The market values of apartment properties have generally held up well, although the most recent indicators suggest some flattening. Properties in the portfolios of pension funds continued to appreciate into the second half of 2002, according to the National Council of Real Estate Investment Fiduciaries, although at a reduced annual rate of less than 2 percent. And the sales price per square foot of ''Class A'' properties monitored by Global Real Analytics rose until turning down in early 2002, posting a 1.6 percent year over year decline in the second quarter.

The continuing value of collateral has helped keep loan quality high on multifamily mortgages. Delinquency rates from all major reporters are at or near record lows, and well below the rates reported for single-family mortgages and commercial properties. At commercial banks, the FDIC reports a non-current loan percentage of 0.38 in the second quarter of 2002. In life insurance company portfolios only .05 percent of residential mortgages were overdue at the end of 2002, and as of the third quarter of 2002 the GSEs were both reporting similarly miniscule delinquency rates of below 0.1 percent; all of these rates are below those of a year earlier.

Multifamily lenders have remained cautious in their underwriting and, together with their regulators, have avoided repeating the mistakes of the 1980s. Many of the senior loan officers surveyed quarterly by the Federal Reserve have reported tightening their terms on commercial mortgages, and that shift likely has occurred in their multifamily lending as well. Perhaps the best indicator of discipline in multifamily lending is the fact that, despite the strong apartment demand during the last half of the 1990s, construction never rose above its long-run sustainable level, unlike the rampant overbuilding that plagued the industry in the mid- and late-1980s.

4. Recent GSE Involvement in Multifamily Finance

As the multifamily mortgage market has expanded since 1999, Fannie Mae and Freddie Mac have increased their lending, picked up market share, introduced new programs, and enhanced others.

Beginning with their whole loans, the GSEs added 34 percent to their combined holdings of multifamily loans in 2001, and another 26 percent in 2002 (*see* Table A.6 below). The growth in multifamily MBS volume was nearly as dramatic, increasing 26 percent in 2001 and another 14 percent in 2002. The gains resulted in the GSEs increasing their share (whole loans and securities combined) of all multifamily debt outstanding to 22.8 percent by the third quarter of 2003, up from 19 percent at year-end 2001, 15 percent at year-end 1999 and 11 percent at the end of 1995. By this combined measure of portfolio holdings and MBS outstanding, at year-end 2002 Fannie Mae had nearly twice ($65 billion versus $37 billion) the multifamily business of Freddie Mac, although Freddie was growing its multifamily business more rapidly (67 percent increase between 2000 and 2002, compared to 46 percent increase for Fannie Mae).

Measures that focus on new multifamily activity, specifically gross mortgage purchase volumes and new security issuance, vary across recent years and between the GSEs. For the GSEs combined, these measures of current business activity show sharp gains of over 70 percent in 2001, following small decreases in activity in 2000. In 2002, the GSEs combined posted small declines for both measures. Measures of multifamily gross mortgage purchases and new security issuance diverged for the two GSEs in 2002. Fannie Mae experienced declines in these balance sheet and new business indicators in 2002 while Freddie Mac experienced gains, particularly in new security issuance. As discussed earlier, the credit quality of GSE multifamily loans has remained very high even with the large gains in loan volume.

Despite the substantial pickup in GSE multifamily activity, the position of these companies in the multifamily mortgage market remains well below their dominance in single-family mortgage finance. At the end of 2002, the GSEs' market share of single family debt outstanding was 44 percent, twice the share of multifamily debt held or securitized by these two companies, according to Federal Reserve statistics. Furthermore, the multifamily share of all housing units financed by the GSEs combined has declined from its 1997 level (Table A.5), although the annual statistics are heavily influenced by the volume of refinancings in the single-family market, which spiked in 1998 and again in 2001 and 2002 in response to the big decline in mortgage rates in those years. Because of lock-out agreements and other loan covenants, multifamily loans are not as prone to rate-induced refinancings as are single-family mortgages.

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Table A.5

Multifamily Share of All Housing Units Financed

	Units Financed								
	Fannie Mae			Freddie Mac			GSEs Combined		
Year	Multifamily	Total	Multifamily Share	Multifamily	Total	Multifamily Share	Multifamily	Total	Multifamily Share
1997	253,065	1,888,547	13.4%	99,470	1,213,126	8.2%	352,535	3,101,673	11.4%
1998	394,345	3,707,839	10.6%	221,319	2,718,565	8.1%	615,664	6,426,404	9.6%
1999	294,186	3,109,885	9.5%	191,492	2,328,800	8.2%	485,678	5,438,685	8.9%
2000	289,891	2,293,397	12.6%	163,580	1,677,295	9.8%	453,471	3,970,692	11.4%
2001	503,909	4,893,900	10.3%	315,868	3,381,036	9.3%	819,777	8,274,936	9.9%
2002	461,397	6,362,315	7.3%	333,038	4,552,277	7.3%	794,435	10,914,592	7.3%

Source: GSE Annual Housing Activity Reports, Table 1; figures for 2001 are adjusted for REMIC weights and participations.

a. Contrasting Business Models

While both Fannie Mae and Freddie Mac have significantly increased their multifamily activities in recent years, they have pursued distinct business models in achieving that growth. As shown in Table A.6, most of Fannie Mae's multifamily growth has come in MBS products, whereas Freddie Mac has relied more on loans purchased and held in its portfolio. At the end of 2002, Fannie Mae had almost four dollars of outstanding MBSs for every dollar of portfolio holdings. Freddie Mac, on the other hand, more than three times as much volume in portfolio as it had in MBS outstanding.

Table A.6

GSE Multifamily Mortgage Activity, 1998-2002

($ millions)

	1998	1999	2000	2001	2002
Fannie Mae					
MF Whole Loans in Portfolio	8,185	7,911	8,361	10,538	13,571
% Change From Previous Year		-3.3%	5.7%	26.0%	28.8%
MF MBS Outstanding	28,535	32,221	35,987	44,909	51,111
% Change From Previous Year		12.9%	11.7%	24.8%	13.8%
MF Purchases (Cash + Securitizations)	11,428	10,012	10,377	19,131	16,611
% Change From Previous Year		-12.4%	3.6%	84.4%	-13.2%
MF MBS Issuance	11,028	8,497	7,596	13,801	12,338
% Change From Previous Year		-23.0%	-10.6%	81.7%	-10.6%
Freddie Mac					
MF Whole Loans in Portfolio	7,978	12,355	16,369	22,483	28,036
% Change From Previous Year		54.9%	32.5%	37.4%	24.7%
MF MBS Outstanding	N/A	4,462	5,708	7,476	8,780
% Change From Previous Year			27.9%	31.0%	17.4%
MF Purchases (Cash + Securitizations)	3,910	7,181	6,030	9,509	10,656
% Change From Previous Year		83.7%	-16.0%	57.7%	12.1%
MF MBS Issuance	937	2,045	1,786	2,356	3,596
% Change From Previous Year		118.2%	-12.7%	31.9%	52.6%
Combined					
MF Whole Loans in Portfolio	16,163	20,266	24,730	33,021	41,607
% Change From Previous Year		25.4%	22.0%	33.5%	26.0%
MF MBS Outstanding	N/A	36,683	41,695	52,385	59,891
% Change From Previous Year			13.7%	25.6%	14.3%
MF Purchases (Cash + Securitizations)	15,338	17,193	16,407	28,640	27,267
% Change From Previous Year		12.1%	-4.6%	74.6%	-4.8%
MF MBS Issuance	11,965	10,542	9,382	16,157	15,934
% Change From Previous Year		-11.9%	-11.0%	72.2%	-1.4%

Source: Calculated from tables in OFHEO 2001 Annual Report.

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The differing emphasis on portfolio holdings and securities issuance is related to the GSEs' contrasting approaches to credit underwriting.[203] Fannie Mae has long had risk-sharing arrangements with its multifamily loan originators, and currently has over 25 Delegated Underwriters and Servicers who are authorized to originate loans meeting Fannie Mae's requirements for sale to the GSE without prior approval of individual transactions. These ''DUS'' lenders retain part of the credit risk on the loans sold to Fannie.

Freddie Mac has taken a different approach to credit underwriting. In the wake of large credit losses on its multifamily business in the late 1980s and 1990, Freddie Mac essentially withdrew from the market. When it re-entered in late 1993, the company elected to retain all underwriting in-house and not delegate this function to the loan originators participating in Freddie Mac's Program Plus network. Because Freddie assumes the entire credit risk on loans it purchases, some commercial banks and other financial institutions desiring to remove multifamily loans and all related liabilities from their books find Freddie's program preferable.

[203] ''No Mistaking GSEs for Twins in Multifamily,'' *American Banker,* October 2, 2002.

b. Affordable Multifamily Lending

Because most of the GSEs' multifamily lending is on properties affordable to households with low- or moderate incomes, financing of affordable multifamily housing by the GSEs has increased almost as much as their total multifamily lending. Approximately 86 percent of Fannie Mae's multifamily lending volume in 2002 qualified as affordable to low- or moderate income households, according to Fannie Mae's annual *Housing Activity Report*, as did 93 percent of Freddie Mac's multifamily units financed. For the entire multifamily rental market, HUD estimates that 90 percent of all housing units qualify as affordable to families at 100 percent of the area median, the standard upon which the low- and moderate-income housing goal is defined.

Owing to this high propensity to qualify as affordable lending, financing of multifamily rental housing is especially important for the GSEs attainment of their affordable housing goals. Less than 8 percent of the units financed by the GSEs in 2002 were multifamily rentals, as described above. Yet 15 percent of the units qualifying as low- and moderate-income purchases were multifamily, according to Table 1 of the GSEs' activity reports for 2002.

The GSEs increased the volume of their affordable multifamily lending dramatically in 2001, the first year of the new, higher affordable housing goals set for the GSEs. As measured by number of units financed, the total affordable lending (shown in the ''low-mod total'' rows of Table A.7) more than doubled from a year earlier, especially after application of the upward adjustment factor authorized for Freddie Mac in the 2000 Rule. In 2002, the GSEs maintained a high volume of affordable multifamily lending with Fannie Mae showing a slight decrease and Freddie Mac a slight increase.

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Table A.7

Multifamily Units Financed

	1998	1999	2000	2001	2002	Source
Fannie Mae						
Total	393,397	294,091	289,509	503,909	461,397	1
Percent Change		-25%	-2%	74%	-8%	
Small	64,753	12,351	7,196	37,449	77,485	2
Large	328,644	281,740	282,312	466,460	383,912	2
Low-Mod Total	334,042	274,026	266,410	463,655	416,905	3
Percent Change		-18%	-3%	74%	-10%	
Small	52,508	10,017	6,244	32,732	67,892	3
Large	281,534	264,009	260,166	430,923	349,012	3
Underserved Areas Total	170,488	110,532	107,603	228,960	203,491	3
Percent Change		-35%	-3%	113%	-11%	
Small	43,133	5,879	4,042	23,794	50,204	3
Large	127,356	104,653	103,561	205,166	153,287	3
Special Affordable Total	180,726	164,068	147,641	267,513	241,359	3
Percent Change		-9%	-10%	81%	-10%	
Small	33,256	5,832	4,450	19,771	39,548	3
Large	147,470	158,236	143,191	247,742	201,811	3
Freddie Mac						
Total	221,319	191,492	163,580	315,370	333,038	1
Percent Change		-13%	-15%	93%	6%	
Small	10,244	4,068	2,996	50,492	44,039	2
Large	211,075	187,424	160,584	264,878	288,999	2
Low-Mod Total	211,760	172,417	151,166	294,875	298,134	3
Percent Change		-19%	-12%	95%	1%	
Small	9,421	3,322	2,621	48,062	40,563	3
Large	202,339	169,095	148,545	246,813	257,570	3
Underserved Areas Total	96,431	69,175	58,758	145,068	153,930	3
Percent Change		-28%	-15%	147%	6%	
Small	5,881	2,059	1,833	43,252	41,023	3
Large	90,550	69,175	56,924	101,817	112,907	3
Special Affordable Total	120,776	82,982	79,375	168,753	159,680	3
Percent Change		-31%	-4%	113%	-5%	
Small	5,785	1,526	1,636	36,600	28,245	3
Large	114,991	81,455	77,739	132,153	131,436	3

Sources: 1. Tables 15a, 15b of Summary Tables for 1993-2000 on HUD User web site for 2001, Annual Housing Activity Report Table 1.

2. For 1998-99, Table 4 of Summary Tables for 1993-2000 on HUD User web site for 2001, Annual Housing Activity Report Table 1.

3. For 1998-99, Table 4 of Summary Tables for 1993-2000 on HUD User web site totals for 1998-99 calculated as sum of small and large for 2000-2001, Annual Housing Activity Report Table 1.

Totals for 2001 are the "adjusted" totals from Annual Housing Activity Report Table 1 exclusive of adjustments for bonuses and Freddie Mac's Temporary Adjustment Factor.

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The figures in Table A.7 are exclusive of the ''Temporary Adjustment Factor (TAF)'' granted to Freddie Mac as part of the 2000 Rule. The TAF was a response to Freddie Mac's limited opportunities for refinancing business because of its minimal involvement in the multifamily market in the early and mid-1990s. [204] The TAF, which expired at the end of 2003, provided a 20 percent upward adjustment to multifamily units in properties with 50 or more units, for purposes of the affordable housing goals.

Multifamily financing made major contributions not only to the GSEs attainment of the overall goal for affordable lending in 2002, but also to the ''underserved areas'' goal and ''special affordable'' goal. As shown in Table A.7, the 2001 increases in lending in each of these categories were substantial at both Fannie Mae and Freddie Mac, again leveling off for both in 2002. The GSEs also met the special multifamily affordable subgoal set in the 2000 Rule in both 2001 and 2002.

c. Multifamily Initiatives of the GSEs

Fannie Mae and Freddie Mac have taken a number of steps since 2000 to expand their multifamily lending and to respond specifically to the goals established in the 2000 Rule. These initiatives are summarized in the annual activity reports filed by the GSEs.[205]

One focus of the 2000 Rule was on lending to small (5-to-50 units) multifamily properties, which the Rule identified as an underserved market. HUD-sponsored research has found that the supply of mortgage credit to small properties was impeded by the substantial fixed costs of multifamily loan originations, by owners' insufficient documentation of property income and expense, and by the limited opportunities for fees for underwriting and servicing small loans.[206] As a result, many multifamily lenders focus on larger properties, which were found to have more loan products available to them and to pay lower interest rates than did small properties.

In an attempt to promote the supply of credit to small properties, the 2000 Rule provided incentives for the GSEs to step up their involvement in this segment of the multifamily mortgage market. The incentives likely contributed to the huge increases in small property lending posted by both Fannie Mae and Freddie Mac in 2001 and continuing into 2002 (Table A.7). The combined total of these units financed in 2001 and 2002 was almost 8 times those financed in the previous two years. This lifted the percentage of all GSE multifamily lending that was on small properties to their highest levels ever.

Programs introduced or enhanced by the GSEs in the past two years have contributed to these striking numerical results. Delegated Underwriting and Servicing (DUS) is Fannie Mae's principle product line for purchasing individual multifamily loans. This product line is offered through 26 lenders with expertise in financing multifamily properties. In 2002, 92% of the DUS loan activity served affordable housing needs, 41% of DUS loans in underserved markets, and 51% addressed ''special affordable'' needs.[207] Fannie Mae markets its specialized 3MaxExpress product line for loans worth less than or equal to $3 million. This program helped secure $4.1 billion in financing since 2001, which has assisted 130,000 families living in small multifamily properties.[208] Fannie Mae additionally has federal Low-Income Housing Tax Credit (LIHTC) programs and special financing projects for special use properties such as Seniors Housing.[209]

[204] For background information on the Freddie Mac TAF, see pages 65054 and 65067–65068 of the 2000 Rule.

[205] *Fannie Mae's 2002 Annual Housing Activities Report,* pages 24–27; *Freddie Mac's Annual Housing Activities Report for 2002,* pages 41–47.

[206] Abt Associates Inc., *An Assessment of the Availability and Cost of Financing for Small Mulifamily Properties,* a report prepared for the U.S. Department of Housing and Urban Development, Office of Policy Development and Research, August 2001.

During 2002, Freddie Mac used innovative financing structures combined with prudent, flexible multifamily lending practices, which were targeted at affordable initiatives through its Program Plus network of lenders resulting in record levels of multifamily mortgage purchases. The GSEs face strong competition in this market from small banks and other depository institutions that prefer to hold these loans in their own portfolios.[210]

The 2000 Rule discussed other ways in which the GSEs might help promote financing of affordable multifamily housing. Two of those were lending for property rehabilitation and leadership in establishing standards for affordable multifamily lending. Many affordable properties are old and in need of capital improvements if they are to remain in the housing stock. Rehabilitation lending is a specialized field, and one in which the GSEs for a variety of reasons have not been major players. Less than 1 percent of all GSE multifamily lending in 2002 was for property rehabilitation. In 2002, Fannie Mae hosted its first ever Preservation Advisory Meeting with leaders in the housing and real estate finance industry to identify best practices and formulate real world solutions to this critical policy issue.[211]

Setting standards for affordable multifamily lending was identified in the 2000 Rule as another area where the GSEs could provide greater leadership. It was also noted, based on HUD-sponsored research underway at that time,[212] that market participants believe the GSEs to be conservative in their approaches to affordable property lending and underwriting. Actions described in the GSEs' annual activity reports for 2001 and 2002 indicate attempts by the GSEs to promote market standards that will reduce the transactions costs of multifamily lending while also providing programs that have the flexibility needed to deal with unique circumstances.

[207] Fannie Mae, *2002 Annual Housing Activities Report,* 2003, p. 25.

[208] Fannie Mae, *2002 Annual Housing Activities Report,* 2003, p. 25.

[209] Fannie Mae, *2002 Annual Housing Activities Report,* 2003, p. 26–27.

[210] ''Fannie Courting Multifamily Sellers; Small Banks Balking,'' *American Banker,* January 13, 2003.

[211] Fannie Mae, *2002 Annual Housing Activities Report,* 2003, p. 27.

[212] Abt Associates, ''Study of Multifamily Underwriting and the GSEs' Role in the Multifamily Market,'' Final Report to the U.S. Department of Housing and Urban Development, Office of Policy Development and Research, August 2001.

5. Future Prospects

The outlook for the multifamily rental housing market is marked by near-term risks and longer-run optimism, according to most observers. The prospects for the next few quarters are dominated by the macroeconomy. In particular, job growth, with its implications for formations of households, will be a key for the resumption of growth in apartment demand. Many forecasters would ascribe to the Federal Reserve's forecast of a slight increase in GDP growth to 4.3 percent in 2004,[213] while also agreeing with the Fed's warning that ''An unusual degree of uncertainty attends the economic outlook at present, in large measure, but not exclusively, because of potential geopolitical developments.'' [214]

When consumer demand does pick up, recovery should be reasonably fast. While the recent production levels have outpaced demand, they have been near the middle of the long run historical range and very close to the average of the last half of the 1990s. Judging from the firm tone to rents and vacancies during that period, total multifamily completions production of 275,000 to 350,000 units is a sustainable level of annual production—that is, the level consistent with long run demographic trends and replacement of units lost from the stock.

Because new construction has remained moderate, there is no massive overhang of product that will need to be absorbed. With increased demand, vacancies should fall and rents firm reasonably promptly. A key assumption behind this forecast for vacancies and rents is that new apartment construction not rise appreciably from its current level.

Recovery in the apartment market may also, perversely, be promoted by the recent unprecedented strength of the single-family market. Typically, economic recoveries bring strong growth in single-family housing demand, some of that coming from apartment renters seeking more space. With single-family activity already near record highs, boosted by historically low mortgage interest rates and despite the recently soft economy, it is uncertain how much higher single-family demand—and the accompanying losses of apartment customers to homeownership—can go.

Whenever the recovery comes, it will put the multifamily rental market back onto a long-run path that appears to promise sustained, moderate growth. As discussed in the 2000 Rule, the demographic outlook is favorable for apartment demand. Even if the homeownership rate increases further and the total number of renter households grows only slowly, as described in the discussion of the single-family housing market earlier in this Rule, apartment demand can be expected

[213] Federal Reserve, Survey of Professional Forecasters, November 2003.

[214] Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress,* February 11, 2003, page 4.

to increase more rapidly than that for other rental housing, owing to the likely changes in age composition and reductions in average household size. One estimate projects the annual growth in apartment households to be one percent.[215]

a. The Outlook for Multifamily Housing Supply

Regarding supply, one of the secrets of the success of the multifamily sector during the 1990s was that production never rose above its long-run sustainable level. The discipline of developers, investors, and their lenders that brought that result needs to be continued if the apartment market is to maintain stability.

Multifamily housing may benefit in the future from more favorable public attitudes and local land use regulation. Higher density housing is a potentially powerful tool for preserving open space, reducing sprawl, and promoting transportation alternatives to the automobile. The recently heightened attention to these issues may increase the acceptance of multifamily rental construction to both potential customers and their prospective neighbors.

Provision of affordable housing will continue to challenge suppliers of multifamily rental housing and policy makers at all levels of governments. Low incomes combined with high housing costs define a difficult situation for millions of renter households. Housing cost reductions are constrained by high land prices and construction costs in many markets. Government action—through land use regulation, building codes, and occupancy standards—are major contributors to those high costs, as is widely recognized by market participants, including the leaders of the GSEs.[216] Reflecting the preferences of the electorate, these regulated constraints are unlikely to change until voter attitudes change.

b. The Future Role of the GSEs

Regarding the mortgage financing of multifamily rental apartments, it is hard to anticipate events that might disrupt the flow or alter the sources of mortgage credit to apartments. In the past, certain events have triggered such changes—notably the savings and loan debacle of the 1980s and Freddie Mac's withdrawal from the market following large losses in the early 1990s—but these are, by definition, surprises. The current structure and performance of the multifamily mortgage market provide some comfort that the risks are slight. The lender base is not overly dependent on any one institution or lender type for either loan originations or funding. Lending discipline appears to have been maintained, given the low mortgage delinquency rates even during the weak economy of the past two years. The near term outlook of most market participants is for ample supply of mortgage financing at historically low interest rates.[217] Yet complacency would be a mistake.

Responding to both market incentives and their public charters, Fannie Mae and Freddie Mac can be expected to build on their recent records of increased multifamily lending and continue to be leaders in financing volumes, in program innovations, and in standards setting. Certainly there is room for expansion of the GSEs' share of the multifamily mortgage market, which, as mentioned earlier, is by the measure of dollar volume outstanding currently only about half the market share enjoyed by the GSEs in single-family lending. And from the perspective of units financed, the statistics from Table A.5 combined with data from the 2001 American Housing Survey indicate that, while the GSEs financed 7.2 percent of all the nation's year-round housing units that year, the percentage of multifamily rental units (that is renter-occupied units and vacant rental units in structures with at least five units) was only 5.7 percent.

The sharp gains since 2000 in small property lending by Fannie Mae and Freddie Mac demonstrate that it is feasible for this important segment of the affordable housing market to be served by the GSEs. Building on the expertise and market contacts gained in the past three years, the GSEs should be able to make even greater in-roads in small property lending, although the challenges noted earlier will continue.

The GSEs' size and market position between loan originators and mortgage investors makes them the logical institutions to identify and promote needed innovations and to establish standards that will improve market efficiency. As their presence in the multifamily market continues to grow, the GSEs will have both the knowledge and the ''clout'' to push simultaneously for market standardization and for programmatic flexibility to meet special needs and circumstances, with the ultimate goal of increasing the availability and reducing the cost of financing for affordable and other multifamily rental properties.

E. Factor 3: Performance and Effort of the GSEs Toward Achieving the Low- and Moderate-Income Housing Goal in Previous Years

This section first discusses each GSE's performance under the Low- and Moderate-Income Housing Goal over the 1996–2002 period.[218] The data presented are ''official results''—*i.e.*, they are based on HUD's analysis of the loan-level data submitted to the Department by the GSEs and the counting provisions contained in HUD's regulations in 24 CFR part 81, subpart B. As explained below, in some cases these ''official results'' differ from goal performance reported by the GSEs in the Annual Housing Activities Reports (AHARs) that they submit to the Department.

The main finding of this section concerning the overall housing goals is that both Fannie Mae and Freddie Mac surpassed the Department's Low- and Moderate-Income Housing Goals for each of the seven years during this period. Specifically:

- The goal was set at 40 percent for 1996; Fannie Mae's performance was 45.6 percent and Freddie Mac's performance was 41.1 percent.
- The goal was set at 42 percent for 1997–2000. Fannie Mae's performance was 45.7 percent in 1997, 44.1 percent in 1998, 45.9 percent in 1999, and 49.5 percent in 2000; and Freddie Mac's performance was 42.6 percent in 1997, 42.9 percent in 1998, 46.1 percent in 1999, and 49.9 percent in 2000.
- In the October 2000 rule, the low- and moderate-income goal was set at 50 percent for 2001–03. As of January 1, 2001, several changes in counting provisions took effect for the low- and moderate-income goal, as follows: ''bonus points'' (double credit) for purchases of goal-qualifying mortgages on small (5–50 unit) multifamily properties and, above a threshold level, mortgages on 2–4 unit owner-occupied properties; a ''temporary adjustment factor'' (1.20 units credit, subsequently increased by Congress to 1.35 units credit) for Freddie Mac's purchases of goal-qualifying mortgages on large (more than 50 units) multifamily properties; changes in the treatment of missing data; a procedure for the use of imputed or proxy rents for determining goal credit for multifamily mortgages; and eligibility of purchases of certain qualifying government-backed loans to receive goal credit. These changes are explained below. Fannie Mae's low-mod goal performance was 51.5 percent in 2001 and 51.8 percent in 2002, and Freddie Mac's performance was 53.2 percent in 2001 and 51.4 percent in 2002, thus both GSEs surpassed this higher goal in both years. This section discusses the October 2000 counting rule changes in detail below, and provides data on what goal performance would have been in 2001–02 without these changes.[219]

After the discussion of the overall housing goals in Sections E.1 to E.5, Sections E.6 to E.12 examine the role of the GSEs in funding home purchase loans for lower-income borrowers and for first-time homebuyers. A summary of the main findings from that analysis is given in Section E.6. Section E.13 then summarizes some recent studies on the GSEs' market role and section E.14 discusses the GSEs' role in the financing of single-family rental properties.

1. Performance on the Low- and Moderate-Income Housing Goal in 1996–2002

HUD's December 1995 rule specified that in 1996 at least 40 percent of the number of units financed by each of the GSEs that were eligible to count toward the Low- and Moderate-Income Goal should qualify as low- or moderate-income, and at least 42 percent of such units should qualify in 1997–2000. HUD's October 2000 rule made various

[215] Jack Goodman, ''The Changing Demography of Multifamily Rental Housing,'' *Housing Policy Debate,* Winter 1999.

[216] Remarks by Franklin D. Raines, Chairman and CEO, Fannie Mae, to the Executive Committee of the National Association of Home Builders, January 18, 2003. *See* also Edward Glaeser and Joseph Gyourko, ''The Impact of Zoning on Housing Affordability,'' Working Paper 8835, National Bureau of Economic Research, March 2002.

[217] ''Capital Markets Outlook 2003,'' *Apartment Finance Today,* Vol. 7, No. 1 (January/February 2003).

[218] Performance for the 1993–95 period was discussed in the October 2000 rule.

[219] To separate out the effects of changes in counting rules that took effect in 2001, this section also compares performance in 2001 to estimated performance in 2000 if the 2001 counting rules had been in effect in that year.

changes in the goal counting rules, as discussed below, and increased the Low- and Moderate-Income Goal to 50 percent for 2001–03.

Table A.8 shows low-mod goal performance over the 1996–2002 period, based on HUD's analysis. The table shows that Fannie Mae surpassed the goals by 5.6 percentage points and 3.7 percentage points in 1996 and 1997, respectively, while Freddie Mac surpassed the goals by narrower margins, 1.1 and 0.6 percentage points. During the heavy refinance year of 1998, Fannie Mae's performance fell by 1.6 percentage points, while Freddie Mac's performance rose slightly, by 0.3 percentage point. Freddie Mac showed a gain in performance to 46.1 percent in 1999, exceeding its previous high by 3.2 percentage points. Fannie Mae's performance in 1999 was 45.9 percent, which, for the first time, slightly lagged Freddie Mac's performance in that year.

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Table A.8

GSEs' Performance on the Low- and Moderate-Income Housing Goal, 1996-2002

	1996	1997	1998	1999	2000	2001*	2002*
Low-and Moderate-Income Goal	40%	42%	42%	42%	42%	50%	50%
Fannie Mae:							
Units Eligible to Count Toward Goal	1,831,690	1,710,530	3,468,428	2,925,347	2,130,686	4,541,456	5,848,788
Low- and Moderate-Income Units	834,393	782,265	1,530,308	1,343,396	1,054,349	2,340,179	3,028,959
Percent Low- and Moderate-Income	45.6%	45.7%	44.1%	45.9%	49.5%	51.5%	51.8%
Freddie Mac:							
Units Eligible to Count Toward Goal	1,293,424	1,173,915	2,654,850	2,224,849	1,578,236	3,238,783	4,275,958
Low- and Moderate-Income Units	532,219	499,590	1,137,660	1,024,660	788,324	1,723,699	2,199,228
Percent Low- and Moderate-Income	41.1%	42.6%	42.9%	46.1%	49.9%	53.2%	51.4%

* Performance in 2001-2002 not directly comparable with performance in 1996-2000 due to changes in goal counting rules, as discussed in text, and shown in Table A.9.

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Both GSEs exhibited sharp gains in goal performance in 2000—Fannie Mae's performance increased by 3.6 percentage points, to a record level of 49.5 percent, while Freddie Mac's performance increased even more, by 3.8 percentage points, which also led to a record level of 49.9 percent. Fannie Mae's performance was 51.5 percent in 2001 and 51.8 percent in 2002; Freddie Mac's performance was 53.2 percent in 2001 and 51.4 percent in 2002. However, as discussed below, using consistent accounting rules for 2000–02, each GSE's performance in 2001–02 was below its performance in 2000.

The official figures for low-mod goal performance presented above differ from the corresponding figures presented by Fannie Mae and Freddie Mac in their Annual Housing Activity Reports to HUD by 0.2–0.3 percentage point in both 1996 and 1997, reflecting minor differences in the application of counting rules. These differences also persisted for Freddie Mac for 1998–2000, but the goal percentages shown above for Fannie Mae for these three years are the same as the results reported by Fannie Mae to the Department. Fannie Mae reported its performance in 2001 as 51.6 percent and Freddie Mac reported its performance as 53.6 percent—both were slightly above the corresponding official figures of 51.5 percent and 53.4 percent, respectively. For 2002, Fannie Mae's reported performance was the same as reported by HUD (51.8 percent), while Freddie Mac's reported performance was 51.3 percent, slightly below HUD's official figure of 51.4 percent.

Fannie Mae's performance on the Low- and Moderate-Income Goal was in the range between 44 percent and 46 percent between 1996 and 1999, but jumped sharply in just one year, from 45.9 percent in 1999 to 49.5 percent in 2000. Freddie Mac's performance was in the range between 41 percent and 43 percent between 1996 and 1998, and then rose to 46.1 percent in 1999 and 49.9 percent in 2000. As discussed above, official performance rose for both GSEs in 2001–02, but this was due to one-time changes in the counting rules—abstracting from counting rule changes, performance fell for both GSEs.

Fannie Mae's performance on the Low- and Moderate-Income Goal surpassed Freddie Mac's in every year through 1998. This pattern was reversed in 1999, as Freddie Mac surpassed Fannie Mae in goal performance for the first time, though by only 0.2 percentage point. This improved relative performance of Freddie Mac was due to its increased purchases of multifamily loans, as it re-entered that market, and to increases in the goal-qualifying shares of its single-family mortgage purchases. Freddie Mac's performance also slightly exceeded Fannie Mae's performance in 2000, 49.9 percent to 49.5 percent. Freddie Mac's official performance also exceeded Fannie Mae's official performance in 2001, but this reflected a difference in the counting rules applicable to the two GSEs that was enacted by Congress; if the same counting rules were applied to both GSEs (that is, Freddie Mac did not receive the 1.35 Temporary Adjustment Factor), Fannie Mae's performance would have exceeded Freddie Mac's performance, by 51.5 percent to 50.5 percent.

In 2002, Freddie Mac's performance on the low mod-goal (51.4 percent) fell short of Fannie Mae's performance (51.8 percent), even though Freddie Mac had the advantage of the Temporary Adjustment Factor. The gap would have been wider without this factor, and in fact Freddie Mac's performance would have been short of the goal, at 49.2 percent.

