MarketWatch

AMY HOAK'S HOME ECONOMICS

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Jumbo mortgages become more affordable

Why banks are originating, and what it could mean for the rest of the market

By Amy Hoak, MarketWatch

CHICAGO (MarketWatch) -- Jumbo mortgage rates experienced a jumbo hike when the meltdown in the mortgage market caused funding for these bigger loans to dry up.

Slowly, rates have fallen, as banks have been more willing to fund the loans too large for purchase by Freddie Mac or Fannie Mae -- up to $417,000 for single-family homes in many markets, and currently up to $729,750 in some high-cost areas.

Dream kitchen on a budget

By choosing products wisely, homeowners are upgrading their kitchens without busting their budgets. MarketWatch's Amy Hoak reports from the Kitchen & Bath Industry Show in Chicago.

Granted, jumbo mortgages are a relatively small segment of the entire mortgage market. The majority of loans are conforming, or those that are small enough to be purchased by Freddie Mac and Fannie Mae. That's saying nothing of the growing percentage of mortgages insured by the Federal Housing Administration.

And underwriting in the jumbo arena is still very strict: Down payments for these mortgages are usually 20% to 25% -- and sometimes higher, said Michael Fratantoni, vice president of research and economics for the Mortgage Bankers Association.

But recent developments in the jumbo market could have greater effects on the rest of the mortgage market, from the possible reduction in conforming loan limits in some areas to the development of a functioning private securitization market for mortgages -- allowing banks to sell the loans and free up more capital for additional lending.

"At the peak of the crisis, every financial institution was trying to stay liquid," Fratantoni said. "Now, we're at the point where many institutions are profitable again -- we're seeing that in quarterly earnings releases." As a result, banks are stepping back into some of their traditional roles, in terms of lending, he said.

By last summer, large lenders were launching jumbo lending programs for "top credit" borrowers, Fratantoni said. Banks held those loans in their portfolios, he said.

Since the beginning of 2010, banks including Wells Fargo, Bank of America and U.S. Bank have gotten more aggressive in originating jumbos, said A.W. Pickel, president of LeaderOne Financial, a mortgage lender in Overland Park, Kan. "If you underwrite carefully and cautiously, a jumbo loan is a very good money maker for a bank," he said.

A new secondary market?

Then, last week, more news on the jumbo front: Redwood Trust Inc., announced it would offer the first private securitization of mortgage-backed debt since 2008. The securities are based on high-quality jumbo mortgages, basically setting it up as a test case to determine if the private securitization markets can be revived, said Keith Gumbinger, vice president of HSH Associates, a publisher of consumer loan information.
See full story.

It's too early to know the outcome of this development, Gumbinger said. But if investors do have an appetite for this kind of debt, "we have a vehicle for banks to get loans off their books," he said. Reestablishing that securitization market is the next step for the jumbo mortgage market, Fratantoni said.

In time, a working private securitization market for mortgages could eventually affect the entire mortgage market, Gumbinger said.

"It's a very small step. A miniscule step," Gumbinger said. But if it works, and a private securitization market develops, "this could be one of the earliest signs of a return to a normalized mortgage market."

That isn't to say we'd ever see a return to the days when underwriting was lenient and lenders required little in terms of documentation or down payment, he said.

But it could eventually mean the gradual easing of lending standards for all mortgages, Gumbinger said. Lending standards have tightened so much on conventional conforming mortgages that many borrowers need to turn to the FHA program in order to get a home loan, he said.

That said, lending standards will only ease so much, Fratantoni said, as the crisis has fundamentally changed investors' appetite for risk.

"This crisis has been seared into memory. Credit underwriting is going to stay tight for a significant period of time," Fratantoni said.

Jumbo improvement

The improvement in jumbo rates also brings up another question: Should the conforming rates be lowered now that the jumbo market has strengthened?

At the end of October 2008, the 30-year fixed-rate jumbo mortgage averaged 7.95% in one of Bankrate.com's weekly surveys. But the spread between conforming and jumbo was at its widest during a week in mid-January 2009, when the jumbo 30-year fixed-rate mortgage averaged 7.07% and its conforming counterpart was 5.28%.

Fast forward to last week: The 30-year fixed-rate jumbo mortgage averaged 5.91% in the Bankrate survey, with the conforming 30-year fixed rate mortgage averaging 5.22% -- moving closer to a historically normal spread between the two products.

The higher conforming limits were put in place when rates on jumbos were high; it was a way to help some home buyers who needed those bigger loans get them at conforming rates. But with the spread between conforming and jumbo mortgages shrinking, should the higher conforming limits remain?

"Can we still make the claim that the private jumbo mortgage market is so crippled that jumbo borrowers cannot obtain a mortgage?" Gumbinger said. "That would seem unlikely, given a slow but steady improvement in portfolio lending and what could be perceived as a growing competitive environment characterized by near-record-low rates for 30-year fixed private-market jumbos.

"Do home buyers and homeowners who can afford homes at two, three or even four times the median price really need 'subsidized' mortgages?"

Others say it's important that any changes to the limits don't come at the expense of a housing market recovery.

"This is not the time to take the tires off and put on a different set of tires," Pickel said.