Mortgage Market Note

Historical Trends in the Conforming Loan Limit

October 16, 2007

Mortgage Market Note 07-2

Introduction

The Emergency Home Finance Act of 1970 chartered Freddie Mac to provide a secondary mortgage market for thrifts and other originators of conventional mortgages. The Act also allowed Fannie Mae to purchase conventional loans and established a conforming loan limit for both Enterprises of $33,000. The Act set the conforming loan limits 50 percent higher for three statutorily-designated high cost areas: Alaska, Hawaii, and Guam (the U.S. Virgin Islands were added later).

Fannie Mae and Freddie Mac are prohibited by charter from purchasing single-family mortgages with unpaid principal balances above the conforming loan limit. Congress raised the limit to $60,000 for 1977 and $67,500 for 1979. The Housing and Community Development Act of 1980 increased the ceiling to $93,750 and indexed future annual increases to changes in average house prices (12 U.S.C. 1717(b)(2) for Fannie Mae and 12 U.S.C. 1454(a)(2) for Freddie Mac). The limits are adjusted each year to reflect the change in the national average purchase price for all conventionally financed single-family homes, as measured by the Federal Housing Finance Board's (FHFB's) Monthly Interest Rate Survey (MIRS). Statutory language relating to the limit permits "adjustments" to the ceiling each January based on the "percentage increase" over the twelve months ending in October of the prior year, as measured by the MIRS.

The 1980 Act also broadened the conforming loan limit concept to apply to mortgages that finance single-family properties with two units ($120,000), three units ($145,000), and four units ($180,000). Limits for mortgages that finance 2-, 3-, and 4-unit homes are indexed in the same manner as loans that finance 1-unit properties. For 2007, the limits are $417,000 for 1-unit, $533,850 for 2-unit, $645,300 for 3-unit, and $801,950 for 4-unit single-family homes. For 2007, the limits for high-cost areas are $625,500 for 1-unit, $800,775 for 2-unit, $967,950 for 3-unit, and $1,202,925 for 4-unit single-family homes.

The Conforming Loan Limit Has Grown More Rapidly than Median Household Income or Consumer Prices

The conforming loan limit rose from $93,750 in 1980 to $417,000 in 2006 and 2007 (Chart 1). Since 1986, cumulative growth in the limit has outpaced cumulative growth in median household income (Chart 2; as discussed in Box 1, each data series has been normalized by dividing the current period's dollar level by the dollar level of that series in 1980). That has been particularly true since 2000, with the limit rising 65 percent while median household income rose 14.8 percent.

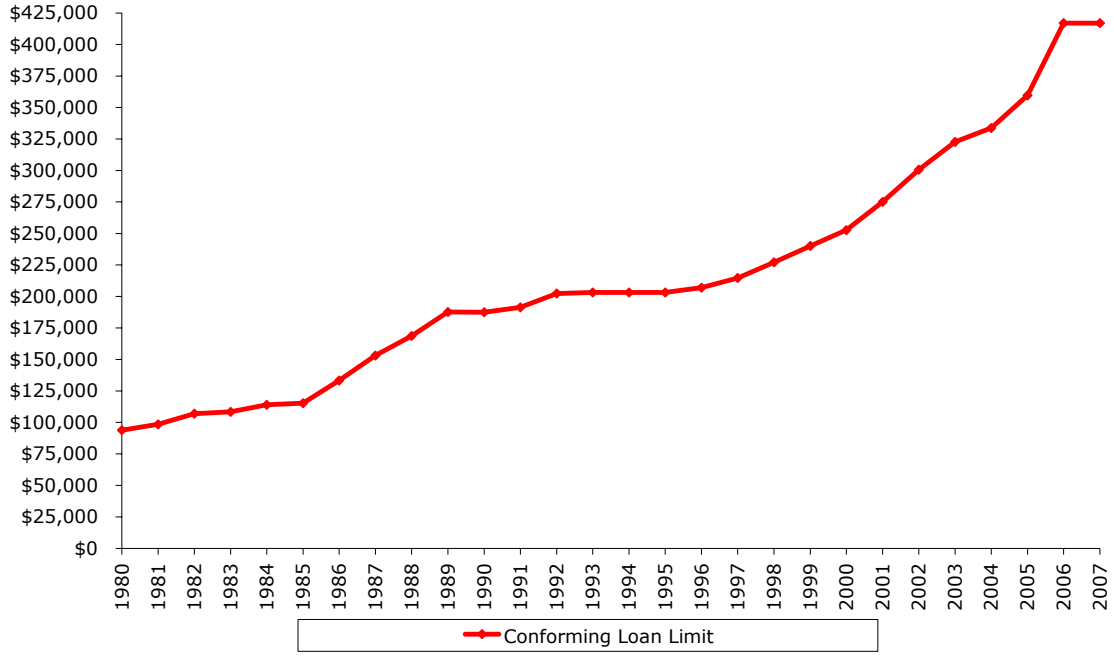
Box 1
Normalizing Data to Facilitate Comparisons