2. Changes in the Goal Counting Rules for 2001–03

A number of changes in the counting rules underlying the calculation of low- and moderate-income goal performance took effect beginning in 2001, as follows:

- *Bonus points for multifamily and single-family rental properties.* During the 2001–03 period the Department awarded ''bonus points'' (double credit in the numerator) for goal-qualifying units in small (5–50 unit) multifamily properties and, above a threshold, 2–4 unit owner-occupied properties whose loans were purchased by the GSEs. By letters dated December 24, 2003, the Department notified the GSEs that these bonus points would not be in effect after December 31, 2003.
- *Freddie Mac's Temporary Adjustment Factor.* As part of the Consolidated Appropriations Act of 2000, Congress required the Department to award 1.35 units of credit for each unit financed in ''large'' multifamily properties (*i.e.*, those with 51 or more units) in the numerator in calculating performance on the housing goals for Freddie Mac for 2001–03.[220] This ''temporary adjustment factor'' (TAF) did not apply to goal performance for Fannie Mae during this period. By letters dated December 24, 2003, the Department notified Freddie Mac that this factor would not be in effect after December 31, 2003.
- *Missing data for single-family properties.* In the past, if a GSE lacked data on rent for rental units or on borrower income for owner-occupied units in single-family properties whose mortgages it purchased, such units were included in the denominator, but not in the numerator, in calculating goal performance. Since some of these units likely would have qualified for one or more of the housing goals, this rule lowered goal performance. Under the new counting rules for the low- and moderate-income goal and the special affordable goal that took effect in 2001, the GSEs are allowed to exclude loans with missing borrower income from the denominator if the property is located in a below-median income census tract. This exclusion is subject to a ceiling of 1 percent of total owner-occupied units financed. The enterprises are also allowed to exclude single-family rental units with missing rental information from the denominator in calculating performance for these two goals; there is no ceiling or restriction to properties located in below-median income census tracts for this exclusion of single-family rental units. No single-family loans can be excluded from the denominator in calculating performance on the underserved areas goal—that is, if a GSE does not have sufficient information to determine whether or not a property is located in an underserved area, all units in such a property are included in the denominator, but not in the numerator, in calculating performance on this goal.
- *Missing data and proxy rents for multifamily properties.* In the past, if a GSE lacked data on rent for rental units in multifamily properties whose mortgages it purchased, such units were included in the denominator, but not in the numerator, in calculating goal performance. Since some of these units likely would have qualified for one or more of the housing goals, this rule lowered goal performance. Under the new counting rules that took effect in 2001, if rent is missing for multifamily units, a GSE may estimate ''proxy rents,'' and, up to a ceiling of 5 percent of total multifamily units financed, may apply these proxy rents in determining whether such units qualify for the low- and moderate income goal and special affordable goal. If such proxy rents cannot be estimated, these multifamily units are excluded from the denominator in calculating performance under these goals. No multifamily loans can be excluded from the denominator in calculating performance on the underserved areas goal—that is, if a GSE does not have sufficient information to determine whether or not a property is located in an underserved area, all units in such a property are included in the denominator, but not in the numerator, in calculating performance on this goal.
- *Purchases of certain government-backed loans.* Prior to 2001, purchases of government-backed loans were not taken into account in determining performance on the GSEs' low- and moderate-income and underserved area housing goals. That is, all such loans were excluded from both the numerator and the denominator in calculating goal performance on these two goals, and in accordance with Section 1333(b)(1)(A) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, purchases of only certain government-backed loans were included in determining performance on the GSEs' special affordable goals. In October 2000 the Department took steps to encourage the enterprises to play more of a role in the secondary market for several types of government-backed loans where it appeared that greater GSE involvement could increase the liquidity of such mortgages. Home equity conversion mortgages (HECMs) were developed in the late-1980s by the Federal Housing Administration (FHA); these mortgages allow senior citizens to draw on the equity in their homes to obtain monthly payments to supplement their incomes. Thus purchases of FHA-insured HECMs now count toward the low- and moderate-income housing goals if the mortgagor's income is less than median income for the area. Similarly, purchases of mortgages on properties on tribal lands insured under FHA's Section 248 program or HUD's Section 184 program may qualify for the GSEs' housing goals. And purchases of mortgages under the Rural Housing Service's Single Family Housing Guaranteed Loan Program

[220] See *Congressional Record*, December 15, 2000, pp. H12295–96.

may also count toward all of the housing goals.[221]

[221] Prior to the October 2000 rule, purchases of these government-backed mortgages were only eligible for credit under the special affordable goal.

3. Effects of Changes in the Counting Rules on Goal Performance in 2001–02

Because of the changes in the low- and moderate-income goal counting rules that took effect in 2001, direct comparisons between official goal performance in 2000 and 2001–02 are somewhat of an ''apples-to-oranges comparison.'' For this reason, the Department has calculated what performance would have been in 2000 under the 2001–03 rules; this may be compared with official performance in 2001–02—an ''apples-to-apples comparison.'' HUD has also calculated what performance would have been in 2001–02 under the 1996–2000 rules; this may be compared with official performance in 2000—an ''oranges-to-oranges comparison.'' These comparisons are presented in Table A.9.

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Table A.9

Effects of Counting Rule Changes on the GSEs' Performance on the Low- and Moderate-Income Goal

GSE	Year	Baseline A*	Technical Changes[1]	Baseline B*	Bonus Points: Small MF[2]	Bonus Points: SF Rental[3]	Temporary Adjustment Factor (TAF)[4]	Baseline C*
Fannie Mae	1999	**45.9%**	0.9%	46.8%	0.4%	1.2%	NA	48.4%
	2000	**49.5%**	1.8%	51.3%	0.3%	0.9%	NA	52.5%
	2001	47.7%	1.5%	49 2%	0.7%	1.6%	NA	**51.5%**
	2002	47.4%	1.6%	49.0%	1.2%	1.6%	NA	**51.8%**
	Change, 2001-02	-0.3%	0.1%	-0.2%	0.5%	0.0%	NA	0.3%
Freddie Mac	1999	**46.1%**	0.5%	46.6%	0.1%	1.3%	2.7%	50.7%
	2000	**49.9%**	0.7%	50.6%	0.2%	1.0%	3.3%	55.1%
	2001	47.2%	0.5%	47.7%	1.5%	1.4%	2.7%	**53.2%**
	2002	46.1%	0.4%	46.5%	1.0%	1.7%	2.2%	**51.4%**
	Change, 2001-02	-1.1%	-0.1%	-1.2%	-0.5%	0.3%	-0.5%	-1.8%

Details may not add to total due to rounding.

*Note: Baseline A represents performance under 1996-2000 scoring, thus figures for 1999-2000 in bold are official performance in those years. Baseline B adjusts Baseline A for technical changes in counting rules. Baseline C represents performance under 2001-03 scoring, thus figures for 2001-2002 in bold are official performance in those years.

[1] *Technical changes* include credit for purchases of certain qualifying government-backed loans, exclusions of loans with missing information from the denominator in calculating performance, and the use of imputed or proxy rent for multifamily properties.

[2] *Small multifamily bonus points*: for 2001-03, every qualifying unit in a 5-50 unit multifamily property counts as two units in the numerator in calculating goal performance.

[3] *Single-family rental bonus points*: above a threshold, every qualifying unit in a 2-4 unit property in which one unit is owner-occupied and the other units are rental counts as two units in the numerator in calculating goal performance for 2001-03.

[4] *Temporary adjustment factor (TAF)*: in December 2000 Congress enacted a provision whereby every qualifying unit in a large (> 50 unit) multifamily property counts as 1.35 units in calculating goal performance for Freddie Mac for 2001-03. This provision does not apply to goal performance for Fannie Mae.

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Specifically, Table A.9 shows performance under the low- and moderate-income goal in three ways. Baseline A represents performance under the counting rules in effect in 1996–2000. Baseline B incorporates the technical changes in counting rules—changes in the treatment of missing data (including use of proxy rents), and eligibility for the goals of certain government-backed loans. Baseline C incorporates in addition to the technical changes the bonus points and, for Freddie Mac, the temporary adjustment factor. Baseline B corresponds to the counting approach proposed in this rule to take effect in 2005. Boldface figures under Baseline A for 1999–2000 and under Baseline C for 2001–02 indicate official goal performance, based on the counting rules in effect in those years—*e.g.*, for Fannie Mae, 45.9 percent in 1999, 49.5 percent in 2000, 51.5 percent in 2001, and 51.8 percent in 2002.

• *Performance on the Low- and Moderate-Income Goal under 1996–2000 Counting Rules Plus Technical Changes.* If the ''Baseline B'' counting approach had been in effect in 2000–02 and the GSEs had purchased the same mortgages that they actually did purchase in those years, both Fannie Mae and Freddie Mac would have surpassed the low- and moderate-income goal in 2000 and fallen short in 2001 and 2002. Specifically, Fannie Mae's performance would have been 51.3 percent in 2000, 49.2 percent in 2001, and 49.0 percent in 2002. Freddie Mac's performance would have been 50.6 percent in 2000, 47.7 percent in 2001, and 46.5 percent in 2002.

• *Performance on the Low- and Moderate-Income Goal under 2001–2003 Counting Rules.* If the 2001–03 counting rules had been in effect in 2000–02 and the GSEs had purchased the same mortgages that they actually did purchase in those years (*i.e.*, abstracting from any behavioral effects of ''bonus points,'' for example), both GSEs would have substantially surpassed the low- and moderate-income goal in all three years, but both GSEs' performance figures would have deteriorated somewhat from 2000 to 2001, and, for Freddie Mac, from 2001 to 2002. Specifically, Fannie Mae's ''Baseline C'' performance would have been 52.5 percent in 2000, 51.5 percent in 2001, and 51.8 percent in 2002. Freddie Mac's performance would have been 55.1 percent in 2000, surpassing its official performance level of 53.2 percent in 2001 and 51.4 percent in 2002. Measured on this consistent basis, then, Fannie Mae's performance fell by 1.0 percentage point in 2001, and Freddie Mac's by 1.9 percentage points in 2001 and an additional 1.8 percentage points in 2002. These reductions were primarily due to 2001–02 being years of heavy refinance activity.

Details of Effects of Changes in Counting Rules on Goal Performance in 2001–02. As discussed above, counting rule changes that took effect in 2001 had significant positive impacts on the performance of both GSEs on the low- and moderate-income goal in that year—3.8 percentage points for Fannie Mae, and 6.0 percentage points for Freddie Mac. This section breaks down the effects of these changes on goal performance for both GSEs; results are shown in Table A.9.

• *Freddie Mac.* The largest impact of the counting rule changes on Freddie Mac's goal performance was due to the application of the temporary adjustment factor for purchases of mortgages on large multifamily properties, as enacted by Congress; this added 2.7 percentage points to goal performance in 2001, as shown in Table A.9. Bonus points for purchases of mortgages on small multifamily properties added 1.5 percentage points to performance, and bonus points for purchase of mortgages on owner-occupied 2–4 unit rental properties added 1.4 percentage points to performance. The remaining impact (0.5 percentage point) was due to technical changes in counting rules—primarily, the exclusion of single-family units with missing information from the denominator in calculating goal performance. Credit for purchases of qualifying government-backed loans played a minor role in determining Freddie Mac's goal performance. These same patterns also appeared in 2002.

• *Fannie Mae.* The temporary adjustment factor applies to Freddie Mac's goal performance, but not to Fannie Mae's performance, thus counting rule changes had less impact on its performance than on Freddie Mac's performance in 2001. The largest impact of the counting rule changes on Fannie Mae's goal performance was due to the application of bonus points for purchases of mortgages on owner-occupied 2–4 unit rental properties, which added 1.6 percentage points to performance, and for purchases of mortgages on small multifamily properties, which added 0.7 percentage point to performance. The remaining impact (1.3 percentage points) was due to technical changes—primarily, the exclusion of single-family units with missing information from the denominator in calculating goal performance.[222] Credit for purchases of qualifying government-backed loans and the use of proxy rent for multifamily properties played a minor role in determining Fannie Mae's goal performance. These same patterns also appeared in 2002 for Fannie Mae.

4. Bonus Points for the Low- and Moderate-Income Goal

As discussed above, the Department established ''bonus points'' to encourage the GSEs to step up their activity in 2001–03 in two segments of the mortgage market—the small (5–50 unit) multifamily mortgage market, and the market for mortgages on 2–4 unit properties where 1 unit is owner-occupied and 1–3 units are occupied by renters. Bonus points did not apply to purchases of mortgages for owner-occupied 1-unit properties, for investor-owned 1–4 unit properties, and for large (more than 50 units) multifamily properties, although as also discussed above, a ''temporary adjustment factor'' applied to Freddie Mac's purchases of qualifying mortgages on large multifamily properties.

Bonus points for small multifamily properties. Each unit financed in a small multifamily property that qualified for any of the housing goals was counted as two units in the numerator (and one unit in the denominator) in calculating goal performance for that goal. For example, if a GSE financed a mortgage on a 40-unit property in which 10 of the units qualified for the low- and moderate-income goal, 20 units would be entered in the numerator and 40 units in the denominator for this property in calculating goal performance.

Small multifamily bonus points thus encouraged the GSEs to play a larger role in this market, and also to purchase mortgages on such properties in which large shares of the units qualified for the housing goals. Some evidence may be gleaned from the data provided to HUD by the GSEs for 2001–02.

Fannie Mae financed 37,403 units in small multifamily properties in 2001 that were eligible for the low- and moderate-income goal, and 58,277 such units in 2002, a two-year increase of more than 700 percent from the 7,196 such units financed in 2000. Small multifamily properties also accounted for a greater share of Fannie Mae's multifamily business in 2001–02—7.4 percent of total multifamily units financed in 2001 and 13.2 percent in 2002, up from 2.5 percent in 2000. However, HUD's 2000 rule reported information from the 1991 Residential Finance Survey that small multifamily properties accounted for 37 percent of all multifamily units, thus Fannie Mae was still less active in this market than in the market for large multifamily properties.[223]

Within the small multifamily market, there was no evidence that Fannie Mae targeted affordable properties to a greater extent in 2001–02 than in 2000. That is, 87 percent of Fannie Mae's small multifamily units qualified for the low- and moderate-income goal in 2000; this fell to 75 percent in 2001, but rose to 89 percent in 2002.

Freddie Mac financed 50,299 units in small multifamily properties in 2001 that were eligible for the low- and moderate-income goal and 42,772 such units in 2002, a two-year increase of more than 1300 percent from the 2,996 units financed in 2000. Small multifamily properties also accounted for a significantly greater share of Freddie Mac's multifamily business in 2001—16.1 percent of total multifamily units financed in 2001 and 13.4 percent in 2002, up from 1.8 percent in 2000.

Within the small multifamily market, there was some evidence that Freddie Mac targeted affordable properties to a greater extent in 2001–02 than in 2000. That is, 87 percent of Freddie Mac's small multifamily units qualified for the low- and moderate-income goal in 2000; this rose to 96 percent in 2001 and 94 percent in 2002.

In summary, then, there is evidence that bonus points for small multifamily properties had an impact on Fannie Mae's role in this market in 2001–02 and an even larger impact on Freddie Mac's role in this market. In addition, Fannie Mae has announced a program to increase its role in this market further in future years.[224]

[222] Exclusion of loans with missing information had a greater impact on Fannie Mae's goal performance than on Freddie Mac's goal performance.

[223] **Federal Register**, October 31, 2000, Footnote 145, p. 65141.

[224] ''Fannie Courting Multifamily Sellers; Small Banks Balking,'' *American Banker*, January 13, 2003, p. 1.

Bonus points for single-family rental properties. Above a threshold, each unit financed in a 2–4 unit property with at least one owner-occupied unit (referred to as ''OO24s'' below) that qualified for any of the housing goals was counted as two units in the numerator (and one unit in the denominator) in calculating goal performance for that goal in 2001–03. The threshold was equal to 60 percent of the average number of such qualifying units over the previous five years. For example, Fannie Mae financed an average of 50,030 low- and moderate-income units in these types of properties between 1996 and 2000, and 101,423 such units in 2001. Thus Fannie Mae received 71,405 bonus points in this area in 2001—that is, 101,423 minus 60 percent of 50,030. So 172,828 units were entered in the numerator for these properties in calculating low- and moderate-income goal performance.

Single-family rental bonus points thus encouraged the GSEs to play a larger role in this market, and also to purchase mortgages on such properties in which large shares of the units qualified for the housing goals. As for small multifamily bonus points, again some evidence may be gleaned from the data provided to HUD by the GSEs for 2001–02.

Fannie Mae financed 175,103 units in OO24s in 2001 that were eligible for the low- and moderate-income goal and 229,632 such units in 2002, a two-year increase of nearly 200 percent from the 77,930 units financed in 2000. However, Fannie Mae's total single-family business increased at approximately the same rate as its OO24 business in 2001 and 2002, thus the share of its business accounted for by OO24s was the same in 2001–02 as in 2000—4 percent.

Within the OO24 market, there was no evidence that Fannie Mae targeted affordable properties to a greater extent in 2001–02 than in 2000. That is, approximately 55–60 percent of Fannie Mae's OO24 units qualified for the low- and moderate-income goal in each of these three years.

Freddie Mac financed 96,050 units in OO24s in 2001 that were eligible for the low- and moderate-income goal and 146,222 such units in 2002, also a two-year increase of nearly 200 percent from the 49,993 units financed in 2000. However, Freddie Mac's total single-family business increased at approximately the same rate as its OO24 business in 2001–02, thus the share of its business accounted for by OO24s was the same in 2002 as in 2000—4 percent.

As for Fannie Mae, within the OO24 market there was no evidence that Freddie Mac targeted affordable properties to a greater extent in 2001–02 than in 2000. That is, 68–69 percent of Fannie Mae's OO24 units qualified for the low- and moderate-income goal in each year from 2000 through 2002.

5. Effects of 2000 Census on Scoring of Loans Toward the Low- and Moderate-Income Housing Goal

Background. Scoring of housing units under the Low- and Moderate-Income Housing Goal is based on data for mortgagors' incomes for owner-occupied units, rents for rental units, and area median incomes, as follows:

For single-family owner-occupied units:

- The mortgagors' income at the time of mortgage origination.
- The median income of an area specified as follows: (i) For properties located in Metropolitan Statistical Areas (MSAs), the area is the MSA; and (ii) for properties located outside of MSAs, the area is the county or the non-metropolitan portion of the State in which the property is located, whichever has the larger median income, as of the year of mortgage origination (which may be for the current year or a prior year).

For rental units in single-family properties with rent data are available (assuming no income data available for actual or prospective tenants):

- The unit rent (or average rent for units of the same type) at the time of mortgage origination.
- The area median income as specified for single-family owner-occupied units.

For rental units in multifamily properties where rent data are available.

- The unit rent (or the average rent for units of the same type) at the time of mortgage acquisition by the GSE.
- The area median income as specified for single-family owner-occupied units, but as of the year the GSE acquired the mortgage.

For rental units in multifamily properties where rent data are not available, the GSE may apply HUD-estimated rents which are based on the following area data;

- The median rent in the census tract where the property is located, as of the most recent decennial census.
- The area median income as specified for single-family owner-occupied units, but as of the most recent decennial census.

Thus, scoring loans under the Low- and Moderate-Income Goal requires a data series showing annual median incomes for MSAs, non-metropolitan counties, and the non-metropolitan portions of states; and decennial census data on median incomes for census tracts.[225]

For scoring loans purchased by the GSEs year-by-year from 1993 through 2002, area median income estimates produced by HUD's Economic and Market Analysis Division were used. An example will illustrate the estimation procedure. To generate the area median income estimates that were used to score GSE loans in 2002, data from the 1990 census on 1989 area median incomes were adjusted to 2002 using Bureau of Labor Statistics survey data on rates of change in average incomes for MSAs and counties between 1989 and 1999, data from the Census Bureau's Current Population Survey on rates of change in median family incomes for the nine Census Divisions between 1989 and 2000, and an assumed 4.0 percent per year inflation factor between 2000 and 2002.[226, 227]

2005 Procedure. Relative to the above procedure, scoring of loans purchased by the GSEs in and after 2005 will be affected by two factors. First, the Economic and Market Analysis Division has begun to incorporate data from the 2000 census into its procedure for estimating annual area median incomes and American Community Survey data are becoming available at increasingly finer levels of geographical detail for use in annual updating. Beginning in 2005 Bureau of Labor Statistics data on rates of inflation in average wages will not be used. For 2005, the procedure for estimating area median incomes will be to adjust 2000 census data on 1999 area median incomes to 2003 using data from the Census Bureau's American Community Survey (ACS) on rates of change in average incomes for States between 1999 and 2003, with a further adjustment to 2005 based on an appropriate annual inflation factor.[228] Increasingly more detailed ACS data will be available and will be used in subsequent years, as ACS estimates for metropolitan and micropolitan areas and counties become available.

The second factor is the Office of Management and Budget's June, 2003, re-specification of MSA boundaries based on analysis of 2000 census data.[229]

Analysis. For purposes of specifying the level of the Low- and Moderate-Income Housing Goal, HUD developed a methodology for scoring loans purchased by the GSEs in past years through 2002 as though the re-benchmarking of area median income estimates to the 2000 census and the 2003 re-designation of MSAs had been in effect and HUD had been using an ACS-based estimation procedure at the time the estimates for these years were prepared. For this purpose, HUD created a series of annual estimates of median incomes for MSAs, non-metropolitan counties, and the non-metropolitan portions of states. For 2000, the estimates were 1999 census medians trended by three-fourths of the 4.0 percent annual

[225] In New England, MSAs were defined through mid-2003 in terms of Towns rather than Counties, and the portion of a New England county outside of any MSA was regarded as equivalent to a county in establishing the metropolitan or non-metropolitan location of a property. The MSA definitions established by the Office of Management and Budget (OMB) in June, 2003 defined MSAs in New England in terms of counties.

[226] The procedure is explained in detail in annual releases entitled ''HUD Methodology for Estimating FY [year] Median Family Incomes'' for years 1993 through 2002, issued by the Economic and Market Analysis Division, Office of Economic Affairs, PD&R, U.S. Department of Housing and Urban Development.

[227] The procedure applicable to the decennial census data used to generate estimated rents is explained in connection with data used to define Underserved Areas in Appendix B.

[228] Transition from the 2002 methodology to the 2005 methodology is occurring in stages in 2003 and 2004. To generate the area median income estimates used to score GSE loans in 2003, data from the 2000 census on 1999 area median incomes were adjusted to 2001 using Bureau of Labor Statistics survey data on rates of change in average incomes for MSAs and counties between 1999 and 2000, data on rates of change in median incomes for the United States and individual States between 1999 and 2001 from Census Bureau's Current Population Survey and American Communities Survey, and an assumed 3.5 percent per year inflation factor between 2001 and 2003. (See ''HUD Methodology for Estimating FY 2003 Median Family Incomes,'' issued by the Economic and Market Analysis Division, *op cit.*) A similar procedure has been used to generate area median income estimates for scoring GSE loans in 2004.

[229] HUD has deferred application of the 2003 MSA specification to 2005, pending completion of the present rulemaking process.

trending factor (to adjust the figures from mid-1999 to April 1, 2000). For 2001, the estimates were based on one-and-three-fourths years of trending, since no data would have been available to use for updating. The 2002 estimates would have used one year of data and 1.75 years of trending. The 2003 estimates would have used two years of data plus 1.75 years of trending. Area median incomes from 1989 to 1999 were estimated based on trend-lines between 1989 and 1999 census data. The 2003 OMB MSA designations were applied.

The resulting estimates of area median incomes for MSAs, non-metropolitan counties, and the non-metropolitan parts of States, were used to re-score loans purchased by the GSEs between 1999 and 2002, and were used further in estimating the share of loans originated in metropolitan areas that would be eligible to score toward the Low- and Moderate-Income Housing Goal, from HMDA data. The results of the retrospective GSE analysis are provided in Table A.10. The results of the GSE-HMDA comparative analysis are presented in the next section.

Table A.10 shows three sets of estimates for each GSE, based respectively on the counting rules in place in 2001–2002 (but disregarding the bonus points and Temporary Adjustment Factor), on the addition of 2000 census re-benchmarking, and finally on the addition of both 2000 census re-benchmarking and 2003 MSA specification.

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Table A.10

Effects of 2000 Census on Scoring Toward Low- and Moderate-Income Goal

	1999	2000	2001	2002
Fannie Mae:				
Benchmark	46.8%	51.3%	49.2%	49.0%
With 2000 Re-benchmarking	46.9%	51.3%	49.2%	49.1%
Adding 2003 MSAs	46.3%	51.2%	48.7%	47.9%
Freddie Mac:				
Benchmark	46.6%	50.6%	47.7%	46.5%
With 2000 Re-benchmarking	46.6%	50.6%	47.7%	46.2%
Adding 2003 MSAs	46.0%	50.2%	47.0%	45.0%

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6. GSEs Compared With the Primary Conventional Conforming Mortgage Market

This section and the next five sections (Sections E.7 to E.12) provide a detailed analysis of the extent to which the GSEs' loan purchases mirror or depart from the patterns found in the primary mortgage market. As in Section C.5, the GSEs' affordable lending performance is also compared with the performance of depository lenders such as commercial banks and thrift institutions. Dimensions of lending considered include the three ''goals-qualifying'' categories—special affordable borrowers, less-than-median income borrowers, and underserved areas. The special affordable category consists mainly of very-low-income borrowers, or borrowers who have an annual income less than 60 percent of area median income. Because this category is more targeted than the broadly-defined less-than-median-income (or low-mod) category, the discussion below will often focus on the special affordable category as well as the underserved areas category which adds a neighborhood dimension (low-income and high-minority census tracts) to the analysis. This section will also compare the performance of Fannie Mae and Freddie Mac in funding first-time homebuyers with that of primary lenders in the conventional conforming market.

The remainder of this introductory section E.6 provides a list of the major and specific findings which are presented in detail in the following Sections E.7 through 12. Sections 7 and 8 define the primary mortgage market and discuss some technical issues related to the use of the GSE and HMDA data. Sections 8 and 9 compare the GSEs' performance with market performance for home purchase and first-time homebuyer loans, while Section 10 does the same for total single family loans (that is, refinance loans and home purchase loans). Section 11 examines GSE purchases in individual metropolitan areas. Following these analyses, Section 12 examines the overall market share of the GSEs in important submarkets such as first-time homebuyers.

a. Main Findings on GSEs' Performance in the Single-Family Market

There are six main findings from this analysis concerning the GSEs' purchases of single-family-owner mortgages:

1. While Freddie Mac has improved its affordable lending performance in recent years, it has consistently lagged the conventional conforming market in funding affordable home purchase loans for special affordable and low-moderate-income borrowers and underserved neighborhoods targeted by the housing goals.[230] However, Freddie Mac's recent performance (2001 and 2002) has been much closer to the market than its earlier performance.

2. In general, Fannie Mae's affordable lending performance has been better than Freddie Mac's. But like Freddie Mac, Fannie Mae's average performance during past periods (*e.g.*, 1993–2002, 1996–2002, 1999–2002) has been below market levels. However, it is encouraging that Fannie Mae markedly improved its affordable lending performance relative to the market during 2001 and 2002, the first two years of HUD's higher housing goal levels. Fannie Mae's average performance during 2001 and 2002 approached the market on the special affordable and underserved areas categories and matched the market on the low-mod category. Under one measure of GSE and market activity, Fannie Mae matched the market during 2002 on the special affordable category and slightly outperformed the market on the low-mod and underserved areas categories. In this case, which is referred to in the text as the ''purchase year'' approach, Fannie Mae's performance is based on comparing its purchases of all loans (both seasoned loans and newly-originated mortgages) during a particular year with loans originated in the market in that year. When Fannie Mae's performance is measured on an ''origination year'' basis (that is, allocating Fannie Mae's purchases in a particular year to the year that the purchased-loan was originated), Fannie Mae matched the market in the low- and moderate-income category during 2002, and lagged the market slightly on the other two categories.

3. Both Fannie Mae and Freddie lag the conventional conforming market in funding first-time homebuyers, and by a rather wide margin. Between 1999 and 2001, first-time homebuyers accounted for 27 percent of each GSE's purchases of home loans, compared with 38 percent for home loans originated in the conventional conforming market.

4. The GSEs have accounted for a significant share of the total (government as well as conventional) market for home purchase loans, but their market share for each of the affordable lending categories (*e.g.*, low-income borrowers and census tracts, high-minority census tracts) has been less than their share of the overall market.

5. The GSEs also account for a very small share of the market for important groups such as minority first-time homebuyers. Considering the total mortgage market (both government and conventional loans), it is estimated that the GSEs purchased only 14 percent of loans originated between 1999 and 2001 for African-American and Hispanic first-time homebuyers, or one-third of their share (42 percent) of all home purchase loans originated during that period. Considering the conventional conforming market and the same time period, it is estimated that the GSEs purchased only 31 percent of loans originated for African-American and Hispanic first-time homebuyers, or about one-half of their share (57 percent) of all home purchase loans in that market.

6. The GSEs' small share of the first-time homebuyer market could be due to the preponderance of high (over 20 percent) downpayment loans in their mortgage purchases.

b. *Specific Findings on GSE Performance in the Single-Family Market*

This section presents 17 specific findings from the analyses reported in Sections E.7 through 12; they are grouped under the following five topic-headings:

(b.1) Longer-term Performance of the GSEs;
(b.2) Performance of the GSEs During Recent Years;
(b.3) The GSEs' Funding First-time Homebuyer Loans;
(b.4) Performance of the GSEs Based on Total (Home Purchase and Refinance) Loans;
(b.5) GSE Market Shares; and,
(b.6) Additional Findings.

(b.1) Longer-Term Performance of the GSEs

The longer-run performance of the GSEs is examined between 1993 and 2002 (which covers the period since the housing goals were put into effect) and between 1996 and 2002 (which covers the period under the current definitions of the housing goals). Of the two borrower-income goals, the analysis below will typically focus on the special affordable category, which is a more targeted category than the rather broadly defined low- and moderate-income category.

(1) Since the early nineties, the mortgage industry has introduced new affordable lending programs and has allowed greater flexibility in underwriting lower-income loans. There is evidence that these programs are paying off in terms of more mortgages for low-income and minority borrowers. As noted earlier, Fannie Mae and Freddie Mac have played an active role in this upsurge of affordable lending, as indicated by the high growth rates of their goals-qualifying business.

- Between 1993 and 2002, the GSEs' purchases of home loans in metropolitan areas increased by 57 percent.[231] Their purchases of home loans for the three housing goals increased at much higher rates—264 percent for special affordable loans, 142 percent for low- and moderate-income loans, and 112 percent for loans in underserved census tracts.

(2) Both Fannie Mae and Freddie Mac have improved their purchases of affordable loans since the housing goals were put in place, as indicated by the increasing share of their business going to the three goals-qualifying categories. (*See* Table A.15 in Section E.9.)

- Between 1992 and 2002, the special affordable share of Fannie Mae's business more than doubled, rising from 6.3 percent to 16.3 percent, while the underserved areas share increased more modestly, from 18.3 percent to 26.7 percent. The figures for Freddie Mac are similar. The special affordable share of Freddie Mac's business rose from 6.5 percent to 15.8 percent, while the underserved areas share also increased but more modestly, from 18.6 percent to 25.8 percent.

(3) While both GSEs improved their performance, they have lagged the primary

[230] The ''affordable lending performance'' of Fannie Mae and Freddie Mac refers to the performance of the GSEs in funding loans for low-income and underserved borrowers through their purchase (or guarantee) of loans originated by primary lenders. It does not, of course, imply that the GSEs themselves are lenders originating loans in the primary market.

[231] Throughout this analysis, the terms ''home loan'' and ''home mortgage'' will refer to a ''home purchase loan,'' as opposed to a ''refinance loan.'' As noted earlier, the mortgage data reported in this paper are for metropolitan areas, unless stated otherwise. Restricting the GSE data to metropolitan areas is necessary to make it comparable with the HMDA-reported conventional primary market data, which is more reliable for metropolitan areas. The analysis of first-time homebuyers in Sections E.9 and E.12 cover both metropolitan and non-metropolitan areas.

market in providing affordable loans to low-income borrowers and underserved neighborhoods. Freddie Mac's average performance, in particular, fell far short of market performance during the 1990s. Fannie Mae's average performance was better than Freddie Mac's during the 1993–2002 period as well as during the 1996–2002 period, which covers the period under HUD's currently-defined housing goals.

• Between 1993 and 2002, 11.8 percent of Freddie Mac's mortgage purchases were for special affordable borrowers, compared with 12.7 percent of Fannie Mae's purchases, 15.4 percent of loans originated by depositories, and 15.4 percent of loans originated in the conventional conforming market (without estimated B&C loans).[232]

• Considering the underserved areas category for the 1996–2002 period, 21.7 percent of Freddie Mac's purchases financed properties in underserved neighborhoods, compared with 23.5 percent of Fannie Mae's purchases, 24.9 percent of loans originated by depositories, and 25.4 percent of loans originated in the conventional conforming market.

(b.2) Performance of the GSEs During Recent Years

The recent performance of the GSEs is examined for the four-year period between 1999 and 2002 and then for 2001 and 2002, which were the first two years that the GSEs operated under the higher goal targets established by HUD in the 2000 Rule. As explained below, the most interesting recent trend concerned Fannie Mae, which improved its performance during 2001 and 2002, at a time when the conventional conforming market was showing little change in affordable lending.

(4) During the recent 1999-to-2002 period, both Fannie Mae and Freddie Mac fell significantly below the market in funding affordable loans.

• Between 1999 and 2002, special affordable loans accounted for 14.4 percent of Fannie Mae's purchases, 14.5 percent of Freddie Mac's purchases, and 16.4 percent of loans originated in the market; thus, the ''Fannie-Mae-to-market'' ratio was 0.88 and the ''Freddie-Mac-to-market'' ratio was also 0.88.

• During the same period, underserved area loans accounted for 24.0 percent of Fannie Mae's purchases, 22.9 percent of Freddie Mac's purchases, and 25.8 percent of loans originated in the market; the ''Fannie-Mae-to-market'' ratio was 0.93 and the ''Freddie-Mac-to-market'' ratio was only 0.89.[233]

(5) After experiencing declines from 1997 to 1999, Fannie Mae's affordable lending performance improved between 2000 and 2002.

• After declining from 23.0 percent in 1997 to 20.4 percent in 1999, the share of Fannie Mae's purchases financing properties in underserved areas jumped by three percentage points to 23.4 percent in 2000, and then increased further to 26.7 percent by 2002.

• After declining from 13.2 percent in 1998 to 12.5 percent in 1999, the share of Fannie Mae's purchases going to special affordable loans rebounded to 13.3 percent in 2000, 14.9 percent in 2001, and 16.3 percent in 2002.

