

Jumbo Loans: Do They Make Sense in Your Situation?

Freddie Mac and Fannie Mae are the names of two federal agencies that are in charge of home loans. Part of the duties of Freddie Mac and Fannie Mae are the setting of conventional loan limits. The conventional loan limit is the amount of a loan that these agencies were permitted to back, any higher amount was considered too risky for the federal government to get involved.

What is a Jumbo Loan?

A jumbo loan is any mortgage loan that exceeds the amount that is considered the conventional loan limit. This amount varies, but until recently has been \$417,000. In a few states that had particularly high housing costs, such as Alaska and Hawaii, the limit was higher. As part of the economic stimulus package that President Bush passed, the conventional loan limit was raised to \$729,750 through December 2008.

The increase in the conventional loan rate is one way to encourage new home purchases. Many people are put off by the thought of taking out a jumbo mortgage. The reason is that jumbo mortgages are more expensive, because they involve more risks. The difference between the conventional limit and the mortgage amount is covered by insurance companies and banks, as investments, and of course, they require a return on their investment. The interest rate on a jumbo mortgage is typically a quarter to one percent higher than the interest rate on a conventional loan. The down payment required for a jumbo loan is also higher, typically an additional five percent.

Who Purchases a Home With a Jumbo Loan?

Traditionally, people that purchased homes with jumbo loans were wealthy and purchasing palatial estates. With the increase in the cost of housing, many traditional home buyers have found themselves in the situation of requiring a jumbo loan for a simple ranch home or town home. This was not the original intention of the jumbo loan, and is one of the reasons that the limit on conventional loans was increased.

What are the Benefits and Drawbacks of a Jumbo Loan?

Without the ability to finance more than the amount covered by a conventional loan, many families would be unable to purchase a home for years as they attempted to save for a substantial down payment, all the while watching housing prices increase. The main benefit of a jumbo loan is that it allows people to buy a nice home, as long as they can afford the monthly payment.

The main drawback of a jumbo loan is the expense. The higher interest rate and the need for additional money down can make a jumbo loan an unattractive option. If you can come up with the down payment, it is always possible to pay down the principle of the home and then refinance when the amount that you owe is less than conventional loan limits.

Should You Consider a Jumbo Loan?

A jumbo loan is not something that people normally choose to take on. The interest rate is higher, the down payment larger and the qualification process more rigorous. However, in some parts of the country, the housing prices have reached the point that a jumbo loan is the only way to purchase a home.

If you find yourself in this situation, make sure that you follow the rules of any other mortgage: Just because the lender says that you can afford it, doesn't mean that you have to borrow it. Large, expensive houses often need large, expensive repairs. Maybe you are moving to a more rural area to improve your quality of life, while at the same time lengthening your commute. Don't be so strapped for cash because of a large house payment that you cannot afford the other things that are important.

If you can afford the monthly payment and decide to take on a jumbo mortgage, pay extra on the principal whenever possible to reduce the amount that you owe on the home. As soon as you get below the magic amount of the conventional loan limit, look into refinancing. If you keep your payment the same, you can substantially decrease the life of the loan. If you would rather save the money each month, you will save quite a bit by sticking with a conventional loan.

About the Author

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