

Debt-to-Income Ratio-Based Mortgage Denials in the Fifth District

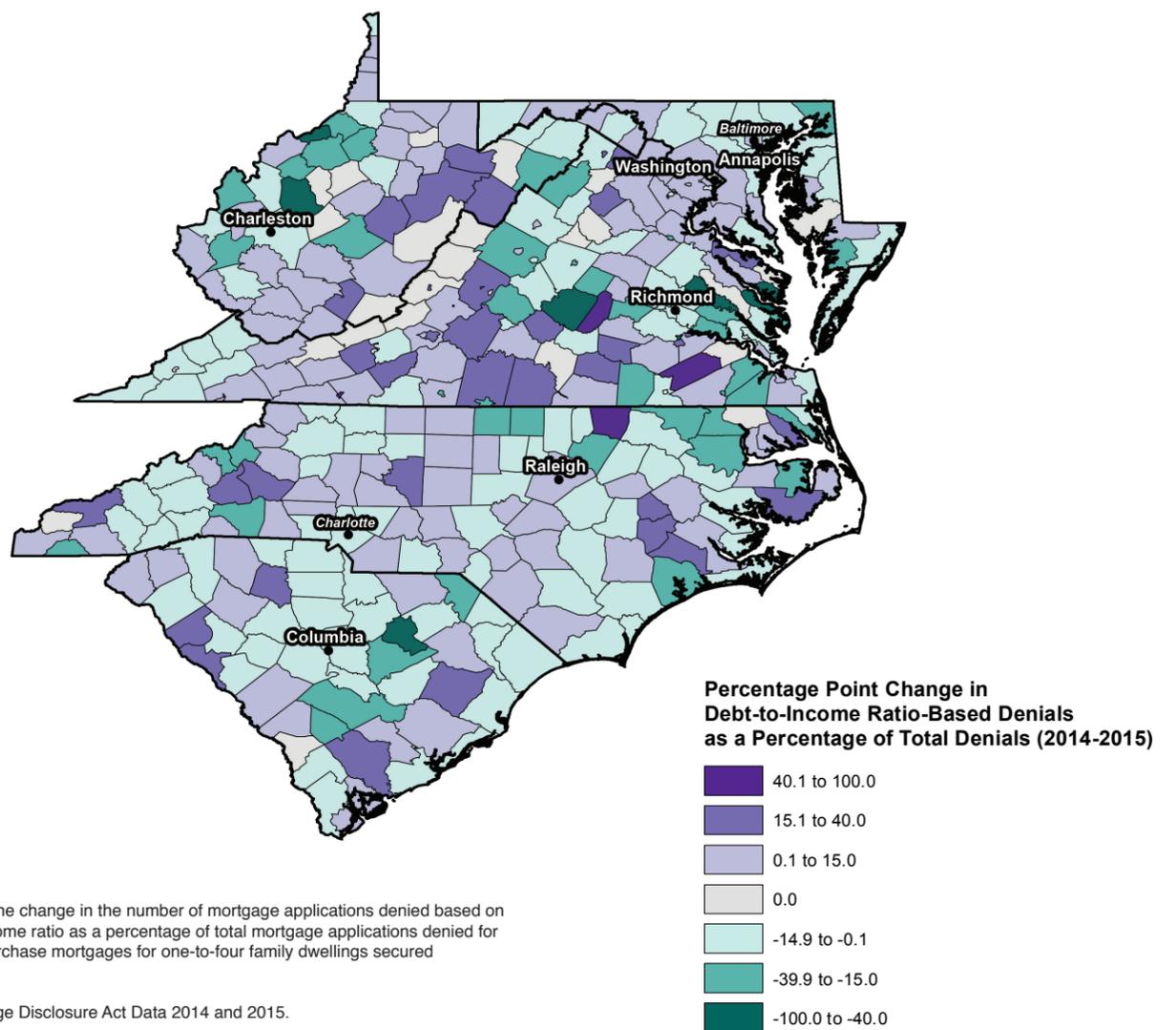
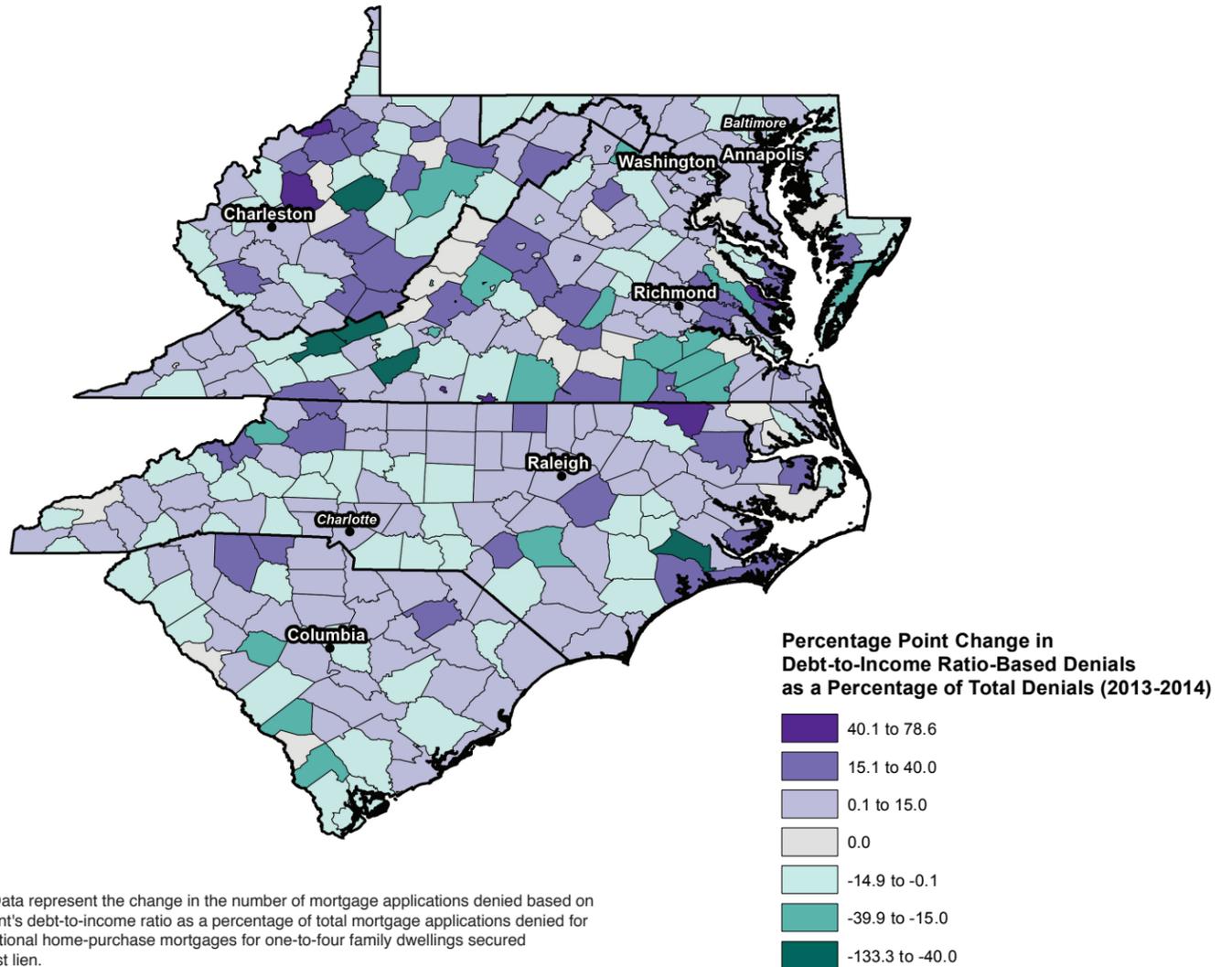
This issue of *5th District Footprint* examines the change in the percentage of mortgage denials based on the applicant's debt-to-income ratio from 2013 to 2014 and from 2014 to 2015. In January 2014, the Ability to Repay (ATR) rule from the Consumer Financial Protection Bureau (CFPB) went into effect, thereby requiring lenders to make a reasonable determination of whether applicants will be able to repay the requested loan based on total debt, income, and credit history. Consequently, in addition to maintaining good credit, mortgage applicants must be aware of their debt-to-income ratio, which is calculated by dividing total monthly debt payments by gross monthly income. In general, under the ATR rule, applicants may qualify for a mortgage if their debt-to-income ratio is less than 43 percent.¹