(6) Freddie Mac's performance on the two borrower-income categories improved between 2000 and 2002, but not as much as Fannie Mae's performance. Freddie Mac's performance on the underserved areas category increased substantially between 2001 and 2002.

• The share of Freddie Mac's single-family-owner business going to special affordable home loans increased from 9.2 in 1997 to 14.7 percent in 2000 before falling to 14.4 percent in 2001 and rising to 15.8 percent in 2001.

• Freddie Mac's purchases of underserved area loans increased at a modest rate from 19.8 percent in 1997 to 22.3 percent in 2001, before sharply jumping to 25.8 percent in 2002.

(7) The long-standing pattern of Fannie Mae outperforming Freddie Mac was reversed during 1999 and 2000. But that pattern returned in 2001 and 2002 when Fannie Mae outperformed Freddie Mac on all three goals-qualifying categories.

• Fannie Mae and Freddie Mac had practically the same performance in 1992 on the three housing goal categories—special affordable loans accounted for 6.3 percent of Fannie Mae's purchases and 6.5 percent of Freddie Mac's purchases, for a ''Fannie-Mae-to-Freddie-Mac'' ratio of 0.97. The 1992 ratio for underserved areas was also 0.98 and that for low-mod, 1.02. Reflecting Fannie Mae's much better performance, the special affordable ''Fannie-Mae-to-Freddie-Mac'' ratio had risen to 1.27 by 1997, the underserved area ratio to 1.17, and the low-mod ratio to 1.10.

• However, in 1999, the ''Fannie-Mae-to-Freddie-Mac'' ratio for each of the three goals-qualifying categories fell to slightly below one. 1999 was the first year since 1992 that Freddie Mac had outperformed Fannie Mae in purchasing affordable home loans (although only by a very slight margin).

• In 2000, Freddie Mac's sharper increases in special affordable and low-mod purchases further reduced the ''Fannie-Mae-to-Freddie-Mac'' ratios for these two categories to 0.90 and 0.96, respectively. Fannie Mae's sharper increase in underserved areas funding resulted in the ''Fannie-Mae-to-Freddie-Mac'' ratio rising from slightly below one (0.98) in 1999 to 1.06 in 2000.

• Fannie Mae's stronger performance during 2001 and 2002 returned the ''Fannie-Mae-to-Freddie-Mac'' ratios for special affordable and low-mod loans to above one (1.03 for both), indicating better performance for Fannie Mae. The ''Fannie-Mae-to-Freddie-Mac'' ratio (1.03) for the underserved area category remained above one in 2002.

(8) While Freddie Mac has consistently improved its performance relative to the market, it continued to lag the market in funding affordable home loans in 2001 and 2002.

• Unlike Fannie Mae, Freddie Mac had not made any progress through 1997 in closing its gap with the market. The ''Freddie Mac-to-market'' ratio for the special affordable category actually declined from 0.63 in 1992 to 0.59 in 1997. But Freddie Mac's sharp improvement in special affordable purchases resulted in the ''Freddie-Mac-to-market'' ratio rising to 0.88 by 2000. After declining from 0.84 in 1992 to 0.80 in 1997, the ''Freddie-Mac-to-market'' ratio for underserved areas had risen only modestly to 0.84 by the year 2000. Thus, Freddie Mac's improvements prior to 2001 allowed it to close its gap with the market, mainly for the special affordable category where its gap had been the widest.

• During 2001 and 2002, Freddie Mac continued to close its gap with the market. By 2002, all three ''Freddie-Mac-to-market'' ratios were higher than in 2000, although they continued to fall below one: special affordable (0.97), low-mod (0.97), and underserved areas (0.98). Thus, during 2002, Freddie Mac lagged the market on all three goals-qualifying categories.

(9) Through 1998, Fannie Mae had significantly improved its performance relative to the market. But as a result of shifts in its purchases of affordable loans, Fannie Mae lagged the market even further in 2000 than it had in some earlier years. During 2001 and 2002, Fannie Mae again improved its performance relative to the market.

• The above analysis and the data reported under this specific finding (9) are based on the ''purchase year'' approach for measuring GSE activity. The purchase year approach assigns GSE purchases of both prior-year (seasoned) and newly-originated mortgages to the calendar year in which they were purchased by the GSE; this results in an inconsistency with the HMDA-reported market data, which covers only newly-originated mortgages. Sections E.9 and E.10 also report the results of an alternative ''origination year'' approach that assigns GSE purchases to their year of origination, placing them on a more consistent basis with the HMDA-reported market data. The findings from the origination-year approach are discussed under specific finding (10).

• Fannie Mae's decline in performance during 1999 resulted in the ''Fannie-Mae-to-market'' ratio falling sharply to 0.74 for special affordable and to 0.81 for underserved areas. In 2000, Fannie Mae improved and reversed its declining trend, as the ''Fannie-Mae-to-market'' ratios increased to 0.79 for special affordable purchases and to 0.89 for underserved area purchases.

• During 2001, Fannie Mae increased its special affordable percentage by 1.6 percentage points to 14.9 percent, which was only 0.7 percentage point below the market's performance of 15.6 percent. Fannie Mae

[232] Unless otherwise noted, the conventional conforming market data reported in this section exclude an estimate of B&C loans; the less-risky A-minus portion of the subprime market is included in the market definition. See Section E.7 and Appendix D for a discussion of primary market definitions and the uncertainty surrounding estimates of the number of B&C loans in HMDA data. As noted there, B&C loans are much more likely to be refinance loans rather than home purchase loans.

[233] Fannie Mae had a particularly poor year during 1999. Therefore, the text also reports averages for 2000–2002, dropping the year 1999 (see Table A.13 in Section E.9). While Fannie Mae's performance is closer to the market, it continues to fall below market levels during the 2000–2002 period.

increased its low-mod percentage from 40.8 percent to 42.9 percent at the same time that the low-mod share of the primary market was falling from 44.4 percent to 42.9 percent, placing Fannie Mae at the market's performance. Similarly, Fannie Mae increased its underserved area percentage from 23.4 percent in 2000 to 24.4 percent in 2001 while the underserved area share of the primary market was falling from 26.4 percent to 25.2 percent, placing Fannie Mae at 0.8 percentage point from the market's performance.

• During 2002, Fannie Mae continued to improve its performance on all three goals categories. Using the purchase-year approach to measure GSE performance, Fannie Mae matched the market on the special affordable category (16.3 percent for both), led the market on the low-mod category (45.3 percent for Fannie Mae compared with 45.2 percent for the market), and led the market on the underserved area category (26.7 percent for Fannie Mae versus 26.4 percent for the market). As explained in the next specific finding, measuring Fannie Mae's performance on the more consistent origination-year basis gives somewhat different results.

(10) This analysis addresses several technical issues involved in measuring GSE performance. The above analysis was based on the ''purchase year'' approach, as defined in (9) above. An alternative ''origination year'' approach has also been utilized, which assigns GSE purchases to their year of origination, placing them on a more consistent basis with the HMDA-reported market data. While the average results (*e.g.*, 1999–2002 GSE performance) are similar under the two reporting approaches, GSE performance in any particular year can be affected, depending on the extent to which the GSE has purchased goals-qualifying seasoned loans in that particular year.

• The choice of which approach to follow particularly affected conclusions about Fannie Mae's performance relative to the market. Under the origination-year approach, Fannie Mae lagged the market on all three housing goal categories during 2001 and on the special affordable and underserved area categories during 2002. In 2002, Fannie Mae essentially matched the market on the low-mod category (45.4 percent for Fannie Mae compared with 45.2 percent of the market).

(b.3) The GSEs' Funding of First-Time Homebuyer Loans

(11) The GSEs' funding of first-time homebuyers has been compared to that of primary lenders in the conventional conforming market. Both Fannie Mae and Freddie lag the market in funding first-Time homebuyers, and by a rather wide margin.

• First-time homebuyers account for 27 percent of each GSE's purchases of home loans, compared with 38 percent for home loans originated in the conventional conforming market.

(b.4) Performance of the GSEs Based on Total (Home Purchase and Refinance) Loans

(12) The GSEs' acquisitions of total loans (including refinance loans as well as home purchase loans) were also examined. The main results indicate that while the GSEs have improved their performance they have consistently lagged the market in funding loans (home purchase and refinance) that qualify for the housing goals. (*See* Table A.20 of Section E.10, which is based on the purchase-year approach for measuring GSE activity.)

• *1999–2002.* During the recent 1999-to-2002 period, both Fannie Mae and Freddie Mac fell significantly below the market in funding affordable loans. Between 1999 and 2002, special affordable loans accounted for 13.8 percent of Fannie Mae's purchases, 13.8 percent of Freddie Mac's purchases, and 15.7 percent of loans originated in the market; thus, the ''Fannie-Mae-to-market'' ratio and the ''Freddie-Mac-to-market'' ratio were each 0.88 during this period.

• During the same period, underserved area loans accounted for 23.8 percent of Fannie Mae's purchases, 23.1 percent of Freddie Mac's purchases, and 25.7 percent of loans originated in the market; thus, the ''Fannie-Mae-to-market'' ratio was 0.93 and the ''Freddie-Mac-to-market'' ratio was 0.90.[234]

• *2002.* During this year of heavy refinancing, Fannie Mae's performance approached but fell below market performance. The ''Fannie-Mae-to-market'' ratios were 0.98 for special affordable loans, 0.99 for low-mod loans, and 0.99 for underserved area loans. The ''Freddie-Mac-to-market'' ratios were 0.04–0.05 lower: 0.93 for special affordable loans, 0.94 for low-mod loans, and 0.94 for underserved area loans.

(b.5) GSE Market Shares

This analysis includes an expanded ''market share'' analysis that documents the GSEs' contribution to important segments of the home purchase and first-time homebuyer markets.

(13) The GSEs account for a significant share of the total (government as well as conventional conforming) market for home purchase loans. However, the GSEs' market share for each of the affordable lending categories is much less than their share of the overall market.

• The GSEs' purchases were estimated to be 46 percent of all home loans originated in metropolitan areas between 1999 and 2002 but only 29 percent of loans originated for African-American and Hispanic borrowers, 37 percent of loans originated for low-income borrowers, and 36 percent for properties in underserved areas. The GSEs' market share for the various affordable lending categories increased during 2001 and 2002, but the above-mentioned pattern remained.

• A study by staff from the Federal Reserve Board suggests that the GSEs have a much more limited role in the affordable lending market than is suggested by the data presented above.[235] The Fed study, which combined market share, downpayment, and default data, concluded that the GSEs play a very minimal role in providing credit support and assuming credit risk for low-income and minority borrowers; for example, the study concluded that in 1995 the GSEs provided only four percent of the credit support going to African-Americans and Hispanic borrowers.

• Section V of this study begins to reconcile these different results by examining the role of the GSEs in the first-time homebuyer market and the downpayment characteristics of mortgages purchased by the GSEs.

(14) The market role of the GSEs appears to be particularly low in important market segments such as minority first-time homebuyers.

• Recent analysis has estimated that the GSEs' share of the market for first-time African-American and Hispanic homebuyers was only 14.3 percent between 1999 and 2001, or about one-third of their share (41.5 percent) of all home purchases during that period. This analysis includes the total market, including government and conventional loans.

• A similar market share analysis was conducted for the conventional conforming market. Between 1999 and 2001, the GSEs' purchases accounted for 56.6 percent of all home loans originated in the conventional conforming market of both metropolitan areas and non-metropolitan areas. Their purchases of first-time homebuyer loans, on the other hand, accounted for only 39.8 percent of all first-time homebuyer loans originated in that market.

• The GSEs have funded an even lower share of the minority first-time homebuyer market in the conventional conforming market. Between 1999 and 2001, the GSEs purchases of African-American and Hispanic first-time homebuyer loans represented 30.9 percent of the conventional conforming market for these loans. Thus, while the GSEs have accounted for 56.6 percent of all home loans in the conventional conforming market, they have accounted for only 30.9 percent of loans originated in that market for African-American and Hispanic first-time homebuyers.

(15) A noticeable pattern among the lower-income-borrower loans purchased by the GSEs is the predominance of loans with high downpayments. This pattern of purchasing mainly high downpayment loans is one factor explaining why the Fed study found such a small market role for the GSEs. It may be the explanation for the small role of Fannie Mae and Freddie Mac in the first-time homebuyer market. Further study of this issue is needed.

• During 2001 and 2002, approximately 50 percent of Fannie Mae's special affordable, low-mod, and underserved areas loans had downpayments of at least 20 percent, a percentage only slightly smaller than the corresponding percentage (53 percent) for all Fannie Mae's home loan purchases. Similar patterns of high downpayments on the goals-qualifying loans were evident in Freddie

[234] As explained in Section E.9, deducting B&C loans from the market totals has more impact on the market percentages for total (both home purchase and refinance) loans than for only home purchase loans. The effects of excluding B&C loans from the total market can be seen by comparing the third and sixth columns of data in Table A.19 in Section E.10.

[235] See Glenn B. Canner, Wayne Passmore, and Brian J. Surette, ''Distribution of Credit Risk Among Providers of Mortgages to Lower-Income and Minority Homebuyers'' in Federal Reserve Bulletin, 82(12): 1077–1102, December, 1996.

Mac's 2001 and 2002 purchases, as well as in prior years for both GSEs.

(b.6) Additional Findings

This analysis examines two additional topics related to minority first-time homebuyers and the use of HMDA data for measuring the characteristics of loans originated in the conventional conforming market.

(16) The share of the GSEs' purchases for minority first-time homebuyers was much less than the share of newly-originated mortgages in the conventional conforming market for those homebuyers.

- Between 1999 and 2001, minority first-time homebuyers accounted for 6.6 percent of Fannie Mae's purchases of home loans, 5.8 percent of Freddie Mac's purchases, and 10.6 percent of home loans originated in the conventional conforming market. For this subgroup, Fannie Mae's performance is 62 percent of market performance, while Freddie Mac's performance is 55 percent of market performance.

(17) Some studies have concluded that HMDA data overstate the share of market loans going to low-income borrowers and underserved areas. This analysis does not support that conclusion.

- This analysis compares the low-income and underserved areas characteristics of the GSEs' purchases of newly-originated (''current-year'') loans as reported both by the GSEs'' own data and by HMDA data.[236] For recent years, HMDA data on loans sold to the GSEs do not always have higher percentages of low-income and underserved areas loans than the GSEs' own data on their purchases of newly-originated mortgages. For example, from 1996–2002, both HMDA and Fannie Mae reported that special affordable loans accounted for about 13 percent of Fannie Mae's purchases of newly-originated loans. HMDA reported a 21.9 underserved areas percentage for Fannie Mae, which was rather similar to the underserved areas percentage (22.4 percent) reported by Fannie Mae itself. Given that similar patterns were observed for Freddie Mac's mortgage purchases, it appears that there is no upward bias in the HMDA-based market benchmarks used in this study.

7. Definition of Primary Market

Conventional Conforming Market. The market analysis section is based mainly on HMDA data for mortgages originated in the conventional conforming market of metropolitan areas during the years 1992 to 2002. Only conventional loans with a principal balance less than or equal to the conforming loan limit are included; the conforming loan limit was $300,700 in 2002—these are called ''conventional conforming loans.'' The GSEs'' purchases of FHA-insured, VA-guaranteed, and Rural Housing Service loans are excluded from this analysis. The conventional conforming market is used as the benchmark against which to evaluate the GSEs because that is the market definition Congress requires that HUD consider when setting the affordable housing goals. However, as discussed in Section II, some have questioned whether lenders in the conventional market are doing an adequate job meeting the credit needs of minority borrowers, which suggests that this market provides a low benchmark.[237]

Manufactured Housing Loans. In their comments on the proposed 2000 Rule, both GSEs raised questions about whether loans on manufactured housing should be excluded when comparing the primary market with the GSEs. The GSEs purchase these loans, but they have not played a significant role in the manufactured housing loan market. As emphasized by HUD in its 2000 GSE Rule, manufactured housing is an important source of home financing for low-income families and for that reason, should be included in any analysis of affordable lending. However, for comparison purposes, data are also presented for the primary market defined without manufactured housing loans. Because this analysis focuses on metropolitan areas, it does not include the substantial number of manufactured housing loans originated in non-metropolitan areas.

Subprime Loans. Both GSEs also raised questions about whether subprime loans should be excluded when comparing the primary market with their performance. In its final 2000 GSE Rule, HUD argued that borrowers in the A-minus portion of the subprime market could benefit from the standardization and lower interest rates that typically accompany an active secondary market effort by the GSEs. A-minus loans are not nearly as risky as B&C loans and the GSEs have already started purchasing A-minus loans (and likely the lower ''B'' grade subprime loans as well). The GSEs themselves have mentioned that a large portion of borrowers in the subprime market could qualify as ''A credit.'' This analysis includes the A-minus portion of the subprime market, or conversely, excludes the B&C portion of that market.

Unfortunately, HMDA does not identify subprime loans, much less separate them into their A-minus and B&C components.[238] Randall M. Scheessele at HUD has identified approximately 200 HMDA reporters that primarily originate subprime loans and account for about 60–70 percent of the subprime market.[239] To adjust HMDA data for B&C loans, this analysis follows HUD's 2000 Rule which assumed that the B&C portion of the subprime market accounted for one-half of the loans originated by the subprime lenders included in Scheessele's list.[240] As shown below, the effects of adjusting the various market percentages for B&C loans are minor mostly because the analysis in this section focuses on home purchase loans, which historically have accounted for less than one quarter of the mortgages originated by subprime lenders—the subprime market is mainly a refinance market.[241]

Lender-Purchased Loans in HMDA. When analyzing HMDA data, Fannie Mae includes in its market totals those HMDA loans identified as having been purchased by the reporting lender, above and beyond loans that were originated by the reporting lender.[242] Fannie Mae contends that there are a subset of loans originated by brokers and subsequently purchased by wholesale lenders that are neither reported by the brokers nor the wholesale lenders as originations but are reported by the wholesale lenders as purchased loans. According to Fannie Mae, these HMDA-reported purchased loans should be added to HMDA-reported originated loans to arrive at an estimate of total mortgage originations.

This rule's market definition includes only HMDA-reported originations; purchased loans are excluded from the market definition. While some purchased loans may not be reported as originations in HMDA (the Fannie Mae argument), there are several reasons for assuming that most HMDA-reported purchased loans are also reported in HMDA as market originations. *First*, Fed staff have told HUD that including purchased loans would result in double counting mortgage originations.[243] *Second*,

[236] In this comparison, a higher special affordable percentage for HMDA-reported mortgage originations that lenders report as also being sold to the GSEs—as compared with the special affordable percentage for newly-originated mortgages that the GSEs report as being actually purchased by them—would suggest that HMDA market data are biased; that is, in this situation, the special affordable percentage for all mortgage originations reported in HMDA would likely be larger than the special affordable percentage for all new mortgage originations, including those not reported in HMDA as well as those reported in HMDA.

[237] The market definition in this section is narrower than the ''Total Market'' data presented earlier in Tables A.1 and A.2, which included all home loans below the conforming loan limit, that is, government loans as well as conventional conforming loans. The market share analysis reported in Section E.12 also examine the GSEs' role in the overall market.

[238] And there is some evidence that many subprime loans are not even reported to HMDA, although there is nothing conclusive on this issue. See *Fair Lending/CRA Compass*, June 1999, p. 3.

[239] The list of subprime lenders as well as Scheessele's list of manufactured housing lenders are available at *http://www.huduser.org/publications/hsgfin.html.*

[240] The one-half estimate is conservative as some observers estimate that B&C loans account for only 30–40 percent of the subprime market. However, varying the B&C share from 50 percent to 30 percent does not significantly change the following analysis of home purchase loans because subprime loans are mainly for refinance purposes. Overstating the share of B&C loans in this manner also allows for any differences in HMDA reporting of different types of loans—for example, if B&C loans account for 35 percent of all subprime loans, then assuming that they account for 50 percent is equivalent to assuming that B&C loans are reported in HMDA at 70 percent of the rate of other loans.

[241] The reductions in the market shares are more significant for total loans, which include refinance as well as home purchase loans; for data on total loans, see Table A.19 in Section 10. Subprime lenders have been focusing more on home purchase loans recently. The home purchase share of loans originated by the subprime lenders in Scheessele's list increased from 26 percent in 1999 to 36 percent in 2000 before dropping to about 30 percent during the heavy refinancing years of 2001 and 2002.

[242] In 2001 (2002), lenders reported in HMDA that they purchased 851,735 (906,684) conventional conforming, home purchase loans in metropolitan areas; this compares with 2,763,230 (2,929,197) loans that these same lenders reported that they originated in metropolitan areas.

[243] *See* Randall M. Scheeselle, *HMDA Coverage of the Mortgage Market*, Housing Finance Working

Continued

comparisons of HMDA-reported FHA data with data reported by FHA supports the Fed's conclusion. For instance, FHA's own data indicate that during 2001 FHA insured 752,319 home purchase loans in metropolitan areas; the sum of HMDA-reported purchased home loans and HMDA-reported originated home loans in metropolitan areas alone yields a much higher figure of 845,176 FHA-insured loans during 2001.[244] While these calculations are for the FHA market (rather than the conventional market), they suggest that including HMDA-reported purchased loans in the market definition would overstate mortgage origination totals. *Third,* Abt Associates surveyed nine wholesale lenders and questioned them concerning their guidelines for reporting in HMDA loans purchased from brokers. Most of these lenders said brokered loans were reported as originations if they [the wholesale lender] make the credit decision; this policy is consistent with the Fed's guidelines for HMDA reporting. Abt Associates concluded that ''brokered loans do seem more likely to be reported as originations * * *.'' [245]

Finally, it should be noted that including purchased loans in the market definition does not significantly change the goals-qualifying shares of the market, mostly because borrower income data are missing for the majority of purchased loans. In addition, the low-income and underserved area shares for purchased and originated loans are rather similar. In 2001, the following shares for the conventional conforming home purchase market were obtained for purchased and originated loans: Low-income (25.8 percent for purchased loans, 28.3 percent for market originations), low-mod income (41.3 percent, 43.2 percent), and underserved areas (24.2 percent, 25.8 percent). In 2002, the comparisons were as follows: low-income (26.6 percent for purchased loans, 29.7 percent for market originations), low-mod income (42.3 percent, 45.3 percent), and underserved areas (28.8 percent, 27.2 percent).[246]

Paper No. HF–007. Office of Policy Development and Research, U.S. Department of Housing and Urban Development, July, 1998.

[244] In this example, HMDA-reported purchased loans insured by FHA have been reduced from 411,930 to 100,251 by a procedure that accounts for missing data and overlapping purchased and originated loans. See Harold L. Bunce, *The GSEs' Funding of Affordable Loans: A 2000 Update,* Working Paper HF–013, Office of Policy and Development and Research, HUD, April 2002, for an alternative analysis showing that a market estimate based on adding HMDA-reported purchased loans to HMDA-reported originations would substantially overstate the volume of FHA mortgage originations in metropolitan areas.

[245] *See* Chapter III, ''Reporting of Brokered and Correspondent Loans under HMDA'', in *Exploratory Study of the Accuracy of HMDA Data,* by Abt Associates Inc. under contract for the Office of Policy Development and Research, HUD, February 12, 1999, page 18.

[246] The percentage shares for purchased loans are obtained after eliminating purchased loans without data and purchased loans that overlap with originated loans. The calculations included 138,536 purchased loans for 2001 and 182,290 purchased loans for 2002.

8. Technical Issues: Using HMDA Data To Measure the Characteristics of GSE Purchases and Mortgage Market Originations [247]

This section discusses important technical issues concerning the use of HMDA data for measuring the GSEs' performance relative to the characteristics of mortgages originated in the primary market. The first issue concerns the reliability of HMDA data for measuring the borrower income and census tract characteristics of loans sold to the GSEs. Fannie Mae, in particular, contends that HMDA data understates the percentages of its business that qualify for the three housing goals. In its comments on the proposed 2000 Rule, Fannie Mae questioned HUD's reliance on HMDA data for measuring its performance. As discussed below, HMDA data on loans sold to the GSEs do not include prior-year (seasoned) loans that are sold to the GSEs. Since about one-fourth of GSE purchases in any particular year involve loans originated in prior years, HMDA data will not provide an accurate measure of the goals-qualifying characteristics of the GSEs' total purchases when the characteristics of prior-year loans differ from those of newly-originated, current-year loans.

A related issue concerns the appropriate definition of the GSE data when making annual comparisons of GSE performance with the market. On the one hand, the GSE annual data can be expressed on a purchase-year basis, which means that all GSE purchases in a particular year would be assigned to that particular year. Alternatively, the GSE annual data can be expressed on an origination-year basis, which means that GSE purchases in a particular year would be assigned to the calendar year that the GSE-purchased mortgage was originated; for example, a GSE's purchase during 2001 of a loan originated in 1999 would be assigned to 1999, the year the loan was originated. These two approaches are discussed further below.

A final technical issue concerns the reliability of HMDA for measuring the percentage of goals-qualifying loans in the primary market. Both GSEs refer to findings from a study by Jim Berkovec and Peter Zorn concerning potential bias in HMDA data.[248] Based on a comparison of the borrower and census tract characteristics between Freddie-Mac-purchased loans (from Freddie Mac's own data) and loans identified in 1993 HMDA data as sold to Freddie Mac, Berkovec and Zorn conclude that HMDA data overstate the percentage of conventional conforming loans originated for lower-income borrowers and for properties located in underserved census tracts. If HMDA data overstate the percentage of goals-qualifying loans, then HUD's market benchmarks (which are based on HMDA data) will also be overstated. The analysis below does not support the Berkovec and Zorn findings—it appears that HMDA data do not overstate the share of goals-qualifying loans in the market. The discussion below of the GSEs' purchases of prior-year and current-year loans also highlights the strategy of purchasing seasoned loans that qualify for the housing goals. The implications of this strategy for understanding recent shifts in the relative performance of Fannie Mae and Freddie Mac are discussed below in Section E.9.

[247] Readers not interested in these technical issues may want to proceed to Section E.9, which compares GSE performance to the primary market.

[248] See Jim Berkovec and Peter Zorn, ''How Complete is HMDA? HMDA Coverage of Freddie Mac Purchases,'' The *Journal of Real Estate Research,* Vol. II, No. 1, Nov. 1, 1996.

a. GSEs' Purchases of ''Prior-Year'' and ''Current-Year'' Mortgages

There are two sources of loan-level information about the characteristics of mortgages purchased by the GSEs—the GSEs themselves and HMDA data. The GSEs provide detailed data on their mortgage purchases to HUD on an annual basis. As part of their annual HMDA reporting responsibilities, lenders are required to indicate whether their new mortgage originations or the loans that they purchase (from affiliates and other institutions) are sold to Fannie Mae, Freddie Mac or some other entity. There have been numerous studies by HUD staff and other researchers that use HMDA data to compare the borrower and neighborhood characteristics of loans sold to the GSEs with the characteristics of all loans originated in the market. One question is whether HMDA data, which is widely available to the public, provides an accurate measure of GSE performance, as compared with the GSEs' own data.[249] Fannie Mae has argued that HMDA data understate its past performance, where performance is defined as the percentage of Fannie Mae's mortgage purchases accounted for by one of the goal-qualifying categories. As explained below, over the past six years, HMDA has provided rather reliable national-level information on the goals-qualifying percentages for the GSEs' purchases of ''current-year'' (*i.e.,* newly-originated) loans, but not for their purchases of ''prior-year'' loans.[250]

In any given calendar year, the GSEs can purchase mortgages originated in that calendar year or mortgages originated in a prior calendar year. In 2001 and 2002, for example, purchases of prior-year mortgages accounted for approximately 20 percent of

[249] For another discussion of this issue, see Randall M. Scheessele, *HMDA Coverage of the Mortgage Market,* Housing Finance Working Paper HF–007, Office of Policy Development and Research, Department of Housing and Urban Development, July 1998. Scheessele reports that HMDA data covered 81.6 percent of the loans acquired by Fannie Mae and Freddie Mac in 1996. The main reason for the under-reporting of GSE acquisitions is a few large lenders failed to report the sale of a significant portion of their loan originations to the GSEs. Also see the analysis of HMDA coverage by Jim Berkovec and Peter Zorn. ''Measuring the Market: Easier Said than Done,'' *Secondary Mortgage Markets.* McLean VA: Freddie Mac, Winter 1996, pp. 18–21; as well as the Berkovec and Zorn study cited in the above footnote.

[250] Between 1993 and 1996, the GSEs' purchases of prior-year loans were not as targeted as they were after 1996; thus, during this period, HMDA provided reasonable estimates of the goals-qualifying percentages of the GSEs' purchases of all (both current-year and prior-year) loans, with a few exceptions (see Table A.11).

the home loans purchased by each GSE.[251] HMDA data provide information mainly on newly-originated mortgages that are sold to the GSEs'that is, HMDA data on loans sold to the GSEs will not include many of their purchases of prior-year loans. The implications of this for measuring GSE performance can be seen in Table A.11, which provides annual data on the borrower and census tract characteristics of GSE purchases, as measured by HMDA data and by the GSEs' own data. Table A.11 divides each of the GSEs' goals-qualifying percentages for a particular acquisition year into two components, the percentage for ''prior-year'' loans and the percentage for ''current-year'' loans.

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[251] During the 1990s, the GSEs increased their purchases of seasoned loans; see Paul B. Manchester, *Goal Performance and Characteristics of Mortgages Purchased by Fannie Mae and Freddie Mac, 1998–2000*, Housing Finance Working Paper No. HF–015, Office of Policy Development and Research, HUD, May 2001.

Table A.11

Annual Trends in GSE Purchases and Single-Family Lending in Metropolitan Areas
Goal-Qualifying Home Purchase Mortgages, 1992-2002

Borrower and Tract Characteristics	Fannie Mae Data			HMDA Data for Fannie Mae	Freddie Mac Data			HMDA Data for Freddie Mac	Conforming Market (W/O B&C Loans[1])
	Prior Year	Current Year	All		Prior Year	Current Year	All		
Special Affordable									
1992				6.3				6.5	10.4
1993	8.3	8.2	8.2	8.8	5.1	7.5	7.3	7.8	12.6
1994	9.7	10.9	10.7	11.4	7.7	8.2	8.2	9.2	14.1
1995	13.4	11.0	11.4	10.5	9.3	8.3	8.4	8.9	14.4
1996	10.8	10.3	10.4	10.5	8.5	8.9	8.8	9.4	15.0
1997	16.1	10.3	11.7	10.5	9.3	9.1	9.2	9.4	15.2
1998	18.1	12.0	13.2	10.7	12.1	11.4	11.5	9.7	15.4
1999	12.1	12.6	12.5	12.5	13.2	12.7	12.8	12.6	17.0
2000	13.5	13.2	13.3	13.7	17.9	13.4	14.7	13.3	16.8
2001	18.1	14.2	14.9	13.4	17.9	13.3	14.4	12.3	15.6
2002	18.8	15.8	16.3	15.5	15.8	15.8	15.8	14.5	16.3
Less Than Area Median Income									
1992				29.2				28.7	34.4
1993	30.8	33.8	33.5	35.0	25.2	32.5	31.9	32.3	38.9
1994	36.1	39.4	38.8	40.1	32.0	34.1	33.7	35.6	41.8
1995	39.0	38.2	38.3	37.1	34.2	32.5	32.8	33.9	41.4
1996	36.0	37.3	37.0	37.7	32.3	34.1	33.7	35.3	42.2
1997	42.3	37.0	38.3	37.5	34.2	34.8	34.7	35.4	42.5
1998	45.9	39.6	40.9	38.1	36.9	37.7	37.6	36.2	42.8
1999	38.0	40.6	40.0	40.2	39.4	41.2	40.8	41.0	44.8
2000	39.8	41.1	40.8	42.0	47.3	40.9	42.7	41.3	44.4
2001	45.3	42.3	42.9	41.5	43.8	40.5	41.3	39.2	42.9
2002	45.3	45.4	45.3	45.6	42.4	44.4	44.0	43.5	45.2
Underserved Areas									
1992				18.3				18.6	22.2
1993	23.8	19.3	20.3	18.2	19.4	18.0	18.2	17.6	21.9
1994	26.5	23.5	24.2	22.5	21.0	19.2	19.6	19.2	24.3
1995	27.4	23.8	24.6	22.8	22.3	19.2	19.9	19.1	25.4
1996	23.4	21.8	22.3	21.6	22.2	18.9	19.6	19.0	24.9
1997	29.1	20.6	23.0	21.0	22.1	19.1	19.7	18.6	24.9
1998	28.3	20.8	22.7	19.6	21.9	19.3	19.8	17.4	24.2
1999	21.9	20.0	20.4	20.3	23.1	20.3	20.9	19.3	25.2
2000	26.6	22.4	23.4	22.5	23.9	21.2	22.0	20.9	26.4
2001	28.3	23.3	24.4	22.0	25.7	21.3	22.3	19.5	25.2
2002	32.7	25.5	26.7	24.6	29.4	25.0	25.8	21.4	26.4

Notes: The Fannie Mae and Freddie Mac data for their purchases of "Prior Year" mortgages, "Current Year" mortgages, and "All" mortgages are from the loan-level data that they provide to HUD. All mortgages are conventional conforming home purchase mortgages. The "HMDA Data for (GSE)" are those mortgages that HMDA identifies as being sold to the GSEs. The Conforming Market data are from HMDA data. 'Mortgages with a loan amount greater than six times borrower income are excluded for the purposes of the low- and moderate-income and special affordable analyses. In both the GSE and market analyses, mortgages classified as special affordable include mortgages from very-low-income borrowers and low-income borrowers living in low-income census tracts. Because missing value percentages differ between GSE and HMDA data, mortgages with missing data are excluded from both the GSE and market data.

