Mortgage Market Note

Potential Implications of Increasing the Conforming Loan Limit in High-Cost Areas

January 11, 2008

MORTGAGE MARKET NOTE 08-1

I. Introduction

Fannie Mae and Freddie Mac are prohibited by charter from purchasing single-family conventional mortgages with unpaid principal balances above the conforming loan limit. For mortgages that finance one-unit properties, that limit is $417,000 in 2008, as it was in 2006 and 2007. Higher limits apply to loans that finance properties with two to four units. The limits for properties of all sizes are 50 percent higher in Alaska, Hawaii, Guam, and the U.S. Virgin Islands. 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). Conventional single-family loans with original balances above the conforming loan limit are generally known as jumbo mortgages.

In May 2007 the House of Representatives passed H.R. 1427, the Federal Housing Enterprises Reform Act of 2007. That bill would increase the conforming loan limit in high-cost areas to the lower of (1) 150 percent of the national limit or (2) the median price in such area. The higher limits would not apply to loans held as assets by an Enterprise, but only to mortgages "on which are based securities issued and sold by the Enterprise involved," unless the director of the new agency created by the bill found that the restriction would increase costs to mortgage borrowers in high-cost areas. Separate adjustments would be made to the limits for mortgages on properties in high-cost areas (as defined geographically by the regulator) with one, two, three, and four units, based on estimates of median prices for properties of each size.

In September 2007 Senator Charles Schumer introduced S. 2036, the Protecting Access to Safe Mortgages Act. That bill would raise the conforming loan limit for all conventional single-family mortgages in high-cost areas, not just loans backing securities issued and sold by the Enterprise involved, but the increase would be only for the year following the date of enactment.

This analysis considers some of the implications of those proposals. The paper is organized as follows. Section II provides background information on the jumbo mortgage market. Section III discusses the potential localities that would be designated high-cost areas and the potential volume of loans that would be affected by the proposals. That analysis focuses only on the limits on loans that finance one-unit properties, which comprise 90 percent of the one-to-four-unit housing stock in the U.S. Section IV examines the characteristics of mortgages that would become newly eligible for Enterprise purchase. Section V discusses the implications for the Enterprises of the proposals. Section VI presents arguments for and against raising the limit and discusses other policy issues raised by the proposals. The Appendix reviews how the conforming loan limit is set under current law, sources of data on the prices of single-family homes, and methodologies used to estimate median house prices.

II. The Jumbo Mortgage Market

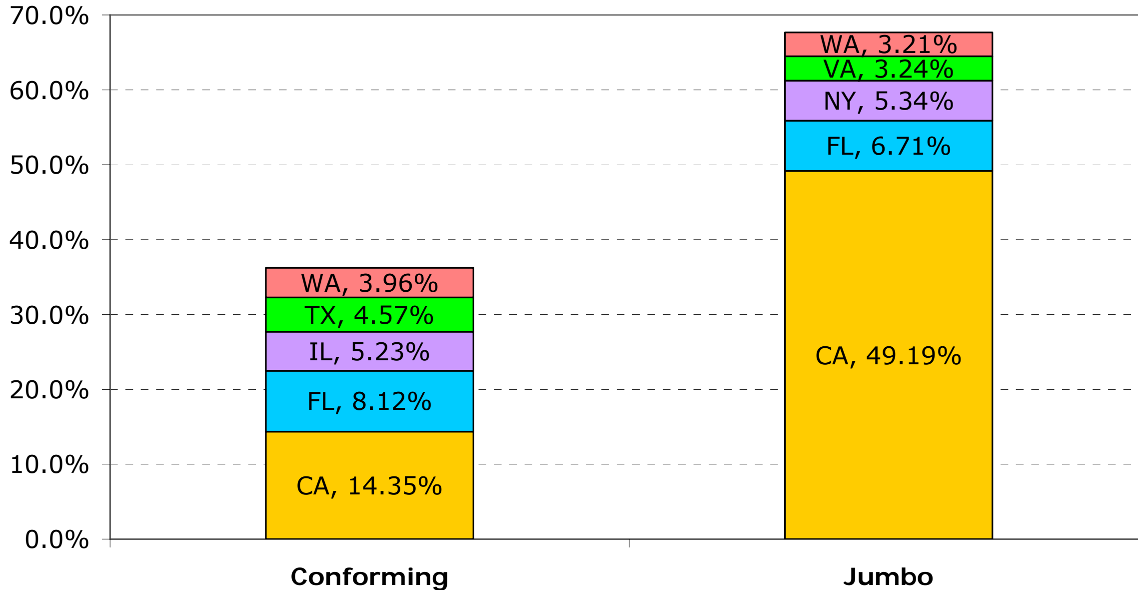
According to Inside Mortgage Finance Publications, originations of jumbo mortgages have ranged from 15 percent to 21 percent of the total single-family market from 2000 through the first half of 2007.[1]

A borrower who made a down payment of 20 percent and took out a mortgage equal to the current conforming limit of $417,000 could finance the purchase of a home worth $521,250. That amount is 2.3 times the national median home price for the U.S. for the end of the second quarter of 2007 of $223,800 estimated by the National Association of Realtors (NAR).

