"A Mortgage Market Conundrum"
A discussion of
Bhutta, Fuster and Hizmo
and
Fuster, Plosser, and Schnabl

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Are mortgages wheat?

“From the taste of wheat it is not possible to tell who produced it, a Russian serf, a French peasant or an English capitalist.”
- Marx

A commodity good should be priced similarly.

Do mortgages taste different?

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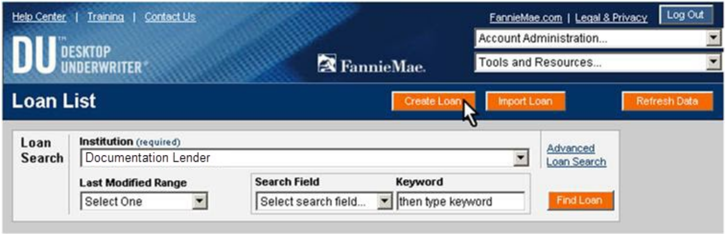
- **90-95% of mortgages are very standardized**



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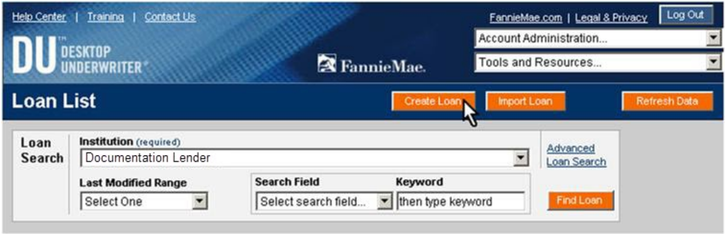

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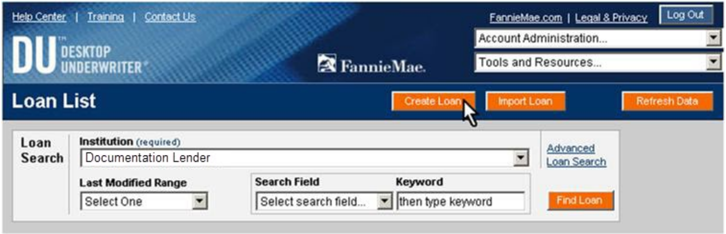
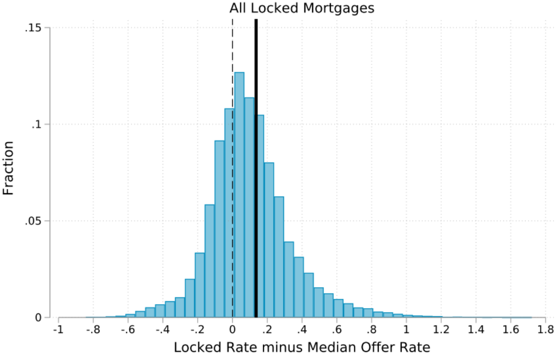


- **There are many (at least 6,700) lending institutions, and market shares tend not to be concentrated.**

- **Borrowers act like they taste the same: 75% of borrowers only apply to one lender**

Bhutta, Fuster, and Hizmo

Not priced the same!



- **Larger gap for low-FICO, lower-income borrowers.**
- **90th/10th percentile gap of $7,500.**

Why?

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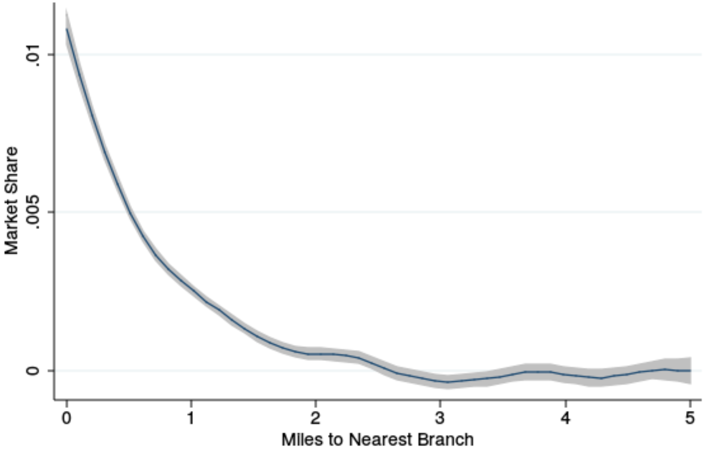
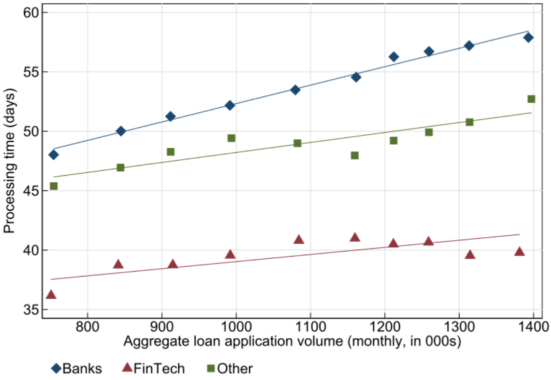
Distance matters even with mortgages



Borrowers prefer lenders with branches close to them.

