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HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac); Final Rule

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 81

[Docket No. FR–4494–F–02]

RIN 2501–AC60

HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)

AGENCY: Office of the Assistant Secretary for Housing ‘‘ Federal Housing Commissioner, HUD.

ACTION: Final rule.

SUMMARY: This final rule establishes new housing goal levels for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the ‘‘Government Sponsored Enterprises,’’ or the ‘‘GSEs’’) for the years 2001 through 2003. The new housing goal levels are established in accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA), and govern the purchase by Fannie Mae and Freddie Mac of mortgages financing low- and moderate-income housing, special affordable housing, and housing in central cities, rural areas and other underserved areas. Specifically, the final rule increases the Low- and Moderate-Income Housing Goal to 50 percent, the Geographically Targeted Goal to 31 percent, and the Special Affordable Housing Goal to 20 percent of units backing each GSE's annual eligible mortgage transactions. The Special Affordable Multifamily Subgoal increases to one percent of each GSE's average annual total dollar mortgage purchases in 1997 through 1999. This rule also establishes new provisions and clarifies certain other provisions of HUD's rules for counting different types of mortgage purchases towards the goals, including provisions regarding the use of bonus points for mortgages that are secured by certain single family rental properties and small multifamily properties; and the disallowance of goals credit for mortgage loans with predatory characteristics.

While Fannie Mae and Freddie Mac have been successful in providing stability and liquidity in the market for certain types of mortgages, their share of the affordable housing market is substantially smaller than their share of the total conventional, conforming mortgage market. There are several reasons for these disparities, related to the GSEs' purchase and underwriting guidelines; and to their relatively low level of activity in specific mortgage markets that provide financing for housing serving low- and moderate-income families, including small multifamily rental properties, single family owner-occupied rental properties, manufactured housing, and markets for seasoned mortgages on properties with affordable housing. As the GSEs continue to grow their businesses, the new goals will provide strong incentives for the two enterprises to more fully address the housing finance needs for very low-, low- and moderate-income families and residents of underserved areas and, thus, more fully realize their public purposes.

In addition, as government sponsored enterprises and market leaders, Fannie Mae and Freddie Mac have a public responsibility to help eliminate predatory mortgage lending practices which are inimical to the home financing and homeownership objectives that the GSEs were established to serve. Fannie Mae and Freddie Mac have adopted policies stating that they will not purchase mortgage loans with certain predatory characteristics. This final rule affirms the GSEs' actions by disallowing housing goals credit for mortgages having features that the GSEs themselves have identified as unacceptable.

EFFECTIVE DATE: January 1, 2001.

FOR FURTHER INFORMATION CONTACT: Director, Office of Government Sponsored Enterprises Oversight, Office of Housing, Room 6182, telephone 202–708–2224. For questions on data or methodology, contact John L. Gardner, Director, Financial Institutions Regulation Division, Office of Policy Development and Research, Room 8234, telephone (202) 708–1464. For legal questions, contact Kenneth A. Markison, Assistant General Counsel for Government Sponsored Enterprises/RESPA, Office of the General Counsel, Room 9262, telephone 202–708–3137. The address for all of these persons is Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410. Persons with hearing and speech impairments may access the phone numbers via TTY by calling the Federal Information Relay Service at (800) 877–8399.

SUPPLEMENTARY INFORMATION

I. General

A. Purpose

This final rule revises existing regulations implementing the Department of Housing and Urban Development's (the ‘‘Department’’ or ‘‘HUD’’) authority to regulate the GSEs. The authority exercised by the Department is established under:

(1) The Federal National Mortgage Association Charter Act (‘‘Fannie Mae Charter Act’’), which is Title III of the National Housing Act, section 301 *et seq.* (12 U.S.C. 1716 *et seq.*);

(2) The Federal Home Loan Mortgage Corporation Act (‘‘Freddie Mac Act’’), which is Title III of the Emergency Home Finance Act of 1970, section 301 *et seq.* (12 U.S.C. 1451 *et seq.*); and

(3) FHEFSSA, enacted as Title XIII of the Housing and Community Development Act of 1992 (Pub. L. 102–550, approved October 28, 1992) (12 U.S.C. 4501–4641).

(4) Section 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)), which provides that the Secretary may make such rules and regulations as may be necessary to carry out his functions, powers, and duties, and may delegate and authorize successive redelegations of such functions, powers, and duties to officers and employees of the Department.

FHEFSSA substantially changed the Department's regulatory authorities governing the GSEs by establishing a separate safety and soundness regulator within the Department and clarified and expanded the Department's regulation of the GSEs' missions. Regulations first implementing the Department's authorities with respect to the GSEs' missions under FHEFSSA were issued on December 1, 1995 (24 CFR part 81).

This rule revises certain portions of those regulations concerning the GSEs' affordable housing goals and provisions related to how mortgage loans are treated in the calculation of performance under the housing goals. The remaining part of the preamble contains several endnotes. These endnotes appear at the end of the preamble.

B. Background

1. Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac engage in two principal businesses: investing in residential mortgages and guaranteeing securities backed by residential mortgages. Fannie Mae and Freddie Mac are chartered by Congress as Government Sponsored Enterprises to: (1) Provide stability in the secondary market for residential mortgages; (2) respond appropriately to the private capital market; (3) provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and (4) promote access to mortgage credit throughout the nation (including central cities, rural areas, and other underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.[1]

Fannie Mae and Freddie Mac receive significant explicit benefits through their status as GSEs that are not enjoyed by any other shareholder-owned corporations in the mortgage market. These benefits include: (1) Conditional access to a $2.25 billion line of credit from the U.S. Treasury; [2] (2) exemption from the securities registration requirements of the Securities and Exchange Commission and the States; [3] and (3) exemption from all State and local taxes except property taxes.[4]

Additionally, although the securities the GSEs guarantee and the debt instruments they issue are not backed by the full faith and credit of the United States, and nothing in this final rule should be construed otherwise, such securities and instruments trade at yields only a few basis points over those of U.S. Treasury securities and at yields lower than those for securities issued by comparable firms that are fully private but may be higher capitalized. The market prices for GSE debt and mortgage-backed securities, and the fact that the market does not require that those securities be rated by a national rating agency, suggest that investors perceive that the government implicitly backs the GSEs' debt and securities. This perception evidently arises from the GSEs' relationship to the Federal Government, including their public purposes, their Congressional charters, their potential direct access to U.S. Department of Treasury funds, and the statutory exemptions of their debt and mortgage-backed securities (MBS) from otherwise mandatory security laws. Consequently, each GSE enjoys a significant implicit benefit—its cost of doing business is significantly less than that of other firms in the mortgage market. According to a U.S. Department of Treasury 1996 study, the benefits of federal sponsorship are worth almost $6 billion annually to Fannie Mae and Freddie Mac. Of this amount, reduced operating costs (*i.e.,* exemption from SEC filing fees and from state and local income taxes) represent approximately $500 million annually. These estimates are broadly consistent with estimates by the Congressional Budget Office and General Accounting Office. According to the Department of the Treasury, Fannie Mae and Freddie Mac appear to pass through part of these benefits to consumers through reduced mortgage costs and retain part for their own stockholders.[5]

The GSEs have achieved an important part of their mission: providing stability and liquidity to large segments of the housing finance markets. As a result of the GSEs' activities, many home buyers have benefited from lower interest rates and increased access to capital, contributing, in part, to a record national homeownership rate of 66.8 percent in 1999. While the GSEs have been successful in providing stability and liquidity to certain portions of the mortgage market, the GSEs must further utilize their entrepreneurial talents and power in the marketplace and "lead the mortgage finance industry" to "ensure that citizens throughout the country enjoy access to the public benefits provided by these federally related entities." [6]

Despite the record national homeownership rate in 1999, lower homeownership rates have prevailed for certain minorities, especially for African-American households (46.3 percent) and Hispanics (45.5 percent). These gaps are only partly explained by differences in income, age, and other socioeconomic factors. Disparities in mortgage lending are a contributing factor to lower homeownership rates and are reflected in loan denial rates of minority groups when compared to white applicants. Denial rates for conventional (non-government-backed) home purchase mortgage loans in 1998 were 54 percent for African Americans, 53 percent for Native American applicants, 39 percent for Hispanic applicants, 26 percent for White applicants, and 12 percent for Asian applicants.[7] Despite strong economic growth, low unemployment, low mortgage interest rates, and relatively stable home prices, housing problems continue to persist for low-income families and certain minorities.

In addition to disparities across racial groups, populations who live in certain types of housing have not benefited to the same degree as have others from the advantages and efficiencies provided by Fannie Mae and Freddie Mac. The GSEs have been much less active in purchasing mortgages in markets where there is a need for additional financing to address persistent housing needs including financing for small multifamily rental properties, manufactured housing, single family owner-occupied rental properties, seasoned affordable housing mortgages, and older housing in need of rehabilitation.

While HUD recognizes that the GSEs have played a significant role in the mortgage finance industry by providing a secondary market and liquidity for mortgage financing for certain segments of the mortgage market, it is this recognition of their ability, along with HUD's comprehensive analyses of the size of the mortgage market and the opportunities available, America's unmet housing needs, identified credit gaps, and HUD's consideration of the statutory factors under FHEFSSA that causes HUD to increase the level of the housing goals so that as the GSEs grow their businesses so they will address new markets and persistent housing finance needs.

2. Regulation of the GSEs

In 1968, Congress assigned HUD general regulatory authority over Fannie Mae,[8] and in 1989, Congress granted the Department essentially identical regulatory authority over Freddie Mac.[9] Under the 1968 law, HUD was authorized to require that a portion of Fannie Mae's mortgage purchases be related to the national goal of providing adequate housing for low- and moderate-income families. Accordingly, the Department established two housing goals—a goal for mortgages on low- and moderate-income housing and a goal for mortgages on housing located in central cities—by regulation, for Fannie Mae in 1978.[10] Each goal was established at the level of 30 percent of mortgage purchases. Similar housing goals for Freddie Mac were proposed by the Department in 1991 but were not finalized before October 1992, when Congress revised the Department's GSE regulatory authorities including requirements for new housing goals.

In 1992, Congress enacted the Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA) as Title XIII of the Housing and Community Development Act of 1992 (Pub. L. 102–550, approved October 28, 1992) (12 U.S.C. 4501–4641), which established the Office of Federal Housing Enterprise Oversight (OFHEO) as the GSEs' safety and soundness regulator and affirmed, clarified and expanded the Secretary of Housing and Urban Development's responsibilities for GSE mission regulation. FHEFSSA provided that, except for the specific authority of the Director of OFHEO, the Secretary retained general regulatory power over the GSEs.[11] FHEFSSA also detailed and expanded the Department's specific

[11] 11. Sec. 1321.

powers and authorities, including the power to establish, monitor, and enforce housing goals for the GSEs' purchases of mortgages that finance housing for low- and moderate-income families; housing located in central cities, rural areas, and other underserved areas; and special affordable housing, affordable to very low-income families and low-income families in low-income areas.[12] The Department is required to establish each of the goals after consideration of certain prescribed factors relevant to the particular goal.[13]

FHEFSSA provided for a transition period during 1993 and 1994 and required HUD to establish interim goals for the transition period (58 FR 53048; October 13, 1993) (59 FR 61504; November 30, 1994). In November 1994, HUD extended the interim goals established for 1994 for both GSEs through 1995 while the Department completed its development of post transition goals.

The Department issued proposed and final rules in 1995 establishing and implementing the housing goals for the years 1996 through 1999. The rule provided that the housing goals for 1999 would continue beyond 1999 if the Department did not change the goals, and further provided that HUD may change the level of the goals for the years 2000 and beyond based upon HUD's experience and in accordance with HUD's statutory authority and responsibility.

In addition to establishing the level of the housing goals, the 1995 final rule included counting requirements for purposes of calculating performance under the housing goals. The new regulations also prohibited the GSEs from discriminating in any manner on any prohibited basis in their mortgage purchases, implemented procedures by which HUD exercises its authority to review new programs of the GSEs, required reports from the GSEs, established a public use data base on the GSEs' mortgage purchase activities while providing protections for confidential and proprietary information, and established enforcement procedures under FHEFSSA.

C. The Proposed Rule

On March 9, 2000,[14] HUD published a rule proposing new housing goal levels for Fannie Mae and Freddie Mac. The rule proposed to increase the level of the housing goals for the purchase by Fannie Mae and Freddie Mac of mortgages financing low- and moderate-income housing, special affordable housing, and housing in central cities, rural areas, and other underserved areas. The rule also proposed to clarify HUD's guidelines for counting different types of mortgage purchases under the housing goals, including treatment of missing affordability data and purchases of seasoned mortgage loans; use of bonus points for goals credit for purchases of mortgages secured by single family rental and small multifamily properties; and providing greater public access to certain types of mortgage data on the GSEs' mortgage purchases in HUD's public use database. The rule also solicited public comments on several other issues related to the housing goals including the appropriate role of credit enhancements in furthering affordable housing lending and whether the use of credit enhancements should be considered in calculating housing goal performance.

D. This Final Rule

In response to the proposed rule, HUD received over 250 comments. The comments came from the GSEs; individuals; representatives of lending institutions; non-profit organizations; community, consumer groups and civil rights organizations; local and State governments; and others. Following full consideration of the comments, HUD developed this final rule. The final rule is consistent with the approach announced in the proposed rule but does include some revisions adopted in light of the comments received. The final rule: (1) Increases the level of the housing goals for the years 2001 through 2003 as a result of HUD's review of the statutory factors under FHEFSSA to ensure that the GSEs continue and strengthen their efforts to carry out Congress' intent that the GSEs provide the benefits of the secondary market to families throughout the nation—the Low- and Moderate-Income Housing Goal increases to 50 percent, the Geographically Targeted Goal increases to 31 percent, the Special Affordable Housing Goal increases to 20 percent; and the Special Affordable Multifamily Subgoal increases to the respective average of one percent of each GSE's total mortgage purchases over 1997 through 1999; (2) establishes the use of bonus points for small multifamily properties with 5 to 50 units and for single family owner-occupied rental properties for the years 2001 through 2003; (3) establishes a temporary adjustment factor for Freddie Mac's multifamily mortgage purchases for the years 2001 through 2003; (4) prohibits the counting of high cost mortgage loans with predatory features for goals credit; (5) provides or clarifies counting rules for the treatment of missing affordability data, purchases of seasoned mortgage loans, purchases of federally insured mortgage loans and purchases of mortgage loans on properties with expiring assistance contracts; (6) provides for HUD's review of transactions to determine appropriate goal treatment; and (7) includes certain definitional and technical corrections to the regulations issued in 1995.

Specific changes included in the Final Rule from the provisions included in the Proposed Rule are as follows:

(1) The period covered by the housing goals is 2001 through 2003 and there is no transition year. The proposed rule had suggested the goals cover the period from 2000 through 2003 with 2000 serving as a transition year.

(2) The Special Affordable Multifamily Subgoal uses the average of 1997 through 1999 as the base period for establishing the level of the goal over the 2001 through 2003 period, rather than 1998 as the base period, as proposed. The subgoal remains a fixed dollar amount for each year of the period covered by the housing goals base equal to one percent of each GSE's average total mortgage purchases in 1997 through 1999.

(3) The final rule does not allow goals credit for predatory mortgage loans, and the rule describes specific characteristics, in addition to the HOEPA definition suggested in the proposed rule, to determine what types of loans are considered predatory. The final rule also identifies good lending practices with which mortgages should conform in order to count towards goals credit.

(4) The proposed provisions for the treatment of missing affordability data are retained but the final rule includes a five percent ceiling on the use of estimated affordability information for multifamily units.

(5) The guidance provided on how to determine if seasoned mortgage loan purchases meet the recycling requirements of the Special Affordable Housing Goal was expanded to (1) include additional types of lending organizations with affordable housing missions that are presumed to meet the recycling requirements; (2) adjust the Community Reinvestment Act (CRA) examination requirement for Federally regulated financial institutions to one "Satisfactory" rating for financial institutions with assets of $250 million or less to accommodate a less frequent examination schedule; and (3) specify requirements that a seller must meet for purposes of evaluating whether the seller meets the recycling requirements of 12 U.S.C. 4563(b)(1)(B).

(6) The final rule does not make changes to the definition of underserved

area other than the inclusion of tribal lands in underserved areas and does not address the public availability of mortgage data in the public use data base. As explained below, HUD will publish a decision on which data elements will be accorded proprietary and non-proprietary treatment by separate Order following publication of this final rule.

The analysis of Fannie Mae's and Freddie Mac's affordable housing performance, which is the basis for many of the changes in the final rule, is primarily based on data from 1997, 1998 and 1999. The GSEs' actual performance is presented through 1999. However, Home Mortgage Disclosure Act (HMDA) data which provides data on the conventional, conforming market was not available for 1999 at the time HUD prepared its analysis supporting this final rule. As HMDA data for 1999 were not available, comparisons between the GSEs and the market as a whole for that year are not possible. Further, as 1998 was a year with a large percentage of refinance mortgage transactions, at times 1997 data is utilized as it presents a more normal year in terms of home purchase mortgage transactions.

In finalizing these regulations, the Department is guided by and affirms the following principles established in the 1995 rulemaking:

(1) To fulfill the intent of FHEFSSA, the GSEs should lead the industry in ensuring that access to mortgage credit is made available for very low-, low- and moderate-income families and residents of underserved areas. HUD recognizes that, to lead the mortgage industry over time, the GSEs will have to stretch to reach certain goals and close the gap between the secondary mortgage market and the primary mortgage market. This approach is consistent with Congress' recognition that "the enterprises will need to stretch their efforts to achieve" the goals.[15]

(2) The Department's role as a regulator is to set broad performance standards for the GSEs through the housing goals, but not to dictate the specific products or delivery mechanisms the GSEs will use to achieve a goal. Regulating two exceedingly large financial enterprises in a dynamic market requires that HUD provide the GSEs with sufficient latitude to use their innovative capacities to determine how best to develop products to carry out their respective missions. HUD's regulations should allow the GSEs to maintain their flexibility and their ability to respond quickly to market opportunities. At the same time, the Department must ensure that the GSEs' strategies serve families in underserved markets and address unmet credit needs. The addition of bonus points to the regulatory structure provides an additional means of encouraging the GSEs' affordable housing activities to address identified, persistent credit needs while leaving the specific approaches to meeting these needs to the GSEs.

(3) Discrimination in lending—albeit sometimes subtle and unintentional—has denied racial and ethnic minorities the same access to credit to purchase a home that has been available to similarly situated non-minorities. The GSEs have a central role and responsibility to promote access to capital for minorities and other identified groups and to demonstrate the benefits of such lending to industry and borrowers alike. The GSEs also have an integral role in eliminating mortgage lending practices that are predatory.

(4) In addition to the GSEs' purchases of single family home loans, the GSEs also must continue to assist in the creation of an active secondary market for multifamily loans. Affordable rental housing is essential for those families who cannot afford or choose not to become homeowners. The GSEs must assist in making capital available to assure the continued development of rental housing.

II. Discussion of Public Comments

A. Overview

1. Public Comment

Of the over 250 comments received, by far the most detailed were the submissions of the two directly affected GSEs—Fannie Mae and Freddie Mac. Each GSE's comments were in large measure supportive of the overall goal structure proposed by the Department. The GSEs, however, did provide extensive appendices questioning the Department's methodology in determining market share for the three affordable housing goals, a key component for establishing the appropriate level of the housing goals.

Other commenters included national and regional industry related groups, non-profit organizations, state and local government officials, lenders, and individuals. In large measure, these commenters were also supportive of the Department's proposal to increase the affordable housing goals and the related provisions designed to streamline the counting rules used to calculate performance under the housing goals.

Other than the goals framework, the areas generating the largest response from commenters were the treatment of high cost mortgages, the role of credit enhancements in affordable lending transactions, and the availability of data on the public use data base. It should be noted that in evaluating these comments a large number of comments were received that included substantially similar responses, in both language and tone, to those submitted by Fannie Mae.

In addressing the appropriate goals treatment for high cost mortgages, one group of commenters, comprised primarily of non-profit and housing advocacy groups, felt the provisions included in the proposed rule disallowing credit for loans that meet the HOEPA definition should be strengthened. Other commenters, consistent with the comments provided by Fannie Mae, opposed any limitation of goals credit for predatory mortgage loans.

With regard to credit enhancements, a substantial majority of commenters noted that credit enhancements are a critical component of many affordable housing transactions. There was little support for limiting goals credit for affordable housing transactions that include credit enhancements without a better understanding of how to ensure that there are not negative implications for affordable housing transactions.

The Department received comments supporting both increased data availability and limited availability of data. One group of commenters, including non-profit organizations and academic researchers, felt the provisions included in the proposed rule should be adopted and, in some instances, expanded in order to fully understand and challenge the GSEs on their affordable housing activities. Again, another group of commenters, consistent with the comments provided by Fannie Mae, opposed the availability of additional data on the public use data base. This group of commenters included both lenders and non-profit organizations which felt the additional data would release confidential business information and could compromise the privacy of individuals, respectively. This final rule does not, however, address the availability of data on the public use data base.

A discussion of the general and specific comments on the rule follows in subsequent sections. While comments are summarized, not all of the comments are addressed explicitly in this preamble. HUD fully considered all of the comments and HUD's response is either explicit in this final rule or implicit in the general discussion of the rule or other comments. HUD is appreciative of the full range of public comments received and acknowledges the value of all of the comments submitted in response to the proposed rule.

2. Other Public Input

As part of the public comment process, the Department conducted extensive outreach to educate and inform interested parties of the nature and extent of the GSEs' affordable housing activities. The outreach was undertaken in order to encourage comments on the proposed rule from a wide range of individuals, organizations and businesses that are interested in or are affected by Congress' charge to the GSEs to further the financing needs of underserved families and neighborhoods. The Department's outreach in this regard included two forums, three subject matter meetings, and meetings with various industry trade groups and non-profit organizations to discuss the provisions of the proposed rule. These sessions are described below. Further, additional information on these meetings is contained in the public docket file of this rule in Room 10276 at HUD Headquarters.

a. Forums. The Department conducted two forums designed to give participants an in-depth look at how well the GSEs are supporting affordable housing activities in local communities. One forum was held in Hartford, Connecticut and the other in Durham, North Carolina. Each forum had approximately 125 participants. In addition to sessions held at both forums that reviewed the GSEs' progress in meeting the affordable housing needs in the respective region, each forum had a session that addressed issues and needs specific to the region. In Hartford, a session was held on the role of multifamily housing in meeting affordable housing needs. Research was presented on how small multifamily properties disproportionately serve low-income families and data was provided on the extent of the GSEs' purchases of mortgages on small multifamily properties. Panel members discussed the unique problems of financing small multifamily properties and how Fannie Mae and Freddie Mac can better serve these markets. In Durham, a session was held on predatory lending. Panel members identified abusive practices and discussed the impacts that predatory lenders were having particularly on the elderly and in minority neighborhoods. Serious questions were raised as to whether Fannie Mae and Freddie Mac should be involved in this market.

b. Subject Matter Meetings. HUD also held three smaller discussion group sessions designed to address specific subject matters included in the proposed rule. Subject matter meetings were held on the availability of data on the public use data base, issues related to identifying and meeting the credit needs of non-metropolitan areas, and the role of credit enhancements in affordable housing lending.

c. Other Meetings. In addition to the meetings described above, the Department met with various industry trade groups and non-profit organizations to present the changes suggested in the proposed rule and the rationale for the changes. HUD also met with Fannie Mae and Freddie Mac to discuss their concerns regarding the proposed rule.

B. Subpart A—General

HUD proposed to revise the definitions of ''median income,'' ''metropolitan area,'' and ''underserved area'' in order to provide greater clarity, consistency and technical guidance. The few comments received on these definitions were supportive of the proposed technical changes. HUD also proposed certain changes to several aspects of the definition of underserved area to solicit public input on how best to identify the areas that are underserved by the mortgage credit markets.

1. Median Income

HUD proposed to change the definition of ''median income'' to require the GSEs to use HUD estimates of median family income to further clarify the appropriate process for the GSEs' determination of area incomes. HUD has implemented this change in this final rule. As part of this change to the definition of ''median income,'' HUD will provide the GSEs, on an annual basis, information specifying how HUD's published median family income estimates are to be applied. This change is needed because, in some cases, HUD publishes area median family income estimates for portions of areas rather than whole metropolitan statistical areas (MSAs) or primary metropolitan statistical areas (PMSAs).

2. Metropolitan Area

HUD proposed to clarify the definition of ''metropolitan area'' by revising the description of the relevant area for determining median incomes to eliminate the reference in § 81.2 to consolidated metropolitan statistical areas (CMSAs). HUD has implemented this change in the final rule. ''Metropolitan area'' was defined in § 81.2 under the 1995 final rule as an MSA, a PMSA, or a CMSA, designated by the Office of Management and Budget of the Executive Office of the President. This definition raised questions as to the definition of ''underserved area'' and the denominator of the affordability ratio used to compute the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal regarding whether to use the median income of the CMSA or the PMSA. HUD has consistently relied upon median incomes of PMSAs in defining underserved areas and determining denominators for the other goals and this final rule clarifies this point.

3. Underserved Area

a. Technical Definition. HUD proposed to revise the definition of ''underserved area'' to clarify the parameters of rural underserved areas. The definition under HUD's 1995 final rule omitted the requirement for a comparison between the ''greater of the State non-metropolitan median income or nationwide non-metropolitan median income'' from the ''income/minority'' provision even though it had provided for this comparison when qualifying mortgage purchases under the ''income-only'' provision. HUD proposed to add the comparative language to the ''income/minority'' provision for rural underserved areas. The revision applies the same median income standard to both the ''income-only'' and the ''income/minority'' definitions. HUD has implemented this change in § 81.2 of this final rule. (HUD also proposed other changes to the definition of ''underserved areas.'' These are discussed in Subpart B—Housing Goals.)

b. Other Changes Proposed and/or Comments Requested. The proposed rule described additional changes to the definition of underserved area relating to tribal lands and requested comments on possible changes to the income and minority requirements of the definition.

(1) Tribal Lands. HUD proposed to revise the definition of ''underserved areas'' in § 81.2 to designate all qualifying Indian reservations and trust lands as underserved areas.

c. Summary of Comments. Fannie Mae stated that it is ''particularly appropriate'' to include these lands in the definition of underserved areas. Fannie Mae added that it ''does not think it is feasible, practical, or appropriate to split trust lands between served and underserved designations, depending on the designation of the surrounding tracts or counties.'' Fannie Mae further commented that HUD's proposal could lead to ''split or proportional treatment of any one trust land,'' and that such areas should be included as underserved areas ''without regard to income or minority status.'' Fannie Mae added that HUD should consider postponing this change until ''the new boundary files and data files'' become available from the 2000 Census. Fannie Mae further stated that HUD's proposal to define some underserved areas in terms of income and minority composition for the balance of a county or census tract excluding the area within any Federal or State American Indian reservation or tribal or individual trust land ''raises operational issues that will be difficult to overcome.''

Freddie Mac stated that ''In principal [sic], Freddie Mac has no objection to treating an American Indian Reservation or tribal land as a geographic whole'' for determining underserved areas. It added, however, that ''adoption of a definition that would involve geocoding rural loans at the subcounty level could present formidable practical problems.'' Freddie Mac recommended that HUD ''designate entire tracts in metropolitan areas and entire counties in nonmetropolitan areas that contain qualifying reservations and trust lands as underserved.''

Other commenters were generally supportive of the Department's proposal. One commenter called for an expansion of the proposal to include tribal service areas and urban living Native Americans.

d. HUD's Determination. HUD believes that treating tribal lands as separate geographic entities implies that the balance of counties or tracts excluding such areas would logically be treated as separate entities, but it recognizes Fannie Mae's argument that this could raise ''operational issues.'' HUD will issue operational guidance on this matter prior to the effective date of this Final Rule.

HUD evaluated Fannie Mae's recommendation to classify all American Indian and Alaskan Native (AIAN) areas as underserved areas, without regard to income or minority status, in light of the problems involved in obtaining a mortgage on even the very few higher-income (or low minority) tribal lands. HUD analyzed data on 1989 median incomes and minority concentrations for AIAN areas provided by the U.S. Bureau of the Census. HUD's analysis showed that, out of 248 AIAN areas with sufficient population to determine an area median family income, 19 areas, or 6.7 percent, would be classified as served and 265 areas, or 93.3 percent, as underserved. The 19 areas include some with very low minority concentrations and some with very high median incomes. HUD concludes that implementation of Fannie Mae's recommendation would, in a small but significant number of instances, substantially breach the principle that underserved areas are areas with low median incomes and/or high minority concentrations, as established in the 1995 Final Rule. Accordingly, HUD has not implemented Fannie Mae's recommendation.

HUD believes that designating entire tracts or counties that contain qualifying tribal lands as underserved areas is not appropriate. The purpose of the definitional change in underserved areas to include all tribal lands is to focus attention on the mortgage financing needs of Native American communities. By designating the entire county or census tract as underserved by virtue of the presence of tribal lands in a portion of it, this focus is lost. HUD believes that any geocoding problems arising from this proposal can be resolved. HUD will issue operational guidance on this matter prior to the effective date of this final rule.

HUD believes that underserved areas must have relatively fixed definitions—tribal service areas are evolving over time. The underserved areas goal is defined broadly by both geographic and area wide demographic features so that borrowers living in underserved areas benefit from the increased attention paid to lending in such areas as a result of HUD's geographic goal.

(2) Enhanced Tract Definition. In the proposed rule, comments were sought on possible changes to the current metropolitan underserved areas definition to better target underserved areas with higher mortgage denial rates and thereby promote better access to mortgage credit for these areas. Specifically, HUD proposed changing the current tract income ratio to an ''enhanced'' tract income ratio requiring that for tracts to qualify as underserved they must have a tract income ratio at or below the maximum of 80 percent of area median income or 80 percent of U.S. median income in metropolitan areas. The proposed change would make the underserved areas definition used by the GSEs consistent with the requirements of Federally insured depository institutions under the Community Reinvestment Act (CRA). The Department believes the concept has substantial merit, and there was a sizeable group of commenters that supported the concept, at least in part. However, there were a number of commenters, including the GSEs, that said that since the redesignation of census tracts as underserved would be based on data from the 1990 Census, and since data from the 2000 Census would not be available for a few years, it would not be appropriate to make such a change at this time. Rather, they suggested that the Department wait until updated information from the 2000 Census is available to analyze. The Department agrees that, with more current information to become available from the 2000 Census in the near future, the timing is not optimal to make a change in the underserved areas designation. Once information from the 2000 Census is available, the Department will determine whether this proposal merits consideration.

(3) Minority Composition. Similarly, the proposed rule requested comment on another approach to target high mortgage denial rate areas. The alternative approach would be to increase the minority component required to identify an area as underserved by increasing the requirement from 30 percent to 50 percent minority. Several commenters noted that increasing the minority component of a census tract to qualify as underserved would have a disproportionately negative impact on the Hispanic population. Commenters observed that Hispanic residential living patterns are not as concentrated as those of other minority groups. In addition, comments were provided suggesting that any changes in this area be considered once data from the 2000 Census is available before making a final determination in this regard. The Department has determined that it will obtain and analyze 2000 Census data and consider various minority population patterns and their relationship to the availability of mortgage credit before deciding whether this proposal continues to merit consideration.

(4) Rural Areas. The proposed rule requested comments on how best to define underserved rural areas, posing questions on whether the underserved rural areas should be identified by census tract or by county. HUD received comments that supported both approaches. Again, the commenters raised the issue of the 2000 Census. Consistent with the Department's other determinations regarding significant changes to the definition of underserved areas, HUD will not make any changes at this time in defining underserved rural areas and will wait for the opportunity to analyze the data from the 2000 Census.

C. Subpart B—Housing Goals

1. Overview

Comments received overwhelmingly supported the Department's proposal to increase the level of the affordable housing goals. Both GSEs commented that, while meeting these goals will be a challenge (particularly the Underserved Areas Goal), they are committed to doing so. While some commenters, including the GSEs, expressed concern that the market scenarios used by HUD did not adequately consider an economic downturn, those commenters still felt that higher goals levels were appropriate. This section of the final rule reviews the statutory factors the Department must consider in setting the level of the housing goals, specific comments on the housing goals including the market methodology, and the determination made with regard to the level for each of the housing goals.

