INFOBYTES SPECIAL ALERT:
HUD PROPOSES ITS OWN QM RULE

October 2, 2013

On September 27, 2013, the Department of Housing and Urban Development ("HUD") released a proposal defining what constitutes a "qualified mortgage" ("QM") for purposes of loans insured by the Federal Housing Administration ("FHA").[1] Once this proposal is finalized and takes effect, it will replace the temporary QM definition for FHA loans established by the Consumer Financial Protection Bureau ("CFPB" or "Bureau") in its January 2013 Ability-to-Repay/Qualified Mortgage Rule ("ATR/QM Rule").[2] QMs, when made in accordance with the applicable requirements, provide lenders with some legal protection against borrower lawsuits under the Truth in Lending Act ("TILA") alleging the lender did not sufficiently consider the borrower's ability to repay the loan.

The CFPB's temporary QM definition will continue to apply to loans that are eligible to be guaranteed or insured by the Department of Veterans Affairs and the Department of Agriculture until those agencies establish their own QM definitions.[3] Similarly, the CFPB's temporary QM definition will continue to apply to loans that are eligible to be purchased or guaranteed by Fannie Mae, Freddie Mac, or any successor entity for as long as those entities remain under the conservatorship or receivership of the Federal Housing Finance Authority or until January 10, 2021, whichever is earlier.[4]

BACKGROUND

Recent increases in FHA mortgage insurance premium ("MIP") costs created pressure for HUD to act quickly to replace the CFPB's QM definition for FHA loans with its own in advance of the January 10, 2014 effective date for the CFPB rule. Under the CFPB's ATR/QM Rule, lenders who make first-lien QMs with an annual percentage rate ("APR") that exceeds the average prime offer rate ("APOR") for a comparable transaction by less than 1.5 percentage points receive "safe harbor" protection from liability. In contrast, loans above that threshold (which are often referred to as "higher-priced mortgage loans" or HPMLs) receive a less-protective rebuttable presumption of compliance.[5] Because mortgage insurance premiums are generally included in the APR, the recent 10 basis point increase in the FHA annual MIP and a new requirement making FHA insurance permanent when the loan-to-value exceeds 90 percent raised significant concerns that fewer FHA loans would qualify for the safe harbor liability protection under the Bureau's ATR/QM Rule, which would potentially have a "chilling effect on FHA lending."[6]

[1] Department of Housing and Urban Development, *Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages*, 78 Fed. Reg. 59890 (Sept. 30, 2013) [hereinafter "*Proposal*"].

[2] 12 C.F.R. § 1026.43(e)(4)(ii)(B) and (iii)(A).

[3] 12 C.F.R. § 1026.43(e)(4)(ii)(C)-(E) and (iii)(A).

[4] 12 C.F.R. § 1026.43(e)(4)(ii)(A) and (iii)(B); Cmts. 43(e)(4)-2 and -3.

[5] 12 C.F.R. § 1026.43(b)(4), (e)(1).

[6] *See, e.g.*, Brian Collins, HUD Starting its Own QM Rule for FHA Loans, American Banker (Mar. 1, 2013); Christina Mlynski, FHA to Establish its Own Qualified Mortgage Rule: Galante, Housing Wire (Mar. 8, 2013).

As a result, HUD has established an abbreviated comment period of less than 60 days so that its QM definitions can take effect at the same time as – and thereby replace – the CFPB's definition for FHA loans on January 10, 2014. Specifically, comments on HUD's proposal are due by October 30, 2013.[7] Notably, however, even after the proposed rule is finalized, FHA loans that are HPMLs must still comply with other applicable TILA requirements.

HUD'S PROPOSED QM DEFINITIONS

HUD proposes to establish two separate QM definitions for loans insured by the FHA under Title II of the National Housing Act, under which the vast majority of FHA single-family loans are insured: one definition for loans that will receive safe harbor liability protection and another for loans that will receive only a rebuttable presumption of compliance. All single family mortgages insured by the FHA under Title II would be QMs of either the safe harbor or rebuttable presumption variety, except for reverse mortgages insured by HUD's Home Equity Conversion Mortgage ("HECM") program because reverse mortgages are exempt from the Bureau's ATR/QM Rule. With the exception of HECM loans, however, FHA would no longer insure loans under Title II that do not meet HUD's QM definitions.

As discussed below, HUD proposed to establish less restrictive QM standards for home improvement loans insured under Title I of the National Housing Act and for Indian and Native Hawaiian housing loans insured or guaranteed under sections 184 and 184A of the Housing and Community Development Act of 1992 (collectively, "non-Title II FHA loans"). In addition, none of HUD's proposed QM standards incorporate the restriction on the debt-to-income ratio associated with underwriting under the ATR/QM Rule's Appendix Q.[8]

Points and Fees.