[1] The adjustment assumes that B&C loans represent one-half of the subprime market. The adjustment for home purchase loans is small because subprime (B&C) loans are mainly refinance loans. For further discussion, see text.

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Consider Fannie Mae's special affordable purchases in 2002. According to Fannie Mae's own data, 16.3 percent of its purchases during 2002 were special affordable loans. According to HMDA data, only 15.5 percent of loans sold to Fannie Mae fell into the special affordable category. In this case, HMDA data underestimate the special affordable share of Fannie Mae's purchases during 2002. What explains these different patterns in the GSE and HMDA data? The reason that HMDA data underestimate the special affordable percentage of Fannie Mae's 2002 purchases can be seen by disaggregating Fannie Mae's purchases during 2002 into their prior-year and current-year components. Table A.11 shows that the overall figure of 16.3 percent for special affordable purchases is a weighted average of 18.8 percent for Fannie Mae's purchases during 2002 of prior-year mortgages and 15.8 percent for its purchases of current-year purchases. The HMDA-reported figure of 15.5 percent is based mainly on newly-mortgaged (current-year) loans that lenders reported as being sold to Fannie Mae during 2002. The HMDA figure is similar in concept to the current-year percentage from the GSEs' own data. And the HMDA figure and the GSE current-year figure are practically the same in this case (15.5 versus 15.8 percent). Thus, the relatively large share of special affordable mortgages in Fannie Mae's purchases of prior-year mortgages explains why Fannie Mae's own data show an overall (both prior-year and current-year) percentage of special affordable loans that is higher than that reported for Fannie Mae in HMDA data.

b. Reliability of HMDA Data

With the above explanation of the basic differences between GSE-reported and HMDA-reported loan information, issues related to the reliability of HMDA data can now be discussed. Table A.12 presents the same information as Table A.11, except that the data are aggregated for the years 1993–5, 1996–2002, and 1999–2002. Comparing HMDA-reported data on GSE purchases with GSE-reported current-year data suggests that, on average, HMDA data have provided reasonable estimates of the goals-qualifying percentages for the GSEs' current-year purchases (with the exception of Freddie Mac's underserved area loans, as discussed below). For example, Fannie Mae reported that 13.0 percent of the current-year loans it purchased between 1996 and 2002 were for special affordable borrowers. In their HMDA submissions, lenders reported a nearly identical figure of 12.7 percent for the special affordable share of loans that they sold to Fannie Mae. The corresponding numbers for Freddie Mac were 12.4 percent reported by them and 11.9 percent reported by HMDA. During the same period, both Fannie Mae and HMDA reported that approximately 22 percent of current-year loans purchased by Fannie Mae financed properties in underserved areas. However, Freddie Mac reported that 21.0 percent of the current-year loans it purchased between 1996 and 2002 financed properties in underserved areas, a figure somewhat higher than the 19.5 percent that HMDA reported as underserved area loans sold to Freddie Mac during that period.[252]

[252] Freddie Mac's underserved area figure for 2002 showed a particularly large discrepancy—as shown in Table A.11, Freddie Mac reported that 25.0 percent of the current-year loans it purchased during 2002 financed properties in underserved areas, a figure much higher than the 21.4 percent that HMDA reported as underserved area loans sold to Freddie Mac during 2002. This is the largest discrepancy in Table A.11, and it is not clear what explains it. This downward bias for HMDA data, is the opposite of that suggested by Berkovec and Zorn, who argued that affordability percentages from HMDA data are biased upward.

Table A.12

HMDA Versus GSE Reporting of GSE Loan Characteristics
Single-Family-Owner Home Loans in Metropolitan Areas, 1993-2002

	Fannie Mae			Freddie Mac		
Borrower and Tract Characteristics	GSE-Reported Current-Year Loan Purchases	HMDA-Reported GSE Purchases	Ratio: HMDA-Reported/ GSE Reported	GSE-Reported Current-Year Loan Purchases	HMDA-Reported GSE Purchases	Ratio: HMDA-Reported/ GSE Reported
Special Affordable						
1993-1995	9.9	10.2	1.03	8.0	8.6	1.08
1996-2002	13.0	12.7	0.98	12.4	11.9	0.96
1999-2002	14.1	13.9	0.99	13.9	13.2	0.95
Less than Area Median Income						
1993-1995	36.8	37.2	1.01	33.0	33.9	1.03
1996-2002	41.0	40.9	1.00	39.6	39.2	0.99
1999-2002	42.6	42.6	1.00	41.9	41.2	0.98
Underserved Areas						
1993-1995	22.0	21.1	0.96	18.8	18.6	0.99
1996-2002	22.4	21.9	0.98	21.0	19.5	0.93
1999-2002	23.1	22.6	0.98	22.1	20.3	0.92

Source: The Fannie Mae and Freddie Mac "current year" data include information on their purchases of home loan originated in the same year they acquired the loans. The data are from the loan-level data that they provide to HUD. All mortgages are conventional conforming mortgages. The "HMDA-Reported" data include information on conventional conforming loans sold to the GSEs as reported by lenders in HMDA. Loans with a loan-to-income ratio greater than six are excluded from the borrower income calculations. Special affordable includes very low-income borrowers and low-income borrowers in low-income census tracts. Data with missing values are excluded.

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The facts that the GSE (both Fannie Mae and Freddie Mac) and HMDA figures for special affordable and low-mod loans are similar, and that the Fannie Mae and HMDA figures for underserved areas are similar, suggest that the Berkovec and Zorn conclusions about HMDA being upward biased are wrong.[253] For the 1996-to-2002 period, the discrepancies reported in Table A.11 as well as Table A.12 are mostly consistent with HMDA being biased in a downward direction, not an upward direction as Berkovec and Zorn contend.[254] In particular, the Freddie-Mac-reported underserved area percentage being larger than the HMDA-reported underserved area percentage suggests a downward bias in HMDA. The more recent and complete (Fannie Mae data as well as Freddie Mac data) analysis does not support the Berkovec and Zorn finding that HMDA overstates the goals-qualifying percentages of the market.[255]

c. Purchase-Year Versus Origination-Year Reporting of GSE Data

In comparing the GSEs' performance to the primary market, HUD has typically expressed the GSEs' annual performance on a purchase-year basis. That is, all mortgages (including both current-year mortgages and prior-year mortgages) purchased by a GSE in a particular year are assigned to the year of GSE purchase. The approach of including a GSE's purchases of both ''current-year'' and ''prior-year'' mortgages gives the GSE full credit for their purchase activity in the year that the purchase actually takes place; this approach is also consistent with the statutory requirement for measuring GSE performance under the housing goals. However, this approach results in an obvious ''apples to oranges'' problem with respect to the HMDA-based market data, which include only newly-originated mortgages (*i.e.*, current-year mortgages). To place the GSE and market data on an ''apples to apples'' basis, HUD has also used an alternative approach that expresses the GSE annual data on an origination-year basis. In this case, all purchases by a GSE in any particular year would be fully reported but they would be allocated to the year that they were originated, rather than to the year they were purchased. Under this approach, a GSE's data for the year 2000 would not only include that GSE's purchases during 2000 of newly-originated mortgages but also any year-2000-originations purchased in later years (*i.e.*, during 2001 and 2002 in this analysis). This approach places the GSE and the market data on a consistent, current-year basis. In the above example, the market data would present the income and underserved area characteristics of mortgages originated in 2000, and the GSE data would present the same characteristics of all year-2000-mortgages that the GSE has purchased to date (*i.e.*, through year 2002).[256]

Below, results will be presented for both the purchase-year and origination-year approaches. Following past HUD studies that have compared GSE performance with the primary market, most of the analysis in this section reports the GSE data on a purchase-year basis; however, the main results are repeated with the GSE data reported on an origination-year basis. This allows the reader to compare any differences in findings about how well the GSEs have been doing relative to the market.

9. Affordable Lending by the GSEs: Home Purchase Loans

This section compares the GSEs' affordable lending performance with the primary market for the years 1993–2002. The analysis in this section begins by presenting the GSE data on a purchase-year basis. As discussed above, the GSE data that are reported to HUD include their purchases of mortgages originated in prior years as well as their purchases of mortgages originated during the current year. The market data reported by HMDA include only mortgages originated in the current year. This means that the GSE-versus-market comparisons are defined somewhat inconsistently for any particular calendar year. Each year, the GSEs have newly-originated loans available for purchase, but they can also purchase loans from a large stock of seasoned (prior-year) loans currently being held in the portfolios of depository lenders. One method for making the purchase-year data more consistent is to aggregate the data over several years, instead of focusing on annual data. This provides a clearer picture of the types of loans that have been originated and are available for purchase by the GSEs. This approach is taken in Table A.13, which is discussed below. Another method for making the GSE and market data consistent is to express the GSE data on an origination-year basis; that approach is taken in Table A.16, which is discussed after presenting the annual results on a purchase-year basis.

a. Longer-Term Performance, 1993–2002 and 1996–2002

Table A.13 summarizes the funding of goals-qualifying mortgages by the GSEs, depositories and the conforming market for the ten-year period between 1993 and 2002. Data are also presented for two important sub-periods: 1993–95 (for showing how much the GSEs have improved their performance since the early-to-mid 1990s); and 1996–2002 (for analyzing their performance since the current definitions of the housing goals were put into effect). Given the importance of the GSEs for expanding homeownership, this section focuses on home purchase mortgages, and the next section will examine first-time homebuyer loans. Section IV below will briefly discuss the GSEs' overall performance, including refinance and home purchase loans. Several points stand out concerning the affordable lending performance of Freddie Mac and Fannie Mae over the two longer-term periods, 1993–2002 and 1996–2002.

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[253] The data in Table A.12 that support Berkovec and Zorn are the 1993–95 special affordable and low-mod data (particularly for Freddie Mac) that show HMDA over reporting percentages by more than a half percentage point. Otherwise, the data in Table A.12, as well as Table A.11, do not present a picture of HMDA's having an upward bias in reporting targeted loans. In fact, the recent years' data suggest a downward bias in HMDA's reporting of targeted loans.

[254] Of course, on an individual year basis, the GSEs' current-year data can differ significantly from the HMDA-reported data on GSE purchases. The other annual data reported in Table A.11 show a mixture of results—in some cases the HMDA percentage is larger than the GSE—current year'' percentage (*e.g.*, Fannie Mae's special affordable purchases in 2000) while in other cases the HMDA percentage is smaller than the GSE current year percentage (*e.g.*, Freddie Mac's underserved areas purchases in recent years). As noted in the text, the differential is typically in the opposite direction to that predicted by Berkovec and Zorn, particularly on the underserved areas category.

[255] Table A.12 also includes aggregates for the more recent period, 1999–2002. The ratios of HMDA-reported-to-GSE-reported averages for this sub-period are similar to those reported for 1996–2002.

[256] Under the origination-year approach, GSE performance for any specific origination year (say year 2000) at the end of a particular GSE purchase year (say year 2002) is subject to change in the future years. Table A.16 (in Section E.9 below) reports that 13.7 percent of year-2000 mortgage originations that Fannie Mae purchased through year 2002 qualify as special affordable; the special affordable share for the market was 16.8 percent in 2000, which indicates that, to date, Fannie Mae has lagged the primary market in funding special affordable mortgages originated during 2000. However, Fannie Mae's special affordable performance could change in the future as Fannie Mae continues to purchase year-2000 originations during 2003 and the following years. Of course, whether Fannie Mae's future purchases result in it ever leading the 2000-year market is not known at this time.

Table A.13

GSE Purchases and Single-Family Lending in Metropolitan Areas
Goal-Qualifying Home Purchase Mortgages, 1993-2002

Borrower and Tract Characteristics	Fannie Mae	Freddie Mac	Ratio Fannie Mae/ Freddie Mac	Depository Total	Depository Portfolio	Conforming Market W/O B&C	Ratio of GSE to Market (W/O B&C) Fannie Mae	Ratio of GSE to Market (W/O B&C) Freddie Mac
Special Affordable								
1993-2002	12.7 %	11.8 %	1.08	15.4 %	16.9 %	15.4 %	0.82	0.77
1993-1995	10.0	8.0	1.25	14.6	17.0	13.7	0.73	0.58
1996-2002	13.5	12.8	1.05	15.6	16.8	16.0	0.84	0.80
1999-2002	14.4	14.5	0.99	16.4	16.9	16.4	0.88	0.88
2000-2002	15.0	14.9	1.01	16.4	17.1	16.2	0.93	0.92
Less than Area Median Income								
1993-2002	40.2 %	38.3 %	1.05	42.8 %	43.3 %	43.0 %	0.93	0.89
1993-1995	36.7	32.8	1.12	41.8	44.0	40.8	0.90	0.80
1996-2002	41.2	39.8	1.04	43.1	43.0	43.6	0.94	0.91
1999-2002	42.5	42.3	1.00	44.2	43.1	44.3	0.96	0.95
2000-2002	43.2	42.7	1.01	44.2	43.3	44.2	0.98	0.97
Underserved Areas								
1993-2002	23.3 %	21.2 %	1.10	24.7	26.5	25.1 %	0.93	0.84
1993-1995	22.8	19.2	1.19	24.1	26.8	24.0	0.95	0.80
1996-2002	23.5	21.7	1.08	24.9	26.4	25.4	0.93	0.85
1999-2002	24.0	22.9	1.05	25.7	26.8	25.8	0.93	0.89
2000-2002	24.9	23.4	1.06	26.1	27.2	26.0	0.96	0.90

Source: The Fannie Mae and Freddie Mac data include information on all their purchases of home loans and are from the loan-level data that they provide to HUD. All mortgages are conventional conforming mortgages. The Depository and Conforming Market data are from HMDA; loans with a loan-to-income ratio greater than six are excluded from the borrower income calculations. "Total Depositories" data are loans originated by HMDA reporters regulated by FDIC, OTS, OCC, FRB, and the National Credit Union Administration; they consist mainly of banks, thrifts, and their subsidieries. The "Depository Portfolio" data refer to new originations that are not sold by banks and thrift institutions and thus are retained in depository portfolios. "Conforming Market W/O B&C" data are the average market percentages after deducting estimates of B&C loans (see text for explanation). Special affordable includes very low-income borrowers and low-income borrowers in low-income census tracts. Data with missing values are excluded.

Freddie Mac lagged both Fannie Mae and the primary market in funding affordable home loans in metropolitan areas between 1993 and 2002. During that period, 11.8 percent of Freddie Mac's mortgage purchases were for special affordable (mainly very-low-income) borrowers, compared with 12.7 percent of Fannie Mae's purchases, 15.4 percent of loans originated by depositories,[257] and 15.4 percent of loans originated in the conforming market without B&C loans.[258]

Although Freddie Mac consistently improved its performance during the 1990s, a similar pattern characterized the 1996–2002 period. During that period, 39.8 percent of Freddie Mac's purchases were for low- and moderate-income borrowers, compared with 41.2 percent of Fannie Mae's purchases, 43.1 percent of loans originated by depositories, and 43.6 percent of loans originated in the conventional conforming market. Over the same period, 21.7 percent of Freddie Mac's purchases financed properties in underserved neighborhoods, compared with 23.5 percent of Fannie Mae's purchases, 24.9 percent of depository originations, and 25.4 percent of loans originated in the primary market.

Fannie Mae's affordable lending performance was better than Freddie Mac's over the 1993 to 2002 period as well as during the 1996 to 2002 period. However, Fannie Mae lagged behind depositories and the overall market in funding affordable loans during both of these periods (see above paragraph). Between 1996 and 2002, the ''Fannie-Mae-to-market'' ratio was only 0.84 on the special affordable category, obtained by dividing Fannie Mae's performance of 13.5 percent by the market's performance of 16.0 percent. Fannie Mae's market ratio was 0.94 on the low-mod category and 0.93 on the underserved area category. The ''Freddie-Mac-to-market'' ratios were lower'0.80 for special affordable, 0.91 for low-mod, and 0.85 for underserved areas.

The above analysis has defined the market to exclude B&C loans, which HUD believes is the appropriate market definition. However, to gauge the sensitivity of the results to how the market is defined, Table A.14 shows the effects on the market percentages for different definitions of the conventional conforming market, such as excluding manufactured housing loans, small loans, and all subprime loans (*i.e.*, the A-minus portion of the subprime market as well as the B&C portion). For example, the average special affordable (underserved area) market percentage for 1996–2002 would fall by about 0.2 (0.6) percentage point if the remaining subprime loans (*i.e.*, the A-minus loans) were also excluded from the market totals. Excluding manufactured housing loans in metropolitan areas would reduce the above market percentage for special affordable (underserved area) loans by 1.5 (1.1) percentage points. The above findings with respect to the GSEs' longer-term performance are not much affected by the choice of market definition.

[257] As shown in Table A.13, the depository percentage is higher (16.9 percent) if the analysis is restricted to those newly-originated loans that depositories do not sell (the latter being a proxy for loans held in depositories' portfolios). Note that during the recent, 1999-to-2002 period (also reported in Table A.13), there is less difference between the two depository figures.

[258] Unless stated otherwise, the market in this section is defined as the conventional conforming market without estimated B&C loans.

Table A.14

Annual Trends in GSE Purchases and Single-Family Lending in Metropolitan Areas
Goal-Qualifying Home Purchase Mortgages, 1996-2002
Various Market Definitions

			Conventional Conforming Market Originations								
Borrower and Tract Characteristics	Fannie Mae Purchases	Freddie Mac Purchases	Total Market	W/O Mfg Loans Only	W/O Loans Less Than $15K	W/O Mfg and Less Than $15K Loans	W/O Subprime Loans	W/O B&C Loans	W/O B&C and Mfg Loans	W/O B&C and LT $15K Loans	W/O B&C and LT $15K W/O Mfg
Special Affordable											
1996	10.4	8.8	15.0	13.3	14.2	12.8	15.0	15.0	13.3	14.2	12.8
1997	11.7	9.2	15.3	13.5	14.6	13.0	15.3	15.2	13.4	14.5	12.9
1998	13.2	11.5	15.6	13.7	15.0	13.4	15.2	15.4	13.4	14.9	13.1
1999	12.5	12.8	17.3	15.3	16.8	15.0	16.7	17.0	14.9	16.5	14.6
2000	13.3	14.7	17.1	15.6	16.5	15.3	16.4	16.8	15.2	16.2	14.9
2001	14.9	14.4	15.8	14.9	15.5	14.6	15.5	15.6	14.7	15.3	14.4
2002	16.3	15.8	16.4	16.0	16.1	15.8	16.2	16.3	15.9	16.0	15.7
1996-2002	13.5	12.8	16.1	14.7	15.6	14.4	15.8	16.0	14.5	15.5	14.2
1999-2002	14.4	14.5	16.6	15.5	16.2	15.2	16.2	16.4	15.2	16.0	14.9
2000-2002	15.0	14.9	16.4	15.5	16.0	15.2	16.0	16.2	15.3	15.8	15.0
Less Than Area Median Income											
1996	37.0	33.7	42.2	40.0	41.4	39.4	42.2	42.2	39.9	41.4	39.4
1997	38.3	34.7	42.5	40.1	41.8	39.6	42.4	42.5	40.0	41.7	39.5
1998	40.8	37.6	43.0	40.7	42.5	40.3	42.7	42.8	40.4	42.3	40.0
1999	40.0	40.8	45.2	42.9	44.7	42.5	44.4	44.8	42.4	44.3	42.0
2000	40.8	42.7	44.8	43.0	44.1	42.6	43.9	44.4	42.5	43.8	42.1
2001	42.9	41.3	43.2	42.0	42.7	41.6	42.7	42.9	41.8	42.5	41.3
2002	45.3	44.0	45.3	44.9	45.0	44.5	45.0	45.2	44.7	44.8	44.4
1996-2002	41.2	39.8	43.9	42.2	43.3	41.7	43.4	43.6	41.9	43.1	41.4
1999-2002	42.5	42.3	44.6	43.2	44.1	42.8	44.0	44.3	42.9	43.8	42.5
2000-2002	43.2	42.7	44.4	43.4	43.9	42.9	43.9	44.2	43.1	43.7	42.7
Underserved Areas											
1996	22.3	19.6	25.0	23.5	24.5	23.1	24.8	24.9	23.4	24.5	23.0
1997	23.0	19.7	25.2	23.7	24.8	23.3	24.7	24.9	23.4	24.5	23.1
1998	22.7	19.8	24.6	23.1	24.3	22.8	23.6	24.2	22.5	23.8	22.3
1999	20.4	20.9	25.8	24.4	25.5	24.1	24.6	25.2	23.7	24.9	23.5
2000	23.4	22.0	27.1	26.1	26.8	25.8	25.6	26.4	25.3	26.8	25.0
2001	24.4	22.3	25.8	25.2	25.5	24.9	24.6	25.2	24.5	24.9	24.2
2002	26.7	25.8	27.2	27.0	27.0	26.7	25.6	26.4	26.2	26.2	25.9
1996-2002	23.5	21.7	25.9	24.9	25.6	24.6	24.8	25.4	24.3	25.0	24.0
1999-2002	24.0	22.9	26.5	25.7	26.2	25.4	25.1	25.8	25.0	25.5	24.7
2000-2002	24.9	23.4	26.7	26.1	26.4	25.8	25.3	26.0	25.4	25.7	25.1

Source: The Fannie Mae and Freddie Mac percentages for 1996 to 2002 are based on the loan-level mortgage purchase data that they provide to HUD. All mortgages are conventional conforming home purchase mortgages. The Conforming Market data are from HMDA; loans with a loan-to-income-ratio greater than six are excluded from all borrower income calculations. See the text for an explanation of the adjustments for manufactured housing (mfg), subprime, and B&C loans. Special affordable includes very low-income census tracts. Data with missing values are excluded.

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b. Recent Performance, 1999–2002

This and the next subsection focus on the average data for 1999–2002 in Table A.13 and the annual data reported in Table A.14. As explained below, the annual data are useful for showing shifts in the relative positions of Fannie Mae and Freddie Mac that began in 1999, and for highlighting the improvements made by Fannie Mae during 2001 and 2002 (which were the first two years under HUD's higher goal levels) and by Freddie Mac during 2002. Between 1993 and 1998, Freddie Mac's performance fell below Fannie Mae's, but a sharp improvement in Freddie Mac's performance during 1999 pushed it pass Fannie Mae on all three goals-qualifying categories. In 2000, Fannie Mae improved its underserved areas performance enough to surpass Freddie Mac on that category, while Freddie Mac continued to out-perform Fannie Mae on the borrower-income categories (special affordable and low-mod). During 2001 and 2002, Fannie Mae improved its performance enough to surpass Freddie Mac on all three goals-qualifying categories and to essentially match the market during these two years.

Consider first the average data for 1999–2002 reported in Table A.13. During this recent period, Freddie Mac's average performance was similar to Fannie Mae's performance for the borrower income categories. Between 1999 and 2002, 14.5 percent of Freddie Mac's purchases and 14.4 percent Fannie Mae's mortgage purchases consisted of special affordable loans, compared with a market average of 16.4 percent. In addition, Freddie Mac purchased low-mod loans at about the same rate as Fannie Mae during this period—42.3 percent for the Freddie Mac, 42.5 percent for Fannie Mae, and 44.3 percent for the market. Freddie Mac (22.9 percent) purchased underserved area loans at a lower rate than Fannie Mae (24.0 percent) and the primary market (25.8 percent). As these figures indicate, both Fannie Mae and Freddie Mac continued to lag the market during this recent four-year period. Both GSEs' market ratios were 0.88 for special affordable loans and approximately 0.95 for low-mod loans. Although less than one (where one indicates equal performance with the market), the ''Fannie-Mae-to-market'' ratio (0.93) for the underserved area category was higher than the ''Freddie-Mac-to-market'' ratio (0.89).

Fannie Mae had an uncharacteristically poor year in 1999. Thus, averages for 2000–2002 are also presented in Table A.13, dropping 1999. These data show an increase in Fannie Mae's performance relative to the market, particularly on the special affordable and underserved areas categories. Between 2000 and 2002, special affordable (underserved area) loans accounted for 15.0 percent (24.9 percent) of Fannie Mae's purchases, compared with 16.2 percent (26.0 percent) for the market.

Table A.14 shows the effects on the market percentages for 1999–2002 (as well as 2000–2002) of different definitions of the conventional conforming market. Excluding manufactured housing loans (as well as B&C loans) in metropolitan areas would reduce the 1999–2002 market percentage for special affordable loans from 16.4 percent to 15.2 percent, which would raise the GSEs' market ratios from approximately 0.88 to 0.95. Similarly, excluding manufactured housing loans would reduce the 1999–2002 market percentage for underserved areas from 25.8 percent to 25.0 percent, which would raise Fannie Mae's market ratio from 0.93 to 0.96 and Freddie Mac's, from 0.89 to 0.92. As shown in Table A.14, Fannie Mae is even closer to the market averages if the year 1999 is dropped—over the 2000–2002 period, Fannie Mae's performance on the underserved area category is practically at market levels under the alternative definitions of the market, and its performance on the special affordable and low-mod categories to close to market levels.

c. GSEs' Performance—Annual Data

Freddie Mac's Annual Performance. As shown by the annual data reported in Table A.15, Freddie Mac significantly improved its purchases of goals-qualifying loans during the 1990s. Its purchases of loans for special affordable borrowers increased from 6.5 percent of its business in 1992 to 9.2 percent in 1997, and then jumped to 14.7 percent in 2000 before falling slightly to 14.4 percent in 2001 and rising again to 15.8 percent in 2002. The underserved areas share of Freddie Mac's purchases increased at a more modest rate, rising from 18.6 percent in 1992 to 22.3 percent by 2001; it then jumped to 25.8 percent in 2002.

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Table A.15

Annual Trends in GSE Purchases and Single-Family Lending in Metropolitan Areas
Goal-Qualifying Home Purchase Mortgages, 1992-2002

Borrower and Tract Characteristics	Fannie Mae	Freddie Mac	Ratio of Fannie Mae to Freddie Mac	Conforming Market (W/O B&C Loans)	Ratio of GSE to Market (W/O B&C) Fannie Mae	Ratio of GSE to Market (W/O B&C) Freddie Mac
Special Affordable						
1992	6.3 %	6.5 %	0.97	10.4 %	0.61	0.63
1993	8.2	7.3	1.12	12.6	0.65	0.58
1994	10.7	8.2	1.30	14.1	0.76	0.58
1995	11.4	8.4	1.36	14.4	0.79	0.58
1996	10.4	8.8	1.18	15.0	0.69	0.59
1997	11.7	9.2	1.27	15.2	0.77	0.61
1998	13.2	11.5	1.15	15.4	0.86	0.75
1999	12.5	12.8	0.98	17.0	0.74	0.75
2000	13.3	14.7	0.90	16.8	0.79	0.88
2001	14.9	14.4	1.03	15.6	0.96	0.92
2002	16.3	15.8	1.03	16.3	1.00	0.97
Less Than Area Median Income						
1992	29.2	28.7	1.02	34.4	0.85	0.83
1993	33.5	31.9	1.05	38.9	0.86	0.82
1994	38.8	33.7	1.15	41.8	0.93	0.81
1995	38.3	32.8	1.17	41.4	0.93	0.79
1996	37.0	33.7	1.10	42.2	0.88	0.80
1997	38.3	34.7	1.10	42.5	0.90	0.82
1998	40.8	37.6	1.09	42.8	0.95	0.88
1999	40.0	40.8	0.98	44.8	0.89	0.91
2000	40.8	42.7	0.96	44.4	0.92	0.96
2001	42.9	41.3	1.04	42.9	1.00	0.96
2002	45.3	44.0	1.03	45.2	1.00	0.97
Underserved Areas						
1992	18.3	18.6	0.98	22.2	0.82	0.84
1993	20.3	18.2	1.12	21.9	0.93	0.83
1994	24.2	19.6	1.23	24.3	1.00	0.81
1995	24.6	19.9	1.24	25.4	0.97	0.78
1996	22.3	19.6	1.14	24.9	0.90	0.79
1997	23.0	19.7	1.17	24.9	0.92	0.79
1998	22.7	19.8	1.15	24.2	0.94	0.82
1999	20.4	20.9	0.98	25.2	0.81	0.83
2000	23.4	22.0	1.06	26.4	0.89	0.83
2001	24.4	22.3	1.09	25.2	0.97	0.88
2002	26.7	25.8	1.03	26.4	1.01	0.98

Source: The Fannie Mae and Freddie Mac percentages for 1993 to 2002 are from the loan-level mortgage purchase data that they provide to HUD; the 1992 GSE data are from HMDA. All mortgages are conventional conforming home purchase mortgages. The Conforming Market data are from HMDA; see text for an explanation of the market adjustment for B&C loans. Loans with a loan-to-income-ratio greater than six are excluded from the borrower income calculations. Special affordable includes very low-income borrowers and low-income borrowers living in low-income census tracts. Data with missing values are excluded.

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With its improved performance, Freddie Mac closed its gap with the market in funding goals-qualifying loans. In 2002, special affordable loans accounted for 15.8 percent of Freddie Mac's purchases and 16.3 percent of loans originated in the conventional conforming market, which produces a ''Freddie-Mac-to-market'' ratio of 0.97 (15.8 divided by 16.3). Table A.15 shows the trend in the ''Freddie-Mac-to-market'' ratio from 1992 to 2002 for each of the goals-qualifying categories. For the special affordable and low-mod categories, Freddie Mac's performance relative to the market remained flat (at approximately 0.60 and 0.80, respectively) through 1997; by 2002, the ''Freddie-Mac-to-market'' ratios had risen to 0.97 for both the special affordable and low-mod categories.

Surprisingly, Freddie Mac did not make much progress during the 1990s closing its gap with the market on the underserved areas category. The ''Freddie-Mac-to-market'' ratio for underserved areas was approximately the same in 2000 (0.83) as it was in 1992 (0.84). While it rose to 0.88 in 2001, that was due more to a decline in the market level than to an improvement in Freddie Mac's performance. However, due to a substantial increase in Freddie Mac's underserved area percentage from 22.3 percent in 2001 to 25.8 percent in 2002, Freddie Mac's performance approached market performance (26.4 percent) during 2002. [259] In the ten years under the housing goals, the year 2002 represented the first time that Freddie Mac's performance in purchasing home loans in underserved areas had ever been within two percentage points of the market's performance.[260]

Fannie Mae's Annual Performance. With respect to purchasing affordable loans, Fannie Mae followed a different path than Freddie Mac. Fannie Mae improved its performance between 1992 and 1998 and made much more progress than Freddie Mac in closing its gap with the market. In fact, by 1998, Fannie Mae's performance was close to that of the primary market for some important components of affordable lending. In 1992, special affordable loans accounted for 6.3 percent of Fannie Mae's purchases and 10.4 percent of all loans originated in the conforming market, giving a ''Fannie Mae-to-market'' ratio of 0.61. By 1998, this ratio had risen to 0.86, as special affordable loans had increased to 13.2 percent of Fannie Mae's purchases and to 15.4 percent of market originations. A similar trend in market ratios can be observed for Fannie Mae on the underserved areas category. In 1992, underserved areas accounted for 18.3 percent of Fannie Mae's purchases and 22.2 percent of market originations, for a ''Fannie Mae-to-market'' ratio of 0.82. By 1998, underserved areas accounted for 22.8 percent of Fannie Mae's purchases and 24.2 percent of market originations, for a higher ''Fannie Mae-to-market'' ratio of 0.94.[261]

The year 1999 saw a shift in the above patterns, with Fannie Mae declining in overall performance while the share of goals-qualifying loans in the market increased. Between 1998 and 1999, the special affordable share of Fannie Mae's business declined from 13.2 percent to 12.5 percent while this type of lending in the market increased from 15.4 percent to 17.0 percent. For this reason, the ''Fannie-Mae-to-market'' ratio for special affordable loans declined sharply from 0.86 in 1998 to 0.74 in 1999. The share of Fannie Mae's purchases in underserved areas also declined, from 22.7 percent in 1998 to 20.4 percent in 1999, which lowered the ''Fannie-Mae-to-market'' ratio from 0.94 to 0.81.

After declining in 1999, Fannie Mae's performance rebounded in 2000, particularly on the underserved areas category. Fannie Mae's underserved areas percentage jumped by three percentage points from 20.4 percent in 1999 to 23.4 percent in 2000. The 2000 figure was similar to its level in 1997 but below Fannie Mae's peak performances of 24–25 percent during 1994 and 1995. Between 1999 and 2000, the ''Fannie-Mae-to-market'' ratio for underserved areas increased from 0.82 to 0.89. Fannie Mae improved its performance on the special affordable goal at a more modest rate. Fannie Mae's special affordable percentage increased by 0.8 percentage points from 12.5 percent in 1999 to 13.3 percent in 2000. The 2000 figure was similar to its previous peak level (13.2 percent) in 1998). The ''Fannie-Mae-to-market'' ratio for special affordable loans increased from 0.74 in 1999 to 0.79 in 2000, with the latter figure remaining below Fannie Mae's peak market ratio (0.86) in 1998.

Fannie Mae continued its improvement in purchasing targeted home loans during 2001, at a time when the conventional conforming market was experiencing a decline in affordable lending, and again in 2002, at a time when the conventional conforming market was increasing enough to return approximately to its year-2000 level. Thus, during the 2000-to-2002 period, Fannie Mae significantly improved its targeted purchasing performance while the primary market originated targeted home loans at about the same rate in 2002 as it did in 2000. As a result, Fannie Mae's performance during 2001 approached the market on the special affordable and underserved area categories and matched the market on the low-mod category. In 2002, Fannie Mae matched the market on the special affordable category, and slightly outperformed the market on the low-mod and underserved areas categories.

