

Office of Federal Housing Enterprise Oversight

Proposed Guidance on Conforming Loan Limit Calculations

The Office of Federal Housing Enterprise Oversight is seeking public comment on a proposed *Guidance on Conforming Loan Limit Calculations*. These calculations establish the maximum size limit for loans that Fannie Mae and Freddie Mac may purchase, as provided in their charters. The conforming loan limit is adjusted annually through a calculation of year over year changes to the existing level of home prices based on data from the Federal Housing Finance Board. Because of the importance of the conforming loan limit, OFHEO has sought to craft procedures that avoid problems in the setting of the limit, that provide an understandable framework for setting the limit and that do not represent significant operational challenges to mortgage and financial markets.

The guidance elaborates on and revises an existing guidance— Supervisory Guidance *Conforming Loan Limit Calculations*, SG-04-01 (February 20, 2004) that delineated OFHEO role in calculating and announcing the conforming loan limit. In 2006, after a decline in housing price numbers, OFHEO announced that, while the conforming loan level had decreased, the resulting decline in the limit would be delayed a year and that OFHEO would revise the existing guidance and address how the decline would be implemented.

OFHEO is seeking comment on all aspects of the guidance. Significant matters include whether and how the limit should decline, rounding of dollar amounts, deferral of loan limit declines for the later of one year or until they reach at least a cumulative one percent (1%) level, “grandfathering” of qualified conforming loans and a number of procedural matters set forth in the guidance.

Because of the importance of Fannie Mae and Freddie Mac and the conforming loan limit to the mortgage markets and the interest of other financial institutions, mortgage bankers, builders, realtors and others, OFHEO has determined to seek public comment on the guidance.

Comments are due by July 19 and should be addressed to Alfred Pollard, General Counsel, OFHEO, at either 1700 G Street N.W., 4thFloor, Washington, D.C. 20552 or ofheoguidancecomments@ofheo.gov.

Guidance and Supplemental Materials Follow

Examination Guidance

Issuance Date: July ____ 2007

Doc. #: PG-07-0_

Subject: Conforming Loan Limit Calculations

TO: Office of Supervision
 OFHEO Associate Directors

Table of Contents

- I. Introduction
 - a. Scope
 - b. Preservation of Existing Authority
- II. Calculation of Conforming Loan Limit
 - a. General Procedures
 - b. Procedures for Years in Which Limit Declines
 - c. Procedures for Adjustments and Technical Changes

References

Supervisory Guidance SG-04-01
Federal Housing Enterprises Financial Safety and Soundness Act
OFHEO Regulations Safety and Soundness Standards, 12 CFR 1720 &
Prompt Supervisory Response & Corrective Act, 12 CFR 1777

I. Introduction

a. Scope

This guidance addresses the annual establishment of the conforming loan limit amount for mortgages purchased by Fannie Mae and Freddie Mac ("the Enterprises") and OFHEO supervisory procedures related to such activity.

This guidance replaces Supervisory Guidance SG-04-01.

(1) OFHEO Supervisory Authority.

OFHEO oversees two housing government sponsored enterprises-- Fannie Mae and Freddie Mac-- to assure they operate in a safe and sound manner and maintain adequate capital; 12 USC 4501, 4511, 4513. OFHEO's responsibilities include avoiding situations that would present safety and soundness problems; 12 CFR 1720, Appendices A and B and 12 CFR 1777. In addressing areas where such problems could arise, OFHEO has highlighted corporate governance and financial disclosures; 12 CFR 1730 and 1710. In its regulation on disclosure, OFHEO noted key areas of concern— access to markets and potential damages to the firm from incurring reputation risk. Therefore, OFHEO has set forth this guidance to ensure that the conforming loan limit is established in a manner consistent with safe and sound operations and with statutory requirements.

For twenty-five years of practice, the Enterprises announced a conforming loan limit. However, in seven of those years adjustments or decisions were made that raise safety and soundness concerns about the annual adjustment to the conforming loan limit. OFHEO believes that the situation may be addressed through appropriate guidance, setting a more regularized process of oversight and control for this matter of national significance, and that is the intent of this guidance.

(2) Conforming Loan Limit (CLL).

The Enterprises are authorized by their charters to purchase mortgages up to a specified limit as adjusted annually; 12 USC 302(b)(2) and 305(a)(2). This limit is referred to as the conforming loan limit (CLL).

