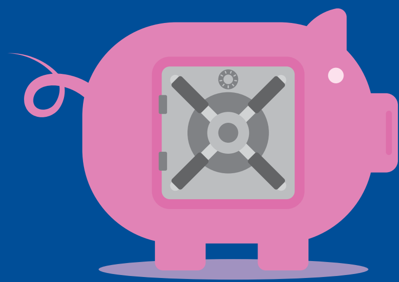
Can banks win the fight for home loan customers?



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Intense competition for home loan customers has created a price war that is affecting profitability. To avoid this race to the bottom, retail banks are seeking innovative ways to differentiate their offers by providing a better experience for their customers. To do this successfully, they need a system to understand the ever-changing needs and increasing expectations of customers and the ability to bring innovative, value-adding solutions to market swiftly. Complicating this already difficult challenge is the need to comply with changing regulatory requirements.

Residential property prices in many countries continue to rise at a rapid pace — particularly in large, urban areas. Between 2006 and 2016, median house values across major Australian cities increased by more than 10 percent a year from US$220,000 to US$540,000. In the same time period, average London house prices rose from US$335,000 to US$590,000,[1] while Greater Toronto saw an average yearly increase of 7.7 percent for two-storey family homes.[2] Even in the US, where the sub-prime market collapsed so spectacularly following the global financial crisis, cities like Los Angeles are now experiencing double-digit annual price growth.[3]

These conditions may have benefited established homeowners and investors, but, along with the higher deposits now demanded, they have also made it increasingly difficult for the next generation of prospective buyers to enter the market. During the last 10 years, average incomes have not kept pace with house price inflation, growing at a compound rate of just 3 percent in Australia, and less than 3 percent in Canada, the UK and the US — resulting in debt-to-income ratios well above historical levels.[4] It's little surprise then, that in the UK, sales of properties for first-time buyers have declined more than any other group[5] — with the 'baby boomers' taking advantage of historically low interest rates to become landlords to

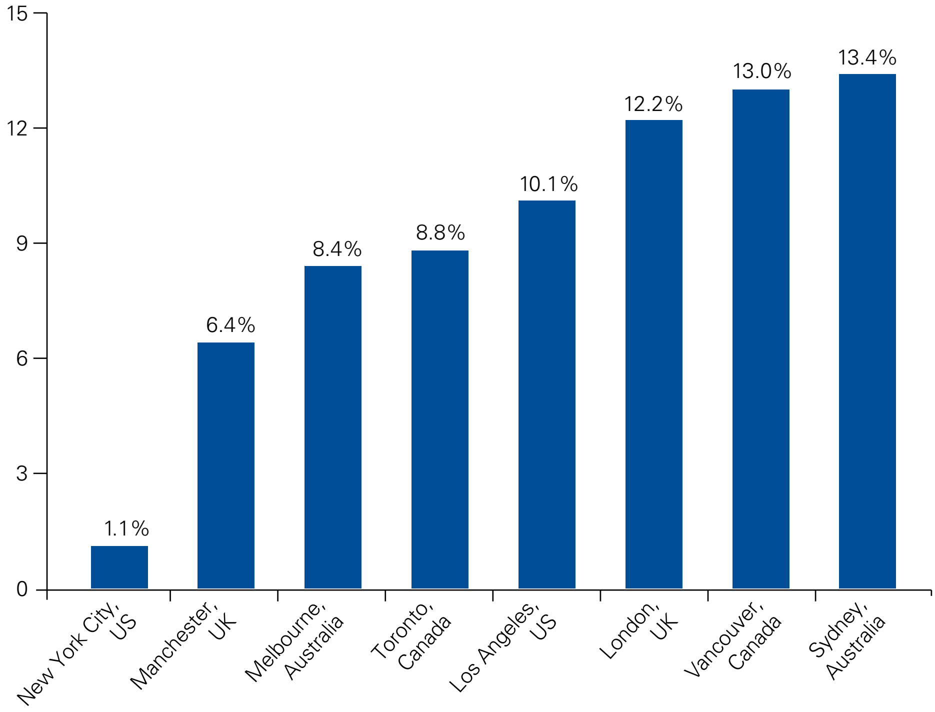
[1] Nationwide House Prices Since 1952 http://www.nationwide.co.uk/about/house-price-index/download-data#xtab:uk-series
[2] *Financial System Review*, Bank of Canada, December 2016.
[3] Source: KPMG Analysis
[4] http://www.tradingeconomics.com/united-kingdom/wages
[5] http://www.telegraph.co.uk/personal-banking/mortgages/over-40-housing-hoarders-shut-out-millennials-says-lse-report/

the younger 'generation rent'.[6] The UK's housing shortage only exacerbates the situation: between 2011 and 2014 just 460,000 houses were built — less than half the estimated demand of 975,000.[7]

With demand outstripping supply in many cities around the world, and memories of the financial crash fresh in their minds, governments are trying to ease conditions for first-time buyers and cool the buy-to-rent segment (investment property), while encouraging responsible lending.

