4. Size of the Conventional Conforming Mortgage Market for Underserved Areas

HUD estimates that underserved areas account for 25–28 percent of the conventional conforming mortgage market. The analysis underlying this estimate is detailed in Appendix D.

5. Ability to Lead the Industry

This factor is the same as the fifth factor considered under the goal for mortgage purchases on housing for low-and moderate-income families.

Accordingly, see Section C.5 of Appendix A for discussion of this factor.

6. Need to Maintain the Sound Financial Condition of the Enterprises

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 1995 and 1996 Central Cities, Rural Areas, and Other Underserved Areas Goal

This section summarizes the Secretary's rationale for choosing targeted definitions of central cities, rural areas, and other underserved areas, compares the characteristics of served and underserved areas, and addresses other issues related to determining the goal. The section draws heavily from earlier sections which have reported findings from HUD's analyses of mortgage credit needs as well as findings from other research studies investigating access to mortgage credit.

1. Market Failure

The nation's housing finance market is a highly efficient system where most homebuyers can put down relatively small amounts of cash and obtain long-term funding at relatively small spreads above the lender's borrowing costs. Indeed, the growth of the secondary mortgage market during the 1980s integrated a previously thrift-dominated mortgage market with the nation's capital markets so that mortgage funds are more readily available and mortgage costs are more closely tied to movements in Treasury interest rates.

Unfortunately, this highly efficient financing system does not work everywhere or for everyone. Access to credit often depends on improper evaluation of characteristics of the mortgage applicant and the neighborhood in which the applicant wishes to buy. HUD's analysis of 1993 and 1994 HMDA data shows that mortgage credit flows are substantially lower in minority and low-income neighborhoods and mortgage denial rates are much higher for minority applicants.

Admittedly, disagreement exists in the economics literature regarding the underlying causes of these disparities in access to mortgage credit, particularly as related to the roles of discrimination, "redlining" of specific neighborhoods, and the barriers posed by underwriting guidelines to potential minority and low-income borrowers. Because the mortgage system is quite complex and involves numerous participants, it will take more data and research to gain a fuller understanding of why these disparities exist. Still, studies reviewed in Section B of this Appendix found

that the individual's race and the racial and income composition of neighborhoods influence mortgage access even after accounting for demand and risk factors that may influence borrowers' decisions to apply for loans and lenders' decisions to make those loans. Therefore, the Secretary concludes that minority and lowincome communities are underserved by the mortgage system.

2. Identifying Urban Underserved Areas

To identify areas underserved by the mortgage market, HUD focused on two traditional measures used in a number of HMDA studies: ⁶² application denial rates and mortgage origination rates per 100 owner-occupied units. ⁶³ Tables B.1 and B.2 in Section B presented detailed data on denial and origination rates by the racial composition and median income of census tracts for metropolitan areas. ⁶⁴ Aggregating those data is useful for examining denial and origination rates for broader groupings of census tracts:

⁶² HMDA data have been expanded in 1993 to cover independent mortgage companies that originated 100 or more home purchase loans in the preceding calendar year. HMDA provides no useful information on rural areas. In addition, although HMDA data now include applications to provide some measure of overall loan demand, prescreening discrimination can discourage would-be homebuyers from applying for a mortgage, leading to an underestimation of demand. Nevertheless, the HMDA data, while not necessarily definitive, are still useful in helping to define underserved areas.

⁶³ Analysis of application rates are not reported here. Although application rates are sometimes used as a measure of mortgage demand, they provide no additional information beyond that provided by looking at both denial and origination rates. The patterns observed for application rates are still very similar to those observed for origination rates.

⁶⁴ As shown in Table B.1, no sharp breaks occur in the denial and origination rates across the minority and income deciles—mostly, the increments are somewhat similar as one moves across the various deciles that account for the major portions of mortgage activity.