

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Federal Housing Enterprise Oversight

Examination Guidance

AGENCY: Office of Federal Housing Enterprise Oversight, HUD.

ACTION: Notice of Final Examination Guidance—Conforming Loan Limit Calculations; Response to Comments.

SUMMARY: The Office of Federal Housing Enterprise Oversight is publishing today an Examination Guidance, “Conforming Loan Limit Calculations,” following two requests for public comment on a proposed examination guidance. Material in the guidance does not constitute a regulation.

DATES: [INSERT DATE PUBLISHED IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: If you have any questions regarding OFHEO’s Examination Guidance—Conforming Loan Limit Calculations, you may contact Alfred M. Pollard, General Counsel, at (202) 414-3800 (not a toll free number). The telephone number for the Telecommunications Device for the Deaf is: (800) 877-8339 (TDD Only).

SUPPLEMENTARY INFORMATION: OFHEO’s Examination Guidance on Conforming Loan Limit Calculations is posted on the Internet at <http://www.ofheo.gov>. This document, as well as all others mentioned in the preamble can also be accessed on business days between the hours of 10 a.m. and 3 p.m., at the Office of Federal Housing

Enterprise Oversight, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. To make an appointment to inspect documents, please call the Office of General Counsel at (202) 414-6924.

I. Background and Statement on the Conforming Loan Limit for 2008.

On November 15, 2006, OFHEO announced that any decline in the house price index used to establish the conforming loan limit would not result in a decline in that limit for 2007. OFHEO also committed at that time, to providing updated guidance on how future reductions in the relevant house price index would affect the conforming loan limit.

On June 20, 2007, OFHEO released on its website for public comment, a proposed revision to its existing Examination Guidance entitled “Conforming Loan Limit Calculations” (the original proposal). Subsequently, on October 22, 2007, OFHEO published in the Federal Register for public comment a revised version of that proposed guidance (the revised proposal). Today, OFHEO is issuing the final Examination Guidance.

II. Comments Received on revised Examination Guidance—Conforming Loan Limit Calculations.

Calculations for the conforming loan limit establish the maximum size of 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’s Monthly Interest Rate Survey (MIRS).

A. Guidance Proposals. OFHEO provided for public comment on the proposed examination guidance through OFHEO’s website on June 20, 2007, and at the end of a

thirty day comment period, some 23 comments from 25 organizations (representing over 2 million individuals and businesses) and individual comments were received. OFHEO took these comments into consideration, altered its proposed draft guidance and reissued it for further public comment on October 22, 2007. Central to OFHEO's consideration was assuring clarity in the process of calculating loan limits, providing for smooth market operations and affording certainty to those involved in making and securing mortgages—Fannie Mae and Freddie Mac, mortgage originators, and homebuyers.

The proposed guidances and the guidance made final today elaborate on, revise and supersede an existing guidance— Supervisory Guidance Conforming Loan Limit Calculations, SG-04-01 (February 20, 2004) that delineated OFHEO's 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 deferred a year. OFHEO also indicated it would revise and update the existing guidance and address how the decline would be implemented. OFHEO sought comment on all aspects of the guidance, noting certain key provisions addressing (1) whether and how existing conforming loans should be grandfathered; (2) a number of procedural matters, including rounding down announced loan limits to the nearest \$100; and (3) needed clarity on treatment of declines in the conforming loan limit. As proposed, the calculated declines of less than one or, alternatively, three percent in the loan limit (currently \$417,000) would be deferred. Once cumulative deferrals reached one or, alternatively, three percent, then the total decline would be subtracted one year later from the calculated conforming loan limit after

adjusting for any subsequent price increase that had occurred. Additional information on OFHEO's original and revised guidance proposals remain on OFHEO's website.

B. Comments Received. OFHEO received comments from seven commentators to its Revised Draft Examination Guidance for calculating the conforming loan limit (CLL), proposed on October 22, 2007. Four housing and mortgage industry trade associations commented, specifically, the National Association of Realtors (NAR), the Mortgage Bankers Association of America (MBA), the National Association of Homebuilders (NAHB), and a joint comment letter from the American Bankers Association and America's Community Bankers (ABA/ACB). Jeff Butchko, a private citizen, submitted a comment letter. Both Freddie Mac and Fannie Mae submitted comment letters.

1. Industry Trade Associations. The NAHB, the NAR, and the MBA reiterated that OFHEO does not have statutory power to reduce the conforming loan limit. The NAHB, NAR, and the MBA asserted that the draft guidance was bad public policy and introduced a complicated calculation method that would distort markets. Additionally, both the MBA and NAHB repeated concerns that the proposed guidance was a regulation under the Administrative Procedure Act and it must be issued in accordance with the requirements of that Act, whereby the APA promulgation would be subject to judicial review. Central to their argument was that, for operational and other reasons, the conforming loan limit should not decline.

