DEBT AND HOUSEHOLD INCOMES

A research project on debt and financial vulnerability in the UK,the current trends and recommendations for policy makers

Summary

CONSUMER CREDIT Counselling Service
A Registered Charity

Consumer Credit Counselling Service

The Consumer Credit Counselling Service (CCCS) is the UK's largest dedicated debt charity.

Providing free debt advice since 1993, CCCS's range of free services includes mortgage counselling, welfare benefit checks and bankruptcy support.

418,000 people sought the charity's help with their debt problems in 2010.

1,145 people seek CCCS's help every day of the year because they are unable to keep up with their credit commitments.

Research by the Department of Business, Innovation and Skills (BIS)[1] has found that the demographic profile of CCCS clients is representative of people who seek debt advice from the not-for-profit sector as a whole.

While the charity's client base encompasses people from across the income spectrum, its average client comes from the lower income groups. The average annual gross income of a CCCS client is £22,401, £3,500 less than the UK average (£25,900).

Fifty-five percent of CCCS's clients receive some type of benefit or tax credit. On average, benefits account for one third of household income for clients receiving some form of welfare support.

"The changing economic environment means that life is likely to get worse for many vulnerable consumers, large numbers of whom will already be at risk of over-indebtedness. Ensuring their plight is not forgotten is CCCS's priority."

LORD STEVENSON OF BALMACARA, CHAIRMAN OF CCCS

THE RESEARCH: DEBT AND HOUSEHOLD INCOMES

Debt and household incomes is our first report in the *Debt and the Family* research project, a three report series which CCCS has commissioned from the Financial Inclusion Centre.

This first report focuses on lowest income, benefit reliant households and low-medium income households (sometimes known as the working poor or 'squeezed middle'). As well as focusing on incomes, the report also looks at the vulnerability of specific at risk groups such as households with low savings, single parent families, homeowners and households who rent.

While the financial position of many households has eased due to record low level interest rates, the future is not so bright. The financial health of vulnerable households will be shaped by a range of socio-economic factors such as high inflation, reduced real household incomes and the impact of deficit reduction measures.

The report's findings are based on existing government data and new analysis of CCCS data. The regular contact CCCS has with thousands of people provides new insights into how debt is affecting vulnerable households. We intend to leverage this data to stimulate debate and influence the policy agenda.

KEY FINDINGS

New analysis by the Financial Inclusion Centre for this report estimates that 6.2 million households are 'financially vulnerable' – 3.2 million are 'already in financial difficulty' either in structural arrears or are already subject to some form of debt action[2], with a further three million 'at risk' of getting into financial difficulty because they are finding it hard to make ends meet and are vulnerable to increases in household bills[3].

1 BIS: Credit, Debt and Financial Difficulty in Britain 2009/10
2 Such as bankruptcy, Individual Voluntary Arrangement, or debt management plan
3 See Debt and household incomes, Section 2. Identifying financially vulnerable, low income households

LOWEST INCOME HOUSEHOLDS

- While we always knew that lowest income households were financially vulnerable, analysis of existing data and new analysis of CCCS data exposes a shocking level of financial vulnerability amongst lowest income households. Since the recession, CCCS clients in the lowest income group have found it even more difficult to repay their unsecured debts.
- Homeowners with incomes of £13,500 or less have total debts worth a staggering 14 times their net incomes. Worryingly, half of clients in this group have no money left at the end of each month to repay their debts[4].
- Lowest income households are more likely to have no or little savings to fall back on and are more likely to have to rely on credit to get by.
- Many of the 'at risk' households are living hand-to-mouth relying on unsecured credit more than those already in severe financial difficulty. 'At risk' households are significantly more likely to be constantly overdrawn or use credit 'all the time' and much less likely to seek debt advice (seven percent compared to 22 percent)[5].

LOWER-MEDIUM AND MEDIUM-HIGHER INCOME HOUSEHOLDS

- Those in the (£13,500 - £25,000) income group are 50 percent more likely to be in financial difficulty than the 'average' household.
- Over a third of CCCS clients earning between £13,500 and £25,000 have no money left at the end of the month to repay their unsecured debts.
- At least a quarter of middle earners (£25,000-£50,000) counselled by CCCS don't have any income to make repayments on their unsecured debt after basic living costs.
- For the last five years, 25 percent of middle income households contacting the charity have had nothing left at the end of the month to pay their mortgage.

6.2 million households are financially vulnerable, who are they?

