* (c) low-income families in multifamily projects that meet minimum income thresholds patterned on the low-income housing tax credit (LIHTC).[66] HUD estimates that the special affordable market is 20–23 percent of the conventional conforming market. This market share estimate is three percentage points higher than the estimate in HUD's proposed rule mainly because low-income renters living in low-income census tracts or rural counties now qualify under the goal as defined in the final rule.

The final rule establishes the Special Affordable Housing Goal for 1996 at 12 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The goal for 1997 and subsequent years is 14 percent. Of the total Special Affordable Housing Goal, each GSE must purchase annually in multifamily mortgages at least an amount equal to 0.8 percent of the total dollar volume of mortgages purchased by the GSE in 1994.

Section F described HUD's methodology for estimating the size of the low- and moderate-income market. Essentially the same methodology is employed here except that the focus is on the very-low-income market (0–60 percent of Area Median Income) and that portion of the low-income market (60–80 percent of Area Median Income) that is located in low-income areas. Data do not exist to estimate the number of renters with incomes between 60 and 80 percent of Area Median Income who live in projects that meet the tax credit thresholds. Thus, this part of the Special Affordable Housing Goal is not included in the market estimate.

1. Special Affordable Shares by Property Type

The basic approach involves estimating for each property type the share of dwelling units financed by mortgages in a particular year that are occupied by very-low-income families or by low-income families living in low-income areas. HUD has combined mortgage information from HMDA and the American Housing Survey in order to estimate these special affordable shares.

a. Very-Low-Income Owner Percentages

The percentage of borrowers with very-low-incomes was reported earlier when discussing the Low- and Moderate-Income Goal. HMDA data show that very-low-income borrowers accounted for 9.4 percent of all conforming home purchase loans in 1992, 11.5 percent in 1993, and 13.1 percent in 1994. Several adjustments were made to the HMDA data (see Table D.4). Excluding mobile home loans, for instance, reduced the 1993 and 1994 very-low-income borrower percentages to the 9–10 percent range. The AHS reports a higher very-low-income percentage of 12.9 percent for home purchase loans in 1993.

b. Very-Low-Income Rental Percentages

Table D.5 in Section F reported the percentages of the single-family rental and multifamily stock affordable to very-low-income families. According to the AHS, 61 percent of single-family units and 51 percent of multifamily units were affordable to very-low-income families in 1993. The corresponding average values for the AHS's five surveys between 1985 and 1993 were 58 percent and 46 percent, respectively.

c. Outstanding Housing Stock versus Mortgage Flow

An important issue concerns whether affordability data based on the existing rental stock can be used to proxy affordability of mortgaged rental units. Previous analysis of this issue has focussed on the relative merits of data from the recently completed stock versus data from the outstanding stock. The very-low-income percentages are much lower for the recently completed stock—for instance, the averages across the five AHS surveys were 15 percent for recently completed multifamily properties versus 46 percent for the multifamily stock. But it seems obvious that data from the recently completed stock would underestimate the affordability of newly-mortgaged units because they exclude purchase and refinance transactions involving older buildings, which generally charge lower rents than newly-constructed buildings. Blackley and Follain concluded that newly-constructed properties did not provide a satisfactory basis for

[65] Or in the case of rural areas, in low-income counties.

[66] There are two LIHTC thresholds: at least 20 percent of the units are affordable at 50 percent of AMI or at least 40 percent of the units are affordable at 60 percent of AMI.

estimating the affordability of newly-mortgaged properties.[67]

The remaining question is how much the affordability percentages from the existing rental stock should be reduced to reflect the flow of mortgage financing.[68] HUD used the 1991 Residential Finance Survey to compare rents of the outstanding stock with rents of properties receiving mortgages. There were two main findings. The first finding—and the important one for the Special Affordable Housing Goal—was that rents of newly-mortgaged properties were higher than those of the existing stock. About 44 percent of the units in newly-mortgaged, multifamily properties were affordable to very-low-income families; this compares with 52 percent for the entire multifamily stock.[69]

The corresponding percentages for single-family rental properties showed an even greater gap—47 percent for the newly-mortgaged stock and 60 percent for the existing stock. These comparisons suggest that in order to serve as a proxy for mortgage flows, the affordability percentages reported by the AHS should be adjusted downward by about 15 percent in the case of multifamily properties and 20 percent in the case of single-family properties. The baseline analysis below will use very-low-income percentages of 42.5 percent for multifamily properties and 45 percent for single-family rentals.[70]

The second finding—and the one important for the low- and moderate-income goal—was that the percentage of newly-mortgaged properties renting at a level affordable to families with less than median income was only slightly lower than the percentage of the stock renting at that level. This finding is not particularly surprising given that most of the rental stock rents at levels affordable to median income families. It suggests that only a small reduction (about 5 percent) in the affordability percentage of the existing stock is needed for it to proxy the mortgage flow.

d. Low-Income in Low-Income Areas

According to HMDA data, the percentage of home purchase borrowers who had an income between 60 and 80 percent of area median income and who lived in a low-income census tract was 1.7 percent in 1992, 1.8 percent in 1993, and 2.2 percent in 1994. The analysis below will vary this rate between 1 and 2 percent, depending on the percentage of very-low-income owners being assumed at the time.

