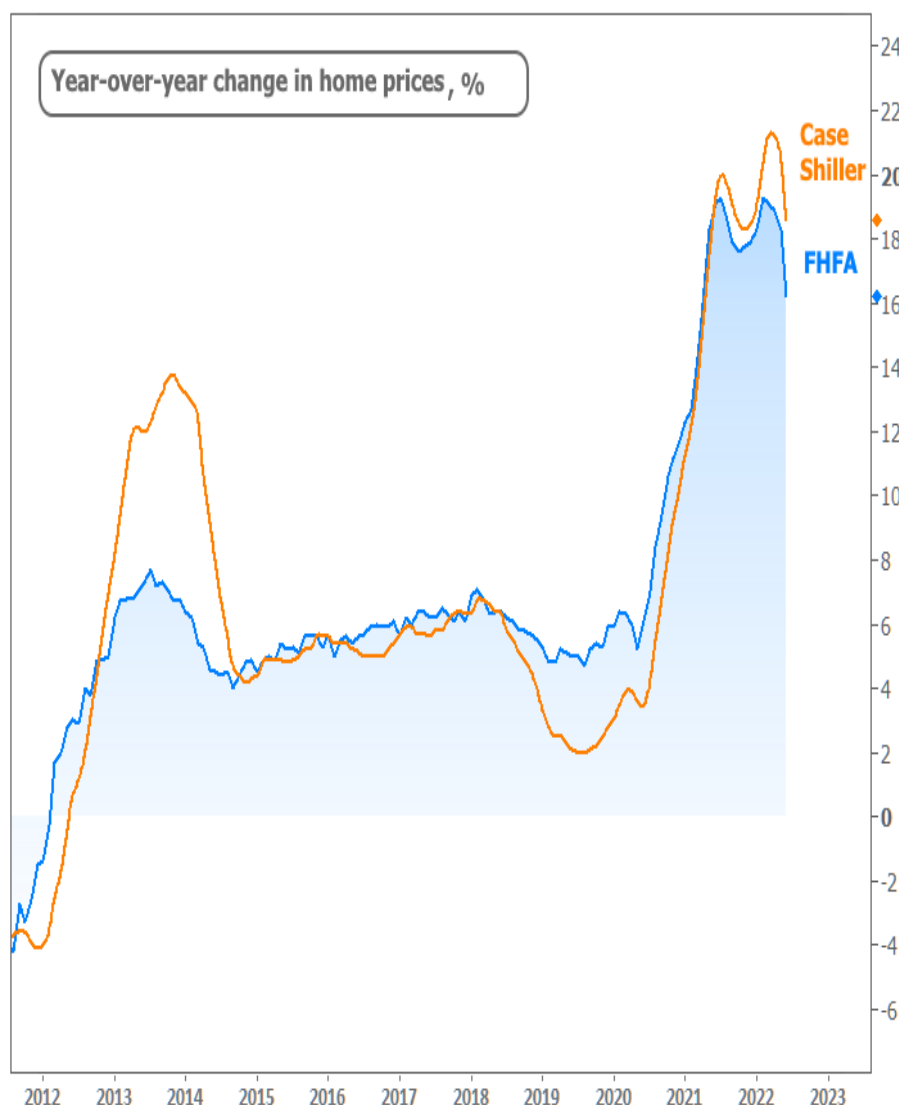




## Home Price Growth Grinds to Halt. What Does It Mean For Conforming Loan Limit Outlook?

Today brings the release of June's home price indices from both the FHFA (the regulator that oversees Fannie and Freddie, the entities that guarantee a majority of mortgages in the U.S.) and S&P Case Shiller. These are the two most widely followed measures of home prices and FHFA's data is particularly important as it determines changes in the conforming loan limit.

Both indices decelerated in June, but both remain historically high in year-over-year terms.



