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Housing Finance & Regulatory Affairs

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Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Constitution Center
400 7th Street, SW
Eighth Floor
Washington, DC 20024

Attention: Input/Notice No. 2015-N-03

Re: Notice of Establishment of Housing Price Index
Notice and Request for Input

Submitted via Electronic Delivery to:
www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form

Dear Mr. Pollard:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to respond to the Federal Housing Finance Agency's (FHFA) Notice and Request for Input on the Establishment of the Housing Price Index (HPI) for assessing the national average single family house price for use in adjusting the conforming loan limits of Fannie Mae and Freddie Mac (the "Enterprises"). Specifically, the established index is used to determine the baseline conforming loan limit, which in turn, is used to determine conforming loan limits in "high-cost" areas, the Federal Housing Administration's (FHA's) loan limits for insured mortgages and the maximum loan guaranty amount allowed by the Veteran's Administration.

NAHB is a Washington-based trade association representing more than 140,000 members involved in all aspects of single family and multifamily residential construction. The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system that offers home buyers access to affordable mortgage financing at reasonable interest rates through all business conditions. Mortgage loan limits that reflect the movement of house prices nationwide are critical to ensure the housing finance market operates effectively in all areas of the country.

Background

Fannie Mae and Freddie Mac are allowed to purchase loans up to a certain dollar amount. This dollar amount is known as the conventional, conforming loan limit. The Enterprises' loan limit is imposed under their federal charters as amended by law and applies to all conventional mortgage loans delivered to the Enterprises for whole loan purchase or MBS pool issuance. The base loan limit applies nationally to 1-family units and is subject to change annually. Loan limits are increased for 2-4 family units and in areas designated as "high-cost" and are calculated from the national base loan limit.

The Housing and Economic Recovery Act of 2008 (HERA) created FHFA and amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act) to require the agency to "establish and maintain a method of assessing the national average 1-family house price for use for adjusting the conforming loan limitations of the Enterprises." HERA amended the charters of Fannie Mae and Freddie Mac to specify that the base loan limit should be changed annually by the percentage change year-over-year in the House Price Index determined by FHFA to be the best candidate for assessing the national average 1-family house price. At the time HERA was enacted, the conforming base loan limit was $417,000 and remains at $417,000 today due to HERA's provision that the base loan limit shall not be allowed to decrease when national average house prices decline. As house prices begin to approach the levels experienced before the Great Recession, it is anticipated that the loan limit calculation in 2015 may indicate an increase for the first time since rising to $417,000 in 2006.

The Safety and Soundness Act identifies specific HPIs that FHFA must consider using to adjust the conforming loan limit. The Safety and Soundness Act requires FHFA to evaluate its own HPI, specifically the HPI maintained by the Office of Federal Housing Enterprise Oversight prior to the effective date of the Federal Housing Finance Regulatory Reform Act, any appropriate HPI of the Bureau of Census of the Department of Commerce, and information from a contemplated FHFA survey of national lenders for measuring the national average 1-family house price. FHFA also considered measures of house price changes from CoreLogic, S&P/Case-Shiller, and the National Association of Realtors (NAR). After evaluating the various indexes from each of these sources, FHFA selected its own "expanded-data" HPI to use for adjusting the baseline conforming loan limit.

To evaluate available measures of house price changes, FHFA established several factors to consider, placing emphasis on whether price changes would correlate closely with changes in the U.S. average home price, the level of transparency concerning how the statistics are constructed, and the length of time the index has been available to minimize the risk that the metric might be discontinued. Importantly, FHFA also appears to have given significant weight to alleviating concern that reliance on an externally produced HPI would subject FHFA to the consequences of a decision by the producer of the index to discontinue its publication and/or incorporate methodological changes that might disrupt the availability of the information necessary to calculate and publish the conforming loan limits.

FHFA, CoreLogic and S&P/Case-Shiller produce weighted, repeat-transactions indexes meaning they measure the average price changes in repeat sales or refinances on the same properties. This ensures the price changes are measuring changes in value based on market conditions rather than measuring the value of the characteristics of different properties. However, within the approach, there are significant variations among the indexes. FHFA produces the all-transactions HPI, the purchase-only HPI, and the expanded-data HPI. The all-transactions HPI and the purchase-only HPI include only mortgage loans purchased by the Enterprises. The all-transactions HPI also includes appraisal values from refinance transactions. The expanded-data HPI was determined to provide the best estimate of the overall change in the U.S. average home price since it incorporates transaction prices for FHA-insured loans and homes whose transactions have been recorded at county recorder offices and does not include appraisal values from refinance mortgages.

The National Association of Realtors (NAR) Average or Median Home Prices index and the Census Bureau's indexes capture monthly median and mean sales prices of sales transactions. Unlike the repeat sales transactions method, using the median and mean sales prices means the physical features of the underlying pool of properties sold are not considered. The index price may change based on the different characteristics of the properties sold each month rather than changing market conditions which is more appropriate for determining whether conforming loan limits should be changed.

