conclusions about credit flows in these areas.

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

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

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

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

Characteristics of HUD's Rural Areas Definition

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

Response to Public Comments

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

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

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

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

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

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

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

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

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