Mortgage Distribution Channels: Estimates of lending

Dean Garratt, Economist, Council of Mortgage Lenders

- *Deregulation and technological advancement have contributed to a multi-channel approach. The competitiveness of the mortgage market is helping to make the number and mix of channels an important strategic variable.*
- *The average lender has 3 channels, with only 13% of lenders, usually local with small mortgage books, having a single channel.*
- *Over half the number of loans in the first half of 2000 came through branch networks, with 35% being introduced business. Just 0.3% of loans came through lenders' internet channels.*
- *In the first half of 2000, the total value of direct mortgage lending coming through the internet was £198 million, compared with £28 billion through branches and £23 billion through intermediaries.*
- *The largest part of lending originating through the internet was for remortgaging. This contrasts with the remaining distribution channels where lending for house purchase is predominant.*
- *Just under half of lenders expect to see no change in the volume of business originating through the internet in two years time, although a quarter thought the volume of business would be 25% to 50% higher and 10% that it would be more than 50% higher.*

Introduction

This article presents the results of a survey of lenders into the value of business coming through different distribution channels. The survey was conducted in the autumn of 2000 and shows the allocation of total lending in the first half of 2000 by distribution channel and by type of loan.

Most lenders choose to use more than one distribution channel and the fact that most have continued to maintain a physical presence in the High Street alongside the development of more technologically advanced channels illustrates the advantages lenders see in a multi-channel strategy. This concept has been captured in the phrase – "the importance of clicks and mortar".

Alternative distribution channels

Distribution channels define the way in which products or services pass to consumers. In this article the focus is on the channels through which the mortgage application process can begin so enabling mortgage business to be conducted. Specifically, mortgage applications originated through branch networks, telephone and postal operations, intermediaries and the internet are considered.

Branch networks

Branch networks have been the bedrock for traditional mortgage lenders and while they continue to be important for mortgage distribution the proportion of business coming through them has reduced over a number of years. There are several reasons for this but probably the most important is their relative cost compared with other distribution methods when in a highly competitive market the pressure to reduce costs is very strong.

Following deregulation in the financial services market and the resultant increase in competition, traditional mortgage lenders were keen to reduce their costs and between 1989 and 1998 the number of bank branches (including those banks that had converted from mutual status to Plc), declined 32% from 16,900 to 11,480. For building societies (excluding those that converted) the decline is smaller at 10% from 2,792 to 2,534. Willis and Marshall (2000) argue that branch rationalisation programmes were given impetus by the downturn in the housing market in the early 1990s.

However, many borrowers place a high value on being able to have face-to-face contact in a mortgage application process. So while this distribution channel may be costly it also has some significant advantages over more remote types of distribution channel.

Intermediaries

Traditional branch based lenders have historically had links with intermediaries such as estate agents and solicitors as a distribution channel alongside their branch networks. These agency arrangements were a way to reach customers away from the immediate vicinity of the local branch and often provided a scaled down version of branch facilities which allowed lenders to keep a presence in more remote areas without the cost associated with a full branch office.

The intermediary sector was bolstered by the entry of new centralised lenders without branch networks following deregulation. The Mortgage Code Compliance Board, which maintains a register of lenders and broker firms who have agreed to abide by the Mortgage Code, had 10,470 registered broker firms at April 2000 covering 43,569 mortgage advisers.

Intermediaries can offer a low cost way of distributing mortgages. They provide some face-to-face contact but there is some lack of control for lenders. Intermediaries may not only offer the mortgage products of more than one lender, they also have their own associated products to sell such as insurance so lenders lose the opportunity to sell their own branded products.

Postal and telephone channels

While intermediaries may offer a relatively cheap way of distribution in comparison with a branch network, lenders lose a degree of control. In addition, maintaining relationships with a large number of intermediaries with very diverse businesses can also be costly. The development of technology and the desire to further reduce the costs of distribution led to the development of direct, but remote distribution channels. These channels are fundamentally different in that they do not depend on physical face-to-face contact with the borrower. Applications are dealt with by post and telephone. The cost advantages of these operations are that call centres can be located where land and labour is cheaper but with no loss of coverage for customers who live a long way away. For example, there has been a large growth in the number of call centres based in Scotland yet the geographical dispersion of the business that comes through this channel is not concentrated around the location of the call centre as would be the case with either intermediary or branch channels.

