

# **Paying Too Much?**

## **Price Dispersion in the US Mortgage Market**

by Bhutta, Fuster, and Hizmo

Discussion by Christopher Palmer  
MIT Sloan & NBER

AEA Real Estate and Housing Finance  
January 3, 2020

# Summary: Unforgettable Facts

1. 96% of mortgagors convinced got the best rate! (Narrator: “...they didn’t.”)
2. Half of mortgagors only consider one lender, only 3% consider 3+
  - ANP (2017): need 3+ quotes to get within 10 bp of best car loan
3. 90-10 gap for similar borrowers is 53 bp (a lot of PV \$s)
4. Within loan officer 90-10 gap is 24 bp
5. High income, educ, financial literacy, FICO, low LTV => lower spreads

# So why do so many borrowers overpay so much?

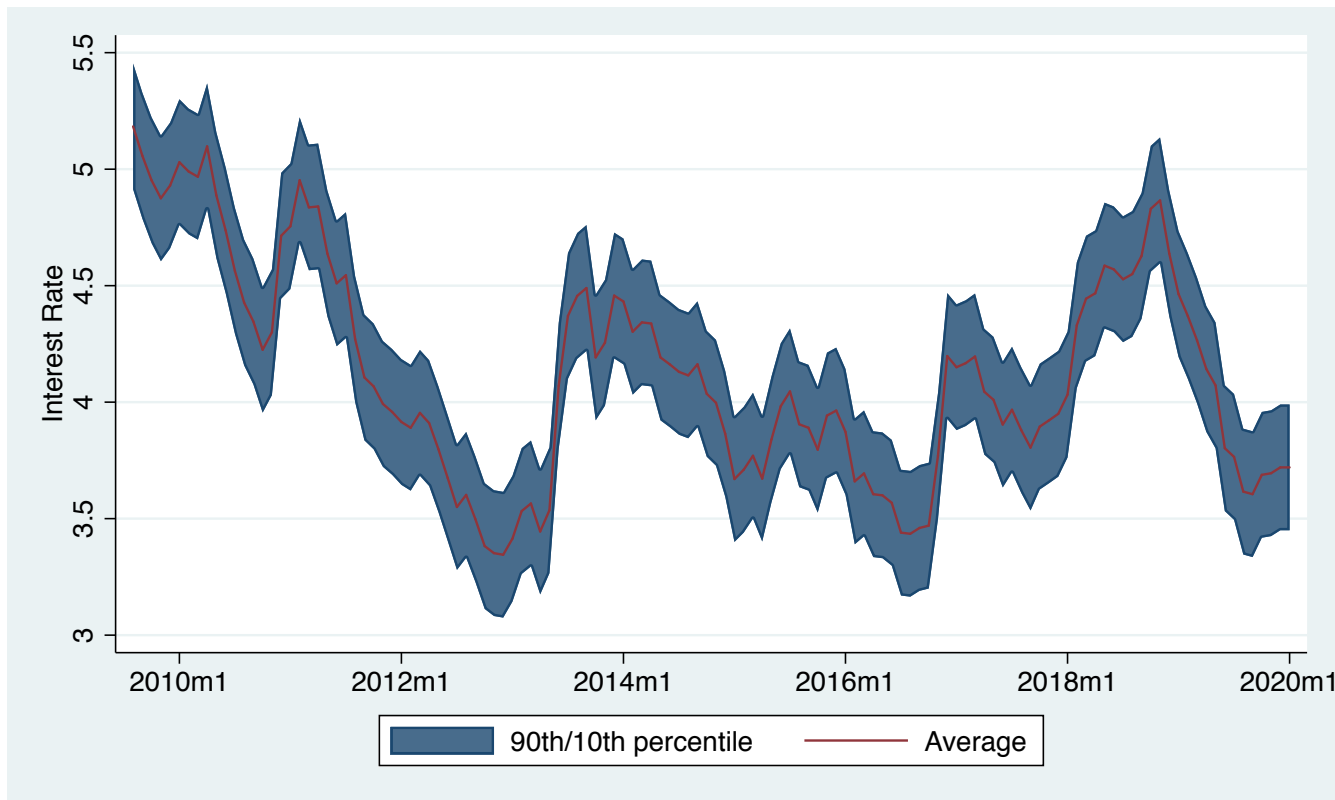
1. Classical search model: buyers know darn well they didn't get the 10<sup>th</sup> percentile price but find it too costly to find it.
2. Rational Inattention: buyers know they aren't fully informed about extent of price dispersion, but don't think worth getting educated
3. Financial literacy / Exponential Growth Bias: buyers don't understand that 53 bp matters => think they got best rate
4. Naïve about market: buyers don't know that there is price dispersion (e.g., WSJ commenters)
5. Negotiating skill heterogeneity: some weak at bargaining, fooled by price-discriminating loan officer that they got the best rate

# Adjudicating overpaying explanations

- 96% of mortgagors convinced got the best rate!
- Rules out classical search model (“no; but not worth it”) and rational inattention (“not sure if I got best rate; who cares”)
- Behavioral: Results stronger if don’t understand compounding. And if the question is “are you satisfied you got best rate” that increases scope for overpayers to say yes even if they know not best rate
- 2/3 of borrowers think “most lenders would offer me the same rates”
  - ⇒ Has to be strongest explanation. Also clear solutions...
- Not convinced by negotiating explanation, could use more details
  - What is that process like? Take-it-or-leave-it offers? How feasible/frequent?

# Cyclicality

- Dispersion is counter-cyclical
- Gas prices: “up like a rocket, down like a feather”
- Suggests behavioral biases, negotiating?
- But counter-cyclicality is only slight: 7 bp narrowing



# Persistence of Lender/Branch/Officer FEs

- ¿ Fair to say “Try local Loans ‘R Us branch—they have good rates” ?
  - Cheapest lender not persistent.
  - Half of gap is explainable by lender/branch
  - What’s the right emphasis here: Only half? or half?
    - Recommendation still gets you half-way there
  - Why persistence of high markups @ branch level?
    1. Low level of searching => can get away with it for many borrowers
    2. Banks use rates to tilt their portfolios, drive deposits
- “Sorry, we’re just not competitive for that product right now, and yes, we know it.”

# Rate Discounts for Deposits

- Residual 90-10 dispersion in rates within branch is 24 bp
- This magnitude plausibly related to other unobservables.
- Chief candidate: maintaining balance / direct deposit
- Economics: deposits and habits are sticky. Worth giving a 25 bp mortgage discount in exchange for additional sticky deposit
- More likely to happen to high-FICO, higher-education, etc.
- More likely to happen when rates are low and banks are trying to compete on something else besides rates
- Worth looking into prevalence of this kind of thing

# Why hasn't competition fixed this?

- Individualized pricing => search costs
- Price match guarantee doesn't work so well in credit market
- Internet not panacea: Ellison and Ellison (2009) Buchak et al. (2018)
- Should be room for an intermediary to fix this
- ...but price dispersion even with brokers (Woodward and Hall)
- Swiss common loan app, AutoSwitch for UK utilities, etc.
- “A 15 minute call could save you 15 minutes or less.”
- OwnUp





# Conclusion

- Striking facts about shopping, why price dispersion persists, magnitudes
- Large magnitudes (although perhaps underappreciated by borrowers)
- Strongly resistant to classical/full-info/rational models
- Price dispersion has distributional consequences!
- Role for policy and private-sector innovation