The state of British household finances: results from the 2006 NMG Research survey

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This article summarises the key results from the latest survey carried out for the Bank by NMG Research about the state of household finances. There was little change in the proportion of households who reported problems with their unsecured debt, although there was a small increase in the proportion of mortgagors having difficulty paying for their mortgage. The share of overall income accounted for by households reporting either type of problem was relatively small, suggesting that any impact on aggregate consumer spending is likely to have been muted. The most common explanations given for debt problems were temporary cash-flow shortfalls and overspending; the most popular way of resolving these issues was to cut back spending. Very few households said they considered bankruptcy a solution to their debt problems.

Introduction

The rapid increase in household debt in recent years has raised questions about the ability of people to repay what they owe. This could have implications for monetary policy if debt problems were widespread and those affected cut their spending sharply. A box in the November 2006 *Inflation Report* (page 15) concluded that the implications of recent debt repayment problems for monetary policy are likely to be small. That is because the households experiencing difficulties repaying their debt likely account for a small proportion of overall consumer spending. It could also have implications for financial stability if a significant number of households were to default on their debts. To throw light on the extent of debt problems, this article investigates the financial position of a sample of households that is representative of the British population.

In September 2006, NMG Research surveyed a representative sample of around 2,000 people and asked them how much debt their household owed, whether they found this to be a burden, whether they felt constrained in the amount they could borrow and their attitudes to bankruptcy. Those who said they were experiencing some difficulty in keeping up with their debt payments were asked what had caused this and what they intended to do about it.[1] The box on page 403 contains more details about how the survey was conducted.

The survey is the fourth that the Bank has commissioned NMG Research to conduct on household finances.[2] Taken together with information from successive waves of the British Household Panel Survey (BHPS), it sheds light on trends in the extent of financial stress at the household level throughout the British population.

Distribution of debt

As in past surveys, debt was not evenly distributed across the households who participated. While 57% of households had some debt, 43% had none (**Table A**). These proportions had hardly changed since 1995. Debt was heavily concentrated among mortgagors, who owed 96% of the outstanding stock

Table A Percentages of households with secured and unsecured debt[(a)]

	BHPS 1995	BHPS 2000	NMG 2004	NMG 2005	NMG 2006
None	46	45	42	43	43
Unsecured only	15	15	23	20	22
Secured only	19	18	13	16	14
Both	21	21	22	21	21

Sources: BHPS, NMG Research surveys and Bank calculations.

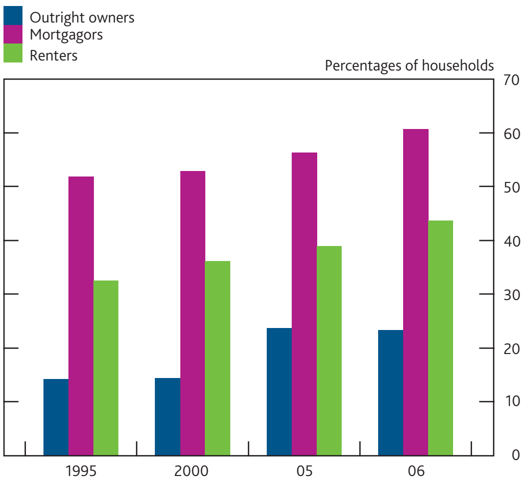
(a) The 2006 NMG survey did not contain questions about second homes and mortgages. As a result, the figures in **Table A** exclude mortgages that outright owners and renters may have on second properties. Figures from past surveys have been recalculated to be consistent with the 2006 survey. Figures may not sum to 100 due to rounding.

(1) The raw survey data are provided at www.bankofengland.co.uk/publications/quarterlybulletin/nmgsurvey2006.xls.
(2) See Barwell, May and Pezzini (2006) for details of the 2005 survey.

of debt identified in the survey: 100% of the secured debt and 62% of the unsecured debt.