Telephone and postal operations allow lenders also to take advantage of economies of scale in processing applications from one site. This can further reduce costs. Another advantage is convenience. Increasingly customers wish to deal with their finances outside of normal working hours and the convenience of a telephone operation open at these times, without the need to queue or have an appointment to attend in person, is clear.

The development of these remote distribution channels allows lenders to reach a different sector of the market more easily. Such channels make it easier for lenders to meet the increasing demands of customers for services that are convenient to them rather than fitting into rigid office working hours. In addition to the costs savings from exploiting economies of scale, the use of these channels also gives the lender back greater control over how mortgages and their associated products are sold.

The internet and other new technologies

The use of the internet as a mortgage distribution channel is relatively new and there is a lot of interest in how this might develop, not least because of the difficulties some large organisations have had in setting up their sites. In many ways the internet channel is just an extension of the telephone and postal operation in that it does not rely on a physical face to face presence with the borrower and can exploit the advantages of being in a remote and less expensive location.

There are advantages associated with the internet and e-mail communication above the telephone. For example, administration can be managed to smooth out peaks and troughs in enquiries. Telephone operations are likely to get busy at particular times in the day and this can put pressure on telephone switchboards and also on staff at those peak times. At other times there may be few enquiries and staff are underemployed. While internet traffic can cause problems with the speed and access to web sites, e-mail enquiries can be smoothed thus avoiding the same problems of peaks and trough. But some see the highly impersonal nature of this channel as a disadvantage.

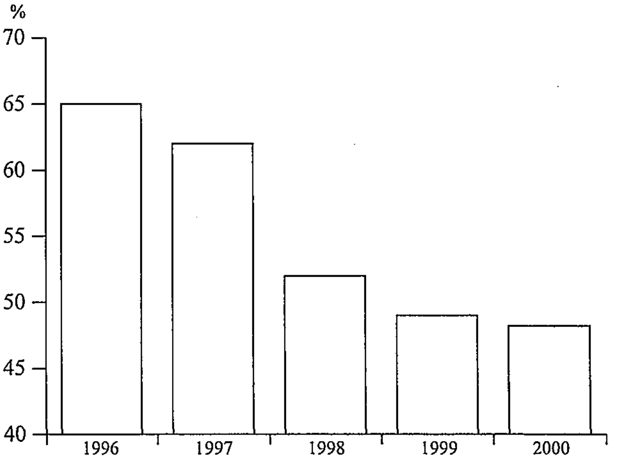
The number of available distribution channels continues to increase with the development of WAP (Wireless Application Protocol) phones and digital TV. In excess of 4 million households already have access to digital TV. Furthermore the development of secure electronic signatures will further enhance this method of mortgage distribution. Once the necessary official licensing bodies are in place to oversee this there is greater potential for the development of this distribution channel.

The number and type of distribution channels have changed a lot over time but there are advantages to each of them. It is for this reason that most lenders choose to use a combination of distribution channels in order to balance costs and coverage of their business. Furthermore, the number and mix of channels through which its business can be conducted has become an important strategic variable. Decisions concerning distribution will usually entail long-term commitments. This is true of the development of telephone call centres and postal operations and, more recently, internet-based technologies. Research by TowerGroup predicted that US lenders in 2000 would spend close on $249 million on internet-related mortgage technologies while in Europe the figure for European lenders was $158 million. They also forecast further growth of around 15% per year up to 2005.

The decision to increase the number of distribution channels has been seen as a way of increasing market presence and to target different customers and different market segments. But the evolution of technology has further broken down barriers to entry into the mortgage market in the same way as deregulation did which opens up the market still further to new competition putting further pressure on costs.

In light of the increased number of distribution channels and the reduction in branch outlets, it is not surprising that CML's annual survey of consumers (carried out by MORI) shows the proportion of outstanding mortgages arranged through lenders' branch operations falling. Between 1996 and 2000 the proportion fell from 65% to 48% (see Chart 1), although the rate of decline has begun to slow.

