

RESEARCH INSIGHTS REPORT ON MORTGAGE BROKERS

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EXECUTIVE SUMMARY

- Mortgage brokerage serves as an intermediary that connects mortgage buyers & lenders that are best suited to borrower's financial position and investment needs providing the convenience of being a one-stop-shop intended to deepen the mortgage market
- Brokers could greatly improve customer experience and satisfaction levels by offering crucial financial advice and preparation of paperwork required for mortgage processing.
- Mortgage brokers increase choice and competition between lenders, leading to better service levels and competitive mortgage pricing.
- Globally, the mortgage brokerage services market has experienced tremendous growth and is expected to maintain its dominance according to Mortgage Brokerage Services Market report in 2021.
- Today in most developed mortgage markets (especially in Canada, the U.S., the UK, Australia, New Zealand and Spain) including developing nations like Nigeria,

South Africa, mortgage brokers are the largest sellers of mortgage products for lenders.

- According to the Australian regulator (ASIC 2019), consumers who are first home buyers and have lack of knowledge about mortgages tend to use the brokers.
- The Royal Commission Report in Australia in 2021 states that the mortgage broking industry is a key distribution channel for home loans, accounting for more than half of all residential home loans settled.
- Mortgage broking is a significant industry, contributing \$2.9 billion in gross value added (GVA) to the Australian economy each year and supporting the employment of more than 27,100 full-time equivalent (FTE) workers according to Deloitte Access Economics report.
- The mortgage broking industry has had an impact on the economies such as Australian, Canada, South Africa through enhancing competition in the credit sector, lowering interest rates and reducing costs for borrowers.



- More than 90% of customers are happy with their mortgage broker's service and performance according to Deloitte Access Economics report.
- The Mortgage Brokers sector is anticipated to grow over the next 5 years according to Market Research Report by IBISWorld's Mortgage Brokers.
- Over the past 42 years, mortgage brokers have emerged as the principal points of contact between consumers and the mortgage industry.
- The growing complexity of the mortgage industry has given unscrupulous mortgage brokers the opportunity to exploit consumers in other economies hence need to regulate against "predatory lending,".
- It is therefore recommended that Mortgage brokerage in Kenya can be developed and regulated to drive mortgage uptake hence home ownership.



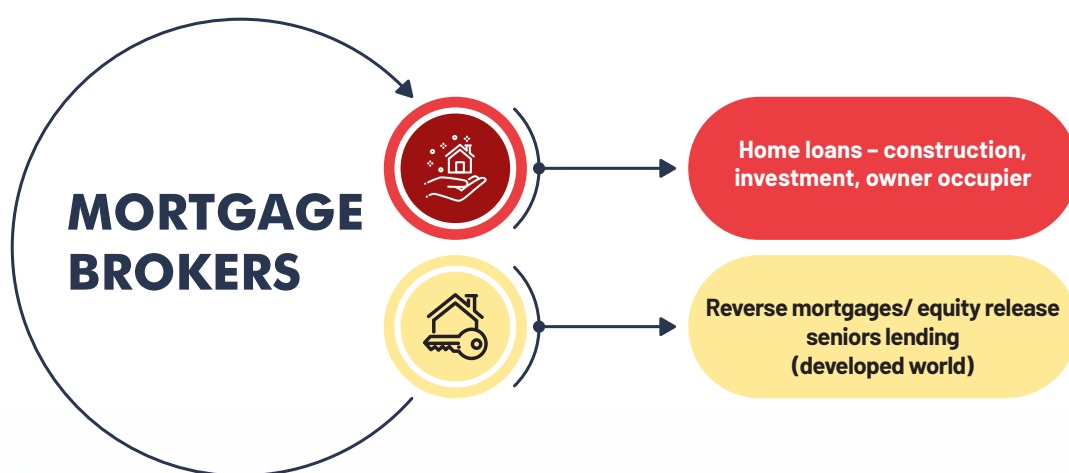
INTRODUCTION

Globally, the mortgage brokerage services market has experienced tremendous growth and is expected to maintain its dominance according to Mortgage Brokerage Services Market report in 2021.

