

# A new dawn of yes

**It's the bane of brokers' and borrowers' lives, the moment a lender says no and doesn't say why. But an alternative is emerging. Sarah Davidson examines who's saying yes to borrowers**

**Ever feel like punching** your computer? You're not alone.

"Computer says no" syndrome is maddening, especially when any sensible person can see it's a ridiculous and illogical response to a perfectly good borrower. But say no the computer does.

A massive 92% of mortgage lending in 2010 was done by the largest six lenders in the UK – Lloyds Banking Group, Royal Bank of Scotland, Nationwide, Barclays, Santander and HSBC. That is despite Trigold listing 78 different lender brands in the market.

The big six are all highly dependent on automated credit scoring to judge whether to accept a borrower or decline them. It's a reasonable system and they will tell you it's better than any other form of underwriting at predicting future default probabilities.

That's as may be. But while there continues to be limited funding, frozen wholesale mortgage markets and a severely limited appetite to lend, computer credit scoring is also a black box to lose good but nevertheless unwanted customers in.

Demand is high enough and supply restricted enough that lenders can cherry pick the best unblemished customers from the top of the heap while still hitting their lending targets.

The flipside is that everyone else is turned away. It's infuriating for brokers and it's life-altering for borrowers. But the market is beginning to find a home for these people. Lenders around the edges of the market are picking up quality borrowers who have been turned down by the high street.

Instead of computer says no, it's

underwriter says yes. David is fighting back against the Goliaths of the high street.

But you have to know where to go. It's not as simple as plugging in your client's requirements to a sourcing system. Mortgage broking is back – it requires skill, knowledge of underwriting and lenders' risk appetites and relationships.

## BROKING IS BACK

"In a competitive world, one where consumers are able to see competing deals on various websites, it's understandable that brokers will succumb to the temptation to use the cheaper mainstream lenders," explains Alan Lakey, principal at Hertfordshire-based Highclere Financial Services.

"However I find increasingly that a stringent obedience to foolish rules and rate-driven cherry picking is making it less likely that the usual suspects will assist my clients."

Tom Cleary, financial services director at London-based Start Financial Services, agrees. "We don't always head for the main lenders but it is difficult bearing in mind that 92% of all residential mortgage lending is through six lenders," he says. "The most competitive rates are only available through the big guys and that is why the smaller lenders have to offer products that are more creative."

And they are being creative, though not necessarily by designing fancy products. More often than not it's about using common sense to make a lending decision.

"The smaller lenders offer more human underwriting not just box ticking, which is usually more reasonable and user-friendly," Melanie Bien, director of Private Finance, says. "They also show more willingness to understand a case and be helpful, perhaps partly because they are dealing in lower volumes and so have more time to spend. Cases tend not to be rejected out of hand which may be the case with some of the bigger lenders."

Despite this, there is still hesitance among brokers about using the Davids of the mortgage lending world rather than just heading for the Goliaths.

Gemma Harle, managing director of network TenetLime, says the reason brokers rely on the big lenders is because of trust. "Brokers are using the smaller players but not universally as some do not have as much confidence in more unknown lenders," she explains. "Information about sourcing products tends to be less readily accessible."

"But these lenders seem able to make more balanced decisions on cases rather than adopting a hard and fast approach to underwriting. The product innovation is also better such as the Coventry 5-year flexible fixed product and the Clydesdale high net worth products."

## SIZE DOESN'T MATTER

Rob Killeen, director at London-based broker Capital Fortune, says he has found it pays to consider the smaller players.

"On product and on criteria, there is a mainstream whisker between the major lenders but niche cases often can be secured by looking at the mutuals, specialist lenders and private banks," he says.

"Specialist and mutual lenders are sometimes prepared to take a holistic rather than a tick box approach and we have successfully placed cases with the underwriter, who often doubles up as the bank manager."

"It can be refreshing to obtain a decision in principle from a vote of the full meeting of an executive committee, rather than an automated answer from a computer."

The lenders he's referring to come in all shapes, sizes and even nationalities. Of the plethora of smaller regional building societies and intermediary players, brokers name Accord, Aldermore, Bank of China, ING Direct, Paragon, Coventry, Kensington and Precise Mortgages as among the most willing to listen to the details of a case.