Data are frequently "normalized" to permit direct comparisons between variables. A common normalization removes differences in levels, which enables one to compare directly growth rates for variables that may start at different levels or may be measured in different units.

In this Note time series variables have been normalized by choosing a "base period" and dividing every value by the value in that period. The transformed (normalized) variable then takes a value of one in the base period and other values directly reflect the proportional change that occurred since that period. A value of 1.5, for example, indicates that the variable's value is 50 percent [= (1.5-1)*100] greater than it was in the base period. To compare growth rates across variables, one merely needs to compare the values of their normalized counterparts.

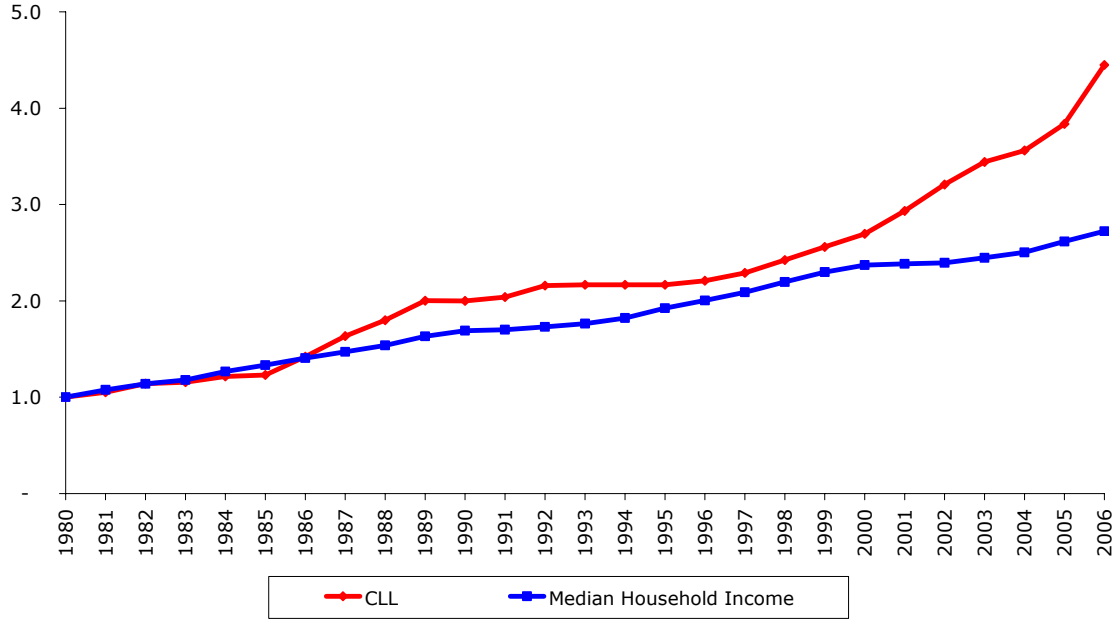
In Charts 2, 3, 4, and 6 in the text and in the tables in the Appendix, the values of the conforming loan limit and other variables have been normalized using 1980 as the base period. As a result, the charts and tables facilitate comparisons of the relative growth rates of those variables from 1980 onward.

