

A decade of debt: lessons for the future

Over the last few months we have seen the gathering clouds of what could prove to be a deep and prolonged recession. People are losing their jobs, house prices are falling and mortgage repossessions are increasing. Indeed, the Council of Mortgage Lenders recently predicted that 2009 could see 75,000 repossessions, a level similar to the peak of the 1990s mortgage arrears crisis.¹ As a result, debt is very much at the forefront of public policy in the wake of the credit crunch. But there is a back-story. Peter Tutton draws on the debt problems encountered by the CAB service over the last ten years to investigate how the recession might affect future debt problems – particularly for lower income households, and what lessons policy makers might take.

Before the crunch: the size and nature of debt

In 2007/08 the CAB service dealt with around 1.7 million enquiries about problem debts, brought by over 500,000 people (people with debt problems tend to have more than one debt). Citizens Advice Bureaux started to see more problems about debt than about welfare benefits, which had been the largest subject area for many years. Debt problems had risen rapidly and continually over the previous decade or so, driven by a spectacular increase in enquiries about consumer credit debt. Just over half (889,000) of the debt enquiries in 2007/08 were about consumer credit agreements, such as credit cards, store cards, unsecured loans, overdrafts, catalogues and hire purchase agreements. By way of comparison, in 1997/98 the CAB service dealt with around 440,000 enquiries about consumer debt, so the number of problems had more than doubled in



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a decade. Go back even further to the early 1990s and consumer credit debts were very much rarer among CAB clients, who were then more likely to seek help with problems paying housing costs, fuel bills and council tax/community charge.

This increase coincides with the development of a mass consumer credit market in the UK. In the later part of the 1990s and up to around 2006, consumer credit lending grew at double-digit rates as consumers found they had easier access to an expanding range of credit products. While this undoubtedly brought consumer benefits, greater exposure to credit also increased borrowers' vulnerability to debt problems in the event of a fall in income or increase in unavoidable expenditure. As the availability of credit expanded, the debts also tended to be bigger – the average amount owed by CAB debt clients increased by about 60 per cent between 2001 and 2008. This progression to greater numbers of more heavily over-indebted borrowers is also reflected in the threefold increase in personal insolvencies in England and Wales between 2001 and 2007.² It is important to remember here that the number of consumer debt enquiries to the CAB service and personal insolvencies had built up over an exceptional period of economic growth.

As a result, there was growing concern that unfair business practices in the rapidly expanding consumer credit markets were at least partly responsible for the increasing levels of over-indebtedness and mainly responsible for much of the resulting hardship borrowers faced.

The CAB service saw too many cases where people had been given credit that appeared to be unaffordable from the outset because the lender had not made sufficient checks on the borrower's ability to meet the repayments. In some of these cases, borrowers, often with little income, had built up tens or even hundreds of thousands of pounds of debt across multiple credit products, seemingly caught in a spiral of using one account to make payments on the next. We also saw too many cases where harsh debt collection practices and excessive default charges had helped make the financial and emotional costs of debt literally unbearable. When a 2001 survey asked CAB clients about the impact debt problems had on their family life, 62 per cent of respondents said they were suffering from stress, anxiety or depression.³

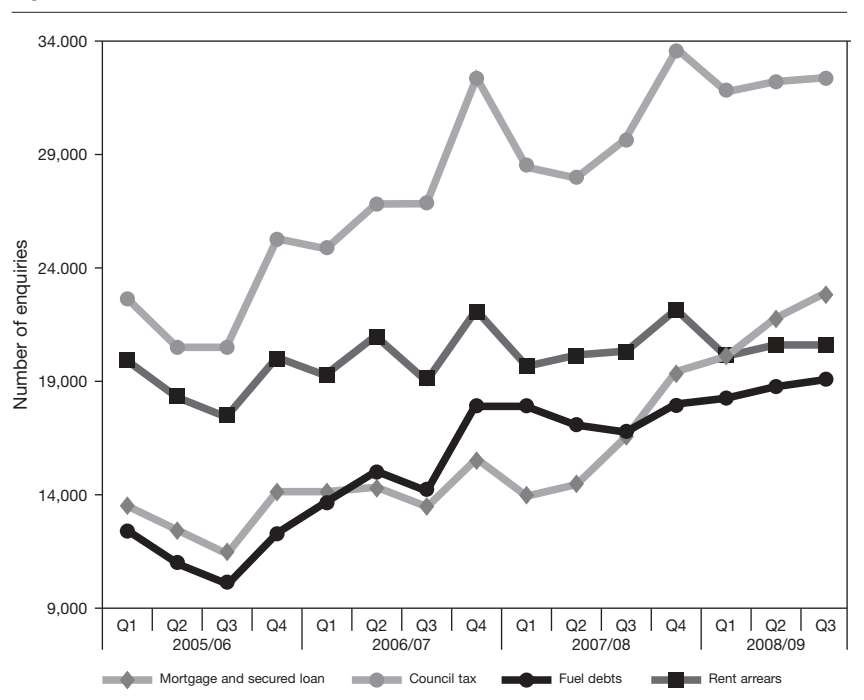
However, there is now some reason to believe that a high watermark of sorts was reached for unsecured consumer debt problems in the year to 18 months or so immediately before the credit crunch. By autumn 2007, the number of both bankruptcy orders and CAB enquiries about credit card and unsecured loan debts had steadied, and even started to decline. This was arguably in consequence of a sharp decline in the growth of unsecured lending starting at around the end of 2005, as lenders tightened their credit criteria in response to increasing levels of bad debt.

