



Strength Against Shocks:

Low-income families and debt

Dalia Ben-Galim and Tess Lanning

February 2010

© ippr 2010

About ippr

The Institute for Public Policy Research (ippr) is the UK's leading progressive think tank, producing cutting-edge research and innovative policy ideas for a just, democratic and sustainable world.

Since 1988, we have been at the forefront of progressive debate and policymaking in the UK. Through our independent research and analysis we define new agendas for change and provide practical solutions to challenges across the full range of public policy issues.

With offices in both London and Newcastle, we ensure our outlook is as broad-based as possible, while our Global Change programme extends our partnerships and influence beyond the UK, giving us a truly world-class reputation for high quality research.

ippr, 30-32 Southampton Street, London WC2E 7RA. Tel: +44 (0)20 7470 6100 E: info@ippr.org
www.ippr.org. Registered Charity No. 800065

This paper was first published in February 2010. © ippr 2010

About the authors

Dalia Ben-Galim is a Senior Research Fellow and Tess Lanning a Researcher at ippr.

Acknowledgements

The authors would like to thank Tony Dolphin, Kayte Lawton and Kate Stanley at ippr for their input to this paper. ippr is grateful to Friends Provident Foundation for their generous funding of the Consumer Spending and Debt project.

Finally, a big thank you goes to all the families who took part in the research for their time and input.

Contents

Executive summary	4
Introduction.....	7
The expansion of credit	7
Trigger events and a spiral of debt	8
The daily realities: consumer spending and debt on a shoestring	12
Choices, attitudes and the 'sub-prime' problem	14
Policy recommendations	17
Conclusion	19
References.....	20
Appendix: Research methodology and profile of the sample	21

Executive summary

The current economic crisis has cast a sharp light on broad cultural trends across all income groups. Consumer-led aspirations and a national obsession with home-ownership are deep-seated cultural developments with both social and economic drivers. But for many families, having access to products and homes means relying heavily on debt.

In the decade to 2008, average household debt in the UK increased substantially – from 93 to 161 per cent of disposable income. The profile of borrowers widened to include lower income groups, which some suggest has led to greater opportunities for social and economic inclusion. But low-income households are the ones that are most vulnerable to debt problems, and ippr's new research illustrates that our reliance on debt – far from creating opportunity – has created vulnerability during this recession.

ippr's innovative research with 58 low-income families in London, Newcastle, Nottingham and Glasgow aimed to understand what the expansion of household debt has meant for the lives of low-income families. In-depth interviews, an income and expenditure diary and regular telephone conversations over four months explored patterns of income, spending and borrowing.

This is the first time the UK has entered a recession with families from all income groups in considerable debt. Reflecting wider trends, 43 per cent of the low-income families in ippr's research were homeowners; 59 per cent had credit cards; 25 per cent had store cards; and 47 per cent used mail order catalogues. The experiences of many of the families also suggest that so-called 'extortionate lenders' are still using high pressure sales techniques, targeting people in financial difficulty.

Our research found that not all low-income families use consumer credit or get into debt, but poverty and job insecurity increase vulnerability to debt problems. Low pay and certain contractual conditions such as temporary and zero-hour contracts can create considerable financial insecurity. Our findings also show how finances are strained by everyday occurrences – a broken washing machine, a leaking pipe, or an unexpectedly high bill – and seasonal and occasional pressures such as Christmas and birthdays.

Saving in advance can help families deal with fluctuations in income and expenditure and should be encouraged. But forward planning is not always realistic for families on low incomes or in financial difficulty. Some families will need access to credit in order to plan ahead. The extension of credit and mortgages was born in part out of recognition that there cannot be one set of rules for poor people and another for everyone else. Our research illustrates the need to combine market regulations with measures to provide fair and sustainable alternatives for all households.

The main cause of a household falling into problem debt, arrears and repossession is a fall in its income. Over a quarter of ippr's research participants experienced a fall in their household income during the research period, and a significant proportion had experienced a sudden loss of income in the past as a result of redundancy, relationship break-up or ill health. Our findings show how, faced with a reduction in earnings over a sustained period, any savings are quickly used up and debt and arrears often spiral out of control.

We found that mortgage-holders are particularly vulnerable when there is a fall in household income. Mortgage debt is problematic because of the size of the debt and the possibility that families will lose their homes if they default. This has potential implications for the emphasis by government on the positive aspects of home-ownership, and policies to support social housing and broaden the appeal of renting require further investigation.

Policy recommendations

In the long term, policy must not lose sight of the need to address income inequality and job insecurity. ippr has, for example, previously argued for action to increase the supply of well-paid, good quality jobs, and for support to low-wage workers to stay in work and progress.

Immediate policy responses must build financial strength and resilience in families and provide greater support for families against external shocks like job loss.

Building financial strength and creating a fairer market for low-income consumers

- **A savings account to build resilience** – ippr proposes a life-long savings account for low-income households, which would be funded by limiting the tax relief on pension contributions to the basic rate for everyone. Current saving initiatives aimed at low-income households, such as the Saving Gateway cash account, are small scale and short term. When it matures, the Saving Gateway should be automatically transferred to an account for low-income savers. Tax credits could also be paid into these accounts, as suggested by some of our research participants. Keeping money in the account and saving should be rewarded with ‘bonuses’. This would help increase low-income households’ resilience to shocks.
- **Funding for affordable credit initiatives for low-income families** – Community Development Finance Initiatives (CDFIs) offer a fair and sustainable lending model and can protect low-income consumers from market fluctuations in credit supply. The community finance sector is growing, but securing long-term funding for the sector is still a challenge. This funding should come from the banking sector: an argument that reflects widespread debate (among our research participants and beyond) on how banks should contribute to society in the aftermath of the economic crisis. The introduction of an American-style Community Reinvestment Act might encourage banks to invest in local communities. The UK banking context means there may need to be stronger measures to ensure the City provides the funds. A percentage of every bank’s assets could be channelled into a fund for affordable credit initiatives, administered by a new organisation or through an existing organisation such as the Community Development Finance Association. Alternatively, if efforts to implement a ‘Tobin tax’ on international transactions are successful, some of the money it generates could be diverted to an affordable credit fund.
- **Online credit comparison** – ippr proposes a consumer-focused website that provides accessible information on local, affordable credit, building on the popularity of price comparison websites, which our research participants used frequently for other products and services.
- **Free and impartial financial advice** – ippr’s research supports the national roll-out of the Money Guidance service currently being piloted, but calls for it to broaden the range of advice offered and maximise its impact through a range of awareness-raising strategies. Our research shows that the lack of impartial advice leads to widespread distrust of many financial products and services. The service should offer impartial mortgage advice and promote awareness of savings and affordable credit initiatives aimed at low-income households. Monitoring and evaluation of the pilots should report on how people have used the service, as well as on outcomes. The evaluation should also seek, several months on, to assess its impact on people who have used the service.

