Specialist lending and smaller British communities.

An in-depth look at the pressures facing borrowers in left-behind parts of Great Britain.

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Abstract

Small communities, in geographically remote areas in particular, are being let down by mainstream mortgage providers, whose underwriting criteria cannot flex to account for the unique pressures and challenges local residents face in modern Britain.

The specialist lending sector offers a possible solution – but awareness of the sector, and its leading brands, is low.

Problem statement

As Britain re-urbanises, job creation and investment is focused around larger cities, and the historic 'North/South' divide is being replaced by an urban/rural divide. One result is smaller communities' increased difficulty in accessing mortgages, as residents are disproportionately influenced by socio-economic trends that render their application incompatible with lenders' criteria.

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Background

Urbanisation in the United Kingdom

The United Kingdom is increasingly urban: 83.1% of us now live in urban areas, with 75 such areas having populations in excess of 100,000. These ultimately account for over 36 million Brits – more than half of us. But that means millions of others continue to live in less developed areas.

Urban areas are typically those with high population density and significant infrastructure. In dictionary terms, urban areas encompass cities and towns, and contrast with rural areas that include villages and hamlets.

However, in the UK there are no hard and fast rules that define whether a settlement can be considered a town (and therefore urban) or a village (and rural) – some towns, such as Shipston-on-Stour, Warwickshire (population 5,038) are smaller than some large villages (e.g. Kidlington, Oxfordshire, population 13,728).

Further complicating the definition is the fact some villages are situated close to larger settlements, and residents are therefore reasonably able to take advantage of facilities. Such an example is Norton, Worcestershire (population 2,324), which lies approximately 4 miles from Worcester city centre.

Therefore, for the purpose of this report, we have defined smaller communities as settlements containing 10,000 or fewer residents, situated at least ten miles from the nearest large settlement (i.e. of 10,000+ residents).

Examples of qualifying settlements:

Market Rasen, Lincolnshire

Population: **3,904**.

Nearest large settlement:
Lincoln, 13 miles.

Liskeard, Cornwall

Population: **9,417**.

Nearest large settlement:
Bodmin, 12 miles.

Cromer, Norfolk

Population: **7,683**.

Nearest large settlement:
Norwich, 23 miles.

Pwllheli, Gwynedd

Population: **4,076**.

Nearest large settlement:
Bangor, 29 miles.

Crieff, Perthshire

Population: **7,368**.

Nearest large settlement:
Perth, 19 miles.

Social mobility

The Government's Social Mobility Commission's 2017 report into social mobility in Great Britain reported a 'visible city-versus-rural divide', stating there is a "postcode lottery" with "hotspots" and "cold spots" found in all regions.

It further named "brain drain" – in which young people travel to cities for university, and then settle away from their home communities – as contributing towards a lack of social mobility in rural and coastal areas. This is reflected in the demography of the UK; based on 2016 mid-year population estimates, 27 of the 38 local government districts in England and Wales where over-65s make up 25% or more of the population are situated on the coast.*

This is reflected in the way cities dominate the British economy; cities account for just 9% of Britain's land, but are home to 54% of businesses, 59% of jobs, and 72% of high-skilled jobs.

* These figures reflect the subsequent merger of Waveney and Suffolk Coastal districts in 2019, both of which had over-65 populations exceeding 25%.

Brexit

The UK voted to leave the European Union in a nationwide referendum on 23rd June 2016. Analysis of the vote result by the BBC and CityMetric has revealed a significant geographical disparity in the vote result.

Remain won in 129 counting areas, and Leave in 270. While Leave won overall in Wales and every English region aside from London, Remain won by a majority of over 900,000 in the 30 major UK cities that each gathered 100,000 votes or more.

A more in-depth analysis of data from the Centre for Cities' Talk of the Town report reveals economic outcomes were the biggest factor in predicting whether a counting area would vote one way or another; in essence, the stronger the local economy, the more likely a Remain vote.

Data from the Office of National Statistics reveals that in 2015, economic output per person was 26% lower in coastal communities versus their inland counterparts; in 2016, 85% of Britain's 98 coastal local authorities had pay levels below the national average.

These economically 'left-behind' seaside communities voted strongly to leave the EU; a tally of the results as estimated by Chris Hanretty, a professor of politics at Royal Holloway, University of London, shows more than 100 of the 120-or-so English parliamentary constituencies that have a coastline voted to leave.

