

Household Debt Explained?

Personal Consumer Debt and its Relationship with Arrears

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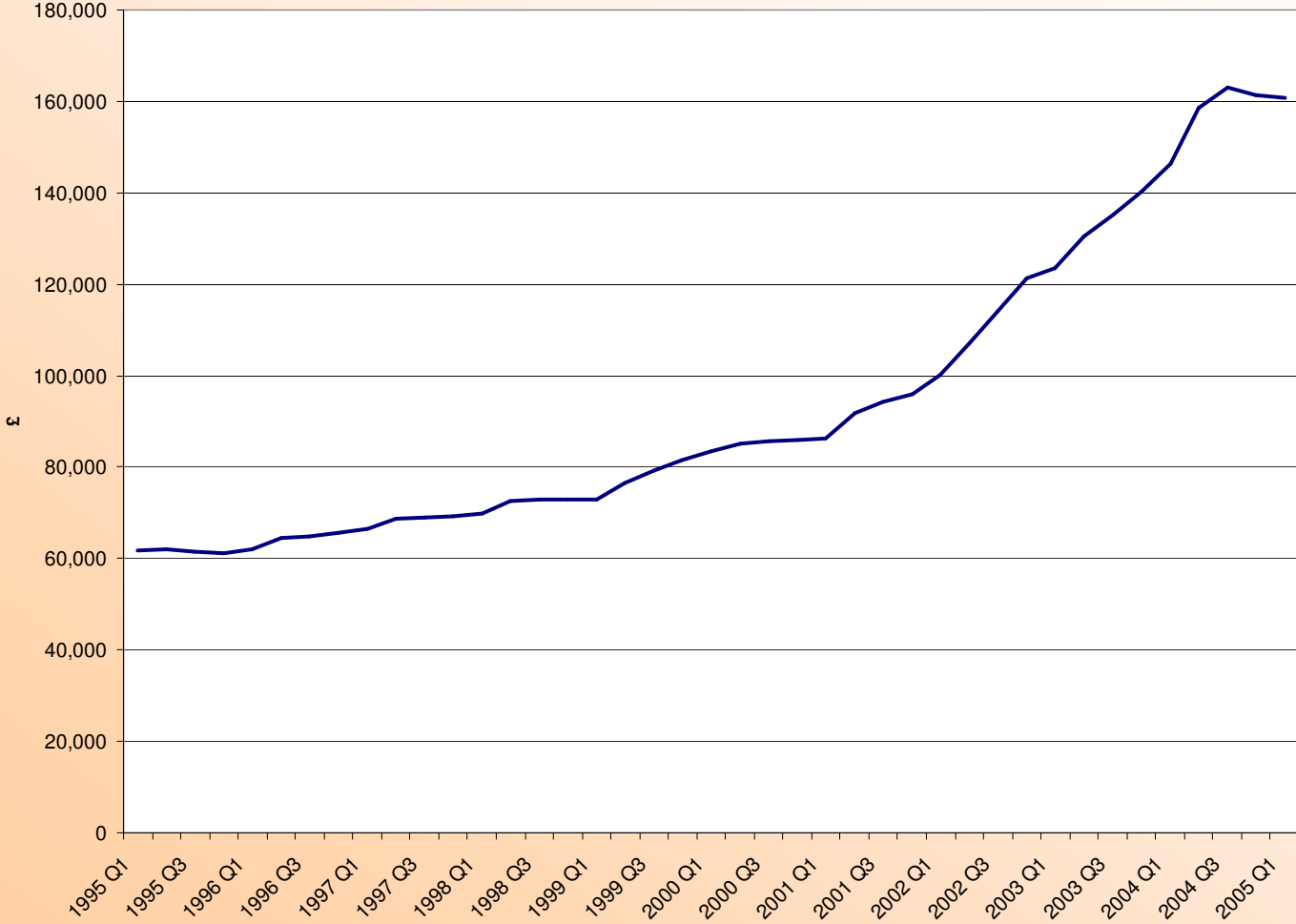


Agenda

- Macro-economic trends
- Key changes
- Household balance sheet
- Household balance sheet and arrears
- Possible uses of the household balance sheet in decisioning
- Conclusions