2. Statutory Considerations in Setting the Level of the Housing Goals

In establishing the housing goals, FHEFSSA requires the Department to consider six factors—national housing needs; economic, housing and demographic conditions; performance and effort of the GSEs toward achieving the goal in previous years; size of the conventional mortgage market serving the targeted population or areas, relative to the size of the overall conventional mortgage market; ability of the GSEs to lead the industry in making mortgage credit available for the targeted population or areas; and the need to maintain the sound financial condition of the GSEs. These factors are discussed in more detail in the following sections of this preamble and in the Appendices to this rule. A summary of HUD's findings relative to each factor follows:

a. National Housing Needs. Analysis and research by HUD and others in the housing industry indicate that there are, and will continue to be in the foreseeable future, substantial unmet housing needs among lower-income and minority families. Data from the American Housing Surveys demonstrate that there are substantial unmet housing needs among lower-income families. Many 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. According to HUD's ''Worst Case Housing Needs'' report, 21 percent of owner households faced a moderate or severe cost burden in 1997. Affordability problems were even more common among renters, with 40 percent paying more than 30 percent of their income for rent in 1997.[16]

Despite the growth during the 1990s in affordable housing lending, disparities in the mortgage market remain, with certain minorities, particularly African-American and Hispanic families, lagging the overall market in rate of homeownership. In addition, there is evidence that the aging stocks of single family rental properties and small multifamily properties with 5–50 units, which play a key role in lower-income housing, have experienced difficulties in obtaining financing. The ability of the nation to maintain the quality and availability of the existing affordable housing stock and to stabilize neighborhoods depends on an adequate supply of affordable credit to rehabilitate and repair older units.

(1) Single Family Mortgage Market. 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 several years, economic expansion, accompanied by low interest rates and increased outreach on the part of the mortgage industry, has improved affordability conditions for lower-income families. Between 1994 and 1999, record numbers of lower-income and minority families purchased homes. First time homeowners have become a major driving force in the home purchase market over the past five years. Thus, the 1990s have seen the development of a strong affordable lending market. Despite the growth of lending to minorities, disparities in the mortgage market remain. For example, African-American applicants are still twice as likely to be denied a loan as white applicants, even after controlling for income.

(2) Multifamily Mortgage Market. Since the early 1990s, the multifamily mortgage market has become more closely integrated with global capital markets, although not to the same degree as the single family mortgage market. Loans on multifamily properties are still viewed as riskier by some than mortgages on single family properties. Property values, vacancy rates, and market rents of multifamily properties appear to be highly correlated with local job market conditions, creating greater sensitivity of loan performance to economic conditions than may be experienced for single family mortgages.

There is a need for an on-going GSE presence in the multifamily secondary market both to increase liquidity and to further affordable housing efforts. The potential for an increased GSE presence is enhanced by the fact that an increasing proportion of multifamily mortgages are now originated in accordance with secondary market standards.

The GSEs can play a role in promoting liquidity for multifamily mortgages and increasing the availability of long-term, fixed rate financing for these properties. Increased GSE presence would provide greater liquidity to lenders, *i.e.*, a viable ''exit strategy,'' that in turn would serve to increase their lending. It appears that the financing of small multifamily rental properties with 5–50 units, where a substantial portion of the nation's affordable housing stock is concentrated, have been adversely affected by excessive borrowing costs. Multifamily properties with significant rehabilitation needs also appear to have experienced difficulty gaining access to mortgage financing. Moreover, the flow of capital into multifamily housing for seniors has been historically characterized by a great deal of volatility.

b. Economic, Housing, and Demographic Conditions. Studies indicate that changing population demographics will result in a need for the mortgage market to meet nontraditional credit needs and to respond to diverse housing preferences. The U.S. population is expected to grow by an average of 2.4 million persons per year over the next 20 years, resulting in 1.1 to 1.2 million new households per year. In particular, the continued influx of immigrants will increase the demand for rental housing while those who immigrated during the 1980s will be in the market to purchase owner-occupied housing. The aging of the baby-boom generation and the entry of the small baby-bust generation into prime home buying age is expected, however, to result in a lessening of housing demand. Non-traditional households have, and will, become more important as overall household formation rates slow down. With later marriages, divorce, and non-traditional living arrangements, the fastest growing household groups have been single parent and single person households. With continued house price appreciation and favorable mortgage terms, ''trade-up buyers'' will also increase their role in the housing market. There will also be increased credit needs from new and expanding market sectors, such as manufactured housing and housing for senior citizens. These demographic trends will lead to greater diversity in the homebuying market, which, in turn, will require greater adaptation by the primary and secondary mortgage markets.

As a result of the above demographic forces, housing starts are expected to average 1.5 million units annually between 2000 and 2003, essentially the same as in 1996–99.[17] Refinancing of existing mortgages, which accounted for 50 percent of originations in 1998 and 34 percent in 1999, is expected to return to lower levels during 2000. The mortgage market remained strong with $1.3 trillion dollars in originations during 1999. A lower number of originations is expected in 2000 with approximately $962 billion in originations being projected by the Mortgage Bankers Association of America.

c. Performance and Effort of the GSEs Toward Achieving the Goal in Previous Years. Both Fannie Mae and Freddie Mac have improved their affordable housing loan performance since the enactment of FHEFSSA in 1992 and HUD's establishment of housing goals under the law. However, the GSEs' mortgage purchases continue to lag the overall market in providing financing for affordable housing to low- and moderate-income families, underserved borrowers and their neighborhoods, indicating that there is more that the GSEs can do to improve their performance. In addition, a large percentage of the lower-income loans purchased by the GSEs have relatively high down payments, which raises questions about whether the GSEs are adequately meeting the needs of those lower-income families who have little cash for making large down payments but can fully meet their monthly payment obligations. The discussion of the performance and effort of the GSEs toward achieving the housing goals in previous years is specific to each of the three housing goals. This topic is discussed below and further details are provided in the Appendices to this rule.

d. Size of the Mortgage Market Serving the Targeted Population or Areas, Relative to the Size of the Overall Conventional, Conforming Mortgage Market. The Department's analyses indicate that the size of the conventional, conforming market relative to each housing goal is greater than earlier estimates (based mainly on HMDA data for 1992 through 1994) used in establishing the 1996–1999 housing goals. The discussion of the size of the conventional mortgage market serving targeted populations or areas relative to the size of the overall conventional, conforming mortgage market is specific to each of the three housing goals. The Department's estimate of the size of the conventional mortgage market is discussed below and further details are provided in the Appendices to this rule.

e. Ability of the GSEs To Lead the Industry in Making Mortgage Credit Available for the Targeted Population or Areas. Research concludes that the GSEs have generally not been leading the market, but have lagged behind the primary market in financing housing for lower-income families and housing in underserved areas. However, the GSEs' state-of-the-art technology, staff resources, share of the total conventional, conforming market, and their financial strength suggest that the GSEs have the ability to lead the industry in making mortgage credit available for lower-income families and underserved neighborhoods.

The legislative history of FHEFSSA indicates Congress's strong concern that the GSEs need to do more to benefit low- and moderate-income families and residents of underserved areas that lack access to credit.[18] The Senate Report on FHEFSSA emphasized that the GSEs should "lead the mortgage finance industry in making mortgage credit available for low- and moderate-income families." [19] FHEFSSA, therefore, specifically required that HUD consider the ability of the GSEs to lead the industry in establishing the level of the housing goals. FHEFSSA also clarified the GSEs' responsibility to complement the requirements of the Community Reinvestment Act [20] and fair lending laws [21] in order to expand access to capital to those historically underserved by the housing finance market.

While leadership may be exhibited through the GSEs' introduction of innovative products, technology, and processes and through establishing partnerships and alliances with local communities and community groups, leadership must always involve increasing the availability of financing for homeownership and affordable rental housing. Thus, the GSEs' obligation to lead the industry entails leadership in facilitating access to affordable credit in the primary market for borrowers at different income levels and housing needs, as well as for underserved urban and rural areas.

While the GSEs cannot be expected to solve all of the nation's housing problems, the efforts of Fannie Mae and Freddie Mac have not matched the opportunities that are available in the primary mortgage market. Although the GSEs were directed by Congress to lead the mortgage finance industry in making mortgage credit available for low- and moderate-income families, depository and other lending institutions have been more successful than the GSEs in providing affordable loans to lower-income borrowers and in historically underserved neighborhoods. In 1998 for example, very low-income borrowers accounted for 9.9 percent of Freddie Mac's acquisitions of home purchase mortgage loans, 11.4 percent of Fannie Mae's acquisitions, 15.2 percent of such mortgage loans originated and retained by depository institutions, and 13.3 percent of such mortgage loans originated in the overall conventional, conforming market. Similarly, mortgage purchases on properties located in underserved areas accounted for 20.0 percent and 22.5 percent of Freddie Mac's and Fannie Mae's purchases of home purchase loans, respectively, 26.1 percent of home purchase mortgages originated and retained by depository institutions and 24.6 percent of home purchase mortgages originated in the overall conventional, conforming market.

Between 1993 and 1998, Fannie Mae improved its affordable lending performance and made progress toward closing the gap between its performance and that of the overall mortgage market. During that period Freddie Mac showed less improvement and, as a result, did not make as much progress in closing the gap between its performance and that of the overall market for home loans. However, during 1999, Freddie Mac's purchases of goals qualifying home loans increased significantly relative to Fannie Mae's purchases and, as a result Freddie Mac now matches or out-performs Fannie Mae in several affordable lending categories. For example, during 1999, very low-income borrowers accounted for 11.0 percent of Freddie Mac's purchases of home loans in metropolitan areas, compared with 10.8 percent of Fannie Mae's. Similarly, mortgages on properties in underserved census tracts accounted for 21.2 percent of Freddie Mac's acquisitions of home purchase mortgage loans in metropolitan areas, compared with 20.6 percent of Fannie Mae's. The extent to which Freddie Mac has closed its performance gap relative to depositories and the overall market will be clarified once HUD has the opportunity to analyze 1999 HMDA data for metropolitan areas.

The Department estimates the GSEs provided financing for 55 percent of units financed by conventional, conforming mortgages in 1998.[22] However, the GSEs' mortgage market presence varies significantly by property type. While the GSEs accounted for about 68 percent of the owner-occupied units financed in the primary market in that year, their role was much less in the market for mortgages on rental properties. Specifically, HUD estimates that Fannie Mae and Freddie Mac accounted for only about 24 percent of rental units financed in 1998. Thus, the GSEs' presence in the rental mortgage market was well under half their presence in the market for mortgages on single family owner-occupied properties.

Within the rental category, GSE purchases have accounted for 29 percent of the multifamily dwelling units that were financed in 1998. The GSEs have yet to play a major role in financing mortgages for rental units in single family rental properties (those with at least one rental unit and no more than four units in total), where their market share was only 19 percent.

As noted above, the GSEs continue to lag the overall conforming, conventional market in providing affordable home purchase loans to lower-income families and for properties in underserved neighborhoods. Additionally, a large percentage of the lower-income loans purchased by both GSEs have relatively high down payments, which raises questions about whether the GSEs are adequately meeting the needs of those lower-income families who find it difficult to raise enough cash for a large down payment. Also, while rental properties are an important source of low- and moderate-income rental housing, they represent only a small portion of the GSEs' business.

The appendices to this rule provide more information on HUD's analysis of the extent to which the GSEs have lagged the mortgage industry in funding loans to underserved borrowers and neighborhoods. From this analysis of the GSEs' performance in comparison with the primary mortgage market and with other participants in the mortgage markets, it is clear that the GSEs need to improve their performance relative to the primary market of conventional, conforming mortgage lending. The need for improvements in the GSEs' performance is especially apparent with respect to the single family and multifamily rental markets.

f. Need To Maintain the Sound Financial Condition of the GSEs. Based on HUD's economic analysis and discussions with the Office of Federal Housing Enterprise Oversight, HUD has concluded that the level of the goals as proposed would not adversely affect the sound financial condition of the GSEs. Further discussion of this issue is found in Appendix A.

3. Determinations Regarding the Level of the Housing Goals

There are several reasons the Department, having considered all the statutory factors, is increasing the level of the housing goals.

a. Market Needs and Opportunities. First, the GSEs appear to have substantial room for growth in serving the affordable housing mortgage market. For example, as discussed above, the Department estimates that the two GSEs' mortgage purchases accounted for 55 percent of the total (single family and multifamily) conventional, conforming mortgage market during 1998. In contrast, GSE purchases comprised only 44 percent of the low- and moderate-income mortgage market in 1998, 46 percent of the underserved areas market, and, a still smaller, 33 percent of the special affordable market. As discussed above, the GSE presence in mortgage markets for rental properties, where much of the nation's affordable housing is concentrated, is far below that in the single family owner-occupied market.

The GSEs' role in the mortgage market varies somewhat from year to year in response to changes in interest rates, mortgage product types, and a variety of other factors. Underlying market trends, however, show a clear and significant increase in the GSEs' role. Specifically, OFHEO estimates that the share (in dollars) of single family mortgages outstanding accounted for by mortgage-backed securities issued by the GSEs and by mortgages held in the GSEs' portfolios has risen from 31 percent in 1990 to 42 percent in 1999. In absolute terms, the GSEs' presence has grown even more sharply, as the total volume of single family mortgage debt outstanding has increased rapidly over this period.

The GSEs have indicated that they expect their role in the mortgage market to continue to increase in the future, as they develop new products, refine existing products, and enter markets where they have not played a major role in the past. The Department's housing goals for the GSEs also anticipate that their involvement in the mortgage market will continue to increase.

There are a number of segments of the multifamily, single family owner, and single family rental markets that the GSEs have not tapped in which the GSEs might play an enhanced role thereby increasing their shares of targeted loans and their performance under the housing goals. Six such areas are discussed below.

(1) Small Multifamily Properties. One sector of the multifamily mortgage market where the GSEs could play an enhanced role involves loans on small multifamily properties—those containing 5–50 units. These loans account for 39 percent of the units in recently mortgaged multifamily properties, according to the 1991 Survey of Residential Finance. However, the GSEs typically purchase relatively few of these loans. HUD estimates that the GSEs acquired loans financing only three percent of units in small multifamily properties originated during 1998. This is substantially less than the GSEs' presence in the overall multifamily mortgage market, which the Department estimates was 29 percent in 1998.

Increased purchases of small multifamily mortgages would make a significant contribution to performance under the goals, since the percentages of these units qualifying for the income-based housing goals are high—in 1999, 95 percent of units backing Fannie Mae's multifamily mortgage transactions qualified for the Low- and Moderate-Income Housing Goal, with a corresponding figure of 90 percent for Freddie Mac. That year, 43 percent of units backing Freddie Mac's multifamily transactions qualified for the Special Affordable Housing Goal, with a corresponding figure of 56 percent for Fannie Mae.

(2) Multifamily Rehabilitation Loans. Another multifamily market segment holding potential for expanded GSE presence involves properties with significant rehabilitation needs. Properties that are more than 10 years old are typically classified as ''C'' or ''D'' properties, and are considered less attractive than newer properties by many lenders and investors. Multifamily rehabilitation loans accounted for only 0.5 percent of units backing Fannie Mae's 1998 mortgage purchases and for 1.6 percent in 1999. These loans accounted for 1.9 percent of Freddie Mac's 1998 multifamily mortgage purchase total (with none indicated in 1999).

(3) Single Family Rental Properties. Studies show that single family rental properties are a major source of affordable housing for lower-income families, yet these properties are only a small portion of the GSEs' overall business.

HUD estimates that approximately 203,000 mortgages were originated on owner-occupied single family rental properties in 1998. These mortgages financed a total of 458,000 units—the owners' units plus an additional 254,000 rental units.[23] Data submitted to HUD by the GSEs indicate that, in 1998, together the GSEs acquired mortgages backed by 188,000 such units, 41 percent of the number of units financed in the primary market, well below the GSEs' overall 1998 market share of 55 percent.[24]

There is ample room for an enhanced GSE role in this goal-rich market. For the GSEs combined, 65 percent of the units in these properties qualified for the Low- and Moderate-Income Housing Goal in 1999, 32 percent qualified for the Special Affordable Housing Goal, and 54 percent qualified for the

Geographically Targeted Goal. Thus, significant gains could be made in performance on all of the goals if Fannie Mae and Freddie Mac played a larger role in the market for mortgages on single family owner-occupied rental properties (two to four units).

(4) Manufactured Homes. The Manufactured Housing Institute, in its Annual Survey of Manufactured Home Financing, reported that 116 reporting institutions originated $15.6 billion in consumer loans on manufactured homes in 1998, and that, with an average loan amount of about $30,000, approximately 520,000 loans were originated.

While the GSEs have traditionally played a minimal role in financing manufactured housing, they have recently stepped up their activity in this market. However, even with their increased level of activity, the GSEs' purchases probably accounted for less than 15 percent of total loans on manufactured homes in 1998—a figure well below their overall market presence of 55 percent.

There is ample room for an enhanced GSE role in this market, with its high concentration of goals qualifying mortgage loans. In 1998, for loans reported by 21 manufactured housing lenders (that are required by HMDA to report loan data), 76 percent qualified for the Low- and Moderate-Income Housing Goal in 1998, 42 percent qualified for the Special Affordable Housing Goal, and 47 percent qualified for the Geographically Targeted Goal. Thus, manufactured housing has significantly higher shares of goal qualifying loans than all single family owner-occupied properties, though purchases of these loans are not quite as goal-rich as loans on multifamily properties. In general, goal performance could be enhanced substantially if the GSEs were to play an increased role in the manufactured housing mortgage market.

(5) A-minus Loans. Industry sources estimate that subprime mortgage originations amounted to about $160 billion in 1999, and that these loans are divided evenly between the more creditworthy (''A-minus'') borrowers and less creditworthy (''B,'' ''C,'' and ''D'') borrowers. Based on HMDA data for 200 subprime lenders, the Department estimates that 58 percent of the units financed by subprime loans qualified for the Low- and Moderate-Income Housing Goal in 1998, 29 percent qualified for the Special Affordable Housing Goal, and 45 percent qualified for the Geographically Targeted Goal.

Freddie Mac has estimated that 10 to 30 percent of subprime borrowers would qualify for a prime conventional loan. Fannie Mae Chairman Franklin Raines has stated that half of all mortgages in the high cost subprime market are candidates for purchase by Fannie Mae. Both Fannie Mae and Freddie Mac recently introduced programs aimed at borrowers with past credit problems that would lower the interest rates for those borrowers that were timely on their mortgage payments. Freddie Mac has also purchased subprime loans through structured transactions that limit Freddie Mac's risk to the ''A'' piece of a senior-subordinated transaction.

However, there may be ample room for further enhancement of both GSEs' roles in the A-minus market. A larger role by the GSEs might help standardize mortgage terms in this market, possibly leading to lower interest rates.

(6) Seasoned Mortgages. Over the past five years, depository institutions (banks and thrifts) have been expanding their affordable loan programs and, as a result, have originated substantial numbers of loans to low-income and minority borrowers and to low-income and predominantly minority neighborhoods, under the incentive of the Community Reinvestment Act (CRA),[25] which requires many depository institutions to help meet the credit needs of their communities. As the GSEs noted in their comments, some of these loans, when originated, may not have met the GSEs' underwriting guidelines. A large number of the ''CRA-type'' loans that have been recently originated remain in thrift and bank portfolios; selling these loans on the secondary market would free up capital for depositories to originate new CRA loans. Given its enormous size, the CRA market segment provides an opportunity for Fannie Mae and Freddie Mac to expand their affordable housing financing programs. The Department recognizes that purchasing these loans may present some challenges for the GSEs. However, it appears these loans are beginning to be purchased by GSEs after the loans have seasoned and through various structured transactions. As explained in Appendix A, Fannie Mae's purchases of seasoned loans improved its performance on the housing goals in 1997 and 1998. Seasoned loan purchases did not have a similar impact in 1999. Freddie Mac, on the other hand, has not been as active as Fannie Mae in purchasing seasoned CRA type loans. With billions of dollars worth of CRA loans in bank portfolios, the early experience of Fannie Mae suggests that purchasing these loans could be an important strategy for reaching the housing goals and provide needed liquidity for a market that is serving the needs of low-income and minority homeowners.

(7) Lending to Minority Borrowers. The GSEs have an opportunity to play a leadership role in making mortgage credit more widely available to African American and other minority borrowers, who represent yet another underserved market. In 1998, for example, African American borrowers accounted for five percent of conventional, conforming single family mortgage loans originated in metropolitan areas, as shown in Appendix A.[26] By contrast, African American borrowers accounted for only 3.1 percent of Fannie Mae's metropolitan area mortgage purchases and three percent of Freddie Mac's mortgage purchases. Hispanic borrowers accounted for 5.2 percent of the metropolitan area conventional, conforming mortgage market in 1998, 4.8 percent of Fannie Mae's mortgage purchases and 4.4 percent of Freddie Mac's mortgage purchases.[27]

b. Market Share Higher than Goal Levels. The shares of the mortgage markets that would qualify for each of the housing goals are higher than the goal levels as they were set through 1999. Specifically, the Low- and Moderate-Income Housing Goal for 1997 through 1999 was 42 percent, but the market share for low- and moderate-income mortgages has been estimated at 50–55 percent. The Geographically Targeted Goal for 1997 through 1999 was 24 percent, but the estimated market share of geographically targeted mortgages has been estimated at 29–32 percent. The Special Affordable Housing Goal for 1997 through 1999 was 14 percent, but the estimated special affordable market share is 23–26 percent.[28] Thus, the increases in the housing goals implemented in this final rule and described below will significantly reduce the disparities that existed between the previous housing goals and HUD's market estimates. HUD's analysis indicates that the goal levels established in the final rule are reasonable and feasible and that its market estimates reflect significantly more adverse economic environments than have recently existed. Reasons for the remaining disparity between the GSE housing goals established in this final rule and the respective shares of the overall mortgage market qualifying for each of the housing goals are discussed below. See Appendix D for further discussion of these issues.

c. Need for Increased Affordable Single Family Mortgage Purchases. Higher housing goals are needed to assure that both Fannie Mae and Freddie Mac increase their purchases of single family mortgages for lower-income families. The GSEs lag behind depository institutions and other lenders in the conventional, conforming market in providing mortgage funds for underserved families and their neighborhoods. Numerous studies have concluded that Fannie Mae and Freddie Mac have room to increase their purchases of affordable loans originated by primary lenders. The single family affordable market, which had only begun to grow when HUD set housing goals in 1995, has now established itself with seven straight years (1993–1999) of solid performance. Current projections suggest that the demand for affordable housing by minorities, immigrants, and non-traditional households will be maintained in the post-1999 period, leading to additional opportunities for the GSEs to support mortgage lending benefiting families targeted by the housing goals.

d. Market Disparities. Despite the recent growth in affordable lending, there are many groups who continue to face problems obtaining mortgage credit and who would benefit from a more active and targeted secondary market. Homeownership rates for lower-income families, certain minorities, and central city residents are substantially below those of other families, and the disparities cannot simply be attributed to differences in income. Immigrants represent a ready supply of potential first-time home buyers and need access to mortgage credit. Special needs in the market, such as rehabilitation of older two- to four-unit properties, could be helped by new mortgage products and more flexibility in underwriting and appraisal guidelines. The GSEs, along with primary lenders and private mortgage insurers, have been making efforts to reach out to these underserved portions of the markets. However, more needs to be done, and the proposed increases in the housing goals are intended to encourage additional efforts by Fannie Mae and Freddie Mac.

e. Impact of Multifamily Mortgage Purchases. When the 1996–99 goals were established in December 1995, Freddie Mac had only recently reentered the multifamily mortgage market, after an absence from the market in the early 1990s. Freddie Mac has made progress in rebuilding its multifamily mortgage purchase program, with its purchases of these loans rising from $191 million in 1993 to $7.6 billion in 1999. Freddie Mac's limited role in the multifamily market was a significant constraint when HUD set the level of the housing goals for 1996 through 1999. While Freddie Mac has made progress in recent years in significantly increasing its multifamily mortgage purchases, Freddie Mac's smaller multifamily portfolio relative to that of Fannie Mae has meant fewer refinance opportunities from within its portfolio. Accordingly, the Department is providing Freddie Mac with a temporary adjustment factor for purchases of mortgages in multifamily properties with more than 50 units under the 2001–2003 goals as it continues to increase its multifamily mortgage purchases, as discussed in more detail, below.

f. Financial Capacity to Support Affordable Housing Lending. A wide variety of quantitative and qualitative indicators demonstrate that the GSEs' have ample, indeed robust, financial strength to improve their affordable lending performance. For example, the combined net income of the GSEs has risen steadily over the last decade, from $677 million in 1987 to over six billion dollars in 1999. This financial strength provides the GSEs with the resources to lead the industry in making mortgage financing available for families and neighborhoods targeted by the housing goals.

g. Closing the Gap Between the GSEs and the Market. This section discusses the relationship between the housing goals, the GSEs' performance and HUD's market estimates; and identifies key segments of the affordable market in which the GSEs have had only a weak presence. To lay the groundwork for this discussion, the following table summarizes the Department's findings regarding GSE performance under the 1997–2000 goals and the new goal levels for 2001–2003 as compared to HUD's estimates for 1995–1998 markets as well as HUD's projected market estimates for 2001–2003:

Percentage of Eligible Units Financed

	1997-2000 Goals	2001-2003 Goals	GSEs' Average performance 1996-1999 (Fannie Mae /Freddie Mac	HUD's Estimated 1995-1998 Market Average[29]	HUD's Projected market Estimate
Low- and Moderate Income	42%	50%	45.3% 43.2%	56%	50-55%
Geographically Targeted	24%	31%	27.7% 26.2%	33%	29-32%
Special Affordable Housing	14%	20%	16.1% 15.6%	28%	23-26%

It is evident from this table that the new goal levels for the Low- and Moderate-Income Housing Goal and Special Affordable Housing Goal are below HUD's projected market estimate for the years covered by the new housing goals. One reason for this disparity can be discerned by disaggregating GSE purchases by property type, which shows that the GSEs have little presence in some important segments of the affordable housing market. For example, as shown in Figure 1, in 1998, the GSEs purchased loans representing only 19 percent of rental units in single family rental properties, and only three percent of units in small multifamily properties mortgaged that year. Figure 2 provides additional detail providing unit data comparing the GSEs' with the conventional, conforming market. Typically, about 90 percent of rental units in single family rental and small multifamily properties qualify for the Low- and Moderate-Income Housing Goal. One reason that the GSEs' performance under the Low- and Moderate-Income Housing Goal falls short of HUD's market estimate is that the GSEs have had only a weak and inconsistent presence in financing these important sources of affordable housing, notwithstanding that these market segments are important components in the market estimate. In the overall conventional, conforming mortgage market, rental units in single family properties and in small multifamily properties are expected to represent approximately 21 percent of the overall mortgage market, and 33 percent of units backing mortgages qualifying for the Low- and Moderate-Income Housing Goal. Yet in 1999, units in such properties accounted for 6.6 percent of the GSEs' overall purchases, and only 11.5 percent of the GSEs' purchases meeting the Low- and Moderate-Income Housing Goal. The continuing weakness in GSE purchases of mortgages on single family rental and small multifamily properties is a major factor explaining the shortfall between GSE performance and that of the primary mortgage market.

For a variety of reasons, the GSEs have historically viewed the single family rental and small multifamily market segments as more difficult for them to penetrate than the single family owner-occupied mortgage market. In order to provide the GSEs with an incentive to enter these markets and to provide this housing the benefits of greater financing through the secondary market, HUD is proposing to award ''bonus points'' for the GSEs' purchases of mortgages on owner-occupied single family rental properties and small multifamily properties in calculating credit toward the housing goals. The bonus points will make the Department's increased housing goals easier for the GSEs to attain if they devote resources to affordable market segments where their past role has been limited and there are significant needs for greater secondary market involvement.

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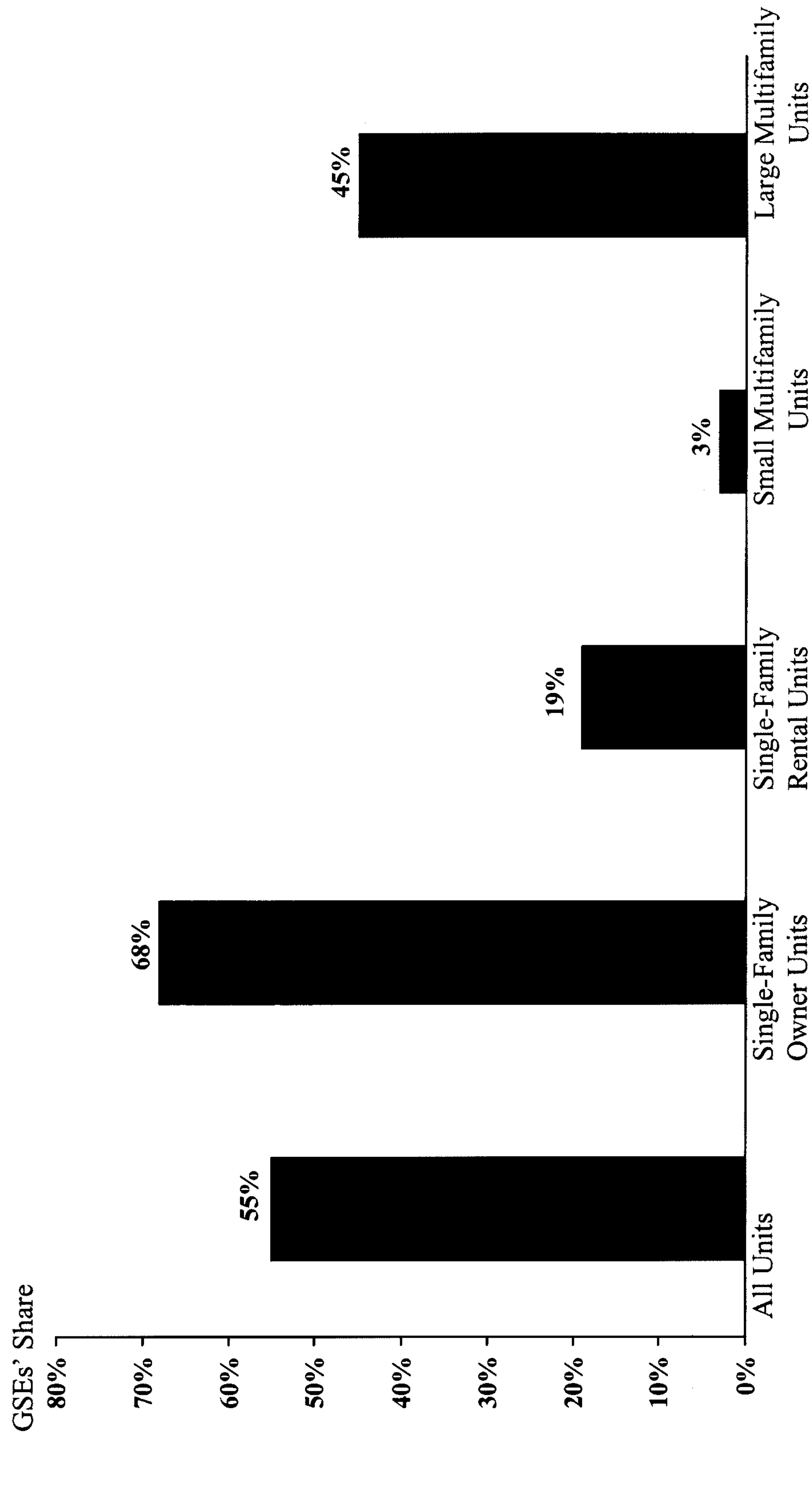
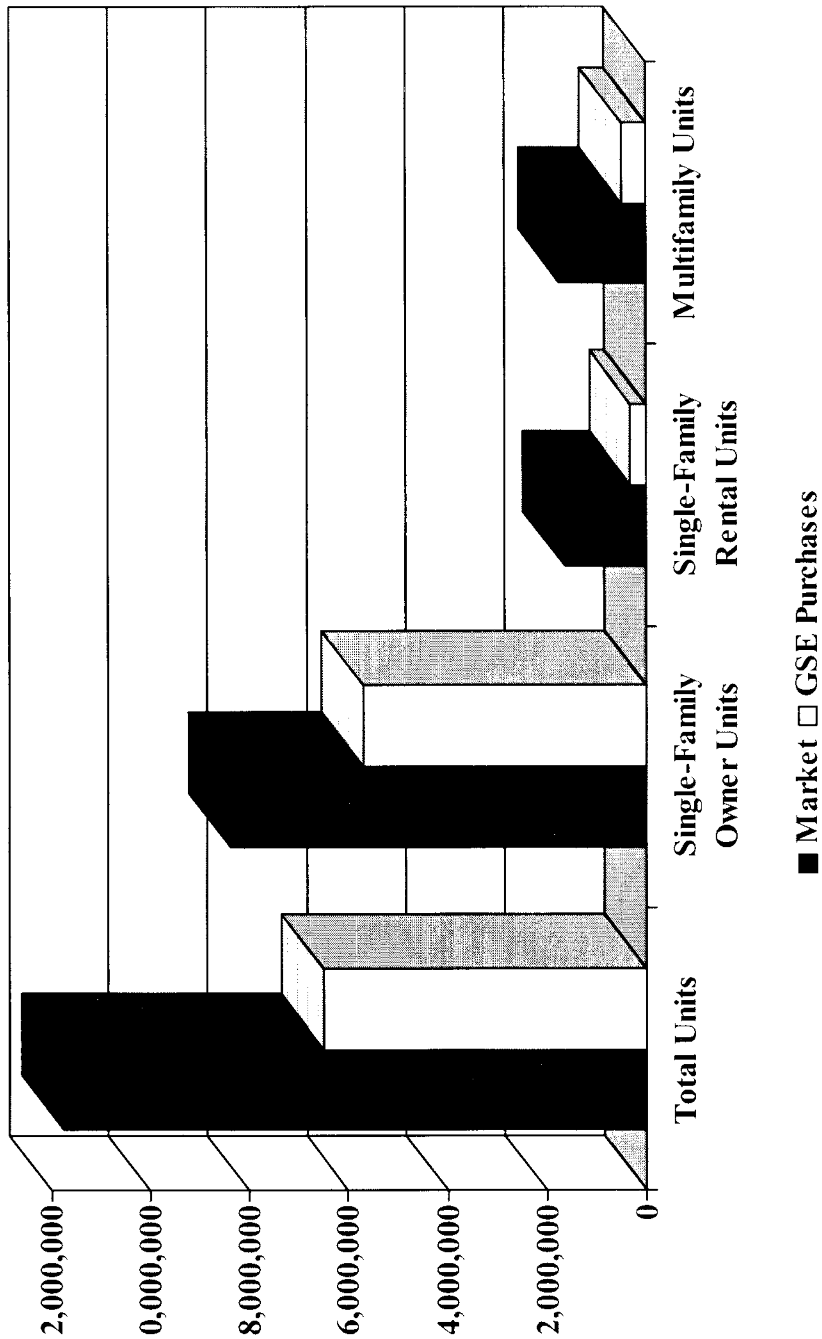
Figure 1
GSEs' Share of the 1998 Conventional Conforming Market by Property Type



Source: See Table A.7b, Appendix A, and discussion of mortgages on small multifamily properties in Appendix A, Section G.

