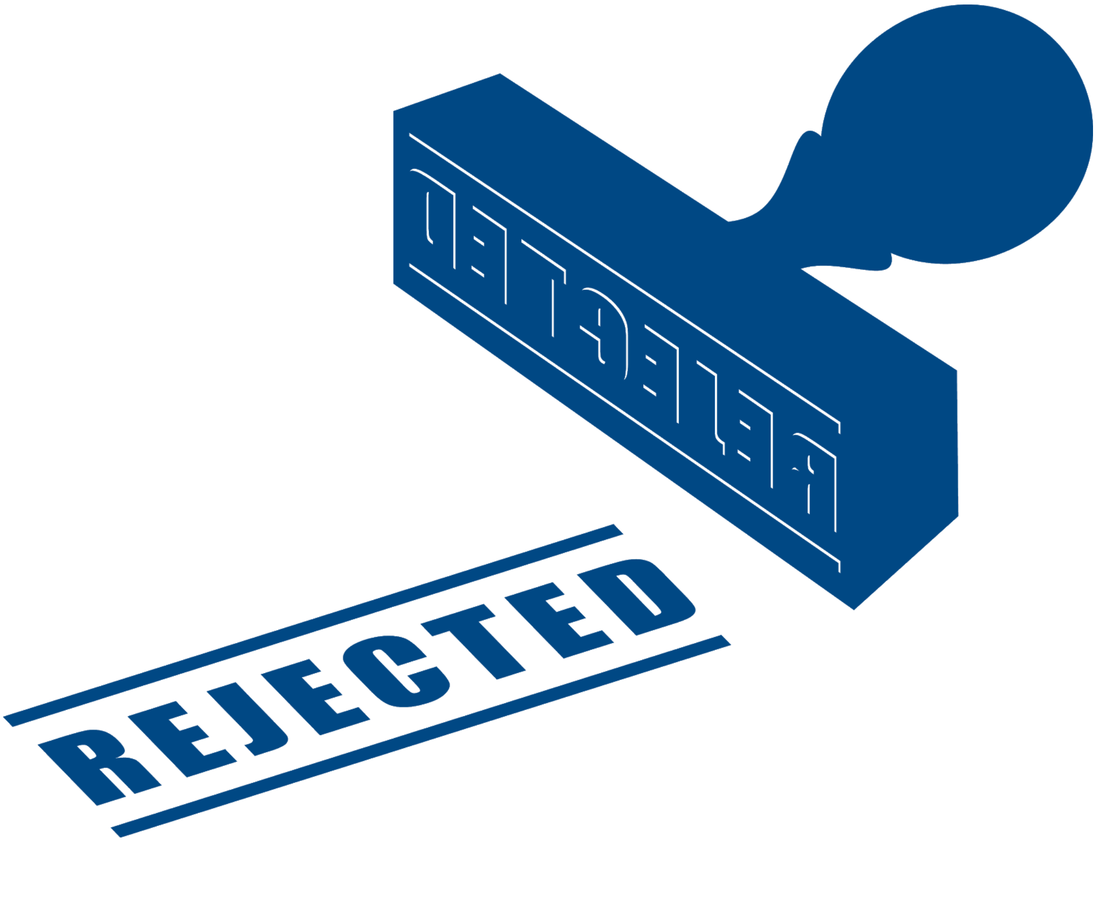
Rent to Return?

The need for consumer protection in the rent-to-own market



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Summary

Rent-to-own companies sell household items, such as appliances, furniture and electronics, through 'hire purchase agreements'. These agreements - usually arranged over three years - involve customers paying off the price of the product as well as interest, in weekly payments.

Citizens Advice helped 5,127 people with rent-to-own debts in 2017. These rent-to-own consumers often show signs of being vulnerable. Our evidence suggests they are often single parents, almost never have a mortgage or own their home, and a large number are out of work due to poor health. Commonly, they hold more than £8,000 of debt.

Rent-to-own services can be useful for consumers - they allow people on low incomes to purchase goods that they cannot afford to pay for upfront. But these goods come at a high cost. Interest rates can be as high as 99.9%, and missed payments are subject to fees of £10-12 per occasion. More generally, rent-to-own goods are a bad deal - with high markups on prices, costly delivery charges, and expensive add ons, such as aftercare and insurance.

To make matters worse, affordability checks often do not identify where clients might face financial difficulties in meeting the cost of these agreements. In particular, they can overlook consumers' levels of expenditure. As a consequence rent-to-own goods often exacerbate existing financial difficulties:

- People with rent-to-own debts are highly likely to be behind on important bills, such as energy or council tax.
- 50% of rent-to-own customers have borrowed to meet payments.
- Only half of all rent-to-own agreements are completed - leaving customers paying large sums for goods that they often do not get to keep.

We are calling on the FCA to provide more protections for rent-to-own customers by capping the cost of credit:

- People who purchase rent-to-own products should never pay back more than 100% of the the list price of the product.
- The cost of late payment fees on rent-to-own goods should be capped, with consumers never paying more than £15 in late payment fees over the course of their agreement.

We estimate that, if existing loans were to be priced down to the cap, consumers could save up to **£62 million** on **245,000** rent-to-own products.

Introduction: What is 'Rent-to-Own'?

