Updated: What, If Anything, Should Replace the QM GSE Patch

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October 2018

This brief enhances our prior research that outlined three options for replacing the exemption that grants qualified mortgage (QM) status to mortgages with high debt-to-income (DTI) ratios guaranteed by Fannie Mae or Freddie Mac. The exemption, commonly known as the government-sponsored enterprise (GSE) patch, is set to expire on January 10, 2021, or when the GSEs are released from conservatorship, whichever comes first. In the original brief, we recommended that the current DTI-heavy framework should be replaced by the mortgage rate, as it measures risk more holistically than the DTI ratio. This revised brief adds more data and evidence to support that recommendation. Specifically, it shows that for all mortgages originated since 1995, the probability of default was higher for loans with higher rates than for loans with lower rates in any given origination period. The previous version of this brief is still available at urban.org.

One of the most significant accomplishments of the Bureau of Consumer Finance Protection (BCFP) was finalizing the qualified mortgage rule. The Dodd-Frank Wall Street Reform and Consumer Protection Act requires mortgage lenders to make "a reasonable, good faith determination" of each borrower's ability to repay the proposed loan, considering such factors as borrower income, assets, debt, and employment. One way to meet this requirement is by originating a "qualified mortgage," as defined by the QM rule. Introduced in January 2014, the QM rule was designed to prevent borrowers from obtaining loans they could not afford while simultaneously protecting lenders from borrower litigation for loans that meet the requirements of the rule. A qualified mortgage can give lenders legal

protection from lawsuits that claim the lender failed to verify a borrower's ability to repay. A borrower who obtains a qualified mortgage is presumed to have the ability to repay.

In addition to the verification and documentation of borrower income and assets, all qualified mortgages should generally meet the following mandatory requirements:

1. The loan cannot have negative amortization, interest-only payments, or balloon payments.
2. Total points and fees cannot exceed 3 percent of the loan amount.[1]
3. The mortgage term must be 30 years or less.
4. Adjustable-rate mortgages must be underwritten to the maximum interest rate applicable during the first five years of the loan.
5. Prepayment penalties are generally permitted but subject to a three-year phaseout.[2]

Qualified mortgages must also satisfy at least one of the following three criteria:

1. The borrower's total monthly DTI ratio must be 43 percent or less.
2. The loan must be eligible for purchase by Fannie Mae or Freddie Mac (the government-sponsored enterprises, or GSEs) or insured by the Federal Housing Administration (FHA), the US Department of Veterans Affairs (VA), or the US Department of Agriculture Rural Development (USDA), regardless of DTI ratio.[3]
3. The loan must be originated by insured depositories with total assets less than $10 billion[4] but only if the mortgage is held in portfolio.

Mortgages that meet the QM definition are presumed to comply with ability to repay in one of two ways. First-lien mortgages with an annual percentage rate no more than 150 basis points above the Average Prime Offered Rate[5] (APOR) receive an irrebuttable presumption of compliance, a so-called safe harbor. This offers lenders the highest level of legal protection against claims that the lender failed to comply with the ability to repay standards. All other QM loans receive a presumption of compliance that can be rebutted in litigation by showing that the lender failed to verify borrower ability to repay.

The BCFP's QM rule created an exemption from the 43 percent DTI cap for mortgages eligible for purchase by Fannie Mae or Freddie Mac. This exemption is commonly known as the "GSE patch." Loans insured by the FHA, VA, or USDA are governed by separate QM rules developed and implemented by each of these agencies.[6] The QM rules finalized by these three agencies have no maximum DTI requirement. The GSE patch is a temporary measure that is set to expire on January 10, 2021, or on the day the GSEs exit Federal Housing Finance Agency conservatorship, whichever occurs first. The FHA, VA, and USDA QM rules are permanent.

It is important to realize that the mandatory requirements of the QM rule offer significant inbuilt protection against irresponsible loosening of credit. Data on loan performance show that the products and features that had the highest historical default rates are already banned under QM. Table 1 shows 90-day delinquency rates for all mortgages by product feature (low documentation, full documentation,

full-documentation with traditional and nontraditional features). In every period shown, low-documentation loans and full-documentation loans with non-traditional features (interest only, balloon payments, negative amortization, prepayment penalty, and terms longer than 30 years) exhibited the highest default rates. These product features are largely nonexistent for post-2009 originations.

