

## Who Has Problems?

**The use of debt has contributed to a significant increase in the level of personal expenditures.**

Credit union tellers, loan officers, member services representatives, and others working at the front line have seemingly endless examples of members who have experienced financial problems.

Some members fall into the category that can be described by the phrase, “Tough times are tough on the budget.” They may have experienced job loss; struggled to care for a family member with a chronic medical condition; or suffered a sudden setback due to flood, tornado or another natural disaster. Some members are hard-working people who even in good times had to juggle the money coming in against the money going out. Even a relatively minor disruption that increases expenses or decreases income can stretch their budget, making it impossible to continue to meet their obligations.

Other members may have bought into the myth that they truly can have everything. Ken King, Executive Director of the Consumer Credit Counseling and Family Service Association, Sheboygan, Wis., describes this syndrome as “affluenza.” Victims of “affluenza” can be found at every level

of education and income and with every type of employment. Figure 1.1 provides an “affluenza” self-test. Those who suffer from “affluenza” are simply living beyond their means.

Combine these groups, and suddenly it becomes apparent that almost any member of a credit union could require financial education counseling.

### Trends Reflect Growing Debt Acceptance

Nationwide, society as a whole has shifted in its attitudes toward debt and spending, making it acceptable both to carry higher levels of debt and to go into debt to fund a wider variety of purchases. Consumers once limited their debt to their mortgage and perhaps their car. Today, credit cards and other forms of debt are used to purchase everything from groceries to postage stamps. A “Credit Card Check-up” that tests your knowledge of “good” and “bad” uses of credit card debt can be found online at <http://trainingdev.cuna.org/playpage/fined.html>. The use of debt has contributed to a significant increase in the level of personal expenditures, as shown in Figure 1.2.

As a result, consumer debt loads have risen rapidly. For example, consumer debt loads in 2005 averaged about 120% of take-home pay. That compares to debt levels that were below 70% of take-home pay in the mid-1980s, as illustrated by Figure 1.3.

Advertising messages often reinforce the advantages of using debt to obtain

### Basic Definitions

**Debt:** What you owe.

**Credit:** Your perceived ability to meet new financial obligations, which is typically based on a combination of your earnings, your existing debt, and your previous history.



goods and services. These messages contribute to growing confusion in consumers' minds between wants and needs, which contributes to overspending as consumers ignore the limits of their budget to pursue perceived needs.

While society and consumers alike have become more accepting of debt, economic trends have contributed by making it feasible for the average consumer to carry more debt. Interest rates began declining in the mid-1980s and remained relatively low through 2005, which in turn lowered the cost of all forms of debt, from credit cards to mortgages.

Beginning in 2005, the Federal Reserve acted to increase interest rates. As interest rates go up, debt becomes more expensive. If consumers have to pay more to borrow money, they are more likely to have difficulty meeting their payments, especially if they cannot or will not alter their borrowing habits.

Other economic trends that could have an impact on consumers' ability to afford high levels of debt include unemployment rates, earning power, and inflation. Shifts in these trends could impact the number of members who have difficulty meeting their financial obligations.

Figure 1.1

### Affluenza Self-Test

- |  |      |       |
|--|------|-------|
| 1. I'm willing to pay more for a jacket if it has a NASCAR or Harley-Davidson logo on it.                | True | False |
| 2. I know if I buy a new cocktail dress, the cocktail party will come.                                   | True | False |
| 3. Sarah Jessica Parker would envy my shoe collection.   | True | False |
| 4. When I'm cold, I turn up the heat, and when I'm hot, I turn up the air.                               | True | False |
| 5. I'm willing to work at a job I hate so I can buy lots of stuff.                                       | True | False |
| 6. The best therapy for depression is to go shopping and treat myself.                                   | True | False |
| 7. I want a big sports utility vehicle (SUV), even though I rarely drive in conditions that warrant one. | True | False |
| 8. I make only the minimum payment on my credit cards.   | True | False |
| 9. I agree with the statement, "Whoever dies with the most toys wins."                                   |      |       |
| 10. I make only the minimum payment on my credit cards.  | True | False |
| 11. Most of the things my family and friends enjoy doing together are free..                             | True | False |
| 12. I don't measure self-worth by what I or others own.  | True | False |
| 13. I consider myself to be very frugal.   | True | False |
| 14. Advertising has a negative effect on the wants of our children.                                      | True | False |
| 15. I prefer to car pool, ride my bike, or use public transportation when I can.                         | True | False |
| 16. I'd rather be shopping right now.  | True | False |

#### Scoring:

Questions 1-9 and Question 15, true=2 points and false=1 point.  
Questions 10-14, true=1 point and false=2 points.