The jumbo market is much more geographically concentrated than the conventional mortgage market as a whole. Data from First American LoanPerformance suggest that California accounted for 49 percent of the dollar volume of first lien jumbo mortgages originated in the first half of 2007 and later securitized (Chart 1). In a comparable sample of conventional loans purchased by the Enterprises, the California market share was 14 percent. The Census Bureau estimates that California accounted for 12 percent of the total U.S. population at mid-2007.

[1] On the history of the secondary market for jumbo loans through 2005, see Hull, Everson W., "Securitized Jumbo Mortgages: 1986-2005," OFHEO Working Paper 07-1 (June 2007).

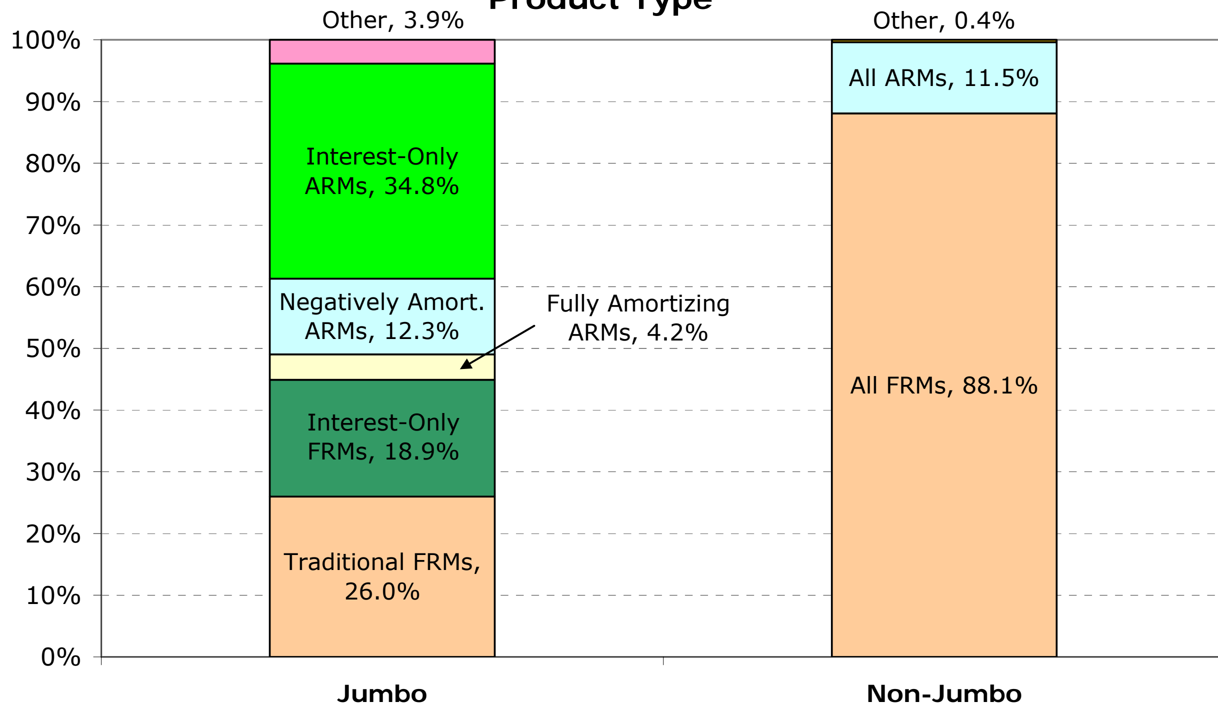
Chart 1: Geographic Concentration of Jumbo Mortgages That Were Later Securitized and Non-Jumbo Loans Purchased by the Enterprises, First Half of 2007 Originations, Top 5 States



Source: OFHEO based on Fannie Mae and Freddie Mac and First American LoanPerformance data.

First American LoanPerformance data also suggest that interest-only (IO) loans and negatively-amortizing adjustable-rate mortgages (ARMs) comprised nearly two-thirds of the dollar volume of first lien jumbo loans originated in the first half of 2007 and later securitized, whereas traditional (fully amortizing) fixed-rate mortgages (FRMs) comprised only a quarter of those loans (Chart 2). In contrast, FRMs comprised over 88 percent of non-jumbo conventional loans originated in the first half of 2007 and purchased by Fannie Mae and Freddie Mac. The sample of Enterprise-purchased loans used to prepare this paper does not permit distinguishing fully-amortizing loans from IO or negative-amortizing mortgages, but other data indicate that IO loans comprised a much smaller share of FRMs purchased by the Enterprises in that period.

Chart 2: Share of Jumbo Mortgages That Were Later Securitized and Non-Jumbo Loans Purchased by the Enterprises, First Half of 2007 Originations, by Product Type



Source: OFHEO based on Fannie Mae and Freddie Mac and First American LoanPerformance data.

One reason for those differences in product mix is that the jumbo market includes many subprime mortgages, whereas the Enterprises purchase few subprime loans outright. In general, borrowers who take out large loans appear to be more willing, relative to borrowers with smaller loans, to incur the interest rate risk or property price appreciation risk posed by ARMs or (in recent years) nontraditional mortgages, in order to reduce their monthly payments.

The sharp decline in originations of subprime and nontraditional mortgages in the second half of 2007 suggests that traditional FRMs and ARMs are likely to comprise a much larger share of jumbo originations in the future than they did in the first half of 2007. Between 1986 and 2005, traditional FRMs and ARMs averaged over 90 percent of jumbo mortgages that were securitized, even when the rapid growth of IO loans and negatively-amortizing ARMs since 2001 is taken into account.

