Home Improvements: Repairing Britain's Mortgage Market.

habito

White Paper
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Introduction.

In this White Paper habito describes the many failings in the UK mortgage market and calls upon the Financial Conduct Authority (FCA) to use its powers to address them and improve the situation for consumers.

There are many good mortgages available from banks and building societies. What prevents consumers finding them are: problems of accessibility; weaknesses in common online tools such as mortgage calculators; a lack of transparency and common terms for fees; detrimental incentive structures at comparison sites; and issues associated with mortgage brokers being tied to estate agents.

Homeownership remains one of the greatest aspirations for most Britons. Of the estimated 23 million households in England, 14.3 million (63%) own their own property. Political parties across the spectrum continue to prioritise housing as a key issue. [1]

For many, mortgage repayments remain the most significant household outgoing.[2] So, with home ownership such an integral part of our lives and, for most of us, the biggest financial commitment we will ever make, it is crucial that the mortgage market functions in a way that serves the best interest of its customers.

Regulators are awake to this fact. The FCA launched a market study into residential mortgages in December 2016,[3] with interim findings due to be published before the end of this year and final findings to come in 2018.

The FCA's review will be focused on whether the mortgage market could be improved to better serve consumers. The FCA will consider whether consumers are empowered; have the information they need to make an informed choice between products and services; and if they are in a position to understand whether these products and services represent value for money.

It will also assess whether better technology could solve any issues it identifies.

The FCA will also consider whether commercial arrangements in some parts of the mortgage sector create a conflict of interest and perverse incentives, to the detriment of consumers.

These themes are summarised by the study's focus on the following two questions:

- At each stage of the consumer journey, do the available tools (including price comparison websites, best buy tables, mortgage calculators and advice from a lender or broker) help mortgage consumers make effective decisions?

- Do commercial arrangements between lenders, brokers and other players lead to conflicts of interest or misaligned incentives to the detriment of consumers?

Ahead of the publication of the FCA's report, digital mortgage broker habito has released the findings of its own investigations into the mortgage broking market, a market that in its view remains confusing and opaque, and as such disadvantages British homeowners so that all too often they are left paying significantly more than they need to.

The problem.

In its present state, the mortgage market is failing. Outdated and inflexible business practices, inadequate online tools and the existence of a special relationship between estate agents and in-house brokers, prevents the market from functioning in a way that prioritises the best interests of the consumer.

In short, the market lacks accessibility, transparency and fairness.

This status quo means the nation is gripped by mortgage paralysis, where borrowers sit paying off expensive mortgages for fear of having to engage with a process that is perceived as arduous, lengthy and difficult. In January this year, on behalf of habito, insight consultancies Corporate Punk and Innovation Bubble conducted qualitative research with groups of consumers, using chartered psychologists. Our research found that both first-time buyers and re-mortgagers perceive banks and mortgage provider practices as not just overwhelming and confusing, but predatory. The research found that having been burnt by mortgage processes in the past, *"mortgage owners exist on a 'disengagement spectrum', where the process of remortgaging now represents a loss of freedom that is to be avoided at all costs."*

The principle of switching providers to save money is well established, and encouraged, by Government and consumer groups in other markets. Individuals willingly and regularly change energy, telecoms and internet providers to be on a cheaper tariff. However, when it comes to mortgages, consumers appear to have a blind spot, causing homeowners to miss out on substantial savings that in some cases can run into thousands of pounds a year.[4]

A recent study carried out by habito and YouGov found that of those that had changed their mortgage in the last three years, only 9% said they did so because they felt changing mortgage provider to save money was no different to switching utility providers.

What's more, there is a huge knowledge gap. Many mortgage holders don't know enough about their biggest financial obligation to enable them to shop around: nearly 1 in 4 don't know what interest rate they pay, and around 1 in 10 don't know if they have a fixed or a variable rate[5].

The Solution.

It is time to put consumers back at the heart of the mortgage market. That means building a market that is accessible, transparent and fair for all.

The remainder of this whitepaper explores these three issues - accessibility, transparency and fairness - in more depth, and sets out evidence of the problems and the solutions in each area.

Accesibility.