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Socioeconomic trends

British society is undergoing a period of significant change

Changing employment trends are being driven by a combination of political and economic factors, resulting in booming self-employment, the emergence of the gig economy, and the prevalence of zero-hours contracts. This means incomes are less regular, which impacts money management and can lead to credit issues.

The housing shortage is also pushing up prices, meaning our path to purchase is changing – many of us are buying later in life, often with help from family or official schemes.

These changes have taken place over decades, becoming particularly acute in recent years; they have become normalised for people across all ages and backgrounds and for many under-30s, it's all they've ever known.

Self-employment

There has been a surge in self-employment in the UK; there were an estimated 4.8 million self-employed Brits in 2018, compared with 3.3 million in 2007.

At the same time, access to mortgages for the self-employed has become restricted. Before the credit crisis of 2007-08, self-employed workers could apply for a 'self-certification' mortgage. Applicants would declare their self-employed income without having to provide supporting evidence in the form of bank statements or certified accounts.

These mortgages were banned in 2011, and self-employed people must go through the same process as employed applicants in proving their ability to afford repayments – typically using tax returns – with a minimum of 12 months' trading, and often two years'.

Potential mortgage applicants – particularly sole traders and freelancers – face a dichotomy in which they look to reduce their tax burden by reclaiming expenses that reduce their overall taxable profit, but which reduces their mortgageable income in the eyes of mortgage lenders.

Popularity of buy-to-let as a source of primary or secondary income

The financial crisis of 2007-08 led to a drop in house prices that made residential property an attractive investment. Consequently, many Brits have invested in property in recent years, perhaps to boost their pension pot or take advantage of a rising property market. It is now estimated that over 2 million Brits are landlords of some form or another.

However, mortgage lenders may not take rental income into account when conducting affordability checks for personal property.

Buying property later in life

The average age of first-time buyers has risen in recent years, as increased property prices mean aspiring homeowners must save for longer in order to raise the necessary deposit.

At the same time, the number of applicants taking mortgages of 30 years or more has increased, possibly to make monthly payments more affordable. The result is that applicants may be looking to take a mortgage term that ends beyond their intended retirement age, which may cause difficulty with some mortgage lenders.

Similarly, an increasing proportion of Brits over the age of 65 choose to continue in employment and earn a wage (2017: 10.2%, 1992: 5.5%) beyond traditional retirement age; however, mortgage providers may not accept this for the purposes of affordability calculations, restricting lending among older borrowers and those approaching retirement age.

Affordability

In a post-2008 world, FCA regulations rightly place an increased burden on mortgage lenders to ensure borrowers can afford the loan they are taking out – both now and in the future, once other living expenses are taken into account. Simply put, you need to earn more to borrow the same amount as you might in the past.

Closure of local banks

The contraction of the banking sector's rural real estate portfolio is well-reported, and takes with it years of experience and expertise in the mortgage industry.

Figures from the Office of National Statistics (ONS) show nearly 6,000 branches (one in three) have closed since 2010, meaning 13 million UK adults live in areas where at least half of all banks and building societies have closed.

This reflects a broader societal trend towards internet banking. The ONS reports 69% of all internet users now conduct some or all of their banking online, compared to 35% in 2008. But this means almost one-in-three still rely on local branches. Additionally, this doesn't account for the one-in-ten households who lack internet access entirely, rising to two-in-five of over-65s living alone.

The lack of local services can prove particularly challenging for the elderly and disabled, but in truth affects anybody who does not drive in parts of the country where public transport services are infrequent.

