# Higher US mortgage rates coming for costlier homes

1:22pm EDT

* Government removes support at upper end of home market

* New limits on Fannie, Freddie loans from Saturday

* Conforming loan limit falls to $625,500 from $729,750

* These borrowers face 50 bps increase in mortgage rates

* Realty experts fear damage to fragile housing market

By Margaret Chadbourn

WASHINGTON, Sept 30 (Reuters) - Many homebuyers in the most expensive U.S. real estate markets will face demands for bigger down payments and higher borrowing costs starting Saturday.

Higher limits on the size of home mortgages that the government buys or insures, which had been increased in 2008 in order to provide liquidity to a mortgage market crippled by the subprime meltdown, will expire on Oct. 1.

The cap on the size of mortgages eligible for government backing in the most expensive real estate markets -- including Washington, D.C., California and the New York City metropolitan area -- will fall back to $625,500 from $729,750.

The cap, known as the confirming loan limit, determines the maximum size of mortgages that the Federal Housing Administration, Fannie Mae and Freddie Mac can buy or guarantee -- a system designed to add liquidity to the mortgage market by taking mortgages off banks' balance sheets, allowing them to offer new loans.

Analysts say the decrease will affect only a sliver of the market, about 2-3 percent, but many say any decrease could be harmful given the already weak state of the housing market.

"Why do any damage at all when the housing market is this fragile?" said Mark Willis, a research fellow at New York University's Furman Center for Real Estate and Urban Policy. "We're not debating the right levels for these loan limits, but the question is why do anything at this moment to weaken what is already an unsteady market."

The reduction in the loan limit is part of an effort to start reducing the government's footprint in the mortgage market and revitalize the role of private lenders -- an effort that has been backed both by President Barack Obama and Federal Reserve Chairman Ben Bernanke, as well as some Republicans in Congress and the FHA itself.

As the government support fades, it means some buyers who fail to meet the standards of private lenders will get locked out of this jumbo-loan market; others will face higher borrowing costs and will need pristine credit histories to secure mortgages.

The average interest rate for a 30-year-fixed rate mortgage for a non-jumbo loan is 4.05 percent, compared with 4.81 percent for a jumbo loan, according to Bankrate.com.

"It will reduce the buying power," said Dan Laytham, a real estate agent for Long & Foster, who has worked in the Northern Virginia suburbs of Washington, D.C., for more than 20 years. He expects the market for higher priced homes in the area will soften on the back of the change.

WEANING THE MARKET OFF SUPPORT

The government now supports about 90 percent of the residential mortgage market through loans financed by Fannie, Freddie, and the FHA. The expiring higher limits at Fannie and Freddie represented around 3 percent of the overall market in 2010, according to the regulator of the two firms, the Federal Housing Finance Agency.

An estimated 40,000 to 45,000 borrowers annually will be affected by the shift, representing about $30 billion in loan originations, according to analysts at Credit Suisse Group AG.

They said the drop in the conforming loans limits would likely raise interest rates on these loans by 30 to 50 basis points, or 0.30 to 0.50 percentage point.

The FHA provides mortgage insurance to borrowers who might not have a sufficient down payment to qualify for a prime loan or who may not have high incomes. Buyers can put down as little as 3.5 percent with an FHA loan.

BANKERS MOVE IN

As government support fades, banks will have an opportunity to increase their share of the jumbo mortgage market, which can be profitable and provide higher yields. But whether they will and to what degree remains a big question.

"There is interest on the sidelines from private investors to get involved in the jumbo loan market," said Janaki Rao, vice president of mortgage research at Morgan Stanley in New York. "Those clean credit borrowers represent a higher yield compared to what is carried in the conventional mortgage market."

Already active lenders in the jumbo market, major banks including Wells Fargo and Bank of America originated $87 billion, or nearly half of all jumbo loans, in 2010, according to Moody's Investors Service.

Independent private mortgage bankers, local banks and portfolio lenders also originate and service their own jumbo loans.
(Reporting by Margaret Chadbourn; Editing by Leslie Adler)