

CSFI

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What will the mortgage of 2020 look like? A round-table discussion with Peter Williams, Matthew Bullock (Norwich&Peterborough) and Ray Boulger (John Charcol) held on Wednesday, December 3, 2008, at Innholder's Hall, 30 College Street, London, EC4R 2RH, from 6:30-8:15pm.

The first speaker was asked by the Building Societies' Association to peer into the future and draw a picture of the 2020 mortgage market. He said the fundamental mortgage product – a bridge between a borrower's current income and the asset price of the target property – was no different in 2008 from 1908. What has changed, dramatically, is lenders' funding models. Firstly they extended their remit into what are known as subprime buyers and secondly shifted towards a wholesale financing model via securitisation. At the same time the growth in intermediaries as a channel of distribution fuelled that innovation as brokers found new markets for lenders to fill.

Currently mortgages are 30% funded by the wholesale rather than retail deposit market, predominantly from mortgage-backed securities with a 2-3 year duration. That model is clearly under threat. Government figures point to a fall in the share of homes in private ownership from 71% to 65% as funding dries up, effectively leaving an extra 7% in social or private renting.

In terms of finding a new model there are many possibilities: long-term fixed rates; indexed products with an equity share; family products; share equity/pension fund products; rent to mortgage; and even Shariah compliant mortgages. All these have pros and cons. The most likely outcome is a more segmented market with a super-prime category – people with high deposits and low risk – who will be heavily competed over. As one goes down the spectrum, there will be less competition, fewer products and greater exclusions.

Some ask if recession will ease some of the pressure by bringing prices down to affordable levels. The answer is no. In the short-term funding problems will constrain lending and in the long run, the imbalance between supply and demand will keep prices relatively high. Innovation will return and there will be new products by 2020 but the next decade will see a very conservative mortgage market.

The second speaker said a shift was needed in the way lenders and brokers looked at mortgages. In the same way that mobile phone companies have moved from trying to extract a maximum one-off price from a consumer to developing a life-long relationship, the housing industry needs to move from the "quick buck" attitude to a lifetime value. In particular trail fees over the life of the mortgage should replace upfront commissions.

But the biggest headache is the funding model. Securitisation did not eliminate risk, but created a temporal concentration – when problems hit, they hit all parts of the market at the same time. One option is to move to a Continental model where people buy later and hold

debt for longer. The speaker questioned whether banks would stay in the market given the opportunities for high rates of return had vanished. He noted that all building societies that had become banks were now either owned by other banks or the government. The mutual model should emerge as the best one to carry out the “boring” job of looking after the mortgage market. One member agreed, saying that credit unions had seen huge inflows.

The speaker said lenders needed to price across the cycle not just at the peak. He said his institution had operated on a forecast of a 30% fall in prices from current values and unemployment above 3 million for some time. He said that the idea of lifetime costs of buying a home – heating, light as well as mortgage payments – would become increasingly important. In the same way that Rolls Royce sells a lifetime servicing contract rather than just an aero engine is a pointer for mortgages.

The third speaker said buyers valued independent advice and dismissed talk of an end to intermediation. He pointed to examples of lenders offering in-branch products half a point cheaper than through brokers. Take-up was limited. He said the problem with trail fees was how to cost that when borrowers could switch provider.

Thinking about the ideal product, the speaker suggested a lifetime tracker mortgage with a “drop-lock” option, which allows mortgage holders to drop into a fixed-rate mortgage at any time without incurring a penalty, with no early repayment penalties. It should also not have a “collar”, which stops the rate borrowers pay on a tracker from falling below a certain level. On the funding side the speaker said that covered bonds, which were heavily used for funding on the Continent could be applied in the UK. There was no reason why MBS could not return, especially if the government took up Sir James Crosby’s recommendations for a government guarantee for new issues.

What innovations should one expect by 2020? The third speaker said lifetime mortgages was the most likely area. Four lenders had come into this market this year alone. Other innovations included greater flexibility to draw down money and a return of human decision-making to stem the rise in “computer says no” outcomes from the rise in automation. The second speaker hoped to see better data on spending patterns of retirees; greater deepening of the derivatives market; and long-term funding options to meet demand for people entering or re-entering the market once prices stabilise. The first speaker declared that the CSFI was “fit for purpose” as it given him plenty of new ideas to incorporate into the final version of his draft BSA report.