The MBA requested further expansion of the "grandfathering" provision due to a decline in the loan limit post-commitment but prior to closing. The NAR, however, stated that despite their statutory authority and public policy concerns, they would support the 3 percent de minimis threshold, the deferral of reductions for at least one year, and the

grandfathering of mortgages approved under higher conforming loan limits. Both the MBA and NAHB resubmitted their previous comment letters to support their criticism of the draft Guidance.

The ABA/ACB, in a joint comment, expressed support of OFHEO's proposed guidance. They stated that the revised guidance addressed their general concern on "grandfathering" issues, and they welcomed the de minimis change from one percent to three percent in the revised guidance.

Mr. Jeff Butchko's comment letter (e-mail) stated that the conforming loan limit is too low for many areas of the country and requested that OFHEO raise this limit.

2. Enterprise Comments. Fannie Mae offered comments on the grandfather rule, questioning whether language in the draft guidance grandfathering loans that were conforming at origination matched the language in the preamble. They expressed a concern that this difference in language could be disruptive to the market. Fannie Mae further argued that the mechanism to provide for decreases in the conforming loan limit had no long-term significance and "potential harmful" short-term effects. They stated that the "question for OFHEO may be not whether it has statutory authority to enforce a 'negative increase' in the CLL but whether the statute requires this result; not whether it can reduce the CLL temporarily but whether it should."

Freddie Mac had specific comments to multiple elements of the revised guidance. Freddie Mac recommended that any decrease in the MIRS should be offset against future increases, rather than reducing the CLL. If OFHEO decided to require a de minimis threshold for a decrease, the proposed three percent threshold should be raised to five percent. Like Fannie Mae, Freddie Mac recommended that the grandfathering language

in the preamble be adopted in the body of the guidance. Finally, Freddie Mac recommended removing the rounding provision altogether. If OFHEO chose to retain the rounding provision, Freddie requested that OFHEO retain its current practice of rounding down to the nearest \$50.

The final examination guidance on conforming loan limit calculations, which OFHEO has determined to revise and issue, is set forth below.

OFHEO
Office of Federal Housing Enterprise Oversight

Examination Guidance

Issuance Date: [INSERT DATE PUBLISHED IN FEDERAL REGISTER] **Doc.**
#: EG-08-001

Subject: Conforming Loan Limit Calculations

To: OFHEO Examiners
OFHEO Associate Directors

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References

- a. Supervisory Guidance SG-04-001
- b. Federal Housing Enterprises Financial Safety and Soundness Act
- c. OFHEO Regulations Safety and Soundness Standards, 12 CFR part 1720 & Prompt Supervisory Response & Corrective Act, 12 CFR part 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 part 1720, Appendices A and B and 12 CFR part 1777. In addressing areas where such problems could arise, OFHEO has highlighted corporate governance and financial disclosures; 12 CFR parts 1730 and 1710. In its regulation on disclosure, OFHEO noted key areas of concern— access to markets and potential damages to the firms 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 raised 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. 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). Under the Enterprise charters, 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 is the basis for changes to the conforming loan limit. The Enterprises apply the percentage change to the current year's conforming loan limit to establish the next year's limit. This number constitutes part of the determinations of 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 a 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 on some occasions adjusted their loan limits in a manner that was different from the survey results and (2) the Federal Housing Finance Board has made technical changes to its methodology for determining housing prices that the Enterprises have not reflected in their adjustments.

On three occasions prior to 2006, 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 loan limit would remain constant at \$203,150, despite declines in house prices of 2.96 percent in 1993 and 1.46 percent in 1994. 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 retroactively for the 1993 and 1994 price declines.

There have been three occasions—in 1992, 1998 and 2003-- 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. 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 staff regarding a change in the methodology for estimating house prices. The Enterprises determined that 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, resulting in 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 to replace the 2004 issuance.

In 2006, the October national 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 0.16 percent amount. OFHEO subsequently announced that in line with its approach in proposed guidances, the conforming loan limit would not decrease in 2008. 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. The purpose of this guidance, which was subject to public notice and comment on two occasions 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

(i) Consistent with statute, OFHEO will utilize the Federal Housing Finance Board's annual October-to-October Monthly Interest Rate Survey (MIRS) data (routinely released in November) to calculate the conforming loan limit for the following calendar year.

