

Built to last

The credit-impaired sector is well established, but the rapid pace of developments over the last 18 months look set to finally cement its position in the market

By Ben Marquand

The UK is rightly proud of its multi-cultural heritage, and most people freely admit that it would not enjoy the status it has today were it not for this.

It has traditionally assimilated cultures from around the world, and the whole is consequently much greater than the sum of its parts. As such, its standing in the world is regarded jealously by others.

While it may be a slight mental leap to suggest that the financial services industry in the UK mirrors this, to a degree the analogy does hold water, especially in the mortgage market. Over the years it has taken on flexible and current account mortgages from Australia, and centralised lending and credit-impaired products from America and run with them.

They have been developed and refined and continue to do so, making the UK mortgage market arguably the most diverse and innovative in the world. What is more impressive is the speed with which these new developments have taken hold.

Just over 10 years ago the situation was very different, with centralised lending only just starting to make an impression on the traditional one product fits all approach of building society mortgage loans. Then in the mid-1990s the whole market was shaken up when lenders launched, specifically targeting the credit-impaired sector. Launching in the middle of the last economic recession, these pioneering lenders ensured their future by borrowing heavily from the successful US experience of sector.

Commenting on the situation at the time, Bill Warren, compliance director at network Complete Mortgage & Loan Services, says: "The early nineties were one of the most challenging periods for homeowners and lenders in particular. The slump in house prices, married to a number of other economic difficulties, created an unprecedented number of repossessions by lenders and a negative equity bubble, which was to take several years to subside. What the lenders, who were primarily building societies at the time, could not do was to find alternative funding in the volumes needed or escape from their regulatory straight jackets and find creative solutions to prevent so many borrowers, often through no fault of their own, being evicted.

"The housing market and the country needed a solution and in simple terms the knight in shining armour was Kensington Mortgage Company who arrived as the first lender set up specifically to lend to the credit-impaired market."

Centralised success

While interest rates were high and margins comfortable, the success of centralised lending changed the face of the mortgage market forever. Other centralised lenders quickly followed then, as the economy turned the corner and house prices started to take-off again, mainstream lenders began to take more of an interest in the credit-impaired market.

At first this was mostly done through subsidiary companies, perhaps in a bid to protect the main brand. So the market saw Nationwide come in through UCB Home Loans, Halifax through BM Solutions and The Mortgage Business and Britannia through Platform. They found themselves competing against subsidiary firms of global financial corporations such as General Motors, through GMAC RFC, and General Electric, through igroup and First National. Today, the market is getting even more crowded as some mainstream lenders are looking to lend in this sector in



Digital Vision

their own right, although admittedly at the 'near prime' end of the scale.

Colin Barrett, product management at BM Solutions, comments: "As soon as an opportunity appears new players will appear in numbers as there are high margins to be made. As competition increases it becomes better for the consumer as prices get forced down to a more natural level. Eventually there comes a stage where products are priced fairly for the risk the lender takes on, and this is pretty much where I think the adverse market is almost at. Obviously we have our views on certain products out there with high margins and high procurement fees since the borrower ends up paying for both of these."

As the market has matured so have people's perceptions and recent research into sub-prime borrowing dispels the myth that the majority of borrowers in this sector are low income earners. In the last 18 months the market has moved on apace, and products are now reflecting the growing maturity of the market. Now there are more products available to borrowers for them to actually choose whether they want a fixed rate or a tracker. As lenders' experience of sub-prime borrower's history builds so does their understanding of the risks involved and so their securitised books receive higher ratings, generating more capital and allowing product pricing and development to become more daring.

Barrett says: "In the prime market borrowers can have the full choice, fixed or tracker. In the sub-prime market maybe only 18 months ago you could generally have one product, generally with an extended tie-in and generally with a low up-front rate and a big payment shock later on. We have wanted to bring in maximum choice for borrowers whatever their status, helping to legitimise the products in this market. Everyone is moving in this direction and it is the competition that is driving it."

Vic Jannels, managing director of packager ATOM, agrees: "Resulting from the growth of this market, there are now numerous lenders competing, often, for the same business. This can only have one effect – lower interest rates and more competitive products to the benefit of the end user. The products may not yet be individually tailored but progress means that this is also getting ever closer."

Warren says: "As the competition has increased, the interest rates and product criteria have decreased bringing relief to many borrowers who for various reasons have had to look for a lender willing to accept or overlook in some cases the credit problems they have sometimes created for themselves."

Despite the growth and evolution of the market it is still difficult to get robust market data on the size of the market. The Council of Mortgage Lenders does not produce figures on non-conforming mortgages such as self-certification and sub prime. However, most lenders look to marketing and business intelligence company, CACI, which estimates that the adverse market is worth around £9bn to £10bn at the moment, which is approximately 10% of the entire market, but the true value depends on the definition of credit-impaired as some people would include self-certification too.

To go from inception to around 10% of the market in a decade is phenomenal growth, but the sector is not yet thought to be saturated and lenders remain convinced there is still room for the market to develop. Barrett says: "I think there would be a concern if the adverse market accounted for

too much of the whole, but I think there is still more to go. It can be seen in the economy at the moment. People have an awful lot of unsecured debt, the base rate has increased over the last year and people took out loans when it was much lower, and at some stage you have to guess that some will struggle and that is where the sub-prime market comes in."

This is where this new sector of the market comes in, the ultra-light or near prime sector. This is where there is a natural convergence between the traditional high street lenders and the impaired credit specialists, and is an area designed for people who are just unable to get a mainstream loan. This area has developed from two sides as a wider section of lenders are now comfortable with their exposure to the market through and buying books or linking with other lenders, and adverse credit lenders look to break into new areas. These synergies have seen lenders from both sides of the fence looking for synergies and is illustrated by the arrangement Bristol & West has with credit-impaired lender Mortgages plc that allows it to market a range of sub-prime mortgages alongside its traditional areas.

The adverse market is worth between £9bn and £10bn at the moment which is approximately 10% of the entire market

Instrumental development

The role of packagers has been instrumental in the development of the sub-prime market. Set up to be third party specialists in sub-prime deals their dual role was to offer the new, centralised lenders a distribution outlet and to give brokers assistance in placing their credit-impaired clients with the right lender.

Much maligned of late, the role of packager was vital in the growth of the industry, but now their role is changing as new developments in technology and their place within the new regulatory environment have raised questions as to their position. Lenders and brokers are polarised around packagers with some lenders such as SPML still receiving 90% of its business through packagers and others such as BM Solutions looking to reduce its use of packagers while confirming that all of its business is now done online.

Undoubtedly, the increasing number of products in the market means technology and online systems are the best way for brokers to track and fulfill their obligation of identifying the best product for a client. Therefore the news that Trigold has developed a sub-prime sourcing tool is good news for the market. Developed in conjunction with six lenders it is aiming to fill a gap in the market, and although it is early days its effectiveness could shake up the market still further and help to improve accuracy and turnaround times for both sides of the equation.

Successive governments have been very fortunate over the last decade or so to have had such an effective force addressing the nation's credit problems, relieving it from the cost and the social problems attached to homelessness. As credit-impaired borrowers experience decreasing interest rates, the demands for social housing volumes could continue to diminish. (MS)