About the Money Advice Trust

The Money Advice Trust (the Trust) is a charity founded in 1991 to help people across the UK tackle their debts and manage their money wisely. The Trust’s main activities are: giving advice, supporting advisers and improving the UK’s money and debt environment.

We give advice to around 140,000 people every year through National Debtline and around 30,000 businesses through Business Debtline.

We support advisers by providing training to the majority of free to client debt advisers in the UK through Wiseradviser, and through innovation and infrastructure grants.

We use the intelligence and insight gained from these activities to improve the UK’s money and debt environment by contributing to policy developments and public debate around these issues.
Foreword

The change in household budgets of recent years is one of the most important shifts in the debt landscape that we have witnessed. However the impressive economic recovery presents an opportunity for Government, creditors and the free advice sector to work together to ensure households are supported to best manage their finances should they fall into financial difficulty.

The gradual erosion of families’ surplus income in the face of rising prices has led to the emergence of a new generation of debt problems – one to which more people are vulnerable, one which is harder to resolve, and one which has no definitive cause or solution.

National Debtline has witnessed this shift in personal debt problems first hand. Our advisers have reported increasingly over recent years that more callers have deficit budgets – where their income doesn’t match their regular expenditure. They’ve also had to help people with a growing number of different debt types – from the emergence of payday loans, to an increase in telephone arrears. In fact nearly all debt types we record at National Debtline have seen record numbers in the last few years. This is reflective of an increasingly insecure labour market and a changing society, one which has a very different attitude to and access to traditional credit products.

With a rise in interest rates imminent, we are also concerned that many more may fall into debt as their day-to-day essential living costs reach a tipping point.

Our attitude to debt is also changing. For many people falling behind on household bills doesn’t constitute a ‘debt’ problem. As such they may be less likely to get help from advice services like National Debtline or Citizens Advice. This is a serious concern. Despite the changing nature of debt problems, advice still works; and the earlier people seek advice, the better outcomes they will have.

This change has introduced a new wave of organisations into the centre of the personal debt world. Companies in the water, telecoms and catalogue industries for example have witnessed an increase in the number of their customers in arrears. It will be important for them to gather a clear understanding of how best to effectively and sustainably help customers to repay their debts.

This year the responsibility for consumer credit regulation transfers to the Financial Conduct Authority (FCA). A vibrant financial services market has the potential to solve some of the problems created by this new debt landscape, and it will be a challenge for the FCA to ensure the industry has room to innovate whilst ensuring consumers are fully protected.

We know there are many individuals and families struggling to manage their finances and we need to help them. There is currently a dichotomy between the impressive recovery of the UK economy and the experiences of some households. However the recovery provides an opportunity to stop the rise of deficit budgets and rebalance household spending patterns.

Joanna Elson, OBE, CDir
Chief Executive, Money Advice Trust
Abstract

Since the onset of the financial crisis in September 2007, the nature of debt and personal finance problems facing UK households has been changing.

A major factor in that change has been that for a long time many price rises have outstripped average income growth. This has meant that a greater proportion of household income is being used to consume a flat level of these goods and services.

This report considers the impact of this trend on household debt problems, drawing on publicly available data as well as information from the debt advice services operated by the Money Advice Trust.

The report looks at the broader economic factors and considers the specific impact on low-to-middle income households.

The report considers seven specific areas for concern: housing costs, council tax, energy bills, water bills, telephone bills, catalogue debts, and the cost of borrowing; highlighting how changes in each area has driven an increase in debt problems and outlines steps creditors, Government and the advice sector can take to alleviate these concerns.

The report concludes that a new model of debt problems has emerged; a deficit budget model that leaves households even more vulnerable to income shocks. Addressing this will require a clear course of action from advice agencies, Government, and creditors.

Proportion of National Debtline clients who are in arrears on household bills

<table>
<thead>
<tr>
<th>2007</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Telephone debt</td>
</tr>
<tr>
<td></td>
<td>3.9%</td>
</tr>
</tbody>
</table>
James and Emma, Hertford

James and Emma live in Hertford. James works locally in a small, supermarket-branded, convenience store whilst Emma commutes to London for her job as an Assistant Researcher. They married in 2009 but have held off having children until their finances are on a more stable footing.

In 2010 James was given a small promotion at work, which came with a 3.5% pay rise, otherwise his salary has remained unaltered since 2008. Emma’s salary has grown less than 1% in the last five years.

In the last couple of years James and Emma have had to consciously cut back spending on various items – eating out only very rarely, rationing use of central heating, staying in Hertford on weekends rather than travelling further afield, and paying for items such as a TV Licence and insurance monthly – rather than taking advantage of cheaper ‘pay-in-one’ deals as they had previously done.

Despite these conscious spending restrictions they eventually found themselves unable to pay all their monthly bills. For a year they attempted the delicate balancing act of paying different bills every month and falling into limited arrears with their rent, council tax, energy, water, and telephone bills.

When their energy arrears grew to three months Emma was encouraged by their supplier to contact National Debtline. An adviser at National Debtline helped Emma to put together a thorough household budget, which showed they were spending about £100 more per month than they had coming in. The adviser helped Emma find a few ways to increase their income (for example by claiming Working Tax Credit), and cut their expenditure (for example by moving on to a water meter), which helped bring their budget in with a surplus which was used to make informal arrangements to pay off their debts in a sustainable way.

James and Emma have been working through their repayments for six months and have to manage spending with a great deal of care. They have to respond to any price rises by consuming less. However they are back in control and hopeful that salary increases might make things easier in the coming years.

Despite these conscious spending restrictions they eventually found themselves unable to pay all their monthly bills.
Inflation, income growth, and household budgets

a) Understanding household spending power

Price changes in energy, water, transport and other sectors are often benchmarked against the Consumer Price Index (CPI) measure of inflation. This enables a comparison to be made between the specific price change and the general trend for increasing prices across a basket of goods – telling us whether or not the specific price change is ‘out of the ordinary’.

What the comparison does not tell us is how the price change affects household finances. For this information we must compare the price change to developments in income levels.

By comparing a price change to average income growth, we can tell whether or not the cost of purchasing a specific good or service will take up more or less of our spending capacity.