Chart 1: Conforming Loan Limit for 1-Unit Single-Family Homes, 1980-2007



Source: Office of Federal Housing Enterprise Oversight

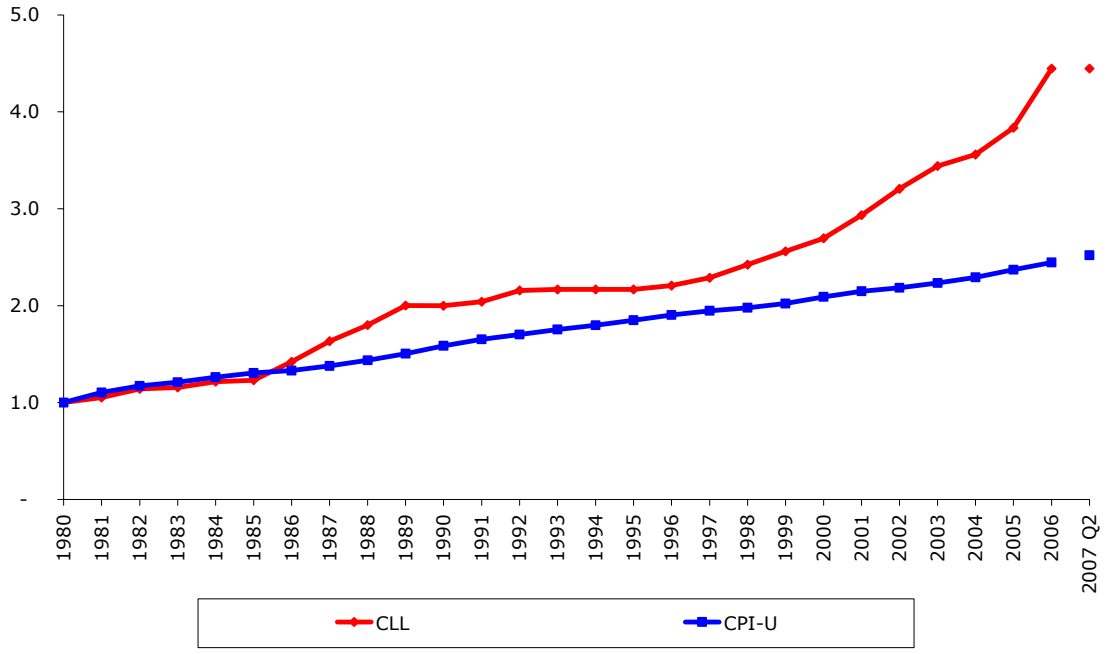
Chart 2: Normalized Conforming Loan Limit and Normalized Median Household Income, 1980-2006 (1980 = 1)



Source: Office of Federal Housing Enterprise Oversight based on U.S. Census Bureau Current Population Survey

Similarly, since 1986 growth in the conforming loan limit has outpaced growth in consumer prices, as measured by the Bureau of Labor Statistics' Consumer Price Index (Chart 3).

Chart 3: Normalized Conforming Loan Limit and Normalized Consumer Prices (CPI-U), 1980-2007 (1980 = 1)



Source: Office of Federal Housing Enterprise Oversight based on Bureau of Labor Statistics CPI-U

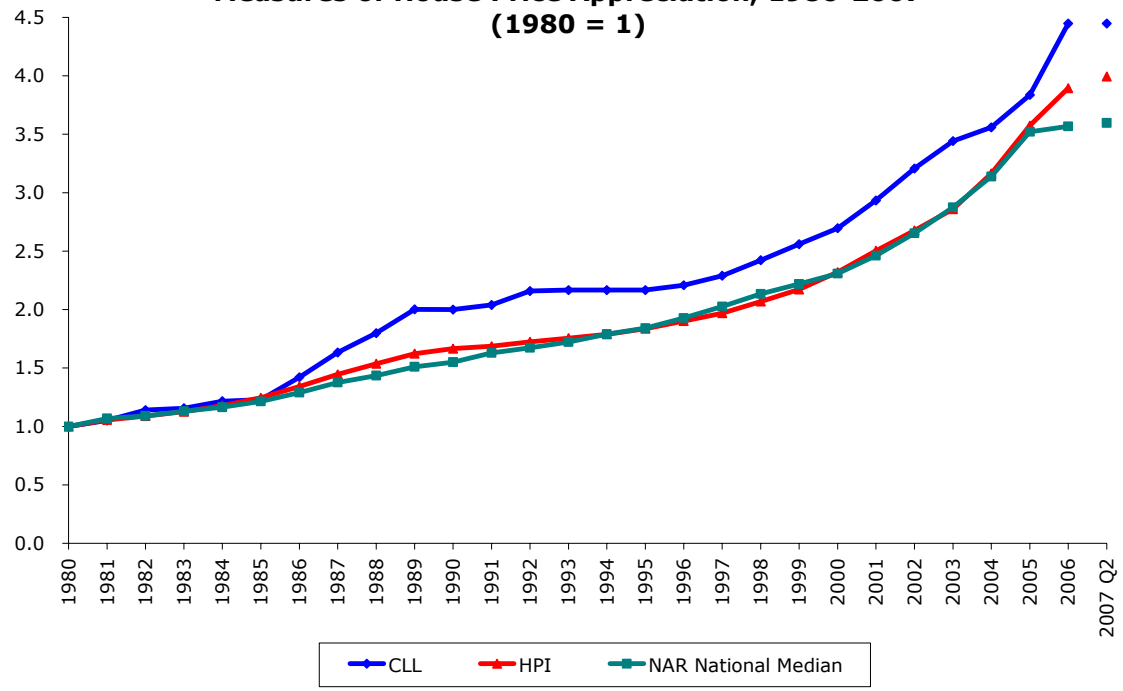
Using Different Measures of National House Price Appreciation to Determine the Limit Would Not Have Affected Its Trajectory Very Significantly