Rent-to-own companies sell household items such as televisions, fridge-freezers and washing machines through hire purchase agreements. Through these agreements, customers make weekly payments over a pre-arranged period of time and pay interest at a rate of up to 99.9%. The consumer takes ownership of the product when they pay the final instalment at the end of the hire period.

Rent-to-own agreements can be of varying lengths; usually lasting for one, two, or three years. Typically however, rent-to-own agreements are paid over three years. Due to the often expensive initial price of the products, the high rate of interest, and costly add-ons - such as insurance and product protection - consumers can find themselves paying three times the off-the-shelf price of the product purchased.

There are two main providers of rent-to-own products in the UK - BrightHouse and PerfectHome. BrightHouse is the largest provider of household hire purchase goods, and has 281 stores and an active customer base of 232,000 clients.[1] PerfectHome has approximately 50,000 customers loaning goods from around 60 shops.[2]

The rent-to-own market is fairly small with 200,000 consumers purchasing a rent-to-own product in 2016, and 400,000 consumers holding rent-to-own debt. However, the people who have rent-to-own products often carry a significant amount of debt. In total the combined debt of these consumers is £500 million, while the average loan size for a rent-to-own product is £1,100.[3]

[1] BrightHouse, (2017) *BrightHouse Annual Report 2016-17*
[2] PerfectHome's business has contracted slightly in the last year, in March 2016 PerfectHome had 70 stores largely concentrated in the North of England. Financial Inclusion Centre, (2016) *Better and Brighter: Responsible Alternatives to the Rent to Own Sector*.
[3] All figures from FCA (2017) High-cost credit: Feedback statement

Part 1: Why are rent-to-own products a cause for concern?

Between 2017 and 2018, Citizens Advice saw an estimated 5,127 people with rent-to-own debts.[4] The average amount of rent-to-own debt held by these clients was £972, but their average overall debt was significantly higher at £8,193.

Clients struggling with rent-to-own debts are three times as likely to be women as men. They tend to be younger - the most common age bracket (37%) for rent-to-own users is 25-34 year olds, and a significant majority of rent-to-own users (63%) have dependent children.[5]

Rent-to-own problems can cause financial difficulty for the following reasons;

- Rent-to-own users are particularly vulnerable
- Rent-to-own users tend to have high levels of indebtedness
- Competition is not effective in controlling costs in the rent-to-own market.

Rent-to-own users are particularly vulnerable

People who purchase rent-to-own products tend to be on very low incomes. The FCA for example, finds that the median income of a rent-to-own consumer is £16,100 per year, which places them in the bottom 25% of earners.[6] Similarly, we found that 7 out of 10 rent-to-own consumers purchased these products because they 'couldn't afford to pay upfront'.[7]

Our data suggests that a number of other indicators of vulnerability are more common amongst clients with rent-to-own debt. People who purchase rent-to-own items are disproportionately likely to be single parents; 41% are single parents, as opposed to 12% of the population as a whole. Single parents

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[4] Citizens Advice does not currently record rent-to-own products as a separate advice issue and so it not possible to give an exact figure of clients who received advice for problems with rent-to-own. Our estimation is based on data from the first three quarters of the year from Q3 2016/17 to Q2 2017/18. Over this period 8,289 unique clients received advice for 'hire purchase arrears'. Of these, 1,906 (23%) had their details recorded in our electronic case recording module for complex debt casework. In the first three quarters, 884 unique clients were identified in this group as having doorstep loan debts, which we assumed to be 1,179 over the entire year. This gives an estimated 5,127 clients who received doorstep loans advice.
[5] Data from Citizens Advice's Money Advice Recording Tool used to record the value of debts held by Citizens Advice debt advice clients.
[6] Before tax, according to Table 3.1a HMRC statistics in 2016.
[7] Citizens Advice Survey, August-September 2016.

have the highest poverty rate among working age households.[8] In addition, these parents are likely to have several children - we found that 38% of rent-to-own users have three or more children. This is more than twice as common as in the population as a whole.[9]

Figure 1: Demographics of rent-to-own debt clients compared with debt clients and the UK population as a whole

Rent-to-own users are also highly likely to live in social housing, with 60% living in housing association or council owned accommodation. A further 30% of rent-to-own clients live in private rented accommodation, and only 2% have a mortgage or own a property.

People who purchase rent-to-own products are significantly more likely to be unemployed and seeking work, 21% as opposed to 4% of the population as a whole. A further 21% are permanently sick or disabled and therefore unable to work. Significantly, nearly half (46%) of clients struggling with rent-to-own debts are disabled or have a long term health condition, as opposed to one in six of the population as a whole.

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[8] Gingerbread (2018) 1 in 4: A profile of single parents in the UK
[9] Office for National Statistics, Families and Households: 2015

Case Study: Sophie

When Sophie was referred to Citizens Advice, she owed more than £9,000 to a rent-to-own provider. She had twelve hire purchase agreements; for an ipad, two iphones, a washing machine, a tumble dryer, a coffee table, a bed, a mattress, a corner sofa, a microwave and a hoover. Sophie has obsessive compulsive disorder, depression and anxiety. In addition, she is agoraphobic and does not like to go out. She was unable to work due to her mental health difficulties, and was in receipt of Employment Support Allowance and Disability Living Allowance.