If, for example, the price of travelling to work on the train goes up 2.5 per cent we may hear that this is in line with CPI inflation. However if a household has seen only 2 per cent income growth in the last year, travelling to work is now taking up a greater proportion of their total budget – leaving less to spend on other items.

As well as specific price changes, it is useful to compare CPI inflation rates with average income growth. This should provide an indication of households’ spending power compared with previous periods of time.

Average earnings and CPI annual growth rates

Source: Office for National Statistics

Figure 1.1
b) Recent trends in spending power

Figure 1.1 shows that CPI inflation, which has remained stubbornly high, spending almost 4 years above the Bank of England’s 2% target rate, has been running higher than (bonus excluded) income growth for the last five years. This means that the average UK household has seen its spending power fall year on year since 2008. The Institute for Fiscal Studies estimates that real income for the median household in 2013–14 was more than 6% below the pre-crisis peak.

c) Challenges for low income households

However, this masks the different cost-of-living problems facing households at either end of the income spectrum – particularly the great number on low incomes.

In compiling the CPI inflation figures the Office for National Statistics (ONS) must decide on a basket of goods which best reflects the broad spending patterns and priorities of the UK public. Of course there are wide variations in spending patterns and priorities between groups of differing income levels. These are reflected in Figure 1.2.

Figure 1.2 shows that price variations in certain elements of the CPI inflation basket are likely to have a disproportionate impact on lower-income households. We can see that price rises in basics like food, rent and energy are particularly likely to impact low income households. Some of the spending categories will be discussed in depth later in this report, for now it is important to note that these spending categories have seen high levels of price rises in recent years (Figure 1.3), meaning the inflation rate for low income households is likely to be higher than the CPI rate of inflation portrayed in Figure 1.1.

This phenomenon is explained by the Resolution Foundation in its ‘Squeezed Britain’ report:

"Although household incomes for all groups have fallen in real terms since the recession, low to middle income households feel the squeeze particularly acutely because they spend a greater proportion of their income on essentials than higher income households. The cost of essentials such as food, fuel and transport have risen much faster than inflation in the overall economy in the last decade, leaving the group facing an ‘inflation premium’. This ‘inflation premium’ means their annual spending power was £280 lower in 2012 than it would have been had they faced the same inflation rate as higher income households from 2003."
Additionally, the income growth portrayed in Figure 1.1 is representative of all income brackets and is therefore unlikely to accurately portray income developments amongst all income brackets. Figure 1.4 shows that whilst those at the top end of the income spectrum saw the most dramatic negative impact in earning since the immediate aftermath of the economic crisis, full-time employees in the bottom quintile of income distribution witnessed negative income growth much earlier – between 2003 and 2011.

A double premium: poverty and inflation

The problems arising from an inflation premium are compounded for low income households by the ‘poverty premium’ they already face whereby they often

- Pay higher than average utility tariffs for a given amount of consumption, because of the payment method used or what is described as sub-optimal deals
- Paying more per unit because of being a lower user – especially an issue in telecommunication
- Paying more because of limited choices of how to buy things, for example not being able to use direct debit or buy online
- Paying high interest on consumer credit

Taken cumulatively, paying higher prices for utilities and credit can raise the costs of a minimum household budget by 10%, a situation exacerbated by not having access to enabling products like full banking facilities or the internet.

Source: Joseph Rowntree Foundation, 2013
Changing household budgets

**d) Moving to a new model of debt problems**

The gap between income relevant inflation and earnings growth for low income households has been significant for a number of years. As a result many households have been driven into arrears on basic household bills, and the traditional model for debt problems in the UK has moved from being ‘change of circumstance’ focussed, to ‘deficit budget’ focussed model.

National Debtline is a telephone and online based service providing free, impartial advice to people living in England, Scotland, and Wales. It was first established in 1986 and since 2003 has been run by the Money Advice Trust (the Trust). Since its launch more than 25 years ago National Debtline has helped millions of people to tackle debt problems. Since the late 1990s these debt problems had centred on financial products – most notably bank loans and overdrafts and credit cards and there was a long-term trend for increasing numbers of people contacting National Debtline reporting debts owed on these products.

This reached a peak in 2007 when 69% of all callers reported a debt owed on a bank loan/overdraft and 67% reported a debt owed on a credit card. These figures underline a traditional model of debt difficulty that National Debtline advisers saw repeatedly between 2003 and 2007. This model featured a person/household managing stretched credit commitments until a major income or expenditure shock (such as relationship breakdown, illness, or unemployment) meant that they could no longer maintain repayments on their credit products.

The extent to which unemployment has driven debt problems in the UK was well documented by Dr John Gathergood in his report ‘Demand, capacity and the need for debt advice in the UK’:

> A one percentage point increase in the International Labour Organisation measure of the unemployment rate is associated with an additional 60,000 debt advice enquiries per quarter.

In 2007, the same year that the proportion of National Debtline callers with debts owed on credit cards and bank loans/overdrafts peaked, the full extent of the financial crisis began to make itself known – with famous images of Northern Rock customers queuing to take their money out of the bank.

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**Average annual growth across the earnings distribution among full-time employees**

![Chart](https://via.placeholder.com/150)

**Figure 1.4**

Source: Resolution Foundation, Squeezed Britain report
The following two years would be characterised by a number of established financial institutions reporting severe financial problems, with Governments throughout the developed world deciding to inject significant funds into the banking sector. This in turn led to a restriction in the credit products supplied by mainstream lenders. It may therefore not be surprising that the proportion of callers to National Debtline reporting debts owed to these products began to slowly decline. In 2013 the proportion of callers reporting debts owed on a bank loan/overdraft was just 52.2% and the proportion of callers reporting debts owed on a credit card was 49.1%.

