Market Estimates in Establishing the Goals

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

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

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

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

Both GSEs commented that HUD's analysis ignored the impact that changes in national economic conditions can

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

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

"fatally flawed" is without merit. HUD agrees that a comprehensive source of information on mortgage markets is not available. HUD considered and analyzed a number of data sources for the purpose of estimating market size, because no single source could provide all the data elements needed. In the appendices, HUD has carefully defined the range of uncertainty associated with each of these data sources and has conducted sensitivity analyses to show the effects of various assumptions. Technical papers prepared by the Urban Institute and other academicians support HUD's analysis.

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

In response to concerns expressed about the volatility of the mortgage markets over time, HUD has taken three steps with regard to the methodology. First, HUD conducted detailed sensitivity analyses for each of the housing goals to reflect economic conditions that are less conducive to homeownership than those that existed during 1993 and 1994. Second, HUD elaborated further on the impact of increased interest rates on long-term affordability and the ability of lowerincome households to become homeowners. Third, with regard to volatility in the multifamily market, the Urban Institute, at HUD's request, designed a "steady-state" multifamily

originations model that produces an alternative means of estimating multifamily originations. This alternative model is designed to generate conservative forecasts of future multifamily loan originations because it omits refinancing activity and balloon loans due to mature in the next several years. This model is less sensitive to year-to-year fluctuations in the historical volume of mortgage originations.

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

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

Three-Year Rolling Average

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

FHEFSSA and the legislative history do not support use of a 3-year rolling average. Instead, they provide a scheme whereby the Secretary is to set goals for each year and performance is to be evaluated during and at the end of each year by the Secretary. FHEFSSA provides that the housing goals are