Executive Summary

Chapter 1. Conceptual Overview and Study Design

- The benefits of homeownership to both individuals and society are well known. It is not surprising, then, that policymakers have adopted a variety of approaches to promote homeownership in the United States. Among these approaches are the special rights and privileges given to the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. The GSEs are expected, indeed mandated, to "lead the mortgage finance industry in making credit available for low- and moderate-income families" (Lind 1996).

- Most studies have argued that the GSEs did not lead the market during the 1990s. The U.S. Department of Housing and Urban Development (HUD) (2000a) itself said that, "Obviously, the GSEs are not leading the industry in financing units that qualify for the housing goals," and that, "A wide variety of quantitative and qualitative indicators demonstrate that the GSEs have ample, indeed robust, financial strength to improve their affordable lending performance."

- It is particularly important to determine what changes, if any, have occurred in the GSEs' underserved market performance since new affordable housing goals were adopted in 2000. This study, therefore, replicates and extends previous work (Williams and Bond 2002; Williams, McConnell, and Nesiba 2001) to cover the years after the new affordable housing goals were established. Via three different approaches, we ask if the GSEs are leading and how is this leadership manifested in the real world? We do not claim that any one strategy alone can provide definitive proof one way or the other of GSE leadership, but, although alternative explanations may be possible for any single finding, the body of evidence as a whole provides a clear picture.

- First, we compare the GSEs' performance with that of the primary market, with the rest of the secondary market, and to each other. We employ alternative definitions of the primary market lenders that the GSEs should be compared with, definitions that both include and exclude government-insured, subprime, and manufactured housing lending. Although the GSEs have argued for more restrictive definitions of the primary market, we argue that more inclusive definitions are justified because (1) the GSEs themselves say many subprime loans go to borrowers who could go elsewhere; (2) many FHA loans could have been underwritten as conventional prime loans; (3) qualified buyers who do not go to the GSEs and their partners likely pay higher interest rates, receive less favorable loan terms, and are sometimes subject to predatory and abusive practices; and (4) it may be possible that the failure of the GSEs and their partners to effectively target and market to these groups is what is causing them to go elsewhere.

- Second, we evaluate how the GSEs meet their affordable housing goals. We examine whether they are serving all members of underserved markets well or whether they tend to focus on the least underserved of the underserved. This analysis considers whether the creation of subgoals or alternative goals would help to better meet the needs of underserved markets.

- Finally, we examine the direct effects of GSE leadership and influence on the primary market. We consider the extent to which the GSEs deal directly with the primary market as opposed to buying their loans from other secondary market entities. We then replicate and extend Williams and Nesiba's (1997) Models of Community Reinvestment Market Share. Through a longitudinal analysis, we determine whether the effects of the GSEs on their partners have become more positive (or at least less negative) over time.

- Five types of underserved markets are examined in this study: very-low-income families, low-income families in low- to moderate-income areas, targeted (underserved) areas, African Americans, and Hispanics. The 1993–2003 period is studied, with a particular emphasis on changes that have occurred in recent years. Home Mortgage Disclosure Act (HMDA) data for metropolitan statistical areas is examined. The Public Use Data Base that HUD compiles from GSE data (File B) is also employed for analyses of the entire nation. Separate analyses that include and exclude FHA loans and loans from subprime and manufactured housing lenders are done.

- We caution that evaluating/assessing GSE performance is not necessarily the same as explaining it. Many factors could have affected GSE performance—an improved economy, lower interest rates, better risk assessment procedures, pressure from HUD, and so on. Although we may speculate, we do not claim that we can disentangle all these influences. Nonetheless, we can show what the net impact of these influences has been, and we can identify areas for possible improvement. Furthermore, we argue that it is not enough for the GSEs simply to show that they are doing the best they can; to justify their special rights and privileges, they must also show that they are being effective.

Chapter 2. Descriptive Comparisons of Nationwide Trends in Primary and Secondary Market Lenders' Underserved Market Performance, 1993–2003

- Underserved markets received more loans from traditional lenders in 2003 than in 1993. Between 1993 and 2000, however, most borrowers from underserved markets did not experience any consistent gains or declines in terms of their share of primary market loans from traditional lenders or GSE purchases. Similarly, between 1993 and 1998, no consistent pattern emerged of the GSEs either gaining ground or losing ground relative to the primary market. Beginning around 1999, however, trends have generally been positive, with underserved markets making gains among traditional primary market lenders and even greater gains in GSE purchases.

- The mixed record with traditional lenders, however, disguises the gains that underserved markets made thanks to subprime and manufactured housing lenders, with whom the GSEs do very little business. After these lenders are considered, underserved markets are revealed to have made steady and clear gains throughout the period studied.

- Very-low-income borrowers constitute the group that has made the most consistent progress over time, among both traditional primary market lenders and the GSEs. This group's share of all traditional primary market loans increased from 10.93 percent in 1993–96 to 13.15 percent in 2001–03. Its share of GSE purchases improved even more, rising from 8.15 percent of all purchases in 1993–96 to 13.45 percent in 2001–03.

- Most measures from both HMDA data and the GSEs' own data indicate that the GSEs have never been "leading the market." The percentage of loans they purchase from underserved markets has almost always been lower than the percentage of such loans that were made in the primary market. The GSEs have also consistently trailed behind their secondary market competitors. Underserved market loans that others were willing to buy or hold in portfolio were loans that the GSEs were either unwilling or unable to purchase.

