Stuck at Home: Mortgage Rates and the Endowment Effect

Is home really where the heart is, or in today's financial climate, has the adage evolved to "home is where your low mortgage rate from three years ago is?" Anecdotally, in conversations with financial advisors, I've heard the same story several times: Clients feel stuck in their homes because they don't want to give up their existing low-rate mortgages for the much higher mortgage rates available today.

It's something I've experienced personally as well. My wife and I were fortunate enough to renovate our house five years ago, and when a guest recently asked if I was happy with our choices, I found myself saying something like, "I am, and I hope I continue to be because we are stuck here!"

Many others seem to feel the same way. A recent survey found that 82% of potential home sellers felt "locked in" to their current homes precisely because of the low interest rates that they possessed.[1] There are many times, of course, when it makes sense to stay even if you'd like to move.

If you previously locked in a low rate, for example, but haven't amassed the capital necessary to upgrade, then moving would most likely mean going to a less desirable home in a similar neighborhood or a similar home in a less desirable neighborhood. Here, we might say there's a certain rationality to staying put: It may be better to wait to move until rates come down or your savings go up.

However, moving could be beneficial in some scenarios, even if it means accepting a higher mortgage rate. If you've saved enough money and can afford a higher monthly mortgage payment, relocating to a home that improves well-being could be worthwhile despite the increased costs. Staying in your current house just because you have a low mortgage rate, despite wanting and being able to afford a better place, might be considered less than rational.

Why might this latter case of "stuckness" arise?

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This reluctance to move might be a manifestation of the “endowment effect,” a psychological phenomenon where people value what they own more than what they don't. It’s a perspective that’s been put forth by others, including Annie Duke.[2]

Understanding the Endowment Effect and Its Impacts on Everyday Life

The endowment effect is one of those rare academic topics that’s made the leap from dusty psychology and economics journals to everyone else. It shows up when we attempt to place a value on something we own and might get rid of or sell. Classic studies have used mugs, finding that people who *own* a mug price it higher than potential buyers are willing to pay for the same mug. I’m sure you’ve noticed the same phenomenon if you’ve ever tried to sell an old item of furniture online. I normally start the process by saying, “$150 for this old stroller is a steal!” and end with, “OK, I guess $25 is fair.”

The story of why the endowment effect arises often revolves around loss aversion. We strive to avoid the negative emotions associated with loss, and parting ways with something we already own can feel like a major one. But a newer body of work led by Carey Morewedge points to another explanation as well: psychological ownership.[3]

The gist is that owning something produces a link between that thing and the self. We value ourselves, so we transfer some of that value onto the thing itself.

Of course, a mortgage rate I locked in several years ago may be very different from a mug or an old stroller. But some of the same principles can apply whether we’re talking about a physical object or something that’s more of an idea.

Strategies to Overcome the Endowment Effect and Make More Rational Choices

There are a few different ways that we can try to put the brakes on our tendency to hold on to old things — or mortgage rates — simply because they are ours.

First, you might try taking an “outside view.” Imagine that a friend of yours had the same dilemma as you. They have a low-interest mortgage rate but have the capital to move, and moving might make a real difference to their quality of life. Would you advise them to stay or go? Are you any different from that friend?

This is a strategy that I commonly tell my students to employ when they are grappling with sunk costs. The lesson is that sunk costs are a thing of the past, and we should make decisions moving forward based on the future and not what came before. A similar lesson applies to our sense of ownership over earlier interest rates.

Second, consider whether you are the same person now as you were several years ago when you locked in at that rate. New research suggests that highlighting how someone has changed from the past to the present can help them make a fresh start and not get bogged down by previous decisions.[4]