There has been risk-based pricing of jumbo mortgages that are securitized. For example, an examination of fully-amortizing first lien jumbo FRMs originated in the first half of 2007 and later securitized shows the interest rates generally declining

for borrowers with higher FICO scores and increasing for borrowers with higher loan to value (LTV) ratios (Table 1). Similar risk-basing pricing occurs for other types of jumbo loans that are securitized.

Table 1. Mean Initial Interest Rate of Jumbo Mortgages Originated in the First Half of 2007 and Securitized, by FICO Score and LTV Ratio Ranges

	LTV < 50%	50% <= LTV < 60%	60% <= LTV < 70%	70% <= LTV < 80%	80% <= LTV < 90%	LTV >= 90%	Total
FICO < 600	7.12%	7.17%	7.34%	8.03%	8.33%	8.92%	8.01%
600 <= FICO < 649	6.58%	6.52%	6.67%	6.78%	7.01%	8.08%	6.97%
650 <= FICO < 699	6.33%	6.40%	6.44%	6.53%	6.62%	7.53%	6.58%
700 <= FICO < 749	6.21%	6.31%	6.35%	6.41%	6.40%	7.36%	6.40%
750 <= FICO < 799	6.20%	6.22%	6.24%	6.30%	6.28%	6.96%	6.28%
FICO >= 800	6.18%	6.19%	6.18%	6.28%	6.24%	6.97%	6.24%
Total	6.24%	6.30%	6.34%	6.43%	6.44%	7.55%	6.43%

Source: OFHEO based on First American LoanPerformance data.

III. Potential Localities and Volume of Mortgages Affected

H.R. 1427 would increase the conforming loan limit in high-cost areas to the lesser of the median house price in each area or 150 percent of the conforming limit. The higher limits would apply only to loans packaged into mortgage-backed securities (MBS) and sold by the Enterprise unless the Enterprises' regulator found that restriction would increase costs to mortgage borrowers in high-cost areas. S. 2036 would temporarily increase the conforming loan limit by the same formula as H.R. 1427; the higher limits would apply to all conventional single-family mortgages. Under both bills, the regulator would select the data used to estimate median prices and define the term "area." This section discusses the potential implications of those choices, which would affect the localities that would qualify as high-cost areas and, thus, would have a higher conforming loan limit each year. The section also discusses the potential effects of differences in house price appreciation rates across localities and of declines in median house prices in high-cost areas.

Implications of Different Sources of House Price Data

H.R. 1427 and S. 2036 do not define the term "area." The new agency could define area as a Metropolitan Statistical Area (MSA) as defined by the Office of Management and Budget (OMB). The NAR publishes quarterly estimates of the median prices of purchased homes for 150 of the 363 MSAs defined by OMB. The NAR estimates are for all single-family properties purchased, not just those with one unit. If H.R. 1427 were in effect in 2008, the agency defined area as an MSA, and the NAR's estimates for the third quarter of 2007 had been used to estimate median house prices for one-unit properties, seven MSAs would qualify as high-cost areas for such properties in 2008 (Table 2, which is based on third quarter data because it was the most recent information available in late 2007.)

Table 2. New Conforming Loan Limits for One-Unit Properties in High-Cost Metropolitan Statistical Areas in 2008 Assuming H.R. 1427 Were in Effect, Based on National Association of Realtors (NAR) Data

Metropolitan Statistical Area (MSA)	Estimated 3Q 2007 Median House Price	New 2008 Conforming Loan Limit	New Limit as a Percentage of Median
Bridgeport-Stamford-Norwalk, CT	$491,100	$491,100	100%
Los Angeles-Long Beach-Santa Ana, CA	$588,400	$588,400	100%
New York-Northern New Jersey-Long Island, NY-NJ-PA	$476,100	$476,100	100%
San Diego-Carlsbad-San Marcos, CA	$589,300	$589,300	100%
San Francisco-Oakland-Fremont, CA	$825,400	$625,500	76%
San Jose-Sunnyvale-Santa Clara, CA	$852,500	$625,500	73%
Washington-Arlington-Alexandria, DC-VA-MD-WV	$438,000	$438,000	100%

Source: OFHEO based on data from the National Association of Realtors for the third quarter of 2007.

Data on the values of one-unit properties purchased in the third quarter of 2007 are available from DataQuick Information Systems for 191 MSAs in 33 states. The DataQuick sample includes 487,532 transactions, which is significantly more than the number of transactions reflected in the survey data used to develop NAR's estimates. If the DataQuick data had been used to estimate median house prices for one-unit properties for the third quarter of 2007, 13 MSAs would qualify as high-cost areas for such properties in 2008 (Table 3).