At the time, to meet the cost of her rent-to-own agreements, Sophie was paying £150 a week and struggling to meet the costs of Council Tax or food. Sophie was unaware that she could cancel her hire purchase agreements, and did not know where to seek help. After applying for food vouchers from her local authority, Sophie was visited by a local welfare officer who identified that she was in dire need of financial advice.

Rent-to-own consumers tend to be highly indebted

Clients who seek support with rent-to-own debts tend to be significantly indebted, most commonly owing debts to six different creditors. The median amount of rent-to-own debt they owe to their provider is £972, whilst the mean amount is £1,337.

Figure 2: Debt and income of rent-to-own clients, by income quartile

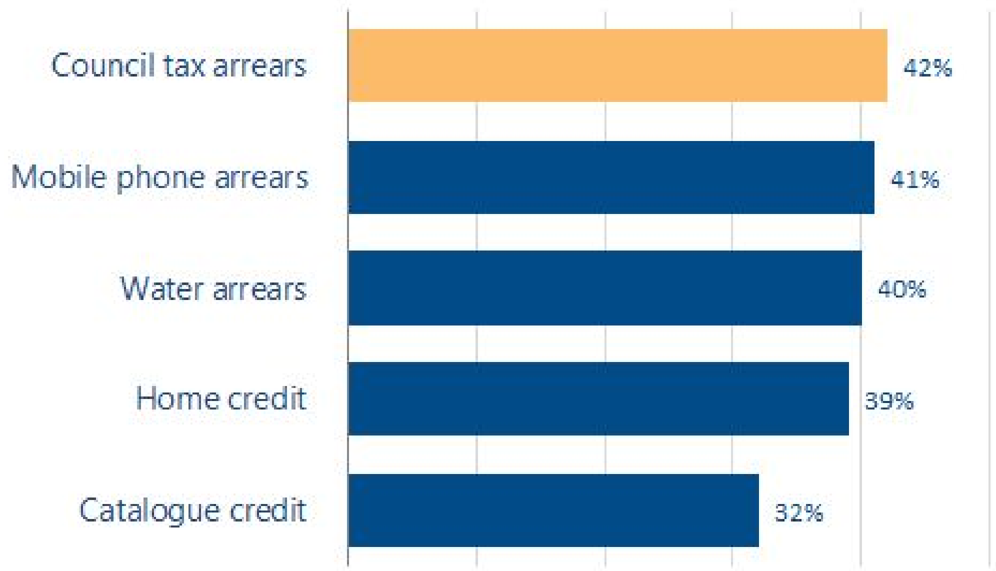
	1st quintile	2nd quintile	3rd quintile	4th quintile	5th quintile
Mean rent-to-own debt	£1,127	£1,081	£1,486	1,460	£1,482
Median income	£7,267	£11,700	£15,064	£19,043	£25,938
Median total debt	£7,194	£6,867	£9,817	£8,738	£9,088
Median RTO debt to income ratio	11%	7%	7%	5%	4%
Overall DTI ratio	99%	59%	65%	46%	35%

This disparity between the mean (£1,337) and the median (£972) is indicative of the numbers of clients who had very high rent-to-own debts. Amongst our clients who seek debt advice, 1 in 7 owed more than 20% of their annual income to their rent-to-own provider.

Even more commonly, our clients had very high debt to income ratios. The median debt to income ratio is 59% and nearly a quarter (23%) held a debt to income ratio of 1:1 when they sought advice. This means that 1 in 4 clients seeking debt advice for rent-to-own loans owed as much or more to creditors than they would receive in income that year. As we can see from Figure 2, this problem is particularly acute amongst clients with the lowest incomes.

The high level of personal indebtedness amongst these clients is spread amongst a range of providers. But, as is clear in figure 3 below, commonly these debts are owed on household bills, including water, mobile phone and council tax arrears. This is in keeping with a wider trend amongst our clients who hold a significant proportion of non commercial credit debt.

Figure 3: The top five debts held by rent-to-own clients



The high rate of mobile phone debts suggests that people with rent-to-own debts are struggling to meet the regular financial outgoings of this demographic.[10] The prominence of catalogue and home credit debts amongst rent-to-own users is not surprising, as these are some of the few forms of credit accessible to

[10] The high proportion of rent-to-own clients with telecommunications debt resonates with the findings of the FCA who point to this as an indication of payment problems amongst people holding these debts. FCA,(2017) Feedback Statement: Technical Annex, 2017.

people with poor credit scores. The increasing household arrears allude to the increased levels of financial instability which affect low income households.[11]

Competition does not operate effectively in the rent-to-own market

Ultimately, our concerns about consumer vulnerability and high indebtedness have implications for the workings of competition in the rent-to-own market. High levels of vulnerability, high indebtedness and low credit scores all restrict consumer choice, preventing the effective operation of competition in this market. In particular, clients are unlikely and unable to shop around, meaning that there is little downward pressure on prices in the rent-to-own market.

