Mortgage Shopping, Mortgage Capitalization, and the Mortgage End of Days A Review of Three Papers

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October 15, 2015

The Three Papers

- Alexandrov and Koulayev on Price Dispersion of Mortgages
- Fuster and Zafar on Financing and Willingness to Pay for Housing
- Johnson and Sarama on HELOCS

It’s All About Measurement

Organization

- What do these papers try to teach us?
- What are the set-ups?
- What are the measurement traps?
- Do the traps matter?

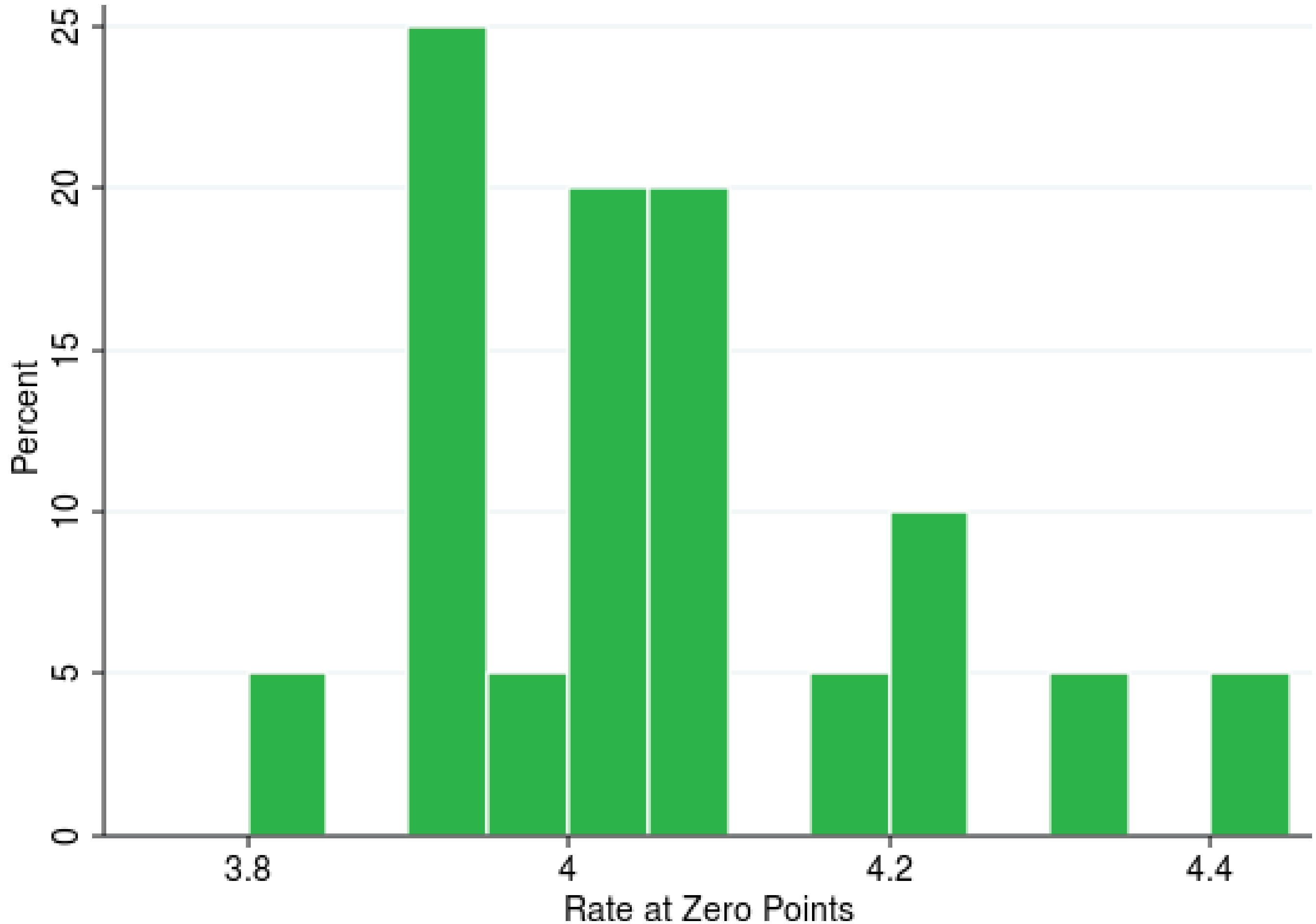
Bottom lines

- Law of one price does not seem to characterize the mortgage market
- Mortgage rates have limited impact on willingness to pay; down-payments have a much larger impact
- Borrower characteristics matter to defaults, but so do payment shocks

Why dispersion?