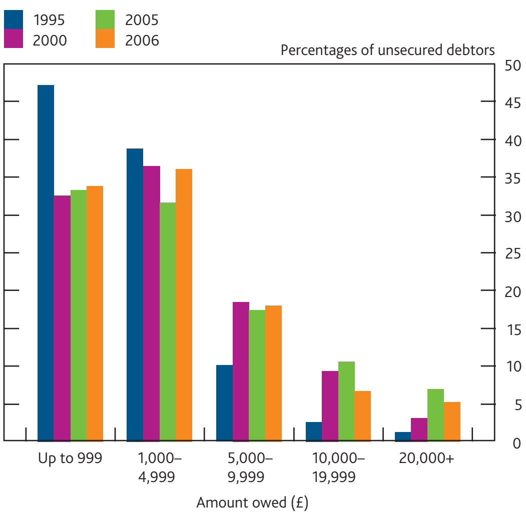
While there was little change in the overall proportion of households with debt, this masks a change in the distribution of debt across types of households.(1) In particular, the proportion of renters with unsecured debt had continued to rise (**Chart 1**). While renters account for a very small proportion of overall outstanding debt (3%), they might be more prone to default than homeowners because they do not have housing equity to draw on if they face financial difficulties.(2) There were also increases in the proportion of mortgagors and outright homeowners with unsecured debt. But the overall proportion of households with unsecured debt was little changed (**Table A**). That is because more homeowners owned their homes outright in the 2006 survey than in past surveys and those who own their homes outright are less likely to have any unsecured debt (**Chart 1**).

Chart 1 Proportion of households with unsecured debt by housing tenure



Sources: BHPS, NMG Research surveys and Bank calculations.

Chart 2 Distribution of unsecured debt

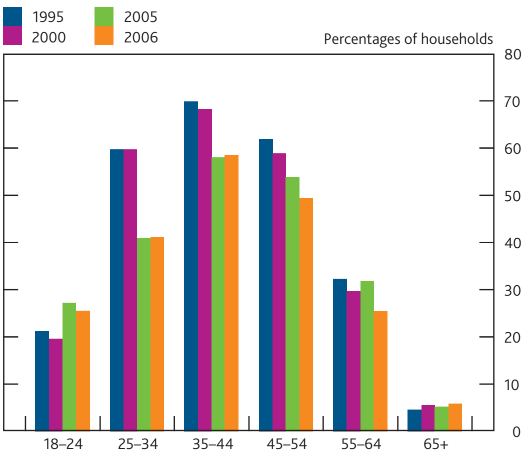


Sources: BHPS, NMG Research surveys and Bank calculations.

The quantity of unsecured debt reported by participating households continued to be unevenly distributed (**Chart 2**). While most debtors reported outstanding debts of less than £5,000, around 5% said that they owed more than £20,000. Other things equal, the households most likely to default on their loans would be those with low incomes in relation to their debts and little or no housing equity. The majority of renters with debt owed small amounts with seemingly affordable repayments. But a small minority (9% of renters with debts) had unsecured debts in excess of their annual pre-tax income.(3) Such households are likely to be experiencing severe difficulties in servicing their debts but this is a very small proportion of households as a whole (around 1%).

There have been changes in the types of households with secured debt. Relative to 1995 and 2000, a smaller proportion of 25–34 year olds had secured debt (**Chart 3**). This is likely to be the result of higher house prices making it more expensive for younger households to enter the housing market. Higher house prices are also likely to be one of the factors behind an increase in the dispersion in the amount of secured debt owed, since new entrants to the housing market need to borrow more than would have been the case in the past. **Chart 4** shows that the distribution of secured debt had shifted to the right: the proportion of mortgagors with small mortgages had fallen and the proportion with large mortgages had risen. This may also reflect remortgaging. Just under 15% of mortgagors had taken out an additional mortgage in the twelve months prior to the survey. This is a little lower than in 2005. The main purpose given for the additional loan was to fund home improvements, but 22% of respondents said that they had used some or all of it to consolidate other debts.

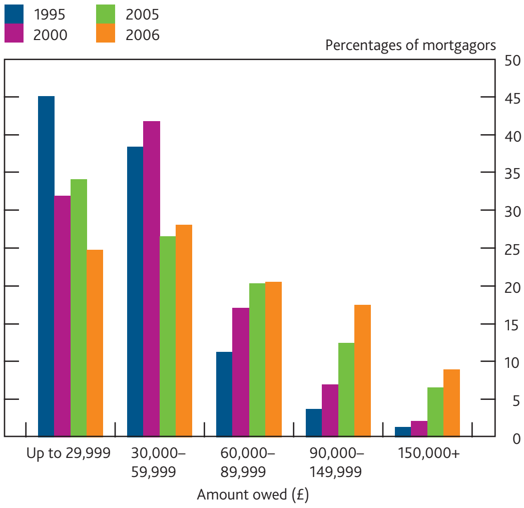
Chart 3 Proportion of households with debt secured on their home by age



Sources: BHPS, NMG Research surveys and Bank calculations.