Home Mortgage Disclosure Act (HMDA) data on the percentage of total mortgage applications denied based on the applicant's debt-to-income ratio from 2013 to 2014 — the year before the ATR rule went into effect compared to the first year it was in effect — and from 2014 to 2015 — the first year the ATR rule was in effect compared to the second — give some insight into the rule's potential impact.² While changes in denial rates from 2013 to 2014 and 2014 to 2015 cannot be fully attributed to the ATR rule, the rule is an important contributing factor. Local economic conditions that affect household income and debt may also be factors. Income reduction brought about by job loss, wage rate decreases, or transitions from full-time to part-time work could increase individuals' debt-to-income ratios, as could high levels of personal debt, including student loan debt.³ Income reduction shrinks the denominator of a debt-to-income ratio while personal debt growth expands the numerator. If changes in these two components do not balance each other out, the overall ratio will change.

The average annual increase of the national debt-to-income ratio-based denial rate was 1.1 percentage points from 2007 to 2013.⁴ Post-implementation, the national rate rose from 19.9 percent in 2013 to 21.4 percent in 2014 and to 22.3 percent in 2015. Of the 23,047 mortgage applications denied in the Fifth District in 2013, 4,551 (19.7 percent) were denied because of the applicant's debt-to-income ratio. This increased to 23.1 percent in 2014 and then decreased slightly to 22.5 percent in 2015. Debt-to-income ratio was the most frequently cited reason for mortgage denials in the Fifth District in both 2014 and 2015. The percent of debt-to-income ratio-based denials increased in all Fifth District states and the District of Columbia from 2013 to 2014, but subsequently decreased from 2014 to 2015 in the District of Columbia and South Carolina. West Virginia is the only Fifth District state that experienced an increase in the

percentage of debt-to-income ratio-based denials in 2014 to 2015 with a 2.6 percentage point increase over this time period.⁵

From 2013 to 2015, the percentage of debt-to-income ratio-based denials increased in 202 Fifth District counties, remained constant in 23 counties, and decreased in 134 counties. Roane County, West Virginia, had the sharpest percentage point increase immediately following the ATR rule implementation, with a 78.6 percentage point increase in debt-to-income ratio-based denials from 2013 to 2014. The county also experienced one of the largest percentage point decreases from 2014 to 2015, resulting in a net increase of 21.5 percentage points in the county from 2013 to 2015.⁶ Mecklenburg County, North Carolina, had the largest total number of debt-to-income ratio-based denials with 687 from 2013 to 2015.⁷



richmondfed.org/publications/community_development

¹ "What is a debt-to-income ratio?" Consumer Financial Protection Bureau (2015).

² HMDA data do not represent all mortgage applications. Depository financial institutions with assets less than \$41 million, \$42 million, or \$43 million as of December 31 of the preceding year were exempt from HMDA reporting in 2013, 2014, or 2015, respectively. Non-depository financial institutions with less than \$10 million in assets as of December 31 of the preceding year were exempt from HMDA reporting. The mortgage applications represented by this data are applications for conventional home-purchase mortgages for one-to-four family dwellings secured by a first lien.

³ "How has the percentage of consumer debt compared to household income changed over the last few decades? What is driving these changes?" Federal Reserve Bank of San Francisco (July 2009); "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* 100(4) (September 2014).

⁴ 2007 is the earliest year for which HMDA data is available from the CFPB.

⁵ From 2014 to 2015, Maryland, North Carolina, and Virginia experienced percentage point changes that fell within a margin of error and so cannot be classified as increases or decreases.

⁶ The number of debt-to-income ratio-based denials in Roane County, West Virginia, was zero out of 15 denials in 2013, 11 out of 14 denials in 2014, and three out of 14 denials in 2015.

⁷ Mecklenburg County, North Carolina, had 204 debt-to-income ratio-based mortgage application denials in 2013, 245 in 2014, and 238 in 2015.