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BRIEFING

Robbing Peter to Pay Paul

How limited access to affordable credit hurts children living in poverty

"You've got to make it stretch more than it will do. That's how you make your money go round. Get what you have to have on the Tuesday – nappies, milk, all of that – then anything else left over, you've got to rob Peter to pay Paul. Some things you can pay one week but you know you'll have to miss that the next."
Single parent, Speke, Liverpool, 2007

Introduction

Policy-makers expend a lot of time and energy exploring the most effective ways to get more money into the pockets of low-income families. But they spend little time considering the unequal way in which that money comes out of families' pockets.

This briefing presents important new data and findings on the borrowing experiences of low-income families:

- Nearly 60% of low-income families have no savings.[1]
- Low-income families[2] have limited credit options, and these are often extremely high cost. Some come with punitive terms for irregular payments, yet for families on a tight budget, irregular payments are hard to avoid.
- 2.3 million people use doorstep lenders who commonly charge interest at 183% APR (annual percentage rate) each year.[3]
- 'Rent to own' retailers such as Brighthouse 'rent' items such as sofas and TVs with total rental payments of several times the normal retail price. These retailers, which are located in deprived areas, have a reputation for rapid repossession of goods if people miss their weekly payments.
- Among those in poverty, 42% have been seriously behind with repaying bills or credit commitments in the past year compared with just 4% of those not in poverty.[4]

In recent years, many low-income families have turned to credit cards and personal loans that offer lower rates of interest. But 36% of low-income credit card users have been exposed to penalty charges and 24% of low-income families have been three months behind on credit agreements.[5]

Many people on low incomes are turned down even by doorstep lenders, sometimes just because of where they live. Some have to use loan sharks lending at very high interest rates, and sustaining their collections by violence, intimidation and even sexual exploitation.[6]

For low-income families and children, struggling to meet credit commitments deepens the stress and hardship of living in poverty and managing on a very tight budget:

- Nearly **one in three** low income families with credit problems say they have difficulties in buying adequate shoes or clothing.
- Nearly **one in four** say they have difficulties in providing food for the family.
- **One in five** say they have difficulties with fuel and heating.[7]

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The implications of these findings on credit are profound for families' lives. At the root of the problem is poverty: families incomes are often too low to secure low cost credit, and their incomes too volatile to service their loans each week. The most vulnerable in our society therefore pay a 'poverty premium', paying a higher price for credit, and dealing with costs of debt.

The solutions are twofold:

- **Eradicating child poverty**

This will ensure that no family relies on credit to meet basic needs. Save the Children believes that an investment of £4 billion to support family incomes should be the first step, ensuring the government meets its target of halving child poverty by 2010.

We believe that one element of this should be seasonal grants. These are lump sum payments for low-income families both in and out of work, to assist with the high costs associated with particularly expensive times of year when many families experience hardship.

- **Ensuring affordable credit for all**

Affordable credit means access to low-interest loans for low-income families, meeting their needs for flexibility and low weekly repayments. This involves reform of the Social Fund, a cost effective policy where the government has been ignoring calls for reform over many years. Alongside this there is scope for the private and voluntary sector to improve the credit options they offer to those on low incomes, and the scale and reach of their services.

Struggling to make ends meet

A single parent with two young children who is not in work has to manage on £165 per week, once rent and council tax have been paid for. That means just £8 per person per day to cover electricity and gas, phones, other bills, food, clothes, washing, transport, health needs, not to mention furnishings, activities for children and all other essential items. It's simply not enough.

The impact on families is evident in the government's statistics on deprivation. Among those in severe poverty:

- 74% cannot replace worn out furniture.
- 93% cannot afford a holiday away from home once a year.
- 84% cannot make regular savings of £10 or more per month.

Among children in severe poverty:

- 41% do not have enough bedrooms for children of different sexes to have separate bedrooms when they are 10.
- 22% cannot afford to go on school trips.
- 25% cannot afford to go to a toddler group, nursery or playgroup at least once a week.[8]

Many families on low incomes are skilful at stretching their resources as far as possible.[9] Getting by from week to week is characterised by strategic spending and tough choices, prioritising basic needs. Parents have a range of strategies to help maximise resources from week to week, and to protect their children as far as possible from the impact of poverty. One study based on interviews with low-income families listed a wide range of strategies.

