

Excerpts from a 1995 Report

Consumer Debt/Equity

There are two key issues relating to our measurement of levels of consumer debt versus levels of equity (total assets). The first is the accuracy of the methodology used to track these levels, and the second is whether, in an historical perspective, the levels are truly significant. Are they nothing but a transitory phenomenon which will be erased by the next wave of inflation?

I cannot speak to the empirical accuracy of the research due to a lack of control and other independent data. I can address the consistency of the methodology to produce relative accuracy, as well as a limited historical perspective in the following narrative.

Historical Perspective:

The first time I analyzed consumer debt/equity relationships in a survey was in 1972-3 for a small study testing the market and applications for the Instant Transaction card (IT), being test-marketed in Syosset, NY for the Hempstead Bank. As I recall, the level of negative equity was insignificant - probably below 1% for the Nassau and Suffolk County communities being tested.

In subsequent market analysis for Security National Bank, King's Lafayette Bank and Chemical Bank, debt/equity measurements were not included in my work, until a 1979 survey for Plymouth Federal Savings and Loan Association. From that point on, it has not only been a consumer market qualifier for every banking study I have designed, but, since 1993, I have been including it in other consumer surveys where I have had reason to believe that debt/equity levels could provide additional insight on current and planned purchase patterns and consumption.

In the 1979 and 1980 local surveys of the towns of Plymouth, Kingston, Carver and Duxbury, MA, levels of negative equity were less than 1%. A Plymouth County Study conducted in 1982, however, produced a level of 4%, split between the 18-34 and 65+ age groups.

Starting in 1985 the survey was expanded to include all homeowners in Southeastern Massachusetts and was overlaid (updated) in 1987 and 1989. From a high of 3% in 1985, negative equity dropped to a statistically insignificant value in 1987. Not a single 1987 respondent indicated a level of secured or unsecured debt in excess of their income differential for the fair market value of their homes and other real property.

Negative equity did re-appear at 3% in 1989. It marked the beginning of an attitudinal shift against banks, bank services and bankers which was of greatest interest, at the time. Further, it was a finding of the research that a majority of consumers had spread their business across many different banks with one bank holding their mortgage, another holding their line of credit and still other institutions holding their checking accounts, IRA's and credit cards.

Based upon the hypothesis that the changes in market attitudes were the result of competitive forces within the bank and non-bank financial services marketplace, the survey methodology and questionnaire were modified to provide greater insight on a means to package bank financial services. It was the objective of the survey to determine the market forces necessary to help increase our client's revenues by bringing more services "under one roof."

The new survey questionnaire was essentially a "Trojan Horse", where respondents were asked to design their own financial services package by indicating the types and amount of loans and debt they wished to consolidate as well as select the additional credit and banking features they wanted. This was a departure from the previous methodology which had asked respondents to declare their assets and liabilities as a straight qualifier and not in the context of requesting a service.

The new questionnaire was first used in a March 1990, pre-test. Since we were not looking at the negative equity component, it was not particularly alarming that it showed up at 5%. A September 1990 overlay, also dismissed at the time, showed a jump to 7.4%. It was not until the November mass survey, tabulated in early December of 1990, when the incidence of negative equity jumped to 12.2%, that the figure and its relationship to consumer attitudes towards banks became prominent.

Three subsequent market overlays conducted between December 1990 and February 1991, produced consistent results and also disclosed a pattern of nearly 30% of homeowners using their credit cards and equity lines as a means to meet mortgage and other secured credit obligations.

Also in a January 1991 focused overlay, using 150 households selected from a single institution's recent loan portfolio, 53% of respondents reported the principal amounts of their secured and unsecured debt to be in excess of the fair market value of their assets. What was most significant about this internal study was that an examination of the financial statements and appraisals in the loan packages did not disclose any negative net worth.

All research through 1992, had been conducted in the Northeast and New England states. After publication of the NEBBie Findings and exposure in a number of news media, we began to collect data from the rest of the country.

In 1992-1993 we accepted six research assignments from six banks and credit institutions to develop and conduct research projects in various cities and regions of the United States. All of the studies used the same questionnaire format for bank services packaging. All studies included both a market survey to provide control data of the institution's geographic market and a focused survey drawn from the institution's loan portfolio or recent lending activity. They all used my "check response" methodology to collect the information and, in return for a substantial discount, they all initially agreed to allow me to integrate their findings in my work.

Of the six surveys commissioned, I am only aware of the results of two. Of the four whose complete data I have never seen, two elected to tabulate the returns internally and, even though they had agreed to share the results, refused to do so, but paid their bill in full. Two others, shortly after the check responses began to trickle in, became non-responsive, and when pressed, claimed to have abandoned the project. They also did not pay the balance on their bills.

Of the two who did complete the projects, they requested and I agreed not to disclose the findings, beyond the point that their findings were consistent with my other research. I can only speculate that this may also be the case for those studies which I have not seen.

