Qualified mortgages: The uncertain future of the GSE patch

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Late last month, President Trump's administration released a wide-sweeping reform and reorganization plan for the federal government. Included in this plan was a proposal to reform two of the largest government sponsored enterprises (GSEs) – Fannie Mae and Freddie Mac – in an effort to lessen government presence in the mortgage market. In anticipation of this possible change, the Consumer Financial Protection Bureau (CFPB) issued a request for information (RFI) from interested parties in order to gain industry input. The overwhelming theme from these responses regarded a change to the qualified mortgage (QM) standards under the ability-to-repay (ATR) rule and what impact the administration's changes would have on the so-called "GSE patch."

The ATR rule requires that lenders make a reasonable and good faith determination of a borrower's ability to repay a loan. One way in which a lender can comply with the ATR rule is through a QM (of which there are three types: general, GSE-eligible and small creditor). A general QM requires a debt-to-income (DTI) ratio of 43 percent or less. However, even when DTI is above the 43 percent threshold, a loan can still be a QM if it is a GSE-eligible loan. The "GSE patch" is an exception to the general QM standard, through which the 43 percent maximum DTI ratio does not apply to mortgage loans backed by Fannie Mae and Freddie Mac. Still, this exception is currently set to expire on January 10, 2021. As this deadline is fast approaching, lenders are eager to gain some clarity on the future of the GSE patch, with many hoping the exception extends beyond the 2021 termination date.

In response to the CFPB's RFI, a multitude of entities issued recommendations on how the QM standards and the GSE patch should be changed. Amongst the recommendations were:

1. The removal of the 2021 termination and indefinite existence of the patch

2. A continuation of the patch only until a more acceptable replacement is instituted by Congress
3. Abolishing the patch altogether and raising the DTI threshold requirement
4. Expanding the patch to include, among other things, jumbo loans (these include any loan higher than the Fannie Mae/Freddie Mac loan limits and not eligible for QM status under the current version of the patch).

While the recommendation varied widely, most entities were in agreement that the current 43 percent threshold is an onerous requirement and that the patch serves as a mitigating alternative to this burden.

It remains unclear which, if any, of these suggestions Congress and the CFPB could follow. As a result, it is important to note how these changes may impact mortgage lenders. If the patch is not renewed or extended past 2021, approximately 13.1 percent to 15.6 percent of GSE borrowers and 35.7 percent to 38.9 percent of Fannie Mae borrowers may have to look to portfolio lenders to get home loan financing. Conversely, extension or formal adoption would provide lenders far greater certainty in the market and afford policy makers time to determine the future of GSE's role in the housing finance system.

The administration's proposal to remove Fannie Mae and Freddie Mac from government conservatorship will require congressional approval and may not take effect until after the mid-term elections in November. Until then, as January 2021 approaches, the future of the GSE patch for qualified mortgages remains unclear.

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