- **Customer circumstances make it hard to shop around.** As we have seen, clients who purchase rent-to-own products tend to be on low incomes, have high levels of vulnerability and have a poor credit history. This radically reduces the choices available to consumers when shopping for essential utilities.
- **There are two dominant providers in the rent-to-own market.** In terms of major high street providers, there are only two competitors in the provision of hire purchase household goods. One of these providers, PerfectHome, operates largely in the North-West of England which gives BrightHouse an effective regional monopoly in other parts of the country. The concentrated nature of this market means that there is likely to be little pressure on prices, and leaves vulnerable consumers paying over the odds for rent-to-own goods.
- **Nonprofit alternatives are small and do not meet the scale of demand.** Important research has been conducted into the potential for nonprofit providers to step in where rent-to-own goods are sold. These initiatives are welcome and can provide much better value for consumers. Unfortunately, these initiatives tend to operate on a relatively small scale, supporting between 3,000 and 5,000 consumers per year within a given geographical locality.[12]

This failure of competition means that rent-to-own products are often unaffordable for the low income consumer group which this market serves. The next section of this report explores the high costs which rent-to-own products have for consumers.

[11] For more information on the increased levels of financial insecurity, please see: Citizens Advice, Walking on Thin Ice: The Cost of Financial Insecurity, 2018.
[12] Financial Inclusion Centre, (2016) *Better and Brighter: Responsible Alternatives to the Rent to Own Sector*.

Part 2: The high cost of rent-to-own products

Rent-to-own products are often unaffordable

Not only are clients who purchase rent-to-own goods disproportionately vulnerable, but rent-to-own goods are also highly expensive when compared to off the shelf products. BrightHouse, for example, makes a 50% gross profit margin on the goods it sells in its stores.[13]

This high upfront cost comes down to a number of factors;

- **Rent-to-own goods have a high mark up on the upfront price of a good.** Even before the additional costs of insurance, aftercare, or interest payments are taken into account, rent-to-own consumers pay over the odds. PerfectHome, for example, sells a 7kg Indesit washing machine for £420.00, whereas an identical model can be found on John Lewis for £238.00.[14]

- **Rent-to-own goods have overpriced add-ons.** For example, 60% of BrightHouse consumers purchase insurance alongside their products.[15] This insurance is charged per week and covers only the cost of the good insured, often making it significantly worse value than home contents insurance.

- **Rent-to-own goods carry expensive delivery and installation costs**. The delivery of rent-to-own goods are often twice as expensive as comparable costs from off the shelf competitors. In addition, these costs are included within the loan amounts so are subject to interest, pushing their cost even further beyond other utilities retailers.

[13] BrightHouse evidence to the Treasury Select Committee, 28 February 2018.
[14] Figures correct as of March 2018.
[15] BrightHouse evidence to the Treasury Select Committee, 28 February 2018.

Figure 4: Installation and delivery costs

Product name[16]	Installation and delivery at BrightHouse before interest	Installation and delivery at Argos	Installation and delivery at John Lewis
55cm fridge-freezer	£55.00	£27.95	£15.00
6kg washing machine	£55.00	£27.95	£25.00
49" television	£65.00	£50.00	£34.99
50cm cooker	£95.00	£80.00	£75.00

Secondly, the structure of hire purchase agreement means that rent-to-own products are costly throughout the term of the loan. This is due to:

- **High rates of interest.** The interest rates of rent-to-own goods typically vary between 68.9% APR and 99.9% APR, dependent on the types of goods being purchased. Rent-to-own providers acknowledge however, that this is a representative interest rate, and that personal APRs vary subject to status.[17] This suggests that certain clients might be at risk of receiving even higher interest rates.

- **Costly late payment fees.** These can significantly increase the cost of the (already expensive) product. Late payments are fairly common - one in three rent-to-own clients miss payments over the course of their agreement.[18] Late payment fees range between £10-12 per period of missed payment, and at one provider are capped at £24 in any consecutive 5-week period and at £48 in any consecutive 13-week period.[19] This is an improvement on prior late payment fees, however it is still possible for clients to pay as much as £192 per year which represents an additional 15% on top of the average loan origination of £1090.

[16] All figures correct as of March 2018.
[17] BrightHouse's website for example states 'The interest rate offered will depend on your financial status, item purchased and length of the agreement.'
[18] 34% of survey respondents had missed one or more payments. Citizens Advice Survey, August-September 2016.
[19] BrightHouse website, (2018) Late Payment Charges.

Affordability checks are inadequate

We are conscious that rent-to-own providers have worked closely with the FCA to improve their affordability assessments amongst their clients. We think this marks an important improvement on prior practices within the market.

Despite this, however, a number of issues continue to emerge amongst our debt clients. These suggest that affordability checks remain insufficient to fully identify where taking out a rent-to-own product might cause clients' greater financial difficulty in the longer term.

1. **Clients' levels of expenditure are insufficiently taken into account.** There are a significant number of examples where clients are unemployed and rely exclusively on welfare payments, but are permitted to take out multiple rent-to-own or hire purchase agreements. This is especially acute where clients have many dependents, as in the case of the nearly 40% of clients using rent-to-own products who have three or more children.[20]

2. **Rent-to-own providers encourage customers to take on multiple products.** 66% of rent-to-own users have 3 or more products, and 28% had five or more products.[21] Qualitative data from our clients suggests that once consumers purchase a rent-to-own product, the provider will often contact them repeatedly to market additional products. The high numbers of clients who purchase multiple products suggests this marketing strategy is effective for rent-to-own providers. Yet, this cycle of rent-to-own products can become particularly damaging for consumers, as meeting the costs of multiple weekly payments can quickly become overwhelming. Amongst clients paying more than 20% of their annual income towards rent-to-own debt, 95% held multiple rent-to-own products.[22]

3. **Rent-to-own companies continue to direct marketing at clients even where they cannot afford to take on new goods.** This is particularly damaging in instances where vulnerable clients, often with limited financial capability, struggle to understand the ultimate cost of rent-to-own products, and are captured instead by the superficially low weekly rates, as in the case study below.

