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## HUD's AFFORDABLE LENDING GOALS FOR FANNIE MAE AND FREDDIE MAC

Fannie Mae and Freddie Mac, government-sponsored enterprises (GSEs) in the secondary mortgage market, are the two largest sources of housing finance in the United States. They fund these mortgages by purchasing loans directly from primary market mortgage originators, such as mortgage bankers and depository institutions, and holding these loans in portfolio, or by acting as a conduit and issuing mortgage-backed securities (MBS), which are then sold in the capital markets to a wide variety of investors. HUD has estimated that 11.7 million dwelling units were financed by conventional conforming mortgages in 1998, and that the GSEs provided financing for 55 percent of these units.<sup>1</sup>

HUD is the mission regulator for Fannie Mae and Freddie Mac, and a major aspect of this regulation involves setting minimum percentage-of-business goals for the GSEs' mortgage purchases. These housing (or lending) goals deal with the enterprises' support for low-income lending and lending in underserved geographic areas. Given the dominant role of the GSEs in the mortgage market, the housing goals play an important role in encouraging mortgage originators to undertake more affordable lending. The Department recently updated these goals, significantly increasing them for the years 2001-03.

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<sup>1</sup> These data are presented in Table A.7b of HUD's regulation of the GSEs, published in the *Federal Register*, October 31, 2000, p. 65128. Conventional mortgages exclude loans that are insured by the Federal Housing Administration or the Rural Housing Administration or guaranteed by the Veterans Administration. Conforming mortgages are those with an unpaid principal balance no greater than the maximum allowable under the GSEs' charter acts—for example, \$252,700 for 1-unit properties in most areas of the United States in 2000.

## **GSEs' Benefits and Purposes**

As GSEs, Fannie Mae and Freddie Mac receive certain benefits from the government, and in return Congress has established certain public purposes for the GSEs, as spelled out in their Charter Acts. The explicit benefits received by the GSEs include: (1) exemption from all state and local taxes except property taxes; (2) exemption from securities registration requirements of the Securities and Exchange Commission and the States; and (3) conditional access to a \$2.25 billion line of credit from the U.S. Treasury. But the most important benefit Fannie Mae and Freddie Mac achieve from their GSE status is implicit—their borrowing costs are lower than the costs for comparable financial institutions, because financial markets perceive an implicit Federal guarantee of GSE securities.<sup>2</sup>

The public purposes of the GSEs, established by Congress and stated in their Federal Charter Acts, are to increase the liquidity of mortgage investments and improve the distribution of investment capital available for residential mortgage financing in order to:

- provide stability in the secondary market for residential mortgages;
- respond appropriately to the private capital market;
- 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); and
- promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas).

## **Regulation of the GSEs**

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 GSE Act) established the current regulatory structure for the GSEs. This legislation gave the Secretary of HUD general regulatory authority over Fannie Mae and Freddie Mac in all areas other than the GSEs' financial safety and soundness. Specifically the Secretary's authority includes the establishment of affordable housing goals, monitoring compliance with fair lending principles, collection of loan-level data from the GSEs on their mortgage purchases, creation and distribution of an extract from the loan-level data in the form of a nonproprietary public use loan-level data base, and new program approval. In particular, the 1992 GSE Act called for the Secretary of HUD to establish three

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<sup>2</sup>Officially there is no Federal backing or insurance of any kind for any obligations issued by the GSEs, but there is a widespread view in the financial markets that both are "too big to fail," and that the government would have to bail them out if it became necessary.

broad affordable housing goals for each of the GSEs: (1) a broad low- and moderate-income goal, for families with less-than-median income; (2) a geographically-targeted goal, for housing located in underserved areas, such as low-income and high-minority census tracts; and (3) a targeted income-based goal, for special affordable housing, which is housing that is affordable to very low-income families and low-income families living in low-income areas.

The 1992 GSE Act also created the Office of Federal Housing Enterprise Oversight (OFHEO), an independent office within HUD headed by a Director, who has authority exclusive of the Secretary with regard to the GSEs' financial safety and soundness. OFHEO has established capital standards for the enterprises and conducts regulatory audits of their operations.

### **Increases in the GSEs' Affordable Housing Goals for 2001-03**

In March 2000, HUD issued a proposed rule, significantly increasing the GSEs' affordable housing goals for the post-2000 period, and this rule was finalized in October. For each year from 2001 through 2003, the goals are:<sup>3</sup>

- *Low- and moderate-income goal.* At least 50 percent of the dwelling units financed by each GSE's mortgage purchases should be for families with incomes no greater than area median income (AMI), defined as median income for the metropolitan area or nonmetropolitan county. The corresponding goal was 42 percent for 1997-2000.
- *Special affordable goal.* At least 20 percent of the dwelling units financed by each GSE's mortgage purchases should be for very low-income families (those with incomes no greater than 60 percent of AMI) or for low-income families (those with incomes no greater than 80 percent of AMI) in low-income areas. The corresponding goal was 14 percent for 1997-2000.<sup>4</sup>
- *Underserved areas goal.* At least 31 percent of the dwelling units financed by each GSE's mortgage purchases should be for units located in underserved areas. Research by HUD and others has demonstrated that low-income and high-minority census tracts have high mortgage denial rates and low mortgage origination rates, and this forms the basis for HUD's definition of underserved areas.<sup>5</sup> The corresponding goal was 24 percent for 1997-2000.

<sup>3</sup>These goals remain in effect for the post-2003 period unless modified prior to 2004.

<sup>4</sup> In addition, HUD has established a special affordable multifamily subgoal, to encourage the GSEs to finance rental units affordable to lower-income families.

<sup>5</sup> Specifically, a census tract in a metropolitan area is classified as an underserved area if median income for the tract is no greater than 90 percent of median income for the metropolitan area or if minorities comprise at least 30 percent of the tract's population and tract median income is no greater than 120 percent of area median income. A similar definition, based on counties, is employed for nonmetropolitan areas.

## GSEs' Past Performance on the Housing Goals

The performance of the GSEs on each of the goals, as measured under the counting rules in effect for 1996-2000, is shown in Figure 1. Both GSEs have surpassed their goals in each of these years, and both have generally increased their performance over the years.<sup>6</sup>

Fannie Mae made a sharp gain on the *low- and moderate-income goal* in the mid-1990s and some subsequent increases since that time, while Freddie Mac showed more gradual progress over the entire period. Freddie Mac's low- and moderate-income shares were below Fannie Mae's shares in every year through 1998, but its goal performance in 1999 (46.1 percent) slightly exceeded Fannie Mae's performance (45.9 percent).

Both GSEs have also shown major gains in performance on the *special affordable goal*. Freddie Mac surpassed Fannie Mae on this goal in 1998, but this pattern was reversed in 1999, when Fannie Mae's performance (17.6 percent) surpassed Freddie Mac's performance (17.2 percent). As mentioned, HUD also established dollar-based special affordable multifamily subgoals for the GSEs. Fannie Mae has surpassed its subgoal by a wide margin in every year; Freddie Mac narrowly exceeded its subgoal in 1996, but has stepped up its performance in recent years, as it has successfully rebuilt its multifamily operations.

Unlike the income-based goals, where the GSEs' performance has increased steadily, Fannie Mae's performance on the *underserved areas goal* in 1995 exceeded its performance in 1999. And last year Freddie Mac outperformed Fannie Mae on this goal (27.5 percent and 26.8 percent, respectively), after lagging in earlier years.

## The GSEs and the Primary Mortgage Market

The 1992 GSE Act requires HUD to consider six factors in establishing the housing goals: (1) national housing needs; (2) economic and demographic conditions; (3) past performance on each goal; (4) the size of the corresponding primary mortgage market; (5) the ability of the GSEs to lead the industry; and (6) the need to maintain the sound financial condition of the GSEs. HUD conducted detailed analyses of each of these factors in setting the goals for 2001-03.

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<sup>6</sup> Freddie Mac fell short on the geographically-targeted goal in 1993-95, when it was targeted to families in central cities, as defined by the Office of Management and Budget; Fannie Mae also fell short on this goal in 1993.

One of the more important factors underlying the goals is the share of the conventional conforming primary mortgage market qualifying for each of the goals. HUD analyzed a variety of data sources in making its estimates of these share, such as data from the American Housing Survey (AHS) and data provided in accordance with the Home Mortgage Disclosure Act (HMDA). The Department projected that low- and moderate-income mortgages would account for 50-55 percent of the primary mortgage market (including both single-family and multifamily mortgages) in the period covered by the new housing goals. Similar estimates were 23-26 percent for the special affordable goal and 29-32 percent for the underserved areas goal. Thus the goals for 2001-03 have been increased sharply, but still are below the midpoints of the estimated market ranges.

In general, both GSEs have lagged the primary mortgage market in funding loans for goal-qualifying properties, for two reasons. First, although the GSEs fund a disproportionately large share of mortgages on owner-occupied single-family properties, the GSEs' goal-qualifying shares of owner-occupied properties are lower than the corresponding shares of mortgages originated in the primary mortgage market, as shown in Figure 2. For example, HUD estimates that special affordable borrowers took out 17.3 percent of home purchase loans originated in the primary market during 1999, but they accounted for only 12.4 percent of the GSEs' combined purchases in that year. HUD also estimates that borrowers in underserved areas accounted for 25.8 percent of home purchase loans originated in the primary market during 1999, but they accounted for only 20.8 percent of the GSEs' combined purchases in that year. Thus the GSEs can make significant gains in goal performance by raising the shares of their owner-occupied mortgages that qualify for the goals.

