National Association of REALTORS®

# Third Survey of Mortgage Originators 2014:

# QM, FHA, FHFA & FICO

REALTOR® NATIONAL ASSOCIATION of REALTORS®

## Executive Summary

Six months after the implementation of the QM/ATR rule, the market appears to be shifting modestly. This survey serves as both a measure of change in the 2nd quarter and a bellwether for originators' impressions of market dynamics in light of regulatory changes under the QM/ATR rule as well as changes at the FHA, FHFA, and new credit scoring models. The panel was expanded in the 2nd quarter to include members of Community Mortgage Lenders of America.

## Highlights of the Survey

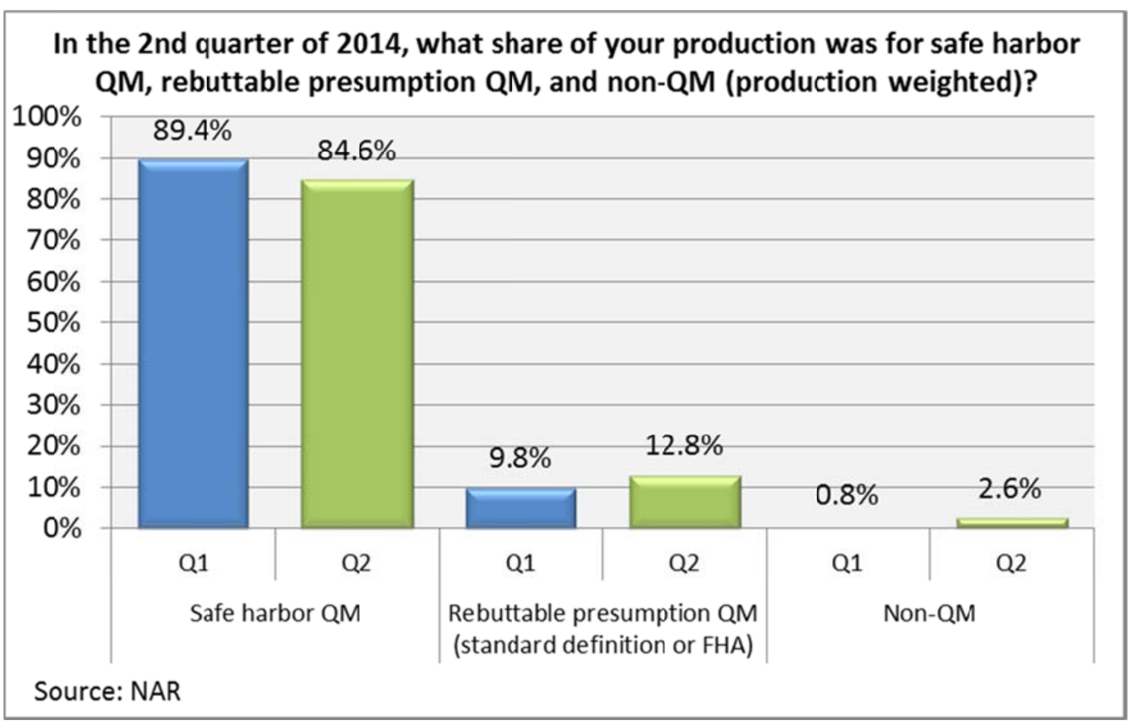
- The non-QM share of originations more than tripled in the 2nd quarter to an originations-weighted 2.6% from 0.8% in the 1st quarter. Rebuttable presumption expanded as well to 12.8% from 9.8% over this same time frame.
- Respondents were less sanguine about their comfort with the QM/ATR rules in the 2nd quarter, with just 61.9% indicating that they had fully adapted compared to 73.7% in the 1st quarter.
- The share of lenders offering rebuttable presumption and non-QM products in the 2nd quarter improved, but willingness to originate non-QM and rebuttable presumption mortgages fell from the 1st quarter to the 2nd quarter. Lenders were more willing to originate prime mortgages, though.
- Over the next 6 months, nearly half of respondents expected improved access to credit for prime borrowers with FICO scores between 620 and 720. However, the vast majority expected no change for rebuttable presumption and non-QM borrowers. Respondents expect improved investor demand for all mortgage types
- Half of respondents indicated that the premium reductions under the FHA's HAWK program were insufficient or the education fees were too high, while 55% indicated that the program would not expand credit.
- Only 15% of respondents felt that FHA's program of early reviews would help to alleviate overlays.
- However, 85% of respondents indicated that a reduction of LLPAs directed at high LTV and low FICO borrowers would stimulate access to credit.
- Finally, 60% of respondents indicated that the Fair Isaac Company's new FICO 9 scoring model would help to stimulate access to credit. Only 35% expected no change as they either defer to their investors' or the GSEs' scoring models.

