National Association of Home Builders

1201 15th Street NW
Washington, DC 20005

T 800 368 5242
F 202 266 8400

www.nahb.org

Housing Finance & Regulatory Affairs

David L. Ledford
Senior Vice President

March 20, 2014

Federal Housing Finance Agency
Office of Policy Analysis and Research
Constitution Center
400 7th Street, SW
Ninth Floor
Washington, DC 20024

Re: Fannie Mae and Freddie Mac Loan Purchase Limits:
Request for Public Input on Implementation Issues

Submitted via electronic delivery to: loanpurchaselimitinput@fhfa.gov

Dear Sir or Madam:

The National Association of Home Builders (NAHB) is pleased to have the opportunity to provide our comments to the Federal Housing Finance Agency (FHFA) in response to the request for public input on the contemplated reduction in loan purchase limits by Fannie Mae and Freddie Mac (the "Enterprises"). NAHB is a Washington-based trade association representing more than 140,000 members involved in all aspects of single-family and multifamily residential construction. NAHB and its members have a strong interest in establishing and sustaining a housing finance system that provides home buyers access to affordable mortgage financing in all geographic areas, in all economic conditions. The importance of the size of the conforming loan limit to the availability of affordable mortgage credit across the nation cannot be over-emphasized.

**Background**

Current Determination of Fannie Mae and Freddie Loan Purchase Limits

The loan limits for Fannie Mae and Freddie Mac are determined annually based on a statutory formula mandated in the *Housing and Economic Recovery Act of 2008* (HERA.) HERA provides for the then-conforming, conventional loan limit of $417,000 to remain as a permanent base loan amount from which all loan limits for the Enterprises, including high-cost area loan limits, will be determined.

HERA not only established the permanent base loan amount of $417,000 for a single-family residence, but also established high-cost area loan limits in areas in which 115 percent of the median house price is above $417,000. For those areas, the loan limits are calculated at 115 percent of the area median house price not to exceed 150 percent of $417,000 or $625,500.

HERA mandates that the base loan amount for the Enterprises must be adjusted each year by calculating the percentage change in the house price index determined by FHFA during the most recent 12-month or 4-quarter period ending before the time of determining such annual adjustment. The current base loan amount is then adjusted by the equivalent percentage to determine the new base loan amount. If the calculation indicates a decrease in the current base loan amount, then no adjustment to the base loan amount is made and any subsequent upward adjustment shall take into account prior declines in the house price index. This rule effectively means the base loan amount shall not be decreased.

Traditionally, loan limit adjustments have been based on the annual change in the October-to-October house price index and are effective as of January 1 of the following year.

<u>Private Label Securities Market</u>

The loan limit effectively divides the conventional mortgage market into the conforming sector which has access to lower mortgage rates through Fannie Mae and Freddie Mac programs and the non-conforming sector supported by the private label securities (PLS) market and portfolio lending by banks and thrifts. The recent crisis in the housing and financial markets had a devastating effect on the private label mortgage-backed securities (MBS) market. Issuance of private label MBS essentially disappeared in 2008 when private capital retreated from the mortgage market. Issuance of Fannie Mae, Freddie Mac and Ginnie Mae securities (agency MBS) increased significantly that same year proving the value of the Enterprises' government-sponsored enterprise status and the countercyclical value of the Federal Housing Administration (FHA). Issuance of agency MBS remains at about 98 percent of the MBS market while private label MBS issuance continues to be almost nonexistent at approximately two percent of the market. Mortgage activity by portfolio lenders is volatile and not consistent or reliable.

There is widespread agreement that this almost total dependence on a government-backed mortgage industry is neither desirable nor sustainable and must be altered. Toward that goal, the industry has spent significant time and energy discussing ways to encourage the return of private capital to the mortgage market. Some believe in order to encourage private capital to reengage, proactive steps must be taken to diminish the competitive advantages that have allowed Fannie Mae and Freddie Mac to dominate the marketplace. These people believe that a key factor to the Enterprises' competitive advantage is being allowed to purchase loans up to $417,000 in all markets and up to $625,500 in certain designated high-cost markets.

To those who subscribe to this theory, it appears obvious that reducing the size of loans eligible for the Enterprises to purchase would decrease the Enterprises' mortgage purchases and security issuance and thus make room for or "crowd in" the private label MBS market. They believe if the Enterprises cannot buy larger-sized loans, private lenders will automatically have a larger universe of loans available for purchase and private label MBS issuers would have access to more loans.

To others, it is less obvious that private capital would step in simply because the Enterprises have access to a smaller universe of originated mortgages. They believe there are bigger obstacles to private capital's return to today's mortgage market. Investors still face many uncertainties such as how the Qualified Residential Mortgage rule will be implemented when finalized; the prospect of some local governments using eminent domain to seize mortgages of distressed homeowners; and lingering doubts about the reliability of lenders' credit underwriting standards and servicing operations.

**FHFA Proposed Reduction in Loan Purchase Limits**

FHFA proposes to decrease the base loan amount of $417,000 to $400,000 and from $625,500 to $600,000 in high cost areas. This is a decrease of approximately four percent. Loan limits in every county and county-equivalent area where the loan limit is tied to the median home price in the area and varies between the base loan amount and the ceiling would be reduced by the same four percent.

