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CHARACTERISTICS OF MORTGAGES PURCHASED BY FANNIE MAE AND FREDDIE MAC, 1993-95

Paul B. Manchester, Sue George Neal, and Harold L. Bunce

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Characteristics of Mortgages Purchased by Fannie Mae and Freddie Mac, 1993-95[1]

I. Introduction

In 1992 Congress expressed concern about an "information vacuum" which impeded efforts to oversee the activities of Fannie Mae and Freddie Mac.[2] To provide a basis for enhanced oversight and regulation of these two government-sponsored enterprises (GSEs) and to increase information about the GSEs' operations, Congress enacted the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("the 1992 GSE Act"). This act:

- Provided for financial safety-and-soundness oversight of the GSEs by the Office of Federal Housing Enterprise Oversight (OFHEO);

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[1] The authors gratefully acknowledge the computer and data assistance of Nana Farshad and Ian Keith and the assistance and comments of Randy Scheessele, particularly on the HMDA and market analysis in Section IV. Helpful comments were also received from Tuyet Cosslett, Theresa DiVenti, Brian Doherty, Sandra Fostek, John Gardner, Peter Kaplan, and William Segal of HUD. The authors assume responsibility for any errors.

[2] The Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, respectively. See the Federal Housing Enterprises Regulatory Reform Act of 1992, Senate Report 102-282, 102nd Congress, 2nd. Session at 39 (1992) for Congressional concerns about the lack of information available on the mortgage purchases of Fannie Mae and Freddie Mac.

- Called for HUD to establish annual affordable and geographic goals for the GSEs' purchases of mortgages--initially for 1993-95 (referred to as “the transition period”) and subsequently for 1996-99[3]; and

- Required the GSEs to submit loan-level data to HUD about the mortgages they buy, including detailed borrower and mortgage characteristics.

[3] 58 FR 53048 and 53072 (October 31, 1993), 59 FR 61504 (November 30, 1994) and 24 CFR Part 81.

The 1992 GSE Act required HUD, after taking proprietary considerations into account, to make the loan-level data submitted by the GSEs available in a public-use data base.[4] The Act also called for the Department to analyze data on the GSEs' operations, in order to report to Congress and the public on the extent to which the GSEs are achieving their statutory purposes.

This paper is intended to help remedy the "information vacuum" that Congress found in 1992. It focuses on the GSEs' performance in funding affordable loans for lower-income families and other disadvantaged borrowers and their neighborhoods. The paper reports the results of several detailed analyses concerning the characteristics of the mortgages purchased by the GSEs from 1993 through 1995. The data reveal changes in the GSEs' performance during this period and allow comparisons between the performance of Fannie Mae and Freddie Mac. A question explored in depth is the degree to which the GSEs' purchase patterns reflect or depart from the patterns of originations found in the primary mortgage origination market.

A. Organization of Paper

The next subsection briefly defines the housing goals and reports the GSEs' performance relative to the goals in 1993-95. Section II reviews Fannie Mae's and Freddie Mac's mortgage purchases by major property type. Section III presents basic characteristics (borrower income and race, type of neighborhood) of the GSEs' purchases of loans on one-family owner properties. Section IV summarizes a study by Bunce and Scheessele (1996) that uses data provided under the Home Mortgage Disclosure Act (HMDA) to compare the characteristics of loans purchased by the GSEs with loans originated in the overall primary market and loans retained in portfolio by banks and thrifts. Finally, Section V analyzes special topics such as first-time homebuyers, low- and moderate-income borrowers, loan-to-value ratios by income level, minority borrowers, the relationship between income and neighborhood characteristics, and various attributes of Fannie Mae's community lending mortgages[5]. Each major section contains a conclusion that summarizes the main findings.

Except for Section IV, which relies on HMDA data, the analysis in this paper is based on the loan-level data that the GSEs submit annually to HUD about the mortgages that they purchase.

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[4] 61 FR 54322-54329 (October 17, 1996).

[5] Freddie Mac's community lending programs are not discussed because they were small during the 1993-95 period--traditionally Freddie Mac has placed less emphasis on such programs than Fannie Mae.

B. Housing Goals and Performance for 1993-95

In October 1993 HUD issued housing goal targets for 1993-94 for the GSEs; these goals were subsequently extended through 1995. During 1993-95, there were three goals:

- o A **low- and moderate-income goal**, which targeted mortgages on housing for families with less than median income;

- o A **central city goal**, which targeted mortgages located in central cities (as defined by the Office of Management and Budget); and

- o A **special affordable goal**, which targeted mortgages on housing for very low-income families and low-income families living in low-income neighborhoods.

Table 1 reports the goal targets set by HUD and the performance of the GSEs on each goal between 1993 and 1995.[6] As shown there, the low-mod and central cities goals were expressed as percentages of the total numbers of dwelling units financed by each enterprise's purchases. The special affordable goals were expressed as minimum dollar amounts, divided into multifamily and single-family subgoals--for 1993-94 combined and for 1995.

Both GSEs' performance exceeded their low-mod goals in every year during the transition period. For example, 43 percent of Fannie Mae's purchases and 39 percent of Freddie Mac's purchases qualified as low-mod purchases in 1995; these figures far surpassed HUD's 30 percent target for the low-mod goal. Fannie Mae surpassed the central cities goals in two of the three years (1994 and 1995), but Freddie Mac fell short of the goals in all three years. With regard to special affordable mortgages, both GSEs exceeded their aggregate targets and their single-family subgoals for 1993-95. Fannie Mae's multifamily special affordable performance also exceeded its multifamily subgoals for both periods, but Freddie Mac fell short of its 1993-94 multifamily subgoal.

To summarize, Fannie Mae's goal performance in the 1993-95 transition period exceeded Freddie Mac's performance. Much of this difference in performance was due to Freddie Mac's relatively low level of multifamily purchases during the transition period (see next section). However, as this paper shows, there is also a significant difference between Fannie Mae and Freddie Mac in their relative purchases of affordable single-family mortgages.

In 1996, HUD established three "permanent" housing goals for 1996-99. The major change from the transition period was that the central cities goal was replaced by an underserved

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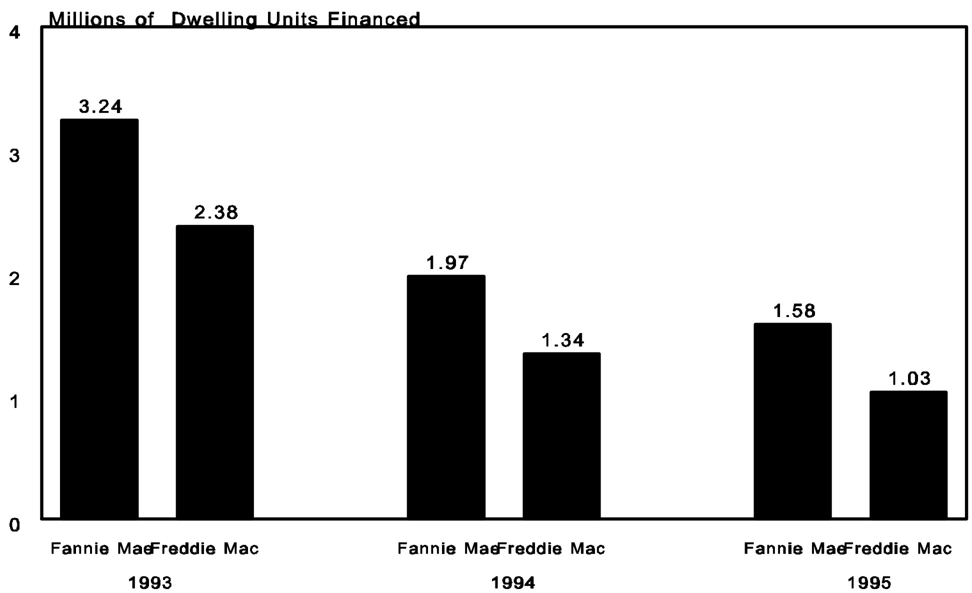
[6] For a full discussion of the transition period housing goals, see Chapter 3 of HUD's privatization study, Privatization of Fannie Mae and Freddie Mac: Desirability and Feasibility, A HUD Report, Office of Policy Development and Research, HUD, July 1996.

areas goal that targeted the GSEs' purchases to low-income and/or high-minority census tracts and nonmetro counties. In addition, the percentage target for the low- and moderate-income goal was increased from 30 percent to 40 percent in 1996 and to 42 percent for 1997-99. Appendix A defines the 1996-99 goals and shows the GSEs' purchases under these new goals during the 1993-95 period.

