FURMAN CENTER
FOR REAL ESTATE & URBAN POLICY
NEW YORK UNIVERSITY
SCHOOL OF LAW • WAGNER SCHOOL OF PUBLIC SERVICE

A Canary in the Mortgage Market?

Why the Recent FHA and GSE Loan Limit Reductions Deserve Attention

Summary: A new white paper by NYU's Furman Center for Real Estate and Urban Policy explores the potential implications of recent reductions in the maximum loan size that can be guaranteed by Fannie Mae and Freddie Mac (Government-Sponsored Enterprises or GSEs), or insured by the Federal Housing Administration (FHA) in many parts of the country. These changes, which went into effect on October 1, 2011, represent the first step in a long-term policy goal to reduce the federal government's current role in the mortgage system.

Key Findings:

- The changes affect eligibility for FHA-insurance in 152 metropolitan areas, containing more than two-thirds of the U.S. population. In 50 of these metro areas, located primarily in California and the East Coast, the GSE limits were lowered as well.
- Less than two percent of the U.S. mortgage loans originated in 2009 were within the range of values for their metropolitan area that are affected by the loan limit change.
- Based on 2009 mortgage origination data, the private sector would have to increase "jumbo" lending by approximately 38 percent in dollars lent, and 56 percent in number of originations, in order to fill the gap left by the GSE loan limit reduction.

Implications:

- Borrowers who might otherwise have relied on an FHA- or GSE-backed loan in a size range no longer eligible for either will have to rely on the private jumbo market, take out a smaller loan, or delay their borrowing. Many such borrowers (especially those who might otherwise rely on an FHA loan) may not be able to qualify for jumbo loans, because they typically have higher interest rates and higher down payment requirements than GSE and FHA-backed loans.
- The loan limit changes will be a significant test of the private mortgage finance system**,** which might respond in different ways to the new gap in FHA and GSE eligibility:
    - The private sector may be unwilling to allocate enough portfolio space to meet the additional demand at affordable rates and with traditional products.
    - The private sector may expand to fill the gap, but primarily through additional portfolio lending, which would not provide clear information about the private sector's capacity to serve the broader housing market if loan limits were reduced further.
    - Or, the private label security market could reemerge to finance an expansion of jumbo lending.
- The success or failure of the jumbo market to serve the increased demand resulting from the loan limit reductions will help policymakers balance further government pullbacks from the mortgage market against the risks of harming the housing market.

Methodology: The paper analyzes mortgage origination data collected under the Home Mortgage Disclosure Act. It includes only first-lien, one-to-four family, non-business related loans originated to owner-occupants in metropolitan areas in 2009.