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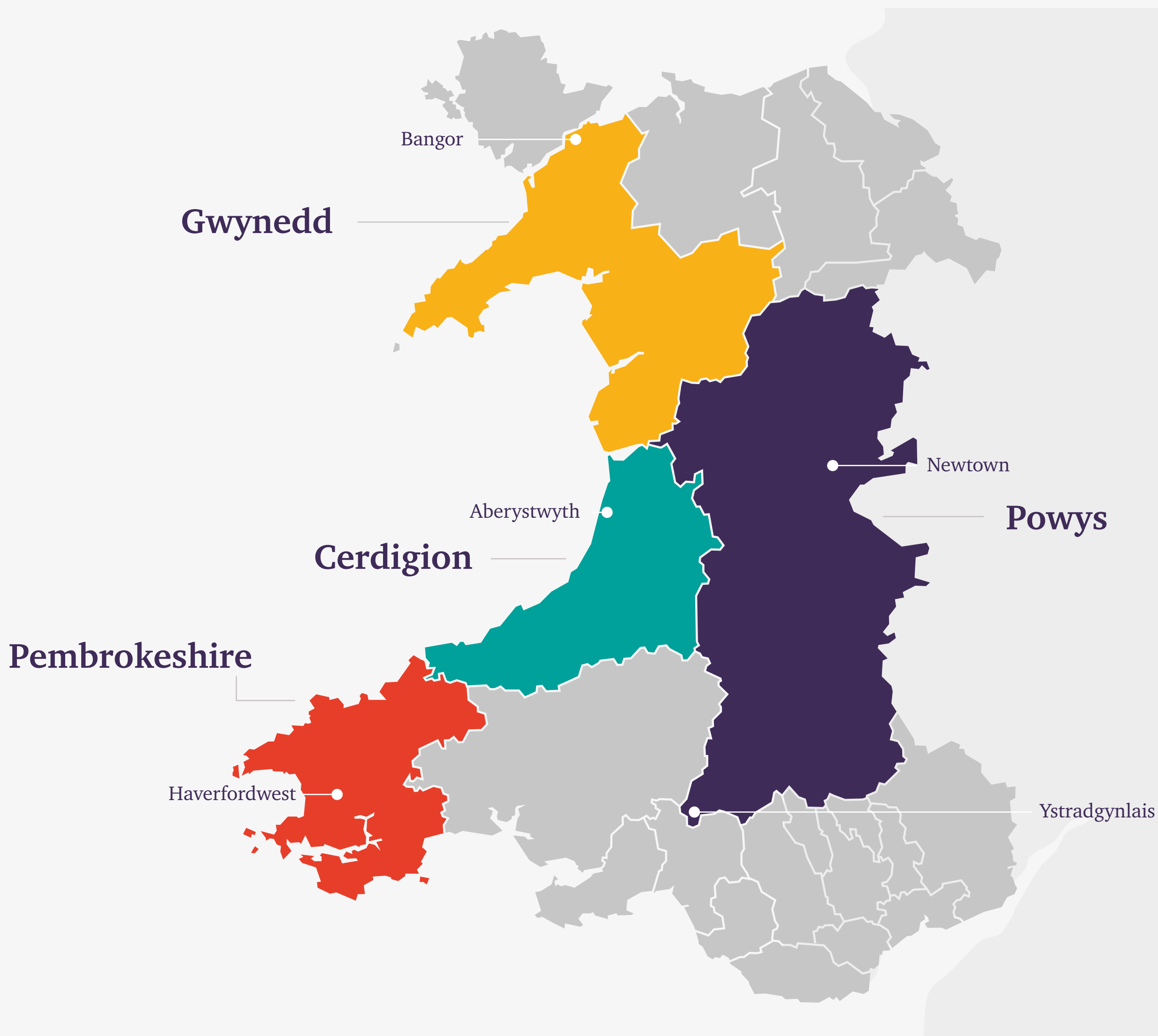
In depth: Rural and coastal Wales

Wales is a nation of small communities; there are just 58 settlements with populations thought to exceed 10,000. However, of these 58, only two are situated in Powys, one in Gwynedd, one in Pembrokeshire, and one in Ceredigion (See Fig. 1).

These four counties are the most sparsely-populated unitary authorities in Wales, making up over half of Wales's land area but holding less than 15% of the Welsh population.

Fig. 1: Location of Powys, Gwynedd, Ceredigion and Pembrokeshire, with towns exceeding 10,000 in population highlighted.



Our analysis reveals that Wales, with its many smaller communities, over-indexes for prevalence of lifestyles or circumstances associated with difficulty in accessing credit or purchasing property.

Self-employment in Wales

Statistics from the Welsh Government for the year ending March 2019 show that the overall self-employment rate in Wales (14.3%) is broadly similar to the wider UK (15.1%), but there is significant disparity between local authorities.