Dealing with financial shocks: support after a fall in household income

- **Integrated advice and support at crisis point** – there is a need for upfront advice in the event of sudden job loss. ippr has identified debt advice and mental health support as gaps in the knowledge of personal advisers working with the unemployed. This research suggests that people who have lost a job may also benefit from better

signposting to family support and counselling services. We reassert our previous recommendation for a national accreditation for personal advisers to ensure high quality and relevant advice and for the development of 'specialist' adviser roles that are equipped to address the challenges faced by customers while they are supported back to work.

- **Flexibility on financial commitments** – low-income mortgage-holders faced with unemployment are particularly vulnerable. As part of the Government Homeowners Mortgage Support, some lenders offer mortgage-holders affected by a temporary fall in income the opportunity to swap to an interest-only mortgage. Lenders that have signed up to the scheme will negotiate deferred interest payments for up to two years for eligible candidates. ippr argues that all lenders should be required to provide this deferment option, while the mortgage-holder's efforts to find a job are supported through welfare-to-work services. The initiative should be permanent and not simply a crisis response to the recession.

Conclusion

Government policy currently focuses on giving households financial education and providing advice at crisis points. But ippr's findings illustrate that debt problems are rarely a result of 'bad' money management. Much of the vulnerability to problem debt is explained by the relative resilience of the industry in which the individual works and the type of contract they are employed on. This suggests that, in the long run, dealing with over-indebtedness is more dependent on the availability and quality of employment than on levels of individual financial capability. As the economy is rebuilt, there is an opportunity to address the flaws of credit-fuelled growth and to reflect on the fact that debt has grown largely as a result of the British desire to own their own homes.

Introduction

The decade to 2007 was characterised by strong consumption-led growth and low unemployment. Relaxed mortgage terms made home-ownership attainable to a wider cross section of British society than before and the use of credit was normalised across all income brackets. Our greater willingness to borrow is reflected in a dramatic increase in the proportion of household debt to income – from 93 per cent in 1998 to its peak of 161 per cent in 2008 (see Figure 1).

But beneath this veneer is a long-term rise in income inequality. Low pay and job insecurity have persisted in many industries, and while most UK debt is owned by higher earners, ‘problem debt’ is associated with low income. The disparity between low pay structures and consumer-driven growth is an integral part of the story of debt in low-income households.

This report presents new evidence from innovative research that ippr conducted with 58 families in 2008–9 to understand what the pre-crunch expansion of credit meant for the lives of low-income families. It illustrates the vulnerability of low-income families to debt, how those families manage debt, and the circumstances that see debt become a ‘problem’.

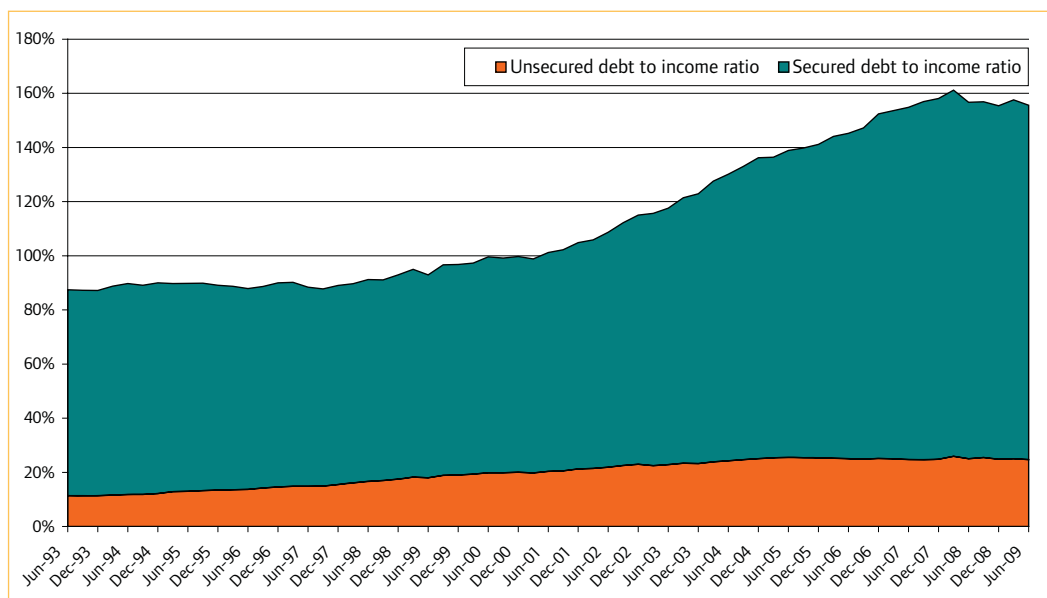
There have been notable attempts to improve financial management by increasing the tools at the disposal of low-income families. But policies often fail to address the reasons behind debt vulnerability – which are often beyond the control of families in difficulty. ippr’s research shows how job insecurity and fluctuations in income and expenditure can expose poorer households to debt problems. Based on the evidence presented, we argue that policy should better address the financial insecurity of low-income families, strengthen financial resilience, and help families cope with the impact of severe financial shocks such as job loss.

The expansion of credit

The expansion of credit fed consumer-driven growth and the housing boom. At its most effective, credit has satisfied the ambitions of many families and helped households cope with financial difficulty. But ippr’s research shows how the extraordinary growth of debt as a proportion of household income – illustrated in Figure 1 – has also increased vulnerability to financial shocks.

Figure 1: UK household debt to income ratio, 1993 to 2009

Source: Data from Bank of England and Office for National Statistics



At its peak in mid-2007, average household debt was over 160 per cent of the average income, largely accounted for by mortgages. In January 2010, average household debt stood at £9,016 in unsecured credit and £57,888 including secured loans¹ (Credit Action 2010).

The social profile of British debtors has broadened. The Right to Buy enabled over two million low-income council tenant households to buy their home (at a substantial discount from the open market value) and the relaxation of mortgage lending terms further increased access to home-ownership after the mid-1990s. There was a rise in self-certified and 'No-Income-No-Job-or-Assets' (NINJA) mortgages for people who would otherwise have struggled to prove their capacity to make repayments. Reflecting wider access to mortgages, 43 per cent of the low-income families that participated in ippr's research were home-owners. All but two of these families had mortgages.

In the boom that preceded the current economic crisis, consumer credit was also extended to a wider cross section of society. The number of lenders and financial products mushroomed. Supermarkets and high street stores as well as banks began to offer unsecured credit. 'Sub-prime' lenders offered unsecured loans without a credit check, providing credit to people with patchy or weak credit histories.² Of the low-income families that participated in ippr's research, 59 per cent had credit cards – just 3 per cent less than the national average for the adult population in 2008 (APACS 2009) – and 25 per cent had store cards. 'Older' forms of credit have also retained popularity: mail order catalogues were used by 47 per cent of the research participants.

Policies to tackle debt and financial difficulty often focus on 'problem debt' – where debt commitments exceed the ability to pay over a sustained period of time. Statistically, younger, less educated and poorer people are at highest risk of debt problems. The 'over-indebted' include a higher proportion of single parents and families with a single earner (Kempson and Atkinson 2006). With 22 lone-parent families and 17 families with just one earner in our sample, two thirds of our participants might be classified as 'at risk' of over-indebtedness.

