Cost Pass-Through and Mortgage Credit: The Case of Guarantee Fees

Ankit Kalda, Gavin Pearson, and David Sovich

ABFER 2025

Discussant: Hyun-Soo Choi (KAIST)

Mortgage Origination and GSE

- GSE is taking a major role in the U.S. housing finance market, particularly these days.
- Unique nature of GSE, having a mandate for affordable housing, coupled with their inability to execute market-quality operations, a fair amount of questions are needed on their actions.
- It is very important to understand well how the fee structure they impose on the market translates to mortgage demand and supply.
- This paper tries to quantify the degree of cost pass-through.

Summary of results

Using the policy change in LLPA in May 2023, the paper finds

- On average, the pass-through rate is 97-99%.
  - Mostly coming through interest rate change (65-68%) (Net upfront fee takes 31-32%)
  - Within net upfront fee change, discount points take the most part, followed by non-point loan fees.

- But it is highly asymmetric and heterogeneous.
  - 129% increase in total loan price for increased LLPA but 70% reduction in total loan price for decreased LLPA.
  - The pattern appears in interest rate changes.
  - Not due to information asymmetry (broker loan, first home buyer), high local market competition, bank vs nonbank

Comment 1: Measurement error in the main variable

Main analysis:

$$P_{i,c,d} = \rho L_{c,d} + \delta_c + \delta_d + \epsilon_{i,c,d}$$

- $L_{c,d}$ is the LLPA Flow, the main variable of interest
- Imputed from loan-level data matching the LLPA matrix on the **delivery date** for LLPA cell (c) and LTV ratio (r).
- Econometrican view: assume that the delivery typically takes a one-month lag.... so the d=t+1, where t is the origination date.
- As a main implication of the paper is the magnitude, not the sign, of the coefficient, the measurement error can be critical in terms of interpretation.

Can we try some different adjustments to see how the results are robust? We can find some upper/lower bounds of the effects, then.

Comment 2: Reverse causality

Where does the updated LLPA matrix of May 2023 come from?

- Unlikely to be random.
- Possibly administrative decision (i.e. policy consideration)

- Authors seem to claim that the changes were not due to the changes in expected credit or prepayment risk of GSEs.
  - I kind of agree, but the arguments against are not as strong.

(1) Flow LLPA is not associated with additional defaults or prepayments. (Table IA.7)
  - If the change is due to a change in risk, it should appear in the test with the earlier sample before the changes. Not in authors' window.
  - i.e. 2021 (FHFA explained that this was the time examining possible reoptimization of the model)

(2) They did not adjust risk pricing from 2013-2022.

(3) They did not care about risk pricing to accomplish the affordable housing mandate (Hurst et al., 2016)

Comment 2: Reverse causality

- Some claims on the change in the view of risk pricing.
  - Official announcement of FHFA director, Sandra Thompson.
  - Attempt to use more granular categories, i.e., including DTI (although rescinded eventually)
  - Edward Golding (MIT, Former FHFA head, HUD senior advisor, executive at Freddie Mac): flattening the pricing by credit score is consistent with prepayment risk being higher in the group.
  - Urban Institute (Apr 27, 2023): "updated LLPA grids continue to reflect risk-based pricing principles" despite the flattened fee curves (might reflect updated assessments of credit risk in more stable economic periods)
- It does not need to be perfect. There should be some degree of change due to risk pricing.
- If so, some part of the current magnitude of the effect runs through reverse causality as LLPA increased to accommodate the needed risk adjustment.
- Again, the important contribution of the paper is the magnitude.

Comment 3: Borrowers may not be a passive policy taker

Mortgage Fee Structure Changes: Understand 2023 LLPA Changes

Conventional mortgage rate pricing shifts lower for fair-credit and low-down-payment homebuyers.

By Jessica Merritt | Reviewed by Whitney Blair Wyckoff | Edited by Emily Roth | Oct. 23, 2023, at 12:57 p.m.

How Homebuyers Can Manage LLPA Changes

If you're a homebuyer navigating the changes to LLPAs, Krichmar recommends considering more mortgage scenarios than you might have in the past. For example, you might run the numbers on putting more than 20% down or fine-tuning your credit to get the best rates. Or you might look at low-down-payment options to see how that affects your mortgage interest rate and the cost of buying discount points.