Issue - Business practices are outdated and inflexible

A failure by the broking industry to embrace technology and more flexible ways of working has narrowed consumer choice. A report on digital change by the Council of Mortgage Lenders concluded that "digital change in the UK mortgage market is happening gradually and incrementally."[6] While technology continues to revolutionise and streamline most aspects of life, the same cannot be said for the mortgage sector, which continues to lag behind other financial services.

As mentioned, a quarter of people don't know what interest rate they pay, and a tenth don't know if they have a fixed or a variable rate. In fact, one in every 20 mortgage holders (over 700,000 people) cannot even name their lender.[7] HSBC recently found that homeowners on a Standard Variable Rate mortgage could find themselves overpaying by more than £4,000 a year on average, compared to a fixed rate.[8]

Against this backdrop, almost three in four consumers choose to use a broker for advice[9] but, to do so, must spend hours on the phone or take time off work for an in-person visit to compare deals on the market. The upshot is that many choose to bury their head in the sand, considering every other method of saving money before thinking about switching their mortgage.[10]

Evidence.

An in-depth look into the mortgage deals available on a number of comparison websites revealed upwards of 108 differently-named fees frequently encountered by consumers in the mortgage application process. In the absence of a standard fee structure, many of these are arbitrary and in fact refer to the same thing; some of those identified include:

· Additional security fee
· Bank transfer fee
· Closure administration fee
· Deeds dispatch fee
· Electronic transfer fee
· Final repayment charge
· Lender conveyancing fee
· Mortgage account fee
· Transfer of funds fee

Research from Mumsnet and habito revealed that the perceived complexity of the market may be one cause of consumer inertia when it comes to switching. Almost half (44%) of mums surveyed said they would need to research the meaning of the term loan-to-value, a third (31%) would need to do the same for standard variable rate, and around a quarter say they would have to look up base rate (25%) and annual percentage rate (22%).

For customers looking to remortgage, many start by going back to their original lender. However, habito research found that the majority of high street lenders do not list deals for existing customers on their websites. This means that to even see a possible new rate, a customer would need to go through a full remortgage application process. On top of this, deals for existing customers are far less competitive than for new customers - meaning that most consumers would need to go out to the market to get the best rate, a daunting process for many.

Comparing fixed rate remortgages over a two year and five year period using the example of a customer with a £250,000 mortgage on a £500,000 house, we found huge price differences.

This is illustrated by taking the remortgage deals listed by one high street lender for current customers. For the two year fix, the difference between remortgaging with them and the lowest rate available in the market was £530 over two years, including fees. For a five year fix, the difference was as much as £6,400 over five years.[11]

Should customers decide to remortgage away from their existing lender, being able to access an advisor to bring any clarity to the process also remains challenging. The same study showed the extent to which the mortgage market fails to accommodate busy mums, meaning they're less likely to be aware when they could be saving money by moving to a more suitable mortgage deal.

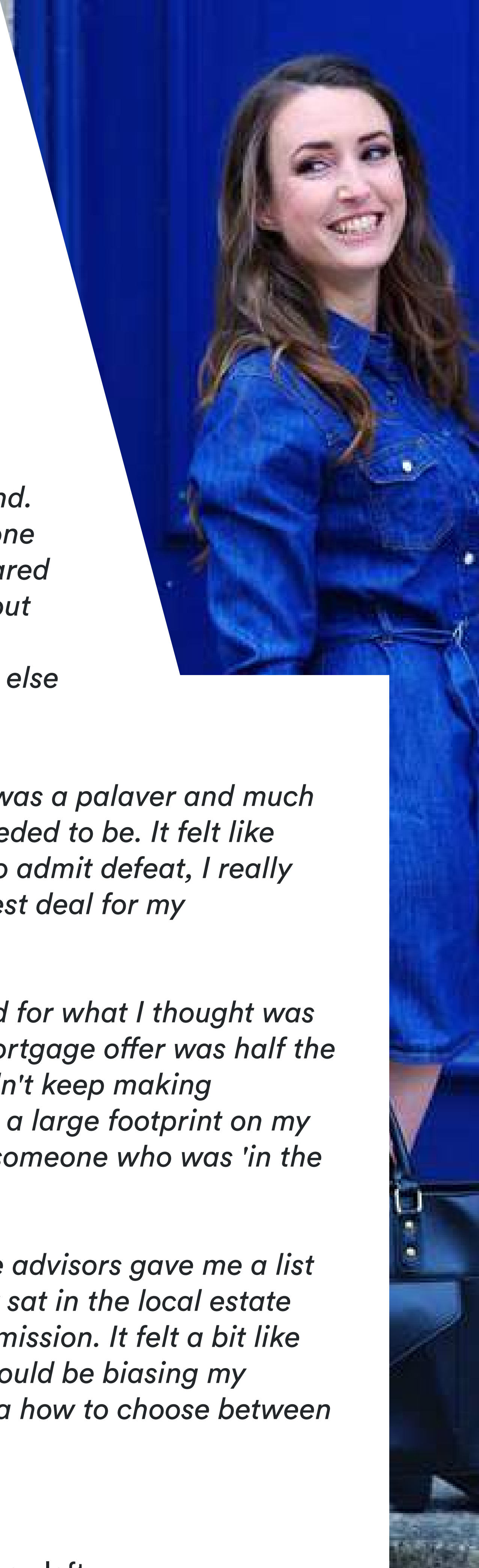
The research found that:

