NAR Research on the Impact of Jumbo Mortgage Credit Crunch

Introduction

Mortgage rates are at 50 year lows, thereby raising housing affordability conditions to all-time high levels. However, the historically low mortgage rates only apply to Federal Housing Administration (FHA) and GSE (the Government Sponsored Enterprises, Fannie Mae and Freddie Mac) loans, not to jumbo loans above the applicable loan limits for the geographic areas of the country. The conforming loan limit has increased from $417,000 to $729,750, depending on relative prices in specific geographic areas. The mortgage market now has three major types of loans: conforming loans to $417,000; conforming loans up to $729,750 depending on locations, sometimes referred to as "Conforming Jumbo" loans; and loans over $729,750, sometimes referred to as "Super Jumbo." The Super Jumbo loans are not covered by Freddie/Fannie/FHA lending availability, and there are also constraints on the number of conforming jumbo loans that can be made.

There continue to be significant problems in the housing markets:

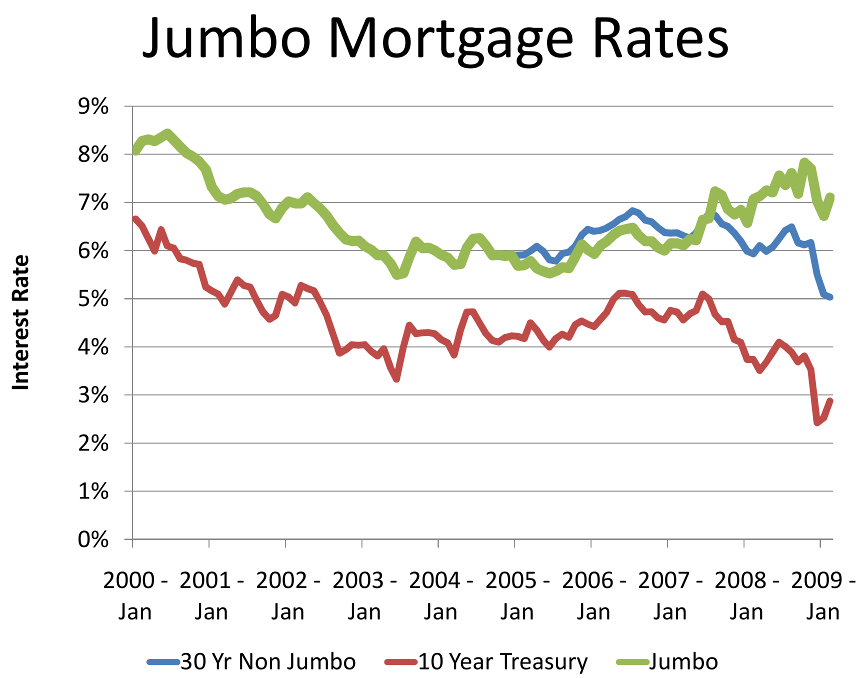
- Interest rates on jumbo mortgages remain elevated above those available for conforming loans, thereby significantly denting home sales.
- Inventories of homes for sale have risen to levels that have put additional downward pressure on home prices.
- Defaults and foreclosures of both conforming and jumbo loans have been rising.

As recently as 2007, jumbo mortgages comprised 10 percent of all mortgages for home purchases and 30 percent of mortgage originations in dollar volume. However, in the midst of the most significant housing downturn since the Great Depression, much less attention has been focused on the jumbo loan segment of the housing market. The share of home sales above $750,000 has fallen from 4.4 percent to approximately 2.3 percent of home sales in the current market environment. Both the emerging economic and housing recoveries are hindered because of credit market difficulties in the jumbo mortgage market.

Background and Overview of Problem

With the increase in the lending limits for conforming loans in high cost areas, the mortgage market now has three major types of mortgage products: conforming loans, up to $417,000; conforming jumbo loans, up to $729,750; and super jumbo loans, loans over $729,750. Although the upward revision of the conforming loan limit is a positive development, overall the jumbo loan market has experienced problems of limited loan availability and higher than usual interest rates in recent months. First, increased credit standards required of borrowers coupled with the increasing reluctance of financial institutions to make jumbo loans have posed major problems at the higher end of the market. In addition, the interest rate spread between ten-year treasuries and jumbo loans has substantially increased—making jumbo loans much more costly than has previously been the case and significantly affecting the upper end of the housing market.

