The Qualified Mortgage Rule: Impact on Lending and the Consumer

NAR Research

February 2014

NATIONAL ASSOCIATION *of* REALTORS®

Executive Summary

The qualified mortgage (QM) rule was implemented in January of 2014. The law is intended to protect consumers by strengthening underwriting standards, but some have argued that the rules will raise costs and reduce access for consumers. This survey queries a sample of mortgage lenders about the rule's impact on their business and how the rule could in turn impact consumers.

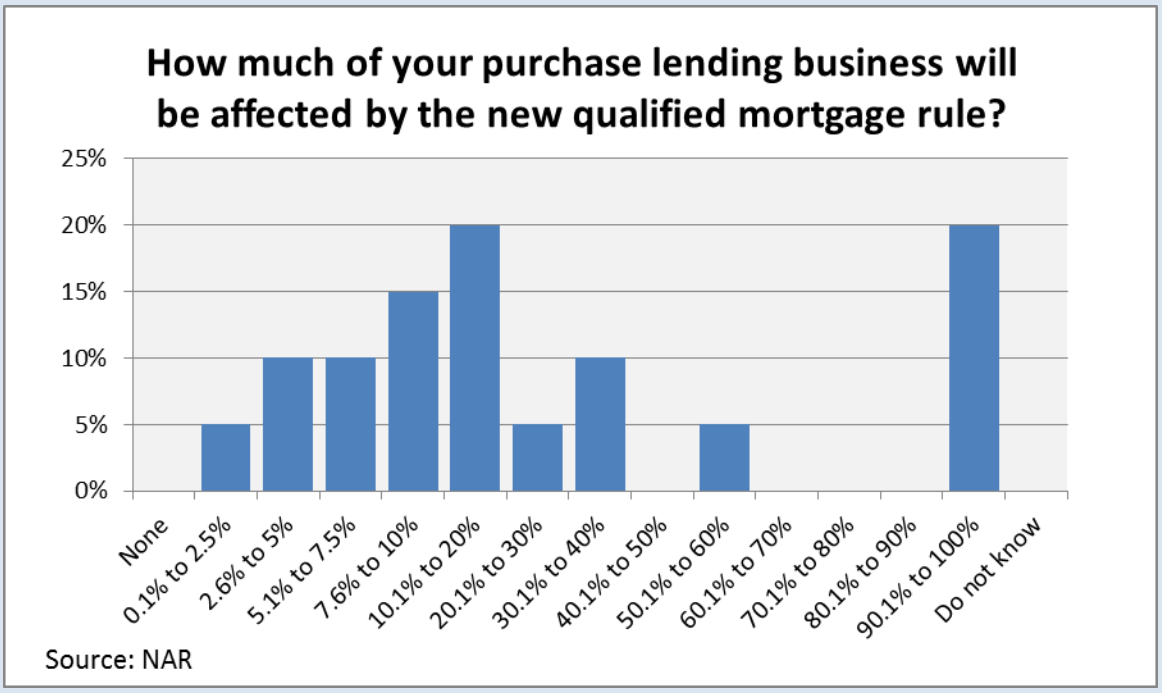
Highlights of the Survey

- When asked about the extent of the QM rule's impact, 55% of survey respondents indicated that the QM rule would affect 2.6% to 20% of their originations
- The 3% cap on points and fees was the feature of the new rule that most concerned respondents as 60% indicated that they were "very concerned"
- A strong majority of respondents indicated that they would defer to investors preferences on how to treat non-QM loans, but 45% indicated that they would not originate non-QM mortgages
- Roughly a fifth of respondents did not know whether or not they would charge non-QM borrowers higher rates, but the most frequently cited change for prime and near-prime borrowers was an increase of 50 to 75 basis points and 150 basis points for sub-prime
- Relative to 2013, respondents indicated a high reluctance to originate mortgages with non-QM features and their aversion toward originating non-QM loans increased as credit scores declined. They also indicated an elevated reticence to originate mortgages that fit into the rebuttable presumption definition of the QM rule and even some hesitance to originate safe harbor QM mortgages.
- A significant share of respondents indicated that they would impose buffers in advance of the 43% back-end debt-to-income ratio, the 3% cap on points and fees, and the limitation on the annual percentage rate to within 150 basis points over the average prime offer for eligibility with the safe harbor definition of the QM
- In response to the new rule, the vast majority of respondents plan to increase staff and expenditures on compliance software. In addition, 11% will shutter affiliated title insurance or other companies.
- Finally, 16.7% of respondents indicated that they had already adapted to the rule, while 44.4% would be ready within three months. Nearly a third of respondents indicated that it would take three to six months before they had adapted, but all would be ready within one year.

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 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]

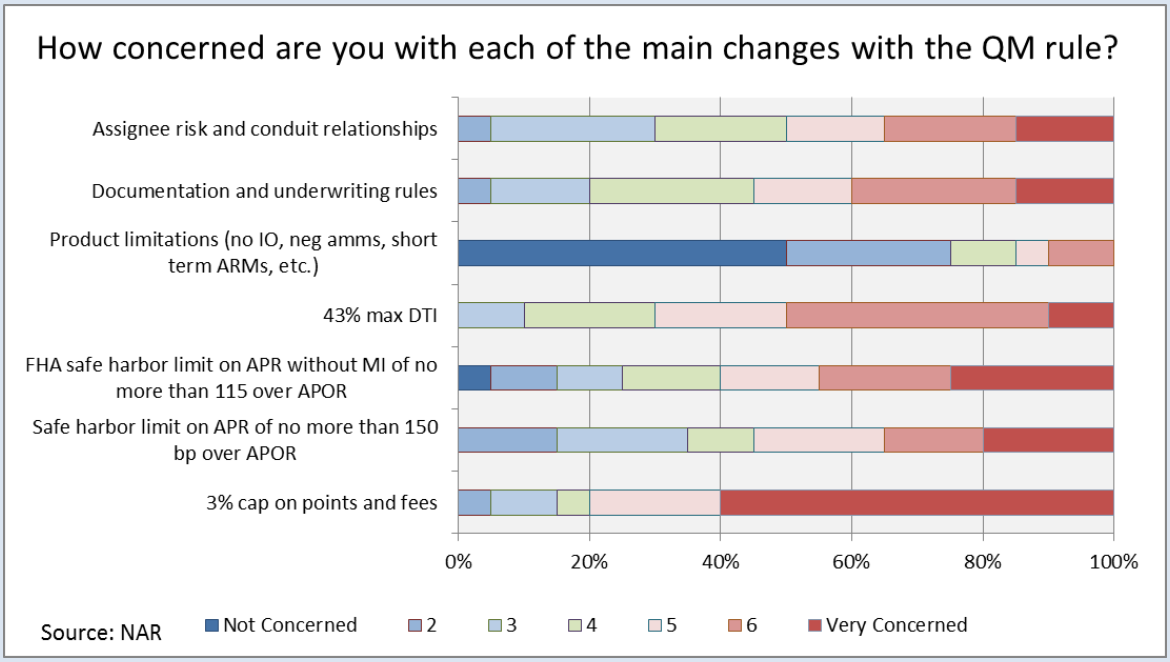
When asked to what extent the QM rule would impact their business, the most frequent responses were 10.1% to 20% and 90.1% to 100% with each garnering 20% shares of the responses. However, 55% of the responses clustered between an impact on 2.6% and 20% of production. The significant share of responses indicating 90 to 100% impact was likely an indication of heightened underwriting for all mortgages regardless of QM status.



