CHAZEN INSTITUTE RESEARCH BRIEF

The Reluctance of Homeowners to Refinance

KEY TAKEAWAYS

- ✓ Enticing offers by banks to refinance mortgages are failing to increase participation, with 51 percent of borrowers deciding not to apply.
- ✓ Among all the behavioral factors examined, only suspicion of banks' motives is consistently related to the probability of accepting a refinancing offer.
- ✓ Those who do not apply leave, on average, $8,719 on the table.
- ✓ Failure to refinance is not only costly for the banking sector, but for society as well since lower payments would reduce defaults.

The 2008 housing crisis wreaked havoc on the U.S. economy and, as a result, eroded consumer trust in financial institutions. Years later, researchers are considering, to what extent, suspicion of banking institutions is influencing the decision of borrowers to refinance.

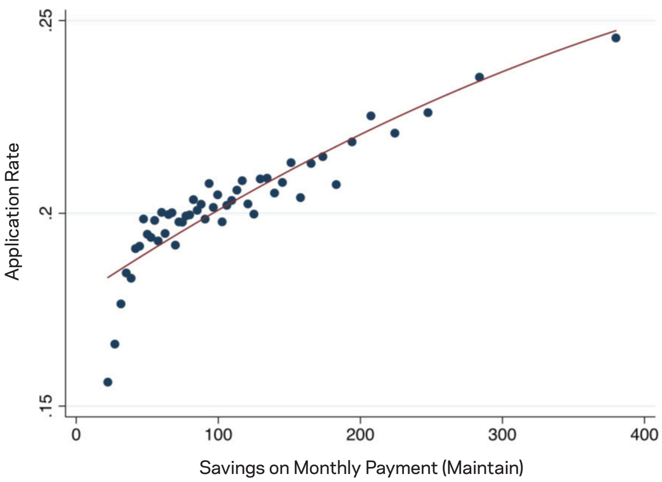
In "What's the Catch? Suspicion of Bank Motives and Sluggish Refinancing," **Stephan Meier, James P. Gorman Professor of Business Strategy and a Chazen Senior Scholar at Columbia Business School**; Eric Johnson, Norman Eig Professor of Business at Columbia Business School; Olivier Toubia, Glaubinger Professor of Business at Columbia Business School; investigate why U.S. homeowners are slow to consider refinancing options even when the terms could save them significant money, and what factors influence their decision not to refinance.

Research

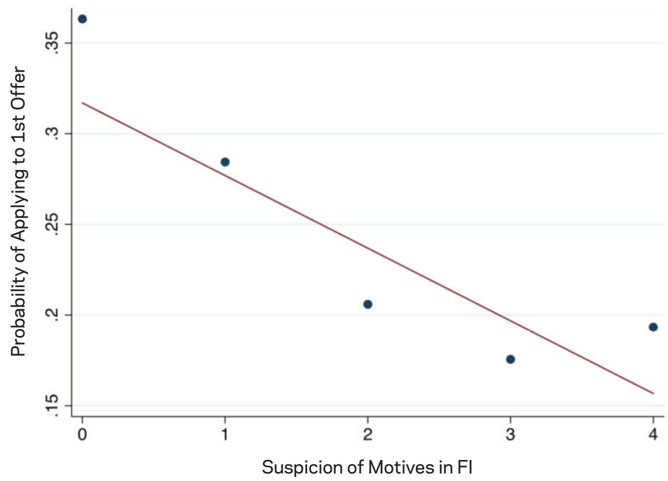
The researchers used administrative data collected from favorable refinance offers (preapproved refinance offers that had no monetary or search costs) sent by a major financial institution (FI) to 550,000 of its borrowers through the Home Affordable Refinance Program (HARP). This allowed them to see at what rate borrowers were likely to apply for a refinance offer under some of the best circumstances.

In a survey of about 4,000 borrowers, which asked respondents to rate how much they agreed or disagreed with statements like "My financial institution will only offer me an option to refinance my mortgage if it is in my best interest to do so," the researchers then sought to identify what behavioral factors might be at play in a homeowner's decision not to take a refinancing offer, even if it would save them money.

Monthly Savings and Application Rates



Suspicious of the Motives of *FI* and Applications



Source: The graphs are produced using binscatter for Stata by Chetty, Friedman, and Rockoff (2014).

In particular, they examined whether suspicion on the part of the household receiving the offer correlated with the rate of people who eventually accepted a refinancing offer.

Finally, the researchers worked with the financial institution (FI) to test whether different refinancing incentives, such as gift card bonuses or cash back guarantees, significantly influenced the outcome of a borrower's decision to refinance.

Results

The data reveals that 51 percent of borrowers who were sent preapproval applications did not decide to refinance their mortgages, a stunningly high proportion given the fact that there were no monetary costs and that the offers were attractive. Those who do not apply leave, on average, $8,719 on the table. While the researchers do not claim, based on this study, that suspicion of banking institutions is the main or only reason that many customers do not accept refinancing offers, they find that the correlation between suspicion and refinancing is robust and significant.

In addition, the researchers demonstrate just how difficult the barriers to refinancing are to overcome. Working with the financial institution (FI), they designed and implemented three interventions to help alleviate borrowers' hesitation. First, they relied on a third party (Fannie Mae and Freddie Mac) to increase the credibility of the offered program. Second, they provided a $500 cash back reward if the process took more than 30 days. Third, they offered an immediate benefit for applying, a gift card. All three interventions failed, suggesting that incentives that try to tackle psychological barriers may be ineffective when consumers are suspicious of banks' motives.

The findings highlight the important role of trust in financial decisions. Without it, the researchers warn that the failure to refinance will not only continue to be costly for the banking sector, but for society as well since lower payments would reduce defaults.

Download the full paper:
https://academic.oup.com/rfs/article-abstract/32/2/467/5001194?redirectedFrom=fulltext

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