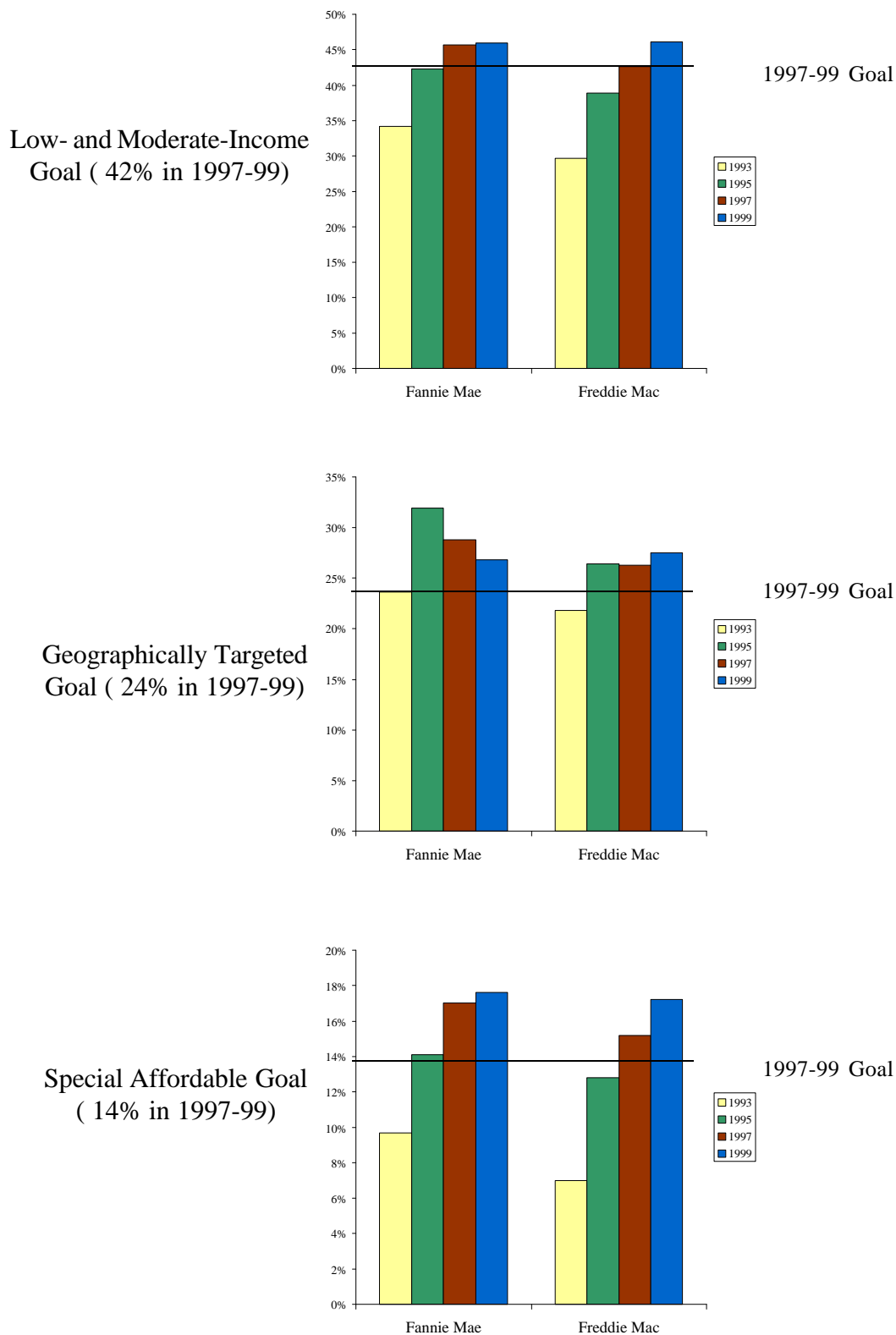
Second, the GSEs finance relatively small shares of mortgages on rental properties (both single-family and multifamily rentals), but these rental properties are major sources of low-income housing. For example, the GSEs accounted for only 19 percent of single-family rental units financed in 1998, but 90 percent of such units qualify for the low- and moderate-income goal. Thus the GSEs can also make gains in goal performance by stepping up their presence in the mortgage market for rental properties. To encourage an enhanced GSE role in the rental market, the Department has established a system of "bonus points" to encourage both GSEs to step up their financing of certain parts of the mortgage market which are especially important in providing affordable housing, such as single-family rental properties and small multifamily properties.

