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The Impact of the Cost-of-Living Crisis on British Credit Unions and Community Lenders

Pål M. Vik and Andrew Wallace

Credit unions are often hypothesised to be less vulnerable to crises than other types of businesses. This paper examines the impact of the cost-of-living crisis on the British credit union and community lender sector drawing on interviews with 25 managers and a focus group with four loan officers. This crisis is affecting businesses and households through high inflation, declining real pay, rising interest rates, and falling economic growth. The findings suggest that credit union and community lender customers are experiencing a deterioration in their finances. They save less, have more unsecured debts, are less likely to qualify for a loan, and are more likely to default on loan payments. Lenders are grappling with a tension between supporting customers affected by the crisis and preserving their own financial position. On the one hand, there is evidence of lenders providing additional support to their members, including emergency loans and hardship payments. On the other, they are mitigating the risks of deteriorating customer finances by tightening lending criteria and reducing lending to higher risk groups. The findings underline the need for future research into the long-term effects on the sector and its ability to provide finance to underserved communities.

Introduction

Today, businesses and households across the world are facing a cost-of-living crisis with rising food and energy prices, and falling real incomes (United Nations, 2022). In the UK, inflation reached 9.9% in the 12 months to August 2022, nearly the highest rate in 30 years (Francis-Devine et al., 2022). Average total pay, conversely, only rose by 5.5% leading to a fall in real term pay of 2.8%, which is one of the greatest falls since records began in 2001 (Office for National Statistics, 2022). The Bank of England and central banks across the world have raised interest rates in response to the high inflation rates, leading to increased borrowing and housing costs. In July 2022, the International Monetary Fund (2022) predicted that global economic growth would fall from 6.1% to 3.2% in 2022 and to 2.9% in 2023 as a result of high inflation.

This paper provides a timely insight into the impact of the cost-of-living crisis on the credit union sector and its customers drawing on qualitative interviews with British credit unions and community development finance institutions (CDFIs). Credit unions are member-owned organisations that provide loans and savings accounts to their members who share an occupational, associational, or residential common bond (Forker et al., 2014). CDFIs are mission-driven, community-based lenders that specialise in providing loans and ancillary support (budgeting support, advice) to low-income consumers and businesses unable to access mainstream finance.

There has been a longstanding interest in academic and policymaker circles about the behaviour and resilience of credit unions and financial co-operatives at times of crises (Birchall & Hammond Ketilson, 2009; Coen et al., 2019; Goddard et al., 2014). The co-operative model is believed to be less affected by crises compared with other business models because of a geographically concentrated customer base, common identity of members, and fewer incentives for risk-taking behaviour (e.g., bonuses, profit and share options for management) (McKillop et al., 2020). Research, especially in the US, has shown that their lending is less linked to business cycles compared with shareholder businesses (Smith & Woodbury, 2010). In fact, following the global financial crisis of 2007-09, credit unions increased rather than reduced the provision of credit as was the case with banks (Lu & Swisher, 2020; Walker, 2016).

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Policymakers and academics are also interested in the effects of financial and economic crises on co-operatives and credit unions because they are often the main or only source of credit and other financial services for some, such as rural communities (Coen et al., 2019). Co-operatives and credit unions often have a wide membership, but many were set up to serve poor, underserved communities (Hoyt & Menzani, 2012; Jones, 2006) that would otherwise resort to costly subprime borrowing with higher likelihood of detrimental customer outcomes (e.g., high debt levels).

The remainder of the article is organised into three sections. The second presents the methods used, whilst the third section presents the findings. The final section concludes with a discussion about the implications of the research.

Methods

The research consisted of semi-structured, online interviews with managers of 17 credit unions and eight CDFIs between 26 May and 3 August 2022 (Table 1). The interviews focused on the impact of the cost-of-living crisis on customers, lending activity, and operations. We also conducted an online focus group with four loan officers from one CDFI and two credit unions on 23 June 2022. The majority of the organisations were medium-sized, and most were based in England.

Table 1: Overview of sample

	Credit unions	CDFIs	Total
Small	2	3	**5**
Medium	10	4	**14**
Large	5	1	**6**
Total	**17**	**8**	**25**

Note: Definition of size based on outstanding loan portfolio: <£2m (small); £2m-£9.9m (medium); ≥£10m (large).