New research for debt charity Consumer Credit Counselling Service (CCCS) has found that 6.2 million households in the UK are 'financially vulnerable', with

- **3 million** 'at risk' of falling into financial difficulty
- **3.2 million** already in financial difficulty (structural arrears)

This breaks down to:

2 million
on low incomes (under £13500)

4.3 million
with no/low savings (under £1000)

2.2 million
in mortgage arrears or struggling to repay their mortgages

2 million
renters in rent arrears or struggling to pay their rents

600,000
lone parent families

1.1 million
unemployed

Note: The combined figures will add up to more than 6.2m as some will be part of more than one vulnerable group

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HOMEOWNERS

- New analysis of Financial Services Authority (FSA) data estimates that 1.2 million mortgages (11 percent) are in some form of distress – already repossessed, in arrears, or subject to forbearance by lenders. The number of homeowners in financial difficulty is far greater than the 2.5 percent to three percent often quoted as in arrears or repossessed.
- There is a decline in the monthly budget positions of homeowners in the lowest income group over the last five years, from an average (or median) surplus of £51 (£65) in 2005, to -£450 (-£261) in 2010.

4 Detailed results from the analysis can be found in Annex I of the main report
5 BIS: Credit, Debt and Financial Difficulty in Britain 2009/10

Financial vulnerability – specific groups

It is estimated that 6.2 million households are financially vulnerable:

- 3.2 million households are already in financial difficulty, facing 'structural' arrears or some form of insolvency action
- 3 million households are 'at risk' of falling into financial difficulty, likely to fall behind with everyday bills, including housing costs

Specific groups who are vulnerable include:

- 2 million on low incomes (with an annual income of less than £13,500)
- 4.3 million with no/low savings (savings under £1,000)
- 2.2 million in arrears or who say they struggle to pay their mortgages
- 2 million renters (in rent arrears or struggling to pay their rents)
- 600,000 lone parent families
- 1.1 million unemployed

Note: The combined figures will add up to more than 6.2m as some will be part of more than one 'vulnerable' group.

"A significant number of financially vulnerable households are in an extremely precarious financial position due to high debt levels or unaffordable repayment schedules."

LORD STEVENSON

LOWER INCOME HOUSEHOLDS – RISKY DEPENDENCY ON CREDIT

Households 'at risk' of getting into financial difficulty are more likely than those already in severe financial difficulty to say they use credit for everyday expenses all the time (36 percent compared to 22 percent) and are constantly or usually overdrawn by pay day (54 percent compared to 41 percent).

New analysis of CCCS data shows that clients who earn up to £13,500 a year have unsecured debts worth 20 percent more than their annual income. This is significantly higher than households earning between £25,000-£50,000, whose average debt is at 95 percent of annual income[6].

This trend is reflected in overdraft debt, where the average overdrafts of debtors in the lowest income group is £400 higher than the average overdraft of debtors earning between £13,500 and £25,000. While households on medium-higher incomes have larger overdrafts, these are much smaller as a proportion of their income compared to the lowest income groups.

Household incomes	Overdraft debt (average)
<£13,500	£1,557
£13,500-£25,000	£1,150
£25,000-£50,000	£1,765
>£50,000	£2,977

CCCS clients receiving benefits have the highest unsecured debt to income ratio, at 124 percent – their unsecured debts are almost a quarter more than their annual net income.

Detailed analysis can be found in Section 3 (Identifying financially vulnerable, low income households) and Annex I of the main report.

LOWER-MEDIUM AND MEDIUM-HIGHER INCOME HOUSEHOLDS - STRUGGLING TO MANAGE DEBT

Over a third of CCCS clients earning between £13,500 and £25,000 have no money left at the end of the month to repay their unsecured debts, while over a quarter of the £25,000 to £50,000 income group counselled by CCCS don't have any income to make repayments on their unsecured debt.

Almost one third of those earning between £13,500 to £25,000 have been identified as being financially vulnerable – 18 percent in financial difficulty and 13 percent 'at risk', and one in five of the medium-higher income group (£25,000 to £50,000) have been identified as being financially vulnerable – ten percent in financial difficulty and ten percent 'at risk'[7].

6 Annex I: Debt and Household Incomes
7 BIS: Credit, Debt and Financial Difficulty in Britain 2009/10

Income band 2010	Annual net income	Monthly Surplus / Deficit
<£13,500		
Average	£8,317	-£100
Median	£6,612	£0
with mortgage/secured		
Average	£6,990	-£450
Median	£7,248	-£261
£13,500 - £25,000		
Average	£14,980	-£2
Median	£14,772	£35
with mortgage/secured		
Average	£15,388	-£136
Median	£15,396	£0

See Section 3 of main report for estimates of mortgages in financial distress and Annex I for detailed analysis of CCCS clients with mortgages.