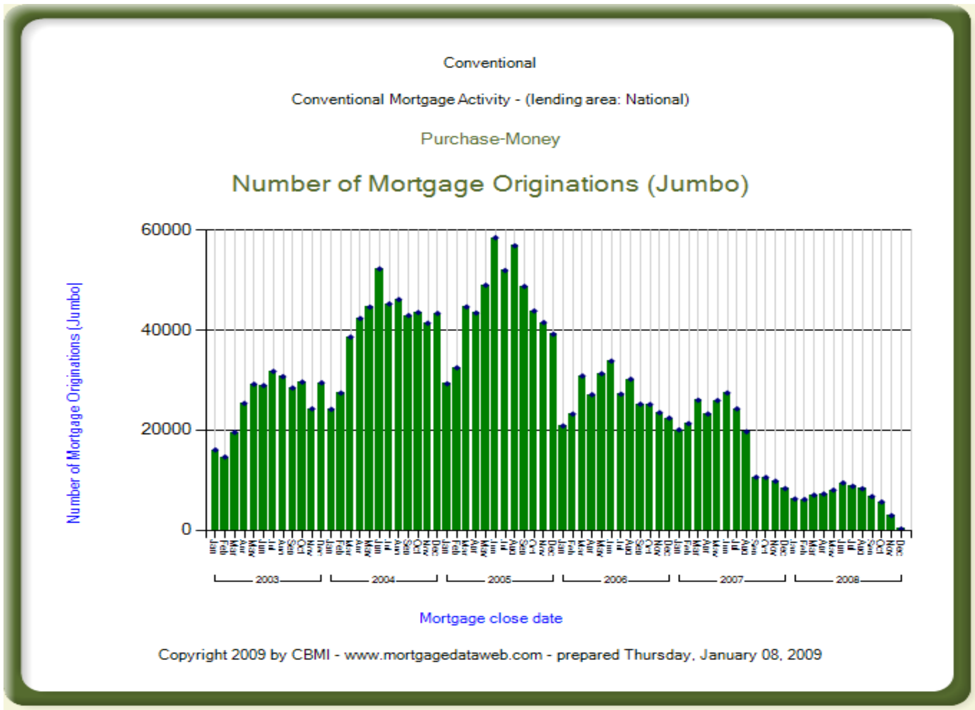
Jumbo loans typically had a rate 144 basis points above ten-year treasuries in 2005, rising to 387 basis points as of March 2009. The increased spread does not appear warranted by increased risk. Prior to the credit crunch beginning in August of 2007, interest rates on jumbo mortgages carried rates 20 to 50 basis points higher than the rates on conforming mortgages.



Source: Wall Street Journal, FHFA

The purchase and issuance of jumbo mortgage backed securities have largely dried up. Originations of jumbo mortgages have fallen by more than 70 percent according to various industry sources.

- Example: *Inside Mortgage Finance* showed $87 billion in jumbo mortgage originations in the first three quarters of 2008 (most recently available data), which is a decline of 71 percent from a comparable period in 2007.
- Because of the dysfunctional securitization loan market for mortgages without any U.S. government backing, the spread between jumbo and conforming mortgages has increased to a range of 150 to 200 basis points.
- The market share of jumbo loan originations has fallen to 6 percent from the typical 15 percent (according to *Inside Mortgage Finance*). High-end home sales, those homes priced above $750,000 and typically requiring a jumbo loan, have fallen from 4.4 percent of sales in 2007 to only 2.3 percent in 2009.
- The months' supply of high-priced homes for sale generally is higher than lower priced homes. However, the inventory situation has dramatically worsened in the high-end market with months' supply in 2009 at 41 months compared to 18 months in 2007. By comparison, the months' supply of all homes has risen only modestly from 9 months to 10 months over the comparable period.



NAR Findings

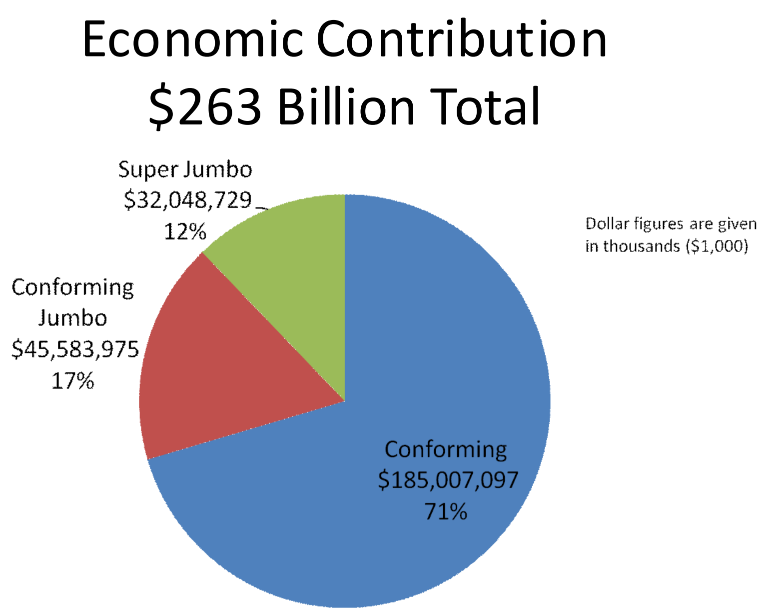
Jumbo loans are of significant importance in high cost areas and states, such as California, New York, and Florida. Adverse jumbo market impacts are believed to result in downward pressures on the rest of the housing market. Decreased jumbo loan availability appears to work its way through much of the entire market, further depressing home prices. Though the jumbo market is often viewed as a market for the very rich, the data suggest much wider prevalence of jumbo mortgages, touching many middle class families in several states.