> *"Doing without; Doing it yourself, not paying for services; Travel distances for cheaper goods; Ring-fence saving of small sums; Delay purchase; Use charity shops; Re-use [clothing] within family; Use black market; Seek interest free credit; Use cheaper outlets; Buy cheaper products; Seek bargains and bulk buy; Spend wisely/carefully; Sell goods to raise money; Co-ordinate family buying of presents; Forward planning; Prioritise; Cut back; Budget for end of month shortage; Focused shopping; Forego quality goods."* [10]

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While there is evidence of poor financial skills among some people on low incomes, the strategies outlined above represent a high level of financial skills.[11] The budgeting methods of low-income families are often appropriate to the conditions they face, reflecting their primary concerns and their time horizon of getting by from week-to-week.

Why millions of families turn to credit

Families in poverty may manage to get by in an average week, though with tough choices. But that's only half the story. Many weeks are not 'just an average week'.

We all experience peaks in personal expenditure associated with certain times of year (such as school holidays or when winter sets in). We often need to buy expensive items that make a big dent in the household budget. Everyone experiences unexpected costs. At these times, people on adequate incomes may turn to savings or credit. But for low-income families the only option is likely to be to turn to credit:

- 57% of low-income families and 72% of lone parents have no savings; very few have more than £300.[12]
- 72% of low-income families and 88% of lone parents say they would find it difficult[13] or impossible to raise £200–£300 in an emergency.
- 80% of low-income families and 88% of lone parents say it would be difficult or impossible to save £500 for a major purchase.[14]

How poor families make their budget stretch

The central budgeting strategy of many poor families is 'robbing Peter to pay Paul'. If families are going to pay for essentials such as heating, food, clothes and shoes for children, some weeks something else has to give:

Missing credit payments: Often the only option for 'flexing the budget' – and the most commonly used – is to miss payments on credit agreements. This explains low-income credit users' reliance on home credit, which allows borrowers to miss payments without penalty – although this flexibility comes at high cost. At the same time, getting used to home credit terms increases people's vulnerability to punitive charges and escalating debt on credit cards and personal loans.

Parental sacrifice: A range of evidence, both qualitative and quantitative, has shown how many parents living in poverty sacrifice their own basic needs in order to protect their children as far as possible from the impact of poverty.[15] For example, in the deprivation figures quoted above, it is the adult needs where the family is much more often lacking than those specifically related to children. In research with low-income families by Save the Children in 2006, 91% of parents said they often go without to make sure their children have enough.[16]

Low price goods, second-hand and 'value' goods: There is often a cheaper option for many products. These may be adequate, but alternatively may be a poor value option – for example, electrical goods that are more likely to break down or that are even dangerous, or food that is less nutritious.

Keeping control: 42% of low-income families manage their finances with cash[17] – rejecting direct debits in favour of cash payments and prepayment meters. While cash payments mean greater expense, they help people manage their expenditure and avoid penalty charges, which might cost them more in the long run.

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What types of credit do families in poverty use?

Price comparison websites promote standard credit cards with interest rates of 15%, cards offering interest-free shopping for 12 months, or balance transfers that do not incur interest over similar periods.[18]

However, for families living in poverty these kinds of credit options are rarely available. An estimated 2.8 million[19] people on low incomes have a need for credit and do not have access to mainstream lending. For these families the main options are:

- mail order credit
- sub-prime credit cards
- home credit / doorstep loans
- home credit shopping
- Brighthouse / rent-to-own
- payday advance
- cash converters
- Social Fund
- loan sharks / illegal lenders.

Around half of those using home credit or doorstep lenders do so because they have no other option, as is the case with more than eight out of ten loan shark users. As Table 1 shows, nearly four out of every ten people living in the 5% most deprived estates refused credit elsewhere in the last 12 months, turned to home credit; more than 15% used cash converters or pawnbrokers and one in ten used loan sharks.

Table 1 Types of credit used by families living in poverty who have had credit refusals in last 12 months (all answers over 5%)

home credit	37%
mail order	29%
no credit used	25%
cash converters / pawnbrokers	16%
loan shark	10%
rent-to-own store	9%
hire purchase	9%
credit card	8%

Base: Residents of most deprived estates (top 5% of indices of multiple deprivation)
Source: Policis and Personal Finance Research Centre, *Illegal Lending in the UK*, Department of Trade and Industry 2006.

