British household indebtedness and financial stress: a household-level picture

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This article summarises the main results of a survey carried out for the Bank in September 2004 about household borrowing, housing wealth and attitudes to debt. The survey was designed to provide a comprehensive, up-to-date picture of household indebtedness. It found significant differences between homeowners and renters: renters are more likely to have debt problems, but their share of total household debt is small. The vast majority of debt is owed by homeowners, very few of whom (by historical standards) show signs of having problems at present. While 40% of total outstanding household debt is owed by those spending more than a quarter of their gross income on servicing their debts, the share of debt owed by those currently with debt problems is lower than a decade ago.

Introduction

Lending to the UK household sector has been growing substantially faster than household incomes in recent years. The amount of debt outstanding now exceeds £1 trillion, equivalent to around 140% of aggregate household income (compared with around 105% ten years ago). This rapid accumulation of debt has raised questions about the ability of people to repay what they owe, especially in the event of a sudden change in economic circumstances; for example, if interest rates were to increase substantially or if households' income expectations proved to have been too optimistic. This could have implications for both *monetary policy*, if the combination of high debt levels and a worsening economic outlook were to cause a slowdown in spending by households, and *financial stability*, if an increasing number of households were to default on their debts.

Such issues are normally explored with reference to aggregate measures of household debt and its affordability, in part because the necessary data are relatively easy to obtain. But these aggregate measures can only tell us about the position of the household sector as a whole or of some notional 'average' household — they apply to no household in particular. While that may be suitable for some purposes, it is less obviously so for the analysis of issues like financial stress — which is most acute, and therefore most likely to manifest itself in arrears or default, or sharp changes in consumption, for those with the highest levels of debt in relation to their income.

In recent years, the Bank has made increasing use of household level surveys to analyse the financial position of the household population. These confirm that debt is distributed very unevenly across households. The richest regular source of such information for the United Kingdom is the British Household Panel Survey (BHPS):(1) each year since 1991, the same set of people has been asked about their economic and social circumstances, including about their secured debt. Every five years, starting in 1995, these individuals have also been asked about their unsecured debts.(2) The BHPS is not very timely, though — the latest available data relate to 2002. A more timely data source is the Survey of Mortgage Lenders (SML), though this only provides information on the flow of *new* mortgages. The SML data were analysed in detail in the previous issue of the *Quarterly Bulletin*.(3)

Between them, the BHPS and the SML provide a substantial amount of information about the distribution of household debt in the United Kingdom. Nevertheless, there are some issues for which their lack of timeliness (in the case of the BHPS) or their coverage

(1) The BHPS data used in this article were made available through the UK Data Archive. The data were originally collected by the Economic and Social Research Council Research Centre on Micro-social Change at the University of Essex, now incorporated within the Institute for Social and Economic Research. Neither the original collectors of the data nor the Archive bear any responsibility for the analyses or interpretations presented here.
(2) The BHPS was analysed in detail in Cox, Whitley and Brierley (2002).
(3) See Hancock and Wood (2004).

(in the case of the SML) leaves gaps in our knowledge. A particular issue at present is why personal bankruptcies, mainly involving unsecured debt,(1) have risen to record levels, while mortgage arrears are, by recent standards, extremely low. This suggests a sharp distinction between financial stress currently faced by those who own their homes or have a mortgage, and those who live in rented accommodation.

This in turn prompts questions about unsecured debt: are more people borrowing in this way? How affordable is it? How much of this borrowing is currently interest free? Are these borrowers vulnerable to financial stress? And is debt placing an increasing burden on household finances?

There are also questions about secured debt that deserve investigation at the household level, especially given the rapid increases in house prices in recent years: by how much does the value of a borrower's home exceed the value of their mortgage? How affordable is their mortgage? How would their financial position be affected in the event of lower house prices?

Furthermore, there are issues regarding the overlap between secured and unsecured borrowing: are homeowners able to consolidate their unsecured debts by remortgaging? Are new entrants to the housing market topping up their mortgage borrowing with unsecured debt? How affordable is the overall debt of people with both secured and unsecured debt, and how does it compare with the value of their house?

In order to address these issues, the Bank commissioned a new survey from NMG Research. In September this year, around 2,000 people were asked questions about their unsecured and mortgage borrowing, the value of their housing assets and their attitudes to debt. A similar survey in October 2003 focused only on unsecured debt.(2) Where possible, we have integrated the findings of the new survey with those of earlier surveys (the October 2003 NMG Research survey and the BHPS) to draw comparisons over time.

The evidence from the latest survey suggests that, while the vast majority of debt is owed by homeowners with mortgages, debt problems are concentrated among renters. For the most part, homeowners are currently comfortable with the amount they owe: only 4% of them admit to having problems paying for their accommodation, and only 5% say that their unsecured debt is a heavy burden. This may partly be because homeowners have been able to take advantage of house price inflation to remortgage and consolidate their debts: around 25% of those remortgaging in the past year have done so for this reason. A significant number of homeowners are using more than a quarter of their gross income to service their debts and these households account for around 40% of total outstanding debt.

The remainder of the article is organised as follows. We first briefly outline the key features of the survey. We then present the main findings about the proportion of households that have debt according to their income and housing tenure. We go on to examine how average amounts of debt differ by household characteristics and which types of households hold the largest proportions of the debt. This leads us on to study the overall amount of debt held by homeowners and how it compares with the value of housing assets and the extent of remortgaging. We then study the affordability of debt for homeowners and renters, making use of both financial and attitudinal information, and look at changes in the burden of debt over time. We conclude with a summary of the main findings.

The survey

In September 2004, NMG Research conducted a survey on household debt commissioned by the Bank, interviewing 1,838 individuals throughout Great Britain. The respondents were all adults aged 18 years or over and were asked about their household's debt commitments (both secured and unsecured), income and housing wealth, together with questions about their attitudes to debt and demographic characteristics. Where possible, the questions were aligned with those in the BHPS to allow comparisons with it and so make it possible to analyse trends in household debt.(3)

A common feature of household surveys is that the amount of unsecured debt reported by survey respondents falls well short of that implied by aggregate

(1) The Insolvency Service estimates that only around 10% of bankrupt individuals have secured debt arising from mortgaged property.
(2) The results of this survey were reported in Tudela and Young (2003).
(3) See the appendix for details of the survey method. A full copy of the survey questionnaire is available at www.bankofengland.co.uk/qb/nmgsurvey.pdf.

data.(1) The new survey is no different in this respect: on the basis of the latest NMG Research survey, aggregate unsecured debt totals £57.1 billion, whereas official statistics show that consumer credit outstanding at the end of September 2004 was £180.6 billion.