Consider some of the ways you can minimize your LLPA fee:

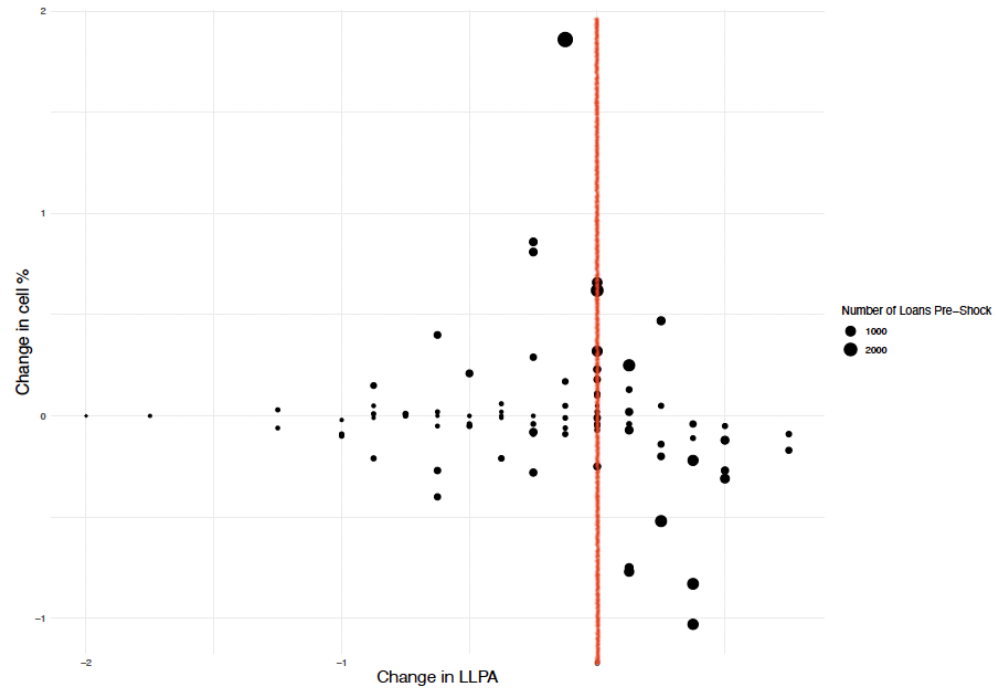
- Improve your credit score, which can lower your LLPA.
- Save for a larger down payment, particularly 20% or more, to reduce your LLPA.
- Get quotes from multiple lenders to find the best terms.
- Consult a mortgage broker for guidance in understanding your choices.

"Now more than ever, make sure you ask for several mortgage options so you can see the difference," Krichmar says.

Comment 3: Borrowers may not be a passive policy taker

- the share of mortgage originations did not change much across the cells (Figure IA.2)

Figure IA.2: Change in the Percent of Loans in Each Base LLPA Cell



Can we see a 2-dimensional matrix regarding the changes in LTV, FICO after the shock by cells? It could be clearer.

Comment 4: Interest Rate and High LTV

Authors report that the asymmetry mostly comes through interest rate adjustment, particularly for the high LTV borrowers with 80% above LTV.

Table 5: Asymmetry of Pass-Through

	Total Loan Price (1)	Interest Rate (2)	Net Upfront Fees (3)	Discount Points (4)	Non-Point Loan Fees (5)	Lender Credits (6)
LLPA Flow	1.29***	0.94***	0.35***	0.23***	0.11**	-0.01
	(0.09)	(0.09)	(0.04)	(0.04)	(0.04)	(0.01)
LLPA Flow × LLPA Decreased	-0.59***	-0.51***	-0.08	0.01	-0.09	0.00
	(0.18)	(0.17)	(0.07)	(0.06)	(0.06)	(0.01)
Cell FE	Yes	Yes	Yes	Yes	Yes	Yes
Month FE	Yes	Yes	Yes	Yes	Yes	Yes
N	84,685	84,685	84,685	84,685	84,685	84,685
R^2	0.50	0.47	0.06	0.04	0.01	0.00

Table 7: Asymmetry Within Credit Score and LTV Subsamples

	Total Loan Price			
	(1)	(2)	(3)	(4)
LLPA Flow	1.28**	1.43***	1.01***	1.40***
	(0.11)	(0.22)	(0.11)	(0.09)
LLPA Flow × LLPA Decreased	-0.60***	-0.68*	-0.21	-0.73***
	(0.11)	(0.34)	(0.20)	(0.22)
Subsample	Low Score	High Score	Low LTV	High LTV
Cell FE	Yes	Yes	Yes	Yes
Month FE	Yes	Yes	Yes	Yes
N	42,343	42,342	42,342	42,343
R^2	0.49	0.46	0.50	0.49

Significant differences? Potentially useful to think about the channel.

Minor Points

- Consistency of LLPA Flow/Flow LLPA
- Particular reason for picking Nov 2022-Nov 2023 window?

Conclusion

In sum, I think this is a great paper.

- Really enjoyed reading and learned a lot.
- Very tight identification and detailed discussions on every aspect, making my job as a discussant hard.
- Wish for good luck for the publication in the top journal.