28 percent of the £13,500 to £25,000 income group uses credit for everyday expenditure – 14 percent all the time and 14 percent once in a while, and 27 percent of the £25,000 to £50,000 income group (13 percent and 14 percent respectively)[8],- which is one of the key signs of a debt problem.

Those in the (£13,500 - £25,000) income group are 50 percent more likely to be in financial difficulty than the 'average' household.

Details can be found in Section 3 of the main report and in Annex III.

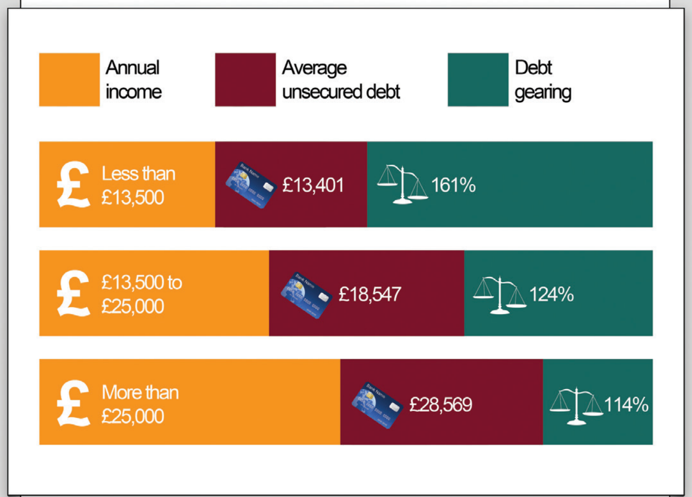
HOMEOWNERS - FACING MORTGAGE DIFFICULTY

New analysis of FSA figures by the Financial Inclusion Centre estimates the number of mortgages in some form of forbearance at over 759,000. This means the total number of mortgages in arrears, in possession or subject to forbearance is 1.2 million. This equates to nearly 11 percent of total outstanding mortgages in some form of financial distress.

Homeowners in the lowest income group have seen a sharp deterioration in their monthly budget positions from 2005 to 2010, from an average (or median) surplus of £51 (£65) in 2005, to -£450 (-£261) in 2010.

The chart above shows the budget positions of CCCS clients on low and middle incomes, highlighting the particular stresses faced by households with mortgage debt.

The lower your income the higher your debt gearing (unsecured debt to income ratio)



New analysis of the 418,000 people who sought help from debt charity Consumer Credit Counselling Service (CCCS) last year shows that households with incomes of £13,500 and under have an unsecured debt to net income ratio of 161%.

This is far higher than those with higher incomes.

Source: Financial Inclusion Centre analysis of CCCS data.

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8 Ibid

What does the future hold for the financially vulnerable?

Section 4 (Prospects for financially vulnerable and low income households) in the main report analyses what the future holds for financially vulnerable households at risk from deficit reduction measures, higher inflation and a potential rise in interest rates.

SHRINKING HOUSEHOLD BUDGETS OF THE FINANCIALLY VULNERABLE

Analysis by the Institute for Fiscal Studies (IFS) projects that the poorest households will see a 3.5 percent slump in their incomes in 2012/13 compared to 2.1 percent for households with incomes in the fifth decile[9]. These falls are expected to become even steeper in 2013/14, with incomes predicted to fall again by 6.3 percent and 3.8 percent respectively[10].

Monthly expenditure of CCCS clients in the lowest income band fell by six percent (£33) between 2005-2010, while rising in every other income group over that period. As a result, half of CCCS clients in this income band currently have no surplus left over at the end of the month so any reduction in income of 3.5 percent would push this group into deficit.

IMPACT OF INFLATION ON FINANCIALLY VULNERABLE GROUPS

Those considered at risk of financial difficulty were more likely to say that their financial circumstances had deteriorated in the past six months compared to those already in financial difficulty (69 percent compared to 54 percent)[11].

This should be a cause for concern. Aside from personal income shocks, it suggests that many of these households are vulnerable to a deterioration in economic conditions such as rising inflation, benefit changes and rising interest rates.

A key pressure point is fuel costs. Between 2010 and 2015 electricity bills are projected by Consumer Focus to rise by 14.5 percent and gas bills by 19.7 percent. This means that for CCCS clients, electricity bills will increase from £52 a month to £59.54 a month, and gas bills from £50 to £59.85 a month, a total hike of £208.68 per year.

