Debt Free Birthday

A report for Zopa

January 2016

Cebr

Contents

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The report was authored by Nina Skero, Cebr Economist with supervision from Scott Corfe, Director. The views expressed herein are those of the authors only and are based upon independent research by them.

Executive summary

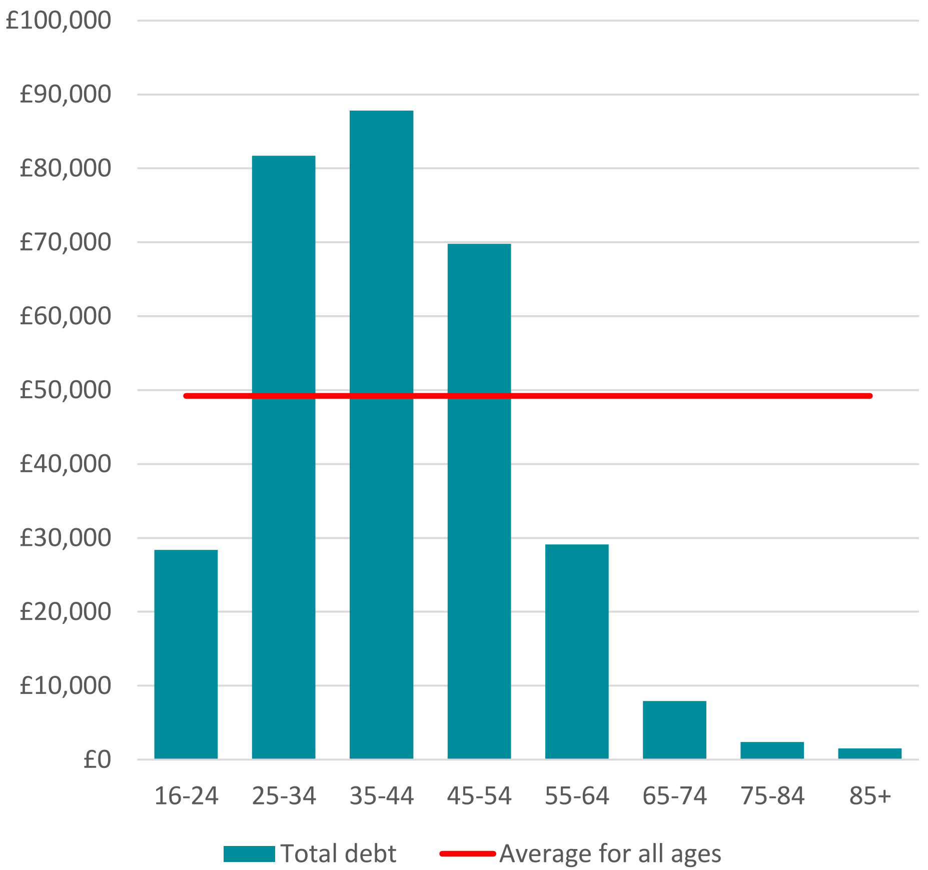
- When we consider total debt including mortgage liabilities, unsecured debt (e.g. credit card and store card balances), student loans and other loans both formal (e.g. car purchase agreements) and informal (e.g. borrowing money from friends), the average UK household is £49,200 in debt.
- If we consider just unsecured debt the average UK household is £4,100 in debt. The extent of indebtedness varies greatly based on age. The most indebted households, with an average of £14,200 in outstanding loans, are those aged 16-24.
- The most commonly cited reason for taking on debt is the inability to fund something upfront due to the lack of money. This is followed by wanting to pay in instalments rather than upfront and in order to avoid using up savings.
- In 2007, just before the financial crisis, the average UK household held £41,900 in debt, £39,100 of which was accounted for by outstanding mortgage payments. In 2015, the total average debt figure stood at £49,200. The 17.6% increase over the past eight years is explained by an increase in both secured (mortgage) and unsecured lending.
- Based on the survey commissioned by Zopa, people today on average expect to be free of unsecured debt such as credit card, car or pay day loans at the age of 50. However data from the Wealth and Asset Survey show that for many, this is an overly optimistic expectation. In fact, on average people become free of unsecured debt at the age of 64 – 14 years later than they expect.
- Based on the survey commissioned by Zopa, households on average expect to be free of mortgage debt by the age of 57. However, the average 55-64 household still has £29,100 in debt, £25,600 of which is mortgage debt. In fact, on average households are not totally debt free until the age of 69.
- Households in the North East become free of unsecured debt the earliest as they tend to both buy homes earlier in life and take on less unsecured debt. At the opposite end of the spectrum, households in London do not celebrate their debt free birthday until the age of 77.
- Although even many of today's indebted households will have to wait until their mid-sixties to be free of unsecured debt, those that are turning 18 in 2015 may not see their unsecured debt free birthday until they are 66 and their mortgage debt free birthday until the age of 74.
- Across households of all ages, the average saving from consolidating unsecured debt through Zopa is just under £100 per year.
- Younger households stand to save even more. The average annual saving for 25-34 year old households is £475 per year followed by £210 for households 35-44.

35-44 year olds more indebted than any other age group

- When we consider total debt including mortgage liabilities, unsecured debt (e.g. credit card and store card balances), student loans and other loans both formal (e.g. car purchase agreements) and informal (e.g. borrowing money from friends), the average UK household is £49,200 in debt.
- The extent of indebtedness varies greatly based on the age of the household reference person*. The most indebted households, with an average of £87,800 in outstanding loans including mortgages, are those aged 35-44.
- The reason behind this is the high level of borrowing against property for this age group. As the average age of a first time buyer in the UK is currently 31, many households in the 35-44 age bracket have only recently acquired a mortgage and therefore still have a large share of it left to pay off.
- This is in contrast to the older age groups that have usually paid off most or all of their mortgage and have much lower debt obligations.

* HRPs provide an individual person within a household to act as a reference point for producing derived statistics and for characterising a whole household according to characteristics of the chosen reference person. For details on how the HRP is selected, see the 2011 Census Glossary on the ONS website.

Average total household debt, secured and unsecured, by age, 2015



Source: Wealth and Asset Survey, Cebr analysis

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Youngest households hold the most unsecured debt

- If we consider just unsecured debt the average UK household is £4,100 in debt.
- The extent of indebtedness again varies greatly based on the age of the household reference person. The most indebted households, with an average of £14,200 in outstanding loans, are those aged 16-24.
- Student loans are the greatest single contributor to this figure.
- Another explanation behind the high figure is that younger households tend to have lower earnings meaning they may need to borrow more in order to meet spending needs.
- Younger household may also feel comfortable holding more unsecured debt with the assumption that higher earnings later in life will allow them to pay it off.