**Score of 10-15** – No warning signs of affluenza at this time.

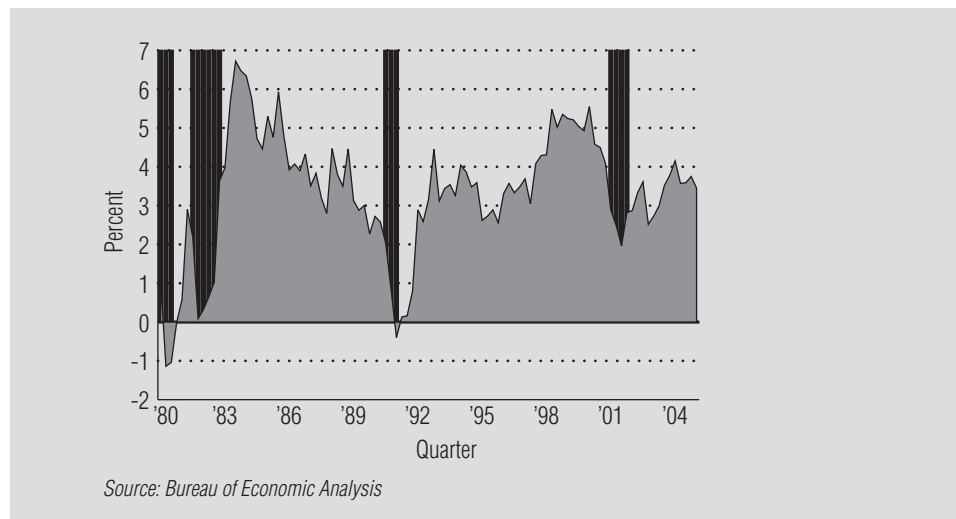
**Score of 16-22** – Warning: You have mild affluenza.

**Score of 23-30** – Cut up your credit cards and call a budget/credit counselor!

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**Figure 1.2**

**Personal Consumption Expenditures (Year-Over-Year % Change)**



**The Impact of Real Estate Values**

Another economic trend that could significantly affect consumers' ability to support current levels of debt and spending is a sudden change in real estate values.

Since the late 1990s, consumers in most marketplaces have become accustomed to steady increases in the value of their homes. These increases outpaced the rate of increase in personal incomes, as shown in Figure 1.4.

When home prices outpace growth in consumer income, economists worry about the possibility of a real

estate "bubble." This is a particular concern in areas where housing values have risen rapidly, such as coastal areas and other popular residential regions.

As long as values remain high, homeowners can continue to borrow against the value of their homes to consolidate debt, sustain their lifestyle, or meet emergency needs.

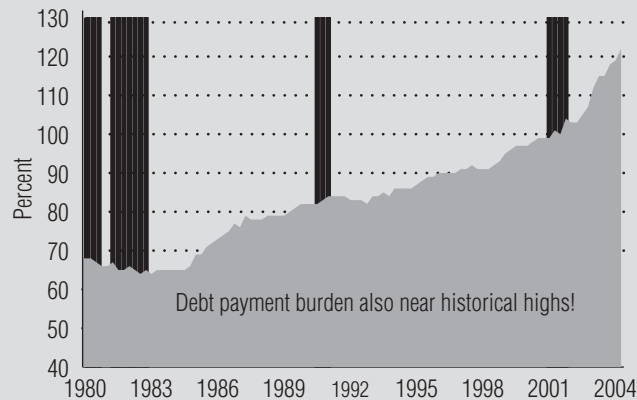
But if values fall suddenly, then consumers could find it difficult to restructure debt or sell their house without a significant loss. Lenders demand a certain percentage of value in comparison to the value of the



**The Impact of Rising Rates**

As rates rise, so do the monthly payments for a fixed-rate 30-year mortgage for \$200,000. The average price for an existing single-family home in the U.S. in 2005 was \$219,000, according to the 2006 *The State of the Nation's Housing* report from Harvard University's Joint Center for Housing Studies.

Interest Rate	5.5%	7%	8.5%
Monthly Payments	\$1135.58	\$1330.60	\$1537.83

**Figure 1.3****Household Debt  
(As a Percent of  
Disposable Income)**

Source: Department of Labor & Federal Reserve.

property mortgaged, so home equity loans or lines of credit might suddenly become unavailable, creating problems for members accustomed to borrowing against their home equity to provide budget flexibility.

If the bubble is combined with an economic slowdown that causes job losses or other cuts in income, then

people who used their home to finance high levels of debt may be at risk for foreclosure. In that case, the potential problems inherent within a real estate bubble could truly hit home.