In the late 1980s, growth in the national average purchase price of conventionally financed single-family homes, reported in the MIRS, was significantly higher than growth in the OFHEO House Price Index (HPI)[1] or the median sales price of existing homes reported by the National Association of Realtors[2] (NAR; Chart 4). In 2006, a shift in the mix of house sales toward less-expensive homes contributed to another divergence. For the other years from 1980 through mid-2007, the three indicators reported very similar national rates of house price appreciation.

[1] http://www.fhfa.gov/DataTools/Downloads/Pages/House-Price-Index.aspx.

[2] http://www.realtor.org/Research.nsf/Pages/MetroPrice.

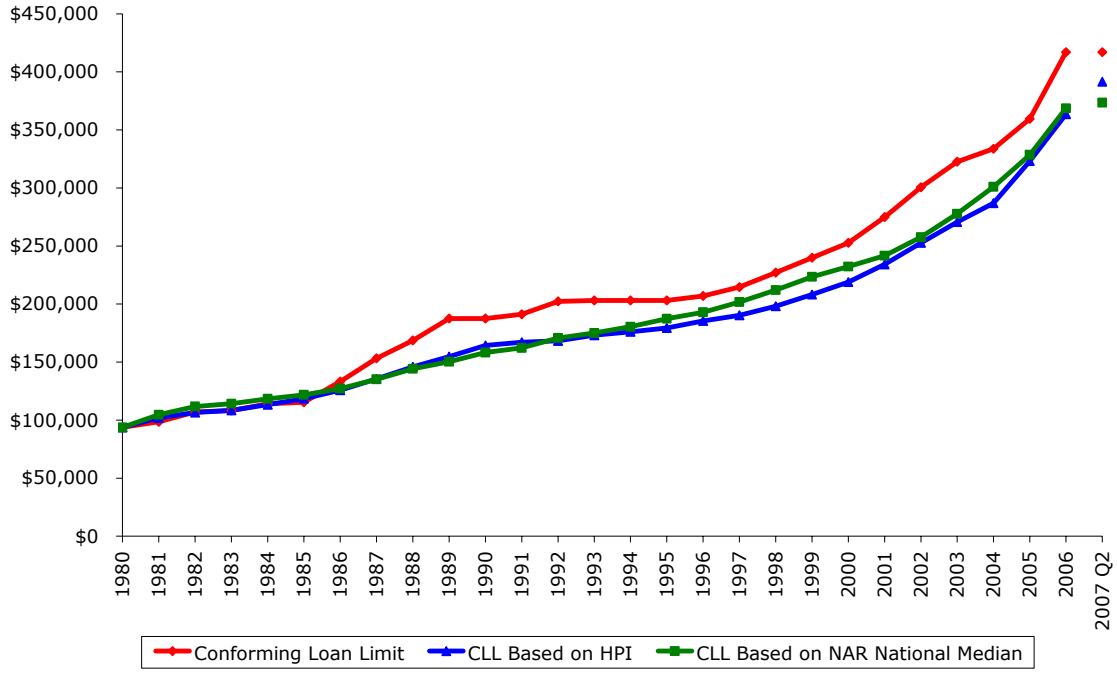
Chart 4: Normalized Conforming Loan Limit and Normalized Measures of House Price Appreciation, 1980-2007 (1980 = 1)



Source: Office of Federal Housing Enterprise Oversight based on National Association of Realtors data

