4. Size of the Conventional Mortgage Market for Central Cities, Rural Areas, and Other Underserved Areas Relative to the Overall Conventional Conforming Market

Section C.4 of Appendix A describes HUD's two approaches for estimating the size of the low- and moderate-income market. The first approach cannot be used for underserved areas because American Housing Survey data are not available at the census tract level. The analysis of underserved areas follows the second approach, which is based on HMDA data and projections of the 1995 mortgage market. The methodology involves estimating for each of the various property types (single family owner, single family investment, etc.) the percentage of dwelling units financed by mortgages that are located in underserved census tracts and, then, computing the overall market share for underserved areas by weighting these underserved area percentages by the mortgage originations for each property type in the 1995 market.

This approach follows the same six steps as outlined in Section C.4.b of Appendix A. In steps (5) and (6), underserved area shares are substituted for low-mod shares:

(5) Estimates of the percentage of dwelling units financed by mortgages that are located in underserved areas were: 15.4 percent for single-family owner-occupied purchase mortgages and 14.1 percent for single-family owner-occupied refinance mortgages (both figures based on 1993 HMDA data); and 45 percent for single-family 2–4's, 35 percent for single-family 1–4's, and 43 percent for multifamily (discussed below).

(6) Applying the above underserved area percentages to the property type weights given in step (4) of Section C.4.b of Appendix A gives an overall estimated underserved area share for 1995 of 23.4 percent.

Sensitivity analyses were conducted for the market importance of each property type and for the underserved area shares of each property type, as discussed in Appendix A. Using 1992 HMDA data for the single-family owner-occupied shares in step (5) gave almost identical results. Sensitivity analysis was more important for the three rental categories where data on underserved areas are not readily available. The percentages (45 percent and 35 percent) of single-family rental mortgages located in underserved areas were based on GSE data—the percentages of Fannie Mae's mortgage purchases in underserved areas for 2–4 and 1–4 properties were 45 percent and 35 percent, respectively, and the corresponding percentages for Freddie Mac were 43 percent and 36 percent, respectively.[46] 1993 (1992) HMDA data on mortgages to properties with non-occupant owners were consistent with the GSE data for 1–4 properties—HMDA reports that almost 32 percent (35 percent) of those mortgages were for properties located in underserved areas.

The multifamily underserved area percentage (43 percent) is based on 1992 and 1993 HMDA data which, admittedly, is quite limited.[47] The only other source is Fannie Mae data, because Freddie Mac's purchases of multifamily mortgages in 1993 were limited. In 1993, about 35 percent of Fannie Mae's multifamily business was in underserved areas. Dropping the multifamily percentage from 43 percent to 40 (35) percent would reduce the estimated market share for underserved areas to 22.9 (21.9) percent. These and other analyses leads the Secretary to conclude that the size of the underserved area market is at least in the 21–23 percent range.

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

This factor is the same as the sixth factor considered under the goal for mortgage purchases on housing for low- and moderate-income families. Accordingly, see Section C.6 of Appendix A for discussion of this factor.

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 underserved area goals. 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 all to 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 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 lending disparities are glaring and persistent and that minority and low-income communities are underserved by the mortgage system.

2. Selection of Targeted Approach

For 1993 and 1994, the Secretary was required to use the OMB list of ''central cities'' for the geographic targeting goal; the OMB definition of central city was a temporary measure to allow time for analysis to define a better targeting standard. HUD, along with the GSEs, Congress, and community groups, recognized that central cities as defined by OMB do not satisfactorily measure cities that are underserved by the mortgage market. There are several reasons for this.

First, major portions of central cities house upper-income families and neighborhoods that are well served by the mortgage market. New York's Upper East Side, Chicago's ''Gold Coast,'' Washington's Georgetown and other wealthy areas within central cities across the nation do not fit into any reasonable definition of an ''underserved area.'' The fact that not all parts of central cities lack access to mortgage credit was demonstrated earlier in Figure B.1. Compared to underserved central city census tracts, the remaining ''served'' tracts have half the denial rate. Mortgage origination rates (per 100 owner occupants) in the served portions of central cities are double the origination rates in the underserved portions of central cities. Thus, central city areas that are not included in HUD's underserved area definition appear to be obtaining mortgage credit. These areas, which account for about half of the central city population, are well served by the mortgage market.

Second, many urban areas not defined as ''central cities'' by OMB are highly distressed and not well served by the mortgage market. Examples of highly distressed urban areas located outside central cities include East Orange and Paterson, New Jersey and Compton, California. Highly distressed Compton, with a poverty rate of 25 percent, is not on OMB's list, but Palo Alto, California, with a poverty rate of only 2 percent, is on OMB's list.

[46] Unlike the low- and moderate-income percentages reported in Appendix A, the likelihood of the GSEs' mortgages being located in an underserved area did not differ much between purchase and refinance mortgages.

[47] The 1992 HMDA data included only $9 billion of the $25 billion in conventional multifamily mortgages originated during 1992. Similarly, the 1993 HMDA data included $11 billion of the total $29 billion in conventional multifamily mortgages originated in 1993.