Mortgage brokerage serves as an intermediary that connects mortgage buyers & lenders that are best suited to borrower's financial needs. A broker also collects data on earnings, assets, employment supporting documents, credit reports, and other required details to evaluate the ability of a borrower to secure financing and meet loan obligations. Effectively, brokers can reduce the observable credit risk of applicants with credit enhancement services. Brokers choose the optimal amount of service to provide to prospective borrowers to maximize the expected profit of each origination. Moreover, they are also responsible for necessary paperwork from a borrower and forward the same to mortgage lenders for underwriting and mortgage approval. Generally, mortgage brokers are regulated to ensure compliance with banking and finance laws and ultimately, consumer protection.

Mortgage brokers are paid on a fee-based schedule. In most cases, the loan origination fee charged by the bank is paid to the broker. This amount is based on the loan amount, which can influence a broker's advice and research. Like some commission-based financial planners, some brokers work mainly with or are partial to certain lenders, which could influence the choices that they offer to potential borrowers. Compensation comes mostly in one of two forms: a finder's fee from the lending institution for bringing in a borrower, or a commission based on a percentage of the total mortgage acquired. The finder's fee is the most common form of compensation making broker usage a cost-free process for most consumers.

A mortgage broker works with everyone involved in the lending process (from the real estate agent to the underwriter and closing agent) to make sure a borrower gets the best loan and the loan closes on time. A broker can work independently or with a brokerage firm. Brokerages such Quebec's Multi Prêts Hypotheques in Canada bring in over \$100 million worth of credit to the banks yearly and this allows for a very strong bargaining position. In Nigeria the mortgage brokers include FirstHome Mortgage Brokers Limited, CTSR Group, ALPHA Solutions, Meet the Property Guy, and Olajumoke Fashanu (an individual). The common practice is for respective countries to set Essential Eligibility Requirements (SOPs) for a broker to fit their local context. Therefore, Mortgage Broker can be a person or an agent (company) securing:





THE ROLE OF MORTGAGE BROKERS

Traditionally, banks and other lending institutions have sold their products directly to the customers. However, as markets for mortgages become

more competitive and sophisticated, the role of the mortgage broker has been amplified. Today in most developed mortgage markets (especially in Canada, the U.S., the UK, Australia, New Zealand and Spain) including developing nations like Nigeria, mortgage brokers are the largest sellers of mortgage products for lenders. Mortgage brokers therefore are important intermediaries between the lenders and the potential customers. Potentially, mortgage brokers can help consumers to explore the complex range of mortgage products and attributes, offer products that meet consumers' needs and assist the mortgage application process.

Brokers could greatly improve customer experience and satisfaction levels by offering crucial financial advice and preparation of paperwork required for mortgage processing. A mortgage broker is an agent that represents the interests of the consumer when securing a loan from a bank or credit institution. Their role is to find the lender with the mortgage terms and interests' rates

that best suit the borrower's needs. Typically, they work independently and do not originate any loans themselves. Instead, they constantly compare rates between the lending institutions to establish which ones are offering the best deal at a point in time. They also have access to private lenders and broker only institutions that customers would not be able to contact themselves. In addition to comparing rates, brokers study the lending profiles of various institutions. Matching a bank's lending strategy to the risk and credit profile of the borrower allows the broker to find the lowest rates available. Mortgage brokers also maintain strong ties with the lending institutions themselves which allows for greater negotiating power. Rate discounts can be negotiated based

on number of borrowers the broker brings to the bank, the quality of borrowers, and amount being borrowed. Naturally, the more customers that the broker matches to a certain bank, the increased likelihood that they will offer a quantity discount to the broker.



According to the Australian regulator (ASIC 2019), consumers who are first home buyers and have lack of knowledge about mortgages tend to use the brokers. Over half of all mortgages origination in Australia are by brokers (MFAA 2018). Brokerages such as Quebec's Multi Prêts Hypotheques in Canada bring in over \$100 million worth of credit to the banks yearly and this allows for a very strong bargaining position. Some smaller credit institutions, such as First National Financial, rely entirely on brokers to find potential borrowers. As they represent the borrower's interests and receive compensation on a transaction basis only, they are motivated to negotiate the best deal possible. Therefore, the work undertaken by the broker will depend on the depth of their service and liabilities. Typically, the following tasks are undertaken:

- Marketing of products to attract clients.
- Assessment of the borrower's circumstances (Mortgage fact find forms interview) – this may include assessment of credit history (normally

obtained via a credit report) and affordability (verified by income documentation)

- Assessing the market to find a mortgage product that fits the client's needs. (Mortgage presentation/recommendations)
- Applying for a lenders agreement in principle (pre-approval)
- Gathering all needed documents (payslips, bank statements, etc.)
- Completing a lender application form (prepare loan applications)
- Explaining the legal disclosures
- Submitting all material to the lender
- Upholding their duty by saving their clients as much money as possible by offering best advice for the clients' circumstances
- Identify client needs for broking services.
- Comply with financial services legislation and industry codes of practice.
- Apply principles of professional practice to work.
- Develop and maintain in-depth knowledge of loan products and services.