High cost credit options for low-income families

Provident and the 'doorstep' lenders market: the impact of high cost credit

With an APR of 183%, doorstep loans are an extremely high cost credit tool. However, it's a mistake to characterise home credit as a 'lender of last resort'. First, many people on low incomes value the service they provide (see below). Second, home credit providers have become increasingly discerning about the customers and the areas they serve. They deny credit to more people than they provide it to. Around 0.7 million people, mainly living in the most deprived estates, don't even have the option of borrowing from the doorstep lenders. As a result, they may turn to loan sharks and illegal lenders.

It's well established that those on low incomes are less concerned about the total cost of credit – how much has to be paid overall – than the amount that has to be paid each week. Low-income families living hand-to-mouth on a weekly basis are vulnerable to doorstep lenders such as Provident who offer families living in poverty very high cost credit, but at low weekly payments, and with considerable flexibility in terms of missing payments. But the high cost of this type of credit means a lower household income over a long time.

A single parent on benefits with two young children taking on loans totalling £500 over the course of a year and paying back £840 is losing a significant proportion of a very limited household income to the lender, equivalent to around two weeks income after rent and council tax has been paid.

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Mainstream credit: the hidden costs of lower interest loans

The cost of an expensive transparent loan can be well understood and incorporated into household budgeting plans. However, the major trend in the provision of credit for those on low incomes is a move away from doorstep lending to credit cards and revolving credit (where credit can continually be extended up to a limit, as opposed to a loan with fixed instalments). These lenders offer low APRs but have minimal flexibility and high costs associated with missed payments – costs that are a very significant component of lender profits.

The cost of credit on an apparently low APR product can escalate very quickly if borrowers miss payments or can become very expensive if only minimum payments are made on a revolving credit line over an extended period (ie, just making the minimum payment on a monthly credit card bill). Debt can escalate in a way which is unexpected and not transparent for many borrowers. Charges can be unpredictable and unmanageable for someone on a very low income, particularly if charges on credit cards also trigger charges for bounced direct debits, as is often the case. Family borrowers and those on the tightest budgets are those most at risk:

- 27% of all low-income credit users and 28% of low-income family borrowers have been charged penalty charges on bank accounts.[20]
- 25% have been charged penalty charges on credit cards and personal loans.[21]
- 30% have been charged penalty charges on credit agreements and 38% for bank account-related charges for low-income borrowers in work.[22]

Those on low incomes taking on credit cards with low card limits – typically £250–£500 for a starter card – can find this type of revolving credit very difficult to manage. Many card users quickly find themselves using up their available credit limit and can then find themselves able to make only the minimum payment on their card, often over a very extended period, sometimes years. This not only results in very high cost credit but also exposes individuals to the risk of penalty charges from missed direct debits for a very long time.

> A borrower in work with a £1,000 credit line at 17.9% APR, paying more than the minimum each month but missing three payments per year (a little less than average), may well receive three sets of penalty charges (3 x £12), and three bank charges for the bounced direct debit (3 x £30).

Brighthouse and 'rent to own': the high cost high street

One form of quasi credit that is particularly damaging to the budgets of low-income families is offered by 'rent to own' retailers, such as Brighthouse, who provide high ticket goods to people who would fail credit checks. Rental payments are made weekly, with contract terms up to three years. The sum paid by the consumer if he or she pays to the end of the contract term will be several times the normal retail price of the goods and goods are not owned by the consumer until the end of the rental period.

Low-income families enter these contracts who cannot obtain items such as sofas, TVs or consumer electronics any other way. Families prioritise these payments before essential spending because of the lenders' reputation for rapid repossession of goods in the event of missed payments.

> *"Now Brighthouse. You just got to pay it every week so if you don't pay it every week your stuff gets uplifted. So as I say, basically that is one of the bills I've got to pay each week like my gas and electricity. It's either that or the kids' stuff gets uplifted and I don't want that."*
> Single parent, Glasgow, 2007

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Illegal lending: the sharp end of the credit market-place

People who are unable to access legitimate credit providers and are forced into the illegal market face the highest costs. The costs of borrowing from an illegal lender can be limitless in that the aim of many such lenders is simply to extort the maximum sum possible from vulnerable households for as long as collection can be sustained by intimidation.