There is, however, no clear dividing line between the indebted and the over-indebted and there are complex reasons for why our dependence on debt is problematic. The easy availability of credit has changed the terms of vulnerability. Having a high level of financial commitment increases the risk when faced with negative shocks to income. Those most likely to borrow to make ends meet after a drop in income are low-income households and people who already have high levels of unsecured debt and mortgages (Kempson and Atkinson 2006). The 'democratisation' of mortgage and consumer credit lending means that, for the first time, we have entered a recession with low-income families in considerable debt. How do these families cope in the event of redundancy?

Trigger events and a spiral of debt

Our findings show that 'trigger' events are the main cause of debt problems and arrears. Redundancy, relationship breakdown and ill health can all result in a sudden, significant and sustained loss of household income that leaves people unable to maintain financial commitments. Those with mortgages are particularly vulnerable. While many families were previously 'coping' with high levels of debt, rising unemployment and repossession have made debt more visible in the current economic climate.

1. 'Secured' refers to loans guaranteed against a property, such as mortgages and car loans. 'Unsecured' refers to sources of credit with no specific property guarantee, such as credit cards and store cards.

2. The term 'sub-prime' has been popularised in reference to mortgage companies in particular. We use it in this paper to refer to both mortgage and consumer credit companies.

Sustained loss of income

Over a quarter of the research participants (15 households) experienced a fall in household income, including five people who lost a job and four self-employed people whose earnings reduced dramatically, in one case resulting in business closure. Others had their hours reduced. Where the loss of earnings was significant, it resulted in a sudden inability to keep up with household costs, particularly in households reliant on a single earner. Faced with reduced income over a sustained period, any savings were quickly used up and debt and arrears spiralled.

The job sector and type of employment contract contributed to people's vulnerability to a fall in income. This recession has, as in previous recessions, hit blue-collar industries such as manufacturing and construction the hardest, in addition to the retail, hospitality and catering sectors (see Dolphin 2009a). The example in the box below describes the impact of instability in the construction industry on one family of four living in London.

A 38-year-old male from London was working for a large construction firm. His wife was the primary carer for their two young children. He was on a zero-hours contract³ and work had become increasingly infrequent. He was occasionally offered casual jobs, but his contract required him to be available for his main employer.

I haven't got guaranteed work. I don't know how many days I'm getting – I ring up [my employer] and they say, "We've got nothing tomorrow." If they said to me, "Right, you've got two days' work this week", I could plan and I could ring my mate up and say "I'm available. If you've got extra work I can come and do that." So I can't even plan. That's the hardest thing. If I get a five day week [it's good because] my day rate isn't bad money.

Before the current downturn, the household's financial history had been stable. The couple bought their house at a low price in the mid-1990s and benefited

from the rise in house prices. The construction industry offered reliable and constant work. They had managed to save both for specific events such as Christmas and as a precautionary measure to protect the household during periods of low demand for construction work. The couple never used any form of unsecured credit. They did not want to pay interest and were against using both mainstream and sub-prime lenders.

With income reduced dramatically, the couple's savings were used up and they fell into arrears on household bills. Their biggest worry was the mortgage. Rather than use credit, the household drew on informal borrowing. They had several good friends who were lending them money from month to month to cover costs. Sometimes the man was able to pay friends back by carrying out work on their homes for free. But without a reliable income the household was increasingly worried about their ability to keep up with costs or pay back the loans.

This family's experience shows how vulnerability to debt and poverty can be linked to the ebb and flow of a particular industry. It is unlikely that better financial management and planning could have changed the situation for this family, and other financial products may not have appealed to them. This raises the question of whether improvements to the UK's financial management address the main reasons for debt vulnerability.

The vulnerability of mortgage-holders

The case described above also hints at the particular vulnerability of families with secured loans. Arrears or failing to pay unsecured credit may incur extra charges and cause financial difficulty. But defaulting on a mortgage can result in repossession and homelessness.

Approximately 11,700 homes were repossessed in the third quarter of 2009 alone. This represents a 5 per cent increase on the same quarter in 2008 (Council of Mortgage Lenders 2009). While not necessarily from the lowest income groups overall, those at risk of

3. A non-legally defined name for an employment contract that pays only for work done and under which the employer does not guarantee to provide work.

repossession tend to have the lowest incomes among home-owning households (Shelter 2008).

In 2007–8, 56 per cent of people in mortgage arrears were in that situation due to a loss of income, primarily as a result of unemployment, sickness or injury, and reductions in pay, hours worked, or self-employed income. Other changes that may result in loss of household income, such as the death of a partner or relationship breakdown, were cited by 29 per cent as the catalyst for mortgage arrears (DCLG 2009a). During our research, fear of repossession was real for many of the families who owned their homes, and the biggest concern for those facing redundancy.

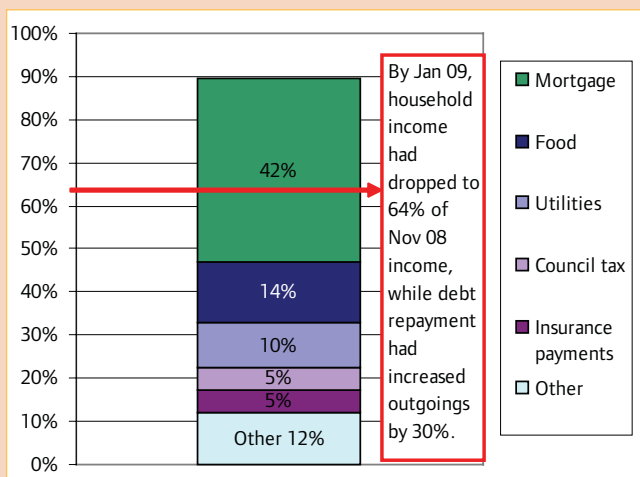
They wonder why they are having to repossess houses and things like that. People can't afford to pay it because, like ourselves, they are going to get paid off [be made redundant]. We are fortunate that we did have insurance to pay our mortgage but my brother-in-law hasn't, my sister hasn't. They've all been paid off as well.

38-year-old female, two-parent family, three children, Glasgow

Between December 2008 and March 2009, the self-employed head of a household in Newcastle experienced a dramatic fall in earnings as demand for his business plummeted. His wife was the primary carer for the couple's two children. Up to November 2008 over 75 per cent of household income was spent on housing costs, council tax, food and utilities (see Figure 2). Other spending went on television and telephone costs, transport and a modest amount on clothing, with 11 per cent left over at the end of the month.

In December 2008 the business did not make enough money to cover household costs and the man took out a loan to try to expand his customer base. Between December and March 2009, income fell to approximately 64 per cent of previous levels.

Figure 2: Main expenditure as a percentage of income, November to December 2008 – before the family's fall in income



The couple were forced to default on two secured loans. The different reactions of the two loan companies show how families are exposed to the differing procedures and compassion of lenders. The mortgage company agreed immediately to defer January's payment and allowed them to split the payment over coming months. Although this was dependent on recovery of the business, it allowed the couple to play for time.

