



Has the QM Rule Made It Harder to Get a Mortgage?

Bing Bai, Laurie Goodman, and Ellen Seidman

March 2016

Introduced in January 2014, the qualified mortgage (QM) rule was designed to prevent borrowers from acquiring loans they cannot afford and to protect lenders from potential borrower litigation. Many worry that the rule has contributed to the well-documented reduction in mortgage credit availability,¹ which has hit low-income and minority borrowers the hardest. To explore this concern, we recently updated our August 2014 analysis of the impact of the QM rule.² Our analysis of the rule at the two-year mark again finds it has had little impact on the availability of mortgage credit. Though the share of mortgages under \$100,000 has decreased, this change can be largely attributed to the sharp rise in home prices.

Four Potential Impacts

The QM rule could decrease the availability of mortgages to low-income and minority communities if the income and assets of these borrowers make QM loans more difficult to underwrite than, for example, interest-only loans or loans with less stringent debt-to-income requirements. To investigate this concern, we used loan-level servicing and security data to closely track four potential indicators of the QM rule's impact:

1. **Fewer interest-only and prepayment penalty loans:** The QM rule disqualifies loans that are interest-only (IO) or have a prepayment penalty (PP), so a reduction in these loans might show QM impact.

2. **Fewer loans with debt-to-income ratios above 43 percent:** The QM rule disqualifies loans with a debt-to-income (DTI) ratio above 43 percent, so a reduction in loans with DTIs above 43 percent might show QM impact.
3. **Reduced adjustable-rate mortgage share:** The QM rule requires that an adjustable-rate mortgage (ARM) be underwritten to the maximum interest rate that could be charged during the loan's first five years. Generally, this restriction should deter lenders, so a reduction in the ARM share might show QM impact.
4. **Fewer small loans:** The QM rule's 3 percent limit on points and fees could discourage lenders from making smaller loans, so a reduction in smaller loans might show QM impact.

As we acknowledged in the 2014 report, it may take some time for this sort of rule to show market impact. January 2016 marked the two-year anniversary of the QM rule's implementation. This brief extends our first study to take into account the latest market performance, and the results are largely consistent with our previous findings. Through October 2015, for both the government-sponsored enterprise (GSE—that is, Fannie Mae and Freddie Mac) and government agency (Ginnie Mae) markets, there has been no impact on IO or PP loans, loans with DTIs over 43 percent, or ARM loans. The only exception is the drop in the share of loans less than \$100,000, especially for Ginnie Mae. However, this drop can be attributed largely to the sharp rise in house prices over the same period.

No Fewer IO or PP Loans

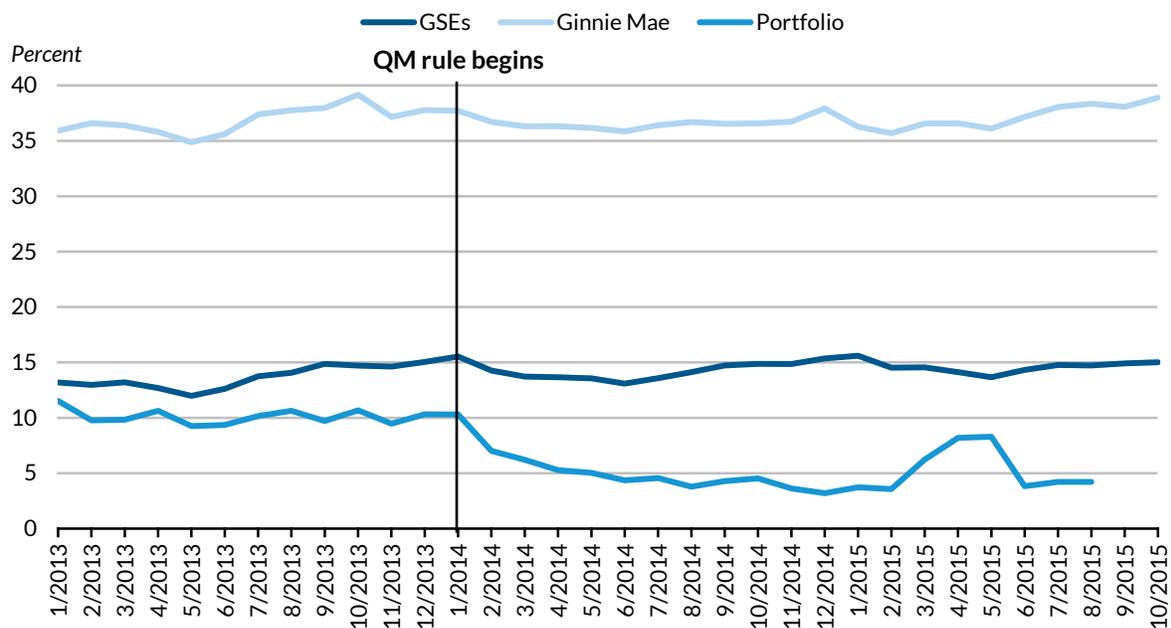
Interest-only and prepayment penalty loans largely became extinct after the housing crisis—well before the QM rule was implemented. In the GSE and government agency markets, the share of interest-only loans has been close to zero before and since QM. The share of prepayment penalty loans before and since QM is too small to measure.

