

See the wood and the trees

Ramona Leavers urges brokers to look beyond the attractive initial rates that many lenders are currently offering to see what additional costs lurk under the surface

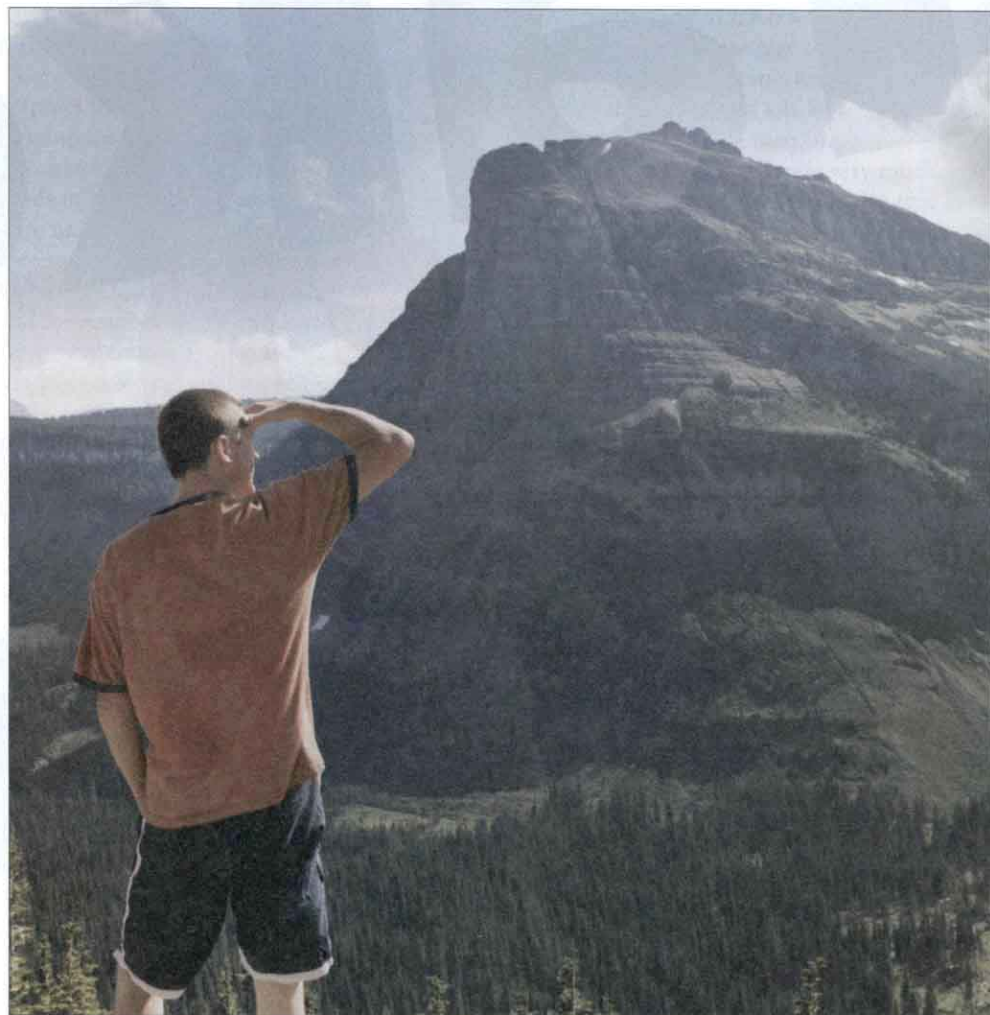
It is generally known and accepted that borrowers are much more astute these days when it comes to finding a mortgage than they were 20 or 30 years ago. Nowadays borrowers are equipped with information that is more readily available, providing them with the knowledge and ability to be more selective when choosing a deal. However, there is still a duty of care that needs to be demonstrated by intermediaries and they must look very carefully at all aspects of the products they recommend to their clients.

Traditionally mortgage markets are, and have been, rate driven. This is unlikely to change in an age where the customer is empowered to find the right deal. Because of this some lenders (although not all) deliberately gear themselves to attract new business by offering a 'hot day one rate'. It is my wish to highlight the need for intermediaries to consider carefully the products that appear to cater for their clients needs giving them what may appear to be a fantastic product at the outset but turning out to be rather disappointing and potentially costly in the long-run.

Pricing

So how do lenders go about pricing incredibly low rate deals? Many lenders practice smart fund management using Swap markets to obtain the right pricing enabling them to offer keenly-priced fixed rates which are particularly popular with first-time-buyers who are normally concerned about the possibility of future rate increases. Another way to enable the funding of attractive products is for lenders to look internally and effect reductions in their own business costings.

By maximising the use of modern technology which, if managed properly, might lead to reductions in other fixed overheads, lenders operating



margins can offer reduced rates at outset providing attractive 'come on down' products in all market sectors. While smart fund management and focusing on costs all help product pricing, these are still not enough on their own to fuel the ongoing cheap rates on offer in the market today. So how are these products being paid for if not by the lender?

Well, there is no surprise coming here in that it is, and probably always will be, the borrower. Most lenders these days charge borrowers additional fees to help cover the cost of administration and to help deliver margins through smart pricing. So what additional charges should your

client expect to pay when you source their mortgage?