Peter Williams, executive director of the Intermediary Mortgage Lenders Association, says its members are finding the stringent credit scoring at the big six lenders offers them an opportunity.

"IMLA members are clearly pitching into the niches developing around the big six," he says. "They're working off the tight

scores used by them and are instead using the opportunity for fuller underwriting on borrowers. They are finding good credit risk despite these borrowers perhaps not fitting the bill for the standard lenders."

Sally Laker, managing director of network Mortgage Intelligence, agrees. "Smaller lenders like Kensington and Precise, mutuals and foreign lenders like Bank of China are prepared to be more innovative on product and the types of borrower they'll consider," she says.

"Brokers are using them slowly but surely and they are very much needed to offer a bit more choice especially outside of the bog standard 60% loan to value perfect credit customer."

"The volume is not there yet for some of the newer lenders but that is a combination of pricing, access and awareness. Not all intermediaries are fully aware of the criteria and availability of funds through some of these lenders, and it takes longer in the current climate to get that awareness out there."

## KNOW YOUR NICHES

Understanding each lender's appetite and preference is becoming increasingly important for brokers. Different lenders want different types of customer and broking deals requires insight.

Nigel Stockton, financial services director at national mortgage brokers Countrywide, says identifying those niches is key.

"Kensington is building a niche market for the self-employed," he explains. "Some of their products need only one year's trading accounts, compared to three for the prime lenders. They also use LTV to differentiate their proposition in the buy-to-let sector. Precise is using short-term and bridging alongside other smaller lenders to gain volume, whilst Borro is using asset-backed borrowing options."

He believes brokers should be considering how the market fits together as a pattern of niches if they are to place the non-vanilla deals successfully.

Dominik Lipnicki, director of Your Mortgage Decisions, explains another niche is "near prime" – customers with



minor credit blips in their pasts that have been resolved.

"Many of these new players make an impact by targeting niche needs in the market, offering clients with minor financial hiccups an opportunity to borrow," he says.

"The past three years have seen a severe tightening of the criteria for borrowing - so much so that consumers who would have received a warm welcome anywhere on the high street before are now left out in the cold by everyone. Many brokers have a tendency to stick to what they know and are slow to start using new lenders. They get used to application processes and criteria whereas new lenders can take them out of their comfort zone.

"However some new lenders have themselves to blame as they fail to understand the intermediary market. Bank of China's impractical pre-requisite of face-to-face interviews with clients before making a decision to lend is just one example."

Matthew Fleming-Duffy, director of Bournemouth-based broker Abacus Financial, is on the same page as Lipnicki.

"The large lenders do appear to be stuck in rigid process currently which

means that some can be extremely difficult to deal with, particularly when presented with first-time buyer cases," he says.

"But I have used Leeds from time to time with no problems and found them easy to deal with. Our local BDM is knowledgeable and knows lending policy inside out. Also, they will lend to age 85 which is handy in some cases and they have underwriters you can actually speak to."

He also notes Bank of China's "very strange application process" but does acknowledge they are in the market to lend.

#### MUTUALS MATTER

Most brokers agree however, that it's the building societies which are performing an increasingly vital role in the mortgage market. Accord, Buckingham, Harpenden, Hanley Economic, Coventry, Leeds and Skipton are all making efforts to help borrowers get a mortgage when the high street brands turn them away.

Though many mutuals will assess a deal and price for risk if they know the broker, it's not always about finding a home for non-standard borrowers.

Skipton's head of products, Kris

Brewster, says there's a balance to be struck. Underwriting deals sensibly doesn't mean he's looking for deals that aren't prime.

"As a mutual, we are working hard to offer people great value mortgages," he says. "But it's fair to say that in doing so we are in competition with bigger lenders for prime residential business. After all, this is our bread and butter and we play an important role in driving the competitiveness of the market.

"But, importantly, we also aim to be as innovative as possible as demonstrated by our 95% mortgage at 5.99% and our return to buy-to-let lending. Our responsible approach to lending allows us to compete in this space and we believe that smaller players such as ourselves are in a good position to support customers in these niche markets not currently being utilised by larger lenders."

Dale Jannels, managing director of All Types of Mortgages, says mutuals have been the mainstay for their business in recent years.

