We make home possible℠

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July 19, 2007

By Courier and Electronic Mail

Alfred M. Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, NW
Fourth Floor
Washington, DC 20552

RE: Proposed Guidance on Conforming Loan Limit Calculations Posted for Public Comment on the OFHEO Web site on June 20, 2007

Dear Mr. Pollard:

Freddie Mac appreciates the opportunity to comment on the Office of Federal Housing Enterprise Oversight's (OFHEO) proposed "Guidance on Conforming Loan Limit Calculations" posted for public comment on the OFHEO web site on June 20, 2007.

OFHEO announced on November 15, 2006 that while the house price level in the Federal Housing Finance Board (FHFB) series had decreased, the effect of that decrease would be delayed a year. The proposed Guidance would establish a process regarding how decreases would be carried out and would address related issues.

Freddie Mac believes decreasing our loan limits would be disruptive to the single-family mortgage market and would increase costs for the full range of single-family mortgage market participants, including homebuyers, homeowners, originators, homebuilders, real estate brokers, secondary market investors, mortgage insurers and the Enterprises. A reduction in our loan limits has repercussions beyond the conventional market, as it also would reduce loan limits for FHA-insured loans and reduce the maximum guarantee amount for VA-guaranteed loans, a loan program that provides important benefits for our nation's veterans.

A decrease in Freddie Mac's loan limits would harm families by adversely affecting homeownership opportunities, increasing the down payment required to refinance into a conforming mortgage, increasing mortgage interest costs, and delaying refinance out of more expensive mortgage products. Accordingly, we do not believe there is any public policy, housing or residential mortgage market reason for reducing Freddie Mac's loan limits. Any public policy objective of keeping the conforming market at roughly a constant percentage of the mortgage market would be better served by offsetting any decrease against future increases in adjusting the loan limits.

While we believe only Freddie Mac has statutory authority to set loan limits, we intend to comply with any Guidance OFHEO may issue. We believe OFHEO should seek to implement any decrease in the loan limits in a manner that is less disruptive to the

single-family mortgage marketplace. We have reviewed the proposed Guidance and offer the following recommendations to accomplish this objective:

1. The proposed Guidance would defer loan limit decreases until the later of one year or until cumulative decreases equal or exceed one percent. Rather than implementing a one percent threshold, we recommend adoption of a five percent threshold to recognize the large volatility in annual growth rates that emerge from the FHFB's Monthly Interest Rate Survey (MIRS).

2. To avoid unnecessary and damaging market disruptions, we recommend any decrease in conforming loan limits for a particular calendar year become effective on the first business day of May of the following calendar year to ensure that nearly all conforming loans in the pipeline would remain conforming. This effective date would help avoid disruptions in the To-be-Announced market for agency mortgage-backed securities.

3. We recommend adding language to the grandfathering provision that would allow the Enterprises to hold any mortgage that was within the conforming loan limit at the time of purchase, and purchase any mortgage that was within the conforming loan limit at the time of commitment to purchase or prior to the effective date of a decrease in the loan limit.

4. We recommend revising the proposed Guidance to round down to the nearest $50 the result of the calculation of the percentage change in the average house price based on the FHFB's October-to-October MIRS, consistent with the Enterprises' and OFHEO's rounding practice.

I. There is no public policy, housing or residential mortgage market reason for OFHEO to decrease the conforming loan limits

Periodic declines in the conforming loan limits would create widespread market uncertainty about the level of the conforming loan limits. This uncertainty would impose costs that would affect all parts of the single-family market.

A decrease in the conforming loan limits would harm families by adversely affecting homeownership opportunities, increasing the down payment required to refinance into a conforming mortgage, increasing mortgage interest costs, and delaying refinance out of more expensive mortgage products.

A. Homebuyers in high-cost markets would be disadvantaged

The impacts of a decline in the conforming loan limits would vary geographically and would have a disproportionate effect in high-cost areas. Most high-cost areas are located near the East and West coasts. Even though house prices have slowed significantly from the double-digit growth rates reached in 2005, the aftermath of the housing boom has left many areas of the country with house prices that have outpaced income growth and reduced affordability.