TABLE 1

90-Day Delinquency Rate by Product Feature

	1995–2000	2001–2004	2005–2008	2009–2018
All loans	6.5%	9.3%	27.4%	3.8%
All low-documentation loans	19.9%	12.2%	29.2%	5.2%
All full-documentation loans	6.2%	9.0%	27.0%	3.5%
All full-documentation loans, nontraditional features	9.0%	12.3%	40.9%	6.9%
All full-documentation loans, traditional features	5.7%	8.0%	20.4%	3.3%

Source: Urban Institute analysis based on Black Knight data.

High-DTI Lending under QM

Data show that a considerable share of federally insured or GSE-guaranteed qualified mortgages over the past several years had DTI ratios over 43 percent. Table 2 shows the share of purchase mortgages with DTI ratios over 43 percent by origination year. About one in five GSE-backed mortgages originated in 2017 had a DTI ratio over 43 percent, and approximately one in two FHA or VA mortgages had a DTI ratio over 43 percent. In comparison, the share of these mortgages in bank portfolios, which consists largely of high-quality jumbo loans, averaged about 15 percent from 2013 to 2018 but has risen to about 20 percent.

TABLE 2

Agency Purchase Originations with DTI Ratios over 43 Percent

	Fannie Mae	Freddie Mac	FHA	VA
2013	13.3%	14.1%	42.4%	33.0%
2014	13.6%	15.1%	42.7%	35.1%
2015	13.2%	17.2%	41.8%	36.6%
2016	13.9%	18.6%	44.7%	38.0%
2017	19.3%	21.2%	51.5%	41.9%
2018[a]	29.0%	24.9%	55.3%	45.9%

Source: Urban Institute calculations based on eMBS data.

Note: FHA = Federal Housing Administration; VA = US Department of Veterans Affairs.

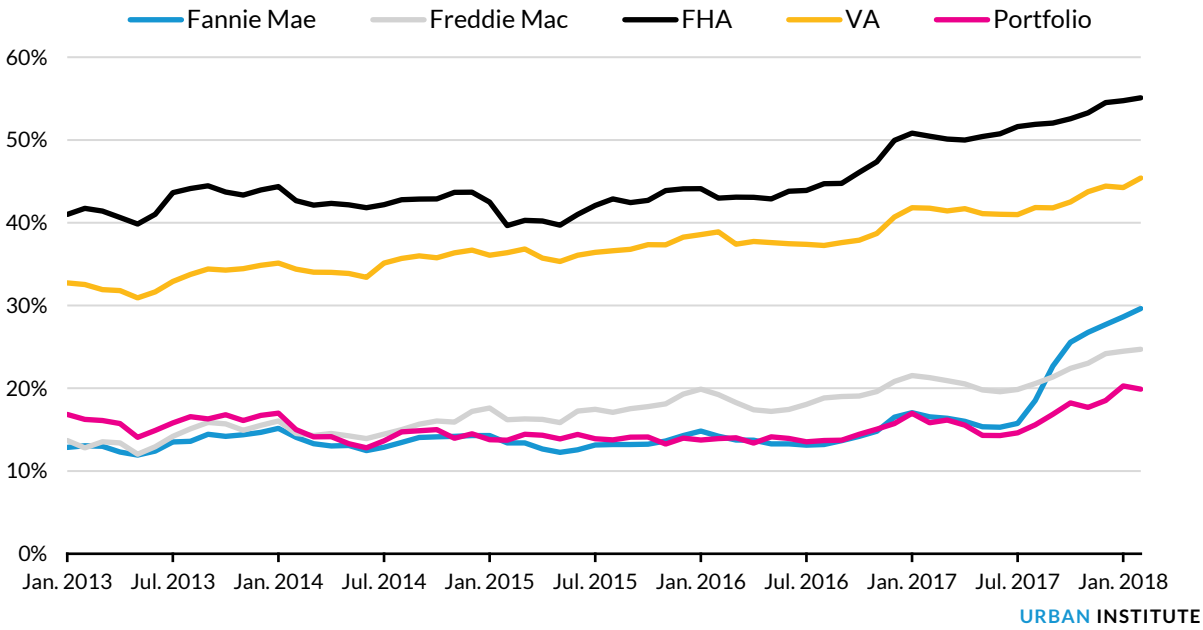
[a] 2018 data are through May 2018.