The Enterprises make this adjustment based on a survey conducted by the Federal Housing Finance Board (FHFB). The FHFB monthly conducts and publishes the

results of a survey of mortgage interest rates, the Monthly Interest Rate Survey (MIRS). The Enterprises, under their charters, use the change in the national average one-family house price during the twelve-month period ending with the previous October as determined by the FHFB in its survey. The Enterprises apply the percentage change to the current year's conforming loan limit to establish the next year's limit. This number determines the eligibility of loans for Enterprise purchases.

OFHEO as safety and soundness regulator has responsibility to oversee safe and sound operations and may act to redress violations of law by the Enterprises. In the case of the conforming loan limits OFHEO determined in 2004 following another problem in technical matters relating to the limits, that a more formalized process for establishing the conforming loan limit was needed.

(3) Background to Conforming Loan Limit Determinations.

Since 1981, the Enterprises have adjusted the conforming loan limit as allowed under the Housing and Community Development Act of 1980. During this time frame, two types of occurrences have transpired that raise the need for a more formal process: (1) the Enterprises some times have adjusted their loan limits in a manner that is different from the survey results and (2) there have been cases where the Federal Housing Finance Board has made technical changes to its methodology for determining housing price that the Enterprises have not reflected in their adjustments.

In 2006 and on three prior occasions the average house price declined from October to October (in 1989, 1993, and 1994). In November 1989, the Enterprises reduced the 1990 conforming loan limit by \$150 from the 1989 level based on a house price decline of 0.07 percent. In November 1993 and November 1994, however, the Enterprises announced that the conforming mortgage loan limit would remain constant at \$203,150, despite two declines in house prices of 2.96 percent in 1993 and 1.46 percent in 1994 from the prior years. After housing prices increased from October 1994 to October 1995, the Enterprises raised the limit for 1996 without any adjustment for the previous declines.

Additionally, in November 1997, the Enterprises took another course, setting a lower number than the adjustment produced. They determined that the 1998 conforming

loan limit would increase by only 3.67 percent, even though the percentage change in house prices using FHFB data for 1996-1997 was 8.44 percent. The practical effect of this action was to adjust for the 1993 and 1994 price declines.

There have been three occasions when the Federal Housing Finance Board made methodological changes to the Monthly Mortgage Interest Rate Survey that required an adjustment to one or both of the reference years, that is, the prior or current year's October calculation (in 1992, 1998, and 2003). In December 1992, the Enterprises determined that the 1993 conforming loan limit would increase 0.42 percent based on adjusted FHFB numbers for October 1991 and October 1992 national average one-family house price published on December 1, 1992. In November 1998, the Enterprises determined that the 1999 conforming mortgage loan limit would increase by 5.66 percent based on an adjusted October 1997 house price survey. Therefore, in 1992 and again in 1998, the Enterprises used the adjusted national average one-family house price(s) provided by the FHFB.

In 2003, however, the Enterprises adopted a conforming loan limit that disregarded communications from the FHFB staff⁶ regarding a change in the methodology for estimating house prices. The Enterprises determined that the increase in the 2004 conforming loan limit would increase by 3.41 percent based on unadjusted national average house prices for October 2002 and October 2003. However, FHFB staff had indicated that the October 2003 national average house price should be adjusted downward by \$1,647, a net increase of 2.71 percent.

Due to this inconsistent application of procedures for price declines and methodology changes, OFHEO issued a conforming loan limit guidance in 2004. To clarify elements of the existing guidance and to address the concerns around possible declines in the national average house price average, OFHEO announced in late 2006 that it would issue a new guidance on the conforming loan limit, replacing the 2004 guidance.

In 2006, the October national average house price average declined by 0.16 percent from the previous October, which by the standard calculation would have reduced the maximum single family conforming loan limit from \$417,000 to \$416,300. OFHEO had previously indicated, however, that the effect of any decrease in the house price average would be deferred until the Fall 2007 calculation of the limits for the following year. OFHEO also stated that for the 2008 calculation, the decrease of 0.16

percent would be deducted from any increase in the average house price in the year ended October 2007 or, if the average price decreased, the loan limit would decrease by that amount. Left to be determined was how a further decline in 2008, if it occurred, would be treated and whether any existing loans would be grandfathered if the limit was reduced for 2008. The purpose of this guidance is to address these and related issues.

b. Preservation of Existing Authority

Nothing contained in this guidance prevents OFHEO from undertaking such supervisory or enforcement actions as may be necessary to meet its statutory obligations to oversee maintenance of safety and soundness and adequate capital.