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[67] ''A Critique of the Methodology Used to Determine Affordable Housing Goals for the Government Sponsored Housing Enterprises.''

[68] Some might argue that no adjustment is needed because the existing stock represents the underlying demand for mortgage credit and thus mortgage flows will have the same characteristics as the stock. While appealing at first sight, particularly if one takes a longer-run perspective, this argument ignores the host of reasons why the mortgage flow might not take on the characteristics of the underlying rental stock—the most obvious being that new construction mortgages are a significant part of mortgage activity (almost 15 percent in 1994) but new properties represent only a minute part of the outstanding housing stock.

[69] First, HUD computed the distribution of units by rent category for existing and newly-mortgaged properties in the RFS. Because only average rent per property is reported in the RFS, all units in a particular property were assigned the same rent. Next, HUD computed the percentage of units that were affordable to families with less than 60 percent of area median income based on 1989 and 1991 AHS data; this was about 50 percent for multifamily units. This 50 percent figure was used to define the absolute rent amount ($400) in the RFS that included the bottom 50 percent of rental units. (Because the rent brackets were in $100 increments, the bottom 52 percent of rents had to be used in the RFS analysis.) Finally, HUD computed the percentage of newly-mortgaged units below $400; as the text discusses, only 44 percent of the newly-mortgaged units were below $400.

[70] Another approach would simply take the weighted average of the very-low-income percentages for newly-constructed multifamily properties (15 percent) and remaining stock (46 percent) with the weights determined by the estimated share of new construction mortgages (almost 15 percent in 1994). Doing this for multifamily also gives 42 percent.

HMDA does not provide similar data for renters. As a substitute, HUD examined the rental housing stock located in low-income zones of 41 metropolitan areas surveyed as part of the AHS between 1989 and 1993. While the low-income zones do not exactly coincide with low-income tracts, they were the only proxy readily available to HUD.[71] Slightly over 13 percent of single-family rental units were both affordable at the 60–80 percent of AMI level and located in low-income zones; almost 16 percent of multifamily units fell into this category.[72] The baseline analysis below assumes that 10 percent of the financed rental units are affordable at 60–80 percent of AMI and located in low-income areas.

2. Size of the Special Affordable Market

The size of the special affordable market depends in large part on the size of the multifamily market and on the very-low-income percentages of both owners and renters. Table D.10 gives market estimates for different combinations of these factors.[73] As before, Case 2 is slightly more conservative than the baseline projections (Case 1) mentioned above. For instance, Case 2 assumes that only 7 percent of rental units are affordable to low-income renters living in low-income areas.

The market estimates in Table D.10 suggest that 20–23 percent is a conservative estimate of the special affordable market. Under HUD's baseline projections, the market estimates remain above 20 percent even if the very-low-income percentage for owners falls as low as 6 percent. Thus, HUD's market estimate allows for the possibility that adverse economic conditions could keep very-low-income families out of the housing market. On the other hand, if the very-low-income percentage stays at its recent levels of 10 percent, the market estimate is as high as 24 percent.

The market estimate drops by approximately one percent if the estimate of the multifamily mortgage market changes from $30 billion to $23 billion. The market estimates under the more conservative Case 2 projections are almost 3 percentage points below those under the Case 1 projections. This is due mainly to Case 2's lower share of single-family rental mortgages (7 percent versus 10 percent in Case 1) and its lower affordability and low-income-area percentages for rental housing (e.g., a combined 48 percent for single-family rental units versus 55 percent for Case 1).

[71] It would have been ideal for this purpose if AHS had identified its respondents by whether they live in a low-income census tract within a metropolitan area or low-income nonmetropolitan county (i.e., a tract or county whose median income is no more than 80 percent of metropolitan area or statewide non-metro median income). AHS would then have yielded an estimate of the percentage of rental units located in such areas whose median income is less than 80 percent of area median, and this could have been combined with an AHS estimate of the percentage of those units whose rents are affordable at 60–80 percent of area median income to generate the desired figure. Instead, AHS identifies respondents in its metropolitan area surveys by a variable called ZONE and provides no corresponding variable outside of metropolitan areas. Zones were defined in the 1970s to be areas of at least 100,000 population that were socioeconomically homogeneous, and their boundaries have been fixed since then. HUD estimated the percentage of rental units in metropolitan areas affordable at 60–80 percent of area median income based on the AHS distribution of rental units by income of zone (relative to 80 percent of area median) and the AHS percentages of units affordable at 60–80 percent of area median within each zone. Because of the size difference between tracts and zones—around 100,000 vs. around 4,000—the percentages that would have been generated if a tract-based analysis had been feasible would probably have been at least as large as the 13 percent and 16 percent figures generated in this analysis. This is because the larger the zones, the closer their median income would tend to be to the metropolitan area median income. HUD has no basis for estimating the degree of bias in extrapolating from this analysis of metropolitan area data to nonmetropolitan areas.