(1) Since the 1995 BHPS survey, there had also been changes in the types of debt being used by households. Student loans and overdrafts had become more prevalent, while hire purchase agreements and personal loans had become less common. But credit cards remained the most commonly used type of unsecured debt.
(2) As an example of this, the Insolvency Service estimates that only around 10% of bankrupt individuals have secured debt arising from mortgaged property.
(3) That number had increased from 7% in the 2005 survey.

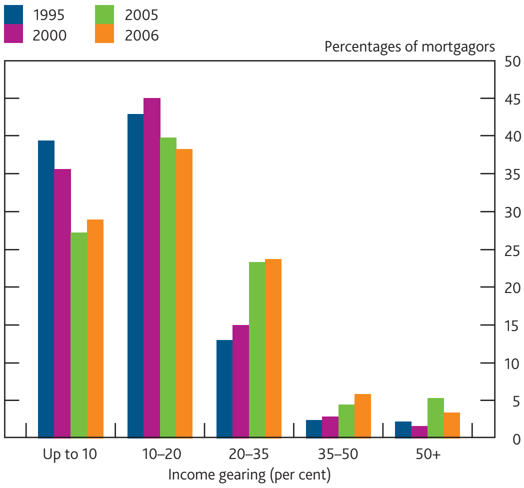
Chart 4 Distribution of secured debt[a]



Sources: BHPS, NMG Research surveys and Bank calculations.

(a) Mortgage debt from the 1995 and 2000 BHPS surveys refers to mortgage debt that mortgagors have on all property they own. Data from the 2005 and 2006 NMG surveys refer to mortgage debt on primary residence only.

Chart 5 Distribution of mortgage income gearing

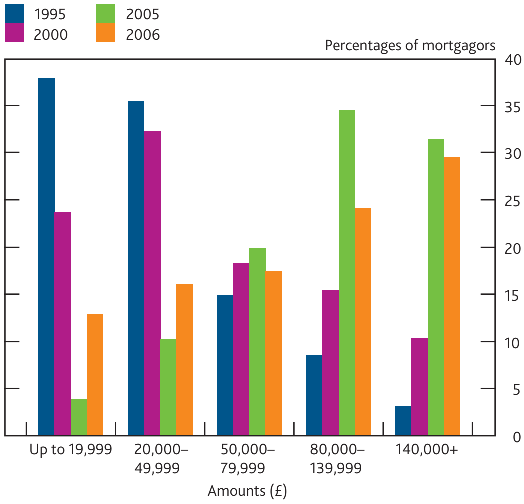


Sources: BHPS, NMG Research surveys and Bank calculations.

The greater dispersion of secured debt raises questions about its affordability, especially for those with the most debt. Affordability can be assessed crudely by looking at mortgage income gearing: the proportion of a household's income that is spent on mortgage payments. In recent years, more mortgagors devoted a relatively large share (more than 20%) of their pre-tax incomes to debt service than in 1995 or 2000 (**Chart 5**).(1)

But the current share of household income devoted to debt service is only a crude guide to underlying affordability. What matters more is whether households have the means to repay the debt over their whole lifetime. Of relevance to this is the amount of equity that borrowers have in their homes. In recent years the proportion of mortgagors with a relatively low level of equity in their homes (less than £20,000) was substantially lower than it had been in 1995 or 2000

Chart 6 Distribution of housing equity[a]



Sources: BHPS, NMG Research surveys and Bank calculations.

(a) Calculated as value of main home minus mortgage debt. Mortgage debt from the 1995 and 2000 BHPS surveys refers to mortgage debt that mortgagors have on all property they own. Data from the 2005 and 2006 NMG surveys refer to mortgage debt on primary residence only.

(**Chart 6**). At the other end of the distribution, around three quarters of mortgagors had more than £50,000 of equity in their homes.