Extending the analysis above, it is possible to construct alternative conforming loan limits based on the NAR and OFHEO data and to compare them to the actual conforming loan limit. Alternative limits based on the yearly Q3-to-Q3 changes in the NAR national median sales price and the OFHEO national HPI are somewhat lower than the actual limit in each year beginning in 1987 (Chart 5). By 2007, when the actual conforming loan limit for 1-unit single-family homes was $417,000, an alternative limit calculated using changes in the NAR median sales price would have been $373,500 (10.4 percent lower), and an alternative limit calculated using changes in the OFHEO HPI would have been $391,600 (6.1 percent lower). Almost all of those differences are attributable to the differences in growth rates for the 1986-1990 period.

Chart 5: Alternative Conforming Loan Limits Based on HPI and NAR National Median Appreciation, 1980-2007



Source: Office of Federal Housing Enterprise Oversight based on National Association of Realtors Data

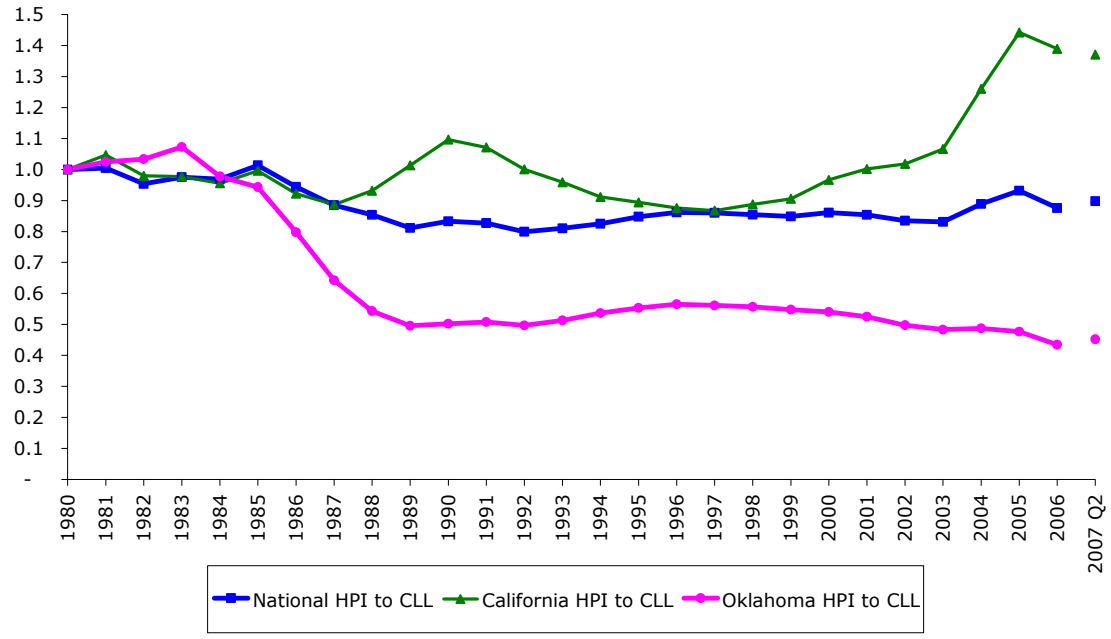
Large Disparities between the Conforming Loan Limit and State, Regional, and Metropolitan House Price Levels Have Emerged Since 1980

House price appreciation has varied significantly among regions of the country, states, and metropolitan areas since the mid-1990s. Over time, those differences have produced significant disparities between the conforming loan limit and house price levels at the state, regional, and metropolitan levels that did not exist when annual indexing of the limit began in 1980.

For example, appreciation was greater in California than in Oklahoma for most of the period 1980 through 2007 Q2. A house in California that in 1980 was just as easy to finance with a conforming loan as another house in Oklahoma was by the spring of 2007 much more difficult to finance with such a loan. That is illustrated in Chart 6, which compares the values of OFHEO's national HPI and state-level indexes for California and Oklahoma to the conforming loan limit during that period (all values are normalized to 1980). (The Appendix tables provide comparable data for all states and the nine Bureau of the Census divisions for selected years from 1980 through 2007 Q2.) By 2007 Q2, house prices in California had risen 37 percent relative to the conforming loan limit, while prices in Oklahoma had fallen 55 percent.