Figure 2
Units in the 1998 Conventional Conforming Mortgage Market Compared to GSE Purchases By Property Type



Source: See Table A.7b, Appendix A.

4. Summary of Comments on HUD's Analysis of Statutory Factors

HUD received several comments on the factors for determining the goal levels. Fannie Mae and Freddie Mac provided numerous technical comments on HUD's analyses in the appendices to the proposed rule. Most of the comments focused on two related topics concerning HUD's market methodology: (a) HUD's model for the determining the market size for each of the three housing goals; and (b) HUD's analysis of the GSEs' performance in the single family owner-occupied portion of the conventional, conforming mortgage market. Section A of Appendices A, B and C and Section B of Appendix D provide a more extensive discussion of HUD's response to the various questions raised by the GSEs about the factors for determining the housing goals.

a. Market Share Methodology. In Appendix D, HUD estimates the following market shares for the three housing goals during 2001–2003: 50–55 percent for the Low-Mod Goal, 23–26 percent for the Special Affordable Goal, and 29–32 percent for the Geographically Targeted Goal. Neither GSE objected to HUD's basic approach to calculating these market shares, which involves estimating (1) the share of the market (in dwelling units) by type of property (single family owner-occupied, single family rental, and multifamily), (2) the proportion of dwelling units financed by mortgages for each type of property meeting each goal, and (3) projecting the size of the total market by weighting each such goal share by the corresponding market share. In fact, both Fannie Mae and Freddie Mac stated that HUD's market share model was a reasonable approach for estimating the goals qualifying shares of the mortgage market. Freddie Mac stated that the Department took the correct approach in estimating the size of the conventional, conforming market by examining several different data sets, using alternative methodologies, and conducting sensitivity analyses. Fannie Mae expressed similar sentiments asserting that HUD's model for assessing the size of the affordable housing market is reasonable.

Both GSEs were critical, however, of HUD's implementation of its market methodology. Their major comments on the market methodology fall into two general areas. First, the GSEs expressed concern about HUD's assumptions and use of specific data elements both in constructing the distribution of property shares among single family owner-occupied, single family rental, and multifamily properties and in estimating the goals qualifying shares for each property type. The GSEs contended that HUD chose assumptions and data sources that resulted in an overstatement of the market estimate for each of the housing goals. In particular, the GSEs claimed that HUD overstated the importance of rental properties (both single family and multifamily) in its market model and overstated the Low- and Moderate-Income, Special Affordable, and Geographically Targeted shares of the single family owner market. Second, both GSEs argued that HUD's market estimates depended heavily on a continuation of recent conditions of economic expansion and low interest rates. According to the GSEs, HUD's range of market estimates did not include periods of adverse economic and affordability conditions such as those which existed in the early 1990s.

b. GSEs' Performance in Single Family Owner-Occupied Market. Both GSEs differed with HUD's conclusions that they lag the conventional, conforming market in funding mortgages for the goals qualifying segments of the single family owner-occupied market. Rather, the GSEs hold strongly that they have led the mortgage market, from both quantitative and qualitative perspectives. The GSEs expressed concern about HUD's assumptions and treatment of HMDA data in estimating the goals qualifying shares for single family owner-occupied mortgages. The GSEs assert that certain portions of the conforming mortgage market (such as manufactured housing loans and selected CRA loans)—those market segments where they have not been very active—should be excluded from HUD's definition of the owner market. From their own analysis that excludes these markets from HMDA data, the GSEs conclude that they match or exceed the market in funding affordable loans.

It should be noted that the GSEs extend their criticism to other researchers that have examined this issue of their leading the market with HMDA and related data. Appendix A summarizes findings of several research studies that have reached the same conclusion as HUD—that the GSEs have lagged the market in affordable lending

c. Volatility of the Mortgage Market. Both GSEs claimed that HUD had not adequately considered the impact that changes in the national economy could have on the size of the affordable lending market and that HUD should significantly lower its market estimates to reflect adverse economic conditions. The GSEs commented that HUD based its market estimates on the unusually favorable economic and housing market conditions that have existed since 1995. The GSEs relied on a Freddie Mac funded study by PriceWaterhouse-Coopers (PWC) which concluded that the low- and moderate-income share of the mortgage market was heavily influenced by interest rate movements and changes in the rate of economic growth.[30] PWC claims that the low-mod share of the market ranged from 35 percent to 56 percent during the 1990s, with a mean of 46 percent. HUD's analysis, on the other hand, finds that the low- and moderate-income share of the market averaged 53 percent during the 1990s.

In HUD's view, a major shortcoming of the PWC report is that it underestimates the size of the multifamily mortgage market by relying on multifamily originations reported in HMDA data. While HMDA is for many purposes a preeminent data source on single family lending, its usefulness as a multifamily data source is much more limited due to severe underreporting of loan originations. Indeed, HMDA is not widely used as a multifamily data source in published works by highly regarded independent researchers, nor by Fannie Mae in its comments submitted in response to HUD's proposed rule.

The discussion of single family lending in the PWC document initially appears to contradict HUD's analysis in Appendix D of the proposed rule, but this is mainly because HUD's analysis is based upon the conforming, conventional mortgage market, whereas PWC includes FHA loans and loans above the conforming loan limit, at least in the same years.[31] Because the GSEs are prohibited from purchasing loans above the conforming limit, and because HUD is directed by statute to focus on the conventional market in setting the housing goals, it is necessary to restrict analyses of the mortgage market to the conventional, conforming market for purposes of establishing the housing goals.

As explained in Appendices A and D, HUD is aware that the mortgage market is dynamic in character and susceptible to significant changes in conditions that would affect the overall level of affordable lending to lower-income families. In response to concerns expressed about the volatility of the mortgage markets over time, HUD has estimated a range of market shares for each of the housing goals for the years 2001–2003 of 50–55 percent for the Low- and Moderate-Income Housing Goal, 23–26 percent for the Special Affordable Housing Goal, and 29–32 percent for the Geographically Targeted Goal—that reflect economic environments significantly more adverse than those which existed during the period between 1995 and 1998, when the units financed in the conventional, conforming market meeting the Low- and Moderate-Income Housing Goal averaged 56 percent, the Special Affordable Housing Goal, 28 percent, and the Geographically Targeted Goal, 33 percent.

HUD conducted detailed sensitivity analyses for each of the housing goals to reflect affordability conditions that are less conducive to lower-income homeownership than those that existed during the mid- to late-1990s. For example, the low- and moderate-income percentage for single family home purchase loans can fall to as low as 34 percent—or four-fifths of its 1995–98 average of over 42 percent—before the projected low- and moderate-income share of the overall market would fall below 50 percent. Additional sensitivity analyses examining recession and proportionately higher refinance scenarios and varying other key assumptions, such as the size of the multifamily market, show that HUD's market estimates consider a range of mortgage market and affordability conditions and provide a sound basis for setting housing goals for the years 2001–03.

HUD recognizes that under certain adverse circumstances, the goals qualifying market shares could fall below its estimates. However, as HUD stated in its 1995 GSE Rule, while the housing goals must be feasible, setting goals so that they can be met even under the very worst of circumstances is unreasonable. As HUD stated in its 1995 Final GSE Rule, policy should not be based on market estimates that include the worst possible economic scenarios.

HUD believes that the range for the market shares should be broad enough to reflect the likely scenarios including an expected range of volatility in the mortgage market over the period during which the new housing goals will be in effect.

FHEFSSA and HUD recognize that conditions could change in ways that would require revised expectations. Thus, HUD is given the statutory discretion to revise the goals if the need arises. Further, current regulations require that, if a GSE fails or if there is a substantial probability that a GSE will fail one or more of the housing goals, notice be provided to the GSE and an opportunity provided for the GSE to explain the reason for the failure, or potential failure, and to provide information as to the feasibility of achieving the housing goal. The Department then makes a determination, taking into consideration market and economic conditions and the financial condition of the GSE, as to whether the goal was feasible. If the goal is determined not to be feasible, no further action is taken. If the goal is determined to be feasible, the GSE is given the opportunity to submit, for HUD's approval, a housing plan demonstrating how the goal will be achieved in the future. Thus, there are adequate protections for the GSEs if they are unable to achieve one or more of their housing goals due to a dramatic downturn in the market.

d. Shortcomings of Mortgage Market Data Bases. Major mortgage market data bases such as HMDA and the American Housing Survey (AHS) are used to implement HUD's market share model. The GSEs made extensive criticisms of these data bases, concluding from their critiques that the ranges for the estimates of the goals-qualifying market shares should be wider to reflect uncertainty due to inadequate data. Examples of problems asserted by the GSEs include: overstating of low-income loans in HMDA data; inability of HMDA data to identify important segments of the market (such as subprime lenders); underreporting of multifamily mortgages in HMDA data and generally unreliable reporting of rental mortgages in other data bases; underreporting of income in the AHS; and the fact that some important mortgage market data bases such as the 1991 Residential Mortgage Finance Survey are dated.

HUD agrees that a single comprehensive source of information on mortgage markets is not available. Nevertheless, HUD considered and analyzed a number of data sources for the purpose of estimating market size, since no single source could provide all the data elements needed for its market model. In the appendices, HUD carefully defines the range of uncertainty associated with each data source, pulls together estimates of important market parameters from independent sources, and conducts sensitivity analyses to show the effects of various assumptions. In fact, Freddie Mac noted that ''We support the Department's approach for addressing the empirical challenges of setting the goals by examining several different data sets, using alternative methodologies, and conducting sensitivity analysis.''

While HUD recognizes the shortcomings of the various data and the inability to derive precise point estimates of various market parameters, HUD does not believe that these limitations call for expanding the range of the market estimates, as suggested by the GSEs. One purpose of the appendices is to demonstrate that careful consideration of independent data sources can lead to reliable ranges of estimates for the goals-qualifying shares of the mortgage market. HUD demonstrates the robustness of its market estimates by reporting the results of numerous sensitivity analyses that examine a range of assumptions about the existing data on the rental and owner markets. It should also be emphasized that while there are some problems with existing mortgage market data, there is a wealth of information on important components of the market. For example, HMDA data provide wide coverage of the single family owner market in metropolitan areas, yielding important information on the borrower income and census tract (underserved area) characteristics of that market, and thus providing useful information on the affordability characteristics of the single family rental and multifamily housing stock.

HUD's specific responses to the GSEs' comments on data are included mainly in Section A of Appendices A, B and C and Section B of Appendix D. For example, as noted there, HUD disagrees with the GSEs' assertions regarding the seriousness of the bias problem (*i.e.*, overstating low-income loans) in HMDA data. HUD does not rely heavily on some of the data bases that the GSEs criticize (*e.g.*, the borrower income data from the AHS and the 1991 Residential Finance Survey).

e. Size of the Multifamily Market. Because a high proportion of multifamily units qualify for the housing goals (*e.g.*, 90 percent typically qualify for the Low- and Moderate-Income Housing Goal and about 50 percent for the Special Affordable Goal), the size of the multifamily market is an important determinant of the overall market shares for the housing goals, as estimated by HUD's model. Both GSEs commented that HUD overstated the role of multifamily financing, which they asserted led to HUD's overstated estimated market shares. Freddie Mac and PriceWaterhouseCoopers, in particular, advocated the use of HMDA data for measuring the size of the multifamily market.

As explained in Appendix D, HUD disagrees with Freddie Mac's and PWC's analysis of the multifamily market. That appendix contains a detailed discussion of the size of the multifamily mortgage market that considers a number of alternative data sources providing ample evidence on multifamily origination volume over the years 1990 to 1999. HUD finds that newly mortgaged multifamily units represent an average of 16–17 percent of units financed during the 1990s. HUD's estimated multifamily market shares exceed estimates prepared by PWC (averaging 8.7 percent for 1991–1998); Appendix D outlines what HUD regards as errors in the PWC study that led to its unrealistically low estimates of the multifamily origination market. The three multifamily market shares—13.5 percent, 15 percent, and 16.5 percent—that HUD emphasizes in its market share model accommodates the possibility of a recession or heavy refinance year.

f. GSEs' Affordable Lending Performance—Defining the Relevant Market. As noted earlier, HUD uses HMDA data to show that even though the GSEs have improved their performance since 1993, they have lagged depositories and others in the conventional, conforming market in funding affordable loans, both since 1993 and particularly during the more recent 1996–98 period when the new housing goals were in effect. In their analyses, the GSEs reach the opposite conclusion—each concludes that they already match or even lead the market, depending on the affordable category being considered. The GSEs obtain this result by adjusting HMDA market data to exclude single family loans that they perceive as not being available for them to purchase.

Both GSEs provided numerous comments concerning the types of mortgages that HUD should exclude from the definition of the single family owner market. Fannie Mae states that it ''can only purchase or securitize mortgages that primary market lenders are willing to sell'' and that ''HUD fails to adjust for those housing markets that are not fully available to Fannie Mae and Freddie Mac.'' Freddie Mac states that it ''has not achieved, and is unlikely to achieve in the near term, the same penetration in the subprime and manufactured housing segments of the market as it has achieved in the conventional, conforming market'' and, therefore, HUD should not include these segments in its market definition. According to the GSEs, markets that are ''not available'' to them or where they are not a ''full participant'' should be excluded from HUD's market definition. In addition to the subprime and manufactured housing markets, examples of market segments mentioned by the GSEs for exclusion consisted of the following: low-down payment mortgages (those with loan-to-value ratios greater than 80 percent) without private mortgage insurance or some other credit enhancement; loans financed through state and local housing finance agencies; below-market-interest-rate mortgages; specialized CRA mortgages; and portions of depository portfolios that are not available for purchase by the GSEs at the time of mortgage origination.

HUD disagrees with the comments offered by the GSEs advocating exclusion of those market segments that they have not yet been able to penetrate. The conventional, conforming market represents the appropriate benchmark for evaluating GSE performance as discussed previously, even if this is not the market that the GSEs perceive as available for them to purchase. However, with respect to the subprime market, HUD believes that the risky, B&C portion of that market should be excluded from the market estimates for each of the housing goals. Thus, HUD includes only the A-minus portion of the subprime market in its overall estimates of the goals-qualifying market shares.

Excluding other important segments of the mortgage market as the GSEs recommend would render the resulting market benchmark useless for evaluating the GSEs' performance. The loans that the GSEs would exclude are important sources of goals credit and, in fact, are the very loans the GSEs are supposed to be reaching out to finance. A recent report by the Department of Treasury demonstrated the targeting of CRA-type loans to lower-income and minority families. Numerous studies have shown that the manufactured home sector is an important source of low-income housing. In many of these markets, a more active secondary market could encourage lending to traditionally underserved borrowers. While HUD recognizes that some segments of the market may be more challenging for the GSEs to enter than others, the data reported in Figure 2 of this Appendix show that the GSEs have ample opportunities to purchase goals-qualifying mortgages. Furthermore, HUD recognizes the challenge of reaching segments of these markets by not setting each goal at the very top of its market estimate range.

Finally, it should also be noted that 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—after these loans have seasoned and the GSEs have had the opportunity to observe their payment performance.

g. HUD's Determination. HUD carefully examined the comments on its analysis of the statutory factors used to determine the appropriate level of the housing goals, particularly the methodology used to establish the market share for each of the goals. Based on that evaluation, as well as HUD's additional analysis of its estimates, HUD determined that its basic methodology is a reasonable and valid approach to estimating market share and that the percentage ranges for each of the three market share estimates do not need to be adjusted from those provided in the proposed rule. While a number of technical changes have been made in this final rule in response to the comments, the approach for determining market size has not been modified substantially. The detailed evaluations show that the methodology, as modified, produces conservative estimates of the market share for each goal. HUD recognizes the uncertainty regarding some of these estimates, which has led the Department to undertake a number of sensitivity and other analyses to reduce this uncertainty and also to provide a range of market estimates (rather than precise point estimates) for each of the housing goals.

5. Period Covered by the Housing Goals

This final rule establishes housing goals for the years 2001 through 2003. The proposed rule would have established housing goals for the GSEs for the year 2000 as well as 2001–2003, with higher housing goals than currently required for 2000, a transition year, and still higher goals for 2001–2003.

The GSEs commented that since the proposed rule would have set transitional goals for 2000, if the goals are established later in 2000, then 2001 should become the transition year.

HUD has considered the issue and concluded that while it could establish higher ''transitional'' goals for 2000 as were proposed late in the year, and require that the GSEs perform at the new goal levels, given the publication date of this final rule, HUD will not require that the GSEs meet higher goals for 2000.

At the same time, HUD has determined that establishing 2001 as a transition year is unnecessary and unwarranted. The goal levels for the years 2001–2003, and 2000, were announced in July 1999 and formally proposed earlier this year, providing the GSEs ample notice of the goal levels expected for these years. Indeed, data indicate that the GSEs have increased their efforts in 2000 in light of the proposed 2001–2003 levels. Moreover, the Department's analysis of the statutory factors supports establishment of the goals for 2001–2003 at the levels proposed as both reasonable and feasible. Accordingly, the housing goals for 2000 shall remain at the levels previously established in accordance with §§ 81.12(c)(3), 81.13(c)(3), and 81.14(c)(3) of the regulations as they existed prior to the effectiveness of this final rule. The housing goals for 2001–2003 are established at the levels HUD proposed.

The Department believes the new goal levels established by this rule to be appropriate based upon consideration of the statutory factors and comments received. Setting the goal levels for years 2001–2003 provides the GSEs with a level of predictability to enable them to develop and implement business strategies to achieve the goals.

6. Low- and Moderate-Income Housing Goal, § 81.12

This section discusses the Department's consideration of the statutory factors in arriving at and the comments received on the new housing goal level for the Low- and Moderate-Income Housing Goal, which targets mortgages on housing for families with incomes at or below the area median income. After consideration of these factors, this final rule establishes the goal for the percentage of dwelling units to be financed by each GSE's mortgage purchases for each of the years 2001–2003 that are affordable to low- and moderate-income families at 50 percent. A short discussion of the statutory factors received follows. Additional information analyzing each of the statutory factors is provided in Appendix A, ''Departmental Considerations to Establish the Low- and Moderate-Income Housing Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for each Housing Goal.''

a. Market Estimate for the Low- and Moderate-Income Housing Goal. The Department estimates that dwelling units serving low- and moderate-income families will account for 50–55 percent of total units financed in the overall conventional, conforming mortgage market during the period 2001 through 2003. HUD has developed a reasonable range, rather than a point estimate, that accounts for significantly more adverse economic conditions than have existed recently.

b. Past Performance of the GSEs under the Low- and Moderate-Income Housing Goal. During the transition period from 1993 through 1995, Fannie Mae's performance under the Low- and Moderate-Income Housing Goal jumped sharply in one year, from 34.2 percent in 1993 to 44.8 percent in 1994, before declining to 42.3 percent in 1995. It then stabilized at just over 45 percent in 1996 and 1997. Fannie Mae's performance in 1998 declined to 44.1 percent due in large measure to the high volume of refinance loans that Fannie Mae funded in 1998, before rising to 45.9 percent in 1999.

During the same period, Freddie Mac demonstrated more consistent gains in performance under the Low- and Moderate-Income Housing Goal, from 29.7 percent in 1993 to 37.4 percent in 1994 and 38.9 percent in 1995. Freddie Mac then achieved 41.1 percent in 1996, and 42.6 percent and 42.9 percent in 1997 and 1998, respectively. In 1999, Freddie Mac's performance increased sharply to 46.1 percent.

The housing goals that have been in effect prior to this final rule specified that in 1996 at least 40 percent of the number of units financed by mortgage purchases of the GSEs and eligible to count toward the Low- and Moderate-Income Goal should qualify as low- and moderate-income, and at least 42 percent should qualify as such in each year from 1997 through 1999. Fannie Mae surpassed these goal levels by 5.6 percentage points in 1996, 3.7 percentage points in 1997, 2.1 percentage points in 1998, and 3.9 percentage points in 1999. Freddie Mac surpassed the goals by 1.1 percentage points, 0.6 percentage points, 0.9 percentage points and 4.1 percentage points in 1996, 1997, 1998 and 1999, respectively.

Fannie Mae's performance on the Low- and Moderate-Income Housing Goal has surpassed Freddie Mac's in every year but one, 1999, when Freddie Mac slightly outperformed Fannie Mae (46.1 percent versus 45.9 percent). However, Freddie Mac's 1999 performance represented a 55 percent increase over its 1993 level, exceeding the 34 percent increase by Fannie Mae over the same period, recognizing, however, that Fannie Mae's 1993 performance was significantly greater than Freddie Mac's.

The GSEs' performance under the Low- and Moderate-Income Housing Goal for the 1996 through 1999 period is summarized below:

SUMMARY OF GSES' PERFORMANCE UNDER THE LOW- AND MODERATE-INCOME HOUSING GOAL 1996–1999 [32]

[In percentages]

	1996	1997	1998	1999
Required Goal Level	40	42	42	42
Fannie Mae: Percent Low- and Moderate-Income	45.6	45.7	44.1	45.9
Freddie Mac: Percent Low- and Moderate-Income	41.1	42.6	42.9	46.1

Freddie Mac's improved performance since 1993 is due mainly to its increased purchases of multifamily loans as it has again become active in this market. Some housing industry observers believe that the establishment of the Low- and Moderate-Income Housing Goal has been an important factor in explaining Freddie Mac's re-entry into the multifamily market. In fact, as indicated above, multifamily mortgage purchases represent a significant component of both GSEs' activities in meeting the Low- and Moderate-Income Housing Goal, even though multifamily loans comprise a relatively small portion of the GSEs' business activities. In 1999, while Fannie Mae's multifamily purchases represented only nine percent of its total mortgage acquisition volume measured in terms of dwelling units, these purchases comprised 20 percent of units qualifying for the Low- and Moderate-Income Housing Goal. Multifamily purchases were eight percent of the units financed by Freddie Mac's 1999 mortgage purchases but represented 17 percent of the units comprising Freddie Mac's low- and moderate-income mortgage purchases.

c. Summary of Comments. A number of commenters recommended that the Low- and Moderate-Income Housing Goal include separate goals targeting a portion of the GSEs' business to multifamily housing and a portion to single family housing. While there are distinctly different issues relevant to the single family market and the multifamily market, the Department does not believe that it is necessary or appropriate to establish separate goals for those two markets. First, the increased level of the Low- and Moderate-Income Housing Goal in this final rule will require an increase in both single family and multifamily mortgage purchases. HUD's present analysis of these markets indicates that a unitary goal will best achieve increased performance in both markets. Second, this final rule adopts a number of incentives to encourage the GSEs to move into markets with unmet needs including the financing of smaller multifamily properties. HUD will, however, continue to examine market needs and evaluate the effects of the goal structure established in this final rule on the GSEs' single family and multifamily mortgage purchase performance. Based on this ongoing review, HUD may at a future date consider separate single family and multifamily goals or subgoals under the Low- and Moderate-Income Housing Goal, as warranted.

Fannie Mae expressed no objection to the higher goal level, provided the Department retains the proposed housing goals framework, including the proposed changes to the counting rules, in the final rule. Freddie Mac supports the goal framework included in the proposed rule and is committed to meeting the new goal levels. The Department's response to the issues raised by Fannie Mae and Freddie Mac relative to HUD's market share methodologies and its analysis of the statutory factors are discussed above.

Overall, other commenters were supportive of the proposed increase in the Low- and Moderate-Income Housing Goal. One group of commenters thought that, since the GSEs are mandated to lead the market, the level of the Low- and Moderate-Income Housing Goal should be increased further. Another group of commenters supported the increased level of the goal, but felt the Department needed to be prepared to accommodate shifts in economic conditions that may have a negative impact on the GSEs' ability to meet the housing goals.

d. HUD's Determination. The Low- and Moderate-Income Housing Goal established in this final rule is reasonable and appropriate having considered the factors set forth in FHEFSSA. HUD set the level of the housing goal conservatively, relative to the Department's market share estimates, in order to accommodate a variety of economic scenarios. Moreover, current examination of the gaps in the mortgage markets, along with the estimated size of the market available to the GSEs, demonstrates that the number of mortgages secured by housing for low- and moderate-income families is more than sufficient for the GSEs to achieve the new goal.

Therefore, having considered all the statutory factors including housing needs, projected economic and demographic conditions for 2001 to 2003, the GSEs' past performance, the size of the market serving low- and moderate-income families, and the GSEs' ability to lead the market while maintaining a sound financial condition; HUD has determined that the annual goal for mortgage purchases qualifying under the Low- and Moderate-Income Housing Goal will be 50 percent of eligible units financed in each of the years 2001, 2002 and 2003. The new goal level will increase the GSEs' current level of performance to a level that is consistent with reasonable estimates of the low- and moderate-income housing market.

7. Central Cities, Rural Areas, and Other Underserved Areas Goal, § 81.13

This section discusses the Department's consideration of the statutory factors in arriving at and comments received on the proposed new housing goal level for the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal (the Geographically Targeted Goal).

The Geographically Targeted Goal focuses on areas currently underserved by the mortgage finance system. The 1995 Final Rule provided that mortgage purchases count toward the Geographically Targeted Goal if such purchases finance properties that are located in underserved census tracts. In § 81.2, HUD defined ''underserved areas'' for metropolitan areas (in central cities and other underserved areas) as census tracts where either: (1) The tract median income is at or below 90 percent of the area median income (AMI); or (2) the minority population is at least 30 percent and the tract median income is at or below 120 percent of AMI. The AMI ratio is calculated by dividing the tract median income by the MSA median income. The minority percent of a tract's population is calculated by dividing the tract's minority population by its total population.

For properties in non-metropolitan (rural) areas, mortgage purchases count toward the Geographically Targeted Goal where such purchases finance properties that are located in underserved counties. These are defined as counties where either: (1) The median income in the county does not exceed 95 percent of the greater of the state or nationwide non-metropolitan median income; or (2) minorities comprise at least 30 percent of the residents and the median income in the county does not exceed 120 percent of the state non-metropolitan median income.

After analyzing the statutory factors and considering the comments, this final rule establishes the goal for the percentage of dwelling units financed by each GSE's mortgage purchases on properties that are located in underserved areas for each of the years 2001–2003 be 31 percent. A short discussion of the statutory factors follows. Additional information analyzing each of the statutory factors is provided in Appendix B, ''Departmental Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.''

a. Market Estimate for the Geographically Targeted Goal. The Department estimates that dwelling units in underserved areas will account for 29–32 percent of total units financed in the overall conventional, conforming mortgage market during the period 2001 through 2003. HUD has developed a reasonable range, rather than a point estimate, that accounts for significantly more adverse economic conditions than have existed recently.

b. *Past Performance of the GSEs under the Geographically Targeted Goal.* The housing goals that have been in effect prior to this final rule required that in 1996 at least 21 percent of the units financed by the GSEs' mortgage purchases should count toward the Geographically Targeted Goal, and at least 24 percent in 1997 through 1999. Fannie Mae surpassed the goal by 7.1 percentage points in 1996, 4.8 percentage points in 1997, 3.0 percentage points in 1998, and 2.8 percentage points in 1999. Freddie Mac surpassed the goal by 4.0, 2.3, 2.1 and 3.5 percentage points in 1996, 1997, 1998, and 1999, respectively. The GSEs' performance for the 1996–99 period is summarized below:

SUMMARY OF GSE PERFORMANCE UNDER THE GEOGRAPHICALLY TARGETED GOAL 1996–1999 [33]

[In percentages]

	1996	1997	1998	1999
Required Goal Level	21	24	24	24
Fannie Mae: Percent Geographically Targeted	28.1	28.8	27.0	26.8
Freddie Mac: Percent Geographically Targeted	25.0	26.3	26.1	27.5

Although both GSEs have improved their performance in underserved areas, on average, their mortgage purchases continue to lag the primary market in providing financing for housing in these areas. On average, during the 1996–1998 period, mortgage purchases on properties in underserved areas accounted for 19.9 percent of Freddie Mac's purchases of single family home purchase mortgages, compared with 22.9 percent of Fannie Mae's purchases, 25.8 percent of mortgages retained by portfolio lenders, and 24.9 percent of all home purchase mortgages originated in the conventional, conforming market. These figures indicate that Freddie Mac has been less likely than Fannie Mae to purchase mortgages on properties in underserved neighborhoods. Through 1998, Freddie Mac had not made progress in reducing the gap between its performance and that of the overall market. In 1992, underserved areas accounted for 18.6 percent of Freddie Mac's purchases of home purchase mortgages and for 22.2 percent of such mortgage loans originated in the conforming market, which yields a ''Freddie Mac-to-Market'' ratio [34] of

0.84. By 1998, the ''Freddie Mac-to-Market'' ratio had actually fallen to 0.81. During the same period, the ''Fannie Mae-to-Market'' ratio increased from 0.82 to 0.93. However, in 1999, Freddie Mac's purchase share for underserved area loans increased while Fannie Mae's declined. In 1999, underserved areas accounted for 21.2 percent of Freddie Mac's home purchase mortgage loan acquisitions, compared with 20.6 percent for Fannie Mae.[35]

In evaluating the GSEs' past performance, it should be noted that while borrowers in underserved metropolitan areas tend to have much lower incomes than borrowers in other areas, this does not mean that GSE performance in underserved areas must be derived from mortgages on housing for lower income families. In 1999, housing for above median-income households accounted for about half of the single family owner-occupied mortgages the GSEs purchased in underserved areas.

c. Summary of Comments. Fannie Mae expressed no objection to the higher goal level provided the Department retains the proposed housing goals framework, including the proposed changes to the counting rules, in the final rule. Freddie Mac supported the overall goal framework included in the proposed rule but recommended that the Geographically Targeted Goal be set at 30 percent. Freddie Mac noted that it was committed to stretching to meet the proposed new goal levels, but believed that the level of the Geographically Targeted Goal was set too far toward the high end of the market estimate, making it more difficult to achieve. The Department's response to the issues raised by both Fannie Mae and Freddie Mac relative to HUD's estimates of the markets and its analysis of the statutory factors used to set the level of the goals was discussed above.