Jumbo Loan Market Share
(dollar share of mortgage loans, 2007)

	Total Jumbo Loans	Loans $417,000 to $730,000	Loan Over $730,000
U.S.	30%	17%	12%
Hawaii	65%	42%	23%
California	63%	36%	27%
New York	51%	28%	22%
District of Columbia	50%	32%	18%
Connecticut	39%	15%	23%
New Jersey	34%	23%	12%
Maryland	32%	23%	10%
Massachusetts	31%	19%	13%
Virginia	31%	22%	8%
Florida	29%	15%	14%
Washington	29%	20%	9%
Nevada	27%	17%	10%
Colorado	26%	14%	12%
Arizona	25%	13%	12%
South Carolina	22%	12%	11%

Source: HMDA

A detailed study of two metro markets clearly shows dramatic market performance differences between high-end and low-end markets. For example, in Pierce County in the Seattle metro market, the months' supply situation has been improving from 10 to 6 months for those homes priced under $750,000 while increasing from 40 to 70 months for those homes priced above $750,000. Similarly in Orange County, California, the months' supply of inventory fell from 7.5 months to 4.5 months for lower priced homes with clear signs of home prices bottoming in that market segment. However, for those homes requiring jumbo loans, estimated to be one-quarter of all housing inventory, the months' supply has significantly increased, is putting downward pressure on prices, and is also raising the potential for default.

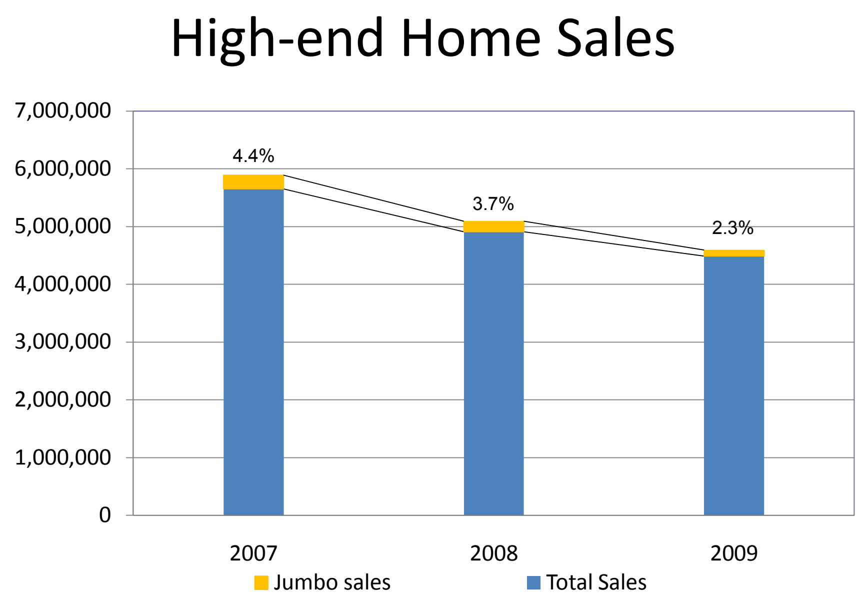


*Based on a per home economic impact of $68,700 in 2007
**Shares are based on an estimate of US economic impact and state and category loan dollar shares

Because of the meaningful importance of jumbo loans to the overall housing market, the current lack of jumbo loan financing is measurably and negatively impacting economic activity. A notable further price decline in the high-end market will hamper economic activity and further worsen bank balance sheets as defaults inevitably rise. In 2007, the mortgage origination dollar volumes for home purchase loans was 30 percent of the total market for mortgages above $417,000 and 12 percent of the total market for mortgages above $730,000.