## **Conclusion**

Lower-income and minority families have made major gains in access to the mortgage market in the 1990s. A variety of reasons have accounted for these gains, including improved housing affordability, enhanced enforcement of the

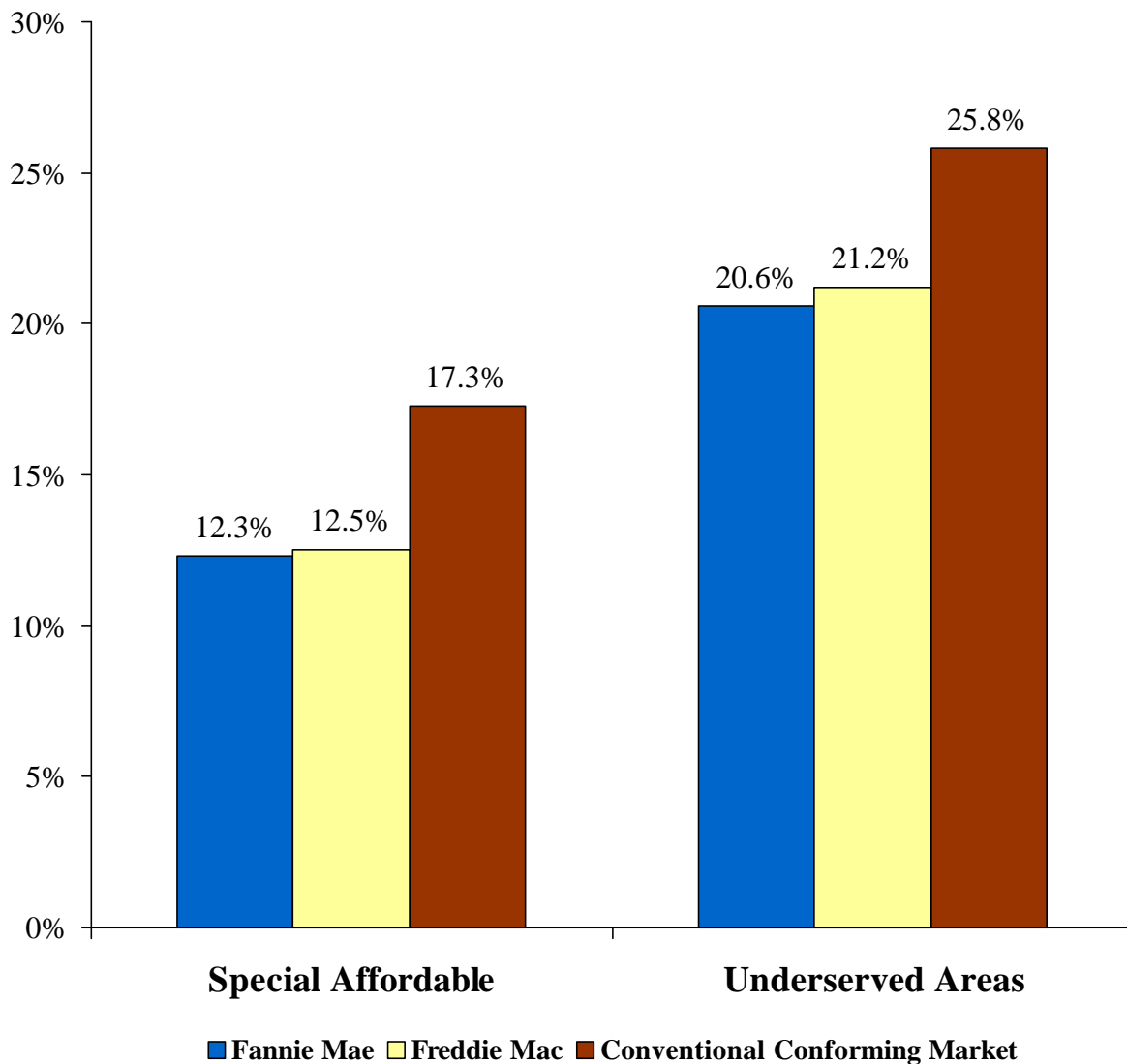
Community Reinvestment Act, more flexible mortgage underwriting, and stepped-up enforcement of the Fair Housing Act. But most industry observers believe that one factor behind these gains has been the improved performance of Fannie Mae and Freddie Mac under HUD's affordable lending goals. HUD's recent increases in the goals for 2001-03 will encourage the GSEs to further step up their support for affordable lending.

**Figure 1**  
**GSE's Performance on HUD's Housing Goals**



Source: HUD's analysis of GSE's loan-level data.

**Figure 2**  
**The Shares of GSE Purchases and Conventional**  
**Conforming Mortgages for Special Affordable**  
**Borrowers and Underserved Areas in 1999**



Source: HUD's analysis of HMDA and GSE data for 1999 on home purchase loans in metropolitan areas. The special affordable goal is targeted toward very low-income families and low-income families in low-income areas. The underserved areas goal is targeted toward low-income and high-minority census tracts.