Some of this discrepancy can be accounted for by differences in the basis on which the statistics are calculated. For example, the survey asked respondents to exclude balances which would be paid off in full at the end of the month, whereas the official statistics include all consumer credit balances outstanding at a particular date, including balances that do not bear interest. This alone could account for around £17 billion of the discrepancy.(2) It is unclear whether the remaining gap is a result of deliberate understatement by respondents, ignorance of debts they or other members of their household (on whose behalf they are responding) owe, or misunderstanding of what constitutes a debt: for example, some may not consider borrowings as a 'debt' if they are up to date with repayments. Nor do we know the extent to which the debts unaccounted for in the survey are owed by people claiming that they have no debts at all or by those who refuse to take part in surveys. We therefore do not attempt to 'gross up' the household-level data to bring them into line with what is implied by the aggregate totals.

The survey figures on secured debt, by contrast, match up much better with the aggregate statistics. Outstanding secured debt at the end of September 2004 was £852.5 billion, according to the official statistics, whereas the survey responses gross up to £679.5 billion — 80% of the aggregate. This pattern is also a characteristic of the BHPS.(3) It may reflect the fact that mortgagors receive regular statements which keep them informed about their amount of outstanding debt, or that the amounts involved change less rapidly than unsecured debts or that they are simply more memorable. Alternatively, it may be that mortgagors are more financially aware than other households and so are more conscious of their financial position. Taken together, the unsecured and secured debt reported in the survey amounts to 72% of what one would expect on the basis of the aggregate data.(4)

Participation in the debt markets

Table A records the proportion of households who had secured and unsecured debt outstanding in September 2004 and compares this with the equivalent rates observed for 1995 and 2000 in the BHPS — the two years for which the BHPS includes information on both secured and unsecured debt. The bottom panels of the table show participation rates by household income for homeowners and renters separately.

There has been no clear change recently in the proportion of households with secured debt. About 41% of households report having secured debt in the 2004 NMG Research survey, compared with 40% in the 2002 BHPS and an average of 41% over the twelve years of the BHPS.(5)

A key question is whether there is any evidence that more households now have unsecured debt than in the recent past. According to the NMG Research survey, around 45% of households have some unsecured debt. This is similar to the estimated 42% of households (34% of individuals) that have any type of unsecured debt according to the previous NMG Research survey in 2003 and an average of 45% in the 1995 and 2000 waves of the BHPS. It seems therefore that there has been little change over this period in the overall participation of households in the unsecured debt market.(6)

But that does not necessarily mean that the types of household with unsecured debt have not changed. The proportion of renters who have unsecured debt, for example, has increased significantly in recent years — in the 1995 BHPS, 39% of renters reported having some unsecured debt; but by 2004, that proportion had increased to 46%.(7) This difference is statistically

(1) See the box in Tudela and Young (2003) for discussion in relation to the 2003 NMG Research survey and Redwood and Tudela (2004) for discussion of grossing up BHPS data. A comparison across a range of different household surveys is provided by Oxera (2004, page 25).
(2) Calculated by subtracting an estimate of credit card balances that do not bear interest from the aggregate total. This estimate is provided by the British Bankers' Association.
(3) See Redwood and Tudela (2004).
(4) Household income in the survey grosses up to represent 73% of that reported by the Office for National Statistics (ONS) for the household sector. The difference partly reflects the definition of income used in the survey and that constructed by the ONS (which also includes the income of non-profit institutions serving households).
(5) A statistical test for the equality of the proportion of households with secured debt between the 2002 BHPS and 2004 NMG Research survey indicates that the null hypothesis of both proportions being equal cannot be rejected.
(6) A statistical test that the proportion of households with unsecured debt in the 2004 NMG survey is significantly different from the proportion of households with unsecured debt in the 2000 BHPS indicates that the proportions are not significantly different.
(7) The increase is broadly similar for private renters and those living in accommodation provided by local authorities or housing associations.

Table A
Participation rates by selected household characteristics

Per cent

	Share of survey population	Secured	Unsecured	Secured only	Unsecured only	Both	None
Whole sample (NMG 2004)	100	41	45	15	22	24	39
Homeowners (NMG 2004)	63	62	45	23	8	38	31
Renters (NMG 2004)	37	2	46	1	47	1	51
Whole sample (BHPS 2000)	100	39	45	13	20	26	41
Homeowners (BHPS 2000)	70	56	47	19	9	37	34
Renters (BHPS 2000)	30	3	43	1	41	2	57
Whole sample (BHPS 1995)	100	40	44	14	19	26	42
Homeowners (BHPS 1995)	67	61	47	21	8	39	32
Renters (BHPS 1995)	33	2	39	1	38	2	60
Homeowners (NMG 2004)							
Household income							
Up to 4,499	1	56	14	49	6	7	37
4,500–9,499	8	13	23	8	18	5	69
9,500–17,499	18	52	48	14	11	38	37
17,500–24,999	9	75	63	15	4	61	20
25,000–34,999	9	81	61	24	6	57	13
35,000–59,999	12	88	63	24	1	63	12
60,000+	5	83	57	34	7	49	10
Renters (NMG 2004)							
Household income							
Up to 4,499	3	–	38			–	61
4,500–9,499	14	1	37			1	62
9,500–17,499	12	2	51			–	46
17,500–24,999	3	6	72			6	25
25,000–34,999	1	8	70			8	31
35,000–59,999	2	11	70			11	33
60,000+	1	–	57			–	49

– indicates no observations.

Notes: Housing tenure relates to the main home in which the respondent lives. Homeowners are those households who own their main home outright or have bought it with a mortgage. Renters include households living in local authority and private rental accommodation and those living in housing association accommodation. Income is gross household income. Figures may not sum to 100 due to rounding.

Sources: BHPS, NMG Research and Bank calculations.

significant and has been offset by a small fall in the proportion of homeowners with unsecured debt, from 47% in 1995 and 2000 to 45% in 2004.

There is also evidence that the types of unsecured debt have changed since the mid-1990s. In the latest survey, credit cards are the most commonly cited type of unsecured debt, with 26% of households owing money on credit cards (Table B).(1) Personal loans (15%) and overdrafts (12%) were the next most common forms of borrowing. The categories of unsecured debt covered by the NMG survey were slightly broader than those included in the 1995 and 2000 BHPS surveys (in part, to try to achieve more comprehensive reporting of unsecured debt), so participation rates may not be strictly comparable. Nonetheless, comparing the results of the different surveys does give us an idea of broader trends in debt participation: the proportion of households holding credit card and overdraft debt is higher in the latest survey, and this has been offset by reduced use of hire purchase agreements and mail order borrowing. So households appear to be making increasing use of more flexible forms of unsecured borrowing.

Table B
Participation rates by types of unsecured debt instrument

Per cent

Debt instrument	BHPS 1995	BHPS 2000	NMG 2004
Hire purchase agreement	15	12	8
Personal loan	18	20	15
Overdraft	n.a.	5	12
Credit card	19	22	26
Store card	n.a.	n.a.	5
Catalogue or mail order agreement	15	13	9
Student loan	n.a.	1	4
DSS social fund loan	1	2	2
Other loans	3	11	1
Any unsecured debt	44	45	45

n.a. indicates that this type of debt was not covered by the survey.

Note: The proportion of households holding each type of unsecured debt does not sum to the proportion of households holding any unsecured debt, as some households hold more than one type.