Scant Evidence of Fewer Loans with DTIs above 43 Percent

The “QM patch” allows the GSEs and government agencies such as the Federal Housing Administration to operate under their own QM rules for seven years or, in the case of the GSEs, when they exit conservatorship, whichever is sooner. This effectively allows these entities to ignore the DTI restriction but retain all other QM elements. As a result, both the GSE and Ginnie Mae markets include loans with higher debt-to-income ratios. However, the share of such loans has not changed much with the implementation of the QM rule. Since the beginning of 2014, the share of loans with DTIs over 43 percent has been fluctuating within a narrow range of 13.1–15.6 percent for the GSEs and 35.7–38.9 percent for Ginnie Mae, virtually unchanged from the years before QM (figure 1).

FIGURE 1

Share of Purchase Loans with Debt-to-Income Ratios above 43 Percent



Source: Urban Institute calculations based on eMBS and CoreLogic servicing data.

Note: GSEs = government-sponsored enterprises; QM = qualified mortgage.

In comparison, a loan in the non-agency market must have a DTI of 43 percent or less to qualify as a QM. In this market, the share of loans with DTIs above 43 percent appears to have been cut by more than half—from 10.3 percent in January 2014 to 4.2 percent in August 2015. However, the volume of private-label securities has been very low since the housing crisis. Our data for the portfolio channel are sparse, with only 245 loans with DTIs above 43 percent in January 2014 and comparably low numbers since.