Overall, other commenters were supportive of the proposed increase in the Geographically Targeted Goal. Certain commenters noted that by placing the level of the goal around the midpoint of the estimate of market size, the GSEs will be encouraged to move into a market leadership position. Another group of commenters supported the increased level of the goal, but felt the Department needed to be prepared to accommodate changes in economic circumstances that may have a negative impact on the GSEs' ability to meet the housing goals.

d. HUD's Determination. The Geographically Targeted Goal established in this final rule is reasonable and appropriate, considering the factors set forth in FHEFSSA. The Department's market share estimates for the Geographically Targeted Goal accommodate a variety of economic scenarios. In addition, a current examination of the gaps in the mortgage markets, along with the estimated size of the market available to the GSEs, demonstrates the opportunities for the GSEs to purchase mortgages secured by housing in underserved areas of the nation.

Therefore, having considered all statutory factors including housing needs, projected economic and demographic conditions for 2001 to 2003, the GSEs' past performance, the size of the market for central cities, rural areas and other underserved areas, and the GSEs' ability to lead the market while maintaining a sound financial condition; HUD is establishing the annual goal for mortgage purchases qualifying under the Geographically Targeted Goal to be 31 percent of eligible units financed in each of the years 2001, 2002 and 2003. The new goal level will increase the GSEs' current level of performance to a level that is consistent with reasonable estimates of the housing market in underserved areas.

8. Special Affordable Housing Goal, § 81.14

This section discusses the Department's consideration of the statutory factors in arriving at, and the comments received on, the new housing goal level for the Special Affordable Housing Goal, which counts mortgages on housing for very low-income families and low-income families living in low-income areas. After consideration of these factors and the comments received, this final rule establishes the goal for the percentage of the total number of dwelling units financed by each GSE's mortgage purchases for housing affordable to very low-income families and low-income families living in low-income areas for each of the years 2001–2003 at 20 percent. A short discussion of the statutory factors follows. Additional information analyzing each of the statutory factors is provided in Appendix C, ''Departmental Considerations to Establish the Special Affordable Housing Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.

a. Market Estimate for the Special Affordable Housing Goal. The Department estimates that dwelling units serving very low-income families and low-income families living in low-income areas will account for 23–26 percent of total units financed in the overall conventional, conforming mortgage market during the period 2001 through 2003. HUD has developed a reasonable range, rather than a point estimate, that accounts for significantly more adverse economic conditions than have existed recently.

b. Past Performance of the GSEs under the Special Affordable Housing Goal. The Special Affordable Housing Goal is designed to ensure that the GSEs serve the very low- and low-income portion of the housing market. However, analysis of HMDA data shows that the shares of mortgage loans for very low-income homebuyers are smaller for the GSEs' mortgage purchases than for depository institutions and others originating mortgage loans in the conforming conventional market. HUD's analysis suggests that the GSEs should improve their performance in providing financing for the very low-income housing market.

The housing goals that have been in effect prior to this final rule specified that in 1996 at least 12 percent of the number of units eligible to count toward the Special Affordable Housing Goal should qualify as special affordable, and at least 14 percent in 1997 through 1999. As indicated below, Fannie Mae surpassed the goal by 3.4 percentage points in 1996, 3.0 percentage points in 1997, 0.3 percentage points in 1998 and 3.6 percentage points in 1999. Freddie Mac surpassed the goal by 2.0, 1.2, 1.9, and 3.2 percentage points in 1996, 1997, 1998, and 1999, respectively. The GSEs' performance for the 1996–99 period is summarized below:

SUMMARY OF GSE PERFORMANCE UNDER THE SPECIAL AFFORDABLE HOUSING GOAL 1996–1999[36]

	1996 (in percent)	1997 (in percent)	1998 (in percent)	1999 (in percent)
Required Goal Level	12	14	14	14
Fannie Mae:				
Percent Low-and Moderate-Income	15.4	17.0	14.3	17.6
Freddie Mac:				

SUMMARY OF GSE PERFORMANCE UNDER THE SPECIAL AFFORDABLE HOUSING GOAL 1996–1999 [36]—Continued

	1996 (in percent)	1997 (in percent)	1998 (in percent)	1999 (in percent)
Percent Low-and Moderate-Income	14.0	15.2	15.9	17.2

As noted above, HMDA and GSE data for metropolitan areas show that both GSEs lag depository institutions and other lenders in providing financing for home loans that qualify for the Special Affordable Housing Goal. Special affordable loans, which include loans for very low-income borrowers and low-income borrowers living in low-income areas, accounted for 9.8 percent of Freddie Mac's purchases of home purchase mortgages during 1996–98, 11.9 percent of Fannie Mae's purchases, 16.7 percent of newly originated loans retained by depository institutions, and 15.3 percent of all new originations in the conventional, conforming market. While Freddie Mac has improved its special affordable lending since the housing goals were put in place in 1993, up until 1999 it had not made as much progress as Fannie Mae in closing the gap with depository institutions and other lenders in the home loan market. In 1998, Freddie Mac's special affordable performance was 73 percent of the primary market proportion of home loans that would qualify under the Special Affordable Housing Goal, compared to Fannie Mae's performance of 85 percent during the same period. In 1999, Freddie Mac did match Fannie Mae, as special affordable loans accounted for 12.5 percent of its home loan purchases versus 12.3 percent of Fannie Mae's home loan purchases. Market data for 1999 are not yet available.

The multifamily market is especially important in the establishment of the Special Affordable Housing Goal for Fannie Mae and Freddie Mac because of the relatively high percentage of multifamily units meeting the Special Affordable Housing Goal. For example, in 1999, 56 percent of units financed by Fannie Mae's multifamily mortgage purchases met the Special Affordable Housing Goal, representing 31 percent of units counted toward the Special Affordable Housing Goal, at a time when multifamily units represented only nine percent of its total purchase volume.[37]

c. Summary of Comments. Fannie Mae expressed no objection to the higher goal level, provided the Department retains the proposed housing goals framework, including the proposed changes to the counting rules, in the final rule. Freddie Mac supported the goal framework included in the proposed rule and is committed to stretching to meet the new goal levels. The Department's response to the issues raised by both Fannie Mae and Freddie Mac relative to HUD's market share methodologies and its analysis of the statutory factors used to set the level of the goals was discussed above.

Overall, other commenters were supportive of the proposed increase in the Special Affordable Housing Goal. One group of commenters thought that, since the GSEs are mandated to lead the market, the level of the Special Affordable Housing Goal should be increased even more, at a minimum, to the lower range of the Department's market share, at 23–24 percent. Another group of commenters supported the increased level of the goal but felt the Department needed to be prepared to accommodate changes in economic circumstances that may have a negative impact on the GSEs' ability to meet the housing goals.

d. HUD Determination. The Special Affordable Housing Goal established in the final rule is reasonable and appropriate, considering the factors set forth in FHEFSSA. The market share estimates for this goal reflect a variety of economic scenarios significantly more adverse than have existed recently. Current examination of the gaps in the mortgage markets, along with the estimated size of the market available to the GSEs, demonstrates that the number of mortgages secured by housing for special affordable families is more than sufficient for the GSEs to achieve the goal.

Having considered all statutory factors including housing needs, projected economic and demographic conditions for 2001 to 2003, the GSEs' past performance, the size of the market serving very low-income families and low-income families living in low-income areas, and the GSEs' ability to lead the market while maintaining a sound financial condition; HUD is establishing the annual goal for mortgage purchases qualifying under the Special Affordable Housing Goal at 20 percent of eligible units financed by each GSE in each of the years 2001, 2002 and 2003. This new goal level will increase the GSEs' current level of performance to a level that is consistent with reasonable estimates of the special affordable housing market.

e. Special Affordable Housing Goal: Multifamily Subgoal. This final rule modifies the proposed rule by implementing a multifamily subgoal based upon each GSE's respective average mortgage purchase volume for the years 1997 through 1999. The proposed rule suggested that the subgoal be established at 0.9 percent of each GSE's dollar volume of combined 1998 mortgage purchases in 2000 and at 1.0 percent of combined 1998 mortgage purchases from 2001 through 2003. In this final rule, the level of the subgoal is established at a fixed level of one percent of the average of each GSE's respective dollar volume of combined (single family and multifamily) mortgage purchases in the years 1997, 1998 and 1999. This level is $2.85 billion for Fannie Mae and $2.11 billion for Freddie Mac, in each of the years 2001 through 2003.

f. Summary of Comments. Both Fannie Mae and Freddie Mac opposed establishing the special affordable multifamily subgoal as a percentage of their 1998 transaction volumes, stating that 1998 was in some respects an unusual year in the mortgage markets. Instead, they both recommended that the special affordable multifamily subgoal be established as a percentage of a five year average of each GSE's transactions volume. Freddie Mac commented further that HUD's proposed subgoal was unreasonably high.

Many other commenters supported the multifamily subgoal, although they questioned whether 1998 was the appropriate base year upon which to establish the subgoal. Some commenters asserted that the proposed subgoal was too high, in light of an expected decline in multifamily origination volume. Other commenters noted that the subgoal was too low, based on the needs of very low- and low-income families and those in rural areas. Yet, others agreed the subgoal should continue to be percentage based, but argued that the baseline year should move from year to year. Still other commenters felt that the multifamily subgoal should be eliminated, as it no longer appears to serve a purpose, particularly since Freddie Mac has re-entered the multifamily market.

g. HUD's Determination. Both the multifamily mortgage market and Freddie Mac's multifamily transactions volume have grown significantly during the 1990's, indicating both increased opportunity and capacity to grow by Freddie Mac. While Freddie Mac continues to lag behind Fannie Mae somewhat in its multifamily volume, it appears to be within reach of catching up with its larger competitor with regard to the multifamily proportion of total purchases. In 1999, Fannie Mae's multifamily mortgage purchases were 9.5 percent of its total mortgage purchases and Freddie Mac's multifamily mortgage purchases were 8.3 percent of its total mortgage purchases.

Freddie Mac's multifamily special affordable transactions volume was $2.7 billion in 1998 and $2.3 billion in 1999, which demonstrates Freddie Mac's capacity to generate significant multifamily special affordable volume in a favorable market environment. However, the Department is mindful of the fact that the multifamily market conditions experienced during 1998 were very favorable and may not be fully representative of future years. HUD expects conventional multifamily volume in 2001 through 2003 to be somewhat lower than the level reached during 1998.

The Special Affordable Housing Multifamily Subgoal established in this final rule is reasonable and appropriate based on the Department's analysis of this market. The Department's decision to retain the multifamily subgoal is based on the fact that HUD's analysis indicates that multifamily housing still serves the housing needs of lower-income families and families in low-income areas to a greater extent than single family housing. By retaining the multifamily subgoal, the Department ensures that the GSEs continue their activity in this market and that they achieve, at least, a minimum level of special affordable multifamily mortgage purchases that are affordable to lower-income families. Now that more recent data is available, it is apparent that taking 1999 mortgage volume into consideration, along with that of 1997 and 1998, more accurately corresponds to the relative size and respective capabilities of the GSEs over the 2001–2003 goals period. Accordingly, as noted above, this final rule establishes each GSE's special affordable multifamily subgoal at the respective average of one percent of that GSEs' combined mortgage purchases over 1997 through 1999.

h. Multifamily Subgoal Alternatives. In the proposed rule, HUD identified three alternative approaches for specifying multifamily subgoals for the GSEs based on a (i) minimum number of units; (ii) minimum percentage of multifamily acquisition volume; and (iii) minimum number of mortgages acquired. While some of these proposals did receive support from commenters, HUD does not see any compelling reason to alter the dollar based structure of the multifamily subgoal as established in the regulations, which can be updated and adapted to the current market environment by basing it upon recent acquisition volume. It is noteworthy that the Special Affordable Housing Goal, as a percentage of business goal based on the number of units financed, combines elements of options (i) and (iii). HUD's decision to award bonus points toward the housing goals for GSE transactions involving small multifamily properties with 5–50 units will achieve some of the intended policy objectives associated with option (iii).

9. Bonuses and Subgoals

a. Overview. The Department proposed to introduce a system of bonus points to encourage the GSEs to increase their activity in specified underserved markets that serve low- and moderate-income families and families in underserved areas. Bonus points were specifically proposed to encourage increased involvement by the GSEs under goals established for the years 2000–2003 for purchases of mortgages financing small multifamily properties (5–50 units) and two to four unit owner-occupied properties that contain rental units. The areas for which bonus points were suggested are areas in which the GSEs' mortgage purchases have traditionally played a minor role but which provide significant sources of affordable housing and for which the need for mortgage credit persists. As a regulatory incentive to encourage the GSEs to increase their mortgage purchase activity in underserved markets, the Department proposed the use of bonus points for mortgage purchases in these important segments of the housing market. HUD also sought comments on the utility of applying bonus points and other regulatory incentives such as subgoals to other underserved segments of the market including manufactured housing, multifamily properties in need of rehabilitation, and properties in tribal areas.

This final rule incorporates the use of bonus points for small multifamily properties and owner-occupied single family rental properties as proposed for the years 2001 through 2003.

b. Summary of Comments. Fannie Mae and Freddie Mac commented in detail on the use of bonus points and subgoals. Fannie Mae supported the use of bonus points to provide incentives to expand its presence in the markets for both the small multifamily and single family owner-occupied, 2–4 unit property. Fannie Mae opposed the use of subgoals for that purpose, however, arguing that they would result in micromanagement of its business operation. Fannie Mae added that "these two property types pose great difficulties for the secondary market to serve and will require new channels, new products, new modes of operation, and significant investments to better understand the risks." Fannie Mae also recommended that if the Department adopts bonus points, the points should continue beyond 2003.

Freddie Mac supported using bonus points and opposed using subgoals for small multifamily and single family owner-occupied, 2–4 unit property mortgage acquisitions. As with Fannie Mae, Freddie Mac commented that subgoals would result in micromanagement of its business. Freddie Mac also recommended calculating the threshold for 2–4 unit properties based on the period from 1995–1999 instead of using a five-year rolling average. Overall, Freddie Mac commented that it would prefer bonus points to subgoals for any targeted market segments.

Other commenters were generally supportive of the use of bonus points, with many noting that bonus points were preferable to additional subgoals. This group of commenters felt that additional subgoals would result in micromanagement of the GSEs' business operations but felt that bonus points provided an incentive rather than a mandate to move into markets that were underserved.

One group of commenters was opposed to bonus points. Among many of these commenters, however, there was support for incentives for the GSEs to purchase mortgages on small rental properties, noting that the market is underserved and provides an excellent source of affordable rental housing. Specific comments regarding the use of bonus points concluded that bonus points would: (a) Allow the GSEs to meet the goals with less effort and that they might lead the GSEs to relax their single family efforts; and (b) inflate goal performance numbers. It was suggested by several commenters that subgoals would be a more appropriate vehicle to encourage the GSEs' involvement in those segments of the market as well as other segments, *e.g.,* mortgages made to minority borrowers and home purchase mortgages. Some commenters suggested that since there was evidence that the small multifamily mortgage market is well served by community banks, thrifts and small life insurance companies, there is no need for HUD to award bonus points as an incentive for the GSEs to enter that market.

c. HUD's Determination. This final rule adopts the two categories for bonus points that were proposed by the Department. Bonus points are a temporary incentive for the GSEs to step up their efforts to serve this particular need. Availability of bonus points for this purpose beyond 2003, therefore, will require a determination by the Department that the bonus points continue to serve this need. HUD's research and analysis indicates that there is substantial unmet need in these two areas and believes that these are markets the GSEs should serve better. While HUD has determined to establish bonus points in the two market areas proposed, HUD does not believe that either the use of subgoals, that would be unenforceable under FHEFSSA (except for the Special Affordable Housing Goal), or bonus points amounts to micromanagement of the GSEs. By utilizing bonus points the GSEs can choose whether to increase their presence in these markets, and by evaluating the impact of these incentives on the GSEs' mortgage purchase patterns, the Department can evaluate the reasonableness and effectiveness of bonus points as a tool to increase activity in specific markets.

d. Additional Bonus Points and Subgoals. Commenters suggested a wide variety of other areas to consider for either bonus points and/or subgoals including those for which views were invited. Suggestions by commenters for subgoals included home purchase mortgages and mortgages to minority borrowers. Commenters also suggested either bonus points and/or subgoals for reverse mortgages, groups with low homeownership rates, rural multifamily housing programs, manufactured housing, and expiring Section 8 assistance contracts, among other types of transactions. While there was some support for directing bonus points for encouraging GSE financing for minorities there was, however, no consensus among the commenters for this or other specific categories that bonus points and subgoals should address. Since HUD believes that the increased goals under this rule will result in increased financing of affordable housing and increased home ownership opportunities for minorities and other families in underserved areas, HUD has determined to establish bonus points only in the two categories proposed at this time. As indicated above, HUD will, however, monitor the effectiveness of these bonus points closely, based on these results and future housing needs, may establish bonus points for other mortgage purchases in the future.

10. Temporary Adjustment Factor for Freddie Mac

a. Overview. To overcome any lingering effects of Freddie Mac's decision to dismantle and then cautiously reestablish a multifamily mortgage purchase program in the early 1990s, the Department proposed an incentive for Freddie Mac to further expand its scope of multifamily operations through the use of a temporary adjustment factor for its multifamily mortgage purchases in calculating its performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal. In determining Freddie Mac's performance for each of these two goals, the Department proposed that each unit in a property with more than 50 units meeting either of these two housing goals would be counted as 1.2 units in the numerator of the respective housing goal percentage. The temporary adjustment factor would be limited to properties with more than 50 units to avoid overlap with the proposal to award bonus points for multifamily properties with 5–50 units. Comments were requested on whether the proposed temporary adjustment factor for Freddie Mac was set at an appropriate level and whether such an adjustment factor should be phased out prior to 2003.

This final rule incorporates the temporary adjustment factor for Freddie Mac for multifamily properties, other than those small multifamily units receiving bonus credit, as proposed for the years 2001 through 2003.

b. Summary of Comments. Fannie Mae and Freddie Mac commented in detail on the application of a temporary adjustment factor for Freddie Mac's multifamily business. Fannie Mae opposed the application of a temporary adjustment factor for Freddie Mac's multifamily business. Fannie Mae stated that Freddie Mac made a business decision to leave the multifamily market and HUD's action would effectively punish Fannie Mae for staying in the market. Fannie Mae recommended that instead of a temporary adjustment factor, HUD should lower Freddie Mac's goals to levels that would represent a similar "stretch" as the higher goal levels that would be established for Fannie Mae.

Freddie Mac supported the idea of a temporary adjustment factor but recommended that it be set at a multiplier of 1.35 instead of 1.2. Noting that the difference in size and age between Freddie Mac's and Fannie Mae's multifamily portfolios makes goal achievement easier for Fannie Mae, Freddie Mac also recommended that the temporary adjustment factor apply to all three goals. Freddie Mac also opposed any phasing out or elimination of the adjustment factor.

Other comments on the proposal were mixed. While there were many comments in support of the proposal, a number of commenters objected to the proposal, observing that by providing the temporary adjustment factor, HUD would be rewarding Freddie Mac for leaving the multifamily mortgage market in previous years. Commenters also suggested that the same objective could be achieved through the Special Affordable Multifamily Subgoal or by establishing separate housing goals for the single family and multifamily market. Many of these commenters said that, if the temporary adjustment factor were adopted for Freddie Mac, it should be phased out over a period of time.

c. HUD's Determination. In the period since HUD's interim housing goals took effect in January 1993, the volume of Freddie Mac's multifamily mortgage purchase transactions has grown significantly, both in absolute terms and as a proportion of its total mortgage purchases. Freddie Mac's 1993 multifamily transactions volume was only $191 million, compared with $7.6 billion in 1999. In 1999, Freddie Mac's multifamily transactions volume represented 8.3 percent of units backing its total mortgage purchases, close to the Fannie Mae proportion of 9.5 percent. Thus, while Freddie Mac continues to lag behind Fannie Mae somewhat in its multifamily volume, it appears to be within reach of catching up with Fannie Mae with regard to the multifamily proportion of total purchases.

In discussing the Department's appropriations for fiscal year 2000, the Conference Report stated in October, 1999 that "* * * the stretch affordable housing efforts required of each of Freddie Mac and Fannie Mae should be equal, so that both enterprises are similarly challenged in attaining the goals. This will require the Secretary to recognize the present composition of each enterprise's overall portfolio in order to ensure regulatory parity in the application of regulatory guidelines measuring goal compliance." [38]

Consistent with Congress' October 1999 guidance, HUD's analysis indicates that a 1.2 adjustment factor applied to Freddie Mac's mortgage purchases for multifamily properties of more than 50 units for purposes of the Low- and Moderate-Income and Special Affordable Housing Goals, as proposed, is sufficient both to overcome any lingering effects of Freddie Mac's decision to leave the multifamily market in the early 1990s and to ''ensure regulatory parity,'' taking account of the recent magnitude of difference between the GSEs' respective multifamily shares of business and the multifamily market projections detailed in Appendix D. Therefore, while the goals are set at the same levels, the Department has decided to implement the temporary adjustment factor as proposed. The temporary adjustment factor of 1.2 will be applied to the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal. The temporary adjustment factor will terminate December 31, 2003. The temporary adjustment factor will not apply to Fannie Mae.

11. High Cost Mortgages

a. Overview. The proposed rule requested comments on whether HUD should disallow goals credit for high cost mortgage loans, and if so, whether HUD should define high cost mortgage loans using the Home Ownership and Equity Protection Act (HOEPA) [39] or an alternative definition. HOEPA defines high cost mortgages as those that meet an annual percentage rate (APR) threshold (more than 10 percentage points above the yield on Treasury securities of comparable maturity; the Federal Reserve Board can adjust the threshold down to 8 percent or up to 12 percent), or a threshold for points and fees charged (exceeding the greater of 8 percent of the loan amount or $400—adjusted for inflation to $451 for the year 2000). HOEPA requires additional disclosures and restricts certain loan terms (*e.g.*, prepayment penalties, balloon payments, and negative amortization) and practices (*e.g.* failing to consider a borrower's ability to repay) for those mortgages.[40]

The proposed rule also requested comments on the potential benefits, if any, associated with the GSEs' presence in the various higher cost mortgage markets, such as the standardization of underwriting guidelines or reductions in interest rates, as well as the potential dangers, if any, associated with the GSEs' presence in those markets. Finally, the proposed rule requested comments on what additional data would be useful for the purposes of monitoring the GSEs' activities in this area and on whether certain of these data elements should be included in the public use data base. The proposed rule noted that possible data elements that could be collected from the GSEs for monitoring include loan level data on the annual percentage rate, debt-to-income ratio, points and fees, and prepayment penalties.

b. HUD/Treasury Report. On June 20, 2000, HUD and the Department of Treasury jointly released a report entitled ''Curbing Predatory Home Mortgage Lending,'' which detailed predatory or abusive lending practices in connection with higher cost loans in the subprime mortgage market. These practices include charging excessive fees, lending to borrowers without regard to their ability to repay, establishing prepayment penalties that prevent high cost borrowers from refinancing into lower cost loans, abusive terms and conditions that include packing loans with products such as single premium credit insurance, and other practices, including failing to steer borrowers to the lowest-cost product for which they qualify and incomplete reporting of borrowers' payment history to credit bureaus. The report recommended legislative and regulatory action to combat predatory lending while maintaining access to credit for low- and moderate-income borrowers. Respecting the secondary mortgage market, the report recommended that HUD restrict the GSEs from funding loans with predatory features since such loans may undermine homeownership by low- and moderate-income families. HUD and Treasury noted ''while the GSEs currently play a relatively small role in the subprime market today, they are beginning to reach out with new products in this marketplace.''

Recently the GSEs have each announced corporate policies against the purchase of loans with certain features. Fannie Mae has established greater limitations than Freddie Mac, although Fannie Mae has been less involved in the subprime market to date. Fannie Mae announced that ''[f]or loans delivered to Fannie Mae, the points and fees charged to a borrower should not exceed 5 percent, except where this would result in an unprofitable origination,'' and that Fannie Mae will not purchase high cost mortgages as defined under HOEPA. Fannie Mae announced further that it ''will not purchase or securitize any mortgage for which a prepaid single-premium credit life insurance policy was sold to the borrower,'' and that it will generally only allow prepayment penalties under the terms of a negotiated contract and where the lender adheres to the following criteria: A mortgage that has a prepayment penalty should provide some benefit to the borrower (such as a rate or fee reduction for accepting the prepayment premium); the borrower also should be offered the choice of another mortgage product that does not require payment of such premium; the terms of the mortgage provision that requires a prepayment penalty should be adequately disclosed to the borrower, and the prepayment penalty should not be charged when the mortgage debt is accelerated as a result of the borrower's default in making his or her mortgage payments.

Fannie Mae also announced that it will not purchase loans from lenders who steer borrowers to higher cost products if those borrowers qualify for lower cost products. Freddie Mac announced that it will not purchase HOEPA loans, nor will it purchase mortgage loans with single-premium credit life insurance. Both GSEs have announced that they will require lenders who sell them loans to file monthly full-file credit reports on every borrower. While the GSEs' policies differ somewhat in their scope and specificity, both have publicly expressed strong concern about predatory lending practices and have adopted policies requiring them to look harder at particular loan terms and their seller/servicers' business practices, and restricting their purchases of loans originated with such terms and practices. However, the GSEs' broad guidelines describing the characteristics of loans that they intend to make ineligible for purchase lack important details and are subject to changes in corporate direction, or other changes. Therefore, HUD and Treasury recognized in the report that such corporate policies may not be sufficient and that regulations would be needed to address this issue.

c. Summary of Comments. Many commenters on the proposed rule supported the disallowance of credit under the GSE housing goals for high cost mortgages. Some of these commenters commended the GSEs for beginning to offer quality loan products to credit-impaired borrowers. Those commenters argued, however, that restrictions on goals credit for certain loans would not prohibit the GSEs from purchasing all subprime loans but merely those that are likely to be predatory and wealth-stripping. Other commenters argued that without adequate controls, the GSEs' forays into the subprime market will not translate into lower costs for borrowers, but will only lower the cost of capital for subprime lenders.

Some commenters wrote that the GSEs should not receive credit under the housing goals for high cost mortgages that are subject to HOEPA. Many other commenters felt that such a standard would not go far enough, and that the GSEs should not receive goals credit for purchasing loans with certain features. Such features would include fees greater than 3 percent of the loan amount, prepayment penalties on high cost loans, and prepaid single premium credit life insurance that is to be financed in the loan. Commenters also provided additional features for which the GSEs should not receive goals credit, including negative amortization and accelerating indebtedness, fees to renew or modify, balloon payments, yield spread premiums, mandatory arbitration, or high cost loans for which the borrower did not receive homeownership counseling.

One commenter suggested that the Department should treat loans purchased from an institution that engages in predatory lending the same as loans that actually have predatory features in order to send a message that such lenders are not responsible business partners and to restrict further the availability of mortgage credit for such loans. Other commenters suggested that the GSEs should not be allowed to purchase subprime loans at all, so that they will have an incentive to develop conventional mortgage products to reach out to those borrowers. Another suggestion was that the GSEs should be affirmatively penalized for purchasing certain abusive mortgages (*i.e.,* by subtracting points from the numerator but fully counting such loans in the denominator).

A number of commenters suggested that GSEs should be required to conduct fair lending reviews of subprime loans before they purchase them in order to receive credit. Such reviews would include determining whether the lending institution is reporting borrowers' full payment histories to credit bureaus.

Many of the commenters that supported the disallowance of goals credit for high cost loans and loans with certain harmful features asserted that the GSEs' support of such lending poses great risks. These commenters argued that the types of mortgage products that strip equity out of homes and lead to higher foreclosures are not consistent with the GSEs' public mission. Further, to the extent that defaults on these loans lead to losses, these commenters asserted that the GSEs' financial condition will likely be affected.

With regard to data collection and reporting, several commenters suggested that the GSEs should be required to provide full information on their subprime loans, including the APR, total closing costs, points, and fees (including financed credit insurance premiums), delinquency and foreclosure rates, and the length of time between purchase and refinance on an aggregate basis.

Both GSEs and a large group of commenters objected to the Department's proposal regarding the disallowance of goals credit for purchases of high cost mortgages. Many of those commenting in this regard provided substantially similar responses to those submitted by Fannie Mae. These commenters emphasized the difference between legitimate subprime lending and lending through the use of abusive and predatory practices such as those outlined in the HUD/Treasury report. Several of these commenters expressed concern that the Department should not take any action that would discourage the GSEs from serving the subprime market. The GSEs both remarked that they are using enhanced technology (*e.g.,* their respective automated underwriting systems) to allow them to offer products targeted toward borrowers with impaired credit, and that they are, therefore, able to move into the legitimate subprime market in a responsible and prudent manner, bringing liquidity, standardization, and efficiency to that market. The GSEs argue that disallowing goals credit for high cost mortgages will provide a disincentive for them to reach out to those borrowers and will do nothing to combat the predatory lending practices about which the Department is concerned. Indeed, Fannie Mae argued that disallowing goals credit for high cost mortgages would simply drive predatory lending "into the government market or to secondary market sources who are less responsible than Fannie Mae on this issue."

Fannie Mae argued that disallowing goals credit for high cost mortgages is inconsistent with the Department's inclusion of A-minus mortgages in the market estimates to which the Department compares the GSEs' performance. Fannie Mae further argued that the Department would need to "recalibrate the goals" in order to implement a system of disallowing goals credit for high cost mortgages, which would be "extremely difficult, if not impossible" due to "the lack of reliable market data on loan costs."

Nonetheless, Fannie Mae urged the Department to work with other regulatory agencies to collect more data on the problem. Freddie Mac urged the Department to await the outcome of any Federal legislative or regulatory initiatives that may arise as a result of the widespread concern and focus on these issues among members of Congress and regulatory agencies.

The GSEs also both objected to any additional reporting requirements related to monitoring their purchases of high cost mortgages. Fannie Mae argued that the relevant information is not now captured in the primary market, and that collecting and reporting this information would force a "tremendous change to the way the market operates." Freddie Mac similarly argued that the required data elements are not stored uniformly across lenders, and collecting and reporting such data elements would require "substantial investments," the economic impacts of which would likely be considerable.

d. HUD's Determination. After considering the issues raised by the commenters, the Department has determined that, in accordance with the Secretary's authority under section 1336(a)(2) of FHEFSSA, the GSEs should not be assigned credit toward the Affordable Housing Goals for purchasing certain high cost mortgages including mortgages with certain unacceptable features. The GSEs have a statutory responsibility to lead the industry in making mortgage credit available to low and moderate income families and underserved areas. In carrying out this responsibility, the GSEs should seek to make the lowest cost credit available while ensuring that they do not purchase loans that actually harm borrowers and support unfair lending practices. The HUD/Treasury report recommended regulatory and/or legislative restrictions that would go beyond the matter of goals credit and would prohibit the GSEs from purchasing certain types of loans with high costs and/or predatory features altogether. These proposals stem from the concern that mortgages with predatory features undermine homeownership by low-and moderate-income families in derogation of the GSEs' Charter missions. As pointed out in the HUD/Treasury Report, "While the secondary market could be viewed as part of the problem of abusive practices in the subprime mortgage market, it may also represent a large part of the solution to the problem. If the secondary market refuses to purchase loans that carry abusive terms, or loans originated by lenders engaging in abusive practices, the primary market might react to the resulting loss of liquidity by ceasing to make these loans.''

Accordingly, consistent with and combining restrictions already voluntarily undertaken by both GSEs, this final rule restricts credit under the goals for purchases of high cost loans including mortgages with certain unacceptable terms and resulting from unacceptable practices. Specifically, the GSEs will not receive credit toward any of the Affordable Housing Goals for dwelling units financed by mortgages that come within HOEPA's thresholds for high cost mortgages, nor will they receive credit for mortgages with certain unacceptable features or resulting from unacceptable practices. The housing goals provide incentives to encourage GSE efforts to finance housing for low and moderate income families, housing in underserved areas, and special affordable housing. Therefore, HUD has determined that the GSEs should not receive the incentive of goals credit for purchasing high cost mortgages including mortgages with unacceptable features.