High-cost markets typically have lower homeownership rates than the national average, more minority households, a higher share of underserved areas, and a higher subprime share of originations. For example, in Los Angeles the homeownership rate was 54 percent in 2006, well below the national average of 69 percent.[1] The minority share of borrowers in Los Angeles is more than double the national average and the share of loans made in underserved areas is twice as large as the rest of the nation. The high cost of housing in Los Angeles is punctuated by the proportion of the market that is jumbo and subprime. According to 2005 Home Mortgage Disclosure Act data, just over one-half of the loans made in Los Angeles were either jumbo or very high-cost loans (primarily subprime loans), a much higher percentage than in the rest of the U.S.

Los Angeles offers but one example of the many East and West Coast cities in which the high cost of housing has made homeownership unaffordable for many families. In addition to having high shares of minority households, many of these cities attract large numbers of immigrant families. Recent immigrant and minority households have much lower rates of homeownership than the national average, and will make up the majority of first-time homeowners in the coming years. A decline in the conforming loan limits would adversely affect homeownership opportunities for families residing in high-cost areas much more strongly than for the middle of the country where housing is more affordable and rates of homeownership are higher.

B. Increased mortgage cost for loans in the mortgage pipeline

In addition to reducing the affordability of homeownership for families in high-cost areas, periodic decreases in the conforming loan limits would increase mortgage interest expenses for families and/or increase the amount of down payment they must make, or lead families to forego applying for a loan. Freddie Mac estimates that approximately 142,000 mortgage loans would be "caught in the mortgage pipeline" in the last three months of 2008 if the conforming loan limits declined by five percent.[2] Further, originators will bear additional market risks and may incur fair value losses for unsettled loans in their pipeline which cross from conforming to nonconforming as a result of a decline in the loan limit. Mortgage loans in the pipeline are those for which lenders have provided or committed to provide interest rate-locks to loan applicants and loans that have yet to be pooled.

Almost one-half of the borrowers within this five-percent wedge, between $396,000 and the current one-family conforming limit of $417,000, are likely to be located in California, New York and Florida, where housing markets have been weak and characterized by declining home values. The OFHEO purchase-only index demonstrates the recent weakness in house-price growth in these three states. The annualized quarterly change in house prices from the 4th quarter of 2006 to the 1st quarter of 2007 was -1.7 percent in New York, -3.9 percent in Florida and -4.5 percent in California. The geographic

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[1] See http://www.census.gov/hhes/www/housing/hvs/annual06/ann06t14.html

[2] This analysis assumes that the 2008 conforming loan limits are the same as the 2007 limits, and that a five percent decline would be announced on or around December 1, 2008, and effective January 1, 2009.

concentration of loans in the mortgage pipeline that will be affected by a decline in the conforming loan limits will exacerbate already weak real estate markets.

Freddie Mac estimates that the full-year effect for 2009 would be that approximately 567,000 conventional single-family mortgage borrowers, of which about 60,000 would be subprime borrowers, would either have to make a larger down payment or pay higher interest costs, or both, or would have to forego a new mortgage loan. Minority families would likely compose approximately 30 percent of all the affected borrowers in the conventional single-family market. In addition, approximately 20,000 FHA and VA borrowers would be affected by a five percent decline in the conforming loan limits (because this would reduce the FHA loan limits and VA maximum guarantee amount), typically minority families and veterans buying their first home, bringing the total number of affected families to 587,000. (See Enclosure 1.)[3]

II. Periodic decreases in the conforming loan limits would be disruptive to the market

A. Decreases in the conforming loan limits would impose costs on all lenders and small lenders would be disproportionately disadvantaged

The proposed Guidance would also impose significant costs associated with modifying single-family mortgage market participants' systems and processes to capture decreases in the conforming loan limits that are not balanced by any commensurate benefit. Both the Enterprises and market participants would need to modify business systems and processes to give effect to new, lower loan limits. These systems and processes range from the initial receipt, recording, storage and monitoring of data to the transformation of data for a variety of business and regulatory purposes, including quality control and risk management.

Decreases in the conforming loan limits would require market participants to adapt current systems in order to accurately price loans in the pipeline at the time of announcement of a decrease in the loan limit for the following year. Loans at or near the previous year's limit would no longer be conforming simply because they were originated in the following calendar year, complicating the servicing and wholesale process. The costs of updating systems to deal with periodic decreases in the loan limit would be borne by all lenders, however these costs would be disproportionately burdensome to small lenders because they originate fewer loans over which to amortize these additional costs. System changes necessitated by periodic decreases in the loan limit would thereby disproportionately advantage large lenders.

