DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Secretary

24 CFR Part 81

[Docket No. R–95–1754; FR–3481–P–01]

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: Proposed rule.

SUMMARY: This proposed rule would establish new regulations implementing the Secretary of Housing and Urban Development's regulatory authorities respecting the Federal National Mortgage Association (''Fannie Mae'') and the Federal Home Loan Mortgage Corporation (''Freddie Mac''). Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (''the Act''), the Secretary has general regulatory authority over Fannie Mae and Freddie Mac (''GSEs'').

Status as a GSE provides substantial advantages to Fannie Mae, Freddie Mac, and their shareholders. With such public benefits flow public responsibilities. In the Act, Congress set forth a framework to ensure that the GSEs fulfill the public purposes set forth in their Charter Acts and serve the housing needs of the country, without threatening the GSEs' safety and soundness. Under the Act, the Secretary is responsible for establishing housing goals to require the GSEs to extend access to mortgage credit to very low-, low-, and moderate-income families and families in central cities, rural areas, and other underserved areas. The Secretary is also responsible for advancing fair lending by requiring that the GSEs not discriminate in their mortgage purchases because of race, color, religion, sex, handicap, familial status, age, or national origin. This regulation requires that the GSEs facilitate enforcement of the Fair Housing Act and the Equal Credit Opportunity Act (ECOA) by submitting data on mortgage lenders to assist investigations of possible Fair Housing Act and ECOA violations. The proposed regulation also directs the GSEs to undertake remedial action against sellers found to violate the Fair Housing Act and ECOA and provides for the Secretary periodically to review and comment on each GSE's underwriting and appraisal guidelines. In addition, the regulation sets forth the scope of other Secretarial responsibilities, including the statutory authority to review and approve new programs of the GSEs, obtain data and reports from the GSEs on their housing activities, and disseminate publicly information related to the GSEs' housing activities while protecting proprietary information.

DATES: Comment due date: May 2, 1995.

ADDRESSES: Comments should be sent to Rules Docket Clerk, Office of General Counsel, room 10276, Department of Housing and Urban Development (HUD), 451 Seventh Street, SW, Washington DC 20410–0500. Communications should refer to the docket number and title. Facsimile (FAX) comments are not acceptable. A copy of each communication submitted will be available for public inspection and copying between the hours of 7:30 a.m. and 5:30 p.m. weekdays at the above address.

FOR FURTHER INFORMATION CONTACT: Harold Bunce, Acting Director, Financial Institutions Regulation, Office of Policy Development and Research, telephone (202) 708–2770; or, for legal questions, Kenneth A. Markison, Assistant General Counsel for Government Sponsored Enterprises/RESPA, Office of the General Counsel, telephone (202) 708–3137; Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, D.C. 20410. A telecommunications device for deaf persons (TDD) is available at (202) 708–9300. (These are not toll-free telephone numbers.)

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 1980 (44 U.S.C. 3501–3520). No person may be subjected to a penalty for failure to comply with these information collection requirements until they have been approved and assigned an OMB control number. The OMB control number, when assigned, will be announced by separate notice in the **Federal Register**.

Public reporting burden for the collection of information requirements contained in this rule is estimated to include the time for reviewing the instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Information on the estimated public reporting burden is provided under the Preamble heading, *Other Matters*. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to the Department of Housing and Urban Development, Rules Docket Clerk, 451 Seventh Street, SW, Room 10276, Washington, DC 20410–0500; and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for HUD, Washington, DC 20503.

I. General

A. Purpose

This proposed rule would establish new regulations implementing the authorities of the Secretary of Housing and Urban Development (''the Secretary'') to regulate the GSEs under the GSEs' respective Charter Acts (the Federal National Mortgage Association Charter Act (Fannie Mae Charter Act), Title III of the National Housing Act, section 301 *et seq.* (12 U.S.C. 1716 *et seq.*); and the Federal Home Loan Mortgage Corporation Act (Freddie Mac Act), Title III of the Emergency Home Finance Act of 1970, section 301 *et seq.* (12 U.S.C. 1451 *et seq.*) and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (''FHEFSSA'' or ''the Act''), 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 to regulate the GSEs, requiring the Secretary to promulgate new regulations. The Secretary proposes these regulations to implement these new authorities, to replace the Secretary's current regulations governing Fannie Mae and, for the first time, to establish regulations governing Freddie Mac.

B. Background

In 1968, Congress chartered Fannie Mae as a stockholder-owned, privately managed corporation to fulfill various public purposes by providing a secondary market for home mortgages. In 1970, Congress chartered Freddie Mac within the Federal Home Loan Bank System.

The GSEs' Charter Acts set forth identical purposes for Fannie Mae and Freddie Mac [1] 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

[1] *Cf.* Fannie Mae Charter Act, section 301, to Freddie Mac Act, section 301.

market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a 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]

1. The Current Fannie Mae Regulations

In 1978, the Secretary promulgated regulations governing Fannie Mae.[3] These regulations were issued under the authority of the Fannie Mae Charter Act and, among other things, implemented the Secretary's ''general regulatory power'' over Fannie Mae and established other specific regulatory powers of the Secretary, including procedures under which the Secretary must approve stock and debt issuances, changes to a statutory debt-to-capital ratio, and new conventional mortgage programs.[4] The regulations also require Secretarial approval of Fannie Mae's underwriting guidelines to implement fair housing requirements and regulate equal opportunity in employment.[5] To ensure that Fannie Mae fulfilled its Charter Act purpose of providing a secondary market for home mortgages for low- and moderate-income families, the regulations required that 30 percent of Fannie Mae's aggregate mortgage purchases be mortgage purchases financing housing secured by mortgages located in central cities and that 30 percent of its aggregate mortgage purchases be mortgages financing housing for low- and moderate-income families.[6] Housing for low- and moderate-income families under the Fannie Mae regulations included multifamily housing insured under Federal Housing Administration (FHA) programs, housing receiving housing assistance payments (HAP), and, for single-family housing, housing purchased at a price not in excess of 2.5 times the area median family income.[7]

2 Fannie Mae Charter Act, section 301, and Freddie Mac Act, section 301(b).

3 24 CFR part 81.

4 24 CFR 81.12, 81.14, 81.15, and 81.16(c).

5 24 CFR 81.18 and 81.19.

6 24 CFR 81.16(d) and 81.17.

7 24 CFR 81.2(l).

2. FIRREA and the Secretary's Assumption of Regulatory Responsibility Over Freddie Mac

Section 731 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (''FIRREA'') (Pub. L. 101–73, approved August 9, 1989) amended the Freddie Mac Act. The Secretary of HUD was granted general regulatory power and essentially the same specific regulatory powers with respect to Freddie Mac as the Secretary had respecting Fannie Mae, so that the Secretary's regulatory authority was ''identical, on all relevant matters, to (the Secretary's) regulatory power over (Fannie Mae).''[8]

3. The Federal Housing Enterprises Financial Safety and Soundness Act

Congress was concerned about the potential for loss to the taxpayers if the GSEs suffered serious losses.[9] In FIRREA, Congress required the Treasury Department, the Congressional Budget Office (CBO), and the General Accounting Office to study the regulation of the GSEs and present recommendations to the Congress.[10] These studies concluded that the current regulatory authorities over the GSEs were inadequate to protect the taxpayer and ensure that the GSEs served the public purposes for which they were chartered. All three agencies recommended that the Government be granted additional authority to regulate the GSEs. The Treasury study formed the basis for a 1991 Administration proposal to create an independent office within HUD to regulate the safety and soundness of the GSEs.

In 1991, the House of Representatives passed H.R. 2900 (102d Cong., 1st Sess. (1991)), establishing an independent office within HUD to regulate the financial safety of the GSEs.[11] The House bill also provided for the establishment of special affordable housing goals to ensure that the GSEs meet the unaddressed needs of very low-income families and lower-income families in lower income areas.[12] The Senate made substantial revisions to the House bill, including changes to clarify the Secretary's authority to establish central cities and low- and moderate-income goals and to modify provisions concerning fair housing.[13]

8 H.R. Rep. No. 101–54, 101st Cong., 1st Sess., pt. 3, at 2 (1989), and S. Rep. No. 101–19, 101st Cong., 1st Sess. 38 (1989).

9 *See, e.g.,* H.R. Rep. 101–54, Part 1, 101st Cong., 1st Sess. 389 (1989).

10 FIRREA, sections 1004 (Comptroller General study) and 1404 (Treasury study), and 2 U.S.C. 621 note (Treasury study and CBO study).

11 H.R. 2900, section 101.

12 *Id.*, at sections 121(n) and 122(l).

In 1992—as the Department was preparing regulations governing Freddie Mac and revising its Fannie Mae regulations—Congress enacted FHEFSSA, which revamped the regulatory structure concerning the GSEs and the GSEs' Charter Acts. In FHEFSSA, Congress chose to separate authority over the GSEs' safety and soundness from authority to assure that the GSEs accomplished their public purposes. FHEFSSA established a new Office of Federal Housing Enterprise Oversight (OFHEO) charged with new regulatory powers over the financial safety of the GSEs.[14] FHEFSSA also granted the Secretary more specific powers and authorities over the housing purposes and fair lending responsibilities of the GSEs.

The Act granted the Secretary the power to establish, monitor, and enforce goals for the GSEs' purchases of mortgages financing housing for low- and moderate-income families, housing located in central cities, rural areas, and other underserved areas, and special affordable housing meeting the unaddressed housing needs of targeted families.[15] Although the authority to establish goals previously existed under the Charter Act and was implemented under the current Fannie Mae regulations,[16] FHEFSSA defined and expanded this authority. Moreover, the Act provided that the goals would be achieved based on income of owners and renters. The regulations, promulgated in 1978, had allowed a proxy of house price[17] that was easier to achieve.

Generally, the Act authorizes the Secretary to establish each of the goals after consideration of certain prescribed factors relevant to the particular goal.[18] However, for a transition period of calendar years 1993 and 1994, the Act established target percentage amounts for purchases by the GSEs of mortgages on housing for low- and moderate-income families and housing located in central cities—which were based on the Fannie Mae regulations—and specific dollar amounts for purchases of mortgages on special affordable

13 S. 2733, 102d Cong., 2d Sess., sections 502, 504, and 514 (1992).

14 Section 1311, and *see, e.g.,* section 1313. Unless otherwise specified, all section cites herein are cites to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.

15 *See generally,* sections 1331–34.

16 *See* 24 CFR 81.16(d) and 81.17.

17 24 CFR 81.2(l)(3).

18 Sections 1332(b), 1333(a)(2), and 1334(b).

housing.[19] For the transition years, the Act set targets for both GSEs that low- and moderate-income and central cities mortgage purchases comprise at least 30 percent of the units financed by the GSEs' total mortgage purchases for these years.[20] The Act also set targets for the special affordable housing goals in the transition years,[21] which, unlike the other goals, were set at no less than a minimum number of dollars of mortgage purchases rather than units financed. For the transition, the Act required that the Secretary establish interim goals to improve the GSEs' performances relative to the statutory targets, so that the GSEs would meet the targets by the end of the transition period.[22]

The Act also established new fair lending requirements for the GSEs under which 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.'' [23] Under the Act, the Secretary also must: 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); 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; direct the GSEs to take remedial action against lenders found to have engaged in discriminatory lending practices in violation of the Fair Housing Act or ECOA; and periodically review and comment on the underwriting and appraisal guidelines of each GSE to ensure that such guidelines are consistent with the Fair Housing Act and the Act.[24]

The Act 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.[25] The Act affirms the Secretary's authority to require reports from the GSEs [26] and details specific data and reports that the GSEs must provide.[27] The Act assigns the Secretary other responsibilities, including establishing a public use data base and implementing requirements for the protection of proprietary information provided by the GSEs.[28] The Act also requires the Secretary to establish procedures to ensure due process for the GSEs in exercising the Secretary's regulatory authorities.[29]

In light of the $850 billion in mortgage-backed securities that were currently outstanding from the GSEs, their $190 billion combined mortgage portfolios, and the GSEs' importance to the National economy, Congress determined that the taxpayers needed increased protection from potential financial losses or risks posed by the GSEs.[30] The Act therefore established a new independent financial regulator for the GSEs within HUD—the Office of Federal Housing Enterprise Oversight (OFHEO) [31]—to design and administer a stress test for capital adequacy and to carry out all regulatory functions to ensure the financial safety of the GSEs.[32] In establishing a new regulatory framework for regulation of the GSEs' financial safety and soundness, the Act deleted several specific authorities of the Secretary, including authority to approve stock offerings, the rate of dividends, and changes in the GSEs' debt-to-capital ratio.[33] The Act assigns authority to approve dividends to the Director of OFHEO [34] and replaces the debt-to-capital ratio with a risk-based capital standard and stress test administered by the Director of OFHEO.[35] Under the Act, the Secretary retains general regulatory power over both GSEs, ''(e)xcept for the authority of the Director of the (OFHEO) described in section 1313(b) and all other matters relating to the safety and soundness of the (GSEs) * * *.'' [36]

4. Previous Proposed Rule

On August 16, 1991, the Secretary published a proposed rule to update the Fannie Mae regulations and establish new regulations governing Freddie Mac.[37] Prior to the promulgation of a final rule, the President signed FHEFSSA into law on October 28, 1992. Since the new Act required complete revision of the rule, the Secretary is withdrawing the former proposed rule and issuing this new proposed rule.

5. Interim Housing Goals

On October 13, 1993, the Secretary published a Notice in the **Federal Register** establishing the interim goals for the GSEs' purchases of mortgages financing low- and moderate-income housing, housing in central cities, and special affordable housing—applicable to the transition years of 1993 and 1994—and requirements for implementation of the goals.[38]

For the transition period of 1993 and 1994, the Act established annual targets for the purchases by both GSEs of mortgages financing housing for low- and moderate-income families and housing located in central cities.[39] The Act set these targets at 30 percent of the units financed by mortgage purchases of the GSEs; [40] the targets were based on the goals established under HUD's Fannie Mae regulations.[41] For the transition period, the Act provided that, where a GSE was not meeting a target as of January 1, 1993, the Secretary must establish the annual goal so that the GSE would improve its performance relative to the 30 percent target.[42] Where a GSE was meeting a target, the Act required the Secretary to establish the goal so that the GSE would improve its performance relative to the 30 percent target.[43] The Act also established dollar targets for the GSEs' purchases of mortgages financing special affordable housing, *i.e.*, housing meeting the needs of and affordable to low-income families in low-income areas and very low-income families.[44] The Secretary established these goals and implementation requirements in the Interim Notice published in October 1993.[45]

The Notice established the goal that 30 percent of the units financed by mortgages purchased by Fannie Mae in 1993 and 1994 should be housing for low- and moderate-income families.[46] The Notice also established the goal that 28 percent of units financed by mortgages purchased by Fannie Mae in 1993, and 30 percent in 1994, should be on housing located in central cities.[47] For the year 1993, Fannie Mae exceeded

[19] Sections 1332(d), 1333(d), and 1334(d).
[20] Sections 1332(d)(1) and 1334(d)(1).
[21] Section 1333(d) (1) and (2).
[22] Sections 1332(d)(2)(A) and 1334(d)(2)(A).
[23] Section 1325(1).
[24] Section 1325 (2)–(6).
[25] Section 1322.
[26] Section 1327.
[27] *See* sections 1381 (o and p) and 1382 (r and s).
[28] Sections 1323 and 1326.
[29] Sections 1322, 1336, and 1341–49.
[30] *See, e.g.*, S. Rep. No. 102–282, 102d Cong., 2d Sess. 10 (1992) (hereinafter cited as ''S. Rep.'').
[31] Section 1311.
[32] *See generally*, section 1313.
[33] Sections 1381 (d)(2), (e)(1), and (k), and 1382(e).
[34] Sections 1381(d)(2) and 1382(e).
[35] Sections 1361–64.
[36] Section 1321.
[37] 56 FR 41022 (1991).
[38] 58 FR 53048 and 53072 (1993).
[39] Sections 1332(d)(1) and 1334(d)(1).
[40] Sections 1332(d)(1) and 1334(d)(1).
[41] 24 CFR 81.16(d) and 81.17.
[42] Sections 1332(d)(2)(A) and 1334(d)(2)(A).
[43] Sections 1332(d)(2)(B) and 1334(d)(2)(B).
[44] Section 1333 (a)(1), (d)(1), and (d)(2).
[45] 58 FR 53048 and 53072 (1993).
[46] 58 FR 53048, 53061 (1993).
[47] *Id.* at 53063.

the goal for low- and moderate-income housing with 35.58 percent and is performing at a rate for 1994 [48] that likely will result in Fannie Mae's exceeding the goal and achieving 40 percent. In 1993, Fannie Mae did not meet the goal for central cities and has developed a housing plan to increase its efforts for 1994.

The Notice established Freddie Mac's goal for purchases of mortgages financing housing for low- and moderate-income families at 28 percent for 1993 and 30 percent for 1994.[49] The Notice established Freddie Mac's goal for purchases of mortgages financing housing located in central cities for 1993 at 26 percent and 30 percent for 1994.[50] For the year 1993, Freddie Mac exceeded the goal for low- and moderate-income housing with 29.18 percent and is performing at a rate for 1994 [51] that likely will result in Freddie Mac's exceeding the goal and achieving 35 percent. In 1993, Freddie Mac did not meet the goal for central cities and has developed a housing plan to increase its efforts for 1994.

C. Secretary's Approach to Regulating the Enterprises

The Secretary recognizes that the GSEs occupy a unique position in this country's housing finance system. The GSEs were created by the Congress, chartered for public purposes and receive significant public benefits, but the GSEs are privately owned and operated. Because of their status as government-sponsored enterprises, the GSEs receive significant benefits not enjoyed by any other shareholder-owned corporation in the mortgage market. The explicit benefits the GSEs receive include: (1) conditional access to a $2.25 billion line of credit from the U.S. Treasury; [52] (2) exemption from securities registration requirements of the Securities and Exchange Commission and the states; [53] (3) exemption from all State and local taxes except property taxes; [54] and (4) higher demand for the GSEs' securities, since the Government gives those securities the attributes of and the same preferred investment status as Treasury debt.[55] These explicit benefits are far outweighed by an implicit benefit—the market's assumption that, even though no explicit Federal guarantee exists,[56] should a GSE fail to meet its obligations, Congress, and ultimately the American taxpayer, would assist the GSEs. As a result of this implicit guarantee, the GSEs can borrow at near-Treasury rates, and they can sell securities at prices that exceed those of wholly private firms.[57] Consequently, the GSEs' cost of doing business is less than that of other competitors in the mortgage market.

This competitive advantage, combined with the GSEs' solid management, has resulted in enormous growth for both GSEs. In 1989, the GSEs purchased $171 billion of mortgages; in 1993, $543 billion, a three-fold increase. In 1993, the GSEs collectively purchased 70 percent of the mortgages originated in the conventional conforming loan market.[58] The GSEs' profitability has more than doubled in the same period, with combined profits of $2.7 billion in 1993, compared to $1.2 billion in 1989. At the end of the first quarter of 1994, the combined dollar amount of mortgages held in portfolio and mortgage-backed securities outstanding between the two GSEs is nearly 2.5 times the thrift industry's holdings and twice as large as the holdings by commercial banks.[59]

Because they are publicly created entities that enjoy substantial publicly derived benefits, Congress requires the GSEs to carry out public purposes not required of other private-sector entities in the housing finance industry. The GSEs' Charter Acts require them to assist in the efficient functioning of a secondary market for residential mortgages, including mortgages for low- and moderate-income families, and to promote access to mortgage credit throughout the nation, including central cities, rural areas, and other underserved areas. The Charter Act requirements create an obligation for the GSEs to ensure that citizens throughout the country have the opportunity to enjoy access to the public benefits provided by these federally related entities.

The GSEs have been successful at achieving an important part of their mission of providing stability in primary mortgage markets and bringing liquidity to housing finance markets through standardization and the development of mortgage-backed securities. Many home buyers have benefitted from lower interest rates and increased access to capital as a result of the GSEs' activities. The importance of the secondary market and its impact on who is able to buy a home and which communities have access to mortgage credit is substantial. Even lenders intending to hold loans in portfolio originate loans using the GSEs' standards, so that the lenders have the option to sell to the GSEs at a future date.

The Act and the legislative history make clear that the GSEs should be serving Americans across the income spectrum and throughout the country. The GSEs do an excellent job of facilitating the availability of mortgage credit for home buyers with more than moderate incomes and for residents of suburban communities. The GSEs must also use their entrepreneurial talents and position in the marketplace to ''ensure that citizens throughout the country enjoy access to the public benefits provided by these federally related entities.'' [60] The GSEs are not expected to provide deep subsidies for the financing of affordable housing on the scale needed to solve the nation's housing problems. However, given the purposes for which Congress created these enterprises and the substantial federal benefits that they receive, it is essential that the GSEs' activities promote the achievement of national housing goals.

D. Leading the Industry

During the consideration of the Act, Congress noted its strong concern that the GSEs were not doing enough to benefit low- and moderate-income families or the residents of underserved areas that lack access to credit.[61] The Act specifically requires that in establishing the goals, the Secretary consider the ability of the GSEs to lead the industry. The intent of the Congress was clearly stated: the GSEs should ''lead the mortgage finance industry in making mortgage credit available for

[48] Fannie Mae's report on its performance under the goal for the first three quarters of 1994 provides that 43.29 percent of its mortgage purchases count toward achievement of the goal for low- and moderate-income families.

[49] 58 FR 53072, 53085 (1993).

[50] *Id.* at 53088.

[51] Freddie Mac's report on its performance under the goal for the first three quarters of 1994 indicates that 36.31 percent of its mortgage purchases count toward achievement of the goal for low- and moderate-income families.

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

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

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

[55] *See, e.g.,* 12 CFR 208, App. A, section III.C.2.

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

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

[58] Fannie Mae Economics Department.

[59] Commercial banks held $555 billion, thrifts held $458 billion, and the GSEs held or backed $1,164 billion. Federal Reserve Bulletin, Vol. 80, No. 8, Table 1.54, at A38 (August 1994).

[60] S. Rep. at 34.

[61] *See, e.g.,* S. Rep. at 34.

low- and moderate-income families''.[62] The Act also clarified the GSEs' responsibility to complement the requirements of the Community Reinvestment Act and fair lending laws in order to expand access to capital to those traditionally underserved by the housing finance market.

Fannie Mae and Freddie Mac do not lead the mortgage finance industry in expanding housing opportunities for low-income home buyers and for families who must rent because they cannot afford to be homeowners. The GSEs do not lead the mortgage finance industry in providing access to mortgage credit for residents of communities that are underserved. But the GSEs can and should provide this leadership. As noted in the Act's legislative history, ''the GSEs need to provide more leadership in all of these areas, and they have indicated a desire to do so. But direct and potentially forceful federal oversight is the only way to ensure that it will happen.'' [63]

The Secretary shares the concern of Congress about the GSEs' level of activity in making mortgage credit available for lower-income families. Loans originated for families with incomes below 80 percent of area median income are less likely to be purchased by the GSEs. Five out of six single-family mortgages purchased by the GSEs are for borrowers with incomes above 80 percent of area median income. Almost 60 percent of the GSEs' single-family business is for borrowers with incomes above 120 percent of area median income.

In considering whether the GSEs are leading the industry and in establishing the appropriate levels for the housing goals, the level of originations by the primary market must be examined. The primary market is able to sell to the GSEs more loans for higher-income families than loans for lower-income families. Based on 1993 mortgage market data, the GSEs purchased 55 percent of the loans originated by the primary market for borrowers with incomes above 120 percent of area median income, but only 41 percent of the mortgages originated for borrowers with incomes less than 60 percent of area median income. This occurred notwithstanding that, in response to the Community Reinvestment Act and their desire to meet the mortgage needs of a broad range of families, lenders are originating many more mortgages for very low- and low-income families than the GSEs are purchasing.

[62] S. Rep. at 34.

[63] S. Rep. at 11.

E. Establishing the Housing Goals

The Secretary recognizes that both GSEs have improved their performance in 1993 in the provision of mortgages financing for low- and moderate-income home buyers and central city residents. Both GSEs have begun new programs to increase their ability to deliver the benefits of their activities to traditionally underserved borrowers. These activities are commendable and the Secretary looks forward to seeing those initiatives carried forward. Both GSEs have also been engaged in initiatives to communicate to lenders that the GSEs' underwriting guidelines are not intended to prevent lenders from originating loans for previously underserved segments of their communities.

The Secretary notes these initiatives and the performance of the GSEs under the 1993 housing goals. Both Fannie Mae and Freddie Mac have made progress in carrying out their Charter-required activities to expand access to credit. At the same time, greater accomplishments are needed to assure that the GSEs fully realize their Charter Act purposes. To meet the intent of the Act, the GSEs must purchase more loans originated by the market for borrowers with lower incomes.

The Secretary does not intend that the GSEs do less business for borrowers with high incomes in order to increase their purchases of mortgages for lower-income families. Given the capacity of the GSEs, a tradeoff between high-income and low-income business does not need to occur. When the mortgage market spiked to a trillion dollars in volume in 1993, the GSEs demonstrated their capacity to expand their volume tremendously. The Secretary does not believe that the GSEs will have to shrink one portion of their business to expand their focus on achieving their Charter purposes of providing access to credit to all Americans.

This view has also been expressed by James A. Johnson, Chairman and Chief Executive Officer of Fannie Mae, in Congressional testimony in April 1994:

> It is a governmental frame of reference to assume (Fannie Mae's) resources are limited (as appropriations would be for a government department) and then to 'assign' them through numerous subgoals to categories of need. But the fact that Fannie Mae helps moderate-income families in no way diverts (Fannie Mae) from supporting low-income families.[64]

[64] Testimony before the Committee on Banking, Finance, and Urban Affairs, Subcommittee on General Oversight, Investigations, and the Resolution of Failed Financial Institutions, U.S. House of Representatives, at 17 (April 20, 1994).

In setting the levels of the housing goals, the Secretary has considered carefully the six factors stipulated in the Act: National housing needs; economic, housing, and demographic conditions; the previous performance and effort of the enterprises in achieving the specific goal; the size of the market for that goal; the ability of the GSEs to lead the industry; and the need to maintain the sound financial condition of the enterprises.[65] The Secretary has concluded that these factors, as well as the requirement that the GSEs lead the industry in affirmative efforts to meet the needs of lower-income families and residents of central cities, rural areas, and other underserved communities, dictate that the levels of the housing goals should be increased for 1995–1996. The Secretary considered the following factors which are analyzed in detail in the appendices:

(1) *Housing Needs.* Homeownership is a key aspiration of most Americans. Homeownership fosters family responsibility and self-sufficiency, expands housing choice and economic opportunity and promotes community stability. A homeowner has the most secure physical environment in which to raise a family. Children of homeowners are more likely to graduate from high school, less likely to commit crime, and less likely to themselves have children as teenagers than children of renters. Recent surveys indicate that lower-income families and minority families who do not own their own homes will make considerable sacrifices to purchase a home.

During the past decade, the goal of homeownership has become more elusive for very low-, low-, and moderate-income families. The homeownership rate in this country declined from on all-time high of 65.6 percent in 1980 to 63.9 percent in 1985, where it has remained essentially unchanged. The families that bore the brunt of this decline in homeownership are households who earn less than the median, particularly single-parent households and households with children.

At the same time, housing needs of families who rent have also increased. Finding affordable housing is by far the most common housing problem for American families nationwide. Poor households compete for a diminishing number of affordable apartments as low-cost units are lost to disrepair or are upgraded to serve higher-income renters. The result is growing numbers of low-income households who pay high shares of their income for

[65] 12 U.S.C. 4562.

inadequate housing. Six million low-income families paid more than 50 percent of their income for rent, leaving them with less money for other necessities like food, clothing, health care, and education. The very lowest income renters (families with incomes below 30 percent of area median income) are particularly hard-hit by high rents relative to their incomes, with over 50 percent of these families spending more than half of their income on rent.

The most unfortunate families have no homes. Precise counts of homeless people are not available. An estimated 600,000 people are homeless on any given night and as many as seven million Americans have experienced homelessness during the late 1980s, some for brief periods and some for years.[66]

(2) *Economic, Housing, and Demographic Conditions.* The Department estimates that in 1995 originations for single-family mortgages will be $615 billion. The demand for purchase mortgages will increase in 1995 and 1996, because of demographic trends, including high levels of immigration, changing age and family composition of households, the growth of the affluent elderly population, and potentially increased homeownership by native-born minorities. In addition, although volatile interest rates strongly influence both housing starts and mortgage market activity, rates that are low by historic standards have improved affordability for first-time home buyers, many of whom were closed out of the market during the 1980s. Increasing income inequality and changes in household composition will continue to create an acute need for rental housing affordable to very low-income families, placing additional pressure on the widespread shortages of rental housing affordable to families with incomes below 30 percent of area median income.

(3) *Previous Performance of the GSEs.* The GSEs exceeded the 1993 goals for low- and moderate-income housing. Neither enterprise met the central cities goal for 1993. For the special affordable housing goal, a two-year goal, both GSEs are on track to meet the single-family portion of the goal. Fannie Mae should meet the multifamily portion of the goal by the end of 1994. It is unclear whether Freddie Mac will meet the multifamily portion of the goal by the end of 1994. The Secretary notes that, during the transition period 1993–1994, both GSEs have engaged in new marketing efforts, and introduced new programs, products, and relationships in an effort to achieve the goals.

(4) *Size of the Conventional Market for Each Goal.* The Secretary recognizes the importance of accurately determining, to the extent possible given current data, the size of the various markets applicable to each of the goals. HUD devoted significant analytical resources to estimating market shares, using information from four major data sources: The 1993 purchases by the GSEs, 1993 HMDA data, the American Housing Survey, and the Residential Finance Survey. HUD estimates that 50 to 55 percent of the mortgage market in 1995–1996 will be composed of mortgages from low- and moderate-income households. As a subset of that market, at least 17–20 percent of the conventional conforming market will be composed of mortgages for very low-income households and low-income households in low-income areas. The market share for the central cities, rural areas, and other underserved areas goal (as redefined) is 21–23 percent.

(5) *Ability of the Enterprises to Lead the Industry.* The Secretary believes that the GSEs are well-positioned to provide the leadership that is needed to encourage the mortgage finance industry to better serve very low-, low-, and moderate-income families and residents of communities underserved by the mortgage markets. The GSEs' ability to lead the industry flows from 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 primary lenders are willing to make, their development and use of cutting-edge technology, their competent and well-trained staff, and their financial resources.

(6) *Need to Maintain the Sound Financial Condition of the Enterprises.* The enterprises are very substantial corporations as measured by their assets and profits. The Secretary has determined that the GSEs can accomplish the goals established in this regulation in such a way that limited, if any, risk is posed to their safety and soundness. The goals would require reasonable increases in the GSEs' purchases of mortgages that are affordable to very low-, low-, and moderate-income households or finance units located in areas that meet the proposed definition of underserved areas. Given the relatively small size of the proposed increases compared to their current business, the potential increase in the credit risk borne by the GSEs will be limited.

F. Setting the Levels of the Housing Goals

In establishing the housing goals for 1995 and 1996, the Secretary balanced the congressionally mandated factors, *i.e.*, size of the market, housing needs, safety and soundness considerations, economic and demographic conditions, previous performance and the GSEs ability to lead the industry.[67] The Secretary was guided by the overarching principle that both enterprises were created by Congress to serve public purposes for which they receive public benefits, and that their unique status requires that they lead the industry in expanding access to mortgage credit for more Americans and communities. The factors and the public purposes of the GSEs also require that the GSEs lead the industry in affirmative efforts to meet the needs of lower-income families and residents of central cities, rural areas, and other underserved communities.[68]

Based on a consideration of the factors, set forth fully in appendices A, B and C to this rule, the Secretary proposes to establish the goals for 1995 and 1996 for mortgage purchases for low and moderate income housing at 38 percent for 1995 and 40 percent for 1996, the goal for mortgage purchases for central cities, rural areas and other underserved housing at 18 percent for 1995 and 21 percent for 1996, and the goals for special affordable housing at 11 percent for 1995 and at 12 percent for 1996.

Based on a consideration of the factors, set forth in the same appendices to the rule, the Secretary proposes to establish all three goals for 1997 and 1998 so that the goals will move the GSEs steadily over a reasonable period of years, including these two years, to a level of mortgage purchases where the GSEs will be leading the industry in purchasing mortgages meeting the goals. In carrying out this objective, the Secretary proposes to establish the goals for 1997 and 1998 at levels ranging from the same amounts established for 1996 to higher levels. The purpose of any higher levels would be to continue to move the GSEs toward purchasing a greater proportion of mortgages originated by the market. The goals for 1997 to 1998 are therefore proposed for comment as a range; in finalizing the goals, the Secretary will specify definite figures on this range. In order to finalize the goals, the Secretary seeks responses from the public on what ''leading the industry'' should mean and what the goals should be over this period and in

[66] *Priority: HOME! The Federal Plan to Break the Cycle of Homeless,* 17 (1994).

[67] *See* Appendices A–C for the Secretary's analysis of these factors.

[68] 12 U.S.C. 4501.

the future to achieve this objective. The Secretary anticipates at this time that future market conditions will require additional adjustment of the goals by future rulemaking in the latter part of the 1990s.

(1) Should the goals be established so that the GSEs are required to lead the industry by buying at least the percentages of mortgages that the market originates for each goal? If yes, at what levels and over what period should the GSE goals be established to achieve this objective and, specifically, at what levels should the 1997 and 1998 goals be established to meet this objective? In responding, please note:

(A) For the housing goal for low- and moderate-income families—the Secretary determined that for 1995 and 1996, 50 percent of the market is comprised of mortgages qualifying under this goal.

(B) For the special affordable housing goal—the Secretary determined that for 1995 and 1996, 17–20 percent of the market would be mortgages qualifying under this goal.

(C) For the central cities, rural areas, and other underserved areas goal—the Secretary determined that for 1995 and 1996, 21–23 percent of the market would be mortgages qualifying under this goal.

(2) Should leading the industry mean and should the goals be established for future years so that the GSEs are required to purchase (as a percentage of the GSEs' total purchases) a higher percentage of mortgages than are originated by the market under each housing goal? For example, if 16 percent of the mortgages originated and available are expected to be originated for mortgages for very low-income families, should the GSEs be expected to purchase, as a percentage of their overall business, an amount greater than 16 percent of mortgages on housing for very low-income families at some future date? If yes, at what levels and over what period should the goals be established to achieve this objective and, specifically, at what levels should the 1997 and 1998 goals be established to achieve this objective? Also, what percentage over the market should be required?

(3) Should the goals be established such that the GSEs purchase an equivalent proportion of loans originated by the market for borrowers under 80 percent of area median income as they do for borrowers over 120 percent of area median income? If yes, at what levels and over what period should the goals be established to achieve this objective and, specifically, at what levels should the 1997 and 1998 goals be established to achieve this objective?

(4) Should the goals be adjusted as the GSEs reach or fail to achieve the goals or should the goals be established and the GSEs' performance evaluated against relatively fixed goals? If the commenter believes that the goals should be adjusted, how frequently or under what conditions should the Secretary take action to adjust the goals?

(5) To what extent should the GSEs' share of the overall mortgage market affect the levels of the goals? The GSEs currently purchase approximately 70 percent of all conventional, conforming mortgages originated. Should the goals increase as the GSEs' market share increases? If yes, how should this work? How and in what manner should the goals be adjusted?

G. Principles Governing Regulation

In considering these regulations, the Secretary has set forth the following principles:

(1) To fulfill the intent of the Act, the GSEs should lead the industry in ensuring that access to credit is made available for very low-, low- and moderate-income families and residents of underserved areas. The Secretary recognizes that, to lead the mortgage industry over time, the GSEs will have to stretch to reach certain goals, which is consistent with the Congressional statement that it "fully expects the enterprises will need to stretch their efforts to achieve" the goals.[69]

(2) The Secretary's role as a regulator is to set direction through the goals, but not to dictate the products or delivery mechanisms the GSEs will use to achieve those goals. Regulating two enormous financial enterprises in a dynamic market requires that the GSEs be allowed to use their innovative capacities to determine how best to deliver products to the primary market. Regulation should allow the GSEs to maintain their flexibility and the ability to respond quickly to market opportunities in order to meet the goals stipulated by the Secretary.

(3) Discrimination in lending—albeit often subtle and even unintentional—has denied racial and ethnic minorities the same access to credit to purchase a home that has been available to similarly situated non-minorities. The GSEs have a critical role and position in promoting access to capital by minorities and other historically underserved groups and demonstrating to other private-sector market players the profit potential in these traditionally underserved markets.

(4) In addition to the GSEs' core business of purchasing single-family-home loans, the GSEs also must assist in the creation of an active secondary market for multifamily loans. As noted, this country has a critical need for affordable rental housing to provide adequate housing for families who cannot afford to become homeowners. Availability of capital is a key constraint in the expansion of development activity to build more rental housing.

(5) Parity between the two enterprises in the level of the goals they are required to meet should be established. Both enterprises operate in the same markets and have similar opportunities to purchase mortgages that will satisfy the goals. Freddie Mac has no operational or organizational constraints that would prevent it from meeting goals that Fannie Mae could meet.[70]

II. Section-by-Section Discussion of Proposed Changes to Fannie Mae Regulations and New Freddie Mac Regulations (Part 81)

Subpart A—General

Section 81.1—Scope of Part

This section provides that these regulations implement the authority of the Secretary concerning the GSEs under the Charter Acts and FHEFSSA. The section states that subpart A contains definitions applicable to this part; subpart B contains the housing goals; subpart C contains Fair Housing requirements; subpart D sets forth program review procedures for new programs; subpart E contains requirements for reports to the Secretary; subpart F contains regulations dealing with access to information; subpart G contains procedures available to the GSEs; subpart H contains book-entry procedures; and subpart I contains regulations dealing with regulatory examinations and other provisions. The section provides that, except where the

[69] S. Rep. at 35.

[70] During the transition period of 1993–1994, the Act established annual targets for the purchases by both GSEs of mortgages financing housing for low- and moderate-income families and housing located in central cities. Sections 1332(d)(1) and 1334(d)(1). For both GSEs, the Act set identical targets at 30 percent of the units financed by mortgage purchases of the GSEs. Although the targets were identical, the Secretary established differential goal levels for Freddie Mac and Fannie Mae, in order to allow Freddie Mac sufficient time to reenter the multifamily market in a prudent and organized manner. Freddie Mac had announced its withdrawal from the multifamily market in 1990. In 1993, Freddie Mac announced its reentry into the multifamily market, after it had reorganized its multifamily division, greatly increased its staffing, implemented new information systems, released a new underwriting guide for multifamily properties, and established a network of originators and servicers with proven local expertise.

Secretary and the Director of the Office of Federal Housing Enterprise Oversight share authority, this part does not implement any authority of the Director of OFHEO.

Section 81.2—Definitions

This section defines terms which are relevant to the Secretary's regulatory authorities. These terms relate to the housing goals, fair housing/fair lending, new program approval, and collection, dissemination and protection of GSE information furnished to the Secretary. Some of the terms are defined in FHEFSSA, some are defined under the Freddie Mac Act and the remainder were defined for these regulations.

The Freddie Mac Act defines terms that are relevant to both GSEs although the same terms are not defined under the Fannie Mae Charter Act. The legislative history of FIRREA indicates that Congress intended that competitive parity exist between the GSEs and that the regulatory power granted to the Secretary be identical for both GSEs.[71] The proposed regulation, therefore, defines terms the same for both GSEs even where the definitions were originally provided in the Freddie Mac Act.

Defined terms that are relevant to all of the housing goals include ''Balloon mortgage'', ''Conventional Mortgage'', ''Dwelling unit'', ''Mortgage'', ''Mortgage purchase'', ''Multifamily Housing'', ''Refinancing'', ''Rental housing'', ''Residence'', ''Seasoned mortgage'', ''Single family housing''. ''Conventional mortgage'' is defined as 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. ''Mortgage purchase'' is defined as a transaction where a GSE buys or otherwise acquires with cash or other thing of value a mortgage for its portfolio or for securitization. ''Multifamily housing'' means a residence having more than four dwelling units. ''Single family housing'' is a residence consisting of one to four dwelling units.''

Terms relating to the low- and moderate-income housing goals include ''Low-income'', ''Median income'', ''Moderate income'', ''Rent,'' ''Utilities,'' and ''Utility allowance''. The term ''Low-income'' is defined as income not in excess of 80 percent of area median income, adjusted for family size for rental units but unadjusted for owner-occupied units. ''Median income'' means, with respect to an area, the unadjusted median family income of the area, as most recently established by the Secretary; an area is the metropolitan statistical area (MSA) if the property is located in an MSA—otherwise, an area is the county in which the property is located. ''Moderate-income'' means income not exceeding area median income and, in the case of rental units, income not in excess of median income with adjustments for family size. ''Rent'' is defined as contract rent if the cost of all utilities are included in contract rent; if all utilities are not included, ''Rent'' is contract rent plus the cost of those utilities or contract rent plus a utility allowance. ''Utilities'' means charges for electricity, gas, water, sewage disposal, fuel, and garbage collection.

Defined terms concerning the central cities, rural areas, and other underserved areas goal include the terms ''Central cities'', ''Rural'' and ''Underserved areas''. As discussed fully below, in this preamble's discussion of the housing goals, the term ''central cities'' is defined as the underserved areas of any political subdivision designated as a central city by the Office of Management and Budget. ''Rural area'' is defined as the underserved areas located outside of any metropolitan statistical area (MSA) designated by the Office of Management and Budget. ''Underserved area'' is defined as a census tract: With a median income at or below 120 percent of the area median income and a minority population of 30 percent or greater; or with a median income at or below 80 percent of area median income.

The special affordable housing goals have specific rules requiring the definition of certain terms. These terms include ''Low-income areas'', ''Portfolio of loans'' and ''Very low-income''. ''Low-income area'' means a census tract in which the median income does not exceed 80 percent of area median income. ''Portfolio of loans'' means ten or more loans. ''Very low-income'' is defined as income not exceeding 60 percent of the area median income—under the Act's definition, this percentage is adjusted for family size for rental units but is not adjusted for family size for owner-occupied units.

Terms concerning the fair housing provisions of these regulations include ''Familial status'', ''Handicap'' and ''Minority''. The terms ''familial status'' and ''handicap'' are defined under these regulations by reference to the definitions contained in the Fair Housing Act regulations at 24 CFR 100.20 and 100.201. ''Minority'' includes American Indians, Alaskan Natives, Asian and Pacific Islanders, African Americans, and Hispanics.

The defined term pertaining to the Secretary's new program approval authority is ''New program.'' ''New program'' is defined in the Act and under these regulations as a program for the purchasing, servicing, lending on the security of, or otherwise dealing in conventional mortgages that is significantly different from a program that: Was approved or engaged in by the GSE at the time of the enactment of FHEFSSA; or represents an expansion above limits expressly contained in any prior approval.

Terms that are relevant to both the reports and information provisions of the regulations include ''Mortgage data'', ''Proprietary information'' and ''Public data''. ''Mortgage data'' is defined as data obtained by the Secretary from the GSEs under the Fannie Mae Charter Act and the Freddie Mac Act relating to the GSEs' mortgage purchases. ''Proprietary information'' is defined as all categories of information and data submitted to the Secretary by the GSE which contain trade secrets and commercial or financial information of the GSE which is privileged or confidential and which, if released, would cause substantial competitive harm. Although this definition parallels the definition under Exemption 4 of the Freedom of Information Act (FOIA), 5 U.S.C. 552(b)(4), in determining which GSE information is proprietary, the Department will not be bound by FOIA, its legislative history, or Exemption 4 case law. ''Public data'' means all mortgage data obtained by the Secretary from the GSEs which the Secretary determines is not proprietary and should be made publicly available; Appendix D to the regulations lists and describes this data.

Finally, the proposed regulation defines the terms: ''Act,'' ''Day,'' ''Director,'' and ''Secretary.'' ''Act'' is defined to mean the Federal Housing Enterprises Financial Safety and Soundness Act or FHEFSSA. ''Day'' is defined as a calendar day rather than a working day. ''Director'' means the Director of the Office of Federal Housing Enterprise Oversight of the Department of Housing and Urban Development. ''Secretary'' means the Secretary of Housing and Urban Development.

Subpart B—Housing Goals

Background

The Secretary is required to establish, by regulation, annual housing goals for each GSE. The goals include a low- and moderate-income housing goal,[72] a

[71] H.R. Rep. No. 101–54, 101st Cong., 1st Sess., pt. 3, at 2 (1989), and S. Rep. No. 101–19, 101st Cong., 1st Sess. 38 (1989).

[72] Section 1332.

special affordable housing goal,[73] and a central cities, rural areas and other underserved areas housing goal.[74] The Act provides that the goals are to be established in a manner consistent with sections 301(3) of the Fannie Mae Charter Act and 301(b)(3) of the Freddie Mac Act, which require the GSEs ''to provide ongoing assistance to the secondary market for residential mortgages (including * * * mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) * * *.'' Under the Act, the Secretary may, by regulation, adjust any housing goal from year to year.[75] The statute provides that, in establishing these goals, the Secretary shall apply certain prescribed factors, as described in Appendices A, B, and C.[76] In this regulation, the Secretary proposes to establish the three housing goals for 1995 and 1996. The Secretary is also planning to establish the level of the goals for 1997 and beyond in the final regulation.

In this regulation, each housing goal requires that a certain percentage of the dwelling units financed by each GSE's total mortgage purchases for the year be the type of dwelling units targeted by the housing goal. For example, for 1995, the housing goal for low- and moderate-income families is established at 38 percent—in other words, 38 percent of the dwelling units financed by each GSE's mortgage purchases would have to be affordable to low- or moderate-income families; thus, if a GSE's mortgage purchases financed 2 million dwelling units, the proposed regulation would require that 38 percent of those 2 million dwelling units, or 760,000 dwelling units, be affordable to low- or moderate-income families.

A single mortgage can count for all three goals. For example, a mortgage that finances a house for a low-income family in a central city would count under the special affordable housing goal (low-income family in a low-income area), the low- and moderate-income housing goal (low-income borrower), and the central cities, rural areas, and other underserved areas goal (central city). Under the housing goals for 1993, the majority of the mortgages that qualified for one goal also qualified for a second goal.

[73] Section 1333.

[74] Section 1334.

[75] Section 1331(c).

[76] Sections 1332(b), 1333(a)(2), and 1334(b).

Housing Goal for Low- and Moderate-Income Families

The Secretary is establishing an annual housing goal for each GSE's purchase of mortgages on housing for low- and moderate-income families (''the low- and moderate-income goal''). The Secretary's detailed findings under the factors for establishing the goal are attached as Appendix A. The annual goal for 1995 for each GSE's purchases of conventional mortgages financing housing for low- and moderate-income families is established at 38 percent of the total number of dwelling units financed by each GSE's mortgage purchases in 1995. The annual goal for 1996 is 40 percent. The final regulation shall establish the annual goals for 1997 and 1998 and the Secretary intends that the 1998 goal apply thereafter, unless revised through subsequent rulemaking; the Secretary seeks comment on the level of the goals for 1997, 1998, and thereafter—see the questions listed above (in the leading the industry discussion) and repeated at the end of this preamble.