By contrast the number of callers reporting debts owed on other items such as water rates, gas/electricity, rent, council tax, telephone bills, and catalogue purchases, has increased significantly both in real and proportionate terms. This shift in debt types reported to National Debtline is demonstrated in Figure 1.5, which reflects a new model of debt problem characterised by a person/household suffering no major change in circumstances, but struggling to make their income stretch to meet their essential expenditure.
Changing household budgets

Proportion of households in each income quintile without home contents insurance

<table>
<thead>
<tr>
<th>Quintile</th>
<th>1999/00</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poorest fifth</td>
<td>50%</td>
<td>60%</td>
</tr>
<tr>
<td>2nd</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>3rd</td>
<td>20%</td>
<td>30%</td>
</tr>
<tr>
<td>4th</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Richest fifth</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: The Family Expenditure Survey (1999/00) and Living Costs and Food Survey (2009), ONS

Figure 1.6

Inflation, income growth, and household budgets

e) The deficit-budget model of debt problem

In the “deficit budget” focussed model of a debt problem a person/household finds that the increased cost of essential-living items outstrips their income and they begin to fall into arrears on some household bills such as energy, water or telephone bills. Whilst different households respond differently to this situation, it has been well documented that many households cut expenditure significantly in an attempt to maintain a functioning budget. In 2011, the Trust undertook research with the University of Bristol to see how household financial management had been impacted by the economic crisis.

This research found many households had made drastic moves to cut expenditure:

“Cutting back on essentials included cutting back on food by “sticking to the basics” or buying raw ingredients instead of pre-prepared meals ... one participant described taking discarded raw food home from his office canteen to supplement meals at home. Many people – from a range of household types – described cutting back on petrol or diesel consumption by leaving the car at home more and more often, opting to cycle, use public transport, or simply not going out to “make a tank of petrol last”. This led some households to question the value of keeping a car (in addition to those that had already sold their cars).”
Other essential spending is also often being cut to ease short-term budgetary constraints leaving households at risk of further financial costs in the medium term, and even more vulnerable to income shocks. More than half of the poorest fifth of UK households do not have home contents insurance (see figure 1.6), and the number is growing. This leaves these households open to significant financial risk. Additionally, calls into National Debtline from people owing money for the TV Licence has increased in recent years (figure 1.7), yet another indicator that household finances are being squeezed and many are taking significant personal and financial risks in order to make expenditure cuts.

Of people using National Debtline’s online budgeting and debt advice tool My Money Steps in 2013, 43 per cent have outgoings that exceed their income. This is up from 37 per cent in 2011. The proliferation of deficit budgets has come despite households cutting back significantly.

The following chapters of this report discuss individual debt types in detail. The various factors underlying increased debt problems across the sectors that will be discussed all have their route in the changing nature of household finances in the UK.

The extent to which low to middle income households have seen their surplus income eroded away over years of price increases outstripping the growth in their income has led to a complete reshaping of the UK debt landscape.

Companies in the mobile telephone industry, catalogue industry, and the energy sector all find themselves facing the prospect of collecting debts from struggling households. How these companies respond to this challenge will have a big impact on the legacy this change in the debt landscape leaves behind.
1. The cost of housing

Perhaps the most fundamental element of any household expenditure budget is the money spent on housing, whether through a mortgage or rent agreement.

The cost of housing over recent years has split somewhat between people renting and people paying a mortgage. Many of those on the property ladder will have benefited from historically low interest rates (as well as the increased proliferation of interest only mortgage agreements). Those renting have faced a very different climate, with a limited stock of rented properties and growing demand (see figure 2.1), the cost of renting has increased consistently since 2007.

More and more people are struggling to maintain rent repayments.

a) Maintaining rent repayments

In the last 12 months the cost of renting privately has reportedly increased at around 2.1 per cent – which has been below the level of CPI inflation, but crucially above the level of average income growth reported by the ONS.

More and more people are struggling to maintain rent repayments. A recent Shelter survey reported that 63% of tenants are struggling to keep up with rent payments, with the problem being most severe for tenants with young families. In 2013 rent arrears were the fastest growing debt problem reported to National Debtline advisers (see figure 2.2).
That rent arrears problems are growing so sharply will be partially attributable to the increasing proportion of the population in the rental market. Another factor in the growth in problems with rent arrears is likely to be the cuts made to welfare payments. Where the newly introduced total cap on benefits is exceeded, Housing Benefit is the payment which is cut, and some families will be facing increases in rent payments as a result of the Spare Room Subsidy cut. However even accounting for these factors, it is clear that the increase in rent arrears problems is partially down to the impact of rent taking a greater proportion of income.

As rent costs continue to outstrip earnings growth, the cost of paying the rent takes up a greater proportion of the household budget. Just like energy bills, water bills, telephone bills, catalogue bills and council tax – paying the rent is getting harder and more people are finding themselves unable to avoid arrears. There is evidence that people in rented accommodation are increasingly likely to be facing broader debt problems. In 2013 57 per cent of National Debtline callers were living in rented accommodation, compared to 43.6 per cent in 2010.

b) Mortgage repayments

For those with a mortgage the situation since 2009 has been a little more comfortable. With arrears falling consistently over the last four years, there is a clear sign that low interest rates have helped households maintain repayments (see figure 2.3).

In 2013 less than one in four callers to National Debtline had a mortgage, compared with 40 per cent in 2010. However, the increased cost-of-living has meant many of these families have been unable to take advantage of the low-interest-rate environment by saving or paying back more debt. This means many households are extremely vulnerable to even a small movement in interest rates. Without a significant change in the status of household finances, mortgage holders will not be able to swallow a rise in mortgage repayments without falling into arrears on one or more of their household bills.

With the broader economy improving significantly the prospect of a rise in the Bank of England Base Rate is becoming a real consideration. The potential for a significant growth in debt problems for mortgage holders will factor into the Bank of England’s decision making, however advice agencies, Government and creditors should all be preparing for a sharp increase in mortgage arrears.
Helping household budgets

...with rent arrears

- Local authorities and local advice agencies should ensure that local Discretionary Housing Payment funds are fully utilised.
- DWP should continue to review, and work with charities and other organisations, to understand the effects of welfare reform on tenants in receipt of housing benefit, as it may not be sustainable to maintain a household budget where housing benefit has been reduced.
- Private landlords should be supported to provide greater security of tenure and ensure that the tenants have access to and awareness of debt advice and other resources.
- Social landlords should adopt a proactive and preventative approach in the way they identify and support households that are falling into arrears. They should ensure that the tenants have access to and awareness of debt advice and other resources to prevent early repossession action.

