Boston has 56 percent of its rental stock in 1- to 4-unit buildings. The market-specific variations suggest that rental housing in 1- to 4-unit properties is not a perfect substitute for multifamily rental housing. The need for multifamily housing is relatively greater in some cities.

The financing of 1- to 4-unit properties is provided by the standard single-family primary and secondary mortgage markets if one of the units is owner-occupied. This segment is relatively well-served by the existing capital-delivery system. If the 1- to 4-unit property is investor-owned, the single-family market is still used, but with greater restrictions such as tighter underwriting ratios. These restrictions are generally in response to the greater credit risk posed by investor-owned 1- to 4-unit properties. The investor-owned side of the 1- to 4-unit rental market also has access to the liquidity of the single-family secondary market, albeit with restrictions.

(x) *Credit Risk of Affordable Housing.* Credit risk is an important factor to be considered by the GSEs in their participation in the multifamily mortgage markets. Does credit risk pose a major obstacle to the development of an efficient and highly liquid secondary market for multifamily mortgages that addresses the full range of multifamily credit needs? If the GSEs broaden their penetration of the multifamily market to purchase more small (under $1 million) mortgages, will the GSEs be taking on additional risk? Unfortunately, the academic literature is deficient in addressing these questions. However, numerous sources suggest that credit risk is not an insurmountable obstacle.

On a whole loan basis, risk levels of multifamily lending are often higher than for single family. There are four major reasons for this. First, multifamily loans, like small business loans, lack standardization. This is particularly true for affordable housing because the financial package often involves tax credits or local subsidy which complicates the loans. Second, multifamily loans are also relatively large, making multifamily portfolios more difficult to diversify than single-family portfolios. Third, there is far less information about the performance of multifamily mortgages than there is for single-family mortgages, particularly those secured by affordable units. And finally, private mortgage insurance is not generally available for multifamily loans as it is for single-family loans.

However, multifamily investments in today's market often involve mortgage pools rather than whole loans. Credit risk remains a concern of investors, but new techniques in multiclass securitization have helped mitigate credit risk on multifamily mortgage pools. For example, Fannie Mae ''swap transactions'' in which Fannie Mae swaps its securities for the top 85 to 90 percent, or the ''A'' piece, of a multifamily mortgage pool, leaves the riskier ''B'' piece, which absorbs the first credit losses from the pool, to be sold at discount in the market.

The B-piece that absorbs all credit losses up to 15 percent of the total unpaid balance on a typical multiclass multifamily pool provides considerable loss protection. This makes the A-piece highly marketable. Recently there has been considerable investor interest in these higher yielding B-pieces as well.

A source of anecdotal information on the credit risk involved with affordable multifamily housing comes from participants in the low-income housing tax credit (LIHTC) program which was created by the 1986 Tax Reform Act. Tax credits are the only major Federal assistance program for new or rehabilitated low-income housing that is currently active. Detailed data on the composition and performance of tax credit projects are not yet available. However, both academic and industry experts have been observing the tax credit program since its inception, and a number of them have shared their observations with HUD.

These market observers tell HUD that tax credit deals typically are financed with 30 to 40 percent equity obtained from investors receiving the tax credits, first mortgage debt of about 40 to 60 percent, and the remaining amount up to 30 percent comes from local subsidies often in the form of ''soft'' second mortgages. Market observers tell us that the trend in tax credit deals is toward increased equity as a share of the total development cost due to increased competition among tax credit syndicators.

The lenders who provide first mortgage financing for tax credit deals consider their loans on these affordable units to be less risky than loans for market-rate multifamily projects. There are several reasons for this conclusion. First, the loan-to-value ratio on these deals is at most 60 percent, which gives lenders substantial protection from credit risk. If the lender must foreclose, the tax credits stay with the property, giving the lender the ability to attract equity from new investors. Other reasons that first mortgage financing on affordable tax credit deals is considered less risky are the low turnover rates of affordable units which keeps project vacancies low, the high potential for future appreciation of the property, and the close scrutiny to initial underwriting by the equity provider or syndicator.[53] This anecdotal experience suggests that not all mortgages on affordable multifamily loans need be high-credit-risk lending.

Continued achievement of the housing goals in this rule may require the GSEs to develop additional capabilities to underwrite classes of multifamily loans such as smaller existing properties, redevelopment projects, seniors' housing, and tax credit deals. This may pose some initial administrative difficulty for the GSEs, but there are no apparent fundamental difficulties in multifamily mortgage origination and purchase activities, such as unmanageable risks. If there were, such risks would be difficult to explain, given the current market trends toward higher multifamily lending activity and new techniques of risk management.

3. Performance and Effort of the GSEs toward Achieving the Low- and Moderate-Income Goal in Previous Years

Each GSE has submitted data on its 1993 and 1994 performance to the Secretary. 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. In 1994, due to rising interest rates and the decline in mortgage refinancings, aggregate purchase volume (in dwelling units) fell by 43 percent, with Fannie Mae purchasing 1.66 million mortgages on 1.97 million units, and Freddie Mac purchasing 1.25 million mortgages on 1.34 million units.

Each GSE also has submitted detailed loan-level data on each loan it purchased in 1993 and 1994. HUD has done extensive analyses to verify the GSEs' stated performance and to measure aspects of their mortgage purchase activities in 1993–94 not contained in tables submitted to HUD in which the GSEs' aggregate data in various ways.[54]

Fannie Mae's data for 1993 show that 34.3 percent of total units financed by its mortgage purchases were affordable to low- and moderate-income families.

[53] See Stuart J. Boesky, ''Tax Credits at Work,'' *Mortgage Banking,* September 1995.

[54] In the following discussion, the GSEs' performance is measured using the counting rules which will be in effect under the final rule, not those under the Interim Notice, which have been used by the GSEs in reporting performance to HUD. For this reason, in some cases the following data differ slightly from the data reported by the GSEs.