In contrast, the second company refused to negotiate repayment on a car loan. Despite advance warning of the household's difficulties, the loan company tried to force them to pay back more than the agreed amount and threatened to repossess the car, which was essential to the business. The couple had to borrow £1,000 from a family member to pay the company, leaving them in considerable debt when business finally began to pick up. The stress of the experience left the family feeling raw.

We went through a couple of the worst months we've ever had. There is no extra, and sometimes you're having to rob Peter to pay Paul and hoping you make the extra up in between to get Peter paid back again. The kids have noticed, even down to pocket money, treats, days out, it's just non-existent. It's very, very demoralising going to work all day and earning nothing. It's horrendous – it affects my moods, it affects home life, everything. This has taught us a very valuable lesson in how quick your life can be taken – your income can be taken from you [through] no fault of your own. (38-year-old male, two-parent household, two children, Newcastle)

The example of the family above illustrates how the flexibility of lenders is crucial to household ability to manage debt when faced with a dramatic reduction in income. The tight margins of the budget for this household before its fall in income illustrate how low-income families struggle to build a significant financial cushion to protect them from unexpected shocks. Moreover, when home-owners are at risk of repossession, there may be limits to what the state and companies can do beyond give advice and support to find another job, and some measure of flexibility in repayment terms.

The vulnerability of low and middle income mortgage-holders has potentially wide-reaching implications, raising questions about access to mortgages. But regulation of mortgage lenders could quickly result in a situation where aspirations for home-ownership continue to be encouraged, but poorer households are excluded. This suggests that the emphasis by government on the positive aspects of home-ownership may need to be reconsidered, and policies to support social housing and broaden the appeal of renting require further investigation.

Deterioration of health and enduring poverty and debt

In addition to shocks that occurred during our research, some families had experienced a rapid deterioration of health that resulted in debt in the past. While people made redundant may hope to find another job, ill health can leave households in permanent poverty.

One couple had both lost their jobs due to ill health in the space of two years. They narrowly avoided having their house reposessed and got into arrears on various credit commitments. Five years later, the man was still unable to work and the woman had been forced to take on various part-time and self-employed roles to make ends meet.

I lost my job and my husband did as well. That just killed my finances completely because we had nearly £40,000 a year coming in and we went from that to nothing. I was getting £60 a week on incapacity [benefit]. He was getting about £80.

46-year-old female, two-parent household, two children, Newcastle

A history of debt and ongoing low income meant families like this were also the ones most likely to face credit restrictions. In one family, the main wage earner had an accident at work that resulted in permanent disability. Before the accident, the couple had both worked. They had savings and investments but these were lost when the household became dependent on a single earner. The couple were still paying off debts two years after the event and had limited access to credit.

I have been disabled since 2007. I had a fall and I've had operations on my back and there is nothing they can do. [My wife] saved up for years with shares and all that and that was supposed to be for us, and we just had to use it to spend on the mortgage and that and just basically living. We've got nothing. We had been saving through the bad times when the kids were young and it's [a] bloody waste, all because I can't work. I couldn't get a credit card now because I'm disabled. I owe some money on a credit card and I've got to pay it off but I've got an arrangement. I only pay a couple of quid. It's still a noose round your neck, isn't it?

42-year-old male, two-parent household, two children, Newcastle

In both of the above two cases, ill health and disability left one partner caring for the other. The ongoing financial impact of caring can be significant. Reflecting the prevalence of carers and the disabled among low-income households and benefit claimants in the UK, 16 of the households in our study (or 26 per cent) included someone with a disability or chronic illness. According to research conducted by Carers UK (2008), almost a third of carers that pay rent or a mortgage struggle to meet the

cost, three out of four carers struggle to pay their utility bills as a result of caring and over half cut back on food to make ends meet.

The daily realities: consumer spending and debt on a shoestring

All income groups can experience a 'shock' to their income. But ippr's findings illustrate how poverty and financial insecurity mean low-income families are already vulnerable to debt. As some of the case studies above suggest, low-income families may find it harder to save as a precautionary measure than those with a higher income, leaving them more vulnerable to shocks (see also Dolphin 2009b).

The literature suggests that poorer households are more acutely aware of inflows and outflows, and low-income families tend to do better than wealthier families at budgeting (Financial Services Authority 2006). Regardless of financial management skills, however, many struggle on a low income (see Rowlingson and McKay 2008). This section shows how resources are stretched to the limit by predictable and unpredictable fluctuations in income and expenditure.

Financial insecurity and debt vulnerability

Our findings show that low quality employment increases vulnerability to cycles of debt. ippr highlighted the problem of high levels of low pay and in-work poverty in the UK in early 2008 (Cooke and Lawton 2008). Further quantitative research demonstrated there is a persistent lack of secure jobs in low-paying sectors such as security, catering, childcare and retail, which means workers in these industries often find themselves in a cycle between work and benefits (Lawton 2009).

Household costs mount up during transition periods between work and unemployment. One of our research participants, a single mother in Nottingham, had found a job that paid relatively well. But it only lasted for a month, three times a year. The gaps in pay while she waited to receive backdated wages and benefit payments had resulted in considerable debt. She was in arrears on all household bills and owed money to family and friends. On top of her current electricity usage, she was paying off her electricity arrears through a meter. She was suffering from depression and said she felt like she was always 'playing catch-up' in a vicious circle of debt.

I can't get a permanent job. I look every day – there's nothing. I've had the bailiffs here for my council tax. I feel like I'm going to cry. It's my fault – when I'm at work I should pay council tax and the rest of the time I'm not paying it. I just got in a complete mess with it all. The [electricity company] have put me an electricity meter in and it's just ridiculous. I'm spending so much on it because it isn't just taking the electricity that I use. It's taking off the debt.

47-year-old female, one-parent household, one child, Nottingham

Short-term bouts of physical illness or depression also left some people vulnerable to being caught in cycles of being in and then out of work. ippr's research on in-work poverty suggested that retaining work may be difficult for people with caring responsibilities or those with a disability or health condition (Lawton 2009).

Our research shows that the quality and terms of employment play a role in how exposed these households are to financial difficulty. Ill health was particularly problematic for people on temporary contracts and those contracted as self-employed – among our research participants, this included builders, and lorry and taxi drivers. They were not entitled to sick

leave so taking time off resulted in lost income. These households sometimes slipped into arrears and had to borrow to meet financial commitments. The threat of another bout of illness caused ongoing stress.

It was dreadful because my husband had been off work for three months because he had an operation on his shoulder. He only got paid one of the months so I had to do two months without his pay. The savings that I had in the bank were used to live on so this took the savings down to nothing. Then the car went so I had to borrow it off my mum.

32-year-old female, two-parent household, three children, Newcastle

There was a clear difference between families dependent on wages which were low and unstable and those in long-term receipt of state benefits. Unemployed households receiving benefits were among the poorest families and represented three-quarters of those living below the poverty line (calculated before housing costs; see Appendix). But these families had a steady – if small – income. When asked about the impact of the economic crisis, their biggest concern was not job losses, but the rise in the cost of food and fuel. Housing benefit offered a stability many working families did not have.

