The Financial Inclusion Centre

Promoting fair, inclusive financial services

# DEBT AND THE FAMILY SERIES: REPORT 2: DEBT AND THE GENERATIONS

# CONTENTS

# SUMMARY

## INTRODUCTION

- This is the second in the Debt and the Family series of reports commissioned by Consumer Credit Counselling Service (CCCS), the UK's leading debt advice charity. This report looks at the impact of debt on different generations of households using published research and new analysis of CCCS's unrivalled client database[1]. As the UK economy enters a difficult period, many households face hard times and uncertainty. Going forward personal debt will increasingly affect the quality of family life in the UK and the capability of the UK financial services industry to emerge from the economic downturn. Therefore, it is important we understand as much as possible how different generations are affected.

## KEY FINDINGS

- Plotting the level of debt against age shows that levels of debt rise to a peak as people reach their mid 30s - mid 40s. While nearly two-thirds (65%) of all debt is held by households aged 35-54, the 35-44 age group alone holds 37%. This has contributed to high levels of financial vulnerability, with the 40-44 age group – where we estimate there are 900,000 financially vulnerable people – most in danger (see page 5 & 16).

- However, our research suggests that this situation may be changing, with consumers now acquiring large levels of debt, especially unsecured debt, much younger. Almost three-quarters of people in the 18-24 and 25-39 age groups now have unsecured debts, compared to around 60% of the 40-54 age group. This may be because younger consumers tend to be less financially aware and more inclined to rely on credit to make ends meet – 19% of the 18-24 age group say they are very or fairly likely to need to borrow in the next 3 months (page 11 & 16).

- Due to rising house prices and reducing incomes it seems unlikely that younger households will be able to acquire assets in the same way their parents and grandparents did. Between 1997 and 2007 the price of the average house grew from around 2.3 times to nearly 5.5 times gross earnings, meaning increasingly first time buyers (FTBs) can only get onto the housing ladder with help from the 'bank of mum and dad' – 45% of all FTBs in 2010 received financial assistance, compared to 20% in 2005. For FTBs under 30, 84% require financial assistance in order to buy. This is leading to the exclusion of poorer young households from the housing market and perpetuating existing disparities in wealth within generations (page 7 & 22).

- Student loans will also impact on the ability of younger households to acquire wealth. There are nearly 3.2 million student loans in place with total debt outstanding amounting to £35 billion, an increase of £13.25 billion over the previous three years. Total student debt outstanding is expected to grow to £153 billion in real terms by 2031, with loan repayments amounting to nearly £7 billion a year. With student loan repayments reducing available income, future generations will find it difficult to save or invest in pensions until they are older, which will impact considerably on their quality of life when they reach retirement age (page 13).

- Older households (55+) tend to be in a much stronger position, with many having acquired significant assets (including property) as they

1 CCCS has 1.3 million clients on database and counsels c190, 000 each year.

approach retirement. The decade in the run up to the financial crisis saw a huge transfer of wealth from younger home buyers to older generations through the mechanism of rising property prices, and taken together the over 60s now own nearly half of all net assets in the UK. In contrast the under 30s own just 5% (page 6).

- However, one worrying issue uncovered by the report is that there is a previously overlooked minority of older people with extreme debts – for example, research suggests that 7% of those aged over 55 still hold secured debts greater than £150,000 – who are struggling to repay them. Our analysis shows that there are significant numbers of older households with very high repayment-to-income (RTI) ratios. Around 12% of those aged 55 and over have an RTI greater than 30%, compared to only 9% of the 18-24 age group. This indicates that some older households on lower incomes have been caught with expensive credit that is hard to escape (page 9 & 11).
- Finally, although our overall findings point to a worsening situation for younger people, it must be remembered that the current economic downturn is affecting all households. Our previous report, Debt and Household Incomes, found that 6.2 million people are financially vulnerable, and analysis of CCCS clients for Debt and the Generations has shown that a £50 reduction in disposable income would increase this number significantly, by as much as 50% for some age groups (page 15).

**KEY RECOMMENDATIONS**

- The priority must be to protect consumers from the aggressive practices of some sub-prime lenders and the commercial debt management companies who exacerbate, rather than alleviate, financial problems. This should be done through a combination of tough, properly enforced consumer protection laws and ensuring financially vulnerable households have access to independent, objective debt advice. Making sure that households get this advice at the earliest stage must be a priority. Early intervention and prevention is critical.
- We have a specific concern about the new national pension scheme NEST that is being introduced from 2012. The very high debt-to-income ratios evident in the NEST target group (low-medium incomes) means they will need good advice or guidance before deciding on whether to pay down debts or auto-enrol into NEST. We urge the free advice sector to work with NEST and other stakeholders to ensure that the potential target group has the necessary advice and guidance needed.
- In the long term, the need to repay debts for longer, and the inability to build up assets and incomes will surely impact on the retirement plans of many households. We may also see an increase in problem mortgage debt amongst older retired households as the wave of over-indebted 'baby boomers' moves towards retirement. This surely points to the need to revisit the role of equity release in helping older, income poor households.
- The absence of sufficiently granular data limits detailed investigation into household finances and their potential vulnerability to changing economic circumstances. Therefore, as with the previous report, we continue to strongly recommend that policymakers, regulators, lenders and data-rich third sector organisations work together to establish comprehensive databases to allow time series monitoring and analysis of household debt.

# 1 INTRODUCTION AND BACKGROUND

The report looks at debt:

i) ***within*** current generations analysing the experiences of younger, 'middle-age', and older households; and
ii) ***between*** generations over time given the lifecycle model of debt repayment[2] and asset accumulation, and the transfer of wealth between younger and older generations though the mechanism of house prices - at its most basic level, one person's debt is another person's assets and wealth.

The report is able to present a more comprehensive picture of the experiences of different generations and debt due to the real advantage gained through the access provided to the CCCS database. This complements the existing published data and allows for a more granular analysis of debt amongst specific age groups. This report is important as the level of exposure to debt, and attitudes towards debt, differ considerably between the generations. Moreover, there appear to be major cultural changes underway in terms of attitudes to debt, while developments such as student loans will alter the debt landscape. Taking on high levels of debt is becoming normalised at an earlier age.

The major public policy issue that emerges from this report is that debt continues to determine the financial circumstances of many households throughout their lifetimes and that various socio-economic trends have seriously impaired consumers' ability to meet credit commitments and accumulate assets. Current and future generations of younger people may well experience debt in a very different way to older generations.

The report is structured in 5 sections. Following this introduction, Section 2 provides a high level view of debt and the generations looking at aggregate levels of debt held by different age groups using previously published research. It also looks at the assets side of the household balance sheet and the very particular role in the UK that property has played in transmitting debt and assets between the various generations. Section 3 then uses CCCS data to go into more detail on secured debt and unsecured debt. Section 4 looks at financial vulnerabilities caused by debt for the generations and different attitudes and behaviours towards debt evident in different age groups. Section 5 looks forward to consider the impact of debt on the financial futures of the different generations and discusses the implications for policymakers.

Readers should note that most of the policy interventions included in the first report in the series – Debt and Household Incomes – apply to this report. However, where relevant we have included some new policy proposals.

The report was researched and written by Mick McAteer, Gareth Evans, and Anna Gavurin of The Financial Inclusion Centre with additional research and analysis provided by Joe Surtees and Mark Haslam from CCCS. As with the first report, we welcome any comments or queries. Please contact Mick.mcateer@inclusioncentre.org.uk.