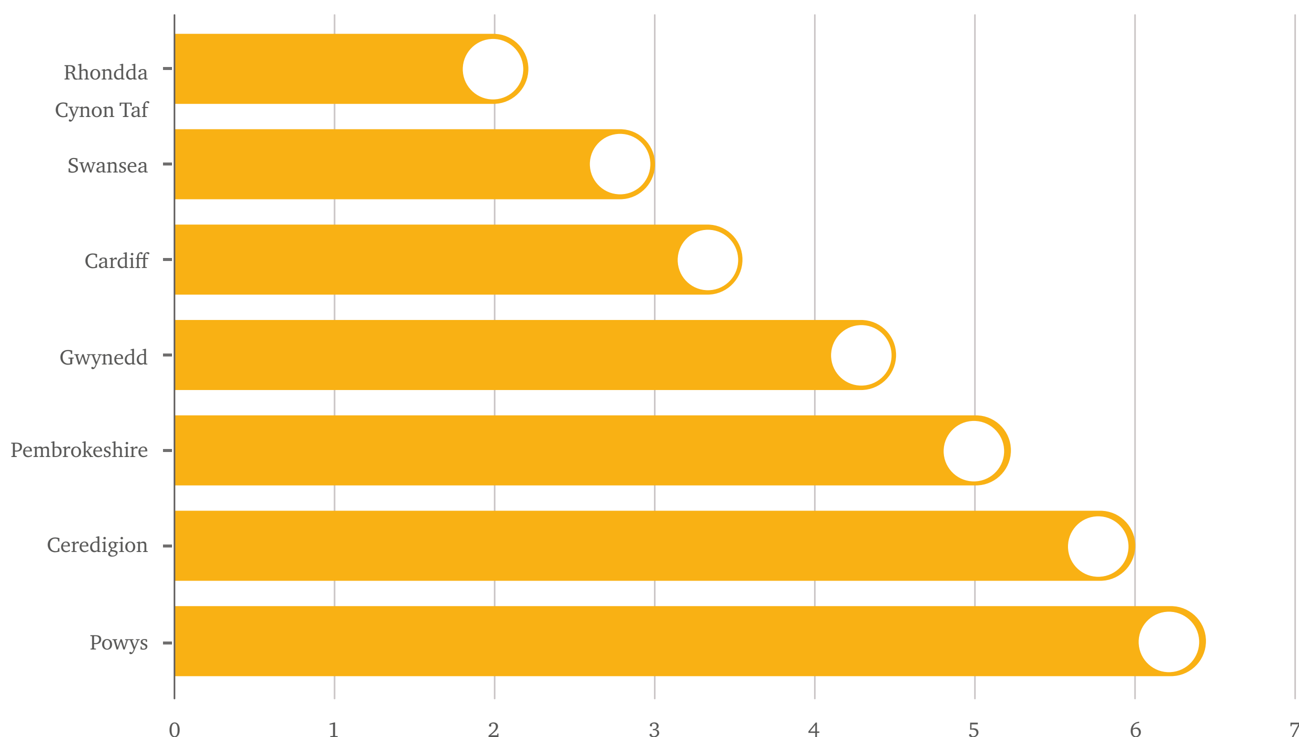
Authorities covering the largest cities – Cardiff (12.4%), Newport (7.9%) and Swansea (12.5%) – have significantly lower self-employment than Ceredigion (24.4%), Gwynedd (22.9%) and Powys (27.6%). The statistics provided do not give a breakdown by business sector, but we hypothesise that the prevalence of farming, and particularly livestock, may contribute towards this disparity; sheep are said to outnumber humans in Powys by ten-to-one.

Landlords in Wales

In 2019, the Government released figures detailing the number of individuals declaring property income on their Self Assessment tax return for 2016-17 (the most recent figure available).

Cross-referencing these statistics against 2018 population estimates from the Office of National Statistics, it is implied that Welsh counties dominated by smaller communities are home to a disproportionate amount of landlords.