I'm secure anyway because it's a council house at the end of the day. I haven't got the worry like a person paying his mortgage who could lose their job tomorrow. He's got more worries than I'll ever have in that respect.

47-year-old male, two-parent household, three children, Nottingham

In contrast, the cost of housing is crucial to understanding debt vulnerability among working families. Over half the families living below the poverty line, as measured after accounting for housing costs, were in work. Of those paying housing costs (33 families), almost a third spent more than 30 per cent of their income on housing. In a period of exceptionally low interest rates, mortgage-holders were spending on average 27.4 per cent on housing costs as a proportion of their income – 6 per cent more than the average paid by the tenants in the sample.

Fluctuations in expenditure

All households experience fluctuations in expenditure. But rising costs have a disproportionate impact on low-income families who, by definition, manage extremely tight budgets. Our findings illustrate how finances are strained by everyday malfunctions – a broken washing machine, a leaky pipe, an unexpectedly high bill, or an annual payment for which families have not managed to save.

I've just repaid all my credit cards off, which was great – a clean slate sort of thing – but then the car insurance, that was £350 and the telephone bill was really expensive, that was £150. I can see [the debt] starting to creep up so it does worry me. By this time next year if we haven't increased our income we're going to be back to square one again.

47-year-old female, two-parent household, three children, London

One of the reasons cited for not saving was that reserves were always used up by unforeseen costs when something broke down. The effort hardly seemed worth it, some people said, because there was no relief or reward at the end.

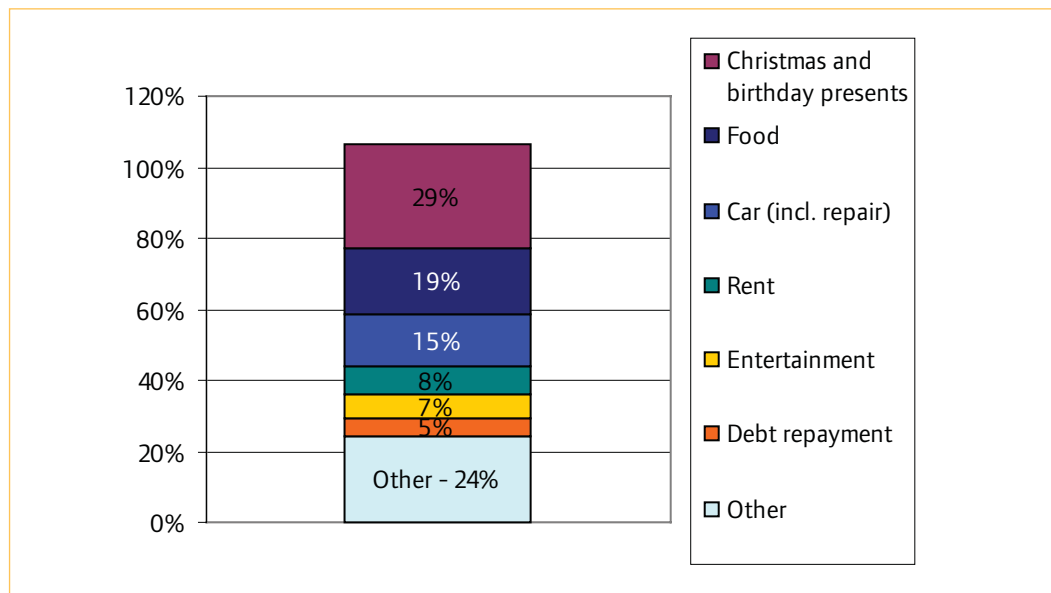
In addition to the unexpected, there were predictable seasonal and occasional fluctuations in expenditure. School holidays, Christmas and birthdays are expensive. Presents for children were the highest single cost at Christmas. Some parents argued that a present can provide year-round entertainment for their children and compensate for a lack of regular family activities in the rest of the year. Many said they would feel guilty denying their children at Christmas.

Especially with the kids at their age, they love [Christmas] – just seeing their faces – so you find the money for it. Obviously last year wasn't a problem because I was earning well. This year is going to be different. They don't understand how bad [our financial situation] is, and they are innocent too, so you don't want to tell them. It's all about your children at Christmas, so you give them a good Christmas and you worry about it afterwards.

38-year-old male, two-parent household, two children, London

In the run-up to Christmas, expenditure exceeded income for more families than during any other months over the project. Figure 3 shows how one family was spending in November and December. Several birthdays coincided with Christmas and together these represented the largest expenditure, at 29 per cent of monthly household income. In total, they spent 106 per cent of their monthly household income. In January, the household spent within budget, but had reduced their consumption to meet debt repayments.

Figure 3: Main expenditure as a percentage of income, November–December 2008, for two-parent family with four children (two of them dependent), Newcastle



Christmas was the most common reason families saved, but many still started the new year with a new debt cycle and January and February were typically austere months. Most households predicted it would take three to four months to recover from the cost. For several families, it would take up to eight months for spending to get back to normal.

Choices, attitudes and the 'sub-prime' problem

The findings presented here have made the case that financial difficulty is not always – or even often – a result of 'bad' financial management. However, attitudes and abilities do inform the way families cope. There were wide variations among the families around use of credit. Patterns of debt were dependent on a combination of available resources, the suitability of different financial products, and attitudes to financial management.

Many expressed negative attitudes towards credit. People were completely aware of the interest rates they paid and many preferred to borrow informally from family or friends. Some households deployed arrears strategically, postponing bills that did not incur charges to juggle payments over costly times of the year. A significant minority actively chose not to use credit. When asked if they ever borrowed or used credit, several families said they had made a decision to always pay for things upfront.

We never get into debt. That's one thing that we've always said we'll never do.

21-year-old female, two-parent family, one child, London

I personally don't like to get into debt. If I can't afford it I save up so I can buy or say to my mum or my dad – my dad will get me it and then I give him the money. I don't believe in paying the interest.

45-year-old female, one-parent household, two children, Glasgow

In addition to those who chose not to use credit, some families had limited access to mainstream lenders. The credit market has contracted. The growth rates of unsecured and secured lending nosedived after the crisis began to unravel in October 2007. While mortgage lenders have made a tentative effort to begin lending again, unsecured credit lending continues to fall (Bank of England 2009). Families found it increasingly difficult to access unsecured credit over the course of our research and people with fixed rate mortgages that were due for renewal were struggling to find a deal.

When the terms of standard credit constrict, people may turn to an alternative credit market. Some companies – in the 'sub-prime' market – provide loans at expensive rates to people who do not meet the requirements of mainstream lenders. But our research shows that the choice of lender also reflects people's circumstances in rational ways. Market operators directed at low-income households, such as doorstep lenders, offer flexible terms. Weekly payment plans allow poorer consumers to buy goods they could not otherwise afford, and to pay in a way compatible with weekly budgeting. Although people knew that they paid over the odds for this sort of credit, financial insecurity meant flexible repayment options were easier to manage than fixed monthly payments.