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[3] A decline in the conforming loan limit would adversely affect FHA-insured and VA-guaranteed loans because the maximum FHA-insured loan limits and maximum VA guarantee amount are linked to the Freddie Mac loan limit. *See* 12 U.S.C. § 1709(b)(2)(A)(ii) (FHA-insured loans) and 38 U.S.C. § 3703(a)(1) (VA-guaranteed loans). Further, we note that such a decline would adversely affect the Rural Housing Service's (RHS) loan guarantee program, which is also linked to the Freddie Mac loan limit (through FHA's 203(b) limits). *See* 7 C.F.R. § 3350.63 (establishes the maximum loan limits for RHS-guaranteed loans).

B. New homebuyers and homebuilders would incur added costs

The market for new homes would be uniquely affected by the proposed Guidance. According to the Census Bureau, in 2006 the average number of months from start to completion of a one-family home was 7 months, and for a two- to four-family home the average was 11 months.[4] In addition, many new homebuyers sign purchase contracts before home construction has started; it is not uncommon for a new homebuyer to settle 9 to 12 months (or longer) after signing the purchase agreement. Many builders offer an extended rate-lock through an affiliated mortgage lender to facilitate the home sale. An OFHEO announcement of a loan limit decline during this period introduces uncertainty in the finance-delivery process, would impose additional costs on homebuyers and builders, and is disruptive to the provision of credit and financing of new homes.

C. Market psychology

OFHEO should also take into account how announcement of a loan limit decrease may affect an already fragile real estate market. It is well-established that house prices are affected by expectations of future price movements.[5] Any government action that highlights or seems to confirm falling house prices could put further downward pressure on prices that is not otherwise supported by market conditions.

III. Analysis of statutory provisions to set or decrease the conforming loan limits

We believe the plain language of section 305(a)(2) of the Freddie Mac Act, 12 U.S.C. § 1454(a)(2), requires Freddie Mac to establish the conforming loan limits by adding any increase to the previous maximum loan limits.[6] The Federal National Mortgage Association Charter Act contains an identical provision.

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[4] *See* http://www.census.gov/const/www/lengthoftimeindex.html.

[5] *See* for example, Karl E. Case and Robert J. Shiller (2003), "Is There a Bubble in the Housing Market? An Analysis," *Brookings Papers on Economic Activity*, No. 2, p. 28, wherein Case and Shiller state,

> The predominant story about home prices is always the prices themselves; the feedback from initial price increases to further price increases is a mechanism that amplifies the effects of the precipitating factors. If prices are going up rapidly, there is much word of mouth communication, a hallmark of a bubble. The word of mouth can spread optimistic stories, and thus help cause an overreaction to other stories, such as stories about employment. The amplification can also work on the downside as well. Price decreases will generate publicity for negative stories about the city...

[6] The definition of the term "residential mortgage" in the Freddie Mac Act comports with the provisions on setting loan limits: a residential mortgage must meet such requirements as to amount as may be prescribed by Freddie Mac. 12 U.S.C. § 1451(h).

It is a well-settled principle of statutory construction that when statutory language is clear and unambiguous, it must be accorded its plain meaning. Caminetti v. United States, 242 U.S. 470, 485 (1917); West Virginia University Hospitals, Inc. v. Casey, 499 U.S. 83, 98; 111 S.Ct. 1138, 1147 (1991).

The clear congressional decision to delegate authority to Freddie Mac to establish the single-family conforming loan limits has been preserved intact since enactment even though Congress has since amended the conforming loan limits provisions several times.

A principal reason Congress established the conforming loan limits was to encourage the flow of mortgage credit to low- and moderate-priced housing.[7] This reason is in keeping with Freddie Mac's public purpose of providing liquidity, stability and affordability to the residential mortgage market. 12 U.S.C. § 1451(b) (Note). The disruptions that would be created in the residential mortgage marketplace by decreasing the loan limit would run counter to this purpose.