If values continue to grow, it will impact members' budgets in other ways. Growth in real estate values also has a significant impact on the budget for members who choose or are forced to rent rather than own their home, especially if they have limited income. The National Low Income Housing Coalition issues an annual report tracking rental costs nationwide. Typically, families were expected to spend no more than 30% of their income on housing and utilities, but the coalition's 2005 report showed that is no longer possible in many parts of the country. A figure of approximately 38% of income is now used for many conventional home loans.

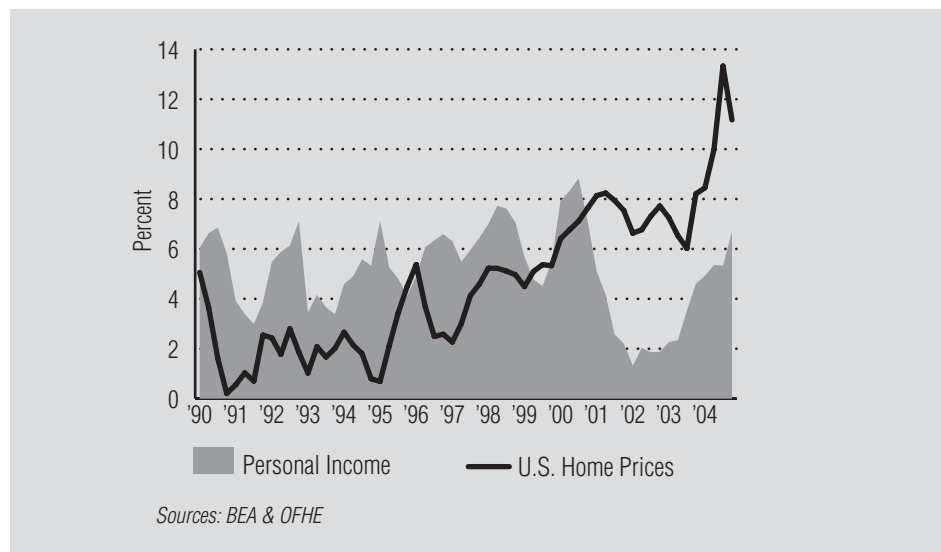
Nationally, the coalition stated that families had to make an average of \$15.78 an hour to afford a two-bedroom apartment in 2005 and stay

### Housing Choices, Housing Costs

Rising housing prices often make it difficult for families to find affordable housing. But housing choices also make a significant difference, as shown by comparing choices made by two sets of newlyweds earning roughly the same incomes in a Midwestern market.

John and Judy rent a one-bedroom apartment for \$750 a month. They spend \$400 a year on renter's insurance, or \$40 a month, for a total housing cost of \$790. They dream of owning a home, but are waiting until they pay off their debts to make sure they can afford the monthly payment.

Mike and Mindy bought a three-bedroom home as soon as they married. In the Midwest's affordable housing market, the 2,000-square-foot home cost \$185,000. They put down a 5% down payment and borrowed the remaining \$175,750 on a 30-year fixed-rate mortgage at 6.5% interest. That gives them a monthly payment of \$1110.86. Annual property tax costs are \$3,600 and home insurance is \$800. When those costs are split into monthly increments and added to their monthly mortgage payment, they spend \$1,477.52 every month on housing costs, excluding the cost of utilities and repairs. They are struggling to pay the mortgage, but they refuse to sacrifice their lifestyle. Every month, they go deeper in debt.

**Figure 1.4****Home Prices & Personal Income (Year-Over-Year Percent Change)**

within the 30% standard. However, the federal minimum wage in 2005 remained at \$5.15 an hour, creating a substantial gap for many working families. The report noted that costs of heating fuel and utilities increased 13% in 2005, making budgeting even more difficult for low-income people.

### Four Problem Categories

Ask any group of credit union employees to detail members' financial problems and they're likely to assemble an exhaustive list. Figure 1.5 was created by credit union employees who interact with members every day. But while members and employees may use different terms to detail their financial problems, most issues fall into four categories.

**Spending Too Much.** Because it is so easy to use credit cards and other forms of borrowing, consumers often fail to keep track of what they spend and where they spend it. They simply have no idea where their money goes. They also may have difficulty separat-

ing "wants" and "needs," with many consumers unwilling or unable to distinguish between them.

Other members may be unwilling to delay gratification until they can save the required amount or pay off existing debts. They think they require the object of their desire now, even if their parents worked 20 years before they could afford it.

Finally, many consumers have made consumption into a recreational activity. Some experts call continual consumption the "drug of choice" for consumers.

### Warning: Mom and Dad Syndrome At Work

There's no age limit on offspring who rely on parents to rescue them from poor financial choices. One of King's clients, an 80-year-old Wisconsin woman, took out a 30-year mortgage of \$50,000. She needed the money to pay credit card bills run up by her 65-year-old son, who receives a monthly pension of \$4,000, lives with his mother and pays no rent or other costs.