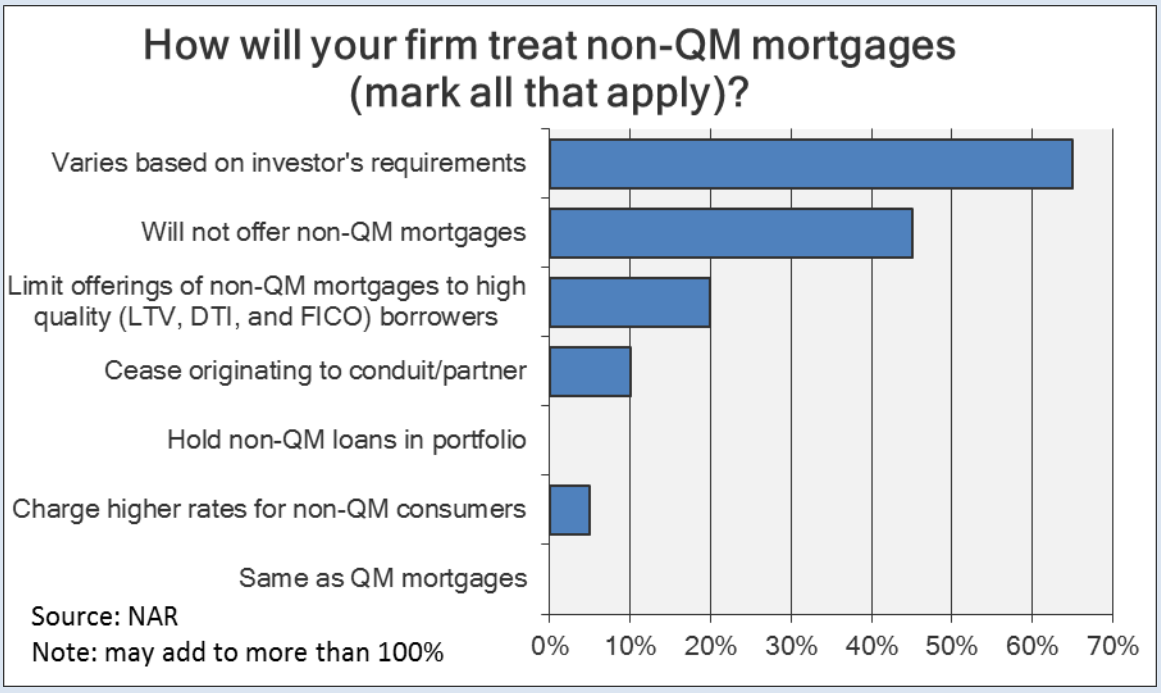
Of the new rules, the 3% cap on fees and points was by far of greatest concern with 60% of respondents indicating that they were "very concerned" about that feature. Also of high concern were the limitations on the annual percentage rate relative to the average prime offer rate for the general QM standard and the FHA's QM standards. The limitation on the back-end debt-to-income ratio of 43%

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

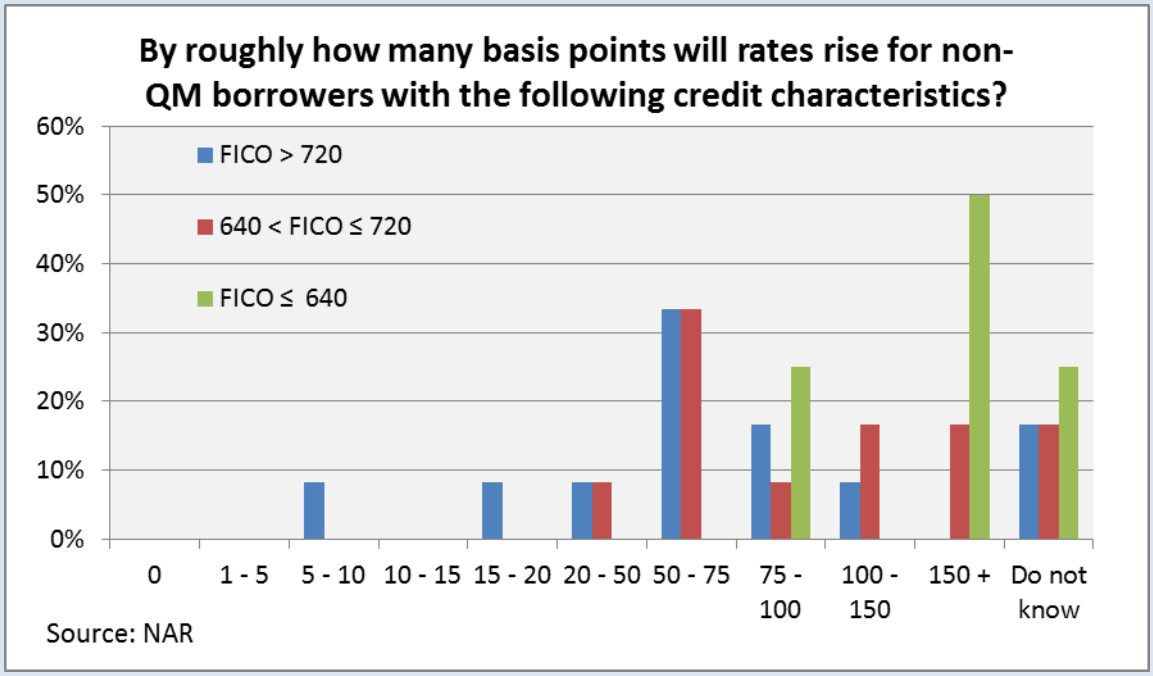
garnered high concern as did the documentation requirements. However, respondents seemed to shake off the limitations on product features as 50% of respondents indicated that they were "not concerned" and no respondents indicated they were "very concerned" about these restrictions. With the exception of interest only jumbo loans, there has been little production with these features in recent years.



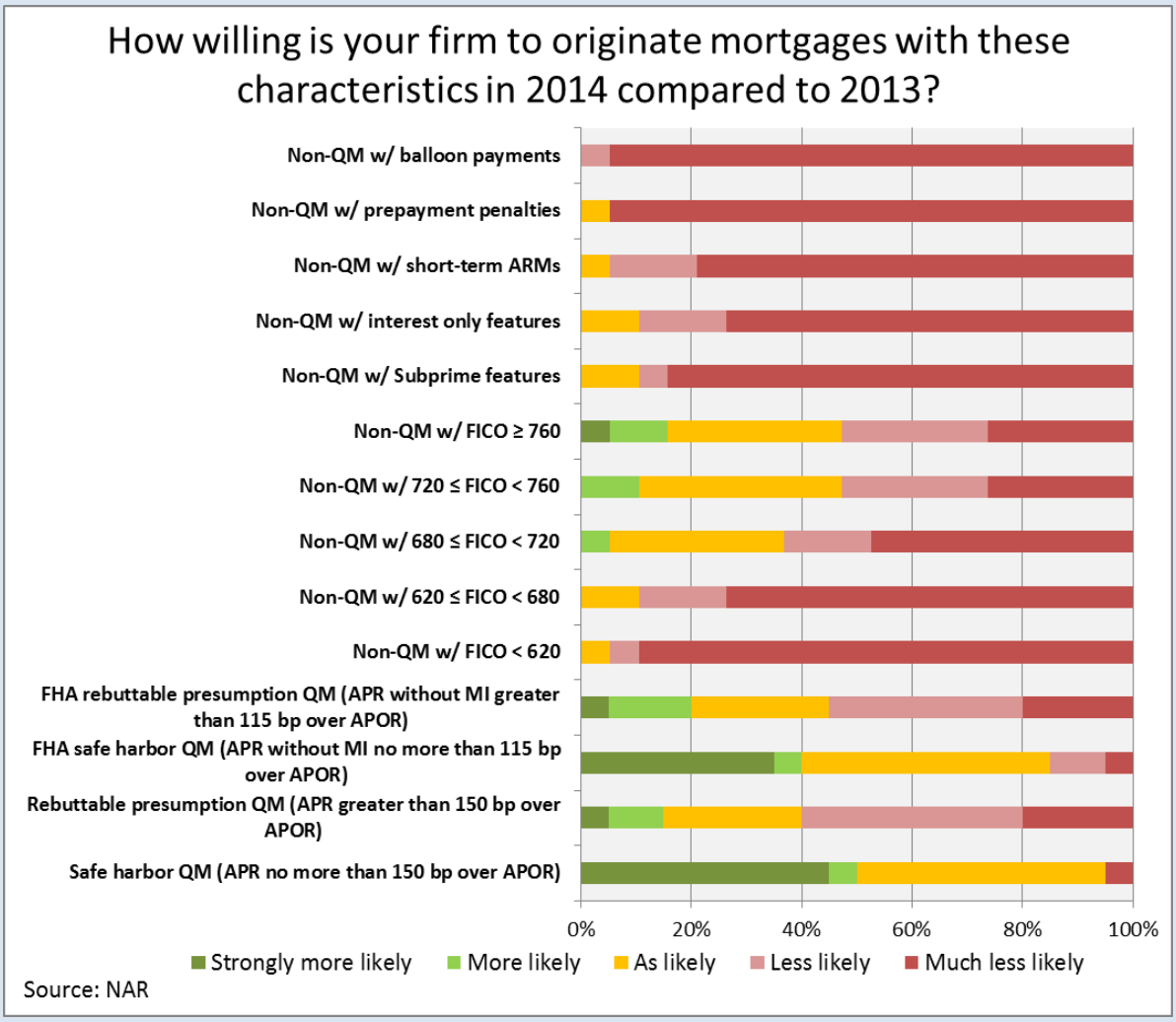
When asked how they would respond to the new regulations, 65% indicated that their response would depend on the requirements of investors, while 45% indicated that they would not offer non-QM mortgages. In addition, 20% would limit offerings of non-QM loans to high quality borrowers, 5% would charge higher rates and 10% would cease originating to conduits or partners. No respondents indicated that non-QM loans would be treated the same.