We believe that decreasing the conforming loan limits based on decreases in the October-to-October FHFB house price survey would be inconsistent with the plain language of the Freddie Mac Act and would run counter to our statutory public purpose.[8]

Finally, we note that on July 13, 2007, the United States Court of Appeals for the District of Columbia Circuit described differences between a guidance document and a legislative rule subject to the requirement for notice and comment rulemaking in the Administrative Procedure Act.[9]

IV. Recommendations for Revisions to the Proposed Guidance

If OFHEO chooses to issue a Guidance for decreasing the conforming loan limits, we believe OFHEO should seek to implement any decrease in a manner that is less disruptive to the single-family mortgage marketplace.[10]

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[7] *See* H.R. Rep. No. 91-1131 at 9 and S. Rep. No. 91-761 at 9 (1970).

[8] Freddie Mac's authority to purchase mortgage loans is part of our charter authority. Because the Secretary of the Department of Housing and Urban Development (HUD), rather than OFHEO, has statutory authority to interpret our charter in any non-safety-and-soundness matter, we assume the proposed Guidance has the concurrence of HUD.

[9] Cement Kiln Recycling Coalition v. EPA, Case No. 06-1005, slip op. at 11 (July 13, 2007).

[10] By providing these comments, we are not conceding OFHEO's authority to establish or decrease the conforming loan limits through the Supervisory Guidance on Conforming Loan Limit Calculations OFHEO adopted in 2004 or through adoption of the proposed Guidance.

A. Procedures for years in which the house price level declines

The proposed Guidance would defer loan limit decreases until the later of one year or until cumulative decreases equal or exceed one percent. In general, this approach would reduce the frequency of market disruptions associated with decreases in the conforming loan limits thereby helping ameliorate adverse consequences to the mortgage marketplace. However, in light of the substantial volatility in MIRS data compared to other measures of house price growth, we believe the appropriate threshold is five percent.

The Government Accountability Office and the Congressional Research Service have both concluded that even though the MIRS average-price series produces a measure of house-price appreciation that is comparable to other house-price series in the long run, in the short term, the MIRS series produces volatile measures of house price growth.[11]

The MIRS data is more volatile than other measures of house price growth. A comparison of the MIRS data with the National Association of Realtors' (NAR) Existing Home Average Prices, also a monthly national series, shows that MIRS is four times more likely to report a one percent decline in house price appreciation over a 12-month period from January 1973 to May 2007. The MIRS has reported national price declines in excess of five percent in 1.2 percent of the one-year intervals over that period, whereas that has never occurred in the NAR series (see Enclosure 2).

For a further indication of the increased volatility of the MIRS series over other house price indices, the MIRS can be converted to a quarterly average series by averaging the three component months, and comparing the results with the OFHEO House Price Index (HPI). Averaging will smooth a time series, so the quarterly average MIRS series should express less volatility in annual appreciation rates than the monthly series. While that is the case, the quarterly MIRS still has a great deal of volatility, revealing an annual decline of more than one percent in 9.6 percent of the one-year intervals. In comparison, over the same time period, OFHEO's HPI did not record a single instance of an annual house price decline greater than one percent (see Enclosure 2).

There is a great degree of variance between the monthly MIRS data and other measures of house price appreciation. Basing a decline in the loan limit on an estimated decline that was measured with a high degree of noise would have unfortunate market consequences. For example, the MIRS for May 1993 reported a <u>decline</u> in annual house prices of 10.3 percent. This coincided with 12-month <u>increases</u> of 0.7 percent and 4.3 percent in the average prices of the NAR survey of existing single-family home sales and the Census Bureau's survey of new home sales, respectively. In fact, over the first nine months of 1993, the MIRS average house prices had five months of <u>negative</u> year-over-year growth when both the NAR and Census Bureau surveys showed <u>positive</u> 12-month growth rates.

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[11] See "Housing Finance: Implications of Alternative Methods of Adjusting the Conforming Loan Limit," Government Accountability Office (October 1994), GAO/RCED-95-6; "House Finance Debates on the Federal and Related Credit Agencies: The 'Conforming Loan' Limits of FNMA and FHLMC," Congressional Research Service Issue Brief (January 27, 1988).