The share of QM loans with DTI ratios over 43 percent has risen mainly because the widening gap between house price appreciation and wage growth has forced homebuyers to borrow more in comparison with incomes. In recent years, house prices have appreciated at an annual rate of 6 to 7 percent while wage growth has averaged about 2 to 3 percent. And since 2016, rising interest rates

have increased monthly payments, further increasing DTI ratios. Through May 2018, the share of purchase originations with DTI ratios over 43 percent is about 25 percent for Freddie Mac loans, 29 percent for Fannie Mae loans, 55 percent for FHA loans, and 46 percent for VA loans (figure 1).

FIGURE 1

Share of Purchase Originations with DTI Ratios over 43 Percent, by Channel



Source: Urban Institute calculations based on eMBS and CoreLogic data.
Note: FHA = Federal Housing Administration; VA = US Department of Veterans Affairs.

To appreciate how significant these numbers are, it is worth looking at the market for loans that fall outside the QM definition. Although reliable data on "non-QM" lending volumes are difficult to come by, estimates of originations range from $20 to $30 billion a year[7] for 2017, a drop in the bucket compared with the $1.8 trillion in total originations. Some lenders attribute the small size of the non-QM market to fears of taking on the risk that a borrower in default will sue, citing lender failure to verify ability to repay, although other factors could be at work, including the lack of a robust private-label securitization market.

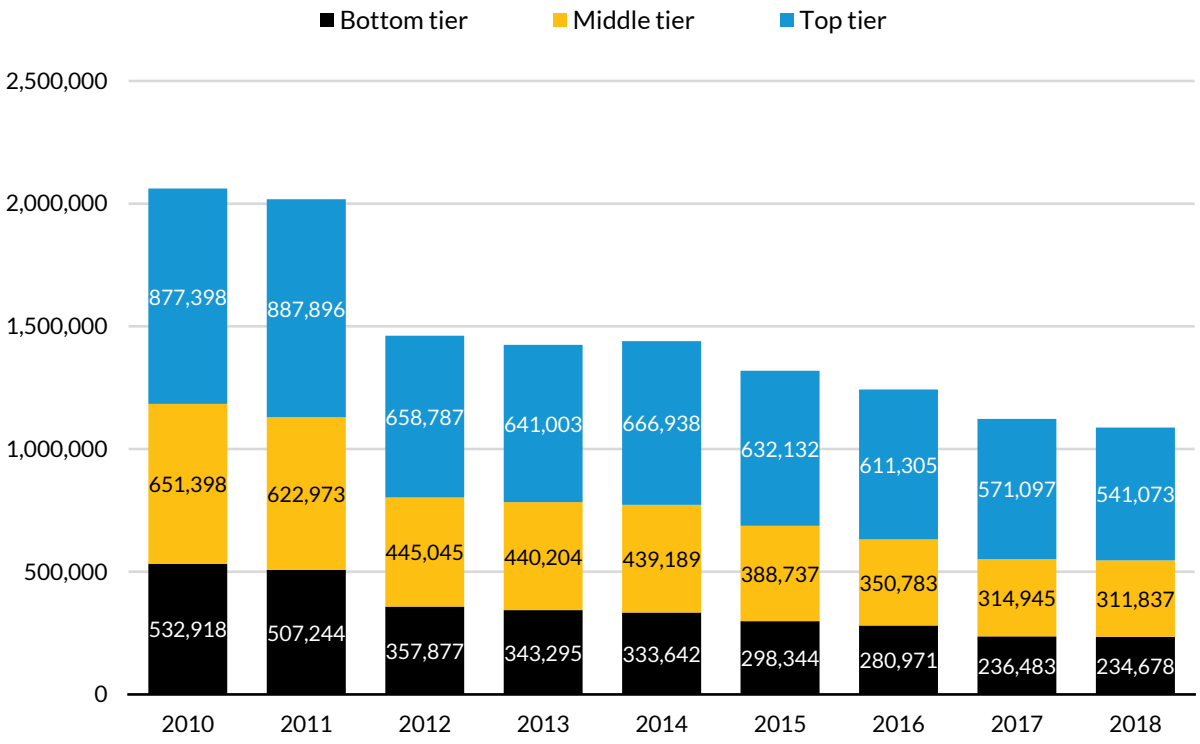
When one combines the small non-QM lending volume with the rise of high-DTI lending, it does not take much imagination to see what would happen to the market—at least in the short run—should the 43 percent DTI ceiling be applied to loans backed by Fannie Mae and Freddie Mac. These loans would either go to the FHA or not be originated. Although theoretically borrowers could buy cheaper homes to lower their DTI ratios, the supply of these homes—and all homes in general—is low. Figure 2 shows the nationwide for-sale inventory of homes by price tier. Since 2010, the inventory of homes whose values are in the bottom third of all home values in a given geography (bottom tier) has declined by more than

