

Finance for when your customer doesn't fit the mould

A BROKER'S GUIDE
TO NEAR-PRIME AND
NON-CONFORMING/
SPECIALIST LOANS

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INTRODUCTION

There's no one size fits all for loans, especially when it comes to self-employed borrowers or those with poor credit (credit impairments). Increase your offering and grow your business through near-prime and specialist (or non-conforming) loans.

Long gone are the days when workers stayed with the same company for their entire working life. Today the average Australian worker changes roles, or even careers, roughly every three years, with many moving between different types of employment including salaried work, freelance, contract, or gig work (the gig economy).

And self-employment is now a popular alternative to the traditional 9-5, with more and more people choosing to be their own boss, or turning their side-hustle into their main hustle.

Nearly 8% of Australian workers are independent contractors* and 40% of broker customers are reported to be self-employed~ – that's a lot of potential customers who may not meet the criteria for a traditional prime full doc loan. But that doesn't mean there isn't a loan for them.

This evolution in employment patterns and income types means customers' needs and expectations have also evolved.

While a traditional low-risk prime full doc loan relies on the borrower having standard, predictable and regular payslips and expenses to demonstrate credit worthiness, borrowers are becoming more diverse in how they generate income and what they need from their loan product.

In addition, there are customers who may have some minor, or dated, credit blemishes preventing them from being approved for a loan from a big bank.

With non-bank lenders filling this gap, brokers have the opportunity to grow their business through additional revenue streams afforded by these diverse customers, amplifying their success when times are good and insulating their business when times are slower.

As you will see, near-prime and specialist (non-confirming) loans don't have to be hard to write, so don't give a customer away just because they don't fit the traditional prime loan mould.

* www.abs.gov.au/statistics/labour/earnings-and-work-hours/working-arrangements/latest-release

~ Resimac Broker Experience Survey (2021)

Types of near-prime and specialist (non-conforming) loans

Homes, cars, non-property investments, business equipment or stock could potentially all be financed through near-prime or specialist (non-conforming) loans.



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TYPES OF NEAR-PRIME AND SPECIALIST (NON-CONFORMING) LOANS

Prime alt doc loans

A loan type that offers great interest rates and allows self-employed borrowers to use alternative forms of income verification beyond paystips and tax returns.

For example, self-employed small business owners may not have two years of full end-of-year financials, or their full-year financials don't accurately reflect the current trading conditions of their business. In other instances, there may be complex business structures that would make providing full documentation hard. Alternate forms of documentation can be used to show their current income.

Specialist (non-conforming) loans

Often, specialist or non-conforming products are associated with debt consolidation – but they're capable of being used for so much more.

Specialist products are particularly suited to four types of applicants:

- Candidates with a history that includes poor credit, such as mortgage, credit card, car and personal loan arrears, defaults or bankruptcy.
- Candidates who need to consolidate debt, including ATO or private/solicitor funding debt.

- Candidates with more diverse credit needs than just purchase and refinance.
- Candidates using security that is considered riskier (such as location category B and C) and also need a higher loan-to-value ratio.

Simply put, specialist loans are great for applicants or scenarios that are a little 'outside the box'. They may not fit traditional prime lending policies because they may be considered slightly riskier.

Also, where prime full doc products usually only count a portion of any income other than full time income, for example 80% of investment, bonus or overtime income, specialist (non-conforming) products may count a higher portion, such as 100% of that income.

As with prime loans, specialist loans can be full doc or alt doc:

Specialist full doc loans

These types of loans could be used when a borrower has regular income and standard documentation but their credit history is less than perfect, or when they're relying on diverse income sources.

Specialist alt doc loans

This product is typically suitable for borrowers whose credit history is less than perfect and those who can't meet full doc application requirements, such as the self-employed.

Myth

Near-prime and specialist loans equal inflated rates and products short on features.

Fact

Many non-bank lenders base their rates on security, not purpose, so their quality near-prime and specialist products offer competitive mortgage-based rates comparable to prime full doc rates.

Their products are designed to compete with prime full doc products too, with all the benefits including offset accounts and redraw facilities.