(ii) Under the terms of an inter-agency agreement, the FHFB will provide OFHEO with the confidential October survey data prior to its public release.

(iii) OFHEO will calculate the percentage change in the average house price, make any adjustment needed to reflect FHFB methodological 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.

(iv) 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.

(v) Each Enterprise under its charter then determines whether to set the conforming loan limit at its institution at or below that level.

(vi) 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

(i) If the October MIRS survey data indicate a decline from the previous October, no decrease in the loan limit for the next year will be required.

(ii) The next increase in the conforming loan limit will take into account prior decline(s) in the MIRS so that an increase in the loan limit will reflect the net change in the MIRS average price since the last loan limit increase. Declines will be accumulated and then reduce increases until increases exceed such prior declines.

c. Procedures for Adjustments and Technical Changes

(i) 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, the Enterprises may provide comments to the FHFB for its consideration. Copies of any Enterprise comments should be provided contemporaneously to OFHEO.

(ii) 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.

III. Changes to the Conforming Loan Limit Guidance.

After careful consideration of comments received and seeking to meet the goals of clarity, ease of implementation, providing market certainty and in light of the temporary increase in the conforming loan limit contained in the Recovery Rebates and Economic Stimulus for the American People Act of 2008, OFHEO has revised and is issuing a final Examination Guidance—Conforming Loan Limit Calculations. Regarding the central topic of most comments and for which differing comments were received, OFHEO has determined that any October-to-October decrease in the national average house price, as reported by the Federal Housing Finance Board’s MIRS, will not require a decrease in the loan limit, but will be charged against the next increase or increases, as necessary. Any percentage increase in the loan limit will not exceed the net percentage increase in the MIRS average price since October of the year preceding the last increase in the loan limit. In sum, the loan limit will not decline from the present \$417,000 level, however, calculated decreases will be accumulated and offset increases until all of the accumulated amounts have been offset. This will ensure that the conforming loan limit remains, as contemplated, a measure tied to housing prices. Over time, both increases and decreases will be reflected in the limit. This also means that the de minimis and grandfathering proposals are no longer relevant.

Other elements of the draft guidance have been adopted as proposed. OFHEO reconsidered whether it should round the maximum permitted loan limit to the nearest \$100, as proposed, or whether it should retain the current practice of rounding to the nearest \$50. In view of the quadrupling of house prices generally since adoption of the \$50 figure, OFHEO determined to adopt the \$100 rounding factor as proposed. Below is

a summary of key provisions and additions or deletions made in the guidance issued today.

A. Loan Limit Declines and Statute.

Some comments received agreed with OFHEO's determination to address declines in home price levels, while others disagreed. OFHEO's view remains the same-- that declines fit within the statutory language as "negative increases." In the alternative, where statutory language is silent, as is the case here, regulators routinely fill gaps in statutes with rational solutions in line with available statutory intent. Since loan limit calculations are tied to annual home price surveys, increases and declines reasonably may be considered in line with that statutory structure.

B. Loan Limit Declines—Deferrals.

In line with a streamlined approach adopted herein, OFHEO has extended the deferral period. Decreases will be accumulated and then applied to the next following increase in the loan level. They are not deferred for a set period, but accumulated until an increase occurs and are then applied to offset increases until increases exceed accumulated decreases.

C. Loan Limit Declines—De Minimis Declines.

In line with a streamlined approach adopted herein, OFHEO has dropped language regarding de minimis declines. Since the conforming loan limit does not decline, but rather increases in the limit may be reduced by prior declines, there are no operational concerns, as were identified in the comment period, regarding offsetting increases with reductions or not making increases where deferred amounts offset any increase.

D. Grandfathering Issues.

In line with the streamlined approach adopted herein, OFHEO has dropped language on grandfathering. Since the conforming loan limit does not decline, no concerns exist about loans made prior to a decline in the loan limit.

E. Rounding Down .

Comments received regarding a rounding down to the lowest \$100 as opposed to the current OFHEO practice of rounding down to the lowest \$50 were mixed with some opposing and others indicating either no objection to or no opinion on OFHEO's proposal. The final guidance adopts the approach of rounding down to the nearest \$100 as having value as to market and consumer simplicity and understanding. Also, it would represent a doubling of this rounding standard, a much smaller percentage change than the four-fold increase in the loan limits since the \$50 standard was adopted.

Accordingly, as stated in the Preamble, OFHEO hereby publishes the text of its Final Examination Guidance on Conforming Loan Limit Calculations.

Signature

Date

James B. Lockhart III,
Director, Office of Federal Housing Enterprise Oversight.