Sources: BHPS, NMG Research and Bank calculations.

In 2004, there is no difference in the proportion of homeowners and renters who have unsecured debt. But for any given income level, renters are more likely than

(1) In a separate question, the NMG Research survey also asked individuals if they have a credit card — independently of their actual use of it for transactions or to obtain credit. This found that 60% of those that have a credit card use it for transactions purposes only. A similar question for store cards revealed that 93% of households use store cards for transactions purposes.

Table C
Average debt of debtors and share of total debt by household characteristics

Per cent

			Households		Secured debtors		Unsecured debtors		For those with secured and unsecured debt	
	Share of survey population	Share of income	Mean total debt (£)	Share of total debt	Mean secured debt (£)	Share of secured debt	Mean unsecured debt (£)	Share of unsecured debt	Mean total debt (£)	Share of total debt
Whole sample	100	100	20,780	100	63,484	100	4,860	100	79,102	78
Homeowners	63	77	33,415	95	62,958	98	5,501	70	77,923	76
Renters	37	23	3,389	5	82,012	2	3,852	30	117,556	2
Homeowners										
Household income										
Up to 4,499	1	0	13,730	1	24,380	1	290	0	35,050	0
4,500–9,499	8	2	2,540	1	19,090	1	2,370	2	43,170	1
9,500–17,499	18	11	15,000	11	31,520	11	4,050	14	45,820	11
17,500–24,999	9	8	45,440	15	63,910	15	3,770	8	72,210	14
25,000–34,999	9	12	50,110	17	58,990	17	6,360	14	66,760	13
35,000–59,999	12	23	58,160	25	64,020	26	7,510	22	71,630	20
60,000+	6	21	134,330	26	161,700	27	8,630	10	169,230	17
Renters										
Household income										
Up to 4,499	3	0	1,360	0			3,830	2		
4,500–9,499	14	4	1,020	1			2,580	6		
9,500–17,499	12	7	1,600	1			2,780	8		
17,500–24,999	3	3	25,980	3			4,730	5		
25,000–34,999	1	2	5,080	0			7,230	3		
35,000–59,999	2	4	4,470	0			5,770	4		
60,000+	1	4	1,110	0			6,060	2		

Note: Figures by household income group rounded to nearest £10.

Sources: NMG Research and Bank calculations.

homeowners to have unsecured debt — especially at low incomes.(1) While most renters, for obvious reasons, only have unsecured debt, 38% of homeowners have both unsecured and secured debt. So it is important to look at both types of debt together.

Amounts of debt

Table C shows simple averages of the amounts of money owed by those with debt, according to their income and housing arrangements. A key feature is that debt is strongly associated with homeownership. While homeowners account for 63% of households, they owe 95% of the debt identified in the survey, including 70% of the unsecured debt.(2)

The average amount of *secured* debt owed by households with mortgages is £63,484 (or £58,975 if we restrict the sample to only households with a mortgage on their main home). By comparison, according to the BHPS in 2002, the average mortgage was £56,040. The average amount of *unsecured* debt owed by households with unsecured debt is £4,860. This compares with £2,872 and £4,375 in 1995 and 2000 respectively, according to the BHPS.(3) The average amount owed by those that have both secured *and* unsecured debt is £79,102, and this group of debtors accounts for 78% of total debt.

Higher income households owe a disproportionate amount of total debt compared with their share in the population. For example, homeowners in the highest income group (£60,000 and over) make up only 6% of the survey population but they owe 26% of the debt. Their share of debt is more in line with their share of income, at 21%. At the other extreme, the small number of low income households who have debt have the highest levels of debt in relation to *their* incomes. But this accounts for a negligible proportion of overall debt. Many of these households are unemployed and it seems plausible to infer that in many cases these debts were built up when their incomes were higher. While the average level of unsecured debt is increasing with income for both homeowners and renters, there is no clear pattern in the difference between the amount owed by homeowners and renters at any given level of income.

(1) The measure of income used throughout is *gross* annual income. In the NMG Research survey, only those respondents who were the chief income earner or main shopper for the household were asked their income. They were asked to report the 'total annual income of the household, before any deductions were made for tax, National Insurance, pension schemes and so on'.
(2) There are a small number of renters in the survey who have secured debt (housing tenure relates to the main home in which the respondent lives, so it is possible for households who live in rental accommodation to hold secured debts against other properties in which they are not living). We do not report the characteristics for those households in this article, because there are too few such households for these to be calculated reliably.
(3) The 2000 BHPS is the latest survey for which we can obtain averages at the household level — the 2003 NMG Research survey related to individuals rather than households.

There are important life-cycle influences on household indebtedness which mean that it is more likely that younger households, particularly those entering the housing market for the first time or raising a family, will be in debt, whereas older households, who will be building up savings for — or be enjoying — retirement, will not. These influences can clearly be seen in the data.

Table D illustrates this by showing the distribution of the total amount of debt held relative to household income — the debt to income ratio — by age, for homeowners and renters. In each table, the categories in the left-hand column relate to quintiles of the debt to income distribution. Those in the top quintile of the homeowner debt to income distribution are predominantly in the 25–44 year old age group, while those without debt are mostly over 55. There is a similar life-cycle pattern for renters, except that a higher proportion of the most indebted are aged between 18 and 24.

Table D
Debt to income ratios by age (per cent)

Homeowners

	Age groups							
	18–24	25–34	35–44	45–54	55–59	60–64	65+	All ages
No debt	0.4	–	1.2	2.3	5.1	5.7	19.4	34.1
Debt to income ratio quintiles								
Up to 50%	0.2	0.2	2.6	3.9	1.6	1.2	3.9	13.5
50%–120%	0.5	1.5	3.8	4.5	1.6	0.8	0.6	13.2
120%–190%	0.8	2.6	4.5	4.1	0.8	–	0.1	13.0
190%–330%	0.4	4.6	3.7	2.6	1.2	0.6	–	13.1
Over 330%	0.8	3.6	5.6	1.5	1.1	0.4	0.1	13.1
All	3.1	12.4	21.4	18.9	11.3	8.6	24.1	100.0

Renters

	Age groups							
	18–24	25–34	35–44	45–54	55–59	60–64	65+	All ages
No debt	4.3	9.6	8.5	7.0	3.4	4.2	18.1	55.2
Debt to income ratio quintiles								
Up to 2.6%	1.5	3.0	2.6	1.5	–	–	0.5	9.0
2.6%–6.8%	1.6	1.9	2.4	1.5	1.2	–	0.4	8.9
6.8%–17%	1.7	1.5	2.8	0.2	1.1	0.7	1.4	9.3
17%–54.1%	1.9	2.1	2.4	1.9	0.4	0.2	0.2	9.1
Over 54%	2.5	2.2	2.2	0.8	0.5	–	0.3	8.5
All	13.4	20.3	20.9	12.8	6.6	5.1	21.0	100.0

– indicates no observations.