Table 3. New Conforming Loan Limits for One-Unit Properties in High-Cost Metropolitan Statistical Areas in 2008 Assuming H.R. 1427 Were in Effect in 2008, Based on DataQuick Data

Metropolitan Statistical Area (MSA)	Estimated 3Q 2007 Median Home Price	New 2008 Conforming Loan Limit	New Limit as a Percentage of Median
Bridgeport-Stamford-Norwalk, CT	$599,000	$599,000	100%
Los Angeles-Long Beach-Santa Ana, CA	$568,000	$568,000	100%
Napa, CA	$550,000	$550,000	100%
New York-Northern New Jersey-Long Island, NY-NJ-PA	$430,000	$430,000	100%
Oxnard-Thousand Oaks-Ventura, CA	$587,750	$587,750	100%
Salinas, CA	$526,806	$526,806	100%
San Diego-Carlsbad-San Marcos, CA	$500,000	$500,000	100%
San Francisco-Oakland-Fremont, CA	$639,000	$625,500	98%
San Jose-Sunnyvale-Santa Clara, CA	$700,000	$625,500	89%
San Luis Obispo-Paso Robles, CA	$525,000	$525,000	100%
Santa Barbara-Santa Maria, CA	$435,000	$435,000	100%
Santa Cruz-Watsonville, CA	$719,500	$625,500	87%
Santa Rosa-Petaluma, CA	$515,000	$515,000	100%

Source: OFHEO based on data from DataQuick Information Systems for the third quarter of 2007.

The higher number of MSAs in Table 3 is due to the DataQuick sample including more MSAs than NAR's published house price data. NAR does not publish house price data for the MSAs included in Table 3 but not in Table 2.

The agency could also define area as a state. If DataQuick data had been used to estimate state-level median house prices for one-unit properties for the third quarter of 2007, two states—New York and California—would qualify as high-cost areas for such properties in 2008. The conforming loan limit for one-unit properties in 2008 would be $460,750 in New York and $434,000 in California.

Implications of Different Definitions of "Area"

The agency's choice about the definition of area would influence significantly the volume of mortgages affected by the proposals. If area was defined as a state, for example, H.R. 1427 and S. 2036 would affect a smaller volume of jumbo mortgages than if area was defined as an MSA or as a zip code.

Table 4 provides estimates of the dollar volume and the share of first lien jumbo mortgages originated in 2005, 2006, and the first half of 2007 and later securitized that would have been eligible for Enterprise purchase if the proposals had been in effect in those periods and area defined as a state.

Table 4. Dollar Volume and Share of Jumbo Mortgages That Were Securitized That Would Have Been Eligible for Enterprise Purchase, Assuming H.R. 1427 Had Been in Effect and Area Defined as a State

	Volume of Loans Using State Definition and DataQuick Data (Millions)	All Jumbo Loans Originated in the Period That Were Securitized (Millions)	Share
2005	$21,986.2	$450,907.2	4.9%
2006	$32,130.5	$378,600.8	8.5%
2007*	$19,627.0	$159,883.4	12.3%

* Data for first half of 2007 only.
Source: OFHEO based on data from DataQuick Information Systems and First American LoanPerformance.

Table 5 provides estimates of the dollar volume and the share of jumbo mortgages originated in 2005, 2006, and the first half of 2007 and later securitized that would have been eligible for Enterprise purchase if H.R. 1427 or S. 2036 had been in effect and the agency had defined area as MSA or zip code.

Table 5. Dollar Volume and Share of Jumbo Mortgages That Were Securitized That Would Have Been Eligible for Enterprise Purchase, Assuming H.R. 1427 Had Been in Effect and Area Defined as MSA or Zip Code

	Volume of Loans Using NAR MSA Definition (Millions)	Volume of Loans Using DataQuick MSA Definition (Millions)	Volume of Loans Using Zip Code Definition and DataQuick Data (Millions)	All Jumbo Loans Originated in the Period That Were Securitized (Millions)	Share Using NAR MSA Definition	Share Using Dataquick MSA Definition	Share Using Zip Code Definition and DataQuick Data
2005	$61,075.6	$80,230.6	$109,040.2	$450,907.2	13.6%	17.8%	24.2%
2006	$72,218.2	$77,016.5	$110,782.1	$378,600.8	19.1%	20.3%	29.3%
2007*	$27,826.4	$28,603.1	$42,256.7	$159,883.4	17.4%	17.9%	26.4%

* Data for first half of 2007 only.
Source: OFHEO based on data from DataQuick Information Systems, National Association of Realtors, and First American LoanPerformance.

Effects of Differences in House Price Appreciation Rates

However the agency defines area, the localities that qualify as high-cost areas could change from year to year due to differences in the house price appreciation rates of properties in different localities. For example, if area had been defined as an MSA and NAR's estimates had been used, the Barnstable Town, MA MSA would have qualified in 2005 but not in any of the three subsequent years; the Boston-Cambridge-Quincy, MA-NH MSA would have qualified in 2005 and 2006 but not in 2007 or 2008; and the San Jose-Sunnyvale-Santa Clara, CA and Washington-Arlington-Alexandria, DC-VA-MD-WV MSAs would not have qualified in 2005 but would have qualified in 2006 through 2008. Three MSAs—Miami-Ft. Lauderdale-Miami Beach, FL; Riverside-San Bernardino-Ontario, CA; and Sacramento-Arden-Arcade-Roseville, CA, would have qualified only in 2006.

If medians estimated with DataQuick data had been used, the Barnstable Town, MA and Boston-Cambridge-Quincy, MA-NH MSAs would have qualified only in 2005; the Sacramento-Arden-Arcade-Roseville, CA MSA would have qualified in 2006 only, and the Naples-Marco Island, FL and Stockton, CA MSAs would have qualified in 2006 and 2007 but not in 2005 or 2008. The Vallejo-Fairfield, CA and Washington-Arlington-Alexandria, DC-VA-MD-WV MSAs would have qualified in 2005 through 2007, but not in 2008, whereas the New York-Northern New Jersey-Long Island, NY-NJ-PA MSA would have qualified only in 2008.