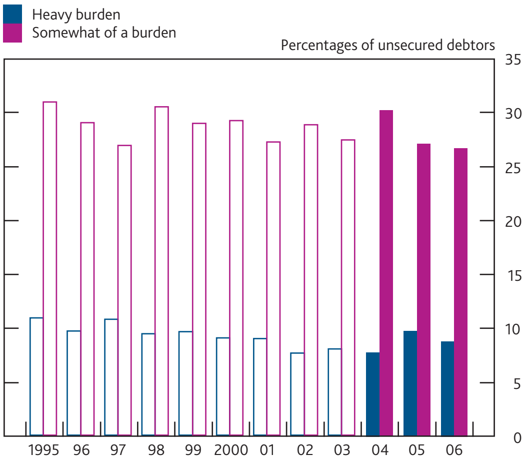
Households facing payment difficulties

Evidence on the amount owed and its affordability has been complemented in the survey by asking households directly whether they have problems paying for their debts. As in previous years, all those with unsecured debt were asked whether they found it to be a burden on their household and those with mortgages were asked whether they had experienced problems in paying for their accommodation.

There has been relatively little change since 1995 in the proportion of households saying that their unsecured debt is a burden. Around one in ten households with unsecured debts found them a heavy burden, and around one in four found them somewhat of a burden (**Chart 7**). Unsecured debts were more likely to be considered a problem by renters than homeowners.(2) As might be expected, households for whom their debt is a burden had more debt than those for whom their debt was not a problem.(3) They also had lower income.(4) Overall, the income of households for whom their unsecured debt is a heavy burden accounted for less than 5% of the total income of all households. So any impact that

(1) Econometric evidence suggests that mortgage payment problems become more likely at high levels of mortgage income gearing (May and Tudela (2005)).
(2) 15% of renters with debt said their unsecured debt was a heavy burden compared with 5% of homeowners.
(3) For homeowners, the average unsecured debt of those who said it was a heavy burden was £13,451 against £8,257 for those who said it was somewhat of a burden and £3,862 for those who said it was not a problem. The equivalent figures for renters were £5,150 for those who said it was a heavy burden, £4,452 for those who said it was somewhat of a burden and £3,178 for those who said it was not a problem.
(4) The average income of those who said their unsecured debt was a heavy burden was £23,932 against £26,550 for those who said it was somewhat of a burden and £32,178 for those who said it was not a problem.

Chart 7 Burden of unsecured debt[a]



Sources: Figures up to 2003 calculated using the BHPS; 2004, 2005 and 2006 figures taken from the NMG Research survey.

(a) Question: To what extent is the repayment of these loans and the interest a financial burden on your household?

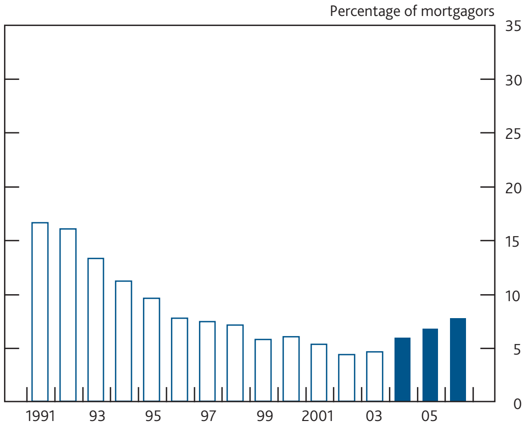
these problems might have had on aggregate spending is likely to have been small.

The relative constancy since 1995 in the proportion of debtors saying their unsecured debt is a burden contrasts with the sharp rise in the proportion of households becoming insolvent over this period.(1) One way of reconciling these trends is to note that out of a thousand adults in England and Wales only around two became insolvent in the past year, whereas on the basis of the NMG Research survey about 40 would say that their unsecured debt is a heavy burden. This suggests that the intensification of debt problems at the very extreme of the debt distribution, revealed by higher insolvencies, is not indicative of greater financial stress for the majority of the population.