Housing Goal for Central Cities, Rural Areas, and Other Underserved Areas

The Secretary is establishing an annual goal for 1995 and 1996 for the GSEs' purchase of mortgages on housing located in central cities, rural areas, and other underserved areas. In accordance with the Act, under this proposed rule, the Secretary is expanding and redefining this goal from the central cities goal, which applied during the transition years of 1993 and 1994, to a goal that is directed to mortgage purchases in central cities, rural areas and other areas, with a focus on underserved areas within those geographic locations. ''Underserved areas'' are those areas that experience problems with the availability of mortgage credit.

For the transition period of 1993 and 1994, the goal was directed solely to the GSEs' purchases of mortgages financing housing located anywhere in ''central cities.'' The Act defined ''central cities'' for the transition period as those cities designated as central cities by the Office of Management and Budget (OMB). These provisions were modelled on HUD's existing Fannie Mae regulations. The legislative history of the Act states that for the transition period the goal only applied to purchases in OMB-defined ''central cities'' to allow time to gather data and establish an appropriate methodology to ''redefine and expand'' the goal.[77] The legislative history also provides that ''following the transition period, geographic areas relating to the goal will be as determined by (the regulator).'' [78]

[77] *See* S. Rep. at 38 and 65.

Following the transition period, the Act requires the Secretary to establish an annual goal for the purchase of mortgages located in ''rural areas and other underserved areas'' as well as ''central cities.'' In establishing the central cities, rural areas, and other underserved areas goal, Congress was concerned with the ''acute'' ''housing problems'' in the nation's cities and with the ''neglected and decaying'' parts of the cities.[79] Congress directed HUD to target ''areas with relatively poor access to mortgage credit,'' areas with ''(i)nadequate access to mortgage credit,'' and areas suffering from ''the vestiges of redlining.'' [80]

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.'' [81] Congress noted that ''* * * mortgage discrimination and redlining have effectively disadvantaged certain geographic areas, particularly *inner city* and rural areas.'' [82] In explaining the conference bill on the floor of the Congress, 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.'' [83]

The title of this goal also leads to the conclusion that Congress intended this geographically targeted goal to focus on underserved areas. ''Central cities, rural areas, and *other* underserved areas'' indicate that central cities and rural areas are intended to be proxies for underserved areas.

[78] S. Rep. at 65.

[79] S. Rep. at 28.

[80] S. Rep. at 38; *see also, id.* at 34 (the GSEs must address ''the disinvestment in central cities and rural communities''). ''(R)edlining ha(s) effectively disadvantaged certain geographic areas, particularly inner city and rural areas.'' *Id.* at 41. *See also,* 138 Cong. Rec. S8606 (daily ed. June 23, 1992) (statement of Sen. Riegle) (the bill would provide ''a greater flow of credit to people who otherwise have a very difficult time financing home mortgages'').

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

[82] S. Rep. at 41 (emphasis added).

[83] 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).

Expanding and Redefining the Goal

In accordance with the requirements of the Act, the Secretary is expanding this goal for 1995 and 1996 to include rural and other underserved areas as well as central cities. At the same time, the Secretary has redefined the term ''central cities'' to encompass the underserved areas of central cities and defined ''rural areas'' as the underserved areas of non-metropolitan areas. The goal is, therefore, intended to focus on communities within central cities, rural areas and other areas which are ''underserved'' in terms of availability of mortgage credit. This determination is based on the legislative intent, the factors for establishing the goal, HUD's research on underserved areas during the transition period, the results of two public forums held with researchers, public-interest groups, other federal agencies, and the GSEs, and data received from the GSEs during the transition.

Underserved Areas

The Act did not define the term ''underserved area'' but the legislative history indicates that it should be defined as those areas that lack access to mortgage credit. As detailed in Appendix B, the Secretary considers ''underserved'' to mean those areas that have an unmet demand for mortgage credit. Using 1993 HMDA data and 1990 Census data, the Department analyzed mortgage application denial and origination rates throughout the country, as well as reports and other research on the availability of mortgage credit and mortgage flows. The research indicated that pervasive and widespread disparities exist in lending across the nation. The Department found, as have other researchers, that the availability of mortgage credit to an area is related to its minority concentration and income characteristics of its residents. Two patterns are clear in the Department's research and that of other researchers:

- Census tracts with higher percentages of minority residents have higher mortgage denial and lower loan origination rates than all-white or predominately white census tracts; and
- Census tracts with lower incomes have higher denial rates and lower origination rates than higher income tracts.

As Appendix B details, HUD's research and that of others has found that the location of a census tract—whether it is located within a central city or a suburb—has minimal impact on whether the tract is underserved.[84] Mortgage flows in a census tract have far less to do with the physical location of a tract, *i.e.*, central city versus suburb, than the minority concentration and 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.

Based on this research, the Secretary has determined that this goal should target those areas in central cities, rural areas, and other areas where: 30 percent or more of the residents in a census tract are minority and the median income of families in the census tract is at or below 120 percent of the area median income; or where the median income of families in the census tract is less than 80 percent of the area median income. The goal therefore is directed to census tracts in central cities, rural areas, and all other parts of the country meeting these criteria. (For purposes of defining ''rural areas,'' the Secretary is seeking comments on whether counties or Block Numbering Areas, which are equivalent to census tracts in rural areas, are the appropriate geographic unit.)

The Department has conducted an intensive research effort on identifying geographic areas underserved by the mortgage markets. This research effort is ongoing and will continue during the period of proposed rulemaking. Research underway includes the analysis of the implications of alternative definitions of underserved areas in urban, suburban, and rural communities. The Department will also engage in a multi-year research effort to identify and analyze indicators of unmet demand for mortgage credit. This long-term research effort will be used by the Department in future years to review the level of the housing goals established for the GSEs. In conducting this research effort on identifying indicators of unmet demand, the Department fully intends to consult with other Federal agencies including Treasury and with the GSEs.

Central Cities

For purposes of this housing goal, the Secretary is defining ''central cities'' as the underserved areas of any political subdivisions designated as central cities by the Office of Management and Budget (OMB). Directing the goal to all areas of central cities identified by the Office of Management and Budget (OMB) would not appropriately target the GSEs' activities to areas that have a relative lack of access to mortgage credit. OMB defines the central city or central cities of a metropolitan statistical area based on population and other factors that measure job location and commuting patterns. OMB does not take into account mortgage credit availability or measures of economic distress. As a result, the list of 545 central cities includes very affluent and well served cities and excludes other obviously distressed cities. For example, Palo Alto, California—with a per capita income of $32,500 and a poverty rate of 2 percent—is a central city but Compton, California—with a per capita income of $7,800 and a poverty rate of 24 percent—is not a central city.

In addition, there are substantial regional variations in the portion of state urban population that are included in central cities. In the southern and western parts of the country, cities have often expanded by annexing adjacent territory. This option was generally not available to cities in the Northeast, which have retained their historical boundaries. As a result, a substantially greater portion of the population lives in central cities in the South and West than in the more urbanized Northeastern states. This has led to perverse results for the central cities goal in place for 1993: Central cities accounted for more than 50 percent of both GSEs' mortgage purchases in Arizona, New Mexico, and North Dakota. In New Jersey, on the other hand, purchases in central cities accounted for only 4 percent of GSE purchases.

James A. Johnson, Fannie Mae's Chairman and Chief Executive Officer, in April 1994 testimony before a Congressional sub-committee summarized some of the problems with using the OMB designation of central cities:

> Central cities are also of limited value as proxies for distressed, needy, minority or low- and moderate-income census tracts. Especially in older cities that are hemmed in by separately incorporated suburbs and other communities, political jurisdictions enforce artificial barriers to describing areas of need. Conversely, where cities can annex neighboring communities as growth occurs, the result is a central city that encompasses so much territory of such diverse nature that

[84] *See, e.g.*, Robert B. Avery, Patricia E. Beeson, and Mark S. Sniderman, ''Underserved Mortgage Markets: Evidence from HMDA Data,'' (presented at the Western Economic Association Annual Meetings, Vancouver BC), July 1994, and William Shear, James Berkovec, Ann Dougherty, and Frank Nothaft, ''Unmet Housing Needs: The Role of Mortgage Markets,'' unpublished paper, June 1, 1994.

it loses much of its distinctive urban character.[85]

Rural Areas

Determining how to define ''rural areas'' within the context of this goal is even more difficult than the complex analyses of HMDA and Census data for cities and suburbs summarized in Appendix B. This occurs for three interrelated reasons: (1) The general lack of accurate data on mortgage flows and credit activity outside metropolitan statistical areas (MSAs), (2) the scarcity of careful current studies on access to mortgage credit in rural locations, and (3) the existence of a variety of statutory and statistical definitions for ''rural.''

To address the many issues pertinent to developing an appropriate and workable definition of ''rural areas'' for purposes of this rule, the Department has consulted with rural demographers and economists at the Department of Agriculture's Economic Research Service, the Census Bureau, the Farmers Home Administration, and the Housing Assistance Council. All of these issues were also discussed at a forum attended by researchers from academia, the Department of Agriculture, the Census Bureau, the Housing Assistance Council, the Congressional Budget Office, public-interest groups, and the GSEs. The Secretary's decisions about defining ''rural areas'' are based on these consultations as well as ongoing analyses of data from the 1990 Census, the American Housing Survey, and the Residential Finance Survey.

Framework for Defining Rural Areas

In considering the issue of how to define rural areas for the central cities, rural areas, and other underserved areas goal, the Department analyzed available data and research on mortgage flows and credit access in rural locations, consulted with rural demographers and economists at government agencies and elsewhere, and considered the multiple existing definitions of ''rural'' currently in use. Based on the evidence that income and housing needs vary as greatly between nonmetropolitan counties and block numbering areas[86] as they do within MSAs, the Secretary has determined that the basic definition of ''underserved areas'' developed above—as areas with high minority shares or low median family income—should also apply in rural areas, that is, outside of MSAs. The Secretary has determined that for purposes of this housing goal that ''rural areas'' are the underserved areas in nonmetropolitan counties, *i.e.*, outside of Metropolitan Statistical Areas.

The Secretary seeks comments on whether the appropriate unit of geographic focus for defining underserved areas in non-MSAs is the county or the Block Numbering Area (the rural equivalent of census tracts). In addition, the Secretary seeks comment on whether this definition of rural should be expanded by including indicators of access to metropolitan areas and/or indicators of jurisdictional size (*i.e.*, include small communities of less than 2,500 people). The following section summarizes the factors the Secretary considered in determining this proposed definition of rural and closes with questions on which the Secretary solicits comments about the proposed definition.

(1) *Unavailability of accurate data on mortgage flows and credit activity in rural locations.* HMDA data, the source used for most of the studies of credit needs summarized in Appendix B, does not provide information on mortgage activity outside of metropolitan statistical areas (MSAs), and within MSAs census tracts may contain both rural and urban segments.[87] Other sources of mortgage flow information, like the Federal Reserve Call Reports, do not detail locations of loans.

(2) *Studies of access to mortgage credit.* Researchers participating in the Department's forum agreed that available studies do not show that rural areas endemically have problems with access to credit, although this (lack of) conclusion may stem from data unavailability. A 1990 study by the Urban Institute, for example, found little evidence of a national rural home credit shortage, and attributed low mortgage activity in some local markets to lack of demand in weak local economies.[88] Yet abundant anecdotal evidence exists that underserved areas in rural communities require a special focus by the GSEs, to redress years of historic neglect by the mortgage market. According to the Housing Assistance Council, access to mortgage credit appears worse as distance from metropolitan centers increases,[89] while Department of Agriculture representatives judge that communities with population below 2,500 or 5,000 are more likely than other rural communities to lack access to credit. More generally, the forum participants agreed that, as found for central cities, rural communities with low income and minority concentrations were those more likely to be underserved by the mortgage markets.

A report by the Economic Research Service of the Department of Agriculture 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.[90] 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.

(3) *Current Definitions of Rural.* In considering a workable definition of ''rural areas,'' the Secretary focused on three major definitions in use: (i) The Census Bureau's official designation; (ii) the Farmer's Home Administration's designation for several of its programs; and (iii) the designation of ''non-metropolitan.'' In this proposed rule, rural areas are defined as ''underserved areas'' ''located outside of any Metropolitan Statistical Area designated by the Office of Management and Budget.'' The reasons for choosing to focus on non-metropolitan areas are described below:

(a) *Census Bureau definition.* The Census Bureau bases its definition of rural on population size and density.[91] Locations that meet the rural definition are designated once per decade, based on decennial Census results. There are two major disadvantages of using the Census Bureau definition as part of a definition of rural areas for this goal. First, few relevant intercensal data

[85] Testimony before the Committee on Banking, Finance, and Urban Affairs, Subcommittee on General Oversight, Investigations, and the Resolution of Failed Financial Institutions, U.S. House of Representatives, at 17 (April 20, 1994).

[86] For data collection in the 1990 Census, block numbering areas (BNAs) are the non-metropolitan equivalent of census tracts—subareas of counties that contain approximately 4,000 people.

[87] Only lending institutions with offices in metropolitan statistical areas (MSAs) report mortgage origination data under HMDA. 12 U.S.C. 2803(a)(1).

[88] The Urban Institute, *The Availability and Use of Mortgage Credit in Rural Areas* (1990), examined data on ownership, mortgage terms and conditions, and Federal program coverage, particularly for moderate-income home buyers.

[89] Statement of Moises Loza, Executive Director of the Housing Assistance Council (HAC), July 21, 1994, to the Subcommittee on Environment, Credit, and Community Development of the House Committee on Agriculture.

[90] *Rural Conditions and Trends,* Vol. 4, No. 3 (Fall 1993), a special 1990 census issue, documents differences between counties in population, education, employment, income, poverty, and housing.

[91] *See* U.S. Bureau of the Census, *1990 Census of Population and Housing: Guide, Part B. Glossary,* 16–17 (1993) (hereinafter cited as ''Census Glossary'').

sources are based on the Census Bureau definition, complicating the work required to establish market segments and set the level of the housing goals. Second, geocoding addresses to rural locations based on this definition would be difficult and burdensome for the GSEs, given the current state of geographic information systems software. The Census Bureau's 1992 Tiger/Line file's ability to provide accurate addresses is weakest in rural areas, particularly for rural route addresses.[92]

(b) *Farmers Home Administration's definition of rural.* The Farmers Home Administration (FmHA) defines rural areas eligible for several programs, including the 515 loan program,[93] and the definitions vary among the programs. Generally, more locations qualify as ''rural'' under these definitions than under the Census Bureau's definition because the FmHA definitions include places with populations above 2,500 and the Bureau would categorize such places as ''urban.''[94] The most critical disadvantage in using a FmHA definition as the rural identifier is that there is no central or machine-readable source of information on areas defined by FmHA as rural; instead, local maps are marked to show the appropriate boundaries and then stored in field offices.

(c) *Non-Metropolitan Statistical Areas.* The Secretary chose to incorporate this designation into the definition of ''rural areas.'' First, geocoding and reporting would be straightforward, since MSAs are composed of counties in most parts of the country. This definition appears to correspond better to the parts of the country where availability of mortgage credit has been an issue. The availability of mortgage credit in the rural fringes of metropolitan areas appears to be less of a problem than in rural communities distant from metropolitan areas. Finally, most intercensal data, including population and household estimates, employment, income estimates, etc., are produced at least annually at the county level.

Questions Related to the Definition of Rural Areas

The Secretary invites comment on the following questions:

(1) Should rural areas be based on the characteristics of Block Numbering Areas or counties? Which of these two options makes better sense for lenders and for GSE reporting? Which option better directs goal performance at areas with poor access to mortgage credit?

(2) In establishing the definition for rural areas, should the income and minority criteria (used for defining central cities and other underserved areas) be supplemented with other indicator(s) of the needs for better access to mortgage credit? Should population size (*e.g.*, communities below 2500 or non-metropolitan counties below 50,000) be considered as such an indicator?

(3) What are the relative merits of indicators of access to metropolitan areas or nonmetropolitan cities such as the ''Beale'' or ''Ghelfi-Parker'' codes?[95]

(4) In New England, where MSAs are not composed of counties, should the definition of rural areas include areas ''outside (P)MSAs'' or ''outside NECMAs''?

Other Underserved Areas

For purposes of this housing goal, the Secretary has determined that ''other underserved areas'' are census tracts located in metropolitan areas located outside of central cities and having the minority and income characteristics described above. This definition will cover suburban communities that lack access to credit.

Alternative Approaches to Defining the Central Cities, Rural Areas, and Other Underserved Areas Goal

The Secretary considered alternative approaches to establishing this goal. One alternative would be to simply expand the goal by retaining all areas in all 545 OMB-designated central cities, all rural areas, and all other underserved areas. If underserved areas are defined as described above, this alternative approach would result in a goal that targets nearly 70 percent of the country's population. The Secretary decided this approach was inconsistent with the intent of the Act.

Congress established the goals to ensure that Fannie Mae and Freddie Mac take special consideration of specific housing needs in carrying out their work. The goals are intended to be priority areas for the GSEs as they carry out their Charter Act purposes. A goal that encompasses so much of the nation's population and geography would be unlikely to provide the GSEs with appropriate direction. Further, this approach would lead to a dispersion of the GSEs' goal-oriented business to a large number of communities that do not meet the Congressional directive that they be areas with a relative lack of mortgage credit. Finally, an overly-broad approach would result in less support for the critical efforts of cities and rural communities to improve and stabilize neighborhoods that, because of past practices and historic patterns, have an unsatisfactory availability of mortgage credit.

The Size of the Goal

Because this goal has been redefined, the market of mortgages originated and available for GSE purchase is different from and indeed smaller than the market of mortgage originations for the 1993–1994 goal. The Secretary estimates that mortgages originated in underserved areas of central cities, rural areas, and other areas comprise 21 to 23 percent of the conventional conforming mortgage market. Thus, the goal is established at a percentage that is lower than the central cities goal in the transition period (1993–94).

Based on a consideration of the factors for establishing the goal detailed in Appendix B, the Secretary establishes the annual goal for 1995 for each GSE's purchases of mortgages financing housing located in underserved areas at 18 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The goal for 1996 is 21 percent. The final regulation shall establish the annual goals for 1997 and 1998 and the Secretary intends that the 1998 goal apply thereafter, unless revised through subsequent rulemaking; the Secretary seeks comment on the level of the goals for 1997, 1998, and thereafter—see the questions listed above (in the leading the industry discussion) and repeated at the end of this preamble. In 1993, 15.9 percent of the dwelling units financed by Fannie Mae's mortgage purchases were in areas defined under the proposed definition of central cities, rural areas, and other underserved areas, while Freddie Mac's performance was 14.4 percent.

Units will count toward this goal if the units are located in a central city as redefined, a rural area as defined, or any other underserved area. Through the use of geocoding or any similarly accurate and reliable method, the GSEs are required to determine whether units

[92] The Tiger/Line files are the extract of the Census Bureau's geographic data base and are produced for geocoding by data users. They categorize all polygons and blocks as either rural or urban and have address ranges for most of the country.

[93] 42 U.S.C. 1490.

[94] *Cf.* 42 U.S.C. 1490 to Census Glossary at 16–17.

[95] These indicators of urban influence were developed by the Department of Agriculture's Economic Research Service. Linda M. Ghelfi, ''County Classifications,'' Rural Conditions and Trends, 4(3): 6–11 (1993).

financed under mortgages purchased by the GSEs are located in central cities, rural areas, and other underserved areas as defined by regulation.

Special Affordable Housing Goal—Background

This goal had no antecedent in the current Fannie Mae regulations. The Act requires that the Secretary ''establish a special annual goal designed to adjust the purchase by each (GSE) of mortgages on rental and owner-occupied housing to meet the then-existing, unaddressed needs of, and affordable to, low-income families in low-income areas and very low-income families.'' [96]

During the transition period (1993–1994), the Act required that each GSE's mortgage purchases under the special affordable housing goal be equally divided between mortgages on single family housing and mortgages on multifamily housing.[97] The multifamily goal was further divided, with 45 percent of the goal devoted to mortgages on multifamily housing where dwelling units were affordable to low-income families.[98] The remaining 55 percent of the dollar volume of multifamily mortgages purchased had to comprise mortgages on multifamily housing in which either: (1) ''at least 20 percent of the units are affordable to families whose incomes do not exceed 50 percent'' of area median income; [99] or (2) ''at least 40 percent of the units are affordable to very low-income families.'' [100] Only the portions of qualifying mortgages on multifamily properties that are attributable to units affordable to low-income families contributed to the achievement of this goal.[101] Under the transition standard, where at least 20 percent of the units were affordable to especially low-income families (families whose incomes do not exceed 50 percent of area median income) or at least 40 percent of the units were affordable to very low-income families, all units from such multifamily projects that were affordable to low-income families counted toward the goal.

The Act required that, for each GSE's mortgage purchases financing single family housing to be counted toward achievement of the special affordable housing goal, 45 percent of the dollar volume of single family mortgages had to comprise mortgages of low-income families living ''in census tracts in which the median income does not exceed 80 percent of the area median income.'' [102] The remaining 55 percent of the dollar volume of single family mortgage purchases had to comprise mortgages of very low-income families.[103]

The Special Affordable Housing Goal

Following the transition period, the Act does not specify the types of mortgage purchases that shall count toward achievement of the special affordable housing goal.[104] Based on experience during the transition, the Secretary concluded that determining GSE performance under these provisions was cumbersome and did not clearly reflect the number of especially low- and very low-income families actually served under the multifamily portion of the special affordable housing goal. Accordingly, as described below, the proposed regulation simplifies the counting under this portion of the goal.

The proposed regulation would substantially simplify the special affordable housing goal to apply to ''rental housing and owner-occupied housing.'' [105] Under the proposed regulation, rental housing would include all units in multifamily housing and all units in single family rental housing. The proposed regulation makes this change in part because of the high percentage of renters in single family dwelling units—41 percent of rental units in properties secured by conventional, conforming mortgages are located in single family properties.[106]

The rental portion of the special affordable housing goal would be targeted to very low-income families because of the substantial housing needs of these renters. Five-eighths of renters with incomes below 50 percent of area median income pay more than 30 percent of their income for housing, live in inadequate housing, or are overcrowded.[107] Even worse, almost half of the 7.4 million renters with incomes below 30 percent of area median income pay more than half of their income for housing or live in severely inadequate housing.[108] The high incidence of severe housing problems among these extremely-low-income renters reflects the severe shortages of units affordable to them.

Under the proposed regulation, only those rental units that are affordable to very low-income families would count toward the goal rather than all low-income units in buildings that had a certain percentage of very low- or especially low-income units. Under the owner-occupied housing portion of the goal, the dwelling units that count toward the goal are units: (1) Located in low-income areas and owned by low-income families; and (2) owned by very low-income families.

The Act provides that, for each GSE, the special affordable housing goal ''shall not be less than 1 percent of the dollar amount of the mortgage purchases by the (GSE) for the previous year.'' [109] Although the goal has been established to exceed one percent of each GSE's total mortgage purchases in the preceding year, to maintain consistency, the special affordable housing goal, like the other two goals, is expressed as a percentage of dwelling units rather than dollars. The Secretary determined that expressing this goal as a percentage of the previous year's business was not preferable for several reasons: (1) Due to the cyclicality of the mortgage market and the GSEs' business volume, use of a fixed percentage of the previous year's purchases could make such a goal less realistic in a year such as 1995, when total purchases are projected to fall sharply from prior-year levels due to the decline in refinancing activity; (2) conversely, in years of sharply increasing activity, the goal represented by a set percentage of total mortgage purchases in the previous year could represent an insufficient commitment by the GSEs to special affordable housing; and (3) where a GSE purchases (for a given sum) mortgages financing two dwelling units that are affordable to families at 30 percent of area median income, the GSE would be making a greater contribution to affordable housing than if the GSE purchased (for the same sum) one mortgage that was affordable to one family at 60 percent of area median income. A units-based goal takes this consideration into account, but a strict dollar-based goal would not.

The proposed regulation provides that for 1995 the special affordable housing goal will be 11 percent of the total

[96] Section 1333(a)(1).

[97] Section 1333(d)(1)–(2).

[98] Section 1333(d)(3)(A)(i).

[99] Section 1333(d)(3)(A)(ii)(I). The Department defined ''especially low-income families'' as those with incomes not in excess of 50 percent of area median income.

[100] Section 1333(d)(3)(A)(ii)(II).

[101] Section 1333(d)(3)(C).

[102] Section 1333(d)(3)(B)(i).

[103] Section 1333(d)(3)(B)(ii).

[104] *See* section 1333.

[105] *See* section 1333(a).

[106] Special tabulation derived from Bureau of the Census, Housing and Household Economic Statistics Division, *1991 Residential Finance Survey*.

[107] U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *Worst Case Needs for Housing Assistance in the United States in 1990 and 1991—A Report to Congress,* 4 (June 1994).

[108] U.S. Department of Housing and Urban Development, Office of Policy Development and Research.

[109] Section 1333(a).

number of dwelling units financed by each GSE's mortgage purchases for 1995. The goal will be 12 percent for 1996. The goal is equally divided between rental housing and owner-occupied housing, *i.e.*, for 1995 the goal for rental housing is 5.5 percent and the goal for owner-occupied housing is 5.5 percent. For 1996, the goal is 6 percent for rental housing and 6 percent for owner-occupied housing. The final regulation shall establish annual goals for 1997 and 1998 and the Secretary intends that the 1998 goal apply thereafter, unless revised through subsequent rulemaking; the Secretary seeks comment on the level of the goals for 1997, 1998, and thereafter—see the questions listed above (in the leading the industry discussion) and repeated at the end of this preamble.

Performance Under the Special Affordable Housing Goal

In evaluating each GSE's performance in achieving this goal, the Act requires that the Secretary give full credit toward achievement of the special affordable housing goal for: (1) The purchase or securitization of federally related mortgages that cannot be readily securitized through the Government National Mortgage Association (GNMA) [110] or another Federal agency, where the GSE's participation substantially enhances the affordability of the housing subject to such mortgages,[111] and the mortgages are on housing that otherwise qualifies under this goal; (2) the purchase or refinancing of seasoned loan portfolios where the seller has a specific program to use the proceeds of such sales to originate new loans that meet the special affordable housing goal and such purchases or refinancings support additional lending for housing that otherwise qualifies under this goal; and (3) the purchase of direct loans made by the Resolution Trust Corporation (RTC) or the Federal Deposit Insurance Corporation (FDIC) where the loans are not guaranteed by the RTC or the FDIC or other Federal agencies, the loans include recourse provisions similar to those offered through private mortgage insurance or other conventional sellers, and such loans are for the purchase of housing that otherwise qualifies under this goal.[112]

This proposed regulation provides that entities qualify as sellers, under (2) above, where the sellers currently operate on their own or actively participate in an ongoing program that results in the origination of loans meeting the special affordable housing goal; thus, a GSE's purchase of such loans supports additional lending for housing that will qualify under this goal. By encompassing active participation, the proposed regulation allows purchases of portfolios from sellers, who actively participate with qualified housing groups that operate programs resulting in the origination of loans meeting this goal, to count toward achievement of the goal. However, if a GSE wants to count portfolio purchases toward achievement of this goal, it must verify and monitor that the sellers currently operate or actively participate in such ongoing programs that result in the origination of additional loans meeting the requirements of this goal. Where a seller's primary business is originating mortgages on housing that qualifies under the special affordable housing goal, the proposed regulation provides that such a seller is presumed to meet the requirement for actively participating in program(s) supporting lending meeting the special affordable housing goal.

Under the Interim Notices, no credit was given toward achieving the special affordable housing goal for any purchases or securitization of mortgages associated with the refinancing of existing GSE portfolios. The intent of this prohibition was to preclude the GSEs from swapping portfolios toward the end of the year in an effort to achieve the special affordable housing goal. After reviewing the experience of the transition period, the Secretary has determined that wholesale exchanges of mortgages between the GSEs shall not count toward achievement of the housing goal; however, refinancings of individual mortgages should count toward the special affordable housing goal so long as the refinancing is an individual ''arms-length'' refinancing by a borrower. This is appropriate for several reasons: (1) The GSEs have very little influence on whether a particular single family mortgagor decides to refinance the mortgage—such refinancings are market driven and normally due to decreases in interest rates, and the Secretary concluded that such market driven refinancings should count toward the goal; and (2) determining whether the GSE had purchased the previous mortgage was time consuming and burdensome for the GSEs and for the Department and yielded little incremental value in producing more affordable housing finance.

General Requirements

Performance under the goals is determined by assessing the portion or percentage of each GSE's business that satisfies each goal. In determining this percentage, a fraction is used with the denominator of the fraction measuring all mortgages purchased that could under appropriate circumstances count towards such a goal and the numerator including only those purchases that count toward the goal. The denominator does not include GSE transactions or activities that are not included in the terms ''mortgage'' or ''mortgage purchase.'' For example, where a GSE purchases a non-conventional mortgage, such as a mortgage insured or guaranteed by the Federal Housing Administration (FHA), such a mortgage purchase shall not be included in the denominator for purposes of determining that GSE's performance under the housing goal for low- and moderate-income housing because ''mortgage purchase'' does not include the purchase of non-conventional mortgages.

In establishing the goals for housing for low- and moderate-income families, housing located in central cities, rural areas, and other underserved areas, and special affordable housing, the Secretary may consider the number of housing units financed by any multifamily housing mortgage purchase.[113] The Secretary has decided to count all dwelling units, whether in multifamily or single family housing, under these goals if the units otherwise meet the requirements of the Act and this proposed regulation.

Special Counting Rules Under the Goals

During the transition period, the Department analyzed the impact of requirements under the Interim Notices concerning the extent various types of transactions should count toward achievement of the goals. Based on that analysis, the Secretary is proposing changes to or is clarifying the treatment of certain transactions, including credit enhancements, cooperative loans, refinancings, second loans, and risk-sharing arrangements between the Department and the GSEs. In determining the level of credit for

[110] A mortgage originated more than 2 years before a GSE purchases it is an example of a mortgage that cannot be readily securitized by GNMA.

[111] Mortgages that cannot be readily securitized through GNMA or another Federal agency, and mortgages where a GSE's participation substantially enhances the affordability of the housing subject to the mortgages, include mortgages under the Home Equity Conversion Mortgage (HECM) Insurance Demonstration Program (sec. 255 of the National Housing Act), 12 U.S.C. 1715z–20, and under the Guaranteed Rural Housing Loan program, 7 U.S.C. 1933.

[112] Section 1333(b)(1).

[113] *See* section 1331(b).

various transactions, the Secretary developed certain principles to guide the determination, and these principles will be used in the future when the Secretary determines whether new types of transactions count toward the goals. The principles are: (1) Where a transaction is substantially equivalent to a mortgage purchase, the transaction generally should receive full credit; (2) where a transaction is less risky than the risk associated with the GSE's mortgage purchases, the amount of credit should be less than full credit; and (3) where a transaction creates a new market or increases liquidity in an existing market, the amount of credit should generally be full credit.

(1) *Credit Enhancements.* Under this proposal, mortgages supported by the following credit enhancements would count toward achievement of the housing goals. Under these credit enhancement transactions, the GSE guarantees housing finance bonds issued by any entity, including a state or local housing finance agency; the GSE provides collateral in the form of specific mortgages owned by the GSE; and the GSE's guarantee has a credit risk substantially equivalent to the credit risk the GSE would have assumed if it had securitized the mortgages financed by the housing bonds. The Secretary will consider whether other types of credit enhancements should count toward the housing goals and, if other types are counted, whether those types of credit enhancements should receive full or partial credit. The Secretary is seeking comments on whether other types of credit enhancements should count.

(2) *REMICs.* The final regulation will provide whether real estate mortgage investment conduits (REMICs) will count toward achievement of any of the housing goals. The Secretary seeks public comment on REMICs and requests views from the public on the following questions:

(i) Where a REMIC contains a GSE's mortgages or mortgage-backed securities (MBS), should that type of REMIC count toward any of the housing goals? How should double counting be avoided?

(ii) Where a REMIC does not contain a GSE's mortgages or MBS, should that type of REMIC count toward any of the housing goals?

(iii) Should other types of REMICs be counted toward any of the housing goals?

(iv) In determining whether any REMICs count toward achievement of the housing goals, what should the Secretary consider?

(v) If any of these REMICs should count toward the housing goals, should the REMICs receive full credit or some level of partial credit? If partial credit, how should the level of credit be determined?

(vi) How should the final regulation deal with types of REMICs that have not yet been created or used in the market? Should such REMICs only count if that type of REMIC is reviewed by the Secretary and the Secretary determines that the type of REMIC should count toward the housing goals?

(3) *Risk-sharing.* Risk-sharing transactions would receive partial credit toward achievement of the housing goals where: (1) The GSE's risk-sharing arrangement is with the Department or another Federal agency; and (2) the GSE and the agency acquire mortgages and share the risks associated with those acquisitions. The credit to be awarded for these risk-sharing activities is to be equal to the amount of the GSE's risk under the risk-sharing arrangement.

For example, under section 542 of the Housing and Community Development Act of 1992, codified as a note to 12 U.S.C. 1707, the Department has entered into separate multifamily risk-sharing agreements with Fannie Mae and Freddie Mac. Under those agreements, each GSE shares risk of mortgage default through re-insurance with HUD on a 50 percent expected loss basis. If, under these agreements, a GSE shares the risk for 1,000 multifamily dwelling units and the GSE certifies that its share of the risk is equal to 50 percent, that GSE's performance under the low- and moderate-income housing goal would include the following calculation: The numerator would include 50 percent of the dwelling units affordable to low- and moderate-income families; and 500 dwelling units would be added to the denominator.

Where a GSE enters a risk-sharing arrangement, to receive credit toward the goals, it must certify what the real percentage of risk is and how that percentage was calculated—that percentage will then be used in calculating the GSE's performance under the relevant goal. The Department notes that in some risk-sharing arrangements, a GSE may assume top loss or catastrophic loss. In those instances, the actual risk assumed by the GSE clearly will not equal the percentage of the risk stipulated, *e.g.*, if a GSE assumes the first 20 percent of the risk, its actual risk is higher than 20 percent.

(4) *Participations.* Where a GSE purchases only a portion of a mortgage, that participation receives partial credit equivalent to the percentage of the mortgage purchased. For example, if a GSE has a 20 percent participation in a mortgage, the denominator shall include 20 percent of the units financed by the mortgage and the numerator will include that portion of the 20 percent of the units that meet the requirements for the particular housing goal.

(5) *Cooperative housing loans.* The purchase of a mortgage on stock in a cooperative housing unit (''a share loan'') is counted the same way as the purchase of single family owner-occupied units and, thus, affordability is based on the income of the owners. Where a GSE purchases a mortgage on a cooperative building (''the blanket loan'') and share loans for units in the same building, both purchases receive full credit, *i.e.*, the blanket loan counts under the housing goals in the same manner as a multifamily mortgage purchase.

(6) *Seasoned loans.* Purchases of seasoned loans are treated the same as purchases of recently originated mortgages and receive full credit under the goals. However, such purchases shall not count if the GSE already counted the mortgages under these housing goals or the goals in the Interim Notice of Housing Goals. To ensure that the housing covered by seasoned loans is affordable and counts, where a mortgage is more than three (3) years old, affordability must be determined based on income and/or rent level information at the time of purchase by the GSE.

(7) *Second loans.* A second mortgage on a residential property will be counted under the goals, if the property otherwise counts. The Secretary is seeking comment on whether these loans should receive partial or full credit toward the goals and, if partial credit, how the amount of credit should be determined. These loans, many of which are originated to pay for the costs of rehabilitating a single-family home, are an important part of lending in underserved communities. Many low-income homeowners cannot purchase new homes but seek to borrow funds to make repairs to their existing homes to increase their habitability and comfort. In many cases, however, these loans will have smaller unpaid principal balances than loans originated for purchase.

(8) *Tax Credit and Mortgage Revenue Bond Purchases.* The Secretary commends the GSEs' involvement in a wide variety of undertakings, including equity investments in projects eligible for Low-Income Housing Tax Credits (tax credits) [114] and purchases of State and local government housing bonds,

[114] 26 U.S.C. 42.

such as mortgage revenue bonds,[115] which serve significant purposes related to low- and moderate-income housing. The Secretary has concluded, however, that—although important in providing financing for low-income housing development—these activities are not equivalent to ''mortgage purchases'' and credit will not be granted toward the goals for these activities. This approach is consistent with the language in the Senate report concerning such activities: ''The (GSEs) are expected to continue such investments, but to carry them out in addition to initiatives necessary to meet the goals contained in this legislation.'' [116]

(9) *Second homes.* Mortgages financing secondary residences would not count toward achievement of any of the goals because the Secretary has determined that the goals should be directed to increasing the supply of primary residences, not secondary residences.

(10) *Refinancings.* The purchase of refinanced mortgages shall fully count toward achievement of the housing goals except as provided in the specific restrictions under the special affordable housing goal which, generally, permits arms-length borrower-driven refinancings to count toward achievement of the goal but excludes wholesale exchanges of mortgages between the GSEs.

Affordability Determination Under the Goals

In analyzing a GSE's performance in achieving these goals, the Secretary will, for mortgage purchases on owner-occupied dwelling units, consider the mortgagors' income as required by the Act.[117]

For mortgage purchases on rental dwelling units, the Secretary will consider, based on data at the time of mortgage purchase, the income of prospective or actual tenants if available. Where such income information is not available, rent on the dwelling units is used as a proxy and compared to the rent levels affordable to very low-, low-, and moderate-income families.[118] To be considered affordable, the rent cannot exceed 30 percent of the maximum income level of the family's classification, *i.e.*, very low-, low-, or moderate-income, with adjustments for unit size.[119]

Consistent with the Act,[120] the Secretary is requiring that tenants' income information be collected by each GSE where such income information is available. Based on the legislative history, income information is available ''when it is known by the lender because, for example, such information is required as a condition of an existing federal housing program.'' [121] Thus, where, as a condition of an existing federal, state, or local housing program, income information of tenants is required to be collected, such income information is considered as known to a lender and, therefore, available to the GSEs.

Where tenant income is not known to the lender, the 30 percent rent proxy is to be used to monitor and evaluate each GSE's performance in achieving the goals.[122] (The Secretary notes that the 30-percent rent standard prescribed by the Act for determining affordability under the low- and moderate-income housing goal is too inclusive. In applying this standard, it can be anticipated that more than 80 percent of rental housing will be regarded as affordable to low- and moderate-income families.)

The term ''rent'' is not defined in the Act. Where the term ''rent'' is used in eligibility and affordability requirements for government housing programs, the term means ''gross rent,'' which includes all utilities, based on either actual data or allowances. Likewise, this proposed regulation defines ''rent'' as gross rent, *i.e.*, contract rent including utilities or contract rent plus utilities where some or all of the utilities are not included in the contract rent.

Where all utilities are not included in rent, use of contract rent is unsatisfactory and excludes a significant component of housing costs from the rent calculation. Utility costs comprise a significantly larger share of total housing costs for lower income families in comparison with higher income families. Moreover, applying the rent test, with rent exclusive of utility costs, would result in an even more unrealistically inclusive test of affordability for rental dwelling units than is the case using gross rent. If contract rent were used, the Department projects that more than 95 percent of all rental units would be classified as affordable to low- and moderate-income families.[123]

To resolve the problem of assuring consideration of gross rents including utility costs, while at the same time providing workable means for including those costs, this proposed regulation allows the GSEs to use: Actual data on utilities; utility allowances based on data from the American Housing Survey (AHS) and issued annually by the Secretary; utility allowances established for the HUD Section 8 Program (section 8 of the United States Housing Act of 1937, 42 U.S.C. 1437f); and/or an alternative adjustment formula subject to approval by the Secretary. The proposed regulation provides that, unless such an alternative approach is approved by the Secretary, the GSEs shall use actual data, the AHS-derived allowances, or the Section 8 allowances.

Where tenant income is not available, the Act requires that the test for affordability of rental dwelling units be applied to units ''with appropriate adjustments for unit size as measured by the number of bedrooms.'' [124] Thus, to determine whether a unit counts toward achievement of a goal, rent on the unit is considered in terms of the number of bedrooms in the unit. The Low-Income Housing Tax Credit (LIHTC) provides an accepted formula for adjustments to determine housing capacity, *see* 26 U.S.C. 42(g)(2)(C), and this proposed regulation requires the use of those adjustments for these goals. These adjustments assume that an efficiency houses one person, a one bedroom unit houses 1.5 persons and each additional bedroom houses an additional 1.5 persons.

Income adjustments for family size, required under the Act to determine whether a renter family's income qualifies as very low, low, or moderate, are established for the HUD Section 8 program and use of these adjustments is also required under this proposed regulation. To determine which rental dwelling units qualify as affordable, this proposed regulation combines the LIHTC unit size adjustment factors with the Section 8 family size adjustment factors to develop the necessary unit size adjustment factors to be applied to rent. For example, under the LIHTC an efficiency is assumed to house one person; under Section 8, for moderate-income, one person's rent may not exceed 70 percent of 30 percent of area median income; thus, an efficiency is affordable for a moderate-income person if the rent does not exceed 21 percent

[115] 26 U.S.C. 143.

[116] *Id.* at 38. *See also, id.* at 31, and H.R. Rep. No. 102–206, 102d Cong., 1st Sess. 60 (1991) (hereinafter cited as ''H. Rep.'').

[117] Sections 1332(c)(1) and 1333(c)(1)(A).

[118] Sections 1332(c) and 1333(c).

[119] Sections 1332(c)(2) and 1333(c)(2).

[120] Sections 1332(c)(1)(B) and 1333(c)(1)(B).

[121] S. Rep. at 35.

[122] *See* sections 1332(c) and 1333(c).

[123] Using rent as defined in this Notice, consistent with current law, 93 percent of existing rental dwelling units and 78 percent of recently constructed rental dwelling units qualify as affordable to low- and moderate-income families.

[124] Sections 1332(c)(2) and 1333(c)(2).

of area median income.[125] Similarly, a two-bedroom unit is assumed to house three persons; three persons' rent may not exceed 90 percent of 30 percent of area median income; thus, a two-bedroom unit is affordable for a moderate-income family if the rent does not exceed 27 percent of area median income. These percentages are included below under ''General Requirements.''

In some instances, the LIHTC unit size adjustments and the Section 8 family size adjustments do not directly correspond to each other. For example, under the LIHTC a one-bedroom apartment is assumed to house 1.5 persons but Section 8 does not provide a family size adjustment for 1.5 persons. Therefore, the HUD Section 8 adjustment factors for one person (70 percent) and two persons (80 percent) have been averaged to obtain a rent not in excess of 75 percent of 30 percent of area median income, yielding a net one-bedroom unit size adjustment factor of 22.5 percent of area median income.[126] Similar interpolations also are made for three-bedroom and five-bedroom units.

In certain rare instances (normally in New England), it may be unclear which area median income should be applied to determine the affordability of certain dwelling units. Under the proposed regulation, where a GSE knows that a property is located in a census tract that is split between two different areas and it is not clear which area median income should be used, the GSE must calculate a median income for the split census tracts. The median income for such split areas equals: (A) The percentage of the population of the census tract that is located in the first area times the median income of that area; plus (B) the percentage of the population of the geographic segment that is located in the second area times the median income of that area.

For example, a GSE purchases a mortgage on a property located in a census tract that is partially in a metropolitan statistical area (MSA) and partially outside the MSA; seventy-five percent of the census tract's population is in the MSA and the remaining 25 percent is outside the MSA; the median income for the MSA is $40,000; the median income for the county outside the MSA is $30,000. The median income for the split census tract would be 75 percent of $40,000 plus 25 percent of $30,000, or $37,500.

HUD seeks guidance on the appropriate reference for income in non-metropolitan areas for determining affordability under the housing goals for low- and moderate-income families and special affordable housing and for defining low-income areas in the goal for central cities, rural areas and other underserved areas. Should borrower and area income in non-metropolitan areas be defined: (1) Relative to the county median income; or (2) relative to the maximum of the county median income or the median income of the non-metropolitan balance of the State?

Housing Plans

The proposed rule provides procedures if a GSE fails to meet any housing goal. If the Secretary determines that either GSE has failed to meet any housing goal or there is a substantial probability that a GSE will fail to meet a housing goal, the Secretary shall, by written notice, preliminarily require that the GSE submit a housing plan.[127] The GSE would then have 30 days (which may be extended by the Secretary) to respond in writing to the Secretary's notice.[128] The GSE's response may include any information that the GSE considers appropriate for the Secretary to consider in determining whether the GSE failed to meet a housing goal, whether there is a substantial probability that the GSE will fail to meet a housing goal, and whether achievement of the housing goal was or is feasible.

After reviewing the GSE's response, the Secretary shall issue a final determination as to whether the GSE has failed or there is a substantial probability that the GSE will fail to meet the housing goal.[129] Additionally, the Secretary shall determine whether achievement of the housing goal was or is feasible based on market and economic conditions and the GSE's financial condition.[130] Where the Secretary determines that the GSE has failed or there is a substantial probability that the GSE will fail to meet the housing goal and that achievement of the housing goal was or is feasible, the Secretary shall require the GSE to submit a housing plan.[131]

Each housing plan must be feasible and sufficiently specific to enable the Secretary to monitor the GSE's performance under and compliance with the plan.[132] A housing plan must describe the specific actions that the GSE will take to achieve the goal in the next calendar year or, where the Secretary has determined that a substantial probability exists that the GSE will fail to meet a goal in the current year, the plan must describe the reasonable improvements the GSE will make in the remainder of the year.[133]

Subpart C—Fair Housing Requirements

The Act requires the Secretary, by regulation, to prohibit the GSEs from discriminating in their mortgage purchase activities and to require that the GSEs submit specified data to the Secretary on mortgage lenders to assist the Secretary's investigative activities under the Fair Housing Act and to assist investigative activities under the Equal Credit Opportunity Act (ECOA).[134] The Act also requires the Secretary to: Obtain and provide to the GSEs information on violators of the Fair Housing Act and ECOA; direct the GSEs to take action against mortgage lenders found to discriminate; and periodically review and comment on the GSEs' underwriting guidelines.[135]

In enacting FHEFSSA, Congress recognized the unique position and responsibilities of the GSEs in the mortgage market and their unparalleled capabilities to effectuate fair housing and fair lending in that market. The GSEs are Federally sponsored and purchase a large majority of all of the conventional mortgages originated by primary lenders. The House Report on the Act stated:

> While the Committee does not intend that the (GSEs) be responsible for investigating and punishing acts of discrimination, the Committee does expect the (GSEs) to use their considerable influence over the mortgage market to ensure that lenders with which they deal are acting in a nondiscriminatory manner.[136]

Discrimination on a prohibited basis is intolerable and socially and economically destructive. The GSEs on many occasions have expressed their commitment to combatting discrimination and advancing fair lending. The Secretary, through this regulation, seeks to make concrete the

[125] Similarly, for purposes of determining affordability to low-income families: An efficiency is assumed to house one person; one person's rent may not exceed 70 percent of 30 percent of 80 percent of area median income (using family size to adjust income); thus, an efficiency is affordable to a low-income family if the rent does not exceed 16.8 percent of the area median income.

