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Federal Retreat on Bigger Loans Rattles Housing

By DAVID STREITFELD

MONTEREY, Calif. — By summer’s end, buyers and sellers in some of the country’s most upscale housing markets are slated to lose one their biggest benefactors: the deep pockets of the federal government. In this seaside community of pricey homes, the dread of yet another housing shock is already spreading.

“We’re looking at more price drops, more foreclosures,” said Rick Del Pozzo, a loan broker. “This snowball that’s been rolling downhill is going to pick up some speed.”

For the last three years, federal agencies have backed new mortgages as large as \$729,750 in desirable neighborhoods in high-cost states like California, New York, New Jersey, Connecticut and Massachusetts. Without the government covering the risk of default, many lenders would have refused to make the loans. With the economy in free fall, Congress broadened its traditionally generous support of housing to a substantial degree.

But now Democrats and Republicans agree that the taxpayer should no longer be responsible for homes valued well above the national average, and are about to turn a top slice of the housing market into a testing ground for whether the private mortgage market can once again go it alone. The result,

analysts say, will be higher-cost loans and fewer potential buyers for more expensive homes.

Michael S. Barr, a former assistant Treasury secretary, said the federal government's retrenchment would be painful for many communities. "There's always going to be a line, and for the person just over it it's always going to be an arbitrary line," said Mr. Barr, who teaches at the University of Michigan Law School. "But there is no entitlement to living in a home that costs \$750,000."

As the housing market braces for more trouble, homeowners everywhere have been reduced to hoping things will someday stop getting worse. In some areas, foreclosures are the only thing selling. New home construction is nearly nonexistent. And CoreLogic, a data company, said Tuesday that house prices fell 7.5 percent over the last year.

The federal government last year backed nine out of 10 new mortgages nationwide, and losses from soured loans are still mounting. Fannie Mae, which buys mortgages from lenders and packages them for investors, said last week it needed an additional \$6.2 billion in aid, bringing the cost of its rescue to nearly \$100 billion.

Getting the government out of the mortgage business, however, is proving much more difficult than doling out new benefits. As regulators prepare to drop the level at which they will guarantee loans — here in Monterey County, the level will drop by a third to \$483,000 — buyers and sellers are wondering why they should be punished simply for living in an expensive region.

Sellers worry that the pool of potential buyers will shrink. "I'm glad to see they're trying to rein in Fannie Mae, but I think I'm being disproportionately penalized," said Rayn Random, who is trying to sell her house in the hills for \$849,000 so she can move to Florida.

Buyers might face less competition in the fall but are likely to see more demands from lenders, including higher [credit scores](#) and larger down payments. Steve McNally, a hotel manager from Vancouver, said he had only about 20 percent to put down on a new home in Monterey County.

If a bigger deposit were required, Mr. McNally said, "I'd wait and rent."

Even those who bought ahead of the changes, scheduled to take effect Sept. 30, worry about the effect on values. Greg Peterson recently purchased a house in Monterey for \$700,000. “That doesn’t get you a palace,” said Mr. Peterson, a flight attendant.

He qualified for government insurance, which meant he needed only a small down payment. If that option is not available in the future, he said, “home prices all around me will plummet.”

The National Association of Realtors, 8,000 of whom have gathered in Washington this week for their midyear legislative meeting, is making an extension of the loan guarantees a top lobbying priority.

“Reducing the limits will put more downward pressure on prices,” said the N.A.R. president, Ron Phipps. “I just don’t think it makes a lot of sense.” But he said that in contrast to last year, when a one-year extension of the higher limits sailed through Congress, “there’s more resistance.”

Federal regulators acknowledge that mortgages will get more expensive in upscale neighborhoods but say the effect of the smaller guarantees on the overall housing market will be muted.

A Federal Housing Administration spokeswoman declined to comment but pointed to the Obama administration’s position paper on reforming the housing market. “Larger loans for more expensive homes will once again be funded only through the private market,” it declares.

Brokers and agents here in Monterey said terms were much tougher for nonguaranteed loans since lenders were so wary. Borrowers are required to come up with down payments of 30 percent or more while showing greater assets, higher credit ratings and lower debt-to-income ratios.

In the Federal Reserve’s quarterly survey of lenders, released last week, only two of the 53 banks said their credit standards for prime residential mortgages had eased. Another two said they had tightened. The other 49 said their standards were the same — tough.

The Mortgage Bankers Association has opposed letting the limits drop, although a spokesman said its

members were studying the issue.

“I don’t want to sugarcoat this,” said Mr. Barr, the former Treasury official. “The housing finance system of the future will be one in which borrowers pay more.”

The loan limits were \$417,000 everywhere in the country before the economy swooned in 2008. The new limits will be determined by various formulas, including the median price in the county, but will not fall back to their precrisis levels. In many affected counties, the loan limit will fall about 15 percent, to \$625,500.

Monterey County, however, will see a much greater drop. The county is really two housing markets: the farming city of Salinas and the more affluent Monterey and Carmel.

Real estate records show that 462 loans were made in Monterey County between the current limit and the new ceiling since the beginning of 2009, according to the research firm DataQuick. That was only about 1 percent of the loans made in the county. But it was a much higher percentage for Monterey and Carmel — about a quarter of their sales.

Heidi Daunt, with Treehouse Mortgage, said loans too large for a government guarantee currently carried interest rates of at least 6 percent, more than a point higher than government-backed loans.

“That can definitely blow a lot of people out of the water,” Ms. Daunt said.



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