WEST COAST POVERTY CENTER

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UNIVERSITY OF WASHINGTON
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Dialogues on Research and Policy

September 2014

Credit and Debt - Issues and Opportunities for Low-Income Households

Assets, in addition to income, are an important component in developing a more complete picture of a household's financial circumstances and economic need. Many households accumulate assets and finance some of their consumption using a mix of credit and debt. Access to credit can help households during periods of low income or reduced earnings. Assets can also serve as an emergency fund, whether or not that fund needs to be tapped. In some cases, the use of credit or taking on debt (e.g., a mortgage) is an investment; in others, it can create a trap of inescapable debt or a cycle of increasing debt. Access to high- or low-interest loans and other means of building credit and accumulating assets is likely to vary by income, with lower-income consumers often relegated to the subprime mortgage market and subject to predatory lending practices.

With funding from the Northwest Area Foundation, WCPC Affiliate and Professor of Public Affairs Marieka Klawitter and Colin Morgan-Cross analyzed patterns of credit, debt, and asset-holding across households with a focus on how low-income families differ from other families. The WCPC shared these findings with a group of practitioners from northwest states and then hosted a conversation to get input about the research and its implications for practice. In this brief, we present a summary of findings from the original report, followed by highlights from the discussion between the researchers and practitioners about the data and its relevance for their work.

DATA ON ASSETS, CREDIT, AND DEBT BY INCOME

In this section, we present a summary of the report prepared by Klawitter and Morgan-Cross. Findings draw on the results from the 2007 and 2009 Survey of Consumer Finances (SCF) , the FINRA National Financial Capability Survey (NFCS) , and existing research. For purposes of this report, unless otherwise specified, "low-income households" are defined as those in the bottom quintile of the income distribution (less than $22,400). The full report and more information about the methods used are available at the WCPC website.

Table 1. Share of Families Holding Financial and Non-Financial Assets

	Percent Holding Asset		
Type of Asset	All Families	Low-Income Families[1]	Low-Wealth Families[2]
Any Asset	98%	93%	93%
Any Financial Asset	95%	83%	85%
Transaction account	92%	77%	80%
CD's	16%	9%	3%
Retirement account	56%	15%	27%
Stocks	14%	4%	4%
Life insurance	24%	15%	9%
Any Non-Financial Asset	93%	77%	76%
Vehicle	87%	66%	73%
Primary residence	70%	42%	20%
Other property	13%	3%	2%
Business equity	14%	4%	3%

Source: Survey of Consumer Finances 2009

1. Families with income below the 20th percentile ($22,400)

2. Families with net wealth below the 20th percentile (under $1,200)

Income Level and Asset Holdings

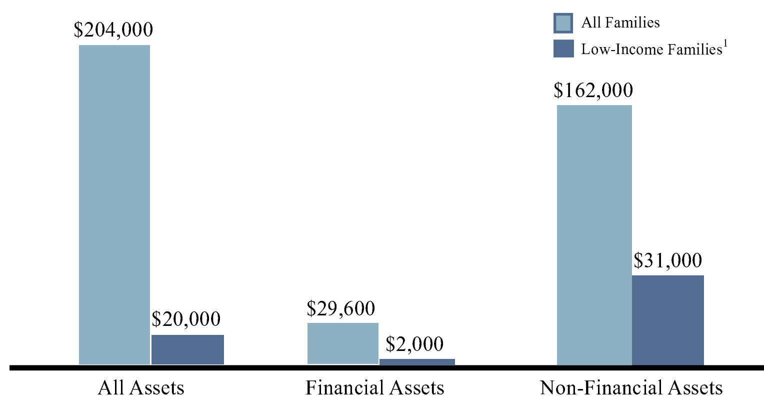
A snapshot of current levels and types of wealth (Table 1) shows that the vast majority of households, including low-income households, report having some assets (98% and 93%, respectively). However, the types of assets held vary by income, with low-income families re-

Generating New Research and Dialogue on Poverty in the West Coast States

The West Coast Poverty Center's DIALOGUES Projects bridge the worlds of academic research and real-world practice by bringing together researchers and policy practitioners to consider the implications of research on critical poverty issues. This fifth issue of DIALOGUES features research about the asset and debt levels of low-income families, as well as a discussion with policy practitioners in northwestern states about credit and debt in the lives of low-income families.