## The Qualified Mortgage Rule and Its Impact

On Friday, January 10th, 2014, the requirements of the ability to repay and qualified mortgage (QM) rule went into effect. The Dodd-Frank act requires that originators make a good faith effort to verify a borrower's ability to repay their mortgage and imposes stiff penalties if they do not. The QM rule allows for varying degrees of assumed compliance with the ability to repay rule, which is advantageous to lenders as it allows them to minimize and to budget for potential penalties and litigation expenses. All mortgage applications received on or after January 10th are required to comply with the ATR/ QM rule which includes full documentation of income, assets and employment, a maximum of 3% for points and fees, a cap of 43% on the back-end debt-to-income ratio, and limitations on the type of mortgage products that qualify and prepayment penalties among other requirements.[1]

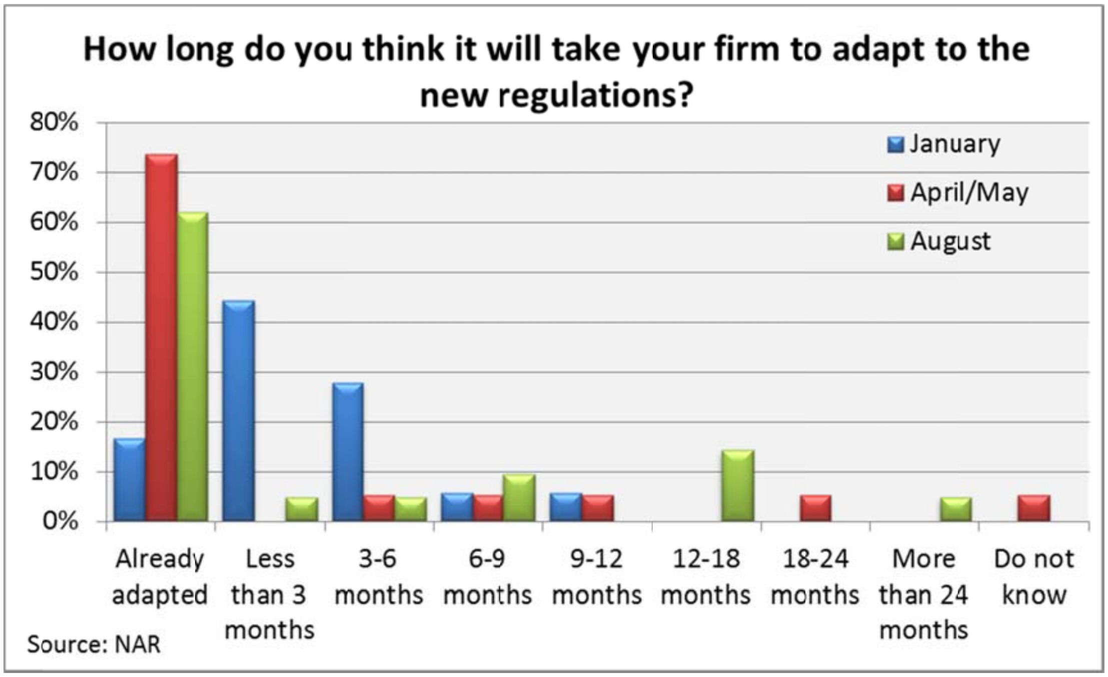
NAR's first Survey of Mortgage Originators queried originators about their expectations for the QM/ATR environment and their anticipated operational changes. This survey is the second that measures the impact of the QM/ATR on production.

Respondents indicated a production-weighted share of 2.6% for non-QM loans in the 2nd quarter, up sharply from 0.8% in the 1st quarter. The improvement was driven by a larger number of lenders offering non-QMs, though net willingness to lend moderated (discussed below). Rebuttable presumption loans also increased as a share of total production over this period, from 9.8% to 12.8%, while safe harbor QM



