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### Economic Commentary

## Ante Up -- and Raise the Limit!

by Lawrence Yun, Chief Economist, NAR Research

Interest rates have fallen for many potential home buyers in the past few months. The average rate on a 30-year fixed rate mortgage for prime borrowers dipped from 6.5 percent in the summer months of this year to less than 6 percent according to the December 11 weekly report from Freddie Mac. Such an improvement in the interest-rate environment generally lifts home sales -- my estimation is about 200,000 on an annualized basis.



### The Subprime Disappearing Act is Over

Yet, home sales have fallen. Existing-home sales had been running at around a 6.2 million annualized pace in the first half of 2007. Then came the summer credit crunch with anything subprime essentially disappearing from the marketplace. Subprime loan originations had accounted for roughly 20 percent of the total mortgage market in 2006 and the early part of 2007. With that part of the market essentially shut down, it should not be surprising that home sales have been trending a similar 20 percent below their sales pace posted in the early part of the year prior to the credit crunch -- running at near a 5 million-unit pace in September and October. In other words: the impact of the virtual disappearance in subprime loans has already been accounted for in the home sales data. The good news: we are likely scraping the bottom in terms of home sales.

With interest rates down for prime borrowers, as well as a boost in FHA loan endorsements, existing-home sales can only rise from this point onwards. But it will not be an easy climb. There is plentiful pent-up housing demand that has been accumulating. Still, many home buyers are taking their time deciding when to buy and which home to purchase given the abundant inventory of properties from which to choose. Some are waiting for foreclosures to top out.

### Unfair Limits

Others home buyers, unfortunately, are getting a raw deal. Yes, interest rates have been falling for those loans that can be backed by Fannie Mae and Freddie Mac. Low interest rate FHA loans are also abundantly available. (More on FHA loans later.) But there are limits on the maximum loan amounts that Fannie and Freddie mortgage products can carry. Currently, the loan limit for Fannie/Freddie-backed loans is \$417,000. That just won't work in some markets. Those loan limits are artificial -- and grossly unfair. Home sales have been hammered in those regions of the country where a loan amount above \$417,000 is often required to buy a home because interest rates on jumbo loans continue to remain very high.

So what's holding back the raising of these loan limits? One reason could be that anything touching on GSEs is politically sensitive. In addition, high interest-rate returns on jumbo loans from banks and financial institutions may be more attractive to profit-making lenders than the returns from low-interest rate loans.

A simple raising of the loan limit to \$625,000 will have an immense beneficial impact on the housing market. Home buyers will get low interest rate loans. Home sales pick up -- in my estimation by 330,000 units. Inventory falls. Home prices strengthen. Foreclosure pressures lessen.

### FHA Could be Better

A similar impact would be unleashed as a result of raising the FHA loan limit -- the mortgage product of choice for many low and moderate income households. On that front, there is some good news to report. The Senate recently passed legislation that would allow raising the loan limit for FHA insured loans. *The FHA Modernization Act of 2007* will help protect the interest of America's current and future homeowners by giving borrowers a safer

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### FSBO Facts in NAR's Latest Profile Report

The level of for-sale-by-owner transactions remains at a record-low market share of 12 percent, according to NAR's **2007 Profile of Home Buyers and Sellers**. Four out of 10 FSBO properties were not placed on the open market but were "closely held" between parties who knew each other in advance.  
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alternative to riskier mortgage products while also helping many homeowners who may be facing foreclosure. In addition, the increase in FHA mortgage loan limits would help first-time home buyers, minority buyers, and people who do not qualify for conventional mortgages. Increased loan limits would also help people living in high-cost areas; current FHA limits make the program unusable in these areas. NAR has long supported modernizing the FHA program allowing for increased loan limits, and reducing eliminating the statutory 3 percent minimum cash down payment.

NAR has been actively lobbying for the change to raise the loan limits on Fannie/Freddie backed loans. Such a change would benefit many consumers who are looking to purchase a home. It begs the question: why are lawmakers dragging their feet in raising the loan limits? Why aren't they looking out for the interests of housing consumers – i.e., homeowners? The legislation addressing loan limits on Fannie and Freddie-backed loans is needed ASAP.

Academic studies on the social benefits of homeownership have shown that people who own their own homes are more invested in their communities. Homeowners also are more likely to be active politically than non-owners: they vote. As we look toward a new year in which Americans will go to the polls, voters will remember those lawmakers who have not been on the side of consumers.

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