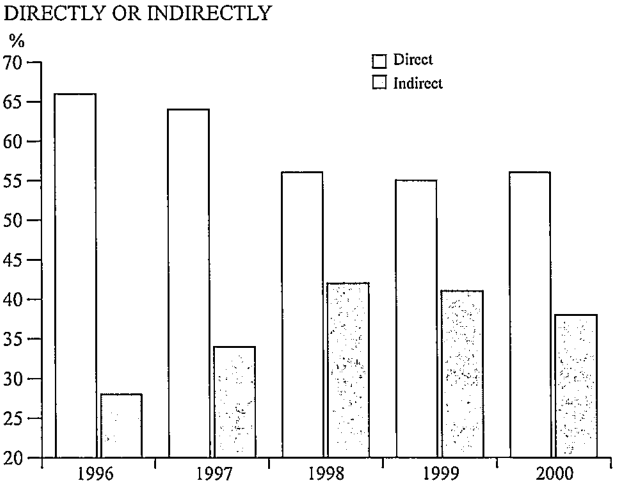
CHART 1: PERCENTAGE OF MORTGAGE STOCK ARRANGED THROUGH BRANCHES, 1996 TO 2000



Source: CML Annual Housing Finance surveys 1996 to 2000, MORI
Note: 2000 data represents those who approached mortgage supplier/lender directly, face to face in a branch, at home or at work

In addition to branch networks, lenders can sell directly to customers through telephone, postal services and internet-based technology (including WAP and digital TV). The 2000 CML Annual Housing Finance Survey shows a halt in the decline of the stock of mortgages originating through all direct channels; 56% of borrowers said they originated their mortgage through 'direct' channels, roughly in line with the figure in the previous two surveys. Therefore, while the market penetration of branches has declined, the business has been redirected to other direct channels.

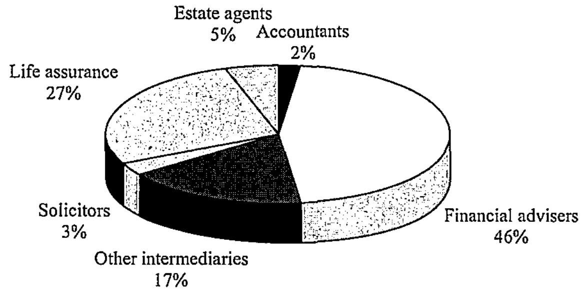
CHART 2: PERCENTAGE OF MORTGAGE STOCK ARRANGED DIRECTLY OR INDIRECTLY



Source: CML Annual Housing finance surveys 1996 to 2000, MORI
Note: Remaining percentage either 'Don't know' or 'Don"t know/someone else arranged it'

There is a diverse range of intermediary businesses. They include estate agents, solicitors, accountants, financial advisers, mortgage intermediaries and life assurance companies. According to data from the Mortgage Code Compliance Board, which maintains a register of lenders and broker firms who have agreed to abide by the Mortgage Code, the two dominant groups were financial advisors who accounted for 46% of all firms and life assurance companies who accounted for 27% of all firms. The CML Annual Housing Finance Survey for 2000 finds 38% of borrowers reporting that their mortgages were originated indirectly. Amongst single households and households with incomes in excess of £15,499 this rises to more than 40% (See Table 1). These groups typically make greater use of financial advisers.

CHART 3: NATURE OF INTERMEDIARIES' BUSINESS, APRIL 2000



Source: Mortgage Code compliance Board Annual Report 2000

TABLE 1: METHOD BY WHICH FIRST APPROACH WAS MADE WITH COMPANY PROVIDING PRESENT MORTGAGE, 2000

	Mortgage status			Total household income			Household status		
	All mortgage holders	First mortgage	Had previous mortgage	Up to £15,499	£15,500-£29.999	Over £30,000	Single	Couple	Mixed adult/other
Financial adviser	25	23	26	22	26	28	30	25	14
Estate agent	7	7	7	8	10	7	6	7	8
Insurance company	2	4	1	3	2	2	4	2	3
Solicitor	2	1	2	4	1	1	2	1	2
Mortgage company/ broker	1	2	1		2	2	0	2	1
Your employer	1	1	1		2	1	1	1	
Total indirect	38	39	38	37	42	41	44	39	29
Total direct	56	55	57	60	55	55	51	56	67