half. Inventory of homes in the middle and top tier is also down significantly, but not by as much, suggesting that housing supply constraints are especially acute at the lower end of the market.

The second theoretical possibility is that prospective homebuyers would pay down their nonfinancial debt to lower their DTI ratio to 43 percent or less. But most renter households that are looking to buy a home do not have the assets to pay down their nonfinancial debt. According to the Federal Reserve's 2016 Survey of Consumer Finances, the median net worth (total assets minus debt) of US renter households was only about $5,200. Median annual income of renters was also low, about $32,000 according to this survey (Bricker et al. 2017).

FIGURE 2

For-Sale Inventory of Homes by Price Tier



Source: Urban Institute calculations based on Zillow data.
Notes: Zillow defines top-, middle-, and bottom-tier homes as those that fall in the top, middle, and bottom third of all home values, respectively, in a given geography (includes single-family and condominium units). 2010–17 data are as of December of those years, and 2018 data are as of August 2018.

The GSE patch is nonetheless set to expire on January 10, 2021, setting up an urgent need to determine what, if anything, should replace it. This brief is an effort to kick-start the debate about the future beyond the GSE patch by exploring three options.

Option 1: Preserve the GSE Patch Largely as Is

The BCFP can preserve the GSE patch one of two ways. The first is a simple extension, leaving the rules that govern qualified mortgages as is. The BCFP would essentially extend the patch to a new expiration date or to the GSEs' exit from conservatorship, whichever comes first. Absent GSE reform, this option would force the BCFP to revisit the patch before the new expiration date. Or the BCFP could drop the sunset date and tie patch expiration to the GSEs' exit from conservatorship.

The BCFP could also go further and expand the GSE patch modestly. All elements of QM would remain in place, but the patch would be expanded to cover mortgages within the risk tolerances of the GSEs' automatic underwriting systems (AUS), even if they are GSE-ineligible for other reasons. For instance, a loan that is ineligible because its size exceeds the conventional loan limit but is otherwise within the AUS risk profile would be deemed a qualified mortgage. For the most part, this expansion would award QM status to jumbo loans with DTI ratios over 43 percent held in bank portfolios. Jumbo loans tend to be high-quality mortgages but are agency-ineligible because their size exceeds the conforming limit.

This option's practical benefit is modest, though: there is ample credit available at the jumbo end of the market. Loans to low- and moderate-income borrowers and first-time homebuyers—for whom access to credit remains tight—are less likely to fall within AUS risk tolerances and thus are less likely to be deemed qualified mortgages under this patch expansion.

We believe this option will yield only modest benefits, and most of them will flow to the high end of the market, where credit availability is not constrained. Additionally, the patch, even if extended, is a temporary solution that will eventually need revisiting. Considering this, we recommend the BCFP consider a more permanent alternative. The next approach, option 2, would constitute a major change to QM but would meaningfully improve credit availability.

Option 2: Drop the DTI Cap and GSE Patch from the QM Definition

Under this option, the QM safe harbor standard would be based on a loan's overall riskiness, as opposed to the DTI ratio, or who insures or guarantees the mortgage. Both the 43 percent DTI cap and GSE patch would be dropped from the BCFP's QM rule. Restrictions on risky products, loan terms, and points and fees would remain unchanged, as would the statutory exemption for portfolio lenders with less than $10 billion in assets. With no DTI cap or the patch, this framework would provide safe harbor status to first-lien mortgages as long as their annual percentage rate is no more than 150 basis points over the APOR and they meet other QM criteria.[8] The underlying premise is that loans priced under the 150 basis point rate-spread threshold would be less risky than loans priced above this threshold. A rate spread–based QM regime offers several advantages.