- Authors measure rates in a reasonable way—figure out the rate for each mortgage that is equivalent to a zero-point, zero closing cost mortgage.
- Process is interpolation
- Does this do the trick?

Price dispersion in Massachusetts for a $400,000 loan for a consumer with 760 FICO (prime) and 80 LTV (20% downpayment), when the loan is securitized by one of the GSEs.



First point—I buy the result

- Some consumers are, er, less than well informed.
- Think about cars. Why does anyone now pay more than a small mark-up over invoice?
- Think about mattresses—it is hard to know what you are getting.

But…the measurement has a problem

- Heterogeneous expectations change the cost of a mortgage
- If I think I am going to move/refinance sooner than the bank does, I will take the zero point loan.
- If I think I am going to move/refinance slower than the bank, I will take the lowest rate loan
- The true cost of the loan is not revealed until after it terminates
- To get a true measure of dispersion, one would need to observe ex post costs. Difficult, to say the least.

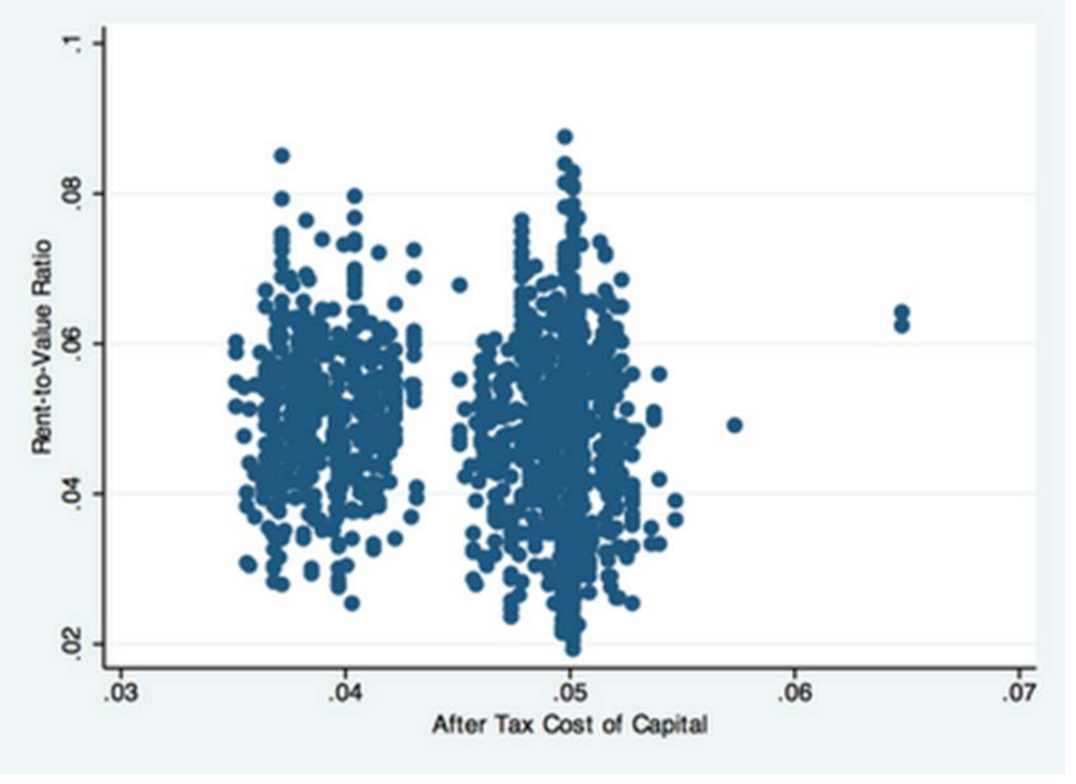
Bu the policy implications are surely correct

- We should encourage people to shop
- We still need to think about a truly transparent disclosure—but maybe this is not possible.
- Even requiring all lenders to post zero point loan might not work.

