Researchers analyze deceptive ads for home loans

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Lenders used misleading tactics in advertising home loans during the U.S. subprime mortgage crisis, according to a new study by a UT Dallas professor.

Dr. Umit G. Gurun, professor of accounting and finance in the Naveen Jindal School of Management, co-authored "Advertising Expensive Mortgages," recently published online in the *Journal of Finance*.

According to the study, borrowers spent on average $7,500 more on a $250,000 mortgage when taking an advertised "low-rate" mortgage, compared to an identical mortgage that was not advertised.

A significant number of these advertisements were misleading—explicitly displaying initial low interest rates without mentioning higher reset rates. For example, a January 2007 ad in the New York Post touted a mortgage company that was "specializing in the 1 percent mortgage," and offered the "lowest fixed rates available." However, the ad failed to highlight that such loans had a reset rate, which is a much higher interest rate a borrower should pay after the reset date.

The researchers classify these types of advertising as "deceptive ads" and concluded the lenders used this method to attract customers who did not realize the rates would substantially increase after a few years. In an analysis of 40,000 advertisements, the researchers found only a handful of them clearly communicated the reset rate and conditions.

"People cannot make these comparisons easily without all the relevant information, so they are more likely to choose something that seems like lower interest at the beginning, but overall it costs them more," Gurun said.

In addition, the study determined that lenders used deceptive ads more in areas with higher rates of minority, less-educated and poor borrowers.

Gurun, an expert on advertising financial products, said the detailed look at whether advertising helped consumers find cheaper mortgages is unprecedented.

"These consumers are borrowing, and they don't really know at what rate they are borrowing," Gurun said. "If they knew how costly this could be in the future—if they did the math—they would decide otherwise."

Gurun said that the researchers wanted to determine the cause of the financial crisis and why people took mortgages when they couldn't pay them. The researchers anticipate the study will help predict potential housing price bubbles and decipher their triggers.

Dr. Gregor Matvos and Dr. Amit Seru, both of the Booth School of Business at the University of Chicago, were co-authors on the paper.

Next, the team plans to look at insurance premiums and other types of financial products that consumers buy potentially without understanding the underlying premise.

"People need to better understand financial products," Gurun said. "Consumers don't reconsider the initial factors that made them buy a financial product with certain features, such as life insurance. People should think about these issues on a regular basis and comparison-shop to see what the advantage would be to switch providers. That kind of involvement in the market can save you a lot of money."

More information: UMIT G. GURUN et al. Advertising Expensive Mortgages, *The Journal of Finance* (2016). DOI: 10.1111/jofi.12423

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