For those curious as to how the recent surge in prices stacks up with the housing boom that preceded the mortgage meltdown and financial crisis, here you go:



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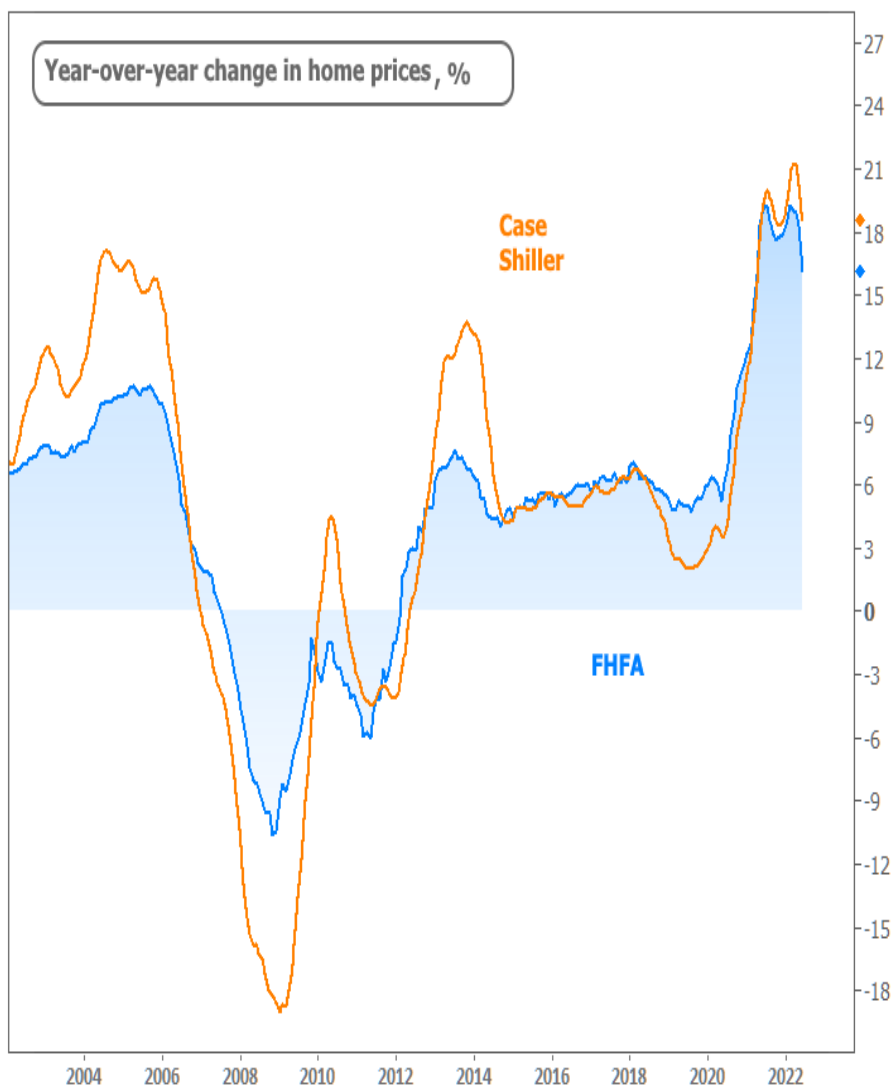
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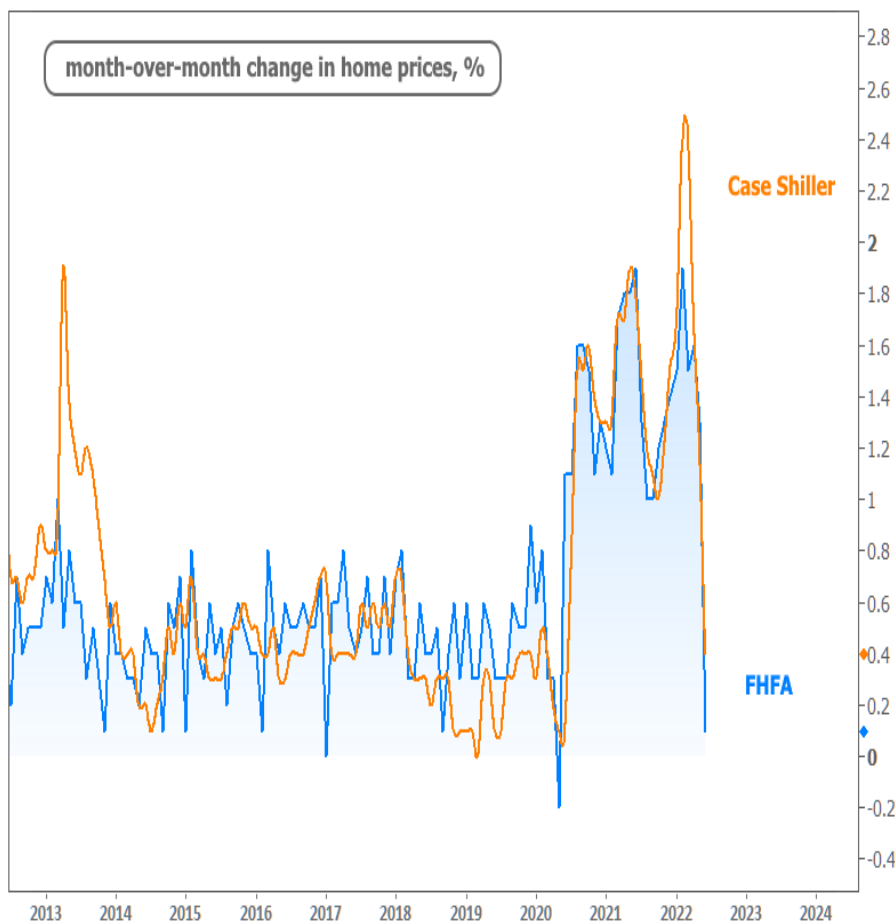
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Year-over-year numbers certainly don't tell the story of the recent shift in prices. The following chart shows the month-over-month changes, with the most recent update for June dropping to 0.1% (versus 1.3% in May) for FHFA and 0.4% (versus 1.2% in May) for Case Shiller.