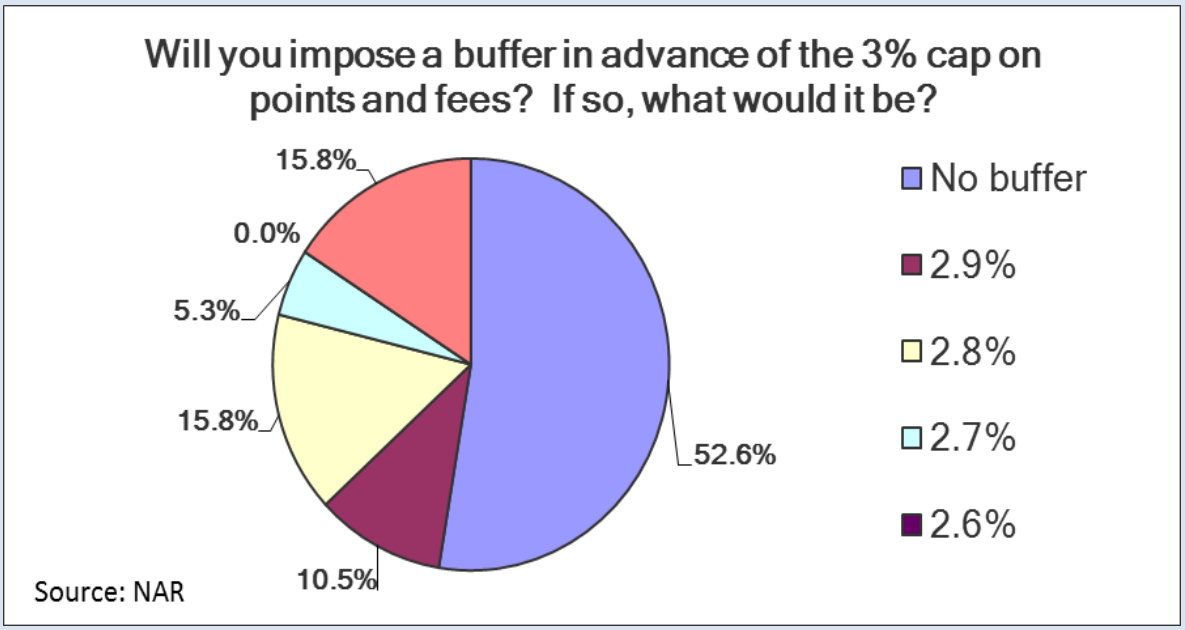
When asked how non-QM status would impact mortgage rates, respondents indicated that mortgage rates would rise for all non-QM borrowers, but that the rate increase would vary based on credit quality. One third of respondents indicated that rates for borrowers with non-QM loans and FICO scores between 640 and 720 as well as those with scores greater than 720 would face rate increases of 50 to 75 basis points, but the distribution of respondents suggested better pricing for prime borrowers as compared to near prime. However, 50% of respondents indicated that borrowers with FICO scores of 640 and below would face rate increases of 150 basis points or more and no respondents indicate the rate increase would be less than 50 to 75 basis points. A significant share indicated that they did not know how much rates would rise for the various degrees of credit quality, but no respondent indicated that rates would not rise for non-QM borrowers.



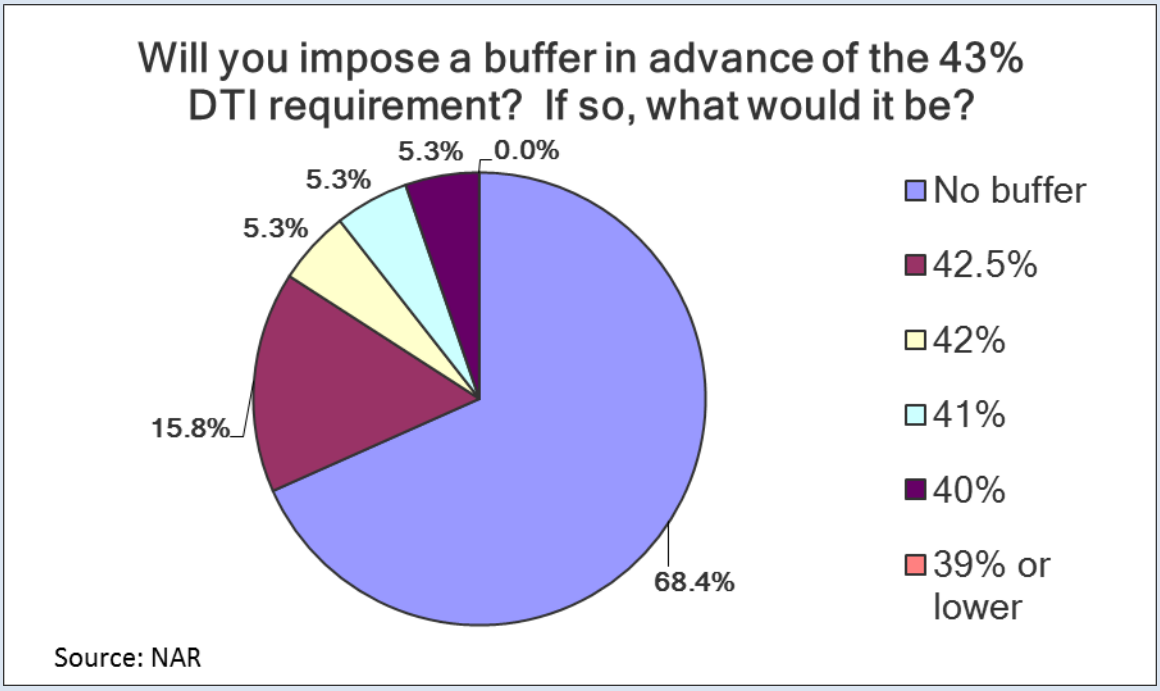
When asked about their willingness to lend to particular borrower types, the majority of originators indicated that they would be "much less likely" to make loans with non-QM product features as compared to 2013. Similar to results shown earlier, originators indicated that they would be much less likely to lend to borrowers with lower credit scores in the non-QM space and this reticence increased as credit quality diminished. Finally, more than half of originators indicated that they were either "less likely" or "much less likely" to originate QM loans that fell under the rebuttable presumption definition of compliance with either the QM standard or the FHA's QM standard. In contrast, 85% and 95% of originators indicated that they would be "as likely" or more likely to originate mortgages that met the safe harbor definition of the standard QM rule and the FHA's QM definition, respectively.