II. Overview of the GSEs' Mortgage Purchases

Fannie Mae and Freddie Mac are very large business operations, both in terms of mortgages purchased and total dwelling units financed (see Tables 2.A and 2.B). In 1995, Fannie Mae's mortgage purchases of $130 billion financed almost 1.6 million dwelling units, while Freddie Mac's mortgage purchases of $92 billion financed more than 1.0 million units. Reflecting market trends, both GSEs' purchases were somewhat lower in 1995 than in 1994, and their 1994 purchases were substantially lower than their purchases during the refinancing wave of 1993, when Fannie Mae purchased $294 billion in mortgages and Freddie Mac purchased $229 billion (see Figure 1.)

Figure 1
GSEs' Total Purchase Volume
1993-1995



Source: Table 1.

A. GSEs' Business by Major Property Type

Mortgages on One-Family Owner Properties. Mortgages purchased by the GSEs are primarily secured by one-family owner properties. Of all the housing units financed by the GSEs in 1995, 77 percent of Fannie Mae's units and 85 percent of Freddie Mac's units were in one-family owner properties (see Figure 2.) HUD estimates that such properties accounted for 67 percent of all dwelling units financed in the conventional conforming market.[7,8] Thus the GSEs,

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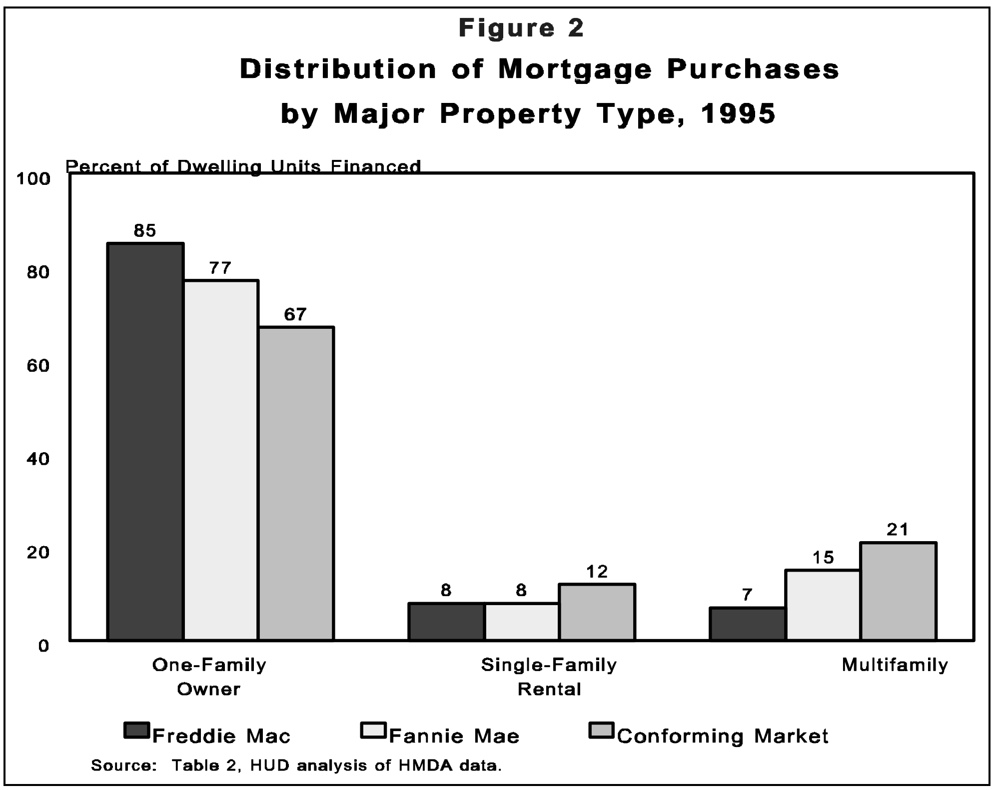
[7] The term "conventional" refers to mortgages that are not insured or guaranteed by a government agency such as the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), or the Rural Development Agency (RDA). The GSEs are restricted to purchasing loans with principal balances within the conforming loan limit, which was $203,150 in 1993-1995.

particularly Freddie Mac, focus their business substantially more on one-family owner properties than does the overall market.

Mortgages on Single-Family Rental Properties. The GSEs also purchase mortgages on single-family rental properties, which include 1- to 4-unit investor properties with no owner-occupied units and 2- to 4-unit properties that contain one owner-occupied unit and one or more rental units.[9] In terms of dwelling units, single-family rental mortgage purchases accounted for approximately 8 percent of each GSE's 1995 total purchases. HUD estimates that these properties typically account for at least 12 percent of the overall mortgage market.



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[8] See Appendix D of HUD (1995) for the methodology for determining the shares of mortgage originations accounted for by the different property types.

[9] Data on the volume of the GSEs' single-family rental purchases backed by 2- to 4-unit owner-occupied properties include the owner-occupied units.

Mortgages on Multifamily Properties. The GSEs also purchase mortgages on multifamily properties, defined as rental properties containing 5 or more units. Freddie Mac reentered the multifamily mortgage market near the end of 1993, thus it had negligible multifamily purchase volume for that year (only $191 million). In 1994, Freddie Mac was in the market for the entire year, as its multifamily mortgage purchases rose to $913 million. Freddie Mac's volume continued to rise in 1995, to $1.58 billion in multifamily mortgages. Despite the increases, Freddie Mac's multifamily purchases represented less than 2 percent of its total dollar purchases in 1995, and 7 percent of the total units it financed that year.[10] By comparison, HUD estimates that multifamily mortgages account for 21 percent of the total number of dwelling units financed in the conventional conforming market.

Fannie Mae has been far more active in the purchase of multifamily mortgages. Fannie Mae's multifamily purchases rose from $4.6 billion in 1993 to $6.1 billion in 1995. Fannie Mae's 1995 multifamily purchases represented 15 percent of the enterprise's overall business in terms of total units financed.

B. GSEs' Share of Market

The GSEs' purchases accounted for a rising share of the single-family conforming market between 1980 and 1993 (see Figure 3.) In the early 1980s, the GSEs' share ranged from 12 to 34 percent of the dollar volume of originations in the single-family conforming conventional market. In the high volume origination years of 1986 and 1987, the GSEs' share rose to about 45 percent, and then rose dramatically in the early 1990s, reaching a peak of 71 percent during the high refinancing year of 1993. In 1994, the GSEs' share of the conforming conventional market dropped to 55 percent, due primarily to a greater volume of conventional adjustable-rate mortgages (ARMs), as interest rates rose after the first quarter.[11] The GSEs' purchases as a share of total originations fell further to 43 percent in 1995, despite a decrease in the ARM share of the market; with higher interest rates in effect in 1995, many originators decided to hold their originations in their portfolios, rather than sell them to the GSEs.

The GSEs represent a much smaller share of the multifamily market than the single-family market. Based on HUD's Survey of Mortgage Lending Activity, approximately $37 billion in new multifamily mortgages were originated in 1995. Thus, the GSEs' combined purchases of $7.7

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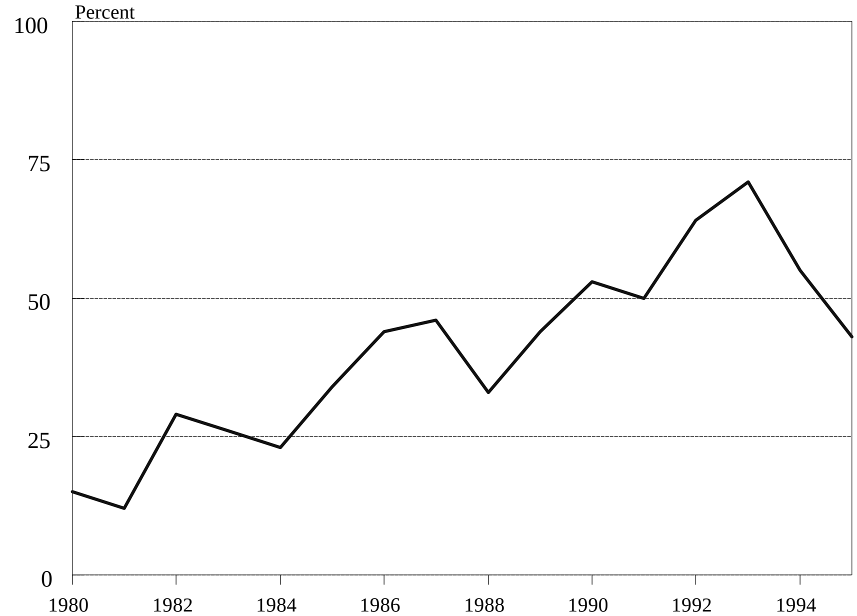
[10] Multifamily purchases consistently represent a greater percentage of total units than of the dollar amount of mortgages purchased. This reflects the fact that multifamily mortgages generally have a lower mortgage amount per unit than mortgages on one-family owner properties (e.g., $23,135 versus $96,777 for Freddie Mac's 1995 purchases).

