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Habit-Forming: Borrowers Keep Piling On Debt

As Lenders' Tighter Standards Cut Off Some Avenues, People Tap Credit Cards, Equity Lines

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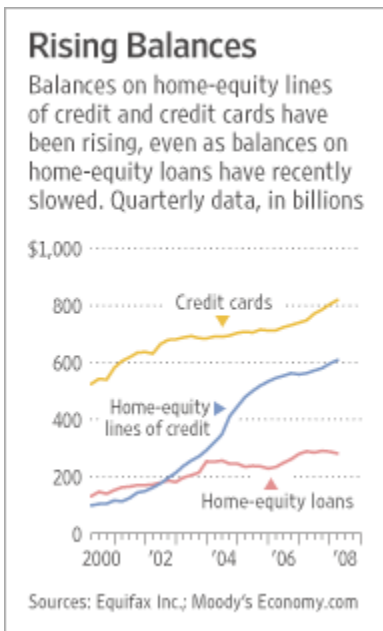
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The credit crunch has made it harder for Americans to indulge in their love affair with debt. So what are they doing?

Borrowing more.

While tighter lending standards have cut off all but the most credit-worthy borrowers from auto loans and home loans, many people are turning to credit cards and tapping more of their home-equity lines of credit to dig themselves in deeper. And lenders, once eager to lend to those with even spotty credit records, are trying to rein in borrowing by cutting consumers' available credit lines.



Average balances on credit cards and home-equity lines of credit are growing rapidly, rising 9.5% and 8.1%, respectively, in the first quarter from a year earlier, according to new data from Equifax Inc. and Moody's Economy.com.

Borrowing is climbing quickest in the regions where house prices plunged most sharply, making it tougher for people to extract money in cash-out refinancings. (In a cash-out refinancing, a homeowner pays off a mortgage by taking out a loan that is larger than the original mortgage and then pocketing the difference.) Credit-card balances rose nearly 15% during the first quarter from a year earlier in California and Florida and more than 20% in Nevada -- all states caught up in the housing bust, according to Equifax and Economy.com.

The rise in borrowing shows just how addicted the U.S. consumer has become to credit. Even as borrowers are cut off in one area,

they promptly look for new sources. Workers have increasingly been raiding their 401(k) plans to take out loans over the past year, according to plan administrators and nonprofit groups.

Now, mortgage brokers say some clients are calling them in a panic, worried that their bank will freeze their home-equity lines. Deborah McNaughton, president of Legacy Financial Services Inc., a mortgage lender in Placentia, Calif., says several of her clients have recently borrowed more from their home-equity lines of credit and stashed the money in bank savings accounts. Theresa Leick of San Juan Capistrano, Calif., a loan processor who works with Ms. McNaughton, pulled \$21,000 from her available home-equity line of credit in February to park in a certificate of deposit.

"I'm fattening my reserves in case I have to go look for more work," says the 40-year-old Ms. Leick, who says she is concerned about losing her income because she works in the mortgage business. She says she would have preferred not to have tapped her home-equity line, "but if the bank takes away my comfort zone, that will make me lose sleep at night."

Across the country, consumers are increasingly relying on credit cards to stay afloat. This week, the Fed reported consumers are boosting their use of credit cards. In February, Americans had \$951.7 billion in total revolving debt, most of it on credit cards -- a seasonally adjusted annualized increase of 5.9%. Although that increase has slowed from the 7.1% pace in January, it is up 8.2% from year-ago levels.

Credit counselors say they have started seeing more people turn to their credit cards to cover everyday items. "Food, fuel and medicine -- people are charging their day care, even their tithes to church, and any incidental items," says Gail Cunningham, a spokeswoman for the National Foundation for Credit Counseling in Silver Spring, Md.

In a conference call last month, **Discover Financial Services** Chief Executive David Nelms told analysts that sales growth in the first quarter "generally became more concentrated in everyday categories such as groceries, gas or discount stores, with less growth in specialized retail segments such as department stores and home improvement."

In a separate survey released last week, Discover said 52% of consumers it surveyed in March expected to spend more in April on household basics by cutting back on discretionary expenses, such as vacations, or by setting aside less money for savings and investing. That is an increase of 12 percentage points from its February survey and close to the highs seen last November, when gas prices spiked.

Major credit bureaus, including TransUnion LLC and **Experian Group Ltd.**, say their own analyses of credit files show that more consumers are turning to credit cards. TransUnion last week said total credit-card balances increased 4.8% in the fourth quarter to \$1,694 per user from the third quarter -- more than double the growth it has typically seen in prior years over the same period -- with the steepest increases in states that have been hit hard by the mortgage crisis, such as Florida, Nevada and California.

The Fed's aggressive rate cuts have helped make home-equity lines of credit, whose rates are typically pegged to the prime rate, more attractive compared with fixed-rate home-equity loans.

For example, utilization rates on home-equity lines -- or the percentage of a credit limit that has been charged up -- increased to 46% in the first quarter, the second consecutive quarterly rise since early 2005, according to data from Equifax and Economy.com. That increase, however, is partly driven by banks cutting available lines of credit.

But home-equity lines, once a major alternative to credit cards, are also getting harder to access. In recent months, certain lenders, such as Countrywide Financial Corp., **Washington Mutual Inc.** and **Bank of America Corp.**, have reduced or frozen certain borrowers' home-equity lines of credit, especially in markets that have been hit by a slump in housing values.

Earlier this year, J. Hwang of Fort Lee, N.J., tried to refinance the 7% rate he was paying on his mortgage but couldn't qualify because his bank was now requiring him to hold more equity in his home. Instead, he decided to take advantage of some credit cards' 0% balance-transfer offers and borrowed roughly \$45,000 to pay down the balance on his home-equity line of credit.

Mr. Hwang's strategy: Since he won't have to pay any interest on the credit cards for about a year, he figures he will be able to save roughly \$2,000 that he would have otherwise had to pay on his home-equity line of credit. Instead, he plans to use the savings to pay down the principal on his mortgage. "I didn't want to give my bank another penny for interest," says the 30-year-old health-care worker.

For the past several years, William Jordan, president of Sentinel Group Inc., a financial-planning and wealth-management firm in Laguna Hills, Calif., has been advising clients to pull equity of their homes and put the money into safe, liquid accounts so they have access to the money. He recently advised one of his clients, Matilda Compean of La Mirada, Calif., to refinance her mortgage and take out cash after she was having trouble making ends meet.

The 54-year-old client-services manager began working extra hours last fall to help pay for higher household expenses, such as gas, and to save money to buy a car for her daughter, who had recently totaled her car in an auto accident. So, in January, she refinanced her mortgage and pulled out \$60,000 in equity to purchase the automobile and set aside an emergency cash cushion. Doing so, says Ms. Compean, "just gave me a lot of room to breathe. I was at my wit's end. I just kept thinking things would get better."

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