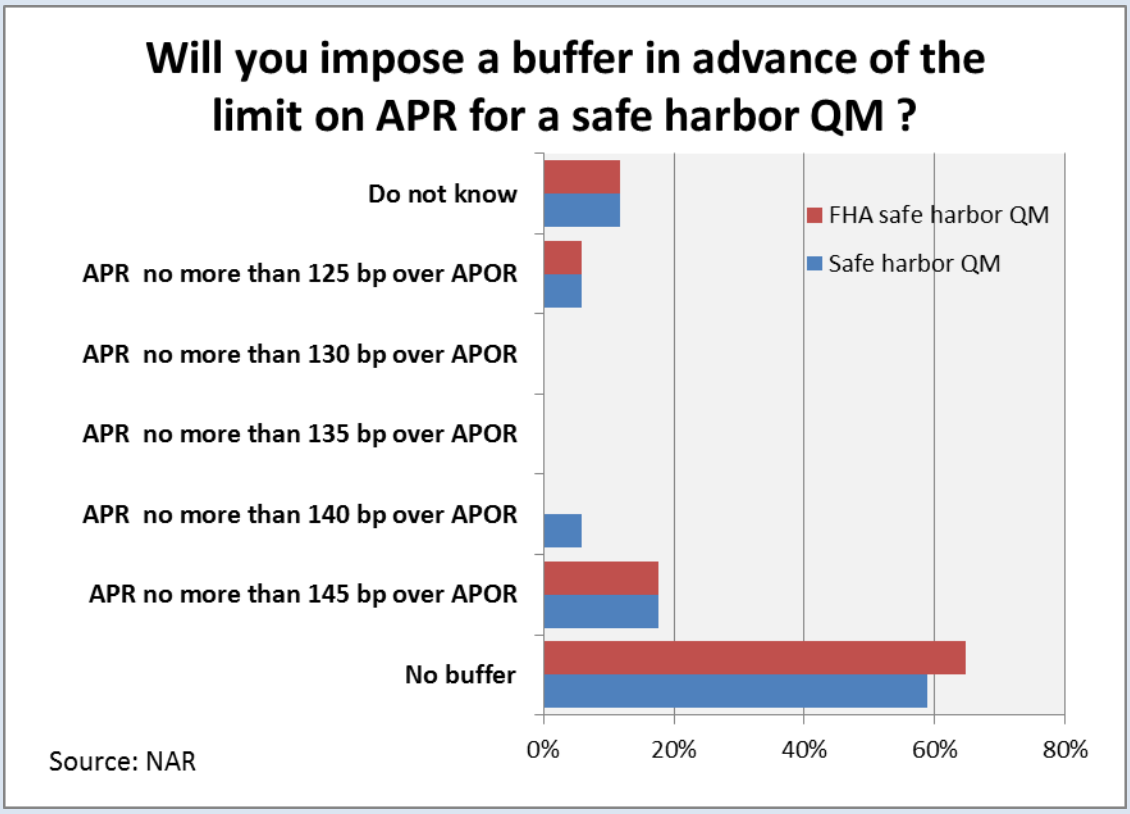
Survey participants were asked whether they would introduce precautionary buffers in advance of certain limitations of the QM rule. More than half of respondents indicated that they would not include a buffer in advance of the 3% cap on fees and points, but slightly less than half indicated that they would implement a buffer. Roughly a third of respondents indicated that they would implement a buffer of either 2.8% or 2.9% and 10.5% indicated that the buffer would be as low as 2.6%. The use of buffers on some safe harbor QM loans corroborates the finding earlier that some lenders would be less likely to originate even safe harbor QM loans relative to last year.



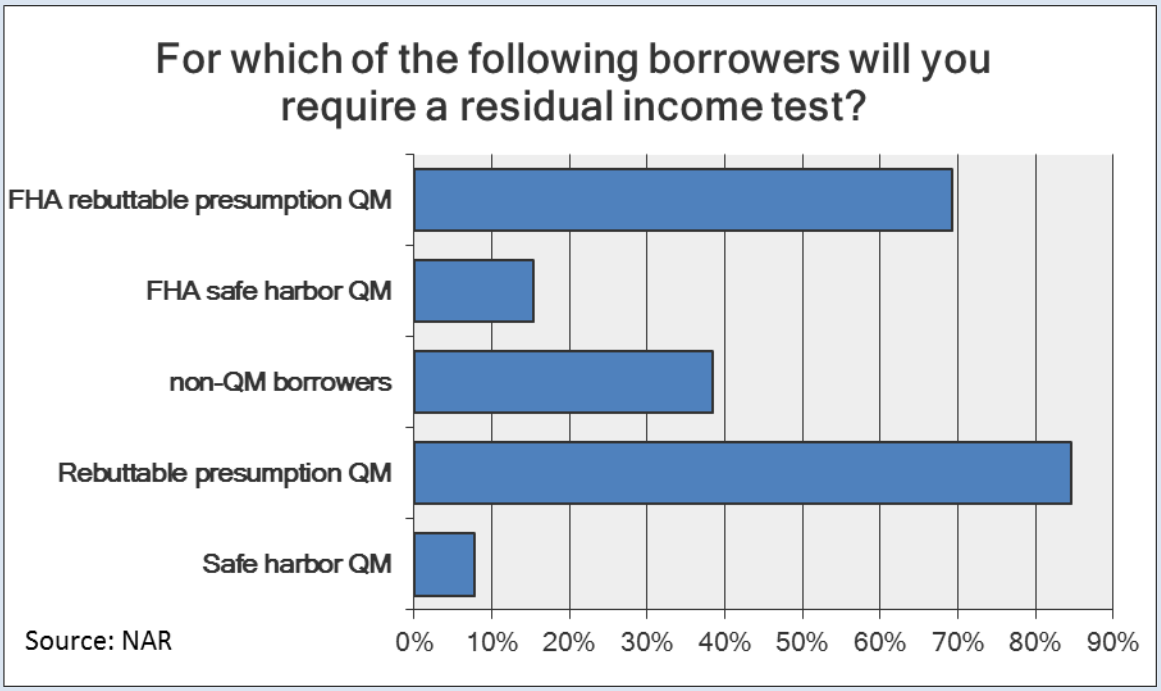
With respect to the maximum back-end debt-to-income ratio of 43%, 68.4% of respondents indicated that they would not have a buffer in advance of that restriction. However, 15.8% indicated that they would impose a modest buffer at 42.5%, while an additional 10.6% of respondents indicated that they would impose buffers of 41% or 42%.