As shown in Table A.15, Fannie Mae increased its special affordable percentage by 1.6 percentage points, from 13.3 percent in 2000 to 14.9 percent in 2001, and then increased it further to 16.3 percent in 2002, the latter being the same as the market's performance of 16.3 percent. The ''Fannie-Mae-to-market'' ratio for special affordable loans jumped from 0.79 in 2000 to 1.00 in 2002. Between 2000 and 2001, Fannie Mae increased its low-mod percentage from 40.8 percent to 42.9 percent at the same time that the low-mod share of the primary market was falling from 44.4 percent to 42.9 percent, placing Fannie Mae at the market's performance in 2001. During 2002, the low-mod share of Fannie Mae's purchases of home loans increased further to 45.3 percent, placing Fannie Mae 0.1 percentage point above the market performance of 45.2 percent. Fannie Mae increased its underserved area percentage from 23.4 percent in 2000 to 24.4 in 2001 percent while the underserved area share of the primary market was falling from 26.4 percent to 25.2 percent, placing Fannie Mae at less than one percentage point from the market's performance. The ''Fannie-Mae-to-market'' ratio for underserved area loans was 0.97 in 2001. During 2002, the underserved area share of Fannie Mae's purchases of home loans increased further to 26.7 percent, placing Fannie Mae slightly ahead of market performance (26.4 percent).

Table A.14 reports Fannie Mae's 2001 and 2002 performance under alternative definitions of the primary market. As shown there, the above results of Fannie Mae's improvement relative to the market during 2001 and 2002 are further reinforced when lower market percentages are used.

Changes in the ''Fannie-Mae-to-Freddie-Mac'' Performance Ratio. The above discussion documents shifts in the relative performance of Fannie Mae and Freddie Mac over the past few years. To highlight these changing patterns, Table A.15 reports the ratio of Fannie Mae's performance to Freddie Mac's performance for each goals category for the years 1992 to 2002. As shown there, the ''Fannie-Mae-to-Freddie-Mac'' ratio for the special affordable category increased from approximately one in 1992 (indicating equal performance) to over 1.3 during the 1994–97 period, indicating that Fannie Mae clearly out-performed Freddie Mac during this period. Between 1997 and 2000, Freddie Mac substantially increased its special affordable share (from 9.2 percent to 14.7 percent), causing the ''Fannie-Mae-to-Freddie-Mac'' ratio to fall from 1.27 in 1997 to 0.90 in 2000 (indicating Freddie Mac surpassed Fannie Mae). But Fannie Mae's stronger performance during 2001 and 2002 returned the ratio to above one (1.03 in both years), indicating slightly better performance for Fannie Mae (*e.g.,* 16.3 percent in 2002 versus 15.8 percent for Freddie Mac). The ''Fannie-Mae-to-Freddie-Mac'' performance ratio for low-mod loans followed a similar pattern, standing at 1.03 in 2002 (45.3 percent for Fannie Mae versus 44.0 percent for Freddie Mac).

Prior to 2000, the ''Fannie-Mae-to-Freddie-Mac'' ratio for underserved areas had also followed a pattern similar to that outlined above for special affordable loans, but at a lower overall level—rising from about one in 1992 (indicating equal performance) to approximately 1.2 during the 1994–97

[259] Table A.14 reports annual market percentages that exclude the effects of manufactured housing, small loans, and subprime loans. Freddie Mac's performance is closer to the market average under the alternative market definitions, particularly during 2001 and 2002.

[260] Prior to 2002, Freddie Mac's performance on the underserved areas category had not approached the market even under the alternative market definitions reported in Table A.14.

[261] Freddie Mac, on the other hand, fell further behind the market during this period. In 1992, Freddie Mac had a slightly higher underserved areas percentage (18.6 percent) than Fannie Mae (18.3 percent). However, Freddie Mac's underserved areas percentage had only increased to 19.8 percent by 1998 (versus 22.7 percent for Fannie Mae). Thus, the ''Freddie Mac-to-market'' ratio fell from 0.84 in 1992 to 0.82 in 1998.

period, before dropping to slightly below one (0.98) in 1999. However, Fannie Mae increased its underserved areas percentage from 20.4 percent in 1999 to 24.4 percent in 2001 while Freddie Mac only increased its percentage from 20.9 percent to 22.3 percent. This resulted in the ''Fannie-Mae-to-Freddie-Mac'' ratio rising from 0.98 in 1999 to 1.09 in 2001. But during 2002, Freddie Mac's underserved area percentage jumped by 3.5 percentage points to 25.8 percent, while Fannie Mae's increased at a more modest rate (by 2.3 percentage points) to 26.7 percent, with the result being that the ''Fannie-Mae-to-Freddie-Mac'' ratio for underserved area loans fell from 1.09 in 2001 to 1.03 in 2002.

To conclude, while Freddie Mac ended the 1990s on a more encouraging note than Fannie Mae, the past three years (2000, 2001, and 2002) have seen a substantial improvement in Fannie Mae's performance on all three goals-qualifying categories. Fannie Mae ended the 1990s with a decline in affordable lending performance at the same time that Freddie Mac was improving and the share of goals-qualifying loans was increasing in the market. Both GSEs' performance during 2000 was encouraging—Freddie Mac continued to improve, particularly with respect to the borrower-income categories, while Fannie Mae reversed its declining performance, particularly with respect to underserved areas. During 2000, Freddie Mac outperformed Fannie Mae on the special affordable and low-mod categories, while Fannie Mae purchased a higher percentage of loans in underserved areas. During 2001, Fannie Mae continued to improve its performance while Freddie Mac's performance remained about the same and the market's originations of affordable loans declined somewhat. The result was that during 2001 Fannie Mae outperformed Freddie Mac on all three goals-qualifying categories, and even matched the market on the low-mod category. During 2002, both Fannie Mae and Freddie Mac again improved their performance; Fannie Mae continued to outperform Freddie Mac and even matched the market on the special affordable category and slightly outperformed the market on the low-mod and underserved area categories. While Freddie Mac lagged the market on all three goals-qualifying categories during 2002, it had significantly closed its gap with the market by the end of 2002, particularly on the underserved area category.

GSE Purchases of Seasoned Loans. When the GSE data are expressed on a purchase-year basis (as in the above analysis), one factor which affects each GSE's performance concerns their purchases of seasoned (prior-year) loans. As shown in Table A.11, Fannie Mae followed a strategy of purchasing targeted seasoned loans between 1996 and 1998, and again during the past three years—all years when Fannie Mae improved its overall affordable lending performance. For example, consider Fannie Mae's underserved area performance of 24.4 percent during 2001, which was helped by its purchases of seasoned mortgages on properties located in underserved neighborhoods. The underserved area percentage for Fannie Mae's purchases of newly-originated (current-year) mortgages was only 23.3 percent in 2001, or 1.9 percentage points below the market average of 25.2 percent. Fannie Mae obtained its higher overall percentage (24.4 percent) by purchasing seasoned loans with a particularly high concentration (28.3 percent) in underserved areas. Similarly, during 2001, the special affordable share of Fannie Mae's purchases of newly-originated mortgages was only 14.2 percent, or 1.4 percentage points below the market average of 15.6 percent. Again, Fannie Mae improved its overall performance by purchasing seasoned loans with a high percentage (18.1) of special affordable loans, enabling Fannie Mae to reduce its gap with the market to 0.7 percentage points—14.9 percent versus 15.6 percent.

As shown in Table A.11, Freddie Mac also followed a strategy of purchasing seasoned special affordable loans mainly during 2000 and 2001. Prior to 2000, Freddie Mac had not pursued such a strategy, or at least not to the same degree as Fannie Mae. During the 1997–99 period, Freddie Mac's purchases of prior-year mortgages and newly-originated mortgages had similar percentages of special affordable (and low-mod) borrowers. Over time, there have been small differentials between Freddie Mac's prior-year and newly-originated mortgages for the underserved areas category but they have been smaller than the differentials for Fannie Mae (*see* Table A.11).

d. GSEs' Annual Purchases of Home Loans—Origination-Year Basis

Table A.16 reports GSE purchase data for 1996 to 2002 on an origination-year basis. Recall that in this case, mortgages purchased by a GSE in any particular calendar year are allocated to the year that the mortgage was originated, rather than to the year that the mortgage was purchased (as in subsections C.1–C.3 above). This approach places the GSE and the market data on a consistent, current-year basis, as explained earlier.

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Table A.16

Annual Trends in GSE Purchases and Single-Family Lending in Metropolitan Areas Goal-Qualifying Home Purchase Mortgages 1996-2002 GSE Data Reported on an Origination-Year Basis[1]

Borrower and Tract Characteristics	Fannie Mae Purchases	Freddie Mac Purchases	Ratio of Fannie Mae to Freddie Mac	Conventional Conforming Market Originations (W/O B&C)	Ratio of GSE to Market (W/O B&C) Fannie Mae	Ratio of GSE to Market (W/O B&C) Freddie Mac
Special Affordable						
1996	11.5	9.4	1.22	15.0	0.77	0.63
1997	11.2	10.0	1.12	15.2	0.74	0.66
1998	12.3	12.2	1.01	15.4	0.80	0.79
1999	13.1	14.0	0.94	17.0	0.77	0.82
2000	13.7	14.0	0.98	16.8	0.82	0.83
2001	14.4	13.5	1.07	15.6	0.92	0.87
2002 [2]	15.8	15.8	1.00	16.3	0.97	0.97
1996-2002	13.3	12.9	1.03	16.0	0.83	0.81
1999-2002	14.3	14.3	1.00	16.4	0.87	0.87
2000-2002	14.7	14.4	1.02	16.2	0.91	0.89
Less Than Area Median Income						
1996	38.5	34.5	1.12	42.2	0.91	0.82
1997	37.9	35.7	1.06	42.5	0.89	0.84
1998	39.7	38.8	1.02	42.8	0.93	0.91
1999	41.0	42.3	0.97	44.8	0.92	0.94
2000	41.4	41.3	1.00	44.4	0.93	0.93
2001	42.3	40.6	1.04	42.9	0.99	0.95
2002 [2]	45.4	44.4	1.02	45.2	1.00	0.98
1996-2002	41.2	40.0	1.03	43.6	0.94	0.92
1999-2002	42.6	42.1	1.01	44.3	0.96	0.95
2000-2002	43.1	42.1	1.02	44.2	0.98	0.95
Underserved Areas						
1996	23.3	19.6	1.19	24.9	0.94	0.79
1997	21.8	19.7	1.11	24.9	0.88	0.79
1998	21.2	20.0	1.06	24.2	0.88	0.83
1999	21.3	21.5	0.99	25.2	0.85	0.85
2000	23.4	22.2	1.05	26.4	0.89	0.84
2001	23.8	22.4	1.06	25.2	0.94	0.89
2002 [2]	25.5	25.0	1.02	26.4	0.97	0.95
1996-2002	23.0	21.6	1.06	25.4	0.91	0.85
1999-2002	23.6	22.8	1.04	25.8	0.91	0.88
2000-2002	24.3	23.2	1.05	26.0	0.93	0.89

Source: See text and notes to previous tables for variable definitions and market methodology.

[1] In this table, GSE data are reported on an "origination-year" basis rather than on a "purchase-year" basis (as are the previous tables on home purchase loans). This means that prior-year loans that the GSEs purchase in a particular calendar year are allocated back to their year of origination. For example, mortgages originated in 2000 but purchased by the GSEs in 2002 would be allocated to 2000 (the year of origination). Thus, the GSE percentages for 2000 represent GSE purchases (in 2000 and in 2001 and in 2002) of mortgages originated in 2000. For this reason, the GSE data in this table are more consistent with the market data. Market percentages are for current-year mortgage originations, based on HMDA data.

[2] The data for 2002 represent only the GSEs' purchases during 2002 of mortgages originated during 2002, as there are not yet any subsequent years in which to report originations. Of course, during 2003 (and during following years), the GSEs will purchase subsequent years in which to report originated in 2002, which would at that time be incorporated into the data for the year 2002.

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In general, the comparisons of Freddie Mac's and the market's performance are similar to those discussed in Sections E.9.a–c above, except for some differences on the special affordable category. The ''Freddie Mac to market'' ratios in Table A.16 show that Freddie Mac has improved its performance but has also consistently lagged the primary market in funding mortgages covered by the housing goals.

The ''Fannie Mae to market'' ratios in Table A.16 show that Fannie Mae has improved its performance, and has generally outperformed Freddie Mac, but has lagged the primary market in funding mortgages covered by the housing goals. Under the origination-year approach, Fannie Mae lagged the market on all three housing goal categories during 2001 and on the special affordable and underserved area categories during 2002. In 2002, low- and moderate-income loans accounted for 45.4 percent of Fannie Mae's purchases and 45.2 percent of the market originations, placing Fannie Mae 0.2 percentage points above the market.

e. GSEs' Purchases of First-Time Homebuyer Mortgages—1999 to 2001

While not a specific housing goal category, mortgages for first-time homebuyers are an important component of the overall home loan market. Making financing available for first-time homebuyers is one approach for helping young families enter the homeownership market. Therefore, this section briefly compares the GSEs' funding of first-time homebuyer loans with that of primary lenders in the conventional conforming market.

During the past few years, the GSEs have increased their purchases of first-time homebuyer loans. Fannie Mae's annual purchases of first-time homebuyer loans increased from approximately 287,000 in 1999 to 373,000 in 2002, while Freddie Mac's annual purchases increased from 199,000 to 259,000 during the same period.[262] However, since 1999, the first-time homebuyer share of the GSEs' purchases of home loans has remained relatively flat, varying within the 25–28 percent range.[263]

Table A.17 compares the first-time homebuyer share of GSE purchases with the corresponding share of home loans originated in the conventional conforming market. Readers are referred to recent work by Bunce and Gardner[264] for the derivation of the estimates of first-time homebuyer market shares reported in Table A.17. This analysis does not include year 2002 data because market data from the American Housing Survey are not yet available for that year. Between 1999 and 2001, first-time homebuyers accounted for 26.5 percent of Fannie Mae's purchases of home loans, 26.5 percent of Freddie Mac's, and 37.6 percent of home loans originated in the conventional conforming market. Thus, both Fannie Mae and Freddie Mac fell substantially short of the primary market in financing first-time homebuyers during this time period. The GSEs' performance was only 70.5 percent of market performance (26.5 percent divided by 37.6 percent).

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[262] These figures include estimates of first-time homebuyer loans for those home purchase loans with a missing first-time homebuyer indicator; the estimates were obtained by multiplying the GSE's first-time homebuyer share (based only on data with a first-time homebuyer indicator) by the number of loans with a missing first-time homebuyer indicator.

[263] The first-time homebuyer share for Fannie Mae was almost 35 percent between 1996 and 1998; it then dropped to 30 percent in 1998 and to 26 percent in 1999. The first-time homebuyer share for Freddie Mac was approximately 29 percent in 1996 and 1997 before dropping to about 25 percent in 1998 and 1999.

[264] See Harold L. Bunce and John L. Gardner, ''First-time Homebuyers in the Conventional Conforming Market: The Role of the GSEs'' (unpublished paper), January 2004.

Table A.17

First-Time Homebuyer Mortgages as a Share of All Conventional Conforming Home Purchase Mortgages, for GSEs' Purchases and Market Originations, 1999-2001 And 1996-2001 Averages

1999-2001 Averages	Fannie Mae	Freddie Mac	Both GSEs	Conventional Conforming Market
All First-Time Homebuyers	26.5%[1]	26.5%	26.5%	37.6%[3]
African-American and Hispanic First-Time Homebuyers	4.0%	3.4%	3.8%	6.9%
Minority First-Time Homebuyers	6.6%[2]	5.8%	6.2%	10.6%[4]
1996-2001 Averages				
All First-Time Homebuyers	29.3%	26.9%	28.3%	38.4%
African-American and Hispanic First-Time Homebuyers	4.3%	3.1%	3.8%	6.8%
Minority First-Time Homebuyers	6.9%	5.3%	6.3%	10.2%

Notes: These data cover the entire U.S. (i.e., both metropolitan and non-metropolitan areas).
The first-time homebuyer concept for the market analysis is homebuyers who have never owned a home.
The concept for the GSEs is purchasers who have not owned a home within the past three years. The market analysis is based on GSE, HMDA, and American Housing Survey data. See Bunce and Gardner (2004) for the methodology for estimating the market first-time homebuyer percentages. Because the percentages for the GSEs include seasoned loans and the market ratios include only current-year mortgage originations, the GSE ratios tend to overstate the GSEs' business shares in each category, compared to mortgage origination activity in a given year.

Interpretations:

[1] First-time homebuyer mortgages were 26.5% of all home purchase mortgages purchased by Fannie Mae in 1999-2001.

[2] Minority first-time homebuyer mortgages were 6.6% of all home purchase mortgages purchased by Fannie Mae in 1999-2001.

[3] First-time homebuyer mortgages were 37.6% of all home purchase mortgage originations in the conventional conforming market during 1999-2001.

[4] Minority first-time homebuyer mortgages were 10.6% of all home purchase mortgage origintions in the conventional conforming market during 1999-2001.

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Table A.17 also reports first-time homebuyer shares for African Americans and Hispanics and for all minorities. Between 1999 and 2001, African-American and Hispanic first-time homebuyers accounted for 4.0 percent of Fannie Mae's purchases of home loans, 3.4 percent of Freddie Mac's purchases, and 6.9 percent of home loans originated in the conventional conforming market. For this subgroup, Fannie Mae's performance is 58 percent of market performance, while Freddie Mac's performance is 49 percent of market performance. The group of all minority first-time homebuyers accounted for 6.6 percent of Fannie Mae's purchases of home loans, 5.8 percent of Freddie Mac's purchases, and 10.6 percent of home loans originated in the conventional conforming market. In this case, Fannie Mae's performance is 62 percent of market performance, while Freddie Mac's performance is 55 percent of market performance.

Section E.12 below will continue this examination of first-time homebuyers by presenting market share analysis that estimates the GSEs' overall importance in the funding of first-time homebuyers.

f. Low- and Moderate-Income Subgoal for Home Purchase Loans

The Department is proposing to establishing a subgoal of 45 percent for each GSE's purchases of home purchase loans for low- and moderate-income families in the single-family-owner market of metropolitan areas for 2005, with the proposed subgoal rising to 46 percent for 2006 and 47 percent for 2007 and 2008. If the GSEs meet this subgoal, they will be leading the primary market by approximately one percentage point in 2005 and by three percentage points in 2007–08, based on historical data (*see* below). This *home purchase* subgoal will encourage the GSEs to expand homeownership opportunities for lower-income homebuyers who are expected to enter the housing market over the next few years. As detailed in Section I, there are four specific reasons for establishing this subgoal: (1) The GSEs have the expertise, resources, and ability to lead the single-family-owner market, which is their ''bread and butter'' business; (2) the GSEs have historically lagged the primary market for low- and moderate-income loans, not lead it; (3) the GSEs can improve their funding of first-time homebuyers and help reduce troublesome disparities in homeownership and access to mortgage credit; and (4) there are ample opportunities for the GSEs to expand their purchases in important and growing market segments such as the market for minority first-time homebuyers. Sections E.9 and G of this appendix provide additional information on opportunities for an enhanced GSE role in the home purchase market and on the ability of the GSEs to lead that market.

As shown in Tables A.13 and A.15, low- and moderate-income families accounted for an average of 44.3 percent of home purchase loans originated in the conventional conforming market of metropolitan areas between 1999 and 2002; the figure is 43.6 percent if the average is computed for the years between 1996 and 2002. Loans in the B&C portion of the subprime market are excluded from these market averages. To reach the proposed 45-percent subgoal for 2005, both GSEs would have to improve their historical performance—Fannie Mae by 0.8 percentage points over its average performance of 44.2 percent in 2001 and 2002, and Freddie by 2.4 percentage points over its average performance of 42.6 percent during the same period. To reach the 47 percent subgoal in 2007–08, each GSE's performance would have to increase by an additional two percentage points.

As explained earlier, HUD will be re-benchmarking its median incomes for metropolitan areas and non-metropolitan counties based on 2000 Census median incomes, and will be incorporating the effects of the new OMB metropolitan area definitions. As explained in Appendix D, HUD projected the effects of these two changes on the low- and moderate-income shares of the single-family-owner market for the years 1999–2002. These estimates will be referred to as ''projected data'' while the 1990-based data reported in the various tables will be referred to as ''historical data.'' With the historical data, the average low-mod share of the conventional conforming market (without B&C loans) was 44.3 percent for home purchase loans (weighted average of 1999–2002 percentages in Table A.13); the corresponding average with the projected data was 43.1 percent, a differential of 1.2 percentage points. The projected low-mod percentages for each year between 1999 and 2002 were as follows (with the historical percentages from Table A.15 in parentheses): 44.0 (44.8) percent for 1999; 43.7 (43.7) percent for 2000; 41.6 (42.9) percent for 2001; and 43.1 (45.2) percent for 2002. The differentials between the projected and historical data are larger in 2001 (1.3 percentage points) and 2002 (2.1 percentage points) than in 1999 (0.8 percentage point) and 2000 (0.7 percentage point). It appears that the low-mod share for single-family-owners in the conventional conforming market will be at least one percentage point less due to the re-benchmarking of area median incomes and the new OMB definitions of metropolitan areas. Thus, based on projected data, the 45-percent (47 percent) subgoal for 2005 (2007) is approximately two (four) percentage points above the 1999–2002 market average.

The estimated low-mod percentages between 1999 and 2002 for Fannie Mae were as follows (with the historical percentages from Table A.15 in parentheses): 39.2 (40.0) percent for 1999; 40.1 (40.8) percent for 2000; 41.7 (42.9) percent for 2001; and 43.6 (45.3) percent for 2002; Fannie Mae's average low-mod performance between 1999 and 2002 based on the projected data was 41.4 percent, compared with 42.5 percent based on historical data. To reach the 45-percent subgoal (47 percent) subgoal for 2005 (2007) based on projected data, Fannie Mae would have to improve its performance by 2.3 (4.3) percentage points over its estimated average performance of 42.7 percent in 2001 and 2002, or by 1.4 (3.4) percentage points over its estimated 2002 low-mod performance of 43.6 percent.

The estimated low-mod percentages between 1999 and 2002 for Freddie Mac were as follows (with the historical percentages from Table A.15 in parentheses): 40.0 (40.8) percent for 1999; 41.7 (42.7) percent for 2000; 39.8 (41.3) percent for 2001; and 42.1 (44.0) percent for 2002; Freddie Mac's average low-mod performance between 1999 and 2002 based on the projected data was 40.9 percent, compared with 42.3 percent based on historical data. To reach the 45-percent subgoal based on projected data, Freddie Mac would have to improve its performance by 4.0 percentage points over its projected average performance of 41.0 percent in 2001 and 2002, or by 2.9 percentage points over its projected 2002 low-mod performance of 42.1 percent.

The subgoal applies only to the GSEs' purchases in metropolitan areas because the HMDA-based market benchmark is only available for metropolitan areas. HMDA data for non-metropolitan areas are not reliable enough to serve as a market benchmark. The Department is also setting home purchase subgoals for the other two goals-qualifying categories, as explained in Appendices B and C.

10. GSEs Purchases of Total (Home Purchase and Refinance) Loans

Section E.9 examined the GSEs' acquisitions of home purchase loans, which is appropriate given the importance of the GSEs for expanding homeownership opportunities. To provide a complete picture of the GSEs' mortgage purchases in metropolitan areas, Tables A.18, A.19, A.20, and A.21 report the GSEs' purchases of all single-family-owner mortgages, including both home purchase loans and refinance loans.[265]

Table A.18 provides a long-run perspective on the GSEs' overall performance. Between 1993 and 2002, as well as during the 1996–2002 period, each GSE's performance was 80–86 percent of market performance for the special affordable category, 91–95 percent of market performance for the low-mod category, and 88–92 percent of market performance for the underserved areas category. For example, between 1996 and 2002, underserved areas accounted for 23.2 percent of Fannie Mae's purchases and 22.4 percent of Freddie Mac's purchases, compared with 25.5 percent for the conventional conforming market (without B&C loans). Similarly, for special affordable loans, both GSEs lagged the market during the 1996–2002 period—Fannie Mae and Freddie Mac averaged approximately 13.0 percent while the market was over two percentage points higher at 15.2 percent.

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[265] The GSE total (home purchase and refinance) data in Tables A.18–A.20 are presented on a purchase-year basis; Table A.21 presents similar data on an origination-year basis.

Table A.18

GSE Purchases and Single-Family Lending in Metropolitan Areas
Goal-Qualifying Home Purchase and Refinance Mortgages, 1993-2002

Borrower and Tract Characteristics	Fannie Mae	Freddie Mac	Ratio of Fannie Mae to Freddie Mac	Conventional Conforming Market		Ratio of GSE to Market (W/O B&C)	
				Total	(W/O B&C Loans)	Fannie Mae	Freddie Mac
Special Affordable							
1993-2002	11.9 %	11.5 %	1.03	15.0 %	14.4 %	0.83	0.80
1993-1995	8.3	7.2	1.15	11.6	11.4	0.73	0.63
1996-2002	13.0	12.7	1.02	15.9	15.2	0.86	0.84
1999-2002	13.8	13.8	1.00	16.3	15.7	0.88	0.88
2000-2002	14.2	13.9	1.02	15.8	15.3	0.93	0.91
Less than Area Median Income							
1993-2002	38.7 %	37.5 %	1.03	42.1 %	41.3 %	0.94	0.91
1993-1995	33.0	31.0	1.06	37.0	36.8	0.90	0.84
1996-2002	40.3	39.4	1.02	43.5	42.6	0.95	0.92
1999-2002	41.5	40.9	1.01	44.2	43.3	0.96	0.94
2000-2002	42.1	40.8	1.03	43.7	42.9	0.98	0.95
Underserved Areas							
1993-2002	22.9 %	21.9 %	1.05	25.9 %	25.0 %	0.92	0.88
1993-1995	21.9	20.3	1.08	23.5	23.2	0.94	0.88
1996-2002	23.2	22.4	1.04	26.5	25.5	0.91	0.88
1999-2002	23.8	23.1	1.03	26.7	25.7	0.93	0.90
2000-2002	24.3	23.1	1.05	26.3	25.4	0.96	0.91

Source: The Fannie Mae and Freddie Mac data include information on all their single-family-owner mortgage purchases from the loan-level data that they provide to HUD. All mortgages are conventional conforming mortgages. "Conventional Conforming Market" data are from HMDA; loans with a loan-to-income ratio greater than six are excluded from the borrower income calculations. The numbers in the "W/O B&C Loans" column are the average market percentages after deducting B&C loans from the adjacent "Total" market column (see text for explanation). Special affordable includes very low-income borrowers and low-income borrowers in low-income census tracts. Data with missing values are excluded.

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Similar to the patterns discussed for home purchase loans, Fannie Mae has tended to outperform Freddie Mac. This can be seen by examining the various ''Fannie-Mae-to-Freddie-Mac'' ratios in Table A.18, which are all equal to or greater than one. Over the recent 1999–2002 period, Fannie Mae and Freddie Mac continued to lag the overall market on all three goals-qualifying categories. Special affordable (underserved area) loans averaged 13.8 (23.8) percent of Fannie Mae's purchases, 13.8 (23.1) percent of Freddie Mac's purchases, and 15.7 (25.7) percent of market originations. Considering both GSEs, the market ratio was 0.88 for special affordable loans, approximately 0.95 for low-mod loans, and slightly over 0.90 for underserved area loans. As with home purchase loans, dropping the year 1999 and characterizing recent performance by the 2000–2002 period improves the performance of both GSEs relative to the market, but particularly Fannie Mae. Over the 2000–2002 period, the ''Fannie-Mae-to-market'' ratio was 0.93 for Special Affordable loans, 0.98 for low-mod loans, and 0.96 for underserved area loans.

The above analysis has defined the market to exclude B&C loans. Table A.19 shows the effects on the market percentages of different definitions of the conventional conforming market. For example, the average 1999–2002 market share for special affordable (underserved areas) loans would fall to 15.1 (25.3) percent if manufactured housing loans in metropolitan areas were excluded from the market definition along with B&C loans. In this case, the market ratio for Fannie Mae (Freddie Mac) would be was 0.91 (0.91) for special affordable loans, 0.97 (0.96) for low-mod loans, and 0.94 (0.91) for underserved area loans.

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Table A.19

Annual Trends in GSE Purchases and Single-Family Lending in Metropolitan Areas
Goal-Qualifying Home Purchase and Refinance Mortgages, 1996-2002
Various Market Definitions

			Conventional Conforming Market Originations						
Borrower and Tract Characteristics	Fannie Mae Purchases	Freddie Mac Purchases	Total Market	W/O Mfg and Less Than $15K Loans	W/O Subprime Loans	W/O B&C Loans	W/O B&C and Mfg Loans	W/O B&C and LT $15K Loans	W/O B&C, Mfg, and LT $15K
Special Affordable									
1996	10.5	9.4	15.3	13.7	14.4	14.8	13.7	14.1	13.2
1997	11.5	10.1	16.4	14.8	14.8	15.6	14.5	15.0	14.0
1998	11.1	11.0	14.2	13.2	12.6	13.5	12.7	13.1	12.4
1999	12.4	13.4	18.3	17.0	16.1	17.3	16.2	16.9	15.9
2000	14.5	16.1	19.3	18.0	17.1	18.3	17.3	17.7	16.9
2001	13.9	13.3	15.0	14.4	13.9	14.5	14.1	14.2	13.9
2002	14.3	13.6	15.1	14.8	14.2	14.6	14.5	14.5	14.4
1996-2002	13.0	12.7	15.9	15.0	14.4	15.2	14.5	14.8	14.2
1999-2002	13.8	13.8	16.3	15.6	14.9	15.7	15.1	15.3	14.9
2000-2002	14.2	13.9	15.8	15.3	14.6	15.3	14.8	15.0	14.6
Less Than Area Median Income									
1996	37.0	34.8	42.4	40.4	41.4	41.9	40.5	41.2	39.8
1997	38.0	36.1	43.7	41.8	41.9	42.9	41.4	42.2	40.8
1998	37.4	36.7	40.9	39.6	38.9	39.9	38.9	39.5	38.6
1999	39.3	41.2	46.3	44.7	43.7	45.1	43.8	44.6	43.4
2000	42.3	44.3	47.4	45.9	44.9	46.3	45.1	45.6	44.6
2001	41.7	40.2	42.3	41.6	40.9	41.6	41.2	41.3	40.9
2002	42.2	40.1	43.2	42.9	41.9	42.6	42.4	42.4	42.2
1996-2002	40.3	39.4	43.5	42.3	41.7	42.6	41.8	42.2	41.4
1999-2002	41.5	40.9	44.2	43.3	42.4	43.3	42.7	43.0	42.4
2000-2002	42.1	40.8	43.7	42.9	42.1	42.9	42.5	42.6	42.1
Underserved Areas									
1996	22.9	20.7	26.7	25.3	25.3	26.0	25.0	25.6	24.6
1997	23.3	21.4	27.8	26.6	25.5	26.7	25.7	26.3	25.3
1998	21.1	20.8	24.8	23.9	22.4	23.6	23.0	23.4	22.7
1999	21.7	23.3	28.2	27.3	25.4	26.9	26.1	26.7	25.9
2000	25.2	24.6	30.3	29.4	27.3	28.9	28.2	28.6	27.9
2001	24.2	22.5	25.7	25.3	23.9	24.9	24.6	24.7	24.4
2002	24.0	22.9	25.2	25.0	23.4	24.3	24.2	24.2	24.1
1996-2002	23.2	22.4	26.5	25.8	24.3	25.5	24.9	25.2	24.7
1999-2002	23.8	23.1	26.7	26.2	24.5	25.7	25.3	25.5	25.1
2000-2002	24.3	23.1	26.3	25.9	24.3	25.4	25.1	25.2	24.9

Source: The Fannie Mae and Freddie Mac percentages are based on the loan-level data that they provide to HUD. All mortgages are conventional conforming home purchase and refinance mortgages. The Conventional Conforming Market data are from HMDA; loans with a loan-to-income-ratio greater than six are excluded from all borrower income calculations. See the text for an explanation of the adjustments for manufactured housing (Mfg), subprime, and B&C loans. Special affordable includes very low-income borrowers and low-income borrowers living in low-income census tracts. Data with missing values are excluded.

Shifts in performance occurred during 2001 and 2002, the first two years under HUD's higher housing goal targets. Table A.20 shows that both GSEs improved their overall performance between 1999 and 2000, but they each fell back a little during the heavy refinancing year of 2001. But the primary market (without B&C loans) experienced a much larger decline in affordable lending during the refinancing wave than did either of the GSEs. Fannie Mae stood out in 2001 because of its particularly small decline in affordable lending. Between 2000 and 2001, Fannie Mae's special affordable lending fell by only 0.6 percentage points while Freddie Mac's fell by 2.8 percentage points and the market's fell by 3.8 percentage points. The corresponding percentage point declines for the underserved areas category were 1.0 for Fannie Mae, 1.9 for Freddie Mac, and 4.0 for the market. By the end of 2001, Fannie Mae led Freddie Mac in all three goals-qualifying categories, and had erased its gap with the low-mod market, but continued to lag the market on the special affordable and underserved areas categories.

