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WHAT IS A JUMBO LOAN?

Borrowers must meet stricter requirements because lenders take on greater risk with jumbo loans.

By: Coryanne Hicks - October 22, 2021

A jumbo loan might sound like something for millionaires, but it may be your best choice to finance even a modest home in some hot or high-priced housing markets.

"The biggest benefit to jumbo loans boils down to being able to make larger purchases," says Ryan Cicchelli, founder of Generations Insurance & Financial Services in Cadillac, Michigan. "As a rule, big money begets bigger money, gaining access to larger parcels of land in more desirable areas, luxurious homes, industrial spaces, development land – you name it."

If you're house shopping in a pricey area or seeking a high-end home, make sure you understand what a jumbo loan is to help you decide whether it's right for you.

What Is a Jumbo Loan?

A jumbo loan is a mortgage that exceeds conforming loan limits set by the Federal Housing Finance Agency, or FHFA, which oversees Fannie Mae and Freddie Mac. Conforming loans meet the requirements to be purchased by Fannie Mae and Freddie Mac, but nonconforming loans – jumbo and government-backed loans – do not.

Lenders have stricter qualification standards because jumbo loans carry greater risk compared with conforming loans: Loans can't be sold to Fannie or Freddie, and more money is involved.

What Are Jumbo Loan Limits?

How large your loan can get before it crosses into jumbo territory depends on where you live.

A jumbo loan is more than $548,250 for a single-family home in most parts of the country, but the ceiling can be higher in some areas. That means a jumbo loan in one county could be a conforming loan in another.

In high-cost regions, such as Northern California and parts of New York and New Jersey, a jumbo loan is anything that exceeds $822,375 for a one-unit property.

The FHFA sets conforming loan limits annually. (Search by county or county-equivalent area for your 2021 loan limit.)

How to Qualify for a Jumbo Loan

Compared with a conforming loan, a jumbo loan can be harder to qualify for because it can't be sold to Fannie or Freddie, "so all risk is carried by the lender," says Sean Grzebin, head of consumer originations at Chase Home Lending.

Borrowers will need to meet, and in some cases exceed, the standard requirements for a conforming mortgage. Plus, each lender sets its own eligibility criteria.

If you want a jumbo loan, make sure you meet these criteria:

High credit score. You will need a credit score of at least 700 to qualify for a jumbo loan of up to $1 million to purchase a one- or two-unit property, according to Detroit-based Rocket Mortgage.

But if you want an even bigger loan, you will have to do better. You will need a credit score of 720 for loans between $1 million and $1.5 million and 740 for loans between $1.5 million and $2 million.

Debt-to-income ratio. Your DTI ratio is a measure of how much debt you have compared with how much income you earn, expressed as a percentage. Consider maintaining a DTI ratio of 36% or less, but some lenders will go up to 43%, according to the Consumer Financial Protection Bureau.

Cash reserves. Show that you can cover at least six to 12 months of mortgage payments, plus closing costs, with money you have in the bank, according to JPMorgan Chase & Co.

Down payment. Jumbo loans typically have much higher down payment requirements compared with conforming loans. "Because the loan is larger, the down payment may also need to be larger," Grzebin says.

Expect to put down 20% for a single-family home and more for a second home or multifamily dwelling, according to Rocket Mortgage. How much you pay is also based on your loan amount and credit score.

What Do You Need to Know About Jumbo Loans During the Pandemic?

You can still get a jumbo loan during the pandemic, but it may be more difficult.

"Jumbo loan qualification standards were impacted by the pandemic in the same way that conforming loans were," Grzebin says. "Standards were temporarily tightened to protect the borrower and the bank from entering a loan agreement amid economic uncertainty."

Chase confirmed that these measures have been lifted.

Unwilling to take on risk, some lenders have stopped offering jumbo loans, Cicchelli says.

"When the world almost ground to a halt in 2020, it created an even riskier financial environment for almost all of us," he says. "In the wake of the pandemic, everyone's a little more wary, and rightfully so. Lenders followed suit."

Lenders scrutinize the borrower's income and employment history. People employed in industries affected by the virus, such as travel or hospitality, could find that getting a loan is difficult.

Compared with before the pandemic, you will need a better credit score – above 700, in many cases – and likely have to put down 20%.

Keep in mind that if your application is weak in one area, you could be able to make up for it with a strong showing in another. Maybe your credit score is on the low side, but you have a large down payment or cash reserves.

Jumbo Loan Rates

Jumbo loans and jumbo interest rates do not go hand in hand, gratefully. Rates can be competitive with conforming loans, but usually they are a bit higher.

"On average, rates will be between 0.25% and 1% higher for a jumbo loan than a conforming loan," Cicchelli says. While the pandemic did create a rate gap between jumbo loans and conforming loans, Cicchelli says that gap has come back down to acceptable levels.

Borrowers should shop around because rates will always vary dramatically by lender, he says. Note that jumbo loan rates will also differ based on factors such as your credit score and down payment, as well as prevailing market rates.

Jumbo Loans vs. Conforming Loans

- Credit score: You will need a score of 620 for a conforming loan and a credit score of at least 700 to qualify for a jumbo loan.
- Cash reserves: If you want a conforming loan, you may need to have enough cash saved to cover a few months' worth of mortgage payments in case of an emergency. For a jumbo loan, the lender may require you to have cash for six to 12 months of mortgage payments.
- DTI ratio: The requirement for a jumbo loan varies by lender, but you will want to keep your DTI ratio as low as possible. Lenders prefer DTI ratios below 43% and sometimes no more than 36% for conforming loans.
- Down payment: If you're a first-time buyer getting a conventional loan, you could make a down payment as low as 3%. Jumbo loans require larger down payments than conventional loans, usually at least 20%.
- Interest rates: You could pay up to 1 percentage point less for a conforming loan than a jumbo loan. Still, rates for jumbo loans can be competitive with conforming loan rates.
- Closing costs: A conforming loan has closing costs that average 3% to 6% of the home's purchase price. Jumbo loans have much higher closing costs. Some lenders may also require a second home appraisal for a jumbo loan.
- Loan-to-value ratio: The LTV ratio is a measure comparing the amount of your mortgage with the appraised value of the property. You can get a conforming loan with an LTV ratio as high as 97%, but a ratio of 80% or lower will help you avoid private mortgage insurance. Jumbo loans may require LTV ratios of 80% or even lower.