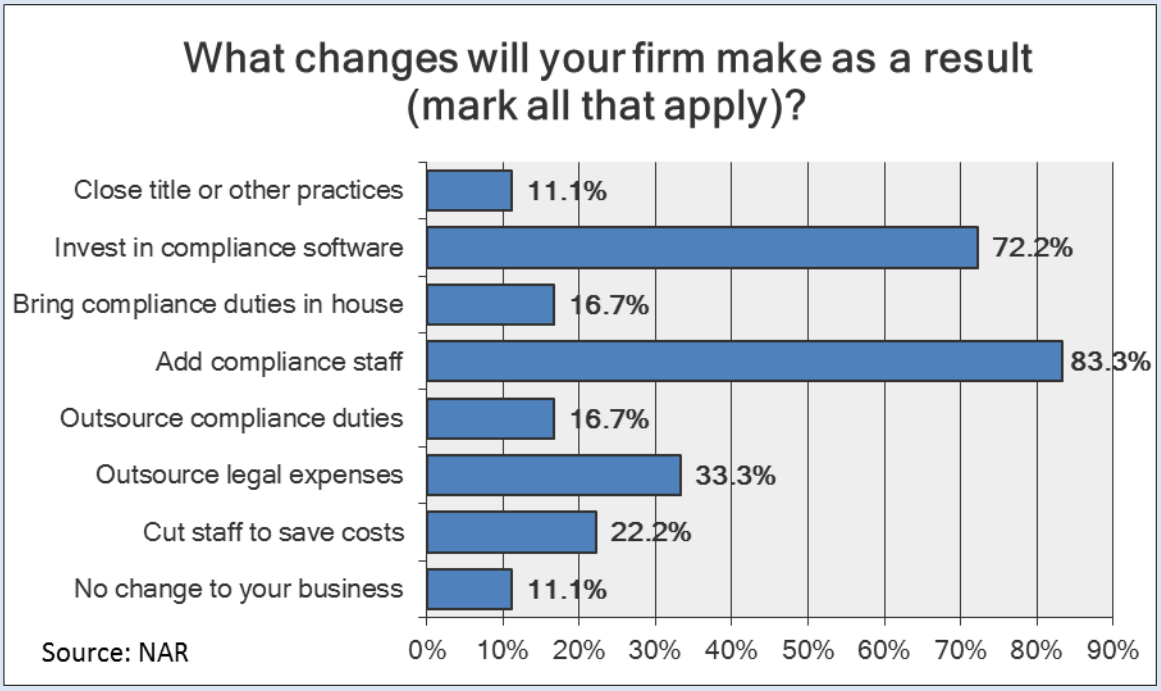
With respect to the limit on the annual percentage rate to less than 150 basis points over the average prime offer rate for safe harbor eligibility, roughly 60% indicated that they would not impose a buffer on pricing, but 18% indicated that they would impose a buffer of 5 basis points for both FHA and general QM safe harbor mortgages and 12% indicated that they were not sure.



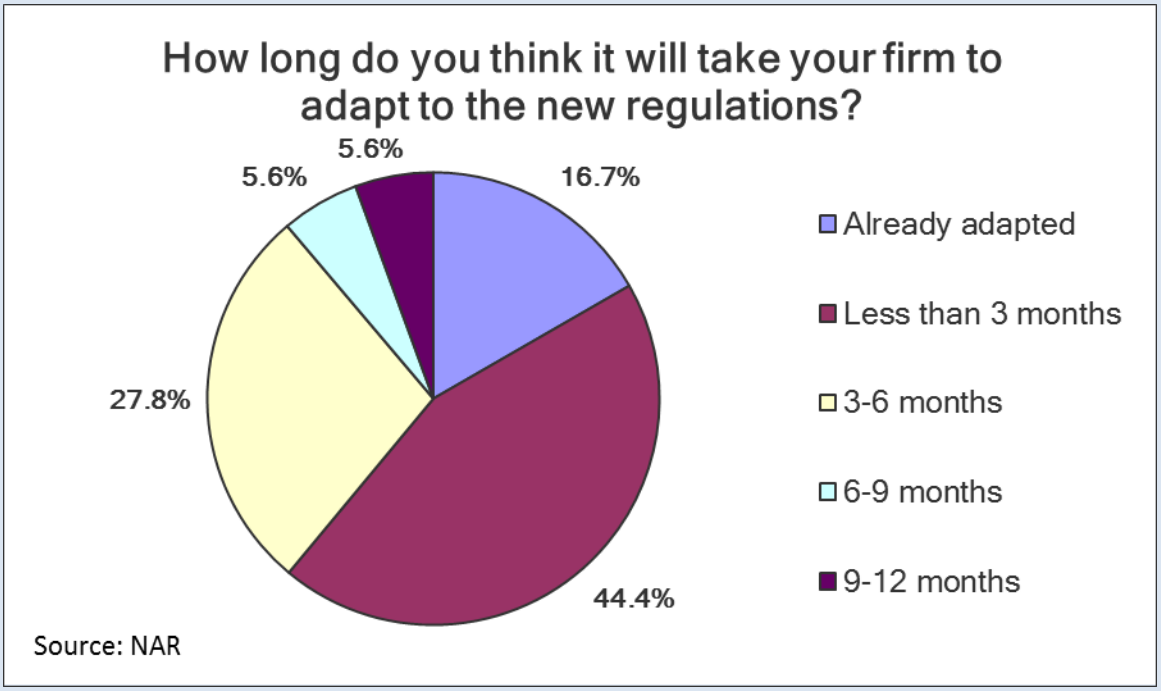
Nearly 70%, 69.2%, of respondents indicated that a residual income test would be required for borrowers that fell into the FHA's definition of rebuttable presumption, while 84.6% would require a test of non-FHA rebuttable presumption borrowers. Just 15.4% of respondents would require a residual income test for mortgages that met the FHA's QM definition of safe harbor, while only 7.7% of respondents would require the test for mortgages that met the general QM safe harbor. However, 38.5% of respondents indicated that they would require a test for non-QM borrowers. This low relative response for non-QM mortgages, which are also bound by the ability to repay rule and would necessitate a residual income test, is likely a reflection of the small share of originators who indicated their willingness to originate non-QM loans.



When asked how concerned they were that their systems and staff were not adequately prepared for the implementation of the QM rule only 15.8% indicated they were not concerned, 52.6% were somewhat concerned, and 31.6% responded that they were very concerned. When asked if they were prepared for the litigation risk, 5.3% indicated that they were not prepared, 52.8% responded "somewhat prepared", 10.5% were "well prepared", and 31.6% were unable to answer or did not know. Finally, when asked about the impact on staffing and costs, no respondents indicated that there would be little or no cost, while 42.1% indicated that the impact would be manageable and 57.9% indicated that the impact would be significant.



In response to the new QM rule, 83.3% of respondents indicated that they would add compliance staff and 72.2% indicated that they would invest in compliance software. Slightly more than 11% would close their title or other affiliated practices, which may reflect a low share that had affiliated business prior to the rule's implementation, and 22.2% would cut staff to save costs. Only 11.1% indicated that there would be no operational changes.



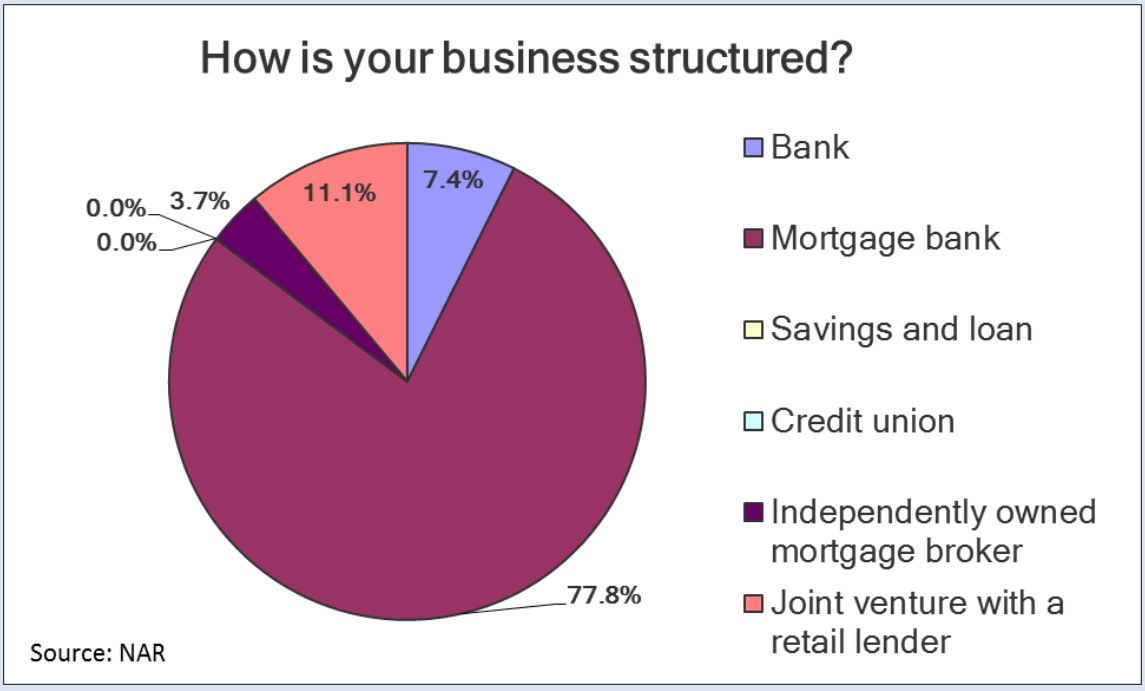
Finally, when asked how long it would take to adjust to the new requirements of the qualified mortgage rule, 16.7% of respondents indicated that they were already adapted, while an additional 44.4% indicated that it would take less than 3 months. Those that felt it would take three to six months only 27.8% of the sample and 11.2% of the sample indicated that it would take either six to nine months or nine months to a year. No respondents indicated that it would take longer than a year to adjust to the changes.