Three quarters (75%) find trying to arrange meetings or calls to organise personal finances is incredibly difficult when you have children.

More than half (53%) have spent hours on hold when trying to manage their finances by phone, and a similar proportion (49%) has had to take a child with them to a meeting about their **finances, as they had no other option.**

Although this represents just one demographic, it is clear that the type of disruption other areas of financial services have seen, that harnesses technology to improve the customer experience, has been noticeably absent from the mortgage market. This means 'switching' remains out of reach for mothers juggling multiple obligations and schedules, and the same is likely to be true for other groups.

Viewpoint from a habito customer



"*I'm a pretty independent person and I think I use common sense when it comes to shopping around. Previously I've always done my own research, compared the figures and worked out what to do for the best without paying someone else to do it for me.*

But getting a mortgage was a palaver and much more stressful than it needed to be. It felt like really hard work. I had to admit defeat, I really couldn't figure out the best deal for my circumstances.

I did my best and applied for what I thought was the right deal, but my mortgage offer was half the amount I needed. I couldn't keep making applications and leaving a large footprint on my credit record - I needed someone who was 'in the know'.

Googling local mortgage advisors gave me a list of 'experts', all generally sat in the local estate agents, working off commission. It felt a bit like using any one of them would be biasing my outcome and had no idea how to choose between them."

Katie Chown

A 34-year-old savvy shopper, left baffled by the mortgage process

The Solution.

1. Promote by prompting a cultural shift that sees consumer education go hand in hand with new technology, we can enable homeowners to manage their mortgage over the lifetime of the loan, and ensure they never overpay. Consumers should be able to switch easily once their fixed rate deal ends, so they are on the best rate possible at all times.

2. Reduce complexity through standardisation of fees, documents, document verification and submission.

3. Create a more flexible and consumer-friendly system. We believe technology can help here; for example the use of chatbots to provide customer support out of hours, giving customers easy access to friendly, impartial advice at any time from any connected device. Technology can now help throughout the mortgage journey. Providing active prompts, for example for gathering documentation from customers to progress the application, or passive prompts, such as an alert to remortgage when a customer's current deal is expiring, will mean that customers always know where they are with their mortgage.

Transpancy.

Issue - Online mortgage tools are inadequate

For most, the first port of call when thinking about mortgages is to search online to gain an understanding of what to expect from the market.

Online tools exist to help consumers estimate how much they may be able to borrow, as well as to compare mortgage deals currently on the market. And in theory that is empowering and enlightening - when it's done right. But there are numerous flaws and biases in the most common tools, which at best paint an imperfect picture of the consumers' options, and at worst present unreliable information and pre-position the customer for a product that may not be right for them. Ultimately, advice from a mortgage expert is still required to make an informed choice.

The most notable example of an online mortgage tool is the mortgage calculator. Offered by most lenders, these tools have become headline grabbers, promising would-be homebuyers large loans on the basis of just a few pieces of information. Most calculators are inherently inaccurate: they don't ask for a comprehensive view of a customer's individual circumstances, so cannot calculate true eligibility for a product. The amount a consumer can ultimately borrow is influenced by a range of factors, such as employment type, income and expenditure, credit history and property type, most of which are absent from basic 'how much can I borrow' calculators.

Transparency.

