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Back to previous page

D.C. area housing market feels the pinch from lower jumbo mortgage limits

By KatherineReynolds Lewis, Published: November 3

Srinivasan Soundararajan and Jennifer Nordin have been thinking about selling their Potomac townhouse and moving into a detached house for some time. With two small children, 1 and 3 years old, they are beginning to outgrow their three-bedroom house.

This past summer, the couple stayed out of the market because of Congress's gridlock over the U.S. debt ceiling; they feared that a spike in interest rates could disrupt a pending house purchase. Once lawmakers agreed to raise the ceiling, they started looking at houses again.

Now that they're close to making an offer on a property, a change in federal housing policy has hampered their plans.

On Oct. 1, Fannie Mae and Freddie Mac lowered the maximum size of so-called jumbo mortgages that they would back to $625,500. Before Oct. 1, Washington-area mortgages as big as $729,750 could be purchased by Fannie and Freddie and repackaged to sell to bond investors, or guaranteed by the Federal Housing Administration. The change was the result of a law Congress passed in 2008 to stimulate the housing market in the depths of the crisis.

As a result, the upper end of the Washington real estate market is feeling the pain as buyers have fewer options to finance the purchase of a house. And sellers, like Soundararajan and Nordin, feel the change constrains the pool of potential buyers for their townhouse, which they expect to list at $725,000.

"It would definitely affect the ability of someone to buy our house," said Soundararajan, a 43-year-old attorney, noting that his sale price equals the new cap plus a down payment of $100,000. "That's not a first-time buyer. We're going to lose that market."

Although a mortgage larger than $600,000 may seem like a lot of money, Washington remains one of the most expensive markets in the country, and such loans are more common here than in other places. Washington ranks fourth among U.S. metropolitan areas in the number of houses affected by the new limits, according to researchers at New York University's Furman Center for Real Estate and Urban Policy . The center found that 2.7 percent of the market, or 1,755 area houses, is no longer eligible for government backing, based on an analysis of 2009 home purchases.

"This part of the market may not be as well served now that we've lowered these limits," said Mark A. Willis, a resident research fellow at the Furman Center. "In those areas where the market is weakest, this is going to be another injury."

In looking at local real estate sales data, it's still early to tell how much of an impact the loan changes have had on sales, said Jonathan Hill, president of RealEstate Business Intelligence. Compared with last October, home sales above the conforming limit slowed by 6 percent in October 2011 in the top 10 median sales price areas of the District, according to preliminary figures from the data firm. That decline occurred while the overall real estate market slowed from 3,109 sales in October 2010 to 2,258 in October 2011, a 27 percent decline.

Taking away a pool of buyers

It's possible to obtain mortgages bigger than $625,500, but they fall into the jumbo category, which often come with higher interest rates. Not only are jumbo mortgages more expensive, but to qualify you need to have better credit, a larger down payment and more assets. They may even call for two appraisals, said Chad Loube, vice president at Rockville-based First Place Bank. Only the wealthiest buyers will qualify.

"You've taken away a pool of buyers that are trying to upgrade their house," Loube said. "It certainly trickles down. The market gets stagnant, which is what is kind of happening now."

Loube and other Washington-area real estate professionals expect to see slower sales, fewer transactions and stagnant prices as a result of the change. The very upper end of the market, at $1.5 million and above, probably won't suffer, but house prices below $1 million will be affected — a part of the market that had held up relatively well in recent months.

When people are unable to sell their houses because the buyers can't obtain financing, they don't "move up" to a larger house, agents say. That reduces demand for real estate and ultimately keeps prices from growing as quickly as they would have otherwise for houses priced above, below and between the conforming loan limits.

"This is not what the real estate community needed," said Harris Rosenblatt, a senior mortgage banker with EagleBank. "In Potomac, Northwest D.C., McLean, if you were selling your house for $900,000, you're really hurting."

First and second trusts:

An expensive alternative

Traci Levine, a Realtor with Long & Foster in Potomac, said she is seeing more first- and second-trust mortgages, in which the first mortgage is a conforming loan at the $625,500 limit and the second mortgage is often a variable-rate, shorter-term loan at a rate a couple of percentage points higher. Since fewer buyers are eligible to obtain this financing, houses are likely to sit on the market longer. "I prepared all my upper-bracket sellers that things would potentially slow down," Levine said.

In Arlington, consultant Alex Braier has had multiple offers for his three-bedroom, $3^1/_2$-bath townhouse, which was listed in mid-October, but none close enough to the $824,900 list price. He believes prospective buyers are having trouble closing the gap between the $625,500 limit and the price of the house.

"First-time homeowners are going to be forced into smaller, less-expensive dwellings," Braier said. "The loan limit is interfering."

When Braier and his wife, Diana, purchase a new house in the spring, they will probably have to take out first and second mortgages because of the drop in the limits. The higher interest rates they'll pay on the second mortgage will consume money they would otherwise have spent in the local economy, Braier said.

"If I were able to do a conforming loan versus a first and second trust, I would be able to use the additional money to buy furniture and to furnish my new house, instead of paying the banks, which has no economic impact whatsoever," he said.

A movement in Congress

to restore old loan limits

But Braier has reason to hope that by the spring, the old limits will be restored. The Senate in late October voted to move the conforming mortgage caps back to the previous levels as part of the appropriations legislation for the Department of Housing and Urban Development. The House has yet to take up the measure; it declined to vote on a similar bill in mid-September.

"We understand it's going to be an uphill battle over there; there's some expressed opposition," said Scott Meyer, assistant vice president at the National Association of Home Builders. "We're hopeful that the 60 votes over in the Senate show significant support."

On the other side, housing policy experts have urged the Obama administration to allow the limits to continue falling as a way of easing the government out of the role of supporting the housing market. Before the 2008 financial crisis, private investors held a large portion of mortgage debt through repackaged securities. That market has dried up, for all sizes of mortgages, and the government now operates Fannie and Freddie under a conservatorship.

In the long term, policymakers say, the only viable future for housing finance is to have private financial institutions replace the government in the role of buying, repackaging and holding mortgage debt. But there's no sign yet of investors clamoring to purchase jumbo loans.

"There's a lot of interest and lots of money waiting on the sidelines, but nobody knows what their exposures are going to be yet or what the regulations are going to be," said Keith Gumbinger, a vice president at HSH.com, a mortgage information Web site. The private sector is waiting for the specifics of new mortgage rules ordered by last year's Dodd-Frank financial overhaul before taking any big steps to invest in jumbo loans.

In the meantime, the market is slowing for sellers in the $700,000 to $900,000 range. And buyers are facing more limited and more expensive options for financing. The families that will be the most hard-pressed are those that previously would have qualified for FHA financing, which allows down payments as low as 3.5 percent. FHA insurance is traditionally aimed at lower-income, first-time home buyers who can't come up with large down payments. But when private-sector mortgage insurance is scarce, the FHA can fill the gap for families at all income levels as long as they meet credit requirements.

"People who don't have a lot of cash for down payment — that's where we're seeing more pain," said Renee Voyta, vice president at First Savings Mortgage in Bethesda.

For Soundararajan and Nordin, the situation adds to the anxiety involved in buying and selling in the Washington area market. When they place a bid on a single-family home, they plan to put their townhouse on the market very quickly. But they're not sure what will happen next.

"Buying a house is a big commitment to an area for any amount of time," Soundararajan said. "This degree of uncertainty is much higher than 10 years ago, when I bought this townhouse."