Mortgages

New Opportunities in the Commercial Loans Market

Small buy to let investors become large buy to let investors and their financing needs change. Mark Dennis believes the commercial mortgage market, traditionally dominated by the high street banks, and the intermediary channel in particular, represents a market on the move.

It's little wonder that commercial mortgage lenders are beginning to take the intermediary sector seriously. Whereas intermediaries arranged 5% of all commercial mortgages just 10 years ago, this has leapt to 20% today and shows no sign of slowing. Consider the fact that intermediaries already account for a massive 80% of the US commercial mortgage market and it soon becomes apparent that 20% is likely to be well short of the ceiling ultimately reached by the UK broker sector.

New broker-orientated commercial lenders such as Commercial First and InterBay are actively encouraging non-specialist commercial mortgage brokers into the commercial arena in a concerted attempt to grow the intermediary channel. Financial intermediaries themselves are increasingly seeking out new income streams due to greater competition in their traditional markets and ever-increasing compliance costs and lenders are usually pushing against an open door.

This of course has potentially far-reaching implications for traditional lenders who have hitherto been able to rely on the vast majority of their business customers coming direct to them for their commercial mortgages.

There are signs that some banks have recognised brokers' growing influence in this particular market and are focusing more of their marketing on the intermediary sector. If commercial mortgage lenders want to maximise the share of business they receive from the intermediary sector, they need to be clear of their intermediary strategy.

Perhaps the most fundamental question is, which intermediaries should be targeted? The options are:

- Specialist commercial mortgage brokers (who may already operate a panel of commercial mortgage lenders).
- Non-specialists currently involved in writing commercial mortgage business but for whom the arranging of commercial mortgages currently accounts for a relatively small part of their total fee income.
- Financial intermediaries not actively involved in commercial mortgages at all.
- Intermediaries who generate commercial mortgage leads but prefer to simply introduce their clients to another (specialist) intermediary, a packager or so-called 'master broker', or maybe direct to a lender.

In this respect it is important for lenders to be able to make a properly informed decision regarding which types of intermediaries to target and how to develop the optimum balance between the various types. A key consideration is what type, or types, of intermediaries are likely to generate the greatest level of business for an individual lender.

Perhaps the instinctive answer to this question from many observers would be, existing specialist commercial mortgage brokers. But how much business does the average specialist broker actually generate? Among how many lenders is this business spread? And how much of their business, in an as yet unregulated environment, tends to be fed through just their top few lenders? In other words, could it be more effective for lenders to target non-specialists who may be generating lower levels of business but with whom it might be easier to become an 'important' lender among what is likely to be a smaller roster of existing providers?

If so, how much potential does a non-specialist broker have to develop into a serious introducer of commercial mortgage business? How open-minded are they to making commercial mortgages a key part of their business profile and what do they require from lenders to up their game in the commercial arena?

The problem for lenders in trying to navigate this area is the relative dearth of information in the commercial mortgage broker market. At Charterhouse Research we have launched an industry survey of commercial mortgage intermediaries designed to provide lenders with the answers to these and other strategic questions such as – having identified the type(s) of intermediaries to target, should we focus on developing relationships with as many of these as possible or should the emphasis be on developing deeper relationships with a limited number of brokers?

From our existing quarterly survey of residential mortgage brokers, 'Mortgage Intermediaries – The Regulated Market', we know that while brokers introduce business to an average of 11 lenders, a substantial 60% of that business is placed with just their top three providers.

This means that in the case of the average broker, no fewer than eight lenders are fighting for a share of just 40% of that broker's residential mortgage business. This shows how, in the domestic mortgage market at least, it is so important to become a key provider to the intermediaries with whom lenders deal.

Our new survey of the commercial mortgage market, due to report its findings in March 2007, will highlight the equivalent pattern of business-placing behaviour among commercial mortgage brokers.

Having identified the type(s) of intermediaries to target and having decided on the relative focus between new broker acquisition and developing deeper relationships with existing supporting brokers, another key plank of a lender's intermediary strategy is to identify precisely what factors have most influence on brokers' choice of lender. These factors can be divided into two groups:

- Those hygiene factors that a lender needs to demonstrate in order to make it onto a broker's formal or informal panel of lenders in the first instance, e.g. the payment of competitive rates of commission.

- Those factors that differentiate one lender from another on a case-by-case basis, e.g. the speed with which agreements in principle can be given.

We believe our research will show that different broker types will have very different drivers of lender selection. For example, one might expect a factor such as whether a lender appoints its own solicitors on a case, to be more influential for specialist commercial mortgage brokers than non-specialists.