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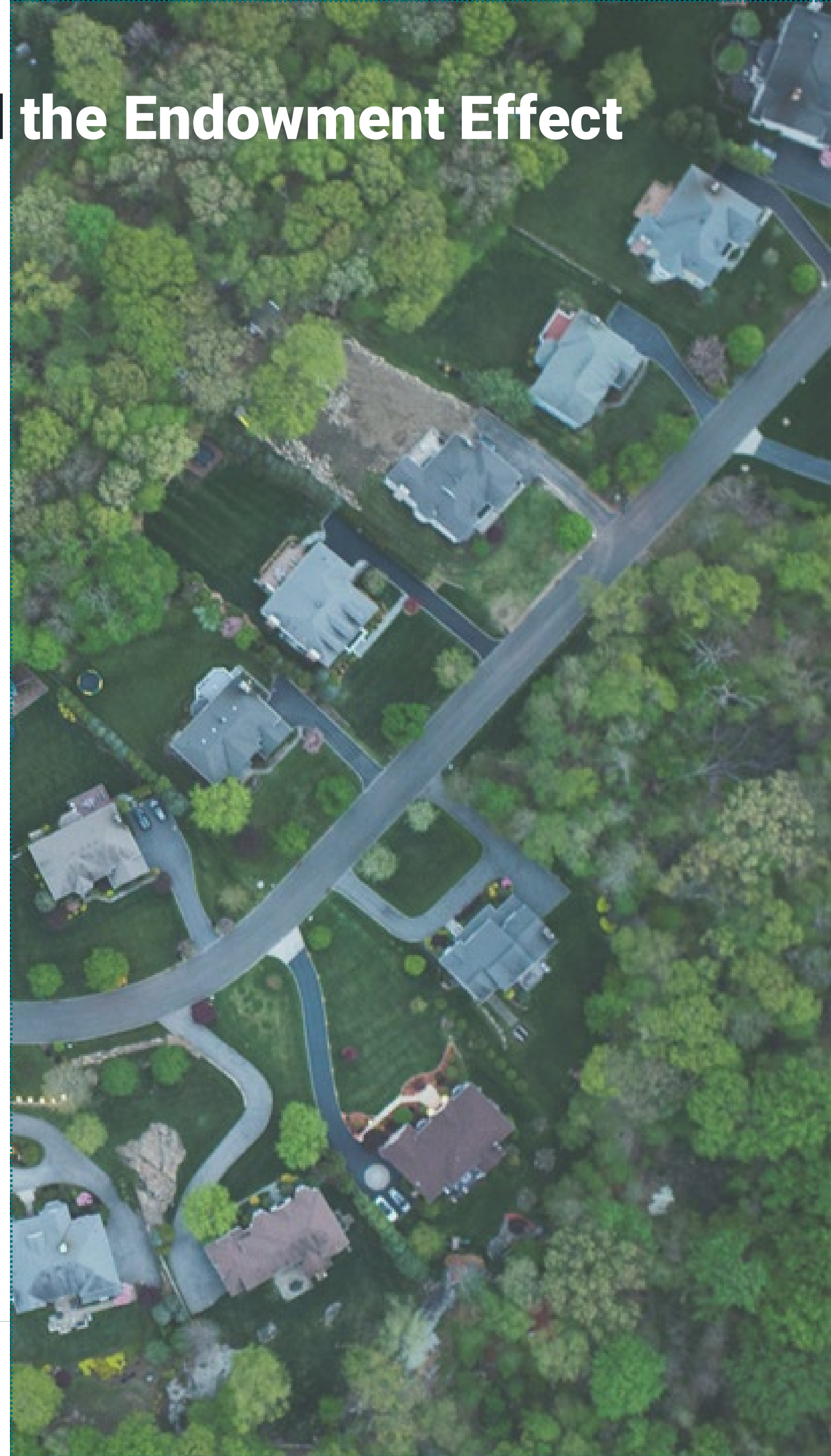

Finally, it can be easy to allocate a disproportionate amount of our attention to a specific mortgage rate. After all, it's a salient, numerical piece of information. But our well-being is impacted by more than just the money we spend and the money we make. So, it may be useful to consider factors other than monthly mortgage payments when deciding whether to move or stay. For instance, how much would you pay to save time commuting to work or friends' houses?

It's not that these are all perfect solutions to dealing with the endowment effect, but taken together, they can help grease the wheels to (slightly) more rational decision-making.

Endnotes

[1] Realtor.com, "Sellers Survey: 82% of Those Looking to Buy and Sell a Home Feel "Locked In" by Low Mortgage Rage," April 17, 2023.

[2] Joe Pinsker and Callum Borchers, "You've Never Had It So Good. That's Why You're Stuck," *Wall Street Journal*, October 13, 2023.

[3] Carey K. Morwedge and Colleen E. Giblin, "Explanations of the endowment effect: an integrative review," *Trends in Cognitive Sciences* 19, No. 6 (June 2015): 339-348.

[4] Anja D. Schanbacher, Nazli Gurdamar-Okutur and David Faro, "It's no longer 'me': Low past-self-continuity reduces the sunk-cost bias," *Journal of Experimental Social Psychology* 95 (July 2021); 104146.