IMPACT OF MORTGAGE BROKERS IN THE MORTGAGE MARKET

Today, about two-thirds of mortgage loan transactions transpire through third-party mortgage brokers who connect clients to products offered by mortgage banks and provide those clients with the necessary information to maneuver through the application process. This transformation of the industry has been associated with important benefits. Home purchase loans to

low-income borrowers increased by 80.4% between 1993 and 2001, compared with a significantly lower 48% growth in overall home purchase lending (Mortgage Brokers and the subprime mortgage market research by Federal Reserve Bank of Chicago in 2005). Mortgage brokers can obtain loan approvals from the largest secondary wholesale market lenders in the country.

In many developed mortgage markets today, (especially in the United States, Canada, the United Kingdom, Australia, New Zealand, and Spain), mortgage brokers are the largest sellers of mortgage products for lenders. The Royal Commission Report in Australia states that the mortgage broking industry is a key distribution channel for home loans, accounting for more than half of all residential home loans settled. Using a novel loan-level dataset for all mortgage originations in the UK, there is motivating evidence on the role of brokers in this market and the key trade-offs consumers may face. When choosing a mortgage, more than 50% of households rely on mortgage brokers to help them decide which alternative best fits their needs and to assist them with the application process. According to a 2004 study by Wholesale Access Mortgage Research & Consulting, Inc., there are approximately 53,000 mortgage brokerage companies that employ an estimated 418,700 employees and that originate 68% of all residential loans in the United States. Brokers offer lenders a way to introduce their products in areas where setting up a branch is costly and consumer take-up of online distribution channels remain low.

The recent report from Deloitte Access Economics explored the role of mortgage brokers in Australia as well as the diverse impacts and value proposition of the broking industry and concluded that the mortgage broking industry contributed approximately \$2.9 billion to the Australian economy in 2017, and the employment of more than 27000 full-time equivalent workers and 22000 part time workers. It's found that the mortgage broking industry drives competition within lenders, in turn benefitting all home buyers and investors; More than 90% of customers are happy with their mortgage broker's service and performance; Mortgage broking channel has contributed to a 3%-point drop in lenders' net interest margin over the past 30 years; The average mortgage broker has access to 34 different lenders and uses an average of 10 lenders on their panel and Sole trading brokers earn an average income after costs and before tax of \$86,417. The Mortgage Brokers sector is anticipated to grow over the next 5 years according to Market Research Report by IBISWorld's Mortgage Brokers.



Customer Experiences of Using Mortgage Brokers Market Research Report Deloitte in 2016 established that Broker customers tend to be more satisfied with their experience than direct to lender customers, Brokers are rated as more likely to be acting 'in the best interest' of customers and Customers using brokers value support, not just price. Consumer Access to Mortgages Report in 2021 by Momentum Intelligence in Australia found that 56% of first-time home buyers use or were planning to use a mortgage broker. The survey uncovered that the mortgage broking channel continues to be the preferred channel among existing borrowers with 60% intending to use a mortgage broker the next time they take out a mortgage. This level of preference is in line with the flow of new mortgages being written via mortgage brokers and reflects the strength of the mortgage broking industry at this time. According to Research by University of Sydney on Mortgage Choice and Consumption and Investment Behaviour in March 2022 compared with non-advised consumers, mortgage-broker-advised consumers express preferences that align with broker incentives to tilt consumers to high-volume and longer-term home loans. Naturally, brokers are typically expected to create stronger and more high-quality trust relationships.

The economic uncertainty stemming from the COVID-19 pandemic has led to more Australians approaching Mortgage Brokers, especially because a mortgage is a long-term commitment. Thus, brokers improve efficiency in the market by reducing costs both for lenders (via lower marginal costs) and households (via lower search costs). In Kenya, with most people working from home, we have seen more demand for mortgages in the 2020 – 2021 period compared to the previous three years informing on a positive trend going into the future. This presents a good opportunity for mortgage brokerage to spur uptake hence KMRCs' business viability. For instance, Fannie Mae may issue a loan approval to a client through its mortgage broker, which can then be assigned to any of several mortgage bankers on the approved list. The broker will often compare rates for that day then assign the loan to a designated licensed lender based on their pricing and closing speed.