- Problems in the jumbo financing market are reducing overall economic activity. The National Association of Realtors® estimates that each home sale at the median generates $67,811 of economic impact (2007). This is based on income to real estate industries, spending on furniture and home furnishings, a multiplier effect on this spending, and the construction of new houses traditionally associated with existing home sales.
- As recently as 2007, jumbo mortgage market activity and associated home sales resulted in $78 billion in economic activity. Because of credit market problems and much weaker activity in the jumbo loan market, NAR estimates a decline of $42 billion in economic activity.

- In California 39.2 percent of homes were priced above $500,000 (above the $417,000 national cap for GSE loans in effect before the high cost area loan limits were adopted). Furthermore, four additional states had more than 20 percent of the housing stock with prices exceeding $500,000. Jumbo mortgages do not impact only a sliver of the population, but affect many middle class families.



Source: NAR
2009 figures are annualized from January and February sales.

The inability of consumers to refinance their jumbo loans is holding back potential consumer spending for the overall economy. Many of the current jumbo mortgage holders, if given the opportunity to refinance into historically lower mortgage rates, could save $6,000 to $15,000 in annual interest costs. In cases where home sales are not occurring as a result of higher interest rates, the outcome is not a transfer of income from jumbo borrower to lenders, but rather a pure deadweight loss for society. Sixty percent of recent home purchasers who used jumbo loans paid at least 20 percent as a down payment. That is significantly higher than down payments for people using GSE or FHA mortgages. In California, where home prices have been falling steeply because of high inventory levels in the high-end market, over 75 percent of recent home purchasers who used jumbo loans put at least 20 percent down. Such high down payment requirements have no doubt deterred buyers, leading to higher inventories, falling home prices, and rising defaults.

As of October 2008, the foreclosure rate on jumbo mortgages reached 2.5 percent versus 1.2 percent for conforming mortgages (according to *Loan Performance*). People who take out jumbo loans have much higher income than a typical borrower. The typical income of a jumbo loan borrower was $207,600 in 2007. Therefore, it was not surprising to observe a lower default rate among jumbo mortgage borrowers compared to other borrowers prior to the credit crunch. However, default rates have been rising among jumbo borrowers recently due to a lack of refinancing opportunities and also due to the pressure of an excessively large housing inventory in the high-end market.

NAR Survey

NAR conducted a member survey in order to obtain REALTOR® input on the jumbo loan situation.

- **Loan Rates:** Higher loan rates relative to conforming loans and relative to historic practice were cited as a problem by an overwhelming majority of REALTOR® respondents.
- **Jumbo loans are less available:** There appear to be fewer loan providers for jumbo loans according to 30 percent of REALTOR® respondents.
- **Loan requirements are increasingly unrealistic.** REALTORS® indicated that required down payments were greater than 20 percent in 60 percent of the cases—with payments required greater than 30 percent in 9 percent.
- **Buyers are Delaying purchases:** Thirty-five percent of REALTOR® respondents reported that buyers are delaying home purchases due to jumbo loan home rates.
- **Buyers are being forced to drop out of the market:** Buyers who want to buy cannot get jumbo mortgages or do not want to pay higher jumbo rates appear to have dropped out of the market according to 85 percent of REALTOR® respondents.

On the basis of REALTOR® input as well as a review of financial data it is clear that there are problems with the jumbo loan market. The spread between ten-year treasuries and jumbo loan rates has widened, and jumbo loan availability has significantly decreased. In many cases we are told that well qualified borrowers are simply unable to obtain loans, apparently due to much higher risk aversion on the part of financial institutions. The availability of jumbo loans is important in high cost areas—e.g., Los Angeles, San Francisco, New York—and real estate markets are being adversely impacted relative to previous experience. A number of REALTORS® noted that adverse impacts at the upper end of the market tend to radiate downward.

REALTOR® Comments

We have received a large number of excellent comments on the jumbo loan situation. Here are a few:

- "I have noticed that a borrower with a 625 credit score and only 5% down payment on a conforming loan amount is being treated like a lower risk than a borrower with an 800 credit score and 20% down payment on a jumbo loan. This seems wrong to me."

- "I deal in country properties and most are priced 100-500K above the conventional loan limit. The new buyers do not want to pay the significant loan interest rate increase and now are just on hold."

- "$729k may be high for the rest of the country, but in California it is far from what we need to get homes other than REOs and short sales to start selling."

- "People needing jumbo loans make good money and have good credit. They should be getting better rates, not worse"

Possible NAR Advocacy Positions

To relieve the jumbo loan problem and help stimulate housing recovery and economic growth, NAR advocates consideration of the following policy measures:

- Temporarily lift the loan limit (even for fairness reasons allowing more people to tap into historically low mortgage rates).
- Use TALF and PPIP to expand jumbo mortgage lending.
- Encourage more lender competition by facilitating warehouse lending to small and medium sized mortgage lenders.