Source: CML Annual Housing Finance Survey 2000, MORI
Note: Remaining percentage either 'Don't know' or 'Don't know/someone else arranged it'

CML Distribution Channels Research Results

A survey of CML members in November 2000 provides a snapshot of the distribution channels by which consumers could begin the mortgage application process and lenders could conduct mortgage business at the end of June 2000. The questionnaire was completed by 72 lenders accounting for 71% of the number of secured loans advanced in the first half of 2000. Lending values and volumes for house purchase, remortgaging and other lending (further advances and top-up loans) were grossed up to reflect the whole industry.

Number of Channels

79% of lenders ran a branch operation, 57% a telephone operation and 43% a postal operation (see Table 2). As of June 2000, 23% of lenders provided consumers with the opportunity to begin the mortgage application process on-line. The overwhelming majority of lenders (86%) accepted introduced business through intermediaries.

Of those lenders with a branch network, 70% accepted introduced business, while one-half have a telephone operation and one-third had postal operations. Only 9% of lenders with a branch network had no other distribution channel and these tended to be local lenders with small mortgages books. Table 2 reports the proportion of lenders able to conduct business through the alternative distribution channels and the proportion of those with a branch network.

TABLE 2: LENDERS BY TYPE OF DISTRIBUTION CHANNEL, 30 JUNE 2000

Channel type	Lenders with channel type	Lenders with branch network with channel type
	%	%
Branch network	79	
Telephone	57	47
Postal	43	33
Internet	23	17
Intermediary	86	70
Other	7	4
No others		9

Source: CML Survey, November 2000

The dominant strategy is multi-channel with the industry average being three channels. Lenders on the whole have taken the view that to be successful they need to match their competitors' distribution mix. Across the industry, while 30% of lenders have three channels, only 13% of lenders have a single channel, while 12% of lenders have as many as five channels.

TABLE 3: LENDERS BY NUMBER OF DISTRIBUTION CHANNELS, 30 JUNE 2000

Number of channels	Number of lenders %
1	13
2	25
3	29
4	22
5	12

Source: CML Survey, November 2000

The evidence indicates that the largest lenders have the greatest number of originating channels. The majority of lenders with mortgage books of over £1 billion had 4 distribution channels compared with 2 for lenders with books worth less than £1 billion.

Rather than implying that small and large lenders differentiate themselves through their distribution mix, the difference is more likely to be a reflection of the resource implications of expanding the number of distribution channels. For larger lenders, the cost of expanding the number of distribution channels can be spread over a greater volume of business. For instance, the proportion of lenders with mortgage books of less than £0.5 billion found to originate mortgages over the internet was only 10% compared with an industry average of 23%.

TABLE 4: NUMBER OF CHANNELS BY SIZE OF MORTGAGE BOOK, 30 JUNE 2000

Mortgage book	Modal number of channels
More than £10 bn	4
£2 bn to £10 bn	3
£1 bn to £2 bn	3
£0.5 bn to £1 bn	2
Less than £0.5 bn	2
All lenders	3

Source: CML Survey, November 2000

Lending volumes by type of distribution channel

The Survey of Mortgage Lenders finds 997,000 secured loans advanced in the first half of 2000; 546,000 were house purchases, 259,000 remortgages and 192,000 other advances. Grossed up estimates from the CML questionnaire show 523,200 or 52% of the total number of mortgage advances were sourced through branches while 348,300 or 35% of loans came through intermediaries (See Table 5). Very little business is attributed to postal operations, although some lenders reported difficulty in separating lending numbers between their telephone and postal operations. Therefore, we have grouped these responses together, showing that 8.5% of mortgages were sourced through postal or telephone operations.

Over half the number of loans in the first half of 2000 were originated through branch networks, with a sizeable 35% being introduced business. While just under a quarter of lenders were able to originate mortgage business on-line at the end of June 2000 only 2,700 mortgages were sourced as coming through the internet distribution channel, equivalent to 0.3% of the total number advanced.