Mortgage rates reflect credit risk more holistically than DTI ratios. The DTI ratio is one of several factors affecting borrower creditworthiness and ability to repay. But it is not a good predictor of default because it is often poorly measured.[9] Consider the following examples: Families who could qualify for a mortgage using only one spouse's earnings would not have the incentive to document and report the second income on their loan application. In this case, household income would be understated, and the DTI ratio would be overstated. As another example, debt owed to individuals, family members, or friends (e.g., money borrowed from parents for college or a car purchase) is not recorded, does not show up in a credit report, and is likely underreported. This would tend to understate the borrower's true debt burden and DTI ratio. In both examples, the ability to repay would be inaccurately measured, and there would be no way for a loan officer to know the household's total debt burden or income. Other situations that can distort the DTI ratio include undisclosed income from a second, part-time, or seasonal job; rental or room-share income; and debt taken on shortly after the loan closes.

Evidence from default rates on historical full-documentation, fully amortizing GSE originations shows the limitations of DTI ratios in predicting default risk (table 3). For each year since 2011, the 90-day delinquency rate for loans with DTI ratios over 45 percent is less than that for loans with DTI ratios between 30 and 45 percent. This inconsistency is not present in other measures of riskiness, such as FICO scores and LTV ratios.

TABLE 3

90-Day Delinquency Rate for GSE Purchase Originations by DTI Ratio, FICO Score, and LTV Ratio

	DTI Ratio			FICO Score			LTV Ratio		
	<30%	30–45%	>45%	>750	700–750	<700	<80%	80–95%	>95%
1999	2.68%	3.81%	4.39%	0.77%	1.82%	6.63%	2.59%	5.08%	5.72%
2000	2.51%	3.34%	3.53%	0.63%	1.59%	6.38%	2.26%	4.46%	5.69%
2001	2.53%	3.59%	4.05%	0.78%	1.91%	6.54%	2.38%	5.52%	6.22%
2002	2.87%	4.26%	4.84%	1.07%	2.60%	7.59%	2.84%	7.00%	7.88%
2003	3.70%	6.14%	7.05%	1.76%	4.30%	10.17%	4.27%	9.32%	11.61%
2004	5.73%	8.81%	9.95%	2.78%	6.48%	14.03%	6.81%	12.85%	15.14%
2005	7.83%	13.14%	15.67%	4.73%	11.05%	20.97%	11.00%	18.13%	20.42%
2006	9.43%	15.55%	19.22%	5.78%	13.69%	25.25%	13.62%	21.05%	27.65%
2007	9.91%	16.99%	21.95%	6.27%	14.89%	28.18%	14.27%	23.98%	29.10%
2008	4.91%	9.73%	15.03%	3.84%	10.43%	22.05%	8.33%	15.12%	15.87%
2009	0.94%	2.40%	4.13%	0.95%	3.04%	8.06%	1.94%	3.17%	2.99%
2010	0.72%	1.76%	2.13%	0.60%	2.08%	5.71%	1.29%	1.89%	3.15%
2011	0.56%	1.38%	1.34%	0.43%	1.58%	4.61%	0.99%	1.42%	1.51%
2012	0.33%	0.85%	0.66%	0.26%	0.98%	3.08%	0.54%	0.94%	1.15%
2013	0.36%	0.87%	0.54%	0.24%	0.88%	2.65%	0.54%	0.96%	1.40%
2014	0.39%	0.88%	0.54%	0.22%	0.75%	2.33%	0.58%	0.96%	1.05%
2015	0.20%	0.47%	0.26%	0.11%	0.36%	1.29%	0.29%	0.50%	0.82%
2016	0.06%	0.14%	0.07%	0.04%	0.10%	0.38%	0.09%	0.15%	0.33%

Source: Urban Institute analysis based on Fannie Mae and Freddie Mac loan-level credit data.
Note: DTI = debt-to-income; GSE = government-sponsored enterprise; LTV = loan-to-value.