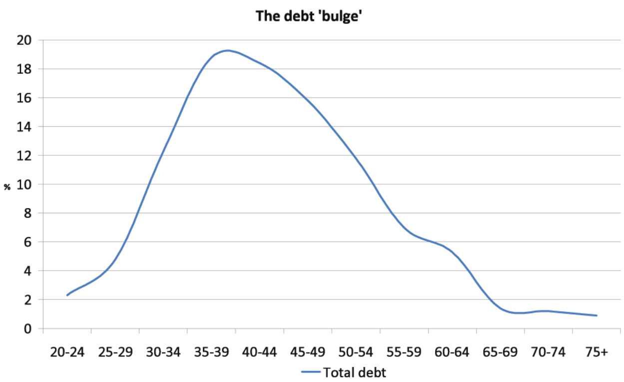
2 'Lifecycle model': income increasing with age allowing large secured and unsecured debts to be paid down and net assets accumulated as retirement approaches.

# 2. DEBT, WEALTH AND THE GENERATIONS

**DEBT**

Middle age households are more exposed to relatively high levels of debt than older households within the general population, therefore there is a higher concentration of over-indebtedness and financial difficulties within these groups.

**Chart 1: Proportion of debt held by different age groups**




*Source: British Household Panel Study, Institute of Social and Economic Research/Future Foundation, 2003*

Nearly two-thirds (65%) of all debt is held by households aged 35-54. The 35-44 age group alone holds 37% of all consumer debt. In contrast, the over 65s hold about 3.5% of total consumer debt. If we plot a chart of debt against age we can see this 'bulge', with levels of debt rising with age and peaking for households as they reach their mid 30s, this continues to their mid 40s. Debt levels then fall off as debt is repaid and retirement approaches.

However, it is likely in the future that various financial and socio-economic trends will change the shape of this curve. The bulge will shift to the right as a wave of younger-middle age households take longer to repay debts (including student loans) acquired when young.

Increasingly younger households are relying on credit, with three-quarters of 18-24 year olds having some form of credit compared to half of households aged 55. This is mainly unsecured credit, two-thirds of households between the ages of 18 and 24 have only unsecured credit compared to 27% of households aged 55 and over.

The number of younger households with secured debt is currently relatively small but this rises until late middle age. Government research presented in the table below shows that 9% of 18-24 households have secured debt compared to 56% of 40-54 group. This is not surprising as it reflects the use of mortgage debt by people getting on the housing ladder and then repaying mortgages over time (we devote a separate section to mortgage debt below).

**Table 1: Use of secured and unsecured credit by age, %**

| | All secured | Secured only | Secured and unsecured | Unsecured only | Any credit |
|---|---|---|---|---|---|
| 18 to 24 | 9 | 2 | 7 | 66 | 75 |
| 25 to 39 | 48 | 14 | 35 | 38 | 86 |
| 40 to 54 | 56 | 20 | 36 | 24 | 80 |
| 55 or over | 23 | 9 | 15 | 27 | 50 |
| All households | 37 | 12 | 25 | 34 | 70 |

*Source: Table A18: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

**Table 2: Average total debt by age, £**

| Age group | 1995 | 2000 | 2005 | Growth 1995/2005 | Growth 2000/2005 |
|---|---|---|---|---|---|
| <20 | 2,000 | 2,000 | - | - | |
| 20-29 | 24,000 | 32,000 | 56,000 | 32,000 | 24,000 |
| 30-39 | 33,000 | 45,000 | 75,000 | 42,000 | 30,000 |
| 40-49 | 26,000 | 33,000 | 54,000 | 28,000 | 21,000 |
| 50-59 | 14,000 | 17,500 | 29,500 | 15,500 | 12,000 |
| 60-69 | 4,000 | 5,000 | 8,000 | 4,000 | 3,000 |
| 70-79 | 2,500 | 2,000 | 3,500 | 1,000 | 1,500 |

*Source: Figure A1, Drivers of Over-indebtedness, Richard Disney, Sarah Bridges, John Gathergood Centre for Policy Evaluation, University of Nottingham, report to DBERR, 2008*

Table 2 illustrates how younger people are now taking on much greater debt than older generations – especially in the 5 years between 2000 and 2005. By 2005, the average debt of the 20-29 age group (£56,000) surpassed that of the 40-49 age group for the first time. The 30-39 age group saw the biggest increase in debt, by £42,000 in the 10 years to end 2005, with almost three-quarters of this increase coming in the five years from 2000-2005.

There are, of course, very important caveats to all this. There is a wide variation of experiences within age bands – driven by household incomes and other characteristics such as single parent family status. Furthermore, the experiences of households who own their own homes and those who rent can be very different[3]. In addition, there is a significant minority of older households who are in financial difficulty. Nevertheless, notwithstanding this caveat, there is an obvious link between debt and age, and age and likelihood of getting into financial difficulty.

## WEALTH

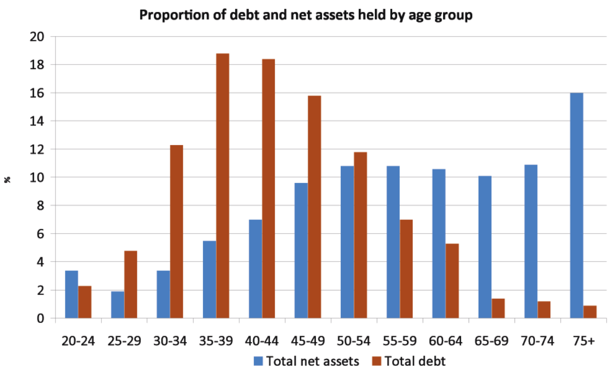
When analysing the impact of debt across different age groups, it is necessary to analyse the assets held by different generations, as this impacts directly on ability to service credit – especially when property assets are such a huge part of UK household wealth.

We have combined data for debt and net assets below to show the lifecycle of debt and asset accumulation that many households have been accustomed to over the previous several decades. Although it is important to recognise that many vulnerable older households have not benefited, income mobility and the lifecycle model of debt had allowed the current generation of older homeowners as a group to pay off mortgage debt during their peak earning years in late-middle age/ pre-retirement phase. As retirement approached they had lower levels of outstanding debt, allowing many older households to build up significant net personal wealth.

The under 30s own 5% of the net assets in the UK; 30-40 year olds just under 9%; 40-50 age group just under 17%; 50-60 age group nearly 22%; 60-70 age group 21%; and the over 70s 27%. Taken together the over 60s own nearly half of all net assets in the UK. This disparity may have become even more pronounced due to the increases in property prices in the run up to the financial crash in 2007/08.

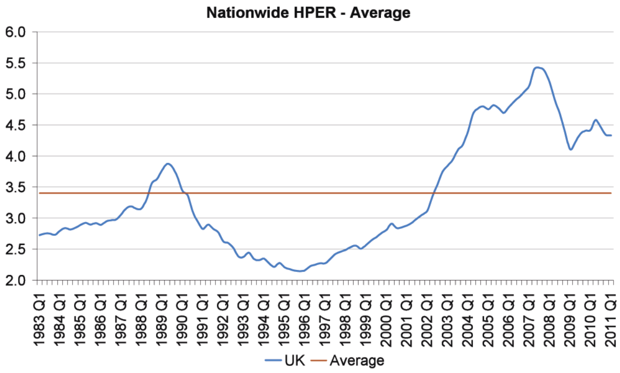
3 See the first report in the Debt and Family Series called Debt and Household Incomes for more information on the financial circumstances of different households.

