Much of the difficulty with multifamily mortgages in recent years was related to the aftermath of wide swings in the tax treatment of multifamily housing. The tax-driven rather than market-driven overbuilding of the early and mid-1980s was followed by the subsequent withdrawal of tax support and the resulting credit crunch in the late 1980s and the early 1990s. During the early 1990s, underwriting of creditworthy multifamily loans may have been difficult. These conditions have now improved markedly.

Currently, multifamily properties offer less risk of loss than most commercial property classes, according to Moody's Investors Service.[3] In overbuilt markets, vacancies have declined due to depressed construction levels in the early 1990s. Accordingly, competition for multifamily loans has increased and securitization has increased in 1993 and again in 1994. Credit risk remains a concern to investors, but new techniques in multi-class securitization have helped mitigate credit risk on multifamily mortgage pools.

HUD realizes that achievement of the housing goals may require deeper penetration of the multifamily mortgage market than the GSEs have heretofore achieved. As discussed in Section C.2 below, Fannie Mae purchased a large portion (nearly half) of the large multifamily loans (those with balances of $1.0 million or more) that were originated in 1993 and reported in the HMDA data. An alternative to very deep penetration of the large loan market would be for the GSEs to broaden their penetration by shifting their focus toward purchase of smaller multifamily loans. There is no evidence that smaller loans represent higher credit risks. Such a shift may require the GSEs to develop additional capabilities to underwrite smaller loans, such as forming new partnerships with community lenders. This may pose some initial difficulty, but the suggestion that there are long-term fundamental difficulties in the purchase of smaller (less than $1 million) multifamily loans is not consistent with the current market trends toward higher multifamily lending activity and new techniques of credit risk management.

5. HUD's Market Methodology

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

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

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

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

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

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

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

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

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

c. Consideration of the Factors

Overview of Sections C.1 and C.2. These sections cover a range of topics on housing needs and economic and

[3] "Moody's: Multifamily Offers Less Loss Risk," *National Mortgage News*, May 1, 1995.