Average unsecured household debt, by age, 2015

Source: Wealth and Asset Survey, Cebr analysis

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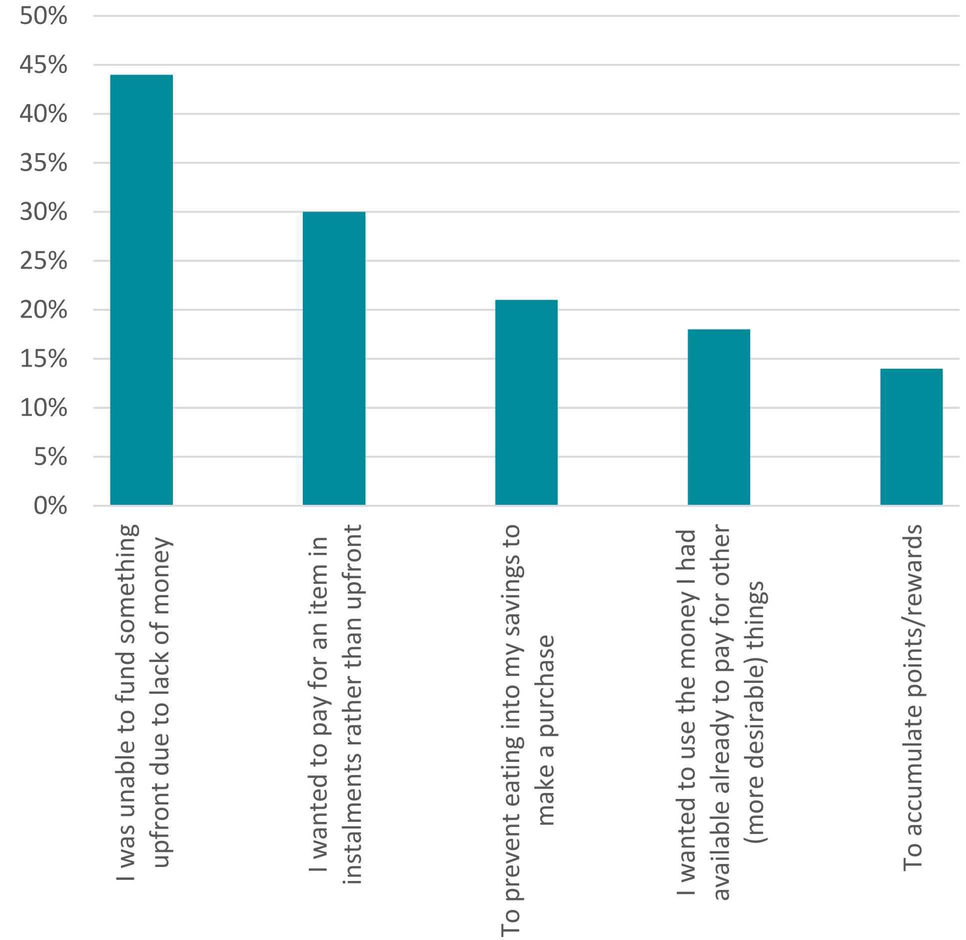
Inability to pay upfront most common reason to take on debt

- The most commonly cited reason for taking on debt is the inability to fund something upfront due to the lack of money.
- This is followed by wanting to pay in instalments rather than upfront and in order to avoid using up savings.
- Although the top reason for borrowing is the same for all age brackets, there is some age-based variation in the reasons behind people's decision to take on debt. For example, only 5% of those aged 18-24 do it to avoid dipping into their savings. Presumably this is because few people that age have savings.
- One reason for taking on debt that varies greatly between UK regions is the desire to accumulate points/awards. In London, 38% of people cite this as a reason for borrowing. However, in the West Midlands, just 3% do. One possible explanation is that stores in some regions do not offer or advertise these types of promotions extensively.