Rapid house price growth

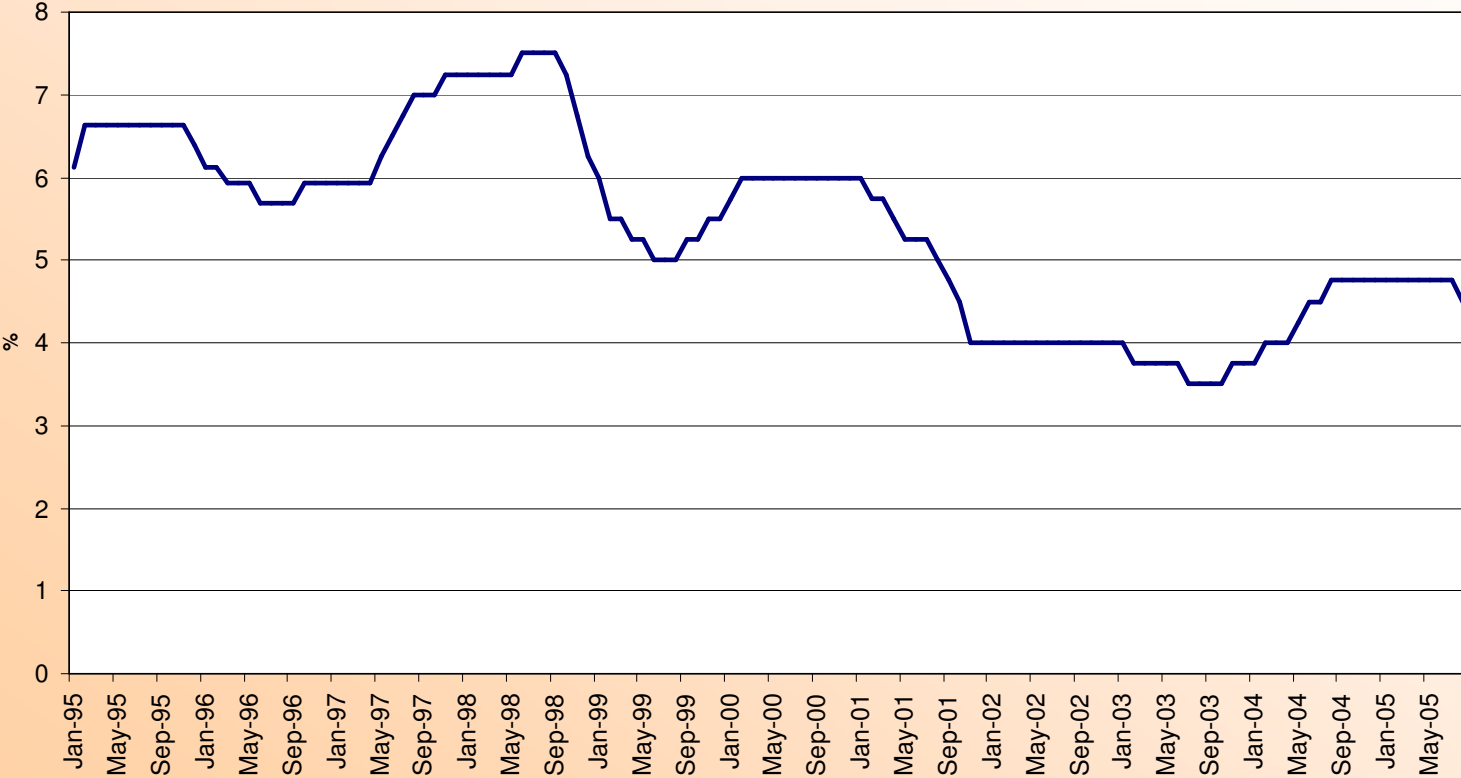
Average UK house price



Source: Halifax House Price Index

Interest rates at historically low levels

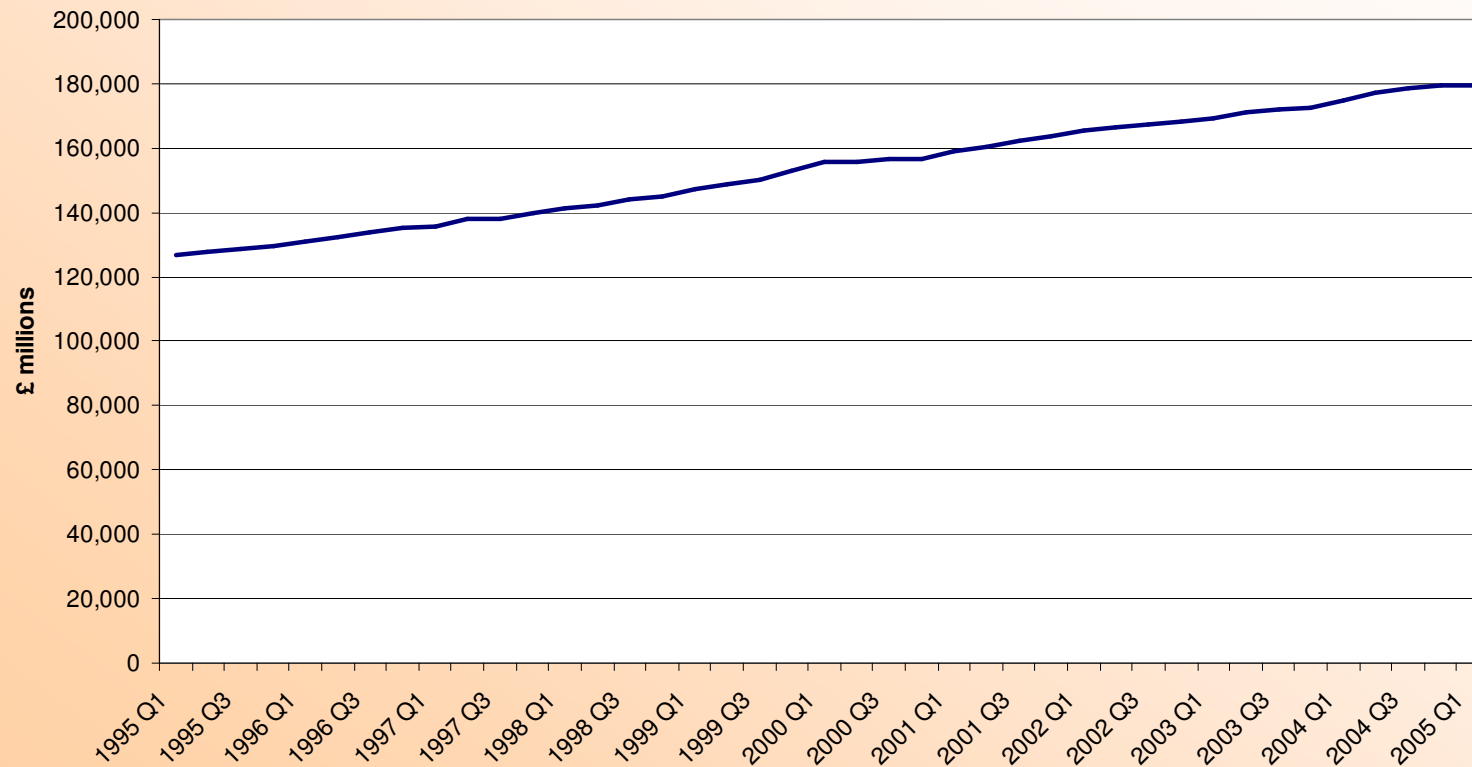
Bank of England Interest Rate



Source: Bank of England

Significant growth in consumer spending