Furthermore, every lender assesses affordability differently, and almost all withhold this scorecard from individual brokers. Attempting to replicate this process in a calculator is misleading. Even if such a system could be replicated, consumers might still find themselves better off with an alternative lender due to the idiosyncrasies of how each makes its calculations.

These online calculations are often based on a multiplication of a user's income of between 4.75 and 5 times, and may or may not take any deposit into account. Factors such as stamp duty or estimates for up-front fees are typically left out. Only by carrying out a search of all options is a consumer likely to get the right answer and find out the true cost of their mortgage.

Inaccurate estimates can lead to customers being disappointed further down the line as they start searching for and viewing properties in a price range that proves unrealistic.

Comparison sites are often no better. Eye-catching deals and teaser rates prevent consumers from comparing deals accurately, and it is often impossible to understand the true cost of a loan from the outset. Most comparison sites show results with ranking by initial headline rate by default, which means that shorter term fixed rates, and products with high fees, get ranked in inappropriate preferential positions. To compound the problem, many of these sites push sponsors' results to the top of the table.

These problems aren't confined to online searches. When seeking advice from a broker, consumers are often dependent on the luck of the draw, as little information exists to assist in rating a good broker from a bad one. A lack of published rankings and reviews, to demonstrate ability and value, often means customers don't know which broker to use.

Evidence.

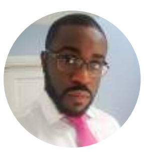
Analysis by habito of the cheapest mortgage deals listed for a typical £160,000 loan by two of the biggest UK mortgage comparison websites shows that the level of fees associated with the prescribed mortgage quote was misleading. Greater transparency around additional fees and standardisation of naming conventions could prevent customers from paying up to £1,200 more than necessary.[12]

The opaque and complex nature of the market makes it incredibly difficult for consumers to navigate, and they are often surprised by the true cost of a mortgage as comparison sites fail to take these additional fees into account when providing an online quote. As a result, homebuyers are unable to make an informed choice, or truly understand the impact these fees will have on their monthly repayments.

Viewpoint from a habito customer

Comparison sites are great websites, but there is a lot of information presented. It was quite overwhelming. It is always good to know everything but with something as expensive as this, you need to have time to digest everything and think slowly.”

Sharon Chana
A 28-year-old Digital Marketer, left confused by comparison websites



“I needed a mortgage quickly and went to an East London broker because it was close to my workplace, to get an Agreement in Principle (AIP). While the broker provided some useful information, he always wanted to meet face-to-face and charge me a fee of £800.”

Juwon Layiwola,
A 26-year-old City Worker & First-Time Buyer, shocked at the price of an AIP

Evidence.

The Solution.

Empower consumers through a sweeping transformation of the process, requiring information to be provided in a transparent, accurate and accessible way.

This should include:

- Mandatory preset text on mortgage calculators and comparison websites, which stipulates that the quote provided is an illustration only as well as prompting customers to seek further mortgage advice before deciding on the option provided.

- Ranking on comparison sites should default to total cost over the term of the loan rather than being ranked by the initial rate.

- Publication of service standards and advice given by brokers, including customer satisfaction, the average time to the first appointment, product type, splits, and more.

In the long term, the adoption of real-time affordability checks by lenders and brokers will enable consumers to skip the search on mortgage calculators and comparison sites altogether. With the coming of Open Banking APIs, this technology could be used to make individual assessments on a customer's suitability to products instantaneously, by comparing income and historic spending to borrowers with similar profiles.

Fairness

Issue - The relationship between estate agents and in-house brokers is broken

Consumers often opt to consult a mortgage broker when looking for clarity on which deal is right for them. For many, their first recommendation for a broker may come from their estate agent, proposing a meeting with their in-house expert with the appeal of the “one-stop-shop” for ease.

Although seemingly impartial, a conflict arises from the fact that estate agents act for sellers, whilst mortgage brokers act for buyers. The key to achieving a level playing field for negotiations is that the two parties have incomplete knowledge of each other.

It is too often the case that estate agents with in-house brokers will insist that before the consumer can view properties, they’ll need to acquire a ‘Mortgage in Principle’ from their broker. This is an unfair practice that pushes the consumer into taking advice on a hugely important financial transaction from someone who may have conflicting interests.