**Chart 2: The lifecycle of debt deleveraging and asset accumulation**




*Source: British Household Panel Study, Institute of Social and Economic Research/Future Foundation, 2003*

**Chart 3: Property prices transfer wealth across generations**




*Source: Nationwide House Price Earnings Ratio (HPER)*

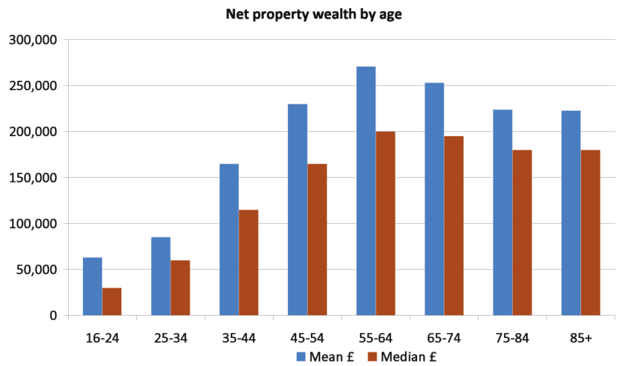
However, changes in the way debt is acquired could have significant knock-on effects on the accumulation of net personal wealth and assets in the future. If today's young have to spend more on mortgages, they will have less opportunity to accumulate wealth than previous generations and hence pass it on to their children. This will be even more of an issue if income mobility falls.

## THE ROLE OF PROPERTY IN ACCUMULATING DEBT AND ASSETS IN THE UK

In 1997, the ratio of house price to earnings (HPER) was around 2.3 times gross earnings. By the eve of the financial crisis in 2007, that HPER had more than doubled to nearly 5.5 times gross earnings. We estimate that in the decade in the run up to the crash, FTBs and younger movers would have paid on average around £30,000 more to get on, or move up, the property ladder than if property prices had risen with long term trends.

This has made it much harder for younger people to get on the property ladder without extra support, which has traditionally come from inheritances or the 'bank of Mum and Dad'. According to the Nationwide house price index, while UK property prices have grown by 3.8% per annum in real terms since 1975, in the decade leading up to the financial crash in 2007 they rose by 8.8% per annum in real terms. This above trend growth was driven by an oversupply of mortgage credit facilitated by liberal lending and regulatory policies.

**Chart 4: Riding the property wave**




*Source: Nationwide House Price Earnings Ratio (HPER)*

As a result younger generations are left with 'extra' debt which represents a huge transfer of wealth to those generations further up the property ladder. The effects can be seen in the distribution of net property wealth by age. The median property wealth of the 25-34 age group is £60,000, while for groups aged over 45 it is between £165,000 and £200,000.

However, while age is a key determining factor – with older generations having fewer and lower debts and greater net assets – there is also a wide variation in the experiences of households within generations.

Many older people have very few assets to speak of. For example, the large numbers of households who have never been able to get on the property ladder have not been able to acquire assets through this transfer of wealth. Similarly, the experiences of women have been very different to men – especially if they are single parents.

It should also be recognised that property can create an illusion of wealth. These assets have to be realisable in some way to provide a genuine benefit for households – this may not always be the case with many older households who are asset rich, but income poor. As this report goes on to show, even though older households as a group have significant net assets, there are a surprisingly large number of older and retired households who have problems with unsecured debts, yet who may be sitting on unrealised property wealth which could be used to ease the financial strain.

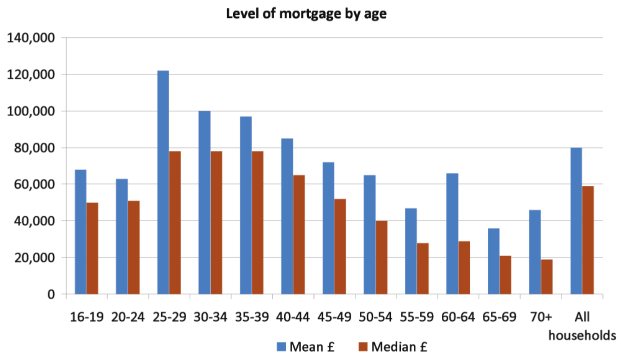
# 3. STATE OF THE NATION: THE GENERATIONS, SECURED AND UNSECURED DEBT

In the previous section, we took a high-level look at how total debt and assets varied between the generations. In this section, we look in more detail at the profiles of secured and unsecured debt.

## SECURED DEBT AND MORTGAGES

Not surprisingly, the level of mortgage debt outstanding reduces considerably with age. Data from the British Household Panel Survey (BHPS) shows that the median secured debt for the 25-39 age groups is just under £80,000, compared to £40,000 for the 50-54 group, and around £30,000 for the 55-64 age groups.

**Chart 5: Level of mortgage debt falls with age**

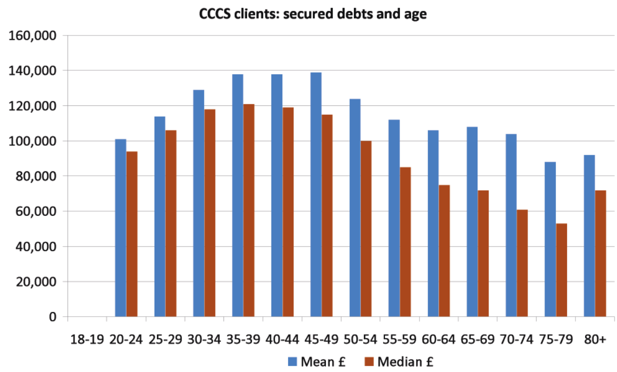



*Source: BHPS 2005/ Debt and Older People, Age UK, PFRC*

This general relationship between age and secured debt is reinforced by CCCS own data, with CCCS clients in the 35-49 age groups having the highest secured debts.

It is interesting to note here the difference between the median and mean level of mortgage outstanding in various age groups in both general population data and CCCS' own data. The mean values are much higher than the median values in certain age bands suggesting that some households have taken on extremely high mortgages.

**Chart 6: Profile of CCCS clients and secured debt**




*Source: FIC analysis of CCCS database*

As a general rule, very high levels of secured debt are evident amongst people in their thirties and early forties. Government research suggests that 26% of those in the 25-39 age group have secured debts greater than £150,000, while 13% have secured debts greater than £200,000. In contrast, 7% of those aged 55 or over have debts greater than £150,000, with 4% having debts greater than £200,000.

**Table 3: Proportions with high levels of secured debt**

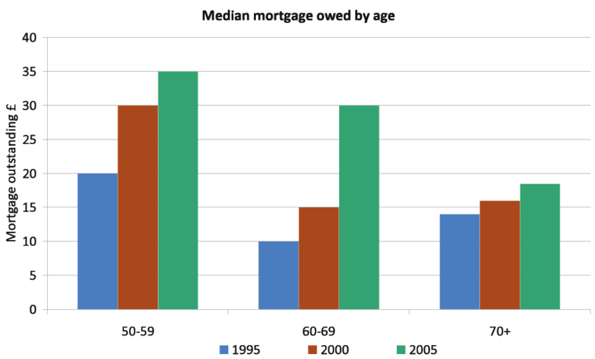
| | >£150,000 | >£200,000 |
|---|---|---|
| 18-24 | 3 | 1 |
| 25-39 | 26 | 13 |
| 40-54 | 19 | 10 |
| 55 and over | 7 | 4 |
| | | |
| All with secured debt | 19 | 10 |

*Source: Table A27: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

However, it is worth noting that while younger households tend to have larger mortgages, the data suggests that there are some older households who are about to enter retirement (or already have) with high mortgage debt. The data in Chart 5 shows that although the median mortgage for the general population in the 60-64 age group is around £30,000, the mean mortgage is around £65,000 implying that some people within this group continue to owe considerable amounts. Similarly, while the median mortgage in the 70+ age group was just under £20,000, the mean was around £46,000.