...with mortgage payments

- In anticipation of a rise in interest rates over the next 12 months, advice agencies should be ready to meet increased demand levels, creditors may be required to extend forbearance measures in order to avoid large-scale repossessions, and the Government should consider what policy responses, such as a successor to the mortgage rescue scheme or extension of assisted voluntary sales, might be required to alleviate such a scenario.
- DWP should ensure that the safety net for mortgage interest help is preserved and extended. Under universal credit, claimants lose mortgage interest help if take up any paid work at all, which may ultimately disincentivise work.
- In anticipation of a rise in interest rates, FCA should consider the appropriate position to take regarding forbearance, should a large number of households find themselves in difficulty.

In 2013 less than one in four callers to National Debtline had a mortgage, compared with 40 per cent in 2010.
2. Council tax

One item that forms an essential part of the cost-of-living which has not seen sharp price increases above the levels of average income growth or dramatic industry changes until 2013 is council tax (see figure 3.1).

This is an annualised tax charged through local authorities with the level dependent upon the value ‘band’ of an occupier’s property. People living in more valuable properties pay more; people in less valuable properties pay less. Council tax rates vary significantly across local authorities, but have broadly not been subject to sharp increases in the last few years.

a) The move to council tax support

In April 2013, Council Tax Benefit was abolished and replaced with a smaller fund which was devolved to local authorities to provide Council Tax Support with the proviso that householders over the age of 65 would see no cut in support. This means many households faced paying council tax for the first time, or faced a sharp rise in bills. Although there have already been reports of increases in council tax arrears, the impact of these changes is unlikely to have been fully realised yet with some larger councils taking action in order to smooth the transition from one benefits system to another.

b) Council tax arrears

However, problem debt related to council tax arrears has been rising consistently, despite the lack of sharp increases in council tax bills since 2009 (see figure 3.2). This can be attributed to some degree to the manner in which local authorities collect council tax arrears – in 2012/2013 local authorities referred debts to bailiffs for collection on 1.8 million occasions – primarily for council tax and parking penalties – this incurs fees and charges which are added to the debt.

Figure 3.1

Source: DCLG Statistical release, August 2013

Average Band D council percentage change

![Average Band D council percentage change](image)
Another issue with council tax repayments is that local authorities often require full repayment of the arrears within the 12 month billing period. This is often unrealistic for households where large arrears have been built up and differs markedly from other creditors who are more likely to accept sustainable repayment arrangements over longer periods of time.

Broader economic factors cannot be ignored as a further cause of the growth in council tax debt problems. Council tax bills have faced greater competition from other expenditure categories within household income. As more and more of a single budget is taken up by the cost of food, transport, energy, water, and other bills, less remains for the payment of council tax. Whilst the punishment for non-payment of council tax can be sufficiently severe to warrant this bill being a top priority for payment, many households do not prioritise council tax bills ahead of other items and so arrears can quickly build up.

One in four National Debtline callers now has arrears on their council tax.

Helping household budgets: ...

- Local authorities should be encouraged to use early intervention in debt collection for council tax and adopt existing tools, guidelines and initiatives such as the Common Financial Statement, MALG Debt and Mental Health Guide and Breathing Space, and required to show they have fully explored alternatives to enforcement action. They should be required to accept sustainable repayment arrangements over longer periods of time.

- Local authorities should be required to publish summary details of use of bailiff, fees and the processes they use to ensure enforcement action is fair.

- DCLG should look again at the costs of enforcement. A small council tax debt can now have £310 in bailiff fees added within a very short period of time, making it even harder for people to pay.

- DCLG should review the extent to which the localisation of council tax benefit has led to low-income households having to make payments on their council tax bills where they would previously have received full council tax benefit.
3. Energy bills

No industry has been so closely tied to the cost-of-living debate as the energy industry. Successive price rises have seen the cost of gas and electricity take up a greater proportion of household budgets. As essential products for safe and healthy modern living, it is not easy for households to drastically cut their consumption of energy products.

However there is evidence that households began a process of cutting energy consumption as far back as 2005. Figure 4.1 shows that energy consumption in the UK has decreased to levels not seen since the early 1980s. Figure 4.2 shows that trends in consumption are inversely correlated with the changing cost of energy.

Energy consumption in the UK has decreased to levels not seen since the early **1980s**.

In 2005, National Debtline advisers answered a total of 2,512 calls from people with arrears owed to their energy company. That figure has increased consistently year-on-year and in 2013 National Debtline advisers answered 31,115 calls from people with arrears owed to their energy company (see figure 4.3). Figures 4.2 and 4.3 demonstrate that calls for help with debt problems are broadly positively correlated with energy price changes.
In 2013 National Debtline advisers answered 31,115 calls from people with arrears owed to their energy company.
The big six energy suppliers in the UK have increased energy prices by an average of 36 per cent since 2010, whereas average earnings have only risen 4.4 per cent during the same period. Whatever the reason behind price increases in the energy sector (UK households tend to spend less per unit of energy than the EU average), there can be little doubt that the increased price of heating the home or turning on the kettle has led to an increase in debt problems despite a correspondent decrease in energy consumption.

Research from Citizens Advice in 2013 reported that 40 per cent of low income households do not believe they can afford to heat their home to a comfortable level through the winter. Many households will be faced with a stark choice between reducing energy consumption to unsustainable levels, building up energy bills that they can’t afford to pay and thereby voluntarily incurring problem debt, or cutting back expenditure in other areas (often referred to as the ‘heat or eat’ decision).

Helping household budgets:
...with energy bills
- The energy sector should continue to adopt existing tools, guidelines and initiatives such as the Common Financial Statement, MALG Debt and Mental Health Guidance and Breathing Space and continue to work closely with the free debt advice sector.
- The energy sector should continue to reduce the costs of pre-payment meters, ensure low income households switch to the cheapest tariff and look again at charging for paper bills.
- Suppliers should communicate clearly with customers, provide appropriate information about payment options, set affordable repayment arrangements and make use of Fuel Direct when appropriate.

Attempts to reduce the cost of energy must be viewed in relation to income growth, and specifically average income growth amongst low-income households. A deceleration in energy price inflation that means bills still go up at a higher rate than incomes, will not make for an improved outlook for households. It is important for energy bills to start to take up a decreasing proportion of total household income. This means energy price inflation that sits below average earnings growth for low-income households.