The Safety and Soundness Act also asks FHFA to take into consideration the monthly survey of all major lenders conducted by FHFA to determine the national average 1-family house price. However, FHFA has not conducted the survey to-date as it is still developing the required data fields making this option unfeasible.

NAHB Comments

NAHB believes FHFA's choice of the expanded-data HPI is reasonable based on the agency's self-imposed criteria of transparency, reliability and control. Using its own expanded-data HPI ensures its continued publication; allows FHFA to incorporate new information as it may become available for enhancements; and, prevents any uncertainty about how the index is calculated which could be a disadvantage of indexes from a third-party source. Too, repeat-transactions methodology for measuring U.S. home prices has merit from an economic measurement point of view. However, by definition, an index based on repeat-transactions fails to account for newly built homes - an important component of the housing market.

FHFA was specifically required to consider appropriate HPIs from the Census Bureau. Though FHFA dismissed the Census Bureau's HPIs as not viable because the statistics track prices of new homes which can differ substantially from price trends for existing homes – a significant drawback according to FHFA – NAHB believes by specifically referencing the Census Bureau HPI, the Safety and Soundness Act is encouraging the incorporation of new home prices in the calculation of the baseline conforming loan limit.

Although in a given year the number of new homes built for owner-occupancy (including both homes built for-sale and owner- or contractor-built homes) is less than the number of existing home sales, the share is still significant. For example, over the last 15 years new, single-family home transactions constituted 17.3 percent of total home purchases/contracts, according to data from the Census Bureau, NAR, and calculations by NAHB.

Moreover, the price of a unit of new construction, controlling for size and quality differences, does not always move at the same rate as the price of an existing home, controlling for size and quality differences through a method like repeat sales. Prices of new homes are set, in part, by the same factors that drive existing home prices, such as total demand for owner-occupied housing and the inventory of homes on the market, but also reflect supply side factors such as building material costs, construction wages, and terms on construction loans that do not directly affect prices of existing homes. For this reason, it is not appropriate to ignore prices of new homes when constructing a price index for conforming loan limits as the loans are used to purchase both new and existing homes.

The Census Bureau, with partial funding from the Department of Housing and Urban Development, produces a series of indexes on new home prices. The most commonly cited, median and average prices in the monthly report on new home sales,[1] would not be appropriate for FHFA's purposes because the Census Bureau does not control for changes in types of homes now being sold. This is particularly important currently because home prices are likely to have been rising in part due to a lack of first-time homebuyers in the market.

However, the Census Bureau's construction price indexes[2] provide relevant alternatives for the new homes that are excluded from the repeat sales calculations. Using data from the Survey of Construction and statistical regression analysis, the Census Bureau is able to control for changes in the types of homes being built (including changes in size, amenities and location), thereby yielding a constant quality measure of new home prices. The resulting constant quality indexes and deflators provide a quality-controlled measure for new home prices comparable to the repeat-transactions method for existing homes.

NAHB Recommendation

NAHB recommends the Census Bureau's constant quality price index for new homes sold as the most appropriate measure of the change in new home prices. The constant quality index is a Laspeyres-type price index that does not allow for substitution effects, but it is the only one of the Census Bureau's construction price indexes that includes the value of land, and the owner of a new home must pay for the land whether acquiring a home built-for-sale, a contractor-built, or owner-built home.

It is appropriate to include contractor-built and owner-built single-family homes, because they also may use loans purchased by Fannie Mae and Freddie Mac for their permanent financing. Although the Census Bureau's constant quality price index for new homes sold is based on a smaller subset of single-family homes, this index still is the best measure because, like the FHFA house price index, it incorporates the value of land.

Therefore, NAHB urges FHFA to use the constant quality price index for new homes sold along with the FHFA expanded-data HPI as a method for adjusting the conforming loan limits of Fannie Mae and Freddie Mac. To combine the two, NAHB recommends a weighted average, with the weights based on recent market share of existing single-family home sales, as estimated by NAR, and new homes built for owner-occupancy as estimated by the Census Bureau—including single-family homes built-for-sale, contractor-built and owner-built.

[1] https://www.census.gov/construction/nrs/index.html

[2] http://www.census.gov/construction/cpi/

More technically, NAHB recommends FHFA use the following formula to adjust the conforming loan limits for inflation:

$$\%\Delta HPI \times w_1/(w_1 + w_2) \; + \; \%\Delta CQ \; w_2/(w_1 + w_2)$$

Where:

- $\%\Delta$HPI is the percentage change in the expanded-data FHFA house price index
- $\%\Delta$CQ is the percentage change in the Census Bureau's constant quality price index for new single-family homes sold
- w_1 is the number of existing single-family home sales, as reported by NAR
- w_2 is the number of single-family homes completed, as reported by the Census Bureau, including built-for-sale, contractor-built and owner-built (i.e., excluding only those built for rent).

Conclusion

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 rfroass@nahb.org.

Sincerely,

David L. Ledford

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