

“A MORTGAGE MARKET CONUNDRUM”
A DISCUSSION OF
BHUTTA, FUSTER AND HIZMO
AND
FUSTER, PLOSSER, AND SCHNABL

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8th Annual FDIC Consumer Research Symposium - 2018

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

The screenshot displays the DU Desktop Underwriter interface. At the top, there are navigation links for Help Center, Training, and Contact Us. On the right, there are links for FannieMae.com, Legal & Privacy, and a Log Out button. Below these are two dropdown menus for Account Administration and Tools and Resources. The main header area is dark blue with the DU logo and the text 'DU DESKTOP UNDERWRITER' and 'FannieMae'. Below the header is a 'Loan List' section with three orange buttons: 'Create Loan', 'Import Loan', and 'Refresh Data'. A mouse cursor is pointing at the 'Create Loan' button. Below this is a search form with a 'Loan Search' label. The form includes a dropdown menu for 'Institution (required)' with 'Documentation Lender' selected, a 'Last Modified Range' dropdown with 'Select One' selected, a 'Search Field' dropdown with 'Select search field...' selected, and a 'Keyword' text input field with the placeholder 'then type keyword'. There is also a 'Find Loan' button and a link for 'Advanced Loan Search'.

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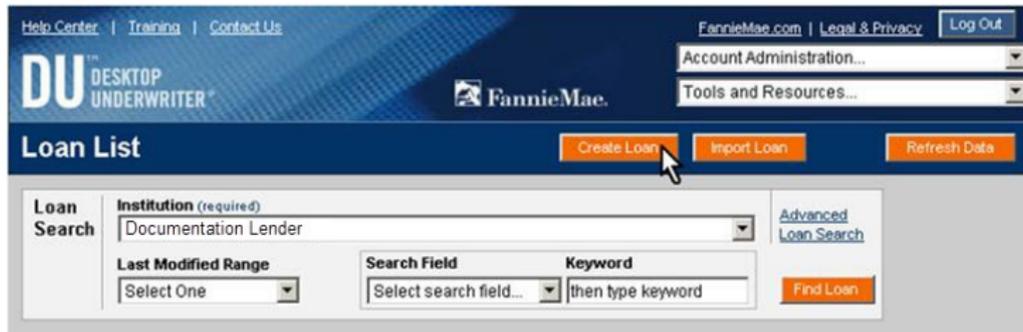
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- Loan Search**
- Institution (required)**: A dropdown menu with "Documentation Lender" selected.
- Last Modified Range**: A dropdown menu with "Select One" selected.
- Search Field**: A dropdown menu with "Select search field..." selected.
- Keyword**: A text input field with the placeholder text "then type keyword".
- Advanced Loan Search**: A link to the right of the Institution dropdown.
- Find Loan**: An orange button to the right of the Keyword field.

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

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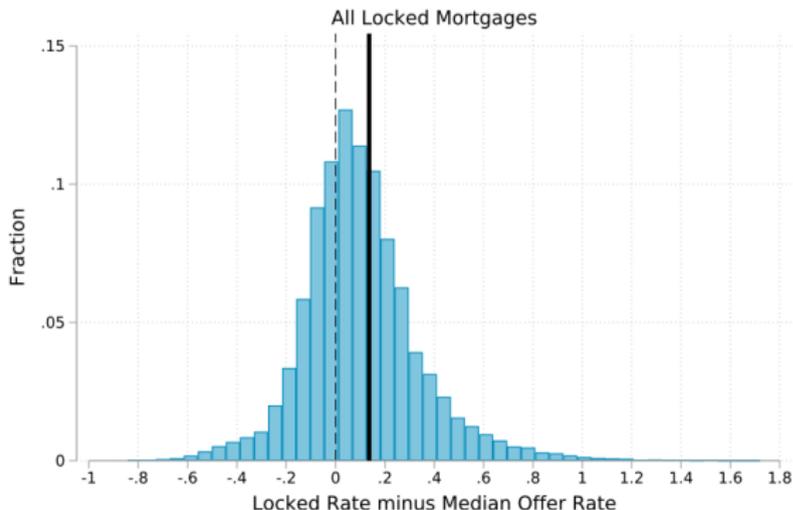


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- There are many (at least 6,700) lending institutions, and market shares tend not to be concentrated.
- Borrowers act like they taste the same: **75% of borrowers only apply to one lender**

BHUTTA, FUSTER, AND HIZMO

Not priced the same!