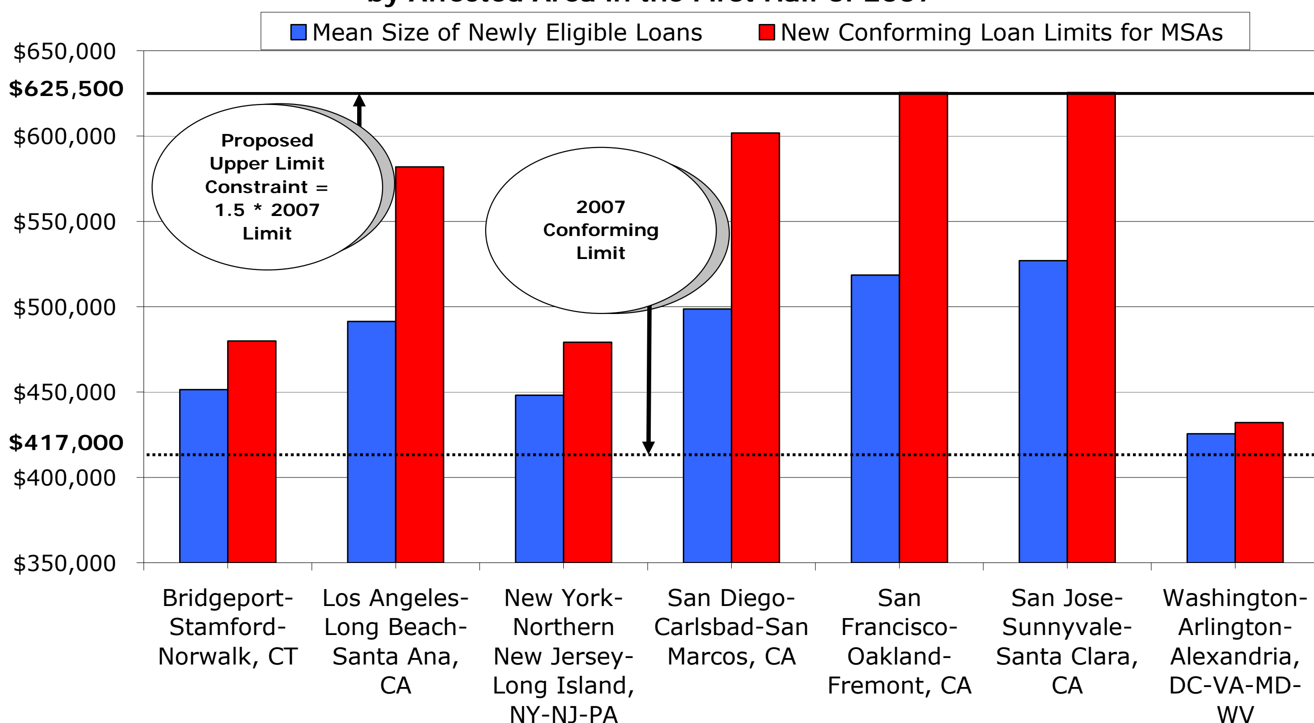
Effects of Declines in Median House Prices

An area's median house price can decline from one year to the next. Such depreciation could reduce the conforming loan limit for an area that qualified as a high-cost area in consecutive years under the two bills. For example, if area had been defined as an MSA and NAR's estimates of house price medians had been used, two MSAs that qualified as high-cost areas in 2007 would have continued to qualify in 2008 but would have had lower conforming loan limits in the second year. The limits in those areas would have declined by $3,100 (0.6 percent) and $12,600 (2.1 percent), respectively.

If medians estimated with DataQuick data had been used, eight MSAs that qualified as high-cost areas in 2007 would have continued to qualify in 2008 but would have had lower conforming loan limits in the second year. The limits in those areas would have fallen by amounts ranging from $1,000 to $180,000, or from 0.1 percent to 29.3 percent.

IV. Characteristics of Mortgages Newly Eligible for Enterprise Purchase

Chart 3 depicts graphically the actual conforming loan limit in 2007 and the maximum conforming limit for one-unit properties in high-cost areas in 2007 if H.R. 1427 or S. 2036 had been in effect in that year, assuming that area was defined as an MSA and the NAR's estimates for the third quarter of 2006 had been used to estimate median house prices for one-unit properties. Chart 3 also depicts, for each affected MSA, the new conforming loan limit and the mean size of first lien jumbo loans originated in the first half of 2007 that would have been eligible for Enterprise purchase if either bill had been in effect. About 92 percent of those loans were originated in California. As noted, California accounted for 49 percent of all jumbo mortgages originated in the first half of 2007 and later securitized and 14 percent of conventional single-family loans originated in that period and purchased by the Enterprises.



Source: OFHEO based on data from National Association of Realtors, First American Loan Performance, Fannie Mae, and Freddie Mac.

Historical data provide several reasons to believe that the credit risk of the mortgages originated in high-cost areas that would become newly eligible for Enterprise purchase if H.R. 1427 or S. 2036 was enacted might be greater on average than the credit risk of conventional single-family loans that the Enterprises have purchased nationwide. First, Chart 2 suggests that a substantial proportion of the mortgages could be IO loans and negatively-amortizing ARMs. Those mortgages pose more credit risk than fully amortizing loans, which comprise the vast majority of the mortgages now purchased by Fannie Mae and Freddie Mac. Since 2003 fully-amortizing loans have comprised less than one-half of jumbo mortgages originated and securitized. However, as noted above, the recent decline in securitization of subprime and nontraditional mortgages is likely to result in fully-amortizing loans accounting for a larger share of jumbo originations going forward.