Under both of HUD's proposed definitions for Title II FHA loans, a QM must satisfy the ATR/QM Rule's "points and fees" limitations. Specifically, the loan's points and fees must not exceed 3% of the loan amount for loans of $100,000 or more (with different thresholds applying to lower loan amounts).[9] However, non-Title II FHA loans are exempt from the points and fees restriction.[10]

Safe Harbor v. Rebuttable Presumption.

Similar to the Bureau's ATR/QM Rule, HUD proposes to provide two degrees of protection against liability for violations of the ability-to-repay requirement for Title II FHA loans. However, HUD's proposal would alter the CFPB's method for determining which loans receive the safe harbor and which receive a rebuttable presumption of compliance. It appears that these modifications are intended to address industry concerns that the recent FHA MIP changes will cause fewer loans to qualify for safe harbor treatment under the Bureau's ATR/QM Rule.

Unlike the Bureau's rule, the HUD proposal would not provide safe harbor protection based on whether a loan is a HPML (*i.e.*, a loan with an APR that is 1.5 percentage points above the APOR for a comparable transaction). Instead, a Title II FHA loan that satisfies the points and fees requirement discussed above

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7 *Proposal*, 78 Fed. Reg. at 59898.

8 *Id.* at 59897.

9 Proposed 24 C.F.R. § 203.19(b)(1).

10 Proposed 24 C.F.R. §§ 201.7, 1005.120, 1007.80; *Proposal*, 78 Fed. Reg. at 59895, 59897.

is a “FHA Safe Harbor QM” if its APR does not exceed the APOR for a comparable transaction, as of the date the interest rate is set, “by more than the combined annual mortgage insurance premium and 1.15 percentage points.”[11] In contrast, a Title II FHA loan with an APR above that threshold receives a rebuttable presumption of compliance with the QM standard.[12] (All non-Title II FHA loans would be FHA Safe Harbor QMs under the proposal, regardless of the APR.[13])

In explaining why it proposed this threshold for Title II FHA loans in place of the Bureau’s HPML threshold, HUD stated that:

> Because all FHA-insured mortgages include a MIP that may vary from time to time to address HUD’s financial soundness responsibilities, including the MIP as an element of the threshold that distinguishes safe harbor from rebuttable presumption allows the threshold to ‘‘float’’ in a manner that allows HUD to fulfill its responsibilities that would not be feasible if HUD adopted a threshold based only on the amount that APR exceeds APOR. If a straight APR over APOR threshold were adopted by HUD, every time HUD would change the MIP, to ensure the financial soundness of its insurance fund and reduce risk to the fund or to reflect a more positive market, HUD would also have to consider changing the threshold APR limit.[14]

It is not immediately clear from HUD’s proposal how lenders would combine the annual MIP with 1.15 percentage points to determine the applicable threshold for the FHA Safe Harbor QM. It appears that HUD intends the lender to calculate the sum of the annual MIP rate and 1.15 percentage points (*e.g.*, 1.30 + 1.15 = 2.45) and then determine whether the loan’s APR exceeds the applicable APOR by that amount.

Rebutting the Presumption of Compliance.

Unlike the CFPB’s rule, the HUD proposal would not permit consumers to rebut the presumption of compliance by showing that they had “insufficient residual income or assets other than the value of the dwelling . . . that secures the loan with which to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware at the time of consummation.”[15] Instead, under HUD’s proposal, a borrower must prove either that:

- The loan exceeded the applicable points and fees limitation;[16] or
- The lender did not make a reasonable and good faith determination of the borrower’s repayment ability at the time of consummation “by failing to consider the [borrower’s] income, debt obligations, alimony, child support, monthly payment on any simultaneous loans, and

[11] Proposed 24 C.F.R. § 203.19(b)(3)(ii).

[12] Proposed 24 C.F.R. § 203.19(b)(2).

[13] Proposed 24 C.F.R. §§ 201.7, 203.19(b)(3)(i), 1005.120, 1007.80.

[14] *Proposal*, 78 Fed. Reg. at 59896.

[15] 12 C.F.R. § 1026.43(e)(1)(ii)(B).

[16] It is not clear why HUD explicitly included this as a means of rebutting the presumption because, even without this provision, a loan is not a QM – whether rebuttable presumption or safe harbor – if it fails the points and fees test.

monthly payment (including mortgage-related obligations) on the mortgage, as applicable to the type of mortgage, when underwriting the mortgage in accordance with HUD requirements."[17]

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Questions regarding the matters discussed in this Alert may be directed to any of our lawyers listed below, or to any other BuckleySandler attorney with whom you have consulted in the past.

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17 Proposed 24 C.F.R. § 203.19(b)(2)(ii).