Notes: Debt to income ratio calculated as all household debt divided by annual gross household income. Quintiles are the four values that split the debt to income distribution into five groups each containing one fifth of the population (such that the one fifth of households with the lowest debt to income ratios lie in the bottom quintile).

Sources: NMG Research and Bank calculations.

Also, some households have very high levels of debt in relation to their income. For homeowners this is largely associated with recent house purchases. For example, the most indebted 20% of homeowners with debt owe more than 330% of their annual income, and the most indebted 20% of renters with debt owe more 54% of their income.

Debt and housing wealth

While a few people have very high debts in relation to their income, many homeowners have an asset — their home — that is more valuable than their debts. This cushion can help them to weather financial shocks. In a recent survey, around 40% of households agreed with the statement that 'My house value has risen so much that I do not worry about other debts I may have'.(1) Sustained house price inflation has clearly raised the value of most homes relative to the original mortgage that financed their purchase. But it is not clear to what extent this has been offset by remortgaging and other unsecured borrowing. Indeed, there is some evidence that house price inflation has encouraged some homeowners to take on more unsecured debt.

The results of the NMG Research survey allow us, for the first time since the 2000 BHPS, to compare the overall debt of homeowners, including unsecured debt and the effects of remortgaging, with the value of their house(s).(2) Table E shows the distribution of the total debt (secured and unsecured) to housing wealth for the homeowners in our sample. These figures indicate that the vast majority of homeowners have a substantial equity stake in their homes. For just over three quarters of homeowners with debt, the amount of debt outstanding is less than half the value of their house.

Table E
Distribution of debt to housing wealth for homeowners with debt

Per cent

Debt to housing wealth	Frequency	Accumulated frequency	Share of total debt	Accumulated share of total debt	Share of unsecured debt	Accumulated share of unsecured debt
100+	1.7	1.7	4.4	4.4	5.7	5.7
90–100	1.5	3.2	1.8	6.2	2.5	8.2
80–90	2.3	5.5	4.6	10.8	4.4	12.5
70–80	3.7	9.2	6.7	17.5	4.7	17.2
50–70	12.9	22.1	26.0	43.5	14.9	32.1
25–50	32.1	54.2	37.7	81.2	22.9	55.0
0–25	45.8	100.0	13.6	94.8	15.0	70.0

Note: Debt to housing wealth calculated as ratio of all household debt to value of all properties owned (outright or with a mortgage) by the homeowner.

Sources: NMG Research and Bank calculations.

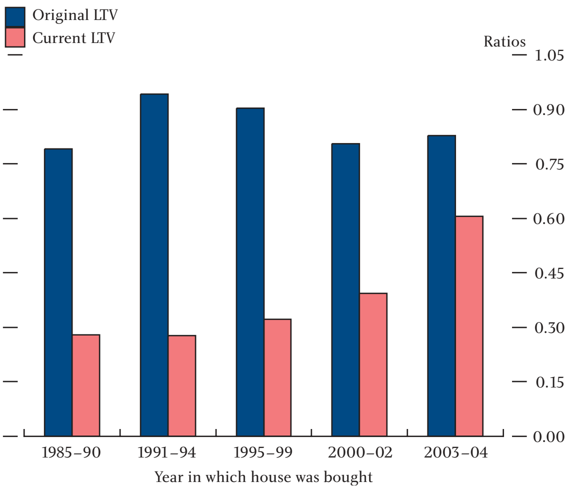
(1) From a survey conducted by NMG Research in March 2004 on behalf of Bradford & Bingley. The survey asked 2,000 individuals — aged between 18 and 75 who had bought their main home with a mortgage and were solely or jointly responsible for financial matters in their household — about their mortgaging behaviour and their attitudes towards mortgages.

(2) Of course, to capture fully the balance sheet of households we would also need information about their financial wealth. The NMG survey did not cover this, but we know from the BHPS that housing wealth represents over 90% of the total wealth of mortgagors.

This group with substantial housing equity has expanded markedly since the mid-1990s when, according to the 1995 BHPS, 52% of debtors were in this position. At the other extreme, 9.2% of homeowners with debt have debts that amount to more than 70% of the value of their housing wealth. Many of those with little housing equity are first-time buyers. These households owe over 17.5% of total debt and tend to hold both secured and unsecured debt. Their financial position would be the most vulnerable to any fall in house prices. But the number of households in this position is considerably lower than in 1995 or 2000, when 32% and 24% respectively had similar debt levels in relation to their housing assets.

The decline in the number of households with low levels of housing equity has clearly been influenced by rising house prices, but this is not the only factor. It is normal for homeowners to have high levels of debt relative to the value of their assets when they enter the housing market, and for this ratio to be reduced over time as the mortgage is paid off and house prices increase. This is confirmed by Chart 1, which plots households' original and current loan to value ratios (LTVs) according to the year of house purchase. The former is defined as the original mortgage relative to the purchase price of the house, the latter as mortgage outstanding to current value of the house — both as reported by the household.(1) As we would expect, current LTVs are highest for those who have recently entered the housing market.

Chart 1
Original and current loan to value ratios (mean values)



Notes: Original loan to value ratio (LTV) calculated as the original mortgage taken relative to the cost of the house. Current LTV is outstanding mortgage relative to current value of the house as reported by households.

Sources: NMG Research and Bank calculations.

In line with evidence from the SML, the average original LTV has declined since the early 1990s from 0.94 to 0.83. This may partly reflect supply factors — lenders may have tightened their lending criteria or, if lenders have limits on the loan to income ratios they are prepared to advance, then rising house price to income ratios may have constrained LTVs. It may also reflect demand factors — households may be more cautious about taking on high LTV loans following the experience of the early 1990s, or may be responding to the fact that the relative cost of lower and higher LTV loans has changed.(2)

We also know from SML data that average LTV ratios for first-time buyers, in particular, have declined in recent years. This means that lending institutions are less exposed to the risk that the value of the property might subsequently fall short of the value of the loan. But at the same time it implies that buyers must be financing a greater proportion of the purchase price by other means. As the NMG sample was chosen to be nationally representative, it inevitably contained only a small number of first-time buyers.(3) And of these, just 20 had raised a deposit to buy their first property. The most common source of their deposit was savings — only two households said that they had used unsecured debt for this purpose.

Despite this general pattern of loan to value ratios declining over the life of the mortgage, a number of homeowners are taking advantage of house price inflation to increase their borrowing by remortgaging. Indeed, the survey found that 11% of mortgagors had taken out an additional mortgage in the twelve months prior to interview. The average value of this loan was £20,000; a quarter of additional loans taken out were under £7,500, while 11% were for £50,000 or more.

The survey results also indicate that mortgagors are generally not taking on additional mortgages for direct consumption purposes. Instead, most say that they used the extra money for home improvements (Table F).(4)

(1) We show LTV ratios from 1985 onwards only given the small sample size for properties bought before 1985.
(2) See Hancock and Wood (2004).
(3) Those respondents who had bought their property with a mortgage in 2002 or subsequently were asked whether their current mortgage was their first-ever — 55 responded that it was their first-ever mortgage.
(4) This is consistent with results from the Survey of English Housing, which show that half of households taking further advances do so in order to make home improvements. See Benito and Power (2004).