(1) Mortgages that Come Within HOEPA's Thresholds. The final rule disallows goals credit for dwelling units financed by mortgages that come within HOEPA's thresholds, *i.e.,* with an APR of 10 percentage points or higher above the yield on Treasury securities of comparable maturity, or with points and fees that are above the greater of 8 percent of the loan amount or $451. HOEPA's thresholds provide a discernible and standard industry measure of a class of loans that are very high cost, that present a very high risk that their borrowers will lose their homes, and that the GSEs themselves have determined not to purchase. While originating such loans is not illegal, but rather made subject to additional disclosures and protections under HOEPA, loans at these levels should not be encouraged by receiving credit under the goals. In incorporating the HOEPA high cost loan standards in this rule, the thresholds are subject to adjustment by the Federal Reserve Board [41] or Congress. This rule is established to encompass such adjustments unless the GSEs are otherwise notified in writing by HUD. While HOEPA itself only covers closed end loans made to refinance existing mortgages and closed end home equity loans, this final rule also applies the HOEPA thresholds to home purchase mortgages.

(2) Mortgages with Unacceptable Terms or Conditions or Resulting from Unacceptable Practices. This final rule also disallows goals credit for dwelling units financed by mortgages with features that the GSEs themselves, either through announced policies or practices, have identified as unfair to borrowers and unacceptable. Specifically, these include mortgages with:

(a) *Excessive fees,* where the total points and fees charged to a borrower exceed 5 percent of the loan amount, except where this restriction would result in an unprofitable origination. For such cases, involving small loans, this rule provides a maximum dollar amount of $1000, or such other amount as may be requested by a GSE and determined appropriate by the Secretary, as an alternative to the 5 percent limit. For purposes of this provision, points and fees include: (i) Origination fees, (ii) underwriting fees, (iii) broker fees, (iv) finder's fees, and (v) charges that the lender imposes as a condition of making the loan—whether they are paid to the lender or a third party. For purposes of this provision, points and fees would not include: (i) Bona fide discount points; (ii) fees paid for actual services rendered in connection with the origination of the mortgage, such as attorneys' fees, notary's fees, and fees paid for property appraisals, credit reports, surveys, title examinations and extracts, flood and tax certifications, and home inspections; (iii) the cost of mortgage insurance or credit-risk price adjustments; (iv) the costs of title, hazard, and flood insurance policies; (v) state and local transfer taxes or fees; (vi) escrow deposits for the future payment of taxes and insurance premiums; and (vii) other miscellaneous fees and charges that, in total, do not exceed 0.25 percent of the loan amount.

This restriction on goals credit for mortgages with excessive fees does not, of course, supplant the restriction on goals credit for HOEPA loans. If a mortgage has fees that exceed 5 percent of the loan amount as described in the immediately preceding paragraph, but do not exceed the 8 percent/$451 threshold under HOEPA, the mortgage would not receive credit toward the goals. HUD, Treasury, the GSEs, and many others have recognized that mortgages with excessive fees are a particularly onerous problem and disproportionately affect the low- and moderate-income borrowers that the GSEs are to serve. Therefore, this final rule will remove any incentive under the goals for the GSEs to purchase loans with excessive fees as described above. Having said that, the HUD/Treasury report called upon the Federal Reserve Board to expand the HOEPA ''points and fees'' threshold to include certain additional types of fees, including (i) fees and amounts imposed by third party closing agents (except payments for escrow and primary mortgage insurance), (ii) prepayment penalties that are levied on a refinancing, and (iii) all compensation received by a mortgage broker in connection with the mortgage transaction. As mentioned above, if the Federal Reserve changes the HOEPA thresholds, such changes will be encompassed within HUD's housing goals, unless HUD notifies the GSEs otherwise.

(b) Prepayment penalties, except where: (i) the mortgage provides some benefits to the borrower (*e.g.,* such as rate or fee reduction for accepting the prepayment premium); (ii) the borrower is offered the choice of a mortgage that does not contain such a penalty; (iii) the terms of the mortgage provision containing the prepayment penalty are adequately disclosed to the borrower; and (iv) the prepayment penalty is not charged when the mortgage debt is accelerated as the result of the borrower's default in making his or her mortgage payments.

(c) Single premium credit life insurance products sold in connection with the origination of the mortgage.

(d) Evidence that the lender did not adequately consider the borrower's ability to make payments, i.e., mortgages that are originated with underwriting techniques that focus on the borrower's equity in the home, and do not give full consideration to the borrower's income and other obligations. Ability to repay must be based upon relating the borrower's income, assets, and liabilities to the mortgage payments.

(3) Mortgages Contrary to Good Lending Practices. As the GSEs have recognized in their own policies and many of the commenters pointed out as well, while good mortgage lending practices can reduce costs to borrowers, contrary practices can result in loans that are higher cost to borrowers in ways that are not directly reflected in the interest rate, points, or fees. Therefore, to remove any goals incentive for the GSEs to purchase mortgages or categories of mortgages regarding which there is evidence that lenders engaged in specific practices contrary to good lending practices identified in the rule, this rule provides that the GSEs may not receive goals credit for such loans or categories of loans. These specific practices identified in this rule that lenders employ to avoid abusive lending include regularly reporting complete borrower information to credit agencies, avoiding steering borrowers to higher cost products, and complying with fair lending requirements.

FHEFSSA and HUD's GSE regulations at 24 CFR 81.41, prohibit the GSEs from discriminating in any manner in making any mortgage purchases because of race, color, religion, sex, handicap, familial status, age or national origin. Since abusive lenders often specifically target and aggressively solicit homeowners in predominantly lower-income and minority communities who may lack sufficient access to mainstream sources of credit, it is essential that the GSEs scrutinize lender practices to protect against buying loans that are the result of unlawful discrimination. For example, good lending practices that help lenders avoid unlawful discrimination include employee training programs, periodic loan sampling, specifically tailored recordkeeping and reporting requirements, and other reviews. The GSEs have reported, consistent with their pledges not to buy certain harmful loans, that they will be looking closer at the lending practices of entities with which they do business, and HUD commends those efforts. HUD will review the processes the GSEs employ to ascertain positive practices to avoid unlawful discrimination and steering borrowers to higher cost products, as well as monthly credit reporting. This final rule provides that where HUD finds evidence that loans or categories of loans do not conform to such positive practices, HUD may deny goals credit for such loans in accordance with § 81.16(d) of this rule.

HUD recognizes that the particular loan terms and practices that are identified as abusive and unacceptable may change as some unscrupulous actors adjust to new restrictions and as the GSEs and HUD gain experience with abuses. Accordingly, to allow flexibility this rule allows the Department to modify the list of terms and practices that will not receive goals credit, by providing that the GSEs may request modifications to the list and that the Secretary will after reviewing such submissions determine whether or not to change the abuses for which goals credit will be restricted. HUD also will continue to monitor the mortgage industry with regard to abusive lending practices and may determine that future modifications are necessary and require further rulemaking.

The restrictions and provisions in sections (1), (2), and (3), above, address terms and practices that are harmful to mortgage borrowers. Accordingly, these restrictions and provisions in this rule apply to mortgages purchased through the GSEs' ''flow'' business, as well as mortgages purchased or guaranteed through structured transactions. Since these restrictions and provisions are consistent with the GSEs' own measures, the Department does not believe that any of these restrictions will provide a disincentive for the GSEs to provide financing for borrowers with slightly impaired credit through innovative products that can bring competition and efficiencies to the legitimate subprime market.

While the GSEs themselves will presumably be obtaining certain additional data and information to carry out their previously announced purchase restrictions and to monitor lending practices, HUD is not establishing any requirements for additional data to carry out these provisions under this rule. Subsequently, HUD plans to request only such additional data as is necessary. In this regard, HUD will consult with the GSEs, as practicable, to develop reasonable data reporting requirements that will not present an undue additional burden.

12. Data On Unit Affordability, § 81.15

The GSEs have reported that at times it can be difficult and costly for them to obtain the data on incomes and rents that is necessary to establish affordability for goals purposes, especially for seasoned loan transactions and some negotiated transactions. HUD proposed to allow (1) the use of estimation techniques to approximate unit rents in multifamily properties where current rental information is unavailable and (2) the exclusion of units, both single family and multifamily, from goal calculations where it is impossible to obtain full data or estimate values, subject to certain limits.

As has been discussed, GSE purchases of mortgages on rental properties disproportionately serve the affordable housing market. Typically, around 90 percent of rental units backing GSE mortgage purchases would count towards the Low- and Moderate-Income Housing Goal and around 50 percent would meet the affordability requirements of the Special Affordable Housing Goal (excluding missing data). HUD did not want the lack of data on affordability to act as a disincentive for the GSEs to purchase mortgages in these important sectors, which have been identified by HUD as having substantial unmet credit needs in the mortgage market. While single family owner-occupied units are also affected by missing data, these units are typically not as affordable as the GSEs' rental purchases. Consequently, the provision in the proposed rule to exclude units from the numerator and denominator for single family owner-occupied properties is limited to properties located in lower income areas and is subject to a cap.

a. Multifamily Rental Units.

(1) Overview. The Department proposed allowing the use of estimated rents for multifamily units with missing data, subject to HUD review and approval of the data sources and methodologies used in computing them. The Department asked for comment on whether it should establish a percentage ceiling on the use of estimated rents.

HUD further proposed that, in cases where multifamily rents are missing and where application of estimated rents is not possible, such units be excluded from both the denominator and numerator for purposes of calculating performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal. The Department requested comment on whether it should establish a percentage ceiling for the exclusion of multifamily units with missing data from the denominator for goal calculation purposes.

(2) Summary of Comments. Several commenters endorsed the concept of using estimated data to calculate performance toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when multifamily rent data are missing. No commenters indicated opposition to allowing the use of estimated rents.

In its comments, Fannie Mae stated that HUD should, in order to provide operational certainty, incorporate an approved methodology into the regulations for estimating rents on multifamily properties where actual rent data are missing. Freddie Mac commented that the GSEs should be given the choice of whether to provide estimated rents or to exclude units from the denominator for purposes of calculating goals performance in instances of missing multifamily rent data.

In cases where calculation of estimated rents is not feasible, a number of commenters wrote in support of excluding the units in question from the denominator as well as the numerator for purposes of calculating performance toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal. One commenter opposed such exclusion, noting that by including all multifamily units in the denominator whether or not the GSEs have the required income and rent data places a more serious burden on the GSEs to obtain the data and focus on affordable lending in the multifamily area.

With regard to the issue of percentage ceilings, Freddie Mac suggested a two-percent (2%) ceiling on the exclusion of multifamily units from the denominator because of missing rents. Other commenters suggested alternative limits, *e.g.*, a half-of-one percent (0.5%) ceiling or a one-percent (1%) ceiling for the combined total of multifamily units with estimated rent and units excluded from the denominator. Only Fannie Mae indicated opposition to such a ceiling, writing that ''Enforcement of percentage ceilings will perpetuate penalties against and create a disincentive for Fannie Mae to engage in the very business that HUD has identified for expanded penetration—single family, owner-occupied, 2–4 unit housing and small multifamily rental properties.''

(3) HUD's Determination. In order to promote liquidity in the multifamily mortgage market, including mortgages on properties which may not have current data on the affordability of such units the Department believes that it is reasonable for the GSEs to provide estimated affordability data for such properties, which would be utilized for purposes of calculating performance toward the Low- and Moderate-Income Goal and the Special Affordable Housing Goal as long as the data sources and methodology are reliable. The data sources and methodology used by a GSE to estimate affordability data are, therefore, subject to HUD review and approval. Estimated affordability data may be used up to a maximum of five (5) percent of units backing GSE multifamily purchases in any given year.

In its evaluation of whether to accept a proposed methodology for estimating affordability data, the Department will seek to determine: (a) The reliability of the data source(s) used including the size of the sample used; (b) the accuracy of the calculations; and (c) the reasonableness of the proposed methodology with regard to providing an unbiased measure of GSE performance toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, including the degree to which the methodology accurately predicts affordability information and goals performance on units backing GSE acquisitions in cases where current affordability data are known. The GSEs will be required to certify that any proposed estimated affordability methodology meets these standards. Methodologies that tend to understate actual rents, or which otherwise tend to overstate the affordability of GSE multifamily mortgage purchases or exaggerate GSE goals performance relative to actual performance, will not be considered acceptable by HUD.

Once a methodology is approved, the Department will closely monitor its implementation and its effects on calculated goals performance. Withdrawal of Departmental approval of an estimated affordability methodology could be warranted if evidence becomes available indicating that use of estimated affordability methodologies is unreliable or has undermined GSE incentives to collect and maintain rent data.

HUD does not believe it is necessary to codify in the regulations the specific methodology for estimating affordability data. The concept of estimating affordability data is new relative to the affordable housing goals. Both HUD and the GSEs need to evaluate the implications of the methodology proposed, monitor performance over time using such data, evaluate new data sources that may become available and become more predictive. HUD needs the flexibility to make changes and refinements to the approved methodology based on experience, without unnecessary limitations. In approving any methodology and data sources, HUD will, of course, be mindful of the GSEs' needs for operational certainty in making determinations.

With regard to circumstances where estimation of affordability on multifamily properties with missing data is not feasible, HUD believes it is reasonable to exclude such units from the denominator as well as the numerator for purposes of calculating performance toward the Low- and Moderate-Income Goal and the Special Affordable Housing Goal. The Department does not believe that a percentage ceiling on the exclusion of multifamily units with missing data from the denominator is needed in order to preserve incentives for data collection, and could actually be harmful from the standpoint of the reliability of the housing goals as a measure of actual GSE performance. Because the percent of multifamily units qualifying for the Low- and-Moderate Income Goal is so much higher than the average across all property types (over 90 percent for multifamily, compared with approximately 45 percent overall), an incentive will remain in place for the GSEs to collect rent data or obtain reliable estimated rents wherever it is feasible to do so. For the same reason, the Department believes that applying a ceiling on exclusion of units from the denominator as well as the numerator for goal calculation purposes would undermine the reliability of the Low- and Moderate Income Goal as a measure of actual GSE performance, since multifamily units above the ceiling would be counted as not being affordable when, in fact, there is approximately a 90 percent probability that such units do meet the requirements of the Low- and Moderate-Income Housing Goal. Similar arguments could be made with regard to the Special Affordable Housing Goal. Therefore, a percentage ceiling on removal of units from the denominator as well as the numerator is not necessary or warranted at this time.

b. Single Family Rental Units.

(1) Overview. The Department further proposed to exclude rental units in 1–4 unit properties with missing rent data from the denominator as well as the numerator in calculating performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal. HUD asked for comment on whether it should establish a percentage ceiling for such exclusions.

This final rule retains the provision excluding rental units in 1–4 unit properties with missing rent data from the numerator and the denominator in calculating performance under the two goals. These properties disproportionately serve affordable housing markets and the GSEs should be active in this segment of the market. As the Department is awarding bonus points for the units in owner-occupied single family rental properties, the GSEs have a large incentive to obtain the required affordability data. When the data is not available, however, the Department does not wish to create a disincentive to purchase mortgages on these properties simply because affordability data is not available.

(2) Summary of Comments. A number of commenters wrote in favor of excluding rental units in 1–4 unit properties from the denominator as well as the numerator for purposes of calculating performance toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when rent data are missing. No commenters indicated opposition to such exclusion.

Writing in support of the ceiling concept, Freddie Mac suggested a two-percent (2%) ceiling on the exclusion of single family rental units from the denominator. Fannie Mae objected to such a ceiling, commenting that a ceiling was unnecessary given that it is in Fannie Mae's interest to obtain rent data on single family rental properties when it is cost effective to do so. Other commenters endorsed a percentage ceiling on the number of single family rental units that would be excluded from the denominator as well as the numerator for purposes of calculating performance toward the Low- and Moderate-Income Housing Goal and the

Special Affordable Housing Goal when rent data are missing.

Fannie Mae and Freddie Mac both suggested that the use of estimated rents should be permitted for single family rental properties with missing data.

(3) HUD's Determination. With regard to single family rental units with missing rent data, HUD believes it is reasonable to remove such units from the denominator as well as the numerator for purposes of calculating performance toward the Low- and Moderate-Income Goal and the Special Affordable Housing Goal. Because of the high degree of affordability of single family rental units, the Department does not believe that a percentage ceiling on exclusion of single family rental units with missing data from the denominator is needed in order to preserve incentives for data collection, and could actually be harmful from the standpoint of the reliability of the housing goals as a measure of actual GSE performance. HUD will monitor the GSEs' use of missing data provisions to ensure that they are being used in a reasonable way.

The Department has determined not to permit the use of estimated affordability data where it is missing for single family rental units. There are several reasons why HUD believes this a reasonable and prudent decision.

A decision to exclude units with missing affordability data from the numerator as well as the denominator for certain goals calculation purposes on single family rental properties removes a potential disincentive to an expanded GSE presence in the markets for mortgages on single family rental properties at the same time. The Department believes this segment of the market has unmet credit needs. To encourage the GSEs to move into this market, it is awarding bonus points for the rental and owner-occupied units in owner-occupied single family rental properties. The use of bonus points will serve as an additional incentive to the GSEs to obtain the necessary affordability data in order to obtain bonus credit.

Furthermore, HUD calculates affordability of single family rental units for purposes of the housing goals using origination-year rents, in contrast to multifamily, where acquisition year rents are used. While acquisition year rents on multifamily properties may sometimes be difficult to provide on seasoned and negotiated transactions where lenders have not continued to collect annual rent data following loan origination, this situation does not apply to single family rental properties, since information on rent at the time of loan origination is ordinarily required by lenders and secondary market institutions as part of the loan underwriting process.

The Department's decision to allow the estimation of affordability data with the limitations provided in this rule for multifamily rental units affords an opportunity to pilot the estimated rent methodology in an appropriately controlled environment.

c. Single Family Owner-Occupied Units.

(1) Overview. The Department also proposed to exclude single family owner-occupied units from the denominator as well as the numerator for purposes of calculating performance toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when data on borrower income are missing, provided the unit is located in a census tract with median income less than or equal to area median. HUD proposed to restrict this exclusion up to a ceiling of one percent (1%) of the total number of single family, owner-occupied dwelling units eligible to be counted toward the respective housing goal.

This final rule retains the provision to exclude single family owner-occupied mortgages from both the numerator and the denominator when borrower income is missing for properties located in lower income areas subject to a one percent maximum.

(2) Summary of Comments. A number of commenters wrote in favor of excluding at least some single family owner-occupied units from the denominator as well as the numerator for purposes of calculating performance toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when income data are missing. One commenter indicated opposition to such exclusion.

Both Fannie Mae and Freddie Mac expressed opposition to restricting the exclusion of single family owner-occupied units with missing income data from the denominator only in lower-income areas. They recommended a two percent ceiling without these geographic restrictions.

In its comments, Fannie Mae stated that ''the place-based restriction that HUD proposes implies an unreasonable assumption that all the units that are missing data outside of the low-income census tracts are not affordable. The effect of the cap is to deny credit for units that are missing data and even when those units have some statistical likelihood of serving loans to low- and moderate-income borrowers. HUD's proposed methodology treats loans to low- and moderate-income borrowers differently simply because the borrower chose to purchase a property in a higher-income area.'' While opposed, in principle, to the concept of a ceiling on the exclusion of missing single family owner-occupied units from the denominator for goals calculation purposes, Fannie Mae stated that any ceiling established by the Department should be set at ''not less than two percent.''

Similarly, Freddie Mac wrote that ''A substantial fraction of mortgages in above-average income tracts are made to low- and moderate-income families' citing 1998 HMDA data in support of this contention. Consequently, ''geographic restrictions would erroneously exclude many low- and moderate-income loans from performance measures.''

Several commenters endorsed HUD's proposed one percent ceiling on exclusion of single family owner-occupied units with missing data from the denominator although some commenters thought the ceiling should be lower than one percent. A number of other commenters expressed opposition to this ceiling. No comments were received on the geographic restrictions aside from those from the GSEs.

(3) HUD's Determination.

With regard to single-family owner-occupied units with missing income data, HUD believes it is reasonable to remove such units from the denominator as well as the numerator up to one percent of the eligible total for purposes of calculating performance toward the Low- and Moderate-Income Goal and the Special Affordable Housing Goal provided such units are located in tracts where median income is less than or equal to area median income.

The percentage ceiling and the restriction to tracts where median income is less than or equal to area median income are both necessary in order to ensure that the exclusion does not result in undue exaggeration of GSE performance as calculated in achieving the housing goals as compared to actual performance. Because single family owner-occupied units are significantly less affordable than all other property types in the conventional, conforming mortgage market according to HUD's estimates (approximately 36 percent single family owner-occupied units meet the Low-and Moderate-Income Housing Goal, compared with 45 percent overall), excluding single family owner-occupied units with missing data from the denominator as well as the numerator could significantly raise the proportion of GSE acquisitions counting toward the Low-and Moderate-Income and Special Affordable Housing Goals above actual performance. The one-percent ceiling on exclusion of single family owner-occupied units from the denominator places a limit on the degree to which such exclusions bias or affect the data, and the restriction to tracts with income less than area median serves to increase the likelihood that the affordability characteristics of the excluded units resembles that of the ''typical'' GSE purchase, further limiting the bias that would otherwise be introduced.

In HUD's view, the proposed geographic restriction on the exclusion of missing single family owner-occupied units from the denominator as well as the numerator for certain goals calculation purposes is, therefore, reasonable and necessary to correct for the bias that would otherwise be introduced even with a one-percent ceiling. Fannie Mae's contention that ''the place-based restriction that HUD proposes implies an unreasonable assumption that all the units that are missing data outside of the low-income census tracts are not affordable'' is not pertinent to HUD's determination. The Department made no such assumption. HUD is well aware that many low-income borrowers choose to live in tracts with median income above the area median, as pointed out by Fannie Mae. Conversely, however, a significant number of above median-income borrowers choose to live in tracts with median income below the area median. HMDA data does, however, show a strong correlation between borrower income as a percent of area median and tract income as a percent of area median, suggesting that tract income serves as a useful predictor of borrower of income. For example, in 1998, 55 percent of conforming, conventional owner-occupied loans in tracts where median income was less than area median were to low-and moderate-income borrowers. In contrast, only 33 percent of loans in high-income tracts were to low-and moderate-income borrowers. (Overall, 42 percent of single family owner-occupied loans in HMDA data were to low-and moderate-income borrowers.) HUD's analysis of GSE loan-level data reveal a similar correlation between borrower income as a percent of area median and tract income as a percent of area median, although the low-mod percentage of GSE acquisitions is lower than in HMDA data.

Accordingly, HMDA findings support the conclusions that HUD's proposed geographic restrictions on the exclusion of missing single family owner-occupied data will (i) result in goals calculations that more accurately track actual performance than would otherwise be the case and (ii) respond appropriately to any perceived weakening of incentives for the GSEs to collect affordability data to the extent feasible.

d. Other Matters. Freddie Mac argued that units with missing census tract data should be excluded from the denominator as well as the numerator for purposes of calculating performance toward the Underserved Areas Goal up to a maximum of 0.5 percent of the total.

The Department has not determined, however, that it is reasonable to remove units with missing geographic information from the denominator as well as the numerator for purposes of calculating performance toward the Underserved Areas Goal. In those limited instances where census tract (for metropolitan areas) or county (for nonmetropolitan areas) cannot be determined using automated methods, manual methods can be used.

13. Seasoned Mortgage Loan Purchases ''Recycling'' Requirement

a. Overview. Under section 1333(b)(1)(B) of FHEFSSA, [42] special rules apply for counting purchases of portfolios of seasoned mortgages under the Special Affordable Housing Goal. Specifically, the statute requires that purchases of seasoned mortgage portfolios receive full credit toward the achievement of the Special Affordable Housing Goal if ''(i) the seller is engaged in a specific program to use the proceeds of such sales to originate additional loans that meet such goal; and (ii) such purchases or refinancings support additional lending for housing that otherwise qualifies under such goal to be considered for purposes of such goal.'' [43] HUD refers to this provision as the ''recycling requirement.''

The proposed rule suggested changes to § 81.14(e)(4) of the current regulations. The proposed language was intended to provide guidance to the GSEs with regard to the recycling requirements described above and to provide new, simpler rules when it is evident based on the characteristics of a mortgage seller that the recycling requirements would likely be met.

The rule proposed that certain categories of lenders could be presumed to conduct a lending program meeting the recycling requirements of the statute and regulations. These categories include federally regulated financial institutions with satisfactory ratings on recent Community Reinvestment Act examinations and specific categories of lenders with affordable housing missions.

b. Guidance Provided on Recycling Requirements. Commenters were generally supportive of the overall guidance proposed by the Department with regard to determining when recycling requirements were met in order to count purchases of seasoned mortgage loans toward the Special Affordable Housing Goal, assuming they otherwise qualified for the goal. These provisions are included in the final rule with three specific changes based on the comments received. The changes made in the proposed language relate to the satisfactory CRA requirement for Federally insured financial institutions, identification of other institutions and/or organizations presumed to meet the recycling requirements, and the treatment of third party originations under the recycling provision. Changes made in the final rule on these three aspects are discussed in more detail below.

c. CRA Requirement.

(1) Summary of Comments. Overall commenters supported the proposed changes identifying specific criteria and standards for the recycling requirements. However, many commenters disagreed with HUD's requirement that a financial institution subject to CRA examinations must have received ''at least a satisfactory performance evaluation rating for at least the two most recent examinations under the Community Reinvestment Act'' to be presumed to meet the recycling requirements.

Fannie Mae, Freddie Mac and several other commenters suggested that a satisfactory performance evaluation rating on the most recent examination is sufficient, as opposed to the two most recent examinations, since the period between examinations can be as long as 60 months. A number of commenters noted that this could be a particularly difficult requirement for small institutions, who are examined much less frequently.

Other commenters suggested that two consecutive outstandings is a more suitable standard, as 78 percent of banks received satisfactory ratings in their 1999 CRA exams and about 75 percent received these ratings in previous years.

Still other commenters were supportive of HUD's proposal of at least a satisfactory performance evaluation rating for at least the two most recent examinations under the Community Reinvestment Act because it would reduce the compliance burden of both the GSEs and depository institutions, allowing them to spend more time on the business of financing housing loans.

(2) HUD's Determination. HUD has reviewed these comments and noted that the proposed rule, in establishing the CRA examinations and ratings of financial depository institutions as a

basis for determining that a financial institution met the recycling requirements for seasoned loan purchases under the Special Affordable Housing Goal, did not make a distinction between small and large depository institutions as intended and reflected in the CRA regulation [44] and the Gramm-Leach-Bliley Act of 1999. [45] The 1995 CRA regulation distinguishes, for examination purposes, four different types of financial institutions based on their size, structures, and operations: Small banks, large banks, wholesale banks, and limited purpose banks. Accordingly, the 1995 regulation provides different performance procedures, standards, ratings, and cycles for small banks, large banks, wholesale banks, and limited purpose banks. All of the procedures reflect the intent of the regulation to establish performance-based CRA examinations that are complete and accurate but, to the maximum extent possible, mitigate the compliance burden for institutions.

Under section 712 of the Gramm-Leach-Bliley Act, small banks with aggregate assets of not more than $250 million will be subject to routine examination:

- Not more than once every 60 months for an institution that has achieved a rating of ''outstanding record of meeting community credit needs'' at its most recent examination;
- Not more than once every 48 months for an institution that has received a rating of ''satisfactory record of meeting community credit needs'' at its most recent examination.
- As deemed necessary by the appropriate federal financial supervisory agency for an institution that has received a rating of ''less than satisfactory record of meeting community credit needs'' at its most recent examination.

In view of the comments received and based on its analysis of the 1995 CRA regulations and the Gramm-Leach-Bliley Act of 1999, this rule includes the recycling requirement that a financial institution have ''at least a satisfactory performance evaluation rating for at least the two most recent examinations under the Community Reinvestment Act'' for large banks and wholesale banks that are subject to CRA examinations. Limited purpose banks are not making home mortgage loans and therefore are not relevant for this analysis. This final rule adds a provision for small institutions with assets of no more than $250 million that such institutions must have received ''a satisfactory performance evaluation rating for the most recent examination under the Community Reinvestment Act to be presumed to meet the requirements in paragraphs (e)(4)(i) through (e)(4)(iv) of this section for seasoned loans.'' This safe harbor provision will also apply to the affiliates of depository institutions, provided that these affiliates are subject to the CRA examinations.

With regard to the suggestion that the standard for CRA examinations be two consecutive outstanding ratings, the Department believes that such a standard would be counterproductive. The purpose of the standard is to identify those financial institutions that are in the business of serving affordable housing markets. Using a satisfactory CRA examination rating achieves that purpose and is retained in the final rule.

d. Classes or Categories of Organizations Presumed to Meet Recycling Requirement.

(1) Summary of Comments. With regard to other additional classes of institutions or organizations that should be recognized as meeting the recycling requirements, most commenters, including the GSEs, agreed with HUD's proposal that State Housing Finance Agencies or Special Affordable Housing Loan Consortia should be presumed to meet the recycling requirements. However, both GSEs urged that HUD provide them with ''as much flexibility as possible on this provision.'' Fannie Mae opposed HUD approval of additional lending institutions or organizations and, instead recommended that HUD provide a list of HUD-approved institutions, and criteria for the GSEs to qualify lenders or certain kinds of lending or transactions. Freddie Mac suggested HUD ''broaden the regulatory presumption of recycling to all sellers of mortgages so long as they originate or purchase qualifying special affordable housing goal mortgages in the ordinary course of business.''

A great number of commenters suggested that HUD's list also include other ''non-traditional lenders'' who serve targeted communities and who could potentially benefit from the liquidity that the change could provide. These commenters mentioned the following institutions: Community development financial institutions, minority owned lenders, women owned lenders, non-profit lenders, and public revolving loan funds.

Other commenters urged HUD to include all credit unions in HUD's list because credit unions originate low-cost residential loans that make housing affordable to millions of credit union members even though they are exempt from CRA requirements. At a minimum, it was suggested that ''seasoned loans purchased from community development credit unions, which are chartered to serve low-income communities, should qualify for goal credit.

(2) HUD's Determination. HUD has reviewed the above comments and agreed to expand the safe harbor provision to include the following institutions or classes of institutions that the GSEs may presume meet the recycling requirements as long as these institutions have an affordable housing mission: State housing finance agencies; affordable housing loan consortia; Federally insured credit unions that are either (a) community development credit unions, or (b) credit unions that are members of the Federal Home Loan Bank System and meet the first-time homebuyer standard of the Community Support Program; community development financial institutions; public loan funds; and non-profit lenders. The final rule retains the requirement that any additional classes of institutions or organizations must be approved by the Department. The final rule establishes a reasonable set of lender characteristics that are presumed to meet the recycling provisions that cover a large portion of the affordable lending market. For those lenders falling outside of these parameters, the final rule provides the GSEs with broad guidance as to what a recycling program should include if a lender does not fall into an accepted category. The GSEs have broad latitude to evaluate the circumstances of a particular lender in counting seasoned loan purchases toward the Special Affordable Housing Goal. A GSE does not have to get prior approval to do business with a lender that does not fall into the presumptive category as long as the GSE verifies and monitors that the lender is conducting an affordable lending program consistent with the guidelines provided. Prior approval is only required if a seller of loans falls outside the boundaries established in the final rule and the GSE wants them designated among the category of institutions already identified and presumed to meet the requirements. The Department does not anticipate that such action will limit the GSEs ability to conduct business in any material way, but rather will relieve the burden of having to verify and monitor the lending programs of those entities presumed to meet the recycling requirements.

e. Third Party Transactions.

(1) Overview. In the proposed rule, HUD solicited comments on the treatment under the recycling provisions of structured transactions where the mortgage loans included in the transaction were originated by a

depository institution or mortgage banker engaged in mortgage lending on special affordable housing but acquired, packaged and re-sold by a third-party, *e.g.,* an investment banking firm that is not in the business of affordable housing lending.

(2) Summary of Comments. Fannie Mae believes that ''the appropriate approach is to extend the streamlined application to third party deliveries.'' Fannie Mae argues that when it purchases loans delivered by third parties, it ''is supporting the marketplace dynamic that provides liquidity,'' and therefore ''the intermediate step in no way degrades the liquidity support provided to the institutions or the mortgage products.''