If I have a crisis I would then go to [the doorstep lenders]. I know you pay three times as much to pay it back but if you've got a problem they normally help you out. They come to the door each week and if you haven't got [the] £10 they want, it's quite easy to give £5 or whatever. They're my backbone.

46-year-old female, two-parent household, three children, Nottingham

Research in the late 1990s showed that while 'extortionate' lenders are used by relatively few people, companies may target high pressure sales techniques at people in financial difficulty, and find loopholes in legislation that prohibits canvassing credit on people's doorsteps (Kempson and Whyley 1999). Only four households in our research (7 per cent of the total) drew on doorstep lenders, but the experiences of many families suggest that such practices still take place.

Several research participants said that it was not uncommon for the same salesperson to visit houses regularly, both to sell credit and collect repayments, and they were often a familiar and 'friendly' face in the neighbourhood. Conversations about credit and debt frequently turned to the aggressive marketing of credit companies. People suggested this had intensified over the past decade, although some said it had tailed off since the economic crisis.

Over the years we've had loans off a few different people, and I used to get phone calls every other week off these people, you know: "Can I offer you something?" I went a bit mental last year – people offering me money over the phone. You still get letters coming through the door.

34-year-old female, two-parent household, three children, Glasgow

Reliance on this sort of credit can lead to problems. One woman in Glasgow had been offered a £5,000 loan despite being unemployed. She took it and her debt quickly spiralled. She eventually had to declare herself bankrupt.

I didn't have a pound in the bank and they offered me a £5,000 loan, which I took. After a few months I couldn't meet the payments, then I had the catalogue and then I was offered a Visa and it just spiralled out of control. I know it was a lot of my own fault because I was taking it. I had my kids [and] they were needing more and more. So I think [the company] should really have taken more control when I had no income before allowing me to get loans.

44-year-old female, two-parent household, two children, Glasgow

The quote from this woman draws attention to timeless debates about whether social policy should be targeted at the market or the consumer, and how paternalist interventions should be. It is easy to make moral judgements on the 'bad' financial decisions that people take across all income groups. Equally, marketing strategies that target people unlikely to be able to repay credit are repulsive to many. For the families we spoke to, such experiences epitomised the perceived irresponsibility that caused the current economic crisis.

For years I have been saying how easy it is to get credit, because people who are really poor shouldn't really be getting credit and every corner you go into there's pawnshops or credit shops that can give you your cash or cheque and that is so tempting for people. It was irresponsible for the people taking up the credit they could not afford but it was more irresponsible for the people offering it to people.

47-year-old female, two-parent household, three children, Glasgow

But interventions to clamp down on credit invariably affect those with low and insecure incomes. The extension of credit and mortgages was born out of recognition that there cannot be one set of rules for poor people and another for everyone else. One option is to combine market regulations with fairer alternatives to consumer credit.

'Local' financial institutions offering credit, such as credit unions, were in general trusted more than large banks and companies by our research participants. The Glaswegian woman bankrupted by easy loans highlighted a Scottish scheme, Scotcash, which is offering an alternative to doorstep lenders in deprived areas. Scotcash provides affordable loans with flexible repayment terms based on people's current income rather than their past credit history.

Most people I know use doorstep lenders. I don't use them any more because they're too expensive. I use Scotcash. They'll see how much you've got coming in, so if you've got £200 a week they'll only lend you enough. They won't give you any more. It's just up and running about a year and a half but it's doing great, and it's stopping [the doorstep lenders] from coming to your door. Every day except Sunday you get doorstep lenders on [the housing estate].

44-year-old female, two-parent household, two children, Glasgow

The tensions between the utility of credit and the irresponsibility associated with debt were themes that emerged throughout our research. These tensions also run through policy responses to problem debt. Pre-crisis policies settled on financial education and advice, which regulate neither the consumer nor the market and were criticised for being ill-targeted and misconceived (see Erturk *et al* 2005). The role of credit and lending in the UK economy is the subject of ongoing debate. Our recommendations are aimed at household level. They reflect the evidence presented on the vulnerability of low-income families to financial insecurity and debt.

Policy recommendations

In the long term, policy must not lose sight of the need to address the income inequality and job insecurity that sit at the root of much problem debt. ippr has, for example, previously argued for action to increase the supply of well-paid, good quality jobs and to support low wage workers to stay in work and progress (Lawton 2009).

Immediate policy responses must build financial strength and resilience in families, create a fairer market for low-income consumers, and provide greater support for families against external shocks, like job loss.

Building financial strength and creating a fairer market for consumers

A savings account to build resilience

Where possible, it is better to save than to borrow. Faced with minor shocks and seasonal fluctuations in expenditure, saving allows families to avoid – often extremely high – interest payments. ippr's research shows the difficulties that low-income families face when trying to save as a precautionary measure (Dolphin 2009b).

Current saving initiatives aimed at low-income households are limited in the stage of life they target and their scale. The Saving Gateway pilots show the success of matched savings schemes for low-income households, but they last just two years with maximum savings of £900. Child Trust Funds are universal and offer extra payments for children in low-income households. But there is no incentive to stop people spending the money all at once when they reach 18.

In an earlier report from this research, ippr proposed a life-long savings account for low-income households, funded by limiting the tax relief on pension contributions to the basic rate for everyone (see Dolphin 2009b for a full discussion). The account should be simple and provide incentives to save. We suggest 'bonuses' to reward people for keeping money in the account and some matched contributions. Child Trust Funds and money saved through the Saving Gateway scheme should be automatically transferred to a life-long account for low-income savers as they mature. Tax credits could also be paid into these accounts (as suggested by one of our research participants).

Fair and sustainable credit

Most families will at times need to access credit. Where credit conditions tighten, it is inevitably those with lower and less stable incomes that are excluded. Ideally, these households should have access to fair and affordable credit rather than to companies charging expensive rates. Our research also shows that trust and locality are important to people and influence how they save and from where they borrow.

We argue that Community Development Finance Institutions (CDFIs) such as credit unions offer a fair and sustainable lending model and can protect low-income consumers from market fluctuations in credit supply to avoid reliance on high-interest lenders. Locally-based and non-profit, cooperative lending initiatives lend at affordable rates on the basis of current income and savings history rather than credit history.

The community finance sector is growing, but securing long-term funding for the sector is still a challenge. Reflecting widespread debate – among our research participants and beyond – on how banks should contribute to society in the aftermath of the economic crisis, ippr argues that funding for affordable credit initiatives for low-income families should come from the banking sector.

There have been calls from the Social Investment Taskforce (2005) and the New Economics Foundation (2009) to introduce a Community Reinvestment Act in the UK. Based on the US model, the act promotes transparency in the banking system. Banks that do not invest in

local communities can be forced to support an affordable lender. The US, however, has many more small, local banks. The fact that in the UK we are dependent on a smaller number of much larger banks means there may need to be stronger measures to encourage banks to provide services for low-income families. A percentage of every bank's assets could be channelled into a fund for affordable credit initiatives, administered by a new organisation or through an existing body such as the Community Development Finance Association. Alternatively, if efforts to implement a 'Tobin tax' on international transactions are successful, some of the money it generates could be diverted to an affordable credit fund.