Main reasons for borrowing and taking on debt, excluding mortgages

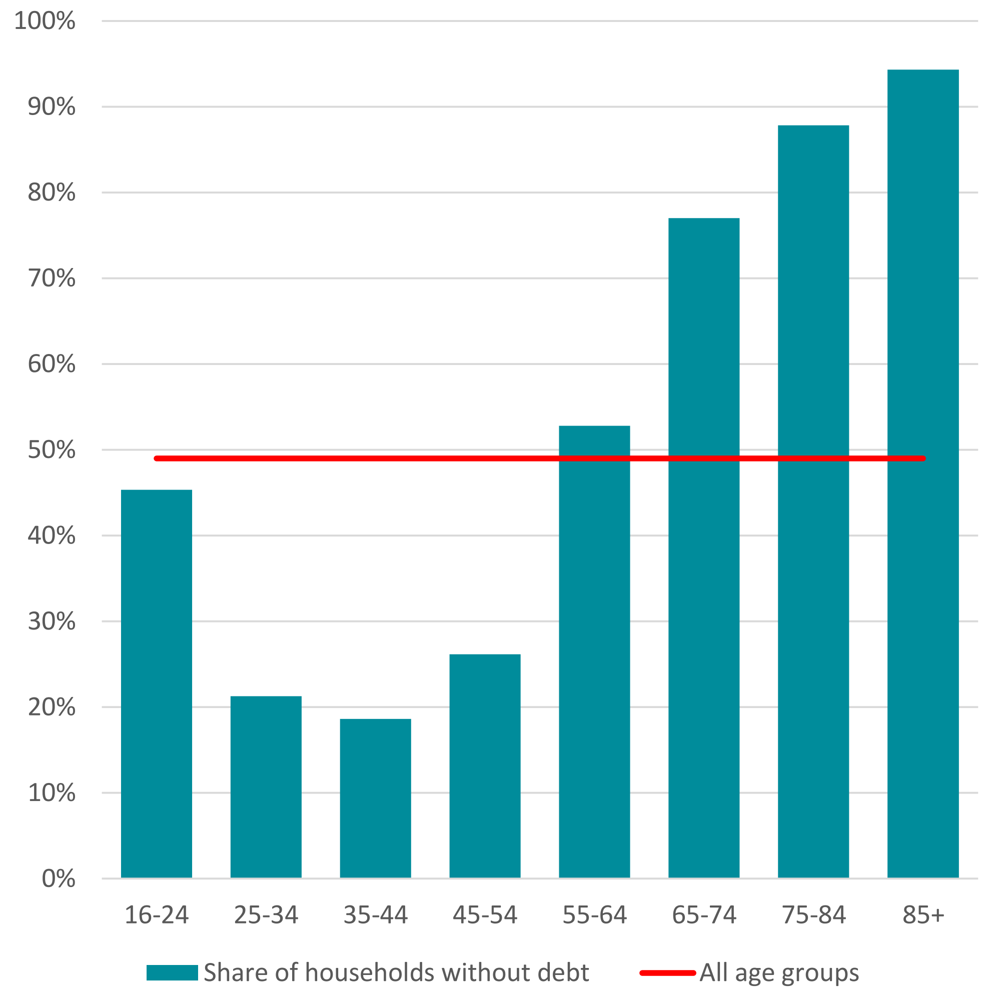


Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016

Many are overly optimistic about the time it takes to pay off debt

- Based on a survey of 2,005 UK adults conducted in January 2016, 58% of people that have some unsecured debt think they will be free of it before they turn 60. Of those that currently have mortgage debt, 46% expect to be debt-free* by the age of 60.
- However, these expectations are not entirely consistent with actual data from the Wealth and Asset Survey which show that some households will maintain a level of debt over their entire life.
- Based on the Wealth and Asset Survey by the age of 60, only 53% of households will be debt free.
- This figure increase to 77% for 70-74 year olds and 88% for 75-84 year olds.

Share of households without debt, by age, 2015



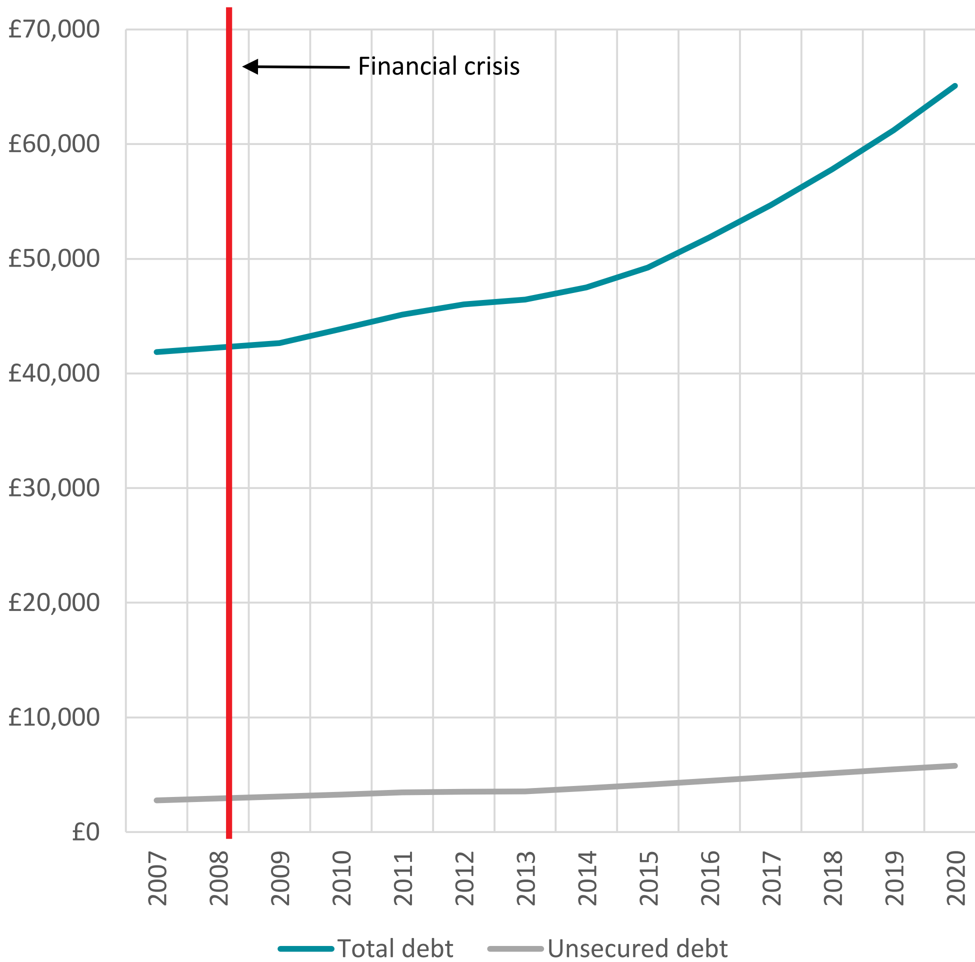
Source: Wealth and Asset Survey, Cebr analysis

* The survey asks the respondents at what age they think they will have paid off their debts, with no future plans of taking on more debt.

Average debt increase post financial crisis, driven by higher house prices

- In 2007, just before the financial crisis, the average UK household held £41,900 in debt, £39,100 of which was accounted for by outstanding mortgage payments.
- In 2015, the total average debt figure stood at £49,200. The 17.6% increase over the past eight years is explained by an increase in both secured (mortgage) and unsecured lending.
- Mortgage debt has increased as a result of rising house prices which make it necessary to borrow higher sums in order to purchase a home. Unsecured debt has expanded as well, especially in the immediate aftermath of the financial crisis. Between 2007 and 2011, average household unsecured debt increased by 25.6%. This is in part because many households found themselves facing great financial difficulty during this period and were unable to meet spending commitments without borrowing.
- In line with our expectations for strong house price growth in the coming years, we expect average total household debt to continue increasing.