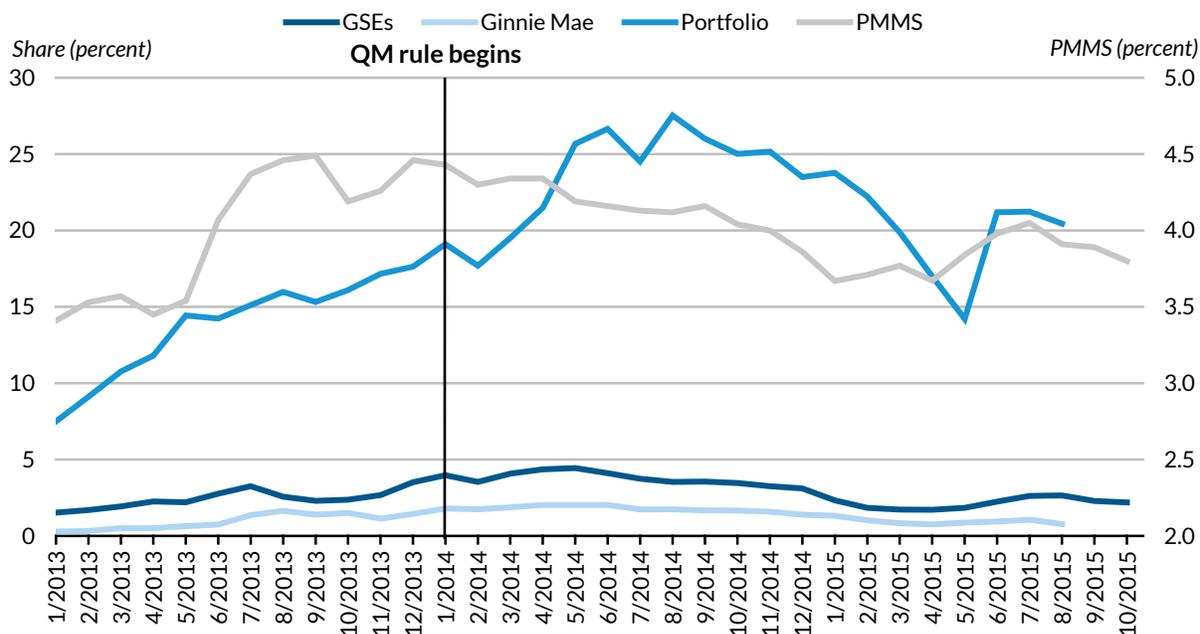
No Reduction in ARM Share

Traditionally, the ARM share follows the direction of interest rates. The ARM share in all three markets went up in the first half of 2014, mostly as a delayed response to the spike in interest rates in 2013 (figure 2). After hitting peak levels in summer 2014, interest rates began to decline, and the ARM share for all three channels followed. Notwithstanding the QM rule, the ARM share in 2014 was generally higher than in 2013. It has declined slightly in 2015 in response to the drop in interest rates starting in September 2014.

In short, QM does not seem to have had an effect on the ARM share, which is governed principally by the absolute level of interest rates, with the shape of the curve a contributing factor.

FIGURE 2

Adjustable-Rate Mortgages as Share of Purchase Loans



Source: Urban Institute calculations based on eMBS and CoreLogic servicing data.

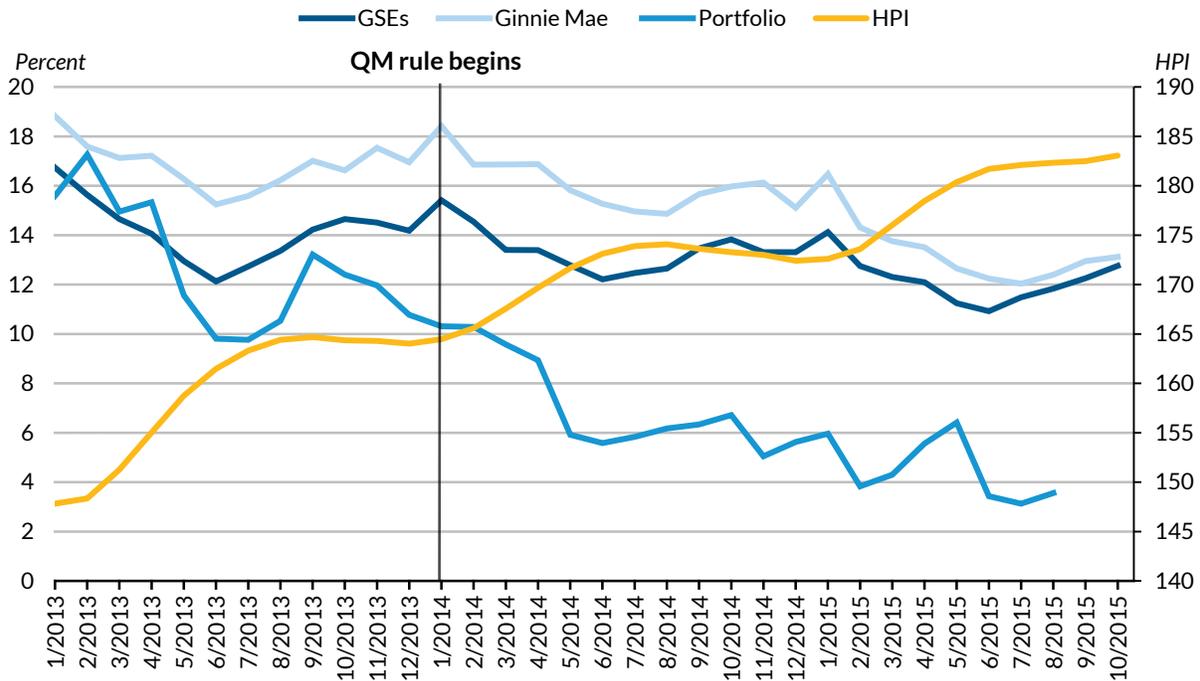
Note: GSEs = government-sponsored enterprises; PMMS = Primary Mortgage Market Survey; QM = qualified mortgage.

Fewer Small Loans

The 3 percent cap on points and fees might limit lenders' interest in making small loans, since the cost of originating a loan doesn't change with the size of the loan, and 3 percent of a small loan is less likely to cover that cost. Though a provision in the QM rule allows lenders to charge more than 3 percent for loans under \$100,000, the exception has a cap of \$3,000—an amount that generally would not cover costs. Rising house prices would also reduce the share of small loans. In 2013, before the QM rule was implemented, the share of loans under \$100,000 dropped 1.33 and 0.41 percentage points, respectively, for the GSEs and Ginnie Mae (figure 3). In 2014, the declines were 1.28 and 1.93 percentage points, respectively. How much of this decline can be attributed to QM, and how much to the sharp increase in house prices from 2013 to 2015, particularly at the lower end of the price distribution where Ginnie Mae is more active?