I should also note that the Bank Financial Services Package Questionnaire format I came up with in 1990 is one of the most successful consumer spending pattern and demographic data gathering tools I have ever used. The format yields greater than 90% returns from the mailings using a \$5.00 or \$10.00 incentive. For this reason, since 1993, I have used it to test national, regional and demographic markets for power tools, consumer electronics, health and fitness products, home improvement products, snacks, and dairy products.

Non Banking Consumer Tests:

When used as a consumer study, the Bank Financial Services Questionnaire has proven to be an excellent means of eliminating bias, skew and squeaky wheel response from my surveys. It tends to obscure the intent or purpose of the questionnaire and also, for a national survey, allows me to piggy back two or three tests into the same questionnaire. Unlike my bank surveys which concentrated on homeowners with mortgages, three of the mailings have been to a US Census proportional sampling, including renters, the elderly, and younger consumers. This is a base of 3,000 US households.

This survey, however, is not without its limitations. There are no write in responses, every response is a check box, so respondents must pick the range which is most applicable, but not an exact amount, when indicating the value of their home, the value of their personal property, the mortgage consolidation amount, the credit card debt consolidation, etc.. Further, each response is requested only once so there is no error checking or multiple response available for determining a mean.

For my purposes, this is not really a flaw. The answers provide a reliable relative index for analyzing the other more important questions in the survey relating to my clients products or services. Further, since the findings have been consistent over multiple surveys over several years, they may be defended as accurate representations of levels of change and trends.

Within the sampling tolerances of our model, it would appear that the negative net worth phenomenon, using the respondent's declared fair market value of all assets against the respondent's stated aggregate secured and unsecured debt is as of the third quarter of 1995 at a high of 13.5%.

This is an incidence figure. It does not show degree of debt, only that 13.5% of households owe more than they are worth by an increment greater than the respondents annual household income. This is the mean based upon a range of responses with the lowest being 12.5% and the highest being 14% from study to study.

In comparing the composition of this index against our 1991 sampling of homeowners, we see that the total incidence has remained relatively unchanged, but that a redistribution has occurred. In 1991 75% of the negative net worth incidence (9% of total) was concentrated in the 35 to 54 demographic. Today, this appears to have dropped to less than 50% (7% of total). Even factoring in the inclusion of renters, since the 35 to 54 is dominated by homeowners, this would indicate that there has been a level of equity rehabilitation in that segment.

The following breaks out the current distribution by age group of negative equity.

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|-------|--------------|
| 18-34 | 4% |
| 35-54 | 7% |
| 55-64 | Less than 1% |
| 65+ | 2.5% |

The 65+ category is an expected level of response due to distribution to heirs, cashing out, avoiding inheritance tax, or Medicare/Medicaid qualifications, but the real surprise comes with the 18-34 group. This group appears to be building debt at a remarkable rate, with apparently no income prospects to accommodate either their rate of consumption or plans for future spending.

What may be even more intriguing is the 55-64 demo. Here we have incredibly high equity, investment and income. These are the parents of the 18-34 group. It would be interesting to see if their assets will be sufficient to cover their kid's markers in 20 years.

If we look at the 4% incidence of negative net worth in the 18-34 demographic, a 29% category, we see that roughly 14% of this category is starting out "underwater".

The boomers (35-54) had a 7% incidence. They are a 39% category, so, roughly 18% of this group is finishing up "underwater". I don't have an historical comparable for the debt/equity relationship of this group back when the boomers were the 18 to 34 category, but I don't believe they started out as deeply in debt as the current category.

Then we have the DEB's (Depression Era Babies). They are 14.4% category who are not, as a group, significantly underwater. This is not to say that we do not have measurable levels of negative home equity in this group. We do and it is around 4%. The difference here is that other assets, including investment portfolio's and retirement accounts more than offset this figure.

The 65+ category has a 2.5% incidence. They are a 21% category, so, roughly 12% of this group is "underwater" either by circumstance or intent.

Home Equity:

In going back over some of the raw data from our last national consumer benchmark and doing tally counts and manual sorts on the qualifiers, the incidence of those homeowner respondents who indicate that the amount of their mortgage is greater than the fair market value of their homes is around one in twelve or 8.3%. Nearly half of this is concentrated in the 55-64 demo. The other half is in the 35 to 54.

This actually doesn't look too bad until we look at the incidence of those respondents who checked identical ranges for both their mortgage debt and home value. Here we had 4 out of 6! This, however, is not so alarming when you consider that checking 100-149,000 for both mortgage principal and fair market value of the home, theoretically allows for up to 49,000 in equity (or 49,000 in negative equity).

