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Have the GSE affordable housing goals increased the supply of mortgage credit?

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Abstract

In the 1980s, housing market analysts and policymakers were concerned that Freddie Mac and Fannie Mae were not adequately facilitating the financing of affordable housing for low- and moderate-income families. To address these concerns, the Department of Housing and Urban Development established quantitative Affordable Housing Goals requiring the Government Sponsored Enterprises (GSEs) to increase their purchases of mortgages originated by low- and moderate-income households and for homes located in low-income neighborhoods. Our analysis indicates that the goals increased the supply of mortgage credit available to low- and moderate-income households, after controlling for other mortgage market factors. Our analysis suggests that the increase in the supply of low-income mortgage credit occurred primarily in 1998.

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1. Introduction

The 1992 Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA) called for the Department of Housing and Urban Development (HUD) to establish quantitative goals regarding the purchase of mortgages for Fannie Mae and Freddie Mac, two Government Sponsored Enterprises (GSEs), because of concerns among

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housing market analysts and policymakers that the GSEs were not adequately facilitating the financing of affordable housing for low- and moderate-income families. The GSEs have generally been able to meet their mandated percentage of business targets since they were established in 1993.^{1,2}

Although it is clear that the GSEs are meeting their target goals, it is unclear as to whether the goals are having the desired affect—that of increasing the overall supply of mortgage credit to borrower groups targeted by the legislation.³ Given the importance of the GSEs to the primary mortgage market and the importance of the Affordable Housing Goals to the supply of credit to targeted households, this study empirically estimates the effect that the Affordable Housing Goals had on the primary mortgage market. To preview the results, we find that the Affordable Housing Goals had a limited effect after controlling for other supply and demand factors.

2. Model development

The central question is whether the GSE Affordable Housing Goals increased the supply of mortgage credit in so-called geo-targeted areas. We examine this issue by estimating via maximum likelihood the parameters of the following mortgage market model:

$$\begin{aligned} D_{it} &= \alpha_1 P_{it} + \beta_1 X_{i1t} + u_{i1t} \\ S_{it} &= \alpha_2 P_{it} + \beta_2 X_{i2t} + \delta_2 I_i + u_{i2t} \\ Q_{it} &= \text{Min}(D_{it}, S_{it}) \\ \Delta P_{it} &= \gamma(D_{it} - S_{it}) \end{aligned} \tag{1}$$

where X_{i1t} and X_{i2t} are exogenous variables determining mortgage demand and supply in area i , respectively, I_i is a dummy variable indicating whether area i is a geo-targeted area, and P_{it} is the price of mortgage funds in area i . Although we do not observe the actual amount of funds demanded or supplied, we do observe X_{i1t} , X_{i2t} , P_{it} , I_i and the quantity of loans originated, Q_{it} .

Fair and Jaffee (1972) used a similar mortgage market model in their study of the housing market and noted that if $D_{it} > S_{it}$, then the quantity of loans originated is determined by the supply function, and if $D_{it} < S_{it}$, then the quantity of loans originated is on the demand function. In this model, the price of mortgage funds is exogenous.

Following Fair and Jaffee (1972), we classify Q_{it} as either being on the demand or supply curve by observing the sign on the change in the price of mortgage funds from one

¹ According to Manchester (1998), the percentage of mortgages purchased by Fannie Mae and Freddie Mac that were originated to low- and moderate-income families increased from 34.1% and 30%, respectively, in 1993 to 45.5% for Fannie Mae and 42.9% for Freddie Mac in 1997.

² Listokin and Wyly (1998), Williams (1999), and Temkin et al. (1999). Temkin et al. and Williams also point out that Fannie Mae and Freddie Mac trail many lenders in terms of service and outreach to low- and moderate-income families.

³ Appendix A provides a brief overview of the goals established by HUD.

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