The West Coast Poverty Center is a collaborative project of the College of Arts and Science, the Evans School or Public Affairs, and the School of Social Work. The Center also receives funding from the Paul G. Allen Family Foundation to support our efforts to bridge the gaps between research, policy, and practice to improve our collective understanding of, and responses to, the causes and consequences of poverty and inequality in the Puget Sound region and beyond. To learn more about our work and read previous issues in the DIALOGUES series, visit our website: wcpc.washington.edu

Figure 1. Median Value of Households' Financial and Non-Financial Assets



[1] Families with income below the 20th percentile ($22,400)

porting much lower ownership of both financial and non-financial assets. Low-income households are less likely than all households to hold financial assets, particularly retirement accounts. While over half (56%) of all families report having a retirement account, only 15% of low-income families report having one. Low-income families are also less likely to hold non-financial assets such as vehicles and homes.

Although some form of asset ownership among low-income households is near-universal, the assets held by low-income households are worth significantly less, with a median value of $20,000 for all assets compared to over $200,000 for all families (Figure 1). The gap is particularly large in proportional terms for financial assets, with low-income families reporting 1/15th the wealth of all families. For non-financial assets, the gap is smaller in terms of proportions, but very large in real terms ($162,000 vs. $31,000). The gap in non-financial assets is driven by a large difference in the median value of homes across the two groups ($178,000 vs. $90,000, not shown).

The likelihood of low-income families owning any asset has increased in the two decades between 1989 and 2009, but asset value did not change for families in the bottom two income quintiles (income less than $39,000, not shown). Among households with the highest incomes, rates of asset ownership remained very high throughout this time period and the value of those assets increased significantly.

Credit Use and Debt

Access to credit can allow households to smooth economic shocks, such as unemployment, and to build assets over time through a mortgage, education, or vehicle loan. However, using debt to finance daily consumption for an extended period or at high interest rates contributes to the risk of becoming overburdened by debt, potentially preventing a household from accumulating assets.

Table 2. Percent of Households Holding Debt

	Percent Holding Debt	
Type of Debt	**All Families**	**Low-Income Families[1]**
Any Debt	76%	56%
Mortgage	47%	12%
Credit card balance	43%	29%
Education loan	18%	12%
Vehicle loan	14%	34%
Other loans	14%	16%

Source: Survey of Consumer Finances, 2009

1. Families with income below the 20th percentile ($22,400)

Low-income households are less likely to hold any debt, and hold different types of debt than do higher-income households (Table 2). Low-income households are significantly less likely to have a mortgage, home equity line of credit, credit card balance, or education loan than the average household, but are more likely to have a vehicle loan. These differences in types of debt held may reflect both less access to credit (e.g., ineligibility because of poor credit scores) as well less interest in these types of mainstream financial products.

Indeed, households with lower incomes are more likely to report debt from alternative financial service products in the last five years (Table 3). These types of debt often carry much higher interest rates than mainstream loans and have shorter repayment periods. As a result, these can create debt quickly and be difficult to pay off. With the exception of auto title loans, lower-income households are more likely than higher-income households to use all of the alternative financial products listed. Middle-income families have similar

Table 3. Debt from Alternative Financial Services (in the past 5 years)