Second, the mean FICO scores of the mortgages newly eligible for Enterprise purchase might be lower on average, and the mean LTV ratios of those loans might be higher, than those of mortgages that Fannie Mae and Freddie Mac now purchase. Single-family mortgages that Freddie Mac purchased in 2006 had a

mean FICO score of 720 and a mean LTV ratio of 73 percent. For Fannie Mae, the corresponding statistics were 716 and 73 percent, respectively. Data from First American LoanPerformance suggest that jumbo mortgages originated in 2006 that were securitized that would have been eligible for Enterprise purchase if H.R. 1427 or S. 2036 had been in effect had a mean FICO score of 697 and a mean LTV ratio of 77 percent. Lower FICO scores and higher LTV ratios would make the credit risk of mortgages newly eligible for Enterprise purchase under H.R. 1427 greater than that of the loans now purchased by the Enterprises.

Third, the distributions of the FICO scores and LTV ratios of mortgages that would be newly eligible for Enterprise purchase might differ from those of loans that the Enterprises now purchase. Data from the first half of 2007 suggest that the proportion of newly eligible conventional single-family mortgages with both FICO scores below 650 and LTV ratios above 80 percent could be nearly 60 percent greater than the proportion of Enterprise-purchased loans with those characteristics. Again, that suggests that the newly eligible mortgages could pose more credit risk than loans now purchased by the Enterprises.

V. Potential Implications for Fannie Mae and Freddie Mac

The enactment of the provisions of H.R. 1427 or S. 2036 that would increase the conforming loan limit in high-cost areas would affect the credit guarantee businesses of Fannie Mae and Freddie Mac by changing the volume of single-family mortgages the Enterprises purchased or securitized and, potentially, by changing the average guarantee fee rate earned by each Enterprise. Those effects would depend on the volume of mortgages originated in high-cost areas that would be newly eligible for Enterprise purchase, the Enterprises' underwriting and pricing policies, and the relative costs of securitization via the Enterprises and private-label conduits.

It is likely that Fannie Mae and Freddie Mac would be willing and able to purchase most FRMs and some fully-amortizing ARMs that were newly eligible for Enterprise purchase. Those two types of loans comprised 30 percent of jumbo mortgages originated in the first half of 2007 and later securitized (Chart 2) and are likely to comprise a larger share of jumbo originations going forward. The Enterprises would be less likely to purchase nontraditional loans, particularly IO mortgages and negatively-amortizing ARMs, in part because they have been cautious in acquiring those loans outright.

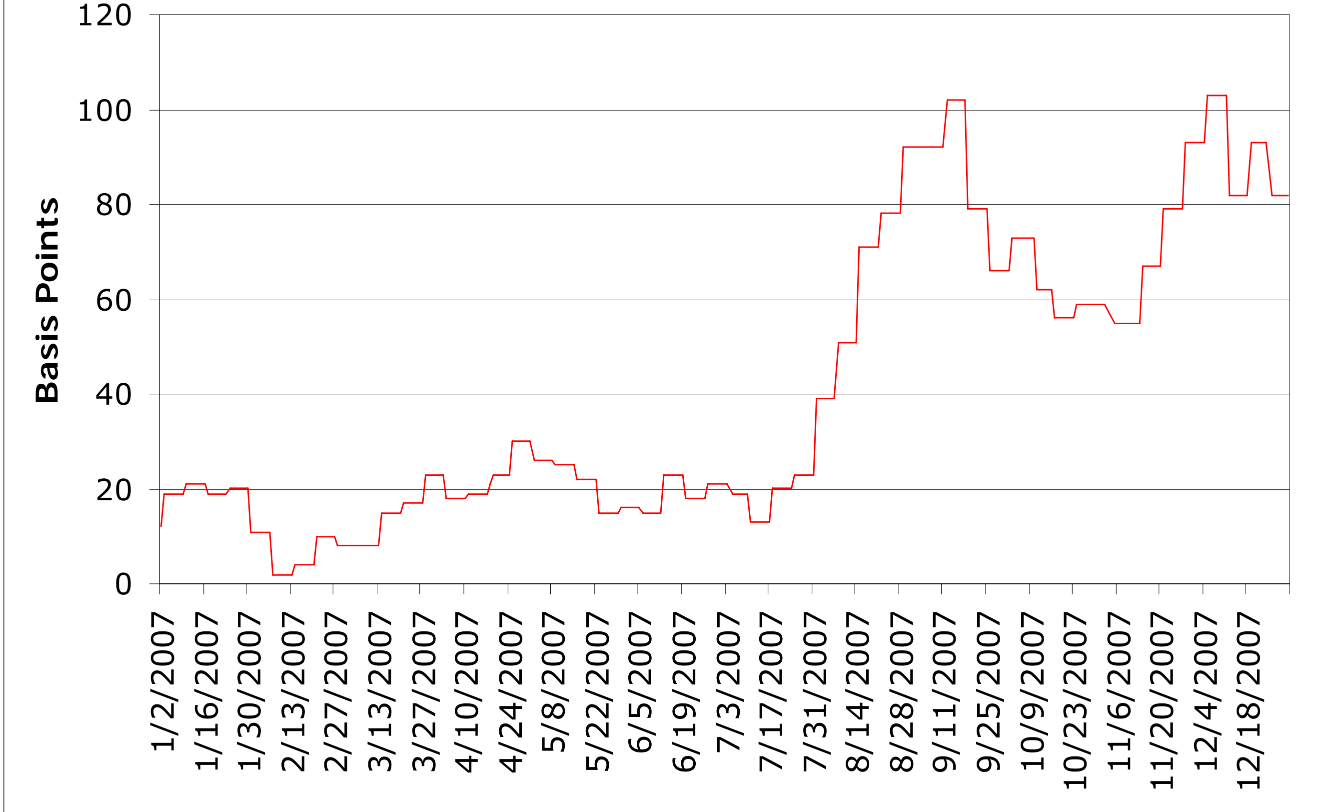
As noted, the newly eligible mortgages originated in high-cost areas might pose greater credit risk on average than loans now purchased by Fannie Mae and