Additional costs

Perhaps the most common is the lender's arrangement fee. This is usually a charge levied by the lender to cover the general administrative charges associated with underwriting a case. The type of charge does depend on the product. For example, Mortgage Trust currently charges a fixed £699 fee on one of its suite of products and up to 1.50 per cent (of the loan amount) on another. In most cases these fees can be added to the loan advance on completion. On this point it is



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important for brokers to make their clients aware that, where the fees are added to the loan balance, interest will be charged on the amount added throughout the whole of the mortgage term. So, if at all possible, it is more cost-effective for the borrower, less so for the lender, to pay the amount required up-front.

Another fee that the client needs to be made aware of is the lender's booking fees – these are mainly charged on fixed, or niche rate, products where the lender anticipates high volumes of business cases and where funds may be limited (Future Mortgages currently charges a non-refundable £300 booking fee on fixed rate products). The fee is charged so the customer can secure the funds needed for their loan amount and the lender has certainty of income even where cases do not proceed to completion.

Where applicants are seeking to borrow more than 85 per cent LTV they will often be subject to a higher lending charge. This fee (formally known as MIG) ultimately protects the lender in case of repossession where the full amount of the original mortgage may not be met from the forced sale. This fee can be quite deceptive in that while it is quoted for mortgage loans over 85 per cent, it is often charged from 75 per cent LTV and is typically calculated as a percentage of the overall loan. As an example, Bristol & West charge 7.25 per cent for the amount borrowed in excess of 75 per cent LTV. So, on a property valued at £100,000 where the borrowers have a 10 per cent deposit, the higher lending charge is calculated on the difference between £75,000 and £90,000 (£15,000) and the resultant charge is £1,087.50. Again, this is normally added to the mortgage advance ensuring the borrower pays interest to the lender during the mortgage term.

Early redemption charge

Most lenders charge an early redemption charge (ERC) during the incentive rate period in an attempt to prevent customers from moving to another lender. However, where a product offers a particularly attractive rate the ERC penalty period may well extend beyond this. These charges are often stepped so the

amount that needs to be repaid, if the borrower redeems early, is usually higher in the first few years. The percentage (sometimes a fixed number of month's payments) is almost always based on the outstanding loan balance.

Because lenders are aware that, should they offer products with no overhanging ERC, their customers may look elsewhere for schemes with lower initial pay rates, some charge overhanging ERC's often linked to a high reversionary rate. In these instances the borrower is at a double disadvantage – the rate they revert to not only stretches their capacity to maintain their payments but because they are tied in for a year or more after the initial deal they are unable to look at other alternative products.

To examine one such scheme, new lender Victoria Mortgage Funding currently charges a three-year ERC of 6 per cent on its one-year discount product with a reversionary rate of up to LIBOR plus 4.75 per cent – a high reversionary rate of 9.60 per cent. In fairness though this lender's suite of mortgage products is both varied and unique and it is not unreasonable for it to charge what it considers to be a fair reward for the service it provides.

Smart lenders?

GMAC-RFC has recently announced a new initiative on its buy-to-let products where if the rental assessments fails to meet its standard 1.25 per cent calculation (and which carries a completion fee of £499) then applicants can opt to have the assessment carried out at 110 per cent (with a completion fee of £1,295) or at 100 per cent where the completion fee rises to £1,495. In this way the lender is not only compensating for the potentially increased risk of rental voids but is also increasing its income. The customer pays for this addition to the mortgage debt providing additional money to the lender.

While such lenders may be congratulated for their fiduciary prowess, others, including large names like Alliance & Leicester, have been criticised recently and have come under fire for increasing

their account closure charges. In theory, it is acceptable that there should be a fee to reflect the work needed to close an account but no one can agree to the heavy cost that some lenders charge. In some cases, fees as high as £250 are levied. It is only a year or so ago when the standard fee for this work was in the region of £50.

Service standards

Life is made easier for brokers when advising their clients as all of these fees, and any others, are now readily available on the lenders' websites. It is in their interests to establish these costs and advise the customer at the outset as it is very difficult to justify them later in the sales process and even more difficult further on in the mortgage cycle.

We live in a litigious society and, while there is a need to remind the consumer that they also have a duty to ensure they understand the contract they are entering into, the intermediary should look further than just the rate when advising clients. While on this point, as important as it is, there is also the need to advise customers that a cheap rate (and the attendant hidden costs) does not always guarantee good lender service. It is my considered view that a customer should be advised that in many cases there might be good reason to accept a less competitive rate for better quality service or where the potentially hidden charges are less onerous or non-existent.

Brokers need to be confident that, if a great rate is offered, the lender is not compromising on service standards in order to attract more business. With some lenders being overly successful, this achievement can take its toll. Speed and ease of the entire process should remain paramount. After all it would be a wasted exercise for an intermediary to recommend a product where the 'devil is not so much in the detail' but in the time it takes the lender to perform. All that glitters is not necessarily gold – professional advisers who care about their client's satisfaction and protection will be able to separate the one from the other without focusing purely on the rate.