Moreover, the amount of mortgage debt owed by older households in the general population rose dramatically in the decade to 2005 – see chart below. The median mortgage owed by the 60-69 age group doubled in just five years from £15,000 to £30,000.

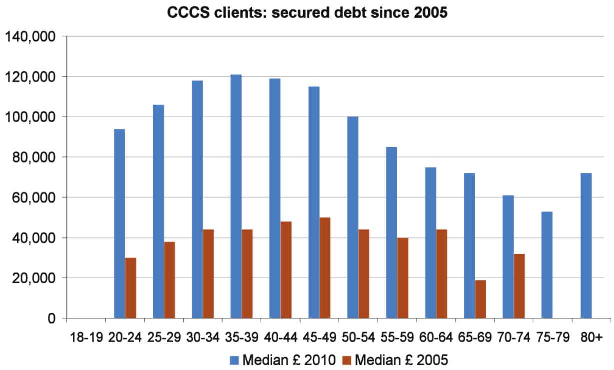
**Chart 7: Older households owing larger mortgages**




*Source: Figure 6.4, Debt and Older People, Age UK/ PFRC*

CCCS data provides an even more striking and up-to-date picture of how secured debt has increased across the age spectrum over the last 5 years. For example, in 2005 the median secured debt amongst 30-34 age group was around £40,000. By 2010, it was nearly £120,000. For the 40-44 age group, the respective debt was £48,000 and £119,000 – an increase of 150%.

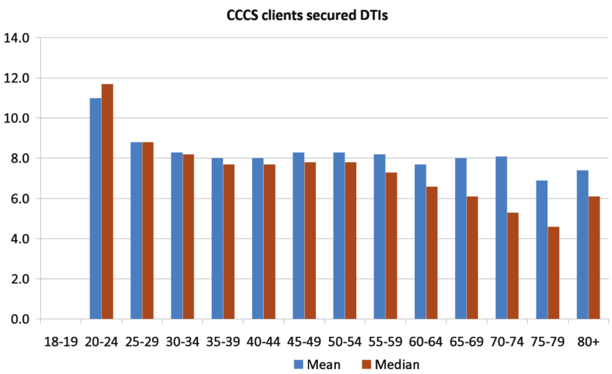
**Chart 8: Secured debt amongst younger households has risen dramatically**




*Source: FIC analysis of CCCS data*

CCCS data allows us to compare debt-to-income (DTI) ratios. These suggest a lot of very younger households are currently finding it more difficult to repay secured debt than middle-aged households. Whereas CCCS clients in 20-24 age group have a median secured DTI of over 11, above the age of 35 no group has an average DTI of higher than 7.7 and many have ratios below 7.

**Chart 9: Older clients have lower secured debt leverage**




*Source: FIC analysis of CCCS database*

However, again the analysis reveals worrying signs of over-indebtedness amongst a significant minority of older people as evidenced by persistently high DTIs. By definition, consumers who are helped by CCCS are over-indebted but the fact that the mean DTI of households in the 70-74 age group is 8 times their income is worrying.

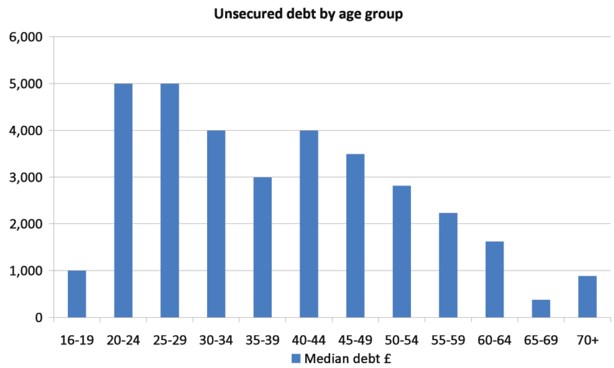
## UNSECURED DEBT

With unsecured debt, for the general population, the same basic relationship holds as with secured debt and mortgages – i.e. younger and middle-age households are more exposed to unsecured debt than older households. However, the pattern is not exactly the same.

Department of Business, Innovation and Skills (BIS) research has shown that 72% of households in the 18-39 age group have unsecured debt; 60% of the 40-54 age group and 41% of the 55+ age group. Younger age groups have more different types of credit. 13% of the 25-39 age group have 4 or more credit commitments compared to 9% of the 40-54 age group and just 3% of the 55+ age group.

Younger households now owe significantly more than older households in unsecured debt. The 20-29 age group owes on average £5,000. This compares to £1,700 and £400 for the 60-64 and 65-69 age groups respectively.

**Chart 10: Levels of unsecured debt falls with age**




*Source: BHPS 2005/ / Debt and Older People, Age UK, PFRC*

In the general population, the proportion of younger age groups with very high unsecured debts is much greater than older groups. For example, 54% of the 18-24 age group with unsecured debt have debts greater than £10,000 compared to only 20% of the 55 and over group.

Younger age groups also have higher unsecured DTIs. 38% of the 18-24 age group have a DTI of more than 60% compared to 17% of the 55+ group.

However, the older age groups have a higher proportion of debtors with high repayment-to-income (RTI) ratios. Of the 18-24 age group, 9% have an RTI greater than 30% compared to 12% of those aged 55 and over. This may be a reflection of a proportion of older households on lower incomes

**Table 4: Proportions of households with high levels of unsecured debt, %**

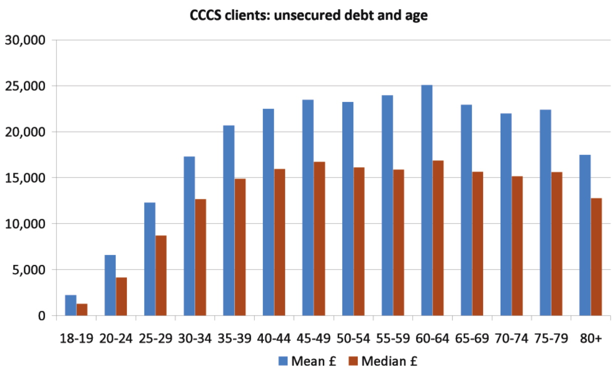
| | >£10,000 | >£20,000 | DTI>60% | RTI>30% |
|---|---|---|---|---|
| 18 to 24 | 54 | 18 | 38 | 9 |
| 25 to 39 | 41 | 16 | 20 | 10 |
| 40 to 54 | 29 | 13 | 16 | 1 1 |
| 55 or over | 20 | 8 | 17 | 1 2 |
| All with unsecured credit | 35 | 13 | 20 | 1 1 |

*Source: Table A26: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

who have been caught with expensive credit that is hard to escape.

Worryingly, CCCS data shows some strikingly large levels of unsecured debt evident amongst older age groups compared to younger groups – indicating that a significant minority (the group accounts for some 10% of CCCS clients) have reached retirement without paying off unsecured debt. The 60-64 age group have the highest unsecured debt amongst CCCS clients.