[72] The corresponding figures for the recently completed stock were 8 and 9 percent, respectively.

[73] Table D.10 shows the size of the special affordable market based on alternative assumptions about the share of single-family owner-occupied units that are occupied by very-low-income households. Special affordable units also include those that are occupied by low-income households in low-income areas. For a very-low-income assumption of 10 percent, the low-income in low-income area assumption is 2 percent. The 2 percent low-income in low-income area assumption is prorated downward as the very-low-income assumption is reduced, falling to 1.2 percent for a very-low-income assumption of 7 percent.

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Table D-10
Special Affordable Mortgage Market:
Sensitivity Analysis

	Size Of Multifamily Market		
	$23 Billion	$30 Billion	$35 Billion
Case 1 With:			
(a) Rent Affordable at 60% AMI: Single-Family Rental Percentage= 45%, Multifamily= 42%;			
(b) Low-Income in Low-Income Areas for Single-Family Rental and Multifamily= 10%; and			
(c) Single-Family Owner-Occupied's Income less than 60% AMI: [a]			
10.0% (1994 HMDA Adjusted)	22.9 %	23.7 %	24.4 %
9.0% (1993 HMDA Adjusted)	21.9	22.7	23.4
8.5%	21.4	22.3	23.0
8.0%	21.0	21.8	22.6
7.5%	20.6	21.4	22.2
7.0%	20.1	21.0	21.8
6.0%	19.3	20.2	21.0
Case 2 With:			
(a) Rent Affordable at 60% AMI: Single-Family Rental Percentage= 40%, Multifamily= 40%;			
(b) Low-Income in Low-Income Areas for Single-Family Rental and Multifamily= 8%; and			
(c) Single-Family Owner-Occupied's Income less than 60% AMI:			
10.0%	20.3 %	21.0 %	21.8 %
9.0%	19.2	20.0	20.8
8.0%	18.3	19.1	19.9
Case 3 With:			
(a) Rent Affordable at 60% AMI: Single-Family Rental Percentage= 50%, Multifamily= 45%;			
(b) Low-Income in Low-Income Areas for Single-Family Rental and Multifamily= 10%; and			
(c) Single-Family Owner-Occupied's Income less than 60% AMI:			
10.0%	25.1 %	25.9 %	26.7 %
9.0%	24.1	24.9	25.7
8.0%	23.3	24.1	24.9

[a] These percentages are used for home purchase loans. Refinaced loans were assumed to be 1.75 percentage points lower for each alternative.

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Tax Credit Definition. Data are not available to measure the increase in market share associated with including low-income units located in multifamily buildings that meet threshhold standards for the low-income housing tax credit. Currently, the effect on GSE performance under the Special Affordable Housing Goal is rather small. For instance, adding the tax credit condition increases Fannie Mae's 1994 performance by only 0.6 percentage points, from 16.1 to 16.7 percent. At first glance, this small effect seems at odds with the fact that almost 25 percent of Fannie Mae's multifamily purchases during 1994 involved properties with a very-low-income occupancy of 100 percent, and 57 percent involved properties with a very-low-income occupancy of over 40 percent. The explanation, of course, is that most of the rental units in these ''tax-credit'' properties are covered by the very-low-income part of the special affordable goal.

3. Conclusions

Sensitivity analyses were conducted for the market shares of each property type, for the very-low-income shares of each property type, and for various assumptions in the market projection model. These analyses suggest that 20–23 percent is a reasonable estimate of the size of the conventional conforming market for the Special Affordable Housing Goal. This estimate allows for the possibility that homeownership will not remain as affordable as it has over the past two years.

Appendix E—Required Loan-Level Data Elements

As required under 24 CFR part 81, subpart E, the GSEs are required to provide to the Secretary the loan level mortgage data listed below.

(a) Loan level data on single family mortgage purchases. Each GSE's submission of loan level data shall include the following information for each single family mortgage purchased by the GSE:

(1) Loan number—a unique numerical identifier for each mortgage purchased;

(2) U.S. postal state—the two-digit numerical Federal Information Processing Standard (FIPS) code;

(3) U.S. postal zip code—the five digit zip code for the property;

(4) MSA code—the four-digit numerical code for the property's metropolitan statistical area (MSA) if the property is located in an MSA;

(5) Place code—the five-digit numerical FIPS code;

(6) County—the county, as designated in the most recent decennial census by the Bureau of the Census, in which the property is located;

(7) Census tract/Block Numbering Area (BNA)—the tract/BNA number as used in the most recent decennial census by the Bureau of the Census;

(8) 1990 census tract—percent minority—the percentage of a census tract's population that is minority based on the most recent decennial census by the Bureau of the Census;

(9) 1990 census tract—median income—the median family income for the census tract;

(10) 1990 local area median income—the median income for the area;

(11) Tract income ratio—the ratio of the 1990 census tract median income to the 1990 local area median income;

(12) Borrower(s) annual income—the combined income of all borrowers;