Low awareness remains a barrier to uptake of many savings and affordable credit initiatives aimed at low-income households. ippr proposes that local authorities, membership bodies such as the Association of British Credit Unions Ltd and the Community Development Finance Association could develop a website to provide accessible information for consumers to compare affordable credit in their area. These types of price comparison websites were frequently used by our research participants for other products and services.

Free and impartial financial advice

Currently, funding for financial advice is focused at crisis points. There is still no way for people to access impartial advice and information on financial products and services. This was reflected in widespread suspicion about seeking financial advice among our research participants.

The Government and the Financial Services Authority are currently piloting an impartial money guidance service in the North of England (FSA 2009). Our research supports the need for the national rollout of the scheme, which is delivered through existing advisory services such as the Citizens Advice Bureau. We also call for the service to be more ambitious to broaden the range of advice it offers and maximise impact through a range of awareness-raising strategies. We propose the current focus on budgeting, planning and 'jargon-busting' should be accompanied by impartial advice on financial products, including savings and affordable credit initiatives aimed at low-income households, and mortgages. It is vital that advice focuses not only on the 'best' mortgage deal, but also on whether or not taking on a mortgage is worth the risk.

Monitoring and evaluation of the pilots should report on how people have used the service as well as outcomes. The evaluation should follow up with people who have used the service several months on to understand and assess its impact.

Dealing with financial shocks: support after a fall in household income

Integrated advice and support at crisis point

ippr's research has shown the dramatic impact of job loss, highlighting the need for upfront advice on what steps to take before families hit crisis point. Previous research by ippr has identified debt advice and mental health support as gaps in the knowledge of personal advisers in Jobcentre Plus and private and voluntary welfare-to-work providers. This research suggests that people who have lost a job may also benefit from being signposted to family support and counselling services. ippr has recommended a national accreditation for advisers working with the unemployed to ensure high quality, relevant advice and strong customer service. We have also argued for the development of 'specialist' adviser roles that are equipped to address the challenges faced by customers while being supported back into work (McNeil 2009).

Flexibility on financial commitments

Our research has highlighted the vulnerability of low-income mortgage-holders faced with a drop in income. Repossession must be a last resort, and at household level what matters when faced with a sudden loss of income is flexibility. As part of the Government Homeowners Mortgage Support (DCLG 2009b), some lenders offer mortgage-holders

affected by a temporary fall in income the opportunity to swap to an interest-only mortgage. Lenders that have signed up to the scheme will negotiate deferred interest payments for up to two years.

ippr argues that all lenders should be required to provide a deferment option while efforts to find a job are supported through welfare-to-work services. While the scale of current job losses makes such measures urgent, people experience loss of income during periods of economic calm too. We therefore argue that this should be a permanent requirement of lenders and not simply a crisis response to the recession.

Conclusion

Debates around debt and access to credit are riddled with inconsistencies and contradictions. The expansion of credit has been underpinned by social justice arguments for the democratisation of credit and the rights of low-income families to own their own homes. At the same time, problem debt is often taken as a sign of financial mismanagement, and much policy time has been devoted to encouraging behaviour change. Financial capability is now on the National Curriculum for secondary school pupils and budgeting skills are soon to be introduced to children as young as five.

The evidence from this research shows why low-income households are most vulnerable to debt problems. While not all low-income families use credit or get into debt, low pay, job insecurity and fluctuations in expenditure cause considerable strain and make it difficult to plan ahead. Financial tools are useful in dealing with financial insecurity. But wider access to credit is not a proxy for addressing poverty.

The main cause of problem debt and arrears, even in a period of economic calm, is loss of household income. The rate of job loss can increase and middle income households plunge further into poverty and debt. This suggests that, in the long run, preventing problem debt is more dependent on the availability and quality of employment than on building individual financial capability.

The current economic crisis has cast a sharp light on broad cultural trends across all income groups. Consumer-led aspirations and a national obsession with home-ownership are deep-seated cultural developments with both social and economic drivers. But for many families, access relies heavily on debt. As the economy is rebuilt, it presents an opportunity to address the flaws of credit-fuelled growth and to reflect on how debt has grown, largely as a result of the British desire to own our own homes.

References

- APACS (UK Payments Administration) (2009) 'Plastic cards facts and figures', www.ukpayments.org.uk/resources_publications/key_facts_and_figures/plastic_cards_facts_and_figures/
- Bank of England (2009) 'Lending to individuals', www.bankofengland.co.uk/statistics/li/2009/oct/index.htm
- Carers UK (2008) *Carers in Crisis: A survey of carers' finances in 2008* London: Carers UK
- Cooke G and Lawton K (2008) *Working Out of Poverty: A study of the low-paid and the 'working poor'* London: ippr, www.ippr.org.uk/publicationsandreports/publication.asp?id=581
- Council of Mortgage Lenders (2009) 'CML cuts 2009 repossession forecast to 48,000', press release, 12 November, www.cml.org.uk/cml/media/press/2456
- Credit Action (2010) 'Debt facts and figures: compiled January 2010', www.creditaction.org.uk/assets/PDF/statistics/2010/january-2010.pdf
- DCLG (Department for Communities and Local Government) (2009a) 'Survey of English Housing', www.communities.gov.uk/housing/housingresearch/housingsurveys/surveyofenglishhousing/
- DCLG (Department for Communities and Local Government) (2009b) 'Homeowners Mortgage Support', www.communities.gov.uk/housing/buyingselling/mortgagesupportscheme/
- Department for Work and Pensions (2009) *Households Below Average Income*, http://research.dwp.gov.uk/asd/hbai_arc.asp
- Dolphin T (2009a) *The Impact of the Recession on Northern City-Regions* London: ippr, www.ippr.org.uk/publicationsandreports/publication.asp?id=706
- Dolphin T (2009b) *Saving and Asset Building in Low Income Households* London: ippr, www.ippr.org.uk/publicationsandreports/publication.asp?id=722
- Erturk I, Froud J, Johal S, Leaver A and Williams K (2005) 'The democratisation of finance? Promises, outcomes and conditions', *CRESC Working Paper* No. 9, The University of Manchester
- Financial Services Authority (2006) *Financial Capability in the UK: Establishing a baseline* London: FSA
- Financial Services Authority (2009) 'Money guidance', www.fsa.gov.uk/financial_capability/our-work/money_guidance.shtml
- Kempson E and Atkinson A (2006) *Overstretched: People at risk of financial difficulties* Bristol: Personal Finance Research Centre, www.pfrc.bris.ac.uk/publications/financial_capability/Reports/PFRC_Overstretched.pdf
- Kempson E and Whyley C (1999) *Extortionate Credit in the UK: a report to the DTI* Bristol: Personal Finance Research Centre
- Lawton K (2009) *Nice Work If You Can Get It: Achieving a sustainable solution to low pay and in-work poverty* London: ippr, www.ippr.org.uk/publicationsandreports/publication.asp?id=641
- McNeil C (2009) *Now It's Personal: Personal Advisers and the new public workforce professional* London: ippr, www.ippr.org.uk/publicationsandreports/publication.asp?id=672
- New Economics Foundation (2009) *Doorstep Robbery: Why the UK needs a fair lending law*, London: NEF
- Rowlingson K and McKay S (2008) 'Debt and savings', in Strelitz J and Lister R (eds) *Why money matters: family income, poverty and children's lives* London: Save the Children
- Shelter (2008) *Breaking Point: How unaffordable housing is pushing us to the limit* London: Shelter, http://england.shelter.org.uk/news/june_2008/?a=86212
- Social Investment Taskforce (2005) 'Enterprising Communities: Wealth Beyond Welfare', www.enterprising-communities.org.uk/rpt-cont.shtml