The more the MIRS data differs from other house price indices based on average monthly home prices (and the more these measures differ among each other) the less likely it is that a price decline reported by MIRS is an accurate representation of falling house prices in the single-family housing market. By calculating the level of dispersion between the different measures of house price growth, over time, a statistically relevant threshold can be generated. This threshold can easily be found by employing a standard statistical "rule of thumb" by which the standard deviation of annual house-price growth, measured across different series, is calculated and multiplied by two.

To calculate the standard deviation, annual growth rates were calculated from the MIRS, the NAR average-price series, and the Census Bureau's average-price series. These measures were chosen because all three are monthly series based on average prices and cover long time periods.[12] For each 12-month period, the standard deviation of the three annual growth rates was computed, obtaining a monthly time series of standard deviations. These were then averaged over time, yielding a mean standard deviation equal to 2.7 percent. To set a 95 percent confidence threshold, so that we have confidence that 95 percent of the time the measured annual growth rate will represent true national trends, the standard deviation is multiplied by two to obtain 5.4 percent. A statistically meaningful threshold, in this case 5.4 percent, generates a 95 percent level of confidence that the observed declines in the MIRS threshold is consistent with other measures of house price growth. Such a confidence level will help ensure that measures of price declines reported by MIRS are representative of market prices and are not a statistical aberration due to the volatility of a series based on average sale prices.

We recommend a threshold of five percent based on the above analysis and on the following two separate statistical approaches. First, the threshold should be statistically relevant. A 5.4 percent threshold provides a statistically meaningful level of confidence that there is congruence between the MIRS growth rate and the true market rate. Second, because the MIRS price series is more volatile than other measures, it is necessary to set a threshold high enough to account for the additional volatility of the MIRS series. For example, the NAR series has a 2.5 percent likelihood of experiencing a one-year decline of one percent or more, comparable to the probability of the MIRS experiencing a decline of four percent or more in a single year. Likewise, the OFHEO HPI has a zero-percent likelihood, based on historical data, of experiencing an annual decline of one percent or more, comparable to the likelihood of a four percent decline in the quarterly average MIRS, as shown in Table 1. A five percent threshold, set in-between the two approaches, produces greater reliability in the MIRS annual-growth series by providing a threshold that accounts for the volatile nature of the series and that is also statistically relevant.

B. Transition period for decreases in the conforming loan limits

The proposed Guidance does not provide a transition period for mortgage loans that would be "caught in the mortgage pipeline" for any year in which a loan limit decrease becomes effective. While the proposed Guidance would defer loan limit decreases until

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[12] This analysis used data from January 1975 to May 2007.

the later of one year or until such cumulative decreases equal or exceed one percent, the actual loan limit for any year would not be announced to market participants until November of the preceding year. For example, assume the average house purchase price goes down during 2008 and the cumulative deferred decline of 0.16 percent from 2006 netted against a hypothetical increase in 2007 (or added to a hypothetical decrease in 2007) equals or exceeds a one percent decrease. In this example, OFHEO would announce the actual full decrease in the conforming loan limits for calendar year 2009 in November 2008.

To avoid unnecessary and damaging market disruptions, we recommend any decrease in conforming loan limits for a particular calendar year become effective on the first business day of May of the following year to ensure that nearly all conforming loans in the pipeline would remain conforming. In particular, this effective date would help avoid disruptions to the To-be-Announced market for agency mortgage-backed securities, which allows lenders to offer consumers interest rate-locks for 30, 60, 90 or 120 days. This effective date would also reduce potential impacts on lenders who may have insufficient loan volumes to originate jumbo loans and on those borrowers who would need to either increase the amount of down payment or pay the higher interest rate costs associated with jumbo loans.

C. Grandfathering

The proposed Guidance provides that all loans within the conforming loan limit at the time of origination would continue to be deemed within the loan limit, regardless of whether the loan limit declines to a level below the loan limit in effect at the time of origination. Proposed Guidance, Section II, b(3).

The proposed Guidance would thereby allow the Enterprises to purchase loans that were conforming when originated. This approach would help reduce uncertainty and unintended consequences for market participants and the Enterprises, and would help reduce operational costs.

However, the proposed Guidance does not address the treatment of loans that were not conforming when originated but subsequently become conforming. The Enterprises should be permitted to purchase and make commitments to purchase such loans. For example, a loan that was originated in 2005 with an original principal balance of $417,000 could not be purchased under the loan limits in effect for 2005 but could be purchased today under the loan limits in effect for 2007.

