

Expanding and Redefining the Goal

In accordance with the requirements of the Act, the Secretary is expanding this goal for 1995 and 1996 to include rural and other underserved areas as well as central cities. At the same time, the Secretary has redefined the term "central cities" to encompass the underserved areas of central cities and defined "rural areas" as the underserved areas of non-metropolitan areas. The goal is, therefore, intended to focus on communities within central cities, rural areas and other areas which are "underserved" in terms of availability of mortgage credit. This determination is based on the legislative intent, the factors for establishing the goal, HUD's research on underserved areas during the transition period, the results of two public forums held with researchers, public-interest groups, other federal agencies, and the GSEs, and data received from the GSEs during the transition.

Underserved Areas

The Act did not define the term "underserved area" but the legislative history indicates that it should be defined as those areas that lack access to mortgage credit. As detailed in Appendix B, the Secretary considers "underserved" to mean those areas that have an unmet demand for mortgage credit. Using 1993 HMDA data and 1990 Census data, the Department analyzed mortgage application denial and origination rates throughout the country, as well as reports and other research on the availability of mortgage credit and mortgage flows. The research indicated that pervasive and widespread disparities exist in lending across the nation. The Department found, as have other researchers, that the availability of mortgage credit to an area is related to its minority concentration and income characteristics of its residents. Two patterns are clear in the Department's research and that of other researchers:

- Census tracts with higher percentages of minority residents have higher mortgage denial and lower loan origination rates than all-white or predominately white census tracts; and
- Census tracts with lower incomes have higher denial rates and lower origination rates than higher income tracts.

As Appendix B details, HUD's research and that of others has found that the location of a census tract—whether it is located within a central city or a suburb—has minimal impact on whether the tract is underserved.⁸⁴

⁸⁴ See, e.g., Robert B. Avery, Patricia E. Beeson, and Mark S. Sniderman, "Underserved Mortgage

Mortgage flows in a census tract have far less to do with the physical location of a tract, *i.e.*, central city versus suburb, than the minority concentration and median income of that tract. The most thorough studies available demonstrate that areas with lower incomes and higher shares of minority residents consistently have poorer access to mortgage credit, with higher denial rates and lower origination rates for mortgages. With income, minority composition, and other relevant census tract variables controlled for, differences in credit availability between central cities and suburbs are minimal.

Based on this research, the Secretary has determined that this goal should target those areas in central cities, rural areas, and other areas where: 30 percent or more of the residents in a census tract are minority and the median income of families in the census tract is at or below 120 percent of the area median income; or where the median income of families in the census tract is less than 80 percent of the area median income. The goal therefore is directed to census tracts in central cities, rural areas, and all other parts of the country meeting these criteria. (For purposes of defining "rural areas," the Secretary is seeking comments on whether counties or Block Numbering Areas, which are equivalent to census tracts in rural areas, are the appropriate geographic unit.)

The Department has conducted an intensive research effort on identifying geographic areas underserved by the mortgage markets. This research effort is ongoing and will continue during the period of proposed rulemaking. Research underway includes the analysis of the implications of alternative definitions of underserved areas in urban, suburban, and rural communities. The Department will also engage in a multi-year research effort to identify and analyze indicators of unmet demand for mortgage credit. This long-term research effort will be used by the Department in future years to review the level of the housing goals established for the GSEs. In conducting this research effort on identifying indicators of unmet demand, the Department fully intends to consult with other Federal agencies including Treasury and with the GSEs.

Central Cities

For purposes of this housing goal, the Secretary is defining "central cities" as

Markets: Evidence from HMDA Data," (presented at the Western Economic Association Annual Meetings, Vancouver BC), July 1994, and William Shear, James Berkovec, Ann Dougherty, and Frank Nothaft, "Unmet Housing Needs: The Role of Mortgage Markets," unpublished paper, June 1, 1994.

the underserved areas of any political subdivisions designated as central cities by the Office of Management and Budget (OMB). Directing the goal to all areas of central cities identified by the Office of Management and Budget (OMB) would not appropriately target the GSEs' activities to areas that have a relative lack of access to mortgage credit. OMB defines the central city or central cities of a metropolitan statistical area based on population and other factors that measure job location and commuting patterns. OMB does not take into account mortgage credit availability or measures of economic distress. As a result, the list of 545 central cities includes very affluent and well served cities and excludes other obviously distressed cities. For example, Palo Alto, California—with a per capita income of \$32,500 and a poverty rate of 2 percent—is a central city but Compton, California—with a per capita income of \$7,800 and a poverty rate of 24 percent—is not a central city.

In addition, there are substantial regional variations in the portion of state urban population that are included in central cities. In the southern and western parts of the country, cities have often expanded by annexing adjacent territory. This option was generally not available to cities in the Northeast, which have retained their historical boundaries. As a result, a substantially greater portion of the population lives in central cities in the South and West than in the more urbanized Northeastern states. This has led to perverse results for the central cities goal in place for 1993: Central cities accounted for more than 50 percent of both GSEs' mortgage purchases in Arizona, New Mexico, and North Dakota. In New Jersey, on the other hand, purchases in central cities accounted for only 4 percent of GSE purchases.

James A. Johnson, Fannie Mae's Chairman and Chief Executive Officer, in April 1994 testimony before a Congressional sub-committee summarized some of the problems with using the OMB designation of central cities:

Central cities are also of limited value as proxies for distressed, needy, minority or low- and moderate-income census tracts. Especially in older cities that are hemmed in by separately incorporated suburbs and other communities, political jurisdictions enforce artificial barriers to describing areas of need. Conversely, where cities can annex neighboring communities as growth occurs, the result is a central city that encompasses so much territory of such diverse nature that