[126] Similarly, for purposes of low-income affordability, the same 75 percent figure is used to obtain a rent not in excess of 75 percent of 30 percent of 80 percent of area median income, yielding a net unit size adjustment factor of 18 percent.

[127] Section 1336(b)(1).

[128] Section 1336(b)(2).

[129] Section 1336(b)(3)(A).

[130] *Id.*

[131] Section 1336(c)(1).

[132] Section 1336(c)(2).

[133] *Id.*

[134] Sections 1325(1)–(3).

[135] Section 1325(4)–(6).

[136] H. Rep. at 57.

GSEs' significant fair housing and fair lending responsibilities under the Act.

These provisions are intended ultimately to further fair lending by primary lenders. Accordingly, in developing these sections, the Secretary consulted with Federal agencies that regulate lending institutions including the Office of Comptroller of the Currency, the Office of Thrift Supervision, the Treasury Department, and the Federal Reserve. Those consultations proved extremely beneficial. Responsibility for enforcement of the Act's fair housing provisions is solely vested in the Department of Housing and Urban Development under the Act, including the HUD Office of Federal Housing Enterprise Oversight (OFHEO), and no provisions in this regulation may impede those authorities. However, the Secretary has concluded that in the implementation of these regulations further consultations in the operational arrangements of these regulations would be valuable.

Consultation will assure needed coordination of regulatory actions within the government and the provision of beneficial information and views from the regulators to the Secretary. The regulations, therefore, specifically require that memoranda of understanding will be established with regulators to specify procedures for submission and dissemination of information from the regulators to the Secretary and to the GSEs. Also, prior to directing any remedial action by a GSE against a lender, the Secretary would be required to solicit and fully consider the views of the lender's regulator. Finally, at all points in the process where warranted, including, without limitation, the Secretary's review of the GSEs' underwriting guidelines and business practices affecting lenders, the Secretary will fully consider the views of the appropriate regulators in the standards used by such regulators in similar circumstances.

Prohibitions Against Discrimination

The regulations generally prohibit the GSEs from discriminating *in any manner* 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 the dwelling or the age of the neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect. The proposed regulation provides that the GSEs are liable for any discrimination by them, or their officers, or employees, or agents in making mortgage purchases. Just as the term ''mortgage purchase'' includes transactions which are substantively similar to mortgage purchases for purposes of the housing goal provisions, the term is similarly inclusive for purposes of the restrictions against discrimination.

The regulation makes clear that prohibited conduct is subject to certain exemptions. For example, while the regulations generally forbid the GSEs from considering factors concerning the age and location of a dwelling, or the area in which the dwelling is located in a manner that has a discriminatory effect, these factors may be considered in certain cases. The age of a dwelling may be used by an appraiser as a basis for conducting more extensive inspections of structural aspects of the dwelling. Location factors that may have a negative effect on a dwelling's value may be properly considered in an appraisal and in other aspects of the underwriting process.

The GSEs may also consider factors justified by business necessity, including requirements of Federal law, relating to a transaction's financial security or to protection against default or reduction of the value of the security. For example, age or location may be considered in circumstances other than appraisals, including requiring a different loan-to-value ratio for an older, more expensive to maintain, multifamily building. However, where a GSE's consideration of a factor or factors has a disparate result based upon 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 order for the factor or factors to continue to be considered, the factor must be justified by business necessity. The business necessity must be manifest and neither hypothetical nor speculative. Even if consideration of the factor can be justified based on business necessity, its use still may be impermissible if an alternative policy or practice could serve the same purpose with less discriminatory effect.

Business Practices Analysis and Underwriting and Appraisal Guidelines

The regulations provide that following their effective date and periodically thereafter as requested by the Secretary, each GSE shall conduct and submit to the Secretary a Business Practices Analysis to further implement the prohibitions against discrimination under the Act and facilitate the reporting requirements under sections 309(n)(2)(G) of the Fannie Mae Act and 307(f)(2)(G) of the Freddie Mac Act[137] and the underwriting and appraisal guideline review requirements under the Act.[138] The GSEs will develop a methodology for conducting the Business Practices Analyses and the Secretary will review and comment on the methodology.

The Business Practices Analysis must assess the GSE's underwriting standards and appraisal practices, repurchase requirements, pricing, fees, procedures, and other business practices 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. The analysis shall specify revisions that will be made to promote affordable housing and fair lending. If disparate results occur because of any business practices, the GSE must demonstrate that a business necessity exists for the practice or demonstrate how the GSE plans to remedy the situation. The GSEs' Charter Acts as amended by FHEFSSA require an analysis of business practices as part of a required report.[139] The analysis will serve as a baseline for future reporting and as a necessary action by the GSEs toward remedying any systemic practices that are discriminatory and assuring that the GSEs are not in violation of the prohibitions under this subpart.

The Secretary recognizes that, at least initially, this highly important analysis will require a considerable amount of time to complete. Accordingly, the Secretary specifically seeks comments concerning the deadline for completing the initial analysis and the time for review by the Secretary which should be included in the final regulations.

Under the Act, the Secretary is required to review the GSEs' underwriting and appraisal guidelines to ensure compliance with the Fair Housing Act, the regulations promulgated thereunder, section 1325 of the Act, and these regulations.[140] In implementing this responsibility—in a manner intended to maximize industry self-regulation—this proposal places initial responsibility on the GSEs themselves, rather than the Department,

[137] These Charter Act sections require the GSEs to ''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 of the borrower, including revisions thereto to promote affordable housing or fair lending.''

[138] Section 1325(6).

[139] Fannie Mae Charter Act, section 309(n)(2)(G), and Freddie Mac Act, section 307(f)(2)(G).

[140] Section 1325(6).

to review all current guidelines and future revisions of the guidelines. Review of the GSEs' current guidelines therefore will involve analyses by the GSEs followed by Secretarial review and comment. The GSEs' analyses of the current guidelines will occur for the first time, under this regulation, as part of the Business Practices Analysis. The regulations require that before instituting a revision, the GSE must certify that after reasonable evaluation and analysis, the GSE has determined in good faith that to the best of its knowledge the change will not be discriminatory.

The Secretary will provide comments and recommendations for changes to guidelines and revisions to ensure consistency with the Fair Housing Act. If a GSE does not make such changes or otherwise resolve comments to the satisfaction of the Secretary, the Secretary may take action under the Fair Housing Act.

In addition to requiring an analysis of the GSEs' business practices as a means of effectuating fair lending, the Secretary seeks comment concerning whether the GSEs should be required to develop a fair lending plan to identify and address impediments to fair housing and fair lending in the primary market. Lending discrimination remains a pervasive and persistent problem in the mortgage industry. The Secretary seeks comment on the following questions:

(1) Should the GSEs be required to prepare a fair lending plan?

(2) Could a fair lending plan offer new ways to lead the primary lending market in eradicating discrimination? If so, how?

(3) What are the appropriate components of such a plan? and

(4) How would the plan effectuate fair housing/fair lending objectives?

Submission of Information to Assist the Secretary

The GSEs are required to 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.[141] The regulation requires that the GSEs: (a) Respond to a specific Secretarial request for information on a particular lender or lenders; (b) provide information when the GSE becomes aware of a questionable activity by a lender; and (c) develop and provide data that could be generated by GSE data systems, *e.g.*, relating data on census tracts to lender mortgage sales. When investigating the practices of a particular lender, GSE data could provide the Secretary useful information on lending patterns of that lender and other lenders in the same area.

The Secretary invites the GSEs and the public to provide comments on additional information that the GSEs could usefully gather on lenders for the Secretary's review in connection with the enforcement of the Fair Housing Act.

Submission of Information by the Secretary to the GSEs

The Secretary will obtain information from Federal, State, and local enforcement agencies with information regarding violations of ECOA, the Fair Housing Act, or State and local anti-discrimination laws. The Secretary will provide this information to the GSEs. Such information may indicate violations of the GSEs' underwriting guidelines and/or representations or certifications from lenders. The specific nature of the violation information to be obtained by the Secretary and the procedures for referral applicable to Federal financial regulators will be governed by memoranda of understanding entered into between the Secretary and such regulators. The Secretary shall also consult with such regulators on the nature of the information to be provided to the GSEs. The Secretary is particularly sensitive to ensuring that only relevant and legally appropriate information—considering financial privacy and other pertinent matters—is obtained and provided to the GSEs under this provision. Although other provisions of the Act and regulations described below allow the Secretary to *direct* sanctions against lenders found to discriminate,[142] these information dissemination provisions neither directly nor indirectly require actions by the GSEs based upon violation information provided by the Secretary. The regulations merely provide that the GSEs may take appropriate action under their procedures based on information provided by HUD concerning lender violations of the Fair Housing Act or ECOA, *i.e.*, the GSEs, in their discretion, may choose to take action against lenders based on violations of binding contractual arrangements with the GSEs forbidding discrimination.

Remedial Actions

The Secretary is required to direct the GSEs to take remedial actions—including suspension, probation, reprimand, or settlement—against lenders which have been found to have engaged in discriminatory lending practices in violation of the Fair Housing Act and ECOA following appropriate proceedings.[143]

For purposes of remedial action, a lender will have been found to have violated ECOA only after a final determination on the matter has been made by an appropriate United States District Court or any other court of competent jurisdiction. A lender will have been found to have violated the Fair Housing Act only after a final determination on the matter has been made by a District Court, a HUD Administrative Law Judge, or the Secretary. Based on such violations, the Secretary shall direct the GSE to take remedial action(s) under this section. Prior to the date the action is to be imposed, the lender may request and, if the request is timely filed, will be entitled to a hearing before a HUD Administrative Law Judge; such hearing shall be limited to review of the appropriateness of the proposed remedial action only. The determination on the underlying violation will not be subject to review at the hearing.

To ensure regulatory coordination and avoid any unnecessary regulatory burden, the Secretary will be required under the proposed regulation, prior to directing any remedial actions under this section, to solicit and fully consider the views of the particular lender's Federal financial regulator concerning the action or actions contemplated. Views will be solicited and considered in accordance with the foregoing memoranda of understanding between the Secretary and such regulators. The regulations address the lenders' due process rights and factors that the Secretary may consider in determining an appropriate action. The Act empowers the Director of OFHEO to enforce violations of section 1325 by the GSEs. Potential violations are to be referred to the Director by the Secretary.

The Fair Housing Act

The Secretary's regulatory authority under section 1325 of the Act is in addition to the Secretary's responsibilities under the Fair Housing Act [144] and Executive Order 12,892.[145] The Fair Housing Act requires that the Secretary administer all HUD programs and activities relating to housing and urban development (which would include GSE oversight responsibilities) so as ''to affirmatively further'' the

[141] Sections 1325 (2)–(3).

[142] Section 1325(5).

[143] Section 1325(5).

[144] 42 U.S.C. 3601–19.

[145] 59 FR 2939 (1994).

purposes of the Fair Housing Act.[146] The Secretary is in the process of developing regulations under the Fair Housing Act that will update HUD's current regulations concerning fair housing and fair lending. Those forthcoming regulations will supplement these GSE regulations. Nothing in these regulations is intended to diminish in any manner the GSEs' responsibilities under the Fair Housing Act.

Subpart D—Review of New Programs

Background

Under both Charter Acts, prior to amendment by FHEFSSA, the Secretary had statutory authority to approve the GSEs' purchasing, servicing, selling, lending on the security of or otherwise dealing in conventional mortgages. Under provisions of FHEFSSA, the Secretary must approve new programs unless the Secretary determines that the program was not authorized under specific provisions of the GSEs' Charter Acts or that the program was not in the public interest.[147] Until one year after the Director's regulations under section 1361(a) of FHEFSSA are issued, the Director also must review new programs and, if the Director determines that the new program would risk significant deterioration of the GSE's financial condition, the new program must be disapproved by the Secretary.[148] The purpose of the Secretary's approval is ''to ensure that (programs) are authorized by the relevant (C)harter Act, not detrimental to housing availability and affordability, and, for an undercapitalized (GSE),to ensure that such programs (will) not worsen the financial condition of the (GSE).'' [149]

Scope of Authority

The Secretary intends to make certain that the GSEs continue to have sufficient latitude to develop innovative programs to serve America's housing needs. In the area of housing finance, dramatic innovations have occurred during the last 25 years, with the introduction of the mortgage-backed security, the REMIC, and other financing vehicles that have brought new sources of investment capital into housing. The GSEs have either developed or refined these vehicles. The Secretary wants to ensure that future innovations are also allowed to develop without unnecessary impediment.

As noted in the House Report on the Act, ''(t)he Secretary's role with regard to approval authority over new programs is not designed to entangle Fannie Mae and Freddie Mac in unnecessary delays, bureaucratic red tape, or extraneous consideration by HUD.'' [150] In reviewing new programs, the Secretary will follow judiciously the standards for review in the Act and will only disapprove a request for new program approval where the program is not within the scope of the GSE's statutory authority, the program is not in the public interest, or, during the transition period, where the Director determines that the new program would risk significant deterioration in a GSE's financial condition.[151]

Each GSE is required to obtain the approval of the Secretary for any ''new program'' before the GSE implements the program.[152] Section 1303(13) of the Act defines ''new program'' as ''any program for the purchasing, servicing, selling, lending on the security of, or otherwise dealing in, conventional mortgages that—(A) is significantly different from programs that have been approved under this Act or that were approved or engaged in by (a GSE) before (October 28, 1992); or (B) represents an expansion, in terms of the dollar volume or number of mortgages or securities involved, of programs above limits expressly contained in any prior approval.'' (Programs that were specifically approved are referred to as ''approved programs.'')

Under the Act, all GSE programs engaged in prior to October 28, 1992, which are referred to in the regulations as ''authorized programs,'' are deemed to be approved even where the GSE did not actually obtain approval from the Secretary and such programs need not be submitted to the Secretary for further review. However, where programs are significantly different from authorized programs, unless such programs are otherwise approved they are ''new programs'' subject to the Secretary's approval.

Under these regulations, the ''new program'' approval procedure applies to ongoing ''programs,'' pilots, and demonstration programs that ''significantly differ'' from authorized or approved programs. ''New program'' also would include a program that is expanded, in dollar volume or number of mortgages or securities involved, above any limits expressly contained in any prior approval by the Secretary.

Where a question exists as to whether an activity is a program, if submission is otherwise required, the GSE must submit the activity for Secretarial review. As noted in the legislative history, where a planned program ''could reasonably raise significant questions'' as to whether the program is within a GSE's statutory purposes or in the public interest, that program ''should be viewed as significantly different from existing programs and, therefore, must be submitted for approval.'' [153] Accordingly, the GSEs shall submit programs for review if the Secretary could reasonably consider the program to be new, even where the GSE believes the program is not new. Where the GSE does not believe that the program is new, the GSE may, in its submission, fully explain its basis for that position.

Fannie Mae undertakes certain housing related activities under section 309(a) of its Charter Act, which authorizes Fannie Mae ''to do all things as are necessary or incidental to the proper management of its affairs and the proper conduct of its business.'' Freddie Mac has similar authority under which Freddie Mac's ''(f)unds * * * may be invested in such investments as (its) Board of Directors may prescribe,'' and Freddie Mac has the power ''to determine its necessary expenditures and the manner in which the same shall be incurred, allowed, and paid.'' [154] Where any of these activities could be regarded as new programs subject to the Secretary's review, the proposed regulation would require the GSEs to submit requests for program approval for those activities (under sections 309(a) of the Fannie Mae Charter Act or 303(c)(9) or (d) of the Freddie Mac Act). The purpose of this requirement is to ensure that the Secretary appropriately reviews all new programs and ensures that the GSEs do not, through use of their corporate powers, violate any provisions of their Charter Acts such as the prohibition against the GSEs originating mortgage loans.[155]

Although new programs will be subject to Secretarial review, the Secretary does not intend to interfere with the GSEs' other activities under sections 309(a) of the Fannie Mae Charter Act or 303(c)(9) or (d) of the Freddie Mac Act. The Secretary encourages the GSEs to continue their activities under these provisions.

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[146] 42 U.S.C. 3608(e)(5).

[147] Section 1322(b)(2).

[148] Section 1322(b)(2).

[149] S. Rep. at 15.

[150] H. Rep. at 55.

[151] Section 1322(b)(1).

[152] Sections 1322(a) of FHEFSSA, 305(c) of the Freddie Mac Act, and 302(b)(6) of the Fannie Mae Charter Act.

[153] S. Rep. at 15.

[154] Freddie Mac Act, sections 303(d) and 303(c)(9).

[155] *See* sections 304(a)(2)(B) of the Fannie Mae Charter Act and 305(a)(5)(B) of the Freddie Mac Act.

Products

A program differs from a product. As noted in the legislative history, ''(o)nce a program is approved, Fannie Mae and Freddie Mac are expected and encouraged to develop a range of specific products under the umbrella of the new program. The Secretary's prior approval authority does not extend to the introduction of new products under an approved program.'' [156]

Significantly Different

To determine whether a planned GSE program is ''significantly different'' from a GSE program that has been approved or authorized, and, therefore, requires the Secretary's approval, the proposed regulation provides that a program is significantly different if it materially differs from the GSE's other approved or authorized programs by entailing substantially greater risk or substantially expanding the GSE's role in the housing markets by involving new categor(ies) of borrowers, properties or other securities, borrowing purposes, or credit enhancements. New programs do not include new activities that are designed to refine approved or authorized programs by repackaging features of those programs, making technical improvements, or creating other nonmaterial variations.

Requested Comments on New Program Approval

In connection with new program approval, the Secretary seeks comments on the following questions:

(1) The Act defines ''new program,'' generally, as a program that is significantly different from GSE programs previously approved or authorized. The Act does not define ''program,'' ''product,'' or ''significantly different.'' Should these term(s) be defined in the final rule and, if so, how should the term(s) be defined?

(2) The Act requires the Secretary to approve a new program unless the program is not authorized by the GSE's Charter Act or the Secretary determines that the new program is not in the public interest. Should the final rule include factors that the Secretary will consider in determining whether a program is not in the public interest and, if so, what factors should be included?

Procedures

Requests from a GSE for new program approval must be submitted in writing and fully explain the program and whether the program is implemented under the authority of sections 305(a) (1), (4), or (5) of the Freddie Mac Act or 302(b) (2)–(5) of the Fannie Mae Charter Act. Each program request shall include: An opinion from counsel setting forth the statutory authority for the new program; a good faith estimate of the anticipated dollar volume of the program over the short- and long-term; a full description of the purpose and operation of the proposed program, the market targeted by the program, the delivery system for the program, the effect of the program on the mortgage market, and material relevant to the public interest.

The Secretary and the Director (where the Director has new program approval authority) may, within 45 days of receiving a request for new program approval, determine that additional information from the GSE is needed to make a decision on the request.[157] When additional information is needed by the Secretary or the Director, the Secretary shall request such information from the GSE. The GSE must provide such information within 10 days of the Secretary's request and, if the GSE fails to do so, the Secretary may deny the request based on the GSE's failure.

The Secretary shall approve or disapprove new program requests within 45 days, or 60 days if additional information is requested from the GSE.[158] When the Secretary approves a new program, the Secretary shall provide written notice of the approval to the GSE. When a new program is not approved, the Secretary shall submit an explanatory report to the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate.[159] If the Secretary fails to approve or disapprove a new program within 45 days (or 60 days where additional information is requested), the request shall be deemed approved.[160]

Where the Secretary disapproves a new program request from a GSE under sections 305(a) (1), (4), or (5) of the Freddie Mac Act or 302(b) (2)–(5) of the Fannie Mae Charter Act and these regulations, the GSE may request within 30 days of the disapproval an opportunity to supplement the administrative record at a meeting with the Secretary or the Secretary's designee or in writing.[161] A meeting will be scheduled within 10 days of a request. Within 10 days after written submission or a meeting, the Secretary will notify the GSE whether the decision is withdrawn, modified or affirmed.

Where the Secretary disapproves a new program because it is not in the public interest or because the Director determined that the program would risk significant deterioration of the GSE's financial condition, the Act [162] and these regulations provide the GSE with notice of and an opportunity for a hearing on the record concerning the disapproval as provided in subpart G.

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 also submit reports to Congress and the Secretary concerning the GSEs' housing activities. The Act requires that the Secretary report to Congress by June 30 of each year on the activities of the GSEs.[163] These regulations implement all of the applicable reporting requirements so that the Secretary is capable of appropriately monitoring the GSEs' activities and reporting to the Congress.

The current Fannie Mae regulations required Fannie Mae to submit numerous reports to the Secretary. The Secretary has reviewed these reporting requirements and determined that a simpler, more effective and less burdensome reporting system should be instituted for both GSEs.

Under the proposed regulations the following submissions would no longer be required from Fannie Mae and would not be instituted for Freddie Mac: A report on business activities (24 CFR 81.22), including a description of any planned or proposed new business activities and the GSE's competitive position in the marketplace; a general plan for the conduct of the GSE's secondary market operations, a special budget plan for the GSE's secondary market operations, a description of pending legal proceedings, and details on each executive officer's ownership of GSE securities, remuneration, and stock options (24 CFR part 81, App. B); a report on each auction of commitments (24 CFR 81.23(a)(1)); a report on investors purchasing Fannie Mae securities (24 CFR 81.23(a)(3)); a statement of the composition of the GSE's loan portfolio (24 CFR 81.23(a)(4)); a report on the characteristics of home loans purchased (24 CFR 81.23(a)(5)); a report on average yields of mortgage loans purchased (24 CFR 81.23(a)(6)); a report on the lender

[156] H. Rep. at 55.

[157] Section 1322(c)(2).

[158] Section 1322(c)(2).

[159] Section 1322(c)(2).

[160] Section 1322(c)(3).

[161] *See* Section 1322(c)(4)(A).

[162] Section 1322(c)(4)(B).

[163] Section 1324.

groups from or to whom the mortgage loans were purchased or sold (24 CFR 81.23(a)(7)); a report on the composition of revenues received, expenditures made, and net income earned (24 CFR 81.23(a)(8)); a report on the distribution of holdings of the GSE's common stock (24 CFR 81.23(a)(9)); and an estimate of the dollar amounts of purchase commitments the GSE expects to issue in its FHA-VA mortgage auction and in its conventional mortgage auction (24 CFR 81.24).

On the other hand, in enacting FHEFSSA, the lack of information on the GSEs' *mortgage purchases* particularly concerned Congress.

> [A]n 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 * * *. The bill requires the collection of data that are central to understanding and evaluating the GSEs' single-family and multifamily businesses.[164]

The Act therefore required detailed reporting of mortgage data and extensive annual reporting on GSE housing activities to both Congress and the Secretary.[165]

To ensure that the Secretary has the information needed to carry out monitoring, compliance, and other regulatory responsibilities, the GSEs shall submit the following:

(1) Quarterly submittals of detailed data and aggregations on mortgage purchases (''the mortgage reports''); and

(2) An annual report (''the annual housing activities report'') that details the GSE's actions toward meeting the housing goals and other issues of concern to Congress as well as year-to-date mortgage data.

The GSEs shall also provide a few periodic reports and the Secretary may require special reports, additional analyses, or such underlying data as the Secretary considers appropriate.

Mortgage Data

Each GSE is required to submit on a quarterly basis, except for the fourth quarter, detailed data on each mortgage purchased (''mortgage data'') in the previous quarter (within 60 days after the end of the quarter). All data shall be submitted in a format specified by the Secretary and shall be year-to-date data. Data will be provided on an aggregate basis, and also on a loan-level basis (in computer-readable format). Appendix D details the reporting formats and the data elements required on each single-family and multifamily mortgage purchased. The Secretary seeks comment on whether Appendix D should include additional data.

The Annual Housing Activities Report

The regulations require each GSE to provide an Annual Housing Activities Report (within 60 days after the end of each calendar year) concerning its performance during the calendar year in achieving the housing goals. The report must 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. The report also must include annual compilations of mortgage data year-to-date and any other information that the Secretary considers necessary for the report and requests in writing. To reduce the reporting burden, the Secretary has combined two annual reports required either by the Charter Act or the Act into the Annual Housing Activities Report.

As part of the Annual Housing Activities Report, the Act requires that each GSE include a discussion of its business practices.[166] To the extent a Business Practices Analysis, required under subpart C, encompasses the information required in this report and where the GSE has conducted such a Business Practices Analysis within the preceding three years, the GSE may reference such Analysis and use the Annual Housing Activities Report to update the GSE's progress concerning any problems referenced in the Analysis.

Subpart F—Access to Information

The Act requires the Secretary to establish a public use data base and to release to the public certain categories of information submitted by the GSEs concerning their mortgage purchases.[167] The Act also requires the protection of proprietary information the GSEs submit to the Secretary.[168] In characterizing the lack of information on the GSEs' performance as ''an information vacuum,'' [169] the Senate Committee noted that ''public access and disclosure of information is a key tool for permitting appropriate public scrutiny and oversight of the activities of the [GSEs] and in evaluating possible improvements in housing finance markets.'' [170] The Act required a public use data base so that the public could obtain information on the GSEs' performance toward meeting their Charter Act purposes of serving a broad range of families and communities. In addition, Congress intended for the GSE public use data base to supplement HMDA data.[171] Finally, the Senate Report stated: ''[E]very effort should be made to provide public disclosure of the information required to be collected and/or reported to the (Secretary), consistent with the exemption for proprietary data * * *. The (Secretary) should also take such action as is necessary to protect the privacy concerns of individual borrowers or renters.'' [172]

Consistent with the legislative intent, the Department shall serve as an information clearinghouse, facilitating an end to the ''information vacuum'' on GSE activities—as expeditiously as possible. To achieve this objective, the Secretary intends that:

(1) Data on the GSEs' activities be made available to the widest range of housing groups, state and local governmental entities, academicians and other persons and entities so that—the efforts of the GSEs in making housing finance available to all segments of the population can be monitored by housing groups, State, and local governments, and similar entities and areas of partnership with the GSEs can be identified to expand housing opportunities;

(2) Data made available should be as inclusive as possible, balancing the proprietary concerns of the GSEs;

(3) Data should supplement data available under the Home Mortgage Disclosure Act (HMDA) to facilitate fair housing review and enforcement; and

(4) Data should be available by all reasonable means.

Public Use Data Base

Consistent with the Act,[173] the regulations establish a public use data base for 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. This data concerns the characteristics of individual mortgage purchases of the

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[164] S. Rep. at 39; *see also*, H. Rep. at 60 (''One reason for adopting the low-income housing provisions set forth in the Committee bill is the Committee's frustration with the lack of concrete information on [the GSEs'] current activity in the area of housing for low-income persons.'')

[165] *See, e.g.*, sections 1324, 1327, 1328, 1381 (o and p), and 1382 (r and s).

[166] Sections 1381(p) and 1382(s).

[167] Section 1323(a).

[168] Sections 1323 and 1326.

[169] S. Rep. at 39.

[170] *Id.* at 44.

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

[172] *Id.* at 40.

[173] Section 1323(a).

GSEs, including, *inter alia,* census tract, location, race and gender of mortgagors. This data may include other characteristics such as the loan-to-value (LTV) ratio of the mortgage, whether the loan was seasoned or whether the units were owner-occupied. In accordance with the Act, these regulations provide that the Secretary may not, by regulation or order, make available to the public data that the Secretary determines are proprietary under section 1326 of the Act *except* that the Secretary may not restrict access to the income, census tract location, race, and gender data of single family properties.[174]

The Secretary shall, from time to time, issues orders providing that certain GSE information is proprietary and shall not be included in the public use data base. The most current Secretarial orders will be periodically published and included as Appendix F of this regulation. On June 7, 1994, the Secretary published a Temporary Order protecting GSE information deemed to be proprietary, pending public comment and further review.[175] As part of the process for establishing the public use data base, the Secretary intends to finalize a revised order early in 1995.

In addition to not including proprietary information of the GSEs, the public use data base will not include information the release of which would invade personal privacy. Additionally, the data base will not include information required to be withheld, including requirements of the Trade Secrets Act, 18 U.S.C. 1905.

The Secretary will routinely disclose to the public information contained in the GSEs' Annual Housing Activities Reports which are submitted to the Secretary, the Committee on Banking, Finance and Urban Affairs of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate, and comprise a detailed picture of the GSEs' activities each year in relation to the housing goals and the Fair Housing provisions of the Act. Proprietary information from this report may be withheld if the GSEs request its designation as proprietary and the Secretary determines that it is proprietary.[176] Under the Act, none of the information under section 1323 or reports under section 1326 may be disclosed where the Secretary issues a final decision, by regulation or order, determining information is proprietary.[177]

Requests for Proprietary Treatment

The regulations establish procedures for the GSEs to request proprietary treatment of information submitted to the Secretary in reports or otherwise. When a GSE submits information to the Secretary, the GSE shall designate which of the information the GSE deems to be proprietary; the GSE's submission must include the bases for the GSE's assertion and a statement or certification from an officer or authorized representative providing that the information is proprietary and has not been disclosed to the public.

Determinations on Requests

The Secretary will review the information and the GSE's views. If the Secretary determines the information is proprietary, the Department will not disclose the data. The regulations then establish 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 that information that is the subject of a GSE request is proprietary, the Secretary shall provide the GSE with an opportunity for a meeting on the matter where the GSE may provide comments and additional information on release. After the meeting date, the Secretary shall determine, in writing, which information is proprietary and shall provide the GSE with 10 days' notice before the information is made available to the public.

FOIA Requests

Information on the GSEs may be requested by the public pursuant to the Freedom of Information Act (FOIA)[178] and these regulations provide guidance on FOIA's applicability to GSE information. For purposes of FOIA, HUD is considered an agency responsible for the regulation and supervision of financial institutions.[179] Accordingly, where appropriate, the Secretary may invoke FOIA Exemption (b)(8)[180] to withhold GSE information "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of" the Secretary.

FOIA Exemption 4[181] allows confidential business information to be protected from disclosure, and the Trade Secrets Act[182] forbids Government officers and employees from releasing trade secret and other confidential business information. Executive Order No. 12,600[183] requires that agencies notify submitters of FOIA requests for confidential business information and afford submitters an opportunity to comment before releasing information. If an agency determines to release notwithstanding a submitter's objections, the Executive Order requires that the agency notify the submitter a reasonable time prior to release. The President of the United States, by memorandum, dated October 4, 1993, to Heads of Departments and Agencies, emphasized the importance of public disclosures under FOIA and the implementing memorandum from the Attorney General, attached to the President's memorandum, instructs agencies to disclose information unless disclosure would harm an interest protected by a FOIA exemption. The President's and the Attorney General's memoranda do not, however, alter Executive Order 12600.

Congressional Requests

If the Department receives a request on behalf of a Congressional Committee or Subcommittee, the Comptroller General, a subpoena from a court of competent jurisdiction, or is otherwise compelled by law to release information determined to be proprietary, personal, or otherwise withheld from the public, the Department will provide the information in accordance with the request. In releasing proprietary information under this provision, the Department will advise the requester that the Secretary has determined that the information is proprietary and that public disclosure of the information may cause competitive harm to the GSEs. To the extent practical, the Department will provide notice to the GSEs after a request under this paragraph is received and before the Department provides information in response to the request.

Subpart G—Procedures for Actions and Review

This subpart establishes procedures for hearings, disclosure of orders and agreements between the Secretary and the GSEs, enforcement of actions by the Secretary, and judicial review. These procedures concern actions by the Secretary to enforce housing goal related matters under subpart B and reporting violations under subpart E, and actions by GSEs seeking review of new program denials under subpart D.

The Act empowers the Secretary to enforce requirements under the housing

[174] Section 1323(b)(2).
[175] 59 FR 29514 (1994).
[176] Section 1326.
[177] Section 1326(c).
[178] 5 U.S.C. 552.
[179] Section 1319F.
[180] 5 U.S.C. 552(b)(8).
[181] 5 U.S.C. 552(b)(4).
[182] 18 U.S.C. 1905.
[183] 3 CFR 235 (1988).

goals provisions through cease-and-desist orders and to assess civil money penalties against the GSEs.[184] In view of the seriousness of these actions, the Act itself details the procedural requirements for enforcement and rights of the GSEs during the sanctions process.[185] Because the Act details procedural requirements, this subpart mainly restates and rarely augments these procedures in the regulations.

Secretarial Enforcement Through Cease-and-Desist Orders and Civil Money Penalties

The Secretary may issue a cease-and-desist order where a GSE fails to: Submit a housing plan that complies with the Act; make a good faith effort to comply with a housing plan approved by the Secretary; or submit any information required under the reporting requirements under the Fannie Mae Charter Act or the Freddie Mac Act.[186] The Secretary will provide the GSEs with written notice of the charges which will fix a date for a hearing to be conducted by a HUD Administrative Law Judge. If, based on the record of the hearing, the Administrative Law Judge finds sufficient facts to sustain the action or the GSE fails to appear at the hearing, the Administrative Law Judge may issue and serve an order. The order may require the GSE to: (1) Submit a housing plan, where the notice of charges was based on the GSE's failure to submit a plan; (2) comply with a housing plan, where the notice was based on the lack of good faith efforts of the GSE to comply with a housing plan; or (3) provide the information, where the notice of charges was based on the GSE's failure to submit information.

Civil Money Penalties

The Secretary may impose civil money penalties on a GSE if the GSE has failed to: Submit a housing plan in substantial compliance with the Act; make a good faith effort to comply with a housing plan approved by the Secretary; or submit information required under the GSEs' Charter Acts.[187] Civil money penalties shall not exceed the following: (1) For failing to submit a housing plan, $25,000 for each day that the failure occurs; and (2) for failing to make a good faith effort to comply with a housing plan or failing to submit information, $10,000 for each day that the failure occurs.[188]

Hearings, Enforcement and Judicial Review

Under this subpart, all hearings are on the record, heard before a HUD Administrative Law Judge, and conducted in accordance with chapter 5 of title 5 of the United States Code and applicable HUD regulations. The Secretary will make available to the public any final order and any written agreement or other written statement for which a violation may be redressed by the Secretary.[189] The Secretary may withhold release of an agreement or statement if the Secretary determines that public disclosure would: seriously threaten the GSE's financial health or security, or be contrary to the public interest.[190]

To enforce any notice or order under this subpart, the Secretary may request that the Attorney General bring an action against the GSE in the United States District Court for the District of Columbia.[191] A GSE may obtain judicial review of a final order by filing a petition praying that the United States Court of Appeals for the District of Columbia modify, terminate, or set aside the order.[192]

Subpart H—Book-Entry Procedures

This subpart authorizes the GSEs' use of book-entry systems to issue and maintain records of the GSEs' securities. The Secretary is authorized to promulgate these provisions under section 1321 of FHEFSSA, which confers on the Secretary general regulatory authority and the authority to ''make such rules and regulations as shall be necessary and proper'' to ensure that the purposes of the Act, the Fannie Mae Charter Act, and the Freddie Mac Act are accomplished.

The GSEs currently issue and maintain records of their securities by entries in record systems maintained by the Federal Reserve banks; these systems are also used for U.S. Treasury securities. The Treasury Department has promulgated regulations establishing book-entry procedures.[193] Treasury regulations [194] permit the GSEs to use the system provided regulations are in force authorizing book-entry. Since 1978, HUD's Fannie Mae regulations (24 CFR 81.41 *et seq.*), authorized Fannie Mae to use book-entry procedures and recently, by regulation, 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 these comprehensive regulations.[195] Freddie Mac currently operates under book-entry regulations (1 CFR part 462) that it promulgated in 1978.

Virtually all of the GSEs' debt and mortgage-backed securities issuances and trading market depend on book-entry procedures. As of September 30, 1994, Fannie Mae debt outstanding was $239.3 billion and Fannie Mae MBS outstanding was $523.5 billion; as of that date, Freddie Mac's debt outstanding was $82 billion and Freddie Mac's MBS outstanding was $464 billion. Providing for use of book-entry GSE securities instead of definitive GSE securities has increased administrative efficiencies for investors, brokers and dealers as well as the GSEs themselves and facilitated the investment of capital in the GSEs' instruments. Use of the book-entry system facilitates the GSEs' Charter Act purposes of assisting the secondary market by improving the distribution of investment capital available for home financing.[196]

The regulations proposed in this subpart track the latest book-entry procedures established by the Department of the Treasury at 31 CFR part 306, subpart O, which are applicable to Treasury securities. The existing Fannie Mae book-entry regulations, 24 CFR part 81, subpart E, tracked an earlier version of Treasury's regulation. Minor changes have been made to adapt the Treasury regulation to the GSEs. In the interest of ensuring that the GSEs may continue to use the book-entry system and, at the same time, ensuring that the GSEs are subject to the same regulations, these regulations would replace Fannie Mae's book-entry regulations at 24 CFR 81.41 *et seq.* and would supersede Freddie Mac's book-entry regulations at 1 CFR part 462.

Subpart I—Other Provisions

This subpart includes miscellaneous regulatory provisions concerning equal employment opportunity and regulatory examinations.

The Secretary has general regulatory power over the GSEs and is directed to make rules and regulations to ensure that the purposes of the Charter Acts are accomplished.[197] To monitor the GSEs' compliance with the Secretary's regulatory authorities under the Charter Acts, these regulations, and the Act, and to verify the GSEs' data submissions and

[184] Sections 1341 and 1345.
[185] *See, e.g.,* sections 1341–1348.
[186] Section 1341(a).
[187] Section 1345(a).
[188] Section 1345(b).
[189] Section 1346(a).
[190] Section 1346(c).
[191] Section 1344(a).
[192] Section 1343(a).
[193] *See* 31 CFR 306.115 *et seq.*
[194] 31 CFR 306.0, n.1.
[195] 59 FR 54366 (Oct. 28, 1994).
[196] Fannie Mae Charter Act, sections 301(3) and (4), and Freddie Mac Act, sections 301(b) (3) and (4).
[197] Section 1321.

reports, the Secretary shall conduct regulatory examinations of the GSEs from time to time.

FIRREA and this regulation require that the GSEs comply with sections 1 and 2 of Executive Order 11478, providing for the adoption and implementation of equal employment opportunity requirements.[198]

Specific Areas for Public Comment

Comment is invited on all aspects of the proposed regulation. In addition, the Secretary requests comments on a number of specific issues. A number of these questions are raised in the preamble and are repeated below for the convenience of commenters:

(1) *Measuring the Goals:* The Act does not require that the goals be established as a percentage of units financed by each GSE in any one year (as required during the transition period for the low- and moderate-income and central cities goals). The Secretary is interested in considering alternative ways of measuring the goals.

(a) Should the Secretary establish the goals on a numerical, instead of a percentage, basis? If so, should the goals be established as:

(i) A certain number of mortgages purchased in one year?

(ii) A certain number of units financed in one year?

(iii) A certain dollar volume of mortgages purchased in one year?

(b) Should the Secretary establish the goals as shares of the target mortgage markets, rather than as shares of each GSE's total purchases; *e.g.,* should each GSE purchase a specified percent of mortgages originated for low- and moderate-income families?

If a commenter supports any of these alternatives or others not described, the commenter should explain in full how such goals might be established, taking into account data availability, and how the Secretary would fulfill the responsibility under section 1326 of the Act to monitor each GSE's compliance with the goals.

(2) *Establishing the Future Level of the Goals:* (a) Should the goals be established so that the GSEs are required to lead the industry by buying at least the percentages of mortgages that the market originates for each goal? If yes, at what levels and over what period should the GSE goals be established to achieve this objective and, specifically, at what levels should the 1997 and 1998 goals be established to meet this objective? In responding, please note:

(i) For the housing goal for low- and moderate-income families—the Secretary determined that for 1995 and 1996, 50 percent of the market is comprised of mortgages qualifying under this goal.

(ii) For the special affordable housing goal—the Secretary determined that for 1995 and 1996, 17–20 percent of the market would be mortgages qualifying under this goal.

(iii) For the central cities, rural areas, and other underserved areas goal—the Secretary determined that for 1995 and 1996, 21–23 percent of the market would be mortgages qualifying under this goal.

(b) Should ''leading the industry'' mean and should the goals be established for future years so that the GSEs are required to purchase (as a percentage of the GSEs' total purchases) a higher percentage of mortgages than are originated by the market under each housing goal? For example, if 16 percent of the mortgages originated and available are expected to be originated for mortgages for very low-income families, should the GSEs be expected to purchase, as a percentage of their overall business, an amount greater than 16 percent of mortgages on housing for very low-income families at some future date? If yes, at what levels and over what period should the goals be established to achieve this objective and, specifically, at what levels should the 1997 and 1998 goals be established to achieve this objective? Also, what percentage over the market should be required?

(c) Should the goals be established such that the GSEs purchase an equivalent proportion of loans originated by the market for borrowers under 80 percent of area median income as they do for borrowers over 120 percent of area median income? If yes, at what levels and over what period should the goals be established to achieve this objective and, specifically, at what levels should the 1997 and 1998 goals be established to achieve this objective?

(d) Should the goals be adjusted as the GSEs reach or fail to achieve the goals or should the goals be established and the GSEs' performance evaluated against relatively fixed goals? If the commenter believes that the goals should be adjusted, how frequently or under what conditions should the Secretary take action to adjust the goals?

(e) To what extent should the GSEs' share of the overall mortgage market affect the levels of the goals? The GSEs currently purchase approximately 70 percent of all conventional, conforming mortgages originated. Should the goals increase as the GSEs' market share increases? If yes, how should this work? How and in what manner should the goals be adjusted?

(3) *Central Cities, Rural Areas, and Other Underserved Area Goal:* (a) Should rural areas be based on the characteristics of Block Numbering Areas or counties? Which of these two options makes better sense for lenders and for GSE reporting? Which option better directs goal performance at areas with poor access to mortgage credit?

(b) In establishing the definition for rural areas, should the income and minority criteria (used for defining central cities and other underserved areas) be supplemented with other indicator(s) of the need for better access to mortgage credit? Should population size (*e.g.,* communities below 2,500 or nonmetropolitan counties below 50,000) be considered as such an indicator?

(c) What are the relative merits of indicators of access to metropolitan areas or nonmetropolitan cities such as the ''Beale'' or ''Ghelfi-Parker'' codes?[199]

(d) In New England, where MSAs are not composed of counties, should the definition of rural areas include areas ''outside (P)MSAs'' or ''outside NECMAs''?

(4) *Counting of Specific Transactions:* (a) *Second mortgages.* Should second mortgages receive full credit or partial credit? If partial credit, how should the level of credit be determined?

(b) *REMICs.*

(i) Where a REMIC contains a GSE's mortgages or mortgage-backed securities (MBS), should that type of REMIC count toward any of the housing goals? How should double counting be avoided?

(ii) Where a REMIC does not contain a GSE's mortgages or MBS, should that type of REMIC count toward any of the housing goals?

(iii) Should other types of REMICs be counted toward any of the housing goals?

(iv) In determining whether any REMICs count toward achievement of the housing goals, what factors should the Secretary consider?

(v) If any of these REMICs should count toward the housing goals, should the REMICs receive full credit or some level of partial credit? If partial credit, how should the level of credit be determined?

(vi) How should the final regulation deal with types of REMICs that have not yet been created or used in the market?

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[198] FIRREA, section 1216(b), codified as 12 U.S.C. 1833e(b).

[199] These indicators of urban influence were developed by the Department of Agriculture's Economic Research Service. Linda M. Ghelfi, ''County Classifications,'' *Rural Conditions and Trends,* 4(3): 6–11 (1993).

Should such REMICs only count if that type of REMIC is reviewed by the Secretary and the Secretary determines that the type of REMIC should count toward the housing goals?

(5) *Fair Lending Plan:* (a) Should the GSEs be required to prepare a fair lending plan?

(b) Could a fair lending plan offer new ways to lead the primary lending market in eradicating discrimination? If so, how?

(c) What are the appropriate components of such a plan? and

(d) How would the plan effectuate fair housing/fair lending objectives?

(6) *Provision of Data:* (a) Is there data, beyond that described in the regulation, that the GSEs could usefully gather on lenders for the Secretary's review in connection with the enforcement of the Fair Housing Act and for review by other agencies in connection with the enforcement of ECOA?

(b) In addition to the loan level data required under Appendix D, what other loan level data should the Secretary collect from the GSEs?

(7) *Affordability in Non-Metropolitan Areas:* HUD seeks guidance on the appropriate reference for income in non-metropolitan areas for determining affordability under the housing goals for low- and moderate-income families and special affordable housing and for defining low-income areas in the goal for central cities, rural areas and other underserved areas. Should borrower and area income in non-metropolitan areas be defined: (a) Relative to the county median income; or (b) relative to the maximum of the county median income or the median income of the non-metropolitan balance of the State?

(8) *New Program Approval:* (a) The Act defines ''new program,'' generally, as a program that is significantly different from GSE programs previously approved or authorized. The Act does not define ''program,'' ''product,'' or ''significantly different.'' Should these term(s) be defined in the final rule and, if so, how should the term(s) be defined?

(b) The Act requires the Secretary to approve a new program unless the program is not authorized by the GSE's Charter Act or the Secretary determines that the new program is not in the public interest. Should the final rule include factors that the Secretary will consider in determining whether a program is not in the public interest and, if so, what factors should be included?

(9) *Indicators of Unaddressed Needs:* The Act states that the special affordable housing goal is designed to meet the ''unaddressed needs of * * * low-income families in low-income areas and very low-income families.'' [200] But the Act does not indicate specifically what these unaddressed needs are. The Department has presented its views regarding ''unaddressed needs'' in Appendices A–C in detail, and the Secretary will closely review the GSEs' performance relative to the factors discussed therein. Specifically, the Secretary is committed to a monitoring and research agenda that will examine: (i) How the GSEs attempt to reach the 1995–96 goals (*e.g.*, balance of rental and owner occupied properties, single and multifamily loans); (ii) the changing risk profiles of their businesses that result from the 1995–96 goals; (iii) the potential for new affordable housing incentives that could increase the pool of qualifying loans for purchase; (iv) how the goals affect local portfolio lender business incentives (*e.g.*, incentives to sell seasoned portfolios to and obtain pre-origination purchase commitments from the GSEs and competitive pressures on loan originations); (v) how economic conditions affect the pool of potential qualifying mortgage originations; and (vi) the extent to which achieving the housing goals and meeting ''unaddressed needs'' require the GSEs to take on unduly risky business.