We suggest adding language that would allow the Enterprises to hold any mortgage that was within the conforming loan limit at the time of purchase, and purchase any mortgage that was within the conforming loan limit at the time of commitment to purchase or prior to the effective date of a decrease in the loan limit. Thus, conforming mortgages previously purchased, conforming mortgages subject to a commitment to purchase, and mortgages that are not conforming at the time of origination but that subsequently become conforming would not be affected by any future decreases in the conforming loan limits.

One way to accomplish this result would be to revise the grandfather provision (Section II, b(3)) to read as follows:

> The Enterprises may purchase and make commitments to purchase any –
>
> (1) conventional mortgage, and
> (2) mortgage-backed security and mortgage related payment security,
>
> where such mortgage has, or such security is backed by mortgages having, an original principal obligation less than or equal to the limit governing the maximum original principal obligation established under the Federal Home Loan Mortgage Corporation Act or the Federal National Mortgage Association Charter Act for the calendar year of origination or any subsequent year.

D. Rounding

Under the proposed Guidance, OFHEO would round down to the nearest $100 the result of the calculation of the percentage change in the average house price based on FHFB October MIRS survey data. Proposed Guidance, Section II, a(3).

Although the proposed Guidance explains that this rounding practice is "in line with existing practice", the rounding practice for at least the past 20 years has been to round down to the nearest $50 the result of the calculation of the percentage change in the average house price based on FHFB October MIRS survey data. Because this has also been the rounding practice OFHEO has used in calculations of the 2005 and 2006 loan limits, we believe the proposed rounding down to the nearest $100 may have been inadvertent. We recommend revising the proposed Guidance to round down to the nearest $50, consistent with existing practice.

* * *

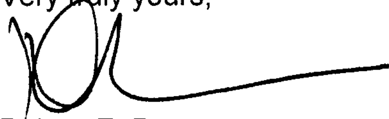
Conclusion

Freddie Mac appreciates the opportunity to comment on OFHEO's proposed "Guidance on Conforming Loan Limit Calculations." As described in our comments, Freddie Mac believes decreasing the conforming loan limits would be disruptive and costly to the full range of single-family mortgage market participants, including homebuyers, homeowners, originators, homebuilders, real estate brokers, secondary market investors, mortgage insurers and the Enterprises.

If OFHEO proceeds with issuance of Guidance on decreasing loan limits, we believe the process should be implemented in a manner that is less disruptive to the single-family mortgage marketplace. Our recommended changes to the proposed Guidance are designed to accomplish this objective. While we believe only Freddie Mac has statutory authority to set loan limits, we intend to comply with any Guidance OFHEO may issue.

Please do not hesitate to contact me if you have any questions.

Very truly yours,



Robert E. Bostrom

Enclosures

Enclosure 1

Exhibit 1: Estimated Number of Loans "Caught in the Pipeline" by a 5 Percent Decrease in the 2009 Conforming Limits

Hypothetical decrease in the 2009 conforming loan limits	5%
2009 1-unit conforming loan limit assuming decrease[1]	$396,000
Percent of loans between $396,000 and $417,000 originated in 2006 and bought by Freddie Mac[2]	3.8%
Estimated percent of loans originated between $396,000 and $417,000 by total market[3]	3.5%
Average number of single-family conventional loans originated monthly[4]	1.35 million
Assumed end of year pipeline[5]	90 days
Number of loans caught in the pipeline by a hypothetical 5 percent decrease in the 2009 conforming limits	141,750 loans
Number of households affected in 2009 by a hypothetical 5 percent decline in the conforming loan limits.	567,000

[1] Analysis assumes that the conforming loan limits for 2008 remain at the 2007 level. Data are from the 2005 Home Mortgage Disclosure Act, which provides the loan amount of the mortgage but does not indicate the number of units on the property, which can range from 1 to 4. We apply only the 1-unit limit in all our analysis for this reason.

[2] The average percent of loans with original loan amount between $396,000 and $417,000 originated in 2006 and purchased by Freddie Mac is tabulated using all conventional, one-unit residences. The loans cover the entire U.S., with higher loan limits in Alaska, Hawaii, Guam, and the U.S. Virgin Islands taken into account (i.e., the pipeline in these areas are loans with original amounts between $594,000 and $625,500).