(13) Area median family income—the current median family income for a family of four for the area as established by the Secretary;

(14) Borrower income ratio—the ratio of borrower(s) annual income to area median family income;

(15) Acquisition UPB—the unpaid principal balance (UPB) in whole dollars of the mortgage when purchased by the GSE; where the mortgage purchase is a participation, the acquisition UPB reflects the participation percentage;

(16) Loan-to-Value Ratio at Origination—the loan-to-value (LTV) ratio of the mortgage at the time of origination;

(17) Date of Mortgage Note—the date the mortgage note was created;

(18) Date of Acquisition—the date the GSE purchased the mortgage;

(19) Purpose of Loan—indicates whether the mortgage was a purchase money mortgage, a refinancing, a second mortgage;

(20) Cooperative Unit Mortgage—indicates whether the mortgage is on a dwelling unit in a cooperative housing building;

(21) Special Affordable, Seasoned Loan Proceeds Recycled—for purposes of the special affordable housing goal, indicates whether the mortgage purchased by the GSE meets the requirements in section 81.14(h)(1)(B);

(22) Product Type—indicates the product type of the mortgage, *i.e.*, fixed rate, adjustable rate mortgage (ARM), balloon, graduated payment mortgage (GPM) or growing equity mortgages (GEM), reverse annuity mortgage, or other;

(23) Federal guarantee—a numeric code that indicates whether the mortgage has a federal guarantee from: the Federal Housing Administration (FHA) or the Department of Veterans Affairs (VA); the Farmers Home Administration's Guaranteed Rural Housing Loan program; or other federal guarantee;

(24) RTC/FDIC—for purposes of the special affordable housing goal, indicates whether the mortgage purchased by the GSE meets the requirements in section 81.14(h)(1)(C);

(25) Term of Mortgage at Origination—the term of the mortgage at the time of origination in months;

(26) Amortization Term—for amortizing mortgages, the amortization term of the mortgage in months;

(27) Lender Institution—the name of the institution that loaned the money for the mortgage;

(28) Lender City—the city location of the institution that loaned the money for the mortgage;

(29) Lender State—the State location of the institution that loaned the money for the mortgage;

(30) Type of Seller Institution—the type of institution that sold the mortgage to the GSE, *i.e.*, mortgage company, Savings Association Insurance Fund (SAIF) insured depositary institution, Bank Insurance Fund (BIF) insured depositary institution, National Credit Union Association (NCUA) insured credit union, or other seller;

(31) Number of borrowers—the number of borrowers;

(32) First-time home buyer—a numeric code that indicates whether the mortgagor(s) are first-time home buyers; second mortgages and refinancings are treated as not first-time home buyers;

(33) Mortgage Purchased under GSE's Community Lending Program—indicates whether the GSE purchased the mortgage under its community lending program;

(34) Acquisition Type—indicates whether the GSE acquired the mortgage with cash, by swap, with a credit enhancement, a bond or debt purchase, reinsurance, risk-sharing, real estate investment trust (REIT), or a real estate mortgage investment conduit (REMIC), or other;

(35) GSE Real Estate Owned—indicates whether the mortgage is on a property that was in the GSE's real estate owned (REO) inventory;

(36) Borrower race or national origin—a numeric code that indicates whether the borrower is: an American Indian or Alaskan Native; an Asian or Pacific Islander; black; Hispanic; white; or other;

(37) Co-borrower race or national origin—a numeric code that indicates whether the co-borrower is: an American Indian or Alaskan Native; an

Asian or Pacific Islander; black; Hispanic; white; or other

(38) Borrower gender—a numeric code that indicates whether the borrower is male or female;

(39) Co-borrower gender—a numeric code that indicates whether the co-borrower is male or female

(40) Age of borrower;

(41) Age of co-borrower;

(42) Occupancy Code—indicates whether the mortgaged property is an owner-occupied principal residence, a second home, or a rental/investment property;

(43) Number of Units—indicates the number of units in the mortgaged property;

(44) Number of Bedrooms—where the property contains non-owner-occupied dwelling units, the number of bedrooms in each of those units;

(45) Owner-Occupied—indicates whether each of those units are owner-occupied;

(46) Affordability Category—where the property contains non-owner-occupied dwelling units, indicates under which, if any, of the special affordable goals the units qualified;

(47) Reported Rent Level—where the property contains non-owner-occupied dwelling units, the rent level for each unit in whole dollars;

(48) Reported Rent Plus Utilities—where the property contains non-owner-occupied dwelling units, the rent level plus the utility cost for each unit in whole dollars;

(b) Loan level data on multifamily mortgage purchases. Each GSE's submission of loan level data shall include the following information for each multifamily mortgage purchased by the GSE:

(1) Loan number—a unique numerical identifier for each mortgage purchased;

(2) U.S. postal state—the two-digit numerical Federal Information Processing Standard (FIPS) code;

(3) U.S. Postal Zip Code—the five digit zip code for the property;

(4) MSA code—the four-digit numerical code for the property's metropolitan statistical area (MSA) if the property is located in an MSA;