Table F
Reasons for taking an additional mortgage

	Percentage of those taking an additional mortgage
Home improvements	59
New goods for property	12
Holiday/car	7
Consolidated debts	25
Bought second property	5
Money into own business	7
Invested or saved money	4
Other	9

Note: Respondents could give more than one answer.

Sources: NMG Research and Bank calculations.

Table G compares the amount of secured debt that mortgagors report they currently owe with the amount of secured debt when they first arranged a mortgage on their property. It shows that three quarters of mortgagors have an outstanding mortgage that is less than or equal to the one they originally took out. For nearly one in four mortgagors, the value of their current mortgage is less than 75% of their original mortgage. But 25% of mortgagors now owe more than when they originally took out their mortgage: through remortgaging or consolidating other debts into their mortgage.(1) Households that have increased the value of their mortgage tend to be those that have benefited from the largest capital gains on their houses.

Table G suggests some association between taking on mortgage debt and cumulative house price inflation: the proportion of mortgagors that took on an additional mortgage (in the twelve months prior to the date of the interview) increases broadly in line with the extent to which their house value has increased.

Affordability

In this section, we analyse the affordability of debt — both in terms of the amount of household income that is devoted to servicing debts (known as income gearing) and households' perceptions of whether their debts are a problem. Information on how much each household spends on servicing its debts each month is provided by the households themselves. This includes their spending on servicing their unsecured debts and takes account of their use of 'interest-free' deals on unsecured debt. More information on the take-up of these deals is provided in the accompanying box on pages 422–23.

Table H shows the distribution of income gearing for homeowners and renters. It shows that about a quarter of all households (and 38% of debtors) have income

Table H
Income gearing

Homeowners

	Percentage of all households	Share of total debt (per cent)	Mean total debt (£)	Mean income (£)
No debt	19.8	–	–	–
Income gearing				
Positive but less than 5%	4.9	5.0	29,090	40,450
5%–10%	6.8	7.9	32,920	36,220
10%–15%	7.2	10.7	42,420	36,940
15%–20%	5.5	15.0	77,930	34,890
20%–25%	5.3	13.5	72,200	29,500
25%–30%	4.7	17.4	105,630	40,230
30%–35%	2.0	4.4	62,870	26,360
35%–40%	2.0	9.8	143,290	33,000
40%–50%	2.3	4.8	59,780	17,540
50%–100%	1.6	4.8	85,920	13,940
100% or more	0.9	0.8	27,070	1,440

Renters

	Percentage of all households	Share of total debt (per cent)	Mean total debt (£)	Mean income (£)
No debt	19.0	–	–	–
Income gearing				
Positive but less than 5%	8.1	4.5	15,940	24,220
5%–10%	2.8	0.3	2,830	16,240
10%–15%	2.9	0.5	4,480	13,270
15%–20%	2.5	0.3	4,000	13,460
20%–25%	0.4	0.1	4,130	8,920
25%–30%	0.4	0.1	4,440	5,250
30%–35%	0.3	0.1	12,720	7,750
35%–40%	0.1	0.0	1,450	7,280
40%–50%	0.2	0.0	3,670	9,200
50%-100%	0.2	0.0	2,340	4,560
100% or more	–	–	–	–

– indicates no observations.

Notes: Income gearing is calculated for each household as previous month's payments on all debt held multiplied by twelve and divided by annual gross household income. All figures rounded to nearest £10.

Sources: NMG Research and Bank calculations.

Table G
Remortgaging and changes in house valuations

Ratio of current value of house to original cost	Ratio of mortgage outstanding to original mortgage					Percentage of sample	Percentage that took an additional mortgage in the past twelve months
	≤0.5	0.5–0.75	0.75–1	1–1.5	>1.5		
Less than 1	–	26	74	–	–	3	6
1–1.25	–	10	78	12	–	7	11
1.25–2	6	16	56	12	10	21	12
2–2.5	7	11	53	9	21	13	22
More than 2.5	12	14	45	9	20	55	15
Proportion in each column	9	14	52	9	16	100	

– indicates no observations.

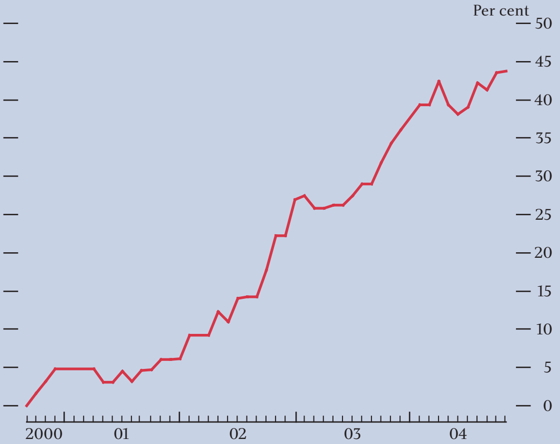
Sources: NMG Research and Bank calculations.

(1) In some cases, this may reflect recall error in replying to the survey — respondents may confuse the amount of debt they originally took out with what they currently owe, or may not remember the size of their mortgage. As we have no way of validating the survey responses, we do not know how large this effect might be.

Interest-free unsecured debt

One current feature of the unsecured credit market is the prevalence of so-called 'zero interest rate' deals — particularly on credit cards. Five years ago, no major institutions offered such deals on credit card borrowing, but now more than 40% of lenders advertise the availability of such deals (Chart A). But little is publicly known about the amount that is borrowed interest free, how it is distributed across households, or what characterises those households with interest-free credit. For this reason, we included a question in the NMG Research survey that asked households with certain types of unsecured debt (credit cards, personal loans, hire purchase agreements, overdrafts and store cards) how much of that debt was interest free.

Chart A
Percentage of credit card issuers offering 0% deals

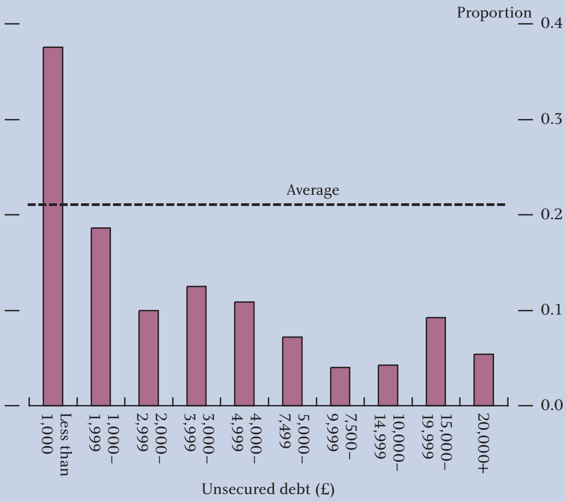


Source: Bank of England.