Near-prime and specialist loan customers

Prospective borrowers can feel like there is a stigma around needing near-prime or specialist products – but there shouldn't be. As a broker, these products give you the versatility and opportunity to help solve a variety of customer needs.

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NEAR-PRIME AND SPECIALIST LOAN CUSTOMERS



As Australian customers become more diverse, so too do their needs, aspirations and their financial situations. Doing things differently is now becoming the new 'normal' and this should be celebrated. Near-prime and specialist products are just as diverse as customers are – they're specifically designed to suit their unique needs and expectations.

Often applicants aspire to be a prime loan customer, but they may not be eligible for one reason or another. It's worth reminding them that the type of product they're eligible for now is just a reflection of their current circumstances. In the future, with the help of prime alt doc or specialist, they may be eligible for the product they aspire to.

In some cases, applicants will want to hold out in the short term until their circumstances change and they're eligible for a prime full doc product. But they risk incurring 'opportunity costs' – which are the costs of delaying a purchase (until they qualify for a prime loan) and missing out on the opportunity. These costs can far outweigh any benefits received once they obtain that prime loan. Often, committing to a near-prime or specialist product now is the more practical and cost-effective solution.

NEAR-PRIME AND SPECIALIST LOAN CUSTOMERS

Investing in a promising business

Over the past few years, I'd become familiar with a variety of businesses. A particular business I had experience with was growing and I had the opportunity to invest in it. I knew the business was going to be really successful, so I didn't want to miss this opportunity.

I needed a few hundred grand and I had good equity in my home, so initially I wanted to fund the investment through a prime full doc loan. The lower interest rates usually associated with prime full doc could help me maximise my return on investment, but there was a strict time limit on this opportunity and getting my financials in order for a full doc loan would have meant missing out.

Obviously, that was out of the question, so I ended up looking around and found a leading non-bank lender who had a great prime alt doc product.

I used an accountant's declaration to show my income – my accountant was able to provide a conservative income declaration based on interim numbers and business bank statements – and we executed the loan as cash out. I also included a letter from the managing director of the business I was investing in as a supporting document, outlining the details of the investment.

Whilst I'm currently paying a slightly higher interest rate than I probably would have with a prime full doc product, I know that when I get my full-year financials in order, I should be able to refinance to a prime full doc product – but this way I didn't miss out on the opportunity.



Ally Merchant, Mortgage Broker (Subcontracted)
Acceptance Finance



I used an accountant's declaration to show my income and we executed the loan as cash out.



Myth

A near-prime or specialist loan cannot be refinanced to a prime loan.

Fact

A variable near-prime or specialist loan can be refinanced to a prime loan if a borrower's circumstances change and they can meet the requirements for a prime loan. In fact, near-prime or specialist loan products can be a great stepping stone to this, or a 'pathway to prime', helping customers rebuild or establish their credit history.

NEAR-PRIME AND SPECIALIST LOAN CUSTOMERS

The self-employed borrower

A self-employed person is one who is operating a business as a sole trader, in a partnership, or as a 'Pty Ltd' company. A self-employed person (sole trader, company, independent contractor or in a partnership) chooses when, where, how and for whom services are performed. They are:

- entitled to all the profits of the business, and
- responsible for all the debts of the business.

The nature of being self-employed means these customers may not have the traditional regular income or financial documentation a PAYG employee has, but they do have the capacity to repay a loan.

For example, a self-employed customer who does contract work may not have consistent month-to-month income, but while the frequency of their income is inconsistent, their overall financial position and credit history is sound.

The self-employed customer may often be looking for finance in order to purchase or refinance a property, consolidate debt (including business debt), or as cash out for investing in their business or any other worthwhile purpose.

Prime alt doc products usually require the applicant to have been operating their business for at least two years (including having their ABN registered for two years). But, for those with less operating time, specialist products may be better suited with some only requiring the applicant to have operated their business for a minimum of six months.



NEAR-PRIME AND SPECIALIST LOAN CUSTOMERS

You'll never know when you'll need a near-prime or specialist lender up your sleeve

I always used to prefer writing prime full doc loans. Business in that space had always been good so I never really needed to look beyond it. But then, one day, I had a client with a very unique situation and I was up for the challenge.

