necessary to exclude certain HMDA loans that may be more targeted to low-income borrowers than those loans included in HUD's analysis. Second, the 50 percent estimate does not take into account the fact that small, second loans may qualify as low-mod in 1995 and 1996. This section explains these issues.

(1) *HMDA Data.* The above analysis of HMDA data is limited to those cases where geocoded information is available on the 1993 HMDA file (that is, information is available to identify the census tract and the metropolitan area of the mortgaged property). There were approximately 804,000 conventional conforming loans in the HMDA file without enough information to identify the metropolitan area (or the census tract) where the property was located. These loans represented 13.2 percent of all conventional conforming loans in 1993.[49] The relative income of the borrower (i.e., borrower income relative to the median income of the metropolitan area) could not be computed for these non-geocoded loans.

HUD analysis suggests that the non-geocoded loans are more likely to be loans for low-income borrowers than the geocoded loans used earlier to determine the low-mod market share. HUD repeated its analysis of the geocoded loans but, instead of using the metropolitan area median income as the base for each borrower's income, HUD used the national metropolitan median income as the base income. The national-metro-median-income approach and the metropolitan-area-median-income approach suggested somewhat similar low-mod shares for the conventional conforming market in 1993, 31.9 percent and 29.6 percent, respectively. The incomes of borrowers taking out non-geocoded loans were then analyzed using the national-metro-median-income approach. This suggested a 45.2 percent low-mod share for non-geocoded loans, which is greater than the 31.9 percent obtained for the geocoded loans using the national-metro-median-income approach. Therefore, not including the non-geocoded loans in the analysis leads to an underestimate of the market's low-mod share.

(2) *Eligibility of Second Mortgages.* This regulation might allow the GSEs to count second mortgages for partial credit because they play a role in the financing of rehabilitation in underserved areas.[50] In 1993, the GSEs purchased only a small number of second mortgages: Fannie Mae purchased 641 seconds, representing $28.5 million, and Freddie Mac purchased 27 seconds, representing $1.4 million. It is unclear how the GSEs would react to the fact that seconds might be eligible under the goals. One scenario might involve a substantial increase in their purchases of small home improvement loans in inner city areas which would increase their performance under the goals. Another scenario might involve only incremental changes to their current business which would only marginally increase their performance under the goals. It is also unclear how to delineate the overall market in which the GSEs might be operating, because their past purchases have been so small. Admittedly, they could purchase second mortgages in all segments of the market (from inner city low-income loans to suburban high-income loans); however, given their current small share of the overall market, it might not be appropriate to assume their purchases would cover the entire market.

The HMDA data does include information on home improvement loans (HILs). In 1993, 620,000 home improvement loans were originated, with an average loan amount of $20,700. Using RFS data, for the period 1989–1991, the average loan amount for HILs was $26,700. The loan distribution for all HILs shows that 59 percent of these loans were for amounts less than $15,000. Compared with purchase mortgages, HILs are more targeted to lower income borrowers. Almost 47 percent of conforming conventional owner-occupied HILs went to low-mod borrowers, compared with 31 percent for purchase mortgages.[51]

In 1993, GSE purchases accounted for only 5.7 percent of the HIL market. Fannie Mae bought 21,100 (3.4 percent) of HILs and Freddie Mac bought 14,300 (2.3 percent) of these mortgages. The distribution of HILs purchased by the GSEs differed from the distribution of the total market. Only 31 percent of the GSEs' HILs went to low-mod borrowers, compared with 47 percent for the market as a whole. But 54 percent of the HILs bought by both GSEs were for borrowers with incomes over 120 percent of area median income; this compares with 40 percent for the market as a whole.

d. Conclusions

Based on the above findings as well as numerous sensitivity analyses, the Secretary concludes that 50 percent is a conservative estimate of the mortgage market's low-mod share for 1995 and 1996.

5. GSEs' Ability to Lead the Industry

The Secretary believes that in light of the benefits that Fannie Mae and Freddie Mac receive from their Charter Acts and the ''implicit guarantee'' of their obligations resulting from their agency status, the GSEs can and should provide the leadership that is needed to encourage the mortgage finance industry to better serve low- and moderate-income borrowers. The GSEs' ability to lead the industry depends on their dominant role in the mortgage market, their ability—through their underwriting standards and new programs and products—to influence the types of loans that private lenders are willing to make, their utilization of cutting edge technology, their highly competent and well-trained staffs, and their financial resources.

a. Dominant Role in Market

Fannie Mae and Freddie Mac together purchased approximately 71 percent of all conventional conforming single-family mortgages in 1993—up from 17 percent in 1980, 33 percent in 1985, 52 percent in 1991, and 65 percent in 1992.[52] Most of the mortgages purchased by both GSEs are securitized, but sizable amounts are held in portfolio—in fact Fannie Mae and Freddie Mac have the first- and fourth-largest mortgage portfolios, respectively, of all mortgage lenders in the United States. The GSEs now hold or securitize about 30 percent of the total dollar volume of mortgages outstanding, compared to about 7 percent in 1980, and they have accounted for over 40 percent of the net increase in mortgages outstanding between 1980 and 1992 and over 70 percent of the net increase between 1989 and 1992.[53]

The dominant position of the GSEs is reinforced by their relationship to other market institutions. Banks and savings and loans are both their competitors and their customers—they compete as portfolio lenders, but at the same time they sell mortgages to the GSEs and buy mortgage securities from them, and also buy the debt securities that the GSEs use to finance their portfolios.[54]

b. Set Underwriting Standards for Market

The GSEs' underwriting guidelines are followed by virtually all mortgage originators, including lenders who do not sell many of their mortgages to Fannie Mae or Freddie Mac.[55] The guidelines are also commonly followed in underwriting ''jumbo'' mortgages, which exceed the maximum principal amount which can be purchased by the GSEs (the conforming loan limit), because such mortgages might eventually be sold to the GSEs as the principal balance is amortized and the conforming loan limit is increased. By setting the credit standards against which lower income families will be judged, the GSEs can influence the rate at which mortgage funds will flow to low-income borrowers and underserved neighborhoods. Congress realized the crucial role played by the GSEs' underwriting guidelines and it required each enterprise to submit a study on its guidelines to the Secretary, the Committee on Banking, Finance and Urban Affairs of the House of Representatives, and the Committee on

[49] As noted earlier, loans less than $15,000, those with loan-to-income ratios that exceed six, and loans to nonowner-occupants are excluded.

[50] On the other hand, second mortgages may be used for purposes totally unrelated to housing, such as making other purchases, paying off debts, etc. Because the rates on seconds are often below other consumer borrowing rates (especially those on credit card debt) and because interest on second mortgages is tax-deductible, there are strong incentives to use second mortgages for purposes other than housing rehabilitation.

[51] Restricting the analysis to purchase mortgages over $15,000, as was done in the earlier calculation of the low-mod market, gives a 38.2 percent share for borrowers with less than the area median income.

[52] Estimates provided by Fannie Mae's Economics Department, 1993.

[53] John C. Weicher, ''The New Structure of the Housing Finance System,'' *Federal Reserve Bank of St. Louis Review,* July/August 1994, pp. 51–52.

[54] *Id.,* pp. 52–53.

[55] The underwriting guidelines published by the two GSEs are not identical, but they are very similar in most aspects. And since November 30, 1992, Fannie Mae and Freddie Mac have provided lenders the same *Uniform Underwriting and Transmittal Summary* (Fannie Mae Form 1008/Freddie Mac Form 1077), which is used by originators to collect certain mortgage information that they need for data entry when mortgages are sold to either GSE.