Examples of steps being taken are stricter limits on loan-to-value ratios for residential lenders coupled with more stringent checking of a buyer's financial situation to reduce the likelihood of a borrower defaulting. Various changes are also being introduced to reduce the attractiveness of rental properties. UK landlords will soon have to pay tax on their full rental income before costs, while Vancouver has announced a 15 percent transfer tax on residential properties for purchasers who are neither permanent residents nor Canadian citizens.

Figure 1: Residential asset price growth: 3-year CAGR 2013–2016[8]



Escaping the race to the bottom in loan profitability

With continued strong demand for residential property, competition amongst retail banks in home lending has become particularly fierce.[9] Aggregator websites are putting further pressure on profit margins by enabling customers to easily compare product features and pricing across different lenders. The UK's online-only Atom Bank is offering mortgages to a range of customers, including first-time buyers and the self-employed,[10] while UK brokers Trussle and Habito's online only remortgaging service provides mortgages from over 100 lenders.[11,12]

To maintain market share, home loan providers are heavily discounting their front books below the standard variable rate. This behavior appears to be particularly acute for deals originated through brokers — who have the freedom to direct customers to a range of banks. The result? Net margins have plunged as low as 20 to 25 basis points on the front books of some banks.[13]

To escape this race to the bottom in home loan profitability, retail banks are increasingly trying to differentiate themselves on service by delivering a superior customer experience (ideally, at a lower cost-to-serve). By reimagining the home loan journey, they are using customer data and advanced analytics to develop more personalized offerings, employing mobile apps and digital platforms for e-conveyancing and settlements.

Investing wisely in the home loan customer experience

Globally, we estimate retail banks will spend as much as US$5 billion in each of the next 2 years on improving the customer home loan experience.[14] But to get the most from this investment, they need to understand what customers really want, and how this may vary by age group, gender and relationship status.

Research conducted by KPMG early in 2016 identified six 'pillars' — personalization, integrity, time and effort, expectations, resolution and empathy — that underpin excellent customer experience and the kind of long-term customer relationships needed to drive growth and shareholder value.[15]

A more recent KPMG study of mass affluent home loan customers (defined as customers with annual incomes between US$60,000 — US$200,000), sought answers to a range of questions about their home lending experience.[16] The responses indicate that:

1. Not all pillars are viewed as equally important in delivering a great home loan experience.
   Respondents to our home loan survey feel that **integrity** (being trustworthy and engendering trust), **simplicity** (minimizing customer effort and creating frictionless processes) and **resolution** (turning a poor experience into a great one) were the most important.

[6] Credit Constraints and the Composition of Home Sales. Farewell to First-time Buyers?, Felipe Carozzi, July 2015.
[7] http://www.bbc.co.uk/news/uk-34311522
[8] Source: KPMG Analysis
[9] Note: We use the term 'retail banks' here in a broad sense, which includes building societies, credit unions and non-bank home loan providers.
[10] https://www.ft.com/content/1e3cd566-bbb1-11e6-8b45-b8b81dd5d080
[11] http://www.telegraph.co.uk/business/2016/04/10/digital-only-mortgage-broker-to-take-on-uk-rivals/
[12] https://www.ft.com/content/36760d6a-96c6-11e6-a80e-bcd69f323a8b
[13] Source: *Home Loan Survey of the Mass Affluent*, KPMG, December 2016.
[14] Source: KPMG information, 2017
[15] Source: *Banking the Customer Experience Dividend*, KPMG Nunwood, 2016.
[16] Source: *Home Loan Survey of the Mass Affluent*, KPMG, December 2016.

The six pillars of customer experience

Personalization
Using individualized attention to drive an emotional connection.

Integrity
Being trustworthy and engendering trust.

Expectations
Managing, meeting and exceeding customer expectations.

Resolution
Turning a poor experience into a great one.

Time and effort
Minimizing customer effort and creating frictionless processes.

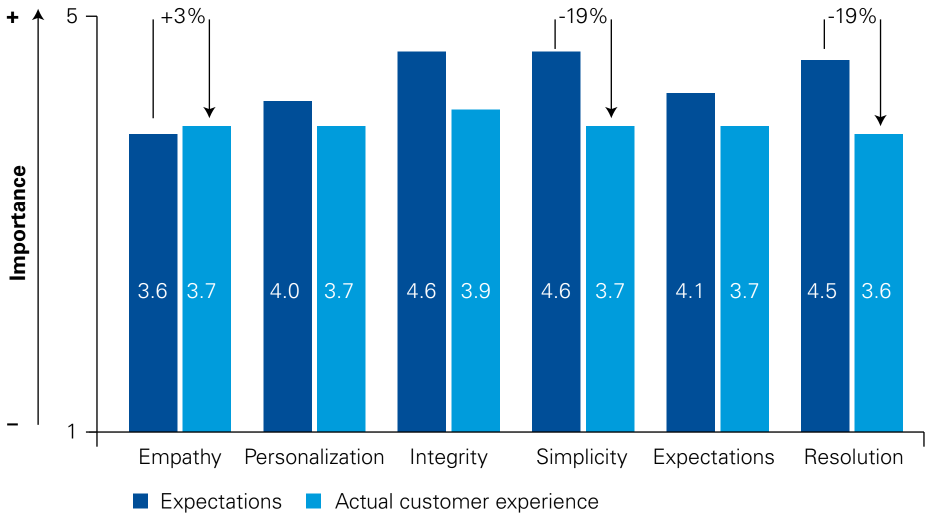
Empathy
Achieving an understanding of the customer's circumstances to drive deep rapport.