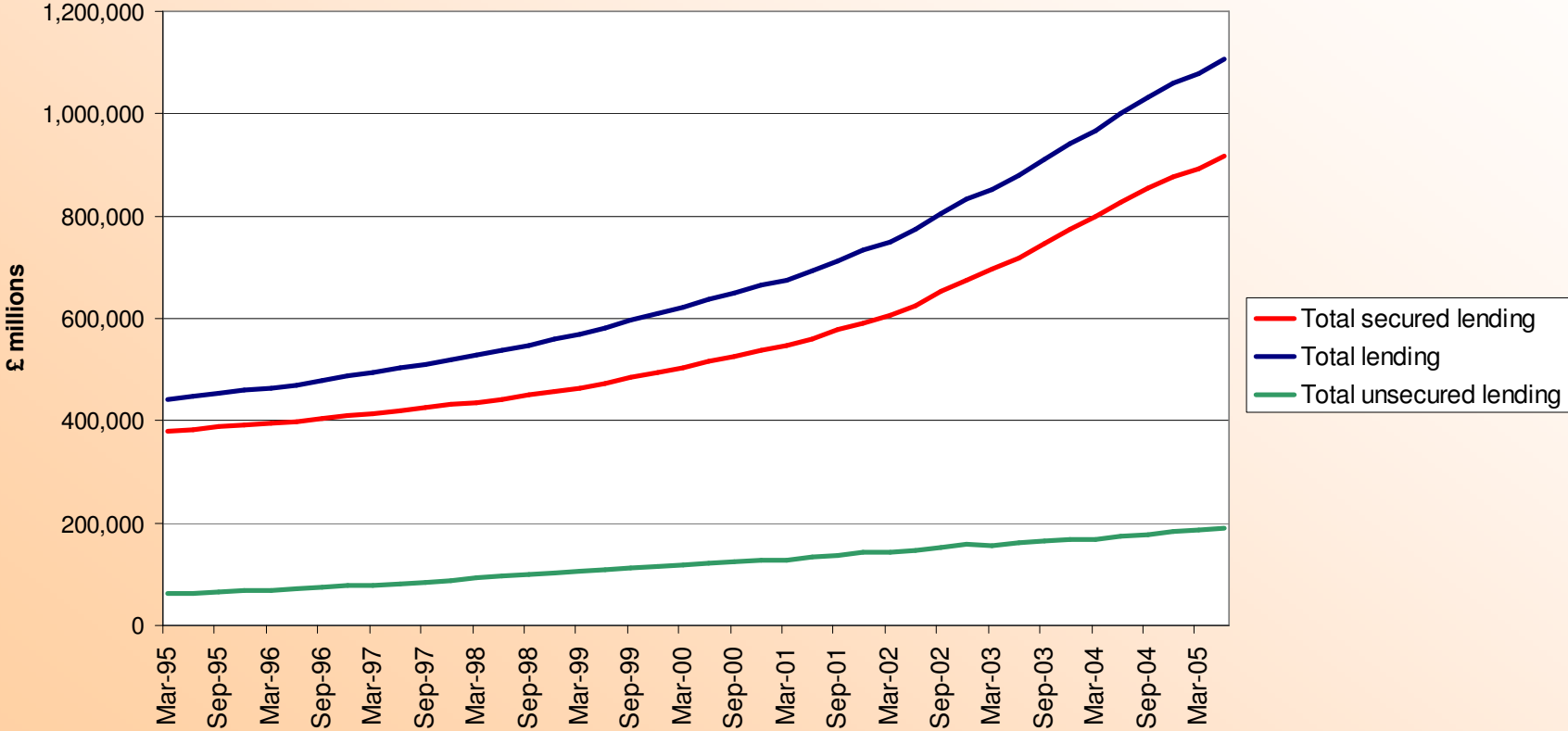
Total household expenditure



Source: Office For National Statistics

Large rise in personal consumer debt

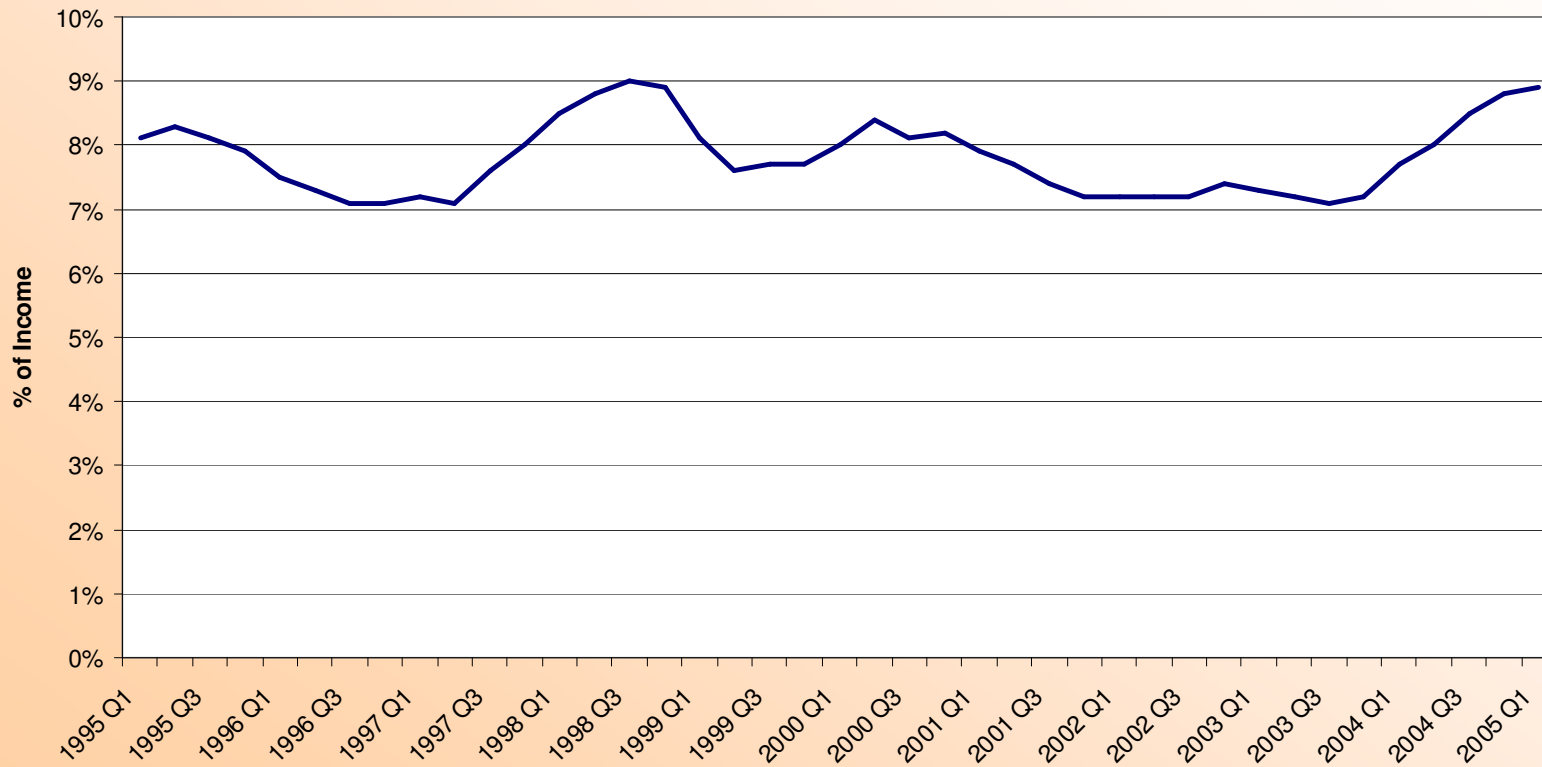
Total consumer lending



Source: Bank of England

Are these levels of debt sustainable?

