Better and Brighter?

Responsible Rent to Own Alternatives – Summary Report

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#ResponsibleRTO

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The Financial Inclusion Centre is an independent research and policy innovation think-tank dedicated to promoting financial inclusion and fair, efficient, competitive and accountable financial markets.

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Summary Report

Like most forms of high cost borrowing in the UK, the Rent to Own (RTO) sector has experienced huge growth following the onset of the recession, establishing itself as ever present on the high streets of our more deprived towns, cities and communities. It enables over 400,000 households, almost exclusively with low incomes and reliant to some degree on benefits, to take out expensive credit to spread the cost of purchasing consumer goods from furniture and large household items such as cookers and washing machines to electrical items such as TVs and computers.

It has proven to be recession proof, more than doubling in size over the last five years since the onset of the economic crisis. The market is dominated by three just providers, with BrightHouse, by far the most well recognised and largest firm, followed by PerfectHome and non-store based provider Buy as You View.

The business model relies upon costly hire purchase arrangements whereby the customer has a credit agreement but does not actually own the goods outright until the last payment. Therefore, in addition to the huge cost of purchasing the products, falling behind with RTO repayment means customers face losing goods, which can put undue pressure to prioritise such payments. A number of other unfair practices have also been highlighted such as; providing unnecessary and expensive service cover, extended warranties, insurance and hidden charges that have all been shown to compound the debt trap for many low income families.

Yet, despite the detriment to consumers, there is still a distinct lack of social providers offering a viable alternative and those that do lack reach and scale to make a tangible impact. This report looks to help address this deficit by highlighting the different delivery models for creating and running fairer and more affordable RTO alternatives. It examines the key considerations and the potential delivery and lending models.

It is intended that the report continues to highlight the concerning practices of the sector but focuses on equipping community stakeholders that are keen to restrict such high cost credit usage with the tools to determine which of the different models might be most feasibility given their local circumstances.

RTO Sector: Key Figures

- More than 400,000 households are now using RTO to purchase household goods; this has increased by 131% from 210,000 users in 2008.
- The typical RTO customer profile is a young female lone parent, living in rented accommodation and almost exclusively from low income households that are wholly or partly reliant on welfare benefits.
- Nationally, there are now 373 RTO stores – a figure which has grown by 140% from 155 stores in 2008.
- According to BrightHouse there is a potential market for 650 stores across the UK.
- Each RTO store is used by between 900 and 1,000 customers annually who borrow approximately £1.95 million each year, equivalent to £2,114 per customer.
- Over the last five years, annual gross profit within the sector has grown by 139% from £127 million to £303 million.
- Annual turnover amongst the three main firms has grown by 118% since 2008 from £238 million to £520 million.

Consumer detriment

There are a number of concerning issues and detrimental practices that are seen within the RTO industry, including:

Price Comparison: Washing Machine

<u>BrightHouse:</u> Cheapest washing machine (with the mandatory 5 star service) is **£471.00**

Purchased using weekly repayment over 3 years (69.9% APR), it would cost **£936.00** (or **£1,056.12** with the optional product insurance, which is required if user does not have contents insurance).

<u>Alternative:</u> Cheapest similar product on high street is **£249.99** (or **£349.97** with delivery, disposal and 3 year breakdown plan).

Purchased using a weekly loan from a Credit Union over 3 years (42.6% APR), it would cost a total of **£491.19.**

- **RTO agreements are expensive and price transparency is poor** - with interest rates reaching 99.9% APR and charges for additional cover, the cost of goods can almost triple.
- **Customer experience high levels of financial difficulties -** with roughly half having some degree of late payment and failing repay.
- **High numbers of customers have their goods taken back -** with over 10% of customers having their goods repossessed.
- **Poor value and often unnecessary bolt-on service cover, warranties and insurances –** with at least 85% of BrightHouse customers estimated to purchase such services.
- **The market structures make customers exposed to over-charging and poor practices –** with few choices consumers are therefore more vulnerable to over-charging and unfair activities.
- **RTO is inappropriate for a proportion of customers –** with firms found not to be considering user's financial circumstances.

Such issues have placed the industry firmly under the spotlight of policy makers and the regulator, with the Financial Conduct Authority (FCA) set to outline new rules in 2016 giving greater protection for vulnerable consumers as well as creating a more level playing field for better value alternatives.

Responsible alternatives

In response, over the last few years a number of social businesses have responded by developing alternatives to compete with the RTO retailers and address some of these consumer detriment issues. These assemble a range of local stakeholder together with suppliers of household goods and affordable credit lines, combining some of the more 'positive' characteristics of the RTO model that appeal to consumers but delivered in a way that designs out some of the more harmful aspects. By doing so, these alternatives are able to generate significant cost savings for low income customers and thus help avoid paying a poverty premium for their essential goods.

"My washing machine broke and I have three children…. For some people BrightHouse is the only option…. I've had stuff off them years back. I never used to think about how much I was paying."