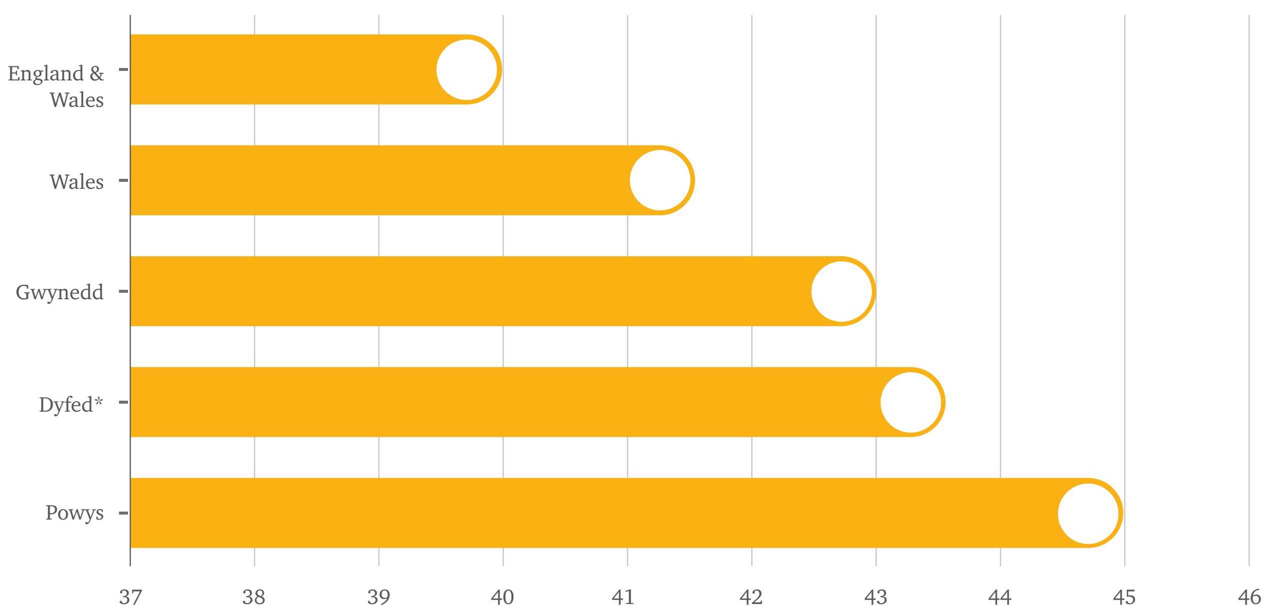
% of total population declaring property income via Self Assessment (2016-17)



Wales's ageing population

Those parts of Wales characterised by smaller communities are older, on average, than Wales overall.

Average age



* The ceremonial county of Dyfed comprises the combined present-day counties of Pembrokeshire, Ceredigion and Carmarthenshire. Data from plumplot.co.uk, based on 2017 estimates.

There are two factors likely to be influencing this:

1. The tendency among younger people to settle away from their home communities after attending university: the 'brain drain' described by the Government's Social Mobility Report.
2. The internal migration flows of over-50s, who tend to relocate towards rural and coastal areas.

This is evidenced by statistics looking at internal migration of local authorities in Wales in 2017-2018.

Gwynedd and Ceredigion actually receive a net gain in young people aged 15-19, which we can attribute to universities in Bangor, Aberystwyth and Lampeter; however, these areas see large losses among those aged 20-24 (presumably as they graduate). Meanwhile, Powys and Pembrokeshire, which do not host any universities, make net losses among comparable age groups, and all four counties are net migration destinations for those aged over 50.

Prices relative to income in Wales

House prices in Wales have increased significantly faster than wages.

Long-term pay growth in Wales is slower than the other countries of the UK, with median full-time pay increasing by 69% between 1998 and 2018; BBC Breakfast reported in 2017 that employees in Gwynedd earn the second-lowest average wage in the country, at £21,246.

Meanwhile, over a similar period (1999 to 2019), average Welsh house prices increased by 228%, from £48,455 to £159,216. Price rises have been particularly acute in some areas. Wales Online analysed figures from the ONS for house prices from 1995 to 2016 to identify the 10 areas with the steepest rises; the top 10 included the Llyn Peninsula in Gwynedd (376%) and North Powys (345%), and the small communities of Rhosneigr, Anglesey (349%) and Raglan, Monmouthshire (326%).

The popularity of second homes in parts of Wales has possibly contributed towards this; in 2017-18, 39% of all property transactions in Gwynedd were for second homes (encompassing both holiday properties and buy-to-let investments). Across the UK, only the affluent inner-London districts of Westminster and Kensington & Chelsea reported higher figures.

Part-time employment

Tourism is a major contributor to the Welsh economy.

Businesses in seaside communities that rely on the tourist industry may be particularly inclined towards offering seasonal and part-time work. This may impact on employees' ability to save a deposit or prove their ability to afford mortgage repayments.

Gwynedd (33.4%), Ceredigion (33.2%) and Pembrokeshire (31.9%) report variances in the prevalence of part-time employment from the Welsh average (27.7%) that are statistically significant, and encompass the entirety of the west Wales coast.