CAB debt enquiries and the recession so far

This pattern of steadying off already seems to be reversing, perhaps initially as a result of changed borrowing conditions in the wake of the credit crunch and then as a result of reduced incomes from employment. At the moment, there is a slight upward trend for credit card and unsecured loan debts, which are the two biggest areas of debt enquiry we see by some margin. If the recession gathers pace and unemployment continues to rise, we might well see a further increase in the number of people struggling to deal with their outstanding credit commitments. The consequences of a deep recession working through high levels of pre-existing over-indebtedness are fairly uncharted waters.

So at this very moment, consumer credit is not currently driving debt enquiries as in previous years, but debt enquiries to the CAB service are still growing. At present, what we seem to be seeing is a return to an older pattern of debt problems, with CAB clients increasingly struggling to keep up with some key basic living expenses. To illustrate this, Figure 1 shows the

Figure 1: **Selected debt enquiries, per quarter by type**



number of enquiries about mortgage arrears, rent arrears (private and social rented sectors combined), council tax arrears and fuel debts since the start of 2005.

Space does not permit any detailed analysis of the way the number of enquiries has moved for each type of debt, but two points stand out: the growth of mortgage arrears when rent arrears cases have remained static, and the fact that enquiries about mortgage, council tax and fuel debt problems start to increase well before the credit crunch.

Enquiries about mortgage arrears had been rising steadily from 2005 and then increased sharply in autumn 2007, while rent arrears enquiries have remained fairly constant over the period. As a result, enquiries about mortgage debt overtook rent arrears in spring 2008 and the gap between them has continued to grow. In December 2007, a Citizens Advice evidence report highlighted some of the reasons why we thought Citizens Advice Bureaux were seeing more mortgage arrears problems.⁴ A common theme in the evidence from CAB clients available at this time was that many borrowers appeared to have started out at the margins of affordable home ownership. Lower income households (in some cases, with persistent very low incomes), people with impaired credit records who had taken higher cost loans from sub-prime lenders and former social tenants who had exercised their right to buy appeared

in disproportionate numbers among people seeking advice. In addition, a later unpublished small scale survey in 2008 found that around half of people seeking advice about mortgage debt also had one or more secured loans in addition to their main mortgage.

This combination of circumstances would have left many of these homeowners unduly vulnerable to mortgage arrears problems if they experienced any change in their income or expenditure patterns. Even though unemployment levels were low, we were seeing people who had lost their jobs, seen their employment income drop, become unable to work through illness or disability, or had experienced a relationship breakdown. Other homeowners appeared to have simply cracked under the burden repayments placed on their income. However, unlike tenants who might have recourse to housing benefit, the safety nets designed to help homeowners deal with a sudden change in circumstances were largely absent or ineffective. Few borrowers had mortgage payment protection insurance policies. Most of those who could get help from the benefits system had to wait 39 weeks before they got assistance with mortgage payments, by which time they were in serious arrears if their lender had not already taken action for repossession. Unlike tenants, there is no support for homeowners with a persistent low income. Although for some years the mortgage markets had been expanding to accommodate these borrowers (in line with government policy to expand access to home ownership), this lack of support was compounded by the aggressive arrears management practices of some lenders, and sub-prime lenders in particular.

In this context we believe the immediate effect of the credit crunch was to bring these various vulnerabilities into sharper relief. Certainly, many borrowers with sub-prime loans in particular would have seen their mortgage costs increase significantly at the end of discounted rate periods as the near disappearance of sub-prime lending left them unable to re-mortgage away from high 'reversionary' rates. But by June 2008, neither rising mortgage costs nor unemployment were the most significant reasons given for mortgage arrears problems. As house prices began to fall, it is likely that homeowners could not solve their arrears problem by selling their properties. This was perhaps the start of the recession working through previous levels of over-indebtedness as many of these homeowners also had large unsecured credit commitments that might also affect their ability

and stamina to fight off repossession.

So if the recession gathers pace and unemployment grows further we can expect to see the number of households in serious mortgage arrears quickly accelerate upwards as payment difficulties move from the margins to include more 'mainstream' borrowers. The extent to which this happens will also depend on the effectiveness of the policy package announced by the Government in September and later in the *Pre-Budget Report*. Reforms to means-tested benefit support for mortgage interest payments should see borrowers get more help and (crucially) get it more quickly, although borrowers stranded on the highest sub-prime rates may still be under-supported by scheme rules limiting payments to a standard interest rate. The mortgage rescue scheme should provide help for some of the more vulnerable homeowners, but the key measure is likely to be the mortgage support scheme, under which the Government will underwrite mortgage lenders to defer interest payments from borrowers by up to two years. Although there are risks here for both lenders and borrowers, if the policy provides lenders with sufficient incentive to give borrowers the necessary time and space to recover, then forecasts of a 1990s level of repossessions might be avoided.