"Some companies already had a great rapport with local mutuals, which tended to service their local areas assisting with unusual cases normally for the elderly, cross collateral charges, guarantors, or

**Taken together, these two pieces of research create a picture of dominant lenders who are cherry-picking the business they're willing to accept, but are not adequately addressing the needs of tens of thousands of borrowers who may be creditworthy but don't match their rigid lending criteria.**

**This was exactly why Aldermore decided to launch a residential mortgage business in May last year: to satisfy borrower needs being ignored by high street lenders.**

**We've started by addressing the most obvious market gap: creditworthy borrowers being declined by inflexible and automated credit scoring systems. For example, we discovered that high street lenders were declining perfectly creditworthy applications because borrowers had recently moved home and were not yet on the voters roll; or**

**because they had changed jobs; or were self-employed and generating income from multiple sources; or because they had minor credit issues which had been satisfactorily resolved many years ago.**

**Unlike most other lenders, Aldermore's decision-making is not dependent on credit scoring, but is based on sensible underwriting rules and criteria applied by experienced people. We encourage brokers to talk to us about their clients circumstances and we use our experience to help deserving borrowers obtain a mortgage.**

**We're happy to keep on developing mortgage solutions for borrowers whose needs are not being adequately addressed by the big lenders. The evidence of our first years trading shows we've only just scratched the surface.**

**So watch this space for further new initiatives!**



Highclere's Lakey agrees. "It is certainly true that mutuals are offering far more flexibility than the big five," he says. "The larger lenders trade on name and rate but have shown themselves to be unwilling to consider anything that doesn't fit within their preferred template.

"Building societies such as the Buckingham and the Harpenden are prepared to give individual consideration to cases and not take a rigid computer-driven approach to income, affordability and other matters."

Tom Cleary, financial services director at London-based adviser Start Financial Services, is keen on the range of products offered by intermediary lenders.

"Precise's product range is opening up all the time and they are certainly filling a niche area that other lenders are unable or unwilling to operate in at the moment," he says. "Its near prime range will definitely be invaluable for those clients that have experienced some difficulties during the last three years but still represent good quality lending opportunities at sensible margins. I've also used Kensington recently for buy-to-let business."

#### INTERMEDIARY PLAYERS

Some brokers are clearly engaging with these smaller niche players then but others complain that the reason they head for the big banks is that there's simply no comparison on rate competitiveness.

But Chris Gardner, director at Essex-based broker Obligo, says that's changing. "When Kensington, Aldermore and more recently Precise first came to market the products were pricey and the additional risk that was accepted was marginal," he says. "In recent months the products have improved dramatically and we have had several occasions to use them. We have found the service good and the promise of individual underwriting a true statement. At this point in the recovery of the market you cannot ask for any more."

Ben Thompson, managing director of Legal & General's mortgage club, explains that because these lenders are offering mortgages to borrowers turned down by the high street lenders, they are right to be charging slightly more.

"These deals are more expensive but the additional cost reflects the perceived increased risk that the lender is taking on by lending a mortgage to an individual with a less than perfect credit record," he explains.

"However to put this in perspective, at time of writing, a 2-year fixed product for a squeaky clean credit record would be circa 3.24% whereas a borrower with minor blemishes would be able to borrow at 4.98%. The difference is 1.74% however the actual charge rate is still only 4.98% which is very cheap indeed by historical standards.

"Even though mortgage underwriting and lending terms have tightened significantly over the last three years, good advisers are still able to occasionally present a case so well that although it might appear to be near prime it can actually be secured on more standard or cheaper terms."

#### CUSTOMER PROFILE

So what sort of clients should brokers be thinking about recommending these lenders to? Is it near prime? Or prime when the computer says no?

It's both. The need these lenders are trying to cater for is wider than a label but essentially the thing all of these borrowers will have in common is that for whatever reason, they don't fit into lenders' boxes.

Uniformity is the name of the high street game now but brokers know that every customer is individual. That's what the smaller lenders are trying to recognise.

"Anything more complicated in terms of income or the property we would tend to take to the smaller players, mutuals or private banks," says Melanie Bien. "If the borrower is wealthy, then the private banks are often the best solution and are much easier for brokers to deal with as they get to know the client so problems tend to be rarer.