Borrowers are paying much more than they need to pay. Can Fintech save them?



Fintech lenders are faster, more responsive to demand, just as good at underwriting.

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Borrowers are getting denied less often, refinancing more, but not paying less.

Maybe this is just the start, price gains will get to borrowers when tech becomes more widespread?

What about the original "Fintech"?

COVER REPORT: INDUSTRY CHANGE

Mortgages *in Minutes*

BY PETER MASELLI

A revolution built around technology and automated underwriting is promising big changes in the days ahead. Artificial intelligence can now decide in seconds which loans Freddie Mac will buy and borrowers are getting loan approval in hours. Widely available next year, the system marks the end of the 30-day mortgage.

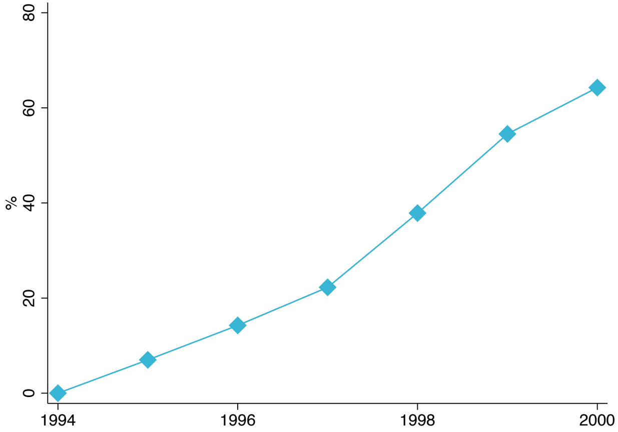
COMPUTERS HELP US PAY OUR BILLS WITHOUT LEAVING HOME, they entertain us, they teach us and help us figure out our taxes. They let us buy theater tickets along with our groceries and do our banking day or night. Soon, they will make it possible to get a mortgage loan in a fraction of the time it now takes.

Technology is already being used to speed up the loan application, origination and sale processes. Shortly, automation will make the dream of buying a home—getting the loan to pay for that home—a reality in as little as five days.

To do this requires a complete reengineering of the underwriting process, a development that "will change the industry as profoundly as the introduction of the amortizing loan during the Great Depression," says James W. Noack of Monument Mortgage, Inc. in Walnut Creek, California.

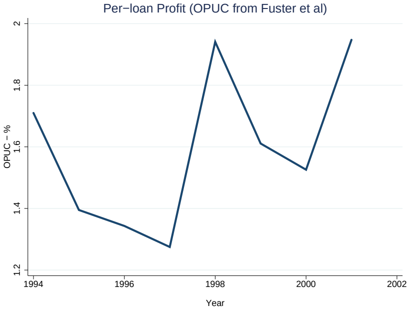
Automated underwriter software (AUS) revolutioned mortgage lending.

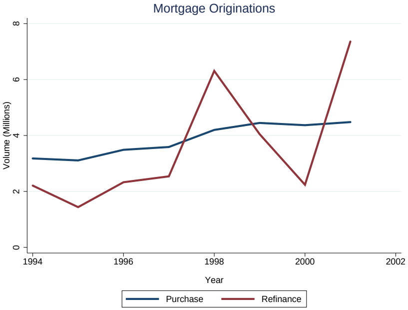
Use of GSE AUS increased



Estimate of originations using Fannie/Freddie AUS from Stephanie Johnson

What happened to the mortgage market?





Profits per loan about the same or increased.

Quantities increased (along with credit box).

Can mortgages become wheat?

The conundrum:

- Many borrowers refuse (or do not know how) to search.
- $\Rightarrow$ Low-cost lenders have little incentive to enter the market.
- $\Rightarrow$ Lenders respond to shocks by adjusting quantities, which may have important distributional and aggregate implications.
- **How do we get to a mortgage market with one price?**
  - What can the jumbo market teach us?

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- **How do we get to a mortgage market with one price?**
  - What can the jumbo market teach us?
- **What would a one price mortgage market look like?**
  - Which lenders will keep operating?
  - Without margin, will lenders push volume? Where?
  - Who gets credit once lower-FICO borrowers are not subsidizing each other *and* higher-FICO borrowers?