Nationally, prices had declined 10.2 percent relative to the limit from their 1980 level. For the implications in dollar terms, consider that it would not have been difficult to finance a $100,000 house with a conforming loan in 1980, regardless of the location of the dwelling. But by the spring of 2007, with the loan limit having increased to $417,000, the value of the Oklahoma house likely was about $201,000, well below the limit, while the California house that had cost the same in 1980 was now likely worth about $610,000.

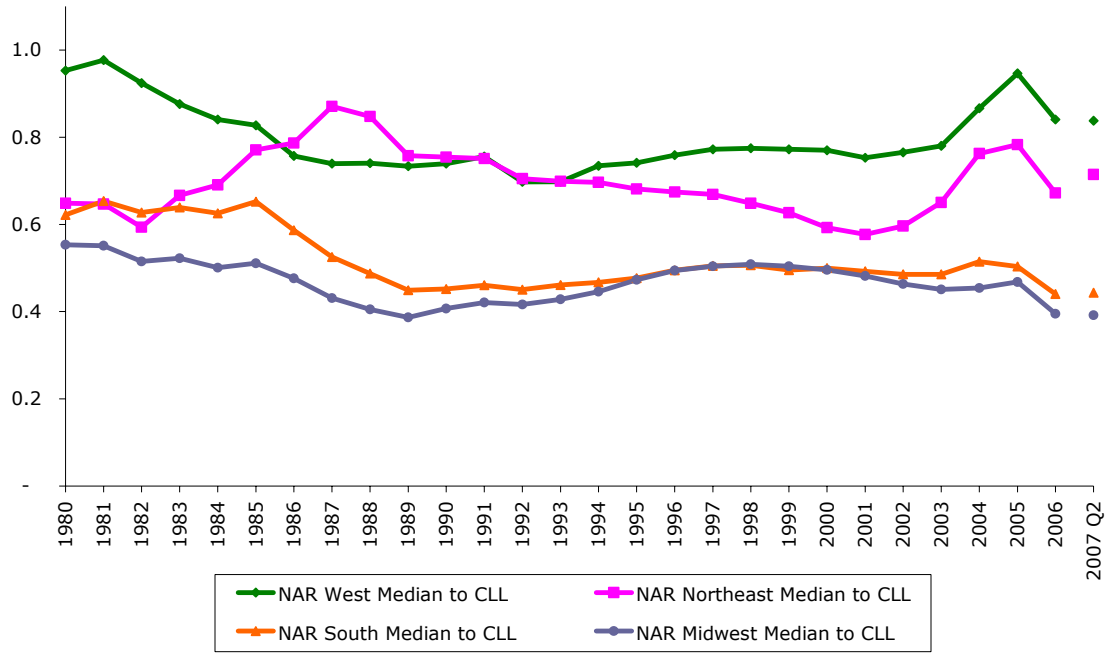
Chart 6: Ratio of Normalized National and State HPI Levels to Normalized Conforming Loan Limit, 1980-2007 (1980 = 1)



Source: Office of Federal Housing Enterprise Oversight

Calculations for the Bureau of the Census' four regions of the country, using the NAR regional median existing home sales prices relative to the conforming loan limit, show that the West region has generally been the most expensive, relative to the conforming loan limit (Chart 7). The Northeast region has also been expensive, and it is the only region whose ratio was greater in 2006 than in 1980, implying that the loan limit had become more constraining. The Midwest and South regions experienced much lower cumulative house price appreciation over that period, with the prices falling relative to the conforming loan limit.