He ran a car dealership and he wanted to finally repay his parents a significant sum – \$1.4 million – after they'd financed his owner-occupied residence during a period when it was difficult to get a hold of a bank and turn-around times were blown out.

Prior to reaching out to me, he had never used a mortgage broker and had always gone to a mainstream bank. However, this time when he reached out to his bank they advised that they would be unable to assist with an equity release of \$1.4 million.

Originally the client's parents deposited him the money to buy – there was clear evidence of the flow of funds – and now his business was established and successful, lockdowns were over and he wanted to repay his parents.

My colleagues were extremely surprised when I told them that a non-bank lender would be able to assist with this loan. I'd worked with this non-bank lender before on some prime full doc deals, and knew they also wrote prime alt doc and specialist loans and they had fair policies.

“

My colleagues were extremely surprised when I told them that a non-bank lender would be able to assist with this loan.

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Ally Merchant, Mortgage Broker (Subcontracted)
Acceptance Finance

So, I thought I'd check them out and it was so much easier than I thought. Their prime alt doc product allowed us to execute the deal as cash out – and there were no concerns about the initial flow of funds because they were well documented and we provided all the evidence as supporting documents – including bank statements showing the receipt of funds and transfer to solicitors, as well as the settlement statement.

The non-bank lender's BDM was exceptional as well, he really set the deal up to succeed. Other than those specific extra docs, everything else was very straight forward. My colleagues owed me a few beers after that deal!



NEAR-PRIME AND SPECIALIST LOAN CUSTOMERS

Fixed-term contractors, permanent part-time, casuals and those on probation

Many people now move regularly between jobs, or they work jobs that allow for greater work-life balance. Their income may be regular, but they cannot demonstrate satisfactory ongoing employment to the extent that a prime full doc loan requires.

Near-prime and specialist products have options for those with varying work history or employment types – even for those currently on their probation period with a minimum of six months previous continuous employment.

The customer with a poor credit history

Life happens. Financial setbacks in the past shouldn't necessarily preclude customers from seeking finance now.

There are a number of lenders that welcome borrowers who have adverse credit events (any single event that caused an adverse credit bureau listing or listings), mortgage arrears or have been declared bankrupt.

If circumstances for these customers have changed, they're on the road to recovery and they have capacity to make repayments, they may be able to be approved for a loan before their credit report is clean.

Examples of common suitable applicants include:

Divorcees: In some divorces, lawyers may recommend that customers stop contributing to shared financial commitments such as mortgage repayments or credit card bills.

Unfortunately, as a byproduct, this results in the customer ending up with a blemished credit history. After the divorce, both parties are going to want to get on with their lives, such as buying out the other partner's share of their residence. These blemishes would naturally limit their eligibility for a prime product, but specialist products may be suitable.

Recovering from health issues: Unfortunately, some are struck down with health issues that temporarily prevent them from working or require the patient to have extended hospital stays or recovery periods. Not to mention, medical treatment is extremely expensive and not always covered by health insurance.

In some cases, the burden falls on the patient to fund their own medical costs – they may go into debt to do so, or miss making other financial commitments such as paying their mortgage. These people shouldn't be punished and excluded from finance because of the circumstances they had to endure, and because they had to prioritise their own health. Whilst they may not be suitable for a prime product, they may be able to refinance or consolidate their debts through specialist finance.

Recovering from debt: Debt can sometimes just get out of hand. It's not necessarily through financial illiteracy, financial mismanagement, excessive risk taking or other nefarious reasons – life just happens. Businesses, for instance, impacted financially by unforeseen events like natural disasters, may fall into this category. These customers may benefit from the net savings made from consolidating various debts into one.

Applicants with unique security scenarios

Sometimes it's not the applicant themselves preventing a prime full doc application from proceeding – it's actually the security or loan size and deposit.

In some cases, the combination of the property's location (usually in a Category B or C location), combined with the required loan size or loan-to-value ratio may not fit a lender's prime full doc policy. The customers themselves are actually strong candidates and they're in a great position to benefit from a specialist product.