Average households debt, by year



Source: Wealth and Asset Survey, Cebr analysis

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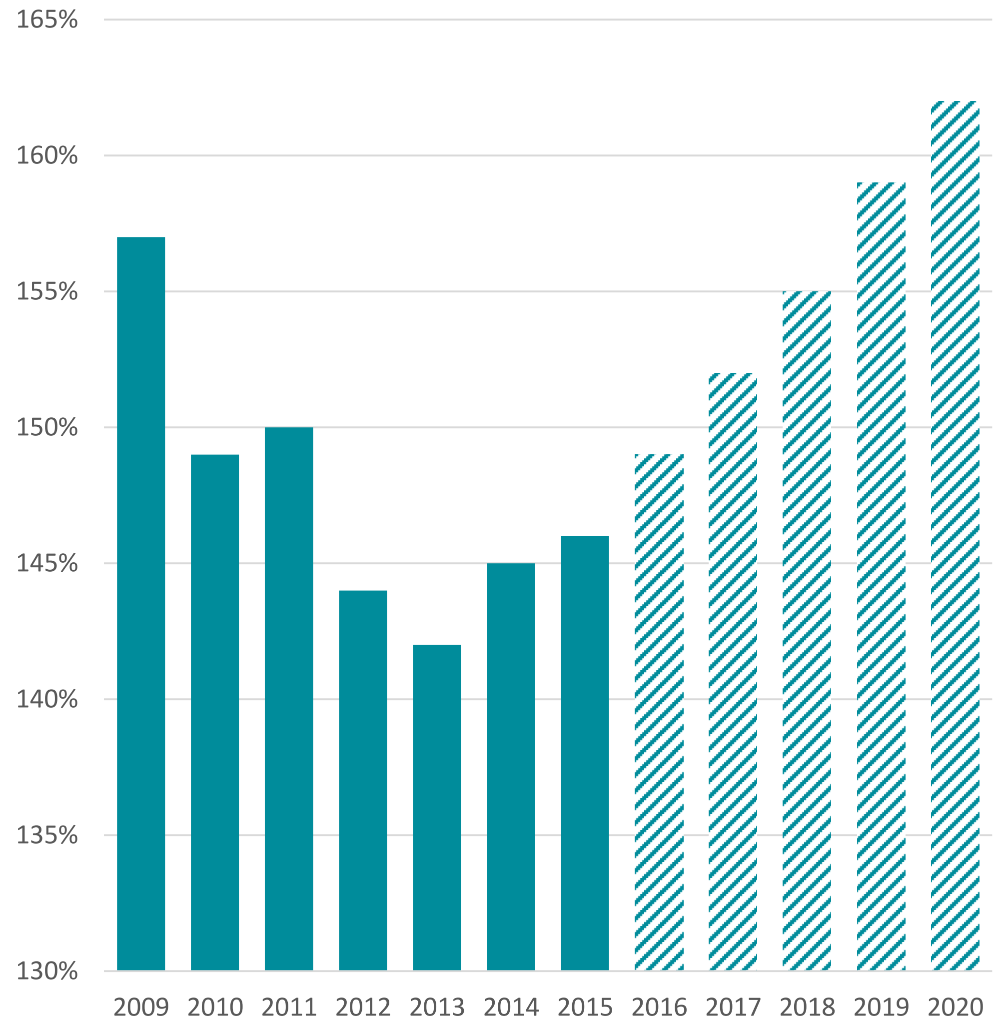
…but the liabilities to income ratio has decreased

- Based on the Office for Budget Responsibility’s data the household liabilities to income ratio stood at 157% in the immediate aftermath of the financial crisis in 2009.
- This would suggest that some households were deleveraging i.e. reducing their share of debt at that time.
- However, the aggregate value of all household liabilities has been increasing every year in the post-crisis period with the exception of 2010.
- Going forward the liabilities to income ratio is expected to increase as households again speed up the pace of taking on unsecured debt and as house prices (which impact mortgages) rise.

Liabilities to income ratio, by year



Source: OBR

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Free of unsecured debt at 64, not 50 as expected

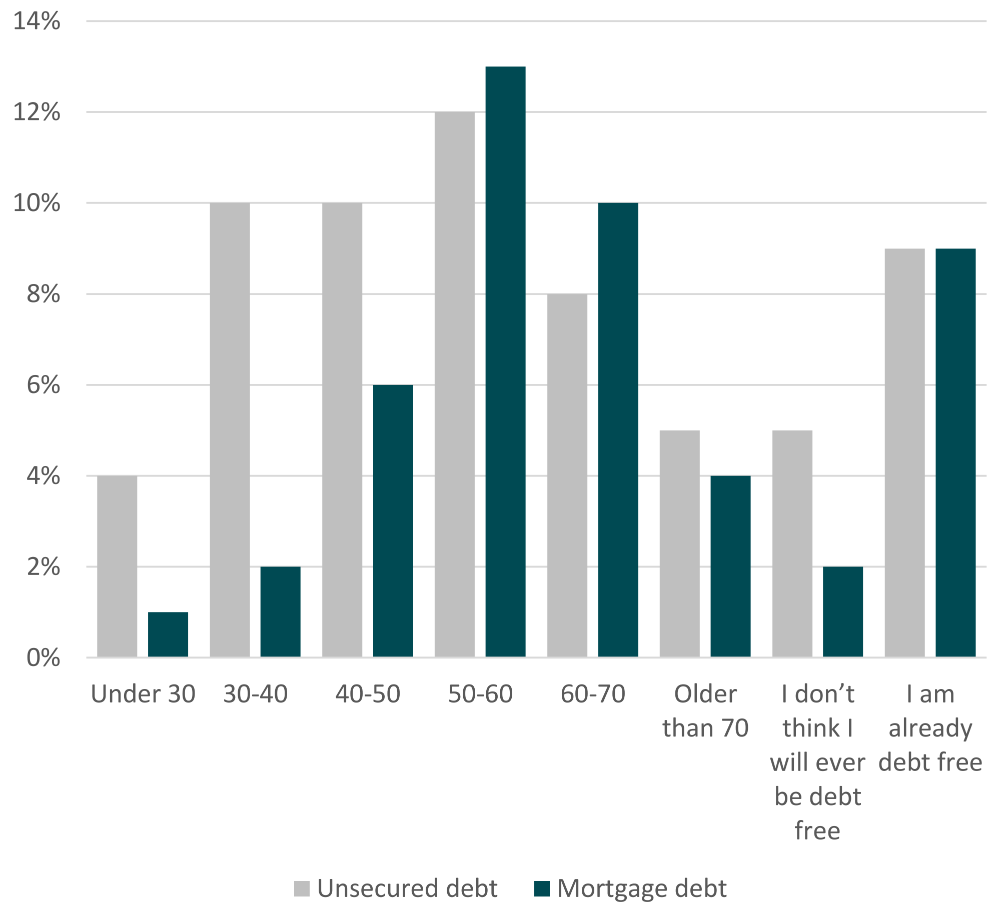
January 2016

- Based on the survey commissioned by Zopa, people on average expect to be free of unsecured debt such as credit card, car or pay day loans at the age of 50.
- However data from the Wealth and Asset Survey shows that for many, this is an overly optimistic expectation. In fact, on average people become free of unsecured debt* at the age of 64** – 14 years later than they expect.
- There are numerous possible explanations for why people are overly optimistic about how long it will take them to pay off their unsecured debt. One is that younger generations are guided by experiences of older ones as people used to hold less debt and hence become debt free earlier in life. Another possibility is that people assume that paying off debt will be a higher priority than it ends up being, meaning they choose to put less of their income towards debt repayment.

* As many people continue to use credit cards over their entire life span, the term 'debt free' does not refer to a time where all households in the age band are entirely debt free, but to a time where the overwhelming majority of households (over 75%) have £0 in debt.