In comparison, the mortgage rate considers a wider set of borrower, property, and loan characteristics, including the DTI ratio, resulting in a more holistic measure. An analysis of the

relationship between the note rate and defaults shows this clearly. Table 4 displays 90-day delinquency rates for mortgages by rate spread for each channel and in aggregate. In this analysis, *rate spread* is the difference between the note rate and Freddie Mac's Primary Mortgage Market Survey (PMMS). We show default rates by rate-spread buckets, in increments of 50 basis points (bps).

For every channel, the 90-day delinquency (D90) rate is lowest for loans with a rate spread of up to 50 bps and highest for loans with spreads over 200 bps. More importantly, there is a gradual increase in default rate from the lowest-priced loans (spread up to 50 bps) to the highest-priced loans (spread above 200 bps). Let us walk through an example. For all 1995–2000 originations, loans with a rate spread up to 50 bps above PMMS had the lowest D90 rate of 4.5 percent. Loans with a spread of 51 to 100 bps had a D90 rate of 6.7 percent, those in the 101 to 150 bps bucket had a D90 rate 9.5 percent, 151 to 200 bps spread loans had a D90 rate of 11.5 percent, and loans priced more than 200 bps above PMMS had the highest default rate of 14.8 percent.

This pattern holds true for every loan channel and origination period with a few exceptions. FHA, VA, and portfolio mortgages originated from 2005 to 2008 with a rate spread of 100 to 150 bps had a slightly *lower* default rate than mortgages in the 50-to-100-bps bucket. 2009–18 FHA mortgages in the above-200-bps rate-spread bucket exhibit a similar pattern. This could reflect mispricing, but we note that the difference in default rates is small.

TABLE 4

90-Day Delinquency Rate by Rate Spread and Origination Period

Spread over PMMS	1995–2000	2001–2004	2005–2008	2009–2018
All loans				
>200 bps	14.8%	24.1%	36.3%	14.2%
151–200 bps	11.5%	20.4%	29.2%	5.0%
101–150 bps	9.5%	17.0%	28.1%	4.3%
51–100 bps	6.7%	10.4%	23.8%	4.4%
<50 bps	4.5%	6.2%	16.5%	2.9%
GSE loans				
>200 bps	18.3%	28.2%	39.3%	7.1%
151–200 bps	12.7%	22.7%	36.1%	3.4%
101–150 bps	8.1%	15.0%	29.4%	2.9%
51–100 bps	4.5%	7.6%	21.7%	1.8%
<50 bps	2.5%	4.4%	12.7%	0.8%
Portfolio loans				
>200 bps	12.5%	19.5%	29.6%	7.1%
151–200 bps	9.6%	13.4%	20.5%	3.1%
101–150 bps	9.5%	11.2%	19.3%	1.7%
51–100 bps	7.3%	6.7%	19.7%	1.0%
<50 bps	4.3%	4.6%	17.1%	0.6%
FHA loans				
>200 bps	20.0%	44.8%	39.1%	12.9%
151–200 bps	18.4%	29.6%	33.3%	15.1%
101–150 bps	15.7%	25.7%	31.3%	13.0%
51–100 bps	13.7%	20.9%	31.8%	12.3%
<50 bps	12.0%	18.5%	30.5%	7.8%
VA loans				
>200 bps	13.2%	57.4%	26.2%	11.1%
151–200 bps	12.4%	20.1%	18.1%	10.4%
101–150 bps	11.3%	14.9%	15.7%	7.5%
51–100 bps	9.9%	10.7%	16.9%	7.3%
<50 bps	8.9%	10.1%	15.8%	3.9%
PLS loans				
>200 bps	19.8%	25.9%	43.2%	39.2%
151–200 bps	10.1%	21.7%	33.2%	11.6%
101–150 bps	6.6%	20.1%	33.1%	8.2%
51–100 bps	3.5%	12.4%	28.8%	6.6%
<50 bps	3.4%	8.4%	27.4%	4.3%

Source: Urban Institute analysis based on Black Knight data.