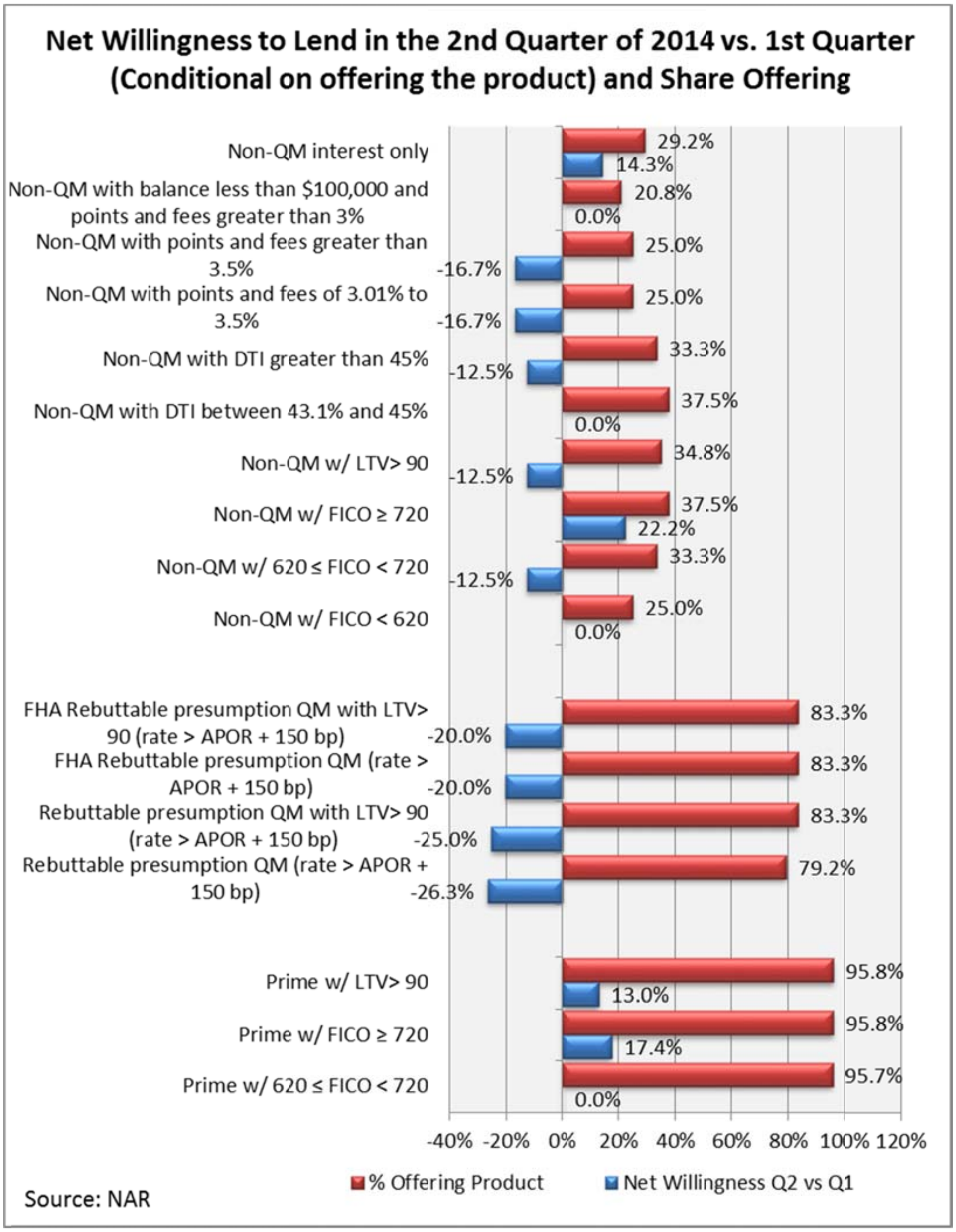

[1] For a more in-depth discussion of the new rules see http://www.realtor.org/articles/summary-of-new-qualified-mortgage-qm-rule

loans shrank from 89.4% to 84.6%. The rise in shares of non-QM and rebuttable presumption may reflect increased numbers of originators offering these products or improved demand from investors.[2]




In a set back from last quarter's survey, fewer respondents indicated having adapted to the regulations, 61.9% versus 73.7% in the 2nd quarter. A surprising 19.1% of respondents indicated that it would take an additional 12 months or more to adapt to the rules. This shift could point to an altered view on the time to fully implement underwriting changes, to overcome investor confidence issues, or to identify potential litigation costs.[3]

[2]Average FICOs for FHA and GSE production as measured by Ellie Mae data along with first-time buyer shares from NAR's RCI survey were relatively stable over this period, suggesting that a loosening of credit did not drive the increased share of non-QM and rebuttable presumption lending.
[3] The difference could also point to a change in the expanded sample not captured by the control measures.

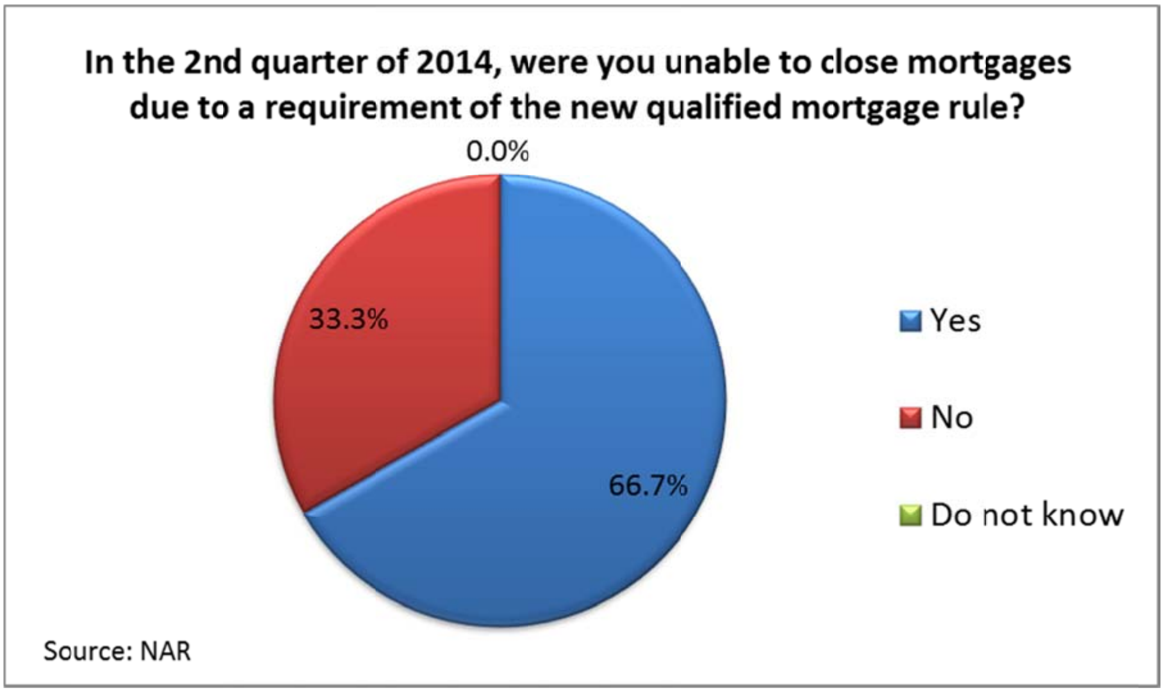



The share of originators offering rebuttable presumption mortgages increased by 16.0% in the 2nd quarter. Originators offering non-QM loans increased as well, but at single-digit improvements. Specifically, the share of originators offering mortgages to non-QM borrowers with credit scores between 680 and 720, points and fees greater than 3.5% and DTIs of 45% and higher increased by 1.8%, 7.0% and 9.2%, respectively.