Right to Buy

The Right to Buy scheme, while controversial, has helped thousands of council tenants to become homeowners across the decades by offering significant discounts on the purchase price of a council-provided property.

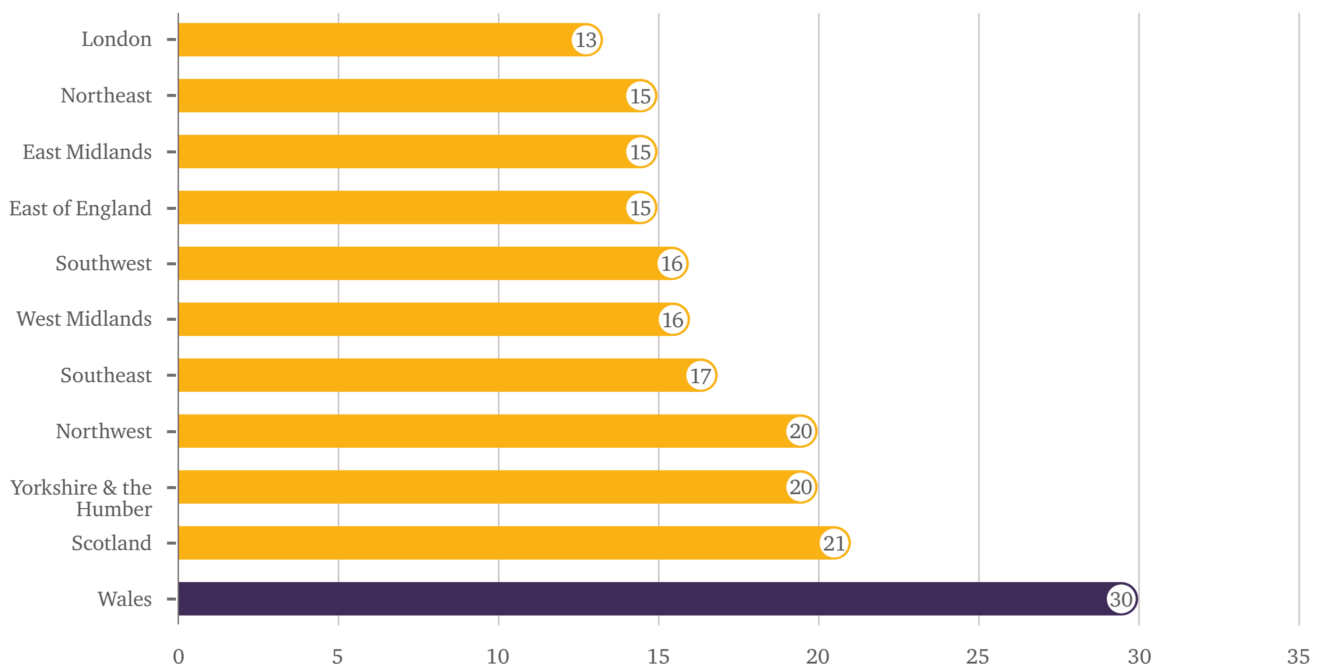
The Right to Buy scheme ended in Wales on 26th January 2019. While this will protect remaining social housing stock across Wales, it reduces access to home-buying for council and housing association tenants – forcing them to turn towards other affordable housing schemes, such as Shared Ownership.

The more complex ownership structure of Shared Ownership properties, and the affordability considerations of paying rent alongside a mortgage, may make obtaining a mortgage through this means more difficult.

Poor credit

Together commissioned YouGov to survey mortgage applicants in 2018*, in a bid to learn more about why so many fall out of the application process between enquiry and funding.

Of all respondents who were rejected by a mortgage provider the last time they made an application, 18% stated that the reason was because of a low credit score or lack of credit history. However, there are significant regional discrepancies, with Wales far over-indexing compared to other areas of Great Britain.



* Total sample size was 2,003 adults. Fieldwork was undertaken between 31st May - 25th June 2018. The survey was carried out online.

Closure of banks: A case study

Small communities across Wales are losing their banks at a rapid rate; one, Llandysul (population 1,439) was previously home to four branches. Upon the closure of the Barclays branch – the last – in 2017, customers were told to visit the branch in another small community, Newcastle Emlyn, 8 miles away. That has since closed too.