The average sum paid is three times the cost of the highest high-cost lenders. So, approximately £285 is paid back for each £100 loaned, ie, the charge for credit averages £185 per £100 borrowed. Penalties for late payment are often arbitrary, disproportionate and escalate the length of loan. The effect is to exacerbate the cycle of debt. An estimated 165,000 households in the UK are using illegal lenders, half of them in the 5% most deprived areas.[23]

> *"What I didn't realise was the extortionate amounts of interest that he put on there, especially when you're having £50 (as penalty for missing payment) put on there. And after a couple of weeks he was literally putting on hundreds if you didn't pay."*
>
> Victims of illegal lenders, Birmingham, 2006

The impact of debt on family life

More than half of low-income families see themselves as having difficulties with their debt. One survey found that 21% are "uncomfortable with my debt and will have to budget carefully"; 14% say "debt (is a) constant worry and (I) will struggle to pay"; and 13% "feel trapped by debt and can't see how (they) will repay".[24] The primary reason that low-income families give for problems with debt is the inadequacy of their income, which nearly half cite as the reason. Many other reasons contribute such as unemployment, relationship breakdown, benefit delays, health problems or an inability to manage money.

For those with debt concerns, the ramifications for family life can be enormous. Among low-income families with debt concerns:

- Nearly one family in three says they have difficulties in buying adequate shoes or clothing.
- Nearly one in four says they have difficulties in providing food for the family.
- One in five says they have difficulties with fuel and heating.
- More than one in eight says they have difficulties with rent or housing.[25]

Credit problems also have an impact on personal relationships within low-income households:

- 25% say credit causes tension and arguments with partners.
- 13% say it causes physical health problems.
- 13% say it causes difficulties in relationships with children.
- 13% say it causes mental health problems.
- 11% say it causes breakdown of relationships with partners.[26]

What must be done?

Low-income families, parents and children are bearing an unacceptable burden in dealing with the impact of their credit and debt. It can't be acceptable that in a wealthy society those with the greatest needs face the highest costs for some things that the more affluent get for free or at minimal cost. We recognise that the private sector offers financial services based on anticipated risk and return, but when basic services are unavailable or provided in a punitive way, policy-makers must respond.

How do we make loans with low interest rates more widely available and more appropriate to the needs of low-income families, so that they move from high cost credit, and its debilitating effect, to low-cost credit?

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A number of steps have been taken in recent years: the Financial Inclusion Fund; the establishment of the Illegal Lending project teams; initiatives to extend lending to higher risk borrowers through the Growth Fund; and the current review of the legislative framework for third sector lenders designed to support future growth. However, it is clear that, after ten years in government, these initiatives are still at an early stage and the scale of the challenge remains immense.

Recommendations to lenders

We call on mainstream banks to:

- **take corporate social responsibility seriously**, ensuring that financial products are made available to the poorest, and that they reflect their needs, reducing penalty charges, offering small sum overdraft facilities and working with governments both central, devolved and local and the voluntary sectors (credit unions and CDFIs) to tailor products for low-income families.

We call on lenders selling lower cost APR cards and loans to:

- **be more transparent in their pricing**, ensuring that customers fully understand the costs of irregular payment patterns or of making only minimum payments on revolving credit lines.

We call on all lenders to:

- ensure people on low incomes have access to **sound financial advice** in order to understand fully the advantages and constraints associated with different credit options.

Recommendations to government

Fundamentally, the problem of the 'poverty premium' is the problem of poverty. As stated above, by far the biggest reason for credit problems for low-income families is their low incomes. The government's commitment to end child poverty is the single most important policy goal in this area.

We call on the government to:

- **Invest £4 billion where it matters**
  Research by the Joseph Rowntree Foundation, based on modelling by the Institute for Fiscal Studies, showed that the government would need to spend £4.5 billion extra per year – highly targeted at particular tax credits – to meet the target of halving child poverty by 2010. After the 2007 Budget, with extra resources directed to child benefit and tax credits, the estimate is now that £4 billion a year will be needed. The Campaign to End Child Poverty is calling for these resources to be invested as a matter of urgency. We believe this must be part of a long-term commitment to ensure that the incomes of all families are adequately supported.