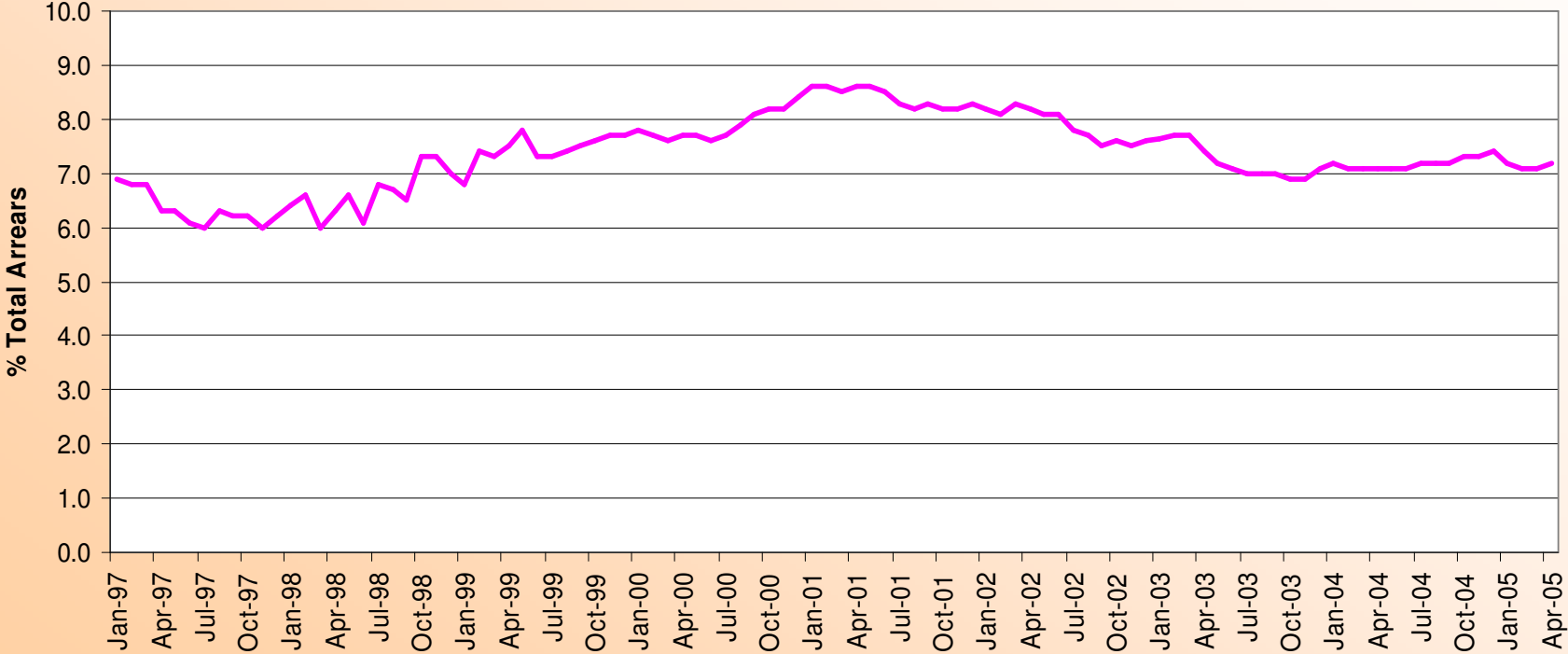
Debt Repayments as % of Income



Source: Office For National Statistics

Is the debt being repaid?

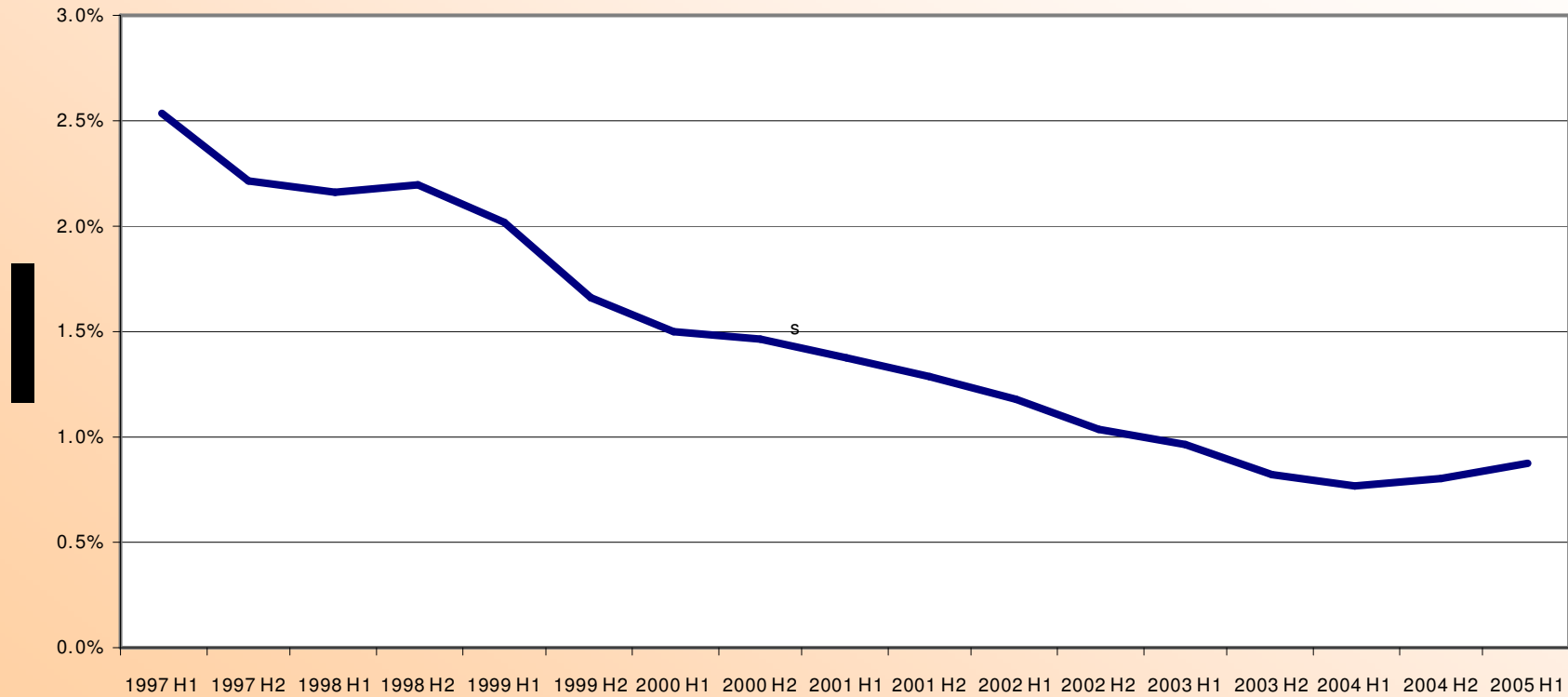
Change in Unsecured Arrears



Source: Finance & Leasing Association

Is the debt being repaid?