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Non-specialists on the other hand are often wary of commercial mortgages, seeing them as excessively complex to arrange, time consuming and uncertain to result in a formal offer from the lender. Our view is that non-specialists are therefore likely to have very different, more basic requirements from lenders.

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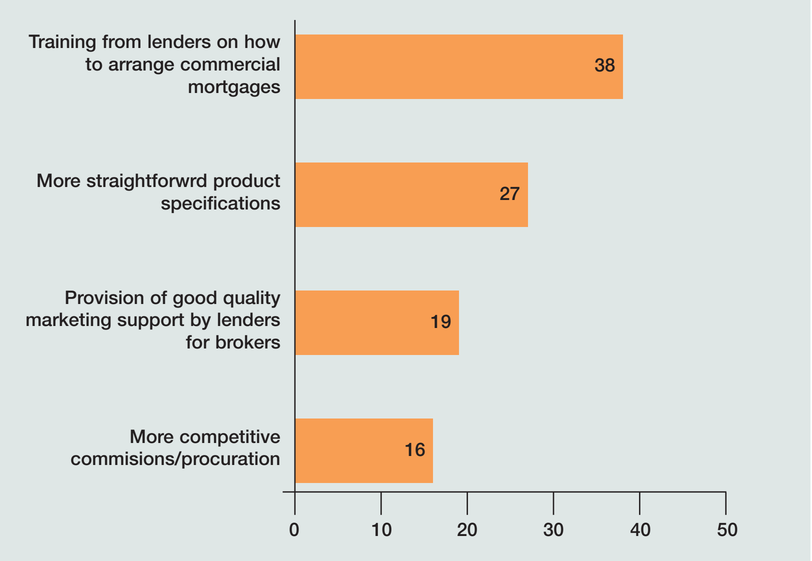
Indeed as part of our existing survey of residential mortgage brokers, we recently asked intermediaries who do not currently place any commercial mortgage business which of a series of four lender initiatives would be most likely to encourage them to arrange commercial mortgages.

The results showed that basic training from lenders on how to arrange commercial mortgages would be the most influential factor, followed by the availability of more straightforward product specifications. Good quality marketing support from lenders came third, while more competitive commission was only fourth out of the four options tested (see graphic below).

IMPORTANCE OF LENDER INITIATIVES TO MORTGAGE INTERMEDIARIES



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As for intermediaries already active in the commercial mortgage market, similar insights will be available from our forthcoming survey of commercial mortgage intermediaries. The study will be conducted among existing generators of commercial mortgage business, with the total sample of 400 brokers split equally between specialists and non-specialists so that it will be possible to identify the different requirements of the two groups.

There are clearly opportunities for commercial lenders who are committed to servicing brokers by providing the right products, the right service, and potentially providing appropriate training and marketing support.

For those commercial mortgage lenders who are able to correctly identify what help non-specialists are looking for from them in order to write more commercial business, the potential rewards are substantial. Our latest quarterly wave of research among residential mortgage brokers revealed that some 42% of residential mortgage brokers already arrange commercial mortgages, highlighting the existence of large numbers of hybrid, 'commercial-residential' mortgage intermediaries. In addition, a further 26% said they planned to start arranging commercial mortgages in the foreseeable future.

So the appetite among residential mortgage brokers for commercial mortgage business is most definitely real. However the challenge, and indeed opportunity, for commercial lenders looking to exploit this open-mindedness will be to help and encourage these intermediaries to make commercial mortgages a bigger part of their overall business mix. This is underlined by the fact that of the 42% of residential mortgage brokers currently active in commercial mortgages, such business accounts for an average of just 5% of their total fee income. In summary commercial mortgages, and the intermediary channel in particular, represents a market on the move. There are clearly opportunities for commercial lenders who are committed to servicing brokers by providing the right products, the right service, and potentially providing appropriate training and marketing support.

But commercial mortgage lenders need to make the right decisions in terms of:

- Which intermediaries should we target? Should we target specialist commercial mortgage brokers, non-specialists, and/or virgin commercial mortgage brokers? Because approaching half of all residential mortgage brokers are also writing commercial mortgage business, should we more actively leverage our existing relationships with residential mortgage brokers?

- What balance should we seek to achieve between maximising the number of supporting brokers we work with and servicing and rewarding a smaller number of key accounts?

- How do we encourage non-specialist brokers to make commercial mortgages a more important part of their product portfolio?

- How do we ensure we maximise our share of introductions from the intermediaries we deal with?

We believe this is a key area for commercial mortgage lenders in the coming months and the effective utilisation of good quality market insight will be fundamental to exploiting this opportunity. ☐

Mark Dennis is a founding director of Charterhouse Research.