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HOUSING SCENE

A tale of two markets divided by the conforming-loan limit

Mortgage rates are low and sales are booming for cheaper homes. But sales are at a virtual standstill for pricier homes because buyers can't get jumbo loans at acceptable rates.

By Lew Sichelman
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Reporting from Washington -- Roused by a combination of low mortgage rates, sagging prices and government largesse, first-time buyers appear to have entered the housing market with a vengeance. According to the latest statistics from the National Assn. of Realtors, half of existing-home sales were to rookies who had never owned homes before.

But at the top of the housing ladder, the move-up market remains at a virtual standstill, stymied by the inability of sellers to attract buyers who can obtain financing at rates close to what first-timers are paying.

What we have is a tale of two markets where the dividing line is $417,000, the so-called conforming-loan limit. It's the ceiling on the loans that can be bought by Fannie Mae and Freddie Mac, the two government-sponsored enterprises that buy loans from primary lenders and package them into securities for sale to investors.

Below that amount, Fannie and Freddie provide the grease that keeps money flowing into housing. But above the ceiling, known as the jumbo-loan market, there is no government underpinning in most places.

"If you ever wondered what the mortgage market would look like without government support, that's what we have today in the jumbo market," says Howard Glaser, a Washington, D.C., financial services industry analyst. "And it's not just the high end of the market that's impacted. It affects the market all the way down the ladder, and I'm not sure policymakers in Washington understand that."

Eighteen months ago, housing at all levels had a predictable supply of mortgage money. But when Fannie's and Freddie's accounting problems got the better of them, and most of Wall Street's investment bankers were unable to pay their bills, private investors pulled out of the mortgage market practically overnight.

The U.S. government came to the rescue by placing Fannie and Freddie under the government's wings until the two companies could right themselves and by bailing out the titans of Wall Street. Lawmakers also acted to goose the upper-price brackets by temporarily raising the Fannie-Freddie loan limit to $729,750 in 76 of the nation's 3,300 counties. (The ceiling in high-cost markets is scheduled to fall back to $625,000 on Jan. 1 unless Congress extends it.)

The limit is somewhere between $417,000 and $729,750 in 600 other places. But investors are still so gun-shy that the great majority of Fannie's and Freddie's mortgage-backed securities are now being bought by our own central bank, the Federal Reserve. Worse, in the jumbo sector, there is hardly any securitization at all, and lenders are increasingly reluctant to make jumbo loans they can't sell, at least at rates that borrowers consider acceptable.

"The jumbo market is not functioning," says Lawrence Yun, chief economist at the Realtors group. "We hear from our members every day, 'Fix the jumbo market, fix the jumbo market.' "

Yun says lenders are increasingly reluctant to make jumbo loans even though historically the risk of default is less. The economist also notes the difference between conforming and jumbo loans has jumped from 1.4 percentage points in 2005 to 3.9 points in March.

"Even when people have the capacity to buy, they're not, because they don't want to pay the high jumbo rate," Yun says.

This isn't just about people who are trying to buy and sell homes costing $500,000 or more. It's about the entire housing market, because when current owners can't sell their houses and move up to the next rung on the ownership ladder, those below cannot move up to the next level, either, so the market becomes clogged.

So for the most part, those who don't have a home to sell before they can buy a new one are fueling current sales. In March, according to the Realtors group, 53% of buyers were first-timers. But that figure can be misinterpreted.

"It doesn't mean first-time buyers are rushing to buy," says David Lereah, the Realtors group's former chief economist. "It just means that there are so few trade-up sales that the first-time-buyer share is automatically going to go up."

According to the real estate agents, the national share of sales above $750,000 this year is only about half what it was just two years earlier, dropping from 4.4% in 2007 to 2.3% currently. As a result, the inventory of houses for sale at or above that price point has more than doubled, from almost a 19 months' supply to what Yun calls "a very, very unhealthy" 41 months' supply.

A price-distribution study by the National Assn. of Home Builders shows that although the sale of houses under $250,000 rose significantly last year over 2005, the height of the housing boom, sales of houses costing more than that are down -- from 32.7% in 2005 to 28% in 2008 in the $250,000 to $500,000 bracket, and from 12.4% to 7.9% in the $500,000 to $1 million range.

There are two markets operating now, says Gopal Ahluwalia, the builders group's chief research economist. "In one, mortgage rates are low and prices are down," he says. "But in the other, rates are high and people can't sell at any price."

According to the National Assn. of Realtors, loans above $417,000 account for 10% or more of the market in 11 states and the District of Columbia. In Hawaii, 43% of loans are above $417,000. In California, the jumbo share is 41%. In D.C., it's 30%, and in New York, it's 22%. In 14 states, moreover, 11% or more of the houses are valued at $500,000 or above. And it's not just the usual places like California and New York. The list includes Delaware, Oregon and Illinois.

The jumbo sector is "more widespread than people are aware," Yun says. "It's not just a few coastal markets."

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