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All About Conforming Loans

With all the recent trouble in the mortgage market, there has been much talk about jumbo and other non-conforming home loans. If you are ready to buy a home and are not familiar with the difference between conforming and non-conforming mortgages, this article is for you!

Conforming loans exist because of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. These are mortgage finance companies authorized by the government to buy residential home loans on the secondary market. In order to ensure that their purchases are sound and as safe as possible, Fannie and Freddie have developed strict standards for the types of loans they will buy. One such standard is a maximum loan amount limit, adjusted as needed each year. The current loan limit is set at $417,000. Other standards include certain debt-to-income ratio limits, and extensive documentation requirements. These restrictions were created in order to create a category of loans that have a very low risk of default and foreclosure, to avoid the resulting losses for the GSEs.

Fannie and Freddie are always buying new loans, which creates a stable demand for these conforming loans. Lenders like to make loans that are guaranteed to be bought up by investors, so conforming loans are a common staple of most mortgage lenders. Any loan not conforming to the GSE standards is called a non-conforming loan. If a loan is larger than the conforming standards it is called a jumbo loan. There is less demand for these loans on the secondary market because they are not bought and guaranteed by Fannie and Freddie and are therefore riskier loans. As a result mortgage lenders charge higher interest rates to consumers for non-conforming or jumbo loans to hedge against the increased risk. The interest rate for a conforming loan will generally be a quarter to a half percentage point lower than it would be on other mortgages.

If you can qualify for a conforming loan, finding a mortgage should not be too tough. If however, you live in an area where the median house price is higher than $417,000, qualifying for and obtaining a mortgage may be much more difficult and expensive right now. One possible solution is to save up enough of a down payment to bring your loan total into the conforming loan range. So say you are looking to buy a home worth $490,000. If you can wait and save up $73,000 for a down payment, you will only need $417,000 more in funding and you’ll be able to qualify for an affordable home loan. If like most people, saving up that much seems impossible, you might have to simply take out a jumbo loan and pay the extra interest.

Another reason you might not qualify for a conforming loan would be a poor credit score. Fannie and Freddie loans specify that you credit score must be above a certain number. If it isn’t, you will have to turn to subprime or poor credit mortgage lenders to find funding. Unfortunately, these types of loans are much harder to come by today as foreclosure rates have skyrocketed on subprime loans and investors for them have been scared off. If you are able to find and qualify for such a loan, be prepared to pay quite a bit more in interest charges. In today’s market you may do best, to wait and save and improve your credit score before entering into homeownership.