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FINANCIAL PLANNING

Debt Problems Are Haunting Even Well-Heeled Consumers

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George Keith was living the good life. Now, he's paying the price.

During the boom years, the 55-year-old Branchburg, N.J., man took his wife and three children to Europe and put a new pool with a spa in his backyard.

Then a year ago, he lost his job as a technology consultant. Now, he has nearly $600,000 in debt -- a combination of student loans for his kids in college, mortgage loans, bank credit lines, and borrowings against his 401(k) retirement plan.

Mr. Keith recently got a lower-paying job with a pharmaceuticals company. Despite a combined income of $185,000, he and his wife are having to cut back to meet their payments.

Worries have been mounting for a while about auto repossessions, personal bankruptcies and mortgage foreclosures; each is at or near its highest level in decades. Now, after a mortgage-refinancing boom and a slew of 0%-financing offers, there's evidence debt levels are becoming an issue for people at all levels of the income spectrum. For many families like the Keiths, just making monthly payments is starting to define their lifestyles.

CAST YOUR VOTE

• How comfortable are you with your level of personal debt? Participate in the **Question of the Day**[1].

TOOLS

• Asset allocation worksheet

• 401(k) planner

• 401(k) contribution calendar

IN TOO DEEP?

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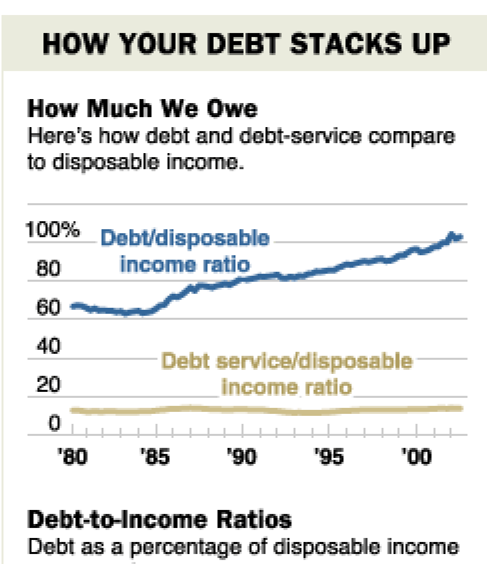
Overall household debt has exploded to more than 100% of disposable income (income after taxes), which is the highest percentage on record. In other words, the average household earns in one year, after taxes, about what it owes in overall long-term debt.



But wealthy families are piling on debt the fastest, largely because of increased borrowing against the value of their homes. Debt for the top-fifth of U.S. households hit 120% of disposable income in the first quarter, up from 100% in 1995, according to Federal Reserve Board calculations. The debt burden for the bottom four-fifths of households also grew, but at a more modest rate. It rose to 80% of disposable income this year, from 70% in 1995, according to the Federal Reserve.

Robert Beitman, an ophthalmologist in West Bloomfield, Mich., says hundreds of his patients have taken advantage of 0% financing for laser vision surgery since he began offering it last fall. "You would think that everybody who took this option would have a cut-off sweatshirt and a car with no muffler," he says. "That isn't the case. [People] leave in Mercedes and BMWs."

The news isn't all bleak. Nationwide, incomes are rising and interest rates are low, meaning many households, especially the wealthiest, are able to manage their higher debt loads. In addition, the Federal Reserve released a report Monday hinting that the debt binge might finally be slowing a bit. The Fed said that consumer borrowing rose at an annual rate of 2.9% in August, a sharp slowdown from the 7% rate in July.

In addition, because of low rates, debt service as a percentage of disposable income is at a manageable 14%. That's at the high end of the past 20 years, but not off the charts. "As long as interest rates remain low, this level of debt is on the whole manageable to people," says David Wyss, chief economist at Standard & Poor's.

Consumers are behaving much differently in this economic cycle than they have in previous ones. Between January 1991 and June 1992, as the economy was emerging from a recession, consumer borrowing fell steadily. This time around, consumers have kept borrowing through a recession and what economists believe are the early stages of a recovery.