Notes: FHA = Federal Housing Administration; GSE = government-sponsored enterprise; PLS = private-label securities; PMMS = Primary Mortgage Market Survey; VA = US Department of Veterans Affairs. Rate spread is the note rate less the PMMS rate (up-front points and costs are not included). This analysis excludes loans with the following nontraditional features, as they are banned under the qualified mortgage rule. For fixed-rate mortgages, interest-only loans, balloon payments, negative amortization, prepayment penalties, and terms longer than 30 years. For adjustable-rate mortgages, more than five years to the first reset, in addition to the above nontraditional features.

A rate-spread framework would create a more level playing field. Moving to a regime that takes a holistic view of credit risk would also level the playing field between the private sector and the agencies, potentially encouraging more lending outside federally backed channels. The safe harbor protection that lenders currently receive for agency-eligible mortgages reduces litigation risk relative to agency-

ineligible loans with similar risk profiles. Assume two loans with the same DTI ratio over 43 percent and the same probability of default. One is agency-eligible and is deemed a qualified mortgage, and the other is not agency-eligible and is not deemed a qualified mortgage even though it is no riskier. Because there is no way to get safe harbor protection for the second loan, the lender will likely either price for the added litigation risk or choose not to originate the loan. Either way, this does not serve the borrower well. Under our recommendation, the lender would be able to get safe harbor for both loans as long as the annual percentage rates are within 150 basis points of the APOR.

The standard would facilitate innovation. Encouraging lenders to originate and hold more high-DTI loans would provide an incentive for them to seek ways to better serve the market, such as by using new innovative methods to verify ability to repay, especially as borrower and household characteristics and work arrangements evolve. Recent technology innovations have automated income and asset verification and reduced the need for paper-based manual entries, which has improved the robustness of loan underwriting and cut down approval times. Such incremental accuracy matters because it can make a difference in a marginal borrower being approved for or denied a loan. The prospect of earning greater profits by holding high-DTI QM loans in portfolio could encourage lenders to make investments that are needed to serve future homebuyers, who are more likely to have nontraditional incomes and heavy student loan burdens than prior generations.

There is ample precedent for a rate-spread test. History shows there is ample precedent for the rate-spread regime. The trigger for restrictions and additional disclosure requirements under the Home Ownership and Equity Protection Act is based on an APOR test. Similarly, the requirement to set up escrows for property taxes and insurance is based on a rate spread.[10] Lastly, certain reporting requirements under the Home Mortgage Disclosure Act are based on the APOR test. Admittedly, the objectives of the QM rule are different. But strong historical precedent for the APOR test merits serious consideration.

For these reasons, a rate spread–based QM safe harbor regime is our recommended alternative to the GSE patch. But there are a couple of downsides. First, it assumes the market would always price credit risk accurately, which is hardly assured. Rate spreads would be lowest when real estate prices have increased rapidly and are expected to continue to do so, such as during economic booms. Credit is also likely to be more loosely available during such periods, increasing the risk of borrowers getting overextended. Mispricing could also occur because of perceptions that certain borrowers are riskier or less risky, steering borrowers into high-cost loans, or other market failures. Finally, a rate spread–based regime could give lenders an incentive to price mortgages just below the threshold to qualify for the safe harbor.

Option 3: Take No Action on the Patch

Here, the BCFP would let the GSE patch expire in 2021, establishing a hard 43 percent DTI cap for mortgages guaranteed by Fannie Mae and Freddie Mac. But this option is not as straightforward because the FHA, VA, and USDA have their own permanent QM rules with no DTI caps. If the BCFP

were to let the GSE patch expire, that would send the market for high-DTI GSE loans to the FHA. This would be the only way for lenders to secure a safe harbor for high-DTI loans. Portfolio lenders might hold on to some high-DTI loans as non-QMs, at least during periods of economic growth and strong house price appreciation.

If a hard 43 percent DTI cap was established for FHA and VA loans through changes to their QM rules (in addition to letting the GSE patch expire), it would fall entirely on the non-QM market to meet the lending needs of high-DTI borrowers.

