

Ken MacDonald & Co

Lawyers and Estate Agents

Mortgage Brokers: A Guide

Introduction

Most people require a mortgage in order to help raise the funds required to purchase a property. They have however become increasingly complex and the marketplace is hugely competitive. As a starting point, the internet can help. Numerous comparison websites now exist that provide details on different products and compare offers. Newspapers also regularly publish 'best buy' tables. Be aware however that some offers do not include all the fees payable and that often once, you begin the application process the product you select is no longer available and another less attractive one is offered in its place.

It is also worth consulting your existing bank or building society. This may be of benefit to first time buyers with no credit history who are struggling to get a mortgage elsewhere but be aware from the outset that they only look at their own financial products, unlike mortgage brokers who are supposed to have access to the entire market, to find the best deal suitable to your specific criteria. Please bear in mind also that the cheapest deal is not necessarily always the best deal for you.

Comparison sites, newspapers and your existing bank and building society are good for finding a benchmark but it is advisable not to just stop there. If you are confident that you know what you want then there is nothing to stop you getting a mortgage direct on your own but the present thinking is that, in the present financial climate, most people are better off using a broker or financial advisor.

An entire industry now exists of mortgage brokers and independent financial advisors. Like any industry, especially one that has increased rapidly during a boom time, there are some good, some bad, and many, many indifferent. The right broker has the advantage of being able to guide you to the most suitable product, hopefully offer you an extra layer of protection should things go wrong, and carry more clout with lenders, thereby easing the acceptance of otherwise unobtainable mortgages. Many brokers also negotiate exclusive deals with lenders that are not available to individual customers.

The mortgage market is so large and deals change so quickly that a specialist can really make a difference, but be aware, not all mortgage brokers are equal. Since 2004 residential mortgage brokers, have been regulated by the Financial Services Authority (FSA). Though welcomed these regulations are not without problems and further regulation is planned which are anticipated to completely shake up the profession like never before and likely to result in a large number leaving the market place.

There are three key questions worth asking any broker:

1. Are you the whole of the market?

This means asking "will you look at all the UK's mortgage lenders to pick the best deal for me?"

Unfortunately the FSA left brokers a loophole that allowed some to claim “whole of market” status while offering only a small panel of lenders and reviewing their “best deals” roughly only every two months. This simply is not good enough in the UK’s fast moving market.

The more advanced question to ask is therefore “Could you, right now, source a mortgage for me from any available UK mortgage lender?”

Some lenders have traditionally never offered new products through mortgage brokers. When the “credit crunch” hit more started to follow this path with their best deals. Under the regulation “whole market” is technically defined as being the whole of the “available market” therefore non-broker products are not required to be included in a comparison, though a good broker should inform you of them. Therefore whilst going to a broker is recommended, it is worth checking the deals available elsewhere. Any company can decide to launch a product available direct to customers only, not via brokers.

Ultimately, it is a question of how much time, resources and understanding you can put into supplementing your broker’s suggested best deal but it is always worth doing a few checks of your own.

2. How will you make your money?

Brokers have three sources of income:-

1. Commission

All lenders pay brokers a “procurement fee” worth anything from 0.3% to 0.5% of the mortgage value, rising up to 1% for “subprime” mortgages (for people with poor credit). On a £150,000 mortgage that can be anything from £450 - £1,500 for just introducing you to a lender and completion of the application form.

It does however often make the term “independent” financial advisor a fiction, as there is always a hidden financial incentive on a broker to direct large volumes of clients to a certain product or lender.

2. Fees

Brokers may also charge you a fee directly. It is said that no reputable broker will charge more than 1.25% even for “subprime” customers. You should think very carefully about using anyone charging more. The best money saving route is to choose a fee free broker but if you find someone you like, trust and is willing to spend time to listen to your requirements, with a low or reasonable fee, then this may be the right route for you.

Traditionally fee charging brokers were rare, most opted for the commission route, but with the downturn in the lending market and reduction in their income more and more brokers are opting for the fee charging route in addition to receiving commission.