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

WHY?

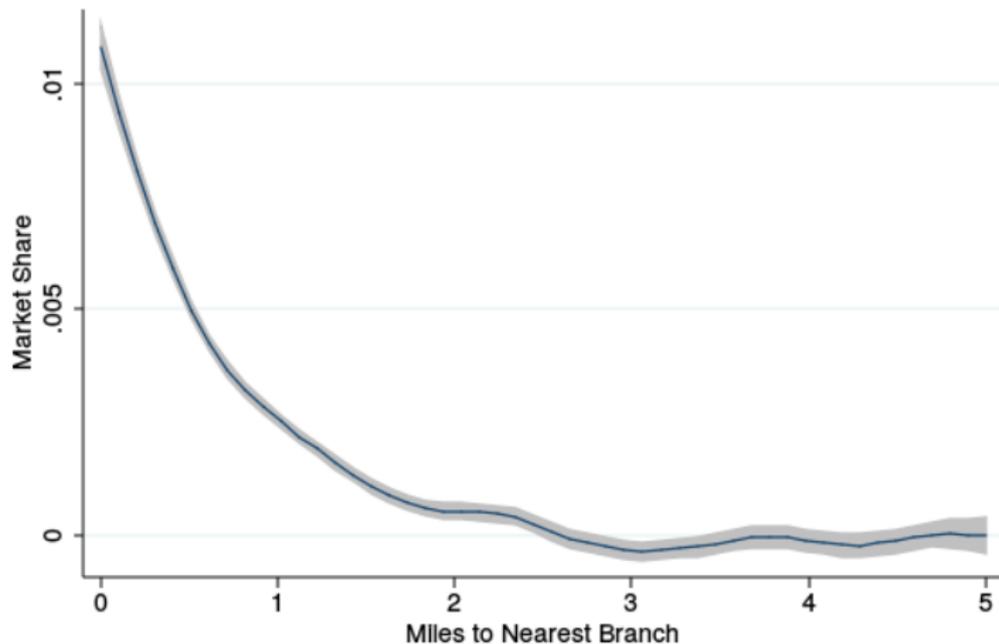
“ ‘The law of one price’ is no law at all” - Varian.

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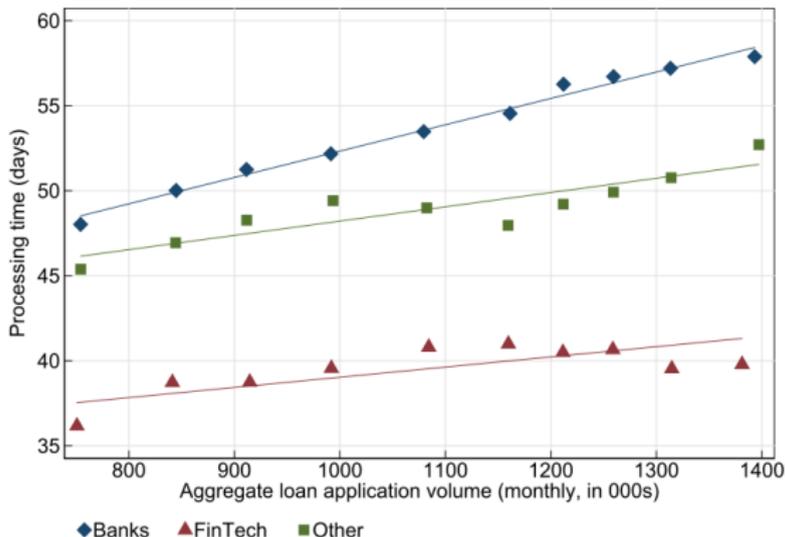
DISTANCE MATTERS EVEN WITH MORTGAGES



Borrowers prefer lenders with branches close to them.