REGULATIONS FOR MORTGAGE BROKERS



Financial advisors are not immune to conflicts of interest, with many of them having misconduct records and being repeat offenders

(Egan et al. 2018). In the housing market, Levitt & Syverson (2008) show how real estate agents exploit their informational advantage to their financial benefit when advising clients on the timing and sales price of their houses. Similarly, Guiso et al. (2018) find evidence of distorted advice when analyzing lenders' in-house mortgage recommendations to borrowers. Financial incentives can also amplify the effects of high search costs by inducing brokers to steer consumers towards inferior products (Egan 2018).

Over the past 42 years, mortgage brokers have emerged as the principal points of contact between consumers and the mortgage industry. Some brokers have been accused of misrepresenting their clients' interests, falsifying loan documents and committing fraud in some countries. The accusations raise the need for effective industry regulation. Licensing may be a way to address these quality issues, yet this form of regulation may have the unintended consequence of increasing prices or restricting market access, particularly for already disadvantaged groups. The growing complexity

of the mortgage industry has given unscrupulous mortgage brokers the opportunity to exploit consumers. While this exploitation, commonly referred to as "predatory lending," is profitable for the mortgage broker, the consequences for the borrower are often devastating. The costs of predatory lending have been estimated at \$9 billion a year in the USA creating the perception that policy intervention in the form of heightened regulation may be necessary. One increasingly widespread regulatory approach, occupational licensing, could have both positive and negative effects on consumers but the former overrides the latter.

For instance, Occupational licensing could benefit consumers by improving the quality of the mortgage broker industry through gate keeping, behavioural changes and eased enforcement. Gate keeping refers to the fact that requiring mortgage brokers to pay fees, complete educational programs and pass licensing tests can keep some negative elements out of the industry by weeding out incompetents and discouraging impatient scam artists.

Licensing might also change the behaviour of those who do enter the industry. Required educational components or formal codes of conduct could incline or enable brokers to behave more positively. Finally, licensing and codes of conduct might make enforcement easier. Rather than prosecuting through the judicial system, licensing boards would have their own procedures for investigating complaints and revoking licenses. In theory, licensing provides a quick, easy, affordable way to stop bad apples from practicing. It is the intent of governance to establish a state system of licensure in addition to rules of practice and conduct of mortgage brokers and loan originators to promote honesty and fair dealing with citizens (home seekers) and to preserve public confidence in the lending and real estate community. Therefore, majority of mortgage brokers are regulated to ensure compliance with banking and or finance laws in the jurisdiction of the consumer; however, the extent of the regulation depends on the jurisdiction.

Table 1.1 – case studies of Regulations in other jurisdictions

Country	Act/Policy	Regulatory Body	Reference
Nigeria	Approved Guidelines issued by Mortgage Banking Association of Nigeria (MBAN) For Mortgage Brokerage Operations	Mortgage Banking Association of Nigeria (MBAN)	http://mban.org.ng/wp-content/uploads/2019/08/AP-PROVED-GUIDELINES
Canada	Mortgage Brokerages, Lenders and Administrators Act, 2006, S.O. 2006, c. 29	Mortgage Banking Association of Nigeria (MBAN)	http://mban.org.ng/wp-content/uploads/2019/08/AP-PROVED-GUIDELINES
Australia	National Consumer Credit Protection Act 2009 (National Credit Act)	The Australian Securities and Investments Commission (ASIC)	https://www.legislation.gov.au
United Kingdom	Financial Services and Markets Act 2000	Financial Conduct Authority (FCA)	http://mban.org.ng/wp-content/uploads/2019/08/AP-PROVED-GUIDELINES

Therefore, it is recommended that Mortgage brokerage in Kenya can be developed and regulated under the Capital Markets Act or CBK Act, 2014. The acts can be reviewed to include Mortgage Broking Act/Regulations/policies i.e., introduce Mortgage Brokers Act under the one of the regulators. For instance, in Australia, mortgage brokerage operations are regulated by the Australian Securities and Investments Commission (ASIC) under National Consumer Credit Protection Act 2009 (National Credit Act) whereas In Nigeria, Mortgage Banking Association of Nigeria (MBAN) duly authorized by the Central Bank of Nigeria (CBN) regulates mortgage brokerage operations.

The two options offer a centralized source to: -



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