Of course energy bills and energy debts do not exist in isolation, but instead sit amongst other household expenditure competing for a slice of the same limited budget as food, water, clothing, transport and much more.

It is perhaps our limited flexibility to manage energy consumption, and therefore spending, that has brought it to the fore in this debate.

Attempts to **reduce** the cost of **energy** must be viewed in relation to **income** growth.
4. Water bills

Similar to energy consumption, our ability to manage the cost of the water we consume is limited. Households can’t choose lower quality water, they can’t stop using water altogether, and without moving home they can’t change supplier.

Also in a similar way to energy, the cost of water has risen significantly in recent years. Figure 5.1 shows that between 2000 and 2011 the price of water rose significantly compared to general CPI inflation. Further price rises since 2011 have exacerbated this trend and so, again like energy, households find that the cost of paying for their water consumption takes up an increased proportion of their household income.

The number of calls answered by National Debtline advisers from people seeking help with their water debts has grown significantly in recent years. In 2013, around four times as many people called the service for help with this debt type as was the case in 2007. This growth in water debt problems is shown in figure 5.2. The rise in water debt problems corresponds closely with the rise in water prices as shown in figure 5.1. As of 1999, water companies have been unable to restrict access to water supply for domestic properties in cases where a debt is owed. This means that water arrears repayments have become a non-priority debt alongside credit cards, bank loans, and other unsecured credit products. The difficulties water companies now face in collecting debts owed has impacted on profit levels, with Thames water reporting last year that its 35 per cent fall in pre-tax profits was partially down to unpaid bills. It will be important for water companies to reduce debt write-offs and agree sustainable repayment plans with struggling customers.

Figure 5.1
Movement in water compared to CPI and other costs

Source: PSE, the University of York
In December 2013, a number of water companies pledged to hold back water price increases below the level of inflation over the next few years (although these companies still reserve the right to apply to the regulator Ofwat for further inflation-linked price rises on an annual basis).

This represents a positive move away from the recent trend for price rises at levels above broader inflation. However, whilst price rises remain higher than the level of average income growth amongst low-income households, the cost of water will continue to eat further and further into those household incomes.

To see an improvement in the number of water-related debt problems as reported in figure 5.2, prices would have to fall relative to average income growth amongst low-income households. There are other positive signs from the water industry; the last 12 months have seen a growing focus on affordability. A number of suppliers have adopted schemes that encourage consumers in debt to engage with them, and make affordable repayments. Incentives include caps on bills and partial write-off of debt and reduced bills through social tariff schemes. These schemes have been proved to pay for themselves through the recovery of previously unpaid bills. These kinds of measures can help alleviate the very worst end of household difficulties.

**Helping household budgets:**

...with water bills

- Water companies should be encouraged to continue efforts to help people with arrears to manage their debts and afford water bills, adopting tools, guidelines and initiatives such the Common Financial Statement, MALG Debt and Mental Health Guidance and Breathing Space.
- Water companies should work together, with WaterUK and Ofwat to try common approaches, a consistent level of support and a good fit with advice services.
- The eligibility criteria for Watersure should be widened, or consideration to be given to ways in which the scheme can be supplemented with a support mechanism to help other low-income groups.

![Figure 5.2](source: National Debtline)

**Proportion (%) of calls answered by National Debtline from people with water rate arrears 2003 – 2013**

Source: National Debtline
5. Telephone bills

November 2013 marked six years since the iPhone first launched in Europe, bringing the concept of smartphones to the UK.

As of 2013, 72 per cent of UK adults owned a smartphone. Smartphones are becoming an essential part of modern life for people across different income brackets. For those on low incomes a smartphone is often the only source of regular and accessible internet connectivity. The need for digital inclusion has been well-documented (the Government has coined the phrase ‘digital by default’) and will become even more important with the roll-out of Universal Credit, for which one may only apply online. Additionally where landline telephones have been disconnected, the upkeep of a mobile telephone can be essential for emergency contact.

The nature of smartphone contracts is such that in many ways they resemble a loan for a small computer. The spread of smartphones across UK households has led to more and more expensive phone contract deals being sold, whereby the borrower receives a free or cut-price handset up-front and pays a monthly fee to cover the cost of calls, data, and text messages as well as the cost of the handset itself. Over the same period National Debtline has seen a sharp rise in calls for help from people with telephone debts (figure 6.1), including a 15 per cent rise in the last 12 months.

This trend may be accelerating, but it is not new. Calls for help with telephone debts have been going up since 2007, the same year the iPhone was launched. National Debtline took 5,830 calls from people with telephone debts that year – representing 3.9 per cent of all calls, but in 2013 that figure had ballooned to 19,247 – representing 10.9 per cent of all calls.

Telephone debts can grow quickly. Of the charity’s My Money Steps users in arrears to their telephone company, over 15 per cent owe more than £1,000 on their phone bills.

![Figure 6.1](source: National Debtline)

Proportion (%) of calls answered by National Debtline from people with telephone bill arrears 2003 - 2013

Source: National Debtline
Figure 6.2 shows that families in poverty tend to spend a greater proportion of their income on communications technologies than the UK average.

Thinking about other income brackets, it is easy to see how a family of four (with two teenage children) might be paying around £120 per month in mobile telephone contract bills – this is more than the average energy bill for a household of four in the UK. Smartphone contracts now represent a significant expense for many households, and one that didn’t exist seven years ago.

Additionally, the length of these contracts has been growing (such contracts now tend to operate over a minimum two year period), making the overall cost far more expensive, and also making it harder for a borrower to maintain repayments. These contracts cannot simply be cancelled and there have been numerous cases of monthly bills being raised mid-contract. There is very little consumer choice around contract length, and where shorter contracts are available they are more expensive (as the cost of the handset has to be absorbed into fewer monthly payments).

The cost of running a mobile phone should be considered as part of the fabric of the cost of living. Telephone debts have now become a major part of the UK’s debt landscape. The increase in calls to National Debtline for help with telephone debts reflects a society that is becoming more reliant on digital services. In the same ways that households are vulnerable to changes in the energy and water industries, they are also vulnerable to changes in the telecoms industry.