Change in Mortgage Arrears



Source: Council of Mortgage Lenders

So all is well then.....?

“...some tightening of lending spreads”

RBS Interim Results 2005

“...a slight deterioration in asset quality”

A&L Interim Results 2005

“HSBC responded to the trends in delinquency by revising its credit scorecards, adopting positive credit reference agency data, further centralising underwriting, strengthening collections capabilities and adding resource to its retail credit function ”

HSBC Interim Results 2005

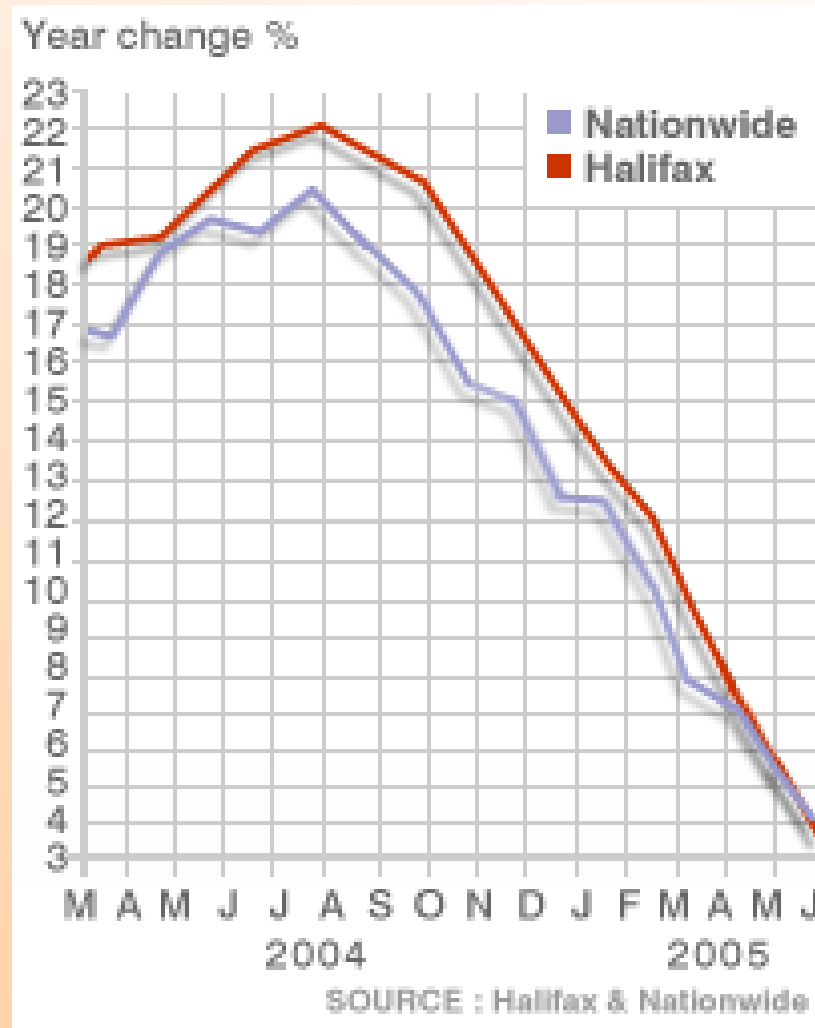
“... with personal loans key initiatives have been increased use of behavioural scoring and risk based pricing ”

LTSB Interim Results 2005

“Last year we reported on the necessary steps taken to tighten lending criteria across our unsecured lending”

HBoS Interim Results 2005

House Price Growth Slowing...



Source: BBC News website

Economic environment is changing...

- Bad debts in unsecured lending sector appear to be rising ... will secured debts follow this trend?
- Consumer boom is fading
A slowdown in the UK economy with GDP year-on-year growth at 1.7%, the weakest rate since Q1 1993
- The number of homes being repossessed has risen for the first time in seven years
(Council of Mortgage Lenders, July 2005)
- The number of individual insolvencies in England and Wales soared by an annual 37% in Q2 2005
(Department of Trade and Industry, August 2005)

Media Interest

BBC NEWS | In Depth | borrowing_debt - Microsoft Internet Explorer provided by A&L browser Set by GPO

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In Depth BORROWING and DEBT POUNDS

Last Updated: Tuesday, 9 August 2005, 07:47 GMT 08:47 UK

Bankruptcies hit another record

The number of individual insolvencies soars by an annual 36.8%, official figures show.

- Creditors avoid bankruptcy action
- Britain braced for credit crunch

DEBT CRISIS

- ▶ Jail term for 8,000% loan shark
- ▶ Consumer credit growth slows down
- ▶ Loan company's debt appeal fails
- ▶ Late credit card fees 'too high'
- ▶ Home repossessions rise sharply

ASK THE EXPERT

Send your questions to our financial experts

Morning after

Are Britons waking up to a major debt hangover?

Q&A: Debt ruling

Could a court victory signal the end of 'unfair' credit?

Useful numbers

Where to go if you need help or information

BORROWING TIPS

Changing credit cards

Switching credit card providers can be a great way to save money. Just be clear what you are signing yourself up for.

- ▶ Do you need a credit card?
- ▶ Maximising your money effectively

GETTING OUT OF DEBT

Ask the expert: My ex's debts

A reader is being chased for her former partner's debts. Is she liable for his debts?

- ▶ Q&A: Managing debt
- ▶ Debt relief for bankrupts

DEBT STORIES

I'm a credit card rate 'tart'

A report has predicted the demise of 0% credit cards. BBC News spoke to one self-confessed rate tart.

- ▶ 'Save Karyn's' charity payback
- ▶ 20 years old and bankrupt

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What does the data say?