The Secretary welcomes the views of others regarding ''unaddressed needs.'' Specifically:

(a) What are appropriate definitions for and measures of unaddressed needs?

(b) What is the magnitude of unaddressed needs? Are GSE goals consistent with the level of unaddressed needs or do the goals require the GSEs to take on unduly risky business?

(c) How can the Department best monitor unaddressed needs and how the GSEs are addressing them?

(d) How should indicators of unaddressed needs be utilized in setting the various goals for the GSEs?

Other Matters

Public Reporting Burden

The information collection requirements contained in this rule have been submitted to the Office of Management and Budget under the Paperwork Reduction Act of 1980 (44 U.S.C. 3501–3520). The Department has determined that the following provisions contain information collection requirements.

BURDEN TO RESPONDENTS

Information	Number of respondents	Frequency of response	Hours required	Total hours
Business Practices Analyses	2	1	500	1,000

(**Note:** this is a one-time report, not an annual report.)

Information	Annual number of respondents	Frequency of response (per year)	Hours required	Total hours
Mortgage Data Reports	2	3	20	120
Annual Housing Activities Report	2	1	40	80
Periodic Reports	2	61	0.08	10
Other Information and Analyses	2	0.25	20	10
Fair Housing Act/ECOA Information	2	1	15	30

[200] Section 1333(a)(1).

ANNUAL COSTS TO RESPONDENTS

Information	Hours required	Cost per hour	Total cost
Business Practices Analyses	1,000	$20	$20,000
Mortgage Data Reports	120	20	2,400
Annual Housing Activities Reports	80	20	1,600
Periodic Reports	10	20	200
Other Information and Analyses	10	20	200
Fair Housing Act/ECOA Information from GSEs	30	20	600

ANNUAL COST TO FEDERAL GOVERNMENT (FOR REVIEWING INFORMATION)

Information	Hours required	Cost per hour	Total cost
Business Practices Analyses	4800	$30	$144,000
Mortgage Data Reports	1440	30	43,200
Annual Housing Activities Reports	400	30	12,000
Periodic Reports	122	30	3,660
Other Information and Analyses	10	30	300
Fair Housing Act/ECOA Information from GSEs	40	30	1,200

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 does not have a significant economic impact on a substantial number of small entities, other than those impacts specifically required to be applied universally by the Act.

Environmental Impact

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332). The finding is available for public inspection during regular business hours in the Office of the General Counsel, Rules Docket Clerk, room 10276, 451 Seventh Street SW., Washington, DC 20410.

Executive Order 12866

The Office of Management and Budget reviewed this proposed rule under Executive Order 12866, Regulatory Planning and Review. Any changes made to the rule as a result of that review are clearly identified in the docket file, which is available for public inspection at the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC. 20410–0500. A Regulatory Impact Analysis (RIA) performed on this proposed rule is also available for review at the same address.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that the policies contained in this proposed rule will 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. Promulgation of this rule expands coverage of the applicable regulatory requirements pursuant to statutory direction.

Executive Order 12606, the Family

The General Counsel, as the Designated Official under Executive Order 12606, The Family, has determined that this proposed rule does not have 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 policies and programs relate to family concerns.

Regulatory Agenda

This rule was listed as Item 1722 in the Department's Semiannual Agenda of Regulations published on November 14, 1994 (59 FR 57632, 57641), in accordance with Executive Order 12866 and the Regulatory Flexibility Act.

List of Subjects in 24 CFR Part 81

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

Accordingly, part 81 in Title 24 of the Code of Federal Regulations is proposed to be revised 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

Sec.
81.1 Scope of Part
81.2 Definitions

Subpart B—Housing Goals

81.11 General.
81.12 Low- and moderate-income housing goal.
81.13 Central cities, rural areas, and other underserved areas housing goal.
81.14 Special affordable housing goal.
81.15 General requirements.
81.16 Special counting requirements.
81.17 Income level definitions for owner-occupied units, actual tenants, and prospective tenants (if family size is known).
81.18 Income level definitions for prospective tenants (if family size is not known).
81.19 Rent level definitions for tenants (if income is not known).
81.20 Actions to be taken to meet the goals.
81.21 Notice and determination of failure to meet goals.
81.22 Housing plans.

Subpart C—Fair Housing

81.41 General.
81.42 Prohibitions against discrimination.
81.43 Review of underwriting guidelines.

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.* This part implements the regulatory power of the Secretary of the Department of Housing and Urban Development over the Federal National Mortgage Association (''Fannie Mae'') and the Federal Home Loan Mortgage Corporation (''Freddie Mac'') (referred to collectively as Government-sponsored enterprises (GSEs).) The Secretary has general regulatory power respecting the 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 or the Act), 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. Under FHEFSSA, the Secretary's responsibilities include: establishing, monitoring, and enforcing housing goals; regulating fair housing requirements; approving new program requests; disseminating information and protecting proprietary information; and requiring reports and data submissions.

(b) *Subparts.* The provisions of this part are as follows: Subpart A contains definitions and other general provisions relating to the entire part; subpart B implements housing goal requirements; subpart C implements Fair Housing requirements; subpart D sets forth procedures for Secretarial review of requests for new program approval by the GSEs; subpart E contains reporting requirements; subpart F sets forth requirements for access to information; subpart G sets forth procedures for Secretarial actions and review of actions; subpart H contains book-entry procedures; and subpart I contains other provisions.

(c) *Purposes of the GSEs.* The purposes of the GSEs are to: Provide stability in the secondary market for residential mortgages; respond appropriately to the private capital market; 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 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 promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

(d) *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 authorities.

§ 81.2 Definitions.

As used in this part, the term—

The Act or FHEFSSA means the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, enacted as Title XIII of the Housing and Community Development Act of 1992, and codified generally at 12 U.S.C. 4501–4641.

Affiliate means any entity that controls, is controlled by, or is under common control with, a GSE.

AHS means the American Housing Survey.

Balloon mortgage means a mortgage providing for payments at regular intervals, with a final payment (''balloon payment'') that is at least five percent more than the periodic payments. The periodic payments may cover some or all of the periodic principal and/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 cities 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 or Charter Acts means the Federal National Mortgage Association Charter Act (Title III of the National Housing Act, 12 U.S.C. 1716 *et seq.*) (''Fannie Mae Charter Act'') and/or the Federal Home Loan Mortgage Corporation Act (Title III of the Emergency Home Finance Act of 1970, 12 U.S.C. 1451 *et seq.*) (''Freddie Mac Act'').

Contract rent means the total rent that is, or is anticipated to be, specified in the rental contract 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 contract rent. 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 the Office of Federal Housing Enterprise Oversight of the Department of Housing and Urban Development.

Dwelling unit means a single, unified combination of rooms designed for use as a dwelling by one family and includes a dwelling unit in a single family property, multifamily property, condominium, cooperative, or planned unit development project.

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.

Family size means, for purposes of reporting on single family mortgages purchased, the number of people in a family including the borrower, the borrower's dependents, the co-borrower, and the co-borrower's dependents.

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

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

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

Government-sponsored enterprise or GSE means:

(1) The Federal National Mortgage Association (or ''Fannie Mae'') and any affiliate thereof; and

(2) The Federal Home Loan Mortgage Corporation (or ''Freddie Mac'') and any affiliate thereof.

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

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 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, income not in excess of 80 percent of area median income, with adjustments for smaller and larger families, as determined by the Secretary.

Low-income area or low-income census tract means a census tract 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. An area means the metropolitan statistical area (MSA) if the property is located in an MSA; otherwise, an area means the county in which the property is located.

Minority means any individual who is included within any one or more 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.

Minority census tract means a census tract in which minority residents comprise 30 percent or more of the total population in the census tract.

Moderate-income means:

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

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

Moderate-income census tract means a census tract in which the median income does not exceed 100 percent of the area median income.

Mortgage means a member of such classes of 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 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 sections 309 (m) and (n) of the Fannie Mae Charter Act and 307 (e) and (f) of the Freddie Mac Act relating to the GSEs' mortgage purchases. Appendix D of this part lists and details this data.

Mortgage purchase means a transaction in which a GSE buys or otherwise acquires 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.

New program means any program, including a pilot or demonstration program, for the purchasing, servicing, selling, lending on the security of, or otherwise dealing in, conventional mortgages that:

(1) Is significantly different from programs that have been approved under the Act or that were approved or engaged in by Fannie Mae or Freddie Mac before October 28, 1992; or

(2) Represents an expansion, in terms of the dollar volume or number of mortgages or securities involved, of programs above limits expressly contained in any prior approval.

OFHEO means the Office of Federal Housing Enterprise Oversight of the Department of Housing and Urban Development.

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

Owner-occupied unit or owner-occupied dwelling unit means a single family dwelling unit in which the borrower or co-borrower (on the mortgage that financed the dwelling 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 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.

Public data means all mortgage data submitted to the Secretary by the GSEs that the Secretary determines is not proprietary and should be made publicly available.

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

Refinancing means a transaction where an existing mortgage is satisfied or replaced by a new mortgage undertaken by the same borrower. Refinancings do 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, where a change in the payment schedule or in 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) The renegotiation of a mortgage on a multifamily property where the property has a balloon mortgage and the balloon payment is due within one year of the date of the closing on the renegotiated mortgage.

Rent means:

(1) The contract rent for a dwelling unit, but only where such contract rent includes all utilities for the dwelling unit;

(2) Where the contract rent for a dwelling unit does not include all utilities, the contract rent for the dwelling unit plus the actual cost of utilities not included in the contract rent; or

(3) The contract rent for a dwelling unit plus a utility allowance as set forth in this part.

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

Rental unit or rental dwelling 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 the underserved areas located outside of any metropolitan statistical area (MSA), primary metropolitan statistical area (PMSA), or consolidated metropolitan statistical area (CMSA) designated by the Office of Management and Budget.

Seasoned mortgage means a mortgage where the date of the mortgage note is more than one 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 or second home 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 officer, employee, or agent of the Department.

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

State means the States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, the Virgin Islands, American Samoa, the Trust Territory of the Pacific Islands, and any other territory or possession of the United States.

Underserved area means a census tract having:

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

(2) A median income at or below 80 percent of area median income.

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 (section 8 of the United States Housing Act of 1937, 42 U.S.C. 1437f) for the area where the property is located.

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, income not in excess of 60 percent of area median income, with adjustments for smaller and larger families, as determined by the Secretary.

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

Subpart B—Housing Goals

§ 81.11 General.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires that the Secretary establish, by regulation, three annual housing goals for the GSEs: A low- and moderate-income housing goal; a central cities, rural areas, and other underserved areas housing goal; and a special affordable housing goal. The Act requires that the Secretary establish these goals after considering prescribed factors and implement these goals in a manner consistent with Section 301(3) of the Fannie Mae Charter Act and Section 301(b)(3) of the Freddie Mac Act, which provide that one purpose of each GSE is to provide ongoing assistance to the secondary market for residential mortgages (including mortgages securing housing for low- and moderate-income families involving a 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. This subpart establishes these goals, implements requirements for measuring performance under the goals, and establishes procedures for monitoring and changing the goals. The Act provides that from year-to-year the Secretary may, by regulation, adjust any housing goal.

§ 81.12 Low- and moderate-income housing goal.

(a) *Authority.* Section 1332 of FHEFSSA requires the Secretary to establish an 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'').

(b) *Purpose of goal.* This goal is intended to achieve increased purchases by the GSEs of mortgages on housing for low- and moderate-income families.

(c) *Factors.* In establishing the low- and moderate-income housing goals, the Act requires the Secretary to consider:

(1) National housing needs;

(2) Economic, housing, and demographic conditions;

(3) The performance and effort of the GSEs 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;

(5) The ability of the GSEs 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 GSEs.

(d) *Consideration of factors.* The Secretary fully considered these factors in establishing the goals in this section. 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,'' is Appendix A of this part.

(e) *Goals.* Based on the Secretary's consideration of the factors in paragraph (c) of this section, the Secretary has established the following goals for each GSE's purchases of conventional mortgages on housing for low- and moderate-income families:

(1) The annual goal for 1995 shall be 38 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1995;

(2) The annual goal for 1996 shall be 40 percent of the 1996 purchases;

(3) The annual goal for 1997 shall be a number ranging from 40 percent of the 1997 purchases to the proportion or percentage of mortgages qualifying under the goal that are originated by that year's market (''the amount of the market'') or the amount of the market plus an additional percentage;

(4) The annual goal for 1998 shall be a number ranging from 40 percent of the 1998 purchases to the amount of the market or the amount of the market plus an additional percentage; and

(5) The annual goal for each succeeding year after 1998 shall be a number ranging from 40 percent of that year's purchases to the amount of the market or the amount of the market plus an additional percentage, or, if the Department does not set an annual goal for such succeeding years, the goal for such years shall be the same as the most recent goal established by the Secretary, pending further adjustment by the Secretary through rulemaking.

(f) The Secretary shall monitor the GSEs' performance under this goal and the GSEs' performance shall be measured as set forth in this subpart.

§ 81.13 Central cities, rural areas, and other underserved areas housing goal.

(a) *Authority.* Section 1334 of FHEFSSA requires the Secretary to establish an annual goal for the purchase by each GSE of mortgages on housing located in central cities, rural areas and other underserved areas.

(b) *Purpose of the goal.* This goal is intended to achieve increased purchases by the GSEs of mortgages financing housing in areas that are underserved by mortgage credit.

(c) *Factors.* In establishing the central cities, rural areas, and other underserved areas goals, the Act 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 efforts of the GSEs toward achieving the central cities, rural areas, and other underserved areas housing 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.

(d) *Consideration of Factors.* The Secretary fully considered these factors in establishing the goals in this section. 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'' is Appendix B of this part.

(e) *Goals.* Based on the Secretary's consideration of the factors in paragraph (c) of this section, the Secretary has established the following goals for each GSE's purchases of conventional mortgages on housing located in central cities, rural areas, and other underserved areas:

(1) The annual goal for 1995 shall be 18 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1995;

(2) The annual goal for 1996 shall be 21 percent of the 1996 purchases;

(3) The annual goal for 1997 shall be a number ranging from 21 percent of the 1997 purchases to the proportion or percentage of mortgages qualifying under the goal that are originated by that year's market (''the amount of the market'') or the amount of the market plus an additional percentage;

(4) The annual goal for 1998 shall be a number ranging from 21 percent of the 1998 purchases to the amount of the market or the amount of the market plus an additional percentage; and

(5) The annual goal for each succeeding year after 1998 shall be a number ranging from 21 percent of that year's purchases to the amount of the market or the amount of the market plus an additional percentage, or, if the Department does not set an annual goal for such succeeding years, the goal for such years shall be the same as the most recent goal established by the Secretary, pending further adjustment by the Secretary through rulemaking.

(f) *Measuring performance.* The Secretary shall monitor the GSEs' performance under this goal. The GSEs shall determine on a mortgage-by-mortgage basis, through geocoding or any similarly accurate and reliable method, whether a mortgage finances dwelling unit(s) located in a central city, rural area, or other underserved area.

§ 81.14 Special affordable housing goal.

(a) *Authority.* Section 1333 of 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 then-existing unaddressed needs of, and affordable to, low-income families in low-income areas and very low-income families.

(b) *Purpose of the goal.* This goal is intended to achieve increased purchases by the GSEs of mortgages meeting the needs of low-income families in low-income areas and very low-income families.

(c) *Factors.* In establishing the special affordable housing goals, the Act 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 within the categories set forth in this section;

(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 GSEs.

(d) *Consideration of Factors.* The Secretary fully considered these factors in establishing the goals in this section. A statement documenting the Secretary's considerations and findings with respect to these factors, entitled ''Secretarial Considerations to Establish the Special Affordable Housing Goal'' is Appendix C of this part.

(e) *Goals.* Based on the Secretary's consideration of the factors in paragraph (c) of this section, the Secretary has established the following annual special affordable housing goals for each GSE:

(1) *Rental housing.* For purchases of conventional mortgages financing rental housing units meeting the then-existing,

unaddressed needs of and affordable to very low-income families:

(i) The annual goal for 1995 shall be 5.5 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1995;

(ii) The annual goal for 1996 shall be 6 percent of the 1996 purchases;

(iii) The annual goal for 1997 shall be a number ranging from 6 percent of the 1997 purchases to the proportion or percentage of mortgages qualifying under the goal that are originated by that year's market (''the amount of the market'') or the amount of the market plus an additional percentage;

(iv) The annual goal for 1998 shall be a number ranging from 6 percent of the 1998 purchases to the amount of the market or the amount of the market plus an additional percentage; and

(v) The annual goal for each succeeding year after 1998 shall be a number ranging from 6 percent of that year's purchases to the amount of the market or the amount of the market plus an additional percentage, or, if the Department does not set an annual goal for such succeeding years, the goal for such years shall be the same as the most recent goal established by the Secretary, pending further adjustment by the Secretary through rulemaking.

(2) *Owner-occupied housing.* For purchases of conventional mortgages financing owner-occupied dwelling units either located in low-income areas and meeting the then-existing, unaddressed needs of and owned by low-income families, or meeting the then-existing, unaddressed needs of and owned by very low-income families:

(i) The annual goal for 1995 shall be 5.5 percent of the total number of dwelling units financed by that GSE's mortgage purchases in 1995;

(ii) The annual goal for 1996 shall be 6 percent of the 1996 purchases;

(iii) The annual goal for 1997 shall be a number ranging from 6 percent of the 1997 purchases to the proportion or percentage of mortgages qualifying under the goal that are originated by that year's market (''the amount of the market'') or the amount of the market plus an additional percentage;

(iv) The annual goal for 1998 shall be a number ranging from 6 percent of the 1998 purchases to the amount of the market or the amount of the market plus an additional percentage; and

(v) The annual goal for each succeeding year after 1998 shall be a number ranging from 6 percent of that year's purchases to the amount of the market or the amount of the market plus an additional percentage, or, if the Department does not set an annual goal for such succeeding years, the goal for such years shall be the same as the most recent goal established by the Secretary, pending further adjustment by the Secretary through rulemaking.

(f) *Performance.* The Secretary shall monitor the GSEs' performance under this goal.

(g) *Double counting.* Each mortgage purchase, or portion of a mortgage where only a portion counts toward achievement of this goal, shall count only once toward achievement of the goal, *i.e.*, shall count under only one subsection of the goal.

(h) *Full credit activities.* (1) As required by FHEFSSA, the Secretary will give full credit toward achievement of the special affordable housing goals for the following mortgage purchases by the GSEs:

(i) (A) The purchase or securitization of federally insured or guaranteed mortgages where:

(*1*) Such mortgages cannot be readily securitized through the Government National Mortgage Association (GNMA) or any other Federal agency;

(*2*) Participation of the GSE 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 such goal.

(B) Mortgages under the Department's Home Equity Conversion Mortgage (HECM) Insurance Demonstration Program, section 255 of the National Housing Act, 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 paragraphs (h)(1)(i)(A) (*1*) and (*2*) of this section.

(ii) The purchase or refinancing of existing, seasoned portfolios of loans where:

(A) The seller is engaged in a specific program to use the proceeds of such sales to originate additional loans that meet the special affordable housing goal; and

(B) Such purchases or refinancings support additional lending for housing that otherwise qualifies under the goal.

(iii) The purchase of direct loans made by the Resolution Trust Corporation (RTC) or the Federal Deposit Insurance Corporation (FDIC) where such loans are:

(A) Not guaranteed by the RTC, FDIC, or other Federal agencies;

(B) Made with recourse provisions similar to those offered through private mortgage insurance or other conventional sellers; and

(C) Made for the purchase of housing that otherwise qualifies under the special affordable housing goal to be considered for purposes of such goal.

(2) For purposes of determining whether a seller is engaging in a specific program to use proceeds of sales to originate additional loans that meet the special affordable housing goal under paragraph (h)(1)(ii) of this section:

(i) 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 (h)(2)(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; and

(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 (h)(2)(i) of this section.

(3) For purposes of this section, 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.

(i) *No credit activities.* As provided in FHEFSSA, 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. In applying this restriction, 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 where 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, ''portfolios of mortgages'' includes mortgages retained by Fannie Mae or Freddie Mac and mortgages utilized to back mortgage-backed securities.

§ 81.15 General requirements.

(a) *General.* The Secretary shall monitor and count the performance of each GSE under each of the housing goals. In determining each GSE's performance, the general requirements in this section shall apply.

(b) *Calculating the numerator and denominator.* Performance under each of the housing goals is based on a fraction that is converted into a percentage. The numerator of each fraction is the number of dwelling units 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 included in the terms ''mortgage'' or ''mortgage purchase.'' Where a GSE lacks sufficient information to determine whether a mortgage purchase counts toward achievement of a particular housing goal, such a mortgage purchase shall be included in the denominator for that housing goal.

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

(d) *Credit toward multiple goals.* For the purposes of counting toward the achievement of the 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 particular year.

(e) *Counting owner-occupied units.* For purposes of counting owner-occupied dwelling units toward achievement of the low- and moderate-income housing goal or the special affordable housing goal, mortgage purchases financing such owner-occupied units shall be evaluated based on the income of the mortgagors 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.

(f) *Counting rental units.*—(1) *Use of income, rent.*—(i) *Generally.* For purposes of counting rental dwelling units toward achievement of the low- and moderate-income housing goal or the special affordable housing goal, mortgage purchases financing such rental 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 tenant income information to the GSE, but only where such information is known to the lender.

(B) Where 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 (f)(4) of this section is applicable. If paragraph (f)(4) (income of prospective tenants) is inapplicable, 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 multifamily properties may count toward achievement of the housing goals only if a GSE determines that:

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

(ii) The number of such units is reasonable and minimal; and

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

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

(4) *Income of prospective tenants.* Where 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. Each GSE shall require lenders to provide such prospective tenants' income information to the GSE where such information is known to the lender. 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.* Where 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 shall be used where such information (whether computerized, automated, or not) is available.

(6) *Timeliness of information.* In determining performance under the housing goals, each GSE shall use tenant information required under this subsection as of the time of mortgage acquisition or, if underwriting occurs within two years of the GSE's purchasing a mortgage, the time of underwriting.

(g) *Median income.* (1) Where, for purposes of comparing a mortgagor's income to the median income for an area, a GSE cannot precisely determine whether the mortgage is on dwelling unit(s) located in one area but can determine that the mortgage is on dwelling unit(s) located in a census tract, or within a census place code, block-group enumeration district, or nine-digit zip code, or another appropriate geographic segment, that is partially located in more than one area (''split area''), the GSE shall calculate a median income for the split area. The median income for such split areas shall equal:

(i) The ratio of the population of the geographic segment that is located in the first area to the total population of the split area times the median income of that area; plus

(ii) The ratio of the population of the geographic segment that is located in the second area to the total population of the split area times the median income of that area.

(2) Where, for purposes of comparing the median income of a census tract to the area median income, a mortgage is on dwelling unit(s) located in a census tract that is partially located in more than one area (''split area''), the GSE shall calculate a median income for the split area as prescribed in paragraph (g)(1) of this section and that area median income shall be compared to the median income of the census tract.

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

(i) *Newly available data.* Where 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; the GSE may continue to use the data that was available at the beginning of the quarter.

§ 81.16 Special counting requirements.

(a) *General.* This section details the extent to which transactions or activities of the GSEs count toward achievement of any of the housing goals and, where the transaction or activity does count, whether full credit or some level of partial credit shall be provided for such transaction or activity. In determining the level of credit to be counted for each transaction or activity, the Secretary considers the following criteria:

(1) Where a transaction or activity is substantially equivalent to a mortgage purchase, the GSE shall receive full credit for the transaction or activity toward achievement of any of the housing goals;

(2) Where a transaction or activity has less than the normative risk associated with the GSE's mortgage purchases, the GSE shall receive less than full credit for the transaction or activity; and

(3) Where a transaction or activity creates a new market or adds liquidity to an existing market, the GSE shall receive full credit for the transaction or activity.

(b) *Not counted.* The following transactions or activities do 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 projects eligible for Low-Income Housing Tax Credits (LIHTC), 26 U.S.C. 42;

(2) Purchases of State and local government housing bonds, including mortgage revenue bonds;

(3) Purchases of non-conventional mortgages, including mortgages insured under HUD's One- to Four-Family Home Mortgage Insurance Program (section 203 (b) and (i) of the National Housing Act, 12 U.S.C. 1709 (b) and (i)), and mortgages guaranteed by the Department of Veterans Affairs, except where such mortgages are acquired under a risk-sharing arrangement with the Department or another Federal agency and except where such mortgages are permitted to count toward achievement of the special affordable housing goals under § 81.14(h)(1)(i);

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

(5) Mortgage purchases to the extent mortgage purchases finance any dwelling units that are secondary residences.

(c) *Other special rules.*—(1) *Credit enhancements.*

(i) Credit enhancement transactions shall count toward achievement of the housing goals where:

(A) The GSE provides specific mortgages it owns as collateral to guarantee bonds issued to finance housing; such bonds may be issued by any entity, including a State or local housing finance agency; and

(B) The GSE assumes a credit risk in the transaction by pledging or guaranteeing repayment and such credit risk is substantially equivalent to that assumed by the GSE if it had securitized the mortgages financed by such State or local housing finance agency.

(ii) Dwelling units financed under this type of credit enhancement transaction shall count toward a goal to the extent such dwelling units otherwise qualify under this rule.

(2) *Real estate mortgage investment conduits (REMICs).*

[Reserved pending responses received on the questions contained in the preamble].

(3) *Risk-sharing.* Mortgage purchases under risk-sharing arrangements between the GSEs and the Department or any other Federal agency under which the GSE and the agency acquire mortgages and share the risk associated with such acquisition shall count toward achievement of the housing goals on a partial credit basis equal to the percentage of risk that the GSE takes under the risk-sharing arrangement multiplied by the number of dwelling units that would have counted toward the goal(s) if the GSE had purchased all of the mortgages. In calculating performance under the housing goals, the denominator shall include the number of dwelling units included in the risk-sharing arrangement multiplied by the percentage of risk that the GSE takes under the arrangement. The GSE shall provide a certification to the Secretary stating the actual percentage of risk to the GSE for each risk-sharing arrangement and explain how that percentage was calculated; that percentage of risk shall be used to count toward achievement of the housing goals.

(4) *Participations.* Participations purchased by a GSE shall receive partial credit toward achievement of the housing goals equivalent to the percentage of the mortgage that the GSE purchases.

(5) *Cooperative housing.* (i) For purposes of counting a GSE's purchase of a mortgage on a cooperative housing unit (''a share loan'') toward achievement of any of the housing goals, such a purchase is counted 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'') 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) shall count toward achievement of the housing goals.

(6) *Seasoned mortgages.* A GSE's purchase of a seasoned mortgage may be treated as a mortgage purchase for purposes of these goals except as provided under the special affordable housing goal and except where the GSE has already counted the mortgages under a housing goal applicable to 1993 or any subsequent year. For seasoned, single family mortgages that are more than 3 years old when purchased by a GSE, the affordability of the housing must be determined based on income and/or rent level information at the time of purchase by the GSE. For multifamily dwelling units, a seasoned, multifamily mortgage will be counted toward achievement of the housing goals based on rental information and area median income as of the time that the GSE purchases the mortgage.

(7) *Purchase of refinanced mortgages.* The purchase of a refinanced mortgage by a GSE shall count toward achievement of the housing goals to the extent the mortgage qualifies, except to the extent that the specific restrictions under the special affordable housing goal apply.

(8) *Second mortgages.* [Reserved pending responses received on the questions contained in the preamble].

§ 81.17 Income level definitions for owner-occupied units, actual tenants, and prospective tenants (if family size is known).

In determining whether a dwelling unit is affordable to very low-, low-, or moderate-income families, where (for rental housing) family size is known, 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 Income level definitions for prospective tenants (if family size is not known).

In determining whether a rental dwelling unit is affordable to very low-, low-, or moderate-income families and counts toward achievement of one or more of these goals, the income of the prospective tenants shall be adjusted for family size. If family size is not known, income will be adjusted using unit size:

(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 Rent level definitions for tenants (if income is not known).

For purposes of determining whether a rental dwelling unit is affordable to very low-, low-, or moderate-income families, where the income of the family in the dwelling unit is not known, 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, it shall be assumed that such units are efficiencies.

§ 81.20 Actions to be taken to meet the goals.

To meet the goals established in this rule, each GSE shall:

(a) Design programs and products that facilitate the use of assistance provided by the Federal, State, and local governments;

(b) Develop relationships with nonprofit and for-profit organizations that develop and finance housing and with State and local governments, including housing finance agencies;

(c) Develop the institutional capacity to help finance low- and moderate-income housing, including housing for first-time home buyers; and

(d) (1) Take affirmative steps to assist:

(i) Primary lenders to make housing credit available in areas with concentrations of low-income and minority families; and

(ii) Insured depository institutions to meet their obligations under the Community Reinvestment Act of 1977.

(2) The steps under paragraph (d)(1) of this section shall include developing appropriate and prudent underwriting standards, business practices, repurchase requirements, pricing, fees, and procedures.

§ 81.21 Notice and determination of failure to meet goals.

(a) *Notice.* If, based on a GSE's reports or other data available to the Secretary, the Secretary determines that the GSE has failed or there is a substantial probability that the GSE will fail to meet any housing goal, the Secretary shall, by written notice to the GSE, issue to the GSE a preliminary determination notice that shall propose to require the GSE to submit a housing plan. Such notice shall include:

(1) The preliminary determination;

(2) The reasons for the determination;

(3) The information on which the Secretary based the determination; and

(4) The proposal to require the GSE to submit a housing plan.

(b) *Response period.*—(1) *In general.* The GSE shall have 30 days from the date of the preliminary determination notice (''response period'') to submit any written information that the GSE considers appropriate for consideration by the Secretary in determining whether:

(i) The GSE has failed to meet the housing goal;

(ii) A substantial probability exists that the GSE will fail to meet any housing goal; or

(iii) Whether achievement of the relevant housing goal was or is feasible.

(2) *Extended period.* If the Secretary determines that good cause exists for extending the response period, the Secretary may extend the response period for up to 30 days.

(3) *Shortened period.* If the Secretary determines that good cause exists for shortening the response period, the Secretary may shorten the response period.

(4) *Waiver of right to comment.* The GSE's failure to provide any written information during the response period (as extended or shortened, if applicable) shall constitute a waiver of any right of the GSE to comment on the determination or the action of the Secretary on the matters addressed in the notice.

(c) *Consideration of information and final determination.* After the expiration of the response period or upon receipt of the GSE's response, whichever occurs first, the Secretary shall consider the GSE's response to the preliminary notice, if any, and finally determine, in writing, whether:

(1) The GSE has failed or there is a substantial probability that the GSE will fail to meet the relevant housing goal; and

(2) Considering market and economic conditions and the GSE's financial condition, the achievement of the housing goals was or is feasible.

(d) *Notice to Congress.* (1) The Secretary shall provide written notice, including the Secretary's response to any information submitted by the GSE during the response period, of:

(i) Each determination that the GSE has failed, or that there is a substantial probability that the GSE will fail, to meet a housing goal;

(ii) Each determination that the achievement of a housing goal was or is feasible; and

(iii) The reasons for each such determination.

(2) The Secretary shall provide such notice to the GSE; the Committee on Banking and Financial Services of the House of Representatives; and the Committee on Banking, Housing, and Urban Affairs of the Senate.

§ 81.22 Housing plans.

(a) If the Secretary determines, under § 81.21(c), 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 provide notice to the GSE requiring 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 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 paragraph (a) of this section. 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.*—(1) *Standard.* The Secretary shall approve a housing plan if the Secretary determines that the plan:

(i) Is likely to succeed; and

(ii) Conforms with the appropriate GSE's Charter Act, the Act, and any other applicable laws and regulations.

(2) *Time period.* The Secretary shall review each housing plan and approve or disapprove the plan within 30 days of the Secretary's receipt of the plan. The Secretary may extend this period for one 30-day period if the Secretary determines such an extension is necessary and shall provide written notice to the GSE of such extension.

(3) *Notice to the GSE.* The Secretary shall provide written notice to the GSE of the approval or disapproval of a housing plan. If the Secretary disapproves a housing plan, the notice shall include the reasons for disapproval.

(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.

(a) *Authority.* This subpart is authorized under sections 1321, 1325, and 1327 of the Act; 309(n)(2)(G) of the Fannie Mae Charter Act; 307(f)(2)(G) of the Freddie Mac Act; and the Fair Housing Act (42 U.S.C. 3601–3619).

(b) *Scope.* The Act requires the Secretary, by regulation, to: Prohibit 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; require that the GSEs submit information to the Secretary to assist Fair Housing Act and Equal Credit Opportunity Act investigations; advise the GSEs of Fair Housing Act and ECOA violations; review the GSEs' underwriting and appraisal guidelines to ensure compliance with the Fair Housing Act; and require that the GSEs take actions as directed by the Secretary following Fair Housing Act and ECOA adjudications. The Act provides, generally, that the Director of OFHEO shall enforce violations by the GSEs of FHEFSSA and regulations in this subpart. This subpart establishes requirements implementing the Secretary's authority and provides for referral of cases to the Director.

§ 81.42 Prohibitions against discrimination.

(a) *General.* 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.

(b) *Bases.* In following the prohibition in paragraph (a) of this section, the GSEs shall not discriminate based on:

(1) The race, color, religion, sex, handicap, familial status, age or national origin of:

(i) The borrower or joint borrower, or applicant or joint applicant;

(ii) Any persons associated with the borrower or joint borrower, or applicant or joint applicant in connection with such mortgage or the purposes thereof;

(iii) The present or prospective owners, lessees, tenants, or occupants of the dwelling or dwellings securing such mortgage; or

(iv) Persons in neighborhoods or communities in which properties secured by mortgages are located; or

(2) The age or location of the dwelling securing the mortgage or the age of the neighborhood or census tract where the dwelling is located or the housing stock in such neighborhood or census tract in a manner that has a discriminatory effect.

(c) *Liability.* Each GSE shall be liable for violations of this subpart that it or its officers, agents, or employees commit.

(d) *Exemptions.* Notwithstanding the prohibitions of paragraphs (a) and (b) of this section:

(1) Certain factors concerning the age and location of a dwelling, or the area in which the dwelling is located, properly may be considered.

(i) The age of the dwelling may be properly considered in the appraisal and underwriting process:

(A) To select comparable properties that have been sold or listed recently in the neighborhood for an appraisal; and

(B) As a basis for conducting more extensive inspections of structural aspects of the dwelling. The structural soundness of a dwelling rather than its age may be considered in appraisal and other aspects of the underwriting process.

(ii) Certain location factors that may have a negative effect on a dwelling's value may be properly considered in an appraisal and in other aspects of the underwriting process. These factors include recent zoning changes, the number of abandoned homes in the immediate vicinity of the property, the condition of streets, parks and recreation areas, availability of public utilities and municipal services, and exposure to flooding, land faults, and other natural or human-made environmental hazards. Such factors, if used, must be specifically documented in the appraisal. Location factors may be used to select comparable properties that have been sold or listed recently in the neighborhood for an appraisal.

(2) This section does not prevent consideration of factors justified by business necessity, including requirements of Federal law, relating to a transaction's financial security or to protection against default or reduction of the value of the security. However, where such factors have a disparate result on the basis 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, as set forth in paragraph (b) of this section, the factors cannot be considered unless they both are justified by business necessity and no less discriminatory alternative to such factors exists.

(3) Age of the borrower or co-borrower may be considered in the underwriting process when required by statute, including the age requirements for Home Equity Conversion Mortgages (HECMs), 12 U.S.C. 1715z–20.

(e) *Business Practices Analysis.* Within ____ days of the effective date of this part, and thereafter periodically as requested by the Secretary, each GSE shall complete a Business Practices Analysis.

(1) Each Business Practices Analysis shall include a complete review of the GSE's business practices respecting the purchase of mortgages, including, without limitation, its underwriting guidelines and appraisal standards, repurchase requirements, pricing criteria, fees, and other procedures and practices affecting mortgage purchases that lead or could lead to discrimination 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. The purpose of the analysis is to determine whether any such business practices yield disparate results 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, and whether such disparate results are justified by business necessity.

(2) Within ____ days after the effective date of this part, each GSE shall submit for the Secretary's review and comment a detailed outline and methodology for its Business Practices Analysis. Within ____ days following receipt of the outline and methodology, the Secretary will respond with comments, if any.

(3) Following completion of its Business Practices Analysis, each GSE shall report the results of the analysis to the Secretary. If a Business Practices Analysis identifies practices yielding disparate results affecting the protected classes under this subpart, the GSE must:

(i) Set forth fully the basis for the GSE's conclusion that a business necessity exists for the practice;

(ii) Present plans to end the practice; or

(iii) Report that the practice has ended.

§ 81.43 Review of underwriting guidelines.

(a) Each GSE shall analyze its underwriting and appraisal guidelines to determine whether such guidelines comply with the Fair Housing Act, the regulations promulgated thereunder, section 1325 of the Act, and this subpart including whether any of the guidelines are discriminatory on the basis 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. Following the analysis, the GSE shall provide to the Secretary a full report on the analysis, including, without limitation, a description of remedies or plans to address any problems reported.

(b) Each GSE shall undertake its first review and analysis of its underwriting and appraisal guidelines as part of its Business Practices Analysis under § 81.42. Thereafter, each GSE shall conduct such a review and analysis periodically as requested by the Secretary.

(c) The Secretary shall review and comment on each report. The Secretary's comments shall specify any guidelines which are, in the Secretary's judgment, inconsistent with the Fair Housing Act or ECOA.

(d) *Revisions to underwriting guidelines.* Each time a GSE revises its underwriting or appraisal guidelines, the GSE shall submit a copy of the revision to the Secretary and a certification by the GSE that after reasonable evaluation and analysis, the GSE has determined in good faith that, to the best of its knowledge, the change does not and will not be discriminatory on the basis of race, color, religion, sex, handicap, familial status, age, or national origin, including any consideration of age or location of a dwelling, or age of a neighborhood or census tract where the dwelling is located in a manner that has a discriminatory effect. To the extent that a revision has or will have disparate results on protected classes under this subpart, the GSE must set forth fully the basis for the GSE's conclusion that a business necessity exists for the practice. The Secretary may review and comment on such changes after they are implemented.

(e) *Additional requests for review.* The GSEs shall, at such times as requested by the Secretary, submit underwriting and appraisal guidelines to the Secretary for the Secretary's review and comment.

(f) *Day-to-day operations.* Review of the GSEs' underwriting and appraisal guidelines and revisions thereto shall not involve the Secretary in the day-to-day operations of the GSEs. The Secretary shall review underwriting guidelines to ensure compliance with the Fair Housing Act, the regulations promulgated thereunder, section 1325 of the Act, and this subpart.

§ 81.44 Submission of information to the Secretary.

(a) *General.* 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. Other Federal agencies responsible for the enforcement of ECOA may submit requests for information through the Secretary or directly to the GSEs. Requested information may include, without limitation, information on mortgages sold by the lender or lenders under investigation to the GSE, 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.

(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. Such information may include, without limitation, comparing the loans purchased by the GSE from a particular lender to data on the racial composition of census tract(s) or providing data on loans sold to the GSE by lenders operating in the same geographical area.

(3) *Information available to a GSE.* Whenever a GSE knows of information relevant to a potential violation of the Fair Housing Act or the Equal Credit Opportunity Act by a particular lender or lenders, the GSE shall report such information to the Secretary.

(4) A GSE receiving any request(s) for information under this subsection shall reply in a complete and timely manner with any and all information that it possesses that is responsive to the request.

(c) *ECOA.* The Secretary shall submit any information received under paragraph (b) of this section concerning compliance with the Equal Credit Opportunity Act to appropriate Federal agencies responsible for ECOA enforcement, as provided in section 704 of ECOA.

(d) *Other assistance.* The GSEs shall, at the request of the Secretary or an official responsible for enforcing ECOA, provide other assistance to the Secretary or other officials in investigating and enforcing Fair Housing Act or ECOA violations. Such assistance may include providing additional relevant materials and testimony concerning information or data produced by the GSE.

§ 81.45 Submission of information to the GSEs.

(a) *Obtaining and disseminating information.* 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, the Equal Credit Opportunity Act, and/or State or local fair housing/lending laws, and make such information available to the GSEs as the Secretary deems appropriate in accordance with applicable law, memoranda of understanding, and other arrangements between the Secretary and Federal financial regulators and other agencies.

(b) *Permissible action.* The GSEs may take appropriate action under their procedures based on such information. Such violations may constitute violations of the GSEs' underwriting guidelines and representations or certifications of lenders.

§ 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 and 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 means a reprimand, probation, temporary suspension, indefinite suspension, or other remedial action.

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) When a charge is issued against a lender for violating the Fair Housing Act or ECOA, the Secretary will notify each GSE. Such notice will inform the GSE of the facts and that the GSE may take action under its procedures.

(2) 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.

(3) Following a final determination sustaining a charge against a lender for violating the Fair Housing Act or ECOA in accordance with paragraph (c)(2) of this section, the Secretary shall determine the remedial action(s) that the GSE is to be directed to take for such violation.

(4) 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). In determining what action(s) to direct, the Secretary in addition will also, without limitation, consider the following:

(i) The gravity of the violation;

(ii) If a judgment by an Administrative Law Judge or a court has previously been rendered against the lender for discriminatory actions, the lender's response to that judgment, including the actions taken and the timeliness of such actions;

(iii) The nature and extent of cases under substantially equivalent State or local laws, or ECOA against the lender including cases which were settled, conciliated, or otherwise resolved;

(iv) The nature and extent of fair housing enforcement actions or judgments by HUD, the Department of Justice, or other regulatory agencies, including cases that were settled or otherwise resolved;

(v) The nature and extent of private fair housing lawsuits and judgments against the lender including cases that were settled, conciliated, or otherwise resolved;

(vi) Whether the lender's actions demonstrate a discriminatory pattern or practice or an individual instance of discrimination;

(vii) The impact or seriousness of the harm;

(viii) The number of people affected by the discriminatory act(s);

(ix) Whether the lender operates an effective program of self assessment and correction;

(x) The extent of any actions or programs by the lender designed to compensate victims and prevent future fair lending violations;

(xi) The effect of the contemplated action(s) on the safety and soundness of the lender (in considering this factor the Secretary shall solicit and fully consider the views of the regulator responsible for regulating the lender and, where warranted, the Director); and

(xii) 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 receipt of the Notice, by filing a request with the Docket Clerk, HUD Administrative Law Judge (ALJ).

(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 ALJ and a final decision rendered in accordance with the procedures set forth in 24 CFR 30.10, 30.15, and part 30, subpart E, to the extent such provisions are not inconsistent with this subpart or the Act. 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 the Department 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 the Department 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) The Act empowers the Director of the Office of Federal Housing Enterprise Oversight to initiate enforcement actions for GSE violations of the provisions of section 1325 of the Act and these regulations. The Secretary shall refer violations and potential violations of section 1325 and these regulations 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.

Sections 305(c) of the Freddie Mac Act and 302(b)(6) of the Fannie Mae Act provide that neither GSE may implement any new program before obtaining the approval of the Secretary under section 1322 of the Act. Section 1322(a) provides that the Secretary shall require each GSE to obtain the Secretary's approval before implementing any new program. 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.

(b) Submission of a program request and Secretarial review 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 (hereinafter an ''approved program''); or

(2) A program that was engaged in by the GSE prior to October 28, 1992, the date of enactment of FHEFSSA (hereinafter an ''authorized program'').

(c) Section 1303(13) of FHEFSSA approves all authorized programs.

(d) Approved programs remain subject to all limitations and requirements under which such programs were being operated by the GSEs on or before October 28, 1992.

(e) *Significantly different programs.* (1) A significantly different program of a GSE is a program that materially differs from approved or authorized programs of the GSE by:

(i) Entailing substantially greater risk than the average financial risks under approved or authorized programs; or

(ii) Substantially expanding the GSE's role in the housing markets by involving new categories of borrowers, properties or other securities, borrowing purposes, or credit enhancements.

(2) Where a planned program reasonably raises questions as to whether it is significantly different from existing programs, the GSE shall submit a program request and may indicate in

its request its views respecting whether the program is subject to the Secretary's review.

(3) New activities that are designed to refine approved or authorized programs by repackaging features of those programs, making technical improvements, or creating other non-material variations are not new programs.

(f) *Requests by the Secretary.* If a GSE does not submit a program request for a program, the Secretary may request information about a 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, Financial Institutions Regulation, U.S. Department of Housing and Urban Development, Washington, D.C. For those requests submitted prior to the date occurring one year after the effective date of the regulations issued by the Director of OFHEO under section 1361(e) of FHEFSSA establishing the risk-based capital test, 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));

(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 before the date occurring one year after the effective date of the regulations issued by the Director under section 1361(e) of FHEFSSA establishing the risk-based capital test, the Director shall review the program request.

(d) *Transition standard for approval by the Secretary and the Director.* Program requests submitted by the GSEs before the date occurring one year after the effective date of the regulations issued by the Director under section 1361(e) of FHEFSSA establishing the risk-based capital test shall be approved by the Secretary unless:

(1) The Secretary determines that the new program is not authorized, for a Freddie Mac program, under sections 305(a) (1), (4), or (5) of the Freddie Mac Act, or, for a Fannie Mae program, sections 302(b) (2)–(5) of the Fannie Mae Charter Act;

(2) The Secretary determines that such program is not in the public interest; or

(3) The Director determines that such program would risk significant deterioration of the GSE's financial condition.

(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 section 1361(e) of FHEFSSA establishing the risk-based capital test shall be approved by the Secretary unless:

(1) The Secretary determines that the new program is not authorized, for a Freddie Mac program, under sections 305(a) (1), (4), or (5) of the Freddie Mac Act, or, for a Fannie Mae program, 302(b) (2)–(5) of the Fannie Mae Charter Act; or

(2) The Secretary determines that the program is not in the public interest.

(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, Financial Institutions Regulation and, where applicable, the Director of OFHEO. If within 45 days after receiving a request, the Secretary and/or the Director of OFHEO determine that additional information is necessary to review the matter and request such information from the GSE, the time period for consideration may be extended 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 of receipt of 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 Congress under paragraph (g) of this section.

(g) *Approval or report.* Within the 45-day period or, if the period is extended, within 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 the time period allowed, the GSE's program request will be deemed approved.

§ 81.54 Review of disapproval.

(a) *Programs disapproved as unauthorized.* Where the Secretary disapproves a program request on the grounds that the new program is not authorized under sections 305(a) (1), (4), or (5) of the Freddie Mac Act, or 302(b) (2)–(5) of the Fannie Mae Charter Act, 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; and/or a meeting with the Secretary or the Secretary's designee. If the request for either is timely, the Secretary shall grant the request.

(1) *Supplementing the record.* A GSE seeking to supplement the record in writing must submit written materials within 30 days after the request to supplement is granted.