**As the WAS data is provided with age bands, the average age band at which people become free of unsecured debt is 65-74 with 70 being the midpoint.

At what age do you think you will be debt free, with no future plans of taking on more debt?



Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016

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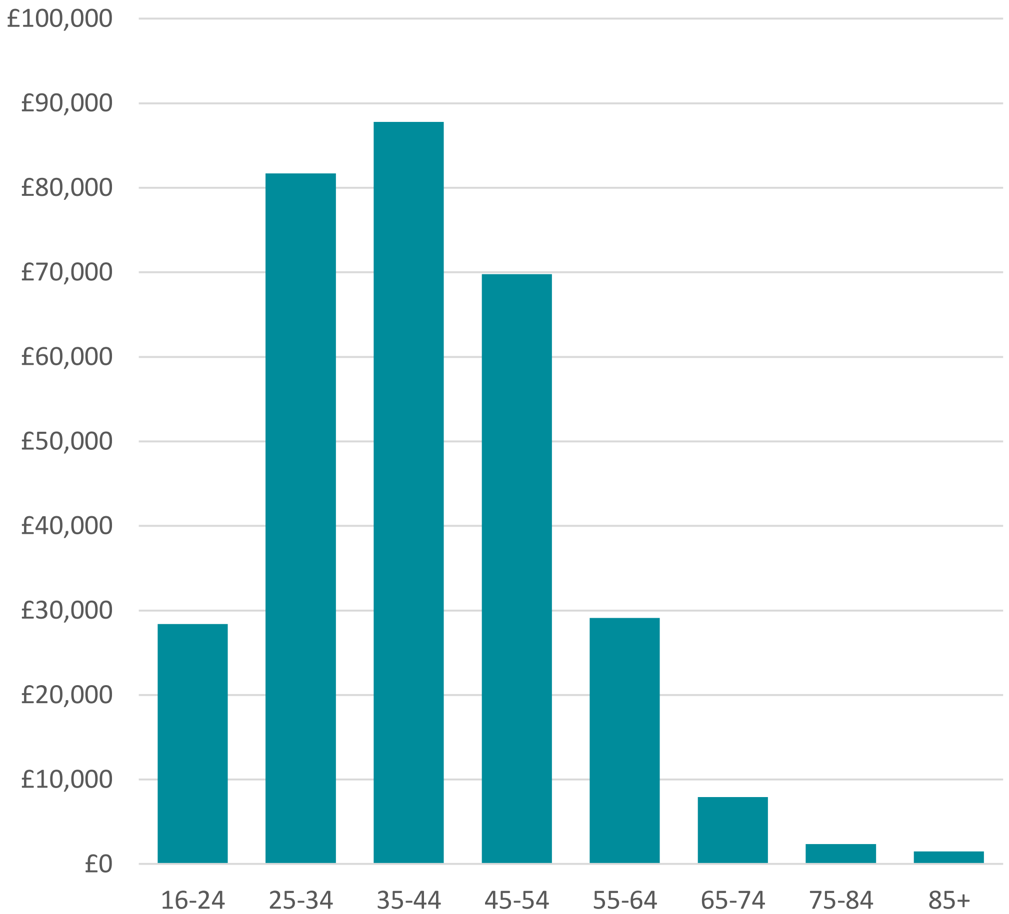
Average UK household celebrates its debt-free birthday at 69

- The average amount of debt across households of all ages is currently £49,200. The amount of indebtedness varies greatly between households of different ages. Total household debt increases with age up to the 35-44 age bracket at which point it starts declining.
- A significant portion of total debt is accounted for by mortgages. In fact, looking across all households, 92% of total indebtedness comes from borrowing against property.
- Based on the survey commissioned by Zopa, households on average expect to be free of mortgage debt by the age of 57. However, the average 55-64 household still has £29,100 in debt, £25,600 of which is mortgage debt.
- In fact, on average households is not totally debt free* until the age of 69.

Average total household debt (unsecured and mortgage) by age, 2015



*The term 'debt free' does not refer to a time where all households in the age band are entirely debt free, but to a time where the overwhelming majority of households (over 75%) have £0 in debt.

Source: Wealth and Asset Survey, Cebr analysis

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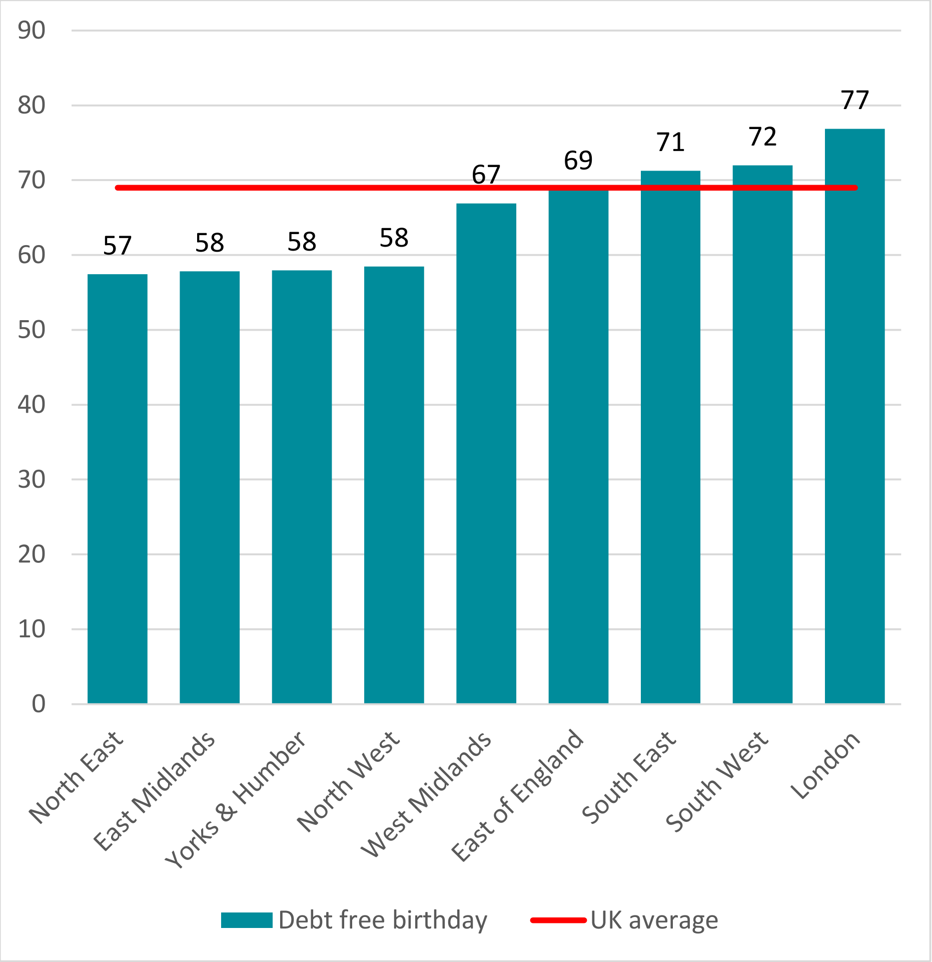
Households in the northern regions celebrate debt free birthdays sooner