For the variety of customers that walk through your door... **think Resimac**

Whether your customer is an employee, self-employed or recovering from a financial setback.

No matter if they're looking to buy or refinance, invest in their business, consolidate debt (even tax debt), get cash out, invest in something other than property, or for any other worthwhile purpose.

Resimac has a range of mortgage-based solutions* that could suit their needs and circumstances.

Plus our interest rates are always great, as they're based on security not purpose.

Our BDMs and Relationship Managers would love to discuss your customer's scenario with you.

To find out more about our products,
visit broker.resimac.com.au



*Not all Resimac products suit all customers and their needs. We offer different products to suit different customer situations, objectives and needs. Terms, condition, limits, exclusions and criteria applies. View product specifications and information at broker.resimac.com.au.

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Documentation, credit history and fees

Just like a prime full doc loan, documentation, credit history and fees are all involved in near-prime and non-confirming specialist loans. While there are some differences in what is required, these shouldn't be considered daunting.

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DOCUMENTATION, CREDIT HISTORY AND FEES

Documentation

For many, the special income documentation requirements present the biggest hurdle when looking to submit a near-prime or specialist application. But they don't have to.

Each lender will have their own specific documentation requirements to show income and an ability to repay a loan, but generally, lenders have the following requirements.

Alt doc income documentation

In general, applicants for prime alt doc or specialist alt doc loans may be able to simply use one of the following:

- an accountant's declaration/verification (where the accountant has worked for the applicant for a minimum period of time). Non-bank lenders provide accountant's verification templates which can be provided to the accountant. It's the accountant's responsibility to complete the letter and they should know exactly what to do.
- six months (two quarters) of lodged Business Activity Statements (BAS). BAS needs to reflect the most recent six months, or two quarters, of trading, and had been lodged with the ATO.
- three months of business bank statements. Bank statements typically need to show the most recent 90 days of business income (credits) and expenses (debits). They should also clearly show the account number and account owner's details as well as the financial institution's details.



Full doc income documentation

For specialist full doc loans, the documentation is similar to that required for a prime full doc loan, for example payslips, or if the applicant is self-employed, two years of end-of-year financials.

The major difference being, you may need to collect a variety of other documents from the variety of income sources, so the lender gets a comprehensive account of your customer's income.

While this process is slightly more time consuming, it isn't necessarily any more complex as the documents required are typically standard and readily available from various sources.

Other documentation

There are some other documents often required that are exclusive to near-prime and specialist applications, but these are typically easy to navigate and not too strenuous to complete, and are often designed to aid in the application process, helping improve the outcome.

Checklists

Non-bank lenders often require checklists to be submitted with applications. Whilst this seems like additional work upfront, checklists are actually great tools that help you avoid work down the track. They will outline all the documents you need to include for each application type.

Rely on these checklists heavily as you begin writing near-prime and specialist, and continue using them as you perfect your skills – you never know what you might overlook one day.

Loan notes

One way to view prime alt doc and specialist products are mortgages for those with interesting stories to tell, for example customers with diverse backgrounds or needs.

By telling the lender your customer's story, you'll help them understand why your customer is a strong candidate. The loan notes give you the opportunity to do this. It can help credit assessment staff better understand, and then, assess the applicant.

Don't be stingy on detail, convey the human side of your customer in the loan notes.

DOCUMENTATION, CREDIT HISTORY AND FEES

Credit history

Specialist products are specifically designed for those with a history of credit events. As such, potential applicants shouldn't hesitate about being transparent about their credit history.

For example, non-bank lenders will typically group multiple adverse credit bureau listings as a single event, provided the borrower can demonstrate that all listings were caused by the single event, within a certain period of time.

Many non-bank lenders can also consider some minor credit events as not material, and therefore, not count them towards the applicant's total number of credit events.

For example, credit events that may be considered not material include:

- defaults below \$2000
- defaults paid more than 12 months prior to the application date
- defaults listed more than two years prior to the application date.