- Completed Mortgage applications from H1 2003 were tracked over 2 years
- Tracking period covers periods of house price growth and stability

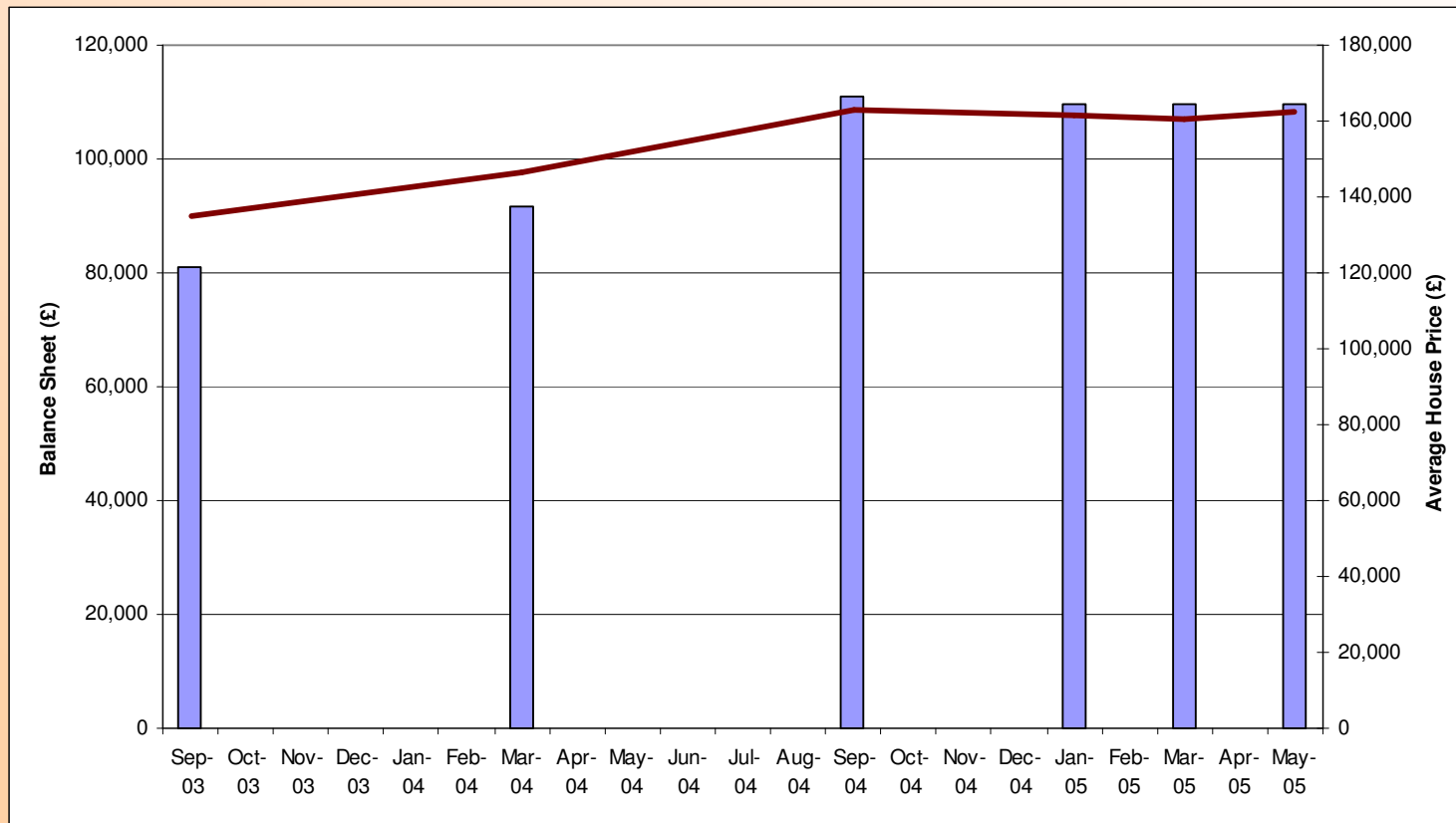
Balance sheet =

- + Indexed House Value (adjusted by HHPI)**
- Unsecured Debt (Experian's DCM value)**
- Secured Debt (Mortgage Balance)**

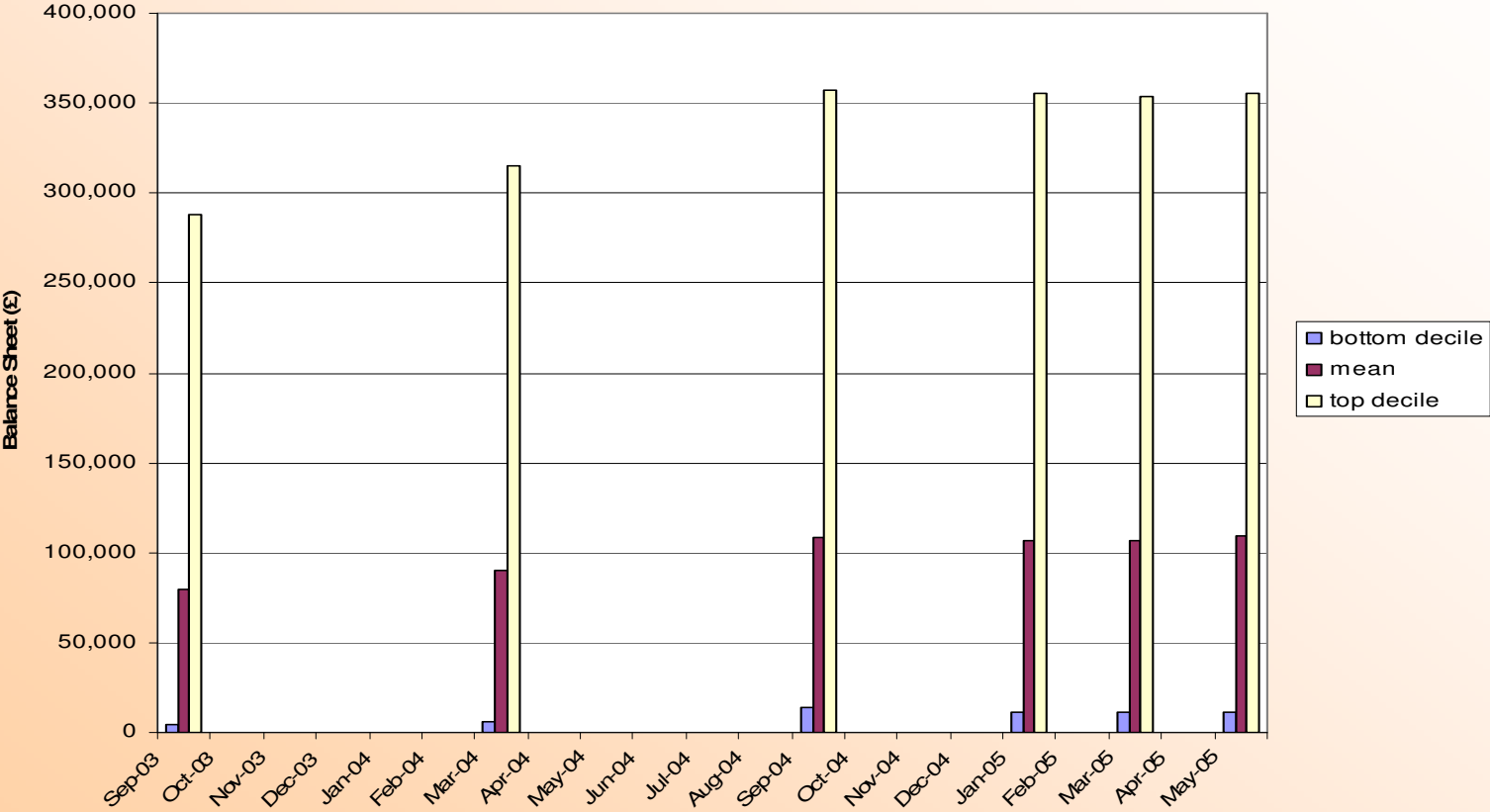
- The balance sheet is an estimate of the liquidity of household
- The constituents of the household balance sheet and arrears were monitored at regular intervals
- Arrears measures: CAIS 2+, A&L Mortgage Arrears and A&L Customer Level Bad Rates