[11] Banks and thrifts are less likely to sell ARMs, which involve little interest rate risk, than fixed-rate mortgages to the GSEs. They generally hold ARMs in their portfolios.

billion represented about 21 percent of the multifamily market. This percentage should increase as Freddie Mac has fully reentered that market since 1995.

Figure 3
GSEs' Purchases as Share of Conventional Conforming Market, 1980-95



Source: Fannie Mae Economics Department.

C. Conclusions

The section has provided a brief overview of the GSEs' mortgage purchases between 1993 and 1995. Following broad market patterns, the GSEs’ mortgage purchases reached record highs during the refinancing wave of 1993, but fell in 1994 and 1995 due to higher interest rates. However, in each year, the distribution of the GSEs’ purchases by major property type differed from the corresponding distribution of market originations--the GSEs' focus their business more on one-family-owner mortgage originations than the overall market. Their business, and particularly that of Freddie Mac, is less focused on single-family rental and multifamily mortgages than the overall market.

Since 1990, the GSEs have generally purchased more than 50 percent of single-family mortgages originated in the conforming conventional mortgage market, peaking at 71 percent in 1993, before declining to 55 percent in 1994 and 43 percent in 1995. In 1995, they accounted for only 21 percent of the multifamily mortgage market.

III. Loan, Borrower, and Neighborhood Characteristics of Mortgages Purchased by the GSEs

This section presents basic characteristics of the mortgages on one-family owner properties purchased by Fannie Mae and Freddie Mac. As reported in Section II, such mortgages accounted for 85 percent of the total units in properties whose mortgages were purchased by Freddie Mac and 77 percent of the total units in properties whose mortgages were purchased by Fannie Mae in 1995. Because they play an important role in the GSEs' activities, and because much more data are available on these loans than on mortgages for rental properties, the remainder of this paper analyzes these purchases in detail.[12]

Specifically, this section describes the characteristics of the mortgages purchased, the borrowers who took out these loans, and the neighborhoods in which the mortgaged properties were located. Because significant differences sometimes occur between borrowers who are purchasing homes and those who are refinancing existing loans, this section presents 1995 data for these two types of borrowers separately. In analyzing 1993-95 trends, the analysis focuses on the GSEs' acquisitions of home purchase loans only, because of the importance of homeownership to American families. Section IV compares the GSEs' purchases with mortgages originated in the primary market.

A standard set of definitions is used to describe borrowers and the metropolitan area census tracts (or non-metro counties) where mortgaged properties are located. These definitions are provided in Table 3.

A. Characteristics of Mortgages Purchased

Information on the financial and locational characteristics of single-family mortgages purchased by the GSEs between 1993 and 1995 is presented in Tables 4 and 5.

Reason for Loan. Almost all of the mortgages acquired by the GSEs are for the purchase of a home or the refinancing of an existing mortgage; second mortgages comprise a small percentage of their acquisitions, although the GSEs have increased their role in the secondary market for second mortgages since 1994. Both GSEs' home purchase mortgage acquisitions fell in 1994 and then rose somewhat in 1995, as shown in Table 4.

[12] See Segal and Szymanoski (1996, 1997) for an analysis of the GSEs' multifamily mortgage purchases.

With regard to refinance mortgages, each GSE's volume of acquisitions declined by more than one-half between 1993 and 1994, and by an additional 50 percent between 1994 and 1995. As a result of these developments, the share of the GSEs' purchases accounted for by refinance mortgages fell from almost 70 percent in 1993 to 33 percent in 1995.[13]

Seasoning. The GSEs have directed more of their purchases to seasoned mortgages (those originated in a previous year) since 1993.[14] In that year 14 percent of the mortgages they purchased were seasoned, but this share rose to 31 percent in 1994, before declining to 24 percent in 1995.

Mortgage Type and Term. The shares of mortgage originations accounted for by fixed-rate mortgages (FRMs) and by adjustable-rate mortgages (ARMs) depend on the level of interest rates (with the ARM share rising at higher interest rates, as borrowers' incentives to lock in low fixed rates decrease) and the difference (spread) between rates on FRMs and ARMs (with a smaller spread reducing incentives to take out ARMs). The ARM share of the market rose from 20 percent in 1993 to 39 percent in 1994, due to an increase in mortgage rates. The further increase in mortgage rates in 1995 was more than offset by a decrease in the FRM-ARM spread from 3.0 percentage points in 1994 to 1.9 percent in 1995, resulting in a decline in the ARM share of originations to 32 percent. The ARM share of GSEs' purchases followed these trends, rising from 9 percent in 1993 to 14 percent in 1994 and 21 percent in 1995 for Freddie Mac.[15]

After 1993 there were significant shifts in the market and in the GSEs' purchases away from 15-year fixed-rate mortgages, which had increased substantially during 1993, when historically low interest rates made monthly payments on shorter-term mortgages affordable to many middle-income homeowners. The 15-year FRM share of GSEs' purchases declined

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[13] The refinance share of total conventional mortgage originations was 50 percent in 1993, 25 percent in 1994, and just over 20 percent in 1995. Thus, refinance mortgages made up a higher percentage of the GSEs' purchases than of the overall market.

[14] Another definition of "seasoned mortgage" is one originated more than 365 days prior to acquisition by a GSE. The conclusions are essentially the same under either definition.

[15] As reported in Freddie Mac's Investor/Analyst Report, Second Quarter 1996, p.18.

accordingly, from 30 percent in 1993 to 21 percent in 1994 and 14 percent in 1995 for Freddie Mac.

Type of Seller. As shown in Table 4, mortgage companies accounted for almost 65 percent of the loans sold to the GSEs in 1995. Fannie Mae has relied much more on mortgage companies than Freddie Mac (68 percent versus 59 percent in 1995). In that year, Freddie Mac purchased 40 percent its mortgages from banks and thrifts, compared to only 29 percent for Fannie Mae.[16]

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[16] Some mortgage companies are owned by banks and thrifts, though the data provided to HUD by the GSEs does not separate such mortgage companies from independent mortgage companies. Over a longer time span, the role of mortgage companies in housing finance (both independent and depository-affiliated) has grown significantly.

Location of Mortgaged Properties. Fannie Mae and Freddie Mac also differ in their purchases in urban and rural areas.[17] In 1995, non-metropolitan areas accounted for 14.8 of Freddie Mac's purchases compared with 12.3 percent of Fannie Mae's purchases. The regional distributions of the GSEs' purchases reported in Table 5 largely reflect the distribution of primary market originations. Three Census regions accounted for about 60 percent of total business for both agencies in 1995: the East North Central, South Atlantic, and Pacific

B. Home Purchase Loans: Borrower Characteristics

There are systematic differences between borrowers who are purchasing homes and those who are refinancing existing loans, and these differences may have significant effects on the performance of the GSEs relative to the housing goals. Therefore, the GSEs' data on borrower and neighborhood characteristics are presented separately for home purchase and refinance loans.

In this subsection, trends for 1993-95 for four key borrower variables (income, race/ethnicity, first-time vs. repeat buyers, and down payment) are discussed for each GSE (see Tables 6 and 7). In general, the GSEs have increased their purchases of loans for lower-income and minority borrowers. To a certain extent, these changes in the GSEs' purchase patterns have simply reflected mortgage origination patterns in the primary mortgage market. However, as discussed below, some of the gains in the GSEs' affordable lending performance likely resulted from new affordable lending programs and outreach efforts initiated by the GSEs.

Borrower Income. Over the 1993-95 period, about 65 percent of the GSEs' home purchase mortgages went to borrowers with incomes above the area median income (AMI), with approximately half going to borrowers whose incomes exceeded 120 percent of AMI. Less than 9 percent of the GSEs' loans went to very low-income (VLI) borrowers, a figure below the VLI share of the primary conventional mortgage market.[18] Data for 1993-95 indicate that Fannie Mae's VLI share has consistently exceeded Freddie Mac's VLI share. Between 1993 and 1995, Fannie Mae's VLI share rose by 2.5 percentage points, from 6.8 percent in 1993 to 9.3 percent in 1995; Freddie Mac's VLI share increased by only 0.6 percentage point during this period, rising from 6.2 percent to 6.8 percent (see Table 7).

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[17] A more detailed analysis of the location of the properties financed by the GSEs is given in subsection III.C.

[18] Section IV contains a comparison of the characteristics of the GSEs' purchases with those of the overall conventional conforming market, based on HMDA data.