Now, customers in Llandysul must travel to Lampeter, 11 miles away. If they cannot drive, a round-trip bus journey via Aberaeron (another no-bank town) takes around three hours. Customers in Newcastle Emlyn are directed to Cardigan, 9 miles away.

Both Lampeter and Cardigan are small communities too. The fate of their banks remains unknown; Natwest has already closed its branches in both.

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Specialist lending

Specialist lending is a sector of the mortgage market that accounts for circumstances and transactions being under-served by the mainstream mortgage market. These leaders are specialist in respect of the customers they are serving (typically in the personal borrowing arena), or in the product being offered (often commercial in nature).

In the commercial finance world, specialist lenders' products include bridging loans, fixed-term secured commercial loans, mortgages for the purchase and refinancing of commercial properties (including semi-commercial properties and land), and buy-to-let mortgages.

In the personal mortgage arena, typical customers are those whose circumstances dictate that their application is incompatible with the lending criteria of the mainstream lenders. This may be the applicants' age; income pattern; credit status; the nature of the transaction; or the property itself. Applications involving multiple complicating circumstances are particularly likely to require the services of a specialist lender.

To reflect the increased risk associated with their mortgages, rates provided by specialist lenders are generally higher than those available through the mainstream mortgage market. So, in order to ensure customers are treated fairly, a specialist lender will advise a customer to shop around before progressing an application it believes could be served by the high street.

Performance of the specialist lending market

Specialist lending is outperforming the overall mortgage market. Since a low of £5bn in 2009, specialist lenders have increased their annual lending by 19% per year, compared to an 8% increase for gross mortgage lending.

Statistics indicate this is accelerating. UK Finance's figures for 2017 (the most recent available at the time of writing) indicate challenger banks and specialist lenders outpaced mainstream rivals in the growth rate of their lending versus 2016, at almost 20%.

Meanwhile, over the same period, five additional lenders were listed as lending £50 million or more, bringing the total to 65 lenders; half of the top 10 largest lenders by gross lending saw a contraction in market share.

Together: Lending for the new normal

Operating nationwide, Together is a specialist lender that has been providing finance to personal and business customers for over 40 years.

Its wide range of products include short-term or 'bridging' finance, auction finance, secured loans, and residential, buy-to-let, and commercial mortgages – all available directly, and through an established distribution network of mortgage brokers and other intermediaries.

With pragmatic underwriting, it is well-placed to serve modern British society. As changes to technology, housing, and employment impact incomes, credit and path to purchase, Together's common-sense approach to lending is more relevant and in-demand than ever.

Any property used as security, including your home, may be repossessed if you do not keep up repayments on your mortgage or any other debt secured on it.

Future of specialist lending

Specialist lending has become more visible following the arrival of the EU's Mortgage Credit Directive (MCD) and the regulation of second-charge mortgages by the Financial Conduct Authority. The MCD is an EU framework of conduct rules for mortgage firms that became effective in the UK on 21st March 2016, and exists as a preventative measure to avoid irresponsible lending and borrowing.

A report from the Intermediary Mortgage Lenders Association revealed that:

"the outlook for [specialist lenders] seems positive for a number of reasons. First, a rising share of mortgages are being sourced through intermediaries who can scan all lenders for the most appropriate loan for a customer based on price and suitability rather than brand. Second, the large lenders who focus primarily on the mainstream mortgage market have been content to leave most of the non-standard or non-prime market to others. And third, the range of borrowers who qualify for a mortgage on standard terms remains restricted, increasing the potential pool of borrowers who require a specialist residential loan."

Awareness of specialist lending

Research commissioned by Together and conducted by CARAT revealed that overall awareness of the specialist lending category stood at 23%, rising to almost two in five (39%) among financial introducers (including mortgage brokers and financial advisers).

However, of those aware of the category, over a quarter erroneously attributed specialist lending to 'high risk' customers with poor credit. Among those unaware of the category, one in five guessed it applies to the same group.

There is clearly work to be done by specialist lending's leading names in educating the public on the existence and nature of the category. But there is a challenge – specialist lenders have, historically, relied on these same mortgage brokers to introduce their brand and the specialist lending category to prospective borrowers (see Accessing specialist lending, below).

