

Why rates for Jumbo Mortgages are now less than those for Conforming Loans?

Chris Morrison – SunCoast Home Loans – 2/27/14

Jumbo mortgages (residential loans for \$417,000 or more) are now being offered by some banks at rates lower than rates for government backed conforming loans (less than \$417,000).

How can this be?

One would assume that a larger loan would carry higher risks for the lender and therefore would be offered at a higher rate. Traditionally that is the case with the rate for Jumbos usually a quarter of a point higher. However, with the volatility in interest rates in recent months, the rates for Conforming loans have risen, while the rates for Jumbos have not, to the point where they are now priced for less than Conforming mortgages. There are three major reason for this conundrum:

1. The government has made Conforming loans more expensive. Fannie Mae and Freddie Mac have always charged a guarantee fee to lenders to sell their loans and have raised those fees by a quarter point over the last three years. The higher fees have reduced the spread between Jumbo rates and Conforming rates.
2. Conforming loans are priced off where mortgage backed securities are traded. Jumbos on the other hand are generally not securitized and most currently end up on banks' balance sheets as portfolio loans, which are held instead of sold off in the secondary market. Banks want to retain these loans in their portfolio when the costs of funds remain low which they have been during the recent run up in rates.
3. The banks are hungry for loans and rich with deposits. Lenders are most interested in lending to credit worthy borrowers who have credit scores of 740 and above, assets and reserves in the bank and are willing and able to put 20% down. Also, these borrowers are great prospects for cross-selling for brokerage accounts, credit cards and other financial products.

With slow growth, banks will continue to look for the best opportunities to lend. As rates have increased, banks have been more willing to put Jumbo loans on their balance sheets. And, more home buyers have been willing to stretch to buy more expensive properties to leverage current interest rates or have been forced to make higher offers as the inventory of homes is currently tight.