[20] Citizens Advice Money Advice Recording Tool Data 2017
[21] Citizens Advice survey of 1938 rent-to-own customers, August-September 2016.
[22] Citizens Advice survey of 1938 rent-to-own customers, August-September 2016.

Case study: Eileen

Eileen is a 74 yr old widow living in private rented housing. Eileen is blind in one eye and has struggled with a learning difficulty throughout her life. She currently has no savings, and debts of nearly £6,000. At the moment, Eileen owes a rent-to-own provider £550 for a tablet computer, a mobile phone and a vacuum cleaner. She struggles to meet her weekly payments of £75.60 to the store, but despite her inability to pay, Eileen finds herself persistently being contacted by the store to purchase 'new and better' goods.

Our advisor recounts that Eileen; *'Has enough to live on, but struggles to understand the high interest rates charged on the goods… [When she is contacted], she feels vulnerable and finds it hard to say no.'*

Part 3: The impact of rent-to-own products

Rent-to-own products exacerbate clients' financial difficulties

As we have seen above, rent-to-own clients are disportionately likely to show signs of vulnerability and to be heavily indebted. In addition, rent-to-own products are disproportionately expensive and often lead to clients paying two or three times the original shelf value of the product. There are two objective indicators which suggest that taking on rent-to-own products is associated with a worsening of people's financial situation:

1. **People who take out rent-to-own agreements tend to see their levels of total debt increase over the course of the agreement, whilst their income does not.** Amongst rent-to-own consumers who took out a loan in 2015, average personal debt has grown from £2000 per consumer to £4300.[23] In addition, rent-to-own consumers tend to have seen their debt to income ratio increase in the period since taking out a loan.

2. **People who take out rent-to-own agreements tend to see their credit history worsen, rather than improve.** The increase in indebtedness, which is not accompanied by an increase in income, is associated also with a worsening credit score on the parts of rent-to-own users. This suggests that clients who took out a rent-to-own agreement in 2016 were likely to have fewer savings, and be missing payments more frequently one year into their rent-to-own agreement.[24]

People need the goods they've purchased so meet the costs of the agreements despite struggling to afford the terms

Our evidence suggests that clients often continue to meet the costs of rent-to-own goods, despite its negative impact on their finances due to the essential nature of the goods which they purchase.

The FCA's High Cost Credit Review highlights that defaults on rent-to-own goods are lower than in other high cost credit markets, due to customer concerns about repossession.[25] This fact, however, masks significant problems.

[23] FCA, (2017) Feedback Statement: High Cost Credit, p.29
[24] FCA, (2017) Feedback Statement: Technical Annex, pp. 23-25
[25] FCA, (2017) Feedback Statement: Technical Annex, p.19.

- **People with rent-to-own debts regularly borrow to meet the cost of repayments.** Overall, more than half of the survey respondents had taken on other debts to make their payments; 28% borrowed from a doorstep lender, 24% used a credit card and 20% took out a payday loan.[26]

- **Customers prioritise weekly rent-to-own payments over other debts and essential expenditure.** This is because the goods which are being paid for - from fridges to washing machines - are vital to prevent further financial difficulty. This prioritisation of rent-to-own payments can create problems further along the line: from increasingly the likelihood of entering into arrears on council tax payments and the threat of bailiff action, to negatively impacting the health of other family members, including children.

Case study: John and Lisa

John and Lisa have dependent children, and are unemployed. They recently purchased a washing machine, TV and playstation on a hire purchase arrangement, but are in arrears on a number of other payments, including their rent. John has stressed that the rent-to-own provider is the family's priority creditor, as it would be impossible for his family to function without a washing machine. The effect of meeting the high cost of these payments is that the couple's debts are mounting, their housing situation is now under threat, and it is becoming increasingly difficult to afford essentials, such as food. Our adviser felt that it was 'a guarantee of serious hardship'.

A large number of rent-to-own agreements fail

Despite high 'willingness to pay' amongst consumers of rent-to-own goods and the essential nature of the goods, a large proportion of rent-to-own agreements fail. This suggests that clients find the products prohibitively expensive:

- Only around half of the main provider's hire purchase agreements are completed over the full term, and end with the customer owning the good outright.

- One third of rent-to-own agreements lead to the client returning the good as they struggle to meet the costs of repayments.

- Around 16% of clients default on their agreement entirely[27]

[26] Hire Purchase: Higher Prices,
[27] BrightHouse evidence to the Treasury Select Committee, 28 February 2018.