Freddie Mac did not address this issue directly but pointed out that Congressional intent underlying the seasoned, recycling requirement was ''to ensure that the proceeds will be used in a manner that increases the availability of mortgage credit for the benefit of low-income families.'' According to Freddie Mac, Congress' interest was to ensure that ''mortgage proceeds were funneled back into the mortgage market, not that specific types of lending programs should be used to recycle these proceeds.'' Thus, Freddie Mac recommends that HUD include all mortgage sellers that regularly engage in originating or purchasing mortgages that meet the special affordable housing goal criteria. The alternative, according to Freddie Mac, would be ''adoption of the BIF/SAIF regulatory presumption while maintaining the current regulatory scheme.''

(3) HUD's Determination. HUD recognizes that Congress intended that the housing goals generally and the recycling provisions specifically were to expand the availability of affordable housing with particular emphasis on the purchase of loans that are originated in conjunction with affordable housing programs, the creation of innovative product lines, or the building of institutional capacity and infrastructure among others in the industry.[46] If the mortgages were, in fact, originated by an entity that meets the new recycling presumptions, *i.e.,* is regularly in the business of mortgage lending; is a BIF-insured or SAIF-insured depository institution; and is subject to, and has received at least a satisfactory performance evaluation rating under the Community Reinvestment Act, or is among the enumerated class or classes of organizations whose primary business is financing affordable housing mortgages; but the mortgages were delivered to the GSEs by a third party seller after a relatively short holding period, the purchase of such mortgages would meet the intent of Congress and fulfill the spirit of the recycling requirement. Therefore, in this final rule, HUD will allow mortgages delivered by such third party sellers to meet the recycling presumptions in § 81.14(e)(4)(vi) and (vii) of this final rule if the mortgages were originated by an entity that comes within the recycling presumptions; and the seller acted for, or in conjunction with, such entity in the transaction with the GSE. A seller that holds loans itself for more than six months is not presumed to be acting for, or in conjunction with, such an entity. Accordingly, the final rule excepts such sellers from the benefit of the presumption. Notwithstanding, a seller that otherwise meets the tests of the recycling provisions may qualify under the rules on its own behalf. Moreover, in any case, if the mortgages were originated by an entity that does not meet the recycling presumptions, the GSEs can still get goals credit under the Special Affordable Housing Goal if they verify and monitor that the originator, acting in conjunction with a seller, meets the recycling requirements in § 81.14(e)(4)(i) through (iv).

14. Counting Federally Insured Mortgages Including HECMs, Mortgages on Housing in Tribal Areas and Mortgages Guaranteed by the Rural Housing Service Under the Housing Goals

a. Overview. Under § 81.16(b)(3) of HUD's regulations prior to this final rule, non-conventional mortgages—mortgages that are guaranteed, insured or otherwise obligations of the United States—did not generally count under the three housing goals. However, mortgage loans under the Home Equity Conversion Mortgage (HECM) Program and the RHS's Guaranteed Rural Housing Loan Program have received credit under the Special Affordable Housing Goal. FHEFSSA specifically provides that mortgages that cannot be readily securitized through the Government National Mortgage Association (GNMA) or another Federal agency and for which a GSE's participation substantially enhances the affordability should receive full credit under the Special Affordable Housing Goal. On this basis, those two categories of mortgages would count under that goal if they finance housing for very low-income families or low-income families in low-income areas and meet recycling requirements if seasoned.

In the proposed rule, HUD proposed to amend § 81.16(b)(3) to count and give full credit for the following types of mortgage loans toward all three housing goals: mortgage loans under the HECM Program, mortgages guaranteed by RHS, and mortgage loans made under FHA's Section 248 program and HUD's Section 184 program for properties in tribal lands. (This section has also been amended as described herein at paragraph 14, Expiring Assistance Contracts.) HUD also proposed that other types of mortgages involving Federal guarantees, insurance or other Federal obligation may be eligible for credit under the goals if a GSE submits documentation to HUD that supports eligibility for HUD's approval and the Department determines, in writing, that the financing needs addressed by such programs are not well served and that the mortgage purchases under such program should count under the housing goals.

b. Summary of Comments. Commenters other than the GSEs generally supported the proposed change allowing goals credit for the GSEs' purchases of HECMs and rural and tribal mortgages. They stressed the need for liquidity for such programs and for encouraging the GSEs to better serve these markets. They pointed out that these markets are still undeveloped and underserved.

Fannie Mae supported the proposed changes with regard to government loans, but Freddie Mac made no comment.

A few commenters recommended that HUD count all reverse mortgages, not just HECMs, toward the three goals. Other commenters suggested that loans guaranteed by the RHS' Sections 538 and 515 programs should also receive goals credit as they provide high quality affordable multifamily housing for lower-income families in rural areas.

Some commenters suggested that HUD also should include all mortgages that are supported in some way by state and local governments. Others recommended that predevelopment grants or loans, interim development or bridge financing, and permanent financing be considered.

Fannie Mae objected to the proposal for HUD's review and approval of goals credit for other types of government loan programs and requested that HUD provide a set of criteria for the GSEs to apply and make their own determinations. According to Fannie Mae, the GSEs should receive goal credit for the purchase of specialized government program loans if two conditions are met: (1) Loans are made under any federally-insured programs (except for FHA loans insured under section 203(b) or VA loans insured under the VA single family insurance program); and (2) the GSEs add valuable liquidity, lower costs, additional credit enhancements, or some other value to the financing of these loans.

c. HUD's Determination. In view of this general support for the proposed changes and based upon its review of data on the GSEs' mortgage purchases of HECMs, RHS mortgages and loans made to Native Americans under FHA's Section 248 program and HUD's Section 184 program, this final rule amends § 81.16(b)(3) to except mortgages under the HECM program, single-family mortgages guaranteed by RHS under the Section 502 program, and loans made under FHA's Section 248 program and HUD's Section 184 program on properties in tribal lands from the general exclusion from goals credit for non-conventional loans. This final rule allows goal credit for those specific Federally insured or guaranteed mortgage loans.

As proposed, the final rule provides that HUD will review other types of mortgages involving Federal guarantees, insurance or other Federal obligation for goals credit. HUD's review of the GSEs' non-conventional mortgage purchases is needed, among other reasons, to ensure compliance with FHEFSSA, which permits mortgages that cannot be readily securitized through GNMA or another Federal agency and for which a GSE's participation substantially enhances liquidity, to receive full credit under the Special Affordable Housing Goal. In view of the ample liquidity among the great majority of FHA loans, HUD must exercise ongoing responsibility to evaluate whether the GSEs' mortgage purchases under non-conventional mortgage programs (other than HECM program, specified RHS mortgage programs, and FHA's Section 248 program and HUD's Section 184 program on properties in tribal lands) should count under the Special Affordable Housing Goal. Beyond its responsibility under the Special Affordable Housing Goal, HUD must continually determine whether goals credit should be provided for particular GSE purchases. HUD has evaluated and considered the specific programs enumerated above and, at this time, is able to determine that goals credit should be given for the GSEs purchases of mortgages under these programs because these purchases will address credit needs that are not well served. For other programs, HUD must make the same careful and complete evaluation before it can decide in accordance with FHEFSSA whether goals credit is warranted.

This final rule retains a provision that to the extent categories of non-conventional mortgage purchases that now count toward the goals, they no longer will be excluded from the denominator of the GSEs' mortgage purchases as are other non-conventional loans that do not receive credit under the goals.

15. Expiring Section 8 Assistance Contracts

a. Overview. Over 900,000 housing units in approximately 10,000 multifamily projects have been financed with FHA-insured mortgages and supported by project based Section 8 housing assistance contracts.[47] Many of these contracts will expire over the next five years. A significant portion of these contracts currently provide for rents for assisted units that substantially exceed the rents for comparable unassisted units in the local market. Simply reducing rents to a level which may not support the project's debt service would risk likely defaults on the FHA-insured mortgage payments resulting in substantial claims to FHA's insurance funds.

In October 1997, Congress enacted the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA; 42 U.S.C. 1737f) specifically to address the problem of expiring contract for project-based Section 8 rent subsidies for certain multifamily rental projects, most of which are insured by FHA. MAHRA authorized a new Mark-to-Market Program designed to preserve low-income rental housing affordability while reducing the long-term costs of Federal rental assistance for these projects.[48] MAHRA establishes processes and standards for debt restructuring under the program where it is determined that such restructuring is appropriate and necessary.

MAHRA also amended section 1335(a) of FHEFSSA (12. U.S.C. 4565(a)(5)) to require Fannie Mae and Freddie Mac to ''assist in maintaining the affordability of assisted units in eligible multifamily housing projects with expiring contracts.'' MAHRA amendments further stipulate that such actions shall constitute part of the contribution of each GSE toward meeting its housing goals as determined by the Secretary. In the proposed rule, HUD proposed to provide partial to full credit under the housing goals as determined by HUD for actions that maintain the affordability of assisted units in eligible multifamily housing projects with expiring contracts include the restructuring or refinancing of mortgages, and credit enhancements or risk-sharing arrangements to modified or refinanced mortgages. HUD solicited comments on how and to what extent the GSEs should receive credit for such actions.

b. Summary of Comments. Commenters who addressed this issue were generally supportive of HUD's proposal to award credit for these activities. Although Freddie Mac did not express an opinion in its comments, Fannie Mae expressed some support for HUD's approach. However, Fannie Mae requested that HUD consider some revisions to its proposal. Specifically, Fannie Mae suggested that HUD broaden its definition of actions which would receive credit to include the purchase of FHA-insured mortgages, mortgage revenue bonds and equity investments, including Low Income Housing Tax Credits. Fannie Mae suggested that HUD strike the language ''* * * as determined by HUD'' from the final rule to avoid a regulatory process that requires prior HUD approval for determining goals credit. Fannie Mae also suggested that actions qualifying for credit under this section should always receive full, rather than partial, credit.

c. HUD's Determination. HUD has determined that it is both appropriate and consistent with the statutory mandates of FHEFSSA and MAHRA that actions taken by the GSEs to assist in maintaining the affordability of assisted multifamily units with expiring contracts receive goals credit as part of the GSEs' contributions in meeting their housing goals as determined by the Secretary. HUD's current counting rules permit the GSEs to receive full credit for purchases of mortgages or interests in mortgages as set forth in 24 CFR 81.16. Those rules address goals eligibility standards for credit enhancements, the purchase of refinanced mortgages, mortgage revenue bonds and risk-sharing. Because HUD intends that goals credit for actions in conjunction with expiring assistance contracts should conform to actions that are already awarded credit in other transactions, HUD has determined that it is not necessary to restate these rules with respect to eligibility of actions for goals credit that assist the Mark-to-Market program. Accordingly, this final rule revises the language to eliminate redundancies by referencing current regulations.

HUD agrees with Fannie Mae that the purchase of FHA-insured mortgages resulting from restructured financings of projects with expiring assistance contracts is an appropriate activity to include in actions eligible for goals credit. Accordingly, HUD has amended § 81.14(e)(3) to specify that purchases of mortgages on projects with expiring assistance contracts that meet the requirements of 12 U.S.C. 4563(b)(1)(A)(i) and (ii) will receive full credit toward achievement of the special affordable housing goal.

This final rule also clarifies the counting treatment for actions a GSE takes to modify or restructure the terms of mortgages with expiring assistance contracts which it may hold in portfolio, provided such restructuring results in lower debt service costs to the project's owner. HUD has added § 81.16(c)(9)(ii) to provide full credit under any housing goal for these activities.

HUD has reviewed comments from Fannie Mae, Freddie Mac, and others regarding awarding goals credit for equity investments, particularly Low Income Housing Tax Credits (LIHTCs). These comments, while not necessarily offered in response to this section of the proposed rule, indicate a continuing interest in counting these transactions under the goals. The Department agrees that the GSEs' participation in LIHTCs plays a vital role in the development of affordable housing. By excluding these investments from goals credit HUD does not intend to convey any lack of appreciation for their importance. However, FHEFSSA imposes certain standards on what can and cannot be counted towards the housing goals.[49]

Specifically, only mortgage purchases as defined in FHEFSSA and the implementing regulation meet the standard for eligibility. As described in the preamble to HUD's 1995 regulation, the purchase of LIHTCs is not a mortgage purchase or the equivalent of a mortgage purchase and, therefore, is not eligible for goals credit under HUD's general counting requirements as set forth in the implementing regulation.

While MAHRA does provide that actions to maintain the affordability of assisted units under MAHRA will count under the goals, MAHRA does not specifically impose standards for counting actions with respect to expiring assistance contracts under the goals but leaves this matter to HUD's determination. In determining whether actions count under the goals, HUD will generally be guided by definitions and counting conventions set forth in the implementing regulation. In instances where a GSE engages in actions not specified in the implementing regulation but which it believes warrant goals credit, or where a GSE provides more than one form of assistance for a single project, the GSE must submit the transaction to HUD for a determination on the appropriate level of credit to be awarded if the goals credit is sought. In making a determination, HUD will award counting treatment for those actions that are required under MAHRA and that may count under FHEFSSA.

A few commenters expressed concern about the counting treatment for mortgage purchases on projects with expiring contracts that ''opt out'' of the assisted program. One commenter suggested that HUD impose additional affordability requirements as a condition of awarding goals credit for such transactions. However, HUD finds that the issue of affordability relative to goals credit is already well established. HUD's current regulations address the income requirements for determining how mortgage purchases are counted under any of the housing goals. There are other statutory provisions that also address long-term affordability. Projects that rely upon or intend to rely upon equity investments from the LIHTC program must meet tax code requirements for affordability for a 15-year period.[50] Mortgages secured by projects subject to restructuring plans must provide for a Use Agreement that includes affordability restrictions and remains in effect for at least 30 years.[51] HUD believes that the current counting rules and statutory definitions under FHEFSSA and MAHRA are sufficient to ensure that goals credit is awarded appropriately for mortgage purchases that meet prescribed housing affordability standards.

16. Provision for HUD to Review New Activities To Determine Appropriate Counting Under the Housing Goals

a. Overview. In order to address confusion about whether a given transaction will receive credit under the housing goals, HUD proposed adding a provision at § 81.16(d) to further clarify its position regarding HUD's authority review new activities, or classes of transactions, to determine appropriate counting treatment under the housing goals.

While the GSEs participate in transactions and activities that support community and housing development in general, FHEFSSA is clear that only ''mortgage purchases'' count toward performance on the housing goals. Section 81.16(a) of the regulations stipulates that the Secretary shall consider whether a transaction or activity of the GSE is substantially equivalent to a mortgage purchase and either creates a new market or adds liquidity to an existing market. As provided in § 81.16(b), HUD has determined that certain transactions do not meet those criteria and, therefore, will not count toward a GSE's housing goals performance. Examples include equity investments in housing development projects; commitments, options or rights of first refusal to acquire mortgages; mortgage purchases financing secondary residences; purchases of non-conventional mortgages and government housing bonds except under certain circumstances. As provided in § 81.16(c), HUD has determined that certain other transactions, including credit enhancements in certain situations, REMIC purchases and guarantees in certain circumstances, and others, do count as mortgage purchases.

HUD believes that, in order to meet higher goal levels, the GSEs will need to continue to develop new products and approaches while also remaining mindful of FHEFSSA's requirements. HUD invited comment on this proposal.

b. Summary of Comments. Commenters who addressed this issue generally offered support for the proposal. Some commenters, however, confused HUD's proposal to review classes of transactions for goals counting treatment with the Department's New Programs Approval authority as set forth in § 81.51 which relates to HUD's review of a new GSE activity to determine whether it is a new program and whether it is authorized under the GSE's charter and in the public interest. The provision in § 81.16(d) of the proposed rule concerns instead whether a class of transactions counts as mortgage purchases that will receive credit under the housing goals. In HUD's proposed rule, no regulatory changes to the New Programs Approval authority were proposed.

Of the comments received, Fannie Mae addressed the issue of counting classes of transactions under the goals in some detail. Generally, Fannie Mae expressed an overall objection to any regulatory provisions that would require prior HUD approval for goals counting purposes, believing instead that HUD should codify clear but flexible rules that remove all uncertainty regarding goals counting treatment. Fannie Mae further stated that prior HUD review could ''put in place a disincentive to the development of new and innovative products.'' Fannie Mae did not suggest any specific examples of classes of transactions or characteristics that HUD should exclude from a prior review process nor did it specify how regulatory guidance could be constructed to address future events. However, Fannie Mae did suggest that HUD impose a 30-day time frame for review after which the transaction(s) would be approved for goals credit unless HUD had notified the GSE otherwise during the review period.

Another commenter expressed concern that HUD intends to count transactions that are not formally mortgages if HUD believes they serve a new market or add liquidity to an existing market, thereby potentially allowing the GSEs to expand their activities into areas now served by others.

c. HUD's Determination. In assessing these concerns, HUD believes that Fannie Mae's suggestions for additional codified regulatory guidance in lieu of any HUD review are impractical and unnecessary. The regulation already includes numerous provisions that address eligible transactions and their counting treatment. In fact, virtually all transactions in current use which could be substantially equivalent to a mortgage purchase have been addressed elsewhere in the counting rules. Nevertheless, given the pace of innovation in the mortgage and investment markets and the likelihood that the GSEs will devise new lending and marketing approaches in the future, providing a prior-review requirement to address goals counting treatment for these future transactions is both an efficient and practical solution while a more prescriptive approach may not be sufficiently foresighted or encompassing thereby disadvantaging both the public's and the GSEs' interests.

HUD regards concerns that by adding § 81.16(d) to the regulation, HUD is opening the door to counting non-mortgage transactions towards the goals as unwarranted. The regulatory language is explicit in stating that, in order to count towards goals performance, transactions must be ''mortgage purchases'' in accordance with FHEFSSA. The regulatory language does not use ''liquidity'' as a criteria for review and approval to count transactions for goals credit, and ''liquidity'' is not a defining element of ''mortgage purchase'' under this regulation. Further, the regulation explicitly states which classes of transactions are currently ineligible, and it provides guidance on criteria necessary for qualifying other classes of transactions. Thus the plain meaning of the regulations including the counting rule conventions set forth in the regulation would preclude a broader interpretation of § 81.16(d).

HUD has further determined that establishment of a time limit for HUD review of GSE requests to count transactions is unnecessary. While HUD is aware of the need for responsive action to a GSE's request for guidance and will respond to such requests reasonably, rigid time frames may not provide sufficient review of complex transactions to best serve the public interest. Accordingly, HUD has implemented § 81.16(d) as originally proposed.

17. Counting Rules—Clarifying Technical Provisions

a. Especially Low Income. Section 81.14(d)(1)(i) of the regulations provides that dwelling units in a multifamily property will count toward the Special Affordable Housing Goal if 20 percent of the units are affordable to families whose incomes do not exceed 50 percent of the area median income. HUD's regulations at §§ 81.17 through 81.19 stipulate that the income requirements are to be adjusted based on family size and provide adjustment tables for qualifying family income where incomes do not exceed from 60 percent to 100 percent of area median income. However, there has been no similar adjustment table provided for families whose incomes do not exceed 50 percent of area median income. HUD proposed to amend those sections to provide additional adjustment tables for such families. To be consistent, HUD also proposed to designate such families as ''especially low-income families'' for purposes of the Department's GSE regulations and to reflect this change in § 81.14. HUD received no comments on these proposals. Therefore, this final rule implements the changes as proposed in § 81.14 and §§ 81.17 through 81.19.

b. Defining the ''Denominator''. HUD proposed amending the calculation of ''Denominator'' to clarify that the denominator does not include GSE transactions or activities that are not mortgages or transactions that are specifically excluded. HUD received no comments on this proposed change, and this final rule implements the change as proposed in 81.14(a)(2).

c. Balloon Note Conversions. HUD proposed to amend the definition of ''Refinancing'' at § 81.2 to exclude a conversion of a balloon mortgage note on a single family property to a fully amortizing mortgage note provided the GSE already owns or has an interest in the balloon note at the time of the conversion. HUD also proposed amending the counting rules at § 81.16(b)(9) to exclude these transactions from the denominator. Fannie Mae suggested deleting other proposed language which sought to clarify that single family loans with conversion features which had already been exercised prior to purchase by the GSE would count as new purchases. Fannie Mae believed this additional language created confusion and was unnecessary stating that the revised definition of ''Refinancing'' at § 81.2 already provided sufficient clarification. HUD agrees with this comment. Accordingly, this final rule implements the proposed changes to § 81.2 and to § 81.16(b)(9), with slight revisions to § 81.16(b)(9) to avoid any potential confusion.

d. Title I. HUD proposed awarding the GSEs half credit for purchases of mortgage loans insured under HUD's Title I property improvement and manufactured homes program. Fannie Mae and one other commenter asked that the Department award full credit for Title I mortgages saying that these mortgages support affordable housing needs. Fannie Mae noted that purchases of these loans were difficult transactions to undertake and for this reason should receive more than half credit. One other commenter recommended that no goals credit be given for Title I loans, asserting that such loans do not directly support affordable housing needs.

Given the limited number of comments and their conflicting nature, the Department decided to retain the provision in the final rule that purchases of Title I loans will receive half credit under the housing goals. As explained in more detail in the appendices to this final rule, HUD has determined that such loans finance an important source of affordable housing and an enhanced GSEs role could improve the affordability of such loans for lower-income families.

18. Credit Enhancements

a. Overview. The GSEs utilize a large variety of credit enhancements, for both single family and multifamily mortgage purchases, to reduce the credit risk to which they might otherwise be exposed. For example, the GSEs generally require the use of mortgage insurance on single family loans with loan-to-value ratios exceeding 80 percent. While more common in the multifamily mortgage market, seller-provided credit enhancements may also be required for GSE purchases of single family mortgage loans. Other types of credit enhancements include arrangements such as credit enhancements in structured transactions where a GSE may acquire a pool of loans, mortgage-backed securities (MBS), or real estate mortgage investment conduits (REMICs), and then create separate senior and subordinated securities, structured so that the subordinated securities absorb credit losses; spread accounts, in which a GSE may create a special class of unguaranteed securities where pass-through payments will cease in the event of default of the underlying mortgage collateral; acquisition of senior tranches of REMIC securities by the GSEs which are enhanced by the presence of subordinate tranches and where the collateral is already credit enhanced prior to purchase; and agency pool insurance coverage provided by a mortgage seller.

Since enactment of FHEFSSA in 1992, HUD's regulations have awarded full goals credit for the purchase of most mortgages or interests in mortgages that otherwise qualify under the definition for each goal regardless of the level of credit risk a GSE might bear in the transaction. However, the increasing complexity of, and prevalence in, the use of credit enhancements have raised questions about whether the GSEs should receive full credit towards the goals for transactions where their credit risk exposure is minimal. In the proposed rule, HUD sought comments on various questions regarding the appropriate goals treatment for transactions with credit enhancements. For example, assuming credit risk can be measured, HUD asked commenters to consider whether HUD should establish a sliding scale from 0 to 100 percent for awarding goals credit depending on the GSE's risk exposure in a transaction. HUD also asked for comments on other issues including whether a minimum risk threshold should be established in order for a transaction to receive any goals credit as well as comments on whether HUD should measure counterparty risk on seller-provided credit enhancements.

b. Summary of Comments. The overwhelming majority of commenters, including Fannie Mae and Freddie Mac, responded with strong opposition to the concept of basing goals credit on the level of credit risk borne by a GSE in the transaction. Freddie Mac expressed concern that, in addition to being inconsistent with the Freddie Mac Act and FHEFSSA, discounting goals credit for protections against default cost would lead to a host of unintended consequences and practical problems, including measurement problems. For example, with regard to multifamily mortgages especially, Freddie Mac stated that ''when cross-default or cross-collateralization techniques are used to price credit enhancements, there is no ready and straightforward method of allocating default cost protection to the risks presented by the individual mortgages, let alone to the housing units that are financed by each of those mortgages.''

Fannie Mae also strongly opposed any goals scoring approach based on the level of credit enhancement. Fannie Mae stated that credit enhancements are essential to its safe and sound operation and, in fact, are explicitly recognized under OFHEO's risk-based capital standard as an important risk management tool. Fannie Mae further stated that reducing goals credit based on the level of credit enhancement ''is contrary to our charter, misconstrues the purpose of Fannie Mae, distorts the efficient functioning of the capital markets, increases the cost of homeownership, restricts the availability of capital, and weakens the financial soundness of Fannie Mae.''

Commenters representing state and local housing finance agencies, for-profit and non-profit advocacy and consumer groups, trade associations, and the mortgage lending and investment industry were nearly unanimous in voicing objections to any regulatory approach that considered levels of credit enhancements in assigning goals credit. The recurring objection held that such an approach would undermine the purpose of the housing goals regulation by disrupting the risk-sharing partnerships that are critical to making affordable housing lending a reality, thereby resulting in a negative consequence to homeownership. For example, some commenters expressed concern that such an approach could interfere with the GSEs' incentive to develop new affordable mortgage products using risk-sharing arrangements while others felt that reducing goals credit based on the level of risk would have the effect of reducing the amount and liquidity of funds available for affordable housing lending rather than force the GSEs to take on more risk than they felt they could effectively manage. These commenters remarked that since risk sharing arrangements allow more industry partners to bring more capital to the mortgage market, they were concerned that the affordable housing market would be adversely impacted if HUD adopted a regulatory counting scheme that penalized the GSEs for sharing risk.

Two commenters, however, suggested there may be instances in which goals credit should be limited and suggested further review and study of the issue. One commenter stated that the financial benefits of GSE status can and should function as an offset for the assumption of some amount of credit risk but also cautioned that HUD must carefully consider the effects of any regulatory change in this area, especially how OFHEO and the financial markets would view encouraging the GSEs to assume certain credit risks and what effect this approach could have on mortgage rates. Another commenter suggested that HUD establish an industry working group to examine these issues in greater detail. This commenter also supported limiting goals credit on the GSEs' purchase of seasoned mortgages when the selling institution provides a credit enhancement beyond customary representations and warranties, and also supported some limitation on goals credit for loans securitized in commercial mortgage-backed securities (CMBS) and REMIC structures to the risk level of the tranches purchased by the GSEs.

One commenter suggested that, in assigning goals credit based on the GSEs' actual involvement in facilitating the flow of private capital into low/mod communities, there may be a useful prototype in the CRA provisions for allotting goals credit based upon the type of mortgage purchase transaction, *i.e.,* the purchase of newly originated loan versus other mortgage investments. HUD appreciates this suggestion and plans to consider it further.

c. HUD's Determination. HUD has taken the position that GSE credit enhancement transactions provide needed liquidity to the mortgage markets and play a key role in affordable housing lending. As explained in a study HUD has undertaken with the Urban Institute to assess recent innovations in the secondary market for low- and moderate-income lending, the GSEs' purchase of interests in CRA loans is identified as one approach to how the enterprises facilitate liquidity for loans that do not conform to standard guidelines.[52] Investment analysts also report that the GSEs' credit enhancement of CRA REMIC securities results in a more attractive debt instrument for investors and a higher return for issuers which benefits lenders seeking to liquidate their CRA portfolios and ultimately borrowers.

HUD recognizes there also are other valid reasons to grant the GSEs full credit under the housing goals for mortgage purchase transactions involving credit enhancements even where the enterprises bear relatively minimal credit risk. For example, in the absence of private mortgage insurance for multifamily mortgages, seller provided credit enhancements apparently are a viable means by which secondary market purchasers may delegate certain of their underwriting responsibilities and share risks. When a GSE purchases a mortgage subject to a recourse agreement or similar arrangement with the lender, the GSE still retains credit risk with respect to holders of the GSEs' mortgage-backed security or, where the mortgage is held in portfolio, for its own account. Of course, even if the GSE is not bearing substantial credit risk, the GSE may still be bearing other types of risk. For example, the protection afforded to the GSE under recourse agreements is dependent on the soundness of the party to whom the GSE has recourse. In addition, the GSE assumes interest rate risk for mortgages that are retained in portfolio.

In analyzing credit enhancement issues, thus far, there has emerged no clear approach to establishing an appropriate ''risk threshold'' associated with mortgages purchased by a GSE, below which credit toward the goals should not be granted. Under typical recourse agreements or similar arrangements, GSEs rarely divest themselves of credit risk associated with mortgage purchases in clear-cut percentages of risk. Some arrangements have time or dollar limits. The relative risk assumed by the GSE on one loan compared to another relates not only to the relative risk management characteristics (including mortgage insurance and recourse arrangements), but also to loan-to-value ratios, multifamily debt coverage ratios, interest rate risk, and many other parameters. Moreover, whether there is subsequent securitization or resecuritization of a GSE interest also bears upon the degree of credit risk retained by the GSE in a transaction.

Any determination about discounting goals credit based on the level of risk borne by a GSE in the transaction also must take into account consistency with the GSEs' Charter Acts which require the GSEs to obtain mortgage insurance or its equivalent for certain single family mortgages, and must consider the financial safety and soundness requirements under FHEFSSA as well as its housing goals provisions.

Accordingly, HUD has determined, based on its analysis of available information on the GSEs' credit enhanced transactions, comments and other input received on the proposed rule, as well as its analysis of the law, the complexity of these issues requires additional evaluations before changes are made to these rules. These evaluations will further assess the extent to which the GSEs' use of credit enhancements add value and liquidity to the marketplace, especially for affordable housing lending, as well as the impact their use has on the GSEs' mandate to play a leadership role in the mortgage markets. To assist its evaluations, HUD is undertaking further review and analysis on credit enhancements. Topics being covered in this review include the GSEs' use of credit enhancements provided by seller-servicers, third party vendors, and buyers of subordinated debt in the GSEs' single family and multifamily mortgage transactions. In addition, HUD will continue its assessments of credit enhancement structures including newly introduced structures to determine how and to what extent, if any, HUD's goal counting rules should be modified in the future.

19. Public Use Data Base and Public Information

Section 1323 of FHEFSSA requires that HUD make available to the public data relating to the GSEs' mortgage purchases. In the legislative history of FHEFSSA, Congress indicated its intent that the GSE public use data base is to supplement HMDA data.[53] The purpose of the GSE data base is to assist the public, including mortgage lenders, planners, researchers, and housing industry groups, as well as HUD and other government agencies, in studying the GSEs' mortgage activities and the flow of mortgage credit and capital into the nation's communities. At the same time, section 1326 of FHEFSSA protects from public access and disclosure, proprietary data and information that the GSEs submit to the Department and requires HUD to protect such data or information by order or regulation.

To comply with FHEFSSA, HUD established a public use data base to collect and make available to the public, loan-level data on the GSEs' single family and multifamily mortgage purchases. In Appendix F to the December 1, 1995 final rule, the Department specified the structure of the GSE public use data base and identified the data to be withheld from public use.

The single family data was to be disclosed in three separate files—a Census Tract File (with geographic identifiers down to the census tract level), a National File A (with mortgage-level data on owner-occupied 1-unit properties), and a National File B (with unit-level data on all single family properties). The national files do not have geographic indicators. The multifamily data was to be disclosed in two separate files ''a Census Tract File and a National File. Each file consists of two parts, one part containing mortgage loan level data and the other containing unit level data for all multifamily properties. For each file, Appendix F identified data elements that were considered proprietary and those that were not proprietary and available to the public, and specified further that certain proprietary elements would be recoded or categorized into ranges to protect the proprietary information and to permit the release of non-proprietary information to the public. This multi-file structure was designed to allow the greatest dissemination of loan-level data, without disclosing proprietary data of the GSEs and causing competitive harm by, for example, allowing competitors to determine the GSEs' marketing and pricing strategies at the local level.

On October 17, 1996, a Final Order describing each data element submitted by the GSEs and the proprietary or nonproprietary nature of each element was published in the **Federal Register**. The Final Order also recoded, adjusted, and categorized in ranges certain proprietary loan-level data elements to protect proprietary GSE information. HUD released the recoded data elements and the data elements that were identified as non-proprietary information to the public.

In the fall of 1996, the Department released the first publicly available GSE loan level data base, containing non-proprietary information on every mortgage purchased by the GSEs from 1993 to 1995. Subsequently, HUD has made the 1996, 1997, 1998, and 1999 databases available to the public. In addition, HUD issued an order determining that certain aggregations of data that may otherwise be proprietary at the loan level is not proprietary at an aggregated level. Through that order, it is possible for HUD to make available to the public specific tables of nonproprietary information about the GSEs' activities and housing goal performance.