FIGURE 3

Share of Purchase Loans under \$100,000



Source: Urban Institute calculations based on eMBS and CoreLogic servicing data.

Note: GSEs = government-sponsored enterprises; HPI = house price index; QM = qualified mortgage.

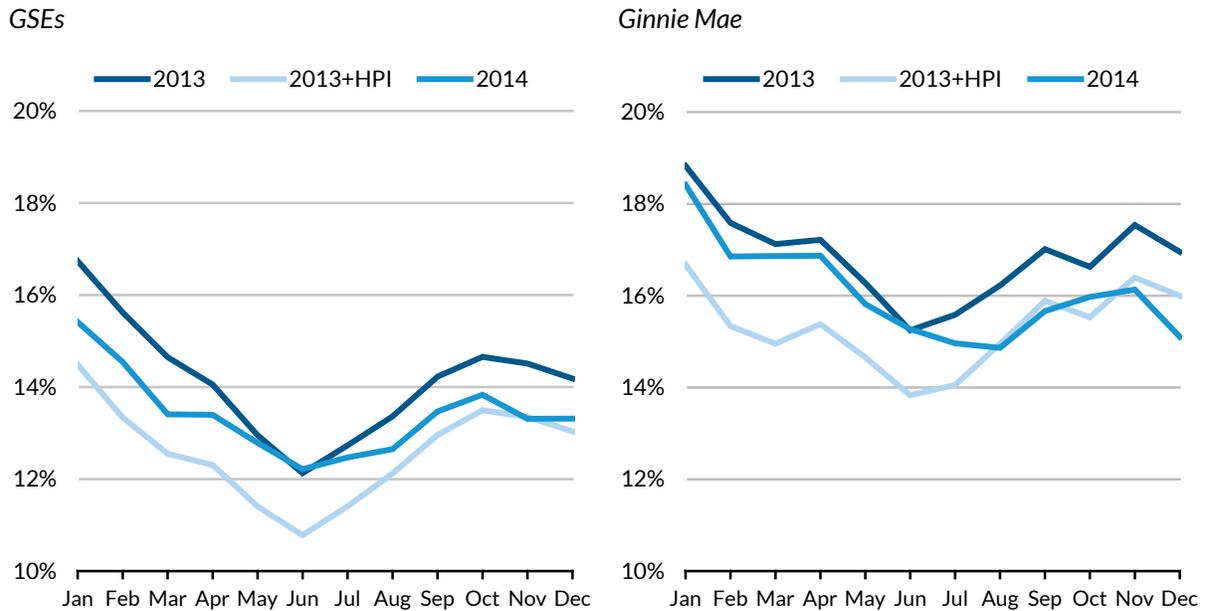
We addressed this question in two ways.

First, we determined the share of small loans for each month in 2013 (figure 4, dark blue lines). Next, we determined the actual year-over-year increase in home prices for each month from 2013 to 2014 to determine what the monthly share should have been in 2014 with just the home price increase (light blue lines). Finally, we compared these shares to the actual share of small loans in 2014 (middle blue lines). Note that we did this analysis for 2013 (right before the rule was implemented) and 2014 (right after the rule was implemented), to try to isolate the impact of the QM rule.

The actual share of loans under \$100,000 in 2014 was mostly higher than or equal to the hypothetical levels derived with only the home price changes. In other words, while an increase in home prices is expected to decrease the share of small loans, more small loans were originated in 2014 than would have been expected based on home price changes alone. If the QM rule caused the decrease in the share of small loans, this decrease is not detectable.

FIGURE 4

Share of Purchase Loans under \$100,000, after Controlling for Home Price Increases



Source: Urban Institute calculations based on eMBS CoreLogic servicing and HPI data.