Race/Ethnicity. More than 80 percent of home purchase loans purchased by the GSEs in 1996 were made to white borrowers. In 1993, only 2-3 percent of the GSEs' home purchase mortgages went to African American borrowers, but by 1995 this had risen to 3-4 percent. Similar gains were also made for Hispanics, from 3-4 percent in 1993 to 4-6 percent in 1995. Both groups' shares have consistently been higher for Fannie Mae than for Freddie Mac, possibly due to Fannie Mae's somewhat greater concentration of business in metropolitan areas or to its greater emphasis on outreach to traditionally underserved borrowers during this period.[19]

First-time and Repeat Buyers. As housing has become more affordable, first-time homebuyers have played a more significant part in the market. These are typically people in the 25-34 year-old age group who purchase modestly-priced homes. Although the proportion of the population in this group decreased from 18 percent in 1985 to 16 percent in 1994, first-time homebuyers increased from about 40 percent of all buyers in the 1980s to 45 percent or more in recent years.[20] The GSEs lag the market in support for first-time homebuyer loans because many such buyers take out loans insured by the FHA. In 1995, 32 percent of Fannie Mae's home purchase loans were for first-time homebuyers, slightly above Freddie Mac's first-time homebuyer share (30 percent)-- both were well below the two-thirds of FHA-insured loans for first-time homebuyers.

Downpayments. Most of the mortgages that the GSEs purchase are originated with high downpayments. As shown in Table 6, 64 percent of the home purchase and refinance loans acquired by Fannie Mae in 1995 had a loan-to-value (LTV) ratio at or below 80 percent.[21] Such low-LTV (high-down payment) loans accounted for almost 70 percent of Freddie Mac's 1995 purchases. Home purchase loans are typically associated with lower downpayments. Still, more than half of the home purchase loans acquired by each GSE during 1994 and 1995 had an LTV

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[19] Differences between the GSEs could also result from differences in underwriting standards and business practices.

[20] See Chicago Title (1996) for data on first-time homebuyers.

[21] The GSEs are required by statute to have private mortgage insurance or some other form of credit enhancement on loans that they purchase with an LTV ratio greater than 80 percent.

ratio at or below 80 percent.[22]

Reflecting its greater orientation toward affordable lending during this period, Fannie Mae purchased a larger proportion of low-down payment loans (with an LTV ratio above 90 percent) than did Freddie Mac. Both GSEs increased their purchases of such low-down payment loans between 1993 and 1995, from 20 to 30 percent of home purchase loans for Fannie Mae and from 16 to 23 percent for Freddie Mac.[23]

[22] The remainder of the discussion on LTV ratios is taken from HUD (1996), pages 98-99. LTV ratios are not shown separately for home purchase loans and refinance loans in Table 6 because in 1997 the GSEs declared such data to be proprietary.

[23] Section V notes that the GSE-purchased loans for lower-income borrowers have lower LTV ratios than purchased loans for higher-income borrowers.

Gains in Affordable Lending. The gains in affordable lending reported above for the GSEs are consistent with the recent expansion of affordable lending programs in the primary market, both of which may in part reflect the emphasis placed by the GSEs on programs to meet the housing goals promulgated by HUD. Between 1993 and 1995, conventional lenders, the GSEs, and private mortgage insurers implemented numerous changes that extended homeownership opportunities to lower-income and minority households. The new initiatives focused on greater flexibility in underwriting, lower up-front mortgage costs, and greater market outreach to traditionally underserved borrowers. In addition, many State and local governments initiated programs to assist lower-income and first-time homebuyers with closing costs and downpayments. The GSEs have been heavily involved in this development, with new products such as Fannie Mae's Community Homebuyers Program and Freddie Mac's Affordable Gold Program.[24]

The GSEs' increased support for affordable housing is also consistent with continued low interest rates, minimal increases in housing prices, and strong economic growth since 1993. Although interest rates rose in 1994-95, the National Association of Realtors' affordability index fell only slightly from its 1993 peak, due to stable home prices and income growth. Housing was still more affordable in 1995 than in any year during the 1975-92 period.

C. Home Purchase Loans: Neighborhood Characteristics

Extensive research has been conducted using HMDA data and other information on issues of redlining and the extent to which lenders are meeting the credit needs of underserved areas. Such studies show substantial disparities between mortgage flows in neighborhoods of varying income levels and minority percentages.[25] This subsection examines the geographic characteristics of the metropolitan areas and neighborhoods containing properties with home purchase mortgages sold to Fannie Mae and Freddie Mac in the 1993-95 period.

Location of Mortgaged Properties in Metropolitan Areas. Almost two-thirds of each

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[24] For a discussion of the GSEs' recent affordability programs, see HUD (1996), pages 92-95.

[25] These studies are reviewed in detail in Appendix B of the Secretary's final rule regulating the GSEs, contained on pp. 61925-61958 of the December 1, 1995 Federal Register.

GSE's one-family-owner mortgage purchases were on properties in the suburbs in 1993-95.[26] Between 1993 and 1995, Fannie Mae's purchases shifted slightly from the suburbs toward central cities, which accounted for almost one-quarter of its one-family owner mortgages in 1995. In contrast, the central city share of Freddie Mac's one-family owner mortgage purchases declined by 2 percentage points between 1993 and 1995.[27]

Underserved Areas. HUD was directed by the 1992 GSE Act to expand and, as appropriate, modify the base for the geographically-targeted goal from central cities, the focus during the 1993-95 transition period, to include rural areas and other underserved areas for subsequent years. After a considerable amount of research on access to mortgage credit, the Department decided that the definition most consonant with Congressional intent was based on income level and minority composition for metropolitan census tracts and nonmetro counties, because such neighborhoods generally have low mortgage origination rates and high loan denial rates. Thus the geographically-targeted goal has been specified in this manner for 1996-99 (see Table 3).

Although the goals for the GSEs were not established on this basis for 1993-95, sufficient information is available from the data supplied by the GSEs to the Department to measure their purchases in such areas during this period. Table 7 shows that purchases of mortgages of properties located in underserved areas accounted for 21.3 percent of Fannie Mae's purchases in 1993, rising to 25.2 percent in 1995; the comparable figures for Freddie Mac were 19.4 percent in 1993 and 21.4 percent in 1995.

Income Level and Minority Composition of Neighborhood. Most home purchase mortgages acquired by the GSEs are on properties in low-minority areas and in areas with above average incomes (see Table 8). Specifically, more than half of each GSE's loans in 1995 were for properties in census tracts in which minority residents comprised less than 10 percent of the population, and about two-thirds were on properties in tracts with median tract incomes above the area median in each year from 1993 through 1995. High-minority low-income tracts accounted for less than 5 percent of home purchase loans sold to each GSE in 1995.

However, larger shares of both GSEs' home purchase loans were on properties in low-

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[26] Suburbs are defined as those portions of metropolitan statistical areas (MSAs) which are outside of central cities. Adjustments were made for split tracts -- i.e., those which cross central city-suburban boundaries.

[27] Single-family rental properties and multifamily properties are more likely to be in central cities than one-family owner properties; thus, the figures stated here understate the percentages of all units in central cities for both GSEs.

income tracts in 1995 than in 1993. Fannie Mae's share of loans in high-minority tracts also rose significantly, while the corresponding figure for Freddie Mac remained approximately constant, as shown in Table 7.

D. Refinance Loan Characteristics

Compared to home purchase borrowers, refinancing mortgagors in a heavy refinance year such as 1993 tended to be older, had higher incomes, were somewhat less likely to be African-American or Hispanic, tended to take out loans with significantly lower LTVs, and were somewhat more likely to live in the suburbs and high-income census tracts. For example, the percentage of Freddie Mac's refinance loans for low-income borrowers in 1993 was 13.3 percent, which was 3.7 percentage points lower than the corresponding percentage for home purchase loans.[28] Although low interest rates in the last few years have induced many borrowers to refinance soon after their mortgages were originated, refinancing mortgagors more typically have been able to build up equity by virtue of having owned their home for some length of time, thus their LTVs are lower.

Some of the same trends were experienced from 1993 to 1995 for refinance loans as for home purchase loans -- proportionally more low-income borrowers took out loans, a larger share of refinance mortgages went to African-Americans and Hispanics, and higher percentages were for properties located in low-income and high-minority tracts.

E. Conclusions

This section has described basic characteristics of the mortgages that the GSEs purchased between 1993 and 1995. Four general points can be gleaned from this discussion. First, GSE purchases depend importantly on what is happening in the overall mortgage market. For instance, GSE purchase activity tends to increase during low-interest-rate periods when borrowers are refinancing into fixed-rate mortgages, and to decrease during high-interest-rate periods when borrowers are switching to ARMs.

Second, there appear to be some fundamental differences between the purchase strategies of the two GSEs. For example, Freddie Mac depends more on thrift institutions and commercial banks for its loans than does Fannie Mae, which relies more on mortgage bankers. Fannie Mae's purchases are more focused on urban areas than Freddie Mac's purchases.

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[28] In a low refinance year such as 1995 some of these differences did not appear--for example, for Freddie Mac the percentage of refinancing borrowers with low income was approximately 2 percentage points higher than the percentage of home purchase borrowers with low income. This suggests that higher-income families are better able to refinance their mortgages at the lowest rates in the interest rate cycle.