**Chart 11: Profile of CCCS clients' unsecured debts**

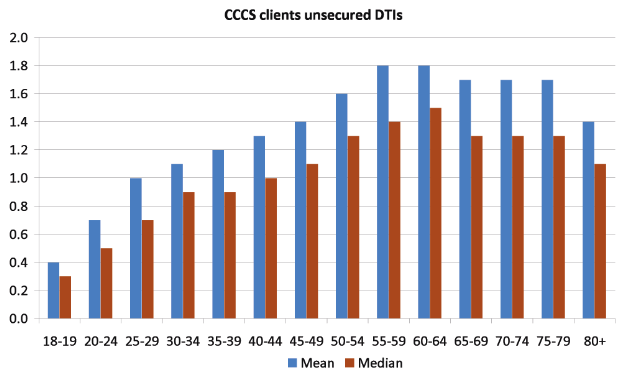



*Source: FIC analysis of CCCS database*

unsecured debts worth around 30% more than his/her net income.

As with the analysis in the previous report, we are unable to say whether these extremely high unsecured DTIs amongst some older groups are as a result of poor lending practices, people suffering serious reductions in incomes after loans had been made or a combination of both. Further work on this would help understand whether improvements to lending practices are needed.

**Chart 12: CCCS client DTIs peak at age 60**




*Source: FIC analysis of CCCS data*

Not only do the 60-64 age group have the highest median and average unsecured debt levels amongst CCCS clients, they also have the highest median and mean DTIs. It is worth noting that the typical CCCS client aged between 65 and 80 has total

## STUDENT DEBT

One of the most contentious debt related issues of recent times is student debt. As the table below shows, as of 2011, there were nearly 3.2 million loans in place with total student debt outstanding

**Table 5: Key data on student loans**[4]

| Financial year | Loans out-standing £m | No of loans millions | Amount lent £m | Amount repaid £m |
|---|---|---|---|---|
| 2007-08 | 21,944 | 2.34 | | |
| 2008-09 | 25,963 | 2.61 | 4,204 | 900 |
| 2009-10 | 30,489 | 2.9 | 5,049 | 1,010 |
| 2010-11 | 35,186 | 3.18 | 5,578 | 1,143 |

*Source: The Students Loan Company/ BIS, SLCSFR 02/2011*

4 NB: this data includes values for EU students studying in the UK, but it is a small minority of the total

amounting to £35 billion. The value of loans outstanding has grown by £13.25 billion over the previous 3 years. Those with student loans are currently repaying £1.1 billion a year.

Data from BIS released as a result of a Freedom of Information request, estimates that total student debt outstanding will grow to £153 billion in real terms by 2031. At that time, people with student loans will be repaying nearly £7 billion a year in real terms.

The government estimates that by the year 2032, the average graduate can expect to have £31,000 of debt at the end of their university degree. This may be an underestimate as it is based on the assumption that university fees will be just over £7,500 and increase in line with inflation over the period. However, the Office of Fair Access estimates the average fee to be around £8,400. This would obviously increase the scale of student debts.

**Table 6: Real terms growth in student debt, £**

| Financial year end | Total outstanding £billion | Amount repaid annually £billion |
|---|---|---|
| 2012 | 35 | 1.7 |
| 2016 | 57 | 2.6 |
| 2021 | 94 | 3.8 |
| 2026 | 126 | 5.1 |
| 2031 | 153 | 6.9 |
| Annualised % growth | 7.7 | 9.4 |

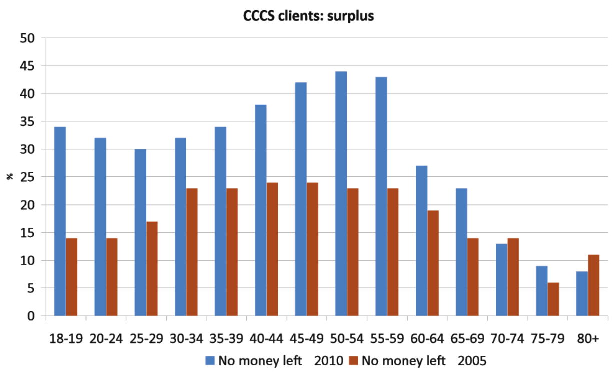
*Source: BIS response to Freedom of Information request, http://www.scribd.com/doc/63078079/LC-exclusive-Student-Debt-Forecast, Annual data can be found in Table A1 in Annex 1*

## 4. FINANCIAL VULNERABILITY AND BEHAVIOURS

One of the advantages of the CCCS data is that it allows us to understand just how vulnerable some households are to changes in financial circumstances. We have been able to analyse – by age group – what proportion of CCCS clients have no money left at the end of the month. The findings are shocking – for age groups between 35 and 59 more than a third of CCCS clients (and for some age ranges almost half) are in this position every month.

Moreover, since 2005 the proportion of CCCS clients with nothing left at the end of the month has risen significantly for almost all age groups (see chart, below). Among the 50-54 age group, for instance, it has almost doubled, from 23% to 44%.

**Chart 13: Proportion of CCCS clients with nothing left at end of the month has risen**




*Source: FIC analysis of CCCS data*

This is a significant deterioration in the position of the most financially vulnerable households. But we fear that the position will get worse. The CCCS data suggests that a large number of clients are just about keeping their heads above water. The most vulnerable to a downturn in household finances appear to be clients with children in their mid-40s and clients in their 50s. As we set out in our previous report, a range of economic and policy reforms are likely to impact disproportionately on lower income households.

To try to get a better understanding of the impact of reductions in income, we have modelled the effect of a £50 per month reduction in disposable incomes.

**Table 7: Impact of £50 per month income reduction on financially vulnerable, %**

| Age group | No money left | Impact of £50 pm reduction - no money left |
|---|---|---|
| 18-19 | 34 | 70 |
| 20-24 | 32 | 60 |
| 25-29 | 30 | 53 |
| 30-34 | 32 | 52 |
| 35-39 | 34 | 53 |
| 40-44 | 38 | 55 |
| 45-49 | 42 | 59 |
| 50-54 | 44 | 60 |
| 55-59 | 43 | 61 |
| 60-64 | 27 | 45 |
| 65-69 | 23 | 39 |
| 70-74 | 13 | 30 |
| 75-79 | 9 | 23 |
| 80+ | 8 | 22 |

*Source: FIC analysis of CCCS database*

As the results show, a £50 per month income reduction would push many more CCCS clients into a budget shortfall. It is interesting to note that the proportion amongst the youngest age groups and oldest age groups would double. The impact is quite striking but perhaps not surprising as younger age groups and older age groups tend to have lower disposable incomes than average.

Over reliance on credit to cover the costs of every day living is generally a strong indication of financial vulnerability. At the moment some 7% of those aged over 55 rely on credit in this way while for the rest of the population it ranges between 12% and 14% (see table A2, Annex 1). Although these are small proportions, they account for a relatively large number of people.

Of the 18-24 age group, 19% say they are very or fairly likely to need to borrow in the next 3 months compared to 15% of the 25-39 group, 11% of the 40-54 group, and just 5% of the 55 and over group (see Table A3, Annex 1).

Households in the 25-39 age group are more than twice as likely to be in arrears or insolvency compared to those in the 55+ group – 15% compared to 7% (see Table A4: Annex 1).