In total, 7% of all unsecured debt reported in the survey is interest free. But the survey suggests that the proportion of unsecured debt that is free of interest varies significantly across households. Overall, 36% of households with unsecured debt hold some that is interest free. This proportion is higher among homeowners (40%) than renters (30%); it increases with household income; and it is greatest among those in employment. So interest-free credit seems to be targeted at — or more accessible to — households who are likely to represent better credit risks.

Among those households who have some interest-free credit, on average around 20% of their total unsecured debts are interest free. This proportion varies substantially with the amount of unsecured debt: it is highest for those with small amounts of unsecured debt (Chart B). This may reflect supply constraints on interest-free credit: lenders may offer interest-free credit up to certain limits, so for those with larger amounts of unsecured debt their interest-free credit 'allowance' will represent a smaller proportion of their debts.

Chart B
Proportion of unsecured debt that is interest free by amount owed

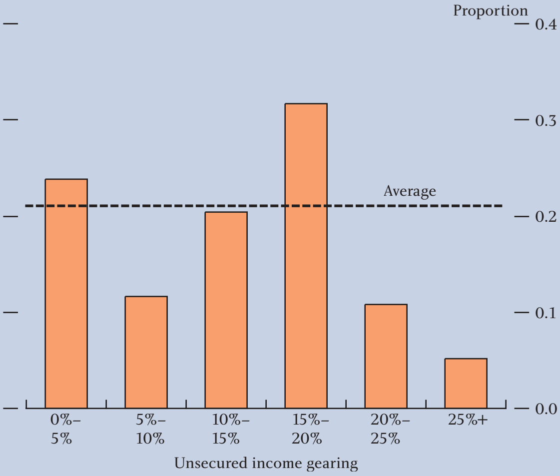


Sources: NMG Research survey and Bank calculations.

But is interest-free credit being used disproportionately by borrowers wanting to alleviate their debt burden? And how much would households with interest-free credit be affected by these special offers being withdrawn? Chart C shows the proportion of unsecured debt that is interest free for debtors with different levels of unsecured income gearing (the ratio of repayments on unsecured debt to gross household income). It shows a bipolar distribution — both households with very low gearing (positive but less than 5%) and those with higher gearing (15%–25%) are more likely than others to hold interest-free credit.

One way to assess the vulnerability of households is to look at the extent to which unsecured income gearing would change if zero interest rate deals were to expire: for example, by assuming that the household would then pay the same rate of interest as on that part of its unsecured debt that is not interest free. This is likely to provide an upper bound on the possible

Chart C
Proportion of unsecured debt that is interest free by unsecured income gearing



Note: Unsecured income gearing calculated as previous month's payments on unsecured debt multiplied by twelve divided by annual gross household income.

Sources: NMG Research survey and Bank calculations.

impact, because on some forms of unsecured credit (for example, some hire purchase agreements) it would not be contractually possible for the lender to increase the rate. Using this simple calibration, we find that the impact would be largest at the top end of the unsecured gearing distribution: for households at the 90th and 95th percentiles of the gearing distribution, unsecured gearing would rise by around 3 percentage points (around 10%), whereas for the median household the impact would be just 0.4 percentage points (Table 1). So removing zero per cent deals would indeed have the largest impact upon those households with high levels of unsecured income gearing.

Table 1
Impact of removing zero interest deals upon unsecured income gearing

Unsecured income gearing	Current position	Without 0% deals
Mean	9.2	10.8
5th percentile	0.4	0.4
10th percentile	0.6	0.7
Median	5.9	6.3
90th percentile	20.7	22.8
95th percentile	28.0	31.4

Note: Unsecured income gearing calculated as previous month's payments on unsecured debt multiplied by twelve divided by annual gross household income.

Sources: NMG Research survey and Bank calculations.

gearing that is positive but less than 10%. But these households account for less than one fifth of the total debt. At the other extreme, only 15% of all households (or 23% of debtors) spend 25% or more of their gross income servicing their debts, but they owe 42% of total debt.

Among homeowners, there is no clear relationship between income and income gearing except among the most highly geared households, whose incomes are well below average. Among renter households, it is those with the lowest incomes who spend the highest proportion of their income on servicing their debts. These households typically have much lower incomes than homeowners and many of them are unemployed.

The survey asked all households whether they had had problems paying for their accommodation over the past twelve months (though the survey did not ask renters about their rent payments, so we do not know what proportion of their income those payments represent). Households with unsecured debt were also asked whether it was a heavy burden, somewhat of a burden or not a problem. Table I shows households' attitudes towards their housing payments and unsecured debt. It shows that problems paying for accommodation and unsecured debt are more prevalent among renter households — 11% of renters reported problems paying for their accommodation, compared with 4% of homeowners,(1) and 46% of renters reported that their unsecured debt was a heavy burden or somewhat of a burden, compared with 32% of mortgagors.(2)

Because the NMG survey used the same questions as the BHPS to ask about debt problems, we can draw comparisons between the latest results and those from earlier surveys. Taking unsecured debt first, such a comparison suggests that the proportion of households having problems meeting their debt obligations is lower than a decade ago. The proportion of debtors reporting that unsecured debt is not a problem has increased slightly, from 58% in 1995 to 62% in 2004 (Chart 2), despite the increase in its average amount. As discussed in Tudela and Young (2003), this may reflect the fact that the interest rates households

(1) This is likely to reflect the fact that renters typically have higher housing payments in relation to their incomes than do homeowners. The BHPS confirms that, on average, rental payments represent a larger fraction of renter households' incomes than do mortgage payments for mortgagors.
(2) This figure probably overstates the difference in problems between homeowners and renters, as it includes households who own their home outright — (not surprisingly) very few of these report problems paying for their accommodation. Nonetheless, the proportion of renters reporting problems (11%) is substantially higher than the proportion of mortgagors reporting problems (6%).