Third, there were significant increases between 1993 and 1995 in the GSEs' support for groups traditionally underserved by the mortgage market. For example, loans for African-American and Hispanic families increased from 6.5 percent of Fannie Mae's purchases in 1993 to 10.6 percent in 1995, with the corresponding increase for Freddie Mac from 5.1 percent to 7.3 percent.

Finally, Fannie Mae provided more funding support for disadvantaged borrowers and their neighborhoods than Freddie Mac in this period. Fannie Mae's performance exceeded Freddie Mac's on all the affordable lending categories examined in this section.

IV. GSEs' Purchases Compared with Originations in the Primary Market[29]

A. Introduction

The data reported in Section III on the characteristics of the GSEs' purchases are difficult to interpret without similar data for the overall market. A key policy question is the extent to which the GSEs' purchases of affordable loans follow or depart from the pattern of mortgage originations in the primary conventional conforming market. The enterprises have stated that their loan purchases reflect the primary mortgage market's origination patterns across different income and racial categories of borrowers, and that their funding for historically underserved borrowers is comparable to that of mortgage portfolio lenders.[30] Other analysts, however, have reached different conclusions -- reporting that the GSEs' record of funding for lower-income borrowers and underserved neighborhoods is not commensurate with the performance of portfolio lenders.[31]

Comparisons of the GSEs with the primary market are based on data provided in accordance with the Home Mortgage Disclosure Act ("HMDA data") for single-family owner home purchase loans. HMDA data provides information on total originations in the conforming conventional mortgage, on mortgages that are sold to each of the GSEs, and on originations not sold to the GSEs. Most mortgages not sold to the GSEs are originated by depository institutions

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[29] This section is adapted from Harold Bunce and Randall M. Scheessele, "The GSEs' Funding of Affordable Loans", Housing Finance Working Paper No. HF-001, Office of Policy Development and Research, Department of Housing and Urban Development, December, 1996.

[30] For example, in its 1995 report, "Financing Homes for a Diverse America", Freddie Mac concluded that the income and racial characteristics of borrowers whose loans it purchased were very similar to those of the overall conventional conforming market.

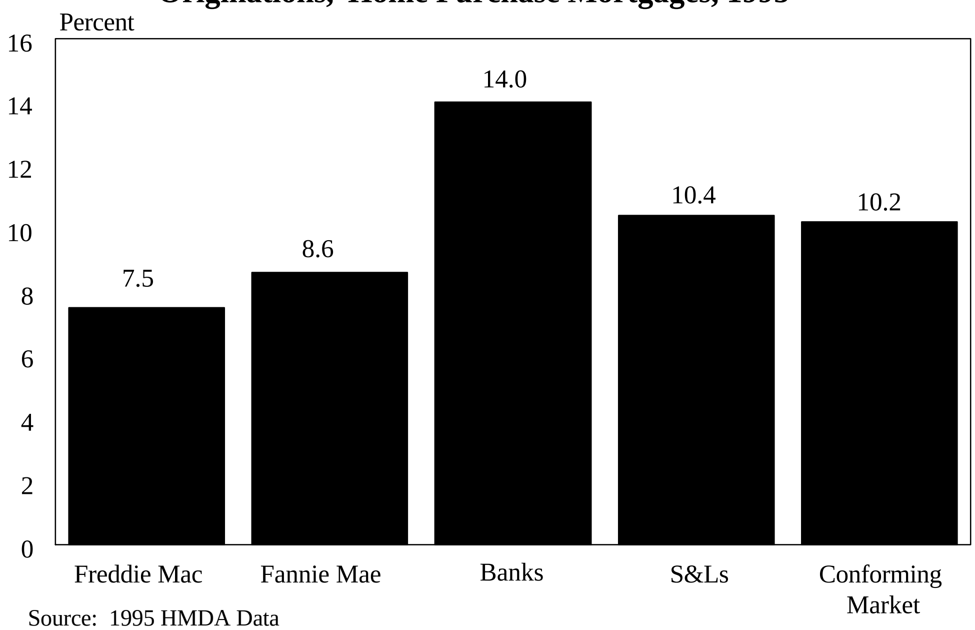
[31] See Canner and Passmore (1995), HUD (1995, 1996), Lind (1996a,b), and Canner et al. (1997).

(banks and thrifts) and held in their portfolios.

Overview and Main Findings. Subsections B and C report that the shares of Fannie Mae's and, especially, Freddie Mac's purchases of mortgages for lower-income borrowers and underserved neighborhoods fell short of the corresponding shares of other market participants in recent years. Subsection D finds that the GSEs significantly improved their affordable lending performance between 1992 and 1995, with the gains for Fannie Mae exceeding those for Freddie Mac. Fannie Mae's improvement allowed it to narrow the gap between its affordable lending performance and that of other lenders in the conforming mortgage market. During this period, Freddie Mac's improvement was not always great enough to keep it in step with Fannie Mae and other lenders in the market. In some cases, Freddie Mac's purchases of mortgages from certain types of lower-income borrowers and neighborhoods actually declined relative to the market over this period. Conclusions are presented in subsection E.

B. Comparison of Borrower and Neighborhood Characteristics: Mortgages Originated in the Market and Mortgages Purchased by the GSEs

Figure 4
Very-Low-Income Share s of GSEs' Purchases, Retained Mortgages, and Market Originations, Home Purchase Mortgages, 1995



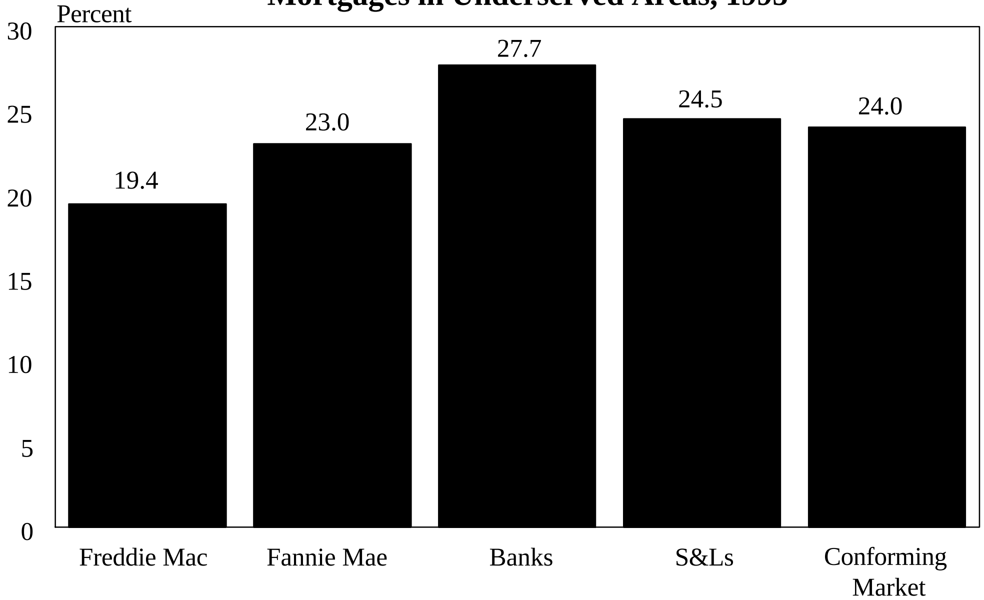
Source: 1995 HMDA Data

Data on "distribution of business" percentages indicate the importance of various borrower and neighborhood characteristics in the mortgage operations of the major mortgage market participants; in Table 9, these are compared with the same characteristics of all loans originated in the conventional conforming market in 1995.[32] Loans purchased by the GSEs were less likely to be taken out by lower-income families than were loans retained by portfolio lenders, especially commercial banks.[33] For example, very low-income borrowers accounted for 7.5 percent of loans purchased by Freddie Mac, 8.6 percent of loans purchased by Fannie Mae, and 14.0 percent of loans retained by banks (see Figure 4.) African-American borrowers accounted for 3.9 percent of loans sold to Freddie Mac and 5.2 percent of loans sold to Fannie Mae, compared with 5.8 percent of loans retained by banks. On the other hand, Hispanic borrowers accounted for a larger share of loans sold to Fannie Mae (7.3 percent) than loans retained by banks (5.5 percent).

[32] The HMDA data are restricted to home purchase mortgages with valid metropolitan tracts only. Mortgages with a balance less than $15,000 and mortgages where the loan amount is more than six times borrower income have been excluded from this analysis. Two definitions of the conforming home purchase mortgage market are included in Table 9 -- one that excludes loans originated by forty-two B&C lenders and nine manufactured housing lenders and one that includes them. The text focuses on the GSEs' share of the conforming market excluding B&C and manufactured housing loans. Appendix A of Bunce and Scheessele (1996) discusses the GSEs' arguments that these loans should not be included in market comparisons with their purchases, and also discusses additional adjustments to the HMDA data.