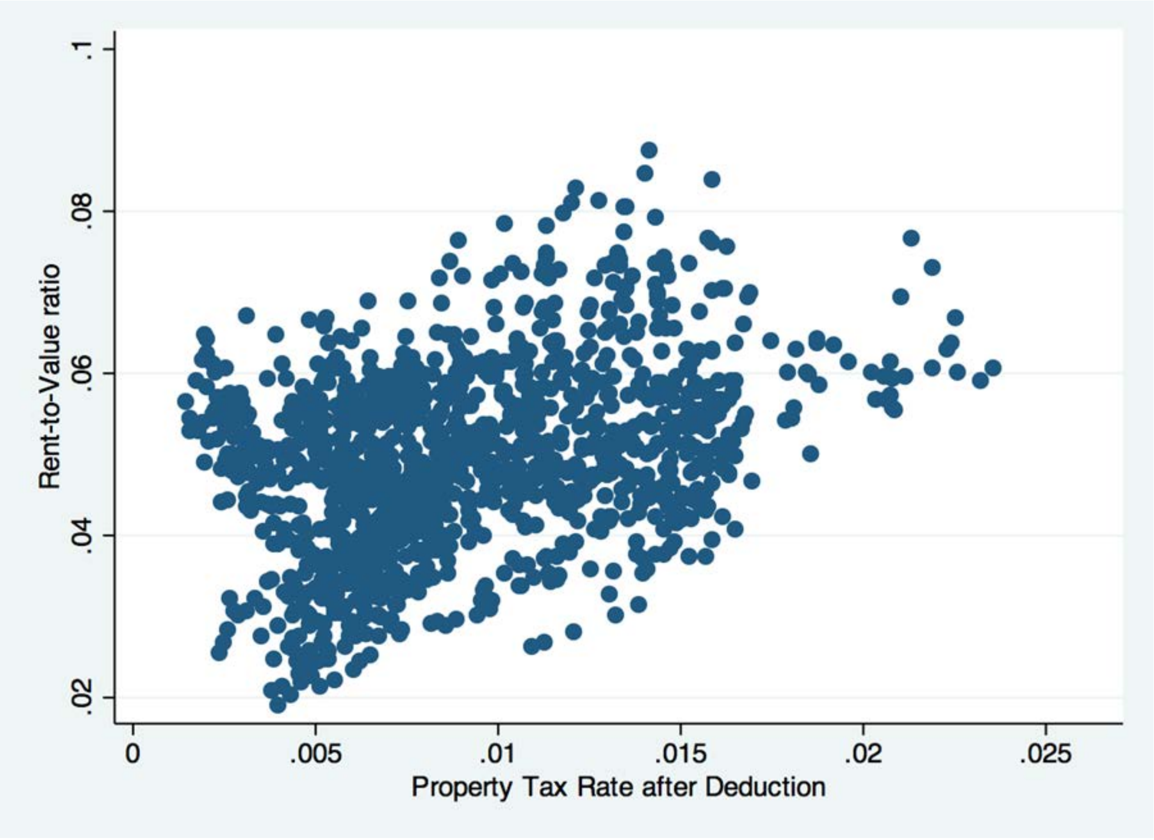
Rates, Down-payments and Willingness to Pay

- Survey people and ask
  - How much are you willing to pay given a range of rates?
  - How much are people willing to pay given a range of down-payment?
- Rates don’t matter much—down-payment does
- Consistent with Linneman and Wachter

What do the data say about interest rates?



What do the data say about property taxes



Departure Between Paper and User Cost Specification

- Income taxes across states and incomes are highly heterogeneous
- Property Taxes are highly heterogeneous
- Expectations about appreciation are highly heterogenous
- Supply elasticity is highly heterogeneous (think Houston vs. San Francisco).