The proportion of mortgagors who reported problems paying for their accommodation remained low at 7.7%. This was slightly up on a year earlier (**Chart 8**) consistent with evidence from the Council of Mortgage Lenders showing a small increase in mortgages in arrears and mortgage possessions since the first half of 2004. As with unsecured debt, households who experience problems paying for their mortgages tend to have more debt than those who do not have problems.(2) But they also have lower incomes, accounting for less than 4% of the total income of all households in the survey.(3) As such, any impact that these problems might have had on aggregate consumer spending is likely to have been muted.

In addition to questions about the burden of unsecured debt and mortgage payment problems, a new question was introduced into this year's survey that asked 'Do you ever have problems repaying your debts?'. Around 87% of homeowners and 76% of renters said they never have any problems paying their debts (**Table B**).(4) About 6% of households said they had problems paying their debts most or every month.

Chart 8 Mortgage payment problems[a]



Sources: Figures up to 2003 calculated using the BHPS; 2004, 2005 and 2006 figures taken from the NMG Research survey.

(a) Question: Many people these days are finding it difficult to keep up with their housing payments. In the last twelve months would you say you have had any difficulties paying for your accommodation?

Table B Frequency of debt payment problems[a][b]

Per cent

	Never	Occasionally	Most months	Every month
Whole sample	83	10	3	3
Homeowners	87	8	3	3
Renters	76	15	5	4

Source: NMG Research survey.

(a) Question: Do you ever have problems repaying your debts?
(b) Figures may not sum to 100 due to rounding.

Those respondents who said that they had ever had problems paying for their debts were asked what had caused them. The two most frequent reasons given were 'lack of cash flow that has been/will be resolved in the future', and 'overspending' (**Table C**). Other factors, representing shocks to household circumstances, like higher-than-expected household bills, unemployment, divorce and illness were much less important. It would appear from this that most households perceived their debt problems as either temporary or arising from their own choices.

Effects of debt problems

Households who said that they had problems repaying their debts were asked what actions they would consider taking to resolve them. The responses are shown in **Table D**. Almost

(1) The vast majority of debt in insolvency cases is unsecured. See footnote 2 on page 398.
(2) The average debt (secured and unsecured) of those reporting mortgage payment problems is £92,970 against £73,648 who report no problems.
(3) The average income of those reporting mortgage payment problems is £29,770 against £38,820 who report no problems.
(4) There is a high, but not complete, overlap between those households who said that they have never experienced debt problems, households who said that their unsecured debt is not a burden, and those that do not have problems paying for their mortgage. The proportion of households with no debt problems of any kind is 80% for homeowners and 68% for renters.

Table C Reasons for debt problem[a][b]

	Percentage that mentioned
Lack of cash that has been or will be resolved in the future	32
Overspending	29
Higher-than-expected household bills	13
Unemployment	10
Loss of income through reduction or cessation of overtime	10
Illness	6
Credit card and other loan offers were too tempting	4
Children's school or university fees	4
Divorce or separation	4
You or your partner leaving work to have a child	4
Redundancy	2
Debt legacy from being a student	2
Other	6
Don't know	10

Sources: NMG Research survey and Bank calculations.

(a) Question: What are the main reasons for the problems you have in repaying your debts?
(b) Households were permitted to make multiple responses so figures do not add up to 100.

Table D Action to resolve debt problem[a]

	Percentage that mentioned
Cut back on spending	60
Take out another loan	5
Take out another mortgage on your house	4
Declare yourself insolvent (ie bankruptcy or IVA)	3
Sell your house	2
Other	6
None of these	20

Source: NMG Research survey.

(a) Question: What action would you consider taking to resolve your debt problems?

60% said that they would cut back spending. This dominates all other possible responses with only 3% considering bankruptcy or an Individual Voluntary Arrangement (IVA).[1]

While borrowers may respond to their own debt problems, lenders may also react to debt problems among their customers. For the first time, this year's survey included questions on whether households felt themselves to be constrained in the amount that they could borrow. The questions covered both *perceived* constraints that discouraged households from applying for credit, and *actual* constraints where the household was prevented from borrowing either by the unavailability of credit or its high price.

Table E shows that about 16% of respondents claimed to be facing a perceived or actual credit constraint. On average, those who were constrained had higher existing unsecured debt than those who were not. This suggests that they might have reached a credit limit. They also tended to be young and living in rented accommodation: around one third of renters aged 18–34 said that they were facing a credit constraint.