In addition fees were in the past only charged on mortgage completion but in the present climate many brokers now charge at any point in the process, often at the outset.

3. Additional Product Commission

The third and often most financially lucrative means by which the majority of brokers receive income from the mortgage process, is through the commission received from selling other financial products to clients.

Please therefore be prepared for and aware of the hard sell on the following:

i) Mortgage Payment Protection Insurance (MPPI)

The idea behind MPPI, often also called accident, sickness and unemployment insurance (ASU) is that they are supposed to cover your mortgage payment if you have an accident or become ill and cannot work. However, MPPI policies are often expensive and generally have a lot of complicated exclusions, for example, self employed people are usually not completely covered and there may be a relatively low maximum payment. It is also important to note that you may have to wait several weeks before the policy pays out, and even then it will usually only cover your mortgage repayment for one year.

Taking into account these restrictions, MPPI may not be suitable for all prospective purchases, especially if your partner's income or your savings could realistically cover bills for at least a couple of months. If however you decide that you do wish MPPI, you can usually get a cheaper, better deal by shopping around.

MPPI have come under adverse press coverage recently due to a decade of brokers miss-selling such products to customers due to the lucrative commission received from product providers.

ii) Buildings / Contents Insurance

You should be extremely suspicious of any deals that insist that you buy your building insurance through your lender. Whilst the amount quoted may seem reasonable in the first year, and it seems easier to go with the same supplier as your mortgage, customers are often then trapped into accepting whatever premium increases that are imposed in subsequent years, for as long as the mortgage is in place. Some lenders charge a fee if you decline to take their insurance but in the long term it proves economic sense to incur this penalty.

Again you should shop around to see what deals are available. Some seriously cheap deals are available but like anything, cheap does not always mean best. It is worthwhile choosing a reputable company and taking the time to understand exactly the terms, conditions and cost of your chosen product.

iii) Life Cover

Do not assume that just because someone sold you one financial product that they will automatically supply you a good or the best suitable deal on additional financial products such as life cover and other insurance. As with MPPI's it is worth shopping around for the best deal.

The point to note about all three of the above types of financial products is that your broker often receives large sums for introducing you to the product provider. It has not been unheard of for a broker to receive payment of a fee direct from the client, obtain a large commission for introducing you to the lender for your mortgage but then leave you completely high and dry when you do not agree to purchase one of the three products referred to above. The clear message this sends out is that the commission must be substantial and often the only one the broker is ultimately interested in.

Taking all three sources of income into account it is common place for brokers to receive in excess of £1,000 from each and every client.

3. What is a Standard Security?

The vast majority of those working in the financial sector do not actually know what a standard security is despite making enormous sums of money through recommending them. A good way of assessing the true worth of the person advising or guiding you on your mortgage choice is to simply ask them to explain to you in layman terms what exactly a standard security is, how it differs from products such as mortgages, secured loans, unsecured loans and charges, how they are created, how they are brought to an end and any risks involved in creating them. We refer you to our information sheet on finance located in the resources section of our property service page of our website to assist you.

Conclusion

We are great believers in using brokers local to the area. Not only do they know the local property market and the various local services providers, they should also have access to the same national market as any broker operating further afield. By following the guidance given above you should be able to get an excellent face to face service that is local to you.

Over the years we have built excellent relations with all the local mortgage brokers, be it the mortgage advisors in the local branches or the local independent financial advisors serving our community, and we have no hesitation in recommending any one of them to you. We do however take pride in our own independence and therefore have always resisted offers to enter into exclusive arrangements with any one broker. In so doing we feel we can serve our clients better by being able to assist them no matter whom they decide to use.

We would be happy to discuss your choice of broker at the outset and if required make the initial introduction on your behalf free of charge and without any commission being made to us.

The material in this guide is for general information only and does not constitute investment, tax legal or any other form of advice. You should not rely on this information to make (or refrain from making) any decisions. Always obtain independent, professional advice for your own particular situation.

This guide should also be read in conjunction with our guides on the buying process, credit rating and mortgages. We also have a selection of information sheets on a variety of topics that will assist you in understanding the legal process.