Average Household Balance Sheet

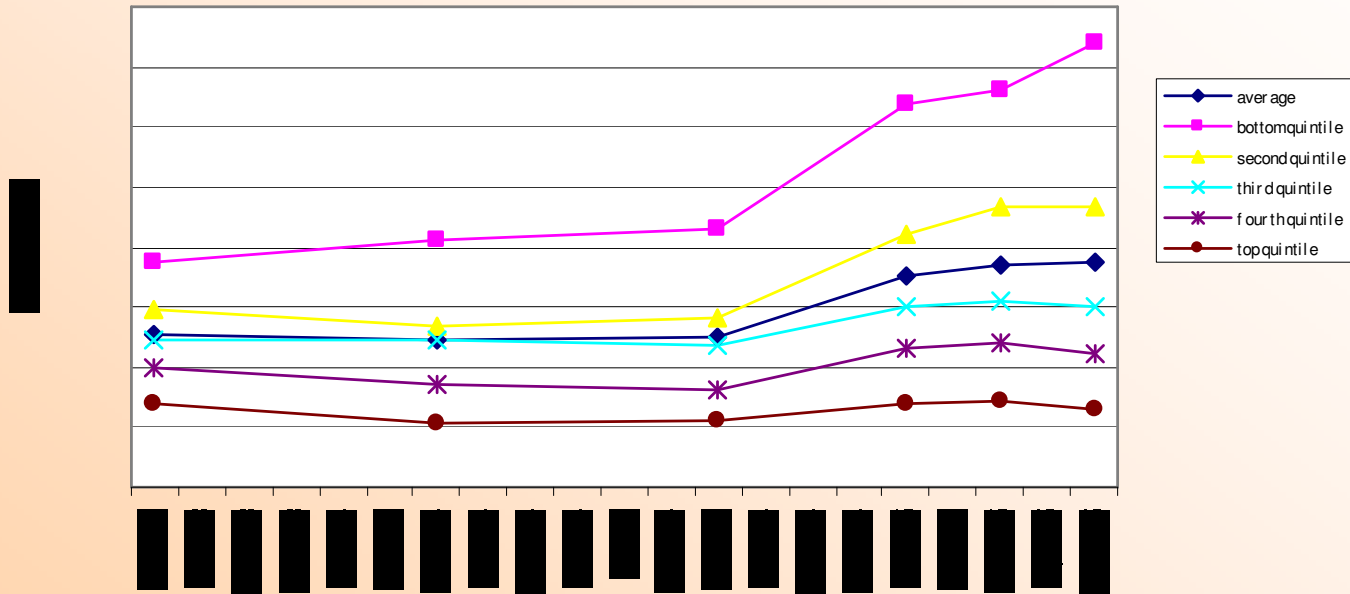
Mean balance sheet follows house price growth