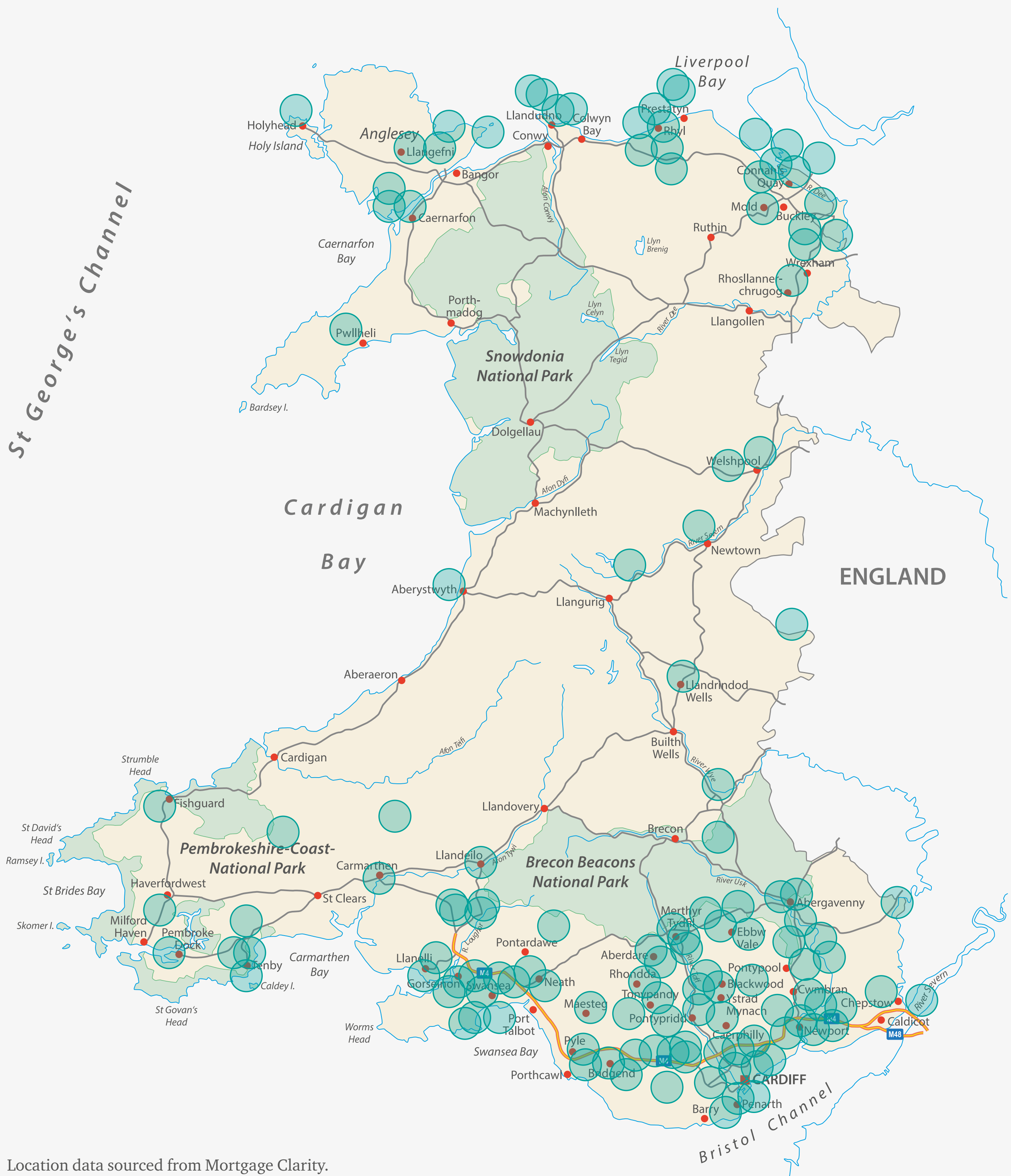
Accessing specialist lending

Until relatively recently, specialist lenders including Together have typically offered their products exclusively through specialist mortgage intermediaries. These intermediaries search the whole of the market to identify an appropriate lender for clients based on circumstances, rather than brand.

These specialist intermediaries tend to be situated in or near to major population centres, therefore restricting access to specialist lending for those who live in smaller communities. (See Fig. 2).

With the introduction of a direct product offer, applicants prepared to conduct their mortgage application by phone and post can access specialist lending even if geography prevents them from meeting face-to-face with an intermediary.

Fig. 2: Location of mortgage brokers in Wales writing mortgage business at rates of 3.5% or more



Location data sourced from Mortgage Clarity.

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