FUSTER, PLOSSER, SCHNABL, VICKERY

**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.

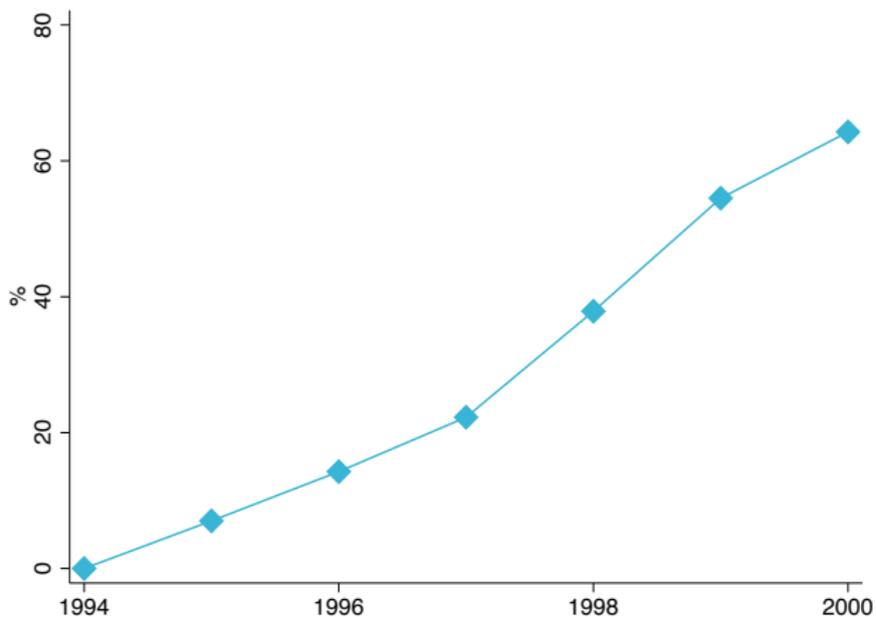
PHOTOGRAPH BY STEVE BRONSTEIN

MORTGAGE BANKING - OCTOBER 1994
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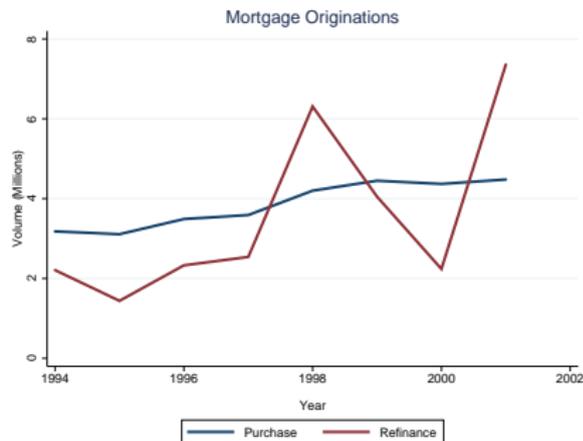
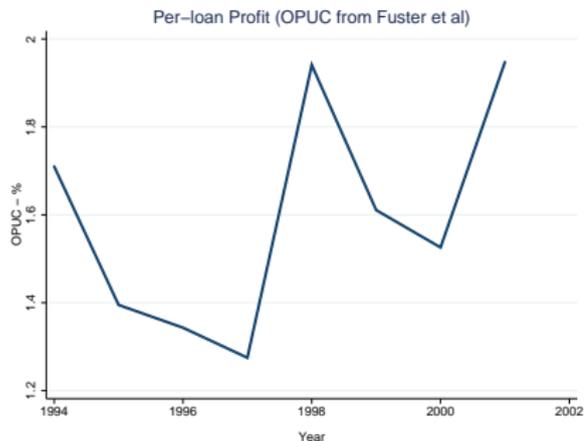
Automated underwriter software (AUS) revolutionized mortgage lending.

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?