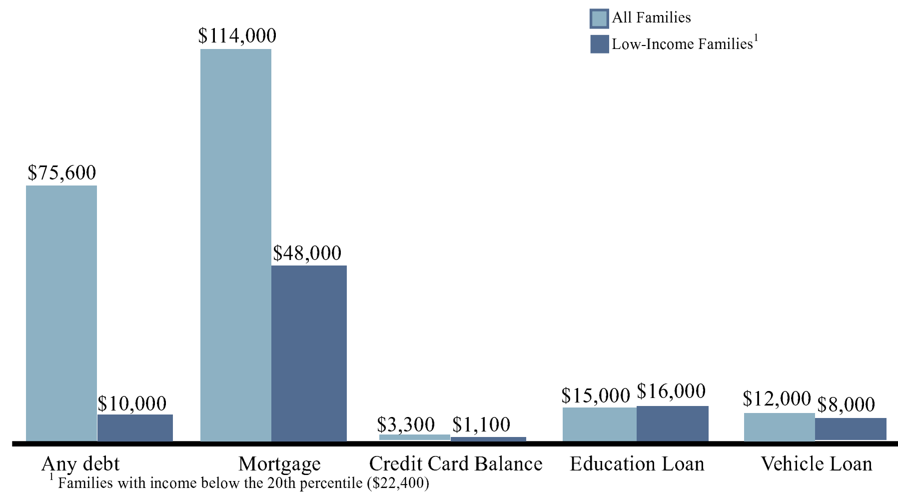
	Income Group		
Type of Alternative Financial Service	**Less than $25,000**	**$25,000 to $75,000**	**More than $75,000**
Auto title loan	5%	7%	10%
Payday loan	6%	6%	2%
Tax refund anticipation loan	12%	7%	3%
Pawn shop	16%	7%	1%
Rent-to-own	8%	4%	1%

Source: FINRA National Financial Capability Survey, 2009

rates of payday loan use as low-income households (6 percent for both groups). The gap between low- and high-income groups is highest for pawn shop debt and rent-to-own services.

Over the last twenty years, the percentage of all families with debt increased slightly (not shown). Low-income families were increasingly likely to report debt over this period, so the gap in the share of high and low-income families holding debt has narrowed. While the proportion of households with debt has remained relatively steady, the median value of debt increased dramatically, from $25,700 in 1989 to over $75,000 in 2009. Median debt amounts remained nearly constant for lower-income households. In 2009, the median debt level for low-income households was $10,000.

Figure 2. Median Value of Selected Types of Households' Debt



[1] Families with income below the 20th percentile ($22,400)

The median value of different types of debt is shown in Figure 2. Low-income households have much lower mortgage amounts than average ($48,000 vs. $114,000); as shown above, this likely reflects lower home values. Median credit card balances are also lower among low-income families than all families ($1,100 vs. $3,300). Low-income households report similar levels of debt from education loans compared to the average household.

Table 4. Leverage Ratio, Debt Ratio, Hardship, and Delinquency		
	All Families	Low-Income Families[1]
Leverage Ratio (total debt to total assets)	15%	14%
Debt ratio (debt payment to income)	19%	19%
Debt hardship (debt payment > 40% of income)	15%	27%
Percent 60 days delinquent on debt	7%	15%
Source: Survey of Consumer Finances, 2009		

On some measures, low-income families do not appear to be over-burdened with debt compared to all families (Table 4). The ratios of total debt to total assets (leverage ratio) and of debt payments to income are similar for low-income households and all families. Although they do not appear to be more heavily leveraged than other families, low-income families do report more difficulties in managing their debt. Low-income households are roughly twice as likely as the average household to report having debt payments of at least 40 percent of their incomes (27 percent vs. 15 percent) and to report being 60 days delinquent on a debt (15 percent versus 7 percent).

Impacts of the Recession on Low Income Households

Comparing participant responses from 2007 and 2009 suggests that, during the recession, income increased for households below the 2007 median ($50,100) and declined for families with income near or above the 2007 median (not shown). However, most families (65 percent) experienced a loss in wealth, which appeared to be driven by a decline in home equity (not shown). As shown in Table 5, relative to the average household, low-income households experienced both a greater loss in the median value of their assets and a greater increase in median debt (Table 5). While the average family saw a decline of 13 percent in the median value of their assets, low-income families saw the median value of their assets drop by 21 percent during the two years of the recession. Similarly, low-income households saw the median amount of debt increase by 14 percent, compared with an 8 percent increase among all households.

