

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

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

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

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

#### Tract-Based Versus Whole-City Approaches

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

Fannie Mae commented that its experience in developing partnerships with central cities demonstrates that including only underserved segments of central cities and rural areas, thereby focusing Fannie Mae's attention especially on low-income or minority

communities, would be a mistake. Fannie Mae stated that "community leaders, Congress, and many national policy makers argue that the health of low-income and minority communities within central cities is tied directly to the overall health of the community."

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

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

regulations implementing the Community Reinvestment Act which also focus on low-income geographies."

#### HUD's Analysis of Metropolitan Underserved Areas

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

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

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

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