For those credit events that are considered significant enough to count, non-bank lenders offer a variety of specialist product variants to accommodate for those with increasing numbers of events. Even those with unlimited mortgage arrears, unlimited credit events greater than \$2,000, or current bankruptcies have a specialist product that could potentially suit.

As with documentation requirements, the adverse credit events a lender will consider vary, but often there's a specialist solution for every situation.

Check the product specifications or talk to your BDM to confirm if your customer's credit history is acceptable.

Fees and charges

The fees and charges associated with a near-prime or specialist loan will vary depending on the lender. Although some of these fees and charges aren't the same as you would see for a prime full doc loan, they often perform a similar role.

Risk fee: Near-prime and specialist loans may attract a risk fee that doesn't normally apply to prime loans. This risk fee could be considered equivalent to lender's mortgage insurance, and many non-bank lenders allow this fee to be capitalised into the loan, much like LMI can be.

Application/settlement fee: Another fee typically associated with a specialist loan is an application or settlement fee, often paid at settlement. This fee reflects the additional work required for the lender to process the application.

Other fees/charges: Other fees and charges like valuation or legal fees are common amongst all products, from prime to specialist, full doc to alt doc. The valuation or legal services are provided by third-party suppliers, so these fees are priced accordingly.

The product specification will detail any fees for a particular loan.



Steps to writing near-prime and specialist loans

Overall, the preparation and submission of a near-prime or specialist loan application is the same as with any normal prime full doc loan.

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STEPS TO WRITING NEAR-PRIME AND SPECIALIST LOANS

The three S's – Security, Servicing, Story

By remembering to focus on the following three S's, you'll help guarantee a speedy and smooth application assessment process.

The biggest difference between a prime full doc and near prime or specialist loan application is in the paperwork being supplied to evidence the applicant's income (if alt doc) and additional notes to explain any credit issues or arrears (if they're a credit impaired customer). It should all help tell the story of why the customer falls outside traditional prime lending guidelines.



Security

Whilst near-prime and specialist products are designed for those with higher risk profiles (compared to prime full doc), lenders still need to have confidence that their investment in your customer is protected.

Whilst interest rates help a lender manage risk, an applicant's security is another big contributor to reducing perceived risk. Make sure that the security your customer has is in good order and acceptable to the lender. There are two tools to help here, the acceptable property location tool which informs which location category the property falls under (A, B or C) and valuation reports. Make sure the results are included in the submission.



Servicing

Servicing, the applicant's ability to repay their debt whilst also maintaining a certain standard of living, is another key factor used by lenders to assess an applicant's risk. Often, having multiple income sources, an applicant's ability to service a loan may be unclear.

To help guarantee your customer's success, don't just provide the required income documents with the application, go above and beyond in the application loan notes to make it clear that your customer can service the loan. Draw attention to the supporting documentation and ensure the borrowers living expenses are accurately captured. This will help the credit assessment team easily understand their income and serviceability position.



Story

Life is meant to be lived. Customers take risks starting their own business, sometimes people make mistakes, other times bad things happen to good people. Non-bank lenders understand this. Their near-prime and specialist products are designed especially for those with interesting stories to tell.

Don't hide your customer's story, celebrate it in the loan notes. Give the credit assessment team a great understanding of who your customer is, their background and their plans. Don't just speak in terms of income, security and loan purpose, showcase the human-side of your applicant. The more information and detail, the better. Commentary is the key to showing that the customer will be in a much better financial situation.

STEPS TO WRITING NEAR-PRIME AND SPECIALIST LOANS

Here are some tips on how to get the information you need to satisfy the three S's.

Know your lenders

Talk to your aggregator about which lenders offering near-prime and specialist loans you have access to. Your aggregator Business Development Managers (BDMs) should have a good introductory understanding of which lenders are more suited to which types of customers – this will get you started in the right direction.

Then, get in touch with the lender's Business Development Managers. They'll be able to give you a comprehensive run down of their products and benefits – they'll also be able to give you all the specific product and policy information (if you're ready for it!).

Equip yourself with as much information as possible so you're ready when an appropriate customer walks through your door.

As a bonus, this will also help you build a relationship with lenders, which you can leverage for future loans you may write.