Table I
Attitudes to debt

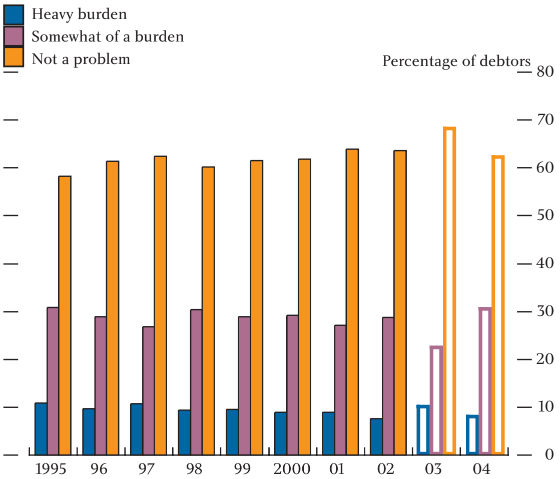
	Problems paying for accommodation				Unsecured debt is a burden			
	Percentage of households with problems	Mean total debt of those with problems (£)	Mean total debt of those without problems (£)	Share of debt of those with problems (per cent)	Percentage of those with unsecured debt that have problems	Mean unsecured debt of those with problems (£)	Mean unsecured debt of those without problems (£)	Share of unsecured debt of those with problems (per cent)
Whole sample	7	22,591	20,719	7	38	6,331	4,001	49
Homeowners	4	63,821	32,084	7	33	8,235	4,265	34
Renters	11	2,716	3,488	1	46	4,299	3,480	15
Homeowners								
Household income								
Up to 4,499	11	35,000	10,800	0	–	–	290	–
4,500–9,499	–	–	2,540	–	20	10,370	670	1
9,500–17,499	4	520	15,260	0	37	7,680	2,170	9
17,500–24,999	1	85,000	44,860	0	30	4,990	3,340	3
25,000–34,999	6	70,060	48,720	1	35	10,980	4,030	8
35,000–59,999	9	92,170	55,450	3	46	9,650	5,710	12
60,000+	6	207,360	128,160	2	15	7,450	8,830	1
Renters								
Household income								
Up to 4,499	11	11,720	440	0	68	5,170	1,140	2
4,500–9,499	7	4,990	690	0	47	2,560	2,600	3
9,500–17,499	17	1,190	1,550	0	50	2,910	2,640	4
17,500–24,999	10	3,930	28,220	0	50	3,640	5,580	2
25,000–34,999	19	–	6,090	–	21	18,380	5,110	2
35,000–59,999	8	5,370	4,380	0	41	6,190	5,480	2
60,000+	7	–	1,110	–	25	16,250	2,630	1

– indicates no observations.

Notes: Households with unsecured debt problems are those who say that their unsecured debt is somewhat of a burden or a heavy burden. Figures by household income groups rounded to nearest £10.

Sources: NMG Research and Bank calculations.

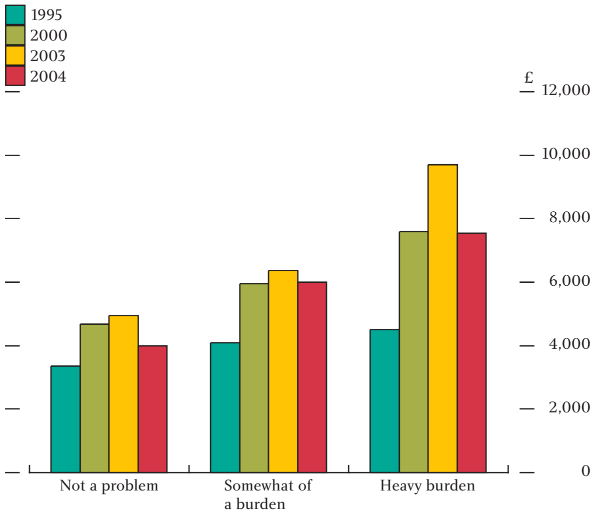
Chart 2
Trends in the burden of unsecured debt



Note: Figures up to 2002 are calculated using the BHPS, 2003 and 2004 figures are from the NMG Research surveys.

Sources: BHPS, NMG Research and Bank calculations.

Chart 3
Average unsecured debt by unsecured debt burden considerations



Note: Figures for 1995 and 2000 are calculated using the BHPS, 2003 and 2004 figures are from the NMG Research surveys.

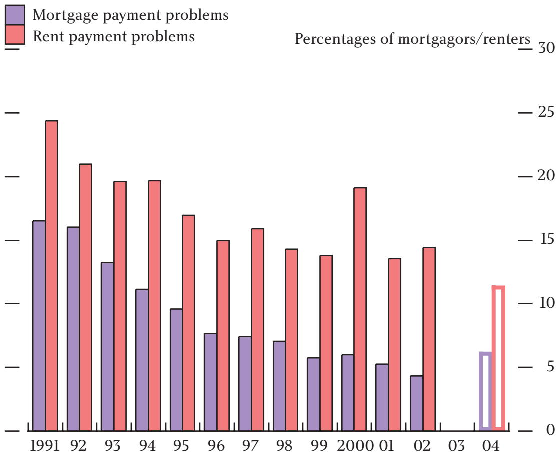
Sources: BHPS, NMG Research and Bank calculations.

pay on their unsecured debt have fallen over that period and the fact that, in aggregate, unsecured debt remains small in relation to household wealth. But the average unsecured debt of those who report it to be a burden has increased by more than for those households who do not consider it a problem (Chart 3). This suggests that the level of unsecured debt at which households consider it to be a problem has increased since 1995.

Compared with the 2003 NMG Research survey, a slightly smaller proportion of debtors reported unsecured debt was a heavy burden in the 2004 survey (8%, compared with 10% in 2003), and a slightly higher proportion reported their debt to be somewhat of a burden (30% in 2004 compared with 22% in 2003). These differences are not statistically significant and therefore inconclusive about broader trends. When we compare the results of the 2004 survey with those of the 2002 BHPS, the proportion of debtors with unsecured debt problems is also little changed.

Turning to reported problems paying for accommodation, Chart 4 shows that the proportion of mortgagors who have problems has fallen from 17% in the 1991 BHPS to 6% in 2004.(1) This may be because mortgage rates have fallen over this period, although the proportion of renters reporting a problem paying rent has also fallen, albeit to a smaller extent — from 24% in 1991 to 11% in 2004.(2) It may also reflect a change in households' perceptions of their mortgage debt burden.(3)

Chart 4
Trends in problems paying for accommodation



Note: Figures up to 2002 are calculated using the BHPS, 2004 figures are from the NMG Research survey.

Sources: BHPS, NMG Research and Bank calculations.

BHPS data confirm that renters are consistently more likely to report problems servicing their unsecured debt than homeowners. Between 1995 and 2002, on average 34% of homeowners with unsecured debt reported that it was somewhat of a burden or a heavy burden, compared with an average of 49% of renters with unsecured debt.

Among homeowners, households who are unemployed are most likely to report problems. So the low level of (and inflows into) unemployment in recent years could help to explain why relatively few homeowners report payment problems and why mortgage arrears are currently at historically low levels.(4) As noted in the introduction, bankruptcies (which mainly involve unsecured debt and those living in rented accommodation) have risen to record levels in recent years. This rise has been common across all types of job status.(5) The survey results are consistent with this — among renters, there is no clear relationship between working status and debt problems.

The affordability of debt is likely to be affected by many factors, among them how large debts are in relation to housing wealth. The previous section showed that there are now relatively few households with high levels of debt in relation to the value of their house(s). Table J cross-tabulates this against income gearing. It shows that those with both high levels of income gearing and high debt in relation to housing assets are more likely to face debt problems. For example, 56% of those with income gearing greater than 25% and capital gearing above 60% (including non-homeowners whose capital gearing is by definition infinite) have some problem paying their debt. At present, only around 9% of debtors (or 5.6% of households) are in this position, but they hold 20% of the stock of debt.

Table K shows the share of secured and unsecured debt that is accounted for by those debtors who report problems paying it. The share of *secured* debt held by those with problems paying their mortgage has fallen from 15% in 1993(6) to 7% in 2004, consistent with the fall in the proportion of mortgagors who report problems. The share of *unsecured* debt accounted for by those who consider unsecured debt to be a burden for their household has fallen from 47% in 1995 to 42% in 2004.