## ESTIMATES OF NUMBERS OF FINANCIALLY VULNERABLE HOUSEHOLDS

Using the same methods as the previous report, we have tried to estimate how many households are either in financial difficulty or at risk of getting into financial difficulty. Unfortunately, due to the different ways government sources categorise age groups, we cannot get a precise match with the CCCS categories. However, we have tried to combine government data and CCCS own data to estimate with as much precision as is possible how many households are financially vulnerable for each age group.

**Table 8: Number of households in each age group facing financial difficulty**

| Age group | In difficulty | | At risk | | Either | |
|---|---|---|---|---|---|---|
| | % | Number 000s | % | Number 000s | % | Number 000s |
| 18-19 | 9 | 45 | 11 | 56 | 20 | 101 |
| 20-24 | 7 | 38 | 9 | 47 | 16 | 85 |
| 25-29 | 14 | 273 | 11 | 218 | 26 | 510 |
| 30-34 | 16 | 311 | 13 | 249 | 30 | 580 |
| 35-39 | 13 | 372 | 12 | 323 | 26 | 720(3) |
| 40-44 | 17 | 465 | 15 | 403 | 32 | 899(1) |
| 45-49 | 14 | 352 | 12 | 305 | 28 | 681(4) |
| 50-54 | 16 | 387 | 14 | 335 | 30 | 748(2) |
| 55-59 | 15 | 339 | 14 | 316 | 29 | 655(5) |
| 60-64 | 8 | 169 | 10 | 218 | 17 | 387 |
| 65-69 | 11 | 190 | 14 | 245 | 25 | 435 |
| 70-74 | 3 | 61 | 4 | 78 | 8 | 139 |
| 75-79 | 5 | 64 | 6 | 78 | 10 | 127 |
| 80+ | 3 | 71 | 4 | 91 | 8 | 161 |
| **Total** | **12** | **3,200** | **11** | **3,100** | **23** | **6,200** |

*Source: FIC estimates based on government population data, CCCS database and BIS research Table A41: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10; rankings are in brackets*

We can see that the age groups with the greatest number of financially vulnerable households (in or at risk of financial difficulty) are the 35-59 age groups. Indeed, these 5 groups constitute over 3.7 million of the total 6.2 million households identified as financially vulnerable (nearly 60% of the total) yet they constitute only 47% of UK households.

It is fair to conclude that compared to older households then, younger-middle age households are more financially vulnerable on a range of measures.

### UNDERSTANDING FINANCIAL VULNERABILITY

It is important to try to understand why certain groups are more financially vulnerable than others. This is a complex field and it is important not to oversimplify but the 2 main reasons are different financial circumstances and different financial behaviours and attitudes.

As we explain above, older households have benefited hugely from the lifecycle model of debt and income mobility so a larger proportion of older households are bound to be in a more comfortable position. But as we can see from the following research, older households are also more likely to exhibit the types of positive behaviours that reduce the risk of getting into financial difficulty and extreme debt.

Of the 25-39 age group, 13% of households have 4 or more types of unsecured credit compared to just 3% of the 55+ group.

Furthermore, 14% of those aged between 25 and 39 say they have a strong or very strong propensity to spend – nearly 3 times the proportion of those aged 55 and over (5%).

**Table 9: Use of unsecured credit by age of household, %**

| | Has unsecured credit commitments | 4 or more types of unsecured credit |
|---|---|---|
| 18 to 24 | 72 | 6 |
| 25 to 39 | 72 | 13 |
| 40 to 54 | 60 | 9 |
| 55 or over | 41 | 3 |

*Source: Table A3: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

**Table 10: Spending orientation by age, %**

| | Strong/very strong | Very weak |
|---|---|---|
| 18 to 24 | 11 | 27 |
| 25 to 39 | 14 | 25 |
| 40 to 54 | 10 | 31 |
| 55 or over | 5 | 45 |

*Source: Table A43: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

Older financial consumers are also more likely to be financially aware. 15% of those aged 18-24, 31% of the 40-54 age group, and 43% of those 55 and over are thought to have moderate-high level of financial awareness, helping them understand the consequences and pitfalls of getting into serious debt.

**Table 11: Levels of financial awareness vary by age, %**

| | High/ moderately high | Low/ moderately low |
|---|---|---|
| 18 to 24 | 15 | 35 |
| 40 to 54 | 31 | 23 |
| 55 or over | 43 | 16 |
| All | 32 | 23 |

*Source: Table A45 Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

As mentioned, only 15% of the youngest groups are considered to have a moderate/high level of financial awareness, yet over one-third have low/moderately low levels of financial awareness. This suggests that much more needs to be done to target younger groups to improve levels of financial capability and raise awareness of the consequences of getting into debt.

**Table 12: How different age groups prefer to obtain debt advice, %**

| | Face to face | Phone | Website | Don't know |
|---|---|---|---|---|
| 18 to 39 | 31 | 42 | 18 | 8 |
| 40 to 54 | 37 | 38 | 22 | 4 |
| 55 or over | 39 | 46 | 10 | 6 |
| Total | 35 | 42 | 17 | 6 |

*Source: Figure D7: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

As we noted in the previous report for this series, significant numbers of financially vulnerable consumers do not seem to be getting debt advice at the emergency stage (when already in difficulty) or preventative stage (when at risk). This should be a priority for policymakers, the Money Advice Service (MAS) and others who provide debt advice. However, for this to be effective, the delivery of debt advice should meet the needs and preferences of consumers. As table 12 shows, there are clear differences in the way different age groups prefer to receive debt advice. Perhaps not surprisingly, older groups prefer the human touch either via face-to-face or telephone, and are less likely to prefer advice delivered online.

## 5. HARD TIMES AND POLICY IMPLICATIONS

As well as developing interventions to protect vulnerable households who are already facing serious debt problems, this report raises major long term public policy issues. Personal debt will be one of the single biggest influences on the quality of household finances in the UK and indeed on the sustainability and behaviours of the UK financial services industry over the next decade.

The changing debt landscape is difficult to forecast with precision at a granular household level given the lack of comprehensive national data. However, it is certain that serious pressures are building up in the finances of UK households both in the short-medium and longer term. The analysis has allowed us to identify those groups who are particularly vulnerable.

As we repeatedly stress there seems to be a sizeable number of households who still face serious debt problems in older age – whether coming up to retirement or actually in retirement. However, the groups who appear to be most vulnerable to generational trends are the middle-aged (who have the highest DTIs and are financially vulnerable), and of course, in future, those with student debt.

The future course of student debt is set out in Table 6 (p13). But for 'young-middle-age' groups, the key question is to what extent they will be able to follow the historic debt-assets lifecycle model. We have grave concerns that many households in these age groups will face very uncertain futures because of the legacy of debt accrued in the run up to the financial crisis and poor future earnings prospects.

We think it is quite likely that the 'debt bulge' will eventually shift up the age range to older groups as a wave of households with stretched incomes start repaying debt at a later age and find it more difficult to build up assets. This has major long term consequences (see below).

**PAYING DOWN DEBT**

Some households are in a position to pay down debts. However, others are clearly unable to. The record low level of interest rates simply provides a breathing space for many households rather than an opportunity to reduce mortgage debt. The large rise in the number of interest only mortgages also suggests many households are not in a position to pay down mortgage debt.

Recent trends show a concerted effort by consumers to pay off unsecured debt. Data from the British Bankers Association[5] shows that the value of overdrafts and personal loans outstanding fell by £125 million over the year to August 2011. Although credit card debt outstanding increased due to interest, consumers actually repaid more than they took out on credit cards.

