WHAT NEXT?

One of the most popular chapters in my previous book "The Art of Marketing Mortgages" was the one largely written by other people. I take no offence at this: the customer is king! In fact, as you will read in the pages that follow, I have built on and expanded this concept.

Last time, I asked 14 industry figures to let me have their views on "What Next?" in the mortgage market. This time I have asked 22. All eminent figures and real experts. I hope you will enjoy reading their views, provided in the latter part of 2005, as much as I have.

It is perhaps a sign of the times that only three of the original 14 are still doing the same jobs they were doing in 1997. However, I was delighted that those three, Adrian Coles, Michael Coogan and Robin Phipps have all contributed again.

Sadly, two of the original 14 contributors - Jim Gilchrist of Scottish Life and Sheila McKechnie of Which? - have died, and are sorely missed by the financial services sector as well as those close and dear to them. I knew Jim better than Sheila, and I miss him as an industry colleague and friend.

One contributor, Mark Wood, announced after writing his copy that he would be leaving Prudential for pastures new, but he graciously agreed that his piece could remain.

The 22 contributors are all individuals so well known to most people in the mortgage world that they need no introduction from me. They are very generous to share their views in this way and I offer them all warmest thanks. Their contributions differ in length because we have reproduced their words verbatim.

I can subscribe to the view that we might be in for a relatively long period of flat or slightly increasing property prices. This is what happens in low interest rate, low inflation economies. I can also appreciate that there may be corrections in some regions where, for example, property prices may have accelerated due to a particular type of demand.

But my prediction is that it is very unlikely that there will be a crash or significant downturn without a major deterioration in economic prospects. We will instead enjoy a period of stability with flat or low house price inflation subject of course to the picture not materially being distorted by Government action, or world events, which cannot be foreseen today.

9. Lender consolidation

As this book goes to press, there are 147 members of the CML, with several new lenders planned for launch in 2006. My good friend, Michael Coogan, Director General of the CML, may be rubbing his hands with glee at the prospect of all this new membership income. But is it sustainable? Can all these lenders survive?

The laws of economics dictate that significant over-supply will lead to long-term consolidation. With the top ten lenders accounting for more than 80% of all mortgage lending, it could be argued that this is already taking place.

I think there are three groups to aim for, namely the big group, a significant, identifiable and sustainable niche or regional. I believe that all lenders need to be shooting for one of those groups.

In the big one there will be commoditisation. Technology, delivery, product innovation and cost:income ratio are all going to be factors that dominate the ability to compete.

There will be many aiming for that group who are, for one part of the year, on a trajectory to maintain a place and, in other parts of the year, not getting there. There will be other lenders who are on a long term trend to miss out, but who do not intend to go out without a fight.

This is therefore a great opportunity for those lenders with our business model, under which assets are created and traded, and we hope to satisfy that demand for many years to come. In the end, though, the big group could only realistically expand to a total of 15 at most, so there will have to be mergers.

There are, currently, clearly identifiable niches including buy-to-let and non-conforming. Some specialist lenders undertake substantial, and profitable, lending by specialising in those areas. This may continue. Moreover, other niches may develop that we cannot today foresee.

A big challenge with niches, of course, is their lack of scalability. In the end, if a niche becomes important enough to attract the attention of the big group then, as they start joining it, the niche becomes mainstream, and so does the pricing.

Buy-to-let lending to standard borrowers is almost there, and the big niche in that sector now is lending to partnerships and corporate landlords. Non-conforming is getting there, but I believe that a substantial niche may still remain in that sector involving the more toxic areas of lending. This will still be offering borrowers a better deal than throwing them to the loan sharks.

Offset is another identifiable niche. There are barriers for entry in terms of the investment necessary to maintain such a product. This investment, and the extra administration involved, needs to be priced into the products for profit sustainability. But it is a great customer retention product.

Strong regional support, particularly when enhanced by a local retail deposit-taking facility, has as good a chance of survival as any other. The theory is that customers will always want the cheapest mortgage rate, or the highest savings rate. But actually, real people make decisions beyond pricing considerations. Service, loyalty and familiarity are all reasons to buy, which could sustain a local or regional presence for many years to come.

The net position, however, is that, if I have enough brain cells left to repeat my cycle of a book every eight years, there will not be 147 lender members of the CML when I come to do the "What Next?" chapter. If I had to place a bet, it would be on the number 50.

10. Intermediaries

Most commentators feel that intermediaries now account for 50% - 60% of all mortgage demand. I think it is probably nearer the latter than the former. Reflect again on those 5000+ product choices that Moneyfacts revealed. Would you be comfortable making a selection from that lot based on one conversation with one lender?

I assume you are probably connected with the mortgage industry in some way (because, otherwise, why on earth would you be reading this book?). If you are uncomfortable with making that selection personally, it is easy to see why the majority of the public might be equally unhappy.

The power of intermediaries is set to grow, but not just because of choice. Getting applications in directly from the public is an extremely expensive and speculative business. By way of contrast, getting business in through intermediaries involves paying out only when the loan completes.

The market is going to have to focus on the fact that intermediaries are growing in importance. Which means that, while many are predicting a reduction in procuration fees, I actually think it will go the other way. Since we are heading for equilibrium pricing, I look to two markets close to home, that already have equilibrium pricing, to inform me as to what might happen here.

In Ireland and the US, intermediaries typically receive 1% of the loan. It is built into the product pricing. I think that is where we are heading. As soon as the subsidies mainly disappear from mainstream lending, the competition could well be around the services and payments made available by lenders to intermediaries.

At the moment, UK intermediaries probably receive a fee on average between 0.50% and 0.75% on their mortgage business when you take into account a weighted average mix of mainstream, niche and non-conforming. They top this up with fees charged to customers.

In a more commoditised equilibrium-pricing environment, fees to customers are going to have to come down. So this can only mean one thing. You guessed it - fees to intermediaries will have to go up.

So we at GMAC-RFC are certainly planning for intermediaries to be even more important to us in the future than they are today. I include packagers in this. I think there could be a healthy future for packagers who concentrate on value-added services to their customers, priced so that everybody can see what they are getting for the extra mortgage rate paid.

Estate agents will also continue to play a vital intermediary role. Although I suspect that more buyers are viewing properties on the web than via estate agency windows or mailings, there is still a deal to be negotiated and advice to be taken. Estate agents have an important opportunity to influence right at the start of a property purchase transaction, and this influence will grow if HIPs are ever introduced, as estate agents employing suitably-qualified assessors are guaranteed a role in pre-purchase. Maintaining good connections with estate agents will therefore be important for all lenders.

I therefore expect business introduced by intermediaries of all types will increase over the next few years, and that will not come cheap for the lending industry.

Wrap Up

So there you have the views of 22 leading industry figures on the subject of what is going to happen next in the UK mortgage market. You also have my views. Now is the time for you to reflect on how much of that you believe, and how much of it you do not.

I cannot foresee market conditions which would prevent the industry from making progress in terms of the breadth and diversity of products and opportunities. Regulation and media comment will sometimes hold these things back, but they do not have to. I am personally optimistic that regulation might be lighter touch in the years to come.

The UK has an opportunity to bring its rich diversity of products to more customers with point of sale offers and I hope this is allowed to happen. I particularly hope that the UK market is not held back by the unachievable dream of European harmonisation.

More than anything, I believe that the future is going to be better than today. Having that belief puts a spring in your step and helps you better address life's challenges. I said on page one that I was lucky, rather than clever. Luck visits more with you when you are smiling.

Now, where's that cat?