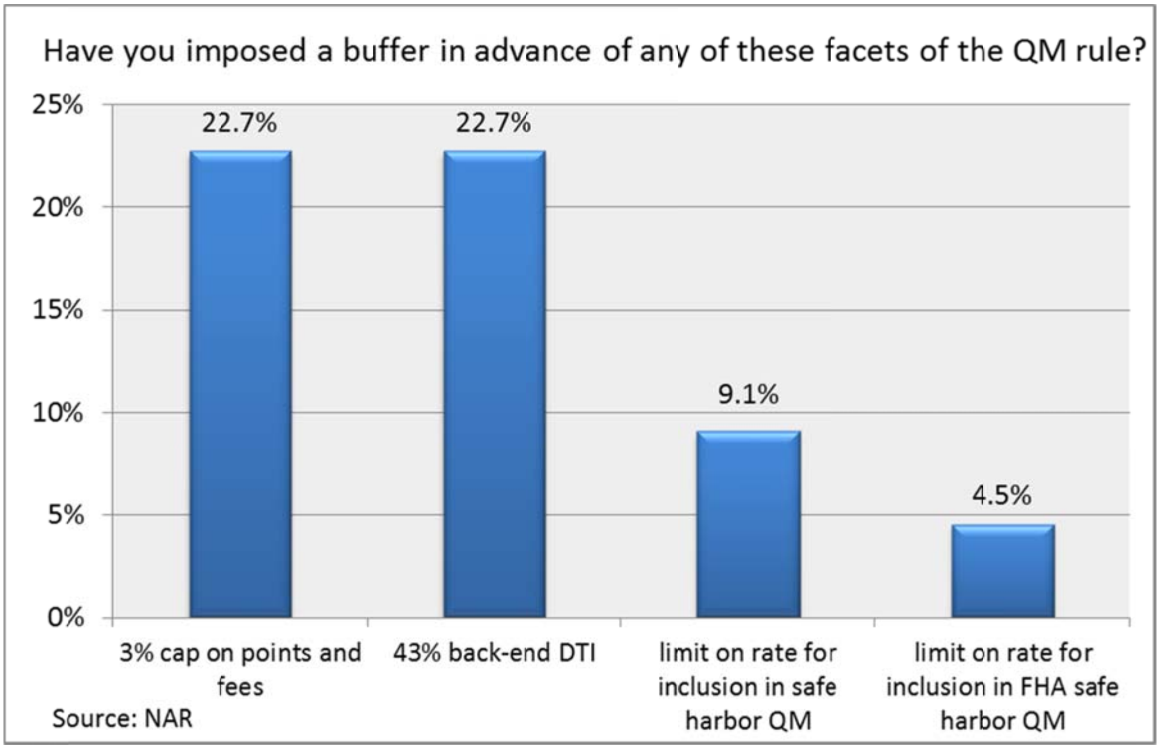
Respondents were also asked to rate their willingness to originate various types of mortgages in the 2nd quarter relative to the 1st quarter, conditional that the firm offers the product. Net willingness, the total difference between those who were more willing versus less willing, and the share that offer this product are displayed above. In general, only 20% to 30% of respondents offered non-QM loans and these were focused on high DTI loans just outside the 43% threshold as well as high FICO borrowers with LTVs greater than 90 and interest only products. Low balance, high fees, and low FICO loans were the least frequently offered.  Relative to last quarter, net willingness to originate interest only and high FICO non-QMs expanded the most while high DTI and low FICOs moderated.

Nearly 80% of respondents offered rebuttable presumption loans, both FHA and non-FHA.  However, net willingness to originate rebuttable presumption loans declined 20.0% from the 1st quarter to the 2nd quarter and 26.3% for non-FHA rebuttable presumption loans.

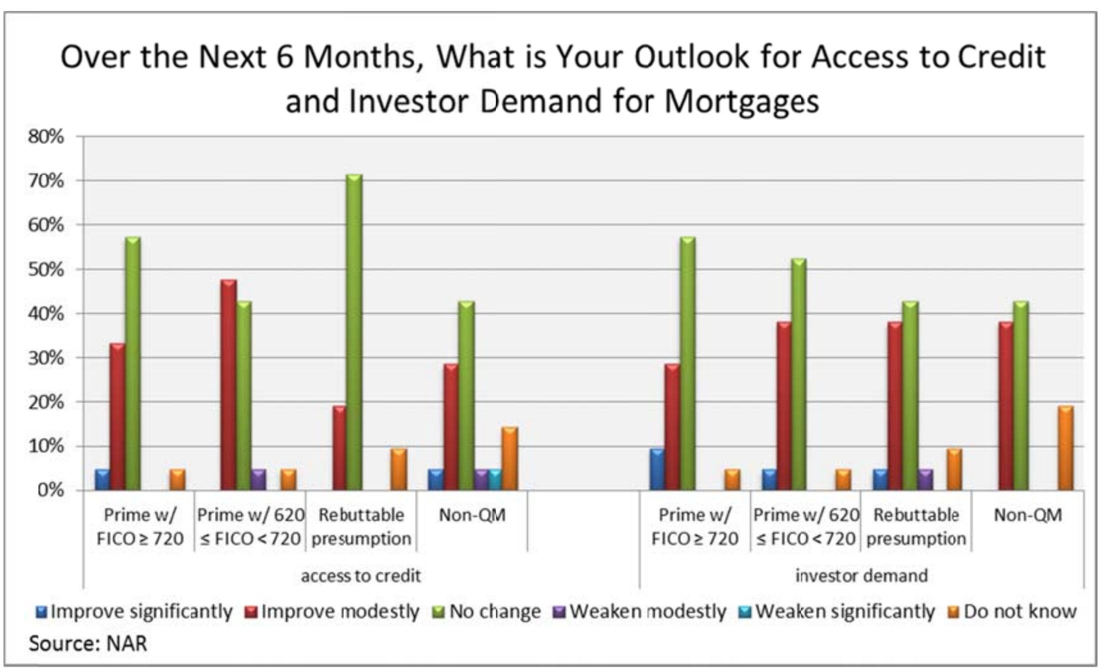
The vast majority of originators were willing to offer prime loans regardless of FICO and LTV.  Willingness to originate mortgages of this type increased over this period by 13.0% and 17.4% for LTVs greater than 90 and FICOs greater than 720, respectively.  However, willingness to originate lower FICO or "near prime" borrowers was flat in the 2nd quarter relative to the first, a sign coupled with the pull back in willingness to lend in the non-QM space of pensiveness across the spectrum.