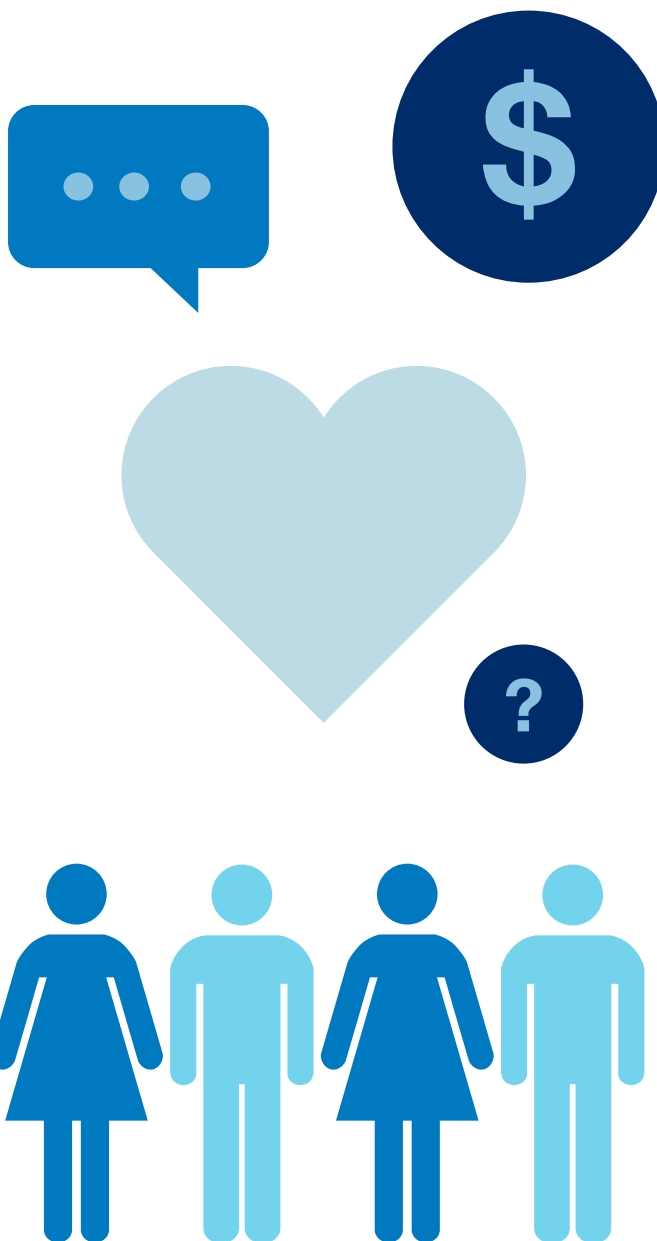
Listen to and understand your customer's needs

Focus on their needs, wants, circumstances and problems. They may be driven by wanting the lowest rate, but with your experience, you'll be able to identify all the other things they should consider, but may never have been aware of.

Near-prime and specialist loans can give you the opportunity to deliver exceptional customer service by providing a much-needed lending solution.

For near-prime customers, their needs are typically more diverse and there's usually a little more to their circumstances and story. They may be using the finance to consolidate debt, expand their business or just get back on their feet following one of life's little 'speedbumps'.

By understanding their circumstances, brokers can help offer near-prime and specialist customers a real and sustainable solution now, and also create a customer for life through great customer service as they help customers on their journey towards eventually becoming a prime loan applicant.



STEPS TO WRITING NEAR-PRIME AND SPECIALIST LOANS

Investigate suitable lenders and products

As with a prime loan, do some research on what lenders and prime alt doc or specialist products on your panel match your customer's needs.

Explain these options to your customer so they can make a decision.