Figure 5: The proportion of rent-to-own customers who manage to complete their agreements

We would challenge providers' narratives that many customers do not seek to 'own' their rent-to-own good, but rather 'change their mind[s]' on the subject of payments.[28]

Instead, our evidence suggests that it is often a lack of choice which pushes clients towards rent-to-own providers. One in three rent-to-own users have been turned down for credit elsewhere, and seven out of ten people purchased the product because they 'could not afford to pay upfront'.[29]

Case study: Susie

Susie and her partner have two young children, and are expecting a third child in April. Susie stays at home to look after her children, whilst her partner works full time. He earns around £1,250 per month, this low income and the need to feed two children means that the couple have struggled financially for several years.

In December, Susie's washing machine broke down and the couple were unable to pay for a replacement outright. The pair know that rent-to-own does not represent good value for money, but felt they had no choice except to take out a hire purchase agreement as their low income and poor credit history means they cannot turn elsewhere for credit. In addition, with two small children and a baby on the way, they cannot afford to go without a washing machine.

[28] BrightHouse evidence to the Treasury Select Committee, 28 February 2018.
[29] Citizens Advice survey of 1938 rent-to-own customers, August-September 2016.

Part 4: Protecting consumers in the rent-to-own market

What policy changes would help protect consumers?

The FCA's regulation of payday lending has been one of its big successes since it took over consumer credit regulation in 2014. The key protections given to payday loan customers has resulted in a dramatic improvement in customer outcomes. Not only have payday lenders continued to operate, but consumer outcomes have improved since their introduction:

- Citizens Advice saw a fall in people needing help with unaffordable payday loan debts by around half, from more than 16,000 people in 2013-14 to less than 9,000 last year.
- FCA analysis shows that improvement reflects improvement in the market more generally. The proportion of loans entering arrears for seven days or more has reduced from 16% to 12%.[30]
- The cap has not been connected with an increase in borrowing from loan sharks, or other forms of illegal money lending.[31]

Recommendation 1: The FCA should cap the cost of credit for rent-to-own consumers

Currently payday loan customers have three protections from high charges. These are:

- A total cost cap which means people cannot repay more than the amount they borrowed in interest and charges.[32]
- Lenders can only charge a maximum of £15 in additional fees and charges.[33]
- An initial cost cap - which means interest charges cannot be more than 0.8% per day.[34]

[30] FCA, (2017) High-cost credit feedback statement
[31] FCA, (2017) High-cost credit feedback statement
[32] CONC 5A.2.2
[33] CONC 5A.2.14
[34] CONC 5A.2.3

We think people who use rent-to-own consumers should be covered by similar protections. In particular:

- People who purchase rent-to-own products should never pay back more than 100% of the the list price of the product.
- The cost of late payment fees on rent-to-own goods should be capped. With consumers never paying more than £15 in late payment fees over the course of their agreement.

How would this protect consumers?

As shown in more detail below, rent-to-own consumers - who don't have these protections - can end up paying back more than twice what they borrowed. This is largely the case where consumers purchase smaller devices, such as laptops or mobile phones, which have APRs which range between 68.9 and 99.9%.

In addition, a large number of rent-to-own users are penalised by late payments fees. 34% of rent-to-own users have missed one or more payments to their rent-to-own company for which they have been charged fees.[35] The FCA's data suggests that there are a small number of rent-to-own users who miss payments for an extended period of time; with around 8% of consumers missing one month's worth of payments, 4% having missed more than two months payments, and 3% missing three months payments.[36] For these consumers, a cap on late payments fees would make a very significant difference.

There is only one part of the payday loan regulation - the initial cost cap - which would be unlikely to affect rent-to-own consumers. The longer duration of hire purchase agreements means that interest rates in the rent-to-own market, although high, do not come in under the interest rate of 0.8% per day.

How should the FCA implement such a cap?

The high cost short term credit cap was introduced under section 137C of the Financial Services and Markets Act, as amended by the Financial Services (Banking Reform) Act 2013. The Act gives the FCA a power to put a limit on the cost of credit.

The FCA should use that power to protect rent-to-own consumers from excessive costs and charges.

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[35] Citizens Advice survey of 1938 rent-to-own customers, August-September 2016.
[36] FCA, (2017) Feedback Statement: Technical Annex, p.89

How would a price cap affect existing rent-to-own loans?

Citizens Advice commissioned Lucerna Partners to develop a model to help us explore the impact of a total cost cap on existing rent-to-own loans, similar to that introduced for high-cost short-term credit.

The model is limited by a lack of available data on the rent-to-own market - particularly on actual APRs paid by customers, the distribution of the market in terms of loan size, and loan period. The model therefore relies on reasonable ranges of assumptions about the characteristics of, and proportion of loans in, each part of the market.[37]

The price cap is made up of three parts. Our model looks at the impact of the two that would have an impact in the rent-to-own market:[38]

- The cost cap of 100% which means that customers cannot repay more than the amount they originally borrowed in interest and charges
- A cap of £15 on the fees charged by lenders for missed or late payments.

Assuming the price cap were introduced into the existing rent-to-own market, we believe between **145,000 and 245,00 loans** a year would be affected. If all these loans were priced down to the level of the cap, this would deliver savings of between **£58 and £62 million** for rent-to-own customers.