Table A.20

Annual Trends in GSE Purchases and Single-Family Lending in Metropolitan Areas Goal-Qualifying Home Purchase and Refinance Mortgages, 1997-2002

Borrower and Tract Characteristics	Fannie Mae Purchases	Freddie Mac Purchases	Ratio of Fannie Mae to Freddie Mac	Conventional Conforming Market Originations (W/O B&C)	Ratio of GSE to Market (W/O B&C) Fannie Mae	Ratio of GSE to Market (W/O B&C) Freddie Mac
Special Affordable Borrower						
1997	11.5	10.1	1.14	15.6	0.74	0.65
1998	11.1	11.0	1.01	13.5	0.82	0.81
1999	12.4	13.4	0.93	17.3	0.72	0.77
2000	14.5	16.1	0.90	18.3	0.79	0.88
2001	13.9	13.3	1.05	14.5	0.96	0.92
2002	14.3	13.6	1.05	14.6	0.98	0.93
Less Than Area Median Income Borrower						
1997	38.0	36.1	1.05	42.9	0.89	0.84
1998	37.4	36.7	1.02	39.9	0.94	0.92
1999	39.3	41.2	0.95	45.1	0.87	0.91
2000	42.3	44.3	0.95	46.3	0.91	0.96
2001	41.7	40.2	1.04	41.6	1.00	0.97
2002	42.2	40.1	1.05	42.6	0.99	0.94
Underserved Areas						
1997	23.3	21.4	1.09	26.7	0.87	0.80
1998	21.1	20.8	1.01	23.6	0.89	0.88
1999	21.7	23.3	0.93	26.9	0.81	0.87
2000	25.2	24.6	1.02	28.9	0.87	0.85
2001	24.2	22.5	1.08	24.9	0.97	0.90
2002	24.0	22.9	1.05	24.3	0.99	0.94

Source: Special affordable includes very low-income borrowers plus low-income borrowers living in low-income census tracts. Very low-income (low-income) is defined as income less than or equal to 60 (80) percent of area median income. An underserved area is defined as a census tract with median income at or below 90 percent of the area median income; or a census tract with median income at or below 120 percent of the median inocme areas and a minority population of 30 percent or greater. Data with missing values are excluded.

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During the refinancing wave of 2002, Fannie Mae improved slightly on the special affordable and low-mod categories and declined slightly on the underserved area category. Freddie Mac showed slight improvement on the special affordable and underserved area categories and remained about the same on the low-mod category. The market showed the same pattern as Fannie Mae. The end result of these changes can be seen by considering the market ratios in Table A.20. In 2002, special affordable loans accounted for 14.3 percent of Fannie Mae's purchases and 14.6 percent of loans originated in the non-B&C portion of the conventional conforming market, yielding a ''Fannie-Mae-to-market'' ratio of 0.98. Since Fannie Mae's market ratio for the special affordable category stood at 0.79 in 2000, Fannie Mae substantially closed its gap with the market during 2001 and 2002. During this period, Fannie Mae also mostly eliminated its market gap for the other two goals-qualifying categories. In 2002, underserved area loans accounted for 24.0 percent of Fannie Mae's purchases and 24.3 percent of loans originated in the non-B&C portion of the conventional conforming market, yielding a ''Fannie-Mae-to-market'' ratio of 0.99, or approximately one. During 2002, low-mod loans accounted for 42.2 percent of Fannie Mae's purchases and 42.6 percent of loans originated in the market, yielding a ''Fannie-Mae-to-market'' ratio of 0.99, or approximately one (also note that Fannie Mae slightly outperformed the low-mod market during 2001). Thus, while Fannie Mae continued to lag the market in 2002 on each of the three goals-qualifying categories, it was close to the market on the low-mod and underserved area categories, in particular.

Freddie Mac significantly lagged the single-family (home purchase and refinance loans combined) market during 2001 and 2002. In 2002, the ''Freddie-Mac-to-market'' ratios were 0.93 for special affordable loans, 0.94 for low-mod loans, and 0.94 for underserved area loans.

Subprime Loans. Table A.14 in Section E.9 showed that the goals-qualifying shares of the home purchase market did not change much when originations by subprime lenders are excluded from the analysis; the reason is that subprime lenders operate primarily in the refinance market. Therefore, in this section's analysis of the total market (including refinance loans), one would expect the treatment of subprime lenders to significantly affect the market estimates and, indeed, this is the case. For the year 2001, excluding subprime loans reduced the goal-qualifying shares of the *total* market as follows: special affordable, from 15.0 to 13.9 percent; low-mod, from 42.3 to 40.9 percent; and underserved areas, from 25.7 to 23.9 percent. (*See* Table A.19.) Similar declines take place in 2002.

As explained earlier, the comparisons in this appendix have defined the market to exclude the B&C portion of the subprime market. Industry observers estimate that A-minus loans account for about two-thirds of all subprime loans while the more risky B&C loans account for the remaining one-third. As explained earlier, this analysis reduces the goal-qualifying percentages from the HMDA data by half the differentials between (a) the market (unadjusted) and (b) the market without the specialized subprime lenders identified by Scheessele. As shown in Table A.19, accounting for B&C loans in this manner reduces the year 2001 HMDA-reported goal-qualifying shares of the total (home purchase and refinance) conforming market as follows: special affordable, from 15.0 to 14.5 percent; low-mod, from 42.3 to 41.6 percent; and underserved areas, from 25.7 to 24.9 percent. Obviously, the GSEs' performance relative to the market will depend on which market definition is used (much as it did with the earlier examples of excluding manufactured housing loans in metropolitan areas from the market definition). For example, defining the conventional conforming market to exclude subprime loans, rather than only B&C loans, would increase Fannie Mae's 2002 special affordable (underserved area) market ratio from 0.98 to 1.01 (0.99 to 1.03). Similarly, it would increase Freddie Mac's special affordable (underserved area) market ratio from 0.93 to 0.96 (0.94 to 0.98). For the broader-defined low-mod category, redefining the market to exclude subprime loans, rather than only B&C loans, would increase Fannie Mae's (Freddie Mac's) market ratio from 0.99 to 1.01 (0.94 to 0.96).

Table A.21 reports GSE purchase data for total (home purchase and refinance) loans on an origination-year basis. The ''Freddie Mac-to-market'' ratios in Table A.21 show that Freddie Mac has lagged the primary market in funding mortgages covered by the housing goals. The ''Fannie Mae-to-market'' ratios in Table A.21 show that except for the low-mod category in 2002 Fannie Mae has lagged the primary market in funding home purchase and refinance mortgages covered by the housing goals.

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Table A.21

Annual Trends in GSE Purchases and Single-Family Lending in Metropolitan Areas
Goal-Qualifying Home Purchase and Refinanace Mortgages
1996-2002 GSE Data Reported on an Origination-Year Basis1

Borrower and Tract Characteristics	Fannie Mae Purchases	Freddie Mac Purchases	Ratio of Fannie Mae to Freddie Mac	Conventional Conforming Market Originations (W/O B&C)	Ratio of GSE to Market (W/O B&C)	
					Fannie Mae	Freddie Mac
Special Affordable						
1996	11.4	9.9	1.15	14.8	0.77	0.67
1997	11.1	10.7	1.04	15.6	0.71	0.69
1998	10.7	11.4	0.94	13.5	0.79	0.84
1999	13.9	15.0	0.93	17.3	0.80	0.87
2000	14.8	15.9	0.93	18.3	0.81	0.87
2001	13.4	12.7	1.06	14.5	0.92	0.88
2002 [2]	14.4	13.5	1.07	14.6	0.99	0.92
1996-2002	13.0	12.8	1.02	15.2	0.86	0.84
1999-2002	14.0	13.8	1.01	15.7	0.89	0.88
2000-2002	14.0	13.6	1.03	15.3	0.92	0.89
Less Than Area Median Income						
1996	38.2	35.6	1.07	41.9	0.91	0.85
1997	37.6	36.7	1.02	42.9	0.88	0.86
1998	36.7	37.3	0.98	39.9	0.92	0.93
1999	41.5	43.3	0.96	45.1	0.92	0.96
2000	42.8	43.8	0.98	46.3	0.92	0.95
2001	41.1	39.3	1.05	41.6	0.99	0.94
2002 [2]	42.8	40.3	1.06	42.6	1.00	0.95
1996-2002	40.4	39.5	1.02	42.6	0.95	0.93
1999-2002	42.0	41.0	1.02	43.3	0.97	0.95
2000-2002	42.1	40.4	1.04	42.9	0.98	0.94
Underserved Areas						
1996	23.7	21.0	1.13	26.0	0.91	0.81
1997	22.1	21.5	1.03	26.7	0.83	0.81
1998	20.5	21.2	0.97	23.6	0.87	0.90
1999	22.8	24.3	0.94	26.9	0.85	0.90
2000	25.4	25.2	1.01	28.9	0.88	0.87
2001	23.6	22.4	1.05	24.9	0.95	0.90
2002 [2]	23.7	22.3	1.06	24.3	0.98	0.92
1996-2002	23.0	22.4	1.03	25.5	0.90	0.88
1999-2002	23.7	23.1	1.03	25.7	0.92	0.90
2000-2002	23.9	22.8	1.05	25.4	0.94	0.90

Source: See text and notes to previous tables for variable definitions and market methodology.

[1] In this table, GSE data are reported on an "origination-year" basis rather than on a "purchase-year" basis (as are the previous tables on home purchase and refinance loans). This means that prior-year loans that the GSEs purchase in a particular calendar year are allocated back to their year of origination. For example, mortgages originated in 2000 but purchased by the GSEs in 2002 would be allocated to 2000 (the year of origination). Thus, the GSE percentages for 2000 represent GSE purchases (in 2000 and in 2001 and in 2002) of mortgages originated in 2000. For this reason, the GSE data in this table are more consistent with the market data. Market percentages are for current-year mortgage originations, based on HMDA data.

[2] The data for 2002 represent only the GSEs' purchases during 2002 of mortgages originated during 2002, as there are not yet any subsequent years in which to report originations to report. Of course, during 2003 (and during following years), the GSEs will purchase prior-year loans originated in 2002, which would at that time be incorporated into the data for the year 2002.

11. GSE Mortgage Purchases in Individual Metropolitan Areas

While the above analyses, as well as earlier studies, concentrate on national-level data, it is also instructive to compare the GSEs' purchases of mortgages in individual metropolitan areas (MSAs). In this section, the GSEs' purchases of single-family owner-occupied home purchase loans are compared to the market in individual MSAs. There are three steps. *First,* goals-qualifying percentages for conventional conforming mortgage originations (without B&C loans) are computed for each year and for each MSA, based on HMDA data. *Second,* corresponding goals-qualifying percentages are computed for each GSE's purchases for each year and for each MSA. These two sets of percentages are the same as those used in the aggregate analysis discussed in the above sections. *Third,* the ''GSE-to-market'' ratio is then calculated by dividing each GSE percentage by the corresponding market percentage. For example, if it is calculated that one of the GSEs' purchases of low- and moderate-income loans in a particular MSA is 40 percent of their overall purchases in that MSA, while 44 percent of all home loans (excluding B&C loans) in that MSA qualify as low-mod, then the GSE-to-market ratio is 40/44 (or 0.91). The goals-qualifying ratios for Fannie Mae and Freddie Mac can be compared for each MSA in a similar manner.

Tables A.22, A.23, and A.24 summarize the performance of the GSEs within MSAs for 2000, 2001 and 2002 originations of home purchase loans. A GSE's performance is determined to be lagging the market if the ratio of the GSE housing goal loan purchases to their overall purchases is less than 99 percent of that same ratio for the market. (The analysis was conducted where the ''lag'' determination is made at 98 percent instead of 99 percent and the results showed little change.) In the example given in the above paragraph, that GSE would be considered lagging the market. Tables A.22 (2000), A.13 (2001) and A.24 report the number of MSAs in which each GSE under-performs the market with respect to each of the three housing goal categories. The following points can be made from this data:

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Table A.22

Analysis of GSEs' Purchases Across MSAs by Housing Goal Category 2000 Originations

	Underserved Areas		Low-Mod Income		Special Affordable	
Number of MSAs Analyzed	331	100.0%	331	100.0%	331	100.0%
Fannie Mae Lags the Market	296	89.4%	269	81.3%	299	90.3%
Freddie Mac Lags the Market	292	88.2%	282	85.2%	299	90.3%
Fannie Mae Lags Freddie Mac	158	47.7%	126	38.1%	153	46.2%
Freddie Mac Lags Fannie Mae	153	46.2%	190	57.4%	168	50.8%

Source: Fannie Mae and Freddie Mac data are from the loan-level data they provide to HUD. The market data are conforming originations as reported in HMDA data.

Notes: The GSE loans in this analysis include all single-family owner-occupied conventional conforming home purchase mortgages in metropolitan areas (as defined by OMB in 2000) purchased by the GSEs between 2000 and 2002 for loans originated in 2000. Loans with a loan-to-income ratio greater than six are excluded from Low-Mod Income and Special Affordable analyses.

In general, a GSE is determined to lag the market (or lag the other GSE) for a category (i.e., underserved area, low- and moderate-income, or special affordable defined as very low-income occupant or low-income occupant in low-income area) if the ratio of the share of category loans in that GSE's purchases to the share of category loans in market originations (or in the other GSE's purchases) is less than 99%. Exceptions to this procedure are as follows:

If, for loans in a category in an MSA, there are fewer than 5 loans reported in the HMDA data and fewer than 5 loans purchased by each of the GSEs, that MSA is excluded from the analysis for that category.

If, for loans in a category in an MSA, there are fewer than 5 loans reported in the HMDA data and fewer than 5 loans purchased by one of the GSEs, that GSE is counted as not lagging the market in that MSA for that category regardless of the calculated ratio.

If, for loans in a category in an MSA, there are 5 or more loans reported in the HMDA data and fewer than 5 loans purchased by each of the GSEs, then neither GSE is counted as lagging the other GSE in that MSA for that category regardless of the calculated ratio.

Table A.23

Analysis of GSEs' Purchases Across MSAs by Housing Goal Category 2001 Originations

	Underserved Areas		Low-Mod Income		Special Affordable	
Number of MSAs Analyzed	331	100.0%	331	100.0%	331	100.0%
Fannie Mae Lags the Market	267	80.7%	202	61.0%	261	78.9%
Freddie Mac Lags the Market	260	78.5%	275	83.1%	279	84.3%
Fannie Mae Lags Freddie Mac	166	50.2%	83	25.1%	117	35.3%
Freddie Mac Lags Fannie Mae	147	44.4%	223	67.4%	201	60.7%

Source: Fannie Mae and Freddie Mac data are from the loan-level data they provide to HUD. The market data are conforming originations as reported in HMDA data.

Notes: The GSE loans in this analysis include all single-family owner-occupied conventional conforming home purchase mortgages in metropolitan areas (as defined by OMB in 2001) purchased by the GSEs between 2001 and 2002 for loans originated in 2001. Loans with a loan-to-income ratio greater than six are excluded from Low-Mod Income and Special Affordable analyses.

In general, a GSE is determined to lag the market (or lag the other GSE) for a category (i.e., underserved area, low- and moderate-income, or special affordable defined as very low-income occupant or low-income occupant in low-income area) if the ratio of the share of category loans in that GSE's purchases to the share of category loans in market originations (or in the other GSE's purchases) is less than 99%. Exceptions to this procedure are as follows:

If, for loans in a category in an MSA, there are fewer than 5 loans reported in the HMDA data and fewer than 5 loans purchased by each of the GSEs, that MSA is excluded from the analysis for that category.

If, for loans in a category in an MSA, there are fewer than 5 loans reported in the HMDA data and fewer than 5 loans purchased by one of the GSEs, that GSE is counted as not lagging the market in that MSA for that category regardless of the calculated ratio.

If, for loans in a category in an MSA, there are 5 or more loans reported in the HMDA data and fewer than 5 loans purchased by each of the GSEs, then neither GSE is counted as lagging the other GSE in that MSA for that category regardless of the calculated ratio.

Table A.24

Analysis of GSEs' Purchases Across MSAs by Housing Goal Category 2002 Originations

	Underserved Areas		Low-Mod Income		Special Affordable	
Number of MSAs Analyzed	331	100.0%	331	100.0%	331	100.0%
Fannie Mae Lags the Market	248	74.9%	133	40.2%	204	61.6%
Freddie Mac Lags the Market	193	58.3%	234	70.7%	235	71.0%
Fannie Mae Lags Freddie Mac	203	61.3%	73	22.1%	121	36.6%
Freddie Mac Lags Fannie Mae	116	35.0%	237	71.6%	196	59.2%

Source: Fannie Mae and Freddie Mac data are from the loan-level data they provide to HUD. The market data are conforming originations as reported in HMDA data.

Notes: The GSE loans in this analysis include all single-family owner-occupied conventional conforming home purchase mortgages in metropolitan areas (as defined by OMB in 2002) purchased by the GSEs in 2002 for loans originated in 2002. Loans with a loan-to-income ratio greater than six are excluded from Low-Mod Income and Special Affordable analyses.

In general, a GSE is determined to lag the market (or lag the other GSE) for a category (i.e., underserved area, low- and moderate-income, or special affordable defined as very low-income occupant or low-income occupant in low-income area) if the ratio of the share of category loans in that GSE's purchases to the share of category loans in market originations (or in the other GSE's purchases) is less than 99%. Exceptions to this procedure are as follows:

If, for loans in a category in an MSA, there are fewer than 5 loans reported in the HMDA data and fewer than 5 loans purchased by each of the GSEs, that MSA is excluded from the analysis for that category.

If, for loans in a category in an MSA, there are fewer than 5 loans reported in the HMDA data and fewer than 5 loans purchased by one of the GSEs, that GSE is counted as not lagging the market in that MSA for that category regardless of the calculated ratio.

If, for loans in a category in an MSA, there are 5 or more loans reported in the HMDA data and fewer than 5 loans purchased by each of the GSEs, then neither GSE is counted as lagging the other GSE in that MSA for that category regardless of the calculated ratio.

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Fannie Mae's improvement between 2000 and 2002 shows up clearly in these tables. In 2000, Fannie Mae lagged the market in 296 (89 percent) of the 331 MSAs in the purchase of underserved area loans; this number decreased to 267 (81 percent) MSAs in 2001 and to 248 (75 percent) MSAs in 2002. Fannie Mae's improvement was even greater for special affordable and low-mod loans; in the latter case, Fannie Mae lagged the market in 133 (40 percent) MSAs in 2002, compared with 269 (81 percent) MSAs in 2000.

Freddie Mac's improvement between 2000 and 2002 was greater for underserved area loans. In 2000, Freddie Mac lagged the market in 292 (88 percent) of the 331 MSAs in the purchase of underserved area loans; this number decreased to 260 (79 percent) MSAs in 2001 and to 193 (58 percent) MSAs in 2002. Freddie Macs made less improvement on the special affordable and low-mod categories; in the former case, Freddie Mac lagged the market in 234 (71 percent) MSAs in 2002, compared with 282 (85 percent) MSAs in 2000.

Freddie Mac outperformed Fannie Mae during 2002 in 65 percent of the MSAs, even though Freddie Mac's average national performance was below Fannie Mae's in that year (see Table A.16 in Section E.9.d); this suggests that Freddie Mac performs better in small MSAs, as compared with Fannie Mae. This is also consistent with the fact that Fannie Mae lagged the market in 75 percent of the MSAs during 2002, even though its average national performance was only slightly below market performance (see Table A.16); this suggests Fannie Mae does better in large MSAs, as compared with small MSAs.

In its comments on the 2000 Proposed Rule, Fannie Mae raised several concerns about HUD's comparisons between Fannie Mae and the primary market at the metropolitan statistical area level. Essentially, Fannie Mae questioned the relevance of any analysis at the local level, given that the housing goals are national-level goals. HUD believes that its metropolitan-area analyses support and clarify the national analyses on GSE performance. While official goal performance is measured only at the national level, HUD believes that analyses of, for example, the numbers of MSAs where Fannie Mae and Freddie Mac lead or lag the local market increases public understanding of the GSEs' performance. For example, if the national aggregate data showed that one GSE lagged the market in funding loans in underserved areas, it would be of interest to the public to determine if this reflected particularly poor performance in a few large MSAs or if it reflected shortfalls in many MSAs. In this case, an analysis of individual MSA data increases public understanding of that GSE's performance.

12. GSE Market Shares: Home Purchase and First-Time Homebuyer Loans

This section examines the role that the GSEs have played in the overall affordable lending market for home loans. There are two differences from the above analyses in Sections E.9 and E.10. The *first difference* is that this section focuses on ''market share'' percentages rather than ''distribution of business'' percentages. A ''market share'' percentage measures the share of loans with a particular borrower or neighborhood characteristic that is funded by a particular market sector (such as FHA or the GSEs). In other words, a ''market share'' percentage measures a sector's share of all home loans originated for a particular targeted group. The ''market share'' of a sector depends not only on the degree to which that sector concentrates its business on a targeted group (*i.e.*, its ''distribution of business'' percentage) but also on the size, or overall mortgage volume, of the sector. If an industry sector has a large ''market share'' for a targeted group, then that sector is making an important contribution to meeting the credit needs of the group. Both ''distribution of business'' and ''market share'' data are important for evaluating the GSEs'' performance. In fact, given the large size of the GSEs', one would expect that a ''market share'' analysis would highlight their importance to the affordable lending market.

The *second difference* is that this section also examines the role of the GSEs in the total market for home loans, as well as in the conventional conforming market. Such an approach provides a useful context for commenting on the contribution of Fannie Mae and Freddie Mac to overall affordable lending, particularly given evidence that conventional lenders have done a relatively poor job providing credit access to disadvantaged families, which renders the conventional market a poor benchmark for evaluating GSE performance. The analysis of first-time homebuyers conducts the market share analysis in terms of both the total market Section E.12.b) and the conventional conforming market (Section E.12.c).

While the GSEs have accounted for a large share of the overall market for home purchase loans, they have accounted for a very small share of the market for important groups such as minority first-time homebuyers. But as this section documents, the GSEs have been increasing their share of the low-income and minority market, which provides an optimistic note on which to go forward.

Section E.12.a uses HMDA and GSE data to estimate the GSEs' share of home loans originated for low-income and minority borrowers and their neighborhoods. Sections E.12.b and E.12.c summarize recent research on the role of the GSEs in the first-time homebuyer market. Section E.12.d examines the downpayment characteristics of home loans purchased by the GSEs, a potentially important determinant of the GSEs' ability to reach first-time homebuyers.

a. GSEs' Share of Home Purchase Lending

Table A.25 reports market share estimates derived by combining HMDA market data with GSE and FHA loan-level data. To understand these estimates, consider the GSE market share percentage of 46 percent for ''All Home Purchase Loans'' at the bottom of the first column in the table. That market share percentage is interpreted as follows:

It is estimated that home loans acquired by Fannie Mae and Freddie Mac during the years 1999 to 2002, totaled 46 percent of all home loans originated in metropolitan areas during that period.

It should be noted that ''all home loans'' refers to all government (FHA and VA) loans plus all conventional loans less than the conforming loan limit; in other words, only ''jumbo loans'' are excluded from this analysis.[266] The analysis is restricted to metropolitan areas because HMDA data (the source of the market estimates) are reliable only for metropolitan areas. B&C originations are included in the market data, since the purpose here is to gauge the GSEs' role in the overall mortgage market. As discussed in Section E.9, excluding B&C loans, or even all subprime loans, would not materially affect this analysis of the home loan market since subprime loans are mainly for refinance purposes. The analysis below frequently combines purchases by Fannie Mae and Freddie Mac since previous sections have compared their performance relative to each other.

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[266] Following the purchase-year approach used in Sections E.9 and E.10, the GSE purchase data include their acquisitions of ''prior-year'' as well as ''current-year'' mortgages, while the market data include only newly-originated (or ''current year'') mortgages.

Table A.25

FHA-Insured Loans and GSE Purchases as Shares of Home Purchase Mortgages Originated in Metropolitan Areas During 1999-2002

	GSE Purchases 1999-2002	GSE Purchases 2001	GSE Purchases 2002	FHA-Insured 1999-2002
Low-Income Borrowers	37%	40%	43%	26% [1]
African-American and Hispanic Borrowers	29	32	34	33
Low-Income Tracts	34	38	44	26
High Minority Tracts	37	40	45	26
Underserved Areas[2]	36	39	44	25
All Home Purchase Loans	46	48	50	18

Source: 1999, 2000, 2001, and 2002 GSE, FHA, and HMDA data.

Notes: The FHA figures refer to percentages of all newly-mortgaged home purchase mortgage loans (except jumbo loans above the conforming loan limit) in metropolitan areas that were FHA insured during 1999, 2000, 2001, and 2002; the FHA data are from FHA. The GSE figures are defined differently-- they include GSE purchases in metropolitan areas during 1999 to 2002, of 1999-2002 conventional conforming mortgage originations and originations prior to 1999. (About 28% of the GSEs' 1999 purchases were mortgages originated prior to 1999.) Borrower and race percentages are calculated by reallocating missing FHA, GSE, and conventional market data for these variables. FHA had fewer cases with missing data than the GSEs and the market. As with the FHA data, the GSE purchases are expressed as a percentage of the total market in metropolitan areas. In this table, the "total market" includes all (government and conventional) home purchase mortgages originated in metropolitan areas during 1999, 2000, 2001, and 2002 that were below each year's conforming loan limit. The market data assume that HMDA covers 85 percent of the metropolitan mortgage market. A lower coverage assumption would increase the market totals and thus reduce the GSE and FHA market shares.

[1] That is, it is estimated that FHA insured 26 percent of all home purchase loans (below the conforming loan limit) that were originated for low-income borrowers in metropolitan areas during 1999-2002.

[2] Metropolitan census tracts with (1) median income less than or equal to 90 percent of AMI or (2) minority concentration greater than or equal to 30 percent and tract median income less than or equal to 120 percent of AMI.

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The GSE market share percentage for ''Low-Income Borrowers'' at the top of the first column of Table A.25 has a similar interpretation:

It is estimated that home loans for low-income borrowers acquired by Fannie Mae and Freddie Mac between 1999 and 2002 totaled 37 percent of all home loans originated for low-income borrowers in metropolitan areas.

According to the data in Table A.25, the GSEs account for a major portion of the market for targeted groups. For example, purchases by Fannie Mae and Freddie Mac represented 37 percent of the low-income-borrower market and 34–37 percent of the markets in low-income, high-minority, and underserved census tracts. Thus, access to credit in these historically underserved markets depends importantly on the purchase activities of Fannie Mae and Freddie Mac. However, the data in Table A.25 show that the GSEs' role in low-income and minority markets is significantly less than their role in the overall home loan market. Fannie Mae and Freddie Mac accounted for 46 percent of all home loans but only 36 percent of the loans financing properties in underserved neighborhoods. Their market share was even lower for loans to African-American and Hispanic borrowers—29 percent, or 17 percentage points less than the GSEs' overall market share of 46 percent.

An encouraging finding is that the GSEs have increased their presence in the affordable lending market during 2001 and 2002, when they accounted for 38–45 percent of the loans financing properties in low-income, high-minority, and underserved neighborhoods and for 32–34 percent of loans for African-American and Hispanic borrowers. These market share figures for the GSEs are much higher than their performance during the two earlier years, 1999 and 2000.

To provide additional perspective, Table A.25 also reports market share estimates for FHA.[267] During the 1999–2002 period, FHA's overall market share was less than half of the GSEs' market share, as FHA insured only 18 percent of all home mortgages originated in metropolitan areas. However, FHA's share of the underserved segments of the market are not far below the GSEs' share, and in one case actually higher by a significant margin. For instance, between 1999 and 2001, FHA insured 26 percent of all mortgages originated in low-income census tracts, which was only eight percentage points less than the GSEs' market share of 34 percent in low-income census tracts. FHA's share of the market was particularly high for African-American and Hispanic borrowers, as FHA insured 33 percent of all home loans originated for these borrowers between 1999 and 2002—a figure four percentage points higher than the GSEs' share of 29 percent.[268] Thus, during the 1999–2002 period, FHA's overall market share was only two-fifths (39 percent) of the GSEs' combined market share, but its share of the market for loans to African Americans and Hispanics was 14 percent larger than the GSEs' share of that market.

The data for the two recent years (2001 and 2002) indicate a larger market role for Fannie Mae and Freddie Mac relative to FHA. While the GSEs continued to have a much larger share of the overall market than FHA (48–50 percent for the GSEs versus 14–17 percent for FHA), their share of home loans for African Americans and Hispanics jumped to 32–34 percent during 2001 and 2002, which was higher than the percentage share for FHA (27–32 percent). The differentials in market share between FHA and the GSEs on the other affordable lending categories listed in Table A.25 were lower in 2001 and 2002 than in earlier years.

b. The GSEs' Share of the Total First-Time Homebuyer Market

This section summarizes two recent analyses of mortgage lending to first-time homebuyers; these two studies examine the total mortgage market, including both government and conventional loans originated throughout the U.S. (*i.e.*, in both metropolitan areas and non-metropolitan areas). Section E.12.c will summarize a third study of first-time homebuyers that focuses on the conventional conforming market. All three studies are market share studies that examine the GSEs' role in the first-time homebuyer market.

First, a study by Bunce concluded that the GSEs have played a particularly small role in funding minority first-time homebuyers.[269] Because HMDA does not require lenders to report information on first-time homebuyers, Bunce used data from the American Housing Survey to estimate the number of first-time homebuyers in the market. Using American Housing Survey data on home purchases from 1997 to 1999, Bunce estimated that the GSEs' share of the market for first-time African-American and Hispanic homebuyers was only 10–11 percent, or less than one-third of their share (36 percent) of all home purchases during that period. FHA's share of this market was 36 percent, or twice its share (18 percent) of all home purchases.[270] These data highlight the small role that the GSEs have played in the important market for minority first-time homebuyers.

Bunce, Neal and Vandenbroucke (BNV) recently updated through 2001 the study by Bunce. In addition, BNV developed an improved methodology that combined industry, HMDA and AHS data to estimate the number of first-time homebuyers (by race and ethnicity) in the mortgage market during the years 1996 to 2001.[271] BNV's analysis includes the total mortgage

[267] As explained in Section E.7, the GSEs' affordable lending performance is evaluated relative to the conventional conforming market, as required by Congress in the 1992 GSE Act that established the housing goals. However, it is insightful to examine their overall role in the mortgage market and to contrast them with other major sectors of the market such as FHA. There is no intention here to imply that the GSEs should purchase the same types of loans that FHA insures.

[268] As explained in the notes to Table A.25, HMDA data are the source of the market figures. It is assumed that HMDA data cover 85 percent of all mortgage originations in metropolitan areas. If HMDA data covered higher (lower) percentages of market loans, then the market shares for both the GSEs and FHA would be lower (higher).

[269] See Harold L. Bunce, *The GSEs' Funding of Affordable Loans: A 2000 Update,* Housing Finance Working Paper No. HF–013, Office of Policy Development and Research, HUD, April 2002.

[270] Bunce explains numerous assumptions and caveats related to combining American Housing Survey data on homebuyers with FHA and GSE data on mortgages. For example, the American Housing Survey (AHS) data used by Bunce included both financed home purchases and homes purchased with cash. If only financed home purchases were used, the market shares of both FHA and the GSEs would have been slightly higher (although the various patterns would have remained the same). The AHS defines first-time homebuyers as buyers who have never owned a home, while FHA and the GSEs define a first-time homebuyer more expansively as buyers who have not owned a home in the past three years. If it were possible to re-define the FHA and GSE data to be consistent with the AHS data, the FHA and GSE first-time homebuyer shares would be lower (to an unknown degree). For additional caveats with the AHS data, also see David A. Vandenbroucke, Sue G. Neal, and Harold L. Bunce, ''First-Time Homebuyers: Trends from the American Housing Survey,'' November 2001, *U.S. Housing Market Condition,* a quarterly publication of the Office of Policy Development and Research at HUD. In some years, home purchases as measured by the AHS declined while home purchases as measured by other data sources (*e.g.*, HMDA) increased. In addition, the AHS home purchase data for separate minority groups (*e.g.*, African-Americans, Hispanics) sometimes exhibited shifts inconsistent with other sources.

[271] BNV's methodology for estimating first-time borrowers consists of three steps: (1) Estimate the total number of home purchase loans originated during a particular year using a mortgage market model that they develop; (2) disaggregate the home purchase loans in step (1) into racial and ethnic groups using HMDA data for metropolitan areas; and (3) for each racial and ethnic group in step (2), estimate the number of first-time homebuyers using mortgage and first-time homebuyer information from the American Housing Survey.

market, that is, the government, conventional conforming, and jumbo sectors of the mortgage market.

Table A.26 presents the key market shares estimated by BNV for the GSEs and FHA. The first figure (40.7) in Table A.26 is interpreted as follows: purchases of home loans by Fannie Mae and Freddie Mac totaled 40.7 percent of all home loans financed between 1996 and 2001. Going down the first column shows that the GSEs' share of the first-time homebuyer market was 24.5 percent during the 1996–to–2001—a market share significantly lower than their overall market share of 40.7 percent.

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Table A.26

Role of GSEs in First-Time Homebuyer Market
Market Shares, 1996-2001

GSE (FHA) Share of Market for:	1996-2001		1999-2001				2001			
	GSEs	FHA	Fannie Mae	Freddie Mac	GSEs	FHA	Fannie Mae	Freddie Mac	GSEs	FHA
1. All Homebuyers	40.7 % [1]	16.6 %	23.8 %	17.7 %	41.5 %	16.4 %	28.1 %	20.6 %	48.7 %	16.7 %
a. African-American and Hispanic	23.8	32.0	14.9	9.4	24.3	31.2	19.6	11.1	30.7	30.9
b. Minority	28.9	27.5	18.1	11.3	29.4	26.8	22.9	13.6	36.5	25.5
2. First-Time Homebuyers	24.5	30.9	14.4	9.7	24.1	31.2	16.9	11.6	28.5	30.7
a. African-American and Hispanic	14.0	44.8	9.1	5.2	14.3	46.5	12.6	7.1	19.7	46.1
b. Minority	17.3 [2]	38.7	10.8	6.4	17.2	39.1	14.7	8.5	23.2	37.8

Source: Bunce, Neal, and Vandenbroucke (2003). GSE home purchase loan data are from the loan-level data they report to HUD. The GSE first-time homebuyer data are from the census tract file of the Public Use Data Base. Missing race and ethnicity data are re-allocated based on the race and ethnicity percentage distribution of the non-missing data. FHA home purchase loan data are from FHA. The market includes all home purchase mortgages (government, conventional conforming, and jumbo loans); see text for explanations of mortgage market estimates for all homebuyers and first-time homebuyers.