Appendix A: About the Survey

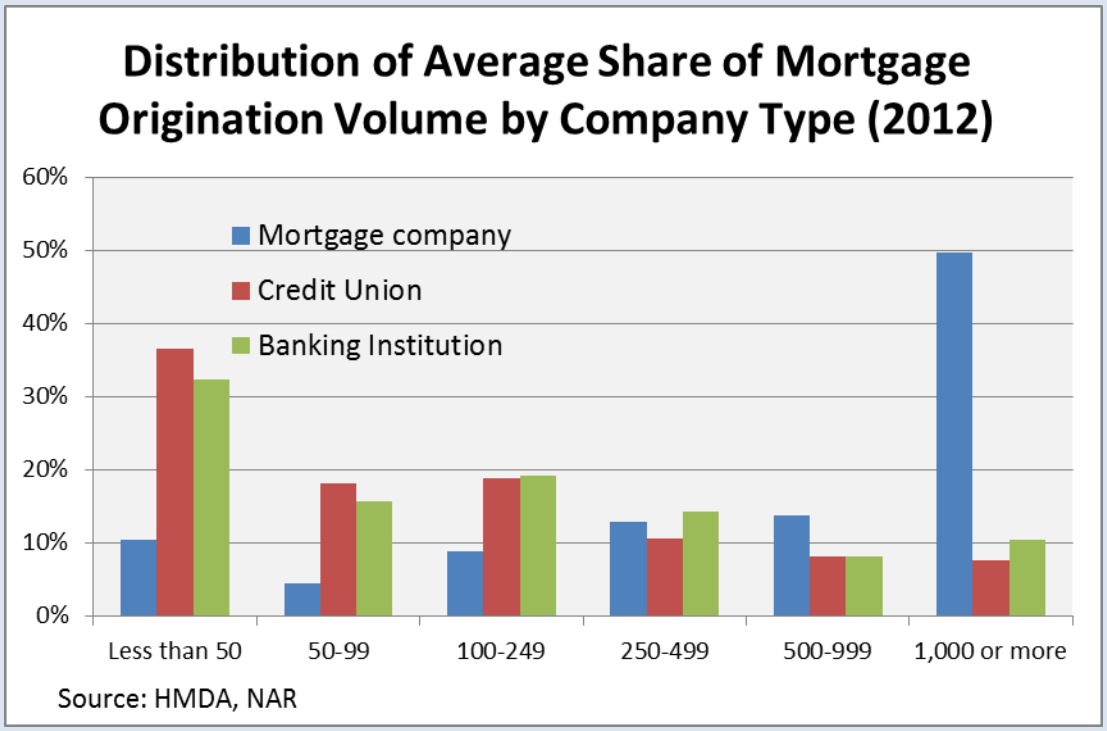
In January of 2014, NAR Research sent out a survey to a panel of 53 different mortgage originating entities. The survey instrument was sent by email on Monday the 6th of January and closed on Monday the 20th. Questions in the survey instrument covered the characteristics of the originators (see appendix B), their general market concerns, and a subset of questions focused on the qualified mortgage rule. There were 27 responses to the survey for a response rate of 51% and a margin of error of 13.7%. NAR will query the sample a second time in the future to measure how firms adjust to the new regulations.

Appendix B: About the Sample

The survey was sent to 53 unique firms with relatively close ties to REALTOR® members. Mortgage bankers dominated the sample with 77.8% followed by non-mortgage banks at 7.4%. Joint venture between a REALTOR®-brokerage firm and a retail lender made up 11.1% of the sample and independently owned mortgage brokers made up 3.7%. No credit unions or savings and loans were represented in the sample responses. This sample is in sharp contrast to the universe of originators reported in the 2012 data collected in compliance with the Home Mortgage Disclosure Act (HMDA). There, 59.1% of all institutions were banking, while an additional 27.1% were credit unions and 2.9% were an affiliate of a banking operation. Just 11% of the lending institutions were mortgage companies (including mortgage banks as defined by HMDA).

