All-cash home buyers pay 10% less than mortgage buyers, study finds

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Owning a home has long been considered a crucial way to build wealth, but making such a purchase has become increasingly difficult for many residents. In addition to steep housing prices and high interest rates, there have been a growing number of all-cash buyers who can close a deal quickly, beating out competing offers from buyers who need to finance their home with a mortgage.

The convenience and certainty of all-cash offers appeals to sellers so much so, that they pay on average 10% less than mortgage buyers, according to a new study from the University of California San Diego Rady School of Management.

"When sellers accept a mortgage offer, it comes with risk," said Michael Reher, study co-author and assistant professor of finance at the Rady School of Management.

"There is a risk the deal will fall through because there's a third-party mortgage lender who needs to approve the loan for the borrower and there are other caveats such as issue the appraisal, or inspection, which is why around 10% of transactions fail when the buyer is paying with a mortgage. We find sellers are willing to leave money on the table to avoid the risk."

The study, titled "The Mortgage-Cash Premium Puzzle" appearing in the *Journal of Finance*, finds that while 10% is the average difference between mortgage and cash buyers, it does not necessarily apply to all buyers who need to purchase a home with a loan. For example, mortgage buyers with a relatively good borrowing profile pay only 6% more than all-cash buyers, especially if the sale is taking place in an area where most real estate transactions are successful.

In areas where there may be more low-income buyers and mortgage transactions carry greater risk, a mortgage buyer can expect to pay up to 17% more, if the seller has a competing offer from an all-cash buyer.

"Considering that about a third of home purchases are all-cash deals, these differences are highly relevant for real estate market participants," said Rossen Valkanov, study co-author and professor of finance for the Rady School.

He added that understanding the "cash discount" in real estate is important because it highlights the friction between mortgage buyers and sellers.

"In policy terms, U.S. taxpayers subsidize $8 trillion of mortgages to promote home-ownership," Valkanov said. "If policymakers made it easier for mortgage buyers to close escrow, it could be a more cost-effective route to promoting home-ownership than subsidizing mortgages for first-time home-buyers."

An example of reducing friction between mortgage buyers and sellers could be reducing the degree of "ambiguity" about the home sale process, from the standpoint of home sellers. This could potentially be achieved by requiring listing agents to make sure that home sellers are well-informed about the amount of risk and the time to close when accepting an all-cash versus a mortgaged offer.

"At the time a mortgage offer is submitted, a listing agent can disclose an easy-to-understand statistic, such as: 'over the last 12 months, 97% of mortgage offers resulted in a sale after 60 days,'" Valkanov said.

The implications of a liquid housing market edging out many first-time buyers

Most first-time home buyers have to finance the purchase with a mortgage and the 10% "cash discount" all-cash buyers receive represents another hurdle in a competitive real estate market. In California for example, where inventory is low, the average age of the first-time homeowner is now almost a decade older compared to the 1980s.

But it has other implications for real estate. The increase in buyers with deeper pockets choosing to finance homes with cash because of higher interest rates also equates to a greater number of buyers possibly getting real estate at prices below the property's actual value. Therefore, a liquid housing market with more all-cash buyers may erode the value of real estate as a savings vehicle, the authors note.

Reher and Valkanov embarked on the study after they both had experienced mortgage offers to homes being rejected because sellers went with an all-cash offer instead.

They replicated the findings in three different studies with the first assessing data from 2 million home sales across more than 90% of U.S. counties from 1980 to 2017. The data from county recorder offices revealed that mortgage buyers paid on average 11% more than all-cash buyers.

The second study utilized data from Redfin which provided the authors with information on more than 20,000 home sales as well as offers on homes that were sold from 2013 to 2021. This data set revealed mortgage buyers paid 8% more than all-cash buyers.

The third study involved an experimental survey designed by the authors where they asked 3,000 independent homeowners to imagine scenarios where they had to sell their home and received two competing offers—one from a mortgage buyer and one from an all-cash buyer.

The responses revealed that the participants would only accept the mortgage buyers offers if they had paid on average 10% more than the all-cash buyer.

More information: The Mortgage-Cash Premium Puzzle, *The Journal of Finance* (2024). papers.ssrn.com/sol3/papers.cf … ?abstract_id=3751917

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