The increase in fuel and council tax debts also suggests that lower income households might be finding it harder to keep up with essential expenditure. To some extent this might reflect some significant price rises in both fuel and council tax bills over the last five years or so. For instance, it has been estimated that average domestic energy bills have nearly doubled since 2003.⁵ Likewise, figures from the Department of Communities and Local Government show that average council tax bills increased by significantly above inflation rates in 2003/04 and 2004/05, followed by more modest rises in subsequent years. Given estimates that around a half of all low-income households are liable to pay full council tax,⁶ it is not surprising that such increases will eventually work through to debt problems.

It is also important to point out here that the majority of CAB debt clients tend to be in lower income households. In 2003, the Citizens Advice evidence report *In Too Deep* reported that CAB debt clients tended to be poorer than the general population, with an average income of less than half the average for UK households. Nearly one-quarter of these clients felt their debt problem resulted, in part, from living long

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Enquiries about mortgage arrears have been rising steadily

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term on a low income. But this does not just apply to people with fuel or council tax debts, but also to people seeking help with consumer credit debts. For instance, from a sample of 4,000 people visiting the CAB service with credit card debts, we estimated that around 70 per cent had an income of less than £1,000 a month and just over one-quarter had an income of under £400 a month. Some of these people will have suffered a recent drop in income, but CAB advisers regularly encounter people who have been using consumer credit to try to make ends meet.

This brings us to what is perhaps the most notable feature about the debt problems that Citizens Advice Bureaux have seen over the last ten years. Lower income households have been able to access credit from mainstream high street lenders at fairly low cost and, in some cases, in very large amounts. This has perhaps helped households to manage a persistent low income, but at the cost of a painful debt problem somewhere further along the line. So it may not be entirely coincidental that we start to see an increase in debts connected to essential expenditure at around the time that access to consumer credit begins to tighten.

Policy responses to a decade of debt

The Government's policy response to the growth in debt problems over the last decade has so far been largely technical in nature, updating previous legislation and improving the effectiveness of already existing measures. The Consumer Credit Act 2006 responds directly to concerns about unfair business practices by giving consumers better access to redress, better legal tools to challenge bad practice by credit businesses and more information about their rights and obligations under a consumer credit agreement. The legislation also gives the Office of Fair Trading better regulatory tools and sanctions to deal with persistent or serious breaches of good practice guidance by firms. The Tribunal, Courts and Enforcement Act 2007 contains measures to improve access to debt relief for those consumers who need it, reviving old provisions like the administration order and providing for a new lower cost form of bankruptcy, the debt relief order, for people with moderate debts but no income or assets.

These two pieces of legislation are important and when fully implemented should make a significant difference to many of the specific problems CAB clients have faced over the last ten years. They also contain some areas of genuine innovation. Both the unfair credit relationships

test in the 2006 Act and the proposals for a statutory debt management plan in the 2007 Act, if introduced thoughtfully, could have a more profound and general impact on the debt landscape. This, along with some industry initiatives to address some of the problems outlined above, should add up to the possibility of a healthier, more customer-centred credit industry emerging from the other side of this recession.

However, nagging away beneath this is the feeling that this will not address the fundamental problem that many CAB debt clients face. It is likely that, for some time to come, lower income households will not get the access to low-cost credit they previously enjoyed. If, as this article suggests, consumer credit has been an important strategy to manage persistent low income, then we are likely to see even more households struggling to pay their essential bills. In effect, the debt problem will simply move somewhere else. It is interesting that the Government has responded quickly and positively to the threat of a systemic crisis, with reform of the benefit system and other support for borrowers in financial difficulties. Yet calls for similar reforms to support lower income homeowners before the credit crunch were shrugged off because the overall level of mortgage arrears was seen to be 'historically low'. Perhaps the key 'debt lesson' that will emerge from this recession is that policy makers now need to pay more attention to the chronic difficulties many low-income households have in meeting essential expenditure. ■

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- 1 Market commentary, 18 December 2008, Council of Mortgage Lenders
- 2 Recent statistics of personal and corporate insolvency can be downloaded from the Insolvency Service website at www.insolvency.gov.uk
- 3 *In Too Deep: CAB clients' experiences of debt*, Citizens Advice, 2003
- 4 *Set up to Fail: CAB clients' experience of mortgage and secured loan arrears problems*, Citizens Advice, 2007
- 5 Submission to Ofgem energy supply markets investigation, Energywatch, 2008
- 6 2008 poverty indicators, New Policy Institute, www.poverty.org.uk