Lenders are starting to play hardball with borrowers who are heavily in debt. Lisa Orman of Madison, Wis., has about $50,000 in debt on five different credit cards from her public-relations business. Even though she says she is rarely late with payments, she receives about four or five calls a week from credit-card companies seeking payments.

"They've gotten more and more relentless and persistent," she says, noting that some credit-card companies regularly call her in advance of the due date for that month's payment.

At Cambridge Credit Counseling Corp. in Springfield, Mass., call volumes have doubled from a year ago, to about 40,000 per day from 20,000. Chris Viale, a Cambridge manager, says the credit-counseling group is increasingly getting calls from higher-income individuals looking for help in managing heavy debt loads.

Consumer credit, of course, has defined American culture for centuries. "The pilgrims came over on an installment plan," says Lendol Calder, an economic historian at Augustana College in Rock Island, Ill., adding that many took years to pay for their passage. Centuries later, in 1949, at the beginning of the long post-war economic boom, a Business Week magazine headline asked, "Is the Country Swamped With Debt?"

This time around, economists say three factors will determine whether today's debt boom turns into a bust: interest rates, incomes and home prices.

FEWER LIMITS

Here are the rules for borrowing today, versus ten years ago:

THEN	NOW
Lenders said the combination of principal, interest, tax, homeowners insurance and other debt should not exceed 36% of a gross income. For a household earning $100,000 annually, that would be $3,000 in payments monthly.	Some payments approach 50% of gross income. For a household with $100,000 in annual income, that's $4,166 monthly.
Many lenders expected a 20% down payment before writing a mortgage. So a buyer of a $100,000 home needed $20,000 cash in hand.	With mortgage insurance, some buyers can get a mortgage with a 3% down payment or less, that's $3,000 on a $100,000 home.
Borrowers financed 90% of the value of a new car and paid the rest out of pocket. That means they came up with $2,000 toward a $20,000 car.	Borrowers finance up to 96% of the value of a car. That means they come up with $2,000 toward a $50,000 car.
The average car loan value was $14,315.	The average car loan value is $26,208.
The average interest rate on a new car loan was 9%.	Average interest rate on a new car is 2%.

Sources: Federal Reserve Board, HSH Associates

Economists worry that interest rates could rise, making it harder for borrowers to repay adjustable-rate loans.

But the outlook for incomes is just as important. Most people don't have debt problems because they borrow too much. Instead, they experience trouble when they suffer a hit to their income that makes it difficult for them to service the debt.

Now the sluggish job market is taking its toll on borrowers like Don Rodriguez. Last year, he was making six figures as a marketing consultant with Accenture in Florham Park, N.J. He lost his job, and now, to pay his mortgage, he is liquidating his retirement assets. To keep payments down on roughly $30,000 in credit-card debt he is switching balances to low-rate offers every chance he gets. "We'll deal with the consequences later," he says.

Home prices are important because many households have been tapping into the value of their homes by taking out home-equity loans or refinancing their mortgages and taking cash out in the process. Because the values of their homes are rising, they have been able to take cash out without putting a serious dent in their overall wealth.

But even with low rates, many homeowners are being squeezed by monster mortgages and heavy spending. Two-and-a-half years ago, Ana and Adam Dierkhising of San Francisco bought a $1.2 million home, and they are putting another $700,000 into expanding it. Now, their payments from the two loans total $4,500 a month. Since the work on their new home isn't finished, the Dierkhisings are paying $4,000 a month to rent the home they just sold. On top of all that, the family pays another $7,500 a month on a second home in Massachusetts that Ms. Dierkhising owns with her brother.

Mr. Dierkhising makes a six-figure salary as a realtor, but his business has been hurt by the slowing market. Recently, the couple stopped going out to eat, laid off their housekeeper and signed their kids up for longer preschool hours to save money on babysitting. Ms. Dierkhising is trying to sell the Massachusetts home. She says, "Before we never thought about the money."

-- *Ruth Simon contributed to this article.*

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