After consideration of the current structure of the GSE public use data base, the Department proposed several changes to its classifications of the GSEs' mortgage data. Those proposed changes were either technical in nature or would, by reclassifying certain data from proprietary to non-proprietary, make available to the public the same data from the GSEs that is made available by primary lenders under the Home Mortgage Disclosure Act (HMDA).

HUD received comments from both GSEs as well as trade organizations, advocacy groups, researchers, and lenders on this issue. Comments were almost evenly divided between those groups approving of increased data disclosure at the loan-level and those that opposed the proposals, mostly out of concern for protecting the privacy of borrowers' and lenders' business strategies. Both GSEs were strongly opposed to increased disclosure, citing competitive issues resulting from the release of what each GSE considered to be proprietary, confidential business information. Fannie Mae and Freddie Mac expressed general concern that recoding certain loan-level data as non-proprietary at either the census tract or national file level would reveal information about lender relationships, pricing arrangements, and management of credit and interest rate risks. Fannie Mae also took issue with HUD's efforts to conform data available in the GSE public use data base to HMDA data for research purposes, contending that both databases are fundamentally different and cannot be readily reconciled. Lenders expressed a similar concern about the potential for additional public data to reveal business strategies, commenting that the more data HUD makes available through the public use data base, the more likely that other lenders would be able to discern the competition's lending strategies.

Some trade organizations viewed the proposed changes as potentially harmful to consumers. Their viewpoints were representative of similar concerns expressed by lenders and the GSEs. One organization wrote that exposing more detailed information about the consumer to the general public will only enhance the ability of sellers of credit to take unfair advantage of the consumer, particularly the urban and minority consumer.'' Another urged that HUD be ''sensitive to emerging technology when deciding what data elements to make public on the [public use data base] files. Consumer financial and credit information privacy must be a paramount concern to the Department.'' A third organization strongly opposed releasing additional data out of concern for borrowers' privacy and ''potential exposure of association members' confidential business information.'' Another commenter, however, supported increased disclosure of data, contending that access to more data should lead to a better understanding of the affordable housing market and to reduced costs for those operating in the market.

Housing and community organizations generally viewed HUD's proposed changes as a series of improvements that would make the public use data base more compatible with HMDA data and, therefore, more valuable as a research tool. One commenter also supported bringing the public use data base into conformity with HMDA stating that comparisons between the two databases are ''extremely important'' in evaluating the GSEs'' mandate to lead the primary market.

HUD recognizes the potential harm that the release of truly proprietary data could have on the GSEs as well as their lending partners and is cognizant of its responsibilities under FHEFSSA to preserve and protect such data from public disclosure. Also, any implication that additional disclosure of GSE data might in fact facilitate a further loss of borrower privacy or encourage predatory lending practices are issues that HUD believes warrant especially close scrutiny.

In recognition of its responsibilities to proceed with the utmost caution in releasing data, HUD follows a rigorous six-factor determination process in considering whether to accord proprietary treatment to mortgage data. For every data element under consideration for non-proprietary treatment, HUD evaluates:

(1) The type of data or information involved and the nature of the adverse consequences to the GSE, financial or otherwise, that could result from disclosure;

(2) The existence and applicability of any prior determinations by HUD, any other Federal agency, or a court, concerning similar data or information;

(3) The measures taken by the GSE to protect the confidentiality of the mortgage data and similar data before and after its submission to the Secretary;

(4) The extent to which the mortgage data is publicly available including whether the data or information is available from other entities, from local government offices or records, including deeds, recorded mortgages, and similar documents, or from publicly available data bases;

(5) The difficulty that a competitor, including a seller/servicer, would face in obtaining or compiling the mortgage data; and

(6) Such additional facts and legal and other authorities as the Secretary may consider appropriate, including the extent to which particular mortgage data, when considered together with other information, could reveal proprietary information.

Section 1326 of FHEFSSA and § 81.75 of the regulations provide that the Department may, by regulation or order, issue a list of information that shall be accorded proprietary treatment. HUD utilized the proposed rule to suggest changes to the proprietary treatment of certain GSE data. The comments received in response offered useful insights into concerns of many different organizations including the GSEs' respecting the proposed changes.

Based on the comments received, HUD is not making a determination on this matter as part of this rulemaking. HUD will issue a decision on which data elements will be accorded proprietary and non-proprietary treatment by separate order following publication of this final rule in accordance with the Department's regulations at §§ 81.72 through 81.74.

20. Other Considerations

a. Data Reporting. Many of the changes included in the final rule involve changes in data reporting requirements. The Department will not establish those requirements in this final rule, but rather will establish them in accordance with FHEFSSA and 24 CFR part 81, considering the proprietary concerns of the GSEs and other considerations in the public interest.

Specific areas where additional data will need to be collected include but are not limited to indicators for mortgages located in tribal lands, identification of units with estimated affordability data mortgage loans receiving bonus points and the temporary adjustment factor, and mortgages relating to Section 8 assistance contracts.

One area in particular that will require additional data elements is high cost mortgage loans. In order to monitor and enforce the restrictions included in this final rule, new data and reporting requirements may be required, as appropriate. The Department notes that the HUD/Treasury report recommended that the Federal Reserve amend its regulations to require the collection of similar data items under the Home Mortgage Disclosure Act (HMDA), including information on loan price (APR and cost of credit) and borrower debt-to-income ratio for HOEPA loans. If such recommendations are implemented, it may affect the data reporting required under this rule.

b. Comments Regarding Regional Issues. Several commenters offered comments on the need to inform various communities and regions around the country of the GSEs' affordable housing goal performance in those areas. Separate from this rulemaking, as described above, HUD has recently taken steps to make more MSA level information, on an aggregated basis, about the GSEs mortgage purchases available to the public. HUD encourages the residents of local communities and regions of the country to increase their knowledge of the roles the GSEs' play in their areas and, toward that end, HUD will make available information to build understanding of the GSEs' activities.

c. Technical Correction. Section 81.76(d) describes the protection of GSE information by HUD officers and employees. That section has cited HUD's Standards of Conduct regulations in 24 CFR part 0. HUD's Standards of Conduct regulations in part 0 were, however, largely superseded by new financial disclosure regulations codified in 5 CFR part 2634, new executive branch-wide Standards of Conduct codified in 5 CFR part 2635, and supplemental HUD-specific Standards of Conduct codified in 5 CFR part 7501. Consequently, in 1996, HUD removed the current text of 24 CFR part 0 and replaced it with a single section (§ 0.1) that provides cross-references to those provisions. (See final rules published in the **Federal Register** on April 5, 1996 (61 Fed. Reg. 15,350), and on July 9, 1996 (61 Fed. Reg. 36,246).) In order to correct § 81.76(d), this final rule will revise the references to those provisions accordingly.

III. Findings and Certifications

Executive Order 12866

The Office of Management and Budget (OMB) reviewed this final rule under Executive Order 12866, *Regulatory Planning and Review*, which the President issued on September 30, 1993. This rule was determined economically significant under E.O. 12866. Any changes made to this final rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC. The Economic Analysis prepared for this rule is also available for public inspection in the Office of the Rules Docket Clerk.

Congressional Review of Major Final Rules

This rule is a ''major rule'' as defined in Chapter 8 of 5 U.S.C. The rule has been submitted for Congressional review in accordance with this chapter.

Paperwork Reduction Act

HUD's collection of information on the GSEs' activities has been reviewed and authorized by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520), as implemented by OMB in regulations at 5 CFR part 1320. The OMB control number is 2502–0514.

Environmental Impact

In accordance with 24 CFR 50.19(c)(1) of HUD's regulations, this final rule would not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate real property acquisition, disposition, lease, rehabilitation, alteration, demolition, or new construction; nor would it establish, revise, or provide for standards for construction or construction materials, manufactured housing, or occupancy. Therefore, this final rule is categorically excluded from the requirements of the National Environmental Policy Act.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that this rule would not have a significant economic impact on a substantial number of small entities. This final regulation is applicable only to the GSEs, which are not small entities for purposes of the Regulatory Flexibility Act, and, thus, does not have a significant economic impact on a substantial number of small entities.

Executive Order 13132, Federalism

Executive Order 13132 (''Federalism'') prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on State and local governments and is not required by statute, or preempts State law, unless the relevant requirements of section 6 of the Executive Order are met. This final rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and the private sector. This final rule would not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Endnotes to Preamble

1. See sec. 301 of the Federal National Mortgage Association Charter Act (Fannie Mae Charter Act) (12 U.S.C. 1716); sec. 301(b) of the Federal Home Loan Mortgage Corporation Act (Freddie Mac Act) (12 U.S.C. 1451 note).
2. Secs. 306(c)(2) of the Freddie Mac Act and 304(c) of the Fannie Mae Charter Act.
3. Secs. 306(g) of the Freddie Mac Act and 304(d) of the Fannie Mae Charter Act.
4. Secs. 303(e) of the Freddie Mac Act and 309(c)(2) of the Fannie Mae Charter Act.
5. U.S. Department of Treasury, *Government Sponsorship of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation* (1996), page 3.
6. S. Rep. No. 282, 102d Cong., 2d Sess. 34 (1992).
7. FFIEC Press Release, July 29, 1999.
8. Section 802(ee) of the Housing and Urban Development Act of 1968 (Pub. L. 90–448, approved August 1, 1968; 82 Stat. 476, 541).
9. See sec. 731 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Pub. L. 101–73, approved August 9, 1989), which amended the Freddie Mac Act.
10. See 24 CFR 81.16(d) and 81.17 (1992 codification).
11. Sec. 1321.
12. See generally secs. 1331–34.
13. Secs. 1332(b), 1333(a)(2), 1334(b).
14. 65 FR 12632–12816
15. S. Rep. No. 282, 102d Cong., 2d Sess. 34 (1992) at 35.
16. *Rental Housing Assistance—The Worsening Crisis: A Report to Congress on Worst Case Housing Needs,* Department of Housing and Urban Development, Office of Policy Development and Research, (March 2000).
17. *Standard & Poor's DRI Review of the U.S. Economy.* (June 2000), p. 57.
18. See, *e.g.,* S. Rep. at 34.
19. S. Rep. at 34.
20. 12 U.S.C. 2901 *et seq.*
21. See section 1335(3)(B).
22. The following discussion is based on analysis of conventional, conforming mortgage loans which were originated in 1998, and which may have been acquired by the GSEs in 1998 or 1999. Appendix A contains further details regarding GSE acquisitions of 1997 originations as well. HUD will analyze GSE purchases in relation to the 1999 mortgage market once HUD has the opportunity to analyze 1999 HMDA data for metropolitan areas.
23. Totals do not add due to rounding.
24. This percentage differs from the GSEs' 19 percent market share for rental units in single family rental properties financed in 1998 chiefly because the 41 percent figure reported here includes owner-occupied units in 2–4 unit properties which also have rental units.
25. A recent Treasury-sponsored report on CRA found that banks and thrifts increased the share of their mortgage originations to low-income borrowers and communities from 25 percent in 1993 to 28 percent in 1998. See Robert E. Litan, Nicolas P. Retsinas, Eric S. Belsky, and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Project,* U.S. Department of Treasury, April 25, 2000.
26. African American borrowers accounted for 6.5 percent of all conforming home loans, including FHA and VA loans, in metropolitan areas in 1998. Further information on the GSEs' purchases of mortgage loans to minority borrowers may be found in Appendix A.
27. Hispanic borrowers were 6.7 percent of all conforming metropolitan area home loans, including FHA and VA loans, in 1998. Further information on the GSEs' purchases of mortgage loans to minority borrowers may be found in Appendix A.

28. The low- and moderate-income market share is the estimated proportion of newly mortgaged units in the market serving low- and moderate-income families. The two other shares are similarly defined. HUD's conservative range of estimates (such as 50–55 percent) reflects uncertainty about future market conditions.

29. Appendix D explains the specific reasons for the 1995–98 market estimates for the low-mode and special affordable housing goals are higher than the upper end of HUD's market projections for the years 2001–2003. Based on average 1993–1998 experience, HUD's projection model assumes that refinance borrowers have higher incomes than home purchase borrowers; however, between 1995 and 1997, refinance borrowers had lower incomes. On average, the 1995–98 period also exhibited a slightly higher percentage of rental units financed than assumed in HUD's projection model. See Appendix D for other reasons the 1995–1998 average market estimates are higher than those projected for the years 2001–2003.

30. PriceWaterhouse-Coopers, ''The Impact of Economic Conditions on the Size and the Composition of the Affordable Housing Market'' (April 5, 2000).

31. In 1998, PWC estimates the size of the single family mortgage market at $1.5 trillion. This estimate is identical to the widely used estimate by the Mortgage Bankers Association for the entire single family mortgage market, including FHA and jumbo loans.

32. The figures presented for goal performance are based on HUD analysis of the GSEs' loan level data. Some results differ marginally from the corresponding figures presented by Fannie Mae and Freddie Mac in their respective Annual Housing Activities Reports (AHARs) to HUD, reflecting differences in application of counting rules.

33. The figures presented for goal performance are based on HUD's analysis of the GSEs' loan level data. Some results differ marginally from the corresponding figures presented by the GSEs in their AHARs, reflecting differences in application of counting rules.

34. GSE to market ratio is calculated by dividing the performance of the respective GSE by the performance of the market.

35. Freddie Mac-to-Market and Fannie Mae-to-Market ratios cannot be calculated until 1999 HMDA data is available.

36. The figures presented for goal performance are based on HUD's analysis of the GSEs' loan level data. Some results differ from the corresponding figures presented by Fannie Mae in its AHARs by one to two percentage points. The difference largely reflects differences between HUD and Fannie Mae in application of counting rules relating to counting of seasoned mortgage loans for purposes of this goal. Freddie Mac's AHAR figures for this goal differ marginally from the official figures presented above, also reflecting differences in application of counting rates.

37. The percentage of Freddie Mac's multifamily transactions counting toward the Special Affordable Goal was unusually low in 1999 relative to previous years, but the multifamily sector still contributed significantly to Freddie Mac's performance on the Special Affordable Goal. In 1999, 43 percent of units backing Freddie Mac's multifamily transactions met the Special Affordable Goal, representing 22% of units counted toward the Goal. Multifamily units were eight per cent of Freddie Mac's total purchase volume in 1999.

38. U.S. House of Representatives, *Congressional Record.* (October 13, 1999), p. H10014.

39. 15 U.S.C. 1601 note; Title I, Subtitle B of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103–325 (Sept. 23, 1994); 108 Stat. 2190–98.

40. Currently, HOEPA covers refinancings of mortgages. 15 U.S.C. 1601(aa)(1).

41. As mentioned above, HOEPA grants the Federal Reserve Board authority to lower the APR trigger to 8 percentage points over comparable treasuries (or to raise it to 12 percentage points above), 15 U.S.C. 1602(aa)(2), and to broaden the class of costs counted toward the fees trigger, 15 U.S.C. 1602(aa)(4)(D).

42. 12 U.S.C. 4563(b)(1)(B).

43. *Id.*

44. CRA regulations were published as a joint final rule on May 4, 1995. The regulation is codified at 12 CFR Part 25, CFR Parts 228 and 203, 12 CFR Part 345, and 12 CFR Part 563e for the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, respectively.

45. Pub. L. 106–102; approved November 12, 1999.

46. See S. Rep. No. 282, 102nd Cong., 2nd Sess. 39 (1992); H.R. Rept. 206, 102nd Cong., 1st Sess. 59 (1991)

47. *Ibid.*

48. 24 CFR parts 401 and 402, Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark-to-Market): Final Rule, March 22, 2000.

49. The 1992 House committee report on the bill that later became FHEFSSA emphasizes that ''the goals included in this legislation are specifically not to include purchases of equity for low-income housing tax credits.'' (House of Representatives Report 102–206, 102d Congress, 1st Session, p. 60.)

50. *Handbook of Housing and Development Law,* 1996, p. 10–8 and IRC Sec. 42 (i)(1).

51. 42 U.S.C. 1437f, sec. 514(e)(6)

52. Kenneth Temkin, Jennifer E. H. Johnston, and Charles Calhoun, *An Assessment of Recent Innovations in the Secondary Market for Low- and Moderate-Income Lending,* report submitted to the U.S. Department of Housing and Urban Development (March 2000).

53. See S. Rep. No. 282, 102d Cong., 2d Sess. 39 (1992).

List of Subjects in 24 CFR Part 81

Accounting, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

Accordingly, 24 CFR part 81 is amended as follows:

PART 81—THE SECRETARY OF HUD'S REGULATION OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE) AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC)

1. The authority citation for 24 CFR part 81 continues to read as follows:

Authority: 12 U.S.C. 1451 *et seq.*, 1716–1723h, and 4501–4641; 42 U.S.C. 3535(d) and 3601–3619.

2. Section 81.2, is amended by revising the definitions of ''*Median income*'' ''*Metropolitan area,*'' and ''*Underserved area*,'' by adding a new paragraph (7) to the definition of ''*Refinancing*,'' and by adding new definitions for ''*HOEPA mortgage,*'' ''*Mortgages contrary to good lending practices*,'' and ''*Mortgages with unacceptable terms or conditions or resulting from unacceptable practices*,'' to read as follows:

§ 81.2 Definitions.

* * * * *

''*HOEPA mortgage*'' means a mortgage for which the annual percentage rate (as calculated in accordance with the relevant provisions of section 107 of the Home Ownership Equity Protection Act (HOEPA) (15 U.S.C. 1606)) exceeds the threshold described in section 103(aa)(1)(A) of HOEPA (15 U.S.C. 1602(aa)(1)(A)), or for which the total points and fees payable by the borrower exceed the threshold described in section 103(aa)(1)(B) of HOEPA (15 U.S.C. 1602(aa)(1)(B)), as those thresholds may be increased or decreased by the Federal Reserve Board or by Congress, unless the GSEs are otherwise notified in writing by HUD. Notwithstanding the exclusions in section 103(aa)(1) of HOEPA, for purposes of this part, the term ''*HOEPA mortgage*'' includes all types of mortgages as defined in this section, including residential mortgage transactions as that term is defined in section 103(w) of HOEPA (15 U.S.C. 1602(w)), but does not include reverse mortgages.

* * * * *

Median income means, with respect to an area, the unadjusted median family income for the area as most recently determined and published by HUD. HUD will provide the GSEs annually with information specifying how HUD's published median family income estimates for metropolitan areas are to be applied for the purposes of determining median family income.

Metropolitan area means a metropolitan statistical area (''MSA''), or primary metropolitan statistical area (''PMSA''), or a portion of such an area for which median family income estimates are published annually by HUD.

* * * * *

''*Mortgages contrary to good lending practices*'' means a mortgage or a group or category of mortgages entered into by a lender and purchased by a GSE where it can be shown that a lender engaged in a practice of failing to:

(1) Report monthly on borrowers' repayment history to credit repositories on the status of each GSE loan that a lender is servicing;

(2) Offer mortgage applicants products for which they qualify, but rather steer applicants to high cost products that are designed for less credit worthy borrowers. Similarly, for consumers who seek financing through a lender's higher-priced subprime lending channel, lenders should not fail to offer or direct such consumers toward the lender's standard mortgage line if they are able to qualify for one of the standard products;

(3) Comply with fair lending requirements; or

(4) Engage in other good lending practices that are:

(i) Identified in writing by a GSE as good lending practices for inclusion in this definition; and

(ii) Determined by the Secretary to constitute good lending practices.

''*Mortgages with unacceptable terms or conditions or resulting from unacceptable practices*'' means a mortgage or a group or category of mortgages with one or more of the following terms or conditions:

(1) Excessive fees, where the total points and fees charged to a borrower exceed the greater of 5 percent of the loan amount or a maximum dollar amount of $1000, or an alternative amount requested by a GSE and determined by the Secretary as appropriate for small mortgages.

(i) For purposes of this definition, points and fees include:

(A) Origination fees;

(B) Underwriting fees;

(C) Broker fees;

(D) Finder's fees; and

(E) Charges that the lender imposes as a condition of making the loan, whether they are paid to the lender or a third party.

(ii) For purposes of this definition, points and fees do not include:

(A) Bona fide discount points;

(B) Fees paid for actual services rendered in connection with the origination of the mortgage, such as attorneys' fees, notary's fees, and fees paid for property appraisals, credit reports, surveys, title examinations and extracts, flood and tax certifications, and home inspections;

(C) The cost of mortgage insurance or credit-risk price adjustments;

(D) The costs of title, hazard, and flood insurance policies;

(E) State and local transfer taxes or fees;

(F) Escrow deposits for the future payment of taxes and insurance premiums; and

(G) Other miscellaneous fees and charges that, in total, do not exceed 0.25 percent of the loan amount.

(2) Prepayment penalties, except where:

(i) The mortgage provides some benefits to the borrower (*e.g.,* such as rate or fee reduction for accepting the prepayment premium);

(ii) The borrower is offered the choice of another mortgage that does not contain payment of such a premium;

(iii) The terms of the mortgage provision containing the prepayment penalty are adequately disclosed to the borrower; and

(iv) The prepayment penalty is not charged when the mortgage debit is accelerated as the result of the borrower's default in making his or her mortgage payments.

(3) The sale or financing of prepaid single-premium credit life insurance products in connection with the origination of the mortgage;

(4) Evidence that the lender did not adequately consider the borrower's ability to make payments, *i.e.,* mortgages that are originated with underwriting techniques that focus on the borrower's equity in the home, and do not give full consideration of the borrower's income and other obligations. Ability to repay must be determined and must be based upon relating the borrower's income, assets, and liabilities to the mortgage payments; or

(5) Other terms or conditions that are:

(i) Identified in writing by a GSE as unacceptable terms or conditions or resulting from unacceptable practices for inclusion in this *definition;* and

(ii) Determined by the Secretary as an unacceptable term or condition of a mortgage for which goals credit should not be received.

* * * * *

Refinancing means * * *

* * * * *

(7) A conversion of a balloon mortgage note on a single family property to a fully amortizing mortgage note where the GSE already owns or has an interest in the balloon note at the time of the conversion.

* * * * *

Underserved area means:

(1) For purposes of the definitions of ''Central city'' and ''Other underserved area,'' a census tract, a Federal or State American Indian reservation or tribal or individual trust land, or the balance of a census tract excluding the area within any Federal or State American Indian reservation or tribal or individual trust land, having:

(i) A median income at or below 120 percent of the median income of the metropolitan area and a minority population of 30 percent or greater; or

(ii) A median income at or below 90 percent of median income of the metropolitan area.

(2) For purposes of the definition of ''*Rural area*'':

(i) In areas other than New England, a whole county, a Federal or State American Indian reservation or tribal or individual trust land, or the balance of a county excluding the area within any Federal or State American Indian reservation or tribal or individual trust land, having:

(A) A median income at or below 120 percent of the greater of the State non-metropolitan median income or the nationwide non-metropolitan median income and a minority population of 30 percent or greater; or

(B) A median income at or below 95 percent of the greater of the State non-metropolitan median income or nationwide non-metropolitan median income.

(ii) In New England, a whole county having the characteristics in paragraphs (2)(i)(A) or (2)(i)(B) of this definition; a Federal or State American Indian reservation or tribal or individual trust land, having the characteristics in paragraphs (2)(i)(A) or (2)(i)(B) of this definition; or the balance of a county, excluding any portion that is within any Federal or State American Indian reservation or tribal or individual trust land, or metropolitan area where the remainder has the characteristics in paragraphs (2)(i)(A) or (2)(i)(B) of this definition.

(3) Any Federal or State American Indian reservation or tribal or individual trust land that includes land that is both within and outside of a metropolitan area and that is designated as an underserved area by HUD. In such cases, HUD will notify the GSEs as to applicability of other definitions and counting conventions.

* * * * *

3. Section 81.12 is amended as follows:

a. Paragraph (b) is amended by revising the last sentence; and

b. Paragraph (c) is revised, to read as follows:

§ 81.12 Low- and Moderate-Income Housing Goal.

* * * * *

(b) *Factors.* * * * A statement documenting HUD's considerations and findings with respect to these factors, entitled ''Departmental Considerations to Establish the Low-and Moderate-Income Housing Goal,'' was published in the **Federal Register** on October 31, 2000.

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on housing for low-and moderate-income families are:

(1) For each of the years 2001–2003, 50 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(2) For the year 2004 and thereafter HUD shall establish annual goals. Pending establishment of goals for the year 2004 and thereafter, the annual goal for each of those years shall be 50 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years.

4. Section 81.13 is amended as follows:

a. Paragraph (b) is amended by revising the last sentence; and

b. Paragraph (c) is revised, to read as follows:

§ 81.13 Central Cities, Rural Areas, and Other Underserved Areas Housing Goal.

* * * * *

(b) *Factors.* * * * A statement documenting HUD's considerations and findings with respect to these factors, entitled ''Departmental Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal,'' was published in the **Federal Register** on October 31, 2000.

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on housing located in central cities, rural areas, and other underserved areas are:

(1) For each of the years 2001–2003, 31 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(2) For the year 2004 and thereafter HUD shall establish annual goals. Pending establishment of goals for the year 2004 and thereafter, the annual goal for each of those years shall be 31 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years.

* * * * *

5. Section 81.14 is amended as follows:

a. Paragraph (b) is amended by revising the last sentence;

b. Paragraph (c) is revised;

c. Paragraph (d) is amended by revising paragraph (d)(1)(i);

d. Paragraph (e) is amended by revising paragraphs (e)(2), (e)(3), and (e)(4);

e. Paragraph (f) is redesignated as paragraph (g) and the last sentence of the newly redesignated paragraph (g) is revised; and

f. A new paragraph (f) is added; to read as follows:

§ 81.14 Special Affordable Housing Goal.

* * * * *

(b) * * * A statement documenting HUD's considerations and findings with respect to these factors, entitled ''Departmental Considerations to Establish the Special Affordable Housing Goal,'' was published in the **Federal Register** on October 31, 2000.

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on rental and owner-occupied housing meeting the then-existing, unaddressed needs of and affordable to low-income families in low-income areas and very low-income families are:

(1) For each of the years 2001, 2002, and 2003, 20 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA. The goal for each year shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the average annual dollar volume of combined (single family and multifamily) mortgages purchased by the respective GSE in 1997, 1998 and 1999, unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(2) For the year 2004 and thereafter HUD shall establish annual goals. Pending establishment of goals for the year 2004 and thereafter, the annual goal for each of those years shall be 20 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years. The goal for each such year shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the annual average dollar volume of combined (single family and multifamily) mortgages purchased by the respective GSE in the years 1997, 1998 and 1999.

(d) * * *

(1) * * *

(i) 20 percent of the dwelling units in the particular multifamily property are affordable to especially low-income families; or

* * * * *

(e) * * *

(2) Mortgages insured under HUD's Home Equity Conversion Mortgage (''HECM'') Insurance Program, 12 U.S.C. 1715 z–20; mortgages guaranteed under the Rural Housing Service's Single Family Housing Guaranteed Loan Program, 42 U.S.C. 1472; mortgages on properties on tribal lands insured under FHA's Section 248 program, 12 U.S.C. 1715 z–13, HUD's Section 184 program, 12 U.S.C. 1515 z–13a, or Title VI of the Native American Housing Assistance and Self-Determination Act of 1996, 25 U.S.C. 4191–4195; meet the requirements of 12 U.S.C. 4563(b)(1)(A)(i) and (ii).

(3) HUD will give full credit toward achievement of the Special Affordable Housing Goal for the activities in 12 U.S.C. 4563(b)(1)(A), provided the GSE submits documentation to HUD that supports eligibility under 12 U.S.C. 4563(b)(1)(A) for HUD's approval.

(4)(i) For purposes of determining whether a seller meets the requirement in 12 U.S.C. 4563(b)(1)(B), a seller must currently operate on its own or actively participate in an on-going, discernible, active, and verifiable program directly targeted at the origination of new mortgage loans that qualify under the Special Affordable Housing Goal.

(ii) A seller's activities must evidence a current intention or plan to reinvest the proceeds of the sale into mortgages qualifying under the Special Affordable Housing Goal, with a current commitment of resources on the part of the seller for this purpose.

(iii) A seller's actions must evidence willingness to buy qualifying loans when these loans become available in the market as part of active, on-going, sustainable efforts to ensure that additional loans that meet the goal are originated.

(iv) Actively participating in such a program includes purchasing qualifying loans from a correspondent originator, including a lender or qualified housing group, that operates an on-going program resulting in the origination of loans that meet the requirements of the goal, has a history of delivering, and currently delivers qualifying loans to the seller.

(v) The GSE must verify and monitor that the seller meets the requirements in paragraphs (e)(4)(i) through (e)(4)(iv) of this section and develop any necessary mechanisms to ensure compliance with the requirements, except as provided in paragraph (e)(4)(vi) and (vii) of this section.

(vi) Where a seller's primary business is originating mortgages on housing that qualifies under this Special Affordable Housing Goal such seller is presumed to meet the requirements in paragraphs (e)(4)(i) through (e)(4)(iv) of this section. Sellers that are institutions that are:

(A) Regularly in the business of mortgage lending;

(B) A BIF-insured or SAIF-insured depository institution; and

(C) Subject to, and has received at least a satisfactory performance evaluation rating for

(*1*) At least the two most recent consecutive examinations under, the Community Reinvestment Act, if the lending institution has total assets in excess of $250 million; or

(*2*) The most recent examination under the Community Reinvestment Act if the lending institutions which have total assets no more than $250 million are identified as sellers that are presumed to have a primary business of originating mortgages on housing that qualifies under this Special Affordable Housing Goal and, therefore, are presumed to meet the requirements in paragraphs (e)(4)(i) through (e)(4)(iv) of this section.

(vii) Classes of institutions or organizations that are presumed have as their primary business originating mortgages on housing that qualifies under this Special Affordable Housing Goal and, therefore. are presumed in paragraphs (e)(4)(i) through (e)(4)(iv) of this section to meet the requirements are as follows: State housing finance agencies; affordable housing loan consortia; Federally insured credit unions that are:

(A) Members of the Federal Home Loan Bank System and meet the first-time homebuyer standard of the Community Support Program; or

(B) Community development credit unions; community development financial institutions; public loan funds; or non-profit mortgage lenders. HUD may determine that additional classes of institutions or organizations are primarily engaged in the business of financing affordable housing mortgages for purposes of this presumption, and if, so will notify the GSEs in writing.

(viii) For purposes of paragraph (e)(4) of this section, if the seller did not originate the mortgage loans, but the originator of the mortgage loans fulfills the requirements of either paragraphs (e)(4)(i) through (e)(4)(iv), paragraph (e)(4)(vi) or paragraph (e)(4)(vii) of this section; and the seller has held the loans for six months or less prior to selling the loans to the GSE, HUD will consider that the seller has met the requirements of this paragraph (e)(4) and of 12 U.S.C. 4563(b)(1)(B).

* * * * *

(f) *Partial credit activities.* Mortgages insured under HUD's Title I program, which includes property improvement and manufactured home loans, shall receive one-half credit toward the Special Affordable Housing Goal until such time as the Government National Mortgage Association fully implements a program to purchase and securitize Title I loans.

(g) *No credit activities.* * * * For purposes of this paragraph (g), ''mortgages or mortgage-backed securities portfolios'' includes mortgages retained by Fannie Mae or Freddie Mac and mortgages utilized to back mortgage-backed securities.

6. In § 81.15, paragraph (a) is revised, paragraph (d) is amended by revising the second sentence and by adding two new sentences at the end, and paragraph (e) is amended by re-designating paragraph (e)(6) as (e)(7), and by adding a new paragraph (e)(6), to read as follows:

§ 81.15 General requirements.

(a) *Calculating the numerator and denominator.* Performance under each of the housing goals shall be measured using a fraction that is converted into a percentage.

(1) *The numerator.* The numerator of each fraction is the number of dwelling units financed by a GSE's mortgage purchases in a particular year that count toward achievement of the housing goal.

(2) *The denominator.* The denominator of each fraction is, for all mortgages purchased, the number of dwelling units that could count toward achievement of the goal under appropriate circumstances. The denominator shall not include GSE transactions or activities that are not mortgages or mortgage purchases as defined by HUD or transactions that are specifically excluded as ineligible under § 81.16(b).

(3) *Missing data or information.* When a GSE lacks sufficient data or information to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of a particular housing goal, that mortgage purchase shall be included in the denominator for that housing goal, except under the circumstances described in paragraphs (d) and (e)(6) of this section.