The survey asked those households who say they have problems paying for their accommodation whether they have cut back on consumption or borrowed more as a result of those problems.(7) Among mortgagors, 42% of those with problems had cut back on consumption, while 29% had borrowed more. A slightly higher proportion of renters with problems cut back on consumption (51%), but the proportion that borrowed more is the same.(8)

(1) The differences in the proportions of mortgagors having problems paying for their mortgage between the 2002 BHPS and the 2004 NMG Research survey are not statistically significant.
(2) This would depend on the relationship between interest rates, house prices and rents. The BHPS confirms that mean mortgage payments fell 1% between 1991 and 1995, whereas mean rental payments rose by 10% (in nominal terms). Between 1996 and 2002 both mortgage payments and rental payments rose by 5% at the mean.
(3) Since 1993, mortgagors have become less likely to report problems for a given level of mortgage income gearing. See discussion in the *Financial Stability Review* (December 2004), page 20.
(4) A number of research papers also highlight the links between unemployment and mortgage payment problems. For further details see Cox, Whitley and Windram (2004) and the references therein.
(5) See the discussion in the *Financial Stability Review* (June 2004, Chapter 1.1).
(6) The earliest year for which the BHPS contains information on amounts of secured debt.
(7) Households were also allowed to state that they had used other means to make the payments without specifying what these were. These could include working more, using savings, selling their home and renting out a room for example.
(8) This is not significantly different from the proportion of mortgagors who borrowed more.

Table J
Income gearing, debt to housing wealth and debt burdens

Percentage of debtors

	Income gearing			
Debt to housing wealth	0–25%	25%–35%	35%–100%	100%+
0%–20%	18	1	1	1
20%–40%	13	4	3	1
40%–60%	8	3	1	–
60%–80%	5	2	2	0
80%+	2	1	2	–
Renters	31	2	1	–

Percentage of households

	Income gearing			
Debt to housing wealth	0–25%	25%–35%	35%–100%	100%+
0%–20%	11	1	1	0
20%–40%	8	2	2	1
40%–60%	5	2	1	–
60%–80%	3	1	1	0
80%+	1	0	1	–
Renters	19	1	1	–

Percentage of total debt

	Income gearing			
Debt to housing wealth	0–25%	25%–35%	35%–100%	100%+
0%–20%	6	1	0	0
20%–40%	15	5	5	1
40%–60%	17	8	2	–
60%–80%	10	5	6	0
80%+	8	2	7	–
Renters	2	0	1	–

Percentage of debtors with problems paying debt

	Income gearing	
Debt to housing wealth	0–25%	25%+
0%–20%	19	n.a.
20%–40%	15	35
40%–60%	25	53
60%+	21	56
Renters	51	n.a.

– indicates no observations.

n.a. indicates that the number of debtors in this category is too small for the percentage to be sensibly calculated.

Notes: Problems paying debt refer to both secured and unsecured debt problems. Figures include only those households who have debt.

Sources: NMG Research and Bank calculations.

Table K
Share of debt held by debtors with problems

Per cent

	Share of secured debt	Share of unsecured debt
1993	15	
1994	13	
1995	10	47
1996	7	
1997	9	
1998	7	
1999	7	
2000	6	45
2001	6	
2002	4	
2003		
2004	7	42

Notes: The share of secured debt held is by those reporting difficulty paying their mortgage. The share of unsecured debt held is calculated for those reporting unsecured debt to be a heavy burden or somewhat of a problem. The 2004 results are taken from the NMG Research survey, those for other years are from the BHPS.

Sources: BHPS, NMG Research and Bank calculations.

Conclusions

This article has explored the distribution of debt across British households and its affordability. It finds that the vast majority of debt is owed by homeowners with mortgages, who appear to have few difficulties at present in servicing it. This may be because the background economic conditions of low interest rates and a strong labour market, together with a buoyant housing market, have been favourable to them. Indeed, those homeowners who might otherwise have experienced some debt-related problems have probably been able to take advantage of the equity in their homes and interest-free borrowing on some unsecured debt to ease what could otherwise have been pressing financial difficulties. At present, the proportion of people with limited housing equity who are also devoting a high proportion of their income to servicing their debts is low compared with the mid-1990s. This is consistent with the very low level of mortgage arrears.

The position of renters is rather different. There is evidence that a somewhat higher proportion of renters borrow money than was the case a decade or so ago. As with homeowners, there is also a clear trend towards more flexible forms of borrowing, with credit cards and overdrafts appearing to be taking the place of credit acquired through catalogues and mail order. This has not resulted in an increase in the proportion of renters having problems with their debt, although the amount borrowed by those in difficulty is higher than in the past. Moreover, renters who borrow unsecured are more likely to have problems than homeowners. This may be partly because they do not have the safety valve of housing equity to help them relieve short-term financial pressures.

The overall conclusion to be derived from the survey evidence is that household debt remains affordable. While circumstances can change suddenly, the survey evidence suggests that, by the standards of the past decade, relatively few households are currently close to a stressed position. This partly reflects buoyant house price inflation in recent years, but also appears to be due to fewer households borrowing at very high loan to value ratios.

Appendix
Survey method

In September 2004, the Bank of England added a set of questions to the monthly omnibus survey, MarketMinder, carried out by NMG Research. In total, 24 questions were added. These asked how the household organised its finances, its holdings of debt (secured and unsecured) and the value of housing assets.(1) Interviews were carried out in the respondents' homes using Computer Assisted Personal Interviewing (CAPI). Fieldwork was conducted between 24 and 30 September 2004.

NMG Research uses a two-stage random location sample design to select sampling points, which are then Acorn stratified to provide a balanced sample. NMG Research then applies quotas to each interview assignment, to ensure a good spread of interviews across demographics. NMG Research uses the National Readership Survey (NRS) to calculate these weights. The NRS is based on the latest census information.(2)

Only those households where the interviewee was the chief income earner or main shopper in the household were asked for their income, so we lack information on income for around 10% of households for that reason. A further 38% of households refused to provide (29%) or did not know (9%) their household income. Respondents who did not know their income tended to be those who were not responsible for looking after the household's money (apart from the respondent's personal money). Refusals were more evenly distributed across the different ways of organising the finances within the households.

Nearly 13% of households refused to answer if they had unsecured debt. These households were mostly those that also refused to declare their household income. Households with incomes in the range of £17,500 to £35,000 had a slightly higher rate of response to the unsecured debt questions; we did not reweight the answers to account for this. The refusal rate for holdings of secured debt was much lower: only 0.7% of interviewees refused to reveal their housing status.

(1) The specific structure and wording of the questions are available at www.bankofengland.co.uk/qb/nmgsurvey.pdf.
(2) Where possible, we compared the survey results against other data sources to assess the robustness of the results. Our analysis indicated that the survey was nationally representative in terms of (among other things): age; housing status; house valuations; and mortgage payments. Results are available upon request.

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