[1] Interpreted as follows: Purchases of home loans by the GSEs between 1996 and 2001 totaled 40.7 percent of all home loans originated during that period.

[2] Interpreted as follows: Purchases of home loans by the GSEs between 1996 and 2001 totaled 17.3 percent of all home loans originated for minority first-time homebuyers during that period.

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FHA's greater focus on first-time homebuyers is also reflected in the market share data reported in Table A.26. While FHA insured only 16.6 percent of all home loans originated between 1996 and 2001, it insured 30.9 percent of all first-time-homebuyer loans during that period. The GSEs, on the other hand, accounted for a larger share (40.7 percent) of the overall home purchase market but a smaller share (24.5 percent) of the first-time homebuyer market.

Table A.26 also reports home purchase and first-time homebuyer information for minorities. During the more recent 1999-to-2001 period, the GSEs' loan purchases represented 41.5 percent of all home mortgages but only 24.3 percent of home loans for African-American and Hispanic families, and just 14.3 percent of home loans for African-American and Hispanic first-time homebuyers. During this period, the GSEs' role in the market for first-time African-American and Hispanic homebuyers was only one-third of their role in the overall home loan market (14.3 percent versus 41.5 percent).

FHA, on the other hand, accounted for a much larger share of the minority first-time homebuyer market than it did of the overall homebuyer market. Between 1999 and 2001, FHA insured 46.5 percent of all loans for African-American and Hispanic first-time homebuyers—a market share that was almost three times its overall market share of 16.4 percent.[272] While FHA's market share was two-fifths of the GSEs' share of the overall home purchase market (16.4 percent versus 41.5 percent), FHA's market share was over three times the GSEs' share of the market for first-time African-American and Hispanic homebuyers (46.5 percent versus 14.3 percent). This finding that the GSEs have played a relatively minor role in the first-time minority market is similar to the conclusion reached by the Fed researchers (see below) and Bunce (2002) that the GSEs have provided little credit support to this underserved borrower group.

The results reported in Table A.26 for the year 2001 suggest some optimism concerning the GSEs' role in the first-time homebuyer market. As explained in earlier sections, both GSEs, but particularly Fannie Mae, improved their affordable lending performance during 2001, at a time when the overall market's performance was slightly declining. This improvement is reflected in the higher first-time market shares for the GSEs during the year 2001, compared with the two previous years, 1999 and 2000 (not reported). The GSEs' share of the market for first-time African-American and Hispanic homebuyers jumped from about 11–12 percent during 1999 and 2000 to 19.7 percent in 2001. Fannie Mae's share of this market almost doubled during this period, rising from 7.0 percent in 1999 to 12.6 percent in 2001. Thus, while the GSEs continue to play a relatively small role in the minority first-time homebuyer market, during 2001 they improved their performance in this area.[273]

c. The GSEs' Share of the Conventional Conforming, First-Time Homebuyer Market

Bunce and Gardner (2004) recently conducted an analysis of first-time homebuyers for the conventional conforming market. The Bunce and Gardner analysis used a similar methodology to the study by Bunce, Neal, and Vandenbroucke of first-time homebuyers in the total mortgage market. Bunce and Gardner restricted their analysis to the funding of first-time homebuyers in the conventional conforming market, which is the market where Fannie Mae and Freddie Mac operate. Their market share results are summarized in Table A.27.

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[272] See Bunce, Neal, and Vandenbroucke, *op. cit.*, for comparisons of various estimates of the market shares for FHA and the GSEs using different data bases and estimation methods. One can compare (a) the 1999–2001 market shares for FHA and the conventional conforming market in metropolitan areas calculated using the same methodology as Table A.25 *with* (b) the 1999–2001 market share estimates reported in Table A.25 for the entire mortgage market (including jumbo loans and covering non-metropolitan areas as well as metropolitan areas). The results are strikingly consistent. For the 1999–to–2001 period, the FHA share of the overall (African American and Hispanic) home loan market is estimated to be 19.0 percent (35.8 percent) under (a) versus 16.4 percent (31.2 percent) under (b). Lower percentage shares are expected for (b) because (b) includes jumbo loans. For the same period, the GSE share of the overall (African American and Hispanic) home loan market is estimated to be 46.0 percent (25–28 percent) under (a) versus 41.5 percent (24.3 percent) under (b).

[273] For other analyses of the GSEs' market role, see the following study by economists at the Federal Reserve Board: Glenn B. Canner, Wayne Passmore, and Brian J. Surette, ''Distribution of Credit Risk among Providers of Mortgages to Lower-Income and Minority Homebuyers'' in *Federal Reserve Bulletin*, 82(12): 1077–1102, December, 1996. This study considered several characteristics of the GSEs' loan purchases (such as amount of downpayment) and concluded that the GSEs have played a minimal role in providing credit support for underserved borrowers.

Table A.27

GSEs' Share of Conventional Conforming Loans for All Homebuyers and for First-Time Homebuyers, 1996-2001

	1999-2001	1996-2001
All Homebuyers		
Fannie Mae Purchases	32.5%	32.4%
Freddie Mac Purchases	24.0%	23.2%
Both GSEs' Purchases	56.6%	55.5%
African-American and Hispanic Homebuyers		
Fannie Mae Purchases	27.7%	28.3%
Freddie Mac Purchases	17.5%	16.7%
Both GSEs' Purchases	45.2%	45.0%
Minority Homebuyers		
Fannie Mae Purchases	31.4%	31.9%
Freddie Mac Purchases	19.5%	18.8%
Both GSEs' Purchases	50.9%	50.7%
All First-Time Homebuyers		
Fannie Mae Purchases	22.9%	24.7%
Freddie Mac Purchases	16.9%	16.3%
Both GSEs' Purchases	39.8%	41.0%
African-American and Hispanic First-Time Homebuyers		
Fannie Mae Purchases	19.0%	20.2%
Freddie Mac Purchases	11.9%	10.4%
Both GSEs' Purchases	30.9%	30.6%
Minority First-Time Homebuyers		
Fannie Mae Purchases	20.1%	22.1%
Freddie Mac Purchases	13.0%	12.1%
Both GSEs' Purchases	33.1%	34.2%

Source: These data cover the entire U.S. market (i.e., both metropolitan and non-metropolitan areas.) See Bunce and Gardner (2004) for derivation of the conventional conforming market estimates and the source of the GSE data. Missing race and ethnicity data for first-time homebuyers are re-allocated based on the race and ethnicity percentage distribution of the non-missing data.

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Between 1999 and 2001, the GSEs' purchases accounted for 56.6 percent of all home loans originated in the conventional conforming market of both metropolitan areas and non-metropolitan areas. In other words, Fannie Mae and Freddie Mac funded almost three out of every five homebuyers entering the conventional conforming market between 1999 and 2001. Their purchases of first-time homebuyer loans, on the other hand, accounted for only 39.8 percent of all first-time homebuyer loans originated in that market. Thus, while the GSEs funded approximately two out of every five first-time homebuyers entering the conventional conforming market, their market share (39.8 percent) for first-time homebuyers was only 70 percent of their market share (56.6 percent) for all home buyers.

As shown in Table A.27, the GSEs have funded an even lower share of the minority first-time homebuyer market. Between 1999 and 2001, the GSEs purchases of African-American and Hispanic first-time homebuyer loans represented 30.9 percent of the conventional conforming market for these loans. Thus, while the GSEs have accounted for 56.6 percent of all home loans in the conventional conforming market, they have accounted for only 30.9 percent of loans originated in that market for African-American and Hispanic first-time homebuyers.

The market share data in Table A.27 show some slight differences between the Freddie Mac and Fannie Mae in serving minority first-time homebuyers. During the 1999-to-2001 period, Freddie Mac's share (11.9 percent) of the African-American and Hispanic first-time homebuyer market was only one-half of its share (24.0 percent) of the home loan market. On the other hand, Fannie Mae's share (19.0 percent) of the African-American and Hispanic first-time homebuyer market was almost 60 percent of its share (32.5 percent) of the home loan market. Thus, while Fannie Mae performance in serving minority first-time homebuyers has been poor, it has been better than Freddie Mac's. This difference in performance between Fannie Mae and Freddie Mac was also seen in the portfolio percentages reported earlier in Table A.17. Loans for African-American and Hispanic first-time homebuyers accounted for 6.9 percent of Fannie Mae's purchases of home loans between 1999 and 2001, a figure higher than Freddie Mac percentage of 5.3 percent. Loans for African-American and Hispanic first-time homebuyers accounted for 10.2 percent of all home loans originated in the conventional conforming market.

d. Downpayments on Loans Purchased by the GSEs

The level of downpayment can be an important obstacle to young families seeking their first homes. Examining the downpayment characteristics of the mortgages purchased by the GSEs might help explain why they have played a rather limited role in the first-time homebuyer market.

Table A.28 reports the loan-to-value (LTV) distribution of home purchase mortgages acquired by the GSEs between 1997 and 2002. In Table A.29, LTV data are provided for the GSEs' purchases of home loans that qualify for the three housing goals'special affordable, low-mod, and underserved areas. Three points stand out.

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Table A.28

Loan-to-Value Distribution for GSE Home Purchase Loans, 1997-2002

	Fannie Mae											
	Number of Mortgages						Percent of Total					
LTV Ratio	1997	1998	1999	2000	2001	2002	1997	1998	1999	2000	2001	2002
0-80%	534,685	681,789	629,425	711,178	799,610	886,024	56.6%	52.3%	53.3%	59.0%	53.1%	53.0%
80-90%	173,786	239,579	189,471	189,021	209,715	215,442	18.4%	18.4%	16.0%	15.7%	13.9%	12.9%
90-95%	188,041	289,999	253,117	219,891	275,973	275,782	19.9%	22.2%	21.4%	18.3%	18.3%	16.5%
95% and Over	31,539	53,491	48,337	51,855	107,287	128,295	3.3%	4.1%	4.1%	4.3%	7.1%	7.7%
Missing	17,130	39,941	60,810	32,847	111,867	167,692	1.8%	3.1%	5.1%	2.7%	7.4%	10.0%
Total Loans	945,181	1,304,799	1,181,160	1,204,792	1,504,452	1,673,235	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Exhibit: Over 90%	219,580	343,490	301,454	271,746	383,260	404,077	23.2%	26.3%	25.5%	22.6%	25.5%	24.1%
	Freddie Mac											
	Number of Mortgages						Percent of Total					
LTV Ratio	1997	1998	1999	2000	2001	2002	1997	1998	1999	2000	2001	2002
0-80%	339,526	456,975	474,156	525,455	617,456	640,394	56.3%	53.8%	55.9%	56.9%	59.8%	59.1%
80-90%	110,745	154,230	137,117	136,968	140,365	152,777	18.4%	18.2%	16.2%	14.8%	13.6%	14.1%
90-95%	146,293	204,804	184,971	181,996	213,864	185,064	24.2%	24.1%	21.8%	19.7%	20.7%	17.1%
95% and Over	6,456	22,203	43,601	54,543	44,232	51,890	1.1%	2.6%	5.1%	5.9%	4.3%	4.8%
Missing	364	11,107	8,767	24,134	16,768	53,790	0.1%	1.3%	1.0%	2.6%	1.6%	5.0%
Total Loans	603,384	849,319	848,612	923,096	1,032,685	1,083,915	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Exhibit: Over 90%	152,749	227,007	228,572	236,539	258,096	236,954	25.3%	26.7%	26.9%	25.6%	25.0%	21.9%

Note: Includes home purchase mortgages financing owner-occupied one-unit properties.

Table A.29

Loan-to-Value Characteristics of GSEs' Home Purchase Mortgages Meeting the Housing Goals, 1999-2002

Fannie Mae

LTV Ratio	Special Affordable				Low-Mod				Underserved Areas			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
0-80%	54.1%	55.2%	49.3%	48.1%	53.5%	56.3%	50.6%	51.3%	47.8%	53.1%	48.0%	46.8%
80-90%	13.8%	13.2%	12.5%	13.8%	16.4%	15.7%	14.2%	14.3%	17.9%	17.4%	15.2%	16.7%
90-95%	19.1%	18.0%	17.7%	18.5%	22.9%	20.4%	20.4%	19.7%	27.3%	22.2%	22.8%	22.5%
95% and Over	7.2%	8.4%	15.7%	14.7%	7.1%	7.4%	12.7%	12.7%	6.9%	7.2%	12.4%	12.4%
Missing	5.9%	5.1%	4.9%	4.9%	0.2%	0.2%	2.1%	2.1%	0.1%	0.1%	1.6%	1.6%
Total Loans	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Exhibit: Over 90%	26.2%	26.5%	33.4%	33.2%	29.9%	27.8%	33.1%	32.3%	34.2%	29.4%	35.2%	34.9%

Freddie Mac

LTV Ratio	Special Affordable				Low-Mod				Underserved Areas			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
0-80%	59.0%	52.4%	53.1%	55.9%	55.0%	52.4%	54.5%	56.1%	50.1%	47.4%	48.7%	53.3%
80-90%	13.9%	12.3%	12.4%	15.5%	15.6%	14.1%	13.6%	15.0%	17.6%	15.7%	15.1%	17.6%
90-95%	19.4%	17.5%	19.0%	18.5%	23.2%	20.1%	21.2%	20.0%	26.6%	24.6%	26.1%	20.8%
95% and Over	7.2%	12.6%	12.3%	4.7%	6.2%	10.1%	8.6%	4.1%	5.6%	9.4%	8.1%	3.6%
Missing	0.5%	5.2%	3.2%	5.4%	0.1%	3.4%	2.1%	4.7%	0.1%	2.9%	2.1%	4.8%
Total Loans	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Exhibit: Over 90%	26.6%	30.1%	31.2%	23.2%	29.3%	30.1%	29.9%	24.2%	32.2%	34.0%	34.2%	24.3%

Note: Includes home purchase mortgages financing owner-occupied one-unit properties.

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First, the GSEs (and particularly Fannie Mae) have recently increased their purchases of home loans with low downpayments. After remaining about 4 percent of Fannie Mae's purchases between 1997 and 2000, over-95-percent-LTV loans (or less-than-five-percent downpayment loans) jumped to 7.1 percent during 2001 and 7.7 percent in 2002. It is interesting that this jump in less-than-five-percent downpayment loans occurred in the same years that Fannie Mae improved its purchases of loans for low-income homebuyers, as discussed in earlier sections. As a share of Freddie Mac's purchases, over-95-percent-LTV loans increased from 1.1 percent in 1997 to 5.9 percent in 2000, before falling to 4.3 percent in 2001 and 4.8 percent in 2002. If the low-downpayment definition is expanded to ten percent (*i.e.*, over-90-percent-LTV loans), Freddie Mac had about the same percentage (25 percent) of low-downpayment loans during 2001 as Fannie Mae. In fact, under the more expansive definition, Freddie Mac had the same share of over-90-percent-LTV loans in 2001 as it did in 1997 (about 25 percent), while Fannie Mae exhibited only a modest increase in the share of its purchases with low downpayments (from 23.2 percent in 1997 to 25.4 percent in 2001). The share of over-90-percent-LTV loans in Freddie Mac's purchases fell sharply from 25.0 percent in 2001 to 21.9 percent in 2002, while the share in Fannie Mae's purchases fell more modestly from 25.4 percent in 2001 to 24.2 percent in 2002.

Second, loans that qualify for the housing goals have lower downpayments than non-qualifying loans. In 2001 and 2002, over-95-percent-LTV loans accounted for about 15 percent of Fannie Mae's purchases of special affordable loans, 13 percent of low-mod loans, and 12 percent of underserved area loans, compared with about 7.5 percent of Fannie Mae's purchases of all home loans. (*See* Table A.29.) These low-downpayment shares for 2001 and 2002 were almost double those for 2000 when over-95-percent-LTV loans accounted for 8.4 percent of Fannie Mae's purchases of special affordable loans and about 7 percent of its purchases of low-mod and underserved area loans. Fannie Mae's low-downpayment shares during 2001 were higher than Freddie Mac's shares of 12.3 percent for special affordable loans and about 8 percent for low-mod and underserved area loans. Between 2001 and 2002, Freddie Mac's over-95-percent-LTV shares fell sharply to 4–5 percent for the three housing goal categories, while Fannie Mae's shares remained in the 12–15 percent range. Under the more expansive, over-90-percent-LTV definition, almost one-third of Fannie Mae's goals-qualifying purchases during 2001 would be considered low downpayment, as would a slightly smaller percentage of Freddie Mac's purchases. However, during 2002, Freddie Mac's over-90-percent-LTV shares for the goals-qualifying loans fell to 23–24 percent.

Third, a noticeable pattern among goals-qualifying loans purchased by the GSEs is the predominance of loans with high downpayments. For example, 55.9 percent of special affordable home loans purchased by Freddie Mac during 2002 had a downpayment of at least 20 percent, a percentage not much lower than the high-downpayment share (59.1 percent) of all Freddie Mac's home loan purchases. Similarly, 46.8 percent of the home loans purchased by Fannie Mae in underserved areas during 2002 had a 20 percent or higher downpayment, compared with 53.0 percent of all home loans purchased by Fannie Mae.

Thus, the data in Tables A.28 and A.29 show a preponderance of high downpayment loans, even among lower-income borrowers who qualify for the housing goals. The past focus of the GSEs on high-downpayment loans provides some insight into a study by staff at the Federal Reserve Board who found that the GSEs have offered little credit support to the lower end of the mortgage market.[274] The fact that approximately half of the goals-qualifying loans purchased by the GSEs have a downpayment of over 20 percent is also consistent with findings reported earlier concerning the GSEs' minimal service to first-time homebuyers, who experience the most problems raising cash for a downpayment. On the other hand, the recent experience of Fannie Mae suggests that purchasing low-downpayment loans may be one technique for reaching out and funding low-income and minority families who are seeking to buy their first home.

13. Other Studies of the GSEs Performance Relative to the Market

This section summarizes briefly the main findings from other studies of the GSEs' affordable housing performance. These include studies by the HUD and the GSEs as well as studies by academics and research organizations.

Freeman and Galster Study.[275] A recent study by Lance Freeman and George Galster uses econometric analysis to test whether the Government-Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac purchases of home mortgages in neighborhoods traditionally underserved by financial institutions stimulate housing market activity in those neighborhoods. Specifically, this study analyzes data of single-family home sales volumes and prices of mortgages originated from 1993–1999 in Cleveland, OH.

The study concludes that aggressive secondary market purchasing behavior by non-GSE entities stimulated sales volumes and prices of homes in low-income and predominantly minority-occupied neighborhoods of Cleveland. The study results also showed a positive relationship between home transaction activity and the actions of the secondary mortgage market, and concludes that the secondary mortgage market (and the non-GSE sector in particular) purchases of mortgages had a positive effect on the number of sales transactions one year later. However, the study also concludes that although non-GSE purchases of non-home purchase mortgages appeared to boost prices one and two years later, no consistent impacts of purchasing rates on sales prices could be observed. In addition, there was no robust evidence that GSE purchasing rates were positively associated with single-family home transactions volumes or sales prices during any periods.

Urban Institute Rural Markets Study.[276] A study by Jeanette Bradley, Noah Sawyer, and Kenneth Temkin uses both quantitative and qualitative data to explore the issue of GSE service to rural areas. The study first summarizes the existing research on rural lending and GSE service to rural areas. It then reviews the current underwriting guidelines of Fannie Mae, Freddie Mac, the USDA Rural Housing Service, and Farmer Mac, focusing on issues relevant to rural underwriting. The GSE public-use database is used to analyze GSE non-metropolitan loan purchasing patterns from 1993–2000. Finally, the study presents the results of a series of discussions conducted with key national industry and lender experts and local experts in three rural sites in south-central Indiana, southwestern New Mexico and southern New Hampshire chosen for the diversity of their region, population, economic structures, and housing markets.

The authors of the study conclude that while Fannie Mae and Freddie Mac have increased their lending to rural areas since 1993, their non-metropolitan loan purchases still lag behind their role

[274] Canner, et al., *op. cit.*

[275] *The Impact of Secondary Mortgage Market and GSE Purchases on Underserved Neighborhood Housing Markets: Final Report to HUD.* July 2002.

[276] *GSE Service to Rural Areas*, 2002.

in metropolitan loan purchases, particularly in regard to the percentage of affordable loans. From the discussions with experts, the authors of the study make the following policy recommendations: underserved populations and rural areas should be specifically targeted at the census-tract level; HUD should set manufactured housing goals; HUD should consider implementing a survey of small rural lenders or setting up an advisory group of small rural lenders in order to determine their suggestions for creating stronger relationships between the GSEs and rural lenders with the goal of increasing GSE non-metropolitan purchase rates.

Urban Institute GSE Impacts Study.[277] A report by Thomas Thibodeau, Brent Ambrose, and Kenneth Temkin analyzes the extent to which the GSEs' responses to The Federal Housing Enterprises Financial Safety and Soundness Act's (FHEFSSA) affordable housing goals have had their intended effect of making low- and moderate-income families better off. Specifically the report examines several methodologies determining that the conceptual model created by Van Order in 1996 [278] provided the most complete description of how the primary and secondary markets interact. This model was then applied in a narrow scope to capital market outcomes which included GSE market shares and effective borrowing costs, and housing market outcomes that include low- and moderate-income homeownership rates. Finally, metropolitan American Housing Survey (AHS) data for eight cities were used to conduct empirical analyses of the two categories of outcomes. These cities included areas surveyed in 1992, the year before HUD adopted the affordable housing goals, to provide the baseline for the analysis. Four metropolitan areas were surveyed in 1992 and again in 1996: Cleveland, Indianapolis, Memphis and Oklahoma City. Four cities were surveyed in 1992 and again in 1998: Birmingham, Norfolk, Providence and Salt Lake City.

The study's empirical analysis suggests that the GSE affordable goals have helped to make homeownership more attainable for target families. The assessment of the effects of the affordable goals on capital markets showed that the GSE share of the conventional conforming market has increased, especially for lower income borrowers and neighborhoods. The study also concludes that the affordable housing goals have an impact on the purchase decisions of Fannie Mae and Freddie Mac. The study also finds that interest rates are lower in markets in which Fannie Mae and Freddie Mac purchase a higher proportion of conventional loans. Finally, the study's analysis shows that overall lending volume in a metropolitan area increases when the GSEs purchase seasoned loans.

Specifically, that homeownership rates increased at a faster rate for low-income families when compared to all families, and that in a subset of MSAs, minority homeownership rates also grew faster when compared to overall homeownership changes in those MSAs.

Finally, the affordable housing goal effects were examined for 80 MSAs in relation to the homeownership rate changes between 1991 and 1997. The study found that the GSEs, by purchasing loans originated to low-income families, helped to reduce the disparity between homeownership rates for lower and higher income families, suggesting that the liquidity created when the GSEs purchase loans originated to low-income families is recycled into more lending targeted to lower income homebuyers.

The authors of the study qualify their results by stating that they are based on available data that does not provide the level of detail necessary to conduct a fully controlled national assessment.

Williams and Bond Study.[279] Richard Williams and Carolyn Bond examine GSE leadership of the mortgage finance industry in making credit available for low- and moderate-income families. Specifically, it asks if the GSEs are doing relatively more of their business with underserved markets than other financial institutions, and whether the GSEs' leadership helps to narrow the gap in home mortgage lending that exists between served and underserved markets. The study uses HMDA data for metropolitan areas and the Public Use Data Base at HUD for compilations of GSE data sets for the entire nation (GSE PUDB File B) to conduct descriptive and multivariate analyses of nationwide lending between 1993 and 2000. Additionally, separate analyses are conducted that include and exclude loans from subprime and manufactured housing lenders.

The study concludes that the GSEs are not leading: They do not purchase relatively more underserved market loans than the primary market makes nor do they purchase as many of these loans as their secondary market competitors. Additionally, the study concludes that the disparities between the GSEs and the primary market are even greater once the growing role of subprime and manufactured housing is considered. The authors admit that there have been signs of progress, particularly in 1999 and 2000 when primary market lending to underserved markets increased and GSE purchases of underserved market loans increased even faster. Regardless, the study concludes that there continues to be significant racial, economic, and geographic disparities in the way that the benefits of GSE activities are distributed and that the benefits of GSE activities still go disproportionately to members of served rather than underserved markets.

14. The GSEs' Support of the Mortgage Market for Single-Family Rental Properties

The 1996 Property Owners and Managers Survey reported that 49 percent of rental units are found in the ''mom and pop shops'' of the rental market''single-family'' rental properties, containing 1–4 units. These small properties are largely individually-owned and managed, and in many cases the owner-managers live in one of the units in the property. They include many properties in older cities, in need of financing for rehabilitation. Single-family rental units play an especially important role in lower-income housing, over half of such units are affordable to very low-income families.

There is not, however, a strong secondary market for single-family rental mortgages. While single-family rental properties comprise a large segment of the rental stock for lower-income families, they make up a small portion of the GSEs' business. In 2001, the GSEs purchased $84 billion in mortgages for such properties, but this represented 6 percent of the total dollar volume of the enterprises' 2002 business and 10 percent of total single-family units financed by each GSE. It follows that since single-family rentals make up such a small part of the GSEs business, they have not penetrated the single-family rental market to the same degree that they have penetrated the owner-occupant market. Table A.30 in Section G below shows that between 1999 and 2002, the GSEs financed 57 percent of

[277] *An Analysis of the Effects of the GSE Affordable Goals on Low- and Moderate-Income Families,* 2001.

[278] Van Order, Robert. 1996. ''Discrimination and the Secondary Mortgage Market.'' In John Goering and Ronald Wienk, eds. *Mortgage Discrimination, Race, and Federal Policy.* The Urban Institute Press, Washington, DC: 335–363.

[279] *Are the GSEs Leading, and if So Do They Have Any Followers? An Analysis of the GSEs' Impact on Home Purchase Lending to Underserved Markets During the 1990s.* University of Notre Dame Working Paper and Technical Series Number 2003–2. 2002

owner-occupied dwelling units in the conventional conforming market, but only 27 percent of single-family rental units.

There are a number of factors that have limited the development of the secondary market for single-family rental property mortgages thus explaining the lack of penetration by the GSEs. Little is collectively known about these properties as a result of the wide spatial dispersion of properties and owners, as well as a wide diversity of characteristics across properties and individuality of owners. This makes it difficult for lenders to properly evaluate the probability of default and severity of loss for these properties.

Single-family rental properties could be important for the GSEs housing goals, especially for meeting the needs of lower-income families. In 2002 around 70 percent of single-family rental units qualified for the Low- and Moderate-Income Goals, compared with 40 percent of one-family owner-occupied properties. This heavy focus on lower-income families meant that single-family rental properties accounted for 15 percent of the units qualifying for the Low- and Moderate-Income Goal, even though they accounted for10 percent of the total units (single-family and multifamily) financed by the GSEs.

Given the large size of this market, the high percentage of these units which qualify for the GSEs' housing goals, and the weakness of the secondary market for mortgages on these properties, an enhanced presence by Fannie Mae and Freddie Mac in the single-family rental mortgage market would seem warranted.[280] Single-family rental housing is an important part of the housing stock because it is an important source of housing for lower-income households.

F. Factor 4: Size of the Conventional Conforming Mortgage Market Serving Low- and Moderate-Income Families Relative to the Overall Conventional Conforming Market

The Department estimates that dwelling units serving low- and moderate-income families will account for 51–57 percent of total units financed in the overall conventional conforming mortgage market during 2005–2008, the period for which the Low- and Moderate-Income Housing Goal is proposed. The market estimates exclude B&C loans and allow for much more adverse economic and market affordability conditions than have existed recently. Between 1999 and 2002 the low-mod market averaged about 57 percent. The detailed analyses underlying these estimates are presented in Appendix D.

G. Factor 5: GSEs' Ability To Lead the Industry

FHEFSSA requires the Secretary, in determining the Low- and Moderate-Income Housing Goal, to consider the GSEs' ability to ''lead the industry in making mortgage credit available for low- and moderate-income families.'' Congress indicated that this goal should ''steer the enterprises toward the development of an increased capacity and commitment to serve this segment of the housing market'' and that it ''fully expect[ed] [that] the enterprises will need to stretch their efforts to achieve [these goals].''[281]

The Department and independent researchers have published numerous studies examining whether or not the GSEs have been leading the single-family market in terms of their affordable lending performance. This research, which is summarized in Section E, concludes that the GSEs have generally lagged behind primary lenders in funding first-time homebuyers, lower-income borrowers and underserved communities. As required by FHEFSSA, the Department has produced estimates of the portion of the total (single-family and multifamily) mortgage market that qualifies for each of the three housing goals (see Appendix D). Congress intended that the Department use these market estimates as one factor in setting the percentage target for each of the housing goals. The Department's estimate for the size of the Low- and Moderate-Income market is 51–57 percent, which is higher than the GSEs' performance on that goal.

This section provides another perspective on the GSEs' performance by examining the share of the total conventional conforming mortgage market and the share of the goal-qualifying markets (low-mod, special affordable, and underserved areas) accounted for by the GSEs' purchases. This analysis, which is conducted by product type (single-family owner, single-family rental, and multifamily), shows the relative importance of the GSEs in each of the goal-qualifying markets.

1. GSEs' Role in Major Sectors of the Mortgage Market

Tables A.30 and A.31 compare GSE mortgage purchases with HUD's estimates of the numbers of units financed in the conventional conforming market. Table A.30 presents aggregate data for 1999–2002 while Table A.31 presents more summary market share data for individual years 2000 and 2002.[282] HUD estimates that there were 48,270,415 owner and rental units financed by new conventional conforming mortgages between 1999 and 2002. Fannie Mae's and Freddie Mac's mortgage purchases financed 23,580,594 of these dwelling units, or 49 percent of all dwelling units financed. As shown in Table A.30, the GSEs have played a smaller role in the goals-qualifying markets than they have played in the overall market. Between 1999 and 2002, new mortgages were originated for 27,158,020 dwelling units that qualified for the Low- and Moderate-Income Goal; the GSEs low-mod purchases financed 11,408,692 dwelling units, or 42 percent of the low-mod market. Similarly, the GSEs' purchases accounted for 41 percent of the underserved areas market, but only 35 percent of the special affordable market. Obviously, the GSEs have not been leading the industry in financing units that qualify for the three housing goals. They need to improve their performance and it appears that there is ample room in the non-GSE portions of the goals-qualifying markets for them to do so. For instance, the GSEs were not involved in almost two-thirds of the special affordable market during the 1999-to-2002 period.

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[280] A detailed discussion of the GSEs' activities in this area is contained in Theresa R. Diventi, The GSEs' Purchases of *Single-Family Rental Property Mortgages,* Housing Finance Working Paper No. HF–004, Office of Policy Development and Research, Department of Housing and Urban Development, (March 1998).

[281] Senate Report 102–282, May 15, 1992, p. 35.

[282] Tables A.30 and A.31 examine GSE purchases on a ''going forward basis by origination year.'' Specifically, it considers GSE purchases of: (a) 1999 mortgage originations during 1999 and 2000; (b) 2000 originations during 2000 and 2002; and (c) 2002 originations during 2002 (and 2002 will be added when those data become available in March 2003). In other words, this analysis looks at the GSEs' purchases of a particular origination year cohort over a two-year period. This approach contrasts with the approach that examines GSE purchases on a ''backward looking basis by purchase year'', for example, GSE purchases during 1999 of both new 1999 originations and originations during previous years (the latter called ''prior-year'' or seasoned loans). Either approach is a valid method for examining GSE purchases; in fact, when analyzing aggregated data such as the combined 1999–2002 data in Table A.30, the two approaches yield somewhat similar results. HUD's methodology for deriving the market estimates is explained in Appendix D. B&C loans have been excluded from the market estimates in Tables A.30 and A.31.