But the non-QM market is small. A simple calculation illustrates the degree to which non-QM lending would have to expand to serve the high-DTI segment. In 2017, Fannie Mae, Freddie Mac, the FHA, and the VA originated 3.3 million purchase mortgages. About 1 million of these had DTI ratios above 43 percent (232,000 Fannie Mae mortgages, 170,000 Freddie Mac mortgages, 426,000 FHA mortgages, and 156,000 VA mortgages). In 2017, total non-QM lending volume was between $20 and $30 billion, and average size of a newly originated purchase loan was $267,000 (Dietrich et al. 2018). That translates into a maximum of 112,000 mortgages, one-ninth of the actual 1 million high-DTI agency mortgages.

Today's non-QM loans are also high quality. Data on recently securitized non-QM loans show pools with mostly full-documentation loans, LTV ratios averaging well under 80 percent, FICO averaging above 700, average DTI ratios ranging well under 43 percent,[11] and low serious delinquency rates. These loans are often made to highly creditworthy borrowers who cannot qualify for agency-backed loans because they do not meet agency documentation requirements, are self-employed, have nontraditional incomes, or for other reasons.

In other words, if a hard 43 percent DTI cap were established for Fannie Mae, Freddie Mac, the FHA, and the VA, the non-QM market would have to undergo a massive multiyear expansion to adequately serve the high DTI lending market, or many borrowers would have to forgo buying a home.

Conclusion

The upcoming GSE patch expiration is an opportunity for the BCFP to modify the patch to make it work better. Evidence from historical default rates shows that the mortgage rate is a better predictor of default than the DTI ratio alone. We believe replacing the current DTI-heavy framework with one that captures risk more holistically (option 2, rate spread) would strike better balance between expanding access while mitigating credit risk. Option 2 would also create a more level playing field between the agency-backed and purely private capital–backed channels, potentially providing incentives for more private lending. Option 1 (preserving the patch) would at best have marginal benefit and would leave unresolved the uncertainty surrounding the patch's future. Option 3 (letting the patch expire) would largely redirect high-DTI lending from one government-backed channel (the GSEs) to another (the FHA). We recognize there might be other options for addressing patch expiration, and we hope this brief is a useful starting point for a robust debate.

Notes

[1] Higher points and fees are allowed for loan amounts below $100,000.

[2] Fixed-rate qualified mortgages that are not non-higher cost priced may charge prepayment penalties as long as the lender also offers the borrower an alternative loan without the penalty.

[3] The BCFP's QM rule governs QM eligibility for private mortgages and those guaranteed by Fannie Mae or Freddie Mac. Mortgages insured by the FHA, VA, or USDA are governed by separate QM rules developed and implemented by these federal agencies.

[4] The original 2014 QM rule had established an asset threshold of $2 billion. The recently passed Economic Growth, Regulatory Relief, and Consumer Protection Act increased the threshold to $10 billion.

[5] The Average Prime Offered Rate is an annual percentage rate based on average interest rates, fees, and other terms on mortgages offered to highly qualified borrowers. The underlying data source for most fixed and adjustable-rate products is Freddie Mac's Primary Mortgage Market Survey.

[6] "Qualified Mortgage Definition for HUD-Insured and Guaranteed Single-Family Mortgages," 78 Fed. Reg., 75215 (December 11, 2013); "Loan Guaranty: Ability-to-Repay Standards and Qualified Mortgage Definition under the Truth in Lending Act," 79 Fed. Reg., 26620 (May 9, 2014); "Single-Family Housing Guaranteed Loan Program," 81 Fed. Reg., 26461 (May 3, 2016).

[7] Brad Finkelstein, "How a CFPB Overhaul of the QM Rule Will Remake Mortgages," *National Mortgage News*, June 4, 2018, https://www.nationalmortgagenews.com/news/how-a-cfpb-overhaul-of-the-qualified-mortgage-rule-will-remake-home-loans; "Non-agency MBS Making Big Strides in 2018 but Still Far from Being a Meaningful Market," Inside Mortgage Finance, May 25, 2018, https://www.insidemortgagefinance.com/issues/imfpubs_ima/2018_20/news/Non-Agency-MBS-Making-Big-Strides-in-2018-1000046167-1.html.

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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 Innovation Forum, a group of organizations and individuals that support high-quality independent research that informs evidence-based policy development. Funds raised through the Forum 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 urban.org/fundingprinciples.

The authors want to thank Patricia McCoy, Ed Golding and Ellen Seidman for helpful comments on an earlier draft.

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