Appendix B—Secretarial Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Goal

A. Establishment of Goal

1. Introduction

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) requires the Secretary to establish an annual goal for the purchase of mortgages on housing located in central cities, rural areas, and other underserved areas (the ''Geographically Targeted Goal'').

In establishing this annual housing goal, FHEFSSA requires the Secretary to consider:

1. Urban and rural housing needs and the housing needs of underserved areas;
2. Economic, housing, and demographic conditions;
3. The performance and effort of the GSEs toward achieving the Geographically Targeted Goal in previous years;
4. The size of the conventional mortgage market for central cities, rural areas, and other underserved areas relative to the size of the overall conventional mortgage market;
5. The ability of the GSEs to lead the industry in making mortgage credit available throughout the United States, including central cities, rural areas, and other underserved areas; and
6. The need to maintain the sound financial condition of the GSEs.

Organization of Appendix. Section A defines the goal and summarizes HUD's assessment of other proposed definitions of the Geographically Targeted Goal. Section B reports findings on access to mortgage credit and Section C addresses the factors listed above. Section D summarizes the Secretary's rationale for setting the level for the Geographically Targeted Goal.

2. HUD's Geographically Targeted Goal

As required by FHEFSSA, during 1993–1995 only mortgages located in central cities, as designated by the Office of Management and Budget (OMB), counted toward the Geographically Targeted Goal. FHEFSSA directed the Secretary to expand the Geographically Targeted Goal to include rural areas and other underserved areas.

HUD's definition of the Geographically Targeted Goal is based on studies of mortgage lending and mortgage credit flows conducted by academic researchers, community groups, the GSEs, HUD and other government agencies. While more research must be done before mortgage access for different types of people and neighborhoods is fully understood, one finding from the existing research literature stands out—minority and low-income neighborhoods have higher mortgage denial rates and lower mortgage origination rates than other neighborhoods. A neighborhood's minority composition and its level of income are useful proxies for measuring access to mortgage credit.

Metropolitan Areas. The rule provides that within metropolitan areas, mortgage purchases will count toward the goal when those mortgage purchases finance properties that are located in census tracts where either the median income of families in the tract does not exceed 90 percent of the area median income, or minorities comprise 30 percent or more of the residents and the median income of families in the tract does not exceed 120 percent of the area median income.

The final rule's definition includes 20,326 of the 43,232 census tracts (47 percent) in metropolitan areas and accounts for 44 percent of the metropolitan population.[1] The tracts included in this definition suffer from poor mortgage access and depressed socioeconomic conditions. The average mortgage denial rate in these tracts is 21 percent, almost twice the denial rate in non-included tracts.

The definition in the final rule adds 3,657 additional tracts to the definition in the proposed rule. These tracts have significant problems with access to credit, as evidenced by relatively high mortgage denial rates and low origination rates.

Nonmetropolitan Areas. The final rule provides that in non-metropolitan areas, mortgage purchases that finance properties that are located in counties will count toward the Geographically Targeted Goal where: minorities comprise 30 percent or more of the residents and the median income of families does not exceed 120 percent of the state nonmetropolitan median income; *or* the median income of families does not exceed 95 percent of the greater of the state nonmetropolitan median income or the nationwide nonmetropolitan median income.

Two important factors influenced HUD's definition of nonmetropolitan underserved areas—lack of available data for measuring mortgage availability in rural areas and the difficulty in operating mortgage programs at the census-tract level in rural areas. Because of these factors, the final rule uses a more inclusive, county-based definition of underservedness in rural areas. HUD's definition includes 1,511 of the 2,305 counties (66 percent) in nonmetropolitan areas and accounts for 54 percent of the nonmetropolitan population.

Goal Levels. The Geographically Targeted Goal is 21 percent in 1996 and 24 percent in 1997 and thereafter. HUD estimates that the mortgage market in areas included in the Geographically Targeted Goal accounts for 25–28 percent of the total number of newly-mortgaged dwelling units. In 1994, 29 percent of Fannie Mae's purchases financed dwelling units located in these areas, compared with 24 percent of Freddie Mac's purchases.

3. Alternative Definitions

Fannie Mae and Freddie Mac each proposed alternative definitions of underserved areas. Several other commenters suggested alternative definitions similar to those proposed by the GSEs. Fannie Mae would define all central city and nonmetropolitan census tracts as underserved; a suburban or non-central city tract would be considered underserved if minorities comprise 50 percent or more of the residents; or if the median income of families does not exceed 80 percent of the area median income. Freddie Mac would define a tract as underserved if minorities comprise 20 percent or more of the residents; or if the median income of families does not exceed 100 percent of the area median income.

HUD conducted extensive analysis of these and other alternative definitions of underserved areas. HUD also contracted with the Urban Institute to evaluate the alternative definitions of underserved areas.[2] That analysis, which is reported in Section B of this appendix, concluded that HUD's definitions in both the proposed rule and this final rule provide much better measures of mortgage access problems.

Fannie Mae Definition. The research conducted by the GSEs, other mortgage

[1] Tracts are excluded from the analysis if median income is suppressed or there are no population or owner-occupied 1–4 unit properties. There are 2,033 of these tracts. When reporting denial, origination, and application rates, tracts are excluded from the analysis if there are no purchase or refinance applications. Tracts are also excluded from the analysis if: (1) group quarters constitute more than 50 percent of housing units or (2) there are less than 15 home purchase applications in the tract and the tract denial rates equal 0 or 100 percent. Excluded tracts account for a small percentage of mortgage applications (1.4 percent). These tracts are not excluded from HUD's underserved areas if they meet the income and minority thresholds. Rather, the tracts are excluded to remove the effects of outliers from the analysis.

[2] George Galster, ''Comments on Defining 'Underserved' Areas in Metropolitan Regions,'' Urban Institute, prepared for the U.S. Department of Housing and Urban Development, August 15, 1995.