[3] Because of the mass point formed at the conforming loan limit, we assume a smaller share originated by the market based on average jumbo shares of 10%. Percent of loans within five percent of the 2007 conforming loan limit are tabulated using the 2005 HMDA and the corresponding 2005 conforming loan limit.

[4] Average number of single-family conventional loans originated each month from 2000 to 2005. Manufactured housing is excluded. According to the Federal Reserve Board of Governors, [Refer to Robert Avery, Kenneth Brevoort, and Glenn Canner, "Higher-Price Home Lending and the 2005 HMDA Data" *Federal Reserve Bulletin,* September (2006).], HMDA represents approximately 80 percent of the Market, therefore, market originations found by increasing monthly HMDA originations by 25 percent.

[5] The mortgage pipeline takes into account the average mortgage rate lock-in period of 60 days and the average number of days from origination to purchase, typically 45 days. A loan that is "caught in the pipeline" is within 5 percent of the conforming limit and has been priced as a conforming loan before the limit has been decreased.

Exhibit 2: Estimated Number of Households with Subprime Mortgages Affected by a 5 Percent Decrease in the 2009 Conforming Limits

Hypothetical decrease in the 2009 conforming loan limits	5%
2009 1-unit conforming loan limit assuming decrease[1]	$396,000
Average number of single-family conventional loans originated monthly[2]	1.35 million
Subprime share of single-family conventional loans originated monthly[3]	20%-25%
Number of subprime loans for home-purchase or refinance originated monthly	270,000 – 337,500 loans
Percent (number) of loans between $396,000 and $417,000 that are subprime originated each month[4]	1.6% (4,320 – 5,400 a month)
Number of households with subprime mortgages affected in 2009 by a 5 percent decline in the conforming loan limit.[5]	51,840 – 64,800 households

[1] Analysis assumes that the conforming loan limits for 2008 remain at the 2007 level. Data are from the 2005 Home Mortgage Disclosure Act, which provides the loan amount of the mortgage but does not indicate the number of units on the property, which can range from 1 to 4. We apply only the 1-unit limit in all our analysis for this reason.

[2] Average number of single-family conventional loans originated each month from 2000 to 2005. Manufactured housing is excluded. According to the Federal Reserve Board of Governors, [Refer to Robert Avery, Kenneth Brevoort, and Glenn Canner, "Higher-Price Home Lending and the 2005 HMDA Data" *Federal Reserve Bulletin,* September (2006).], HMDA represents approximately 80 percent of the Market, therefore, market originations found by increasing monthly HMDA originations by 25 percent.

[3] Estimate is based on single-family, first-lien mortgages defined as "high cost" in the 2005 HMDA and excludes manufactured housing. HMDA reports that 20 percent of the dollar volume and 24 percent of the number of first lien single-family loan originations in 2005 were "high cost." Inside Mortgage Finance also reports that subprime originations were equal to 20 percent of the dollar volume of first lien single-family originations in 2005 and 2006.

[4] Percent of loans within five percent of the 2007 conforming loan limit are tabulated using the 2005 HMDA and the corresponding 2005 conforming loan limit.

[5] According to the 2005 HMDA data 1.6 percent of all subprime mortgage originations (1st liens, one-to-four family, manufactured housing excluded) were within five percent of the 2005 conforming loan limit. Many of the subprime adjustable-rate loans originated in 2005 and 2006 are scheduled for reset in 2008 or 2009. A five percent decrease in the conforming loan limit could affect approximately 60,000 homeowners at a critical time in the life of their mortgage by increasing the required down payment necessary to refinance into a conforming mortgage, by increasing mortgage interest cost, or by delaying refinance out of the more expensive subprime product.

Exhibit 3: Estimated Number of Households with FHA and VA Mortgages Affected by a 5 Percent Decrease in the 2009 Conforming Limit

	FHA	VA
Hypothetical decrease in the 2009 conforming loan limits	5%	5%
2009 1-unit conforming loan limit assuming decrease[1]	Varies by County	$396,000
Average number of single-family government-backed loans originated monthly	96,200 loans	28,000 loans
Percent of loans that are within 5% of the loan maximum[2]	1.5%	0.87%
Number of households with government-backed mortgages affected in 2009 by a 5 percent decline in the conforming loan limit.	17,315 households	2,930 households

CONCLUSION: 587,000 Households will be affected by a hypothetical five percent decline in the conforming loan limit in 2009.