"If the client has any issues with their credit file, even if these are now resolved, then some of the smaller lenders who have a human face to their underwriting, tend to be a better option."

Chris Gardner says brokers should be pragmatic.

"It's vital that on every application that ▶



by Charles Haresnape, managing director, Aldermore Residential

**Research published by Moneyfacts in February this year confirmed that the UK's seven biggest mortgage lenders including Lloyds banking Group, Santander and HSBC, have a 75% market share but account for only 29% of the top 500 mortgage deals.**

**More recently L&G and the Association of Mortgage Intermediaries published research confirming that, of the 3.4 million borrowers who plan to apply for a mortgage over the next 12 months, only a third are confident that they would actually be able to get a mortgage.**

we seek to find the most cost effective solution for our customers," he says. "In practice, that has to mean approaching the mainstream market and exhausting that route first on the basis of cost.

"However once we know the case has to move out of the mainstream it's a case of finding the most appropriate deal from a lender prepared to lend. A good example of this was a customer who wished to purchase a property but had a default registered by a mobile phone network five years ago for £120 - affordability was well within limits, the LTV was just 40%, and track record on all other credit was spot on (including the existing mortgage but because of this default the existing lender didn't want to do the new deal!).

"It failed score elsewhere, however both Kensington and Aldermore were prepared to do the case on the basis of the whole case not just an arbitrary credit score."

Alan Lakey gives several examples of what he calls "foolish underwriting practices" he's seen his clients endure.

"One lender refused to consider any income generated by a tax-efficient employee benefit trust," he says. "Another ignored a salary of £75,000 because this resulted in my client's company making a smaller loss; another ignored the £120,000 net profit of a limited company because the sole director had not taken a salary or dividends."

All are good examples of a reason to take clients to the smaller players.

#### COMPETITION WELCOMED

So what does Goliath think about all of these Davids in the market?

Jeremy Duncombe, head of sales at Abbey for Intermediaries, says competition is to be welcomed.

"As the biggest intermediary lender supporting the market, we believe in a strong mortgage market and we welcome competition that will support intermediaries and borrowers."

David Finlay, Barclays intermediary managing director, agrees. "It is great to see that activity in the mortgage market is increasing," he says. "We welcome the move towards a more competitive landscape with more players, even smaller

lenders, looking to offer lending solutions to borrowers that we, as a provider, do not wish to pursue at the moment.

"In my view, the market needs to be made up of a mix of big providers and smaller lenders and between us we should be offering a spectrum of lending solutions to the market which meets both customers' and lenders' needs within the current financial and regulatory framework."

Start's Tom Cleary agrees that diversity is vital for brokers. "As intermediaries we want to see as diverse a mortgage market as possible as this will present us with the edge over our direct competition," he explains. "We have access to ING which has proved invaluable as our foil to HSBC."

"We want as many lenders as possible to give us the widest possible spread to offer our clients. The benefit to our clients is our advice, so the more complex their situation, the more valuable we become."



by Alan Cleary, managing director, Precise Mortgages

**My intelligence tells me that many of the high street banks are starting to fall behind on their mortgage lending targets and this may well have a positive effect on the intermediary market. The last three years have seen the high street banks fill their boots with sub 60% LTV prime business at margins approximately 10 times greater than pre-credit crunch levels.**

**Some of the high street lenders could comfortably meet their lending aspirations through their direct operations and as such we started to see dual pricing and dual criteria become more prevalent as they sought to reduce their reliance on brokers.**

**As the high street banks begin to struggle with volumes they will inevitably start to put products out that move higher up the LTV curve and**

Mutuals and smaller intermediary lenders are moving in the right direction but Lipnicki identifies some areas of the market that are still underserved.

"We would welcome a more sensible approach to LTV that includes more 95% schemes - especially in the remortgage market," he says. "While areas in the south are recovering, many others are going through a property price double dip with clients languishing on Standard Variable Rates without any hope of securing a better deal. New lenders also need to be serious about the intermediary sector and employ BDMs to spread knowledge about their products. We can't use them if we don't know what they have to offer."