- While today the average age at which UK households become debt free is 69, this figure varies greatly between regions.
- The variation is in part due to different levels of borrowing and the age at which people become home owners.
- Households in the North East become free of unsecured debt the earliest as they tend to both buy homes earlier in life and take on less unsecured debt.
- At the opposite end of the spectrum, households in London do not celebrate their debt free birthday until the age of 77. Although London households have higher average incomes than the rest of the country they still take on more unsecured debt and acquire mortgages later in life pushing up their debt free age.

Age at which the average household becomes debt free, 2015

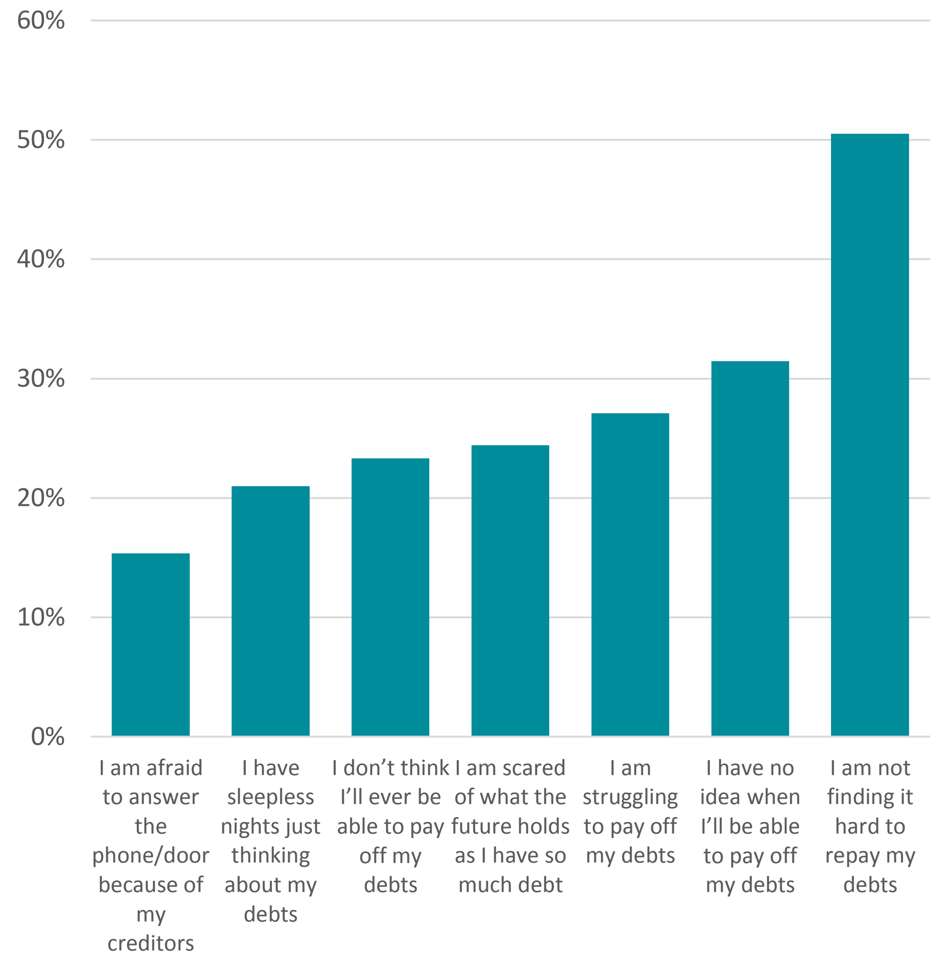


Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016, Cebr analysis

Households to stay indebted for longer in the future

- Although even many of today's indebted households will have to wait until their mid-sixties to be free of unsecured debt, those that are turning 18 in 2015 may not see their unsecured debt free birthday until they are 66.
- This is because growth in credit card bills, student loans and other sources of unsecured debt is projected to grow faster than earnings meaning it will take households longer to pay off their debt obligations.
- Households that are 18 today, wish to buy a home and start saving for a deposit immediately, could celebrate their debt free birthday as late as 74. This is based on house price projections, the average mortgage terms, savings ratio and homeownership rate projections.
- The projected increase in the debt-free age suggests that although at present just over half of all households have no difficulty repaying their debt, this share may increase in the future.