(5) Place code—the five-digit numeric FIPS code;

(6) County—the county, as designated in the most recent decennial census by the Bureau of the Census, in which the property is located;

(7) Census tract/Block Numbering Area (BNA)—the tract/BNA number as used in the most recent decennial census by the Bureau of the Census;

(8) 1990 census tract—percent minority—the percentage of a census tract's population that is minority based on the most recent decennial census by the Bureau of the Census;

(9) 1990 census tract—median income—the median family income for the census tract;

(10) 1990 local area median income—the median income for the area;

(11) Tract income ratio—the ratio of the 1990 census tract median income to the 1990 local area median income;

(12) Area median family income—the current median family income for a family of four for the area as established by the Secretary;

(13) Affordability Category—indicates under which, if any, of the special affordable goals the property qualified;

(14) Acquisition UPB—the unpaid principal balance (UPB) in whole dollars of the mortgage when purchased by the GSE; where the mortgage purchase is a participation, the acquisition UPB reflects the participation percentage;

(15) Participation Percent—where the mortgage purchase is a participation, the percentage of the mortgage that the GSE purchased;

(16) Date of Mortgage Note—the date the mortgage note was created;

(17) Date of Acquisition—the date the GSE purchased the mortgage;

(18) Purpose of Loan—indicates whether the mortgage was a purchase money mortgage, a refinancing, a new construction mortgage, a mortgage financing property rehabilitation;

(19) Cooperative Project Loan—indicates whether the mortgage is a project loan on a cooperative housing building;

(20) Refinancing Loan from Own Portfolio—indicates, where the GSE has purchased a refinanced mortgage, whether the GSE owned the previous mortgage on the same property;

(21) Special Affordable, Seasoned Loans: Proceeds Recycled?—for purposes of the special affordable housing goal, indicates whether the mortgage purchased by the GSE meets the requirements in section 81.14(h)(1)(ii);

(22) Mortgagor Type—indicates the type of mortgagor, *i.e.*, an individual, a for-profit entity such as a corporation or partnership, a nonprofit entity such a corporation or partnership, a public entity, or other type of entity;

(23) Term of Mortgage at Origination—the term of the mortgage at the time of origination in months;

(24) Loan Type—indicates the type of the loan, *i.e.*, fixed rate, adjustable rate mortgage (ARM), balloon, or graduated payment mortgage (GPM);

(25) Construction Loan—indicates whether the mortgage is for a construction loan;

(26) Amortization Term—for amortizing mortgages, the amortization term of the mortgage in months;

(27) Lender Institution—the name of the institution that loaned the money for the mortgage;

(28) Lender City—the city location of the institution that loaned the money for the mortgage;

(29) Lender State—the State location of the institution that loaned the money for the mortgage;

(30) Type of Seller Institution—the type of institution that sold the mortgage to the GSE, *i.e.*, mortgage company, Savings Association Insurance Fund (SAIF) insured depositary institution, Bank Insurance Fund (BIF) insured depositary institution, National Credit Union Association (NCUA) insured credit union, or other seller;

(31) Government insurance—indicates whether any part of the mortgage has government insurance;

(32) FHA Risk Share Percent—the percentage of risk assumed for the mortgage purchased under a risk-sharing arrangement with the Department.

(33) Acquisition Type—indicates whether the GSE acquired the mortgage with cash, by swap, with a credit enhancement, a bond or debt purchase, reinsurance, risk-sharing, real estate investment trust (REIT), or a real estate mortgage investment conduit (REMIC), or other;

(34) GSE Real Estate Owned—indicates whether the mortgage is on a property that was in the GSE's real estate owned (REO) inventory;

(35) Public Subsidy Program—indicates whether the mortgage property is involved in a public subsidy program and which level(s) of government are involved in the subsidy program, *i.e.*, Federal government only, state or local government only, other only, Federal government and either state or local government, Federal government and other, state or local government and other, and Federal, state, or local government and other;

(36) Total Number of Units—indicates the number of dwelling units in the mortgaged property;

(37) The following data apply to unit types in a particular mortgaged property. The unit types are defined by the GSEs for each property and are differentiated based on the number of bedrooms in the units and on the average contract rent for the units. A unit type must be included for each bedroom size category represented in the property:

(A) Unit Type XX—Number of Bedroom(s)—the number of bedrooms in the unit type;

(B) Unit Type XX—Number of Units—the number of units in the property within the unit type;

(C) Unit Type XX—Average Reported Rent Level—the average rent level for the unit type in whole dollars;

(D) Unit Type XX—Average Reported Rent Plus Utilities—the average reported rent level plus the utility cost for each unit in whole dollars; and

(E) Unit Type XX—Affordability Level—the ratio of the average reported rent plus utilities for the unit type to the adjusted area median income;

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APPENDIX F

ORDER

GSE MORTGAGE DATA AND AHAR INFORMATION: PROPRIETARY INFORMATION/PUBLIC-USE DATA

THIS ORDER SETS FORTH THAT CERTAIN INFORMATION SUBMITTED BY THE FEDERAL NATIONAL MORTAGE ASSOCIATION AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION TO HUD IS PROPRIETARY AND SHALL NOT BE DISCLOSED TO THE PUBLIC AT THIS TIME. THIS ORDER SHALL BE EFFECTIVE UNTIL SUCH TIME AS IT IS DETERMINED NECESSARY AND/OR APPROPRIATE TO WITHDRAW OR MODIFY IT.