Table A.30

Number of Newly-Mortgaged Units by Type in the 1999-2002 Conventional Conforming Market Compared To Fannie Mae and Freddie Mac Purchases

	Single-Family Owner		Single-Family Rental		Multifamily		Total Rental		Total Market	
Total Units										
Market	34,600,351	71.7%	6,652,020	13.8%	7,018,044	14.5%	13,670,064	28.3%	48,270,415	100.0%
Fannie Mae	11,218,908	81.9%	1,161,490	8.5%	1,316,132	9.6%	2,477,622	18.1%	13,696,530	100.0%
Freddie Mac	8,442,070	85.4%	629,221	6.4%	812,772	8.2%	1,441,993	14.6%	9,884,063	100.0%
GSE Total	19,660,978	83.4%	1,790,711	7.6%	2,128,904	9.0%	3,919,615	16.6%	23,580,594	100.0%
GSE % of Market	56.8%		26.9%		30.3%		28.7%		48.9%	
Low-Mod Units										
Market	14,854,964	54.7%	5,986,817	22.0%	6,316,239	23.3%	12,303,056	45.3%	27,158,020	100.0%
Fannie Mae	4,533,822	66.8%	1,036,199	15.3%	1,216,084	17.9%	2,252,283	33.2%	6,786,105	100.0%
Freddie Mac	3,314,500	71.7%	554,914	12.0%	753,171	16.3%	1,308,086	28.3%	4,622,586	100.0%
GSE Total	7,848,322	68.8%	1,591,113	13.9%	1,969,256	17.3%	3,560,369	31.2%	11,408,692	100.0%
GSE % of Market	52.8%		26.6%		31.2%		28.9%		42.0%	
Underserved Area Units										
Market	9,193,023	58.0%	2,984,588	18.8%	3,672,576	23.2%	6,657,164	42.0%	15,850,187	100.0%
Fannie Mae	2,775,679	70.9%	600,645	15.3%	541,268	13.8%	1,141,913	29.1%	3,917,592	100.0%
Freddie Mac	2,035,600	76.8%	306,968	11.6%	308,938	11.7%	615,906	23.2%	2,651,506	100.0%
GSE Total	4,811,279	73.2%	907,612	13.8%	850,206	12.9%	1,757,819	26.8%	6,569,098	100.0%
GSE % of Market	52.3%		30.4%		23.2%		26.4%		41.4%	
Special Affordable Units										
Market	5,303,912	40.1%	3,858,171	29.2%	4,070,466	30.8%	7,928,637	59.9%	13,232,549	100.0%
Fannie Mae	1,487,409	53.5%	580,794	20.9%	711,825	25.6%	1,292,619	46.5%	2,780,028	100.0%
Freddie Mac	1,099,028	60.5%	316,283	17.4%	399,862	22.0%	716,145	39.5%	1,815,172	100.0%
GSE Total	2,586,437	56.3%	897,077	19.5%	1,111,687	24.2%	2,008,764	43.7%	4,595,201	100.0%
GSE % of Market	48.8%		23.3%		27.3%		25.3%		34.7%	

Source: The market data are the estimated number of newly mortgaged units between 1999-2002. The single-family owner market data exclude B&C loans; including B&C loans in the owner market would have reduced the GSE share of the owner market from 56.8 percent to 52.5 percent. See Appendix D for an explanation of the market methodology. The GSE data include units from mortgages originated between 1999 and 2002 and purchased by one of the GSEs during the same period. GSE data with missing affordability or geocode are reallocated based the distribution of existing data.

Table A.31

GSE Share of Newly-Mortgaged Units
Conventional Conforming Market
2000, 2001 and 2002

	Single-Family Owner	Single-Family Rental	Multifamily	Total Rental	Total Market
2000 Financed Units					
Total	48	23	32	28	41
Low-Mod	44	22	33	28	36
Underserved Area	44	26	24	25	35
Special Affordable	40	20	29	25	31
2001 Financed Units					
Total	57	27	32	30	49
Low-Mod	54	28	33	30	43
Underserved Area	53	31	25	28	42
Special Affordable	50	25	28	26	36
2002 Financed Units					
Total	62	32	32	32	54
Low-Mod	58	31	32	32	47
Underserved Area	57	37	23	30	47
Special Affordable	56	27	29	28	40

Source: See notes to Table A.27. The first figure ("50") is interpreted as follows: Fannie Mae's and Freddie Mac's acquisitions (during 2000, 2001 and 2002) of single-family-owner home purchase mortgages originated in 2000 accounted for 50 percent of all such mortgages originated that year in the conventional conforming market.

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While the GSEs are free to meet the Department's goals in any manner that they deem appropriate, it is useful to consider their performance relative to the industry by property type. The GSEs accounted for 57 percent of the single-family owner market but only 30 percent of the multifamily market and 27 percent of the single-family rental market (or a combined 29 percent share of the rental market).

Single-family Owner Market. As stated in the 2000 Rule, the single-family-owner market is the bread-and-butter of the GSEs' business, and based on the financial and other factors discussed below, the GSEs clearly have the ability to lead the primary market in providing credit for low- and moderate-income owners of single-family properties. However, the GSEs have historically lagged behind the market in funding single-family-owner loans that qualify for the housing goals and, as discussed in Section E, they have played a rather small role in funding minority first-time homebuyers. The market share data reported in Table A.30 for the single-family-owner market tell the same story. The GSEs' purchases of single-family-owner loans represented 57 percent of all single-family-owner loans originated between 1999 and 2002, compared with 53 percent of the low-mod loans that were originated, 52 percent of underserved area loans, and 49 percent of the special affordable loans.

The data in Table A.31 indicate the GSEs' growing market share during the heavy refinance years of 2001 and 2002. For example, the GSEs accounted for 62 percent of the overall single-family-owner market that year, and 56–58 percent of the markets covered by the three housing goal categories. While this improvement is an encouraging trend, there are ample opportunities for the GSEs to continue their improvement. Almost one-half of the goals-qualifying loans originated during 2002 remained available to the GSEs to purchase; there are clearly affordable loans being originated that the GSEs can purchase. Furthermore, the GSEs' purchases under the housing goals are not limited to new mortgages that are originated in the current calendar year. The GSEs can purchase loans from the substantial, existing stock of affordable loans held in lenders' portfolios, after these loans have seasoned and the GSEs have had the opportunity to observe their payment performance. In fact, based on Fannie Mae's recent experience, the purchase of seasoned loans appears to be one effective strategy for purchasing goals-qualifying loans.

Single-family Rental Market. Single-family rental housing is a major source of low-income housing. As discussed in Appendix D, data on the size of the primary market for mortgages on these properties is limited, but available information indicate that the GSEs are much less active in this market than in the single-family owner market. HUD estimates that GSE purchases between 1999 and 2002 totaled only 27 percent of all newly-mortgaged single-family rental units that were affordable to low- and moderate-income families.

As explained in the 2000 Rule, many of these properties are ''mom-and-pop'' operations, which may not follow financing procedures consistent with the GSEs' guidelines. Much of the financing needed in this area is for rehabilitation loans on 2–4 unit properties in older areas, a market in which the GSEs' have not played a major role. However, this sector could certainly benefit from an enhanced role by the GSEs, and the data in Table A.30 indicate that there is room for such an enhanced role, as approximately three-fourths of this market remains for the GSEs to enter.

Multifamily Market. Fannie Mae is the largest single source of multifamily finance in the United States, and Freddie Mac has made a solid reentry into this market over the last nine years. However, there are a number of measures by which the GSEs lag the multifamily market. For example, the share of GSE resources committed to the multifamily purchases falls short of the multifamily proportion prevailing in the overall mortgage market. HUD estimates that newly-mortgaged units in multifamily properties represented almost 14 percent of all (single-family and multifamily) dwelling units financed between 1999 and 2002.[283] As shown in Table A.30, multifamily acquisitions represented 9 percent of dwelling units financed by the GSEs between 1999 and 2002.

The GSEs' role in the multifamily market is significantly smaller than in single-family. As shown in Table A.30, GSE purchases have accounted for 30 percent of newly financed multifamily units between 1999 and 2002—a market share much lower than their 57 percent share of the single-family-owner market. Stated in terms of portfolio shares, single-family-owner loans accounted for 83 percent of all dwelling units financed by the GSEs during this period, versus 73 percent of all units financed in the conventional conforming market.

While it is recognized that the GSEs have been increasing their multifamily purchases, a further enlargement of their role in the multifamily market seems feasible and appropriate, particularly in the affordable (lower rent) end of the market. As noted in Section D.3, market participants believe that the GSEs have been conservative in their approaches to affordable multifamily lending and underwriting.[284] Certainly the GSEs face a number of challenges in better meeting the needs of the affordable multifamily market. For example, thrifts and other depository institutions may sometimes retain their best loans in portfolio, and the resulting information asymmetries may act as an impediment to expanded secondary market transaction volume.[285] However, the GSEs have demonstrated that they have the depth of expertise and the financial resources to devise innovative solutions to problems in the multifamily market. The GSEs can build on their recent records of increased multifamily lending and innovative products to make further in-roads into the affordable market. As explained in Section D.3, the GSEs have the expertise and market presence to push simultaneously for market standardization and for programmatic flexibility to meet the special needs and circumstances of the lower-income portion of the multifamily market.

Conclusions. While HUD recognizes that some segments of the market may be more challenging for the GSEs than others, the data reported in Tables A.30 and A.31 show that the GSEs have ample opportunities to purchase goals-qualifying mortgages. Furthermore, if a GSE makes a business decision to not pursue certain types of goals-qualifying loans in one segment of the market, they are free to pursue goals-qualifying owner and rental property mortgages in other segments of the market. As market leaders, the GSEs should be looking for innovative ways to pursue this business. Furthermore, there is evidence that the GSEs can earn reasonable returns on their goals business. The Regulatory Analysis that accompanies this proposed rule provides evidence that

[283] Based on Table A.30, multifamily properties represented 14.5 percent of total units financed between 1999 and 2002 (obtained by dividing 7,018,044 multifamily units by 48,270,415 ''Total Market'' units). Increasing the single-family-owner number in Table A.30 by 2,817,258 to account for excluded B&C mortgages increases the ''Total Market'' number to 51,087,673 which produces a multifamily share of 13.7 percent. See Appendix D for discussion of the B&C market.

[284] Abt Associates, *op. cit.* (August 2002).

[285] The problem of secondary market ''adverse selection'' is described in James R. Follain and Edward J. Szymanoski. ''A Framework for Evaluating Government's Evolving Role in Multifamily Mortgage Markets,'' *Cityscape: A Journal of Policy Development and Research* 1(2), 1995.

the GSEs can earn financial returns on their purchases of goals-qualifying loans that are only slightly below their return on equity from their normal business.

2. Qualitative Dimensions of the GSEs' Ability To Lead the Industry

This section discusses several qualitative factors that are indicators of the GSEs' ability to lead the industry in affordable lending. It discusses the GSEs' role in the mortgage market; their ability, through their underwriting standards, new programs, and innovative products, to influence the types of loans made by private lenders; their development and utilization of state-of-the-art technology; the competence, expertise and training of their staffs; and their financial resources.

a. Role in the Mortgage Market

The GSEs have played a dominant role in the single-family mortgage market. As reported in Section C.3, mortgage purchases by the GSEs reached extraordinary levels in 2001 and 2003. Purchases by Fannie Mae stood at $568 billion in 2001 and $848 billion in 2002. Freddie Mac's single-family mortgage purchases were $393 billion in 2001 and $475 billion in 2002. The Office of Federal Housing Enterprise Oversight (OFHEO) estimates that the GSEs' purchased 40 percent of newly-originated conventional mortgages in 2001. Total GSE purchases, including loans originated in prior years, amounted to 46 percent of conventional originations in 2001.

The dominant position of the GSEs in the mortgage market is reinforced by their relationships with other market institutions. Commercial banks, mutual savings banks, and savings and loans are their competitors as well as their customers—they compete to the extent they hold mortgages in portfolio, but at the same time they sell mortgages to the GSEs. They also buy mortgage-backed securities, as well as the debt securities used to finance the GSEs' portfolios. Mortgage bankers sell virtually all of their prime conventional conforming loans to the GSEs. Private mortgage insurers are closely linked to the GSEs, because mortgages purchased by the enterprises that have loan-to-value ratios in excess of 80 percent are normally required to be covered by private mortgage insurance, in accordance with the GSEs' charter acts.

b. Underwriting Standards for the Primary Mortgage Market

The GSEs' underwriting guidelines are followed by virtually all originators of prime mortgages, including lenders who do not sell many of their mortgages to Fannie Mae or Freddie Mac. 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)—such mortgages eventually might be sold to the GSEs, as the principal balance is amortized or when the conforming loan limit is otherwise increased. Changes that the GSEs have made to their underwriting standards in order to address the unique needs of low-income families were discussed in Section C.4 of this Appendix. The GSEs' market influence is one reason these new, more flexible underwriting standards have spread throughout the market. Because the GSEs' guidelines set the credit standards against which the mortgage applications of lower-income families are judged, the enterprises have a profound influence on the rate at which mortgage funds flow to low- and moderate-income borrowers and underserved neighborhoods.

As discussed below, the GSEs' new automated underwriting systems are widely used to originate mortgages in today's market. As discussed in Sections C.7 and C.8, the GSEs have started adapting their underwriting systems for subprime loans and other loans that have not met their traditional underwriting standards.

c. State-of-the-Art Technology

Both GSEs are in the forefront of new developments in mortgage industry technology. Automated underwriting and online mortgage processing are a couple of the new technologies that have impacted the mortgage market, expanding homeownership opportunities. This section provides an overview of these new technologies and the extent of their use.

Each enterprise released an automated underwriting system in 1995—Freddie Mac's ''Loan Prospector'' (LP) and Fannie Mae's ''Desktop Underwriter'' (DU). During 2001 and 2002, roughly 60 percent of all newly-originated mortgages that Freddie Mac purchased were processed through LP. Lenders and brokers used LP to evaluate 7.3 million loan applications in 2001 (almost double the amount in 2000) and 8.2 million loans in 2002.[286] As of the end of 2002, LP had processed 25 million loans since its inception. Fannie Mae also reports that roughly 60 percent of the loans it purchased during 2001 and 2002 were processed through DU. DU evaluated more than 10 million loans in 2002, compared with 8 million in 2001. As of the end of 2002, DU had processed over 26 million loans since its inception. The GSEs' systems have also been adapted for FHA and jumbo loans. Automated underwriting systems are being further adapted to facilitate risk-based pricing, which enables mortgage lenders to offer each borrow an individual rate based on his or her risk. As discussed earlier, concerns about the use of automated underwriting and risk-based pricing include the disparate impact on minorities and low-income borrowers and the ''black box'' nature of the score algorithm.

The GSEs are using their state-of-the-art technology in certain ways to help expand homeownership opportunities. For example, Fannie Mae has developed *Fannie Mae Property GeoCoder* a computerized mapping service offered to lenders, nonprofit organizations, and state and local governments to help them determine whether a property is located in an area that qualifies for Fannie Mae's community lending products designed to increase homeownership and revitalization in traditionally underserved areas. In addition, *eFannieMae.com* is Fannie Mae's business-to-business web site where lenders can access product information and important technology tools, view upcoming events, and receive news about training opportunities. This site receives on average 80,000 visitors per week.[287] Freddie Mac has introduced in recent years internet-based debt auctions, debt repurchase operations, and debt exchanges. These mechanisms benefit investors by providing more uniform pricing, greater transparency and faster price discovery—all of which makes Freddie Mac debt more attractive to investors and reduces the cost of funding mortgages.[288] In addition, Freddie Mac has provided automated tools for lenders to identify and work with borrowers most likely to encounter problems making their mortgage payments. *EarlyIndicator* has become the industry standard for default management technology. It can reduce the consequences of mortgage delinquency for borrowers, servicers and investors.[289]

The GSEs are also expanding homeownership opportunities through the use of the Internet in processing

[286] This section is based heavily on ''DU and LP Usage Continues to Rise,'' in *Inside Mortgage Technology* published by Inside Mortgage Finance, January 27, 2003, page 1–2.

[287] Fannie Mae, *2002 Annual Housing Activities Report*, 2003, pp. 10–11.

[288] Freddie Mac, *2002 Annual Housing Activities Report*, 2003, p. 14.

[289] Freddie Mac, *2002 Annual Housing Activities Report*, 2003, p. 52.

mortgage originations. New online mortgage originations reached $267.6 billion in the first half of 2002, compared with $97 billion for the first six months of 2001. The 2002 six-month volume comprised 26.5 percent of the estimated $1.01 trillion in total mortgage originations for the same time period.[290] Freddie Mac made Loan Prospector on the Internet service available to lenders for their retail operations. Freddie Mac also adopted the mortgage industry's XML (extensible markup language) data standard, which is integral to streamlining and simplifying Internet-based transactions. In addition, Congress enacted legislation that allows the use of electronic signature in contracts in 2001, making a completely electronic mortgage transaction possible. With the use of electronic signatures, electronic mortgages are expected to improve the mortgage process, further reducing origination and servicing costs. In October 2000, Freddie Mac purchased its first electronic mortgage under the new law.

Fannie Mae also offers a variety of other online tools and applications that have the potential to make the mortgage loan process more cost effective and efficient for lenders. For example, ''HomeBuyer Funds Finder,'' a one-stop online resource designed for lenders and other housing professionals, enables users to access a database of local housing subsidy programs available for low- and moderate-income borrowers. In 2002, the HomeBuyer Funds Finder web site received over 24,500 hits.[291] ''Home Counselor Online'' provides homeownership counselors with the necessary tools to help consumers financially prepare to purchase a home. As of February 2002, over 1,200 counselors representing 542 organizations were using *Home Counselor Online*.[292] A more complete list of Fannie Mae's online tool and applications can be found in its Annual Housing Activities Report. In 2002, Fannie Mae's total eBusiness volume was $1.1 trillion, up from $800 billion in 2000.[293]

d. Staff Resources

Both Fannie Mae and Freddie Mac are well-known throughout the mortgage industry for the expertise of their staffs in carrying out their current programs, conducting basic and applied research regarding mortgage markets, developing innovative new programs, and undertaking sophisticated analyses that may lead to new programs in the future. The role that the GSEs have played in spreading the use of technology throughout the mortgage market reflects the enormous expertise of their staff. The leaders of these corporations frequently testify before Congressional committees on a wide range of housing issues, and both GSEs have developed extensive working relationships with a broad spectrum of mortgage market participants, including various nonprofit groups, academics, and government housing authorities.

e. Financial Strength

Fannie Mae. The benefits that accrue to the GSEs because of their GSE status, as well as their solid management, have made them two of the nation's most profitable businesses. Fannie Mae's net income was $3.9 billion in 1999, $4.4 billion in 2000, $5.9 billion in 2001, and $4.6 billion in 2002.[294] Fannie Mae's return on equity averaged 24.0 percent over the 1995–99 period—far above the rates achieved by most financial corporations. Fannie Mae's return on equity reached 26.1 percent in 2002, an increase of 3 percent over the previous year.[295] In 2002, Fannie Mae's core business earnings grew by 19 percent, credit losses fell to their lowest level since 1983 and taxable equivalent revenues grew by 17 percent.[296]

Fannie Mae's core business earnings have increased from 39 cents a share in 1987 to $6.31 in 2002, and dividends per common share have increased from $.96 in 1998 to $1.32 in 2002, an 10 percent increase over 2001. Although operating earnings per diluted common share decreased from 2001 to 2002 by 21% to $4.53, Fannie Mae has still produced double-digit increases for the past 16 years in core business earnings per share, placing them among the best of the S&P 500 companies.[297]

Freddie Mac. Freddie Mac has shown similar trends. Freddie Mac's net income was $3.7 billion in 2000 and rose to $10.1 billion in 2002, an increase of 320 percent from the previous year.[298] Freddie Mac's return on equity averaged 23.4 percent over the 1995–99 period—also well above the rates achieved by most financial corporations. Freddie Mac's return on common equity exceeded 20 percent in 2001 for the twentieth consecutive year, reaching a high of 39.2 percent in 2001. Freddie Mac's total revenues grew to $7.4 billion in 2001, up from $4.5 billion in 2000.[299]

Investors in Freddie Mac's common stock have seen their annual dividends per share increase from $0.68 in 2000 to $0.88 in 2002.[300] Earnings per diluted common share increased from $4.23 in 2001 to $14.18 in 2002.[301]

Other Indicators. Additional indicators of the strength of the GSEs are provided by various rankings of American corporations. *Business Week* has reported that among Standard & Poor's 500 companies in 1999, Fannie Mae and Freddie Mac respectively ranked 49th and 88th in market value, and 24th and 43rd in total profits.[302] Fannie Mae ranked 30th in market value and 13th in total profits in 2001, while Freddie Mac ranked 23rd in annual growth revenues from 1991–2001.[303]

f. Conclusion About Leading the Industry

In light of these considerations, the Secretary has determined that the GSEs have the ability to lead the industry in making mortgage credit available for low- and moderate-income families.

H. Factor 6: The Need To Maintain the Sound Financial Condition of the GSEs

HUD has undertaken a separate, detailed economic analysis of this final rule, which includes consideration of (a) the financial returns that the GSEs earn on low- and moderate-income loans and (b) the financial safety and soundness implications of the housing goals. Based on this economic analysis and reviewed by the Office of Federal Housing Enterprise Oversight, HUD concludes that the goals raise minimal, if any, safety and soundness concerns.

[290] *Inside Mortgage Finance,* ''Online Volume Comprises One-Fourth of Total Originations in First Half '02,'' September 20, 2002, p. 8.

[291] Fannie Mae, *2002 Annual Housing Activities Report,* 2003, p. 12.

[292] Fannie Mae, *2002 Annual Housing Activities Report,* 2003, p. 11.

[293] Fannie Mae, *2002 Annual Housing Activities Report,* 2003, p. 10.

[294] The 22% decrease in Fannie Mae's 2002 net income resulted primarily from a $4.508 billion increase in purchased options expense, which occurred due to an increase in the notional amount of purchased options outstanding and the declining interest rate environment. Recorded purchased options expense for 2001 was only $37 million by comparison. *Fannie Mae 2002 Annual Report,* 2003, p. 23.

[295] Fannie Mae, *2002 Annual Report to Shareholders,* ''Financial Highlights.''

[296] Fannie Mae, *2002 Annual Report to Shareholders,* Financial Highlights and Letter to Shareholders.

[297] Fannie Mae, *2002 Annual Report to Shareholders,* Financial Highlights and Letter to Shareholders.

[298] Freddie Mac, Consolidated Statements of Income, Restated November 21, 2003.

[299] Freddie Mac, *2001 Annual Report to Shareholders,* pp. 21–22.

[300] Freddie Mac, Consolidated Statements of Income, Restated November 21, 2003.

[301] Freddie Mac, Consolidated Statements of Income, Restated November 21, 2003.

[302] *Business Week,* March 27, 2000, p. 197.

[303] The ''2002 Fortune 500 Top Performing Companies and Industries.'' <*http://www.fortune.com/fortune/fortune500/topperformers/0,14940,00.html*>.

I. Determination of the Low- and Moderate-Income Housing Goals

The annual goal for each GSE's purchases of mortgages financing housing for low- and moderate-income families is proposed to be established at 52 percent of eligible units financed in each of calendar years 2005, 53 percent in 2006, 55 percent in 2007, and 57 percent in 2008. This goal will remain in effect thereafter, unless changed by the Secretary prior to that time. In addition, a low- and moderate-income subgoal of 45 percent in 2005, 46 percent in 2006, and 47 percent in both 2007 and is proposed for the GSEs' acquisitions of single-family-owner home purchase loans in metropolitan areas. This subgoal is designed to encourage the GSEs to lead the primary market in offering homeownership opportunities to low- and moderate-income families. The Secretary's consideration of the six statutory factors that led to the choice of these goals is summarized in this section.

1. Housing Needs and Demographic Conditions

Affordability Problems. Data from the 2000 Census and the American Housing Surveys demonstrate that there are substantial housing needs among low- and moderate-income families. Many of these households are burdened by high homeownership costs or rent payments and will likely continue to face serious housing problems, given the dim prospects for earnings growth in entry-level occupations. There is evidence of deep and persistent housing problems for Americans with the lowest incomes. Recent HUD analysis reveals that in 1999, 4.9 million households had ''worst case'' housing needs, defined as housing costs greater than 50 percent of household income or severely inadequate housing among unassisted very-low-income renter households. Among the 34 million renters in all income categories, 6.3 million (19 percent) had a severe rent burden and over one million renters (3 percent) lived in housing that was severely inadequate.

Demographic Trends. Changing population demographics will result in a need for the primary and secondary mortgage markets to meet nontraditional credit needs, respond to diverse housing preferences and overcome information and other barriers that many immigrants and minorities face. It is projected that there will be 1.2 million new households each year over the next decade. The aging of the baby-boom generation and the entry of the baby-bust generation into prime home buying age will have a dampening effect on housing demand. However, the continued influx of immigrants will increase the demand for rental housing, while those who immigrated during the 1980s and 1990s will be in the market for owner-occupied housing. Immigrants and other minorities—who accounted for nearly 40 percent of the growth in the nation's homeownership rate over the past five years—will be responsible for almost two-thirds of the growth in the number of new households over the next ten years. Non-traditional households have become more important, as overall household formation rates have slowed. With later marriages, divorce, and non-traditional living arrangements, the fastest growing household groups have been single-parent and single-person households. As these demographic factors play out, the overall effect on housing demand will likely be sustained growth and an increasingly diverse household population from which to draw new renters and homeowners. According to the National Association of Homebuilders, annual housing demand will average 1.82 million units over the next decade.

Growth in Single-Family Affordable Lending. Many younger, minority and lower-income families did not become homeowners during the 1980s due to the slow growth of earnings, high real interest rates, and continued house price increases. Over the past ten years, economic expansion, accompanied by low interest rates and increased outreach on the part of the mortgage industry, has improved affordability conditions for these families. As this appendix explains, there has been a ''revolution in affordable lending'' that has extended homeownership opportunities to historically underserved households. The mortgage industry has offered more customized mortgage products, more flexible underwriting, and expanded outreach to low-income and minority borrowers. Fannie Mae and Freddie Mac have been a big part of this ''revolution in affordable lending.'' HMDA data suggest that the industry and GSE initiatives are increasing the flow of credit to underserved borrowers. Between 1993 and 2002, conventional loans to low-income and minority families increased at much faster rates than loans to upper-income and non-minority families. Thus, the 1990s and the early part of the current decade have seen the development of a strong affordable lending market.

Disparities in Housing and Mortgage Markets. Despite this strong growth in affordable lending, serious disparities in the nation's housing and mortgage markets remain. The homeownership rate for African-American and Hispanic households is about 25 percentage points below that of white households. In addition to low income, barriers to homeownership that disproportionately affect minorities and immigrants include: lack of capital for down payment and closing costs; poor credit history; lack of access to mainstream lenders; little understanding of the homebuying process; and, continued discrimination in housing markets and mortgage lending. With respect to the latter, a recent HUD-sponsored study of discrimination in the rental and owner markets found that while differential treatment between minority and white home seekers had declined over the past ten years, it continued at an unacceptable level in the year 2000. In addition, disparities in mortgage lending continued across the nation in 2002, when the loan denial rate for African-American applicants was almost three times that for white applicants, even after controlling for income of the applicant. HUD studies also show that African Americans and Hispanics are subject to discriminatory treatment during the pre-qualification process of applying for a mortgage.

Single-Family Mortgage Market. Heavy refinancing due to low interest rates increased single-family mortgage originations to record levels during 2001–2003. Demographic forces, industry outreach, and low interest rates also kept lending for home purchase at record levels as well. As noted above, the potential homeowner population over the next decade will be highly diverse, as growing demand from immigrants and minorities are expected to sustain the home purchase market, as our population ages. Single-family housing starts are expected to continue in the 1.65–1.70 million range over the next few years. Refinancing of existing mortgages, which accounted for about 65 percent of originations during 2000–2003 is expected to return to more normal levels. As this Appendix explains, the GSEs will continue to play a dominant role in the single-family market and will both impact and be affected by major market developments such as the growth in subprime lending and the increasing use automated underwriting.

Multifamily Mortgage Market. The market for financing of multifamily apartments has grown to record volumes. The favorable long-term prospects for apartments, combined with record low interest rates, have kept investor demand for apartments strong and supported property prices. As explained below, Fannie Mae and Freddie Mac have been among those boosting volumes and introducing new programs to serve the multifamily market. The long run outlook for the multifamily rental market is sustained, moderate growth, based on favorable demographics. The minority population, especially Hispanics, provides a growing source of demand for affordable rental housing. ''Lifestyle renters'' (older, middle-income households) are also a fast growing segment of the rental population. However, provision of affordable housing will continue to challenge suppliers of multifamily rental housing and policy makers at all levels of governments. Low incomes combined with high housing costs define a difficult situation for millions of renter households. Housing cost reductions are constrained by high land prices and construction costs in many markets. Government action—through land use regulation, building codes, and occupancy standards—are major contributors to those high costs. In addition to fewer regulatory barriers and costs, multifamily housing would benefit from more favorable public attitudes. Higher density housing is a potentially powerful tool for preserving open space, reducing sprawl, and promoting transportation alternatives to the automobile. The recently heightened attention to these issues may increase the acceptance of multifamily rental construction to both potential customers and their prospective neighbors.

2. Past Performance of the GSEs

This section reviews the low- and moderate-income performance of Fannie Mae and Freddie Mac. It first reviews the GSEs' performance on the Low- and Moderate-Income Goal, then reviews findings from Section E.2 regarding the GSEs' purchases of home loans for historically underserved families and their communities. Finally, it reviews findings from Section G concerning the GSEs' presence in owner and rental markets.

a. Housing Goals Performance

In the October 2000 rule, the low- and moderate-income goal was set at 50 percent for 2001–03. Effective on January 1, 2001, several changes in counting requirements came into effect for the low- and moderate-income goal, as follows: (a) ''B.00000000onus points'' (double credit) for purchases of mortgages on small (5–50 unit) multifamily properties and, above a threshold level, mortgages on 2–4 unit owner-occupied properties; (b) a ''temporary adjustment factor'' (1.35 unit credit) for Freddie Mac's purchases of mortgages on large (more than 50 units) multifamily properties; (c) changes in the treatment of missing data; and (d) a procedure for the use of imputed or proxy rents for determining goal credit for multifamily mortgages. Fannie Mae's performance was 51.5 percent in 2001 and 51.8 percent in 2002, and Freddie Mac's performance was 53.2 percent in 2001 and 51.4 percent in 2002; thus both GSEs surpassed this higher goal.

Counting requirements (a) and (b) expired at the end of 2003, while (c) and (d) will remain in effect after that. If this counting approach—without the bonus points and the ''temporary adjustment factor'' had been in effect in 2000 and 2001, and the GSEs had purchased the same mortgages that they actually did purchase in both years, then Fannie Mae's performance would have been 51.3 percent in 2000, 49.2 percent in 2001, and 49.0 percent in 2002. Freddie Mac's performance would have been 50.6 percent in 2000, 47.7 percent in 2001, and 46.5 percent in 2001. Thus, both Fannie Mae and Freddie Mac would have surpassed the low- and moderate-income goal of 50 percent in 2000 and fallen short in 2001 and 2002. (See Figure A.1.)

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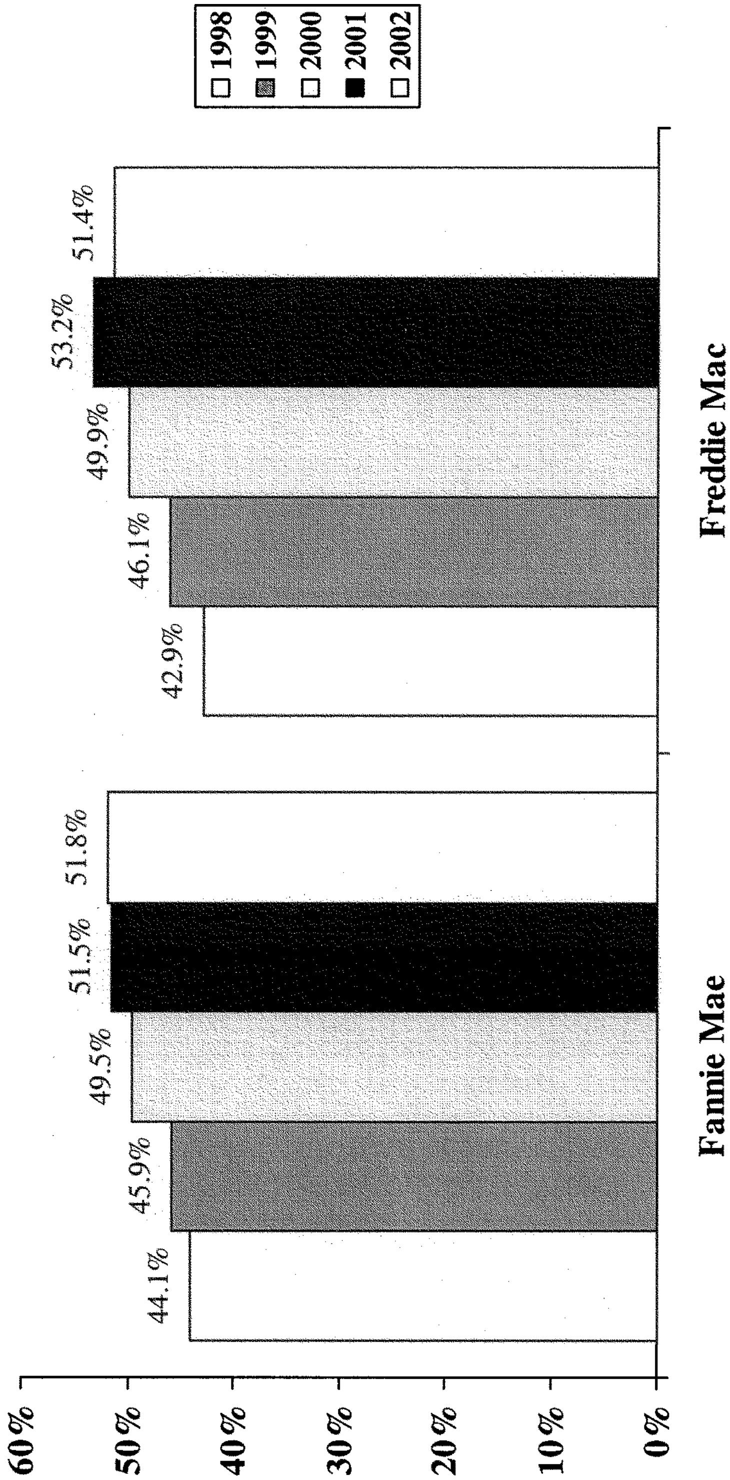
Figure A.1

Low- and Moderate-Income Mortgage Purchases



Low- and Moderate-Income Goal was 42% of units financed for 1998-2000 and 50% for 2001 and 2002.

Source: HUD analysis of GSEs' loan-level data. Due to changes in goal counting procedures in 2001, performance in 2001-02 is not strictly comparable with performance in 1998-2000, as discussed in text.

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