Appendix: Research methodology and profile of the sample

ippr's qualitative research took place over four months in 2008 and 2009, with 58 low-income families in London, Newcastle upon Tyne, Nottingham and Glasgow. The research explored people's experiences and decisions that affect financial management, including attitudes towards credit and debt. A longitudinal methodology allowed us to look beyond a particular snapshot in time, as follows:

- Face-to-face, in-depth interviews were conducted in December 2008 and January 2009.
- Families were then asked to complete a weekly diary for a month, which provided detailed data on household income and expenditure.
- Between February and May 2009, researchers conducted short telephone interviews every two weeks to monitor changes to income and expenditure.
- Final in-depth interviews took place in April and May 2009 with 52 families (six families did not complete the research).

Participants were selected to reflect a range of household sizes and composition, ethnicity, caring responsibilities, home-ownership, benefit entitlement and employment status, as follows:

- Out of the 58 families interviewed, 34 were two-parent households, 22 were headed by lone parents, and two families were living with family or friends.
- The families had between one and five children below working age.
- 77 per cent of the participants who self-selected themselves to answer the questions on family finances were female (45 households).
- The age of the participants ranged from 21 to 50 years old. 14 respondents (24 per cent of the sample) were aged between 21 and 30; 19 (33 per cent) were aged 31 to 40; and 25 (43 per cent) were aged 41 to 50.
- 50 households were white British, four were British Asian, two were mixed race (West Indian/White British) and another two were non-UK-nationals.
- 16 of the households (28 per cent) included someone with a disability.
- 22 households (16 of them couples) had mortgages, and two single mothers and one couple owned their houses outright. Of the 33 tenants, 15 had their rent paid by housing benefits (11 of them single mothers).

Figure A1 shows the employment status of the households at the start of the study. More than half of the families were single-earner households and in eight of the 10 families with two working adults, one or both worked part time.

We applied a broad definition of 'low income' to capture the diversity of experiences among low-income families. Figures A2 and A3 show the families' equivalised household income⁵ against the UK median income and the poverty line, before and after housing costs.

- Over three-quarters of the sample had below average income, and about a quarter of families were living below or on the poverty line.

5. The data was equivalised using the McClements Equivalence Scale. Poverty line and median income on 2007/8, levels also using the McClements scale, are from the Households Below Average Income (Department for Work and Pensions 2009). The data for seven households was incomplete and is therefore not included in Figures A2 and A3.

- The remaining families earned a little over the UK median income, and two families had comparatively high ratios of income to the number of people in the household.
- For more than two-thirds of all households, benefits and tax credits comprised over 30 per cent of total income.

Figure A1:
Employment status at the start of project

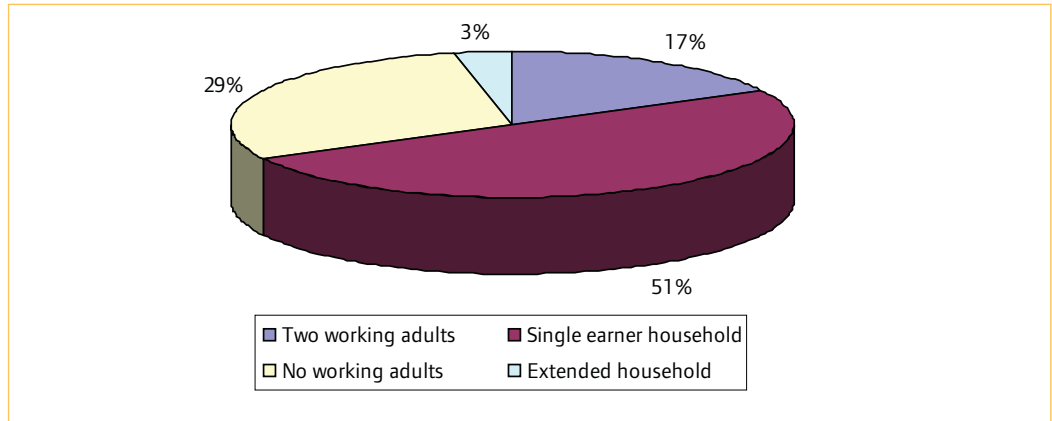


Figure A2:
Household weekly income before housing costs

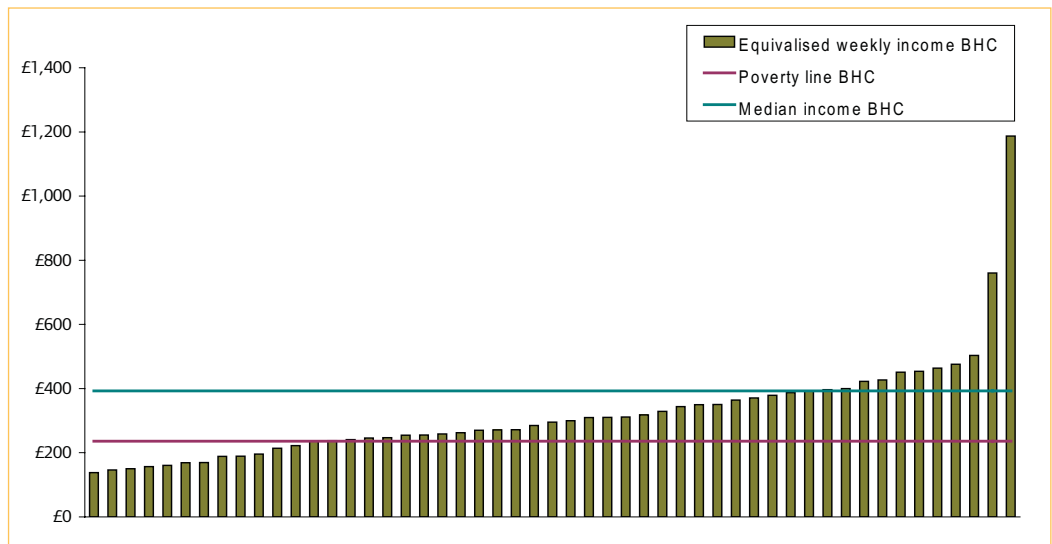


Figure A3:
Household weekly income after housing costs