Share of households with debt that would agree with the given statement

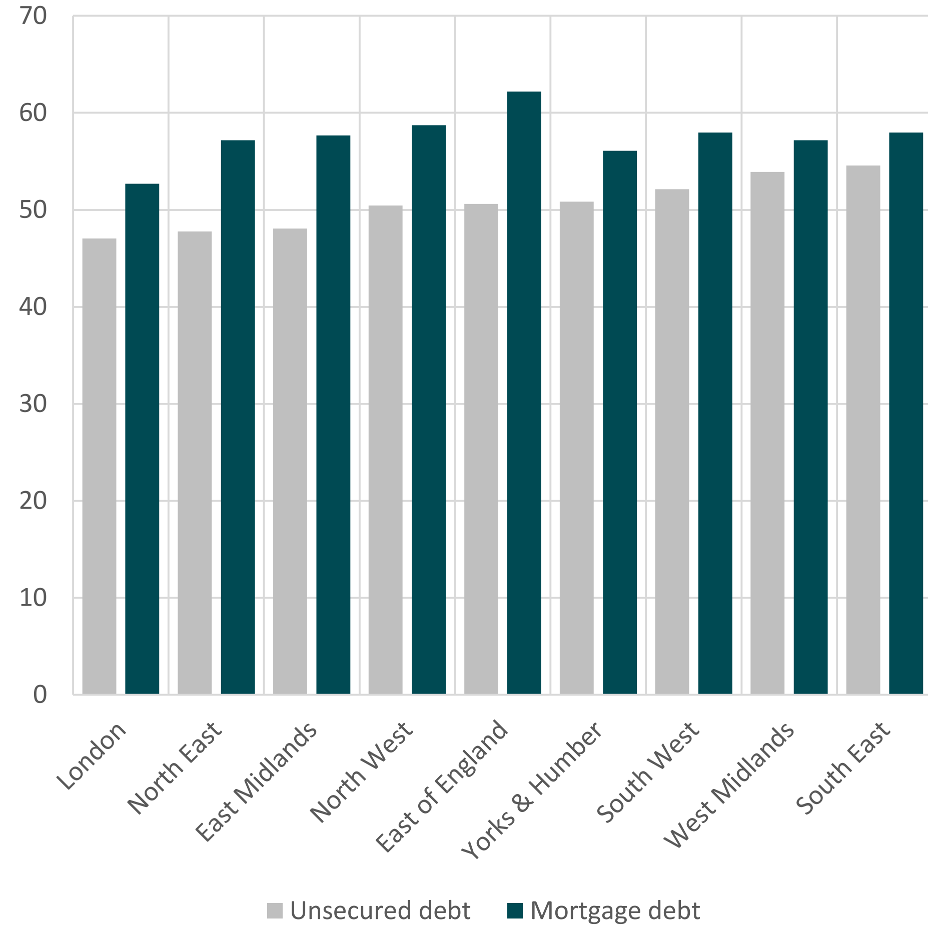


Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016

London households unrealistic about their debt obligations

- While data show that it takes London households the longest to pay off their debts – at the age of 77 on average – households in the capital are still the most optimistic about the amount of time necessary to become debt free.
- Based on a survey commissioned by Zopa, Londoners expect to be free of unsecured debt at 47 and of mortgage debt at 53 – sooner than households in any other region.
- Given the especially high cost of living and buying property in London this optimism is somewhat surprising. One possible explanation is that due to higher wages in the capital, London households feel more confident about their ability to pay off debt more quickly. However, while average London wages are higher than in the rest of the country so are the average debt obligations meaning that many London residents are overly optimistic regarding paying off their debts.
- An alternative explanation is that some households anticipate moving out of London down the line and taking advantage of lower living costs outside of the capital. Those that own a home could also benefit from house price appreciation in this scenario.
- The following slide shows the extent to which other regions are realistic about the time necessary to pay off debts.

Age at which the average household expects to be debt free, by region



Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016

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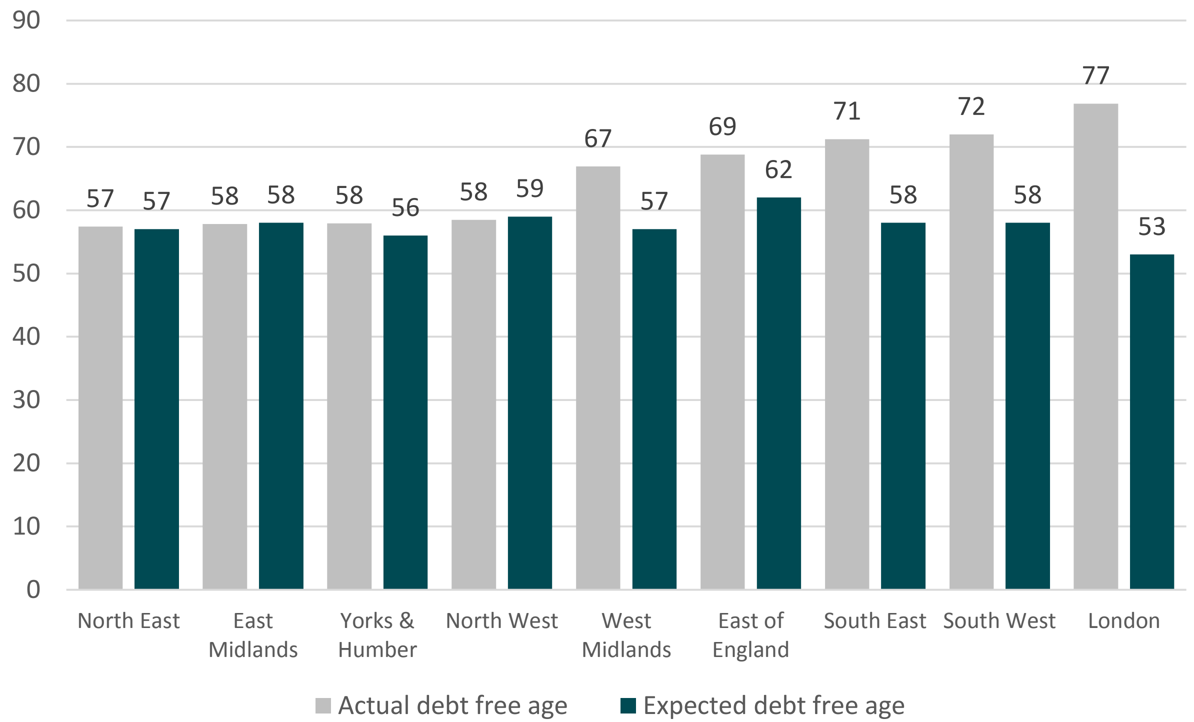
Age at which the average household expects to be debt free v. at what age the average household actually becomes debt free, by region