Again, this is for the month of JUNE, and there have been another 2 months of housing market activity since then. Other, more timely home price metrics suggest the trend continued, with the following comments from Black Knight being particularly interesting:

"The median home price fell by 0.77% in July, the largest single-month drop since January 2011. On a seasonally adjusted basis, July's dip ranked among the 10 largest monthly declines on record, dating back more than 30 years."

-Black Knight

It remains to be seen if a similar decline will show up in the FHFA/Case-Shiller data. Perhaps more important is what happens next. It was not an unpopular opinion that home prices had risen too quickly in 2020 and 2021. The rapid return to near-zero price growth in June was necessary and perhaps even "welcome" depending on whom you ask.

The price trajectory has two options in the next 3 months.

Option 1: buyers are waiting in the wings and simply wanted prices to level off (with some of the visible effects being seen in the form of list price cuts). In this case, prices wouldn't necessarily move any lower on a seasonally adjusted basis and year-over-year growth would remain well over 10%. This is the stronger option for home prices.

Option 2: buyers are waiting for prices to actually fall back into a more affordable range, closer to levels seen in the first quarter of the year. This would result in a more historically normal year-over-year improvement through the 3rd quarter as well as several months of prices moving slightly lower.

These options are offered without any probabilities attached, purely to lay out the playing field for the coming months. There are a few other options (such as prices moving back up, or falling at an even faster pace), but we'll attach some probabilities to those and say experts don't see those extremes being as likely as the options above.

Why do we care about the next 3 months so much? To be fair, it's July, August, and September's home price data that we're really focused on here. The next 3 months are when that data will be reflected in the official indices. We care because that quarter of data will determine the increase in conforming loan limits for 2023.

The current limit is \$647,200 as a baseline and up to \$970,800 in certain high cost areas. If prices merely remained perfectly flat in Q3, we've already seen enough of an increase in the other 3 quarters for the baseline to rise to \$723k and the high-cost limit to rise to \$1.084m.

Notably, the data that feeds the loan limit calculation is slightly different than FHFA's headline price index. Whereas the annual change in prices stood at 16.2% at the headline level (depicted in the first 2 charts above), the "expanded quarterly" data series used for the conforming loan limit was up more than 17% over the same time period. It also made substantially better improvement in Q2, rising almost 6% versus Q1 while the headline index was up only 3% from March or 4.6% from the Jan-March average.

In other words, the data feeding the loan limit calc is a bit friendlier than the monthly price index. Why is it different? In FHFA's own words, the quarterly expanded data includes "FHA-backed mortgage transactions as well as sales price information sourced from county recorder offices (with sales prices below the annual loan limit ceiling)." This adds a bit more weight to lower-priced homes relative to FHFA's monthly index, and those lower priced homes are more insulated from price declines (or looked at another way, those lower priced homes were more capable of continuing to appreciate as affordability deteriorated sharply in the first half of 2022).