Helping household budgets: ...with telephone bills

- The telecommunications industry should work with the free debt advice sector and consider approaches such as early intervention, forbearance, breathing space, accepting Common Financial Statement compliant offers and avoiding disconnection.
- Telecommunications companies should build more flexibility into the contract length on mobile phone contracts.
6. Catalogue debts

News reports about changing shopping habits amongst UK consumers most often focus on how much more retail business is conducted online rather than in store (see figure 7.1).

What is less often remarked upon is the changing way UK consumers pay for their shopping, especially clothing or big-ticket items.

The practice of retail sales agreements where the products are purchased in instalments is certainly not new, mail order catalogues have existed for many years, but it is growing significantly. In recent financial updates companies which specialise in this kind of retail business model such as N Brown, Shop Direct, and the Home Retail Group have reported significant sales growth.

Understandably, these organisations attribute sales growth to their own work rather than market conditions, and to some extent they will be justified in this. However there is also a clear connection between the state of UK household finances and an increased appetite for paying for products in instalments.

With household budgets extremely stretched, many don’t have the necessary surplus to fund irregular/semi-regular purchases such as white goods or clothing. Instead households must spread the cost of these purchases, even if it means an increase in total expenditure.
As a result of an increase in these types of agreements, more people will, of course, fall into arrears if their finances worsen to a point that the monthly repayments are no longer affordable. National Debtline has seen a sharp rise in calls for help with catalogue debts over the last ten years (see figure 7.2). Retail/catalogue debts are the fifth most common problem presented to National Debtline advisers, rating higher than debt types such as mortgage arrears, rent arrears, payday loans, and water debts.

The change in our retailing habits is both a cause and effect of the cost-of-living crisis. It is a cause because it is another way in which households become reliant on unsecured credit and thus become more vulnerable to fluctuations in their income. It is an effect because many households have no other choice; if a fridge needs replacing or a child needs a school uniform, often these purchases cannot be afforded without resorting to credit of one kind or another.

Helping household budgets:
...with catalogue debt

- Encourage cooperation between catalogue industry and free debt advice, sector, including the adoption of tools, guidelines and approaches such as forbearance, accepting Common Financial Statement compliant offers, and Breathing Space.
- Catalogue companies should encourage responsible lending, ensure consumers understand that they are entering into a consumer credit agreement and know what the interest rates and penalties are for non-payment.

Retail/catalogue debts are the **fifth most common problem** presented to National Debtline advisers.
Changing household budgets

7. The cost of borrowing

Different households respond in different ways to a squeezed budget. Some seek to cut back spending to balance their income and expenditure; others see bills run into arrears; and some borrow to cover the gaps in the finances.

Most households will react in more than one of these ways – for example one might use credit initially to cover budget gaps in the belief it is a short-term problem, following that they may cut back spending significantly, and when they can cut no further bills will run into arrears.

The decline in supply of credit can be largely linked to new capital requirements placed on organisations selling credit products. Borrowing to cover a structural household budget deficit is nearly always counter-productive to getting the household back into financial health. When budgets are squeezed they have little flexibility and it can be easy to fall behind with credit commitments.

The period of time following the financial crises that took place between 2007 and 2009 saw a fall in total outstanding consumer credit which lasted until the end of 2013 (figure 8.1). Whilst we cannot know to what extent this fall is attributable to the two causes of declining supply and declining demand, we can surmise that there was some decline in both.

The decline in supply of credit can be largely linked to new capital requirements placed on organisations selling credit products. The cause of decline in demand is trickier to pin down.

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**Figure 8.1**

Percentage changes year on year in total outstanding consumer credit

*Source: Bank of England, Trends in Lending October 2013 report*
Figure 8.1 shows how total (net) consumer credit lending fell during the financial crisis. ‘Other unsecured loans’ declined up to 2010, recovering to growth around the end of 2012. For credit cards, limited growth was observed throughout the period, which might suggest that credit card balances have been rising during the same period. However, credit card balances actually peaked in 2006 and, following that, fell steadily to the end of 2011 and have subsequently remained more or less flat. The flexibility of credit cards means that they may, in some cases, have been used by households with squeezed budgets to cover the gaps in their finances. ‘Other unsecured loans’ have been traditionally dominated by personal bank loans. It is perhaps understandable that households would be less inclined to take on these credit products which represent a longer term financial commitment and a more geared for funding one-off expenses, which many households would have delayed making.

One contributing factor to the re-established growth in unsecured credit is the emergence of a short-term high-cost credit market – better known as the payday loans industry. The appetite for short-term credit agreements, rather than longer-term commitments, chimes closely with budgets being less flexible and households being reluctant to make long-term financial commitments.

The growth of this industry is reflected in the number of calls National Debtline has received on payday loans over the last few years. Figure 8.2 shows that payday loans have moved from being a peripheral player in the consumer credit market to a major part of the debt landscape. It should be noted however that the market has reduced in size and there have been a drop in payday lending over the past few months due to a number of companies leaving the market and a tightening of FCA regulation.

A downside of the overall growth in short-term, flexible lending is that it is more expensive (largely because a relatively similar overhead expenditure must be accounted for in a shorter repayment period and because of the high default rate on such loans). The inflated cost of borrowing allied to budget inflexibility means households can more easily fall into a debt spiral in cases where further credit or loan rollovers are used to meet existing credit commitments.

Source: National Debtline

Proportion (%) of calls answered by National Debtline from people with payday loans 2003 – 2013
In some cases this increased cost of credit has exacerbated debt problems caused by the cost-of-living. There has been significant debate about how to prevent this consumer detriment and a cap on the total cost of credit is likely to be introduced by the Financial Conduct Authority in 2015.

Whilst a cap on the cost of credit could prevent some consumer detriment, it is important to recognise that the need for short-term credit products (be they loans or credit cards) remains whilst budgets are squeezed so tightly. Additionally, it will be important for households to be encouraged to not use credit products to cover deficit household budgets, but instead to seek free, impartial advice on how to get back into financial health.

The prospect of an increase in interest rates should not just worry mortgage holders. The quoted average rate of a £10,000 personal loan correlates closely with demand for debt advice (figure 8.3). Should these interest rates increase (most likely following a rise in the Bank of England Base Rate) it will be interesting to see if debt problems remain correlated to this measure, or if the growth of short-term, high-cost credit means that demand for debt help and the average rate of a £10,000 personal loan are now decoupled.