This estimate assumes that:

- 65% of customers take out three year loans, 25% of customers take out two year loans and 10% of customers take out a one year loan.
- 90% of the goods purchased from rent-to-own providers are household appliances, furniture, or TVs with a representative APR ranging between 68.4% and 69.5%. 10% of consumers purchase smaller devices such as mobile phones, tablets, or computers with a representative APR of 99.9%.[39]
- 75% of white goods are sold at the representative APR of 68.4-69.5%, 25% of white goods are sold at an intermediate APR of 99.9%. 75% of smaller

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[37] A full methodology is available in Appendix 1

[38] The four big home credit lenders don't currently charge default fees which means the third part of the cost cap - a £15 cap on default fees - would have no impact

[39] This assumption is based on responses to our Rent-to-Own Survey August-September 2016. Amongst these rent-to-own customers, 10% of the goods purchased were smaller devices which would be likely to have an APR of 99.9%.

devices are sold at the representative APR of 99.9%, 25% of smaller devices are sold at a higher APR of 139.9%.

- 10% of one year loans are charged missed payment fees, 20% of two year loans are charged missed payment fees and 30% of three year loans are charged for missing payments.

The total number of loans affected and money saved is based on the number of loans where the total cost is over 100% of the capital borrowed. The upper bound of this figure calculates the number of loans which would be likely to be affected by a fee cap, if all clients who missed payments were charged an upper limit of £45 over the course of the loan. The lower bound estimates the number of loans affected if all clients missing payments are charged a maximum of £15 over the course of the loan.

The majority of loans affected are due to the total cost being pushed over 100%. This is primarily on loans which have higher APRs, starting from 94.9%. In addition, the majority of loans affected in our model are longer term loans, as it is over this period that the interest accumulates to reach 100% of the original cost.

Our model relies on assumptions based on the best available evidence. The modelling approach is therefore inevitably crude. Modelling along the lines that the FCA was able to do for the payday loan cap would be needed to properly understand the impact of price caps in these markets.

What is the potential for unintended consequences?

A common argument against better regulation of payday lending - and against better protections for rent-to-own consumers - is that it will lead to unintended consequences. The predicted unintended consequences of better protection for payday lenders have been limited. For the majority of people declined when they apply for a payday loan, the impact on their finances is positive:[40]

- **They are not pushed into financial difficulty.** Nearly 2 in 5 (37%) say they took no action as a result. Only 1% said they missed a bill as a result and 63% said they thought it was for the best.

- **They are not pushed to other high-cost lenders.** The majority of people who are declined don't go on to borrow from other sources of high-cost credit. Only 15% did.

[40] FCA (2016) High-Cost Credit: Call for input

- **They do not borrow from illegal lenders or 'loan sharks'.** Our evidence, as well as that of the FCA, shows that there has not been an increase in problems with illegal lending. That is partly because people can still access credit and partly because loan sharks aren't a substitute for legal credit. The FCA found 'no robust evidence of declined applicants increasingly turning to illegal money lenders.'

One concern repeatedly raised is that - if a price cap were introduced - rent-to-own providers would simply increase the upfront price of the good.[41] If paired with better affordability checks and transparent pricing practices, a higher headline price might act as a deterrent for consumers, and prevent lending to those least likely to afford the product. Crucially, our evidence suggests that, where clients are likely to struggle to meet the cost of repayments, high cost credit is likely to exacerbate, rather than resolve, the problems faced by low income consumers.

We remain concerned about the shortage of options available to people who struggle to access mainstream credit. This will form the basis of upcoming work to promote and explore alternative forms of low cost credit. However, the evidence that people do not always shop around in this market suggest that promoting alternatives is not a substitute for effective regulation.

Recommendation 2: The FCA should require high-cost credit providers to conduct better affordability checks

Our evidence shows that as well as paying high costs, large numbers of rent-to-own consumers are being lent money they can't afford to repay. The median debt to income ratio of people we helped with rent-to-own debts was 59%. In the market more widely, the median debt to income ratio is 29%.[42]

The FCA should introduce rules for high-cost short-term credit providers to give clarity over what is expected when they conduct affordability checks. Currently, while all lenders have to conduct affordability checks, there are no rules on what those checks have to include. The FCA's current guidance, for example, is that the lender considers 'sufficient information' to take 'reasonable creditworthiness statement'.

It sets out a number of factors that lenders should consider, including; existing financial commitments, future financial commitments and customer

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[41] If such increases were to occur, the FCA could challenge providers on grounds of a lack of price transparency, due to the integration of interest into the ultimate cost of the product.
[42] FCA, (2017) High-cost credit feedback statement

vulnerability. The emphasis on proportionality however, makes it unclear - both for providers and consumers - about a ‘reasonable’ or ‘proportionate affordability assessment’ means for high cost products.

The FCA should make its guidance in the Consumer Credit Sourcebook on responsible lending into rules for rent-to-own credit lenders. As a minimum those rules should require lenders to check proof of income and expenditure when making lending decisions.

Conclusion

Whilst the rent-to-own market is fairly small, with around 400,000 people holding rent-to-own debts, the problems faced by these consumers tend to be acute. Not only do they tend to have low incomes and high levels of personal debt, but they also show other signs of financial stress. Two thirds of rent-to-own users are in social housing, 40% are single parents and a similar proportion are unemployed or unable to work.