2. The biggest gap between customer expectations and actual experience are against the customer experience pillars that matter most to this segment.
   Integrity, **simplicity** (time and effort) and **resolution** all failed to meet home loan customers' expectations, as figure 2 shows. Applicants expect a fair deal, with transparent terms and conditions. They also expect a fast and easy process in which required customer information is captured and processed correctly the first time (no rework). In the event that issues are encountered, at a minimum, they demand a speedy and equitable resolution.

   The lengthy mortgage application process has long been a burden for consumers, involving reams of paperwork, multiple touchpoints and third parties. One UK high street lender is applying machine learning to the credit approval process to significantly reduce decision times and referrals to credit experts. Another major UK retail bank aims to reduce the entire cycle from submission to offer from 14 days to just 3 days. Some of these UK players are also investing in technology that offers live video links to mortgage advisors and allows customers to perform transactions directly through their smartphones.

3. The quality of home loan experience varies by acquisition channel.
   Of the three channels (applying through one's existing bank relationship, applying directly with a new financial institution or applying through a broker), brokers had the lowest score across all six pillars. This is a major concern given the increasing reliance home loan providers are placing on broker networks in countries like Australia, Canada, the UK and the US.

Figure 2: Comparison of expectations, with actual customer experience, when taking out a loan



Walt Disney thinks like a customer — and so can banks

Customers at Walt Disney World Resort are given digitally enabled wristbands (Magicbands) that let them buy food and merchandise and give them faster access to all the Disney experiences. And should they encounter long queues, Disney can identify the wristband holders and even send over their favorite Disney characters to entertain them during their wait. As part of the process of reimagining customers' home loan experience, banks should consider these kinds of data-rich tools to enable them to anticipate and react to customers' needs.

How banks can create a unique customer home loan experience:

- identify which elements of the experience matter most to customers
- establish an internal process for quickly coming up with ideas and getting them tested and into the market
- make sure that every customer touchpoint — including third parties — is geared to a consistently positive experience
- build appropriate controls to comply with regulations.

Additionally, customers who applied for their home loan through a broker are highly motivated by price and have a much greater propensity to either renegotiate their loan or switch lenders within 2 years of completing the deal. For example, figures from Canada show that when it comes to renewals and refinancing, borrowers returned to their bank 67 percent of the time in contrast to just 33 percent for their mortgage broker.[17] Any bank choosing to work with intermediaries should, therefore, consider how they can partner with brokers more closely, to ensure there are no weak links in the customer experience.

Striding ahead in the fight for home loan customers

Banks typically view the customer home loan journey as a series of steps beginning with a loan request and ending with drawdown of the loan and settlement. By reimagining this experience as a value chain centered around an individual/couple/family moving home, they can start to get under the skin of the customer.[18] Internally, cross-functional customer experience teams should begin by understanding what triggers the thought processes of prospective customers, and how they can ensure that the bank is front of mind from the earliest stage.

The next step in the reimagination process is to articulate the customer's various needs at each stage of the extended value chain; e.g. dreaming of a home (which includes a pre-research and a research phase), applying for a home loan and owning a home. The team can then generate ideas on how the bank (or its strategic partners) can best fulfill these needs and satisfy all six customer experience pillars. Examples could include innovations like facial recognition technology to identify the customer (currently under trial by a company called #ashching), or offering preferred rates with removal companies as a value-adding service (part of USAA's proposition to its home loan customers in the US).

A bank may find it easy to generate numerous innovative ideas for delivering greater value to customers looking to move home or acquire a new property. But it also needs a systematic process for narrowing this list down, along with the capabilities to rapidly develop and test ideas — to decide which to choose and which to disregard.

Creating a great customer experience is not a one-off exercise. The ultimate goal is a repeatable system for identifying unmet customer needs, producing exciting, distinctive ways to better satisfy these needs, and creating an agile environment that encourages experimentation and quickly brings feasible solutions to market. Banks that master this discipline are the ones that should ultimately win the battle for home loan customers. But the demand for responsible lending means that any efforts to deliver an outstanding customer experience must conform to ever-changing regulatory requirements. ■

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[17] *The Annual State of the Residential Mortgage Market*, Mortgage Professionals Canada, December 2016.
[18] We prefer the expression 'moving home' over 'obtaining a home loan' or 'applying for a home loan' to describe the end-to-end customer experience as it encourages design teams to think more broadly and extend the value chain both upstream and downstream.