Figure 8.3

Source: Demand and Capacity 2014, Dr John Gathergood, The University of Nottingham

Helping household budgets:

...cost of borrowing

- HMT and DWP should commit to the expansion of credit unions and other forms of lower cost and lower interest social enterprise lending programmes to reduce reliance on high-cost credit.
- DWP and regulators should continue to explore what more can be done to encourage responsible lending. The implementation of the FCA cap on the total cost of credit is a welcome regulatory move.
- FCA should require short-term, high-cost lenders to refer rejected applicants to free debt advice, and ban lead generation at this point.
- HMT, banks and partner should continue to explore basic bank accounts provision by the development of alternative payment methods such as ‘jam-jar’ accounts, to assist low-income consumers with budgeting and provide access cheaper direct debits.
Ayesha opened her hair-dressing business on the outer-edge of Leeds city centre in 2006. She had financed the opening partly with money inherited from her father and partly through a business loan from a high street bank. It took 18 months for Ayesha to make enough money such that she could draw a limited salary out of the business.

Whilst the first two years of the business was centred on gaining new customers, the number of people coming through the door reached a bit of a saturation point in late 2008 – despite various promotional efforts, she struggled to get more than a handful of extra customers.

Having struggled but managed from 2009 to 2011, the rises in the cost of water and energy left her falling behind with repayments. Ayesha increased her prices to reflect her increase costs but found that some customers stopped coming altogether and many of the others came less frequently.

By mid-2013 Ayesha was building up significant arrears with her energy, water, telephone, bank loan, and business rates. A friend told her about National Debtline.

When Ayesha called National Debtline she was offered a specialist service for small business owners – Business Debtline. The business budget showed that Ayesha’s business could generate enough profit to pay her a workable salary if she could cut some expenditure lines, but she would only have a limited amount to pay towards her arrears.

Ayesha used sample letter templates to contact her creditors and suggest a plan of action for repaying the debts which would enable her to keep trading.

A Business Debtline adviser helped Ayesha put together a more sustainable budget, which separated her personal and business finances.
The trend for price rises in essential expenditure areas has distanced some households from the impressive recovery of the UK economy in recent years. These households have instead witnessed a steady but undeniable decline in their spending power and a greater strain on their household finances. The recent return to steady growth presents

Many households, especially those in rented accommodation, have not seen much upside from measures to help boost economic growth, and have not benefitted significantly from that growth either.

Households have been faced with a range of price increases across essential spending items that have outstripped increases in their income. Some households have cut back spending significantly in different areas, some have changed their spending habits, and some have fallen into arrears on basic household bills. Many have witnessed all three of these changes to some extent.

The economic crisis of 2007 – 2011 has precipitated the most dramatic change of the last 20 years in the UK’s debt landscape. Not only does it broaden the range of problem debt types, but it also makes households more vulnerable to problem debt.

Problem debt need no longer have a specific ‘cause’ such as unemployment, illness, or relationship breakdown. Instead problem debt can be the result of nothing more that the slow erosion of a household budget in the face of ever-increasing bills. This model of problem debt means that relatively small levels of total debt can trigger severe financial difficulties due to a lack of budget flexibility. National Debtline has seen an increase in the number of people with debt problems despite owing less than £5,000.

In 2007, around 20 per cent of National Debtline callers reported debts totalling less than £5,000, by the end of 2013 more than 40 per cent of callers had less than £5,000 outstanding debts.

For those households at the front line of these economic struggles, it can be difficult to see a way out. There are specific things households can do to budget more effectively or increase their income, but for many these measures will only have a limited impact. It is important for households to keep an honest and open dialogue with creditors when they are struggling and not turn to credit products to provide for essentials on a regular basis.

Where households are running a deficit budget, options can be even more limiting. The growth in deficit budgets alongside an impressive economic recovery poses a major challenge to all stakeholders in the UK consumer credit market. However with an upturn in the economy, there is a real opportunity for Government, regulators, creditors and advice agencies to work together to support the recovery, placing household finances on a firmer footing so that all levels of society benefit.
Our recommendations

With an upturn in the economy, there is a real opportunity for Government, regulators, creditors and advice agencies to work together to support the recovery and place household finances on a firmer footing so that all levels of society benefit. We have set out a number of recommendations on specific areas of household expenditure in this report. We look forward to exploring these further with our partners – the advice sector, Government, regulators and creditors – over coming months.

a) The role of Government and regulators

The changing debt landscape is made up of two core elements: income, and the price of essential goods and services. The cause is relatively simple: one side of the scale – the cost of essential goods and services – has outweighed the other over a protracted period of time. The problems this causes are unlikely to be solved simply through changes to one side of the equation – rather it will require a marked increase in average incomes and a reverse in the trend for price rises for essential goods and services.

There is an understanding across the political spectrum that neither of these elements can be easily achieved. However the economic growth and reduction in unemployment represent clear opportunities to help struggling households feel the benefit of economic recovery, and it is positive to see the Government and all major parties commit to a rise in the minimum wage. Moves like these, and wider initiatives such as the Living Wage, a review of zero-hour contracts and promotion of savings initiatives for low income households could help rebalance the economy and stop the rise of deficit household budgets.

The current wave of welfare reforms, and in particular the roll-out of Universal Credit, marks a significant shift in welfare provision and presents some real potential. The growing recognition of the impact of debt on claimants, and risk of falling further into debt is welcome; we look forward to working with Government to explore initiatives to support this group. We would also encourage a review financial assistance and grants provided by local welfare assistance schemes to ensure sufficient access to affordable interest-free loans.

Government also has a critical role to play in ensuring the continued provision of free debt advice services. It has been estimated by the Money Advice Service that approximately 8.8m people, or 18% of the UK adult population are over-indebted; the fact that many don’t access advice is well-documented. It is important that Government recognise the scale of need and continue to support the free debt advice sector.

b) The role of creditors

Creditors will need to understand the nature of deficit budgets and seek urgently to assist those households whose income does not match essential expenditure – this will require improving the already close ties between creditors and advice agencies. Creditors can also play a key role in preventing individual debt problems from becoming intractable by engaging in major early-intervention projects, adopting the Common Financial Statement and breathing space and showing forbearance. The roll-out of Welfare Reform is likely to pose a further challenge and creditors will need to ensure collections staff understand how it affect their customers.