Estimates of the volume of house purchase loans, remortgages and other secured advances were obtained from the questionnaire. The results are again shown in Table 5. The highest proportion of lending going through intermediaries is for house purchase. Outside of house purchase and remortgaging little use is made of intermediaries - 90% of 'other lending' is done directly. Having established a relationship with a lender, consumers find it convenient to deal with lenders directly for further advances.

To date there has been more use of the internet by existing home-owners to switch lenders than there has been buyers purchasing property. Not only was the internet's involvement in remortgaging proportionately higher than for other categories of secured lending in the first half of 2000, but the internet also saw double the number of remortgages than loans for house purchase. To some extent this will reflect the greater experience of existing home-owners in the housing market and their ability to use the internet to compare information across lenders, such as the interest rate on their current mortgage, and to switch lenders accordingly. It might indicate that the type of person using the internet is financially sophisticated and willing to shop around for mortgages. However, an important reason why the internet may have generated less business for house purchase loans than for remortgages, despite its ability to convey information, is the greater complexity of a house purchase loan.

Lending values by type of distribution channel

The Survey of Mortgage Lenders reports gross lending of £56.9 billion in the first six months of 2000. Of this £38.2 billion was for house purchases, £15.7 billion remortgaging and £3 billion other secured lending. Results from the survey suggest that of the £56.9 billion advanced, £50.5 billion or 89% is

TABLE 5: CATEGORY OF SECURED LENDING BY DISTRIBUTION CHANNEL, H1 2000

	Total lending		House purchase		Remortgaging		Other lending	
	No.	%	No.	%	No.	%	No.	%
Branch Network	523,200	52.5	252,500	46.2	134,300	51.9	136,400	71.0
Telephone/Postal	85,100	8.5	30,800	5.6	20,700	8.0	33,800	17.6
Internet	2,700	0.3	700	0.1	1,400	0.5	600	0.3
Intermediary	348,300	34.9	229,500	42.0	99,500	38.4	19,300	10.1
Direct	611,000	61.3	284,000	52.0	156,300	60.3	170,800	89.0
Indirect	348,300	34.9	229,500	42.0	99,500	38.4	19,300	10.1
Other	37,400	3.8	32,400	5.9	3,200	1.2	1,900	1.0
Total	997,000	100	546,000	100	259,000	100	192,000	100

Source: CML Survey, November 2000

Note: Number of loans is to nearest hundred; some internal inconsistencies due to rounding. Internet includes WAP phones and digital TV.

TABLE 6: VALUE OF SECURED LOANS ADVANCED BY DISTRIBUTION CHANNEL, H1 2000

	Total lending		House purchase		Remortgaging		Other lending	
	£m	%	£m	%	£m	%	£m	%
Branch Network	27,641	48.6	17,927	46.9	7,489	47.7	2,225	74.2
Telephone/Postal	4,303	7.6	2,164	5.7	1,750	11.1	390	13.0
Internet	198	0.3	75	0.2	116	0.7	7	0.2
Intermediary	22,886	40.2	16,373	42.9	6,180	39.4	333	11.1
Direct	32,117	56.5	20,166	55.8	9,354	59.6	2,622	87.4
Indirect	22,886	40.2	16,373	42.9	6,180	39.4	333	11.1
Other	1,857	3.3	1,651	4.3	161	1.0	46	1.5
Total	56,900	100	38,200	100	15,700	100	3,000	100

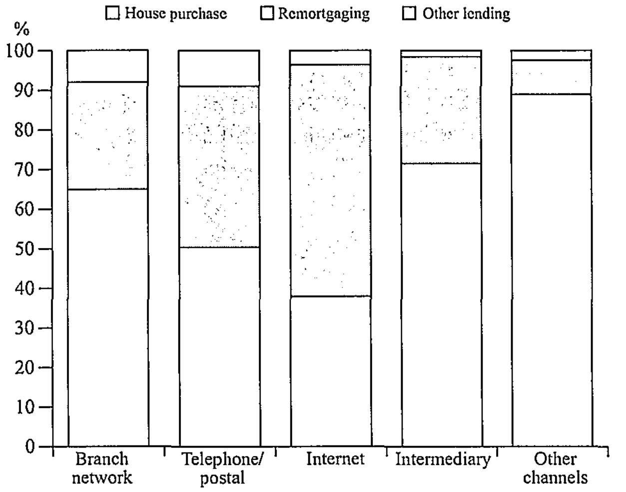
Source: CML Survey, November 2000
Note: Internal inconsistencies due to rounding

accounted for by branch networks and intermediaries (See Table 6).

