c. The Urban Institute Study.

HUD commissioned the Urban Institute to evaluate the Department's effort to define underserved metropolitan areas. The Urban Institute analysis examined how HUD's, Fannie Mae's, and Freddie Mac's underserved definitions are related to a measure of credit flow problems. An underserved definition can be judged on how accurately it predicts the ''credit flow measure.'' In its analysis, the Urban Institute used mortgage denial rates as the credit flow measure.

The Urban Institute tested each of the definitions using a denial rate threshold of 22 percent.[37] The proposed rule's definitions correctly predict the credit flow measure for 71 percent of the tracts, while the Freddie Mac definition correctly predicts only 63 percent of the tracts, and the Fannie Mae definition only 58 percent of the tracts. Moreover, the HUD definition is not sensitive to changes in the threshold that defines credit flow problems. The Urban Institute also concluded that the final rule's definition is superior to the Freddie Mac and Fannie Mae definitions when the tract denial rate threshold is reduced to 17 percent.

4. Identifying Underserved Locations in Rural Areas[38]

This section discusses the final rule's definition of rural underserved areas, reviews the existing literature on rural housing needs and rural mortgage credit problems, and summarizes discussions held with rural lenders, rural housing developers, public interest groups, and the GSEs at forums on rural lending sponsored by HUD.[39] In addition, this section explains why defining underservedness in rural areas is more difficult than in metropolitan areas.

a. Basic Characteristics of Rural Areas

Identifying underserved rural areas is more difficult than identifying underserved metropolitan areas. In part, this difficulty results from the use of multiple definitions of ''rural'' by researchers, policy makers, and Federal agencies. The Census Bureau defines rural as communities with fewer than 2,500 residents. The Department of Agriculture's Rural Housing and Community Development Service (formerly the Farmers Home Administration) uses several definitions of rural, each specific to one of its housing programs. Maps outlining the areas covered by the various RHCDS programs are available only at local agriculture field offices.[40]

For the purposes of the final rule, HUD defines rural to be any area that lies outside of metropolitan boundaries established by OMB. The OMB nonmetropolitan definition is easily understood by lenders and the GSEs. Approximately 21 percent of the United States population lives in nonmetropolitan areas, with 75 percent of the nonmetropolitan population concentrated in the South and Midwest.

Proportionately more poor people and fewer minorities live in nonmetropolitan areas than in metropolitan areas. The poverty rate in nonmetropolitan areas is 17 percent, compared to 12 percent in metropolitan areas; minorities make up 15 percent of the population in nonmetropolitan areas compared to 27 percent in metropolitan areas. The South and West nonmetropolitan regions have the highest poverty rates and minority percentages. The South, for example, has a 21 percent poverty rate and a 23 percent minority concentration. Poverty rates are highest in remote counties that are not adjacent to a metropolitan area and have less than 2,500 in urban areas. These remote counties account for 12 percent of nonmetropolitan population.

b. Data Issues and Previous Research

Defining rural underserved areas requires a different approach than in metropolitan areas because of the lack of mortgage flow data, differences in housing needs between urban and rural areas, and the difficulty of implementing mortgage programs at the census tract level in rural areas. Evaluating which rural areas are underserved in terms of access to mortgage credit cannot be done with HMDA data, the source used for most studies of credit needs, because HMDA does not provide geographic identifiers on mortgage activity outside of metropolitan statistical areas.[41]

There are few conclusive studies on access to mortgage credit in rural areas because of the lack of adequate data.[42] The studies that do exist only suggest broad conclusions about credit flows in rural areas. Recognizing this lack of research on credit flows in rural areas, the Department consulted with researchers from academia, the Department of Agriculture, the Census Bureau, the Housing Assistance Council, and the Congressional Budget Office. The Department also conducted a series of forums to solicit information on rural mortgage markets from lenders, rural housing groups, and the GSEs. The following section summarizes the existing research on rural credit flows and describes further analysis conducted by HUD.

The Urban Institute Study (''The Availability and Use of Mortgage Credit in Rural Areas'' 1990) concludes that while little data on mortgage credit in rural areas is available, evidence suggests that there is no rural credit shortage that would warrant changes in federal mortgage credit policy. Symptoms of credit shortage identified by the Urban Institute include low homeownership rates, limited borrowing to finance home purchase, adverse credit terms for qualified borrowers, and larger portions of income spent on housing. Because these symptoms do not exist in the majority of rural areas, the Urban Institute concluded that most rural areas suffering from inactive local mortgage markets have weak economies in which demand for home mortgages is low.

The Urban Institute's indicators of a credit shortage and their focus on fixed-rate conventional mortgages could have led to the wrong conclusions about mortgage credit availability in rural areas. Higher homeownership rates in rural areas, for example, are not necessarily indicative of the lack of a credit shortage. Although nonmetropolitan households are more likely to own their homes than metropolitan households—the homeownership rate is 73 and 62 percent, respectively, in nonmetropolitan and metropolitan areas—the higher homeownership rate likely reflects the lack of rental

[37] The unweighted average of denial rates across metropolitan census tracts is 17 percent. The weighted average, which takes into account the number of applications in a tract, is 13 percent.

[38] In this Appendix definition, ''rural'' is used synonymously with ''nonmetropolitan,'' which differs from the terminology employed by the Census Bureau.

[39] Records of these forums are part of the public docket for this rule, and are available for public inspection at the HUD Headquarters Building, Room 10276.

[40] For example, the Rural Housing and Community Development Service (RHCDS) defines rural for its Rural Guaranteed Housing Program as any community with less than 10,000 people in a metropolitan area and less than 20,000 outside an MSA.

[41] Lenders are not required to report under HMDA the location of those mortgage applications for properties outside MSA boundaries. Moreover, a large portion of the data compiled by banking regulators does not distinguish between mortgage activity of rural branches of large regional banks and mortgage activity of the bank's metropolitan headquarters.

[42] Studies include: ''Analysis of Underserved Rural Areas,'' Housing Assistance Council, 1995; ''Effect of Federal Home Loan Bank System District Banks on the Housing Finance System in Rural Areas,'' ICF Incorporated, 1993; ''The Availability and Use of Mortgage Credit in Rural Areas,'' The Urban Institute, 1990; and ''Location, Location, Location: Report on Residential Mortgage Credit Availability in Rural Areas,'' The Center for Community Change, 1990.