The interviewees were recruited through calls for participants issued through the main trade bodies as well as using our network of contacts. We used a theoretical sampling approach seeking to ensure representation from a wide range of types and experiences rather than obtaining a probability sample. All the interviews were transcribed and analysed for dominant themes. The findings we report in the article were widespread across a range of different lenders and material with the organisations.

Findings

The credit unions and CDFIs were observing several trends indicating a deterioration in the financial circumstances of their customers and members. Lenders were having to reject a significantly higher percentage of loan applications compared with before the crisis. According to one CDFI manager: “Historically, we would decline about 60% of our applicants. That’s now increased to about 75%”. According to another lender:

> The volumes of applications have increased considerably over the last few weeks, but unfortunately so have declines. It used to be quite stable around 30% of applications, but in April it was 35% and then in May it went up again to 37% and this month it’s looking to rise again (Credit union loan officer).

As suggested by the above quotes, it was not uncommon for lenders to report percentage point increases of 7-15% in loan application decline rates. Often lenders were having to reject applications from existing customers they would have approved prior to the crisis. The increase in decline rates was mainly caused by a worsening of financial circumstances of applicants,

which would make servicing a loan unaffordable. Salaries and welfare benefit payments were not keeping up with rising prices:

> Their expenditures are rising considerably. When they were making their loan previous application, they were maybe quite comfortable, and they were managing to pay fine. Now you're looking at their application and thinking: this person's never going to be able to pay all their bills (Credit union manager).

For some groups, who emerged out of the Covid-19 pandemic with lower income and higher debt, the cost-of-living crisis further exacerbated their financial difficulties. Although low-income customers were seen as especially vulnerable, rising living costs were affecting a wide range of customers:

> We definitely are seeing the effects of the cost-of-living crisis and we have even had customers say that they've rung in sick rather than go to work because they can't afford to put petrol in their car, and these are frontline police officers. It's definitely having an impact on members (Credit union loan officer).

As a further signal of worsening financial circumstances, lenders were observing higher levels of unsecured debt on applicants' credit files:

> People are more indebted. We have seen the average amount on a credit file go up by a few £1,000 on their credit file as they're juggling and taking out more credit (CDFI manager).

Rising debt levels among customers contributed to the increasing loan application rejection rates because it meant they had less surplus income to service a CDFI or credit union loan. Buy-now-pay-later credit was among the most common and fastest growing sources of consumer debt, with consumers often having multiple such payments going out of their accounts:

> Customers' use of buy-now-pay-later seems to have skyrocketed and people that we assessed applications a year ago who did not use buy-now-pay-later are now maybe spending 10-20% of their income on it (CDFI loan officer).

Most lenders reported that average approved loan amounts were smaller than before the onset of the cost-of-living crisis. There were indications that customers were delaying or not going ahead with nonessential expenditure. Instead, customers were increasingly borrowing to cover essential items and living costs:

> We did more loans than usual, but probably about 2/3 of the value to what we're used to seeing. It was Christmas kind of numbers, but for smaller amounts. We're doing more loans for unexpected bill payments, which is fine, but we wouldn't usually do loans for regular bills (Credit union manager).

Borrowing to pay for day-to-day living costs and necessities is an important indicator of financial distress and financial vulnerability. There were also indications that customers were saving less compared with before the crisis.

Most credit unions reported an outright fall or a lower than projected growth in savings, due to both lower intake and greater withdrawals. Some of this may be because people were drawing on excess savings accumulated during Covid-19 or because people were moving savings in response to increasing interest rates among competitors. However, managers and loan officers also attributed the fall in savings to worsening customer finances:

> We have found in last few months that our members' ability to save has fallen. We tend to see a £1m growth per month in savings. We are now seeing growth of £800,000, which is 20% lower. This is because household bills have increased. For many people the rainy day has arrived (Credit union manager).

Not only were customers, especially those on low incomes, reportedly taking out or not depositing savings "for day-to-day living and necessities" (Credit union loan officer), but credit unions were receiving an increased number of requests to release savings used to underpin loans. The final manifestation of worsening customer finances among several CDFIs and credit

unions was an increase in loan delinquency, especially missed payments and payment holiday requests:

> Arrears have been high. They've already grown quite significantly over the last three months by a few £100,000 over and above budget (Credit union manager).

Lenders were particularly concerned about arrears on loans issued prior to the cost-of-living crisis.