Compile the information

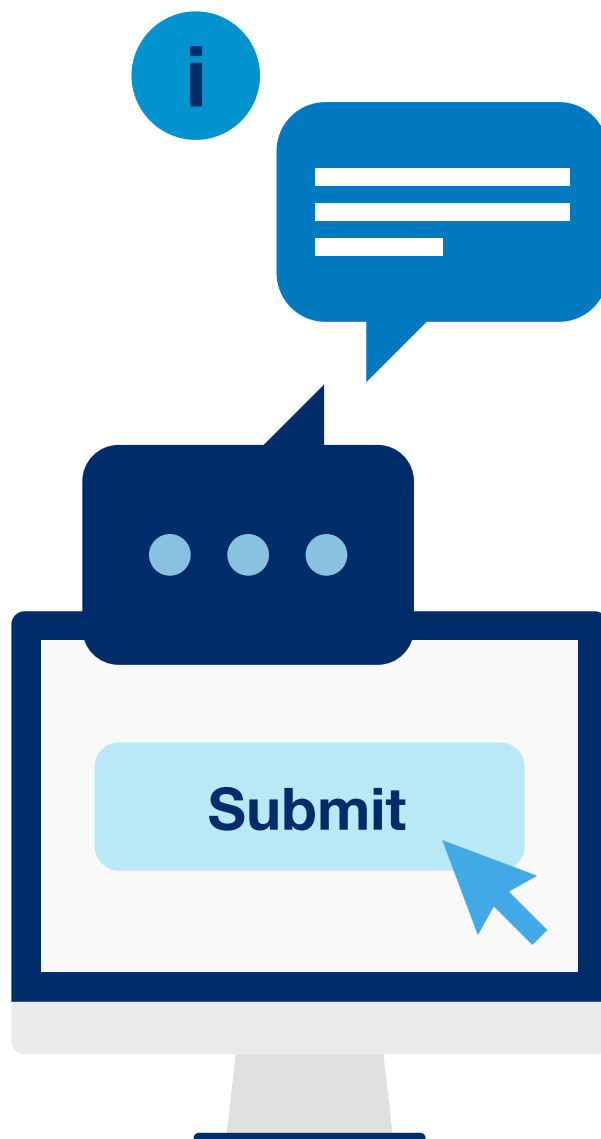
Once you've identified that a near-prime or specialist loan matches your customer's needs and circumstances, you'll need to prepare the application.

While the documentation you'll need from each customer may differ slightly, and there may be additional information required, as with all loans, having all the information prepared will help the assessment process move quicker.

You can always talk with your lender's BDMs as you're preparing the application to confirm you have the right documentation before submitting it. This will help make the process smoother and reduce the need for an application to be reworked.

Submit the application

If the application is approved, explain any conditions of approval to your customer and what the next steps are for them depending on the purpose for the loan.



Myth

The application process for near-prime and specialist loans takes too long and is too much work to make them worth it.

Fact

Any time you're working with a new product for the first time you may encounter some unknowns, but the different documentation and questions that need to be answered for a near-prime or specialist loan are just that – different, they don't need to lead to a lengthy time-consuming process.

And, the more loans you write, the more comfortable you'll be.

STEPS TO WRITING NEAR-PRIME AND SPECIALIST LOANS

I had a couple who ran a caravan park along the coast in Queensland. The site the park was situated on came up for sale and they saw acquiring it as a great opportunity to grow their business.

It meant they could stop paying rent and it gave them more certainty and security. It also meant that they could invest further in the site and develop their business through new facilities and services.

They needed a loan of \$1.1 million to purchase and they had their own home which they could use as security.

Looking at the options available at the time, I went to this particular non-bank lender because of their leading Specialist Alt Doc product.

This product provided my clients with lots of advantages. It allowed for unlimited cash out up to 80% loan-to-value ratio, even for business purposes, and they could use their business bank statements to declare their income which suited them due to the fluctuating tourism market around the time.

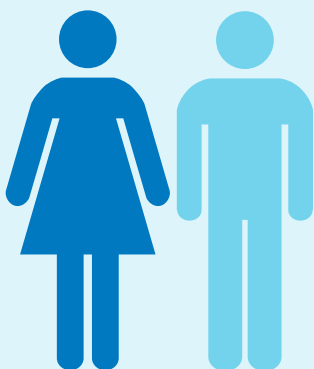


Julie Cassidy, Commercial/Corporate Lending, Partners Lending / Partners Wealth Group

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