Note: The following matrices distinguish proprietary from public-use mortage data elements. A "YES" designation indicates that the data element is included in the public-use data base in the format indicated. For some data elements, where disclosure of census tract information would divulge proprietary information, alternative formats for disclosure that will not divulge proprietary information are indicated.

GSE Single-Family Mortgage Data
Owner- and Renter-Occupied 1- to 4-Unit Properties
Proprietary Information/Public-Use Data

#	Field Description	Values	Release on Census Tract File	Release on National File A	Release on National File B
0	Agency Flag	1=Fannie Mae 2=Freddie Mac	YES	YES	YES
1	Loan Number		Recode Using Random Number*	Recode Using Random Number*	Recode Using Random Number*
2	US Postal State	0=Missing	YES		
3	US Postal Zip Code				
4	MSA Code	0=Missing	YES		
5	Place Code - FIPS				
6	County - 1990 Census	0=Missing	YES		
7	Census Tract/BNA - 1990 Census	0=Missing	YES		
8**	Census Tract Geographic Designation	1=Tract Entirely Within Central City 2=Tract Entirely Outside Central City 3=Central City Split Tract 9=Not Able To Code	YES		
9**	Central City Flag 1	9999=Not Able To Code	YES		
10**	Central City Flag 2	9998=Not Available 9999=Not Applicable	YES		
11	1990 Census Tract - Percent Minority	9999=Not Available	YES	YES, but recode as: 1=0-<10% 2=10-<30% 3=30-100% 9=Missing	YES, but recode as: 1=0-<10% 2=10-<30% 3=30-100% 9=Missing
12	1990 Census Tract - Median Income	999999=Not Available	YES		
13	1990 Local Area Median Income	999999=Not Available	YES		
14	Tract Income Ratio	9999=Not Applicable	YES	YES, but recode as: 1=0-<=80% 2=80-<=120% 3= >120% 9=Missing Add Underserved Areas Indicator	YES, but recode as: 1=0-<=80% 2=80-<=120% 3= >120% 9=Missing Add Underserved Areas Indicator
15	Borrower(s) Annual Income	999999=Not Available	YES		
16	Area Median Family Income	999999=Not Available	YES		
17	Borrower Income Ratio	9999=Not Applicable/not available	YES - recode to include ratios for investor-owned properties	YES, but recode as: 1=0- <=60% 2=60- <=100% 3= >100 9=Not Applicable	YES, but recode as: 1=0- <=60% 2=60- <=100% 3= >100 9=Not Applicable
18	Acquisition UPB		YES, but recode as: Actual values for < $200,000 999998= >=$200,000 999999=Missing		
19	LTV @ Origination	999=Not Applicable		YES, but recode as: 1=0-60% 2=60+-80% 3=80+-90% 4=90+-95% 5=95%+	
20	Date of Mortgage Note				YES, but recode as: 1=Seasoned 2=Unseasoned
21	Date of Acquisition				
22	Purpose of Loan	1=Purchase 2=Refinancing 3=Second 9=Not Applicable			YES
23	Cooperative Unit Mortgage	1=Yes 2=No 8=Not Available 9=Not Applicable			