Tina

Case studies:

We have identified a number of exciting examples of RTO alternatives run locally and nationally:

Fair For You – fairer prices for you and your family	• Online outlet (and catalogue) • Outsourced product management direct to national manufacturer • In-house credit (raised investment) • Open access (available to all who meet affordability criteria)
own YOUR own	• Online outlet (and catalogue) • Outsourced product management to local supplier • Outsourced finance partner with Credit Union • Restricted access (only open to residents of partners)
furniture4U	• Retail shop outlet (planned website and catalogue) • Outsourced product management to local suppliers • Outsourced finance partner with Credit Union (under same roof) • Open access (available to all within geographical area)
The Smarterbuys Store	• Online outlet (with catalogue) • Franchise with products management centrally • Outsourced finance (capital via partners) • Restricted access (only residents of partners – except Bradford)
thestore	• Retail shop outlet (with catalogue) and online outlet • In-house product management • Outsourced finance partner with Credit Union (under same roof) • Open access (available to all in geographical area)

Delivery model options:

These five examples of RTO alternatives demonstrate just how different the delivery models can be and each with its own particular challenges and critical choices around:

Credit provision - who will deliver the lending facility.

- **In-house loan delivery directly by the social RTO firm** - This requires the creation of new lending vehicles with effort and time to obtain regulatory permissions and raising of capital finances.
- **Outsource credit delivery to an existing social lender -** Partnering with an existing affordable credit provider (typically a credit union or CDFI) can benefit from its ability to raise capital, its existing lending track record/infrastructure and user's access to other financial services. Yet, it can be more restrictive, being tied to certain lending criteria, approaches or risk appetites.

No matter who provides the borrowing, three important lessons have emerged:

- The consumer's selection of the goods and their credit application/decision needs to be seamless, even if it is actually operated by two different entities.
- The loan process needs to be straightforward and decisioning making needs to be made almost immediately through the social lender's own systems.
- Some degree of automation and access to credit scoring/reference data is important and therefore the selected credit provider will require appropriately developed IT technology.

Lending capital – who provides the capital for lending and who shoulders the lending risk.

If the credit provision is undertaken in-house or via a franchise model, significant capital will need to be secured. Equally, an outsourced credit partner could still require external capital to be raised depending on their available funds and willingness to lend for this type of purpose/product.

Moreover, lending risk could be shared by establishing either 'ring-fenced' lending capital or an underwriting agreement to cover potential defaults. This gives greater flexibility to lend to 'those in the grey area' who might ordinarily be too risky for the social lender's traditional credit assessment.

Delivery outlet - how will household goods and lending be promoted and accessed by customers.

- **Retail shop –** for some, creating a high street retail outlet that mimics the look of BrightHouse is seen as essential. The main consideration is the huge start-up and ongoing operational costs and whether it can be financially viable from the income generated primarily from product mark-up.
- **Online provision –** websites enabling product selection and ordering combined with loan application and assessment should be an essential aspect of any RTO alternative. Whether this is the sole route to market or one of many channels is the key consideration with the choice set in the context of the target customer and their ability to access a purely online facility.
- **Catalogue delivery** – a complementary brochure is also very important, particularly with a restricted access model focused on social housing residents. Consideration also needs to be given to a telephone-based facility that enables customers to both apply for credit and place orders.

Product operations – who manages the stock, order delivery and customer relationship.

- **Developing in-house product operations** – this option is particularly challenging as it needs extensive scale and volumes to make it financially viable and significant upfront / ongoing costs.
- **Outsourcing by partnering with an existing RTO provider –** the far easier option would be to piggy backing on an existing RTO alternative and utilising their supply chains – either by working with a formal franchise (e.g. Smarterbuys or Coop Electical) or a particular scheme (e.g. Fair For You). However, this may limit the scope for product tailoring and reduce income generation.
- **Creating direct arrangements with individual suppliers** – either local/regional businesses (e.g. Furniture 4U) or national firms/manufactures (e.g. Fair For You). This enables the selection of certain product lines based on quality and income generation potential and could also be attractive from a local economic development and employment perspective.

Customer base – should it provide open access to all or be restricted to certain users.

- **Open access** – with the need for scale and volume an open access model would appear to provide the greatest scope for financial sustainability.
- **Restricted access** – this model is often found amongst social housing providers delivering a RTO alternative specifically for their residents and is confined primarily from a wish to focus resources only at their own users. Alternatively, this could still be achieved through an open access model but with the ring-fencing of funds for specific groups of users.

Conclusion

By exploring the current crop of social providers offering RTO alternatives, it is clear that there is no single approach that offers the perfect delivery solution. Instead, there are a number of delivery considerations that can developed to best match the specific local circumstances and aspirations. One common feature of all the featured case studies is the need to involve a range of stakeholders. It should not be embarked upon alone but be a partnership bringing together local authorities, social housing providers and other third-sector organisations looking to address this issue.

Ultimately, it is hoped that the research stimulates debate, providing further focus on the rationale for intervention in this market and providing a starting point for anyone considering the various options for which type of RTO alternative offers the most appropriate solution.