IMPACT OF POTENTIAL INTEREST RATE RISES ON HOMEOWNERS

The proportion of households reporting payment problems is close to levels seen in 1995 – yet interest rates were five percent higher in 1995.

However, there are concerns that interest rates will have to rise to deal with higher inflation. The Financial Inclusion Centre estimates that a one percent increase in interest rates would result in a typical homeowner paying an extra £77 a month.

Analysis of CCCS data suggests an increase in mortgage costs as a result of an interest rate rise would badly affect the most financially vulnerable households. Fifty percent of the lowest income households are already in deficit on their monthly budgets so their position would be exacerbated.

The median household with mortgage debt in the lower to medium income (£13,500 - £25,000) band is just about breaking even. Any increase in mortgage costs would push these households into deficit each month unless they could find savings elsewhere.

Households on middle incomes (£25,000 - £50,000) do have a cushion to withstand increases in mortgage rates. However, even then, a quarter of households in this band have zero income left at the end of the month so an increase in mortgage rates would also push this group into monthly deficit.

HOW CAN THE FINANCIALLY VULNERABLE BE HELPED?

> ***"Whatever the causes of over-indebtedness, appropriate policy responses need to be developed that deal with the levels of over-indebtedness and protect the millions of financially vulnerable households who experience consumer detriment."***
>
> LORD STEVENSON

9 Source: Personal tax and benefit changes, James Browne, Institute for Fiscal Studies
10 Ibid
11 BIS: Credit, Debt and Financial Difficulty in Britain 2009/10

Susan, 52, runs her own holiday cottage letting business in Derbyshire that has been severely affected by the downturn in the economy. This has led to a "massive" reduction to her household income over the last few years.

At the same time, her debts have mounted and currently stand at £48,000 via a combination of five credit cards and two bank loans, which she is finding it almost impossible to repay.

"You can't understand just how much pressure and stress you're placed under, people phoning you constantly at eight, nine o'clock in the evening, threatening collection agencies. You just never know who to pay first.

"We've cut back to the bone and been right back to basics for a long-time now. We're keeping up but it's a constant struggle."

As well as being at risk of over-indebtedness, CCCS fears that financially vulnerable households will be increasingly exposed to a range of detrimental market practices that include: arrears management practices in the sub-prime market; aggressive targeting by commercial debt management providers; poor compliance and regulation of debt management firms; limited access to fair, affordable credit and an increase in sub-prime, and worse, illegal lending.

DEBT ADVICE

CCCS believes that, despite the best efforts of debt advice charities, the majority of financially vulnerable consumers for a number of reasons are not actually getting professional debt advice – even those who seem to be in serious financial difficulties. According to BIS research, only seven percent of respondents to a survey who said they had some difficulties keeping up with bills and payments in 2009/10 sought professional debt advice in the preceding six months. For those who said they were constantly struggling or were falling behind with payments the figure was 13 percent.

The major debt advice charities dealt with an estimated 1.3 million clients in 2010. When this is compared to the 6.2 million households we estimate to be in financial difficulties or financially vulnerable, the gap in take up of support is significant. Of course, the fact that such a small minority are getting advice may not be a problem. Many individuals will be perfectly capable of resolving their own problems. However, it must be a cause for concern that so many households in such a detrimental position are not seeking advice or are not being reached by debt advice charities.

DEALING WITH OVERINDEBTEDNESS

CCCS would like to launch a debate on the following interventions proposed in the report:

- Commercial debt management plan (DMP) providers have been a real source of concern for CCCS and other campaigners due to the high level and structure of charges, in some cases unfair practices and the regulation of DMPs is ineffective. CCCS believes a national advertising campaign is needed to raise awareness of free debt advice and all lenders should commit to 'hot-key' borrowers with multiple debts to debt advice charities, not to commercial DMP providers.
- Access to fair and affordable credit is a major issue for low to medium income households who are targeted by aggressive marketing from sub-prime lenders and, worse, illegal loan sharks.
- A strengthening of the regulatory regime that protects vulnerable financial consumers, as it is currently much weaker than that available to better off consumers who buy products and services from FSA regulated providers.
- Improving statutory regulation takes time. Therefore, we urge the OFT to publish tougher guidance on treating borrowers fairly, increase monitoring and surveillance of the consumer credit markets, and place a greater focus on tougher enforcement of existing regulation. We encourage the FSA, OFT, Financial Ombudsman Service (FOS), industry trade bodies and consumer groups to work together to develop best practice compliance statements covering marketing and selling, relationships with consumers, and treating customers fairly.

About the Financial Inclusion Centre

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. For general information on the Centre's work please see: www.inclusioncentre.org.uk