But the average picture hides some stress



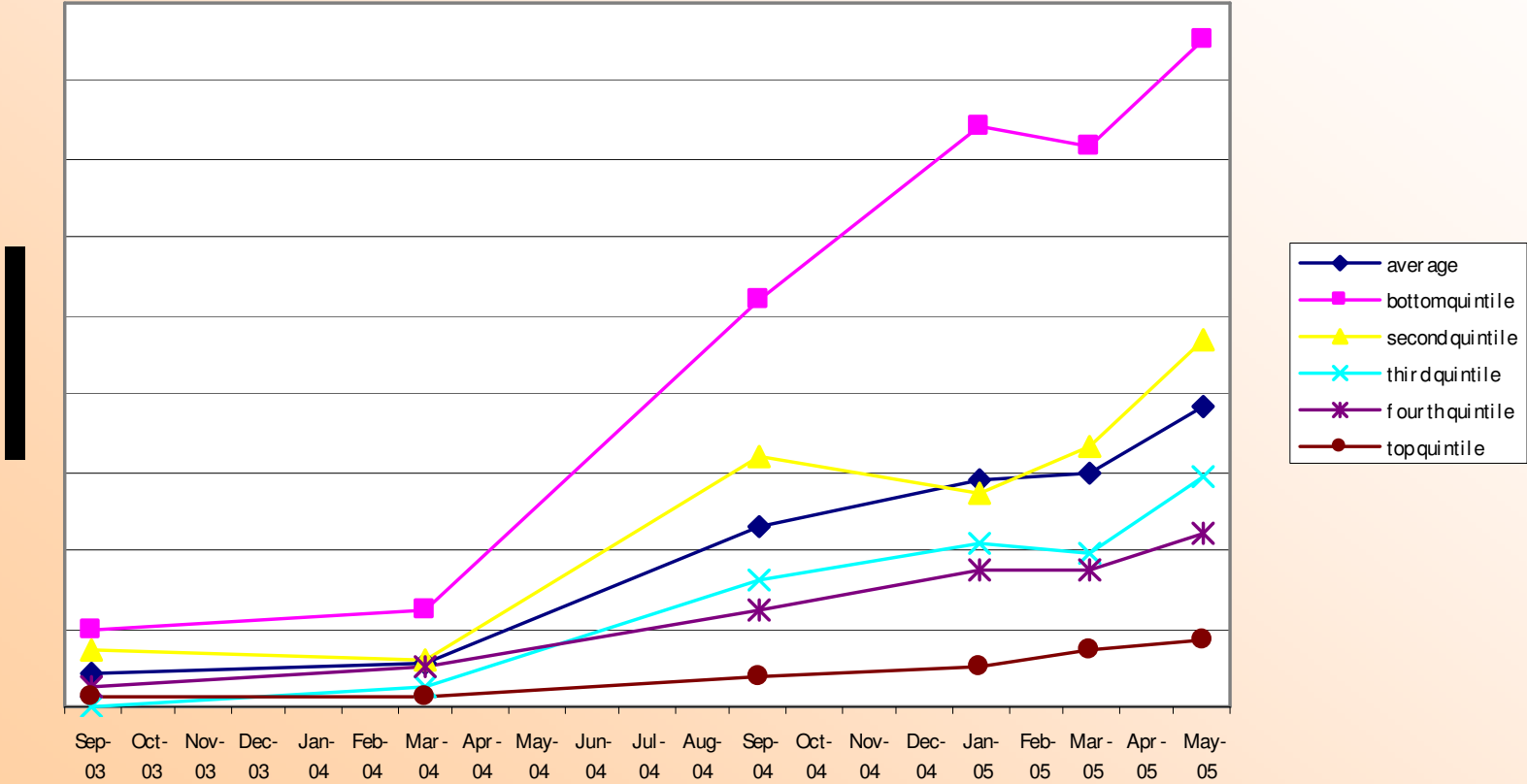
Household Balance Sheet and Arrears



- Bottom quintile shows 97% growth in bad rate, compared to 48% overall and -9% for the top quintile
- Rise in arrears coincident with slowing house prices and rising interest rates
- So poor balance sheet at the start of the relationship gives an increased likelihood of arrears... no great surprise...

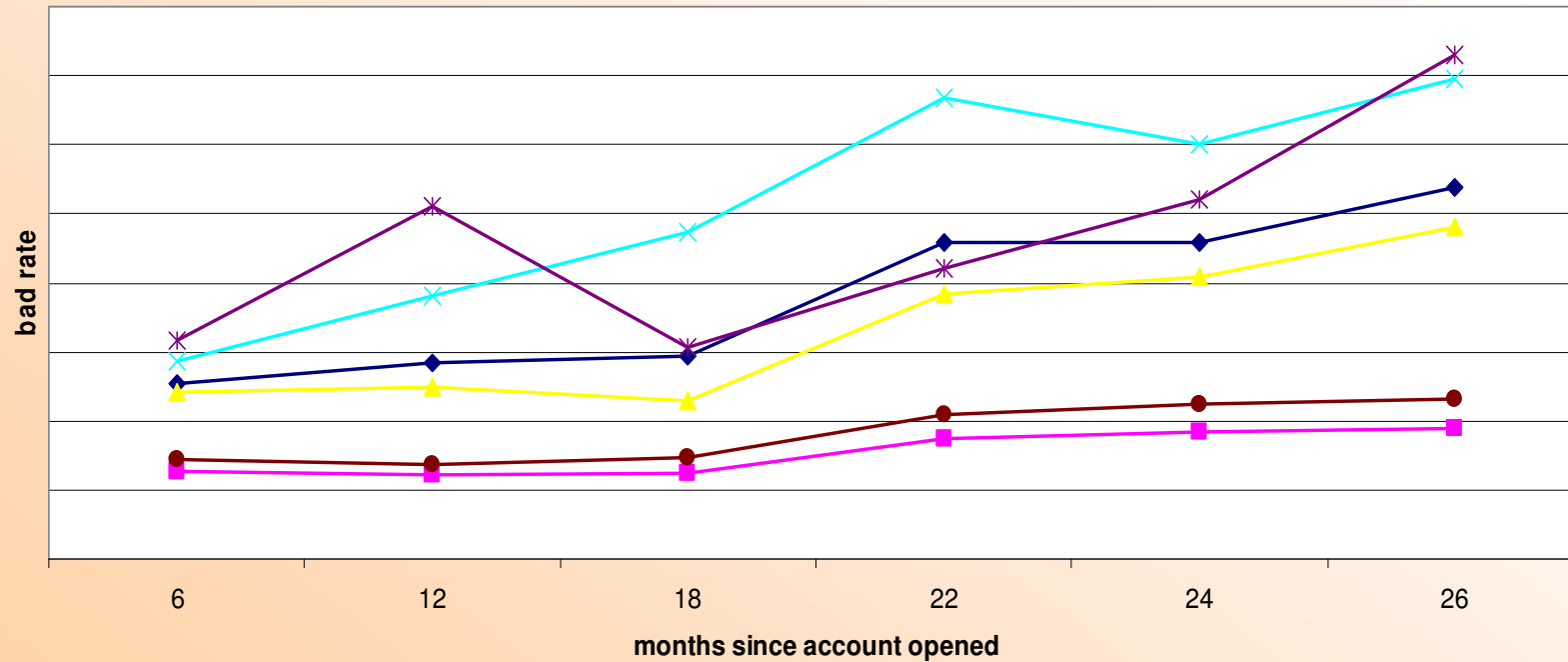
Household balance sheet and A&L mortgage arrears

Also true for A&L mortgage arrears and...



The impact of keeping up with the Joneses

What if you built up debt in a period where house prices were growing?



- ◆ balance sheet less than 10k at 6 months
- average
- ▲ balance sheet less than 10k at 6 months and 10k plus at 18 months
- ✕ balance sheet less than 10k at 6 months and less than 10k at 18 months
- ✱ balance sheet between 10k-60k at 6 months and less than 10k at 18 months
- balance sheet between 10k-60k at 6 months and 10k plus at 18 months

A Sticky Situation for the Jones' Neighbours

- 82% of households with a balance sheet less than 10k through first 18 months (house price growth) remain there after 26 months
- Of those which have a balance sheet of between 10k-60k at 6 months and then reduce their balance sheet to less than 10k by 18 months, 73% will still have a balance sheet less than 10k after 26 months



Possible Uses of Household Balance Sheet

- Household balance sheet is predictive of poorer credit performance
- Does it add value at the application stage for mortgage scoring?
- What about behavioural scoring?
- Portfolio assessment?
- Collections Strategies?

Behavioural Scoring

Bad rates for Balance Sheet quintiles



Conclusions

- Household debt and, more importantly liquidity, are predictive of future arrears
- Currently the groups under stress are relatively small
- Most homeowners have benefited from low interest rates and house price growth
- Some have used a period of house price growth to spend – these people are now having more difficulties repaying their debts
- Will reducing interest rates and possible further house price growth enable major issues to be avoided?