Table 5. Change in Value of Asset Holdings and Debt from 2007-2009		
	Income Group	
	All Families	Low-Income Families
Percent change in median value of assets	-13%	-21%
Percent change in median debt	8%	14%
Source: FINRA National Financial Capability Survey, 2009		

PRACTITIONER RESPONSE

The West Coast Poverty Center invited five practitioners involved in asset-building work in northwest states for a conversation with Professor Marieka Klawitter and Collin Morgan-Cross about their report on assets, credit use and debt among low-income households. Highlights from the discussion are organized below around the most resonant themes and issues raised by the respondents for advocates, practitioners and researchers to consider in their work as well as questions for further exploration.

1) What surprises did the findings present?

Overall the data presented were consistent with the expectations and experiences of the practitioners participating in the discussion. Participants provided a few key observations. Janet Byrd identified the lack of cash holdings among low-income families as an interesting but unsurprising finding, and one that reinforces her organization's efforts to create incentives for emergency savings. Given her clients' circumstances, she was surprised that even 15 percent of low-income households reported having retirement accounts.

The lower levels of debt and credit card balances held by lower-income households stood out to another respondent, who expected those rates to be higher. The researchers noted that while low-income households may have less debt, relative to higher-income households, that debt creates more of a hardship as it consumes a larger portion of their income.

Another respondent, David Sieminski, was surprised by the overall increase in the number of assets held over the last two decades, particularly by low-income households and was curious about any policies that could have caused the increase. Marieka Klawitter responded that while the data did not address policy incentives, vehicles, transaction accounts, and home ownership made up the majority of asset increases for these households.

2) What key issues or trends does this research surface?

The research findings both resonated with practitioners and stimulated a discussion of additional issues including different types of prevalent debt, the extent to which the data reflects these types of debt, and the challenges associated with maintaining debt as good credit rather than an increasing liability. The discussion also turned to the ripple effects of debt and possible unintended consequence of policy decisions or programs designed to address asset and debt issues.

The research presented showed that low-income households are more likely than high-income families to have education, vehicle, and other types of loan debt. There are a number of other types of debt that might be specifically relevant to low-income households. Multiple respondents agree that debt owed to landlords is a significant issue for this population. This type of debt can be difficult to erase from credit reports and can affect the renter's ability to secure housing in their own name even after the debt has been paid. Medical debt was another issue many respondents reported seeing among their clients. It is unclear how well these large-scale surveys capture the nuances of household financial circumstances. There may be types of debt that are unlikely to be captured by these surveys (such as small claims judgments, liens, debt to landlords) but which are consequential for individuals. If these surveys miss these types of debt, it's possible they understate the financial issues people face.

Respondents discussed some of their efforts to mitigate the tension of short-term needs and long-term planning by using Individual Development Accounts to establish emergency savings or for retirement. The difficulty of finding one-size-fits-all solutions to help low-income families emerged in this discussion. While one respondent noted efforts to build credit by counting payment of rent or utility bills as a positive transaction on a credit report, another respondent noted that, particularly in the case of utility bills, programs designed to build credit through on- time payment may clash with those that encourage delayed or no payments in the winter as a form of energy assistance. Respondents hoped that new programs would account for possible disincentives across programs and policies that undermine the ability of low-in-

DIALOGUE Participants

Researchers:

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Discussants:

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Janet Byrd, Executive Director, Neighborhood Partnerships, (Oregon)

Dave Sieminski, Managing Director, Express Advantage, (Washington State)*

Ron Elwood, Minnesota Legal Services, Legal Services Advocacy Project

Christina Barsky, Assistant Director for Asset-Development, Rural Dynamics Montana*

West Coast Poverty Center:

Shannon Harper, Research Director

*Participants' affiliations at the time of the call.

come households to consistently make progress.