#	Field Description	Values	Release on Census Tract File	Release on National File A	Release on National File B
24**	Refinancing Loan from Own Portfolio	1=Yes 2=No 9=Not Applicable			
25	Special Affordable, Seasoned Loan: Are Proceeds Recycled?	1=Yes 2=No 9=Not Applicable			
26	Product Type	01=Fixed Rate 02=ARM 03=Balloon 04=GPM/GEM 05=Reverse Annuity Mortgage 06=Other 07...98=List Other Distinct Products 99=Not Available			
27	Federal Guarantee	1=FHA/VA 2=FMHA-Guaranteed Rural Housing Loan 3=Other Federal Guarantee 4=No Federal Guarantee		YES	YES
28	RTC/FDIC	1=Yes 2=No			
29	Term of Mortgage at Origination				
30	Amortization Term	998=Non-Amortizing Loan 999=Not Available			
31***	Lender Institution Name				
32***	Lender City				
33***	Lender State				
34	Type of Seller Institution	1=Mortgage Company 2=SAIF Insured Depository Institution 3=BIF Insured Depository Institution 4=NCUA Insured Credit Union 5=Other			YES
35	Number of Borrowers		YES		
36	First-Time Home Buyer	1=Yes 2=No 9=Not Available	YES		
37	Mortgage Purchased under GSE's Community Lending Program	1=FNMA's Community Homebuyer Program 2=FNMA's Community Lending Other 3=FNMA's Other Housing Impact Programs OR 1=FHLMC's Affordable Gold 2=FHLMC's Alternative Qualifying 9=Not Applicable			
38	Acquisition Type	1=Cash 2=SWAP 3=Credit Enhancement 4=Bond or Debt Purchase 5=Reinsurance 6=Risk Sharing 7=REIT 8=REMIC 9=Other			
39	GSE's Real Estate Owned	1=Yes 2=No 3=Not Available			
40**	Public Subsidy Programs	1=Federal only 2=State or Local only 3=Other/Private Subsidy only 4=Federal and State or Local 5=Federal and Other 6=State or Local and Other 7=Federal, State or Local and Other 9=Data Not Provided			
41	Borrower Race or National Origin	1=American Indian or Alaskan Native 2=Asian or Pacific Islander 3=Black 4=Hispanic 5=White 6=Other 7=Information Not Provided by Applicant In Mail or Telephone Application 8=Not Applicable 9=Not Available	YES	Combine Fields 41 and 42 1=American Indian or Alaskan Native 2=Asian or Pacific Islander 3=Black 4=Hispanic 5=White 6=Other 7=Borrower/Co-Borrower Are Different 9=Original 7, 8, 9	Combine Fields 41 and 42 1=American Indian or Alaskan Native 2=Asian or Pacific Islander 3=Black 4=Hispanic 5=White 6=Other 7=Borrower/Co-Borrower Are Different 9=Original 7, 8, 9
42	Co-Borrower Race or National Origin	1=American Indian or Alaskan Native 2=Asian or Pacific Islander 3=Black 4=Hispanic 5=White 6=Other 7=Information Not Provided by Applicant In Mail or Telephone Application 8=Not Applicable 9=Not Available	YES		

#	Field Description	Values	Release on Census Tract File	Release on National File A	Release on National File B
43	Borrower Gender	1=Male 2=Female 3=Information Not Provided by Applicant In Mail or Telephone Application 4=Not Applicable 9=Not Available	YES	Combine Fields 43 and 44 1=Male(s) only 2=Female(s) Only 3=Male and Female 9=Original 3, 4, 9	Combine Fields 43 and 44 1=Male(s) only 2=Female(s) Only 3=Male and Female 9=Original 3, 4, 9
44	Co-Borrower Gender	1=Male 2=Female 3=Information Not Provided by Applicant In Mail or Telephone Application 4=Not Applicable 9=Not Available	YES		
45	Age of Borrower	999=Data Not Provided	YES		
46	Age of Co-Borrower	999=Data Not Provided	YES		
47	Occupancy Code	1=Principal Residence/Owner Occupied 3=Investment Property (Rental)			YES
48	Number of Units			YES	YES
49	Unit 1 - Number of Bedrooms	99=Data Not Provided			
50	Unit 1 - Owner Occupied	1=Yes 2=No			
51	Unit 1 - Affordability Category	1=Low-Income Family (but not Very Low-Income) in a Low-Income Area 2=Very Low-Income Family, in a Low-Income Area 3=Very Low-Income Family, Not in a Low-Income Area 4=Other 9=Not Available		YES	YES
52	Unit 1 - Reported Rent Level	99999=Not Applicable			
53	Unit 1 - Reported Rent Plus Utilities	99999=Not Applicable			
54	Unit 2 - Number of Bedrooms	99=Data Not Provided			
55	Unit 2 - Owner Occupied	1=Yes 2=No			
56	Unit 2 - Affordability Category	1=Low-Income Family (but not Very Low-Income) in a Low-Income Area 2=Very Low-Income Family, in a Low-Income Area 3=Very Low-Income Family, Not in a Low-Income Area 4=Other 9=Not Available		YES	YES
57	Unit 2 - Reported Rent Level	99999=Not Applicable			
58	Unit 2 - Reported Rent Plus Utilities	99999=Not Applicable			
59	Unit 3 - Number of Bedrooms	99=Data Not Provided			
60	Unit 3 - Owner Occupied	1=Yes 2=No			
61	Unit 3 - Affordability Category	1=Low-Income Family (but not Very Low-Income) in a Low-Income Area 2=Very Low-Income Family, in a Low-Income Area 3=Very Low-Income Family, Not in a Low-Income Area 4=Other 9=Not Available		YES	YES
62	Unit 3 - Reported Rent Level	99999=Not Applicable			
63	Unit 3 - Reported Rent Plus Utilities	99999=Not Applicable			
64	Unit 4 - Number of Bedrooms	99=Data Not Provided			
65	Unit 4 - Owner Occupied	1=Yes 2=No			
66	Unit 4 - Affordability Category	1=Low-Income Family (but not Very Low-Income) in a Low-Income Area 2=Very Low-Income Family, in a Low-Income Area 3=Very Low-Income Family, Not in a Low-Income Area 4=Other 9=Not Available		YES	YES
67	Unit 4 - Reported Rent Level	99999=Not Applicable			
68	Unit 4 - Reported Rent Plus Utilities	99999=Not Applicable			
69	Fannie Mae Exclusions	1=Excluded from Goal Reporting			

* Different random number on each of the tract and national files.
** Not applicable to 1996 and beyond data sets.
*** Not applicable to 1993-1995 data sets.

