MarketWatch

Amy Hoak's Home Economics

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Why you may end up in a cheaper house

Changes in mortgage rules will make some borrowers pay more for loans

By Amy Hoak, MarketWatch

CHICAGO (MarketWatch) — People buying homes in the country's most expensive housing markets will face pricier mortgages starting in the fall.

That's when the current conforming mortgage limits are scheduled to expire, with limits for the most expensive markets falling to $625,500 from $729,750 in the contiguous U.S. (Keep in mind that Congress may decide to keep the higher loan limits. Read more about how lawmakers on Friday introduced a bill in the U.S. House of Representatives that would do just that.)

Mortgages over the conforming limit are considered jumbo loans, and can't be purchased and securitized by Fannie Mae or Freddie Mac. As such, they carry higher interest rates. The limits apply to both first mortgages and refinancings.

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Limits vary by market, and the lower limits are equal to 115% of the median single-family home price, ranging from $417,000 to as much as $625,500.

"The fact that the limits are changing is going to raise the cost of homeownership for homes priced in that range between the old and the new limit," said Greg McBride, senior financial analyst for Bankrate.com. While the change officially takes effect Oct. 1, it may be reflected in loan quotes as early as the end of July, he said.

Now, if you're sitting in Chicago, this doesn't mean much to you because the limit in that area will remain $417,000. But in high-cost ZIP codes, including Washington, D.C., New York and San Francisco, mortgages will get more expensive.

The loan-limit reduction will affect 250 counties in the country, according to the Federal Housing Finance Agency. That's just 8% of the counties in the U.S., according to Capital Economics, an economic analysis firm.

But many of those areas are highly populated. "About 60% of the U.S. population lives in a market where either the conforming loan limit or the FHA loan limit will be declining," McBride said. The Federal Housing Administration also has loan limits for the loans it will insure, and those will be changing in the fall as well.

A boon for adjustable-rate loans?

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A few years ago, the difference in interest rates between a jumbo and conforming mortgage was much greater. Today, borrowers can expect a spread of between one-half to three-quarters of a percentage point between a conforming and jumbo mortgage, said Robert Van Order, professor of finance and chairman of George Washington University's Center for Real Estate and Urban Analysis.

On July 12, rates on a 30-year fixed-rate mortgage for $200,000 in California were about 4.5%, according to Bank of America's website. For a 30-year jumbo mortgage of $750,000, rates were at 5%. Rates on a seven-year adjustable-rate mortgage for a $750,000 mortgage in California were 3.75%, while a five-year ARM for that amount was 3.375%, according to Bank of America. Read more about mortgage rates.

Because fixed-rate mortgages will be somewhat higher for some jumbo borrowers, "more people will take out these adjustable-rate mortgages," Van Order said.

"But it's not like [jumbo] mortgages won't be available," he said. In fact, more lenders have been making jumbo loans in the past couple of years.

"Large banks will take advantage of their portfolios to lend in this environment," said Matt Vernon, who heads up Bank of America's retail mortgage division. "From a credit-availability perspective, the large banks that have portfolios allow for customers to continue to buy homes in this space." ("Portfolio lending" refers to when banks make loans and hold them on their books, as opposed to securitizing them.)

Credit questions

But just because the money is available doesn't mean it will be easy to get.

Often, lenders require jumbo borrowers to have a FICO score of at least 760, according to Capital Economics. A score of 720 is often needed to qualify for a conforming mortgage, it says.

Also, jumbo borrowers often have to come up with bigger down payments, possibly as much as 30%, McBride said. A 35% down payment for a jumbo mortgage isn't unheard of either, said Scott Sheldon, a loan officer with Sonoma County Mortgages, in Petaluma, Calif.

"Some people are blowing it off like it's not a big deal," Sheldon said of the loan-limit changes on the way. He said in markets like his, there will be a negative effect.

"It's going to price people out of the market," he said, especially those who are looking for a competitively priced 30-year, fixed-rate mortgage above the loan limit. Most 30-year, fixed-rate jumbo mortgage quotes he is seeing lately have rates of nearly 6%.

But the higher loan limits were always considered temporary, and were never intended to be a permanent fix, Vernon said.

"If you're looking at buying a house for $875,000, putting 20% down and taking a $700,000 loan, a couple of months from now it will come at a higher interest rate and you will have to put more money down," in some high-cost markets, McBride said.

That's not enough to cause borrowers to rush into a home purchase before they're ready, he said. But for those looking to refinance in areas where the limits are dropping, McBride said, the time to take action is now.