(2) *Meeting.* Upon receipt of a timely request from a GSE for a meeting, the Secretary shall arrange such a meeting which shall be conducted by the Secretary or the Secretary's designee within 10 business days of receipt of the request. Such a meeting shall not be on the record and formal rules of procedure shall not apply. The GSE may be represented by counsel and may present all relevant information and materials to the Secretary or the Secretary's designee.

(3) *Determination.* Within 10 days after submission of the information and materials presented in writing or a meeting, the Secretary shall in writing withdraw, modify, or affirm the program disapproval and shall provide the GSE with that decision.

(b) *Program disproved under public interest determination.* Where a program request is disapproved because the Secretary determines that the program is not in the public interest or because the Director determined that the new program would risk significant deterioration of the GSE's financial condition, the Secretary shall provide the GSE with notice of, and an 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 Report to Congress under § 81.53(g). The procedures for such hearings are provided in subpart G of this part.

Subpart E—Reporting Requirements

§ 81.61 General.

Sections 309(m) of the Fannie Mae Charter Act and 307(e) of the Freddie Mac Act require each GSE to collect, maintain, and provide to the Secretary data, in a form determined by the Secretary, on each single family and multifamily mortgage purchased by each GSE. Sections 309(n) of the Fannie Mae Charter Act and 307(f) of the Freddie Mac Act require each GSE to report on its housing activities under the housing provisions of the Act to the Committee on Banking, Finance and Urban Affairs of the House of Representatives, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Secretary. Section 1327 of the Act provides that the Secretary shall require reports from the GSEs as the Secretary considers appropriate, and section 1328 requires the Secretary to submit an annual report to the Congress on the activities of the GSEs. This subpart establishes quarterly and annual data submission and reporting requirements to carry out the requirements of the GSEs' Charter Acts and FHEFSSA.

§ 81.62 Mortgage data.

(a) *Required data.* Under sections 309(m) of the Fannie Mae Charter Act and 307(e) of the Freddie Mac Act, the GSEs are required to provide the Secretary with the following data relating to mortgage purchases:

(1) *For single family mortgages:*

(i) The income, census tract location, race, and gender of mortgagors under such mortgages;

(ii) The loan-to-value ratios of purchased mortgages at the time of origination;

(iii) Whether a particular mortgage purchased is newly originated or seasoned;

(iv) The number of units in the housing subject to the mortgage and whether the units are owner-occupied; and

(v) Any other characteristics that the Secretary considers appropriate and to the extent practicable.

(2) *For multifamily mortgages:*

(i) Census tract location of housing;

(ii) Income levels and characteristics of tenants (where such data is available);

(iii) Rent levels for units in the housing;

(iv) Mortgage characteristics (such as the number of units financed per mortgage and the amount of loans);

(v) Mortgagor characteristics (such as nonprofit, for-profit, limited equity cooperative);

(vi) Use of funds such as new construction, rehabilitation, refinancing);

(vii) Type of originating institution; and

(viii) Any other information that the Secretary considers appropriate, to the extent practicable.

(b) *Data elements and aggregated data.* To implement the data collection and submission requirements for mortgage data under paragraph (a) of this section, each GSE shall collect and compile computerized loan level data on each mortgage purchased. Appendix D of this part details the loan level data.

(c) *Mortgage reports.* Each GSE shall submit to the Secretary quarterly a Mortgage Report consisting of the loan level data compiled under paragraph (b) of this section. Such data shall be aggregated and the mortgage reports shall include the dollar volume, the number of units, and the number of mortgages on owner-occupied and rental properties purchased by the GSE that do and do not qualify under each housing goal and subgoal as set forth in this part and aggregations of the data in the formats specified, in writing, by the Secretary. The GSEs shall submit the Mortgage Report for each of the first three quarters within 60 days of the end of the quarter, and each Mortgage Report shall provide data on both a quarterly and a year-to-date basis. Any time prior to submission of the Annual Housing Activities Report, the GSE may revise any of the quarterly reports for that year. The GSEs shall submit to the Secretary computer-generated data included in the Mortgage Report in the format specified by the Secretary.

§ 81.63 Annual Housing Activities Report.

(a) *General.* Sections 309(n) of the Fannie Mae Charter Act and 307(f) of the Freddie Mac Act require each GSE to report annually to the Secretary and to the Congress concerning its housing activities under the housing goal provisions of FHEFSSA. Under the Act, the report must include:

(1) In aggregate form and by appropriate category:

(i) The dollar volume and number of mortgages on owner-occupied and rental properties that relate to each of the housing goals;

(ii) The number of families served by the GSE; the income class, race, and gender of home buyers served; the income class of tenants of rental housing (to the extent such information is available); the characteristics of census tracts; and the geographic distribution of the housing financed;

(2) The extent to which the mortgages purchased by the GSE have been used in conjunction with public subsidy programs;

(3) Information on the proportion of mortgages purchased by the GSE and financing housing for first-time home buyers;

(4) In aggregate form and by appropriate category the mortgage data required under § 81.62 for the year;

(5) A comparison of the level of securitization by the GSE versus portfolio activity by the GSE;

(6) An assessment of the GSE's 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 of the borrower, including revisions thereto to promote affordable housing or fair lending;

(7) A description of trends in both the primary and secondary multifamily markets, including a description of progress made and any factors impeding progress toward the standardization and securitization of mortgage products for multifamily housing;

(8) A description of trends in the delinquency and default rates for mortgages secured by housing for low- and moderate-income families bought by the GSE, a comparison of these rates with rates for families above median income, and an evaluation of the impact of such trends on the standards and levels of risk of mortgage products serving low- and moderate-income families;

(9) A description of the seller servicing network of the GSE, including the volume of mortgages purchased from minority-owned, women-owned and community-oriented lenders and a description of the GSE's efforts to facilitate relationships with such lenders;

(10) A description of the activities undertaken by the GSE with nonprofit and for-profit organizations and with State and local governments and housing finance agencies, including activities supporting comprehensive housing affordability strategies under section 105 of the Cranston-Gonzalez National Affordable Housing Act; and

(11) Other information that the Secretary considers appropriate.

(b) To implement the requirements in paragraph (a) of this section and to assist the Secretary in preparing the Secretary's Annual Report to the

Congress, each GSE shall submit to the Secretary an Annual Housing Activities Report including the information in paragraph (a) of this section and mortgage year-to-date data as specified, in writing, by the Secretary. Each GSE shall submit such report, within 60 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 Annual Housing Activities Report available to the public at its principal and regional offices. Before making such reports available to the public, the GSE may exclude from the report any information that the Secretary has deemed proprietary.

(c) Subpart C of this part requires each GSE to submit Business Practices Analyses. To the extent such a Business Practices Analysis encompasses the information required under paragraph (a)(6) of this section, and where the GSE has conducted such a Business Practices Analysis within the preceding three years, the GSE may, in connection with meeting the requirements of paragraph (a)(6) of this section, reference such Analysis and use the Annual Housing Activities Report to update the GSE's progress concerning the GSE's most recent Business Practices Analysis.

§ 81.64 Periodic reports.

Each GSE shall provide to the Secretary all releases of information that are disclosed to entities outside of the GSE, at the time such information is disclosed, including, but not limited to:

(a) Material prepared for the GSE's Housing Advisory Council;

(b) Press releases;

(c) Investor reports; and

(d) Proxy statements.

§ 81.65 Other information and analyses.

In addition to the regular reports required under this subpart, the GSEs shall furnish to the Secretary the data underlying the reports required under this subpart and conduct additional analyses, as required by the Secretary. The GSEs shall submit additional reports concerning their activities, as the Secretary considers appropriate and requests.

§ 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, Financial Institutions Regulation Staff, Department of Housing and Urban Development, 451 7th Street, SW. Washington, DC. 20410. Each GSE shall submit computerized data, reports, and information required under this subpart to the Director, Financial Institutions Regulations Staff.

Subpart F—Access to Information

§ 81.71 General.

This subpart provides for the establishment of a public use data base to make available to the public mortgage data that the GSEs are required to submit to the Secretary under section 309(m) of the Fannie Mae Charter Act, section 307(e) of the Freddie Mac Act, and subpart E of this part. The Act provides that proprietary information and data may not be made publicly available. This subpart establishes mechanisms for the GSEs to designate information as proprietary and for the Secretary to determine whether information is proprietary and to withhold such proprietary information from the public. This subpart provides procedures for disclosure of information submitted by or relating to the GSEs under the Freedom of Information Act or at the request of Congress and sets forth protections for treatment of GSE information by the Secretary, Departmental officers and employees, and contractors. This subpart provides that 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 data base and public information.

(a) *General.* The Secretary shall establish and make available for public use, in accordance with this section, a public use data base and shall make available for public inspection and copying the GSE's Annual Housing Activities Reports, except for information the Secretary determines to be proprietary.

(b) *Examination of submissions.* Following receipt of mortgage data and Annual Housing Activity Reports from the GSEs and any other information submissions from the GSEs, the Secretary shall, as expeditiously as possible, examine the submissions for information that:

(1) Has been deemed proprietary under this part or subsequent order;

(2) The GSE has designated as proprietary in accordance with § 81.73;

(3) Would constitute a clearly unwarranted invasion of personal privacy if such information were released to the public; or

(4) Is required to be withheld under applicable laws or regulations.

(c) *Public data and proprietary data.* The Secretary shall exclude from the public use data base and from public disclosure all information within the scope of paragraphs (b)(1), (b)(3), and (b)(4) of this section and, following a determination under § 81.74, concerning data identified by the GSE as proprietary, the Secretary shall place all public data in the public use data base.

(d) *Access.* The Secretary shall provide such means as the Secretary determines are reasonable for the public to gain access to the public use data base. To obtain access to the public use data base, the public should contact the Director, Financial Institutions Regulation, 451 7th St. SW. Washington, DC. 20410, (202) 708–1464 (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 data base. 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 data and information submitted to the Secretary. Such a request does not in any manner affect the GSE's responsibility to provide the information to the Secretary.

(b) *Request for proprietary treatment.* Where a GSE seeks to have information treated as proprietary information by the Secretary and withheld from public disclosure, the GSE shall submit a Request for Proprietary Treatment that shall:

(1) Clearly designate those portions of the 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 each page. If such marking is impractical under the circumstances, the GSE shall attach a cover sheet prominently marked ''Proprietary Information—Confidential Treatment Requested by (name of GSE)'' to the information for which confidential treatment is requested;

(2) Accompany its request with a certification by an officer or authorized representative of the GSE that the information is proprietary;

(3) Submit a statement explaining the reasons for the assertion that the information is proprietary, including without limitation:

(i) A description of the information; the nature of the adverse consequences to the GSE, financial or otherwise, that would result from its disclosure and the reasons therefor, including any adverse effect on the GSE's competitive position. Conclusory statements that particular information would be useful to competitors or would impair business dealings, or similar statements, ordinarily will not be considered sufficient to justify a determination that the information is proprietary;

(ii) The existence and applicability of any prior determinations by the Department, other Federal agencies, or a court, concerning similar information;

(iii) The measures taken by the GSE to protect the confidentiality of the information in question and of similar information prior to and after its submission to the Secretary;

(iv) The extent to which the information is publicly available from other entities, such as information available to the public through local government offices or records, including deeds, recorded mortgages, and similar documents;

(v) The difficulty of a competitor, including a seller/servicer, obtaining or compiling the information; and

(vi) Such additional facts and such legal and other authorities as the GSE may consider appropriate.

§ 81.74 Secretarial determination on GSE request.

(a) *General.* The Secretary shall review Requests for Proprietary Treatment from the GSEs and other information, if any, that the Secretary may elicit from other sources. The Secretary shall determine whether the information designated as proprietary by the GSE is proprietary information, or whether the information is not proprietary and should be released notwithstanding the GSE's request. During the time a request is pending determination by the Secretary, information submitted by the GSE that is the subject of such request shall not be disclosed to, or subject to the examination of data by, the public or any person or representative of any person or agency outside of HUD.

(b) *Determination to withhold.* (1) Where the Secretary determines that information is proprietary, the Secretary shall notify the GSE that the request has been granted and may, in the discretion of the Secretary, issue a temporary order, a final order or a regulation providing that the information is not subject to public disclosure. Where the Secretary determines that information is proprietary, the Secretary shall not make such information publicly available.

(2) 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 an order that would reveal the proprietary information shall be withheld from public disclosure.

(3) Publications of temporary orders shall invite public comments where feasible.

(c) *Determination not to withhold or to seek further information.* Where the Secretary determines, in response to a Request for Proprietary Treatment, that information submitted by the GSE may not be proprietary information, that the request may only be granted 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 departmental officers or employees to discuss the matter, for the purpose of gaining additional information concerning the request. Such meetings shall be informal and not on the record;

(2) Following the meeting, based on the Secretary's review of the information and the GSE's views as to whether the information is proprietary, the Secretary shall make a determination;

(3) If the Secretary determines to withhold the information as proprietary, the procedures in paragraph (b) of this section shall apply; and

(4) If the Secretary determines that any information covered by the request is not proprietary, the Secretary shall provide notice in writing to the GSE of the reasons for this conclusion, and such notice shall provide that the Secretary shall not release the information to the public for 7 days.

§ 81.75 Mortgage data withheld by order and regulation.

(a) *List of withheld data.* Appendix E of this part shall include a list and appropriately identify those categories of mortgage data (''data elements'') that the GSEs submit under sections 309(m) of the Fannie Mae Charter Act and 307(e) of the Freddie Mac Act, and that are determined to be proprietary information. Appendix E shall identify the reasons data elements have been withheld.

(b) *Updating of list.* Following issuance of regulations or orders to withhold mortgage data, the Secretary shall expeditiously update Appendix E where needed to inform the public of any modifications to the list of proprietary information.

§ 81.76 Requests for GSE Information.

(a) *General.* Information submitted to the Secretary by the GSEs is subject to request under the Freedom of Information Act (FOIA), 5 U.S.C. 552. The Department shall process such FOIA requests in accordance with the Department's FOIA and Privacy Act regulations, 24 CFR parts 15 and 16, and other applicable statutes, regulations, and guidelines, including the Trade Secrets Act, 18 U.S.C. 1905, and Executive Order 12,600.

(b) *Protection from disclosure.* In responding to requests for information submitted by or relating to the GSEs, the Secretary may invoke provisions of the Freedom of Information Act and FHEFSSA to protect information from disclosure.

(1) *Exemption (b)(8).* Under section 1319F of the Act, the Secretary may invoke FOIA exemption (b)(8) to withhold from the public any GSE information contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of HUD.

(2) *Other FOIA exemptions.* Under 24 CFR part 15, the Secretary may invoke other exemptions including, without limitation, exemption 4 (5 U.S.C. 552(b)(4)), to withhold from public disclosure confidential GSE business information, and exemption 6 (5 U.S.C. 552(b)(6)), to protect information that would constitute a clearly unwarranted invasion of personal privacy.

(c) *Requests for business information under Executive Order 12600.* The Department 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 12600. Under these procedures, the Secretary will not release records marked by the GSE as proprietary or records that are reasonably expected to contain proprietary materials, if at all, until the following occurs:

(1) The Secretary notifies the GSE that a request for such records has been received;

(2) The GSE is provided a reasonable opportunity to provide detailed comments on and objections to the release of the records; and

(3) Following receipt of any objection by a GSE, if the Secretary determines not to sustain wholly the objection, the GSE must be notified in writing of the Secretary's determination and given a brief explanation of such decision. The Secretary shall provide such notification enough in advance of a specified disclosure date so that the GSE will have an opportunity to obtain judicial review.

(d) *Release in response to requests on behalf of Congress, the Comptroller*

General, a Subpoena, or Other Legal Process. If the Department receives a request on behalf of a congressional committee or subcommittee, the Comptroller General, or a subpoena from a court of competent jurisdiction, or is otherwise compelled by law to release information determined to be proprietary under this section, the Secretary shall provide the information in accordance with the request without regard to the provisions of this section. In releasing requested information under this paragraph, the Secretary will, where applicable, include a statement with the information to the effect that the GSE regards the information as proprietary, public disclosure of the information may cause competitive harm to the GSE, and the Secretary has determined that the information is proprietary under this section. To the extent practicable, the Secretary will provide notice to the GSE after a request under this paragraph is received and before the information is provided in response to the request.

§ 81.77 Protection of GSE Information.

(a) *Protection of information by officers and employees.* The Secretary will institute all reasonable safeguards to protect GSE information, including, but not limited to, advising all departmental officers and employees having access to information submitted by or pertaining to either GSE of the legal restrictions against unauthorized disclosure of such information under HUD Standards of Conduct regulations, 24 CFR part 0; 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 0 and 5 CFR part 2635 to criminal prosecution.

(b) *Protection of information by contractors.* (1) In relevant contracts and agreements where contractors have access to confidential business information submitted by or pertaining to either GSE, the Department shall include detailed provisions specifying that neither the contractor nor any of its officers, employees, agents, or subcontractors may release data submitted by or pertaining to either GSE without HUD's authorization, and that unauthorized disclosure may be a basis for:

(i) Terminating the contract for default;

(ii) Suspending or debarring the contractor; or

(iii) 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 that the contractor indemnify and hold HUD harmless against unauthorized disclosure of data belonging to the GSEs or HUD.

Subpart G—Procedures for Actions and Review of Actions

§ 81.81 General.

This subpart sets forth procedures for the Secretary to issue cease-and-desist orders and institute civil money penalties to enforce housing goal provisions at subpart C of this part and information submission and reporting requirements under subpart E of this part. The subpart also provides procedures for hearings, enforcement of Secretarial actions, public disclosure of agreements, and judicial review of enforcement actions.

§ 81.82 Cease-and-desist proceedings.

(a) *Issuance.* The Secretary may issue and serve upon a GSE a notice of charges for a cease-and-desist order, in accordance with this section, if the Secretary determines:

(1) The GSE has failed to submit a housing plan that substantially complies with § 81.22 within the applicable period for submission under that section;

(2) The GSE is engaging or has engaged, or the Secretary has reasonable cause to believe that the GSE is about to engage, in any failure to make a good faith effort to comply with a housing plan submitted and approved by the Secretary; or

(3) The GSE has failed to submit any of the information required under sections 309 (m) or (n) of the Fannie Mae Charter Act, or 307 (e) or (f) of the Freddie Mac Act, or under §§ 81.62 or 81.63 of this part.

(b) *Procedure for issuance.*—(1) *Notice of charges.* The Secretary shall notify the GSE in writing of the notice of charges. The notification shall provide:

(i) A concise statement of the facts constituting the conduct upon which the Secretary has relied in determining that an order should be issued and the violations with which the GSE is charged;

(ii) Notice of the GSE's right to a hearing on the record on the cease-and-desist order;

(iii) A time and date for a hearing on the record on whether the order should issue;

(iv) 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.* The hearing and other proceedings conducted under this section shall be presided over by a HUD Administrative Law Judge, in accordance with § 81.84 and 24 CFR 30.10, 30.15, and part 30, subpart E, to the extent such provisions are not inconsistent with any of the procedures in these regulations or the Act.

(3) *Issuance of order.* If the Administrative Law Judge finds, based on the record, that any of the conduct specified in the notice of charges sufficient to sustain the charges has been established by substantial evidence (or a GSE consents to the order), the Administrative Law Judge may issue and serve upon the GSE an order requiring the GSE to:

(i) Submit a housing plan in compliance with § 81.22;

(ii) Comply with the 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 upon the expiration of the 30-day period beginning on the service of the order upon the GSE (except in the case of an order issued upon consent, which shall become effective at the time specified therein), and shall remain effective and enforceable as provided in the order, except to the extent that the Secretary stays, modifies, terminates, or sets aside the order as provided in § 81.84(l).

§ 81.83 Civil money penalties.

(a) *Imposition.* The Secretary may impose a civil money penalty, in accordance with the provisions of this section, on a GSE that has failed:

(1) To submit a housing plan that substantially complies with § 81.22 within the applicable period required under the regulations;

(2) To make a good faith effort to comply with a housing plan for the GSE submitted and approved by the Secretary; or

(3) To submit any of the information required under subsection (m) or (n) of Section 309 of the Fannie Mae Charter Act, under subsection (e) or (f) of section 307 of the Freddie Mac Act, or under §§ 81.62 or 81.63.

(b) *Amount of penalty.* The Secretary shall determine the amount of the penalty, and such 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 (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 give consideration to such factors as:

(1) The gravity of the offense;

(2) Any history of prior offenses;

(3) The GSE's ability to pay the penalty;

(4) The nature of the injury to the public caused by the failure;

(5) The benefits received by the GSE because of the GSE's failure;

(6) Deterrence of future violations that would result from the penalty; and

(7) Other factors that the Secretary determines in the public interest warrant consideration.

(d) *Procedures.*—(1) *Notice of determination to impose civil money penalties.* 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 conduct upon which the Secretary has relied in determining that a civil penalty should be imposed;

(ii) The amount of the civil money penalty that the Secretary intends to impose;

(iii) Notice of the GSE's right to a hearing on the record on the civil money penalty;

(iv) The procedures to follow to obtain such a hearing;

(v) The consequences of failing to request a hearing; and

(vi) The date the penalty shall be due unless stayed or rescinded.

(2) To appeal the Secretary's decision to impose a civil money penalty, a GSE shall, within 20 days after receiving 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) The hearing and other proceedings conducted under this section shall be presided over by a HUD Administrative Law Judge, in accordance with § 81.84 and 24 CFR 30.10, 30.15, and part 30, subpart E, to the extent such provisions are not inconsistent with any of the procedures in these regulations or the Act.

(4) *Issuance of order.* If the Administrative Law Judge finds, on the record made at a hearing, that any conduct specified in the notice of charges has been established by a preponderance of the evidence (or a GSE consents to the order pursuant to § 81.84), the Administrative Law Judge may issue an order imposing a civil money penalty.

(5) *Consultation with the Director.* In the Secretary's discretion, the Director of the Office of Federal Housing Enterprise Oversight may be requested to review any Notice of Intent, determination, order, or interlocutory ruling arising from a hearing.

(e) *Action to collect penalty.* If a GSE fails to comply with an order by the Secretary imposing a civil money penalty under this section, after the order is no longer subject to review as provided by sections 1342 and 1343 of the Act, 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 to obtain a monetary judgment against the GSE and such other relief as may be available. The monetary judgment may, in the court's discretion, include attorney fees and other expenses incurred by the United States in connection with the action. In an action under this subsection, the validity and appropriateness of the order imposing the penalty is not subject to review.

(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.

(g) *Deposit of penalties.* The Secretary shall deposit any civil money penalties collected under this section into the general fund of the Treasury.

§ 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.

(b) *Hearing requirements*—(1) Hearings shall be held on the record and in the District of Columbia.

(2) Hearings shall be conducted by a HUD Administrative Law Judge authorized to conduct proceedings under 24 CFR part 30.

(c) *Timing.* Unless an earlier or later date is requested by a GSE and such request is granted by the Administrative Law Judge, hearings shall be fixed for a date not earlier than 30 days, nor later than 60 days, after: service of the notice of charges under § 81.82; service of the Notice of Intent to Impose Civil Money Penalt(ies) under § 81.83; or 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 part 30, subpart E, to the extent that such provisions are not inconsistent with any of the procedures in these regulations or the Act.

(e) *Method of service.* Any service required or authorized to be made by the Secretary under this subpart may be made to the Chief Executive Officer of a GSE or such other representative as the GSE may designate in writing to the Secretary.

(f) *Subpoena authority*—(1) *General.* In the course of or in connection with any hearing, the Secretary and/or the Administrative Law Judge 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 by the Secretary.

(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 at any designated place where such proceeding is being conducted.

(3) *Enforcement.* The Secretary may request the Attorney General of the United States to bring an action in the United States District Court for the judicial district in which such proceeding is being conducted or where the witness resides or conducts business, or in the United States District Court for the District of Columbia, for enforcement of any subpoena or subpoena duces tecum issued pursuant to this section.

(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. Any court having jurisdiction of any proceeding instituted under this section may allow to any such party such reasonable expenses and attorneys fees as the court deems just and proper. 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.* All hearings shall be open to the public, unless the Secretary, in the Secretary's discretion, determines that holding an open hearing would be contrary to the public interest.

(i) *Decision of Administrative Law Judge.* After each hearing, the Administrative Law Judge shall issue an initial decision and serve the initial decision on the GSE, the Secretary, any other parties, and the General Counsel of the Department.

(j) *Review of initial decision*—(1) *At the Secretary's discretion.* The Secretary, in the Secretary's discretion, may review any initial decision.

(2) *Requested by a party.* Any party may file within 15 days after receipt of the initial decision a notice of appeal to the Secretary seeking review of an initial decision. The Secretary shall decide within 30 days after receipt of a notice of appeal whether to review or to decline review of the initial decision.

(k) *Final decision.* (1) The initial decision will become the final decision of the Department unless the Secretary or the Secretary's designee issues a final decision within 90 days after the initial decision is served on the Secretary. The Secretary by written notice to the parties may extend such 90 day period for an additional 30 days.

(2) *Issuance of final decision by Secretary.* The Secretary or the Secretary's designee may review any finding of fact, conclusion of law, or order contained in the initial decision of the Administrative Law Judge and may issue a final decision in the proceeding. Any decision shall include findings of fact upon which the decision is predicated. The Secretary or the Secretary's designee 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 Administrative Law Judge.

(l) *Decisions on remand.* If the initial decision is remanded for further proceedings, the Administrative Law Judge shall 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.

(m) *Modification.* The Secretary or the Secretary's designee may at any time, modify, terminate, or set aside any order, upon such notice and in such manner as the Secretary or designee considers proper. When a petition for judicial review is timely filed as provided in § 81.87, and after the Secretary has filed the record in the proceeding with the court, the Secretary or designee may modify, terminate, or set aside any such order with permission of the court.

§ 81.85 Public disclosure of final orders and agreements.

(a) *General.* The Secretary shall make available to the public:

(1) Any written agreement or other written statement for which a violation may be redressed by the Secretary, or any modification to or termination of such agreement or statement, unless the Secretary, in the Secretary's discretion, determines that public disclosure would be contrary to the public interest, or determines under paragraph (b) of this section that public disclosure would seriously threaten the GSE's financial health or security;

(2) Any order that is issued with respect to any administrative enforcement proceeding initiated by the Secretary under this subpart and that has become final in accordance with §§ 81.84 and 81.87; and

(3) Any modification to or termination of any final order made public pursuant to this section.

(b) *Delay of public disclosure under exceptional circumstances.* If the Secretary makes a determination in writing that the public disclosure of any final order pursuant to paragraph (a)(1) of this section would seriously threaten a GSE's financial soundness, the Secretary may delay the public disclosure of such order for a reasonable time.

(c) *Documents filed under seal in public enforcement hearings.* The Secretary may file any document or part thereof under seal in any hearing under this subpart if the Secretary determines in writing that disclosure thereof would be contrary to the public interest.

(d) *Retention of documents.* The Secretary shall keep and maintain a record, for not less than 6 years, of all documents described in paragraph (a) of this section and all enforcement agreements and other supervisory actions and supporting documents issued with respect to, or in connection with, any enforcement proceeding initiated by the Secretary under this subpart.

(e) *Disclosures to Congress.* This section shall not be construed to authorize the withholding, or to prohibit the disclosure, of any information to the Congress or any committee or subcommittee thereof.

§ 81.86 Enforcement and jurisdiction.

(a) *Enforcement.* 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 court has the jurisdiction and power to order and require compliance with such notice or order.

(b) *Limitation on jurisdiction.* Except as otherwise provided in sections 1341–49 of the Act, no court has jurisdiction to affect, by injunction or otherwise, the issuance or enforcement of any notice or order under §§ 81.82 or 81.83, or to review, modify, suspend, terminate, or set aside any such notice or order.

(c) *Other relief.* The Secretary may obtain such other relief as may be available, including attorney fees and other expenses, in connection with the action.

(d) *Interest.* In the case of civil money penalties, interest on and other charges for any unpaid penalty may be assessed in accordance with 31 U.S.C. 3717.

§ 81.87 Judicial review.

(a) *Commencement.* A GSE 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. The clerk of the court shall transmit a copy of the petition to the Secretary and the Chief Docket Clerk, Office of Administrative Law Judges.

(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) *Jurisdiction.* Upon the filing of a petition, such court shall have jurisdiction, which upon the filing of the record by the Secretary shall be exclusive (except as provided in § 81.84(l)), to affirm, modify, terminate, or set aside, in whole or in part, the order of the Secretary.

(d) *Review.* Review of such proceedings shall be governed by chapter 7 of title 5, United States Code.

(e) *Order To pay penalty.* Such court has the authority in any such review to order payment of any penalty imposed by the Secretary under this subpart.

(f) *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 Definition of terms.

In this subpart, unless the context otherwise requires or indicates:

Book-entry GSE security means a GSE security in the form of an entry made as prescribed in this subpart on the records of a Reserve Bank.

Date of call means:

(1) With respect to GSE securities issued by Fannie Mae under section 304 (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;

(2) With respect to GSE securities issued by Fannie Mae under section 304(b) of the Fannie Mae Charter Act, the date fixed in the offering notice issued by Fannie Mae; and

(3) With respect to GSE securities issued by Freddie Mac, the date fixed in the authorizing resolution of the Board of Directors of Freddie Mac on which Freddie Mac will make payment of the security before maturity in accordance with its terms.

Definitive GSE security means a GSE security in engraved or printed form.

GSE security means any obligation of a GSE (except short-term discount notes and obligations convertible into shares of common stock) issued under the Freddie Mac Act, or sections 304 (b), (d), or (e) of the Fannie Mae Charter Act, in the form of a definitive GSE security or book-entry GSE security.

Member bank means any national bank, State bank, or bank or trust company that is member of a Reserve Bank.

Pledge includes a pledge of, or any other security interest in, GSE securities as collateral for loans or advances or to secure deposits of public monies or the performance of an obligation.

Reserve Bank means a Federal Reserve bank and its branches acting as Fiscal Agent of a GSE and, when indicated, acting in its individual capacity or as Fiscal Agent of the United States.

§ 81.92 Authority of Reserve Banks.

Each Reserve Bank is hereby authorized, in accordance with the provisions of this subpart, to:

(a) Issue book-entry GSE securities by means of entries on its records that shall include the name of the depositor, the amount, the loan title (or series), and maturity date;

(b) Effect conversions between book-entry GSE securities and definitive GSE securities;

(c) Otherwise service and maintain book-entry GSE securities; and

(d) Issue a confirmation of transaction in the form of a written advice (serially numbered or otherwise) that 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 a GSE may apply the book-entry procedure provided for in this subpart to any GSE securities that 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 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 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 paragraph. Whenever the book-entry procedure is applied to such GSE 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 GSE securities.

(b) A Reserve bank, as fiscal agent of a GSE, shall apply the book-entry procedure to GSE securities deposited as collateral pledged to the United States under current revisions of Department of the Treasury Circulars Nos. 92 and 176 (31 CFR parts 203 and 202), and may apply the book-entry procedure, with the approval of the Secretary of the Treasury, to any other GSE securities deposited with a Reserve bank, as fiscal agent of the United States.

(c) Any person having an interest in GSE securities that 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 GSE securities pursuant to the provisions of this subpart 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) (1) A transfer or a pledge of book-entry GSE 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 this subpart, 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:

(i) Have the effect of a delivery in bearer form of definitive GSE securities;

(ii) Have the effect of a taking of delivery by the transferee or pledgee;

(iii) Constitute the transferee or pledgee a holder; and

(iv) If a pledge, effect a perfected security interest therein in favor of the pledgee.

(2) A transfer or pledge of book-entry GSE securities effected under paragraph (a) of this section 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 GSE securities, or any interest therein, that is maintained by a Reserve bank (in its individual capacity or as fiscal agent of the United States) in a book-entry account under this subpart, 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 GSE 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 GSE 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 GSE 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 transfers thereof under this paragraph. Where transferable GSE securities are recorded on the books of a depositary (a bank, banking institution, financial firm, or similar party that regularly accepts in the course of its business GSE securities as a custodial service for customers and maintains accounts in the names of such customers reflecting ownership of or interest in such securities) for 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 effecting 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 paragraph, 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 subpart, notwithstanding any transfer or pledge effected or perfected under this section.

(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 GSE securities or any interest therein.

(d) A Reserve bank shall, upon receipt of appropriate instructions, convert book-entry GSE securities into definitive GSE securities and deliver them in accordance with such instructions; no such conversion shall affect existing interests in such GSE securities.

(e) A transfer of book-entry GSE securities within a Reserve bank shall be made in accordance with procedures established by the bank not inconsistent with this subpart. The transfer of book-entry GSE 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 GSE securities.

(a) A depositor of book-entry GSE securities may withdraw them from a Reserve bank by requesting delivery of like definitive GSE securities to itself, or on its order, to a transferee.

(b) GSE securities that are actually to be delivered upon withdrawal may be issued either in registered or in bearer form.

§ 81.96 Delivery of GSE securities.

A Reserve bank that has received GSE 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. A Reserve bank shall be fully discharged of its obligations under this subpart by the delivery of GSE securities in definitive form to its depositor or upon the order of such depositor. Customers of a member bank or other depositary (other than a Reserve bank) may obtain GSE securities in definitive form only by causing the depositor of the Reserve bank to order the withdrawal thereof from the Reserve bank.

§ 81.97 Registered bonds and notes.

No formal assignment shall be required for the conversion to book-entry GSE securities of registered GSE 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 subpart for any purpose specified in § 81.93(a). Registered GSE securities deposited thereafter with a Reserve bank for any purpose specified in section 81.93 shall be assigned for conversion to book-entry GSE securities. The assignment, which shall be executed in accordance with the provisions of subpart F of 31 CFR part 306, as amended or revised, so far as applicable, shall be to ''Federal Reserve Bank of ____________________, as fiscal agent of [name of the GSE], for conversion to book-entry [name of the GSE] securities.''

§ 81.98 Servicing book-entry GSE securities; payment of interest, payment at maturity or upon call.

Interest becoming due on book-entry GSE securities shall be charged on the interest-due date and remitted or credited in accordance with the depositor's instructions. Such securities shall be redeemed and charged in the account on the date of maturity or call, and the redemption proceeds, principal and interest shall be disposed of in accordance with the depositor's instructions. For Fannie Mae, interest becoming due on book-entry Fannie Mae securities shall be charged to Fannie Mae's account at the New York Federal Reserve Bank.

§ 81.99 Treasury Department regulations; applicability to GSEs.

The provisions of Treasury Department Circular No. 300, 31 CFR part 306 (other than subpart O), as amended or recodified from time to time, shall apply, insofar as appropriate, to GSE obligations for which a Reserve bank shall act as Fiscal Agent of the GSE, and to the extent that such provisions are consistent with agreements between the GSE and the Reserve banks acting as Fiscal Agents of the GSE. Definitions and terms used in Treasury Department Circular No. 300 should read as though modified to effectuate the application of the regulations to the GSEs.

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 803 (1966–70 Compilation), as amended by Executive Order 12106, 3 CFR 263 (1978)), 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 Regulatory examinations.

Each GSE may be examined at any time by the Secretary or any contractors, agents, officers, or employees of the Department (hereinafter ''the examiners'') to monitor compliance with the Secretary's regulatory authorities under these regulations, the Act, or the applicable Charter Act. The examiners shall have access, upon request to a GSE, to any relevant books, accounts, financial records, reports, files, or other papers, things, or property belonging to or in use or used by the GSE.

Appendix A—Secretarial Considerations to Establish the Low- and Moderate-Income Housing Goal

A. 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 conforming mortgage market serving low- and moderate-income families relative to the size of the overall conventional conforming mortgage market; [1]

[1] ''Conventional'' mortgages are those which do not carry any government guarantee or insurance. That is, conventional mortgages exclude FHA, FmHA, and VA loans. ''Conforming'' loans are those whose principal amount does not exceed the maximum allowed for purchase by Fannie Mae or Freddie Mac. Currently, this limit is $203,150 for 1-unit properties, except that it is 50 percent higher

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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.

B. Underlying Data

In considering the factors under the Act to establish these goals, the Secretary relied upon data gathered 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. The Secretary used data provided by the GSEs to determine their prior performance in meeting the needs of low- and moderate-income families and their financial condition. These data included loan-level information on all mortgages purchased by the GSEs in 1993.

Section C discusses each of the factors listed above. Section D summarizes the Secretary's rationale for selecting the low- and moderate-income goals for 1995 and 1996.

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 demographic trends that are important for understanding mortgage markets. Certain information, such as trends in income inequality, is provided because it helps explain problems that the low- and moderate-income housing goal is intended to address. Other 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 goal. Finally, information is provided that documents the severe housing problems faced by lower income families.

This information has led the Secretary to the following conclusions:

• 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 increase in immigrants will increase the demand for both rental and owner-occupied housing. Non-traditional households have 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 are single-parent and single-person households.

• The volume of mortgage originations is expected to fall from its 1993 record level of one trillion dollars to about $600 billion in 1995. Purchase mortgages, including those for first-time homebuyers, will replace refinance mortgages as the dominant mortgage type.

• The predominance of purchase mortgages, as opposed to refinance mortgages, will make it easier for the GSEs to meet a given low- and moderate-income goal. Historically, mortgages for low- and moderate-income borrowers have represented a larger proportion of purchase mortgages than of refinance mortgages.

• The recent rise in interest rates from 25 year lows could make it more difficult for marginal borrowers to afford homeownership. However, interest rates continue to remain lower and housing more affordable than was true for any previous extended period since 1977. Borrowers will also be helped by the rising incomes that accompany economic growth.

1. National Housing Needs

a. Housing Problems Among Low- and Moderate-Income Owners and Renters

Under the income definitions in the Act, almost three-fifths of U.S. households qualified as ''low-'' or ''moderate-''income families in 1991. Almost half of all homeowners (49 percent) had incomes below their (unadjusted) area median family income, while 71 percent of renters had income below their area's HUD-adjusted median family income.[2]

Housing needs in 1991 varied sharply with income. One-eighth of owners with moderate incomes (income 80 to 100 percent of area median) and one-fourth of moderate-income renters had a housing problem, compared to 17 percent of low-income owners and 44 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.[3]

b. Affordability Problems and Worst Case Housing Needs

Finding affordable housing is by far the most common housing problem for American families nationwide.[4] 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.[5] 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.[6] Poor homeowners also pay 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.[7]

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.[8]

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.[9]

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.[10]

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in Alaska, Hawaii, Guam, and the Virgin Islands. The conforming loan limit is adjusted annually based on the October-to-October percentage increase in house prices, as determined by the Federal Housing Finance Board's Monthly Interest Rate Survey. In practice, the conforming loan limit has only been increased since 1990; in the case of declines in house prices, the limit has been held constant.

[2] 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.

[3] 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.

[4] Since the early 1980s, ''affordable housing'' has generally been interpreted as housing in which the homeowner or renter pays no more than 30 percent of family income for housing costs, including utilities.

[5] U.S. Departments of Housing and Urban Development and Commerce, *American Housing Survey for the United States in 1991,* April 1993.

[6] 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.

[7] 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.

[8] 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.

[9] Congress defines ''worst case needs'' for housing assistance as unassisted renters with incomes below 50 percent of area median income who have priority problems.

[10] *Worst Case Needs for Housing Assistance in the United States in 1990 and 1991.* HUD–1481–PDR, June 1994.

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 the 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.

c. Increasing Numbers of Homeless Individuals and Families

The homeless clearly have the most acute housing needs. Precise counts of homeless individuals are difficult to determine, but a study by the Urban Institute estimated that there were between 496,000 and 600,000 homeless persons in the United States during a seven-day period in March 1987, and more than one million persons were homeless at some time during that year.[11] The Congressional Budget Office estimated a one-day homeless population of approximately 700,000 for 1991.[12] The Census Bureau supplemented its regular 1990 census operations with a special one-night ''Street and Shelter Night'' count of the homeless, and found more than 228,000 homeless individuals at emergency homeless shelters and at pre-identified street locations on the night of March 20, 1990.[13] Recent studies of turnover in shelters suggest, moreover, that the number ''who experience at least one episode of homelessness * * * (over a one to five-year period) may exceed the best estimates of single-shot street and shelter counts by a factor of ten or more.'' [14]

d. Unmet Demands for Homeownership

Homeownership is a key aspiration of 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 those families with children. Children of homeowners are more likely to graduate from high school, less likely to commit crime, and less likely to have children as teenagers than children of renters.[15] Recent surveys indicate that lower-income and minority families who do not own their homes will make considerable sacrifices to attain this goal.

During the 1980s, the goal of homeownership became more elusive for low- and moderate-income families. 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 1993.

Declines in ownership rates during the 1980s were most pronounced for younger, lower-income households, particularly families with children. Although homeownership rates held steady or increased among families where the head of the household was born before or shortly after World War II, homeownership rates declined among younger households with lower incomes:

Between 1980 and 1992, homeownership among younger households dropped roughly 10 percentage points from 1980 levels, from 43.3 percent to 33.1 percent for households with the head aged 25 to 29, and from 61.1 percent 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.[16]

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 level, declines were greatest for families with children. Among very low-income families with children, homeownership rates dropped by nearly a fourth.[17]

The stability in ownership after 1985 resulted from increases among elderly households and single individuals, offset by further declines among families with children. Declines among families with children were greatest at incomes 80–100 percent and 30–50 percent of unadjusted area median income.

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 total ownership rate from 65.6 to 64.2 percent translated into a fall of seven percentage points among families with children, from an ownership rate of 70.4 percent down to 63.4 percent.

e. Obstacles to Increased Homeownership

Insufficient income, high debt burdens, and limited savings pose obstacles for younger families in purchasing a home. As home prices skyrocketed during the late 1970s and early 1980s, real incomes stagnated, with earnings growth particularly slow for blue collar jobs and less educated workers. The combination of relatively high interest rates and slow income growth through most of the 1980s made homeowner mortgage payments claim larger fractions of family income, and increasing rents made saving for home purchase more difficult. Thus, fewer households had the financial resources to meet down payment requirements, closing costs, and monthly mortgage payments. A 1991 survey by the National Association of Home Builders found that one-fifth of first-time homeowners had to rely on their relatives for most of their down payment.[18] A survey by the National Association of Realtors found that approximately one-third of recent first-time homeowners relied on gifts and loans from parents.[19]

In addition to low income, high debts are a primary reason households cannot afford homes. Nearly 53 percent of renter families have both insufficient income and excessive debt problems that may cause difficulty in financing a home purchase. High debt-to-income ratios frequently make potential borrowers ineligible for mortgages based on the underwriting criteria established in the conventional mortgage market.

In a recent study, the Census Bureau estimated that in 1991 nearly 90 percent of renters could not afford a modest home (priced at the bottom twenty-fifth percentile) in their Census division.[20] Seventy-eight percent could not afford a home priced at the tenth percentile. Such affordability problems are especially pronounced among single-parent households. While almost 76 percent of married-couple renter families could not afford a modestly priced home in their area using fixed-rate FHA financing, the figure rises to 90.3 percent for single male householders and 96 percent for households headed by single women.

2. Economic, Housing, and Demographic Conditions

A number of economic, housing, and demographic considerations have influenced the Secretary's determination of housing goals for low- and moderate-income families. 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 widespread shortages of rental housing

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[11] Interagency Council on the Homeless, *Executive Summary: The 1990 Annual Report of the Interagency Council on the Homeless,* 1991.

[12] *Ibid.* at 21. This figure was based on a memorandum written by the Congressional Budget Office which used the 1987 Urban Institute study as its starting point and was updated using a 5 percent annual growth rate.

[13] Interagency Council on the Homeless, Fact Sheet, ''How Many Homeless People Are There?,'' April 1991, No. 1–1.

[14] Interagency Council on the Homeless, *Priority: Home! The Federal Plan to Break the Cycle of Homelessness,* 1994, p. 19.

[15] 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.

[16] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing,* 1993, Table A–4.

[17] Kathryn Nelson and Jill Khadduri, ''To Whom Should Limited Housing Resources Be Directed?'' *Housing Policy Debate* Vol. 3, 1992, pp. 1–55, Table 3.

[18] National Association of Home Builders, *Profile of the New Home Buyer Survey,* 1991.

[19] National Association of Realtors, *Survey of Homeowners and Renters,* 1991.

[20] 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.

affordable to incomes below 30 percent of median income. Reacting to high vacancy rates in market-rate housing, multifamily starts have been low in the last few years, though starts have picked up in 1994. Although volatile interest rates strongly influence both starts and mortgage market activity, rates that are relatively low by historical standards have improved affordability for first-time buyers.

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 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.[21] 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.[22]

(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, there were 6 million legal immigrants into 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 placed 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.[23] About 62 percent of Black 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, most 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, according to the annual Home Buyers Survey of the Chicago Title and Trust Company. They accounted for a third of first-time homebuyers in 1992 and 1993, up from slightly over one-quarter of first-time buyers in 1990 and 1991, and as discussed above, ownership rates among non-elderly single individuals rose steadily during the 1980s.[24] Low interest rates during the past two years apparently enticed even more single renters to become homeowners.

b. Economic Conditions

(1) *Income Inequality.* Growing inequality in the distribution of income makes 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 mainly to wage rates becoming more unequal—as the economy moved away from manufacturing to more advanced computer and knowledge-intensive industries, 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 squeezing of the middle class.

(2) *Interest Rates.* Volatile interest rates continue to be a major determinant of housing and mortgage market activity. 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 9.32 percent in 1991 and then fell further to averages of 8.24 percent in 1992 and 7.20 percent in 1993. The October 1993 rate of 6.80 percent was the lowest level in more than twenty years.[25]

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.[26] 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.

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 and helped turned the housing market around. Single-family starts increased from less than 900,000 during the recessionary years of 1990 and 1991 to 1.030 million in 1992 and 1.126 million in 1993. Volume in 1993 was almost 35 percent higher than 1991's recessionary low of 840,000.

(3) *First-time Home Buyers.* First-time home buyers have been the driving force in the recovery of the nation's housing market in the past two 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 of those over age 25 in 1980 to 25.4 percent in 1992.[27] Nonetheless, as reported in a series of annual Home Buyers Surveys conducted by the Chicago Title and Trust Company, 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, and 46

[21] W. Gregory Mankiw and David N. Weil, ''The Baby Boom, the Baby Bust, and the Housing Market,'' *Regional Science and Urban Economics,* May 1989.

[22] See, for example, Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 1994,* 1994.

[23] 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.

[24] Chicago Title and Trust Family of Insurers, *Who's Buying Homes in America,* January 1992 and January 1993.

[25] Council of Economic Advisers, *Economic Indicators,* September 1994 and *Economic Report of the President,* February 1994.

[26] Monthly average refinancing data obtained from Freddie Mac's *Primary Mortgage Market Survey.*

[27] 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.

percent in 1993.[28] The 1992 figure was the highest percentage for first-time buyers since the annual Home Buyers Survey was initiated in 1976.