* * * * *

(d) *Counting owner-occupied units.* * * * To determine whether mortgagors may be counted under a particular family income level, *i.e.* especially low, very low, low or moderate income, the income of the mortgagors is compared to the median income for the area at the time of the mortgage application, using the appropriate percentage factor provided under § 81.17. When the income of the mortgagors is not available to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, a GSE may exclude single family owner-occupied units located in census tracts with median income less than or equal to area median income according to the most recent census from the denominator as well as the numerator, up to a ceiling of one percent of the total number of single family owner-occupied dwelling units eligible to be counted toward the respective housing goal in the current year. Mortgage purchases in excess of the ceiling will be included in the denominator and excluded from the numerator if they are missing data.

(e) * * *

(6) *Affordability data unavailable.* (i) *Multifamily.* When information regarding the affordability of a rental unit is not available, a GSE's performance with respect to such a unit may be evaluated with estimated affordability information, so long as the Department has reviewed and approved the data source and methodology for such estimated data. The use of estimated information to determine affordability may be used up to a maximum of five percent of the total number of units backing the GSEs' multifamily mortgage purchases in the current year, adjusted for REMIC percentage and participation percent. When the application of affordability data based on an approved market rental data source and methodology is not possible, and therefore the GSE lacks sufficient information to determine whether the purchase of a mortgage originated after 1992 counts toward the achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, HUD will exclude units in multifamily properties from the denominator as well as the numerator in calculating performance under those goals.

(ii) *Rental units in 1–4 unit single family properties.* When neither the income of prospective or actual tenants of a rental unit in a 1–4 unit single family property nor actual or average rent data is available, and, therefore, the GSE lacks sufficient information to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the Low- and Moderate-Income Housing Goal or the

Special Affordable Housing Goal, a GSE may exclude rental units in 1–4 unit single family properties from the denominator as well as the numerator in calculating performance under those goals.

* * * * *

7. Section 81.16 is amended as follows:

a. Paragraph (a) is revised;

b. Paragraph (b) is amended by revising paragraphs (b)(3) and (b)(9) and by adding a new paragraph (b)(10);

c. Paragraph (c) is amended by adding introductory text, by revising paragraph (c)(6), and by adding new paragraphs (c)(9), (c)(10), (c)(11), (c)(12), and (c)(13); and

d. A new paragraph (d) is added; to read as follows:

§ 81.16 Special counting requirements.

(a) *General.* HUD shall determine whether a GSE shall receive full, partial, or no credit for a transaction toward achievement of any of the housing goals. In this determination, HUD will consider whether a transaction or activity of the GSE is substantially equivalent to a mortgage purchase and either creates a new market or adds liquidity to an existing market, provided however that such mortgage purchase actually fulfills the GSE's purposes and is in accordance with its Charter Act.

(b) * * *

(3) Purchases of non-conventional mortgages except:

(i) Where such mortgages are acquired under a risk-sharing arrangement with a Federal agency;

(ii) Mortgages insured under HUD's Home Equity Conversion Mortgage (''HECM'') insurance program, 12 U.S.C. 1715z–20; mortgages guaranteed under the Rural Housing Service's Single Family Housing Guaranteed Loan Program, 42 U.S.C. 1472; mortgages on properties on lands insured under FHA's Section 248 program, 12 U.S.C. 1715z–13, or HUD's Section 184 program, 12 U.S.C. 1515z–13a, or Title VI of the Native American Housing Assistance and Self-Determination Act of 1996, 25 U.S.C. 4191–4195; and mortgages with expiring assistance contracts as defined at 42 U.S.C. 1737f;

(iii) Mortgages under other mortgage programs involving Federal guarantees, insurance or other Federal obligation where the Department determines in writing that the financing needs addressed by the particular mortgage program are not well served and that the mortgage purchases under such program should count under the housing goals, provided the GSE submits documentation to HUD that supports eligibility and that HUD makes such a determination, or

(iv) As provided in § 81.14(e)(3)

* * * * *

(9) Single family mortgage refinancings that result from conversion of balloon notes to fully amortizing notes, if the GSE already owns or has an interest in the balloon note at the time conversion occurs.

(10) Any combination of factors in paragraphs (b)(1) through (9) of this section.

(c) *Other special rules.* Subject to HUD's primary determination of whether a GSE shall receive full, partial, or no credit for a transaction toward achievement of any of the housing goals as provided in paragraph (a) of this section, the following supplemental rules apply:

* * * * *

(6) *Seasoned mortgages.* A GSE's purchase of a seasoned mortgage shall be treated as a mortgage purchase for purposes of these goals and shall be included in the numerator, as appropriate, and the denominator in calculating the GSE's performance under the housing goals, except where the GSE has already counted the mortgage under a housing goal applicable to 1993 or any subsequent year, or where the Department determines, based upon a written request by a GSE, that a seasoned mortgage or class of such mortgages should be excluded from the numerator and the denominator in order to further the purposes of the Special Affordable Housing Goal.

* * * * *

(9) *Expiring assistance contracts.* In accordance with 12 U.S.C. 4565(a)(5), actions that assist in maintaining the affordability of assisted units in eligible multifamily housing projects with expiring contracts shall receive credit under the housing goals as provided in paragraph (b)(3)(ii) and in accordance with paragraphs (b) and (c)(1) through (c)(9) of this section.

(i) For restructured (modified) multifamily mortgage loans with an expiring assistance contract where a GSE holds the loan in portfolio and facilitates modification of loan terms that results in lower debt service to the project's owner, the GSE shall receive full credit under any of the housing goals for which the units covered by the mortgage otherwise qualify.

(ii) Where a GSE undertakes more than one action to assist a single project or where a GSE engages in an activity that it believes assists in maintaining the affordability of assisted units in eligible multifamily housing projects but which is not otherwise covered in paragraph (c)(9)(i) of this section, the GSE must submit the transaction to HUD for a determination on appropriate goals counting treatment.

(10) *Bonus points.* The following transactions or activities, to the extent the units otherwise qualify for one or more of the housing goals, will receive bonus points toward the particular goal or goals, by receiving double weight in the numerator under a housing goal or goals and receiving single weight in the denominator for the housing goal or goals. Bonus points will not be awarded for the purposes of calculating performance under the special affordable housing multifamily subgoal described in § 81.14(c). All transactions or activities meeting the following criteria will qualify for bonus points even if a unit is missing affordability data and the missing affordability data is treated consistent with § 81.15(e)(6)(i). Bonus points are available to the GSEs for purposes of determining housing goal performance for each year 2001 through 2003. Beginning in the year 2004, bonus points are not available for goal performance counting purposes unless the Department extends their availability beyond December 31, 2003 for one or more types of activities and notifies the GSEs by letter of that determination.

(i) *Small multifamily properties.* HUD will assign double weight in the numerator under a housing goal or goals for each unit financed by GSE mortgage purchases in small multifamily properties (5 to 50 physical units), provided, however, that bonus points will not be awarded for properties that are aggregated or disaggregated into 5–50 unit financing packages for the purpose of earning bonus points.

(ii) *Units in 2–4 unit owner-occupied properties.* HUD will assign double weight in the numerator under the housing goals for each unit financed by GSE mortgage purchases in 2- to 4-unit owner-occupied properties, to the extent that the number of such units financed by mortgage purchases are in excess of 60 percent of the yearly average number of units qualifying for the respective housing goal during the five years immediately preceding the year of mortgage purchase.

(11) *Temporary adjustment factor for Freddie Mac.* In determining Freddie Mac's performance on the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, HUD will count each qualifying unit in a property with more than 50 units as 1.2 units in calculating the numerator and as one unit in calculating the

denominator, for the respective housing goal. HUD will apply this temporary adjustment factor for each year from 2001 through 2003; for the year 2004 and thereafter, this temporary adjustment factor will no longer apply.

(12) *HOEPA mortgages and mortgages with unacceptable terms and conditions.* HOEPA mortgages and mortgages with unacceptable terms or conditions as defined in § 81.2 will not receive credit toward any of the three housing goals.

(13) *Mortgages contrary to good lending practices.* The Secretary will monitor the practices and processes of the GSEs to ensure that they are not purchasing loans that are contrary to good lending practices as defined in § 81.2. Based on the results of such monitoring, the Secretary may determine in accordance with paragraph (d) of this section that mortgages or categories of mortgages where a lender has not engaged in good lending practices will not receive credit toward the three housing goals.

(d) *HUD review of transactions.* HUD will determine whether a class of transactions counts as a mortgage purchase under the housing goals. If a GSE seeks to have a class of transactions counted under the housing goals that does not otherwise count under the rules in this part, the GSE may provide HUD detailed information regarding the transactions for evaluation and determination by HUD in accordance with this section. In making its determination, HUD may also request and evaluate additional information from a GSE with regard to how the GSE believes the transactions should be counted. HUD will notify the GSE of its determination regarding the extent to which the class of transactions may count under the goals.

8. Section 81.17 is amended by adding a new paragraph (d), to read as follows:

§ 81.17 Affordability—Income level definitions—family size and income known (owner-occupied units, actual tenants, and prospective tenants).

* * * * *

(d) *Especially-low-income* means, in the case of rental units, where the income of actual or prospective tenants is available, income not in excess of the following percentages of area median income corresponding to the following family sizes:

Number of persons in family	Percentage of area median income
1	35
2	40
3	45
4	50
5 or more	(*)

*50% plus (4.0% multiplied by the number of persons in excess of 4).

9. Section 81.18 is amended by adding a new paragraph (d), to read as follows:

§ 81.18 Affordability—Income level definitions—family size not known (actual or prospective tenants).

* * * * *

(d) *For especially-low-income,* income of prospective tenants shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	35
1 bedroom	37.5
2 bedrooms	45
3 bedrooms or more	(*)

*52% plus (6.0% multiplied by the number of bedrooms in excess of 3).

10. In § 81.19, paragraph (d) is re-designated as paragraph (e), a new paragraph (d) is added and the second sentence of the newly re-designated paragraph (e) is revised, to read as follows:

§ 81.19 Affordability—Rent level definitions—tenant income is not known.

* * * * *

(d) *For especially-low-income,* maximum affordable rents to count as housing for especially-low-income families shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	10.5
1 bedroom	11.25
2 bedrooms	13.5
3 bedrooms or more	(*)

*15.6% plus (1.8% multiplied by the number of bedrooms in excess of 3).

* * * * *

(e) *Missing Information.* * * * If a GSE makes such efforts but cannot obtain data on the number of bedrooms in particular units, in making the calculations on such units, the units shall be assumed to be efficiencies except as provided in § 81.15(e)(6)(i)

11. In § 81.76, paragraph (d) is revised to read as follows:

§ 81.76 FOIA requests and protection of GSE information.

* * * * *

(d) *Protection of information by HUD officers and employees.* The Secretary will institute all reasonable safeguards to protect data or information submitted by or relating to either GSE, including, but not limited to, advising all HUD officers and employees having access to data or information submitted by or relating to either GSE of the legal restrictions against unauthorized disclosure of such data or information under the executive branch-wide standards of ethical conduct, 5 CFR part 2635, and the Trade Secrets Act, 18 U.S.C. 1905. Officers and employees shall be advised of the penalties for unauthorized disclosure, ranging from disciplinary action under 5 CFR part 2635 to criminal prosecution.

* * * * *

Dated: October 16, 2000.

William C. Apgar,

Assistant Secretary for Housing—Federal Housing Commissioner.

Note: The Following Appendices Will Not Appear in the Code of Federal Regulations.

Appendix A—Departmental Considerations To Establish the Low- and Moderate-Income Housing Goal

A. Introduction and Response to Comments

Sections 1 and 2 provide a basic description of the rule process. Section 3 discusses comments on the proposed rule and the Department's responses. Section 4 discusses conclusions based on consideration of the factors.

1. Establishment of Goal

In establishing the Low- and Moderate-Income Housing Goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), collectively referred to as the Government-Sponsored Enterprises (GSEs), Section 1332 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4562) (FHEFSSA) requires the Secretary to consider:

1. National housing needs;
2. Economic, housing, and demographic conditions;
3. The performance and effort of the enterprises toward achieving the Low- and Moderate-Income Housing Goal in previous years;
4. The size of the conventional mortgage market serving low- and moderate-income families relative to the size of the overall conventional mortgage market;
5. The ability of the enterprises to lead the industry in making mortgage credit available for low- and moderate-income families; and
6. The need to maintain the sound financial condition of the enterprises.

2. Underlying Data

In considering the statutory factors in establishing these goals, HUD relied on data from the 1995 American Housing Survey (AHS), the 1990 Census of Population and Housing, the 1991 Residential Finance Survey (RFS), the 1995 Property Owners and Managers Survey (POMS), other government reports, reports submitted in accordance with the Home Mortgage Disclosure Act (HMDA), and the GSEs. In order to measure performance toward achieving the Low- and Moderate-Income Housing Goal in previous years, HUD analyzed the loan-level data on all mortgages purchased by the GSEs for 1993–99 in accordance with the goal counting provisions established by the Department in the December 1995 rule (24 CFR part 81).

3. Response to Comments

a. Introduction

Fannie Mae and Freddie Mac provided detailed comments on HUD's discussion of the factors for determining the goal levels in Appendix A of the proposed rule. A major portion of their substantive comments concerned HUD's analysis of the GSEs' performance relative to the market. Both GSEs disagreed with HUD's conclusions that they lag the conventional conforming market in funding mortgages for the goals-qualifying segments (low-mod borrowers, special affordable borrowers, and underserved neighborhoods) of the single-family owner market. The GSEs argued strongly that they have led the mortgage market, from both quantitative and qualitative perspectives (explained below). The GSEs expressed concern about HUD's assumptions and treatment of specific data in estimating the goals-qualifying shares for single-family owner mortgages. The GSEs concluded that HUD chose assumptions and data sources that result in an overstatement of the low-mod, special affordable, and underserved areas shares of owner mortgages.

It should be noted that the GSEs extended their criticisms to other researchers who have examined this issue of their targeted lending performance relative to the overall mortgage market. Section E.3 of this appendix summarizes findings of several independent studies that have also concluded that the GSEs have lagged the market in affordable lending. For the most part, these studies have used the same HMDA-based methodology described in Section E.2 of this appendix.

The GSEs focused many of their comments on the adequacy of HMDA data, the main source for the goals-qualifying shares of the conventional conforming market, against which the GSEs are compared. The GSEs argued that HMDA data are biased (*i.e.,* overstate the goals-qualifying shares of the market) and that significant portions of HMDA data are not relevant for calculating the market standard for evaluating GSE performance in the conventional conforming market. These and related comments of the GSEs are discussed below in subsections b–f.

Both GSEs also argued that HUD's analysis and conclusions depended on a continuation of recent conditions of economic expansion and low interest rates. According to the GSEs, HUD's range of market estimates did not include periods of adverse economic and affordability conditions, such as existed in the early 1990s. HUD discusses the GSEs' comments on economic volatility in Section B of Appendix D. As explained there, HUD's ranges of market estimates for each of the housing goals are conservative, because they allow for economic and interest rate conditions much more adverse than existed during the mid- to late-1990s.

The discussion that follows summarizes HUD's responses to the GSEs' comments on the "leading the market" analysis that HUD has conducted in Section E.2 of this appendix—that section fully develops the various concepts referenced here. The final two subsections, g and h, discuss additional issues that the GSEs raised about HUD's analysis of the factors in Appendix A.

b. Overview of Leading the Owner Market—Quantitative Analysis

The analysis of HMDA data in Section E.2 of this appendix indicates demonstrates that even though the GSEs have improved their performance since 1993, they have lagged depositories and others in the conventional conforming market in funding affordable loans, both since 1993 and during the more recent 1996–98 period when the new housing goals have been in effect. For example, underserved areas accounted for 22.9 (19.9) percent of Fannie Mae's (Freddie Mac's) purchases of home loans between 1996 and 1998, compared with 24.4 percent for the entire conforming market (excluding B&C loans). Based on comparisons such as these, HUD concludes that the GSEs need to continue improving their performance so that they can match or exceed the overall market in affordable lending.

In their comments, the GSEs reached the opposite conclusion—each stated that they already match or even lead the market, depending on the affordable category being considered. The GSEs also assert that HUD's analysis does not accurately reflect their performance relative to the overall market. Freddie Mac stated that "the shares of Freddie Mac's loan purchases serving low- and moderate-income families, families in underserved areas and minority families mirror those of the primary market". Freddie Mac said that its market calculations "account for the limitations on loans we [Freddie Mac] can purchase" (see below). Similarly, Fannie Mae stated that "an appropriate comparison between Fannie Mae and the primary single-family market shows that we [Fannie Mae] serve a higher percentage of low- and moderate-income borrowers, a higher percentage of minority borrowers, and a higher percentage of borrowers in underserved areas than does the primary market".

Both the GSEs and HUD rely on HMDA data for the market estimates. However, as suggested by the GSEs' comments, they frequently adjust HMDA data to exclude loans in the market that they perceive as not being available for them to purchase. The types of adjustments made by the GSEs, and HUD's response to those adjustments, are discussed in the next subsection. HUD's conclusions about the appropriate definition of the conventional conforming market are also discussed in Section E of this appendix, which provides a detailed analysis of the GSEs' goals-qualifying purchases in the single-family-owner market, and in Appendix D, which provides overall (both single-family and multifamily) estimates of the goals-qualifying shares of the market. In Appendix D, HUD excludes B&C loans from its overall estimates of the market. In this appendix, HUD illustrates (to the extent HMDA data allow) the effects of excluding B&C loans on the GSE-market comparisons, as well as the effects of excluding other loan categories such as manufactured housing loans. However, as explained below, HUD does not believe that HMDA data for the conventional conforming market should be adjusted to reflect the GSEs' perceptions about the characteristics of loans that are available for them to purchase.

c. Relevant Market for Single-Family Owner Properties

Both GSEs provided numerous comments concerning the types of mortgages that HUD should exclude from the definition of the single-family owner market, both when HUD is evaluating the GSEs' performance relative to the conventional conforming owner market (*i.e.,* determining whether the GSEs' lead or lag the market for single-family-owner mortgages) and when HUD is calculating the overall market shares for each housing goal (as described in Appendix D). Fannie Mae stated that it "can only purchase or securitize mortgages that primary market lenders are willing to sell" and that certain types of products (such as ARMs) "are particularly difficult to structure for sale to the secondary market". Fannie Mae added that "HUD fails to adjust for those housing markets that are not fully available to Fannie Mae and Freddie Mac". Freddie Mac stated that it "has not achieved, and is unlikely to achieve in the near term, the same penetration in the subprime and manufactured housing segments of the market as it has achieved in the conventional, conforming market" and therefore HUD should not include these segments in its market definition. According to the GSEs, markets that are "not available" to them or where they are not a "full participant" should be excluded from HUD's market definition. In addition to the subprime and manufactured housing markets, examples of market segments mentioned by the GSEs for exclusion included: low-down payment mortgages (those with loan-to-value ratios greater than 80 percent) without private mortgage insurance or some other credit enhancement; loans financed through state and local housing finance agencies; below-market-interest-rate mortgages; specialized CRA mortgages; and portions of depository portfolios that are not available at mortgage origination for purchase by the GSEs.

To analyze the availability of loans originated by depositories to the GSEs, Fannie Mae funded a study by KPMG Barefoot-Marrinan (KPMG). According to Fannie Mae, KPMG found that the advent of the Community Reinvestment Act (CRA) had encouraged depositories to hold lower-income loans in portfolio. Depositories may not offer their products for sale on the secondary market not only because they are outside of the GSEs' guidelines, but also because of business and portfolio strategy reasons (such as the interest-rate-duration advantage of holding ARMs in portfolio).

Freddie Mac estimated the impacts on HUD's market estimates of excluding from the market definition both specialized community development (CRA-type) loans and portions of depository portfolios. Based on Freddie Mac's analysis, the low-mod (underserved areas) share of the owner market would fall by four (three) percentage points and HUD's overall low-mod and underserved areas market estimates would each fall by about two percentage points. In commenting on whether Freddie Mac leads or lags depositories in affordable lending, Freddie Mac said that the HMDA data for depositories should be adjusted downward to exclude depositories' high-LTV loans without private mortgage insurance, their below-market rate loans, their subprime loans, and coverage bias in HMDA (see the next subsection). Based on these adjustments, Freddie Mac reduced the 1998 HMDA-reported underserved areas percentage for depositories from 26.1 percent to 20.0, which led Freddie Mac to conclude that its performance equals or exceeds the performance of depositories on loans that are likely to be sold to Freddie Mac.

HUD's Response. In general, HUD disagrees with the comments offered by the GSEs about excluding those market segments that they haven't yet been able to penetrate fully. Congress stated that HUD was to estimate the size of the conventional conforming mortgage market, not the market that the GSEs perceive as available for them to purchase. However, with respect to the subprime market, HUD believes that the risky, B&C portion of that market should be excluded from the market definition for each of the housing goals. Thus, HUD includes only the A-minus portion of the subprime market in its overall estimates of the goals-qualifying market shares. In Appendix D, HUD explains its methodology for adjusting the overall market estimates to exclude B&C loans. Section E.2 of this appendix uses HMDA data and the GSEs' loan-level data to examine the GSEs' performance in the single-family owner portion of the conventional conforming mortgage market in metropolitan areas. B&C loans are not identified in HMDA data; however, HUD shows the effects of adjusting the owner market definition for subprime and B&C loans by using a list of lenders that specialize in subprime loans (see Table A.4b).

Excluding other important segments of the lower-income mortgage market, as the GSEs recommend, would render the resulting market benchmark useless for evaluating the GSEs' performance. The loans that the GSEs would exclude are important sources of lower-income credit and, in fact, are among the very loans the GSEs are supposed to be funding. A recent report by the Department of Treasury demonstrated the targeting of CRA-type loans to lower-income and minority families. Numerous studies have shown that the manufactured home sector is an important source of low-income housing. In many of these markets, a more active secondary market would encourage lending to traditionally underserved borrowers. While HUD recognizes that some segments of the market may be more challenging for the GSEs than others, the data reported in Tables A.7a and A.7b of this Appendix show that the GSEs have ample opportunities to purchase goals-qualifying mortgages. As market leaders, the GSEs should be looking for innovative ways to pursue this business, rather than suggesting that it is not available to the secondary market. Furthermore, there is evidence that the GSEs can earn reasonable returns on their goals business. The Economic Analysis that accompanies this final rule provides evidence that the GSEs have been earning financial returns on their purchases of goals-qualifying loans that are only slightly below their 20–25 percent return on equity from their normal business.

HUD also disagrees with other specific comments offered by the GSEs. For example, HUD does not think that the data for depositories should be adjusted downward as proposed by Freddie Mac and Fannie Mae. Both types of institutions receive government benefits and both operate in the conventional conforming market. 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. With respect to loans that are originated without private mortgage insurance, the GSEs have been quite innovative in structuring transactions to provide alternative credit enhancements. Between 1997 and 1999, Freddie Mac was involved in 16 structured transactions totaling $8.1 billion, with Freddie Mac's 1999 business accounting for over $5 billion of this total.[1] HUD gives full goals credit for such credit-enhanced transactions.

Finally, it should be noted that 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 experience in 1997–98, the purchase of seasoned loans appears to be one useful strategy for purchasing goals-qualifying loans. In Section E.2, HUD's comparisons of the GSEs' single-family performance with those of depositories and the overall single-family market include the GSEs' purchases of prior-year as well newly-originated loans.

d. Bias in HMDA Data

Both GSEs refer to findings from a study by Peter Zorn and Jim Berkovec concerning potential bias in HMDA data.[2] 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, Zorn and Berkovec conclude that HMDA data overstates the percentage of conventional, conforming loans originated for lower-income borrowers and for properties located in underserved census tracts. The data reported in Table A.4a of this appendix, which are based on more recent data than the Zorn and Berkovec paper, do not appear to support their findings. With respect to the goals-qualifying percentages for GSE purchases, comparing columns 2 and 4 for Fannie Mae, and columns 6 and 8 for Freddie Mac, show that the HMDA-reported goals-qualifying percentages for loans sold to the GSEs are not always larger than the corresponding percentages for loans the GSEs report as purchased. In fact, the HMDA-reported percentages are more likely to be smaller than the GSE-reported percentages for the Special Affordable and Underserved Areas Goals, yielding conclusions different from those drawn by Zorn and Berkovec with regard to bias in the HMDA data. In addition, as noted in Appendix D, other research has concluded that a portion of lower-income loan originations are not even reported to HMDA. Thus it is not clear that more recent and complete data would support the Zorn and Berkovec findings.

e. Other Technical Comments Related to GSE Performance in Single-Family Owner Market

MSA-Level Analysis. In its comments, Fannie Mae raised several concerns about HUD's comparisons between Fannie Mae and the primary market at the metropolitan statistical area (MSA) level (see Table A.5 in this appendix). 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 would increase public understanding of that GSE's performance.

Missing Data. Both GSEs mentioned the increasing problem of missing information in HMDA data and in their own data bases—particularly with regard to borrower race/ethnicity. HUD agrees that treatment of missing data is an important issue when measuring GSE performance and developing estimates of the size of the affordable market. Both Appendices A and D use several techniques for situations where data are limited or missing. HUD's treatment of missing data reflects a consistent commitment to fair and reasonable analyses, and is designed to permit ''apples-to-apples'' comparisons between the GSEs and the market to the extent possible. When calculating portfolio percentages for different sectors of the mortgage market, HUD followed its usual procedure of excluding loans with missing data. In certain analyses involving market shares, HUD used a variety of techniques such as reallocating missing data, making adjustments for undercoverage by HMDA data, or using data from other sources to estimate the absolute number of mortgage originations. In general, HUD believes that methods for addressing missing data are reasonable and appropriate.

Lender-Purchased Loans. When analyzing HMDA data, Fannie Mae included loans purchased by lenders, as well as loans originated by lenders, in its market definition. HUD included only HMDA-reported mortgage originations in its market definition—mortgages purchased by lenders were not included in HUD's market data. To do so would involve double counting loan originations in the HMDA data.

Prior-Year/Current-Year Analysis. Fannie Mae raised a number of concerns about HUD's separation of its purchases into ''prior-year'' loans and ''current-year'' loans. Section E.2 of this appendix discusses this issue in some detail. Much of HUD's analysis is conducted along the lines that Fannie Mae recommends—considering each GSE's total purchases (of both prior-year mortgages and current-year mortgages) in a single calendar year. For example, see the discussion of the GSEs' past performance in Section E of this appendix and the data in Tables A.3 and A.4. But HUD believes the GSEs' performance should also be analyzed by focusing on the total number of mortgages from a particular origination year that the GSEs have purchased to date. Comparing the GSEs' current-year purchases, including prior-year originations, with newly-originated mortgages would result in somewhat of an ''apples-to-oranges'' comparison. Hence, to conduct more of an ''apples-to-apples'' comparison between the GSEs and the market, it is necessary to restrict the analysis to GSE loan acquisitions originated in a particular year (see Tables A.7a and A.7b). HUD recognizes some of the problems that result from analyses that focus on a single origination year. However, as indicated by the variety of analyses provided in Appendix A, HUD believes that both frameworks are useful for understanding the GSEs' role in the affordable lending market.

f. Leading the Market—The Qualitative Dimension

The GSEs commented that they make a sizable contribution toward serving the housing needs of a wide range of American families through their innovative outreach and the overall leadership they provide to the affordable lending market. This ''qualitative'' dimension of market leadership comes from their normal operations in the market. Each GSE gave numerous examples of their market leadership, similar to the discussion that HUD provides in Section G of this appendix. Fannie Mae noted its *Trillion Dollar Commitment,* its programs with minority-and women-owned lenders, its initiative with Community Development Financial Institutions, and its numerous initiatives in the technology area. Freddie Mac noted similar program initiatives and outreach efforts, and stated that it has been a ''leader in removing historical barriers to mortgage credit'' and that a recent HUD-commission study commended both Freddie Mac and Fannie Mae for their leadership in the liberalization of mortgage underwriting standards.

HUD understands the important role that the GSEs play in the market and applauds their efforts to re-examine their underwriting standards and to reach out to traditionally underserved borrowers and neighborhoods. This perspective is reflected in Section G of this appendix, which discusses qualitative dimensions of the GSEs' ability to lead the industry. HUD concludes that due to their dominant role in the market, their ability to influence the types of loans that lenders will originate, their utilization of state-of-the-art technology, and their financial strength, the GSEs have the ability to lead the market in affordable lending and to reach out to those markets that have traditionally not received the benefits of an active secondary market.

g. Linking Housing Needs to GSEs

Fannie Mae commented that HUD's analysis of housing needs in Appendix A needed to more carefully identify the appropriate roles for the public sector and the GSEs. Similar to its comments on HUD's 1995 rule, Fannie Mae expressed concern that HUD did not distinguish between general housing needs of low- and moderate-income households and those needs that the GSEs can reasonably be expected to address. In this appendix, HUD presents an analysis of general housing needs to comply with FHEFSSA, which requires the Secretary to consider such needs when establishing the housing goals. HUD's examination of national housing needs does not suggest that the GSEs can or should meet all of those needs. Rather, the analysis is intended to provide background on the evolution and current state of the housing markets for low- and moderate-income households. HUD recognizes that the GSEs alone can not mitigate some of the more extreme problems identified in this analysis.

However, with more focused effort, the GSEs can assist in addressing several problems discussed in this appendix with regard to single-family and multifamily housing. On the single-family side, the GSEs can develop secondary market programs for ''untapped'' markets such as 2–4 unit rental properties and properties needing rehabilitation in the nation's inner cities. The GSEs can increase their support of more customized mortgage products and underwriting, with greater outreach to those families who have not been served with traditional products, underwriting, and marketing. Particularly important in this regard, the GSEs can ensure that their automated underwriting systems recognize the special circumstances of lower-income and minority borrowers. As discussed in Section 3.d of this appendix, HUD and others are concerned about potential negative effects of mortgage scoring on industry efforts to reach out to lower-income and minority families.

On the multifamily side, with new product development and partnerships, the GSEs can more fully address the credit needs of the current market for affordable rental housing. This appendix cities several areas where the GSEs can help. One segment that would benefit from a more active secondary market is small multifamily properties—an important part of the rental housing market that is currently not being adequately served by the GSEs. The GSEs can work to improve overall efficiency and stability in this market by developing new products and promoting increased standardization and streamlined procedures.

The GSEs have been immensely successful in the financing of traditional single-family housing. HUD recognizes that ''untapped'' markets will present some difficulties and challenges for the GSEs. But by helping develop a secondary market in these areas, the GSEs will bring increased liquidity, added stability, and ultimately lower interest rates and rents for lower-income families in these segments of the market.

h. Barriers to Higher GSE Performance on the Housing Goals

Fannie Mae raised concerns with respect to the interplay of the housing goals and the risk-based capital standard proposed by OFHEO. Fannie Mae stated that ''the risk-based capital proposal represents another potentially significant barrier to meeting the goals that was not analyzed by the Department.'' OFHEO previously addressed this question in their notice of proposed rulemaking, dated April 13, 1999, concluding that ''the risk-based capital standard will not affect the Enterprises' ability to purchase affordable housing loans.'' [3] In part, this conclusion was based on the finding that in 1996 and 1997, Freddie Mac would have enjoyed capital surpluses under OFHEO's proposed rule, despite increased purchases of loans meeting the housing goals. OFHEO concluded that even in more adverse economic environments, ''the capital cost of single family loans meeting the Enterprises' affordable housing goals should not be materially different, on average, from the cost of other loans.''

Of the various issues mentioned by Fannie Mae in relation to OFHEO's proposed regulation, implications of the rule for high-LTV and multifamily lending are of the greatest relevance with regard to affordable lending and the GSEs' housing goals.

High-LTV Lending. Fannie Mae stated concerns regarding the impacts of the proposed OFHEO regulation on high-LTV lending:

> The risk-based capital regulation as proposed imposes disproportionately high capital requirements on high-LTV loans. These requirements will impair our ability to serve those borrowers with limited resources. High-LTV lending is critically important to our affordable housing initiatives and outreach to first-time homebuyers.[4]

It is not apparent that OFHEO's proposed rulemaking would impose ''disproportionate'' capital requirements on high-LTV loans. Because high-LTV loans typically have higher default rates, it is reasonable to require the GSEs to hold more capital against high-LTV loans than against low-LTV loans, other things being equal.

If Fannie Mae's view is that the proposed OFHEO regulation requires the GSEs to hold more capital against high-LTV loans than is the case for other financial institutions, their comments submitted in response to HUD's proposed housing goals rule do not contain any material documenting such a claim.