The FCA has previously highlighted the relationship between brokers, lenders and estate agents as an area for investigation, with the regulator concerned about the practice of agents earning money from referring customers to particular brokers. Implications that the use of a particular broker will in some way increase the chances of securing a property are a great cause for concern, with perverse incentives prompting brokers to recommend mortgages that might not be in the best interest of the customer.

Evidence.

The following examples are part of what we believe to be widespread industry weakness due to poor incentive structure and are not intended to single out any one broker or estate agent.

The largest single mortgage broker in Britain is also Britain's biggest estate agent, CountryWide. In 2015 the company arranged £12.2bn worth of mortgages and made £81m of related income.

Connells estate agent is much smaller but still sold more in mortgages than housing sales; £4.3bn in property versus brokering £4.4bn worth of mortgages in 2014. Currently, all of the country's top estate agents, including LSL, Purplebricks, Foxtons, Savills, Kinleigh and Spicerhaart offer a mortgage broking service in-house.

Mortgage broking is highly profitable for estate agents, at a time when the rise of online players has meant a squeeze on traditional estate agent commissions. According to analysts at UBS, online agents who charge just £500-1,000 in fees, has meant that estate agent commissions are down to an average of 1.3% of sale value, compared to 1.8% five years ago. These commissions look set to fall further.

As fees fall, estate agents are pursuing other revenue streams, including in-house mortgage advice and provision, but agressive tactics are often at the expense of the consumer's best interests.

This year, a spotlight has been shone by reports in the Metro, Telegraph and Guardian newspapers on the questionable role played by the mortgage brokers who operate within estate agents. Many of the tactics discussed in recent reports are not new, indeed they were shown through undercover filming in Channel 4's 'Dispatches - Undercover in the Property Market', aired in October 2013. In the programme, undercover reporters posed as first-time buyers to see if they would be forced to use the agent's mortgage broker. The programme also showed a former estate agent revealing how much pressure he was under to sell mortgages and that he earned £350 commission for each mortgage arranged.

The reports and articles have focused on tactics including "priority viewings" - where buyers are told that if they use the firm's in-house mortgage broker they will get to hear about properties earlier, and "prioritised offers" - meaning if buyers use the in-house broker, their offer would be "prioritised" to the vendor.

There are of course firms who manage this in-house conflict of interest better than others. While media reports have focused on certain players in the market, the problems associated with using in-house brokers stem from an inherently conflicted customer model.

The tricks of being an agent's broker

Many of the Mortgage Experts within the habito team have previously worked in-house, and left because of their perceived conflict of interest between agents, who should act on behalf of the seller, and brokers, who should act on behalf of the buyer. Our mortgage experts have given first-hand accounts of the ways in which some prospective buyers are coerced into expensive mortgage products with promises of first viewings, life-time memberships, and preferential treatment of their offers over those made by other bidders.

> “*In my previous role, the estate agent would tell the buyer that they had to see me in my capacity as the in-house broker. It didn’t matter if they already had a mortgage, cash or a mortgage in principle - the agents were trained not to take no for an answer and incentivised with cash bonuses to book the appointment regardless.”*

> “*When the buyer came in to see me, I had been told to present a compelling set of reasons as to why they should use us. These could simply be that it would be easier to only deal with one company, or that, as a ‘premium’ customer, we could send them details of new house listings that hadn't been put online yet, so giving them a preview of incoming stock. We would put subtle pressure on buyers to take a mortgage with us by saying things like, “this vendor has been burnt before so it would help your case to mortgage with us, so we can tell them the money is real.”*

View point.

The tricks of being an agent's broker

> *“On the seller side, agents were trained to heavily couch offers made by buyers who hadn’t come through our in-house broker as not being dependable. The estate agents would also argue for sellers to sign an agreement that the agency could vet potential house-viewers. In reality, this meant that if we as a company didn’t do the associated financing, a prospective buyer wouldn’t be allowed to view the house.”*

A Mortgage (in Principle) - a costly mistake

Our broking team have strong feelings about mortgages in principle. The main concern is the difference between how they are perceived by customers and how they are treated in reality by the industry. One of our broking experts shared a previous customer’s horror story:

> *“In my previous job at NatWest, a customer came to me because another major high street bank had not upheld the Mortgage In Principle (MIP) agreement. The buyer, having received his paper copy MIP document, had bought a house at auction and put down the standard 10% of the sale price as a non-refundable holding deposit to secure his new property. On going back to them to get the mortgage, he failed a credit check due to an outstanding County Court Judgment and they rejected his mortgage application. NatWest also couldn’t help him and he lost tens of thousands of pounds. At best a Mortgage In Principle is a meaningless piece of paper, and at worst could mislead a buyer into making an incredibly costly mistake.”*

The Solution.