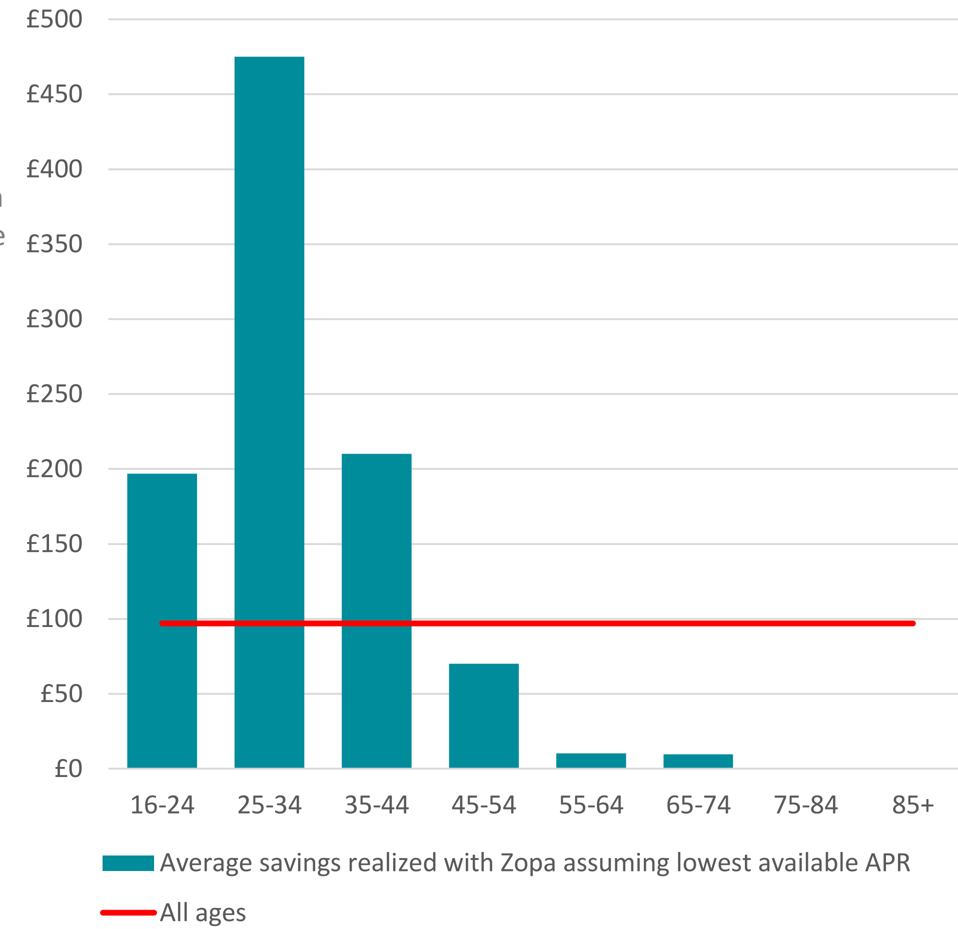


Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016, Cebr analysis

The average 25-34 household could save up to £475 per year by using Zopa

- Considering that the average UK household holds £4,120 in unsecured debt and that the average rate of interest paid is 9.2% this implies that the average annual cost of maintaining unsecured debt is £382.
- The average amount spent on interest varies greatly based on age. Households that are in the 25-34 age bracket spent more than any other age group – an average of £766 per year.
- When we consider the Annual Percentage Rates (APR) offered by Zopa, the average households in each age band up to 74 can save by consolidating their debt through the peer-to-peer lender. Households 75+ usually hold too little unsecured debt to consider a Zopa loan.
- Across households of all ages, the average saving from consolidating through Zopa is just under £100 per year.
- Younger households stand to save even more. The average annual saving for 25-34 year old households is £475 per year followed by £210 for households 35-44.
- Given the saving potential of debt consolidation it is surprising that just 24% of borrowers have done it with a further 21% being willing to consider it (see graph on following slide).

Average savings realize with Zopa, assuming lowest available APR, by age



Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016, Zopa Website, WAS, Cebr analysis

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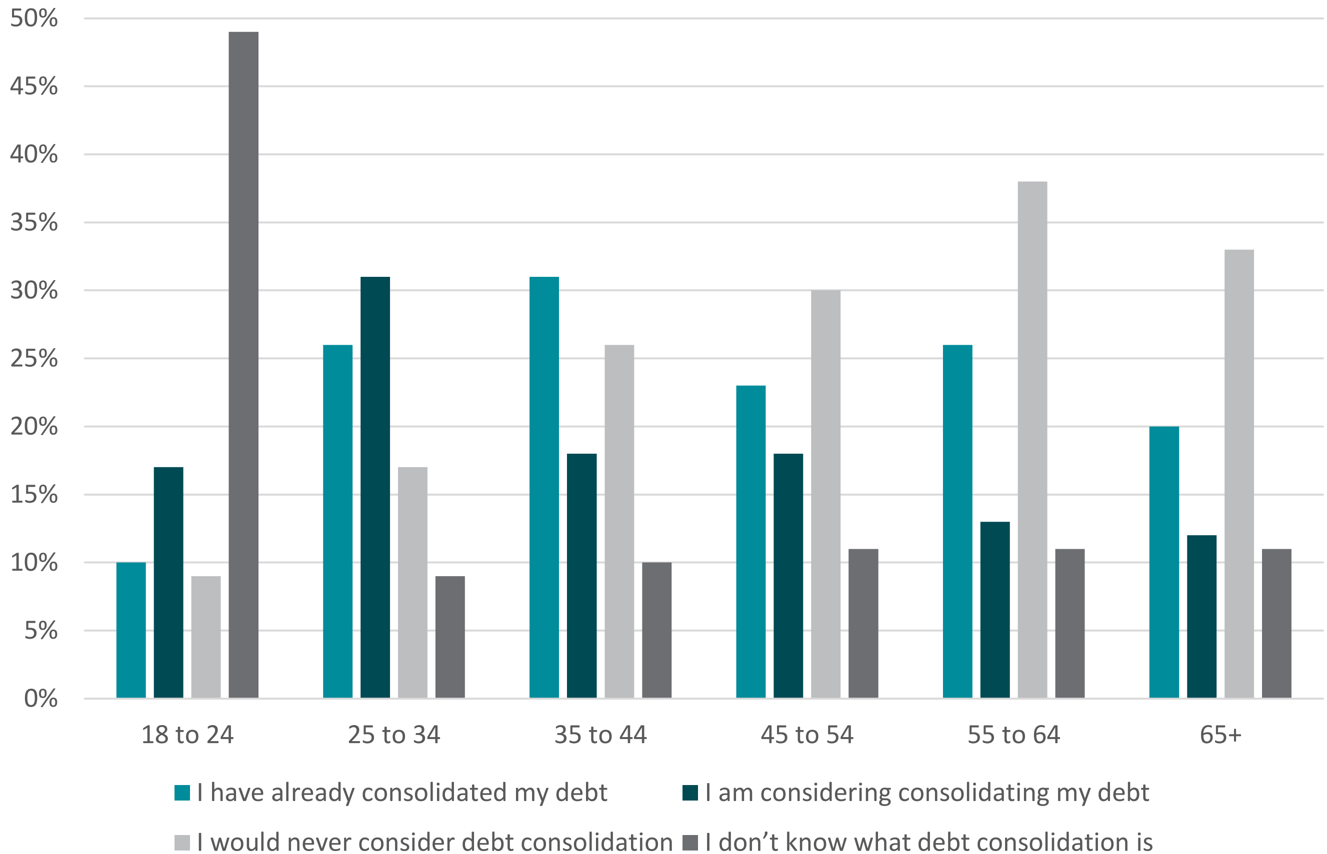
View of debt consolidation, by age



Source: Survey of 2,005 UK adults commissioned by Brands2Life on behalf of Zopa in Jan 2016

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