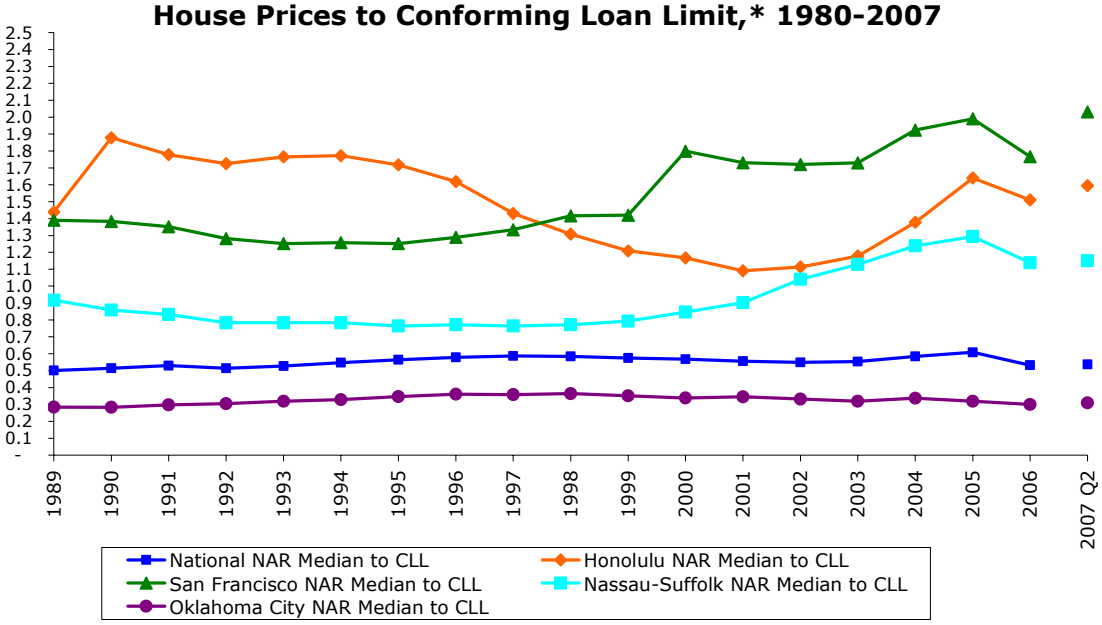
Chart 7: Ratio of NAR Regional Medians to Conforming Loan Limit, 1980-2007



Source: Office of Federal Housing Enterprise Oversight Based on National Association of Realtors Data

House price levels and appreciation rates have differed most among metropolitan areas. Chart 8 shows the ratios between the NAR national and metropolitan area median sales prices and the conforming loan limit to illustrate the disparate trajectories of house prices in the Honolulu, San Francisco, Oklahoma City, and Nassau-Suffolk metropolitan statistical areas (MSAs). The limit for the contiguous 48 states was used in each case, although the limit in Hawaii has been 50 percent higher. Indeed, in the early 1980s, house prices were much higher there. Over the past decade, though, the San Francisco MSA experienced significantly greater cumulative house price growth, with prices surpassing those in Honolulu, and prices in Nassau-Suffolk have nearly caught up. Oklahoma City prices, by contrast, have remained well below these MSAs and the nation as a whole.

Chart 8: Ratio of National and MSA NAR Median House Prices to Conforming Loan Limit,* 1980-2007



* The conforming loan limit for the contiguous 48 states is used in each case. The actual limit in Honolulu has been 50 percent higher.

Source: Office of Federal Housing Enterprise Oversight based on National Association of Realtors Data

Appendix

Table A-1: Ratio of Normalized State HPI Levels to Normalized Conforming Loan Limit for Selected Years, 1980 – 2007 (1980=1)