3) Ongoing Policy Issues

Respondents raised a number of ongoing policy challenges in building and managing good credit and minimizing the risks of debt for low-income households. Practitioners noticed their clients' debt increasing in the years since the most recent recession, suggesting ongoing or deepening hardships. The types of debt seemed to be changing, with practitioners reporting more interest in borrowing for higher education and micro-enterprise rather than homeownership. As a result, one respondent indicated a notable increase in education-related debt and predatory lending practices that quickly escalate student debt. In addition, even as credit may be loosening up post-recession, a number of people may not be able to qualify because of debts that accrued during the recession. At the same time, another respondent noted that, while the recession may have exaggerated the effects of debt for low-income households, low-income households could be considered "recession-proof" to the extent that they face severe economic hardships before, during, and after the recession.

The respondents discussed inequity of policy responses across the income spectrum that discourage and undermine wealth building for low-income households. One respondent cited state and federal-level analyses of the distribution of policy incentives to build assets. Citing Oregon State as an example, one practitioner noted that the state provides few and small incentives for individuals at the low end of the income scale compared with the many incentives for high income households. Similarly, policies intended to bolster individuals during downturns, such as Unemployment Insurance also do not reach fully across the income scale despite work history. Respondents also noted widespread efforts to remove asset limits from policies such as Temporary Assistance to Needy Families that currently do not allow poor families to build their own safety net as their earnings increase.

Even new policies that might be expected to help low-income families may have unexpected pitfalls. One practitioner worried that the Affordable Care Act may create medical debt if low-income consumers prefer to purchase low premium and high deductible insurance that can quickly generate debt should a health event occur.

With respect to predatory lending and other alternative financial products, practitioners agreed they are constantly playing "whack-a-mole" in an attempt to regulate predatory lending practices. Even as they are able to cap high lending rates or particular types of loans, lenders will create new products or institutions outside the boundary of legislation. One respondent offered that regulating the entity rather than the product has helped in his state.

The practitioners discussed these structural policy challenges in the context of moving asset-building practices and products to scale. One participant raised the issue of the proliferation of efforts to address debt issues. That participant wondered whether the "field" would have been better off with one large, resource-intensive effort rather than innumerable small pilots that generally fail to show significant impacts.

4) What additional questions or areas for investigation would address the issues and policy challenges raised by the data?

There were a number of areas where respondents would appreciate additional research. For example, several practitioners raised the issue of constant financial need as an ongoing challenge for asset development programs. Much of the discussion revolved around how long-term planning can be promoted in the face of short-term needs such as emergency savings and day to day living expenses. Participants were interested in understanding what programs and policies can successfully address daily consumption needs while also promoting long-term asset development.

Other questions involved trends in the years since this data was collected. One respondent wanted to know more about why he saw savings decrease and credit use increase among his clients after a reluctance to use credit during the recession. How has the credit/debt picture changed for low-income households as the economy has improved?

Respondents also expressed interest in a better understanding of the saving and borrowing patterns over the life cycle. In addition to the emerging issue of education-related debt, practitioners wondered how adults in the 55-65 year age range could maintain assets when they may have health problems and need to retire at an earlier age but cannot yet access Medicare or Social Security.

Finally, all the participants expressed strong interest in untangling "good" credit from debt as a liability. Respondents would like to understand how credit can be used wisely for investment in assets, to allow the build up of savings, or serve as launching pad to continually make progress and achieve goals. Is the process or policy framework different for low-income families and, if so, what systems or products would better support more "good credit"?

FUTURE RESEARCH

In terms of next steps, it would be valuable to explore these findings in the context of asset building strategies, such as homeownership and credit-building programs, and policy solutions such as regulation of alternative financial services and low-cost credit alternatives for low-income households. Longitudinal studies exploring the changes to a household's credit use and debt over a substantial period of time could also help us understand how these changes contribute to a household's long-term income and wealth.