GSE Multifamily Mortgage Data
Property Level
Proprietary Information/Public-Use Data

#	Field Description	Values	Release on Census Tract file	Release on National File
0	Agency Flag	1=Fannie Mae 2=Freddie Mac	YES	YES
1	Loan Number		Recode Using Random Number*	Recode Using Random Number*
2	US Postal State		YES	
3	US Postal Zip Code			
4	MSA Code		YES	
5	Place Code - FIPS			
6	County - 1990 Census		YES	
7	Census Tract/BNA - 1990 Census		YES	
8**	Census Tract Geographic Designation	1=Tract Entirely Within Central City 2=Tract Entirely Outside Central City 3=Central City Split Tract 9=Not Able To Code	YES	
9**	Central City Flag 1	9999=Not Able To Code	YES	
10**	Central City Flag 2	9998=Not Available 9999=Not Applicable	YES	
11	1990 Census Tract - Percent Minority	9999=Not Available	YES	YES, but recode as: 1=0-<10% 2=10-<30% 3=30-100% 9=Missing
12	1990 Census Tract - Median Income	999999=Not Available	YES	
13	1990 Local Area Median Income	999999=Not Available	YES	
14	Tract Income Ratio	9999=Not Applicable	YES	YES, but recode as: 1=0-<=80% 2=80-<=120% 3= >120% 9=Missing Add Underserved Areas Indicator
15	Area Median Family Income	999999=Not Available	YES	
16	Affordability Category	1. >=20% especially low income and <40% very low income 2. <20% & >=40% 3. >=20% & >=40% 4. <20% & <40% 8=Not Available 9=Not Eligible 0=Missing-Eligible But Does Not Qualify		YES
17	Acquisition UPB		YES, but recode as: 1= <= $500,000 2= $500k-<=$1m 3= $1m-<=$2m 4= $2m-<=$4m 5= > $4m 9= Missing	
18	Participation Percent			
19	Date of Mortgage Note			
20	Date of Acquisition			
21	Purpose of Loan	1=Purchase 2=Refinancing 3=New Construction 4=Rehabilitation 9=Not Applicable		YES
22	Cooperative Project Loan	1=Yes 2=No 8=Not Available 9=Not Applicable		
23**	Refinancing Loan from Own Portfolio	1=Yes 2=No 9=Not Applicable		
24	Special Affordable, Seasoned Loan: Are Proceeds Recycled?	1=Yes 2=No 9=Not Applicable		
25	Mortgagor Type	1=Individual 2=For Profit Entity 3=Nonprofit Entity 4=Public Entity 5=Other		

#	Field Description	Values	Release on Census Tract file	Release on National File
26	Term of Mortgage at Origination			
27	Loan Type	1=Fixed Rate 2=ARM 3=GPM		
28	Construction Loan	1=Yes 2=No		
29	Amortization Term	998=Non-Amortizing Loan 999=Not Available		
30***	Lender Institution			
31***	Lender City			
32***	Lender State			
33	Type of Seller Institution	1=Mortgage Company 2=SAIF Insured Depository Institution 3=BIF Insured Depository Institution 4=NCUA Insured Credit Union 5=Other	YES	YES
34	Government Insurance	1=Yes 2=No 9=Not Available		YES
35	FHA Risk Share Percent			
36	Acquisition Type	1=Cash 2=Swap 3=Other 4=Credit Enhancement 5=Bond/Debt Purchased 6=REMIC 7=Reinsurance 8=Risk Sharing 9=REIT		
37	GSE Real Estate Owned	1=Yes 2=No 3=Not Available		
38	Public Subsidy Program	1=Federal only 2=State or Local only 3=Other/Private Subsidy only 4=Federal and State or Local 5=Federal and Other 6=State or Local and Other 7=Federal, State or Local and Other 9=Data Not Provided		
39	Total Number of Units			YES
40**	Special Affordable - 45 Percent			YES
41**	Special Affordable - 55 Percent			YES
42	Fannie Mae Exclusions	1=Excluded from Goal Reporting		

* Different random numbers on tract and national files
** Not applicable to 1996 and beyond data sets.
*** Not applicable to 1993-1995 data sets.

GSE Multifamily Mortgage Data
Unit Level
Proprietary Information/Public-Use Data

0	Agency Flag			YES
1	Loan Number			Recoded As A Random Number****
43	Unit Type XX-Number of Bedrooms			YES, but recode as: 1=0-1 Bedroom 2= 2+ Bedrooms
44	Unit Type XX-Number of Units			YES, but recode to correspond to #43
45	Unit Type XX-Average Rent Level			
46	Unit Type XX-Average Rent Plus Utilities			
47	Unit Type XX-Affordability Level			YES, but recode as: 1=0-50% 2=50-60% 3=60-80% 4=80-100% 5= > 100% 9=Not Available

**** This number will match the property level random number on the national file.

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