[33] The HMDA data in Table 9 on GSE purchases by various racial and income categories is quite similar to the GSE loan-level data reported in Section III, generally differing by only a percentage point. Tables A.1 and A.2 in Bunce and Scheessele (1996) contain comparisons of the loan-level data that the GSEs provide to HUD with HMDA data on GSE purchases.

Figure 5
Shares of GSEs' Purchases, Retained Mortgages, and Market Originations of Home Purchase Mortgages in Underserved Areas, 1995



Source: 1995 HMDA Data.

Neighborhood data in Table 9 show similar differentials between the GSEs and banks. Low-income census tracts accounted for 7.7 percent of loans sold to Freddie Mac and 9.5 percent of loans sold to Fannie Mae, compared with 13.1 percent of loans retained by banks in 1995. High African-American neighborhoods[34] accounted for 3.2 percent of Freddie Mac's loans and 4.2 percent of Fannie Mae's loans, compared with 5.4 percent of loans retained by banks. However, high-minority census tracts (those in which African-Americans, Hispanics, and Asian-Americans are at least 30 percent of total population) accounted for a larger proportion of the loans purchased by Fannie Mae (15.4 percent) than of the mortgages retained by banks (13.1 percent). With regard to lending in underserved areas (as defined by HUD), in 1995 the GSEs lagged behind commercial banks and thrift institutions, as shown in Figure 5.

In general, the HMDA data show that the GSEs are not doing as good a job as portfolio lenders in funding disadvantaged borrowers and neighborhoods. Freddie Mac's affordable lending performance, in particular, stands out as lagging other sectors of the market. Fannie Mae funds disadvantaged borrowers and underserved neighborhoods at a much higher rate than Freddie Mac, which agrees with the findings reported in Section III. In fact, Fannie Mae's performance in some instances approaches or exceeds that of the thrift industry.

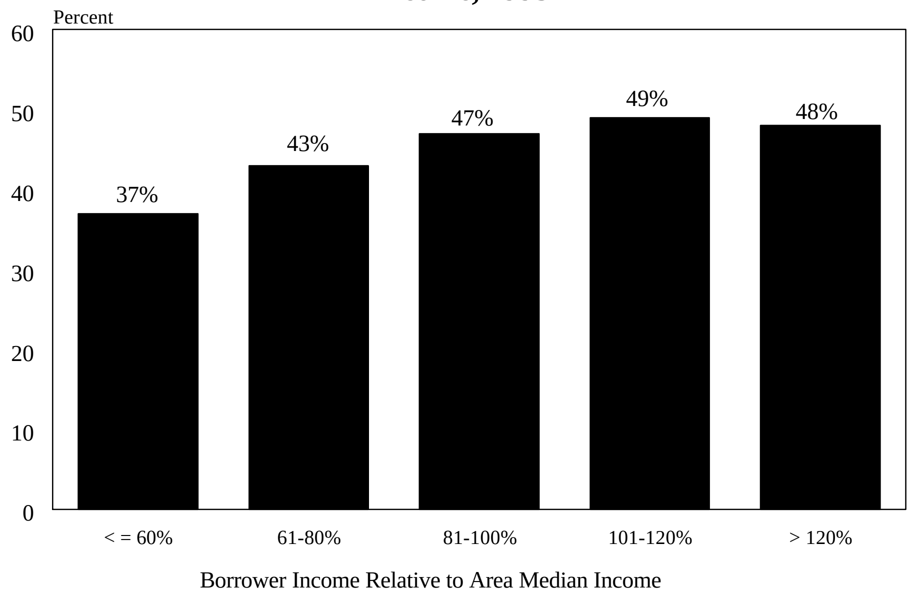
C. GSEs' Purchases as Shares of Mortgages Originated in the Market by Borrower

[34] High African-American neighborhoods are census tracts where African-Americans account for at least 30 percent of the tract population.

and Neighborhood Characteristics

The GSEs' purchases as shares of all conforming conventional loans originated provide another measure of the GSEs' role in providing funding for various types of borrowers and neighborhoods (see Table 10.) While the GSEs purchased 37 percent of loans made to very low-income borrowers, they bought 48 percent of loans made to high-income borrowers (see Figure 6.) The GSEs purchased 40 percent of loans taken out by African-Americans, 47 percent of

Figure 6
GSEs' Home Loan Purchases as Share of Conforming Conventional Market, by Borrower Income, 1995



Source: 1995 HMDA data.

Hispanics' loans, and 45 percent of non-Hispanic whites' loans. Thus the GSEs play a more important role in the higher-income, white, and Hispanic markets than they do in the markets for lower-income and African-American borrowers.

Similar results are obtained from a comparison of neighborhood characteristics for loans originated and loans purchased by the GSEs. The GSEs' share of the market in 1995 increased from 41 percent of originations in low-income tracts to 53 percent of the loans in high-income tracts. The data for minority composition of the tract show a more mixed pattern. The GSEs purchased 41 percent of the loans in high-African-American tracts, compared with 50 percent of the loans in predominantly white tracts. However, the GSEs' share of the market did not vary much with regard to the percent of the tract population accounted for by all minorities (i.e., African-Americans, Hispanics, and Asian-Americans). The GSEs purchased 45 percent of the loans made on properties in underserved areas, as defined by HUD, compared with 51 percent of the loans made on properties in other areas.

Broader Market Definition. The market shares discussed above exclude most manufactured housing (MH) and B&C loans made by specialized lenders from the market totals because such loans have generally not met the GSEs' underwriting criteria.[35] The last column of Table 10 presents data on the GSEs' share of each market segment using a broader market definition that includes these two loan types, thus providing a more comprehensive picture of the GSEs' affordable purchases relative to the total conforming market. The GSEs purchased 30 percent of all conforming loans made to very low-income borrowers, and 45 percent of all loans for borrowers with incomes exceeding 120 percent of area median -- a larger differential between their roles at various income levels than that reported above. Similarly, the GSEs' share of this broader market in 1995 varied more with the income of the census tract -- from 36 percent of all loans in low-income tracts to 51 percent in high-income tracts. As expected, these data show a heavier concentration by the GSEs on the "higher end" of the market than the earlier comparisons, which excluded specialized lenders' manufactured housing and B&C loans from the analysis.

D. Affordable Lending: Trends and the GSEs' Role

The HMDA data show clearly that the GSEs lagged the overall market in 1995 in serving disadvantaged groups. An additional issue is whether the GSEs have improved their affordable lending performance relative to the primary market between 1992 and 1995.

Section II noted that the GSEs, private lenders, and private mortgage insurers have all markedly increased their outreach efforts and have developed new products aimed at serving lower-income and minority borrowers and their communities during the 1990s. Data on trends in affordable lending suggest that these industry initiatives are working (see Table 11.) Loans to lower-income families and minorities increased substantially as a share of all loans between 1992 and 1995. For example, very low-income families' share of home purchase loans increased by 34 percent during this period, from 7.6 percent to 10.2 percent. Similarly, the combined share for African-Americans and Hispanics increased by 53 percent, from 7.5 percent to 11.5 percent. Low interest rates, income growth, and moderate house price inflation made homeownership very affordable during this period, but most observers think that the new industry initiatives were also an important factor explaining the substantial improvement in lending to lower-income and minority families.

Performance of GSEs Relative to Depositories. GSEs and depositories (banks and

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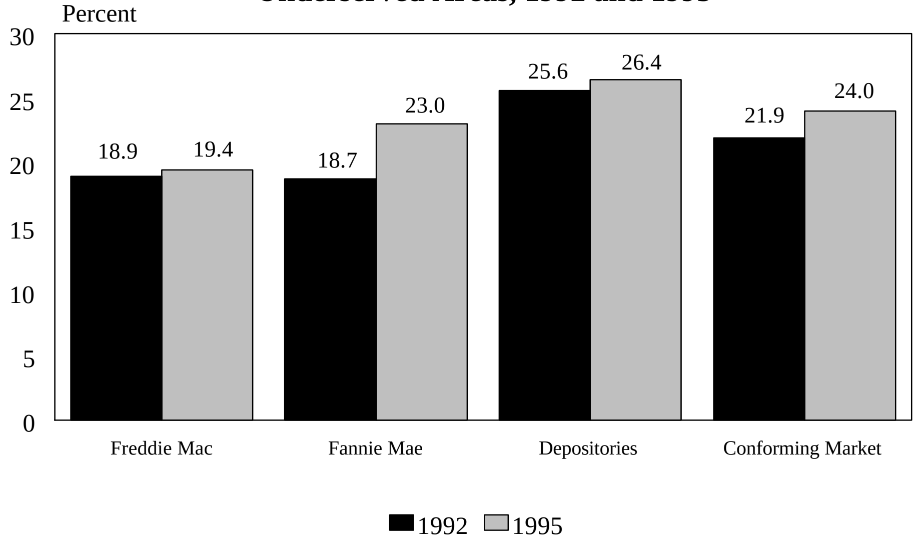
[35] Manufactured housing and B&C loans originated by depository institutions could not be separately identified and thus are included in all the analyses. Bunce and Scheessele (1996) argue that including these loans in the depository data is appropriate given that the GSEs and the depositories both receive substantial benefits from the Federal government. See Bunce and Scheessele for the various arguments for including (and excluding) manufactured housing and B&C loans from the market comparisons.

thrifts) both improved their affordable lending performance between 1992 and 1995. Fannie Mae significantly improved its affordable lending performance relative to depositories, which is consistent with the many special programs it has initiated over the past few years. For example, in 1992 very low-income (VLI) borrowers accounted for 5.1 percent of Fannie Mae’s home loan purchases and 10.4 percent of home purchase loans retained by depositories, for a "Fannie Mae-to-depositories VLI performance ratio" of 0.49 (5.1/10.4). By 1995, this ratio rose to 0.69 (8.6/12.5) -- that is, the VLI share of Fannie Mae’s purchases had increased from 49 percent to 69 percent of the depositories' VLI share.

