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, 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. 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).
HAS THE QM RULE MADE IT HARDER TO GET A MORTGAGE?

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.
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?
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.
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.
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.


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