Freddie Mac. The Enterprises would have to charge higher average guarantee fees to compensate for any greater risk or focus their purchases on the mortgages in the newly eligible group whose credit risk was comparable to the loans they now purchase. In addition, it is unlikely that a large proportion of the newly eligible mortgages would count toward the affordable housing goals imposed by the Secretary of Housing and Urban Development.

VI. Potential Implications for Mortgage Borrowers

At present, enactment of the provisions of H.R. 1427 or S. 2036 that would increase the conforming loan limit in high-cost areas could enable borrowers in high-cost areas who took out traditional FRMs that were newly eligible for Enterprise purchase to reap savings in interest costs. A variety of studies suggest that government sponsorship of Fannie Mae and Freddie Mac has contributed to the differential between the yields on traditional FRMs with principal balances at origination that are below the conforming loan limit. Estimates of that differential, calculated using data from various years from 1986 through 2003, have varied from 15 to 60 basis points, with estimates for the most recent years falling at the lower end of that range.[2] The sharp decline in origination and securitization of jumbo FRMs in the third quarter of 2007 led to a significant increase in the differential. Data collected by UBS suggest the differential averaged 17 basis points in the eight months from January through July 2007 and 74 basis points in the five months from August through December 2007, peaked twice at more than 100 basis points in mid-September and again in mid-December, and was about 80 basis points at the end of the year (Chart 4). If the secondary market liquidity of MBS backed by jumbo mortgages improved significantly, the differential might return to levels near those seen in the first half of 2007. In that event, the savings in interest costs achieved by borrowers who took out newly eligible traditional FRMs would be much lower.

[2] The most recent studies are Ambrose, Brent W.; Michael LaCour-Little; and Anthony B. Sanders, "The Effect of Conforming Loan Status on Mortgage Yield Spreads," *Real Estate Economics* (2004), 32: 4, 541-569; McKenzie, Joseph A., "A Reconsideration of the Jumbo/Non-Jumbo Mortgage Rate Differential", *Journal of Real Estate Finance and Economics*, 25: 2-3, 197-213; and Passmore, Wayne; Shane M. Sherlund; and Gillian Burgess, "The Effect of Housing Government-Sponsored Enterprises on Mortgage Rates," *Real Estate Economics* (2005), 33 :3, 427-463.



Source: OFHEO based on data from UBS Mortgage Strategy Group.

There is little or no hard evidence that the activities of Fannie Mae and Freddie Mac lower the yields on fully amortizing ARMs or on nontraditional mortgages. As noted above, traditional FRMs made up about 26 percent of jumbo mortgages originated in the first half of 2007 and later securitized. (Historically, that percentage has been close to 50 percent.) It is not clear that enactment of H.R. 1427 or S. 2036 would be likely to reduce materially the yields of other types of mortgages in affected high-cost areas that would become eligible for Enterprise purchase. However, in periods of market turmoil such as the last few months, reductions in the yields of those loans might be more widespread and larger than in more typical market environments.

A portion of the savings reaped by borrowers who took out traditional FRMs whose interest costs were reduced by enactment of H.R. 1427 or S. 2036 would likely be capitalized in the prices of homes financed with those loans. Already high-priced markets could become even higher-priced. To the extent that occurred, the

proposals would be unlikely to reduce greatly the affordability problems of affected borrowers.

S. 2036 would raise the conforming loan limit for all conventional single-family mortgages in high-cost areas for one year following the date of enactment. The prospect of the higher limits expiring would give borrowers and lenders an incentive to ensure that loans that were newly eligible for Enterprise purchase were closed by the end of that year, which could lead to market distortions.

How much increasing the limit for one year only would affect the interest rates on mortgages newly eligible for Enterprise purchase and originated during that year would depend in part on how the market accommodated the short-term nature of the increase. Important issues would be whether lenders could place the newly eligible mortgages in pools of loans financed with MBS sold in the To-Be-Announced (TBA) market and whether the Enterprises could purchase such securities after the one-year period.

VII. Policy Issues

Jumbo mortgages affected by H.R. 1427 or S. 2036 would have a mean size that would be substantially larger than the mean size of Enterprise-purchased loans in the affected areas. For example, if the provision had been in effect in 2006 (when the conforming limit was $417,000), area defined as an MSA, and NAR data used to identify affected MSAs, the mean size of newly non-jumbo loans would have been about $491,638, whereas the mean size of Enterprise-purchased loans was about $275,622.