In most cases Freddie Mac also improved its performance relative to depositories, but not as much as Fannie Mae. Freddie Mac's very-low-income share (5.2 percent) was slightly greater than Fannie Mae's in 1992, but its VLI share increased by less, to 7.5 percent, by 1995. Thus the "Freddie Mac-to-depositories VLI performance ratio" increased from 0.50 in 1992 to 0.60 in 1995, while Fannie Mae's ratio increased from 0.49 to 0.69 over the same period, as discussed above. With regard to underserved areas, the "Freddie Mac-to-depositories ratio" declined slightly (from 0.74 in 1992 to 0.73 in 1995), while Fannie Mae's ratio increased from 0.73 to 0.87. (See Figure 7.)

Performance of GSEs Relative to the Overall Conforming Market. Table 11 also reports (in parentheses) the shares of GSEs’ loans relative to the shares of the overall conforming conventional market. The shares of Fannie Mae's purchases for lower-income and minority borrowers and their neighborhoods have increased markedly relative to the corresponding shares for the overall market. In fact, Fannie Mae's improvement eliminated the gap between its performance and that of the market in some cases (e.g., African-American and Hispanic borrowers). However, the shares of its mortgages for some borrowers and neighborhoods (e.g., VLI borrowers and properties in high African-American tracts) continue to be below the primary market’s shares.

Figure 7
Shares of GSEs' Purchases Depositories' Retained Mortgages, and Conforming Market Originations of Home Purchase Mortgages in Underserved Areas, 1992 and 1995



Source: 1992-95 HMDA Data.

Freddie Mac's improvements between 1992 and 1995 were not large enough to significantly reduce its affordable lending gap relative to the conforming market. For several socioeconomic categories examined here, Freddie Mac's performance either declined relative to the market or showed only very slight increases. For example, the "Freddie Mac-to-market" ratio for low-income census tracts declined from 0.79 in 1992 to 0.73 in 1995, while the ratio for African-American borrowers increased slightly from 0.71 to 0.74.

E. Conclusions

This section has analyzed HMDA data to place the GSEs' affordable lending performance in perspective. Between 1992 and 1995, Fannie Mae improved its performance relative to both depositories and the overall market. In 1995, the share of Fannie Mae's loans exceeded or was close to the market for several categories (e.g., Hispanic and African-American borrowers, high-minority tracts, underserved areas); however, Fannie Mae's performance fell significantly short of portfolio lenders (especially commercial banks) on most dimensions of affordable lending.

Between 1992 and 1995, Freddie Mac improved its performance relative to portfolio lenders but not relative to Fannie Mae and the overall market. In fact, Freddie Mac started the period purchasing affordable mortgages at the same rate as Fannie Mae; but by 1995, Freddie Mac had been outpaced by Fannie Mae in purchasing affordable loans. Freddie Mac's 1995 performance also fell significantly short of both portfolio lenders and the overall conforming market on all dimensions of affordable lending.

There are several reasons why portfolio lenders might serve disadvantaged groups better than the GSEs. Canner and Passmore (1995) pointed out that portfolio lenders have extensive knowledge of their communities, which they are able to utilize to manage credit risk. In addition, they may have direct interactions with their borrowers, further enabling them to assess credit risk more accurately. These factors allow portfolio lenders to underwrite loans more flexibly than firms strictly following the GSEs' guidelines. Secondary market firms such as the GSEs must set underwriting standards more strictly to compensate for the fact that they do not have such detailed knowledge.

Another important factor influencing the types of loans held by portfolio lenders is the Community Reinvestment Act (CRA), which requires depository institutions to help meet the credit needs of their communities. CRA provides an incentive for portfolio lenders to initiate affordable lending programs with underwriting flexibility, and the loans are often held in portfolio because they do not conform to the GSEs’ underwriting standards.

These factors may explain why portfolio lenders are retaining disproportionally high shares of the affordable loans that they originate.   However, in the 1992 GSE Act, Congress stated that it expected the GSEs to meet public purposes in return for the sizeable benefits that accrue to them from their Federal charters. Specifically, Congress referred to the ability of the GSEs to “lead the industry” in the financing of homes for lower-income borrowers and for properties in underserved neighborhoods. Based on the findings of this section, the GSEs, especially Freddie Mac, have some ways to go before they accomplish this objective.

V. GSEs' Purchases of Loans on One-Family Owner Properties: Analyses of Special Topics

The previous sections have presented basic characteristics of the GSEs' purchases of loans on one-family owner-occupied properties and have compared the GSEs' activities with primary market originations and mortgages retained by depositories. This section extends that analysis by using the loan-level data that the GSEs submit to HUD to address a variety of more specialized topics. Issues discussed in this section include the characteristics of first-time homebuyers, low- and moderate-income borrowers, and minority homebuyers; loan-to-value (LTV) ratios by income level; and the relationship between income and neighborhood characteristics. Finally, analyses of the characteristics of the loans and borrowers in Fannie Mae's community lending programs are presented, and comparisons are made with Fannie Mae's total purchases.[36]

A. First-Time Homebuyer Characteristics

As discussed in Section III, first-time buyers have been a major factor in the housing market in the 1990s, accounting for almost 50 percent of all homebuyers. The GSEs have been less active in this market, with about 30 percent of their home purchase loans between 1993 and 1995 going to first-time homebuyers.[37]

First-time Homebuyers and Other Mortgagors. As shown in Table 12, first-time homebuyers whose loans were purchased by the GSEs were younger, had lower incomes, and were more likely to be minority group members than other mortgagors (i.e., repeat buyers plus refinancers). For example, 27 percent of first-time homebuyers with Fannie Mae-purchased loans in 1995 were low-income families, compared to 17 percent of other mortgagors. In addition, first-time buyers more frequently took out loans with high loan-to-value ratios and tended to buy more often in lower-income and higher-minority neighborhoods and in central cities. As reported

[36] Freddie Mac's specialized community lending program has not been analyzed because it was much smaller than Fannie Mae's program during this period-- Freddie Mac has traditionally placed more emphasis on using its standard program to fund affordable mortgages.

[37] In contrast, about two-thirds of FHA's home purchase mortgages are for first-time homebuyers. With respect to the total market (FHA, VA and conventional), Chicago Title (1996) reported that first-time homebuyers accounted for 46 percent of all homebuyers in 1995.

in HUD's privatization study, the share of first-time buyers with loan-to-value ratios over 90 percent was about twice the share for other mortgagors for both GSEs.[38] Still, a surprisingly large percentage of the GSEs' first-time homebuyer loans have had high downpayments--in 1995, 35 percent of Fannie Mae's and 41 percent of Freddie Mac's first-time homebuyer loans had downpayments of 20 percent or more.

Still, most differences between first-time homebuyers and other mortgagors are a matter of degree. As shown in Table 12, the bulk of first-time buyers are similar to other mortgagors in many respects -- they have above-median incomes and buy outside of central cities and minority and low-income neighborhoods. As noted above, while first-time buyers generally put less money down at closing than other mortgagors, a large percentage put down more than 20 percent.

Differences Between the GSEs. Fannie Mae and Freddie Mac are generally similar with regard to the characteristics of their mortgagors other than first-time homebuyers. They exhibit larger differences in the characteristics of their first-time buyer mortgages. Relative to Freddie Mac, Fannie Mae more frequently purchased loans made to such buyers in low-income and high-minority neighborhoods and in central cities, and their first-time homebuyers were more likely to be low-income or minority borrowers.

B. Low- and Moderate-Income Borrower Characteristics

Demographics. Relative to borrowers with incomes greater than the area median, low- and moderate-income ("low-mod") borrowers are younger, more often minority group members, and more frequently first-time homebuyers (see Table 13.) They more frequently purchase in low-income and high-minority tracts and in central cities. Despite their lower incomes, and presumably lower assets, low-mod borrowers do not have higher loan-to-value ratios, an issue examined further in the next subsection.