FHFA states it is seeking input on this proposal and will not make a final decision to lower loan purchase limits until comments have been reviewed. Any reduction would not take place before October 2014.

FHFA proposes to decrease loan limits as a means of reducing the number of loans that would be eligible for purchase by the Enterprises. FHFA believes this would accomplish two goals: 1) reduce risk to taxpayers since the Enterprise-purchased loans are used to collateralize agency MBS that are guaranteed by the federal government, and 2) provide incentive for private capital to reenter the mortgage marketplace by increasing the universe of loans available for purchase by private capital.

Lowering the conforming loan limits was not part of FHFA's Strategic Plan for contracting the presence of the Enterprises. However, Acting Director DeMarco refers to President Obama's expressed interest in a gradual reduction in maximum loans limits at the Enterprises as authorization for this approach. In August 2013, the Obama Administration outlined the President's principles for housing finance reform. One step in its proposed transition to a new housing finance system calls on FHFA to "closely examine using their existing authorities to reduce loan limits."

**NAHB Comments**

NAHB is fundamentally opposed to the agency's plan to reduce the loan purchase limits at Fannie Mae and Freddie Mac below the limits provided by statute in HERA. We are opposed for the following reasons:

- NAHB believes the determination of conforming loan limits should be a component of comprehensive housing finance system reform passed by Congress. The formulas for calculating conforming loan limits always have been determined by law – HERA was an act of Congress and before HERA, Congress passed the Charter Acts creating Fannie Mae and Freddie Mac that specified the annual calculation of conforming loan limits. FHFA may have the authority to decide that the Enterprises' loan limits will be set below the HERA mandated limits in a given year, but NAHB does not believe it is appropriate for FHFA to establish a new process for determining future loan limits on an annual or otherwise basis outside of and prior to Congressionally-mandated housing finance system reform. NAHB does not support FHFA getting ahead of Congress on an issue so vital to the future of the housing industry.

- The nation's housing market is making a gradual and cautious recovery. Though housing starts, existing home sales, and property values all showed steady improvement in 2013, the recovery is far from robust and its sustainability is not certain. Experts predict home purchases will be impacted by limited inventory, higher mortgage rates and continued tight mortgage credit in 2014. The credit box for mortgage loans remains exceedingly tight with the average FICO score for a mortgage sold to the Enterprises at 753 and the average loan-to-value ratio at 70 percent. NAHB is concerned that the unknown impact of lower loan limits will contribute to uncertainty that will prevent the market from gaining the momentum necessary for a vigorous and sustainable recovery.

- FHFA indicates the agency's intent is to continue decreasing the loan limits and asks for a suggested method for scheduling and determining future decreases. NAHB is concerned that the proposal only considers loan limit decreases and does not make any mention of the current statute that requires the calculation to take into account the condition of the housing market and year-over-year changes in house prices that might indicate an increase in loan limits. To consider issuing pre-set reductions without taking into account improving house prices is a significant deviation from the way loan limits are determined currently. FHFA is contemplating a much more significant policy change than simply a reduction in loan limits.

- The initial decrease of four percent in the conforming loan limits proposed by FHFA does not appear to be based on any rationale and therefore seems arbitrary. FHFA concludes that the number of consumers impacted by the initial proposed reduction from $417,000 to $400,000 is modest, but NAHB believes that whether or not a significant number of consumers are impacted initially, for some, the possibility of accessible and affordable mortgage credit will be eliminated while no borrowers will actually derive any benefit from the proposed plan. Consumers who are unable to increase their downpayment or secure secondary financing in order to qualify for a conforming loan amount will be forced into the nonconforming or jumbo loan category and likely will be subject to increased rates and/or more restrictive underwriting requirements. This is an unacceptable consequence in light of the tenuous recovery the housing market is undergoing.

- The impact of continued decreases in conforming loan limits is entirely unknown because it is impossible to gauge, *a priori*, the interest and capacity of private capital. It is speculative at best to presume the private market will step in to purchase loans that become ineligible for purchase by the Enterprises. NAHB agrees with those who believe there are factors other than the competitive advantage of the Enterprises keeping the private investors from returning to the mortgage market.

- As the housing market improves, if the loan limits at the Enterprises continue to decrease, the gap between house prices and loan limits will grow, increasing the number of borrowers dependent on the whims of private capital. NAHB believes this would impede a more robust housing recovery by continuing to restrict access to credit.

## Conclusion

NAHB strongly opposes any reduction in the loan purchase limits at Fannie Mae and Freddie Mac by FHFA. We do not believe it is in the best interest of the housing market for FHFA to take the lead on this critical issue. Congress is in the midst of effecting comprehensive housing finance system reform and changes to loan limits, particularly reductions, outside of

Congressionally-mandated reform will create additional and unnecessary uncertainty for a vulnerable housing market.

In light of the current fragile mortgage marketplace and little to no indication that private capital is ready to reengage in the mortgage market in any significant way, lowering the loan purchase limits of Fannie Mae and Freddie Mac would limit their ability to meet their responsibility to "foster liquid, efficient, competitive, and resilient national housing finance markets."

Thank you for your consideration of NAHB's comments. If you have questions, please contact Becky Froass, Director, Financial Institutions and Capital Markets, at 202.266.8529 or email rfroass@nahb.org.

Sincerely,

David L. Ledford
Senior Vice President
Housing Finance & Regulatory Affairs