- Customers should not be penalised if they don't use an agent's in-house broker, nor should they feel pressured into using a certain provider in order to secure the home they want to buy.

- The FCA must regulate against these practices to bring them to an end.

- Increased consumer awareness of competition from digital players (both in the property search and sale, as well as broker area), challenger banks, and direct innovation from lenders should also squeeze down on these practices, as consumers feel more confident and informed to go elsewhere.

Conclusion.

The FCA has indicated that their final market report into residential mortgages will be published in early 2018. Should the regulator find the market is not working well, we could see a raft of corrective measures, ranging in severity from publishing general guidance, to market-wide rule changes, or even launching competition investigations.

Habito's position is that, in its current state, the mortgage market is not working to the benefit of consumers. It is time to rebuild it from first principles.

For most people, it doesn't matter who provides their home loan; consumers just want to know they have the best deal possible. They don't want to trawl through the huge and complicated mortgage marketplace, but don't want to be patronised either. They don't want to be sold to, but do want to be served. It's time to bring mortgages into the 21st century.

The Council of Mortgage Lenders says that digital change in the UK mortgage market is happening gradually and incrementally. We would argue that, in many ways, the mortgage application process is almost no different to 30 years ago. In 2017, eight out of ten brokers still need to call a lender on behalf of each consumer between three and six times per case.[13]

Conclusion.

There is potential for regulation to drive innovation, and we are hopeful that the Payment Services Directive 2 (PSD2) and open banking data APIs could lead to improved integration and automation between lenders' legacy systems and brokers - speeding up the process and bettering the experience for end consumers.

Together, technology and regulation have the power to transform the system to be more flexible, transparent and consumer friendly. Standards should improve and prices fall as information and advice become more accessible.

Habito has been highlighted by industry bodies and has won awards for its combination of technology with industry-leading Mortgage Experts to deliver the best possible results for customers. We use machines to do the repetitive work: they are good (and incredibly accurate) at form filling, document collation, product research. This frees up our Mortgage Experts to be where they can add the most value - answering questions from our customers and guiding them seamlessly through the process.

The FCA has shown its support of disruptive innovation and competition through its launch of "Project Innovate"[14] and we hope the watchdog is mindful of the need to foster innovation when it reveals its findings and recommendations in the forthcoming report. Meanwhile, habito will continue to champion the interests of British homeowners, helping them to save money and addressing the need for a more accessible, transparent and fair system.

About us.

Habito is the UK's digital mortgage broker, using technology to bring the mortgage application process into the 21st century. Simple, fast & honest, homeowners can be sure they're getting the best mortgage on the market for the first time. No jargon, no fees and no misinformation.

Habito is backed by Ribbit Capital and Mosaic Ventures, with a stellar lineup of angel investors including Transferwise CEO Taavet Hinrikus, Funding Circle's founder Samir Desai, and Yuri Milner.

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Appendix.

[1] English Housing Survey, Headline Report, 2015-16
[2] Family spending in the UK: financial year ending March 2016, ONS
[3] FCA launches market study on mortgage sector

[4] HSBC, March 2017

[5] Habito and YouGov survey, May 2016

[6] Council of Mortgage Lenders Digital report
[7] Habito and YouGov survey, May 2016
[8] HSBC, March 2017
[9] Intermediary Mortgage Lenders Association (IMLA)
[10] Habito and Mumsnet survey, June 2017

[11] Findings are based on deals listed on lender's sites for current customers. Where only a four-year fix was available, one year was added to the calculation at a variable rate to take the period to five-year term.

[12] Findings are based on calculations by habito, who have taken a typical mortgage value of £160,000 on a £270,000 new property purchase and searched the two biggest mortgage aggregators in the UK for their cheapest mortgage.

[13] IRESS, Association of Mortgage Intermediaries (AMI) and the Intermediary Mortgage Lenders Association (IMLA). (2017). Intermediary Mortgage Survey Report
[14] FCA-innovate