The managers interviewed were conscious of and concerned about the deteriorating finances of their members and customers. Lenders were taking numerous actions to try and help them weather the crisis. As noted above, they were making smaller loans for emergencies and bills. They introduced new policies to allow customers to withdraw savings linked to loans. Some lenders had introduced or were considering providing grants or hardship payments for customers not qualifying for a loan:

> We've created a small hardship fund as well, which we're going to use to make grant payments to members that apply to us for credit and we can't support them with a loan in good conscience, but we've got genuine concern for their welfare (Credit union manager).

However, managers were also conscious of the financial risks and pressures their organisations were facing as a result of the cost-of-living crisis. Mainly, they were concerned that, unchecked, the deteriorating financial circumstances of customers could result in higher loan delinquency and bad debt provisioning costs:

> The big thing we are concerned about is around risk and defaults. We're seeing our customers being impacted significantly by the cost-of-living crisis. Increases for things like the request for payment holidays or we've seen a lot more things like not even the first payment being made on a loan (CDFI manager).

Aside from being a significant cost — the largest after staffing — bad debts are an important source of uncertainty and volatility in the sector. Some lenders were also concerned that smaller loan amounts would translate into smaller future loan books and hence lower interest income. A small group saw the combination of lower future income and higher provisioning costs as an existential threat to the sector:

> When the banks collapsed in 2008, I remember being really worried about the future of the credit union. I'm more worried this time than I was back then. I felt like back then it was we were in a better position. Unless things change, we're not going to be here in 5-10 years' time (Credit union manager).

However, the majority did not believe the cost-of-living crisis would negatively affect their viability in a significant way. This was partly because they were well capitalised, had large loan portfolios and generated significant surpluses to weather any falls in income and increases in costs:

> I'm concerned about the cost-of-living crisis and the effect it has on our business, but more so on our consumers. It would be nice to be able to lend to more people, but that's not going to happen (CDFI manager).

Lenders were also taking steps to manage the financial risks associated with the cost-of-living crisis. The most common mitigation was tightening lending criteria:

> We've tightened up the minimum credit score that we would expect for the smaller value loans, and we've also introduced new guidance around the evidence that we would require for small value loans. Typically, we would rely on a credit report alone for many borrowers, but we've increased the frequency of doing an open banking affordability assessment for small value loans (Credit union manager).

As per the quote above, this took two main forms. Firstly, lenders heightened lending criteria in terms of surplus household income to service debt and minimum credit score. Secondly, there was increased scrutiny and additional checks of data provided by applicants, especially the use

of open banking data to verify spending data. Possibly as a result of this tightening of criteria, some organisations were shifting lending towards lower risk, better off borrowers:

> The cost-of-living crisis will ultimately take some of our existing customers because it will become no longer affordable for them, but we expect that there are people that probably sit price wise below our current segments that will move into our market. So, from that lens alone, I would say we'll be in an acquisitionally commercially neutral position (Community lender manager).

This is significant because it suggests that the finances of prime or near-prime borrowers may be worsening to an extent that they are unable to access mainstream finance, and because serving financially vulnerable, low-income consumers is an important part of the mission of the credit union and community lending sector.

Conclusion

This paper has shone a light on how the cost-of-living crisis unfolding globally is affecting the British credit union and CDFI sector. This is important because the sector is often held up as a different, more inclusive, and less volatile business model compared with the dominant capitalist shareholder model.

It is important to stress the qualitative nature of this study and the uncertainties surrounding the cost-of-living crisis. We used theoretical sampling to ensure representation of a wide range of experiences and settings rather than a large probability sample. This means that we do not know and cannot say if our findings are applicable to the wider sector. Instead, the findings say something about the range and type of impacts experienced across a range of different providers. Further, given the great uncertainty about the development of the cost-of-living crisis in terms of its duration, nature, and impact, we cannot say anything definite about its future effects on these lenders and their customers. However, the qualitative and quantitative evidence provided by interviewees suggest that the cost-of-living crisis has caused a significant deterioration in customer finances. They face higher living costs, have greater levels of unsecured debts, and less savings than before the crisis.

Lenders are seeking to manage the tension between supporting low-income, financially vulnerable customers, and protecting and preserving their own financial viability through reducing and mitigating the risks associated with the crisis. Whilst they are helping members with smaller emergency loans and, in some cases, hardship payments, credit unions and CDFIs are also tightening their lending process and criteria. There are indications that lenders may be (forced to) shift to lower risk, less financially vulnerable customers to preserve their financial position.

The findings underline the need for research and monitoring into the long-term effects of the cost-of-living crisis on the viability of the sector and its ability to provide finance to underserved communities.

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