The share of respondents that had issues closing mortgage(s) due to some facet of the qualified mortgage rule (QM) jumped from 47.4% in the 1st quarter to 66.7% in the 2nd.  A full third of respondents did not have an issue closing their production due to the QM rule.




Some lenders have opted for buffers ahead of the QM parameters to prevent producing a rebuttable presumption or non-QM mortgage.  The use of buffers was most common on the 3% cap and 43% back-end DTIs with 22.7% of respondents employing one.  Only 9.1% and 4.5% of respondents used buffers ahead of the pricing delineation between rebuttable presumption and safe harbor standard definitions of QM.   9.5% of respondents indicated that they would not remove buffers even once they were adapted to the QM rules, a decline from 22.2% last quarter.

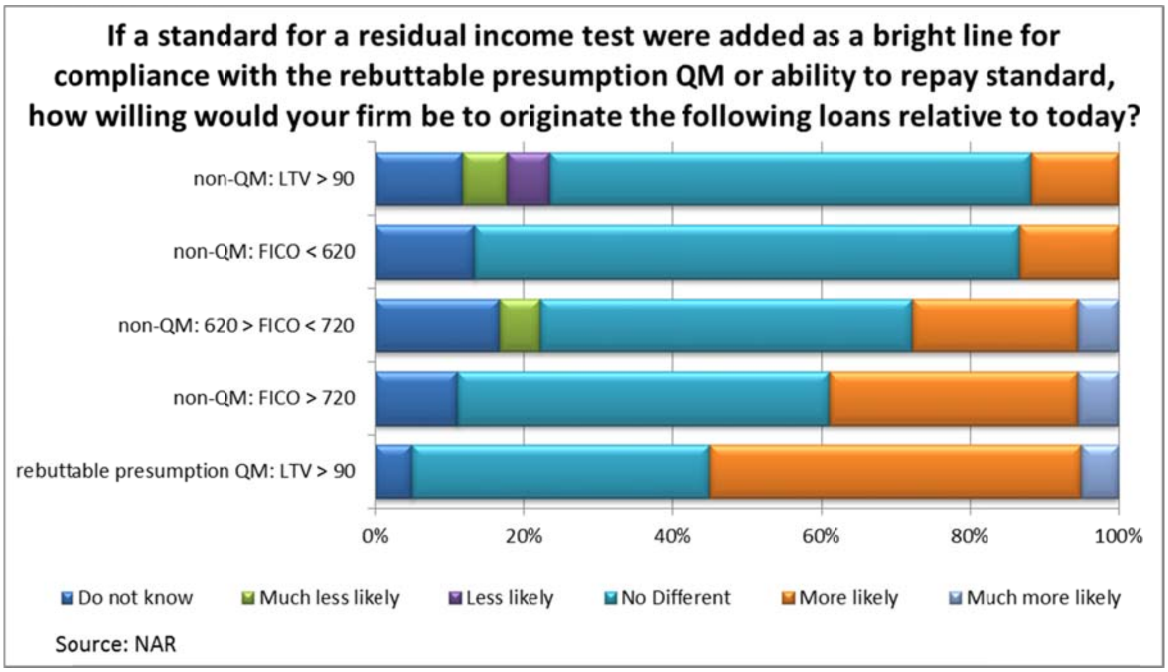



Looking to the 2nd half ot 2014, nearly half of respondents expected improved access to credit for prime borrowers with FICO scores between 620 and 720.  However, the vast majority expected no change for rebutable presumption loans and 33.4% expected improvement in the acces for non-QM borrowers, while 9.6% expected it to weaken.

