Mortgages in 2020

A future view of products, processes and markets

Summary of a report for the Building Societies Association by Peter Williams

Building Societies Association

2020 Vision

A mortgage borrower from 1909 might find the mortgage market of 2009 strangely familiar. Yes, over the preceding century mortgage availability has widened to levels that few would have expected, but the basic principle of a mortgage being a long term loan secured on the property that is being bought remains.

But is this mortgage relevant to the mortgage market of the future?

Over the last ten years, property prices have enjoyed a rapid growth that has outstripped rises in salary levels, so it is hardly surprising that the well reported affordability problems have developed. As a consequence, the average age of first time buyers has increased to the early thirties, and buyers are not just borrowing increasing amounts, but repaying it over a longer period as well.

Property prices have declined over the last year, and are expected to continue to do so for the remainder of 2009. However, we expect them to eventually recover, and while property price inflation may not reach the heady heights we have seen recently, we expect the upward trend of property prices to continue and affordability problems to worsen.

This will see the average age of first time buyers continuing to increase, and if things do not change, by 2020, first time buyers are likely to be both so old and taking out such a large mortgage that they will be paying it well into retirement.

Against such a background, the Building Societies Association commissioned research looking at how both demand for mortgages and mortgage products themselves will change between now and 2020. So what has the research found?

The Borrower of 2020

Population and household change is continuing. Demand for housing will be increased by both an ever expanding population (with the population of the UK expected to increase from 61 million in 2007 to 66.7 million in 2020) and by the well documented increase in the numbers of single households.

What is interesting about the rise in the numbers of single people is their age. The rise is not in the number of young single people, but the numbers of older people living on their own, either as a result of relationship breakdown and bereavement or, increasingly, as a lifestyle choice.

This raises interesting implications for mortgage lenders. While mortgage models may have been based on two borrowers living together, in the future there will be a sizeable number of single people looking for mortgages that can be sustained with just one income.

But these single people may not be single all their lives. What is also becoming apparent is that people are living more complex lives than before. While twenty years ago someone may have left school into a job, married five years later and continued in that job (and maybe house) right up to retirement and death, now people have many different "life events". They may have several long term relationships, return to education and have a number of different careers.

This is again going to have a fundamental impact on the mortgage business. Increasingly, borrowers are going to be looking for mortgage products that reflect lifestyles that are both very different and that can see someone's financial situation vary widely from year to year.

Distribution

One of the lessons from the credit crunch has been the need for lenders to fully understand who they are lending to, and what risks are associated with that. While the responsible lending policies followed by building societies has meant that they have suffered less than other lenders with borrowers defaulting on loans, they fully appreciate the need to ensure that lending is done appropriately.

Yet increasingly rising customer expectations mean that no longer can a lender take several weeks to process a mortgage application. A rapid decision is becoming an important way lenders can differentiate themselves in the marketplace.

The need to reconcile these two conflicting needs will lead to the fundamental change in the way that mortgages are distributed. Lenders will be keen to target "super prime" borrowers who have a very good financial history and represent a very low level of risk. Statistical and computer techniques will be used to profile and target these borrowers who will represent the lowest risk.

Dealing direct, lenders will seek to develop long term relationships with these borrowers over a wide range of financial products and services.

Beneath these "super prime" group of borrowers will be groups who find securing a mortgage more difficult. Although the first of these groups will have a good credit history, they will, as noted above, have less favourable work and income patterns. They will need the services of an advisor who will be able to look at their circumstances and find a lender who will be prepared to provide them with a loan.

Advisors will have close links with panels of lenders. However, this will not just be through preferential rates and other commercial issues. Increasingly, lenders will be using brokers to provide an initial assessment of these borrowers with a less than perfect credit score. Not only will this see brokers adding value to their clients (who may be paying them for the service that they provide), but they will also be helping the lender – by making initial enquiries into the borrower's financial circumstances the lender will be able to process the application far quicker than otherwise.

Links between the lender and the broker will be much closer than at present, with the broker undertaking the assessment of the aspirant borrower effectively on behalf of the lender.