These questions were not asked in previous surveys. So to get a sense of whether conditions had changed, respondents were asked whether they found it easier or harder to borrow to finance spending than a year earlier. The answers were fairly evenly split: 26% said it was easier, 19% said it was harder and the rest either thought lending conditions had not changed or did not answer. But the responses were not random. Just over 40% of those who found it harder to get credit were themselves now credit constrained. This accounts for 8% of households as a whole.[2]

Table E Credit constraints and unsecured debt[a]

	Share in survey population	Mean unsecured debt	Share of unsecured debt	Easier to get credit	Harder to get credit
Unconstrained	84	1,595	59	82	57
Constrained	16	5,349	41	18	43

Sources: NMG Research survey and Bank calculations.

(a) Questions: Have you been put off spending because you are concerned that you will not be able to get further credit when you need it, say because you are close to your credit limit or you think your loan application would be turned down? Have you found it easier or harder to borrow to finance spending than a year ago? Would you like to borrow any more at the moment but find it too expensive or difficult to do so?

Bankruptcy

When asked whether they would consider bankruptcy if they were unable to keep up with their debt payments, 7% of all households said that they would seriously consider it and 5% that they might possibly consider it (**Table F**). These proportions are little changed from last year and suggest that the vast majority of households would not consider bankruptcy as a way of alleviating debt problems. Only around 3% of households identified as having debt payment problems said they were considering bankruptcy or an IVA to resolve it (**Table D**). This is a very small proportion of households as a whole. But there is some evidence that attitudes to bankruptcy are not independent of how much

Table F Attitudes towards bankruptcy[a][b]

Percentages of households

	Whole sample	Homeowners	Renters	Knows a bankrupt person	Does not know a bankrupt person
I would never consider it	54	57	49	43	58
I would only consider it as a last resort	34	35	32	43	31
I might possibly consider it	5	3	8	6	5
I would seriously consider it	7	5	11	9	6

Sources: NMG Research survey and Bank calculations.

(a) Questions: If you were unable to keep up to date with your debt, which of the following statements best describes your views on personal bankruptcy? Do you personally know anyone who has become bankrupt?
(b) Figures may not sum to 100 due to rounding.

(1) IVAs are an alternative to bankruptcy, where creditors accept an arrangement for the debtor to follow a specified repayment plan.
(2) Among those renters who found it harder to get credit 55% reported being constrained. This accounts for 4% of households as a whole.

debt is owed by the respondent or their housing collateral. Renters are more likely to consider bankruptcy than homeowners, while homeowners are more likely to consider bankruptcy the more unsecured debt they owe.

Another issue is whether the rise in bankruptcy changes the attitudes of others to its rise: could the stigma of bankruptcy be reduced as it becomes more common? The survey reveals that the proportion of people who know somebody who has become bankrupt has risen over the past year from 21% to 24% of the population — suggesting that almost a quarter of the population now know someone who has become bankrupt. Moreover, those who know a bankrupt person are somewhat more inclined to consider bankruptcy themselves. That is consistent with the idea that a rising bankruptcy rate softens attitudes towards it. But it may also arise simply because those who are more likely to become bankrupt have similar characteristics (age, region, housing tenure) and so are more likely to know each other.

Pensions

Most of the survey is focused on how households cope with their debts. A similar issue concerns how they would respond if their pension turns out not to be as much as had been planned. The responses of different age groups to this question are shown in **Table G**. There did not seem to be any pattern between the age of the respondent and the response. A large fraction of respondents of all ages said they did not know what they would do. Of those who did, responses were fairly evenly split between those who said they would cut spending (or increase saving), those who would put off retiring, and those who would move to smaller or cheaper homes.

Table G Response to lower-than-expected pension by age[(a)(b)]

Percentages of households not yet retired

	18–24	25–34	35–44	45–54	55–64	65+[(c)]
Increase saving/cut spending	33	37	27	23	30	18
Put off retiring	15	12	18	15	20	36
Move to smaller or cheaper home	13	19	27	24	19	0
Other	1	2	5	6	5	2
Don't know	38	30	23	32	25	44

Sources: NMG Research survey and Bank calculations.

(a) Question: If, between now and when you currently plan to retire, you find that the value of your savings or private pension is not as much as you had planned, how do you think you would be most likely to respond?
(b) Figures may not sum to 100 due to rounding.
(c) The number of respondents who were aged 65 or over but had not yet retired was 13, so these figures may be unreliable.

