Credit crunch hits cash-strapped homeowners

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Homeowners have drawn on their biggest asset, the roof over their heads, not to fund 'champagne moments' but to get through hard times; that's the finding of a preliminary study by Durham University.

Mortgage equity withdrawal is a much more popular and frequent event than previously thought. New figures show that borrowers haven't just used their housing equity to splash out on holidays or cars; struggling households have borrowed against their homes to meet their basic needs like bringing up the kids.

Durham University researchers looked at the borrowing patterns of over 8000 households in the UK from 2001-2005. They found that in any one year, 2 in 5 homeowners ended up with higher mortgages than in the previous year, even though they had not moved home. Instead they had re-mortgaged or extended their existing home loan. On average, these households borrowed an additional £5000 to £7500 in a given year. Some of them tapped into as much as three-quarters of their home equity in this way.

Durham University housing expert Susan Smith said: "The Credit Crunch is a welfare disaster for struggling households who have previously relied on the option to borrow up against the value of their home.

"In the early years of this century we saw a form of self-administered welfare payment develop where home-owners cash in on their homes, in boom times: to support children, smooth over a fall in income, or meet the costs of relationship breakdown."

The Durham research team - Dr. Beverley Searle and Professor Susan Smith – has linked up with Australia's RMIT University to research and compare the mortgage choices of UK and Australian homeowners over the same four years (2001-2005). This was a period with rising house prices and easy credit and there are more similarities than differences in the two countries.

The research, funded by the Economic and Social Research Council, uses panel survey data that tracks the same households through every year. This ongoing study is monitoring what prompts households' use of a growing range of flexible mortgages and low cost refinancing opportunities to draw from housing wealth, and release money to spend on other things.

The findings show that this facility – to borrow against housing wealth cheaply, easily and without moving home – is a factor in the recent escalation of personal debt. However, these findings also suggest that the popular perception of equity withdrawal is not always used for life's luxuries - it's used to meet more basic needs.

Professor Smith said "This suggest that the credit crunch is not just precipitating a crisis in the finance community; it could produce a crisis of welfare too. Without the option to use mortgages to channel housing wealth into spending money, families under pressure lose access to their most significant asset base for welfare and are forced to look at other ways of getting by.

"The figures show that housing equity withdrawal has provided a lifeline for struggling families but the credit crunch threatens what has become a new form of self-administered welfare."

Source: Durham University