Advertisement

Real Estate Economics / Volume 33, Issue 4 / pp. 595-617

The Effect of Refinancing Costs and Market Imperfections on the Optimal Call Strategy and the Pricing of Debt Contracts

Kenneth B. Dunn, Chester S. Spatt

First published: 16 November 2005

https://doi.org/10.1111/j.1540-6229.2005.00132.x

PDF

Abstract

This article, which was originally written in 1986, develops a methodology for valuing mortgage-backed securities with refinancing costs. We solve simultaneously for the valuation of the mortgage-backed security (loan) and the borrower's refinancing strategy, pricing all coupon levels simultaneously. Because the borrower may refinance his or her loan and incur costs at many times in the future, the optimal refinancing decisions arise from an optimal dynamic strategy that reflects the costs of all potential future refinancings. Though the borrower faces multiple rounds of refinancing costs, the market value of the loan cannot exceed the call price plus a single round of refinancing costs.

References

Bennett, P., R. Peach and S. Peristiani. 2001. Structural Change in the Mortgage Market and the Propensity to Refinance. *Journal of Money, Credit and Banking* **33**: 955–975.

Google Scholar

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Web of Science® Google Scholar

Dammon, R. and C. Spatt. 1996. The Optimal Trading and Pricing of Securities with Asymmetric Capital Gains Taxes and Transaction Costs. *Review of Financial Studies* **9**: 921–952.

Web of Science® Google Scholar

Dunn, K. and J. McConnell. 1981a. A Comparison of Alternative Models for Pricing GNMA Mortgage-Backed Securities. *The Journal of Finance* **36**: 471–484.

Web of Science® Google Scholar

Dunn, K. and J. McConnell. 1981b. Valuation of GNMA Mortgage-Backed Securities. *The Journal of Finance* **36**: 599–616.

Web of Science® Google Scholar

Dunn, K. and C. Spatt. 1985. An Analysis of Mortgage Contracting: Prepayment Penalties and the Due-on-Sale Clause. *The Journal of Finance* **40**: 293–308.

Web of Science® Google Scholar

Dunn, K. and C. Spatt. 1988. Private Information and Incentives: Implications for Mortgage Contract Terms and Pricing. *The Journal of Real Estate Finance and Economics* **1**: 47–60.

Google Scholar

Dunn, K. and C. Spatt. 1999. Call Options, Points and Dominance Restrictions on Debt Contracts. *The Journal of Finance* **54**: 2317–2337.

Web of Science® Google Scholar

Elton, E. and M. Gruber. 1971. Dynamic Programming Models in Finance. *The Journal of Finance* **26**: 473–505.

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Hendershott, P., S. Hu and K. Villani. 1983. The Economics of Mortgage Terminations: Implications for Mortgage Lenders and Mortgage Terms. *Housing Finance Review* **2**: 127–142.

Web of Science® | Google Scholar

Ingersoll, J. 1977a. A Contingent-Claims Valuation of Convertible Securities. *Journal of Financial Economics* **4**: 289–321.

Web of Science® | Google Scholar

Ingersoll, J. 1977b. An Examination of Corporate Call Policies on Convertible Securities. *The Journal of Finance* **32**: 463–478.

Web of Science® | Google Scholar

Kalyman, B. 1971. The Bond Refunding Problem with Stochastic Interest Rates. *Management Science* **18**: 171–184.

Web of Science® | Google Scholar

Kraus, A. 1973. The Bond Refunding Decision in an Efficient Market. *Journal of Financial and Quantitative Analysis* **8**: 793–806.

Web of Science® | Google Scholar

Kraus, A. 1983. An Analysis of Call Provisions and the Corporate Refunding Decision. *Midland Corporate Finance Journal* **1**: 46–60.

Google Scholar

Richard, S. and R. Roll. 1989. Prepayments on Fixed-Rate Mortgage-Backed Securities. *Journal of Portfolio Management* **15**: 73–82.

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Web of Science® | Google Scholar

Timmis, G.C. 1985. Valuation of GNMA Mortgage-Backed Securities with Transaction Costs, Heterogeneous Households, and Endogenously Generated Prepayment Rates. Working Paper. Carnegie Mellon University , Pittsburgh , PA .

Google Scholar

Vu, J. 1986. An Examination of Corporate Call Behavior of Nonconvertible Bonds. *Journal of Financial Economics* **16**: 235–265.

Web of Science® | Google Scholar

Weingarten, H.M. 1967. Optimal Timing of Bond Refunding. *Management Science* **13**: 511–524.

Google Scholar

Citing Literature

Download PDF

ABOUT WILEY ONLINE LIBRARY

Privacy Policy
Terms of Use
About Cookies
Manage Cookies
Accessibility
Wiley Research DE&I Statement and Publishing Policies

HELP & SUPPORT

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences
Accept All
Reject Non-Essential

CONNECT WITH WILEY

The Wiley Network

Wiley Press Room

Copyright © 1999-2026 John Wiley & Sons, Inc or related companies. All rights reserved, including rights for text and data mining and training of artificial intelligence technologies or similar technologies.

WILEY

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential