TAX TALKS

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23 | Insights of a Mortgage Broker

Mortgage broker Jonathan Preston shares his insights of mortgage brokering and the industry in general. Mortgage brokering is a $344b industry, responsible for more than half of all mortgages originated in Australia. And it is sitting right in front of tax professionals in the supply chain. Meaning mortgage brokers come in at the very start of an investment cycle, while tax professionals tend to handle the tax side going forward.

And yet mortgage brokers and tax professionals tend to never meet or talk, hence this interview of Jonathan Preston. Jonathan is a mortgage broker at Home Loan Experts in Sydney.

Insights of a Mortgage Broker

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How did you transition from financial markets to mortgage brokering?

"I started my career in financial markets in quite a speculative capacity. I guess part of that comes down to age. Wanting to be successful when you are young. I saw using a lot of leverage as an opportunity to do that.

As I matured in my career and with my investments, I generally found that when I was trying to speculate using a lot of leverage, the results would be very volatile.

Sometimes ambition works against you when it comes to leverage.

So I started to transition out of using significant leverage and began trading in physical equities. From that I made some significant gains in a number of stocks.

Encouraged by these gains, I started to become more interested in getting into the property side of things. I had enough money to start buying properties.

More and more people started asking me for advice. And I really enjoyed that aspect. I began to help people steer their financial destiny, avoid bad financial decisions and invest in the right way for their risk profile.

So I slowly shifted my career away from financial markets to financial planning and property investments.

As this continued I acquired more and more property. And I got more and more people coming to me with property related questions, wanting to talk about how they could potentially build a portfolio and a number of things like this.

Overtime basically I was becoming more and more sought after in terms of talking about property and then I saw a good opportunity here to make a move into mortgage broking which I felt would allow me to talk 100% of the time on the topic of property and that sort of where I find myself today."

How does one become a mortgage broker?

"You don't need a huge level of qualification to get into the industry.

However, from the outside all mortgage brokers look the same and all the banks look pretty similar and the products look pretty similar. But when you actually look inside the industry, you notice the differences in credit policies between banks. And how you need to specifically cater to someone's personal circumstance with the right lender to get approval.

Everyone's circumstances are different. So there is actually a substantial learning curve and a big difference between lenders.

So getting the formal qualification to become licensed as a mortgage broker is one thing. But to become a good mortgage broker can be very difficult. Making sure you can get big deals across the line is a completely different story altogether."

What's your role at Home Loan Expert?

"I am a mortgage broker at Home Loan Experts. Basically I manage the full client relationship, I will assess the transaction and see which lender will fit a client's profile. And then I have a team that helps me to facilitate it all the way to settlement. But I am responsible for the full client relationship. I am responsible for finding the right lender and getting the loan actually approved."

What's the relationship between mortgage brokers and financial advisers?

"It differs from client to client. We are seeing more and more financial advisers getting into the mortgage brokering space so they tend to be more a competitor.

The challenge around that though is the lack of actual brokering experience. They can be great financial advisers and understand someone's risk profile and personal circumstances and everything else. But they don't see a significant volume of mortgages and variety of circumstances. They don't have enough brokering experience on the ground in terms of seeing clients scenarios and getting hundreds of loans approved. This will really hinder them. There will be a number of situations that they're not equipped to deliver on."

The mortgage broking market works on commission?

"Correct. In most scenarios this is the case. For very complex transactions or for a commercial transaction or for a small transaction brokers will sometimes charge a brokerage fee which is effectively a fee for service component.

Most standard loans do pay a similar rate of commission. Some specialist lenders pay more or less. And some transactions take significantly longer to get approved. When it comes to commercial loans, it all tends to be case by case.

So the vast majority of it is commission based but in an increasing number of cases we are seeing a fee for service brokerage component being implemented."

The commission is paid by the banks?

“Yes, paid by the banks. Then it goes to an aggregator, then to the company that you are working for.”

How do banks liaise with mortgage brokers?

“The banks will have business development managers. One manager will typically be responsible for 100 to 500 brokers. That would normally be your point of reference when you have a scenario that you want to discuss with the banks. Or you have something that goes against their rule but maybe there are reasons they might make an exception.

With some banks you tend to build a relationship with overtime. And also some business development managers have a strong relationship with the credit team. And in that case they will support an application and say that in their opinion its likely to work and its gonna be fine and they will have to push it through.

At other banks the BDMs will answer your questions but then it gets to the credit department. And if credit doesn’t want it, then credit doesn’t want it. So, it depends on the lender.

Typically the smaller the lender, the more the BDM is able to help.

The large lenders tend to be more regiment and less flexible when it comes to making an exception. Policy is a whole different story. The big banks may have more flexible policies. But the BDMs tend to have less say.

When it comes to the BDMs having pulling power, you tend to find that more at smaller or specialised lenders.”

How is mortgage brokering market fragmented?

“The market as I see it has three levels.

There are a number of big players in the market. These larger companies tend to have a number of contracted brokers. Typically the large firms have very little training. They tend to do a course for a couple of weeks – something very basic where they teach you real basics. And after that they say “Off you go” and give you a couple of leads a month. They will say, “Convert that. Go to community events. Go and get your own clients.”And when you get a client, you somehow have to make it work all on your own.

Then you have your large independent brokering companies like Home Loan Experts. At these you might have 15 to 50 brokers or maybe even 5 to 50 brokers. And they tend to be more like a close-knit unit. The companies are large enough that you are getting the benefit of scale. You are on the radar of the banks in terms of getting their help. And you also have the shared experience across the group. We can walk around the room and half of the staff here are ex-bank. We can discuss difficult transactions. All this really helps to get positioned in the right way. You don’t get that as an independent agent sitting alone in your office.

And then you have the one-man bands or maybe with 2 brokers. In some cases they can be excellent. There are some excellent small brokers. But in a lot of cases they are not seeing enough transactions. They are not getting a lot of loans from the banks since they are quite small independent players. And so in some ways this is a significant disadvantage.”

Do clients usually liaise with you before buying a property?

“Most of the time they do come in first to get a pre-approval. Some people are over confident. They will go and buy a property, maybe at an auction or put money down. And then they find out that their approval did not hold weight.

So that’s something we are seeing more and more in today’s market as financing is becoming more challenging.

Another thing is off-the-plan properties. The seller has told the buyer, " You can have any finance. Don't worry. It's easy. Just sign here." Until recently, agents were typically paid 50% of upfront and 50% upon settlement. So they just really want the transaction across the line.

And then we get someone who is three weeks out of settlement. They applied somewhere that they thought is going to give them approval without any problems. And all of a sudden it's a big issue. They might have gone to their local bank that they've banked with their whole life and then the bank says, "No, we can't help you because of this." They then tend to find us online and say, "Here's what I am up against. I really need your help. Here are my issues. Can you help me find a lender that would work around that?" We do a lot of that."

What do the banks look for when it comes to approval? Is there a difference between commercial and residential?

"Yes there's a pretty big difference. Let's talk about residential versus commercial first.

Residential is much more regulated. You typically have to meet a minimum assessment rate. Assessment rate is an assessed interest rate above the actual interest rate. This way the lenders ensures that everyone could afford their mortgaged payment even if rates go much higher. So you have to show that you have sufficient income to actually cover that mortgage even if rates go much higher.

So even if you are buying an investment property as a standard purchase through a standard residential, it is still a regulated loan if it is in your personal name. And even if rent looks to be covering the mortgage payments it still has to meet that assessment rate. So income is very important. You need to verify your income. Not only through the rent of the property but also through your job, your self employment or perhaps just a low doc loan which might be a BAS statement, account declaration or something of this sort.

The other part of that is the deposit and the character of the person who is actually borrowing, so effectively your credit file. Have you had defaults? Have you had a judgment or a bankruptcy in the past?

So, residential really comes down to income, deposit and who you are as a a borrower.

Commercial is much more case by case. If a transaction makes sense to a lender, they are willing to look more outside the box. The deposit requirement is usually larger for commercial. The rental income from the commercial property and the lease terms are often more important.

As is the type of security. Obviously in residential that is important in residential as well but I am making the assumption here that in residential we are talking about a standard house, a standard unit or a standard kind of residential property. In commercial you've got a very wide range of property . So we might be talking about your average shop that's on the street, we might be talking about a warehouse or we might be talking about a medical centre or a childcare centre. Some of these securities are very specialised. A childcare centre can only be leased to effectively a childcare operator. Some banks are fine with that, some don't want that. Or, they have already too much of these on the books.

You obviously have to show enough income to service the commercial loan but its not regulated in the same way as in the residential market.

The other part of this is, if we are talking commercial is development loans. Development loans are a whole different kettle of fish altogether. With development loans it's rare that you gonna build a hundred apartments and have the service ability till the end. So that's where you use pre-sales to show that you have enough sales from the building to cover the debt. And that's something you can do to to mitigate that issues. So commercial is a lot more flexible in terms of what can be done because its effectively unregulated compared to residential. Residential is regulated by the NCCP."

Is there a difference between inside an SMSF (LRBA) or outside?

"Outside an SMSF is what we have discussed so far.

Inside an SMSF, you've got to meet all sort of superannuation rules. You have to comply with the LRBA rules. So for an SMSF loan, you need a much larger deposit. The bank will look at your ability to service the loan based on your SG contributions plus in some cases additional contributions as well as the rent from the property. And the assessment rate tends to be higher as well.

So, the qualifications for an SMSF property tends to be harsher. There are also stricter requirements around what you can buy within a SMSF. So some SMSF lenders might not like off-the-plan properties.

It's a lot more regulated – for example the amount of contributions each year – and that's why the banks are more nervous about it and want to see a lot more money on the table. So we need to consider a number of things.

I guess I have to be careful not go too far on this topic. It is more the domain of an accredited financial adviser. But certainly it is a much more regulated area. The banks have to be more careful as to how they finance it.

But the main difference is that the deposit has to be much larger. That is the main difference in order to qualify to buy within the SMSF with leverage."

Do you do more residential or more commercial?

"Definitely, much more residential. But we are branching out into more and more commercial.

We do quite a bit of commercial with great outcomes. I've done one for three commercial buildings not far out of Sydney City. The purchases signed the contract about two years prior to settlement. We were able to do 100% financing since the value of the property had gone up over that time. So the bank was willing to say that the current value far exceeded the purchase price. The value had gone up so much that they did not have to put in a deposit. There was already enough security. Things like this you can do in commercial.

We are also increasingly doing development loans. This is becoming more and more the domain of brokers as opposed to the banks because the banks tend to be turning away would be developers. People who don't have the experience of several previous projects. At the moment the banks rarely want to look at these.

So a lot of that now has to go through specialised development lenders. So we are seeing more and more of that coming through. Councils are becoming more open to increase density with higher house prices and an increase in population. So we are seeing a lot of people starting out as developers and starting to do small projects and increasingly we are doing a lot of those transactions."

Are there differences in the products banks offer?

"The banks don't differ that much. We've got variable. We've got fixed. You've got some combination of both. You've got some minimal sort of changes between the way banks offer their products but the real difference is around lending policy. That is where we really see the big difference.

Some banks will have post code restrictions. They don't want lend to some specific areas.

Some banks don't like high rise development.

Some banks reduce the rent percentage if the complex has a lift.

For some banks probation is an issue, casual employment can be an issue , overseas income is an issue.

For some it is whether you've got defaults, are you buying with other people, are you trying to exclude detriment of other debt.

There's just like 50 or 60 little specifics that can vary in someone's circumstances. If you don't choose the right lender, you might cripple a person's borrowing capacity. So finding the right lender for what they are looking to do is the most important part for many people in today's market."

So this was the interview with Jonathan Preston.

The new commissioner for Royal Commission into banking (QC Kenneth Hayne) has just widened the banking inquiry by expanding the definition of a financial services entity.

Before this change, financial services entities for this inquiry included Authorised Deposit-taking Institutions, so ADIs / banks, insurers, holders of AFSL licences and registrable superannuation licencees.

But the new definition also includes intermediaries between borrowers and lenders, hence will include mortgage brokers. So we will probably hear a lot more about mortgage brokering as this enquiry proceeds.

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