Beneath this group will be people who will need extensive help from brokers to get a loan as a consequence of their poor credit history. Some in this group (who may have previously been able to obtain a mortgage) may find that they are unable to do so, while others may find themselves having to spend time rebuilding their credit history. This may create opportunities for `fast start' type savings products to help these customers rebuild their credit standing.

There are two unknowns that could impact on this further. Firstly there is the impact of estate agents on mortgage distribution. Many estate agents now help buyers secure a mortgage, while a number of lenders offer estate agency services, and as both these trends continue, it will be interesting to see if true integration occurs towards a seamless purchasing and funding process.

The other unknown is if new consumer brands (such as the supermarkets) will make inroads into the mortgage market, as they have in many other financial services areas. Should they do so, a fundamental question is if they will just serve as a new distribution channel or if they will seek to introduce new types of product to the market.

Regulation

With the regulatory system having sustained so much criticism during the credit crunch, it is likely that there will be fundamental changes to the way that the mortgage market is regulated both in the UK and beyond.

With such fundamental change taking place on the demand side for mortgage finance, it is imperative that regulators allow the market to evolve to reflect these changing demands. Any move to a "no failure" culture could potentially see product innovation stifled.

The 2020 Mortgage Market

As the lessons of the credit crunch are learnt, the overriding characteristic will be a much more conservative mortgage market. Whilst we won't go back to the mortgage queues of before, it is likely that lenders won't be so much chasing volume as quality. This doesn't mean that there won't be some of the higher risk lending, but that it will be priced to reflect that risk.

Borrowers who do not enjoy "super prime" status and the benefits that go with that, will find that they have a relatively high cost mortgage. However, as they establish a track record, they will find that they are able to move to a more competitively priced product. While this is already happening to a certain extent, in the future it will be managed much more closely by the lender.

The recession will have also made consumers more conservative, and aware of the implications of borrowing beyond their means. By 2020 some will be excluded from the home ownership market as they will be unable to secure a loan, while others will make a conscious decision to remain enjoying the flexibility and freedom offered by renting.

The 2020 Mortgage - A Vision of the Future

Against such a background, mortgage lenders face three major challenges to 2020:

Encouraging Borrowers to Save

Previous attempts to link savings and mortgages have been unsuccessful. While offset mortgages have been successful, they tend to be targeted at people who already have relatively large amounts of savings.

However, with property prices so high, buyers now need a sizeable deposit if they are to get a mortgage. While it is unlikely that lenders will continue to require the very large deposits that they currently are as a consequence of the credit crunch in the future, with property prices being so high, aspirant borrowers are going to have to save a significant sum to secure funding.

A savings product that demonstrated a track record of saving and that provided at least a small deposit would at least show to a lender that the borrower has a track record of financial responsibility would be very powerful. If lenders are saying that they value this history highly, then perhaps they should incentivise this behaviour even more with a premium rate, moving the lender closer to the long term customer relationship they will be looking to develop with their best customers.

Finding a Middle Way

The Government has developed a number of schemes that seek to allow buyers to buy just a share in their home. However, these have achieved only limited success, since they effectively see borrowers borrowing the maximum they can yet only owning a share of their home and few have "staircased" to full ownership.

The development of a shared ownership product that encouraged (or required?) the buyer to gradually take an increasing stake in the property could represent an attractive proposition to aspirant buyers who can be confident of future income growth.

The reintroduction of mortgage insurance guarantees (which have almost died out in the UK due to competitive and PR issues) could encourage more lenders to enter this market, since it would give them greater confidence that their interests would be upheld.

Getting the Family Involved

The "nation of inheritors" that was forecast in the 1980s is taking longer to come about than expected. Increasing lifespan isn't seeing housing wealth "trickling"down the generations as quickly as was expected.

However, what we have seen is the emergence of a large number of relatively elderly people who have considerable sums tied up in their homes yet have low incomes. At the same time, their children (or grandchildren) are enjoying relatively high incomes yet they are unable to afford a home.

Already some lenders offer products that allow parents or grand-parents to either act as guarantors for their offspring's mortgage. Lenders need to develop products that allow parents to use their housing equity to buy a home in a structure that then allows them to provide income assistance to their parents.

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