Again, this is another example of the limitations of my current methodology. It is terribly crude. Of course when a respondent checks 100 -149,000 for mortgage debt and 75 - 99,000 for fair market value of their home, there is no question. The problem is that there may be a substantial incidence of other households underwater in the less clearly defined responses.

For the purpose of analysis, therefore, I have applied a differential based on total household income as an equally crude, but essential filter of the incremental deviation. Therefore the differential must be greater than the respondents annual household income to classified as negative.

Other Assets and Liabilities:

The real source of the problem appears to be levels of unsecured debt and lack of other assets to offset this debt. . With the exception of the 55-64 and 65+ (50- 74,999) the median value of investment portfolios is (4,000-5,999). Additionally we have median savings (2-3,999) and real personal property including cars, boats, campers (10-14,999). This is offset by the median incidence of car loans (10-14,999), credit cards (6-9,999), and other unsecured debt (6-9,999).

In the six consumer surveys, it would appear that the debt levels are rising while the asset levels have declined over the past three years. In no group is the more apparent than in the 18-34. More important, the income levels for this group have remained unchanged since 1993.

One of the drawbacks to the way we have collected this data is that the segmentation for the banner does not allow us to separate the respondents in the 18-34 category into 18-24 and 25-34 segments or to determine exactly what percentage of this debt is their student loan, if any, since this was not specifically requested on any of the questionnaires.

Spending Trends:

The prime focus of consumer research is determining relationships between penetration and intent (what the respondent purchased last cycle, most recent purchase, next planned purchase and purchases planned for the next cycle). We call this the market conversion/exchange dynamic. I have included a separate paper on how we model this for our clients in your package. Here we again see some new trends which relate, at the very least to debt.

It is an overall finding of our consumer research that the intent to purchase (market volume of equilibrium) including, in some cases the absolute need to purchase (ie. home maintenance, repair, automotive, education, medical/dental) is 300% greater than the current level of purchases.

While this would normally be a great leading indicator of economic expansion, there is a fly in the ointment. What we do not see is the means. This narrows in on our supply/demand vector.

We show very high distribution/access and promotion/recognition, but the supply/demand numbers are totally out of kilter. Essentially, for every category tested except food and meal events, levels of most recent purchase (exchange) and next planned purchase (conversion) for those categories of product in high demand, are nearly zero. These categories only come in on purchases planned in the next three months, three years or 5 years, depending on the category of product being tested.

Over the past three years, I have seen this pattern solidify. Purchases are being pushed off into the distant future and, as they push them back, demand grows and the conversion potential increases. Essentially the markets for these products and services have no discretionary income to pay for them or ability to accommodate the debt service for a credit purchase.

The exception to this is in the food and meal event category. Here, levels of food spending have increased by more than 50% while income levels have stayed the same and discretionary income has declined.

One could say that consumers are eating themselves out of house and home. I estimate that, as a share of consumer discretionary income, the percentage spend for food and meals has doubled since 1990.

This is particularly prevalent in the 18-34 category where we are finding an increasing pattern of 5 meal events per day, of which 3 meals are prepared and/or consumed outside the home. To explore this, we are currently working on a study of the workday meal accommodations market.

Other Items and Summary:

What struck me when I was looking at the tables was the dependant relationship between the 18-34 category and the 35-54 group. One of the issues I have been trying to highlight since 1991 has been the fact that when this very large "Boomer" generation hits retirement, somewhere between 20 and 30% will be totally dependant upon entitlement programs to maintain a minimum standard of living and, because they are going to live longer, they may need this support for 25 to 30 years.

Can the Boomer generation depend on the income of the current 18-34 group, who already are exhibiting an alarming level of negative net worth, to add sufficient contribution to entitlements as they approach their peak earning and peak expenditure phase in 10 to 15 years?

How about the next boomlet?

Do we actually have a problem or are we seeing the emergence of a new age of feudalism? Is individual wealth essential to the quality of life and can such wealth be defined solely by property?

Maybe the real question I, regardless of consistency, can the findings presented to you today be trusted to represent the nation as a whole? No national census based body of research exists to either validate or refute the data I present. My data is represents isolated samplings either by geography or market. The Freddie Mac study is only representative of their loan portfolio. Even the new Michigan Study, while a vast improvement over its predecessor, does not include the necessary qualifiers to to produce a definitive finding.

It would also appear that there are some differing views. Mr. Gray in New York, for example, sees a much lower incidence of negative equity. He may be right. It is quite possible that the check box approach we use to gather the data on debt and equity or the formula we apply to produce an index is flawed. Then again, maybe it is not.

The bottom line is that the only way we will be able to anticipate and track this phenomenon is with a national census based methodology and, at a minimum, annual overlays. Additionally, the survey must be blind. Notwithstanding public policy against monetary incentives, my record demonstrates the speed, economies and consistency of this technique.

I therefore request that you reconsider my proposal in light of the vital information such a survey would produce. Thank-you.

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