- **Introduce seasonal grants**
  Save the Children believes that one element of this £4 billion investment should be seasonal grants, a lump sum payment paid at a rate of £100 per child in summer and winter, and £100 per household in winter, targeted at those in receipt of maximum child tax credit (households with children in receipt of out-of-work benefits or the working tax credit). Seasonal grants could take 440,000 children out poverty, and meet a range of goals around deprivation, educational inclusion and fuel poverty. They are strongly supported by low-income families, and the general public as a whole.

- **Reform the Social Fund**
  Government's commitment to combat poverty would benefit from reform of the Social Fund to ensure greater availability and access to existing and new products. This is a cost effective tool that the government has failed to reform, despite the wide acknowledgement that it is not serving the needs of those on low incomes effectively. There is a vital role for interest-free credit for low-income borrowers to help meet the costs of essential items – the existing system of budgeting loans and crisis loans must be protected, ideally with expanded funding and access.

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There is a clear role for low-interest credit to supplement this, which could be provided by a range of appropriately regulated lenders. Any provision of low-cost or no-cost credit should be non-stigmatising, and application processes should protect dignity, privacy and be simple to use, offering a variety of application routes (written, phone, face-to-face). These should be supported by access to good quality financial advice. Provision should facilitate independence and modest asset building to assist both with immediate need and with ironing out future emergency challenges through further access to low-cost financial help.

Reforms could link with other initiatives such as the Savings Gateway and to credit unions and community development finance institutions to help people on low incomes improve their credit ratings as well as increase saving and build assets; and to the provision of financial education and advice on income entitlements.

Notes

[1] Policis / National Consumer Council survey of 1,520 low-income consumers and credit users aged 18–64, excluding full-time students, 2005

[2] In statistics used in this paper, 'low income' refers to people in the lowest 20% of income distribution.

[3] Competition Commission, *Home Credit Market Investigation*, 2006; see Providentpersonalcredit.com

[4] Data from Policis. All data in this report is supplied by Policis unless otherwise stated.

[5] Taylor Nelson Sofres survey for Policis of 991 low-income credit users, 2005

[6] Personal Finance Research Centre / Policis, *Illegal Lending in the UK*, Department for Trade and Industry, 2005

[7] Competition Commission, *Home Credit Market Investigation*, 2006

[8] S Middleton and M Magadi, *Severe Child Poverty in the UK*, Save the Children, 2007

[9] A Atkinson, S McKay, E, Kempson and S Collard, *Levels of Financial Capability in the UK: Results of a baseline survey*, Financial Services Authority, 2006

[10] J McKendrick, S Cunningham-Burley and K Backett-Milburn, *Life in Low Income Families in Scotland*, Scottish Executive, 2003

[11] See A Atkinson, *Financial capability amongst adults with literacy and numeracy needs*, Personal Finance Research Centre, 2007, for a discussion of these issues

[12] See note 1.

[13] See note 7. Also Kempson and Collard, *Affordable Credit: The way forward*, 2006

[14] See note 7. Also Kempson and Collard, *Affordable Credit: The way forward*, 2006

[15] E Kempson, *Life on a Low Income*, Joseph Rowntree Foundation, 1996; S Middleton, K Ashworth and I Braithwaite, *Small Fortunes*, Joseph Rowntree Foundation, 1997; L Adelman, S Middleton and K Ashworth, *Britain's Poorest Children: Severe and persistent poverty and social exclusion*, Save the Children, 2003.

[16] Save the Children, *Hard Times*, 2006

[17] See note 4.

[18] See www.moneysupermarket.com

[19] Policis estimates. Personal Finance Research Centre and Policis, *Illegal Lending in the UK*, Department for Trade and Industry, 2006

[20] See note 7.

[21] See note 7.

[22] See note 7.

[23] Personal Finance Research Centre and Policis, *Illegal Lending in the UK*, Department for Trade and Industry, 2006

[24] See note 7.

[25] See note 7.

[26] See note 7.

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For more information contact
j.strelitz@savethechildren.org.uk

Save the Children is a member of the Campaign to End Child Poverty.

Save the Children
1 St John's Lane
London EC1M 4AR
UK

Tel +44 (0)20 7012 6400

www.savethechildren.org.uk

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