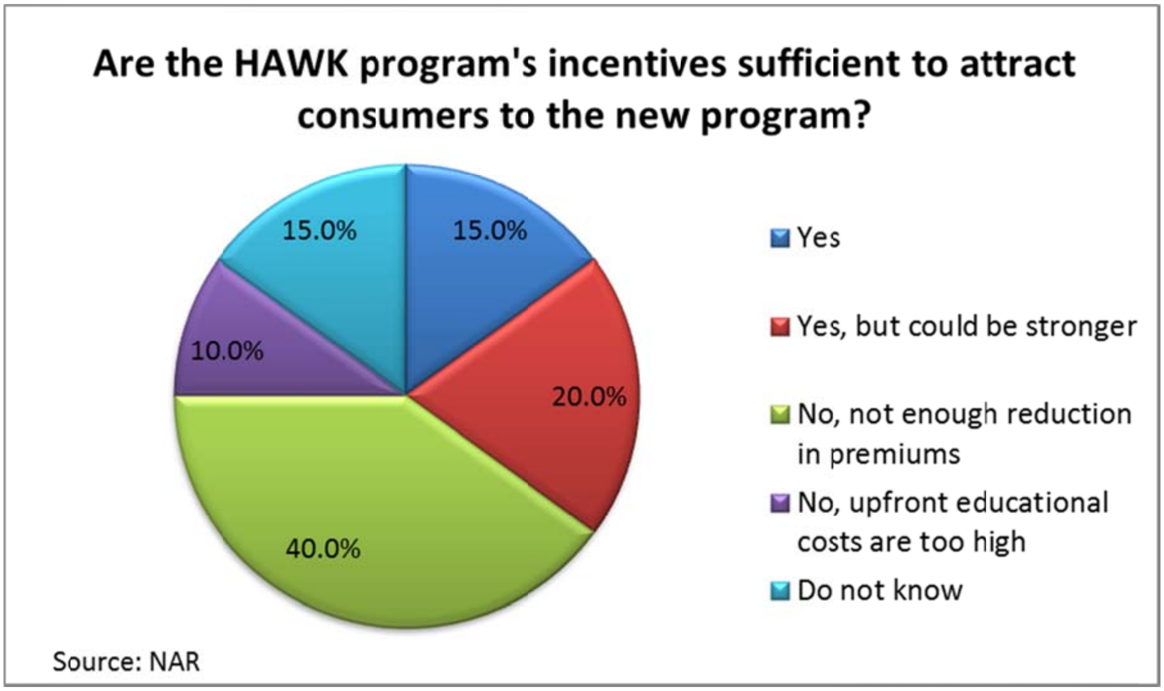
More than 40% of respondents expected investor demand for both rebuttable presumption QM and prime borrowers with credit scores between 620 and 720. Interest in non-QM lending was also expected to improve, roughly in line with that of high FICO, prime lending.

## Other Industry and Policy Issues

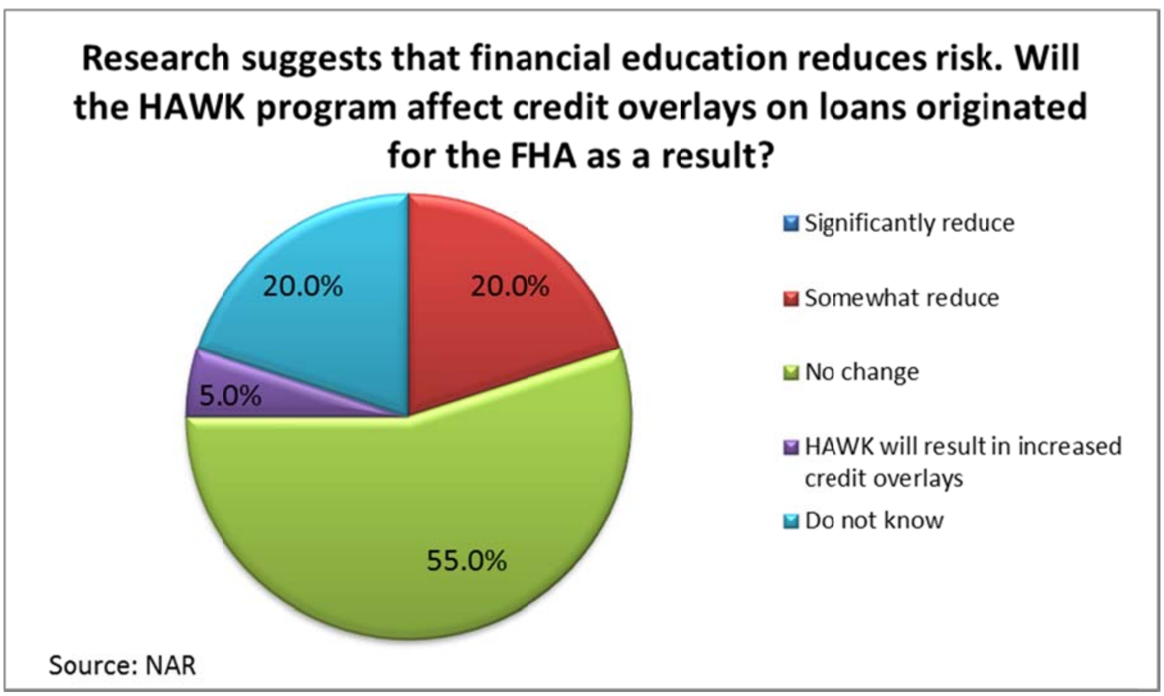
Under the ATR rule, a residual income test can be used as supporting evidence of a borrower's ability to repay a loan, but it is not a definitive "bright line" proof of compliance with the rule. Participants were asked whether the addition of a "bright line" residual income test to the QM/ATR would improve their willingness to originate in the rebuttable presumption and/or non-QM space. Respondents who offered the products indicated that a residual income test would be most helpful in the rebuttable presumption space, with 53.0% indicating that they would be either more likely or much more likely to originate. A definitive residual income test would also help in the non-QM space, but even there, lenders displayed a reluctance to originate product of lower quality.




In the summer of 2014, the FHA announced its HAWK program that will offer a discount of 10 bps in annual MIP and 50 bps in the UFMIP to consumers who complete a buyer education program. The annual MIP would fall by an additional 15 basis points if the borrower is not delinquent after 18 months. The education program is estimated to cost the borrower $400 upfront. Respondents were asked whether the incentives are sufficient to attract consumers to the new program. Only 15% of respondents indicated that the incentives would result in increased demand for FHA insurance, while 20% felt that it would help, but could be stronger and 40% felt that they were not. 10% of respondents indicated that the upfront costs of the education program were too high for consumers.