If a family spent 25 percent of its income on the principal and interest payments on a 30-year mortgage of $417,000 with an interest rate of 6.25 percent, the family would have an annual income of more than $123,000. Clearly, the current conforming limit is capable of serving many households with incomes thought to be high under most other government programs. A loan limit that was 50 percent higher—$625,500—would be serving families with incomes of $185,000 or more.

House price depreciation could reduce the conforming loan limit for an area that qualified as a high-cost area. That possibility raises the same issue as the possibility of declines from year to year in the national conforming loan limit.

The definition of area could affect significantly the volume of jumbo mortgages and the localities affected by the provisions of H.R. 1427 and S. 2036 that would increase the conforming loan limit in high-cost areas. The choice would also

influence the magnitude of the operational costs associated with maintaining systems that distinguished accurately between jumbo and non-jumbo loans originated in the localities determined to be high-cost areas each year. Defining areas at the zip code level would impose additional costs and could create confusion, as many neighborhoods would have two or more conforming loan limits. Those costs would be borne by the Enterprises and mortgage lenders and, to a degree, by borrowers.

The proportion of mortgages newly eligible to be purchased by Fannie Mae and Freddie Mac under H.R. 1427 or S. 2036 that count toward the affordable housing goals would be significantly smaller than the proportion of single-family mortgages now purchased by the Enterprises that count toward those goals. If the volume of newly eligible loans purchased by Fannie Mae and Freddie Mac became large, the Enterprises would likely request a reduction in the percentages for each goal.

The loan limits applicable to mortgages insured by the Federal Housing Administration (FHA) are tied to the conforming loan limits. If one of the objectives of raising the conforming limit is to increase the FHA loan limits, that could be accomplished by legislation to modernize FHA. Thus, Congress may wish to ensure that any increase in the conforming limit is coordinated with that legislation.

Finally, a $500,000 mortgage owned or guaranteed by Fannie Mae or Freddie Mac would require twice as much capital for regulatory purposes as a $250,000 mortgage. Permitting the Enterprises to purchase jumbo mortgages, even if only for securitization, could absorb capital that would otherwise be used to support the purchase of a larger number of smaller loans, especially if Fannie Mae and Freddie Mac faced capital constraints.

Appendix: Data Sources and Methodologies

The Federal Housing Finance Board (FHFB) releases monthly estimates of the national average purchase price of single-family houses. Under current law the FHFB's estimate for October of each year, which is released in November, provides the basis for setting the conforming loan limit for the following year.

The FHFB's estimates are based on a survey of major lenders that are asked to report the terms and conditions on all conventional, single-family, fully amortized, purchase-money mortgages closed during the last five working days of the month. The survey data thus exclude homes financed with mortgages insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA) and refinance and balloon loans. The survey also deletes information on the prices of homes financed with mortgages with terms to maturity less than 10 years.

The estimate for October 2006, which provided the basis for setting the conforming loan limit for 2007, was based on 14,729 reported loans from 82 lenders, representing savings associations, mortgage companies, and commercial banks. The FHFB weights the reported data to reflect the shares of mortgage lending by lender size and lender type as reported in the Federal Reserve Board's latest release of Home Mortgage Disclosure Act data.

First American LoanPerformance collects information on single-family mortgages that collateralize private-label MBS and leases datasets containing standardized, loan-level information about those mortgages. The dataset on loans backing MBS collateralized by jumbo mortgages can be used to study the secondary market for jumbo mortgages and the prices of homes financed with jumbo loans. The analysis in this paper used information from a dataset released by First American LoanPerformance in December 2007 that contains information on mortgages securitized through October of that year. After appropriate screening, that dataset provided information on 606,561 first-lien, one-unit jumbo loans originated in 2006 that had an aggregate unpaid principal balance at origination of $378.6 billion.

DataQuick Information Systems collects information on real estate transactions from county recorder and assessor records in 220 Metropolitan Statistical Areas (MSAs) in 42 states. For three states that provide mortgage data but no sales prices, DataQuick Information Systems

estimates sales prices based on mortgage amounts. The analysis in this paper used a dataset released by DataQuick Information Systems in November 2007. That dataset includes sales prices for 487,532 homes purchased in the third quarter of 2006.

The National Association of Realtors (NAR) publishes quarterly estimates of median sales prices for existing single-family homes for 150 MSAs in 45 states plus the District of Columbia. For the third quarter of 2007, the NAR reported estimates for 145 of those MSAs. The NAR develops the estimates from data on home sales reported by local boards of realtors from their multiple listing systems. The local boards report not the prices of individual properties but the number of properties sold with prices in different (currently 18) price categories. The NAR uses that information to estimate median sales prices for each metropolitan area, except those in California, which are estimated by the California Association of Realtors using the same methodology and provided to the NAR.

Index to Relevant Documents
(active Web links below)

MORTGAGE MARKET NOTE 07-2: Historical Trends in the Conforming Loan Limit - (October 16, 2007)

MORTGAGE MARKET NOTE 07-1: Portfolio Caps and Conforming Loan Limits - (September 06, 2007)

OFHEO STAFF WORKING PAPER 07-1 "Securitized Jumbo Mortgages: 1986 - 2005" (June 2007)