Among the active first-time buyers was a record contingent of single-individual households. As noted above, 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 apparently 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 try homeownership. A strong pent-up demand to own a home should not be 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.[29] Thus there are many potential home buyers among the 34 million households that are currently renting.

c. Housing Conditions

(1) *Affordability of Home Purchase.* Potential home buyers in 1992 and 1993 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 137 in 1993.[30] The 1993 figure indicates that the U.S median family income was 37 percent more than was needed to qualify for a mortgage on the nation's median priced house. 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 around 110 to 117.

In addition to its overall affordability index, NAR also estimates the ability of first-time home buyers to purchase a modestly-priced home. 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. NAR's first-time home buyer index increased from 75 to 89 between 1991 and 1993. The fact that this index remained below 100 indicates that the monthly mortgage payment continued to place a significant burden on first-time home buyers even during a period of record low interest rates. The recent jump in interest rates reduced housing affordability slightly. According to Freddie Mac' 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 8.46 percent in the third quarter of 1994.[31] This increase can be expected to make it more difficult for potential first-time home buyers to qualify for conventional mortgages, as reflected in the third dip in NAR's composite affordability index from 142 in the fourth quarter of 1993 to 128 in the third quarter of 1994. The first-time home buyer's index dropped from 92.3 to 83.0 during this period. Both indexes would have fallen further if incomes had not risen to partially offset the effects of increased interest rates. 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.

(2) *Declines in the Number of Low Rent Units in the Housing Stock.* The rental housing stock considered affordable to poor families (the number of units with rents less than $300 per month, in constant 1989 dollars) fell from 9.9 million units in 1974 to 9.5 million units in 1985, and to 9.2 million units in 1991.[32] Such declines in the number of low-rent units, combined with sharp increases in the number of poor families, underlie Congressional concerns about the need to expand the supply of affordable rental housing.[33]

Such shortages of rental units relative to renters occur mainly among units affordable to renters with incomes below 30 percent of area median. Analysis of Census data shows that nationally there were only four units for every five renters with incomes below 30 percent of area median in 1990, while for renters with incomes below 50 percent of median nationally there was a *surplus*—1.24 units for every renter.[34] Similarly, at the state level, 30 states had shortages of units affordable below 30 percent of median, while only 3 had shortages of units affordable below 50 percent of median.[35] Such shortages were strongly correlated with the incidence of worst case needs by state. The combined effects of a declining low-rent housing stock and the demand for rental units by young families that are locked out of the homeownership market have kept rents high for poor renter families.

(3) *Multifamily Production and Finance.* This section discusses three important trends in the multifamily industry, including recent shifts in construction levels, projections for the mortgage market, and shifts in financing trends. Peaks and troughs have characterized multifamily construction since 1959. The most recent peak year was 1985, in which 576,000 multifamily units were started.[36] The downturn from this peak was particularly severe, and resulted from lower net household growth and the loss of favorable tax treatment due to the Tax Reform Act of 1986. For the last 3 years, multifamily housing production has been at the lowest levels recorded since the Government began collecting these data 35 years ago. In 1993 only 131,200 multifamily units were started, far below the annual average of 435,000 units from 1964 through 1992.

While multifamily production will probably continue at below-average rates for the next few years, signs indicate that this sector of the housing industry has begun a modest recovery in 1994. Much of what is being produced now is because of Low-Income Housing Tax Credits—about 50,000 units in both 1992 and 1993. In addition, an increasing share 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 moderate income families is capturing a large share of the multifamily units that are being produced.

Multifamily mortgage originations have paralleled the patterns of multifamily construction starts. Conventional mortgage originations peaked at $41 billion in 1986 (a year after the peak in construction starts), and then declined every year to a trough of about $25 billion in 1991 and 1992, while the 1993 level rose to almost $29 billion. The 1994 level is projected to be about $33 billion, with an increase to the $35–$40 billion range for 1995 and 1996.

The decline in total multifamily lending in the late 1980s accompanied a change in the structure of the market.[37] In 1985, thrift institutions originated a peak of 42 percent of multifamily mortgages. However, their holdings have decreased by $41 billion since 1988, due to defaults and write-offs, failure of institutions and refinancing of thrift-held

[28] Chicago Title and Trust Family of Insurers, *Who's Buying Homes in America,* January 1992, January 1993, and January 1994.

[29] National Association of Realtors, *Survey of Homeowners and Renters,* 1991.

[30] See *News Release,* ''Housing Affordability Sustained Despite Rise in Interest Rates'', National Association of Realtors, August 9, 1994.

[31] The most recent surveys for the last weeks of November showed that interest rates had settled in the neighborhood of 9.25 percent.

[32] 1974 and 1985 figures from Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing,* 1992, p. 35. The 1991 figure is calculated from Exhibit 21 of the 1994 Joint Center report on *The State of the Nation's Housing.*

[33] U.S. Senate, 1992. Report accompanying S.3031, the *National Affordable Housing Act Amendments of 1992.* 102d Congress, 2d Session, Report 102–232, p. 8.

[34] Amy Bogdon *et al., National Analysis of Housing Affordability, Adequacy, and Availability,* HUD–1448–PDR, 1994, pp 52–53.

[35] U.S. Department of Housing and Urban Development, *Worst Case Needs for Housing Assistance in the United States in 1990 and 1991,* HUD–1481–PDR, 1994, Table 8.

[36] The record high was 906,200 multifamily units started in 1972.

[37] The following discussion is drawn from The Hamilton Securities Group Inc, The National Multi Housing Council, and The National Apartment Association, ''A Report on the Multifamily Mortgage Industry,'' 1994.

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. The decline of thrift multifamily lending is part of a larger pattern of more concentration in the multifamily finance market. An additional pattern is the decline of long-term and fixed rate financing. 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 lack of a strong secondary market for multifamily loans has made it more difficult to obtain debt financing for multifamily housing. In 1993, Fannie Mae purchased $4.6 billion in multifamily mortgages, while Freddie Mac purchased $191 million. This compares to almost $29 billion in total multifamily mortgage originations in that year. Thus, the GSEs' purchases amounted to about 17 percent of originations. Given that some of the GSEs' purchases were seasoned loans, their share of the current market is even smaller. Freddie Mac had been out of the multifamily business completely for nearly five years, and only began in December 1993 to fully re-enter the market. In 1993, Fannie Mae and Freddie Mac held or had securitized about 10 percent of outstanding multifamily mortgage debt. State and local housing finance agencies and insurance companies each held another 10 percent of the outstanding debt. Depository institutions held 36 percent, but as mentioned earlier, thrifts have decreased holdings considerably in recent years. GNMA held 12 percent, pension funds held 2 percent, and the remainder was spread in small shares over a number of sources. The decline in direct federal subsidies and the collapse of the thrift industry decreased the lending sources for affordable multifamily housing. The country needs an established secondary market for multifamily mortgages which has the depth and resiliency of the single-family system to bring new sources of primary financing into the market.

3. Performance and Effort of the GSEs Toward Achieving the Goal in Previous Years

Each GSE submitted data on its 1993 performance to the Secretary, in formats specified by the Department, and based on the procedures specified by the Department in the Notice of Interim Housing Goals published in the **Federal Register** on October 13, 1993. 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. Each GSE also submitted detailed loan level data on each loan it purchased in 1993. HUD has done extensive analyses to verify the GSEs' stated performance and to measure aspects of their mortgage purchase activities in 1993 not contained in the tables they submitted to the Department.

Fannie Mae's data for 1993 show that 31.8 percent of single family dwelling units, 95.4 percent of multifamily dwelling units, and 35.6 percent of total units financed by its mortgage purchases were affordable to low- and moderate-income families. Thus there was a significant increase in the low- and moderate-income percentage from 28 percent in 1992, and Fannie Mae's performance substantially exceeded the 30 percent goal established for Fannie Mae by the Secretary.[38]

Freddie Mac's data for 1993 show that 28.9 percent of single family dwelling units, 94.3 percent of multifamily dwelling units, and 29.2 percent of total units financed by its mortgage purchases were affordable to low- and moderate-income families. Thus there was a significant increase in the low- and moderate-income percentage from 24 percent in 1992, and Freddie Mac's performance exceeded the 28 percent goal established for Freddie Mac by the Secretary.

On November 29, 1994 both enterprises reported on their purchases for the first three quarters of the year. Fannie Mae stated that 43.3 percent of its purchases were for low- and moderate-income families, and the corresponding figure for Freddie Mac was 36.3 percent. Thus both enterprises have sharply increased their low- and moderate-income purchases above the 1993 level, and both are running well above the 1994 goal of 30 percent.[39] For all periods, performance would be somewhat higher utilizing the scoring provisions of this regulation, in contrast to those spelled out in the **Federal Register** on October 13, 1993.

For both enterprises, although they surpassed their low- and moderate-income goals in 1993, more than 50 percent of their single-family purchases and their total purchases were for families with incomes in excess of 120 percent of area median income, as indicated in the following table:

DISTRIBUTION OF DWELLING UNITS IN TOTAL GSE PURCHASES BY INCOME CLASS OF MORTGAGOR OR RENTER, 1993

[In percent]

Income of mortgagor(s) or renter(s) relative to area median income	Fannie Mae			Freddie Mac		
	Single-family	Multi-family	Total	Single-family	Multi-family	Total
0%–60%	6.3	43.3	8.7	5.3	71.2	5.6
60%–80%	11.1	43.8	13.2	10.3	19.5	10.4
80%–100%	14.2	8.3	13.9	14.0	3.7	14.0
100%–120%	14.5	1.8	13.7	14.7	2.2	14.6
Exceeds 120%	53.8	2.8	50.6	55.7	3.4	55.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

This indicates that achievement of the low- and moderate-income goal in 1993 did not deter the GSEs from buying many mortgages on properties purchased by higher income families.

4. Size of the Conventional Conforming Mortgage Market Serving Low- and Moderate-Income Families Relative to the Overall Conventional Conforming Market

This section explains the Secretary's methodology for estimating the low- and moderate-income (''low-mod'') share of the mortgage market. Ideally, computing this share would be straightforward, consisting of three steps:

(1) Projecting the size of the four major property types included in the conventional conforming mortgage market: (a) Single-family owner-occupied dwelling units, (b) single-family owner-occupied, two-to-four units (called ''2–4's''), (c) single-family one-to-four investment units (called ''1–4's''), and (d) multifamily units (properties with more than 4 units). Property types (b), (c), and (d) consist of rental units. As noted below, property types (b) and (c) must sometimes be combined due to data limitations; in this case, they are referred to as ''single-family 1–4 rental units''.

(2) Projecting the percentage that are low- and moderate-income for each of the above four property types (for example, the percentage of those single-family owner-

[38] Some mortgage purchases are not eligible for possible inclusion under the low- and moderate-income goal, such as federally guaranteed mortgages, second 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 low-mod percentage. These exclusions amounted to 14 percent of Fannie Mae's purchases and 9 percent of Freddie Mac's purchases.

[39] 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.

occupied dwelling units financed by mortgages in a particular year that are occupied by households with incomes below the area median).

(3) Multiplying the four percentages in (2) by their corresponding market shares in (1), thus arriving 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-mod occupancy; rental properties tend to have much higher percentages of low-income occupants than owner-occupied properties. It is often necessary to distinguish between purchase and refinance mortgages because purchase mortgages are more apt to finance units occupied by low-income occupants.

Unfortunately, complete and consistent mortgage data are not readily available to easily carry out the above three steps. Therefore, HUD had to combine information from several data sources in order to estimate the market shares. Two approaches were taken—one based on American Housing Survey and Residential Finance Survey data and one based on 1993 HMDA data and projections of the mortgage market for 1995 and 1996. HUD also relied on the mortgage purchase data for 1993 supplied by the GSEs. The following sections explain HUD's methodology and present results of several sensitivity analyses of the estimated size of the low-mod market.

a. American Housing Survey/Residential Finance Survey Method

To obtain an overall perspective of the mortgage market, data from the American Housing Surveys for 1985, 1987, 1989, and 1991 were analyzed. This data showed that, overall, 30 percent of those families who recently purchased or refinanced their homes, and who obtained conventional mortgages below the conforming loan limits, had incomes below the area median. Restricting the American Housing Survey (AHS) analysis to 1991 (the latest year that for which data is available) yields about the same estimate (31 percent) for the low-mod share of single-family owner-occupied properties.

The AHS does not include data on mortgages for rental properties (1–4 properties including (b) and (c) above and multifamily); rather, it includes data on the characteristics of the existing 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, the Act provides that a rent level is affordable if it does not exceed 30 percent of the maximum income level for the low-income or moderate-income category, with appropriate adjustments for unit size as measured by the number of bedrooms.

Analysis of the same four American Housing Surveys shows that for 1–4 unit unsubsidized rental properties ((b) and (c) properties are combined], 90 percent of all units, and 69 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 family income. For multifamily unsubsidized rental properties, the corresponding figures are 92 percent of all units, and 83 percent of units constructed in the preceding three years. Restricting the analysis to 1991 gave similar results—91 percent and 68 percent for 1–4 properties and 92 percent and 83 percent for multifamily properties. It should be noted that data for recently completed units probably underestimate the low- and moderate-income percentage of rental housing under the Act's definition, because they exclude purchase and refinance transactions on older buildings, which generally charge lower rents than newly-constructed buildings.

The GSEs' 1993 purchase data for rental properties also provides a useful reference point. Freddie Mac's data suggest a 66 percent low-mod share for rental 1–4 properties and Fannie Mae's data suggest a 73 percent low-mod share.[40] The GSE percentages are similar to the AHS low-mod share (69 percent) for recently completed 1–4 properties. On the multifamily side, Fannie Mae's data suggest a 95 percent low-mod share which is about the same as the AHS estimate for existing properties. Freddie Mac's multifamily business is too small to provide reliable data.

To calculate the size of the potential market for mortgages financing housing for low- and moderate-income families, data on the number of owner-occupied dwelling units, rental units in 1–4 unit properties, and rental units in multifamily properties are necessary. In determining the proportions of dwelling units in these three different types of properties, HUD used data from the Residential Finance Survey (RFS) on the number of properties with conventional conforming mortgages acquired during the 1987–91 period, and the total number of dwelling units for each type of property, derived from the same source. Based on this data, 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 in 1–4 family rental properties, and 25.6 percent were located in multifamily rental properties.[41] Applying the AHS percentages of affordable dwelling units (30 percent of owner-occupied dwelling units, 69 percent of single-family recently completed rental units, and 83 percent of recently completed multifamily rental units) to these percentages of properties results in an estimate that 51 percent of the dwelling units secured by conventional mortgages, eligible for purchase by the GSEs, are affordable to low- and moderate-income families.[42]

The 51 percent fIgure is based on the percentage estimates for newly-constructed affordable rental units rather than the higher estimates for all affordable rental units and GSE purchases. Using the AHS low-mod estimates for the existing stock (90 percent for 1–4 properties and 92 percent for multifamily properties) increases the low-mod share to 57 percent. Using the low-mod percentages of Fannie Mae's 1993 rental purchases (75 percent for 1–4 properties and 95 percent for multifamily properties) suggests a 54 percent low-mod share.

One concern with the Residential Finance Survey data is the seemingly high percentage share of multifamily units, given that multifamily mortgage originations have declined from their high levels in the mid- to late-1980s. Between 1987 and 1991, annual multifamily conventional mortgage originations averaged $32 billion, representing 8.8 percent of total conventional mortgage originations. In 1993, conventional multifamily originations stood at $28.5 billion and, because of the record trillion dollars in single-family mortgage originations, the multifamily share had dropped to 3 percent. Based on estimates provided by the GSEs, multifamily originations are expected to be about 7 percent of conventional mortgage originations in 1995 and 1996. This increase in the multifamily share for 1995 and 1996 is mainly due to the projected decline in single family originations caused by the collapse of the refinance market. Conventional multifamily originations are expected to be about $35 billion in 1995 and 1996.

Sensitivity analysis can show the effect of shifting the relative market importance of the different property categories. For example, reducing the multifamily weight from 25.6 percent to 20 percent, and assuming the owner category is 65 percent and the rental 1–4 category is 15 percent, yields the following estimates of the low-mod share of the market: 46 percent using AHS data for recently completed rental properties, 51 percent using AHS data for existing rental properties, and 50 percent using Fannie Mae data to estimate the low-mod shares for rental 1–4 and multifamily properties.

b. HMDA/Market Projection Method

HUD's second approach for estimating the low-mod share more explicitly considers the relative importance of the various property types in the 1995 and 1996 mortgage market. This second approach uses 1993 HMDA data and projections of mortgage originations for 1995 and 1996 including shifts in the mortgage market, such as a reduction in refinance activity.[43] The mortgage origination

[40] Disaggregating the rental 1–4 category into its two components, Freddie Mac's data showed a 54 percent low-mod share for rental 2–4's and a 85 percent low-mod share for 1–4 investment properties. Fannie Mae's data showed a 62 percent low-mod share for rental 2–4's and a 86 percent low-mod share for 1–4 investment properties. The low-mod percentages were practically the same for purchase and refinance mortgages.

[41] Restricting the RFS analysis to 1991 resulted in only minor changes to the market shares.

[42] The 51 percent figure was derived by adding the following: (1) 16.95% (percentage of owner-occupied units [56.5%] times percentage of those units that are affordable to low- and moderate-income families [30%]); (2) 12.35% (percentage of rental units in 1–4 family properties [17.9%] times percentage of those units that are affordable to low- and moderate-income families [69%]); and (3) 21.25% (percentage of rental units in multi-family properties [25.6%] times percentage of those units that are affordable to low- and moderate-income families [83%]).

[43] The HMDA data were mainly needed because its census tract level information was necessary for estimating the size of the underserved area market

Continued

projections are based on HUD's Survey of Mortgage Lending Activity (SMLA). The HMDA data are expressed in terms of number of loans rather than number of units, thus undercounting single-family 1–4's and multifamily units. SMLA data are also expressed in dollar terms rather than in terms of the number of dwelling units. Neither data source distinguishes between single-family owner-occupied one-unit properties and single-family owner-occupied rental properties. Therefore, several assumptions must be made to derive low-mod estimates for the conforming conventional market. The following six steps outline how the low-mod share was estimated under this approach:

(1) Single-family (1–4) mortgage originations for 1995 are estimated to be $615 billion, a reduction of $395 billion from the record setting $1,010 billion in 1993.[44] The reduction is due to the decline in refinance activity which is projected to fall from almost 60 percent of originations in 1993 to 15 percent in 1995.

(2) To derive single-family unit projections, the following assumptions were made:[45] the average conventional loan amount equals $107,000; conforming originations equal 81 percent of the conventional market; units per 2–4 rental property equal 2.25; and units per 1–4 investment property equal 1.35. Property shares for the 1995 single-family, conventional conforming mortgage market are assumed to be 88 percent for single-family owner-occupied, 2 percent for single family 2–4's, and 10 percent for single family 1–4's.

(3) Multifamily originations are projected to increase from $30 billion in 1993 to $33 billion in 1995. The average per unit loan amount is projected to be $32,500; sensitivity analysis was conducted for lower amounts.[46]

(4) Under the above ''base case'' assumptions, shares of dwelling units to be financed in the 1995 mortgage market are projected to be 68 percent for single family owner-occupants, 4 percent for single family 2–4's, 10 percent for single family 1–4's, and 18 percent for multifamily.

(5) Estimates of the percentage of dwelling units occupied by low- and moderate-income families were as follows: 38.2 percent for single family owner-occupied purchase mortgages and 29.3 percent for single family owner-occupied refinance mortgages—both estimates are based on 1993 HMDA data; and 62 percent for single family 2–4's, 91 percent for single family 1–4's, and 93 percent for multifamily. The low-mod percentages for the three rental categories were based on 1993 GSE data and 1991 AHS data.[47]

(6) Applying the above low-mod shares to the property type weights in (4) suggests that 54 percent of the dwelling units financed by conventional conforming mortgages in 1995 will be occupied by low- and moderate-income families.

The 1992 share of the single-family owner-occupied mortgage market accounted for by low- and moderate-income borrowers was less than the 1993 share reported above. According to 1992 HMDA data, 33.5 percent (25.1 percent) of single-family owner-occupied purchase (refinance) mortgages were taken out by low-mod borrowers. Substituting these 1992 figures for the 1993 HMDA data (38.2 percent and 29.3 percent, respectively) in step (5) suggests that 50 percent of the dwelling units financed by conventional conforming mortgages in 1995 will be occupied by low- and moderate-income families. Averaging the 1992 and 1993 HMDA data suggests a 52 percent low-mod share for the market.

When conducting this market analysis, an issue arose concerning interpretation of the above HMDA estimates of the low-mod market. The low-mod shares are derived by comparing individual borrower incomes reported on the mortgage application with the median income of the metropolitan area where the borrower lives. If the borrower's income is less than metropolitan area median income, the borrower's loan is classified as a low-mod loan. Unfortunately, the median income for individual metropolitan areas are only available from the decennial censuses; estimates are required for the years between the censuses. HUD provides area median income projections that are used both by the Federal Reserve Board to classify HMDA loans and by the GSEs to classify their loans for purposes of the low-mod and special affordable housing goals.[48] Recently available Census data on 1993 median income for the nation as a whole suggest that HUD overestimated 1993 area median incomes by about seven percent, on average. Comparing actual borrower incomes to overestimated area median incomes leads to an overestimate of the percentage of low-mod borrowers in the GSE and HMDA data bases. Rerunning the 1993 HMDA data but reducing area median incomes by seven percent causes the low-mod share of purchase mortgages to decline from 38.2 percent to 32.8 percent, and the low-mod share of refinance mortgages to fall from 29.3 percent to 24.2 percent. Substituting these lower, adjusted percentages into steps (5) and (6) above reduces the low-mod share for the overall market to 50 percent.

Because of uncertainty about the property type weights, additional sensitivity analyses were conducted for the market importance of each property type as well as for the low-mod shares of each property type. For example, the property weights in (4) for the three rental categories are less than those referenced earlier based on the Residential Finance Survey data. Because the rental property types exhibit a higher low-mod share, increasing their weights increases HUD's estimate of the mortgage market's low-mod share. The single-family rental property low-mod shares based on GSE data are less than those reported earlier based on AHS data. Therefore, substituting the AHS data for the GSE data increases the overall estimate of the low-mod share of the market.

HUD also conducted several sensitivity analyses of assumptions made in steps (1)–(3); in most instances, the estimated low-mod share was in the 50–55 percent range.

c. Caveat: Low-Mod Market Share Estimate May Be Lower Than Market Share

The above estimate of the low-mod market will continue to be refined as more data become available to HUD. However, two caveats about the 50 percent estimate should be kept in mind. First, the low-mod market may be greater than 50 percent because it was

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in Appendix B. However, HMDA data also provide income information for single-family borrowers; thus, it was decided to use these data as an alternative to the AHS data for estimating the low-mod share in this Appendix and for estimating the very low-income share in Appendix C. Unfortunately, HMDA does not provide any useful income information for rental properties. The data used in the analysis exclude loans less than $15,000, those with loan-to-income ratios that exceed six, and loans to non-owner occupants.

[44] Fannie Mae, Freddie Mac, and the Mortgage Bankers Association have provided HUD with estimates of 1995 mortgage originations. The single-family and multifamily origination data reported in this section are based on the projections of these organizations and the Department. Except for a slightly higher estimate for multifamily originations, the 1996 market is expected to be similar to the 1995 market. Therefore, the discussion focuses on the 1995 market. The various market estimates for the 1995 market reported in Appendices A, B, and C serve as a proxy for the 1996 market.

[45] The average loan amount is derived from the Federal Housing Finance Board's monthly survey of major lenders which reports mortgage terms and conditions. The proportions of conventional originations that are conforming is derived from the Residential Finance Survey, and is consistent with GSE estimates.

[46] In 1993, Fannie Mae's per unit multifamily loan amount was $24,679 and Freddie Mac's was $17,695. Both agencies project about $26,000 for 1995. Given the uncertainty about the correct market average per loan amount, sensitivity analysis was done using an average of $30,000 for the market. This had the effect of raising the estimated low-mod market share in step (6) by less than one percentage point.

[47] Little data exists on the low-mod shares for the two single-family rental property types; for this reason, it was necessary to use the GSE data. Fannie Mae's low-mod percentages for 2–4 and 1–4 properties were 62 percent and 87 percent, respectively. Freddie Mac's were somewhat lower at 54 percent and 85 percent, respectively. The American Housing Survey, which combines these two property categories shows a 69 percent low-mod share for recently build 1–4 rental units and a 91 percent low-mod share for the existing stock. The 2–4 low-mod share (63 percent) is based on Fannie Mae's data which is probably a conservative estimate for the overall 2–4 market. The 1–4 low-mod share (91 percent) is consistent with both the AHS and GSE data. The multifamily low-mod share (93 percent) is consistent with both the AHS and Fannie Mae's data.

[48] To obtain annual estimates of area median incomes, HUD starts with area median incomes from the 1990 census and projects them forward based on trends in national median income which is available annually on a lagged basis. These metropolitan area income projections, which are also used in HUD's rental assistance programs to define eligibly for subsidy, must be made prior to the program year in which they apply. They are made in the quarter preceding the applicable program year and are based on national Census data available at that time. For example, the 1993 income projections were made in the fourth quarter of 1992 and they were based on Census median income data from a March 1992 survey that measured mid-1991 income levels for the nation as a whole. HUD used the survey data to project metropolitan area income estimates from the 1990 Census to mid-1991, and then applied a four percent annual income growth rate to derive a 1993 income estimate for each metropolitan area. For further information, see ''FY93 Income Limits Briefing Material'' which is available from HUD.

necessary to exclude certain HMDA loans that may be more targeted to low-income borrowers than those loans included in HUD's analysis. Second, the 50 percent estimate does not take into account the fact that small, second loans may qualify as low-mod in 1995 and 1996. This section explains these issues.

(1) *HMDA Data.* The above analysis of HMDA data is limited to those cases where geocoded information is available on the 1993 HMDA file (that is, information is available to identify the census tract and the metropolitan area of the mortgaged property). There were approximately 804,000 conventional conforming loans in the HMDA file without enough information to identify the metropolitan area (or the census tract) where the property was located. These loans represented 13.2 percent of all conventional conforming loans in 1993.[49] The relative income of the borrower (i.e., borrower income relative to the median income of the metropolitan area) could not be computed for these non-geocoded loans.

HUD analysis suggests that the non-geocoded loans are more likely to be loans for low-income borrowers than the geocoded loans used earlier to determine the low-mod market share. HUD repeated its analysis of the geocoded loans but, instead of using the metropolitan area median income as the base for each borrower's income, HUD used the national metropolitan median income as the base income. The national-metro-median-income approach and the metropolitan-area-median-income approach suggested somewhat similar low-mod shares for the conventional conforming market in 1993, 31.9 percent and 29.6 percent, respectively. The incomes of borrowers taking out non-geocoded loans were then analyzed using the national-metro-median-income approach. This suggested a 45.2 percent low-mod share for non-geocoded loans, which is greater than the 31.9 percent obtained for the geocoded loans using the national-metro-median-income approach. Therefore, not including the non-geocoded loans in the analysis leads to an underestimate of the market's low-mod share.

(2) *Eligibility of Second Mortgages.* This regulation might allow the GSEs to count second mortgages for partial credit because they play a role in the financing of rehabilitation in underserved areas.[50] In 1993, the GSEs purchased only a small number of second mortgages: Fannie Mae purchased 641 seconds, representing $28.5 million, and Freddie Mac purchased 27 seconds, representing $1.4 million. It is unclear how the GSEs would react to the fact that seconds might 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.

The HMDA data does 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-mod borrowers, compared with 31 percent for purchase mortgages.[51]

In 1993, GSE purchases accounted for only 5.7 percent of the HIL market. Fannie Mae bought 21,100 (3.4 percent) of HILs and Freddie Mac bought 14,300 (2.3 percent) of these mortgages. The distribution of HILs purchased by the GSEs differed from the distribution of the total market. Only 31 percent of the GSEs' HILs went to low-mod borrowers, compared with 47 percent for the market as a whole. But 54 percent of the HILs bought by both GSEs were for borrowers with incomes over 120 percent of area median income; this compares with 40 percent for the market as a whole.

d. Conclusions

Based on the above findings as well as numerous sensitivity analyses, the Secretary concludes that 50 percent is a conservative estimate of the mortgage market's low-mod share for 1995 and 1996.

5. GSEs' Ability to Lead the Industry

The Secretary believes that in light of the benefits that Fannie Mae and Freddie Mac receive from their Charter Acts and the ''implicit guarantee'' of their obligations resulting from their agency status, the GSEs can and should provide the leadership that is needed to encourage the mortgage finance industry to better serve low- and moderate-income borrowers. 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

Fannie Mae and Freddie Mac together purchased approximately 71 percent of all conventional conforming single-family mortgages in 1993—up from 17 percent in 1980, 33 percent in 1985, 52 percent in 1991, and 65 percent in 1992.[52] Most of the mortgages purchased by both 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 lenders 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.[53]

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.[54]

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.[55] 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 might eventually be sold to the GSEs as the principal balance is amortized and the conforming loan limit is increased. By setting the credit standards against which lower income families will be judged, the GSEs can influence the rate at which mortgage funds will flow to low-income borrowers and underserved neighborhoods. Congress realized the crucial role played by the GSEs' underwriting guidelines and it required each enterprise to submit a study on its guidelines to the Secretary, the Committee on Banking, Finance and Urban Affairs of the House of Representatives, and the Committee on

[49] As noted earlier, loans less than $15,000, those with loan-to-income ratios that exceed six, and loans to nonowner-occupants are excluded.

[50] On the other hand, second mortgages may be used for purposes totally unrelated to housing, such as making other purchases, paying off debts, etc. Because the rates on seconds are often below other consumer borrowing rates (especially those on credit card debt) and because interest on second mortgages is tax-deductible, there are strong incentives to use second mortgages for purposes other than housing rehabilitation.

[51] Restricting the analysis to purchase mortgages over $15,000, as was done in the earlier calculation of the low-mod market, gives a 38.2 percent share for borrowers with less than the area median income.

[52] Estimates provided by Fannie Mae's Economics Department, 1993.

[53] John C. Weicher, ''The New Structure of the Housing Finance System,'' *Federal Reserve Bank of St. Louis Review,* July/August 1994, pp. 51–52.

[54] *Id.*, pp. 52–53.

[55] 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.

Banking, Housing, and Urban Affairs of the Senate in October 1993. In addition, the Secretary is required to periodically review the GSEs' underwriting and appraisal guidelines.

c. Leading Edge Technology

With regard to technology, both GSEs have been in the forefront of new developments. 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 in underserved areas. Both enterprises have been developing automated underwriting systems designed to reduce the time required to process loan applications.

d. Staff Resources

Both enterprises are well-known throughout the mortgage industry for the expertise of their staffs in carrying out their current programs, researching and developing improvements to the mortgage market in general, developing innovative new programs, and conducting research which 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 agency status have made them two of the nation's most profitable businesses. Fannie Mae's profits have increased from $807 million in 1989 to $1.2 billion in 1990, $1.4 billion in 1991, $1.6 billion in 1992, and $1.9 billion in 1993, and for the first three quarters of 1994 they were accruing at an annual rate of $2.1 billion. Fannie Mae's return on equity averaged 28.9 percent over the 1989–93 period—far above the rates achieved by most financial corporations. In addition, Fannie Mae's dividends per share more than quadrupled over this period, rising from $0.43 in 1989 to $1.84 in 1993.

Freddie Mac has shown similar trends. Freddie Mac's profits have increased from $414 million in 1990 to $555 million in 1991, $622 million in 1992, and $786 million in 1993, and for the first three quarters of 1994 they were accruing at an annual rate of $975 million. Freddie Mac's return on average equity averaged 22.5 percent over the 1989–93 period—also well above the rates achieved by most financial corporations. Freddie Mac's dividends per share rose 66 percent over this period, rising from $0.53 in 1989 to $0.88 in 1993.

One measure of the strength of the GSEs was provided by a recent Business Week ranking of American corporations. This survey found that Fannie Mae was second of all companies in total assets and Freddie Mac ranked 23rd; with regard to total profits, Fannie Mae ranked 14th and Freddie Mac ranked 55th.[56]

Under the 1992 Act, 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. For the transition period ending in the first quarter of 1994, the corresponding percentages were 2.25 percent and 0.40 percent respectively. The Director has found both GSEs adequately capitalized as of June 30, 1993, September 30, 1993, December 31, 1993, and March 31, 1994. For the last period, both GSEs also exceeded the fully phased-in capital requirements.

f. Conclusions 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. However, as discussed in Section D, HUD is concerned about the current level of the GSEs' assistance to the lower-income end of the market. Existing data indicate that there is room for the GSEs to improve their performance—low- and moderate-income units are estimated to comprise at least 50 percent of the conventional conforming market, while in 1993 the GSEs performed at rates of 29 percent (Freddie Mac) and 36 percent (Fannie Mae). The low- and moderate-income goals that HUD sets in Section D (38 percent in 1995 and 40 percent in 1996) are intended to move the GSEs closer to the market standard. By using their immense resources to improve their performance and meet these goals, the GSEs will be making a good first step toward closing their current market gap.

6. The Need To Maintain the Sound Financial Condition of the GSEs

Congress directed the Secretary of HUD to consider the safety and soundness of the GSEs, along with the five other factors, in formulating the level and direction of the housing goals.[57] As part of these regulations, HUD has prepared a Regulatory Impact Analysis (RIA) that examines the costs and benefits of the housing goals. The detailed RIA provides a complete discussion of the issues summarized below as well as quantitative estimates of the impact of the goals on the GSEs. Based on that analysis, HUD concludes that achieving the housing goals described in the proposed rule will result in limited, if any, net increase in risk to the sound financial condition of the GSEs' operations.

The RIA examines the extent to which the three housing goals will affect the capital levels of the GSEs. The RIA does this by assessing the extent to which achieving the housing goals will affect the profitability of the GSEs. Profitability is used as an approximation for sound financial condition, since losses could reduce the GSEs' level of capital. The principal cost from mortgage loan purchases of any kind is that of loan default, or credit risk. Below is a summary of the RIA's main findings regarding the potential credit costs of meeting the three goals.

- Goals-oriented purchases are already made by the GSEs in the course of their ongoing operations. The relevant question is the impact of additional units required in order to meet regulatory targets. The goals are not mutually exclusive, so that loan purchases required to meet them are not additive. Thus the required level of additional purchases is not as great as it would be if each goal were unique to itself. HUD finds that, under a variety of potential GSE strategies, the dollar amounts of additional loan purchases are small relative to the total volume of business being undertaken by the GSEs. For example, baseline projections show Fannie Mae purchasing over $170 billion of loans in 1995. The amount of additional purchases required for it to meet the regulatory targets will likely be less than $1.5 billion. Because its past goals-oriented purchases have been less than Fannie Mae's, Freddie Mac will likely require a larger degree of additional targeted purchasing to meet the goals. HUD's baseline purchase volume projection for Freddie Mac in 1995 is about $130 billion, and additional purchase requirements to satisfy the goals could be as high as $6 billion, depending on Freddie Mac's business strategy.
- The additional loans required to meet the housing goals are profitable business under the baseline consensus economics scenario examined in the RIA.
- Historically, moderate- and middle-income loans have the lowest overall default rates of all borrower income cohorts. If the GSEs continue their 1993 purchase patterns, loans required to meet the low- and moderate-income goal will be primarily from loans to households with incomes in the ''moderate'' 80–100 percent of median cohort. Therefore, there is unlikely to be any significant increase in credit risk exposure associated with the low- and moderate-income goal.
- The potential size of goals-qualifying purchase pools for single-family owner-occupied property loans is enlarged by the statutory definition of median income used for these rules. HUD must use median family income, unadjusted for household size, to determine eligibility under the housing goals. The median-family income figures then used to determine goals qualification are roughly equal to the median incomes of three-person households. As a result, many smaller-sized households with above median income—when adjusted for family size—will count as below median for purposes of meeting the housing goals.[58] This same issue also enhances the credit quality of special

[56] Business Week, March 28, 1994, p. 131.

[57] HUD's independent Office of Federal Housing Enterprise Oversight (OFHEO) has the primary responsibility for monitoring the safety and soundness of the GSEs. OFHEO is currently building the stress-test models necessary for analyzing the capital strength of the GSEs and establishing appropriate capital levels. HUD expects that OFHEO will take into account in its required capital levels the GSEs' housing-goal-related purchases.

[58] HUD adjustments for family size cost-of-living factors would reduce the effective median income measure for 1-person households by 22 percent, that of 2-person households by 11 percent, and would increase that of 4-person households by 20 percent.

affordable loan purchases. In that case, small-sized owner households can qualify as below 60 percent of median income simply because the dollar threshold is effectively defined for a three-person household.[59]

- Under the special affordable housing goal, the GSEs will increase their purchases of very low-income loans. Historically, these loan purchases have primarily had loan-to-value ratios below 80 percent, so that credit risk is minimal. In 1993, about 75 percent of the very low-income loans purchases by the GSEs had downpayments in excess of 20 percent.
- Under an economic downturn, such as the 1980s-type economics scenario in the RIA, additional goals-oriented loan purchases only have projected losses on Freddie Mac single family special affordable loans. These would be more than offset by remaining profits on other loans. Because of its much heavier use of a retained portfolio, Fannie Mae would have a much larger cushion against losses in an economic downturn.
- The GSEs have the ability to purchase loans with higher default risk without commensurately higher credit risk. They can do this through combinations of requiring deeper mortgage insurance coverage and charging higher guarantee fees.[60] Resulting price increases to lower-income borrowers could be more than offset by other innovations which are now driving down the cost of mortgage originations for all borrowers.
- As a group, multifamily loans have a higher default potential than do single-family loans. Appropriately underwritten multifamily loans also earn higher guarantee fees for the GSEs, offsetting their higher credit risk. Yet the analysis developed in the RIA shows a discernable risk-return tradeoff with respect to multifamily lending: Higher profit margins under stable economic conditions, but larger potential losses in economic downturns. Fannie Mae has virtually eliminated this loss potential by holding a much larger percentage of multifamily loan purchases in retained portfolio. Freddie Mac could follow much the same strategy as it increases its multifamily business. The housing goals are structured such that the GSEs can meet the goals without significantly increasing their credit risk from multifamily purchases much beyond that imbedded in current baseline multifamily purchase targets for 1995 and 1996.
- Guarantee fee income from securitized loans is sufficient to cover the expected credit costs of any additional goals-oriented purchases under baseline consensus economics. The much larger profit margins on their retained portfolios allow the GSEs to compete on guarantee fee prices, and still provide financial cushions against potential economic downturns.
- Increased retention in portfolio of additional, targeted loans purchased to help satisfy the housing goals is one possible way to hedge any increased credit risk. HUD's analysis finds that guarantee fees alone are insufficient to provide the earnings necessary to prevent losses on these loans in the event of a severe economic downturn. Portfolio earnings are five-to-eight times as large as guarantee fee income, as a percent of dollar loan volumes. The increase in total portfolio holdings required to fully protect against credit risk in the economic downturn scenario developed by HUD is so small as to not raise concerns about exposing the GSEs to any greater interest-rate risk.
- Lenders, the GSEs, and private mortgage insurers are implementing changes in mortgage marketing and underwriting that extend homeownership opportunities to below-median-income households without measurably increasing credit risk. These changes are increasing the pool of potential loan purchases that are both sound investments and qualify under the regulatory goals.
- These same risk-mitigation measures and alternative underwriting criteria should increase loan originations in minority and low-income neighborhoods and directly increase the GSEs' abilities to meet the central cities, rural areas, and other underserved areas goal. In addition, about 60 percent of underserved area home buyers have incomes above median income, which strengthens the credit quality of targeted purchases in these areas.

D. Determination of the 1995 and 1996 Low- and Moderate-Income Housing Goals

The annual goal for 1995 for each GSE's purchases of mortgages financing housing for low- and moderate-income families is established at 38 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The 1996 goal is established at 40 percent. These goals represent an increase over the 1994 goal of 30 percent. Several considerations, many of which have been reviewed in earlier sections of this Appendix, led to the choice of these goals.

1. Housing Need

Almost three-fifths of American households qualify as low- and moderate-income under the Act'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 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 realize their goal of homeownership 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 put strains on the housing finance system during the 1990s. The continued increase in 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 other non-traditional living arrangements, the fastest growing household groups are single-parent and single-person households.

2. GSE Performance Shows Mixed Results

The Charter Acts require that the GSEs provide ongoing assistance to the secondary market including mortgages for low- and moderate-income families. The GSEs certainly 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. 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.

However, 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 1993, homeowners with incomes less than 60 percent of median represented only 5 percent of GSE purchases, and those with incomes less than 80 percent of median represented only 15 percent of GSE purchases. Families with incomes over 120 percent of median, on the other hand, accounted for over 55 percent of single-family mortgages purchased by the GSEs.

The market is originating many more loans for lower income homebuyers than the GSEs are purchasing. (See Figure A.2, which compares GSE performance with the market). The GSEs, based on 1993 HMDA data, purchased a much smaller proportion of conforming mortgages originated for very low-income homebuyers than of mortgages originated for high-income homebuyers (41 percent versus 55 percent). The HMDA data suggest that there is room in the lower income end of the homebuyer market for the GSEs to improve their performance.

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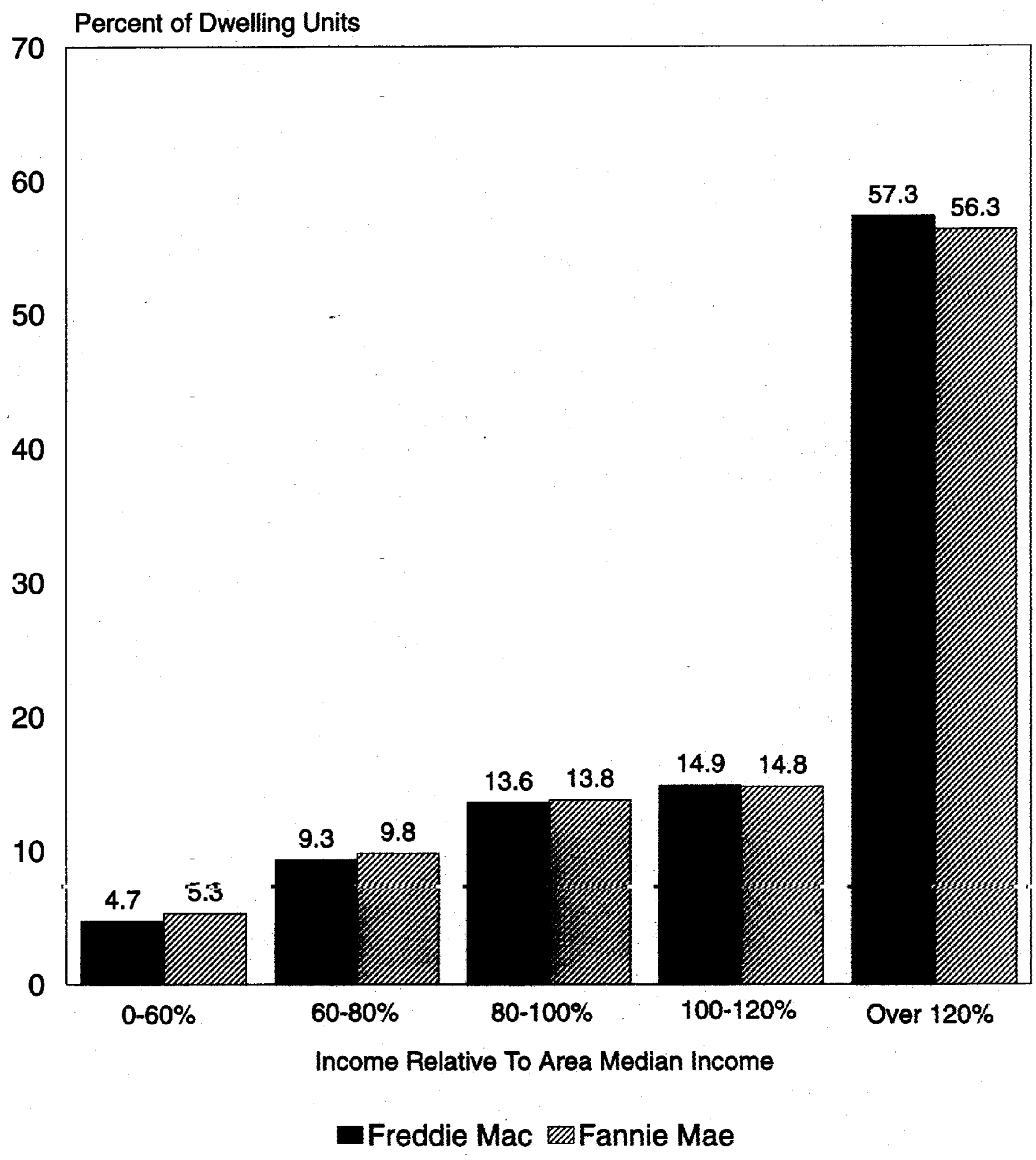
[59] Based on national income distributions, there are 4.2 million one- and two-person households who qualify as below median income according to the housing goals, but whose real income is above median when adjustments for size are factored in. Likewise, there are 2.85 million four-to-six person households who do not qualify as having below median income for goals purposes, but whose incomes are below median when adjusted for household size. On net, then, using an overall family median income has the potential for increasing the pool of potentially goals-qualifying mortgage loans for GSE purchase.

[60] The limits to this in the competitive mortgage originations market are not yet known, but both GSEs recently increased the depth of mortgage insurance required on low downpayment loans.