Summary and conclusions

The latest survey provides a guide to the extent of debt problems in the household sector as a whole, updating analysis from previous years. As in previous years, almost all (96%) of the reported debt was owed by mortgagors.

The vast majority of mortgagors appeared to be comfortable with their debts. The size of the typical housing equity buffer was higher than at any time since the mid-1990s. Only around 10% of mortgagors had less than £20,000 of equity in their home. While the proportion of mortgagors reporting problems paying for their accommodation remained low, it had increased over the past year to about 8%. Nevertheless, the affected households account for less than 4% of the total income reported in the survey. As such, these problems are unlikely to have large implications for monetary policy because any effect that they might have had on aggregate consumer spending is likely to have been relatively small.

Similarly, the implications for monetary policy of the financial problems faced by indebted renters will also be small. These households appear to have had the greatest problems, both in getting access to credit and in servicing it. They account for a large share of insolvencies, but only a small proportion of total income. Their difficulties reflect both their lower incomes on average and the fact that they did not own homes that could act as collateral for loans. The majority of renters (56%) did not have any unsecured debt. But for those renters who did have unsecured debt, some were experiencing problems in servicing it.

Most of those who reported problems repaying their debts said that this was because of temporary cash-flow problems or because of overspending. Most expected to resolve their debt problems by cutting spending. Bankruptcy was seen as a last resort by most respondents, although those with high debt and those who knew somebody who had become bankrupt were a little more likely to consider it as a way of resolving their debt problems than those who did not.

Survey method

The survey was undertaken by adding 22 questions to the monthly omnibus survey, MarketMinder, carried out by NMG Research. Interviews were conducted in the respondents' homes using Computer Assisted Personal Interviewing (CAPI). Altogether 1,844 people were interviewed between 24 and 30 September 2006.

One of the limitations of all surveys about sensitive issues such as household finances is that some people may be reluctant to discuss them in face-to-face interviews. Because of embarrassment, those who face the most financial stress might be more likely than others to refuse to answer certain questions or to understate their difficulties.(1) As in previous years, the survey was designed to reduce these possibilities. In order to encourage respondents to divulge sensitive information, they were told that the survey was being carried out on behalf of the Bank of England and would be useful in assessing how spending might be affected by its interest rate decisions and in judging the risks to financial stability. They were assured that their replies would be treated in the strictest confidence, would not be passed to any third party at any stage in the future and would not under any circumstances be used for sales or marketing purposes. Also, to avoid embarrassment in revealing sensitive information to the interviewer, replies to questions were coded and recorded in such a way that the interviewer would not know the content of respondents answers.

Response rates were similar to those obtained in previous years. Only those respondents who were the chief income earner or main shopper were asked for their income. This meant that 10% of respondents were not asked about their income. A further 32% of households refused to provide their household income and 11% did not know what it was.

About 17% of respondents refused to say whether their households had any unsecured debt and a further 5% did not know. Of those known to have unsecured debt, almost 9% refused to say how much they had, while 9% did not know. There was a large overlap between those households who refused to provide information about their income and their unsecured debt. There was greater openness and awareness about secured debt. Only 3% of those asked did not know how much they owed and only 4% refused to say how much.

Several possible approaches can be used to adjust for missing values arising from non-response to particular survey questions. Effectively, these all involve imputing a value for missing observations.(2) All calculations reported in this article have been carried out ignoring non-responses. This implicitly assumes that non-responses are distributed in the same way as recorded responses. But non-response for individual survey questions is not distributed uniformly across groups in the survey population. For example, internal Bank research on the 2004 NMG Research survey shows that men, and people from the AB social group, are more likely to refuse to say whether they have any unsecured debt. Ignoring this biases downwards estimates of the proportion of the population with unsecured debt and the overall amount owed. Nevertheless, internal analysis shows that the overall conclusions from the survey are not sensitive to which of the available imputation methods is used.

(1) There is a large literature on the psychology of survey responses. See for example Tourangeau *et al* (2000).
(2) The most common imputation methods are mean imputation, hot decking, multiple imputation and regression-based approaches. See Little and Rubin (2002) for further details.

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