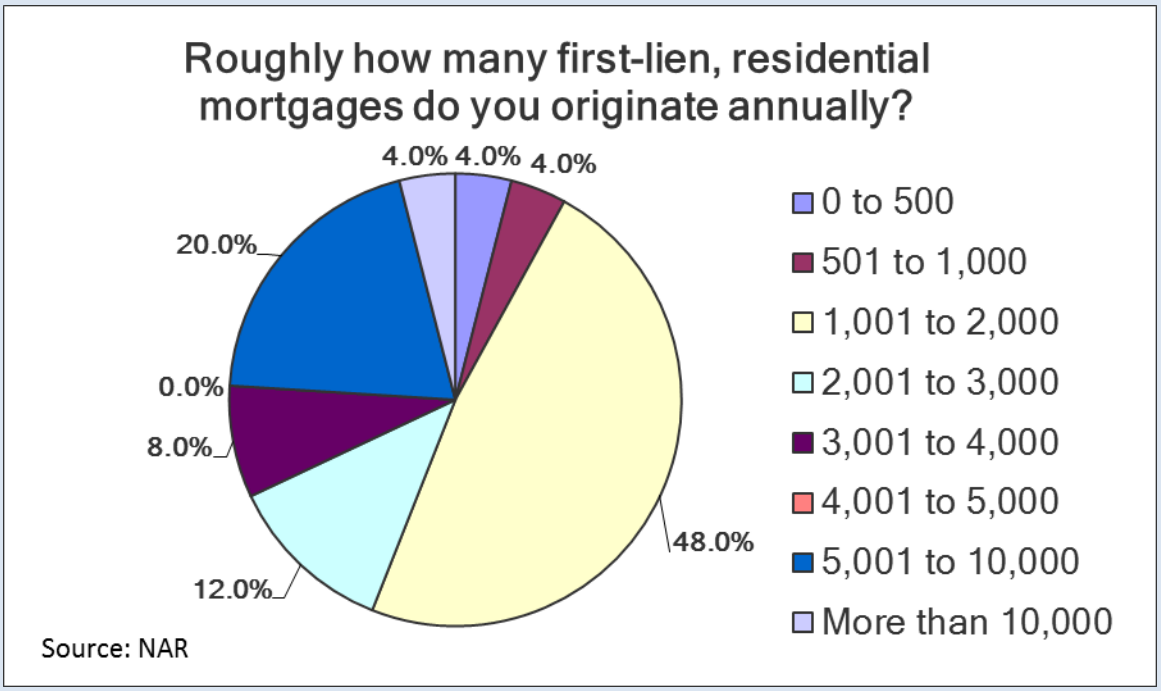


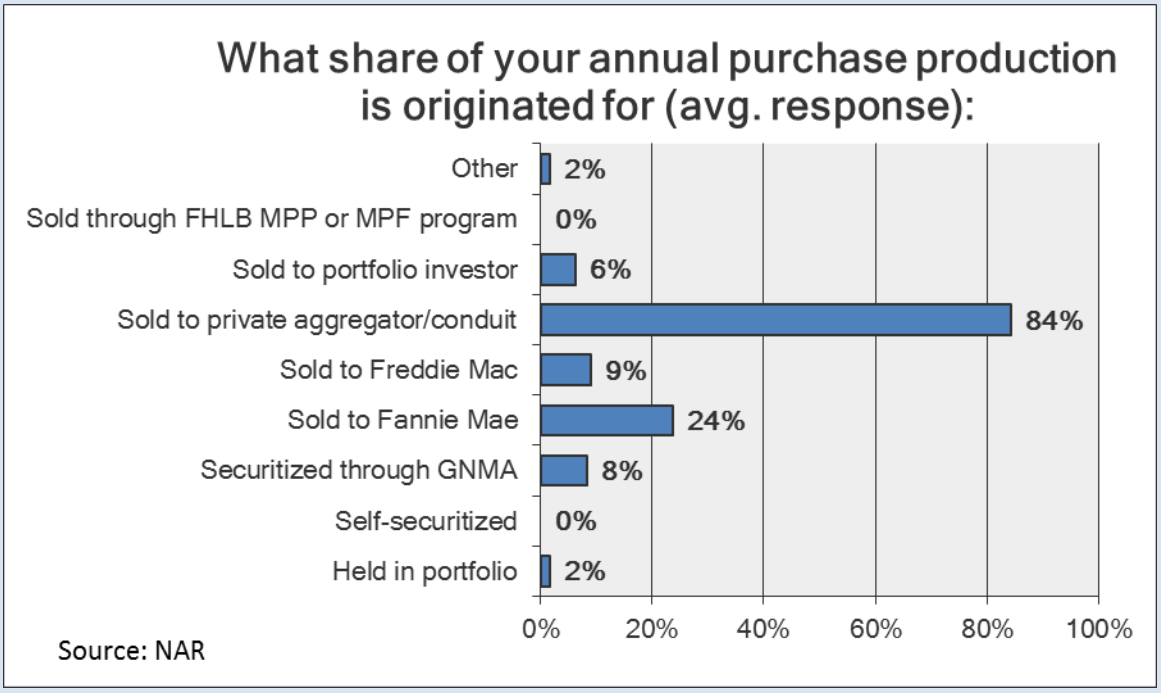
Because of the close ties to REALTOR® members, the firms in this sample tend to specialize in purchase originations as 96% of the originators in the sample indicated having 70% or more of their originations as for purchase. A full 28% of the sample indicated that 90% to 100% of their lending was for the purchase market.



Though small in numbers, mortgage companies tend to dominate the volume of originations on a per institution basis. In the 2012 HMDA dataset, 50% of mortgage companies originate 1,000 or more mortgages compared to just 10% and 8% for banks and credit unions, respectively. This pattern is not new. As noted by Avery, Brevoort, and Canner, "In 2005, for example, nearly 80% of the 8,850 reporting institutions were depository institutions but together they reported only 37% of all the lending-related activity."[2] In this NAR survey of mortgage originators, 92% of respondents originate more than 1,000 mortgages on average, 4% with 500 to 1,000 originates, and only 4% with fewer than 500. The latter point is important as it is one of the exemptions for compliance with the qualified mortgage rule. Finally, 24% of the sample originated 5,000 or more mortgages annually.

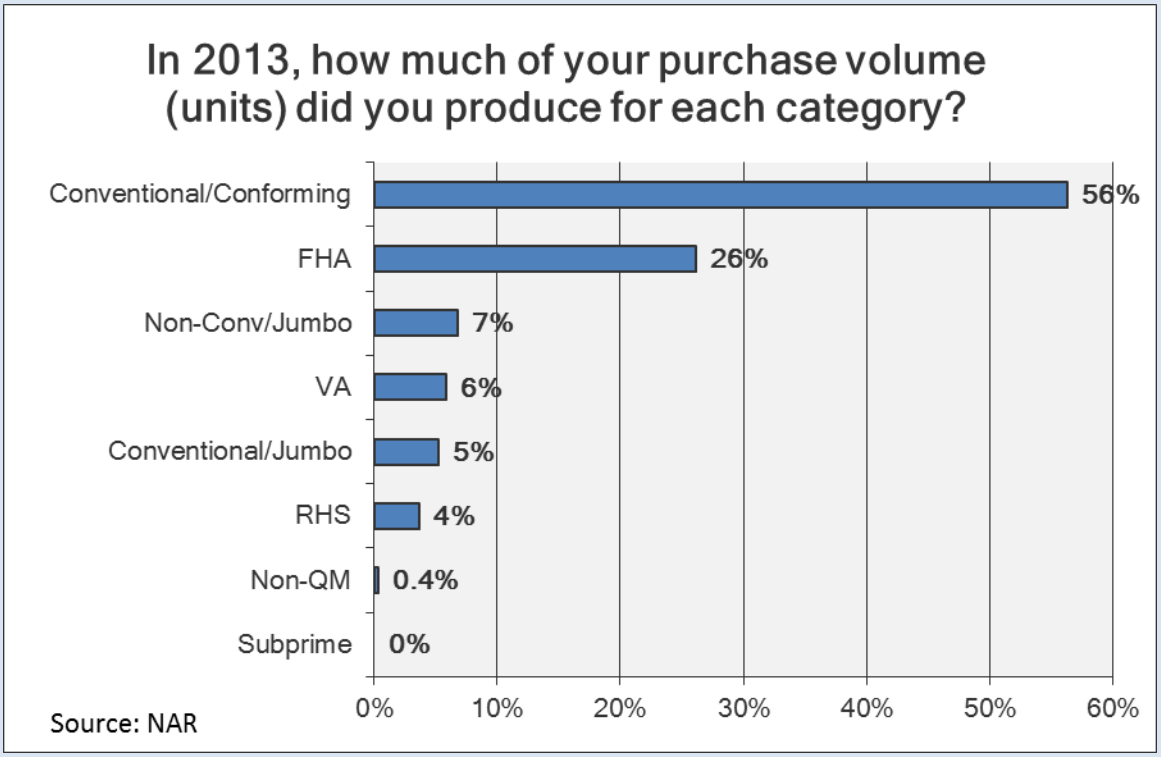
[2] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner. "Opportunties and Issues in Using HMDA Data." 2007. JRER, Vol. 29, No. 4. 2007