Low-mod borrowers are as likely as higher-income borrowers to purchase in the suburbs. Nearly 25 percent buy in tracts with median incomes above 120 percent of the area median, compared to 43 percent of borrowers with incomes above the median. One out of every seven low-mod borrowers buys in low-income tracts.

Differences Between the GSEs. There are systematic differences between the GSEs' low-mod borrowers. Higher percentages of Fannie Mae's borrowers are younger, minority group members, first-time homebuyers, and have high loan-to-value ratios than Freddie Mac's borrowers, and a greater percentage of the properties are in low-income and high-minority tracts and in central cities. For example, 19.7 percent of Fannie Mae's low-mod purchases in 1995 were on properties in tracts with minority population exceeding 30 percent; the corresponding figure for Freddie Mac was 14.9 percent.

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[38] See Privatization of Fannie Mae and Freddie Mac: Desirability and Feasibility, A HUD Report, July 1996, p. 99.

C. LTV Ratios by Income Level

Lower-income households are constrained in two ways from becoming homeowners. Their incomes limit the monthly mortgage payment for which they can qualify and also make it more difficult for them to accumulate a down payment. Table 14 examines the distribution of loan-to-value ratios by borrower income and other characteristics for the GSEs' home purchase mortgages in 1995.[39]

Surprisingly, lower-income borrowers did not have higher loan-to-value ratios than other income groups, despite their greater difficulty in accumulating a down payment. About 19 percent of very low-income borrowers had LTV ratios over 90 percent, which was about the same as the corresponding percentage for higher-income borrowers. In addition, very low-income borrowers were more likely to have larger downpayments than all higher-income groups. In 1995, 71 percent of very low-income borrowers had LTV ratios less than 80 percent, compared with about 64 percent of borrowers in higher-income groups.

Other Characteristics. Aside from borrower income, the relationship between loan-to-value ratio and other characteristics is more in line with expectations. Groups expected to have fewer assets for a large down payment, such as first-time homebuyers, minorities, and those who purchase in low-income tracts or high-minority tracts, were more likely to have high-LTV mortgages than the average borrower (see Table 14.) For example, in 1995, almost 25 percent of loans in low-income census tracts had an LTV ratio over 90 percent, compared with 15 percent of loans in high-income tracts.

D. Minority Homebuyer Characteristics

First-time homebuyers were more prevalent among minority buyers than among non-minority buyers, and a higher percentage of minority homebuyers purchased in low-income and high-minority tracts (see Table 15.) Minorities also purchased more frequently in urban areas and less frequently in rural areas. African-American borrowers tended to be older than non-minority borrowers, or other minority borrowers, while Hispanic and Asian-American homebuyers tended to be younger than non-minority borrowers. Hispanics and African-Americans were much more likely than whites to have high-LTV loans.[40] In 1995, 42 percent of Fannie Mae's African-American borrowers had LTV ratios in excess of 90 percent, compared with 19 percent of white borrowers; the corresponding figures for Freddie Mac's borrowers were 31 percent and 15 percent.

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[39] To simplify the analysis, data are combined for the two GSEs since there is little difference between them in the relationship of LTV ratios to the other variables in Table 14.

[40] African-Americans have fewer assets than whites, even after controlling for income. See Susan M. Wachter and Isaac F. Megbolugbe, "Racial and Ethnic Disparities in Homeownership," Housing Policy Debate, 1992, pages 333-370.

E. Relationship Between Borrower Income and Neighborhood Characteristics

A common assumption is that borrowers in low-income and high-minority tracts are mostly low-income families. In fact, there is much diversity in the characteristics of the borrowers in such tracts (see Table 16.) These areas do have higher proportions of lower-income and minority borrowers than tracts with higher incomes and smaller minority populations. However, higher-income borrowers still have a significant presence in the lower-income tracts. In 1995, 41 percent of borrowers in low-income tracts had above-median incomes. Above-median-income borrowers comprised 57 percent of all borrowers in high-minority tracts. In census tracts that were both low-income and high-minority, these higher-income borrowers accounted for 41 percent of home purchase loans in 1995.

F. Characteristics of Community Lending Mortgages

This section reviews characteristics of loans designated by the GSEs as "community lending mortgages," that is, loans in programs particularly structured to lower-income borrowers who may have difficulty meeting traditional down payment requirements. This section draws from Chapter 4 of HUD's privatization study (HUD, 1996).

Volume of Activity. Fannie Mae has been the more active of the two GSEs in the designated community lending area, with 86,000 such loans reported to HUD in 1995, compared with 10,000 community lending loans reported by Freddie Mac. Fannie Mae had a higher volume of these loans in 1994 (93,000), which was a sharp increase from 55,000 loans of this type in 1993. Freddie Mac's 1995 community lending business was a jump from 5,000 loans in 1994 and 6,000 loans in 1993.

Differences between Community Lending Mortgages and Other Mortgages. Because of their greater volume of such designated mortgages, comparisons between community lending home purchase mortgages and total book of business are discussed for Fannie Mae only. In general, community lending mortgages went disproportionately to disadvantaged groups over the time period.

- Community lending mortgages had higher loan-to-value ratios than Fannie Mae's overall business in 1995 -- 79 percent of the former had LTV ratios over 90 percent in 1995 (up significantly from 1993), versus 35 percent of the latter.

- Sixty-two percent of community lending mortgages and 45 percent of total loans were for low-income families.

- Thirty percent of Fannie Mae's community lending loans were for African-American or Hispanic borrowers in 1995 (an increase over 1993), nearly twice the percentage of their total business for these groups.

- Fifty-six percent of community lending loans were for first-time homebuyers in 1995 (an increase from 1993), but only 31 percent of all home purchase mortgages were in this category.

- Other characteristics: Fannie Mae's community lending loans were somewhat less likely than total loans to be made on suburban properties, more likely to be on properties in low-income census tracts, and somewhat more likely to be made on properties in high-minority tracts.

G. Conclusions

The analyses reported in this section have yielded both expected and unexpected conclusions about the characteristics of the loans that the GSEs purchase. First, as anticipated, in comparison with repeat buyers, first-time homebuyers were younger, had lower incomes, were more likely to be members of minority groups, and took out loans with higher loan-to-value ratios. Also, minority homebuyers were more frequently first-time buyers than non-minority buyers, and purchased more frequently in low-income and high-minority tracts of urban areas, and less frequently in rural areas.

Second, somewhat surprisingly, low- and moderate-income borrowers were as likely as higher-income borrowers to purchase homes in the suburbs, and nearly 30 percent bought in tracts with median incomes greater than 120 percent of area median. And high loan-to-value ratio loans were found as often among low-income borrowers as among middle- and high-income borrowers.

Third, the data showed a significant amount of income diversity in low-income and high-minority tracts. For example, in 1995, borrowers with above-median incomes comprised 41 percent of borrowers in low-income tracts and 57 percent of all borrowers in high-minority tracts.

Finally, consistent with expectations, community lending loans purchased by Fannie Mae in 1995 differed dramatically from other loans purchased by Fannie Mae. For example, they exhibited much higher shares for low-income and minority families and for first-time homebuyers.

Appendix A
GSEs' Housing Goals for 1996-99

In December 1995 the Secretary established three goals for Fannie Mae and Freddie Mac:

- **A low- and moderate-income goal**, set at 40 percent for 1996 and 42 percent for 1997-99--i.e., for each year, 1997-99, at least 42 percent of total units financed by each GSE's mortgage purchases would have to be (1) owner-occupied units for which the borrower's income is less than or equal to area median income or (2) rental units with rents (adjusted for unit size) not in excess of 30 percent of area median income;

- **A geographically-targeted goal**, set at 21 percent for 1996 and 24 percent for 1997-99--i.e., for each year, 1997-99, at least 24 percent of total units financed by each GSE's mortgage purchases would have to be owner-occupied or rental units in "underserved areas," defined as metropolitan census tracts and nonmetropolitan counties with (1) median tract [county] income less than or equal to 90 percent of area median income [95 percent in nonmetropolitan areas] or (2) minority concentration of at least 30 percent with median tract or county income no greater than 120 percent of area median income; and

- **A special affordable goal**, set at 12 percent for 1996 and 14 percent for 1997-99--i.e., for each year, 1997-99, at least 14 percent of total units financed by each GSE's mortgage purchases would have to be owner-occupied units for which the borrower's income is less than or equal to (1) 60 percent of area median income (very low-income families) or (2) if located in a low-income census tract or nonmetropolitan county, 80 percent of area median income (low-income families in low-income areas), or rental units affordable at these income levels.

Although the GSEs' goals were not formulated on the same basis for 1993-95, loan-level data provided by the GSEs has allowed the Department to calculate what their performance would have been in those years under the 1996-99 goal structure. These results are shown in Table A.1.

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