

Permanently Increasing the Government Loan Limits Would Help Unfreeze the Housing Finance System

MBA RECOMMENDS

MBA requests Congress to help make mortgage credit more available and affordable by setting the Fannie Mae, Freddie Mac (GSEs) and Federal Housing Administration (FHA) standard, nationwide loan limits at \$625,500, and up to \$729,750 in high-cost areas on a permanent basis.

GSE CONFORMING LOAN LIMIT

The GSEs are restricted by law from purchasing loans in amounts over a dollar ceiling, called the conforming loan limit (CLL). A loan ceiling also applies to loans the FHA can insure. The Federal Housing Finance Agency (FHFA), the primary regulator for Fannie Mae and Freddie Mac, has the authority to adjust the CLL during years when the national median home price increases. FHFA also has the authority to set higher limits in areas where the median home price is significantly higher than the national median. Since the GSEs cannot buy loans higher than the CLL, liquidity resources for such loans are limited. This is because a lender either must find a private investor to purchase the loan, or hold the loan on its own books plus an additional amount in reserve in case the borrower defaults.

As the housing finance market began to deteriorate in August of 2007, private investors exited the housing finance market, leaving the GSEs and FHA as the only outlets for mortgage lenders to sell loans in the current market. The result was that interest rates on 30-year fixed-rate jumbo loans increased from their usual spread of roughly a quarter of a percentage point over equivalent credit risk conforming loans to over one percent.

The higher rates on loans over the CLL of \$417,000 had an immediate and negative sustained impact on mortgage originations for home purchases and refinances in high-cost areas such as California, and portions of Florida, mid-Atlantic and Northeast states, but eventually all parts of the country were affected.

Additionally, in many low-cost areas, FHA's loan limits were insufficient to cover the costs of new construction. New construction targeted to first-time homebuyers has historically been a part of the market in which FHA has had a large presence.

In an attempt to jumpstart the market for large balance or jumbo loans, Congress included a provision in the Economic Stimulus Act of 2008 to increase temporarily the CLL from \$417,000 to \$625,500. The act set the CLL in high-cost areas based on the areas' home prices compared to the national median, up to a maximum of \$729,750. This increase had a demonstrable impact on the mortgage market by increasing liquidity for and lowering the interest rates of loans that were previously beyond the GSEs' purchasing authority. However, because the higher loan limit was temporary, the investment community announced it would not purchase bundles of loans if they included more than ten percent of loans over \$417,000. Since many lenders report the volume of high balance loan transactions exceeds ten percent of their total volume, lenders must continue to resort to costlier alternatives to the securitization market. This dilutes the full benefits of the higher CLL because of the artificial restriction in liquidity.

The temporary increase expired on December 31, 2008, when the Housing and Economic Recovery Act (HERA) limits of \$417,000 (standard) and \$625,500 (high cost) became effective. As a result, loans above the HERA limits became more expensive and harder to obtain.

Without the GSEs as a funding channel, the costs associated with holding a nonconforming loan in portfolio, or the higher premiums charged by private investors to purchase a nonconforming loan became prohibitively expensive.

FHA LOAN LIMIT

Like the GSEs, eligibility for FHA mortgage insurance includes a maximum loan amount in high-cost areas. Additionally, there is a “floor” for low-cost areas, defined as an area where 95 percent of the median house price is at or below 48 percent of the CLL. Prior to the Economic Stimulus Act of 2008, the limit for FHA-insured loans in high cost areas was 87 percent of the GSE CLL, or \$362,790. The ceiling in “low-cost” areas was 48 percent of the GSE CLL, or \$200,160.

The Economic Stimulus Act of 2008 temporarily raised the maximum FHA loan amount in high-cost areas to \$729,750. Also, an area was considered low-cost if 125 percent of the median house price is at or below 65 percent of the GSE CLL, \$271,500, which became the new temporary floor.

The method for calculating the FHA limits also expired on December 31, 2008, and was replaced by a methodology established by HERA. For example, although the floor of \$271,500 remained, the definition of low-cost area changed to areas where 115 percent of the median house price is at or below 65 percent of the GSE CLL. The limit for high-cost areas is set at \$625,500.

Higher temporary loan limits have benefited the mortgage industry and consumers during what has been a turbulent period for our nation’s economy. In the current economic downturn, Fannie Mae, Freddie Mac and FHA are the only significant sources of housing finance liquidity. MBA believes it is important for these three entities to provide market support to the broadest possible spectrum of home prices.

It is especially important for FHA financing to be relevant in areas with high home prices. MBA believes raising the limits to the GSEs’ conforming limits in these areas strikes a good

balance between serving a greater number of borrowers and taking on additional risk. For lenders in high-cost areas, such as California, New York, and the Washington, D.C. area, FHA was not a viable option for their customers prior to 2008. It is important to note that if you evaluate the approximate 3,300 counties in the country, only 75 counties reached the highest list, which was \$729,750. Approximately 600 to 650 counties are between \$271,160 and \$729,750. FHA has traditionally focused on the needs of first-time, minority, and/or low-and moderate-income borrowers and it is important that FHA continue to serve these populations, particularly in areas where home prices are higher and they would have the most difficulty affording a home.

According to FHA’s own data, there is no positive correlation between the size of a mortgage and the rate of payment default. In fact, larger FHA-insured mortgages tend to perform better, while mortgages under \$100,000 have the highest rate of payment default. It should also be noted that higher FHA loan limits do not cost the government any more money because the FHA Insurance Fund is fully supported by premiums paid by borrowers who receive FHA-insured mortgage loans.

BENEFITS

In order to restore vitality, and revive the housing finance system, MBA believes it is important for these entities to provide secondary market support to the broadest spectrum of home prices possible. Therefore, MBA urges Congress to set the GSEs’ standard conforming loan limit to \$625,500 and up to \$729,750 in high-cost areas on a permanent basis. MBA also requests Congress to set the FHA loan limits to \$625,500 and \$729,750 in high-cost areas on a permanent basis. This change will enable the GSEs and FHA to boost the availability of housing finance funding to the broadest spectrum of borrowers possible. A permanent change will also spur the investment community to lift their requirement that loan pools contain no more than ten percent of high balance loans, thus further reducing borrowing costs.