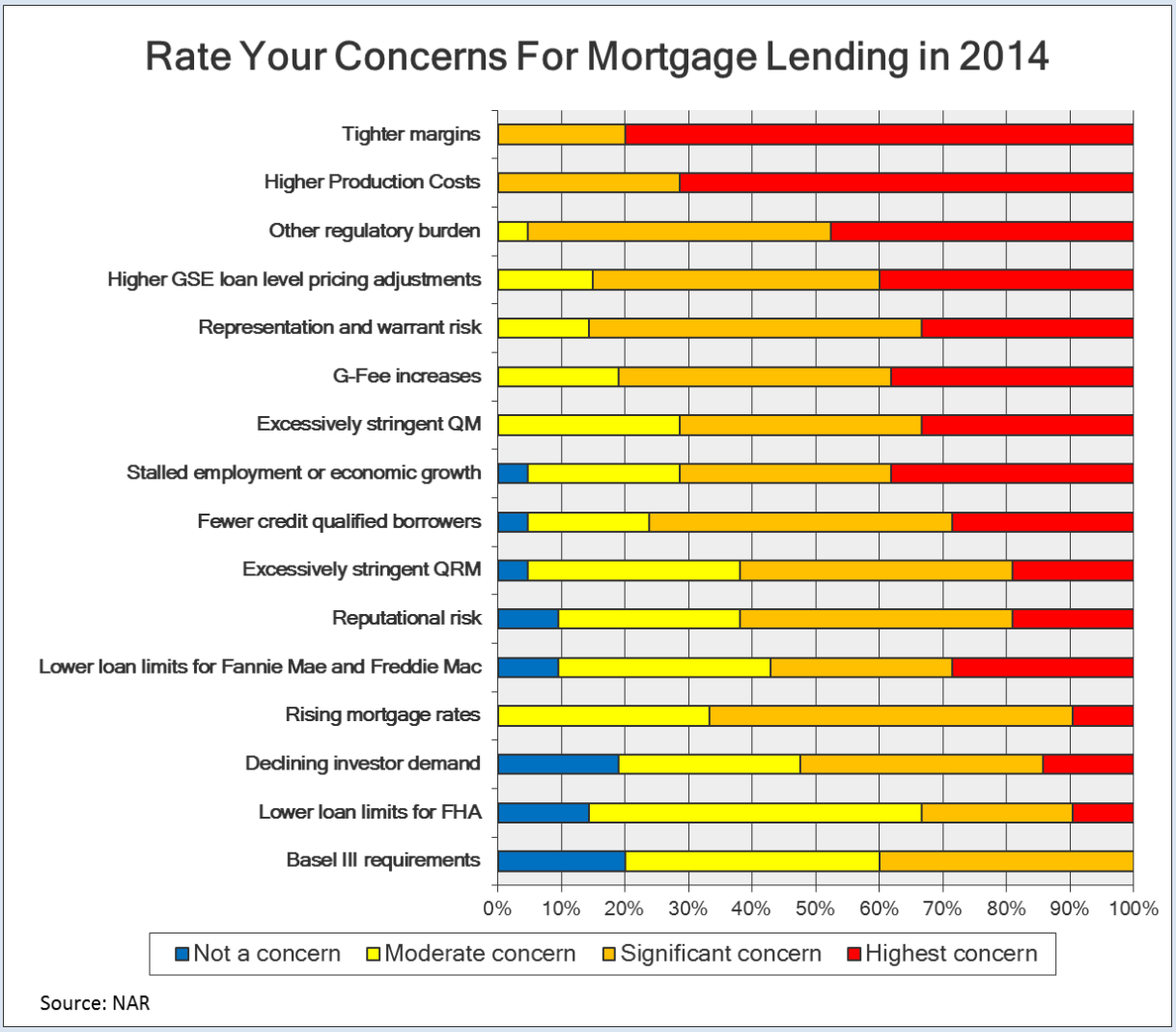




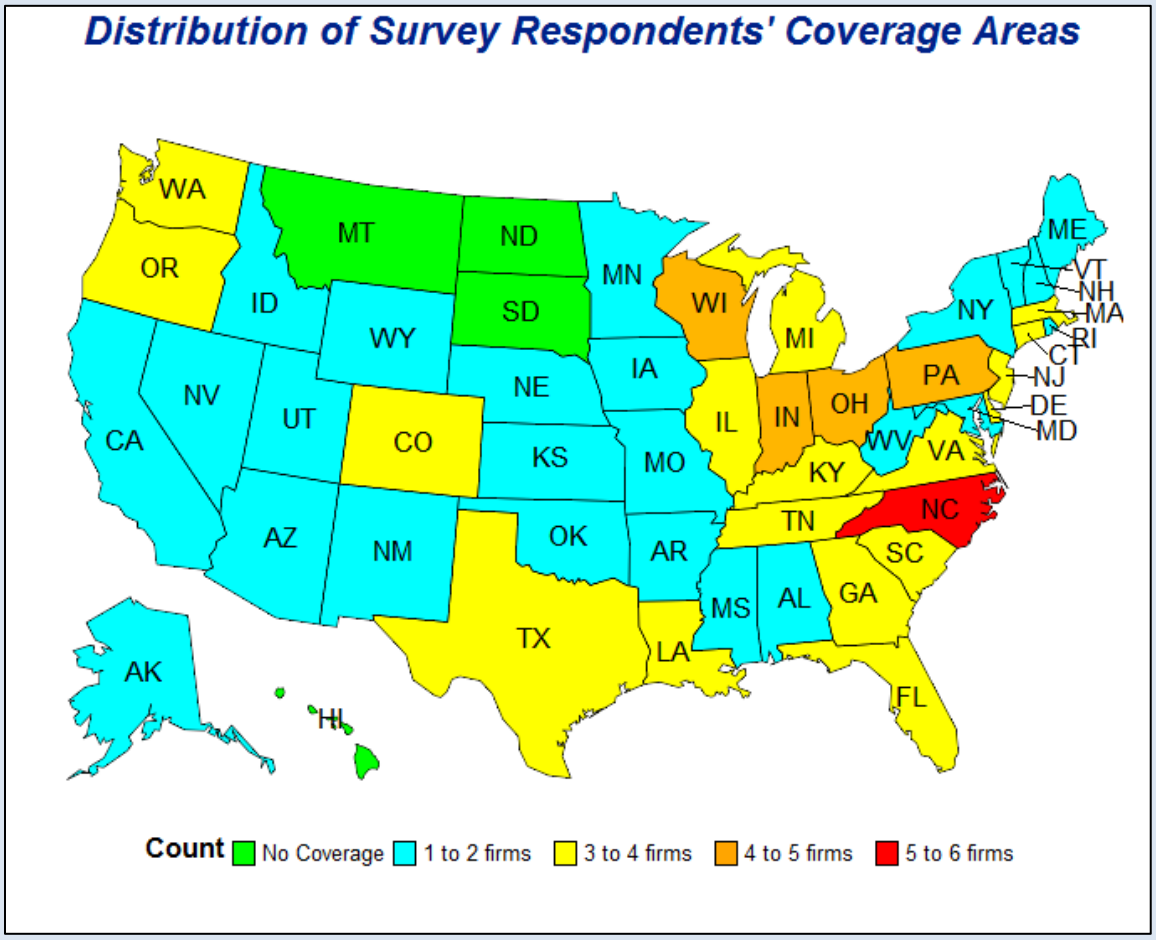
Mortgage originators in this sample tend to sell the bulk of their mortgages to aggregators or conduits with an average share of 84% of their production handled in this way. However, respondents designate a significant portion of their originations on average to be sold directly to Freddie Mac or Fannie Mae, 9% and 24% respectively, while only 8% on average were securitized directly through Ginnie Mae and 6% were held in portfolio. With respect to mortgage servicing rights (MSRs), the vast majority, 81.8%, sold 90% or more of their MSRs, while 9% held 10% to 30% and an additional 9% held more than 50% of MSRs in their originations.

On average, a 56% majority of originations were conventional, conforming while 26% were for the FHA. Conventional jumbos were 5% and non-conventional jumbos were 7%. VA and RHS made up 10% of production on average, while subprime production was negligible.





Regulations ranked relatively high on respondents list of concerns. However, tighter margins and higher production costs ranked at the top of the list slightly ahead of the new QM requirements and other regulations. This ranking might reflect unease over the current competitive landscape as compared to a regulatory process that is not set in stone and can be fluid to some extent. Events that would raise loan pricing, including G-fee increases, loan level pricing adjustments, and representation and warranty risk also ranked high as did stalled employment growth and troubles finding credit qualified borrowers. Lenders were less concerned about mortgage rates, perhaps suggesting that the Federal Reserve's taper or economic growth is priced in. Concerns about investor demand were low. Likewise, there was only moderate concern for lower FHA loan limits and changes from Basel III requirements, the former reflecting higher pricing at the FHA and new alternatives for financing, while the latter may reflect the dominance of non-depositories in this sample.



Geographically, survey respondents operate in nearly all states and regions. A few states in the mountain region, North and South Dakota as well as Montana, as well as Hawaii, Guam and the Virgin Island were not represented in this sample.

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