However, the picture with mortgage debt is more concerning. The sheer scale of mortgage debt taken out means that it makes by far the biggest contribution to the record levels of debt accrued in the UK. The interesting question is whether households have been using the low level of interest rates to increase the pace at which they pay down mortgage debt.

The most recent research suggests that they have not. Over the period January 2006 to September

5 http://www.bba.org.uk/statistics/article/august-2011-figures-for-the-main-high-street-banks, see Table 6

2008 when the average mortgage interest rate was around 7%, households – on aggregate – made an average of £1.4 billion worth of lump sum payments to mortgages each month. However, in comparison, from October 2008 to February 2010 when mortgage interest rates averaged around 4%, households on aggregate made lump sum payments of around £1.05 billion a month[6].

It appears many households are only able to pay off the interest on their mortgage or are relying on the forbearance of their lender. While we estimate that 11% of mortgages are currently in financial difficulty, it appears borrowers with interest-only mortgages or non income-verified mortgages are significantly more likely to be in financial difficulty.

The share of interest-only mortgages rose during the 2000s from 13% at the start of the decade to nearly one-third in 2007. Three-quarters of interest-only mortgages do not have a repayment vehicle specified[7]. It may well be that these borrowers do have some means of repaying their mortgage but the very large number without a means specified is a very real concern.

According to the FSA[8], in the period April 2005 to March 2010, income was not verified on almost half of all new mortgages (45%). And in 2008, more than half of mortgages (52%) were arranged without income being verified. The FSA estimated that at the end of 2009, 21% of these mortgages were in arrears or already in possession compared to around 6.5% of mortgages where income was verified.

The FSA's analysis of households with mortgages shows that going into the financial crisis, many households were already in financial trouble. The FSA calculated that between 2005 and 2008, 46% of households with a mortgage had no money left or had a shortfall that would have to be covered from savings or credit[9]. The position was worse for the lowest income households. 55% of those in the third lowest income decile, 60% of those in the second lowest income decile and nearly 75% of those in the lowest income decile had no money left at the end of the month. The median shortfall for those groups was between £500-600 per month.

This is likely to present more of a problem for middle-aged consumers with high mortgage levels, and those groups approaching middle-age who have recently taken on secured debts. As this report has previously shown the median secured debt of those in, or close to, their 40s is close to 3 times greater than those households over 60. With high levels of secured debt this group is most likely to be hit by interest rate rises, so it is especially concerning that the very high levels of secured debt are also concentrated in these middle-age and 'younger middle-age' groups. BIS research has found that between a fifth and a quarter of household aged 25-54 have secured debt greater than £150,000 (see above).

So how have these households been surviving? As explained previously, lenders have been exercising greater levels of forbearance towards borrowers in trouble and interest rates have been low. However, there are other possible 'coping' strategies. One way is to obtain a further advance on the mortgage. The FSA estimates that between 2007-09, further advances accounted for 22% of all new loans with an average size of £25,000. This could allow borrowers to conceal mortgage payment problems. The FSA calculates that a borrower could cover a £600 per month shortfall for 3 years with

6 FSA Mortgage Market Review (MMR): Responsible Lending, CP10/16, Exhibit 2.10 http://www.fsa.gov.uk/pubs/cp/cp10_16.pdf
7 FSA Mortgage Market Review (MMR): Responsible Lending, CP10/16, Exhibits 3.1, 3.2
8 FSA Mortgage Market Review (MMR): Responsible Lending, CP10/16, Annex 3 http://www.fsa.gov.uk/pubs/cp/cp10_16.pdf
9 FSA MMR Responsible Lending, CP10/16, Annex 3, Exhibit 2.3

a further advance of £25,000 at an interest rate of 5% per annum.

'Coping' strategies and policy interventions (and record low interest rates) have shielded many homeowners with extremely high of debt-to-income levels from the full effects of over-indebtedness. However, it is not clear how long this will continue. It is important to recognise that many households with large mortgage debt have not faced up to the future. They are simply storing up a great deal of trouble and will live for much longer with huge debts.

**FUTURE INCOMES**

As the previous report in the series shows, the growth in personal debt far outstripped the growth in earnings in the 2000s so that total household debt was equal to 160% of household incomes by 2010. Changing the trajectory of debt so that debt as a proportion of incomes reduces significantly requires earnings growth to outstrip growth in personal debt.

However, a number of recent studies strongly suggest that many households will actually see substantial declines in their real earnings, certainly in the short term. Research by the IFS suggests that living standards will continue to decline until 2013/14[10]. New analysis by the TUC estimates that by 2013, lower-medium income households will lose between 6-10% of their earnings[11].

It is very difficult to see how households on lower-medium incomes will be in a position to pay down debts in the short term given this very gloomy prognosis for short term earnings growth. Long term debt reduction will depend on long term upward income mobility for these over-indebted households. The future for long term income mobility is outside the scope of this research. However, we urge policymakers and other stakeholders to focus research on the potential for income mobility amongst younger-middle age groups as this will have serious implications for debt management in the long term.

**IMPACT OF STUDENT DEBT**

Recent estimates suggest that a new generation of young people could end up with total student debts of £53,000[12]. It could be argued that debt is being normalised to an even greater degree and at a younger age than hitherto has been the case. This is likely to make it more difficult for younger generations without access to financial support (or inheritances) to buy their first home. Again, this is likely to result in households having debt for longer and finding it more difficult to build up net financial wealth.

**GETTING ON THE HOUSING LADDER**

There is no question that getting on the housing ladder is more difficult for FTBs in the post-financial crisis world. The Council of Mortgage Lenders (CML) estimates that before the credit crunch, a typical FTB borrowed around 90% of the value of the property s/he was buying. This meant that s/he would need to pay a deposit of less than 40% of their annual income. However, post credit crunch, loan-to-value (LTV) ratios have become much tighter with the result that many FTBs are now paying a deposit equivalent to one year's income[13].

Not surprisingly, the number of FTBs has dropped considerably. Pre-credit crunch, over the period 2005-2007, the number of loans advanced to FTBs each quarter averaged almost 100,000. However, from 2008-2010, the number of loans advanced to FTBs fell to just under 50,000 each quarter[14]. The

10 The Great Recession, IFS, http://www.ifs.org.uk/pr/frdb_recession.pdf
11 TUC, Unhappy Families: How ordinary people are paying the price for austerity, September 2011
12 Source: PUSH Student Debt Survey, http://push.co.uk/student-debt-survey-2011/
13 http://www.cml.org.uk/cml/publications/newsandviews/83/303

more constrained lending conditions means that a larger proportion of FTBs who do manage to get on the housing ladder, are relying on financial support from their parents or grandparents.

**Table 13: FTBs aged under 30 who required financial assistance, %**

| | FTBs under 30 | All FTBs |
|---|---|---|
| 2005 (Q2-Q4) | 38 | 20 |
| 2006 | 41 | 22 |
| 2007 | 47 | 26 |
| 2008 | 61 | 34 |
| 2009 | 84 | 47 |
| 2010 (Jan - Oct) | 84 | 45 |

*Source: CML analysis of Regulated Mortgage Survey, CML News and Views, February 2011, Table 2*

It is important to note that the data in Table 13 does **not** mean that the number of parents or grandparents helping FTBs has doubled. While the proportion has more than doubled, the total number of FTB loans advanced has more or less halved. This implies that there has been a relatively small increase in the actual number of FTBs getting financial help from parents/ grandparents.