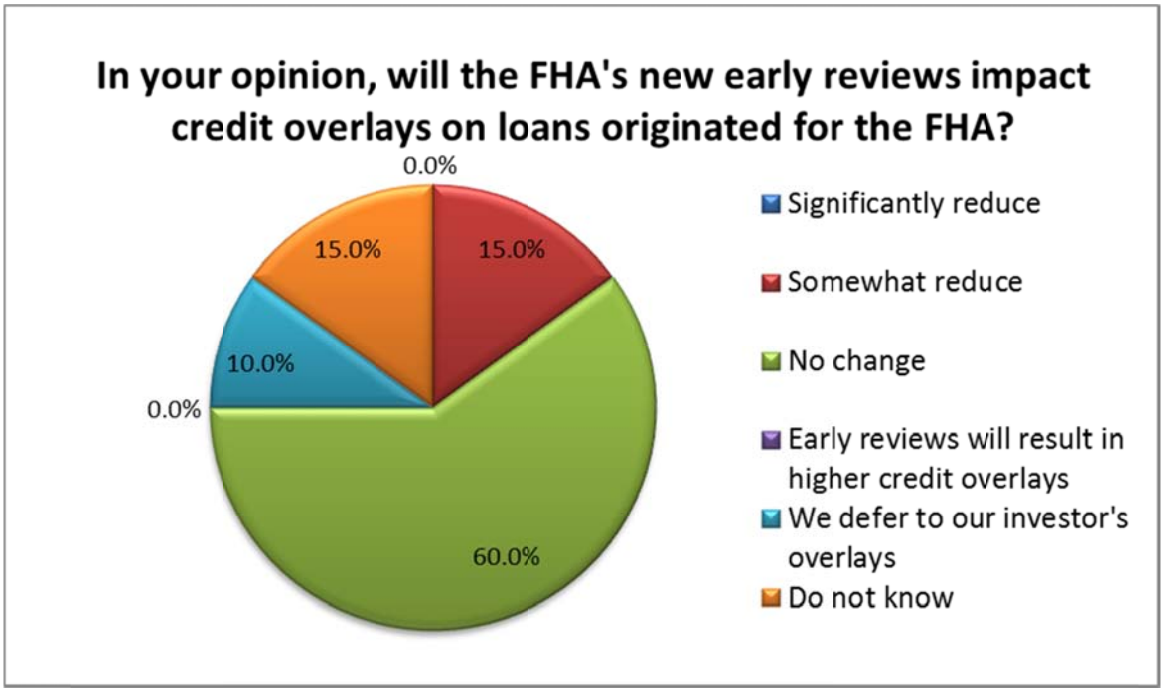



In its press release for the HAWK program, the FHA cited research that shows a reduction in serious delinquency rates of up to 30% for counseled borrowers compared to similar borrowers without counseling. Survey participants were asked whether, given the evidence of reduced risk, the HAWK program would affect lenders' credit overlays on loans originated for the FHA. A 55% majority indicated that there would be no change in access, while 20% indicated that it would ease credit tightness somewhat.

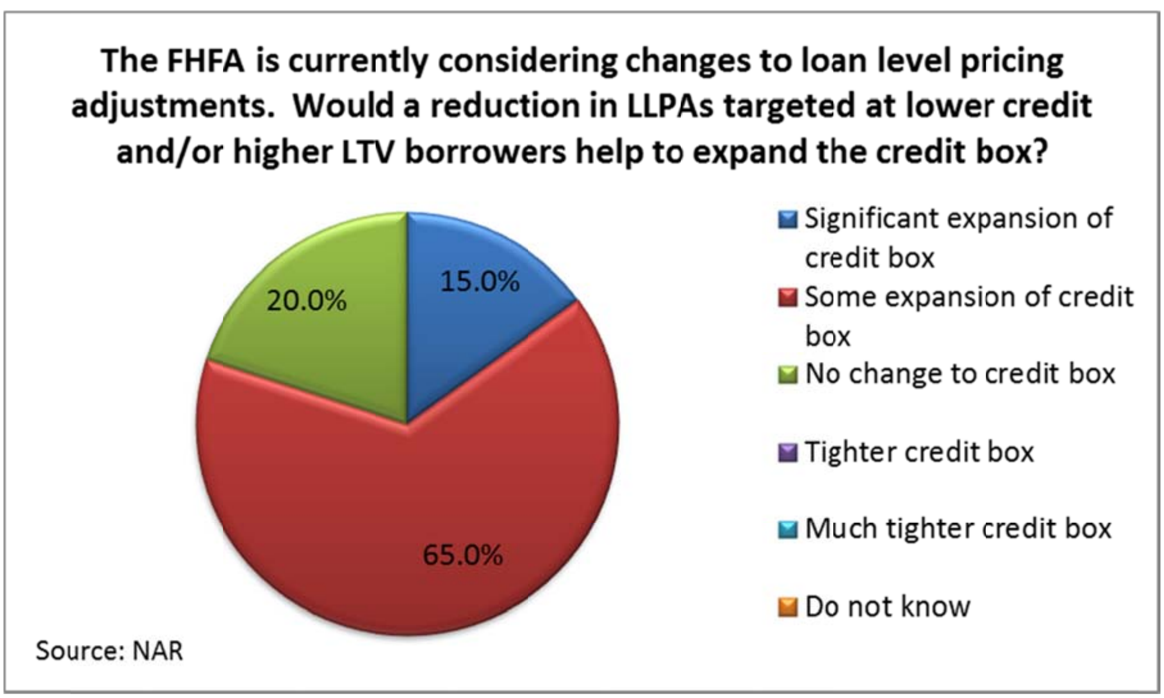



The FHA is also rolling out a program for earlier reviews of mortgage files. The program is intended to reduce the risk to lenders of problems in loan files that could lead to subsequent costly put-backs. FHA's intent is to ameliorate concerns about buy-back risk and to reduce lender overlays in turn. Participants were asked whether the early reviews would impact credit overlays on loans originated for the FHA.