It would be ludicrous to suggest regional building societies and smaller lenders are winning the battle against the high street's Goliaths just yet, but they are fighting their corner and creating competition in a market desperately in need of it. ■

**they will conveniently become more intermediary friendly. Even as this occurs there will be parts of the market that will not be served by the high street either because the volumes are too small or because the credit risk is outside of their appetite.**

**Precise Mortgages focuses on the near prime market and short-term lending, our strategy is to identify markets that have the right risk reward profile for our business. There are literally millions of customers who can't get a mortgage on the high street due to some form of issue in their credit history and we have the most comprehensive set of products of any lender for this type of customer.**

**Our near prime range has rates from as low as 4.87% which seems pretty reasonable given that these customers would otherwise be locked out of the mortgage market. This unlocks a significant group of customers that can only be dealt with by intermediaries as there is no chance of a branch based mortgage adviser being able to do such a deal.**

## A mutual perspective



by Paul Broadhead, head of mortgage policy, Building Societies Association

**Mutuals offer the choice, diversity, customer service, efficiency, and democracy that the coalition Government is seeking as part of a renewed, reshaped and reinvigorated financial services landscape.**

**So, having made these assertions, what do UK mutuals really bring to the table? Well, for a start the sector is built on a business model that, in general, did not require taxpayer support and that delivered a strong recovery in financial results during 2010. Mutuals' sensible attitude to risk sees levels of mortgage arrears, proportionately, around two thirds of the industry average; their attitude to customer service is second to none; on a wide range of customer satisfaction measures they exceed those in the public company sector; and perhaps most importantly, they offer a wide range of increasingly attractive mortgage and savings products.**

**Mutuals have their roots firmly in the communities that they serve, whether local, regional or national and as such are well equipped to provide a local solution to a local challenge. Smaller building societies can be fleet of foot when developing innovative products and are able to react to changes in their local markets quickly.**

**In recent years mutuals have punched well above their weight, particularly in terms of the amount of lending for affordable housing, both shared ownership and shared equity. Some have even entered into local deals in their heartlands with housing associations focussed on resolving local issues. Mutuals have also continued to lend to first-time buyers; over a quarter of all**

**loans in 2010 by mutuals were for first-time buyers.**

**And the majority of lenders providing finance to self-builders, an area of increased Government priority? You've guessed it, they are mutuals.**

**It is common across the sector to see a different approach to underwriting mortgage loans. While some larger mutuals have some automated processing systems and employ differing levels of credit scoring, many others still underwrite each loan manually which enables each case to be assessed on its merits.**

**Those borrowers with more complex needs often find a mutual lender willing to lend to them; the customer has the opportunity to fully discuss their needs with an underwriter and can also explain their situation fully.**

**Former BSA chairman David Webster's speech at our recent annual conference highlighted the opportunities mutuals now have, and the plans for many to increase their mortgage lending this year. The generally up-beat event was marked by a huge confidence that for mutuals the worst, for the time-being at least, was over and that the market was crying out for the service, products and**

**"Smaller building societies can be fleet of foot when developing innovative products and are able to react to changes in their local markets quickly"**

**approach to business that mutuals can offer.**

**One notable feature of the recession is that size has not provided any indication of success. The largest mutuals have been successful, as have many of the smaller institutions. One can hardly assert that size has been closely correlated with success in the banking sector.**

**What really matters is having a sensible business plan and a strong management team and board capable of implementing it. There is plenty of evidence that many mutuals, of all sizes, possess both of those characteristics.**

**I am confident about the role that mutuals continue to play. First, contrary to the views of some commentators, mutual mortgage lenders remain open for business. Indeed three of the top ten lenders - based on amount of gross mortgage lending - in 2009 were mutuals, as were nine of the top 20. These figures are likely to be at least matched when the data for 2010 becomes available.**

**Across the vast majority of our members, capital ratios, a key indicator of financial strength, increased in 2009 and 2010, and reliance on the wholesale funding markets decreased. Cost ratios have been cut in almost every society, and well over half of our members have cut the absolute level of their costs. Indeed, one of the big firms of auditors, in their September 2010 analysis of the sector, noted that "cost control has been a key plus point in societies' recent performance".**

**So, the sector is open for business, it's getting more efficient, and it maintains very high service and lending standards. Linked closely to high levels of service is their democratic structure. Customers are offered a say on topics such as who is on the board of directors and board remuneration policy. I don't believe there are any other institutions in financial services in the UK that give customers a say in that crucial decision.**