- There are indications, however, that GSE performance has recently improved. The GSEs made greater gains in 1999–2003 than did traditional primary market lenders. The GSEs also made gains against their secondary market competitors between 1998 and 2003, and after 1999 they actually had a lead with very-low-income borrowers. Conversely, although the GSEs have increased their purchases from Hispanics, GSE gains have not been as great as those made by the primary market with Hispanics.

- It is, of course, difficult to know whether increased GSE purchases were a cause or simply a reflection of activity in the primary market. Nonetheless, it is worth noting that, as the GSEs made disproportionately large gains with underserved markets, the primary market did a better and more consistent job of serving those groups.

- A factor contributing to GSE gains in recent years has been the greater improvement in Fannie Mae's underserved market performance. For much of the decade, Freddie Mac trailed Fannie Mae in most underserved markets. By 2000, however, Freddie Mac was close to parity with Fannie Mae in most categories and actually had slight leads in a few others. After 2000, however, Fannie Mae's gains among underserved markets were larger and more consistent.

- In short, although the GSEs may still not "lead the market," they have made clear gains in recent years. Even the narrowest definitions of the primary market rarely show the GSEs leading, but even the most inclusive definitions show them making progress over time.

Chapter 3. Goals, Subgoals, and Alternative Goals for Underserved Markets

- Since 1997, seasoned loans have had a modest but fairly consistent positive impact on the GSEs' gains in underserved markets. Seasoned loans may be less risky than other underserved market loans because the borrowers have established a record of payment; indeed, in some cases, the borrower may no longer belong to an underserved market. Hence, by purchasing seasoned loans, the GSEs may not be serving the most underserved of the underserved. The impact of seasoned loans on the GSEs' overall performance is modest, however, and the purchase of such loans declined in recent years.

- Between 1993 and 1998, the GSEs appeared to be serving the least underserved of the underserved. The underserved market loans they purchased tended to come from borrowers who had higher incomes, were less likely to be minorities, and were more likely to live in higher income neighborhoods and metropolitan statistical areas. By 2001–03, however, these differences had greatly diminished.

- For most underserved markets, little change occurred between the 1993–98 and 1999–2000 periods in the likelihood that the GSEs would purchase a loan from that market. Underserved markets did make clear gains in one key area, however. Having a very low income went from being the greatest obstacle to the GSEs purchasing a loan to being almost no obstacle at all. Furthermore, after 2000, the effects of all underserved market characteristics (except for being Hispanic) declined, meaning that most underserved groups were more likely to have their loans purchased by the GSEs than had been the case in the past. Also, regional differences in income, although important in 1993–98, had almost no effect on GSE purchases after that period.

- Unmeasured variables unrelated to anything the GSEs did, such as improved credit scores, might account for these developments. More flexible GSE underwriting guidelines and the implementation of programs aimed at underserved market borrowers, however, are also plausible explanations for the improvements that occurred. Changes in the affordable housing goals also likely spurred improvements in GSE performance.

Chapter 4. Direct Effects of GSE Leadership and Influence

- Over time, the GSEs have increasingly come to rely on other sellers, rather than primary market lenders, for their loan purchases. Large numbers of purchases from other sellers appeared to be a historical aberration in 1998, but subsequent numbers of GSE purchases have been much closer to the 1998 levels than to those of earlier years. These loans tend to disproportionately come from underserved markets. Whether these other sellers then use these funds to reinvest in home mortgage lending is unclear, but, in any event, their impact on overall GSE underserved market performance has generally been minor.

- If GSE policies and programs are beneficial to underserved markets, then the lenders who do the most business with the GSEs should be the lenders who make the most loans to underserved markets. We find that, between 1993 and 2003, just the opposite is almost always true: the greater the number of its conventional home purchase loans a lender sells to the GSEs, the fewer of its loans go to underserved markets.

- For every underserved market, this negative effect of the GSEs was significantly smaller in 1999–2003 than it was in 1993–98. Furthermore, for very-low-income borrowers, the GSE effect is actually slightly positive after 1998: the greater the number of its loans a lender sells to the GSEs, the more likely it is to make loans to very-low-income borrowers. Although it may be disappointing that the GSEs did not make additional gains after 2000, it is also reassuring that the gains seen in 1999 and 2000 were not just a temporary aberration.

- Factors unrelated to anything the GSEs did could account for these findings. Nonetheless, one possible explanation for the improved performance of lenders over time is that GSE policies and programs became more beneficial (or at least less harmful) to underserved markets than they had been in the past.

Chapter 5. Assessing GSE Performance

- Previous studies have concluded that the GSEs were not leading the conventional, conformation market. The ultimate conclusion of this study is the same; however, by virtually every criterion examined in this study, it is also clear that in recent years the GSEs have made noteworthy progress.

- Even the narrowest definitions of the primary market never showed the GSEs leading, but even the broadest definitions showed the GSEs making gains. In recent years, the GSEs have been much less likely to serve the least underserved of the underserved. Obstacles to underserved market purchases by the GSEs have diminished, albeit not disappeared altogether. With the GSEs doing a better job of serving all members of underserved markets, the need for subgoals or alternative goals is perhaps less great now than it was a few years ago. Lenders that do the most business with the GSEs are also doing a better job of serving underserved markets.

- Concerns persist, however, that government regulators, lenders, and the GSEs themselves should consider. The GSEs have made significant gains with underserved markets, but, for the most part, they still do not lead. Exercising greater influence on their partners, expanding their efforts in the subprime and manufactured housing arenas, reaching out to Hispanics, and making stronger efforts (by Freddie Mac, in particular) are all possible means by which the GSEs could better serve underserved markets.