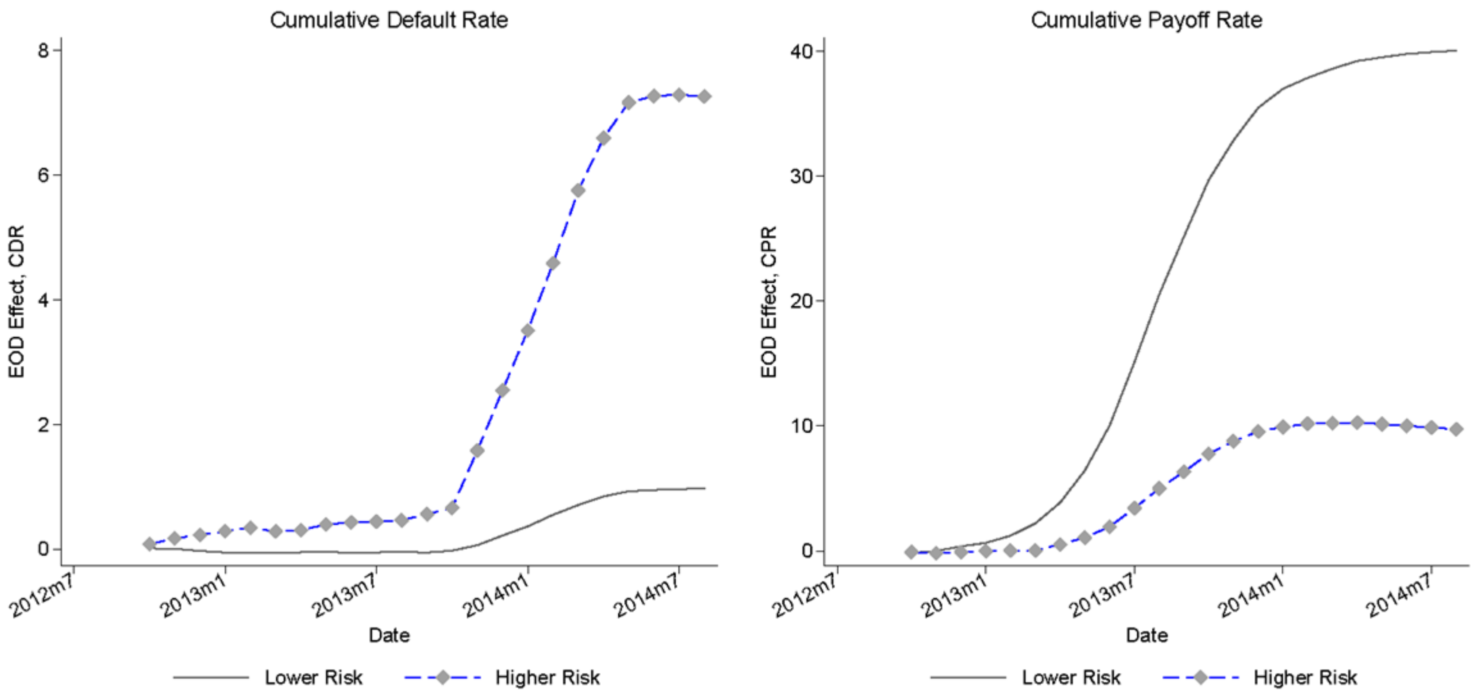
Policy implication

- Maybe yanking the MID would be less traumatic than people think?
- If we want to encourage homeownership, what is the net impact of lowering downpayment?
  - + Eliminates credit constraint
  - - Makes housing more expensive

HELOCS

- Borrower characteristics matter
- Payment shock matters

Measurement Issue—Picky and Important



Policy Implications

- What does this mean for those about to turn 65? They will be facing a more traumatic “end-of-draw”
- From 1989-2013, median income for 55-64 year olds grew by 15 percent. Median mortgage balance grew by 183 percent (source: SCF)
- How do we design a better mortgage product for seniors
- HELOCS have problems—and HECMs have problems