[1] Analysis assumes that the conforming loan limits for 2008 remain at the 2007 level. Data are from the 2005 Home Mortgage Disclosure Act, which provides the loan amount of the mortgage but does not indicate the number of units on the property, which can range from 1 to 4. We apply only the 1-unit limit in all our analysis for this reason.

The FHA program classifies counties into three groups. In the first group, the maximum loan amount is 87 percent of the conforming loan limit, or $362,790 in 2007 and 344,650 assuming a hypothetical five percent increase in the conforming loan limit in 2009. In the second group of counties, the maximum loan amount is set to 48 percent of the conforming loan limit, or $200,160 in 2007 and 190,152 assuming a hypothetical five percent decrease in 2009. In the third group of counties, the maximum loan amount is set to the median sales price for that county.

The VA program sets the maximum guarantee amount at 25 percent of the Freddie Mac 1-unit conforming loan limit, which in effect creates a loan limit for the VA mortgage program.

[2]Percent of loans within five percent of the loan maximum for 2007are tabulated using the 2005 HMDA and the corresponding 2005 conforming loan limit.

Enclosure 2

Distribution of House Price Declines

Percent Change in Home Prices Measured Over Multi-year Time Intervals
(Monthly Series, January 1973 - May 2007)

	Occurrences					Probability				
Amount of Change	1-Year	2-Years	3-Years	4-Years	5-Years	1-Year	2-Years	3-Years	4-Years	5-Years
FHFB MIRS (413 Months)										
1% Decline	39	27	27	19	12	9.7%	6.9%	7.2%	5.2%	3.4%
2% Decline	22	21	20	16	8	5.5%	5.4%	5.3%	4.4%	2.3%
3% Decline	16	13	12	11	7	4.0%	3.3%	3.2%	3.0%	2.0%
4% Decline	10	9	7	7	3	2.5%	2.3%	1.9%	1.9%	0.8%
5% Decline	5	6	4	0	1	1.2%	1.5%	1.1%	0.0%	0.3%
NAR Existing Homes Average (413 Months)										
1% Decline	10	0	0	0	0	2.5%	0.0%	0.0%	0.0%	0.0%
2% Decline	5	0	0	0	0	1.2%	0.0%	0.0%	0.0%	0.0%
3% Decline	1	0	0	0	0	0.2%	0.0%	0.0%	0.0%	0.0%
4% Decline	0	0	0	0	0	0.0%	0.0%	0.0%	0.0%	0.0%
5% Decline	0	0	0	0	0	0.0%	0.0%	0.0%	0.0%	0.0%

(Quarterly Series, 1975Q1 - 2007Q1)

	Occurrences					Probability				
Amount of Change	1-Year	2-Years	3-Years	4-Years	5-Years	1-Year	2-Years	3-Years	4-Years	5-Years
FHFB MIRS (129 Quarters)										
1% Decline	12	8	8	4	3	9.6%	6.6%	6.8%	3.5%	2.8%
2% Decline	3	7	5	2	2	2.4%	5.8%	4.3%	1.8%	1.8%
3% Decline	2	4	4	1	0	1.6%	3.3%	3.4%	0.9%	0.0%
4% Decline	0	2	1	1	0	0.0%	1.7%	0.9%	0.9%	0.0%
5% Decline	0	1	1	1	0	0.0%	0.8%	0.9%	0.9%	0.0%
OFHEO HPI (129 Quarters)										
1% Decline	0	0	0	0	0	0.0%	0.0%	0.0%	0.0%	0.0%
2% Decline	0	0	0	0	0	0.0%	0.0%	0.0%	0.0%	0.0%
3% Decline	0	0	0	0	0	0.0%	0.0%	0.0%	0.0%	0.0%
4% Decline	0	0	0	0	0	0.0%	0.0%	0.0%	0.0%	0.0%
5% Decline	0	0	0	0	0	0.0%	0.0%	0.0%	0.0%	0.0%