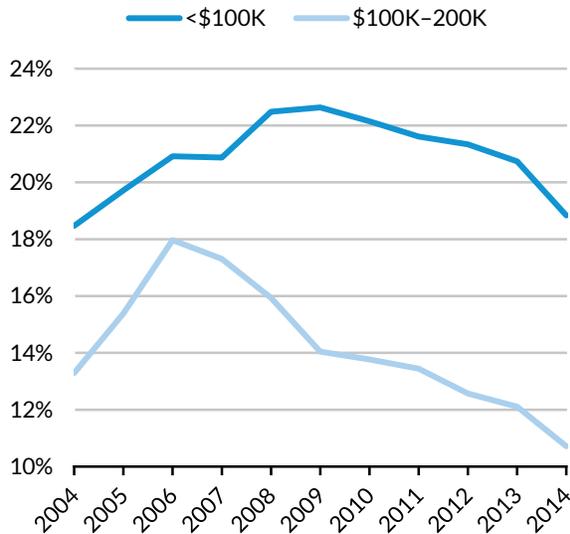
Note: GSEs = government-sponsored enterprises; HPI = house price index.

Next, we examined differences in denial rates for loans below and above \$100,000 before and after the QM rule was implemented. As shown in figure 5, denial rates for the under-\$100,000 and \$100,000–200,000 categories stayed mostly parallel from 2004 to 2014. Most important, the rates do not seem to have widened noticeably from 2013 to 2014, when the QM rule became effective. If anything, the gap became slightly smaller during this period, declining from 8.6 percent in 2013 to 8.1 percent in 2014 for GSE loans and from 6.4 percent to 6.1 percent for Ginnie Mae loans. We did not do this for 2015, as we relied on Home Mortgage Disclosure Act data, the only data available on denial rates. The 2014 data were released in September 2015, and we do not expect the 2015 data until September 2016.

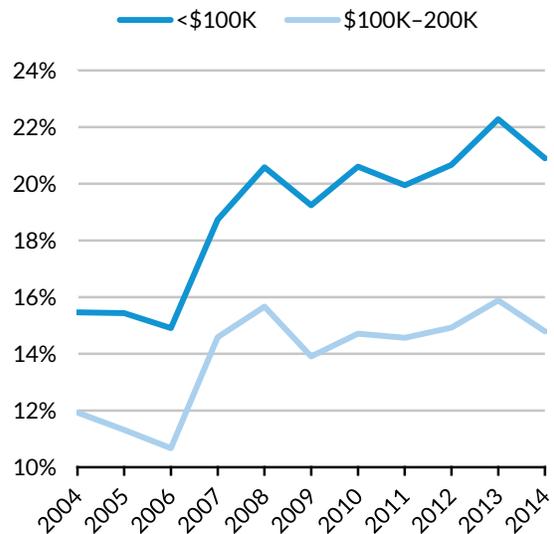
FIGURE 5

Denial Rates by Loan Size

GSEs



Ginnie Mae



Source: Urban Institute calculations based on Home Mortgage Disclosure Act data.

Note: GSEs = government-sponsored enterprises.

Conclusion

The second anniversary of the QM rule is an appropriate occasion to evaluate the rule’s impact on credit availability. The data we reviewed suggest that the impact has been small: IO and PP mortgages were virtually extinct before QM took effect; the ARM share still tracks interest rate changes; and the share of loans with a DTI above 43 percent remains largely unchanged, as far as we can tell. And while there has been a decrease in small loans, the drop is largely attributable to home price appreciation.

What does this mean? First, the market had largely abandoned risky products before the QM rule codified Dodd-Frank’s restrictions. Similarly, the financial crisis highlighted the risk of ARMs with short resets, and the market had largely moved to ARMs with five years or longer to the first reset. And the points and fees rules appear not to have reduced the share of small loans below their pre-QM share.

Make no mistake, underwriting has become much more costly, and the costs of underwriting a small loan are just as high as for a large loan. However, the rule as written appears to give lenders the flexibility (using a combination of rate and fees) to make smaller loans at least at the same rate they did in 2013 and come in under 3 percent.

Though the effect of the QM rule appears small to nonexistent now, with the financial crisis still fresh in our collective memory and a credit box that was tight before QM, this rule reminds us that lenders need to ensure that borrowers are able to repay their mortgages. Long after our collective

memory has faded, this codification will be a legacy of the crisis, helping prevent some of the risky lending practices that could cause another downturn.

Notes

1. For example, see “Housing Credit Availability Index,” Urban Institute, last updated January 12, 2016, <http://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-credit-availability-index>.
2. Laurie Goodman, Ellen Seidman, Jim Parrott, and Bing Bai, “Data Show Surprisingly Little Impact of New Mortgage Rules,” *Urban Wire* (blog), Urban Institute, August 21, 2014, <http://www.urban.org/urban-wire/data-show-surprisingly-little-impact-new-mortgage-rules>.

