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Home Economics

Economic Stimulus' Biggest Real Estate Winners

Matt Woolsey, 03.05.08, 2:45 PM ET

There's some good news on the horizon for homeowners in cities like San Diego, Washington D.C. and Sacramento, Calif., where the real estate boom and bust has left those markets reeling from the effects of overbuilding, bad loans and foreclosures.

It's a provision of the recently signed Economic Stimulus Act of 2008 that is designed to boost sales in cities where high home prices have historically prevented government-sponsored enterprise (GSE) lenders Fannie Mae and Freddie Mac from securitizing mortgages, a process effectively akin to insurance that lowers risk for both lenders and borrowers.

The provision calls for increasing GSE loan limits to 125% of a city's median home price. Previously, all housing markets were subject to a $417,000 limit. The adjusted limit is capped at $729,750. The hope is that in raising the limit, more local residents will secure mortgages and buying activity will rise.

Before this took effect, in cities like San Francisco or New York, where the median home price is above $417,000, Freddie and Fannie couldn't securitize homes at the median level. Without securitization in a tight credit market, home sales volume drops.

But now, loans originating between July 1, 2007 and Dec. 31, 2008, will see a temporary boost in the amount Fannie and Freddie can securitize. (Existing loans issued in the second half of 2007 can be refinanced under these new terms).

For some cities, that's a monumental shift. Using median home prices that included condos, foreclosures and new construction, Radar Logic, a New York-based real estate research firm, calculated which markets' housing stock would be most affected by new loan limits.

In Los Angeles, for example, a new loan limit of $700,000, or 125% of the current median price, would suddenly place 32% of homes in that metro under Freddie and Fannie's umbrella, according to Radar Logic. In San Diego, another hard-hit market, the new loan limits open up 18% of the market to Fannie and Freddie securitization.

What do you think of the government's plan? Weigh in. Add your thoughts in the Reader Comments section below.

In affected markets, this program helps in two ways. First, it makes home buying easier by making credit less risky for banks. Fannie and Freddie are backed by the federal government; the lower risk makes lenders more likely to offer credit because lenders know they'll still recoup costs in the case of a default.

It also reduces consumer interest rates. Loans above Fannie and Freddie's limit are known as "jumbo" loans, and because they aren't backed by the government, these riskier loans carry higher interest rates. Under the limit increase in the stimulus package, loans that are recategorized from jumbos to conforming loans (54% in San Jose, 44% in San Francisco, 17% in New York) will carry lower interest rates. For potential buyers, this makes home buying more affordable, and for many current mortgage holders, it makes refinancing to a lower rate possible.

Taken together, these benefits should make credit less risky for lenders and cheaper for home buyers, which could help boost transaction volume and lead to price recoveries.

At least that's what the government is banking on.