However, what the data does suggest very strongly is that the opportunity to get on the housing ladder at an early age is becoming increasingly restricted to those FTBs who are older or who have access to financial help. In the 3 years in the run up to the financial crisis, the average age of FTBs who did not receive financial assistance was around 33. However, post crisis, this has risen to 37[15].

Inheritances also play a big role determining whether people can buy a property in the first place not just the age at which they buy their first home. 72% of households in socio-economic group E received no inheritances, compared to 62% from group D, 60% of those in the C2, 51% in the C1, and 42% in the AB groups[16].

In the past, the property market in the UK has been a very powerful transmission mechanism for accumulating and transferring wealth across generations, and enhancing future incomes – especially for those fortunate enough to enter and exit the property market at the right time. Whether or not future generations will benefit to the same degree will of course very much depend on the future path of property prices. However, if property prices do return to trend growth, younger people fortunate enough to get financial assistance from family to get on the property market will benefit to a much greater extent from the lifecycle model of debt decumulation and wealth accumulation than younger people who have to find the necessary deposit themselves. So in effect what we see in many cases is a recycling of debt-generated wealth from older generations to their dependants. This in turn perpetuates existing disparities in wealth and incomes within current generations.

## WIDER SOCIO-ECONOMIC CONSEQUENCES

The main conclusion that emerges from this report is that we could be seeing a major change to the historic relationship between debt and asset accumulation.

As we noted in our previous report, there is a rather frustrating and worrying lack of good detailed time series data related to the debt circumstances of UK households. But, looking at the available research data there is a sense that if economic trends continue many of the current younger-middle age generation of households who currently have huge secured and unsecured debts will not be able

14 http://www.cml.org.uk/cml/publications/newsandviews/83/303
15 CML News and Views, August 2009
16 Table 3.2, Attitudes to inheritance in Britain, Karen Rowlingson and Stephen McKay, Josepeh Rowntree Foundation, 2005

to look forward to previous patterns of income growth, associated debt repayment, and asset accumulation. Many households with large debts are at best treading water and will not be able to look forward to income mobility to lift them out of trouble.

This has worrying implications in the short-medium term. The most obvious is the need to tailor the delivery of debt advice to meet the needs of consumers' changing lives.

However, we fear that this legacy of debt has wider implications for households and the financial services industry if as we expect the UK economy enters a sustained period of high debt, low growth, low interest rates/ financial returns, and higher inflation.

The debt legacy will remain with us for longer than is usual with many households left with a huge debt burden for years to come. In the long term, the need to repay debts for longer, and the inability to build up assets and incomes will surely impact on the retirement plans of many households. We may also see an increase in problem mortgage debt amongst older retired households as the wave of over-indebted late middle age households move towards retirement. This surely points to the need to revisit the role of equity release in helping older asset rich, income poor households.

Making sure that households get advice at the earliest stage must be a priority. Those who can afford to should pay down debt in case interest rates do turn. We have a specific concern about the new national pension scheme NEST that is being introduced from 2012. We are very supportive of NEST. It is a much more efficient way of providing pensions than personal pensions. But the very high debt-to-income ratios evident in the NEST target group (low-medium incomes) means they will need good advice or guidance before deciding on whether to pay down debts or auto-enrol into NEST.

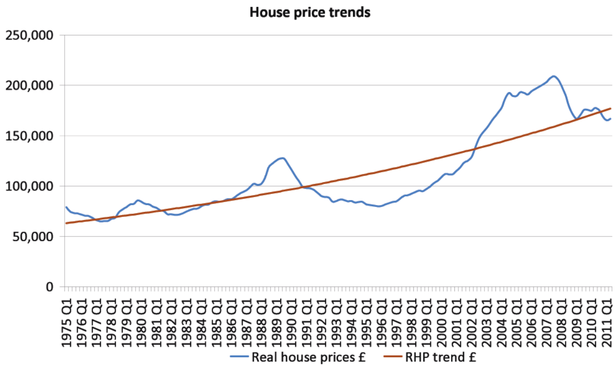
Households who do not have a repayment mortgage in place (or who have switched to interest only) may find debt a burden for much longer. The current high level of forbearance exercised by lenders suggests there is already a hidden problem. On top of this, the low investment returns means we may need to start worrying again about whether mortgage endowment policies are on track to repay the mortgage principal.

In the absence of tougher consumer credit regulation, we have serious concerns about financially vulnerable households being targeted by commercial debt management companies. The combination of lower disposable incomes and downward pressures on profitability means that the industry is likely to focus even more on more profitable, less risky consumers. This will result in greater financial exclusion.

To conclude, the combination of the debt legacy and a new economic paradigm of low growth, low interest rates/ financial returns, and higher than expected inflation could have serious consequences for households, industry and policymakers. This will have major impacts on household disposable incomes, consumer behaviour, access to products, product pricing and design, investment returns and attitudes to risk, sustainability of business models, and both consumer protection and prudential regulation. Policymakers, regulators, and consumer representatives should plan for this new environment.

# ANNEX 1: ADDITIONAL CHARTS AND TABLES

### Chart A1: UK housing market 'lottery'




*Source: Nationwide House Price Index*

### Table A1: Annual growth in student debt outstanding, £

| Financial year end | Total outstanding £billion | Amount paid annually £billion |
|---|---|---|
| 2012 | 35 | 1.7 |
| 2013 | 39 | 1.8 |
| 2014 | 44 | 2.1 |
| 2015 | 50 | 2.3 |
| 2016 | 57 | 2.6 |
| 2017 | 64 | 2.8 |
| 2018 | 72 | 3 |
| 2019 | 80 | 3.3 |
| 2020 | 87 | 3.5 |
| 2021 | 94 | 3.8 |
| 2022 | 101 | 4.1 |
| 2023 | 107 | 4.3 |
| 2024 | 114 | 4.5 |
| 2025 | 120 | 4.8 |
| 2026 | 126 | 5.1 |
| 2027 | 132 | 5.4 |
| 2028 | 136 | 5.8 |
| 2029 | 143 | 6.1 |
| 2030 | 148 | 6.5 |
| 2031 | 153 | 6.9 |
| **Annualised % growth** | **7.7** | **9.4** |

*Source: BIS response to Freedom of Information request, http://www.scribd.com/doc/63078079/LC-exclusive-Student-Debt-Forecast*

### Table A2: Use of credit for everyday expenses by age, %

| | All the time | Once in a while | Either |
|---|---|---|---|
| 18 to 24 | 12 | 10 | 22 |
| 25 to 39 | 14 | 17 | 31 |
| 40 to 54 | 14 | 16 | 29 |
| 55 or over | 7 | 11 | 18 |

*Source: Table A6: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

### Table A3: Likelihood of needing to borrow more money in next 3 months, %

| | Very/ fairly likely | Very/ fairly unlikely |
|---|---|---|
| 18 to 24 | 19 | 56 |
| 25 to 39 | 15 | 62 |
| 40 to 54 | 11 | 67 |
| 55 or over | 5 | 82 |

*Source: Table A12: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

### Table A4: Households in arrears or insolvency, %

| | In arrears/ insolvency |
|---|---|
| 18 to 24 | 8 |
| 25 to 39 | 15 |
| 40 to 54 | 15 |
| 55 or over | 7 |
| All | 12 |

*Source: Table A33: Credit, Debt, and Financial Difficulty in Britain, BIS, 2009/10*

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