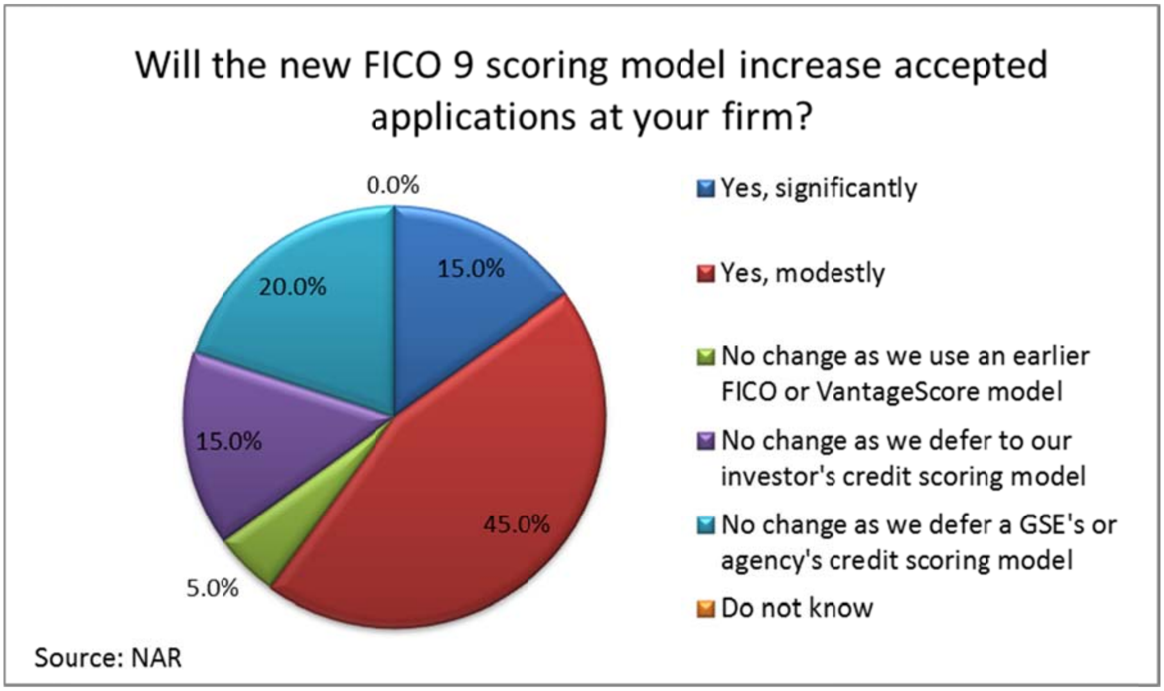
60% indicated that there would be no change, while 15% indicated that the reviews would both somewhat and significantly reduce overlays.  10% defer to their investors' rules.




The FHFA took comments from the public in early September as to whether the current g-fee structure was appropriate.  Several of the questions posed by the FHFA dealt with the impact of the g-fees on demand in general and from high LTV and low credit borrowers.  Survey participants were asked whether a reduction in LLPAs targeted at lower FICO and/or higher LTV borrowers would help to expand the credit box.  A robust majority of 80% felt that a reduction in rates would help to expand the credit box, while 20% felt that there would be no change.




Finally, the Fair Isaac Corporation recently introduced a new scoring model.  In "FICO 9", less emphasis is given to the impact of unpaid medical bills and the effect of missed payments on debts that have subsequently been paid off are eliminated. FICO estimates that the new model could improve scores by 25 basis points for the former group and by as much as 100 points for the latter group. Survey participants were asked if this new scoring model would increase accepted applications at their firm.




A 60% majority indicated that the new scoring model would increase accepted applications. 5% indicated that it would not impact their decision to accept as they use an earlier version of the model, while 35% deferred to their investor's model or that of the GSEs. This result was a surprise given the GSE's market share and their reliance on an earlier FICO model.

## Appendix A: About the Survey

In August of 2014, NAR Research sent out a survey to a panel of 135 different mortgage originating entities. The panel was expanded in the second quarter from 65 to include members of Community Mortgage Lenders of America. The survey instrument was sent by email on Tuesday the 19th of August and closed on Tuesday, September 2nd. Questions in the survey instrument covered the characteristics of the originators, a subset of questions focused on the qualified mortgage rule, and a set of questions focused on the FHA, FHFA, and the new FICO 9 score. There were 24 unique responses to the survey for a response rate of 17.8% and a margin of error of 6.4% at a 95% level of confidence.

Mortgage bankers dominated this sample, but this sample had more diversity in terms of size of annual originations, a proxy for bank size. Originator profiles were also consistent with prior surveys in terms of geographic distribution, purchase share, average annual production volume, and the distribution of destinations/purchasers of the originator's production.

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