II. Calculation of Conforming Loan Limit

a. General Procedures

- (1) Consistent with statute, OFHEO will utilize the October MIRS survey data (routinely released in November) to calculate the conforming loan limit for the following calendar year.
- (2) Under the terms of an inter-agency agreement, the FHFB will provide OFHEO with the confidential October survey data prior to its public release.
- (3) OFHEO will calculate the percentage change in the average house price, make any adjustment needed to reflect FHFB technological changes and determine the new maximum conforming loan limit for the following year. The result of the calculation will be rounded downward, in line with existing practice, to the nearest \$100, for marketplace convenience and administrative simplicity.
- (4) Immediately following the FHFB's October MIRS announcement, OFHEO will announce the maximum level of the new conforming loan limit and simultaneously issue a letter with its determination to each Enterprise.
- (5) Each Enterprise under its charter then determines whether to set the conforming loan limit at its institution at or below that level.

(6) The purchase of any mortgage above the limit by Fannie Mae or Freddie Mac will be considered an unsafe and unsound practice, running contrary to statute.

b. Procedures for Years in Which The House Price Level Declines

(1) In a year in which the October house price level is lower than the level of the previous October, OFHEO will defer the impact of that decline on the conforming loan limit for one full year. The effect of the price level decline of 0.16% from October 2005 to October 2006 was deferred in this manner.

(2) After deferring the impact of a decline in the average price level for one year

(A) if the price level falls in the following year, the latter decline will be deferred one year, and the maximum loan limit will be adjusted by the decline of the former year. However, the decrease will be deferred to the next year unless it exceeds one percent (1%); or

(B) if the price level increases the following year, then the prior year's (or years') decline(s) will be subtracted from such increase, unless such subtraction(s) result(s) in a decrease of less than 1%, in which case such decrease will be carried forward to the next year.

(3) All loans that were within the conforming loan limit at the time of origination will continue to be deemed within the conforming loan limit during the remaining lives of such loans, regardless of whether the loan limit for any subsequent year declines to a level below the limit at the time of origination.

c. Procedures for Adjustments and Technical Changes

(1) At any time during the year after a calculation has been made and the conforming loan limit set, if the FHFB revises the MIRS or any calculation, OFHEO or the Enterprises may provide comments to the FHFB for its consideration; copies of any Enterprise comment should be produced contemporaneously to OFHEO.

(2) Once the FHFB has determined the nature, scope and timing of technical changes or adjustments, OFHEO will make adjustments to the next year's conforming loan limit based upon the procedures set forth in this Guidance.

Examples of How Increases and Declines in House Prices Affect the Conforming Loan Limit under OFHEO's Proposed Guidance

To facilitate comment on the conforming loan limit guidance, currently out for public comment, the following examples reflect how declines and increases would be addressed in future years:

The current loan limit is \$417,000. In 2006, the average house purchase price declined by 0.16 percent and this decline was deferred one year until the next calculation in November 2007 for the 2008 limits. OFHEO has proposed that declines always should be deferred a year and that they should accumulate to a one percent threshold before being implemented on the downside.

In November 2007,

(a) if the average house purchase price has **gone up** during the year, for example by 2 percent, the deferred decline of 0.16 percent would be subtracted, and the new loan limit beginning January 2008 would show an increase of 1.84 percent.

(b) if the average house purchase price has **gone up** during the year, for example by 0.10 percent, then the deferred decline would offset that 0.10 percent increase and a 0.06 decline would be carried forward. The conforming loan limit would remain the same at \$417,000.

(c) if the average house purchase price has **gone down, the conforming loan limit will remain at \$417,000 for 2008.**

The deferred decline will be added to the 0.16 percent and carried forward until the next calculation in November 2008, as follows:

(i) if the average house purchase price **goes up** during 2008, the conforming loan limit will be calculated per (a) or (b) above with the offset being the cumulative deferred decline of 0.16% and the November 2007 decline;

(ii) if the average house purchase price **goes down** during 2008 and the cumulative deferred decline of 0.16 percent from 2006 and the decline from 2007 coupled with the 2008 decline still total less than 1 percent, the conforming loan limit would remain at \$417,000 in 2009; or,

(iii) if the average house purchase price **goes down** during 2008 and the cumulative deferred decline of 0.16 percent from 2006 and the decline from 2007 and 2008 totals 1.0 percent or greater, then the conforming loan limit for 2009 will be adjusted downward by that cumulative deferred decline.