Such difficulties make it harder for consumers to shop around, find cheaper products, or even access credit at all. As such, rent-to-own companies are not obliged to operate in a competitive market, and can exploit the lack of choice available to their clients.

As a consequence, the cost of rent-to-own products is excessive, with APRs as high as 99.9% over the course of three years, and punitive late payment fees which build upon the original cost. Similarly, rent-to-own providers charge expensive, and often unnecessary, add-ons to their products, which can add as much as 35% of the original cost in addition to interest and late payment fees.

These costs exacerbate the financial difficulties of rent-to-own users. Often we find that customers continue to meet the costs of rent-to-own payments, despite experiencing financial detriment. Such a prioritisation can lead clients to borrow further to meet the cost of weekly payments, or to delay paying other vital bills, such as council tax.

Finally, the high rate of failure in rent-to-own agreements suggest that these loans are not working for consumers. 1 in 3 consumers rent-to-own consumers return their goods to the store, despite having made a significant contribution towards the costs.

The vulnerable characteristics of consumers and the inefficacy of competition in the rent-to-own market means that consumers who use this product need greater protections. To address this detriment, we propose that:

- **The FCA provide more protections for rent-to-own customers by capping the cost of credit.**
- **The FCA should require high-cost credit providers to conduct better affordability checks**

For this research, we commissioned a consultancy to model the effect of such a cap. We found that a cap would affect as many as **245,000 rent-to-own loans** and could save consumers as much as **£62 million per year.**

Appendix 1 - Methodology

This report uses two main sources of data: Citizens Advice client data and modelling conducted by an external consultant to analyse the impact of a total cost cap on existing rent-to-own loans.

Citizens Advice client data

Citizens Advice records extensive information of advice trends provided to its face-to-face debt clients. This includes demographic information and advice trend data.

Data on the value of rent-to-own and other debts, income, and demographics of clients with rent-to-own was gathered using debt recording tools, typically only used during specialist debt advice sessions. Not all clients progress to this level of advice. The data used in this report therefore cannot be generalised to all Citizens Advice debt clients, though it provides insight into those clients who are struggling with rent-to-own debts.

Finally, advisers are able to submit case notes for study where they believe a case demonstrates a particular policy issue worthy of consideration by our researchers. All the case studies in this document derive from data collected in Citizens Advice offices between June 2017 and March 2018.

Price cap modelling

Citizens Advice commissioned an external consultancy, Lucerna Partners, to model the impact of a total cost cap on existing rent-to-own loans, similar to that introduced for high-cost short-term credit.

The price cap is made up of three parts. Our model looks at the impact of the 2 that would have an impact in the rent-to-own market:

- The cost cap of 100% which means that customers cannot repay more than the amount they originally borrowed in interest and charges
- A cap of £15 on the fees charged by lenders for missed or late payments.

We have not had access to the kinds of industry and customer data that FCA was able to use to model the impact of the payday loan cap. The model is limited by a lack of available data on the rent-to-own market - particularly on actual APRs paid by customers, the distribution of the market in terms of loan size and loan period. The model therefore relies on reasonable ranges of assumptions about the characteristics of, and proportion of loans in, each part of the market.

To attempt to address this problem, the model divides each market into 'parts' each with different loan characteristics. We make reasonable ranges of assumptions about the characteristics of, and proportion of loans in, each part of the market.

The approach to estimating the savings from applying price caps is also highly stylized. For example, we chose to construct a model which assumes all current loan contracts affected by the modelled caps repriced down to the cap. In practice market participants would respond to price caps in a range of ways, depending for example on suppliers' costs, customer credit ratings, customers' willingness to pay, and competitive responses.

This modelling approach is therefore inevitably crude. Modelling along the lines that the FCA was able to do for the payday loan cap would be needed to properly understand the impact of price caps in these markets.

Our model assumes:

- 600,000 originations per year. We split those by customer market share of the two main providers.[43]
- The average origination size of a loan is £1,100.[44]
- 65% of customers take out three year loans, 25% of customers take out two year loans and 10% of customers take out one year loan.
- 90% of the goods purchased from rent-to-own providers are household appliances, furniture, or TVs with a representative APR ranging between 68.4% and 69.5%. 10% of consumers purchase smaller devices such as mobile phones, tablets, or computers with a representative APR of 99.9%.[45]
- 75% of white goods are sold at the representative APR of 68.4-69.5%, 25% of white goods are sold at an intermediate APR of 99.9%. 75% of smaller devices are sold at the representative APR of 99.9%, 25% of smaller devices are sold at a higher APR of 139.9%.

[43] Customer numbers for the two main rent-to-own providers were taken from the Number of annual originations is derived from Credit Reference Agency data published in FCA (2017) High-Cost Credit Review Technical Annex 1

[44] FCA (2017) High-Cost Credit Review Technical Annex 1

[45] This assumption is based on responses to our Rent-to-Own Survey August-September 2016. Amongst these rent-to-own customers, 10% of the goods purchased were smaller devices which would be likely to have an APR of 99.9%.

- 10% of one year loans are charged missed payment fees, 20% of two year loans are charged missed payment fees and 30% of three year loans are charged for missing payments.

Estimated total missed payment fees paid over the loan period	Loans Affected	Amount saved
£15	144,914	£58,715,108
£45	244,725	£61,709,443

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