Creditors have three-fold stake in getting engagement with customers in debt right:

1. as part of a commitment to responsible business practices
2. to maintain and improve long-term customer relationships
3. to reduce write-offs for bad debt
Helping people tackle problem debt is a situation where helping the individual also helps the bottom line, this should help motivate creditors in sectors new to debt advice to act quickly in engaging with some of the ideas and recommendations laid out in this report.

c) The role of advice agencies

This is also a major challenge for advice agencies. The Money Advice Trust has developed a chart to assist agencies in helping those with deficit budgets find new ways to increase their income and cut their outgoings. Advice agencies can also work to streamline existing tools and guidance; current moves to introduce a single income and expenditure statement are a step in the right direction. Proposals to include a default savings element within this should also help to encourage and embed a savings ethos among those vulnerable to debt building a degree of resilience into stretched household budgets.

Advisers need to develop an understanding of new industries, such as water and telecoms in order to best help clients. In many cases this means understanding new sets of regulations and gaining an insight into how these different industries deal with indebted customers.

Advice agencies also have to respond to the way in which clients might perceive their own financial difficulties. For many, falling behind on household bills isn’t necessarily a ‘debt problem’ – but instead is a more fundamental issue of not bringing in enough income. These clients may not be aware of how debt advice could profoundly improve their situation. It is up to organisations providing free and impartial advice to ensure this audience accesses the services that could make a positive difference in their lives.

d) Helping household budgets

…with rent arrears

- Local authorities and local advice agencies should ensure that local Discretionary Housing Payment funds are fully utilised.
- DWP should continue to work with charities and others, to understand the effects of welfare reform on tenants in receipt of housing benefit, as it may not be sustainable to maintain a household budget where housing benefit has been reduced.

- Private landlords should be supported to provide greater security of tenure and ensure that the tenants have access to and awareness of debt advice and other resources.
- Social landlords should adopt a proactive and preventative approach in the way they identify and support households that are falling into arrears. They should ensure that the tenants have access to and awareness of debt advice and other resources to prevent early repossession action.

…with mortgage payments

- In anticipation of a rise in interest rates over the next 12 months, advice agencies should be ready to meet increased demand levels, creditors may be required to extend forbearance measures in order to avoid large-scale repossessions, and the Government should consider what policy responses, such as a successor to the mortgage rescue scheme or extension of assisted voluntary sale, might be required to alleviate such a scenario.
- DWP should ensure that the safety net for mortgage interest help is preserved and extended. Under UC, claimants lose mortgage interest help if take up any paid work at all, which may ultimately disincentivise work.
- In anticipation of a rise in interest rates, FCA should consider the appropriate position to take regarding forbearance, should a large number of households find themselves in difficulty.

…with council tax

- Local authorities should be encourage to use early intervention in debt collection for council tax and adopt existing tools, guidelines and initiatives such the Common Financial Statement, MALG Debt and Mental Health Guide and Breathing Space, and required to show that they have fully explored alternatives to enforcement action.
- Local authorities should be required to show that they have based repayment arrangements on ability to pay over longer periods of time.
- Local authorities should be required to publish summary details of use of bailiff, fees and the processes to ensure enforcement action is fair.

Our recommendations
• DCLG should look again at the costs of enforcement. A small council tax debt can now have £310 in bailiff fees added within a very short period of time, making it even harder for people to pay.

• DCLG should review the extent to which the localisation of council tax benefit has led to low-income households having to make payments on their council tax bills where they would previously have received full council tax benefit.

...with energy bills

• The energy sector should continue to adopt existing tools, guidelines and initiatives such as the Common Financial Statement, MALG Debt and Mental Health Guidance and Breathing Space and continue to work closely with the free debt advice sector.

• The energy sector should continue to reduce the costs of pre-payment meters, ensure low income households switch to the cheapest tariff and look again at charging for paper bills.

• Suppliers should communicate clearly with customers, provide appropriate information about payment options, set affordable repayment arrangements and make use of Fuel Direct when appropriate.

...with water bills

• Water companies should be encouraged to continue efforts to help people with arrears to manage their debts and afford with water bills, adopting tools, guidelines and initiatives such the Common Financial Statement, MALG Debt and Mental Health Guidance and Breathing Space.

• Water companies should work together, with WaterUK and Ofwat to try common approaches, a consistent level of support and a good fit with advice services.

• The eligibility criteria for Watersure should be widened, or consideration to be given to ways in which the scheme can be supplemented with a support mechanism to help other low-income groups.

...with telephone bills

• The telecommunications industry should work with the free debt advice sector and consider approaches such as early intervention, forbearance, breathing space, accepting Common Financial Statement complaint offers and avoiding disconnection.

• Telecommunications companies should build more flexibility into the contract length on mobile phone contracts.

...with catalogue debt

• Encourage cooperation between catalogue industry and free debt advice, sector, including the adoption of tools guidelines and approaches such as forbearance, accepting Common Financial Statement compliant offers, and Breathing Space.

• Catalogue companies should encourage responsible lending, ensure consumers understand that they are entering into a consumer credit agreement and know what the interest rates and penalties are for non-payment.

...cost of borrowing

• HMT and DWP should commitment to expansion of credit unions and other forms of lower cost and lower interest social enterprise lending programmes to reduce reliance on high-cost credit.

• DWP and regulators should continue to explore what more can be done to encourage responsible lending. The implementation of the FCA cap on the total cost of credit is a welcome regulatory move.

- FCA should require short-term, high-cost lenders to refer rejected applicants to free debt advice, and ban lead generation at this point.

• HMT, banks and partner should continue to explore basic bank accounts provision by the development of alternative payment methods such as ‘jam-jar’ accounts, to assist low-income consumers with budgeting and provide access cheaper direct debits.
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Money Advice Trust

The Money Advice Trust (MAT) is a charity formed in 1991 to help people across the UK tackle their debts and manage their money wisely.

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www.nationaldebtline.org
www.wiseradviser.org