About the Authors



Bing Bai is a research associate with the Housing Finance Policy Center at the Urban Institute, where he helps build, manage, and explore data to analyze housing finance trends and related policy issues. Formerly an economic modeling senior at Freddie Mac, Bai conducted research on housing and mortgage markets and developed models to evaluate foreclosure alternatives for nonperforming mortgage loans. He holds a PhD in economics from Clemson University.



Laurie Goodman is the director of the Housing Finance Policy Center at the Urban Institute. The center provides data-driven analysis that policymakers can depend on for relevance, accuracy, and independence.

Before joining Urban, Goodman spent 30 years as an analyst and research department manager at a number of Wall Street firms. From 2008 to 2013, she was a senior managing director at Amherst Securities Group, LP, a boutique broker/dealer specializing in securitized products, where her strategy effort became known for its analysis of housing policy issues. From 1993 to 2008, Goodman was head of global fixed income research and manager of US securitized products research at UBS and predecessor firms, which was ranked first by *Institutional Investor* for 11 straight years. She has also held positions as a senior fixed income analyst, a mortgage portfolio manager, and a senior economist at the Federal Reserve Bank of New York.

Goodman was inducted into the Fixed Income Analysts Hall of Fame in 2009. She serves on the board of directors of MFA Financial, is an advisor to Amherst Capital Management, and is a member of the Bipartisan Policy Center’s Housing Commission, the Federal Reserve Bank of New York’s Financial Advisory Roundtable, and the New York State Mortgage Relief Incentive Fund Advisory Committee. She has published more than 200 articles in professional and academic journals, and has coauthored and coedited five books.

Goodman has a BA in mathematics from the University of Pennsylvania and a MA and PhD in economics from Stanford University.



Ellen Seidman is a senior fellow in the Housing Finance Policy Center. She sits on the consumer advisory board of the Consumer Financial Protection Bureau and chairs the boards of Coastal Enterprises Inc. and Aeris Insight. Seidman also sits on the board of City First Bank of DC and on the National Community Advisory Council of Bank of America. She cofounded and chaired the board of the Center for Financial Services Innovation and was the 2013–14 New York University Stern–Citi Leadership and Ethics Distinguished Fellow.

From 2012 to 2014, Seidman was a visiting scholar with the community development department of the Federal Reserve Bank of San Francisco, where she edited *Investing in What Works for America's Communities*, *What Counts: Harnessing Data for America's Communities*, and *What It's Worth: Strengthening the Financial Future of Families, Communities and the Nation*.

From 2002 to 2010, Seidman held various positions at ShoreBank Corporation, and from 1997 to 2001, she directed the Office of Thrift Supervision. She also sat on the board of directors of the Federal Deposit Insurance Corporation and chaired the board of directors for the Neighborhood Reinvestment Corporation. Seidman was senior counsel to the Democratic staff of the House Financial Services Committee, special assistant to the president for economic policy, and held senior positions at Fannie Mae and the US Departments of Transportation and the Treasury.

Seidman received an AB from Radcliffe College, an MBA from George Washington University, and a JD from Georgetown University.

Acknowledgments

The Housing Finance Policy Center (HFPC) was launched with generous support at the leadership level from the Citi Foundation and John D. and Catherine T. MacArthur Foundation. Additional support was provided by The Ford Foundation and The Open Society Foundations.

Ongoing support for HFPC is also provided by the Housing Finance Council, a group of firms and individuals supporting high-quality independent research that informs evidence-based policy development. Funds raised through the Council provide flexible resources, allowing HFPC to anticipate and respond to emerging policy issues with timely analysis. This funding supports HFPC's research, outreach and engagement, and general operating activities.

This brief was funded by these combined sources. We are grateful to them and to all our funders, who make it possible for Urban to advance its mission.

The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders. Funders do not determine research findings or the insights and recommendations of Urban experts. Further information on the Urban Institute's funding principles is available at www.urban.org/support.



2100 M Street NW
Washington, DC 20037
www.urban.org

ABOUT THE URBAN INSTITUTE

The nonprofit Urban Institute is dedicated to elevating the debate on social and economic policy. For nearly five decades, Urban scholars have conducted research and offered evidence-based solutions that improve lives and strengthen communities across a rapidly urbanizing world. Their objective research helps expand opportunities for all, reduce hardship among the most vulnerable, and strengthen the effectiveness of the public sector.

Copyright © March 2016. Urban Institute. Permission is granted for reproduction of this file, with attribution to the Urban Institute.