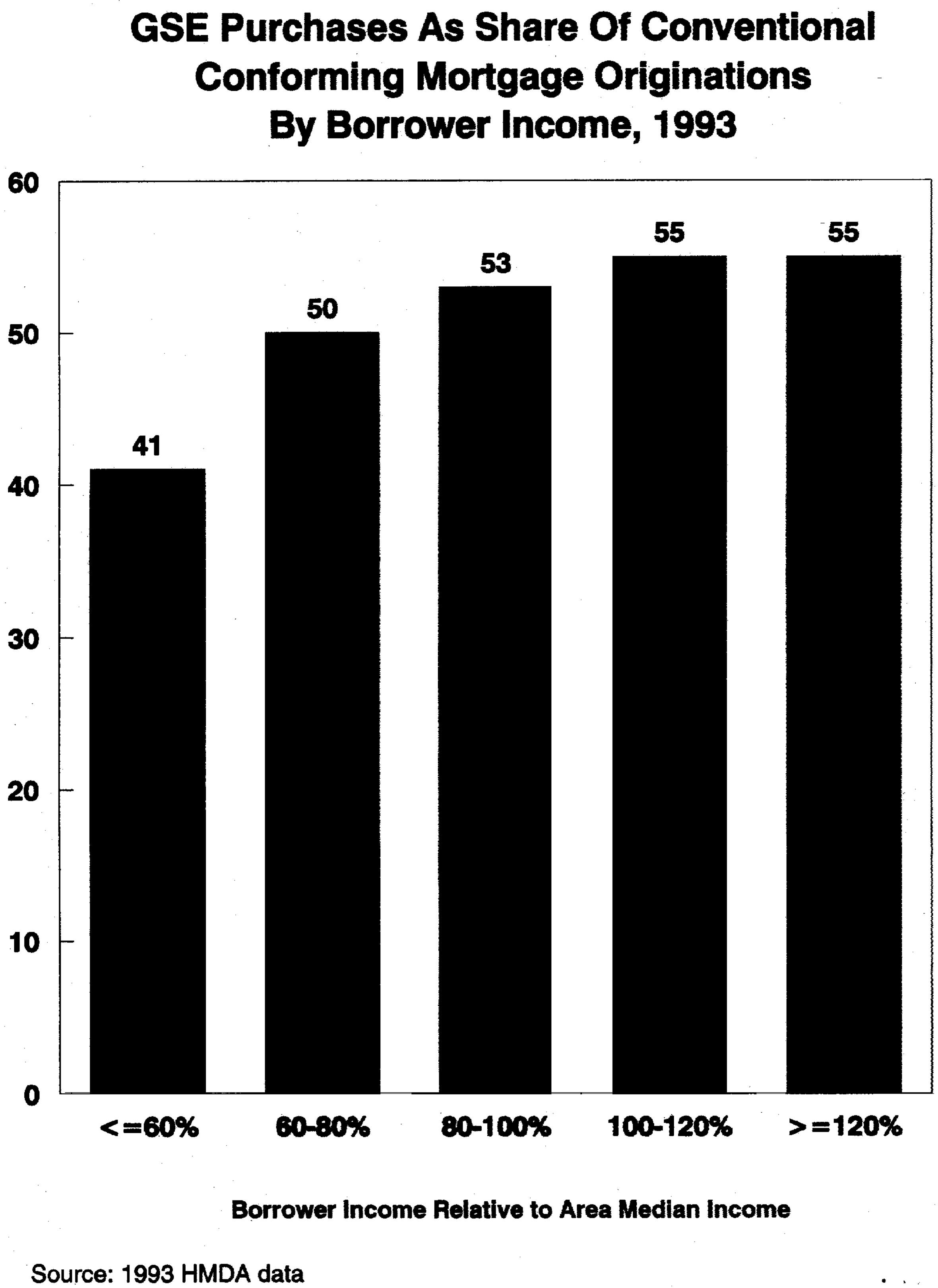
FIGURE A.1

Distribution Of Total Single-Family Dwelling Units In GSE Purchases By Income Class of Mortgagor For 1993



One-unit, owner-occupied units only;
no federal guarantees, second mortgages, or second homes.

FIGURE A.2



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The Secretary is particularly concerned about the level of Freddie Mac's activity in the multifamily area. In 1993, Freddie Mac purchased $191 million in multifamily mortgages, compared with almost $5 billion in purchases by Fannie Mae. 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. The 1995 and 1996 low-mod goals are intended to encourage Freddie Mac's expansion of its multifamily activities.

3. Market Feasibility and Changing Market Conditions

The potential size of the market for low- and moderate-income mortgages is a major determinant of the GSEs' agencies' ability to reach a specific low-mod goal. As detailed in Section C.4, the low-mod mortgage market is quite large, accounting for at least 50 percent of dwelling units financed by conventional conforming mortgages. Figure A.3 compares recent GSE performance, the 1995 and 1996 goals, and the size of the low-mod market. Given the size of the market, the 1995 and 1996 goals are feasible.

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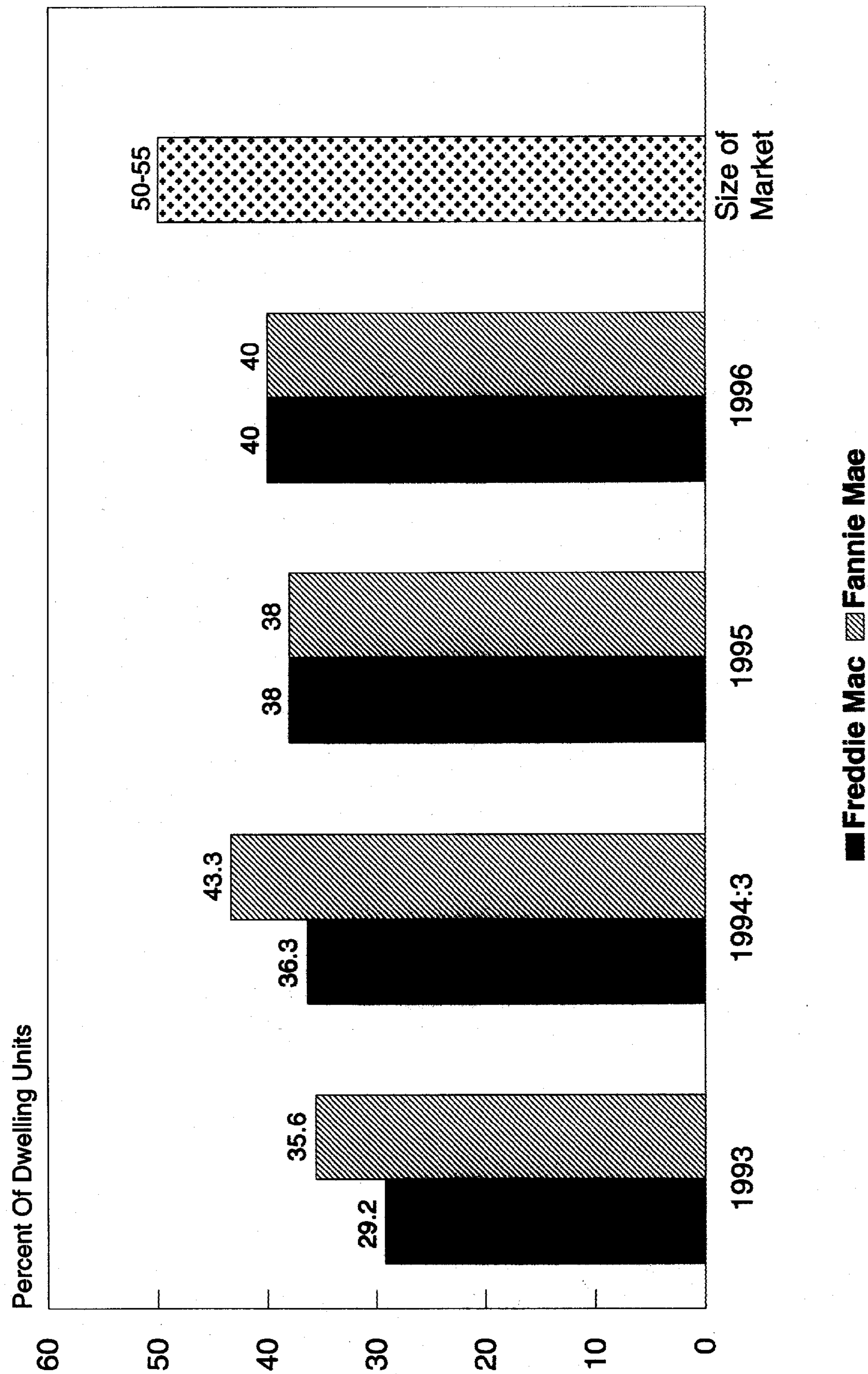
FIGURE A.3

Low- And Moderate-Income Activity And Goals For Freddie Mac And Fannie Mae, 1993-96



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The GSEs' performance under the housing goals will be heavily influenced by overall housing market activity in 1995 and 1996. Low interest rates caused 1993 to be a record year for mortgage originations as refinancings accounted for about 70 percent of the GSEs' business. First-time home buyers were the driving force on the home-purchase side of the market. As explained above, the 1995 and 1996 market is expected to be quite different. Single-family mortgage originations are projected to decline by almost 40 percent between 1993 and 1995, from one trillion dollars to $615 billion. This market fall-off is due entirely to the collapse of the refinance market which is expected to decline from over 55 percent of mortgage activity in 1992 and 1993 to below 20 percent in 1995 and 1996. HUD considered these expected market changes when setting housing goals for 1995 and 1996. HUD's analysis suggested the following effects:

- The projected market shift from refinance to purchase mortgages should increase the low- and moderate-income proportion of mortgage market activity because purchase mortgages are more apt to be obtained by lower-income borrowers than are refinance mortgages. For instance, in 1993, 33 percent of Fannie Mae's single-family purchase mortgages qualified as low-mod versus only 27 percent of its refinance mortgages.
- The substantial decline in single-family mortgage originations, combined with the GSEs' stated intentions to increase purchases of multifamily mortgages, should increase the low- and moderate-income proportion of each GSE's business because practically all multifamily units qualify as low-mod under the Act's definitions. Section C.4 provided estimates of the increase in the multifamily share of the market in 1995 and 1996.
- The recent rise in interest rates from 25 year lows could make it more difficult for lower-income borrowers to qualify for mortgages underwritten according to GSE guidelines. However, interest rates continue to remain lower and housing more affordable than was true for any previous extended period since 1977. Higher interest rates should be partially offset by other demand factors such as rising incomes during the economic recovery and a continued strong first-time homebuyer market due to the pent-up demand for homeownership on the part of renters left out of the market during the 1980s. Furthermore, lenders, the GSEs, and private mortgage insurers are implementing changes in mortgage marketing and underwriting that will extend homeownership opportunities to lower-income households. These changes are increasing the pool of potential loan applicants that qualify under the low-mod goal.

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 1993 multifamily mortgage purchases accounted for only 1.6 percent of their overall low-mod performance (versus 16 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, it should be able to match Fannie Mae's performance in achieving the 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.'' [61]

5. Conclusions

To conclude, the Secretary has determined that the 1995 and 1996 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.

Based on a consideration of the factors, the Secretary proposes to establish all three goals for 1997 and 1998 so that the goals will move the GSEs steadily over a reasonable period of years, including these two years, to a level of mortgage purchases where the GSEs will be leading the industry in purchasing mortgages meeting the goals. In carrying out this objective, the Secretary proposes to establish the goals for 1997 and 1998 at levels ranging from the same amounts established for 1996 to higher levels. The purpose of any higher levels would be to continue to move the GSEs toward purchasing a greater proportion of targeted mortgages originated by the market.

[61] Senate Report 102–282, p. 36.

Appendix B—Secretarial Considerations To Establish the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal

A. Establishment of Goal

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.

In establishing this annual housing goal, the Act 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 enterprises toward achieving the central cities, rural areas, and other underserved areas housing 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 enterprises 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 enterprises.

As described in Section 1334(d) of the Act, the annual target for this goal for the 1993–94 transition period was that 30 percent of units financed by mortgages purchased by each enterprise should be located in ''central cities,'' as designated by the Office of Management and Budget. Starting in 1995, this interim target is to be replaced with a goal targeting areas with relatively poor access to credit in ''central cities, rural areas, and other underserved areas.'' [1] The Secretary has defined ''central city'' as the underserved area of any political subdivision designated as a central city by OMB. The Secretary has defined ''rural area'' as any underserved area located outside of any metropolitan statistical area (MSA) designated by OMB. The Secretary has determined that ''underserved areas'' are defined as census tracts or non-metropolitan counties where: Minorities comprise 30 percent or more of the residents and the median income of families does not exceed 120 percent of the area median income; or where the median income of families does not exceed 80 percent of the area median income.

Section B reports findings on access to mortgage credit and Section C addresses the six factors listed above. Section D summarizes the Secretary's rationale for selecting the goals for central cities, rural areas, and other underserved areas for 1995 and 1996.

B. Underlying Data and Identifying Underserved Areas

1. Introduction and Overview

For the post-transition period, the Secretary was charged with redefining and expanding this goal from the transition target of ''central cities'' to include ''rural areas and other underserved areas.'' The legislative history shows that Congress intended that the goal target geographic areas with ''relatively poor'' or ''inadequate'' access to mortgage credit and areas suffering from ''the vestiges of redlining.'' [2]

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, past enterprise performance, and the size of the conventional market in ''underserved'' areas, it is essential to define ''underserved areas'' as accurately as possible from existing data. To provide essential background for understanding the Secretary's proposed definition of underserved areas for this goal, this section carefully reviews the evolving literature investigating access to credit and reports findings from HUD's analysis of 1993 HMDA data.

Two main points are made in this section:

[1] FHEFSSA, section 1334(a).

[2] Senate Report at 38.

• The existence of substantial geographic disparities in mortgage credit is well documented. 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 proxy for determining whether that area is being underserved by the mortgage market.

• The research strongly supports a targeted definition of underserved areas. 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 central city location play only a minor role in explaining disparities in mortgage lending.

2. Evidence About Access to Credit

The viability of neighborhoods—whether urban, rural, or suburban—depends on the access of their residents to mortgage capital to purchase and improve houses. 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. There is growing evidence that discrimination and other factors, such as inflexible and restrictive underwriting guidelines, limit access to mortgage credit and leave potential borrowers in certain areas underserved.[3]

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] 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 Black neighborhoods in the city of Boston." [10]

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 shows that high-minority and low-income census tracts have both higher loan application denial rates and lower loan origination rates.[11]

Table B.1 presents denial and origination rates by the minority composition and median income of census tracts for metropolitan areas. The tract minority and income data are grouped by deciles. 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 80 percent minority is about two-and-a-half times that for census tracts with less than 10 percent minority.[12]

• Census tracts with lower incomes have higher denial rates and lower origination rates than higher income tracts. The average number of mortgage originations in high-income census tracts (i.e., tracts with a median income over 120 percent of area median) was 12.7 per 100 owner-occupants; this compares with a range of 3.6 to 6.6 originations for the census tract deciles with income less than 80 percent of area median.

Denial rates increase in increments ranging from 1.6 to 3.0 percent as one moves from low-minority to 60-percent-minority tracts. They decline in decrements ranging from 1.0 to 3.4 percent as tract income increases from 60 percent of area median to over 120 percent of area median.

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[3] Because of concern about these problem issues, Federal agencies have formed an Interagency Task Force on Fair Lending to establish a uniform policy against discriminatory lending. At the same time, both Fannie Mae and Freddie Mac have made efforts to make their underwriting guidelines more flexible to allow alternative mechanisms for low-income borrowers to demonstrate creditworthiness.

[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.

[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.

[10] Holmes and Horvitz, and Schill and Wachter conduct more rigorous tests of the redlining hypothesis that control for several characteristics of the neighborhood, including credit risk. Their findings are reviewed in Section 2.e below.

[11] 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.

[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 Conforming Mortgages

Tract Minority %	Originations Per 100 Owner-Occupied Units (Purchase and Refinances)	Denial Rate (Purchase)
LT 10%	13.9	10.7%
10-20	13.0	13.1
20-30	11.3	16.1
30-40	10.5	18.2
40-50	9.5	19.8
50-60	8.9	21.7
60-70	8.5	22.3
70-80	8.0	22.6
80-90	6.6	24.4
90-100	3.6	27.9
Tract Income Relative to MSA Median		
LT 20%	*	25.8%
20-30	4.4	23.5
30-40	3.5	25.5
40-50	4.2	26.3
50-60	4.7	24.8
60-70	5.8	23.6
70-80	6.8	21.3
80-90	8.5	18.5
90-100	10.2	15.8
100-110	12.2	13.2
110-120	14.3	11.3
120+	17.7	8.8

* Not applicable due to missing owner occupied data.

Source: HUD analysis of 1993 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 had a denial rate of 8.4 percent and an origination rate of 18.0. The high-minority (over 50 percent), low-income (under 80 percent of area median) group has a denial rate of 26.6 percent and an origination rate of only 4.7. 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 (22.0 percent versus 11.9 percent) and half the average origination rate (7.0 versus 14.1). 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 (14.2) for high-income tracts with a minority share of population over 30 percent is slightly above the average (14.1) 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

Origination Rates (per 100 owner occupants)

Tract Income	Minority Composition			
	LT 30%	30-50%	50-100%	Total
LT 80%	**6.6**	**5.9**	**4.7**	5.9
80-120%	11.7	**10.1**	**8.2**	11.3
120%+	18.0	14.9	13.1	17.7
Total	13.4	10.1	6.6	12.3

Denial Rates

Tract Income	Minority Composition			
	LT 30%	30-50%	50-100%	Total
LT 80%	**20.5**	**22.2**	**26.6**	22.9
80-120%	13.5	**18.8**	**22.1**	14.4
120%+	8.4	15.0	16.4	8.8
Total	11.8	18.9	23.7	13.2

Note: Bold categories are included in HUD's Underserved Area definition.

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 mortgage (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. They found that minorities' higher denial rates could not be explained fully by income and credit risk factors. Blacks 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 minority denial rates 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.

The Boston Fed and HUD studies 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[16] and by underwriting standards that have disparate effects on minority and lower income borrowers and neighborhoods.[17]

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.[18] Their regression model included as explanatory variables the economic viability of the loan and 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 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 Black 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* (emphasis added) taking account of variables that are rationally connected with the economics of the mortgage lending process."[19]

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.[20] 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.[21]

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[22] and characteristics of the neighborhood where the property collateralizing the loan is located. Because they rely on public data, Schill and Wachter do not have information on several loan and property risk variables, such as loan-to-value ratio, that are known to affect the mortgage

[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] ICF Incorporated, Ann B. Schnare, and Stuart A. Gabriel, "The Role of FHA in the Provision of Credit to Minorities," prepared for the U.S. Department of Housing and Urban Development, April 25, 1994.

[16] 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.

[17] 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.

[18] 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.

[19] Holmes and Horvitz, page 97. 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.

[20] Schill and Wachter. Although its 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 one can reach definitive conclusions about redlining.

[21] 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.

[22] 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).

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.[23] Finally, to test for the existence of racially-induced lending patterns across census tracts, Schill and Wachter include the percentage of persons in the census tract that are Black 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 is Black or Hispanic—showed significant negative effects on the probability that a loan will be accepted. Schill and Wachter state 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 is Black also shows a significant and negative coefficient, a result that is consistent with redlining. However, when the neighborhood risk proxies are included in the model along with the individual loan variables, the percentage of the census tract that is Black becomes insignificant. Thus, similar to Holmes and Horvitz, Schill and Wachter state 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.''[24]

In their conclusion, however, Schill and Wachter state that while their results do not support the hypothesis of redlining, they cannot 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 Black or Hispanic) remains 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 is positively correlated with the census tract race variable. It may be that the applicant race variable is picking up effects that should properly be attributed to the census tract race variable.[25] 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 of underserved areas? 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 22.2 percent denial rate in underserved areas of central cities is twice the 11.2 percent denial rate in the remaining areas of central cities. Similarly, the average mortgage origination rate (per 100 owner occupants) in underserved areas of central cities is 6.2, much lower than the average of 13.1 for the remaining areas of central cities.

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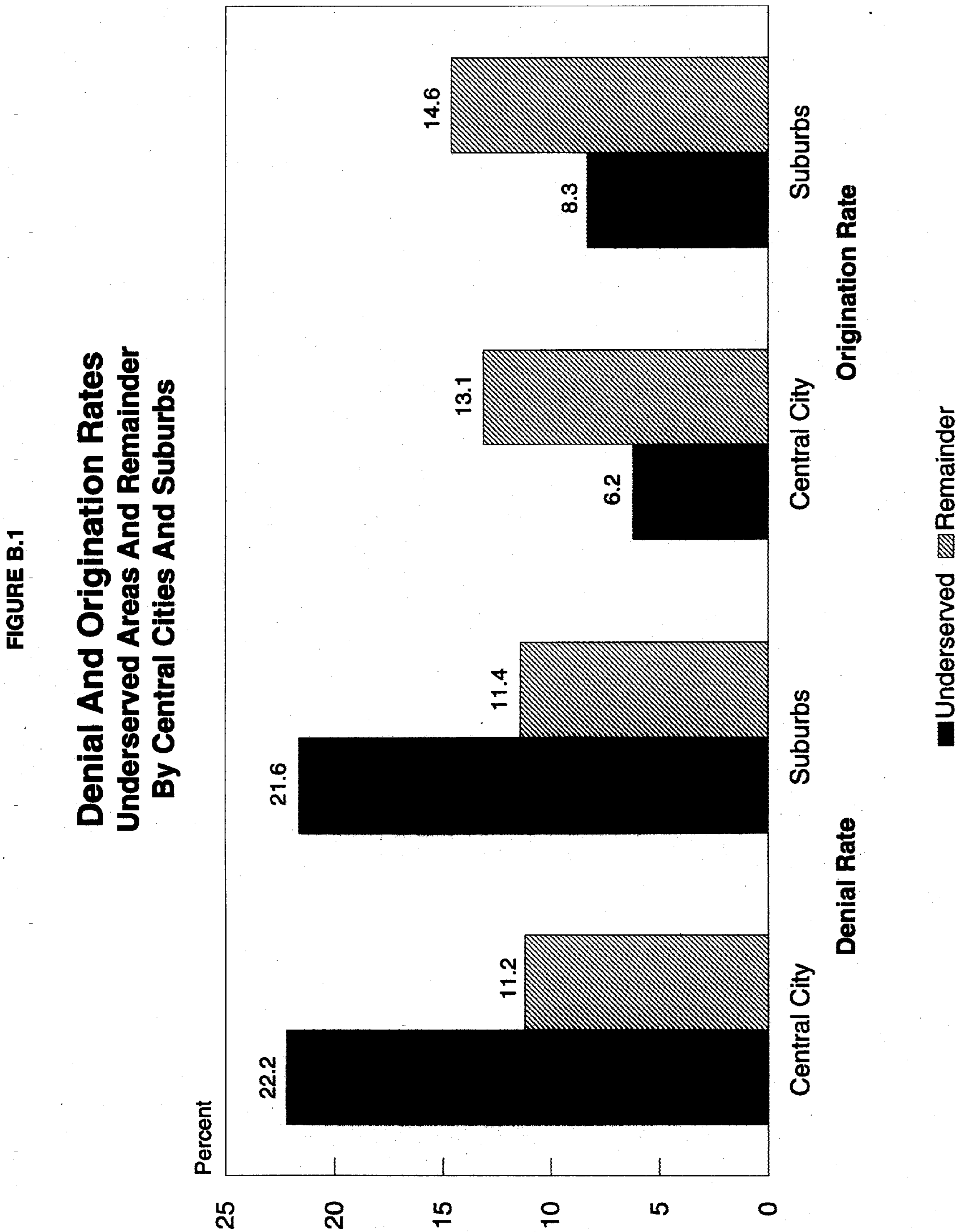
[23] Their neighborhood risk proxies include median income and house value (inverse indicators of risk), percent of households receiving welfare, median age of houses, homeownership rate (an inverse indicator), vacancy rate, and the rent-to-value ratio (an inverse indicator). A high rent-to-value ratio suggests lower expectations of capital gains on properties in the neighborhood.

[24] 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.

[25] 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.



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A broad, inclusive definition of ''central city'' that includes all areas of all central cities would include the ''remaining'' portions of central cities. Figure B.1 shows that these areas, which account for approximately half of the central city population, appear to be well served by the mortgage market. They are not experiencing problems obtaining access to mortgage credit.[26]

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 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 23 percent of the suburban population, should also be included in the definition of 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.[27] 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:

- Black and Hispanic census tracts 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-Black 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.[28]

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.[29] 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. Black 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.[30] For white applicants, on the other hand, denial rates were significantly higher in minority tracts.[31] That is, minorities 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 central city as a proxy.

Insights Gained About Underserved Areas. HUD's analysis of 1993 HMDA data has led it to propose a targeted definition of central cities, rural areas, and other underserved areas based on the income and minority characteristics of the census tract. The studies by Shear, *et al.* and Avery, Beeson, and Sniderman support a targeted approach to defining underserved areas. HUD recognizes that the mortgage origination and denial rates that served as the basis for determining the tract income and minority thresholds in its definition of underserved areas are the result of a multitude of risk, demand and supply factors operating at the individual applicant and neighborhood levels that analysts have yet to completely disentangle and interpret. Like the above researchers, HUD believes that this technical concern, although important, does not negate the fact that there are widespread and pervasive differences in mortgage credit flows between neighborhoods and that these differences suggest a targeted rather than a broad approach for defining underserved areas. The next section will also document that there are equally widespread and pervasive differences in socioeconomic conditions across neighborhoods, which also supports a targeted definition of central

[26] Section D below will provide additional reasons why central city location should not be used as a proxy for underserved areas.

[27] 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.

[28] Shear *et al.*, p. 18.

[29] See Avery, *et al.*

[30] 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.

[31] 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.

cities, rural areas, and other underserved areas.

f. Mortgage Access Problems and Socioeconomic Distress

To this point the discussion has focused on the credit problems of minority and low-income neighborhoods. However, there has also been a great deal of concern about poor living conditions in the nation's distressed neighborhoods. This section brings these two issues together, showing that lack of access to credit markets is closely related to distressed living conditions.

HUD's analysis of underserved census tracts shows that they are substantially more distressed than served tracts:

- Poor persons are highly concentrated in underserved areas. In metropolitan areas, 64 percent of all poor people live in underserved areas. The share is even higher in central cities, with 76 percent of poor persons in underserved areas.
- Table B.3 shows that residents in underserved areas have higher poverty rates, higher minority concentration, lower incomes, and higher unemployment rates. For instance, underserved areas show a poverty rate of 23 percent, compared with only 7 percent in served areas.
- In terms of housing, Table B.3 shows that underserved areas have a larger percentage of renters, more boarded-up units, more older housing, and more low-valued housing than do served areas. The average value of owner-occupied housing in underserved areas was $81,681, compared with $127,423 in served areas.

The socioeconomic differences between underserved and served census tracts hold when the comparisons are made separately for central cities and suburban areas. These findings further support the targeting approach and point to the usefulness of the minority and income variables as proxies for underserved conditions.

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Table B.3

Characteristics of Underserved and Served Tracts: Metropolitan Areas

	Central Cities		Suburbs		Metropolitan Areas	
	Underserved	Served	Underserved	Served	Underserved	Served
Number of Census Tracts	12,531	10,629	4,806	16,481	17,337	27,110
Poverty Rate	26.7%	8.4%	16.6%	6.5%	22.7%	7.2%
Tract Income/MSA Income	63	124	77	119	67	121
Minority Percentage	63.3%	13.3%	41.9%	8.7%	54.4%	10.5%
Percent Old Houses *	45.6%	28.9%	26.7%	21.3%	40.3%	24.3%
Median House Value	$75,431	$122,459	$97,975	$130,624	$81,681	$127,423
Percent Renter	58.6%	35.4%	43.5%	23.4%	54.4%	28.1%
Percent Boarded Up	1.31%	.15%	.43%	.12%	1.07%	.13%
Unemployment Rate	12.5%	5.0%	8.7%	4.6%	11.4%	4.8%

*Percent of housing units built before 1950.

Note: Except for the unemployment and poverty rates, percentages represent unweighted averages across census tracts.

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g. Identifying Underserved Locations in Rural Areas

Evaluating which rural locations are underserved in terms of access to mortgage credit cannot be done with HMDA data, the source used for most of the studies of credit needs summarized here, because these data do not provide geographic identifiers on mortgage activity outside of metropolitan statistical areas. Moreover, there are few careful current studies on access to mortgage credit in rural locations. A 1990 study by the Urban Institute, for example, found little evidence of a national rural home credit shortage, and attributed low mortgage activity in some local markets to lack of demand in weak local economies.[32]

To address issues about defining underserved areas in rural contexts, the Department consulted with researchers from academia, the Department of Agriculture, the Census Bureau, the Housing Assistance Council, the Congressional Budget Office, public-interest groups, and the GSEs. Researchers participating in a forum on these issues agreed that available studies do *not* show that rural areas have endemic problems with access to credit, although this conclusion may stem from lack of adequate data. Yet there is much anecdotal evidence that underserved areas in rural communities have less access to credit and particularly to the secondary market. According to the Housing Assistance Council (HAC), access to mortgage credit worsens as distance from metropolitan centers increases,[33] while Department of Agriculture representatives judge that communities with population below 2,500 or 5,000 most often lack access to lenders. In general, the forum participants agreed that, as found for cities and suburbs, rural communities with low income or minority concentrations were those more likely to be underserved.

3. Conclusions From HUD's Analysis and the Economics Literature About 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 HMDA data shows that low-income and 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 beginning to test 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.[34]

Finally, the 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.

C. Consideration of the Factors

As the above review 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. Experts on rural housing concur that these dimensions also influence credit availability in rural and non-metropolitan areas. 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 identified as underserved under the Secretary's proposed definition. Section C.1. describes housing needs in urban and rural areas generally, after which the extreme social and economic problems of distressed neighborhoods are noted. 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 proposed definition, 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. Housing Needs in Urban and Rural Areas

a. Regional and Urban/Rural Differences in Housing Needs

The incidence of housing problems and severe housing problems varies markedly by location. At almost every income level in 1990, both renters and owners were most likely to have housing problems in the West, and residents of central cities more often had problems than those in suburbs or outside metropolitan areas.[35] In each type of location, affordability problems were most common. Although households in non-metropolitan areas, for example, were less likely than those in cities or suburbs to pay more than 30 percent of income for housing in 1991, affordability problems (25 percent) were still much more common for them than physically inadequate housing (10 percent). Three-quarters of non-metropolitan housing units are in the South and the Midwest. These households have a relatively high incidence of substandard housing, but affordability is less of a problem than elsewhere in the nation. Housing conditions are worst in the South, where over one-fourth of non-metropolitan units have some type of physical deficiency.

Very low-income renters similarly were more likely to have worst case problems in the West and Northeast than in the Midwest and South. Nationally, over half of worst case households lived in central cities, while a third lived in the suburbs.[36] In all four regions, renters living outside of metropolitan areas least often had worst case problems.

Although ''non-metropolitan,'' as defined by OMB is often considered equivalent to ''rural,'' as defined by the Census Bureau, almost half of rural households live in metropolitan areas. Moreover, over one-third of non-metropolitan households live in communities the Census Bureau classifies as urban. Thus, any discussion of rural and urban housing needs must define terms carefully. Analysis of 1991 American Housing Survey data reveals that rural households in metropolitan areas actually have higher ownership rates and fewer housing problems than either urban or rural residents of non-metropolitan areas. Furthermore, in non-metropolitan counties, housing problems are more frequent and more often severe, for urban than for rural residents.

The Economic Research Service of the Department of Agriculture 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.[37] 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

[32] The Urban Institute, 1990. *The Availability and Use of Mortgage Credit in Rural Areas* examined data on ownership, mortgage terms and conditions, and Federal program coverage, particularly for moderate-income homebuyers.

[33] Statement of Moises Loza, Executive Director of HAC, July 21, 1994, to the Subcommittee on Environment, Credit, and Community Development of the House Committee on Agriculture.

[34] 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.

[35] 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.

[36] 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.

[37] *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.

counties are concentrated in Appalachia and in areas with high proportions of minority residents.

Higher proportions of rural households are homeowners than those in urban areas (79 percent versus 60 percent), in part because of wider availability of mobile homes. Because of lower mobility and higher shares of elderly householders who have paid off their mortgages, rural homeowners are less likely to have mortgages than urban homeowners (46 versus 64 percent). Those that do have mortgages are more reliant on non-institutional sources than homeowners in metropolitan areas.[38]

b. Housing Needs in Distressed Neighborhoods

Although analysis of housing problems in areas defined as underserved by the Secretary is still underway, over the past three decades evidence of growing poverty concentrations has caused mounting 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.[39] 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 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.[40] 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.[41] As discussed earlier, the tracts qualifying as underserved under HUD's definition have similar socioeconomic problems and are substantially worse off than other parts of metropolitan areas in terms of both social and housing problems (see Table B.3).

2. Economic, Housing, and Demographic 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 Housing Discrimination Study sponsored by HUD and conducted in 1989 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.[42] The incidence of discrimination was higher for Blacks than for Hispanics and for homebuyers than for renters. For renters, the incidence of discrimination was 46 percent for Hispanics and 53 percent for Blacks. The incidence among buyers was 56 percent for Hispanics and 59 percent for Blacks.

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. 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.[43]

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 Blacks, 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.[44]
- Discrimination, while not the only cause, contributes to the pervasive level of segregation that persists between Blacks 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.

The housing problems of minorities and the neighborhoods where they live are of growing importance, in part, because minorities, particularly Hispanics, are becoming an increasingly large share of the U.S. population. In Los Angeles and Miami, with rapid growth in Hispanic immigrant population and slow growth in the native-born non-Hispanic White population, minorities already represent more than half the total population.

Homeownership rates vary consistently by neighborhood characteristics. As Table B.4 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.

3. Previous Performance and Effort of the GSEs In Connection With the Central Cities, Rural Areas and Other Underserved Areas Goal

The central cities, rural areas, and other underserved areas goal will be in effect for the first time in 1995, replacing the central city goal. Because it is a new goal, the GSEs did not provide specific reports to HUD regarding their 1993 performance in connection with underserved areas. HUD did examine the GSEs' performance in the areas covered by the newly defined goal using 1993 HMDA data and the loan-level data submitted by the GSEs to HUD for 1993 mortgage purchases.

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[38] The Urban Institute.

[39] ''Inner-City Concentrated Poverty and Neighborhood Distress: 1970 to 1990.'' *Housing Policy Debate,* 4(3): 253–302.

[40] 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.

[41] 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.

[42] 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.

[43] Margery A. Turner, ''Discrimination in Urban Housing Markets: Lessons from Fair Housing Audits,'' *Housing Policy Debate,* Vol. 3, Issue 2, 1992, pp. 185–215.

[44] 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.4

Homeownership Rates for Metropolitan Census Tracts

Tract Median Income as % of Area Median	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	7.3%	4.8%	15.3%	17.3%	18.2%	16.1%	16.6%	19.2%	18.9%	16.9%	17.1%
30-40%	18.1%	9.2%	17.9%	22.2%	20.6%	20.0%	23.9%	24.7%	26.5%	27.5%	25.0%
40-50%	30.1%	27.6%	27.1%	25.7%	27.1%	26.4%	26.7%	26.8%	28.8%	32.4%	29.6%
50-60%	54.8%	37.7%	37.6%	30.1%	32.0%	34.7%	35.9%	34.7%	35.8%	39.7%	37.5%
60-80%	62.0%	48.3%	43.1%	41.9%	39.9%	43.1%	43.0%	45.4%	44.9%	48.6%	48.3%
80-100%	70.6%	58.5%	53.3%	51.4%	49.4%	52.5%	52.8%	54.9%	55.9%	62.5%	62.0%
100-120%	76.1%	64.5%	60.3%	57.6%	59.0%	62.0%	65.9%	65.1%	71.2%	64.6%	70.1%
More Than 120%	79.3%	67.3%	65.6%	67.1%	66.4%	66.6%	73.6%	74.7%	69.9%	71.6%	74.0%
TOTAL	74.3%	61.1%	54.6%	50.4%	47.3%	47.2%	46.4%	46.7%	44.1%	39.8%	61.8%

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a. GSE Performance: 1993 HMDA Data

HMDA data permit examination of the GSEs' performance in metropolitan areas.[45] According to 1993 HMDA data, 13.1 percent of Fannie Mae's single-family business was in underserved areas. Of its total underserved business, 23.8 percent was in low-income tracts (i.e., tracts with income not exceeding 80 percent of area median but with minority population less than 30 percent), 49.8 percent was in high-minority tracts (i.e., tracts with minority population greater than or equal to 30 percent and with incomes between 80 and 120 percent of the area median), and 26.4 percent was in high-minority, low-income tracts.

Based on 1993 HMDA data 13.6 percent of Freddie Mac's single-family business was in underserved areas. Of its underserved business, 23.1 percent was in low-income tracts, 50.0 percent was in high-minority tracts, and 27.0 percent was in high-minority, low-income tracts.

HMDA data can also be used to compare GSE performance in low-income and high-minority census tracts with that of the overall market. Combined, GSE purchases accounted for a higher percentage of loans in high-income census tracts than in low-income census tracts. GSEs purchased 44 percent of the loans in under-50-percent income tracts, 47 percent of the loans in 50–80-percent income tracts, 51 percent of the loans in 80–100-percent income tracts, and 59 percent in the above-median income tracts. The GSE purchase share declined sharply relative to the market in very-high-minority tracts (over 90 percent).

b. GSE Performance: 1993 GSE Data

Table B.5 summarizes GSE purchases in underserved areas using the 1993 loan-level data that Fannie Mae and Freddie Mac submitted to HUD. In 1993, 15.9 percent of Fannie Mae's business and 14.4 percent of Freddie Mac's business was in underserved areas. The share of GSE business in underserved areas varies rather dramatically by property type; for example, about 13 percent of Fannie Mae's single-family owner purchases were in underserved areas compared with over 30 percent for the three rental property types given in Table B.5.

As Table B.6 shows, approximately 40 percent of GSE purchases in underserved areas were mortgages of low- and moderate-income households. Thus above-median income households accounted for 60 percent of the mortgages that the GSEs purchased in underserved areas which suggests these areas are quite diverse. In central cities, one-third of the GSEs' low-mod purchases were in underserved areas, whereas in the suburbs, only 16 percent were. This reflects the much greater concentration of poverty in central cities.

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[45] HMDA data are not useful for examining rural performance. However this, by itself, will have little effect on the estimate of performance because the GSEs do only a small portion of their business in non-metropolitan areas. Share of metropolitan business in underserved areas will be very close to share of total business in underserved areas. Metropolitan underserved share is only an underestimate of total underserved share if the rural business is much more highly targeted to underserved areas than is the metropolitan business.

Table B.5

Share of 1993 Purchases That Were In Underserved Areas

	Fannie Mae	Freddie Mac
SF-Owner	12.7%**	12.8%
SF 2-4	45.2	43.0
SF Investor	35.4	35.6
Multifamily	35.0	37.9
Total	15.9	14.4

* Excluding FHA/VA purchases.

** 12.7 percent of Fannie Mae single-family owner-occupied units were in underserved areas.

Table B.6

1993 Fannie Mae And Freddie Mac Mortgage Purchases By Underserved Area And Low- And Moderate-Income

Share of 1993 Underserved Units That Are Also Low- And Moderate-Income Units		
	Fannie Mae	Freddie Mac
Central City	44.8%*	42.5%
Suburbs	41.6	40.1
Non-metro	20.8	22.8
Total	42.0	39.5
Share Of Low- And Moderate-Income Units That Are In Underserved Areas		
	Fannie Mae	Freddie Mac
Central City	33.4%**	32.8%
Suburbs	14.1	14.2
Non-metro	4.8	8.9
Total	18.1	18.0

* 44.8 percent of Fannie Mae's 1993 central city single-family owner-occupied purchases in underserved areas went to low-mod borrowers. (Properties with missing data excluded.)

** 33.4 percent of Fannie Mae's 1993 low-mod units located in central cities are also located in underserved areas. (Properties with missing data excluded.)

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4. Size of the Conventional Mortgage Market for Central Cities, Rural Areas, and Other Underserved Areas Relative to the Overall Conventional Conforming Market

Section C.4 of Appendix A describes HUD's two approaches for estimating the size of the low- and moderate-income market. The first approach cannot be used for underserved areas because American Housing Survey data are not available at the census tract level. The analysis of underserved areas follows the second approach, which is based on HMDA data and projections of the 1995 mortgage market. The methodology involves estimating for each of the various property types (single family owner, single family investment, etc.) the percentage of dwelling units financed by mortgages that are located in underserved census tracts and, then, computing the overall market share for underserved areas by weighting these underserved area percentages by the mortgage originations for each property type in the 1995 market.

This approach follows the same six steps as outlined in Section C.4.b of Appendix A. In steps (5) and (6), underserved area shares are substituted for low-mod shares:

(5) Estimates of the percentage of dwelling units financed by mortgages that are located in underserved areas were: 15.4 percent for single-family owner-occupied purchase mortgages and 14.1 percent for single-family owner-occupied refinance mortgages (both figures based on 1993 HMDA data); and 45 percent for single-family 2–4's, 35 percent for single-family 1–4's, and 43 percent for multifamily (discussed below).

(6) Applying the above underserved area percentages to the property type weights given in step (4) of Section C.4.b of Appendix A gives an overall estimated underserved area share for 1995 of 23.4 percent.

Sensitivity analyses were conducted for the market importance of each property type and for the underserved area shares of each property type, as discussed in Appendix A. Using 1992 HMDA data for the single-family owner-occupied shares in step (5) gave almost identical results. Sensitivity analysis was more important for the three rental categories where data on underserved areas are not readily available. The percentages (45 percent and 35 percent) of single-family rental mortgages located in underserved areas were based on GSE data—the percentages of Fannie Mae's mortgage purchases in underserved areas for 2–4 and 1–4 properties were 45 percent and 35 percent, respectively, and the corresponding percentages for Freddie Mac were 43 percent and 36 percent, respectively.[46] 1993 (1992) HMDA data on mortgages to properties with non-occupant owners were consistent with the GSE data for 1–4 properties—HMDA reports that almost 32 percent (35 percent) of those mortgages were for properties located in underserved areas.

The multifamily underserved area percentage (43 percent) is based on 1992 and 1993 HMDA data which, admittedly, is quite limited.[47] The only other source is Fannie Mae data, because Freddie Mac's purchases of multifamily mortgages in 1993 were limited. In 1993, about 35 percent of Fannie Mae's multifamily business was in underserved areas. Dropping the multifamily percentage from 43 percent to 40 (35) percent would reduce the estimated market share for underserved areas to 22.9 (21.9) percent. These and other analyses leads the Secretary to conclude that the size of the underserved area market is at least in the 21–23 percent range.

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

This factor is the same as the sixth factor considered under the goal for mortgage purchases on housing for low- and moderate-income families. Accordingly, see Section C.6 of Appendix A for discussion of this factor.

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 underserved area goals. 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 all to 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 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 lending disparities are glaring and persistent and that minority and low-income communities are underserved by the mortgage system.

2. Selection of Targeted Approach

For 1993 and 1994, the Secretary was required to use the OMB list of ''central cities'' for the geographic targeting goal; the OMB definition of central city was a temporary measure to allow time for analysis to define a better targeting standard. HUD, along with the GSEs, Congress, and community groups, recognized that central cities as defined by OMB do not satisfactorily measure cities that are underserved by the mortgage market. There are several reasons for this.

First, major portions of central cities house upper-income families and neighborhoods that are well served by the mortgage market. New York's Upper East Side, Chicago's ''Gold Coast,'' Washington's Georgetown and other wealthy areas within central cities across the nation do not fit into any reasonable definition of an ''underserved area.'' The fact that not all parts of central cities lack access to mortgage credit was demonstrated earlier in Figure B.1. Compared to underserved central city census tracts, the remaining ''served'' tracts have half the denial rate. Mortgage origination rates (per 100 owner occupants) in the served portions of central cities are double the origination rates in the underserved portions of central cities. Thus, central city areas that are not included in HUD's underserved area definition appear to be obtaining mortgage credit. These areas, which account for about half of the central city population, are well served by the mortgage market.

Second, many urban areas not defined as ''central cities'' by OMB are highly distressed and not well served by the mortgage market. Examples of highly distressed urban areas located outside central cities include East Orange and Paterson, New Jersey and Compton, California. Highly distressed Compton, with a poverty rate of 25 percent, is not on OMB's list, but Palo Alto, California, with a poverty rate of only 2 percent, is on OMB's list.

[46] Unlike the low- and moderate-income percentages reported in Appendix A, the likelihood of the GSEs' mortgages being located in an underserved area did not differ much between purchase and refinance mortgages.

[47] The 1992 HMDA data included only $9 billion of the $25 billion in conventional multifamily mortgages originated during 1992. Similarly, the 1993 HMDA data included $11 billion of the total $29 billion in conventional multifamily mortgages originated in 1993.

Third, OMB states that:

In cases where there is no statutory requirement and an agency elects to use the (Metropolitan Area (MA)) definitions in a nonstatistical program, it is the sponsoring agency's responsibility to ensure that the definitions are appropriate for such use.[48]

Strictly speaking, this OMB statement applies only to MAs, but by logical extension it also applies to the central cities within these MAs. The Secretary has examined OMB's definition of central cities, in accordance with this memorandum, and concluded that it alone does not provide a satisfactory definition of all (or a part) of appropriately-defined ''underserved areas.''

Finally, there is substantial regional variation in the portion of state urban populations that are included within central cities. In the Southern and Western parts of the United States, cities have often expanded by annexing adjacent territory. This option was generally not available to cities in the Northeast, which have retained their historical boundaries. Thus, a substantially greater portion of the population lives in central cities in South and West than in the more urbanized Northeastern states. Central cities accounted for more than 50 percent of both GSEs' 1993 purchases in Arizona, New Mexico, and North Dakota. In New Jersey, on the other hand, central cities accounted for only 4 percent of GSE purchases.[49]

For 1995 and beyond, Congress directed that the transition ''central cities goal'' be changed to better emphasize underserved areas. Although Congress did not define ''underserved areas,'' it indicated that they are locations with relatively poor access to mortgage credit. Thus the goal should target those parts of central cities and those parts of rural areas with poor access to mortgage credit, as well as any other areas with problems with access to credit.

Ideally, the definition of areas with poor access to mortgage credit would be based on a clear determination of areas that do not receive the level of mortgage credit they require. Section B reported HUD's analysis of 1993 HMDA data and the main findings of several studies of mortgage lending conducted by community groups, government agencies, and academic researchers. While there is much research left to be done to fully understand mortgage access for different types of persons and neighborhoods, one finding remains clear—minority and low-income neighborhoods have higher mortgage denial rates and lower mortgage origination rates than other neighborhoods.

As mentioned earlier, studies that have controlled for borrower and neighborhood risk characteristics find that racial differentials in denial rates and mortgage flows persist. Recent studies have concluded that characteristics of the applicant and the neighborhood where the property is located are the major determinants of mortgage denials and originations—once these characteristics are accounted for, other influences such as central city location play only a minor role in explaining disparities in mortgage lending.[50] These studies, as well as HUD's own analysis, provide strong support for a targeted approach to identifying underserved areas. In addition, they point to two useful proxy variables for measuring access to mortgage credit—a neighborhood's minority composition and its level of income.

3. Identifying Underserved Areas

To identify areas underserved by the mortgage market, HUD focused on two traditional measures used in a number of HMDA studies:[51] Application denial rates and mortgage origination rates per 100 owner-occupied units.[52] 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.[53] Aggregating those data is useful for examining denial and origination rates for broader groupings of census tracts:

Minority composition (percent)	Denial rate (percent)	Origination rate	Tract income (percent)	Denial rate (percent)	Origination rate
0–30	12	13.4	Less than 80	23	5.9
30–50	19	10.1	80–120	15	11.3
50–100	24	6.6	Greater than 120	9	17.7

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.[54] 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 80 percent of area median have almost three times the denial rate and one-third the origination rate of tracts with income over 120 percent of area median.

