

might be sold to the GSEs as the principal balance is amortized or the conforming loan limit is increased. By setting the credit standards against which the mortgage applications of lower-income families will be judged, the GSEs influence the rate at which mortgage funds flow to low-income borrowers and underserved neighborhoods. Congress realized the crucial role played by the GSEs' underwriting guidelines when it required each enterprise to submit a study on its guidelines to the Secretary and to Congress.

#### c. Leading Edge Technology

Both GSEs are in the forefront of new developments in mortgage industry technology. For example, Fannie Mae has developed FannieMaps®, a computerized mapping service offered to lenders, nonprofit organizations, and state and local governments to help them implement community lending programs. Both GSEs released automated underwriting systems in 1995. The Freddie Mac system is based on credit scoring, which allows explicit consideration of compensating factors, while the Fannie Mae system automates current underwriting standards. Such systems have the potential to reduce the cost of loan origination, particularly for low-risk loans.

#### d. Staff Resources

Both GSEs are well-known throughout the mortgage industry for the expertise of their staffs in carrying out their current programs, researching and developing improvements in the mortgage market in general, developing innovative new programs, and conducting research that may lead to new programs in the future. Their key executives frequently testify before Congressional committees on a wide range of housing issues, and both GSEs have developed extensive working relationships with a broad spectrum of mortgage market participants, including various nonprofit groups and government housing authorities.

#### e. Financial Strength

The benefits that accrue to the GSEs because of their GSE status and solid management have made them two of the nation's most profitable businesses. Fannie Mae's net income has increased steadily from \$807 million in 1989 to \$2.1 billion in 1994, and for the first two quarters of 1995 net income was accruing at an annual rate of \$2.3 billion, despite a 46 percent drop in mortgage purchases and a 60 percent drop in MBS issued in comparison with the first half of 1994. Through the

second quarter of 1995, Fannie Mae has recorded 30 consecutive quarters of increased net income. Fannie Mae's return on equity averaged 27.5 percent over the 1990-94 period—far above the rates achieved by most financial corporations. In addition, Fannie Mae's dividends per share more than tripled over this period, rising from \$0.72 in 1990 to \$2.40 in 1994.

Freddie Mac has shown similar trends. Freddie Mac's net income has increased steadily from \$414 million in 1990 to \$983 million in 1994, and for the first two quarters of 1995 net income was accruing at an annual rate of \$1.04 billion, despite declines in business volume similar to those experienced by Fannie Mae. Freddie Mac's return on equity averaged 20.9 percent over the 1990-94 period—also well above the rates achieved by most financial corporations. Freddie Mac's dividends per share nearly doubled over this period, rising from \$0.53 in 1990 to \$1.04 in 1994.

One measure of the strength of the GSEs was provided by a recent ranking of American corporations. This survey found that Fannie Mae was first of all companies in total assets and Freddie Mac ranked 17th; with regard to total profits, Fannie Mae ranked 20th and Freddie Mac ranked 52nd.<sup>67</sup>

Under FHEFSSA, beginning with the second quarter of 1994, the GSEs must meet fully phased-in minimum core capital requirements of 2.5 percent of on-balance sheet assets and 0.45 percent of outstanding mortgage-backed securities and other off-balance sheet obligations, except as adjusted by the Director of OFHEO.<sup>68</sup> For the transition period from June 30, 1993 through March 31, 1994, the corresponding percentages were 2.25 percent and 0.40 percent respectively. Based on the relation between actual core capital and minimum core capital, a GSE is classified as adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized.

The Director has found both GSEs adequately capitalized for all nine quarters ending June 30, 1993 through June 30, 1995. At the end of the second quarter of 1995, Fannie Mae's core capital of \$10.323 billion exceeded its minimum capital requirement of \$9.684 billion by \$639 million, and Freddie Mac's core capital of \$5.538 billion exceeded its minimum capital

requirement of \$5.256 billion by \$282 million.

#### f. Conclusion About Leading the Market

In light of these factors, the Secretary has determined that the GSEs have the ability to lead the industry in making mortgage credit available for low- and moderate-income families.

#### 6. The Need to Maintain the Sound Financial Condition of the GSEs

HUD has undertaken a separate, detailed economic analysis of this rule, which includes consideration of the financial safety and soundness implications of the housing goals. The analysis considered the likely mortgage default implications of the goals and implications for the profitability of the GSEs under various alternative economic assumptions. Among the conclusions are: that the goals will have, at most, only limited impacts on credit risk, which the GSEs should be able to handle without significant lowering of underwriting standards; that risks associated with increased multifamily mortgage purchase volumes under the goals are manageable, considering the scope of the increases implied by the goals; and that the goals imply no meaningful increase in risk to the sound financial condition of the GSEs' operations. Based on this analysis, HUD concludes that the goals raise minimal, if any, safety and soundness concerns.

#### D. Determination of the Low- and Moderate-Income Housing Goals

The annual goal for 1996 for each GSE's purchases of mortgages financing housing for low- and moderate-income families is established at 40 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The goal for 1997 and thereafter, unless changed, is 42 percent. These goals represent an increase over the statutorily-mandated 1994 goal of 30 percent, but they are conservative relative to the market share estimates in Appendix D, below Fannie Mae's low-mod performance in 1994, and only slightly above Freddie Mac's performance in 1994. The Secretary's considerations of the six statutory factors led to the choice of these goals.

##### 1. Housing Need

Almost three-fifths of American households qualify as low- and moderate-income under FHEFSSA's definitions—half of owners and 70 percent of renters. Data from the Census and from the American Housing Surveys demonstrate that housing problems and needs for affordable housing are indeed substantial among

<sup>67</sup> *Business Week*, March 27, 1995, p. 154.

<sup>68</sup> Core capital is defined as the sum of the par or stated value of outstanding common or perpetual, noncumulative preferred stock, paid-in capital, and retained earnings.