The patterns shown in lending volumes are largely reflected in the value of lending. However, while Table 6 shows that in value terms the breakdown between direct and indirect is 56% to 40%, in volumes the split was 61% to 35%. The difference is largely attributable to the split in lending with indirect channels involved in a relatively small proportion of further advances and top-up loans. These have a lower average value than remortgages and house purchases. For the third quarter of 2000, figures from the Survey of Mortgage Lenders report the average loan for house purchase to have been £70,363, compared to £61,758 for remortgages, £17,459 for further advances and £16,536 for top-up loans.

In the first half of 2000, the total value of direct mortgage lending through the internet was £198 million, or 0.3% of the value of total advances. The largest part of lending originating through the internet was for remortgaging. This contrasts with the remaining distribution channels where lending for house purchase is predominant (see Chart 4).

CHART 4: TYPE OF LENDING ORIGINATING THROUGH DIFFERENT DISTRIBUTION CHANNELS, H1 2000



Source: CML Survey, November 2000
Note: Percentage based on the value of business

Expectations

The survey also asked lenders to look two years ahead and to assume that they would be writing the same volumes of business as today. Lenders were then asked to consider the split of their lending between distribution channels. Just under half of the respondents expected to see no change in the volume of business originating through the internet, although a quarter thought the volume of business would be 25% to 50% higher and 10% that it would be more than 50% higher. Optimism was also shown in the potential for the telephone as an originating channel with one-third of lenders predicting some growth in business. Lenders, however, thought the growth in business through the internet and telephone channels would come at the expense of the branch network and intermediaries. A quarter of lenders thought the volumes of business through both these channels would decrease.

While at the mid-point of 2000 approaching six out of ten lenders conducted mortgage business by phone and a quarter through the internet, if intentions expressed in the CML questionnaire materialise, then in a short period of time almost half of lenders will provide for internet originations. Furthermore, the presence of the internet extends to the introduced business. Charcoline reported that in the nine months from November 1999, '£160 m worth of proceeding applications' had come through the internet.

The success that lenders are likely to derive from adopting the internet channel is crucially dependent upon the public's willingness to use the technology to transact. The CML's Annual Housing Finance Survey for 2000 asked individuals to consider how likely they would be to look for information on mortgages on the internet next time they were considering a mortgage. 19% replied that they were fairly or very likely to look for information on the internet and 4% were certain to. However, when asked if they would actually apply for a mortgage via the internet, only 8% were fairly or very likely to and just 1% were certain to. Consequently, while the number of lenders offering the internet for mortgage applications continues to grow there remains some reluctance on the part of consumers to transact as well as using the internet as a means for gathering information.

Conclusions

The dominant strategy amongst lenders is to offer several channels through which mortgages can be originated. The typical lender offers three channels, although the largest lenders (by size of mortgage book) are often more able to provide the greatest number of channels. The multi-channel approach has arisen from deregulation of the mortgage industry and the development of new technologies. The choice of distribution mix has become increasingly important as the competition within the mortgage industry as intensified. As lenders have increased the number of distribution channels the role of the branch network has been questioned. Whereas the branch network was once an important determinant of market presence, new channels enable lenders to potentially extend their market presence more cost effectively.

Lenders see the potential for further growth in mortgage business from telephone operations, but also from the internet. The prospect of an end to the traditional branch strategy is, however, unlikely. Just under half of lenders expect to see similar levels of business through branch networks in two years time. Therefore, we are likely to hear further references to the much talked about clicks and mortar strategy. A significant factor in the continuation of the multi-channel approach is that around 90% of mortgage lending (by both value and volume) in the first half of 2000 came through either the branch network or intermediaries. While telephone/postal originations amount to a sizeable 9% of mortgages advanced, the internet accounted for just 0.3% of advances.

References

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