	1980	1985	1990	1995	2000	2005	2007 Q2
Alabama	1.00	0.96	0.70	0.78	0.74	0.66	0.65
Alaska	1.00	1.33	0.64	0.78	0.73	0.74	0.75
Arizona	1.00	1.01	0.64	0.71	0.73	0.90	0.94
Arkansas	1.00	0.95	0.62	0.70	0.65	0.59	0.57
California	1.00	1.00	1.10	0.89	0.97	1.44	1.37
Colorado	1.00	0.99	0.62	0.83	0.96	0.87	0.80
Connecticut	1.00	1.25	1.21	1.00	0.98	1.12	1.05
Delaware	1.00	1.09	1.06	1.00	0.94	1.09	1.09
District of Columbia	1.00	0.91	0.97	0.87	0.93	1.44	1.47
Florida	1.00	1.01	0.74	0.75	0.74	1.02	1.05
Georgia	1.00	1.07	0.79	0.82	0.87	0.79	0.75
Hawaii	1.00	0.92	1.15	1.17	0.84	1.17	1.21
Idaho	1.00	0.90	0.61	0.79	0.73	0.71	0.78
Illinois	1.00	0.93	0.84	0.93	0.91	0.90	0.86
Indiana	1.00	0.90	0.69	0.79	0.77	0.64	0.58
Iowa	1.00	0.83	0.59	0.71	0.70	0.62	0.57
Kansas	1.00	0.88	0.59	0.65	0.67	0.59	0.55
Kentucky	1.00	0.92	0.71	0.81	0.80	0.70	0.65
Louisiana	1.00	0.91	0.51	0.60	0.60	0.55	0.56
Maine	1.00	1.18	1.12	0.99	1.00	1.17	1.10
Maryland	1.00	1.01	0.97	0.94	0.87	1.15	1.19
Massachusetts	1.00	1.63	1.43	1.26	1.49	1.76	1.53
Michigan	1.00	0.81	0.72	0.83	0.94	0.82	0.70
Minnesota	1.00	0.93	0.68	0.75	0.84	0.90	0.82
Mississippi	1.00	0.99	0.63	0.70	0.68	0.59	0.59
Missouri	1.00	0.96	0.69	0.74	0.75	0.70	0.66
Montana	1.00	0.94	0.60	0.83	0.80	0.83	0.87
Nebraska	1.00	0.91	0.62	0.73	0.74	0.63	0.58
Nevada	1.00	0.93	0.69	0.75	0.68	0.94	0.88
New Hampshire	1.00	1.29	1.09	0.89	1.00	1.20	1.09
New Jersey	1.00	1.22	1.17	1.06	1.05	1.34	1.30
New Mexico	1.00	1.04	0.67	0.84	0.74	0.72	0.76
New York	1.00	1.41	1.30	1.19	1.20	1.45	1.38
North Carolina	1.00	1.07	0.81	0.88	0.88	0.77	0.76
North Dakota	1.00	0.88	0.55	0.62	0.58	0.55	0.55
Ohio	1.00	0.88	0.71	0.81	0.80	0.69	0.60
Oklahoma	1.00	0.94	0.50	0.55	0.54	0.48	0.45
Oregon	1.00	0.78	0.63	0.90	0.91	0.95	1.03
Pennsylvania	1.00	1.02	0.98	0.97	0.88	0.94	0.92
Rhode Island	1.00	1.13	1.28	1.09	1.06	1.48	1.34
South Carolina	1.00	1.00	0.76	0.81	0.82	0.74	0.73
South Dakota	1.00	0.88	0.61	0.75	0.74	0.68	0.64
Tennessee	1.00	1.02	0.75	0.82	0.81	0.71	0.70
Texas	1.00	1.01	0.57	0.59	0.58	0.50	0.49
Utah	1.00	0.93	0.58	0.87	0.87	0.74	0.84
Vermont	1.00	1.03	1.02	0.96	0.90	1.02	1.01
Virginia	1.00	1.04	0.91	0.89	0.85	1.05	1.05
Washington	1.00	0.90	0.86	0.98	1.01	1.04	1.13
West Virginia	1.00	0.78	0.54	0.61	0.57	0.53	0.51
Wisconsin	1.00	0.87	0.67	0.83	0.84	0.80	0.75
Wyoming	1.00	0.79	0.45	0.60	0.57	0.59	0.64

Source: Office of Federal Housing Enterprise Oversight

Appendix

Table A-2: Ratio of Normalized Census Division HPI Levels to Normalized Conforming Loan Limit for Selected Years, 1980 - 2006 (1980=1)

	1980	1985	1990	1995	2000	2005	2007 Q2
New England	1.00	1.46	1.33	1.14	1.25	1.49	1.34
Middle Atlantic	1.00	1.19	1.13	1.05	1.02	1.20	1.16
South Atlantic	1.00	1.03	0.83	0.84	0.83	0.95	0.94
East South Central	1.00	0.97	0.71	0.79	0.78	0.68	0.67
West South Central	1.00	0.98	0.55	0.59	0.58	0.51	0.50
West North Central	1.00	0.92	0.65	0.72	0.75	0.73	0.67
East North Central	1.00	0.88	0.74	0.85	0.87	0.79	0.71
Mountain	1.00	0.97	0.62	0.79	0.80	0.83	0.85
Pacific	1.00	0.98	1.04	0.93	0.98	1.31	1.30

Source: Office of Federal Housing Enterprise Oversight

Index to Relevant Documents

Current OFHEO Guidance on the Conforming Loan Limit:
http://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Examination-Guidance.aspx.

Proposed Changes to the Conforming Loan Limit Guidance:
http://www.fhfa.gov/SupervisionRegulation/Rules/Pages/OFHEO-Conforming-Loan-Limit-Calculations-Proposed-Guidance-June-20-2007-Revising-SG0401-February-20-2004.aspx.

Public Comments Received on Proposed Changes to Conforming Loan Limit Guidance:
http://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-List.aspx?RuleID=39.