HUD chose over 30-percent minority and under 80-percent income as the thresholds for defining underserved areas. There are three 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 (22.0 percent) in underserved areas is almost double that (11.9 percent) in served areas; and the mortgage origination rate (5.4 per 100 owner occupants) in underserved areas is about half that (10.3 per 100 owner occupants) in served areas. Thus, an advantage of a targeted definition of underserved areas is illustrated by sharp differences in measures of mortgage access between served and underserved areas. The less-than-80-percent income cutoff in HUD's definition has the further advantage of consistency with the Community Reinvestment Act (CRA) definition that applies to depository institutions.

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 23 percent of the suburban population, compared with 51 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.

A third advantage is that the minority and income cutoffs identify tracts that resemble distressed neighborhoods. The socioeconomic characteristics of underserved areas are discussed in the next section.

4. Characteristics of Underserved Areas

The Secretary's definition of central cities, rural areas, and other underserved areas includes 17,337 of the 44,447 census tracts in

[48] Office of Management and Budget, Memorandum M–94–22, May 5, 1994.

[49] For more discussion of this issue, see James A. Johnson, Chairman and Chief Executive Officer, Fannie Mae, testimony before the Committee on Banking, Finance, and Urban Affairs Subcommittee on General Oversight, Investigations and the Resolution of Failed Financial Institutions, U. S. House of Representatives, April 20, 1994, p. 16.

[50] Shear, *et al.*, and Avery, *et al.*

[51] 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.

[52] 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 approval (origination) rates. Although denial rates vary by census tract characteristics, the patterns observed for application rates are still very similar to those observed for approval rates.

[53] As discussed in Section B, no sharp breaks occur in the denial and origination rates across the minority and income deciles given in Table B.1—mostly, the increments are somewhat similar as one moves across the various deciles that account for the major portions of mortgage activity.

[54] 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 denial rate differentials to persist, even after controlling for risk of the borrower. See Section B for a review of that study.

metropolitan areas, covering 36 percent of the metropolitan population, 51 percent of the OMB-defined central city population, and 23 percent of the suburban population. In rural (non-metropolitan) areas, the underserved area definition includes 3,160 tracts, or 21 percent of the total 15,045 rural tracts, which covers 21 percent of the rural population.[55]

Underserved tracts are substantially more distressed than served tracts. Poor persons are highly concentrated in underserved areas—64 percent of the metropolitan area poor live in underserved areas as do 76 percent of the central city poor. Underserved areas have higher poverty rates, higher minority concentration, lower incomes, and higher unemployment rates. For instance, the average poverty rate in underserved areas is 23 percent, compared with only 7 percent in served areas. Underserved areas also have more boarded-up units, older housing, and lower valued housing than do served areas. The average value of owner-occupied housing in underserved areas was $81,681, compared with $127,423 in served areas. (See Table B.3 in Section B.)

Table B.7 shows that the Secretary's definition covers most of the population of the nation's most distressed OMB-defined central cities: Newark (99 percent), Detroit (94 percent), Hartford (95 percent), Baltimore (85 percent), and Cleveland (80 percent). The nation's five largest cities also contain large concentrations of underserved areas: New York (60 percent), Los Angeles (68 percent), Chicago (72 percent), Houston (66 percent), and Philadelphia (69 percent). It should be noted that HUD's definition of underserved excludes high minority tracts with median income above 120 percent of area median income. As shown in Table B.8, 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), high house values ($185,000), and incomes almost 50 percent greater than area median. The high income minority tracts are concentrated in a few metropolitan areas: 10 percent of Los Angeles' population lives in them; the corresponding figures are 6% for New York, 24% for Miami, 26% for Honolulu, and 10% for San Antonio. By contrast, most relatively distressed metropolitan areas have few households in such areas—for example, Cleveland and Detroit (1%); and Memphis, Milwaukee, and Philadelphia (0%).

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[55] The Preamble discusses issues related to the choice of tracts or counties to define underserved areas in non-metropolitan sections of the country.

Table B.7

Needy Areas In Central Cities Would Be Covered

Large Central Cities With High Concentrations of Underserved Tracts (Percent of Population)			
Newark	99		
Gary	96		
Paterson	96		
Hartford	95		
Detroit	94		
Jersey City	92		
Miami	91		
Baltimore	85		
Cleveland	80		
St. Louis	79		
Five Largest Cities			
New York	60		
Los Angeles	68		
Chicago	72		
Houston	66		
Philadelphia	69		
Central Cities With Small Concentrations			
<u>**Large Cities**</u>		<u>**Small Cities**</u>	
Tulsa	31	Naples, FL	2
Raleigh	31	Appleton, WI	4
Colorado Springs	31	Olympia, WA	6
Wichita	32	Wheeling, WV	10
Oklahoma City	33	Dubuque, IA	11
Nashville	34	Salem, OR	11
Jacksonville	37	Elkhart, IN	11
Phoenix	44	Casper, WY	18

Table B.8

Characteristics of High Income Minority and Moderate Income Tracts

	SERVED TRACTS			UNDERSERVED TRACTS
	HIMTs	80-100% OF AREA MEDIAN INCOME	REMAINING SERVED TRACTS	
Unemployment Rate	5.5%	6.0%	4.2%	11.4%
Tract/MSA Income	147	91	134	67
Median House Value	$185,455	$85,327	$143,723	$81,681
Poverty Rate	7.0%	10.7%	5.7%	22.7%
African American	23.4%	3.8%	2.7%	31.6%
Hispanic	18.2%	3.4%	3.2%	17.6%
Asian	12.1%	1.5%	2.3%	4.2%

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 80 and 100 percent of area median and minority percentage less than 30 percent.

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Among other issues considered in setting the underserved definition included setting the income threshold to the area median income, to include more moderate income areas. This alternative would add tracts with incomes between 80 and 100 percent of the area median. However, it should be noted that minority tracts (over 30 percent minority) at this income level are included in the underserved definition described above, and raising the income limit to the area median would add only tracts with low minority concentration (below 30 percent). These areas represent 8296 Census tracts, and comprise 19 percent of metropolitan population.

Low-minority moderate-income tracts have denial rates almost 30 percent below those of tracts that meet HUD's underserved definition (16 versus 22 percent). By contrast, 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 (9.7) is noticeably higher than that in underserved tracts (7.0).

Table B.8 compares socio-economic conditions in low-minority moderate income tracts to those in underserved tracts. Low-minority moderate-income tracts appear much better off than underserved tracts. While they have housing prices that are only slightly higher than those in underserved tracts, they have unemployment and poverty rates that are half those in tracts meeting HUD's underserved definition.

5. Other Issues

a. GSE Funding in Central Cities, Rural Areas, and Underserved Areas

In 1993, 15.9 percent of Fannie Mae's business was in underserved areas as was 14.4 percent of Freddie Mac's business. The share of GSE business in underserved areas varies rather dramatically by property type; about 13 percent of single-family owner purchases were in underserved areas compared with over 30 percent for the three rental property types (single-family 2–4's and 1–4's and multifamily). Thus, one reason for Freddie Mac's relatively low share is its low level of multifamily purchases in 1993.

The fact that underserved areas have much lower incomes than other areas does not mean that most of their mortgage activity derives from lower income families. In 1993, above-median income households accounted for 60 percent of the mortgages that the GSEs purchased in underserved areas. This suggests these areas are quite diverse.

b. GSE Performance Relative to the Market

As explained in Section C.4, the Secretary estimates that underserved areas account for about 21–23 percent of the conventional conforming market. GSE performance in 1993 was about 15 percent, or less than three-fourths of the market share for underserved areas. HMDA data suggests that the GSEs are particularly underperforming in lower income census tracts. In 1993, GSE purchases accounted for 44 percent of the conventional conforming market in under-50-percent income tracts and 47 percent in 50–80-percent income tracts; in above-median-income tracts, on the other hand, they accounted for 59 percent of the market.

The profitability of the GSEs, their sophisticated systems for purchasing loans, and the size of the underserved market suggest that the GSEs can improve their performance. The Secretary has therefore set annual goals of 18 percent for 1995 and 21 percent for 1996, which will encourage the GSEs to improve their performance relative to the market. Figure B.2 presents these goals in relation to the GSEs' past performance and the size of the market.

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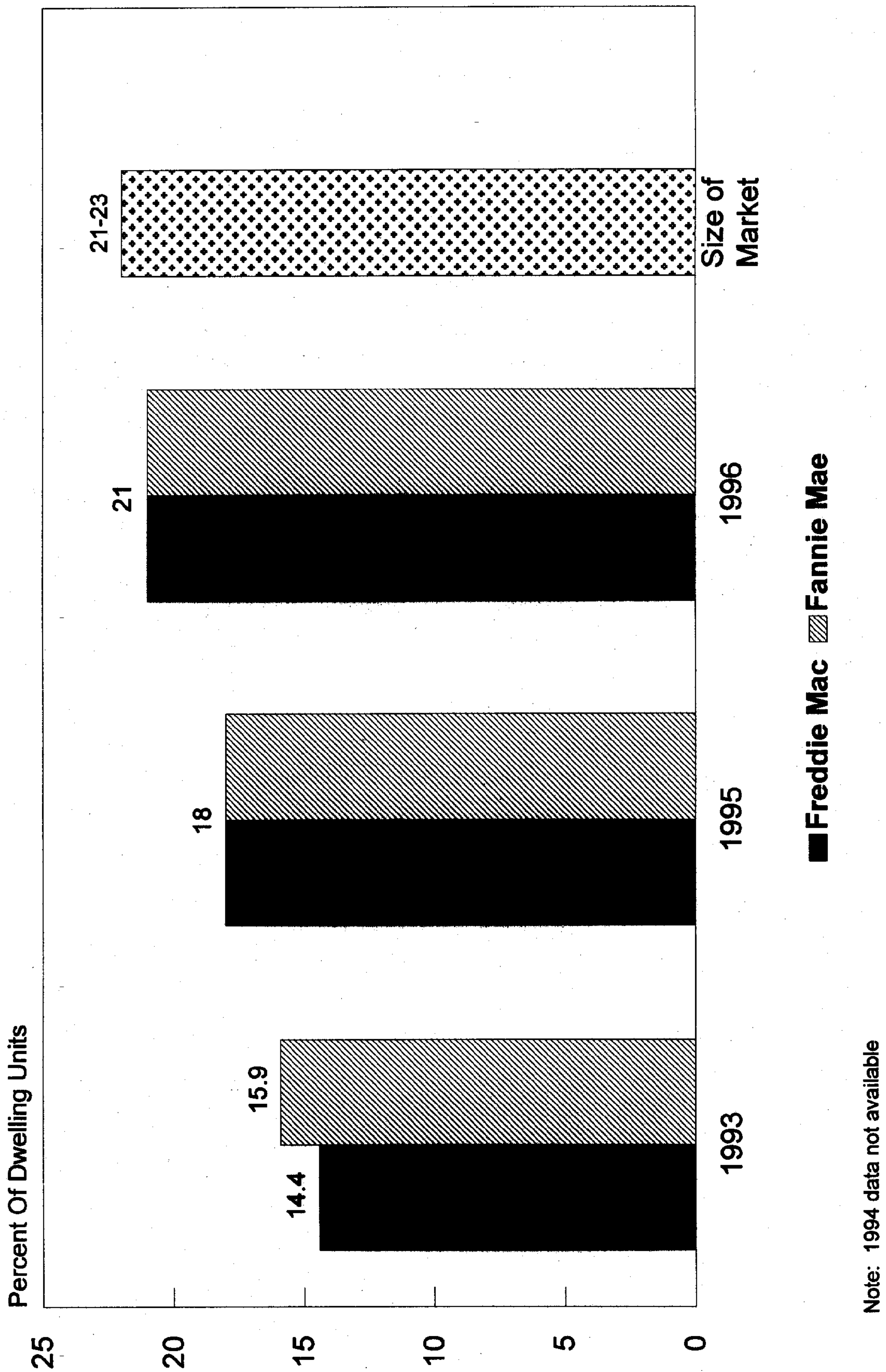
FIGURE B.2

Activity and Goals in Central Cities, Rural Areas, and Other Underserved Areas For Freddie Mac And Fannie Mae, 1993-96



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6. Conclusion

The Secretary has determined that the 1995 and 1996 goals will require the GSEs to address the unmet credit needs of central cities, rural areas, and other underserved areas, and take into account the GSEs' performance in the past in purchasing mortgages in these areas, as well as the size of the mortgage market. Moreover, the Secretary has considered the GSEs' ability to lead the industry as well as their financial condition. The Secretary has determined that this goal is necessary and achievable.

Based on a consideration of the factors, the Secretary proposes to establish all three goals for 1997 and 1998 so that the goals will move the GSEs steadily over a reasonable period of years, to a level of mortgage purchases where the GSEs will be leading the industry in purchasing mortgages meeting the goals. In carrying out this objective, the Secretary proposes to establish the goals for 1997 and 1998 at levels ranging from the same amounts established for 1996 to higher levels. The purpose of any higher levels would be to continue to move the GSEs toward purchasing a greater proportion of mortgages originated by the market.

Appendix C—Secretarial Considerations To Establish the Special Affordable Housing Goal

A. Establishment of 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 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.

In establishing the special affordable housing goal, the Act 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 effort of the enterprises toward achieving the special affordable housing goal in previous years;
3. National housing needs of low-income families in low-income areas and very low-income families;
4. The ability of the enterprises 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.

B. Underlying Data

In considering the factors under the Act to establish the special affordable housing goal, the Secretary relied upon data gathered from the American Housing Survey, the Residential Finance Survey, the 1990 Census of Population and Housing, other government reports, Home Mortgage Disclosure Act (HMDA) reports, and the GSEs. The Secretary used loan-level data provided by the GSEs to determine their prior performance in meeting the needs of low-income families in low-income areas and very low-income families.

Section C discusses the factors listed above and estimates the size of the conventional conforming market for special affordable mortgages. Section D gives the Secretary's rationale for establishing the special affordable goals.

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 Previous Performance and Effort of the GSEs

The discussions of these two factors have been combined because they overlap to a significant degree. The proposed regulation would revise the special affordable housing goal based on the experience of HUD and the GSEs in the transition period, in accordance with FHEFSSA and the legislative history of the Act.[1] For the 1993–94 transition period, the goal requires purchases of special affordable mortgages of at least $2 billion for Fannie Mae and $1.5 billion for Freddie Mac, evenly divided between single family mortgages and multifamily mortgages, and the Senate report states that such amounts shall be ''above and beyond existing performance and commitments.''[2] In order to determine existing performance, the Secretary required the GSEs to submit good faith estimates of their mortgage purchases that would have qualified for the special affordable goal in 1992. Fannie Mae estimated that such transactions amounted to $5.85 billion in single family purchases and $1.34 billion in multifamily purchases. Freddie Mac estimated that such transactions amounted to $5.19 billion in single family purchases and $0.02 billion in multifamily purchases. The Department doubled these estimates of 1992 purchases and added the increments specified by the Act to obtain the 1993–94 minimum single family special affordable housing goals; $16.40 billion for Fannie Mae, of which at least $12.71 billion was required to be purchases of mortgages on single family housing and $3.68 billion was required to be purchases of mortgages on multifamily housing; and $11.92 billion for Freddie Mac, of which at least $11.13 billion was required to be purchases of mortgages on single family housing and $0.79 billion was required to be purchases of mortgages on multifamily housing.

On March 1, 1994 Fannie Mae reported that qualifying mortgage purchases in 1993 amounted to $8.84 billion single family and $2.06 billion multifamily; thus in 1993 Fannie Mae achieved 70 percent and 56 percent respectively of the two-year goals. On March 1, 1994, Freddie Mac reported that qualifying mortgage purchases in 1993 amounted to $6.60 billion single family and $0.02 billion multifamily.[3] Thus in 1993 Freddie Mac achieved 59 percent and 3 percent respectively of the two-year goals. Freddie Mac's low multifamily performance in 1993 was due to its prolonged absence from the multifamily market to restructure its multifamily operations. Freddie Mac fully completed reentry into the multifamily business in December 1993. Total performance toward the 1993–94 special affordable goals will be determined after the GSEs report on their 1994 special affordable purchases on March 1, 1995.

After the 1993–94 transition period, the Act states that this goal shall be established at not less than one percent of the dollar amount of the mortgage purchases by the enterprise for the previous year. Because the Senate report on the 1992 Act states that one of the purposes of the goal is to increase the GSE's purchases of mortgages serving low-income families ''above and beyond'' their existing performance, these one percent minimum goals serve as a floor for the setting of the 1995–96 goals.

The 1992 Act requires the Secretary to ''establish a special annual goal designed to adjust the purchase by each enterprise of mortgages on rental and owner-occupied housing to meet the then-existing unaddressed needs of, and affordable to, low-income families in low-income areas and very low-income families.''[4]

For 1995 and thereafter, the special affordable housing goal is evenly divided between:

(1) Owner-occupied units affordable to very low-income families or to low-income families in low-income areas; and

(2) Rental units (multifamily or single-family) affordable to very low-income families.

The Department has simplified the multifamily special affordable housing subgoal, as described in the Interim Notice, substantially, while closely adhering to the language of the 1992 Act.

The Department is also proposing to revise the Interim Notices' treatment of refinancings of loans from the existing enterprises' portfolios. Under this provision of the Notices, the Department has not allowed any credit toward the special affordable housing goal during the transition period. This has imposed significant compliance burdens on the enterprises, requiring time-consuming and costly examinations of their mortgage purchases to screen out such refinancings or to estimate the volume of refinancings from the GSEs' portfolios. And this provision is contrary to the common method of financing multifamily properties by relatively short-term balloon mortgages, which by their nature must be refinanced frequently to maintain project viability.

With regard to single family loans, it has been argued that refinancings of mortgages from the GSEs' portfolios add no new financing for affordable housing. But, to the extent that this is the case, it is true for all refinancings, not solely refinancings from the GSEs' portfolios. Clearly Congress could have excluded all refinancings from receiving credit toward the special affordable housing goal, but it chose not to do so.

Thus in measuring past performance, the relevant data is the GSEs' special affordable purchases without excluding estimated refinancings from their own portfolios.

[1] ''After the experience of the first two years, the (regulator) may redesign the categories to target more effectively low-income family needs and reflect any gaps in GSE performance.'' S. Rep. No. 102–282, 102d Cong., 2d Sess. 37 (1992).

[2] S. Rep. No. 102–282, 102d Cong., 2d Sess. 36 (1992).

[3] Minor revisions were made in Freddie Mac's estimates on April 11, 1994.

[4] Section 1333(a)(1).

In 1993, the special affordable purchases of mortgages on *owner-occupied housing*, including all refinancings, were:

	Fannie Mae		Freddie Mac	
	No. units	Percent units	No. units	Percent units
Low-income families in low-income areas [5]	25,130	0.9	19,870	0.9
Very low-income families [6]	129,622	4.6	95,056	4.4
Subtotal	154,752	5.5	114,926	5.3
Total eligible [7]	2,798,351	100.0	2,161,223	100.0

[5] Excluding very low-income families in low-income areas.
[6] Including very low-income families in low-income areas.
[7] Mortgages eligible to qualify as low- and moderate-income.

In 1993, the GSEs' purchases of mortgages on *rental units* affordable to very low-income families, including all refinancings, were:

	Fannie Mae		Freddie Mac	
	No. units	Percent units	No. units	Percent units
Units in 2–4 unit owner-occupied properties [8]	15,680	0.6	10,035	0.5
Rental units in 1–4 unit investor-owned properties	19,296	0.7	13,236	0.6
Rental units in multifamily properties	67,437	2.4	7,853	0.4
Subtotal	102,413	3.7	31,151	1.4
Total eligible	2,798,351	100.0	2,161,223	100.0

[8] Including owner-occupied units.

Thus in 1993, Fannie Mae's mortgage purchases financed 257,165 dwelling units that would have counted toward the goal, as proposed in this regulation—these units represented 9.2 percent of the total units financed by Fannie Mae in 1993.[9] And Freddie Mac's mortgage purchases financed 146,077 dwelling units that would have counted toward the goal, as proposed in this regulation—these units represented 6.8 percent of the total units financed by Freddie Mac in 1993.

Loan-level data for 1994 to date is not available for the special affordable goal as proposed to be redefined herein. However, data for the first three quarters of 1994 indicate that Fannie Mae's special affordable purchases were more than 14 percent of total purchases, and that Freddie Mac's special affordable purchases were more than 9 percent of total purchases—additional increases are likely as Freddie Mac further steps up its multifamily activities. Thus the 1994 purchase data make it likely that the GSEs will be able to meet the special affordable goals established by the Secretary for 1995 and 1996.

3. National Housing Needs of Low-Income Families in Low-Income Areas and Very Low-Income Families

Detailed analyses of the housing problems and demographic trends for lower income families were contained in Section C of Appendix A. This section focuses on very low-income families with the greatest needs.

a. Housing Problems Among Very Low-Income Families

Data from the 1990 Census and from the 1989 and 1991 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) show clearly that sharp differentials by income characterized all regions of the nation as well as their city, suburban, and nonmetropolitan portions.[10] 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.[11] Severe cost burdens—paying more than half of income for housing and utilities—varied even more markedly by income, troubling fewer than 5 percent of moderate-income households, but more than half of the 7 million renters and 4 million owners with incomes below 30 percent of area median income.

Census counts of inadequate housing are incomplete, and the CHAS tabulations are based on HUD-adjusted median income for both owners and renters, rather than on unadjusted median income for owners, as the 1992 Act specifies.[12] But tabulations of the 1991 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.[13] Priority problems of severe cost burden or severely inadequate housing are even more noticeably concentrated among renters and owners with incomes below 30 percent of area median income.

[9] Low-mod eligible units have been used as the denominator because total units include cases with missing information, which are expected to be virtually eliminated in 1995 and subsequent years.

[10] Bogdon *et al.*, 1994.

[11] 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 Bogdon *et al.*

[12] To determine eligibility for Section 8 and other HUD programs, the Department 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.

[13] Tabulations of the 1991 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.

Income as percent of area median income	Renters		Owners	
	Any problems (percent)	Priority problems (percent)	Any problems (percent)	Priority problems (percent)
Less than 30	67	48	66	37
30–50	67	27	31	9
50–60	61	11	20	5
60–80	44	6	17	5
80–100	26	3	12	3

Comparisons by income reveal that low-income owners and renters (those with incomes 60–80 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.[14] In 1991, 5.3 million unassisted renter households with incomes below 50 percent of area median income had ''worst case'' housing needs. 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

It is important to note that 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 with three or more children, 44 percent of whom live in crowded housing. A certain amount of variation in need exists, by region and degree of urbanization. Although 18 percent of worst case renters need other housing (because of crowding or severe inadequacy), this figure varies from 11 percent in the Northeastern suburbs to 30 percent in the South's nonmetro areas. Shortages of housing units are 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.[15] This shortage appears to be 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.[16] 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.[17] 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.

4. 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 a discussion of this factor.

5. Need To Maintain the Sound Financial Condition of the Enterprises

This factor is the same as the sixth factor considered under the goal for mortgage purchases on housing for low- and moderate-income families. Accordingly, see Section C.6 of Appendix A for discussion of this factor.

6. Size of the Conventional Mortgage Market for Special Affordable Mortgages Relative to the Overall Conventional Conforming Market

This section presents estimates of the special affordable portion of the conventional conforming mortgage market for 1995.

The special affordable goal consists of: (1) single-family owner-occupied dwelling units which are occupied by very low-income families or low-income families in low-income census tracts;[18] and (2) rental units which are occupied by very low-income families. The analysis suggests that the special affordable market is at least 17–20 percent of the conventional conforming market. Section D below provides HUD's rationale for the specific goals selected for 1995 and 1996.

Section C.4 of Appendix A describes HUD's two methodologies 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 and low-income markets. The basic approach involves estimating for each of the various property types (single-family owner, single-family rental 2–4's and 1–4's, and multifamily) the share of dwelling units financed by mortgages in a particular year that are occupied by very low-income (VLI) families or by low-income families in low-income areas. As explained in Appendix A, HUD has combined mortgage information from several data sources in order to estimate the market shares. Two approaches were taken—one based on American Housing Survey (AHS) and Residential Finance Survey (RFS) data, and one based on 1993 HMDA data and projections of the mortgage market for 1995 and 1996.

a. American Housing Survey/Residential Finance Survey Approach

Data from the American Housing Surveys for 1985, 1987, 1989, and 1991 indicate that 11 percent of those families who recently purchased or refinanced their homes, and who obtained conventional conforming mortgages, had incomes below 60 percent of the area median. It is estimated that 1.8 percent of single-family mortgages will be for families who have incomes between 60 and 80 percent of area median and who also live in low-income census tracts.[19] This suggests that 12.8 percent of single-family owner-occupied mortgages and dwelling units are for very low-income families or low-income families living in low-income areas.

As Appendix A explains, information is not available from the American Housing Survey on mortgages for rental properties; for this reason, the analysis focuses on the income and rent characteristics of the existing and recently completed rental stock. Analysis of the same four American Housing Surveys shows that for 1–4 unit unsubsidized rental properties, 54 percent of all units, and 20 percent of units constructed in the preceding three years had rent affordable to very low-income families.[20] For multifamily unsubsidized rental properties, the corresponding figures are 41 percent of all

[14] 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.

[15] 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.

[16] 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.

[17] Id., Table 6.

[18] This definition includes all very low-income families plus families who have incomes between 60 and 80 percent of area median income and who also live in census tracts with a median income less than 80 percent of area median income.

[19] Low-income census tracts are defined as tracts with a median income less than or equal to 80 percent of the area median. 1993 HMDA data show that 1.9 (1.3) percent of single-family owner-occupied purchase (refinance) mortgages were for families with incomes in the 60–80 percent range and also living in low-income tracts. Applying 85/15 percent purchase/refinance shares gives the 1.8 percent value cited in the text.

[20] Affordable to VLI families is defined as less than or equal to 30 percent of 60 percent of area median family income—that is, less than 18 percent of area median family income, with adjustments for unit size as measured by the number of bedrooms.

units and 9 percent of units constructed in the preceding three years. The data for recently completed units underestimate the affordable percentage of rental housing because they exclude purchase and refinance transactions involving older buildings, which generally charge lower rents than newly-constructed buildings.

The other pertinent data for examining this issue were the GSEs' purchase data for rental properties. GSE data for all 1–4 unit properties (i.e., combining 2–4 units and investment 1–4 units) suggest a VLI share of slightly over 20 percent, which is similar to the figure (20 percent) from the AHS for the recently completed stock. On the multifamily side, Fannie Mae's data suggest a 42 percent VLI share, which is consistent with the AHS estimate for existing properties.[21] [22]

This section applies weights for single-family rental and multifamily properties to the above estimates of the VLI share.

To calculate the size of the potential market for mortgages financing housing for VLI families, data on the number of owner-occupied dwelling units, rental units in 1–4 unit properties, and rental units in multifamily properties are necessary. As Appendix A explains, HUD utilized data from the 1991 Residential Finance Survey on the number of properties with conventional conforming mortgages acquired during the 1987–91 period, and the total number of dwelling units for each type of property, derived from the same source. Based on this data, it was estimated that, of total dwelling units in properties with recently acquired conventional conforming mortgages, 56.5 percent were owner-occupied units, 17.9 percent were in 1–4 unit rental properties, and 25.6 percent were located in multifamily rental properties. Applying the percentages of affordable dwelling units from the AHS (12.9 percent for owner-occupied dwelling units, 20 percent for the recently-completed stock of rental 1–4 units, and 41 percent for multifamily rental units) to these percentages of properties results in an estimate that 21.4 percent of the dwelling units secured by conforming conventional mortgages are affordable to very low-income families or low-income families in low-income areas.[23]

Appendix A notes that one concern with the Residential Finance Survey data is the seemingly high percentage share of rental properties, given that multifamily mortgage originations have declined from their high levels in the mid- to late-1980s. This is important because of the relatively high VLI share for multifamily properties. Sensitivity analysis is used to show the effect of shifting the relative importance of the different property categories. Reducing the multifamily weight from 25.6 percent to 20 percent, and assuming the owner category is 65 percent and the rental 1–4 category is 15 percent reduces the estimate of the size of the special affordable market to 19 percent. As noted earlier, the 20 percent estimate of the VLI share for rental 1–4 units is probably too low because it is based on AHS data for the recently completed stock. Assuming a 30 percent VLI share increases the special affordable market share from 19 to almost 21 percent. Using the AHS figure (54 percent) for the existing stock further increases the special affordable market share to 24 percent.

b. HMDA/Market Projection Approach

This approach follows the same six steps as outlined in Section C.4 of Appendix A. In steps (5) and (6), the low-mod shares are adjusted as follows:

(5) Estimates of the percentage of dwelling units occupied by very low-income (VLI) families or low-income families in low-income areas were: 11.8 percent for single family owner-occupied purchase mortgages and 6.9 percent for single family owner-occupied refinance mortgages based on 1993 HMDA data; and 20 percent for single family 2–4's, 30 percent for single family 1–4's, and 42 percent for multifamily. The VLI percentages for the single-family rental categories were based on 1993 GSE data and the VLI percentage for multifamily properties was based on 1993 Fannie Mae data and AHS data for the existing multifamily stock.[24]

(6) Applying the above VLI shares to the property type weights given in step (4) of Section C.4.b of Appendix A suggests that 19 percent of mortgage originations in 1995 will be on housing for very low-income families or low-income families in owner-occupied housing located in low-income census tracts.

Sensitivity analyses similar to those reported in Appendix A for the low-mod goal were also conducted for the special affordable goal. Substituting the lower single-family owner-occupied shares from 1992 HMDA data—9.5 percent for purchase mortgages and 5.3 percent for refinance mortgages—reduced the special affordable market share from 19.1 percent to 17.5 percent. Adjusting 1993 HMDA data for HUD's overprojection of 1993 area median incomes (see Appendix A for explanation) also produced a 17.4 percent market share.

c. Conclusions

Sensitivity analyses were conducted for the market shares of each property type, for the VLI shares of each property type, and for various assumptions in the market projection model, as discussed in Appendix A.[25] These analyses suggest that the size of the special affordable market is at least in the 17–20 percent range.[26]

D. Determination of the Special Affordable Housing Goal

The annual goal for 1995 for each GSE's purchases of conventional mortgages under the special affordable goal is established at 11 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The 1996 goal is established at 12 percent. Each annual goal is to be split equally between:

(a) *Owner-Occupied Units*—Owner-occupied units which are occupied by very low-income families or households who are low income and also live in low-income census tracts. This portion of the goal will be 5.5 percent in 1995 and 6.0 percent in 1996.

(b) *Rental Units*—Rental units which are occupied by very low-income families. No distinction is made between single-family and multifamily rental units because both provide affordable housing to lower income families. This portion of the goal will be 5.5 percent in 1995 and 6.0 percent in 1996.

The special affordable goal provides the opportunity for the Department to focus the GSEs on a sector where they have been underperforming—the low- and very low-income portion of the housing market where housing needs are great. Several considerations, many of which have been reviewed in earlier sections of this Appendix, led to the choice of these goals.

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 following table 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.

[21] The very low-income shares were calculated separately for the GSEs' 1993 refinance and purchase mortgages. The estimates for 1995 were derived by assuming a 18 percent refinance share for small rental properties. The estimates were not very sensitive to reasonable variations in the refinance share.

[22] Freddie Mac's multifamily purchases in 1993 were insufficient to provide an accurate measure of rents for multifamily properties.

[23] 21.4 percent was derived by adding the following: (1) 7.3% (percentage of owner-occupied units [56.5%] times percentage of those units that are affordable to very low-income families or low-income families in low-income areas [12.5%]); (2) 3.6% (percentage of rental units in 1–4 family properties [17.9%] times percentage of those units that are affordable to very low income families [20%]); and (3) 10.5% (percentage of rental units in multifamily properties [25.6%] times percentage of those units that are affordable to very low income families [41%]).

[24] As Appendix A explains, there is little data on the affordable shares for the two single-family rental property types, which necessitated using the GSE data. Assuming a 18 percent refinance share, Fannie Mae's 1993 data suggest VLI percentages for 2–4 and 1–4 properties of 21 percent and 28 percent, respectively. Freddie Mac's data suggest VLI percentages of 18 percent and 30 percent, respectively. The American Housing Survey, which combines these two categories, shows a 20 percent VLI share for recently built 1–4 rental units and a 54 percent VLI share for the existing stock. In step (5) the 2–4 VLI share (20 percent) and the 1–4 VLI share (30 percent) are based on GSE data, which are probably conservative estimates for the overall 2–4 market. The multifamily VLI percentage (42 percent) is consistent with both the AHS and Fannie Mae's data.

[25] For example, reducing the average per unit multifamily loan amount from $32,500 to $30,000 and raising the VLI share of the rental 1–4's from 30 percent to 40 percent increases the special affordable market share estimate from 19.1 percent to 20.4 percent.

[26] Also see Appendix A, for a discussion of why the HMDA data reported in this section may be underestimating the size of the lower income market.

PRIORITY PROBLEMS BY INCOME AS PERCENT OF MEDIAN INCOME AND TENURE, 1991

Income (percent)	Renters (percent)	Owners (percent)
<30	48	37
30–50	27	9
50–60	11	5
60–80	6	5
80–100	3	3

Lack of housing is particularly severe among very low-income families with three or more children, 44 percent of whom live in crowded housing. The relative decline in low-rent dwelling units has been concentrated among the least expensive rental units—those with rents affordable to families with incomes below 30 percent of 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, but by 1989 the gap had widened to 39 percent, a shortage of 2.7 million units.

2. GSE Performance and the Market

Limitations of the Low-Mod Goal. The low- and moderate-income goal has not been an effective tool for targeting GSE activity to very low-income families. The bulk of the GSEs' low- and moderate-income mortgage purchases are for the higher income portion of the low-mod category. The lowest income borrowers accounted for a very small percentage of each GSE's purchases. Only 5 percent of the GSEs' 1993 mortgage purchases financed homes for single-family homeowners with incomes below 60 percent of area median. (See Figure A.1 in Appendix A.)

GSE Performance Lags the Market's Performance. Analysis of both American Housing Survey and HMDA data show that the GSEs are purchasing much smaller proportions of very low-income loans produced by the market than they are of higher-income loans. (See Figure A.2 in Appendix A.) For example, in 1993 the GSEs collectively purchased only 41 percent of mortgages originated for borrowers under 60 percent of median income, but 55 percent of mortgages originated for borrowers over 120 percent of median income. This suggests that there is room in the very low-income end of the homebuyer market for the GSEs to improve their performance.

As explained in Section C.6, the Secretary has determined that the very low-income market for both single family and multifamily mortgages is at least 17–20 percent of the overall conventional conforming market. Figure C.1 compares recent GSE performance, the 1995 and 1996 special affordable goals, and the size of the very low income market. In 1993, both Fannie Mae and Freddie Mac fell far short of the 17 percent market share for special affordable mortgages—Fannie Mae by 8 percentage points and Freddie Mac by 10 percentage points. The goals that the Secretary has established for 1995 and 1996 are intended to move the GSEs closer to the market.

Freddie Mac's Multifamily Performance. Nowhere has GSE performance lagged more than Freddie Mac's multifamily performance. Freddie Mac's 1993 multifamily purchases totaled only $191 million, compared with $4.6 billion for Fannie Mae and $28.5 billion for the conventional market. HUD is concerned about the pace of Freddie Mac's re-entry into the multifamily market.

Changing Market Conditions. As Section D in Appendix A notes, several market factors will tend to increase the share of GSE purchases benefitting lower income households: the shift from refinance to home-purchase mortgages, the increase in multifamily activity at the same time that single-family activity is declining, continued strong housing demand on the part of first-time homebuyers, and rising incomes due to economic growth. These market factors will offset other market changes, such as higher interest rates, that tend to reduce the share of GSE purchases going to lower income families.

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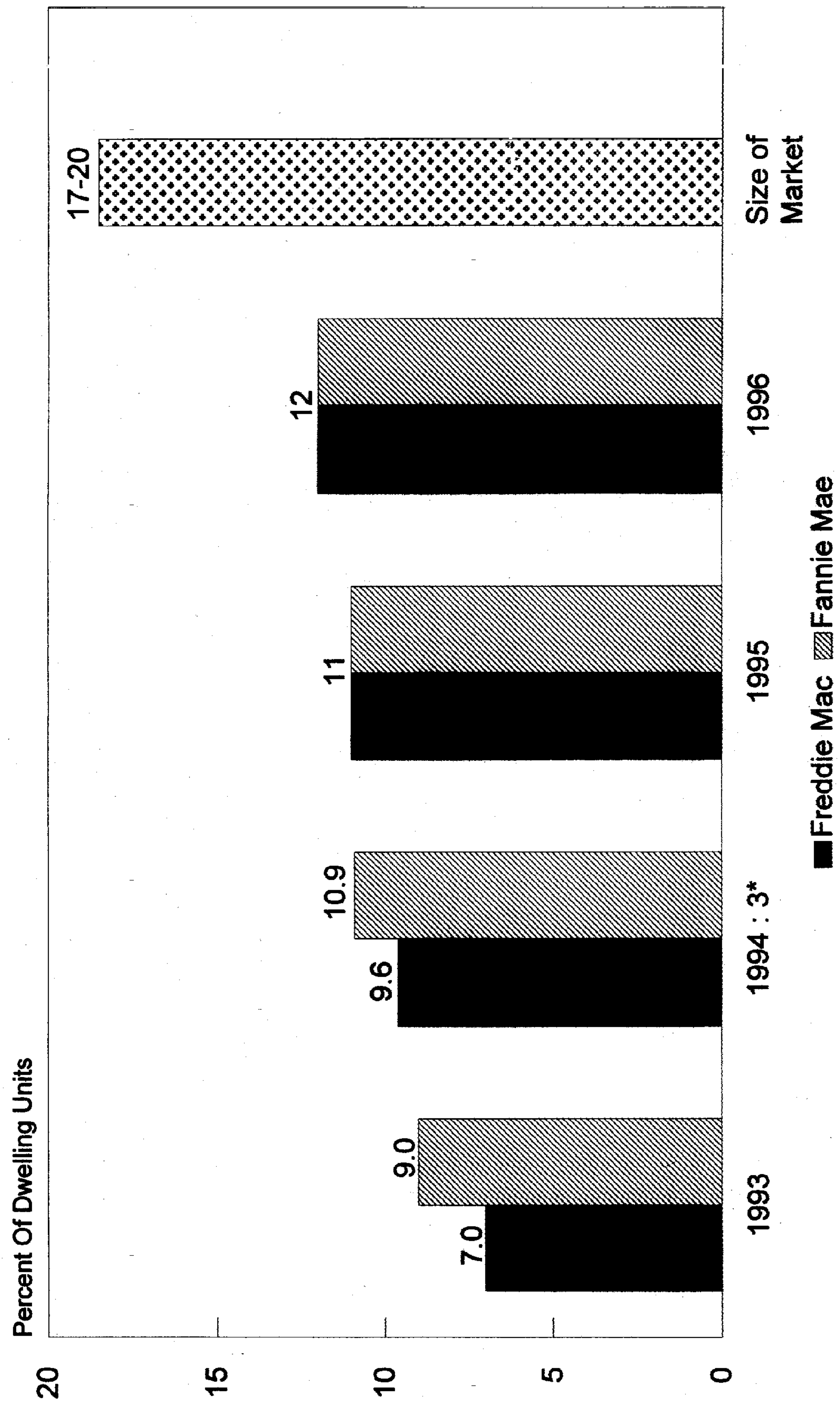
FIGURE C.1

Special Affordable Activity And Goals For Freddie Mac And Fannie Mae 1993-96



* Estimates based on GSE report submissions to the Secretary

Note: 1993 and 1994:3 performance estimates are based on the definition of special affordable in the proposed rule.

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3. Conclusion

To conclude, the Secretary has determined that the 1995 and 1996 special affordable goals set forth above address national housing needs within the income categories specified for this goal, while accounting for the GSEs' performance in the past in purchasing very low-income mortgages, as well as the size of the conventional mortgage market serving very low-income families. Moreover, the Secretary has considered the GSEs' ability to lead the industry as well as their financial condition. This goal will necessitate an increase in the GSEs' purchases targeted to very low-income families. The Secretary has determined that this goal is necessary and achievable.

Based on a consideration of the factors, the Secretary proposes to establish all three goals for 1997 and 1998 so that the goals will move the GSEs steadily over a reasonable period of years, including these two years, to a level of mortgage purchases where the GSEs will be leading the industry in purchasing mortgages meeting the goals. In carrying out this objective, the Secretary proposes to establish the goals for 1997 and 1998 at levels ranging from the same amounts established for 1996 to higher levels. The purpose of any higher levels would be to continue to move the GSEs toward purchasing a greater proportion of mortgages originated by the market.

Appendix D—Mortgage Reports

As required under Subpart E of this regulation, the GSEs are required to provide to the Secretary the loan level mortgage data listed in this Appendix D.

(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 state code used in the most recent decennial census by the Bureau of the Census;

(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 Federal Information Processing Standard (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—the tract number as used in the most recent decennial census by the Bureau of the Census;

(8) Census tract geographic designation—a numeric code that specifies whether the census tract is entirely within a central city, entirely outside a central city, or a split tract, *i.e.*, partially in a central city and partially outside a central city;

(9) Central city flag 1—for split census tracts, the proportion of a census tract that is located in one geographic area, such as a central city;

(10) Central city flag 2—for split census tracts, the proportion of a census tract that is located in another geographic area, such as another central city;

(11) 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;

(12) 1990 census tract—median income—the median family income for the census tract;

(13) 1990 local area median income—the median income for the area;

(14) Tract income ratio—the ratio of the 1990 census tract—median income to the 1990 local area median income;

(15) Borrower(s) annual income—the combined income of all borrowers;

(16) Area median family income—the current median family income for a family of four for the area as established by the Secretary;

(17) Borrower income ratio—the ratio of borrower(s) annual income to area median family income;

(18) 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;

(19) Loan-to-Value Ratio at Origination—the loan-to-value (LTV) ratio of the mortgage at the time of origination;

(20) Date of Mortgage Note—the date the mortgage note was created;

(21) Date of Acquisition—the date the GSE purchased the mortgage;

(22) Purpose of Loan—indicates whether the mortgage was a purchase money mortgage, a refinancing, a second mortgage;

(23) Cooperative Unit Mortgage—indicates whether the mortgage is on a dwelling unit in a cooperative housing building;

(24) 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;

(25) 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 § 81.14(h)(1)(B);

(26) 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;

(27) 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;

(28) RTC/FDIC—for purposes of the special affordable housing goal, indicates whether the mortgage purchased by the GSE meets the requirements in § 81.14(h)(1)(C);

(29) Term of Mortgage at Origination—the term of the mortgage at the time of origination in months;

(30) Amortization Term—for amortizing mortgages, the amortization term of the mortgage in months;

(31) Lender Institution—the name and unique numerical identifier of the institution that loaned the money for the mortgage;

(32) 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;

(33) Number of borrowers—the number of borrowers;

(34) 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;

(35) Mortgage Purchased under GSE's Community Lending Program—indicates whether the GSE purchased the mortgage under its community lending program;

(36) Acquisition Type—indicates whether the GSE acquired the mortgage with cash or by swap;

(37) GSE Real Estate Owned—indicates whether the mortgage is on a property that was in the GSE's real estate owned (REO) inventory;

(38) 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 and private subsidy 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;

(39) 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;

(40) 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

(41) Borrower gender—a numeric code that indicates whether the borrower is male or female;

(42) Co-borrower gender—a numeric code that indicates whether the co-borrower is male or female

(43) Age of borrower;

(44) Age of co-borrower;

(45) Family size of borrower—the number of individuals in the borrower's family including the borrower;

(46) Family size of co-borrower—the number of individuals in the co-borrower's family including the co-borrower;

(47) Occupancy Code—indicates whether the mortgaged property is an owner-occupied principal residence, a second home, or a rental/investment property;

(48) Number of Units—indicates the number of units in the mortgaged property;

(49) Number of Bedrooms—where the property contains non-owner-occupied dwelling units, the number of bedrooms in each of those units;

(50) Owner-Occupied—where the property has two to four units, indicates whether each of those units are owner-occupied;

(51) Affordability Category—where the property contains non-owner-occupied dwelling units, indicates under which, if any, of the special affordable goals the units qualified;

(52) Reported Rent Level—where the property contains non-owner-occupied dwelling units, the rent level for each unit in whole dollars;

(53) 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;

(54) Low- and moderate-income housing goal flag—indicates whether the GSE counted the mortgage purchase toward the low- and moderate-income goal;

(55) Special affordable housing goal flag—indicates whether the GSE counted the mortgage purchase toward the special affordable goal and under which part of the goal;

(56) Central cities, rural areas, and other underserved areas goal flag—indicates whether the GSE counted the mortgage purchase toward the central cities, rural areas, and other underserved goal.

(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 state code used in the most recent decennial census by the Bureau of the Census;

(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 Federal Information Processing Standard (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—the tract 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) Amortization Term—for amortizing mortgages, the amortization term of the mortgage in months;

(26) Lender Institution—the name and unique numerical identifier of the institution that loaned the money for the mortgage;

(27) 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;

(28) Government insurance—indicates whether any part of the mortgage has government insurance;

(29) Acquisition Type—indicates whether the GSE acquired the mortgage with cash, by swap, other, with a credit enhancement, a bond or debt purchase, or a real estate mortgage investment conduit (REMIC);

(30) GSE Real Estate Owned—indicates whether the mortgage is on a property that was in the GSE's real estate owned (REO) inventory;

(31) 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;

(32) Total Number of Units—indicates the number of dwelling units in the mortgaged property;

(33) Special Affordable—45 Percent—for the special affordable Interim Housing Goal for 1993–94, the dollar amount of the mortgage that counted toward achievement of the goal (based on dwelling units affordable to low-income families);

(34) Special Affordable—55 Percent—for the special affordable Interim Housing Goal for 1993–94, the dollar amount of the mortgage that counted toward achievement of the goal (based on properties where at least 20 percent of the dwelling units were affordable to especially low-income families or at least 40 percent of the dwelling units were affordable to very low-income families);

(35) 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. The maximum number of unit types in any one property is ten and 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;

(36) Low- and moderate-income housing goal flag—indicates whether the GSE counted the mortgage purchase toward the low- and moderate-income goal;

(37) Special affordable housing goal flag—indicates whether the GSE counted the mortgage purchase toward the special affordable goal and under which part of the goal;

(38) Central cities, rural areas, and other underserved areas goal flag—indicates whether the GSE counted the mortgage purchase toward the central cities, rural areas, and other underserved goal.

Appendix E—Proprietary Information—[Reserved]

Dated: December 23, 1994.

Henry G. Cisneros,

Secretary.

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