**Figure 1.5****What Problems Face Your Members?**

Credit union employees who completed CUNA's Financial Education Counseling School compiled this list of problems from their experiences with members. Check the problems that apply to your members.

**POOR FINANCIAL ATTITUDES**

- Unable to face the reality that they are outspending their income
- Unable to acknowledge total indebtedness
- Lack the funds to meet current obligations
- Have a lifestyle that outpaces their income
- Refuse to give up "fun" to pay down debt
- Unable to budget for a full month's obligations at any one time
- Lack a sense of financial priorities
- Unwilling or unable to reduce spending on basic items, such as fixing a meal at home instead of eating out
- Unable to distinguish between "wants" and "needs" for themselves and their families
- Lack understanding of the role of savings in making a budget work
- Lack education about the banking system, budgeting, or financial management
- Poor communication with spouse about spending and budgeting
- Unwilling to accept responsibility: "It's not my fault."

**UNWISE FINANCIAL PRACTICES**

- Consolidation loans to support lifestyle
- Frequent account overdrafts
- Late payments on loans
- Use of payday lenders
- Minimum payments on credit card
- Inquiries about refinancing home equity loans
- Addictions (legal or illegal), including gambling
- Compulsive behavior, such as excessive shopping

**INCREASED FINANCIAL RISKS**

- Lack health insurance/uninsured medical expenses
- Medical debt
- Used payday lending and got caught in cycle of growing, rollover debt
- Job loss eliminated steady source of income
- Underemployment or loss in pay due to changing economy
- Displaced from housing and/or job due to natural disaster
- Significant personal financial loss due to natural disaster
- Credit Card Debt
- High monthly debt payments as a percentage of income
- Low credit score, which increases cost of credit and decreases access to financial services
- Single parent household
- Divorce
- Loss of spouse
- Child support payments consume a significant portion of disposable income
- Lack of savings
- Lack of assets that support access to low-cost, secured credit
- Ignorance of long-term cost of bankruptcy

**Saving Too Little.** As consumers have embraced debt, they have moved away from the concept of saving to pay for large purchases or cover unexpected expenses. Americans' personal savings rate, or savings as a share of disposable income, was 10.8% in 1984, when it began a steady decline. The personal savings rate hit zero in June 2005 and actually was less than 0% for several months at the end of 2005 and the beginning of 2006, according to figures from the U.S. Department of Commerce. A savings rate that falls below 0% means that more money is being withdrawn from savings than is being deposited nationwide.

The ability to obtain items immedi-

ately by going into debt has undercut the motivation to save for many consumers, who may look only at their current needs in deciding whether it is worth sacrificing instant gratification to wait until savings accumulate. Members often fail to realize how much more they spend due to interest costs when they use debt to pay for items that have already been acquired, rather than saving in advance so they can pay in full when the purchase is made.

Some members may justify their lack of savings by noting that they are committed to placing a percentage of every paycheck in a 401(k) account. Unfortunately, these funds are unavailable to help cover purchases unless the owner is willing to pay a significant tax penalty, which can swallow as much as one-third of the account balance. Borrowing from a 401(k) also significantly reduces interest earnings, taking away money that will be needed to fund the retirement years.

**Carrying Too Much Debt.** "How much can you afford?" It's a simple question, but one that members with poor financial habits cannot answer. These members think of each new obligation as only a few dollars a month, never totting up the total owed. Their focus is on the minimum payment, rather than reducing the amount owed.

Because their focus is always on the amount due now rather than the total cost, a "no payments until next year" offer is likely to be irresistible. These consumers often fail to read the fine print that stipulates that if the loan is not paid off in full by the designated date, interest will be charged dating



**Even commonplace events can cause difficulties for people living paycheck-to-paycheck.**

back to the date when the loan was issued. Likewise, debt consolidation is appealing, since it allows them to maintain their lifestyle by extending the repayment period.

**Caring Too Little About Their Financial Future.** Many people in financial difficulties are surprised to find themselves in trouble. Until the moment when their budget collapses under the strain of accumulated debt, they may be unaware that financial problems are looming. They may have failed to pay attention to how much they've spent, how much debt is costing them in interest and fees, or how long it will take them to pay for purchases. They may have ignored notices that payments are due, failed to balance their checking account, or justified each new obligation as "just a few dollars each month."

As a result, they may be unaware that there is no room in their budget for minor or major emergencies. It is true that some major emergencies can put a dent in any budget, such as a devastating illness or injury. But even commonplace events can cause difficulties for people living paycheck-to-paycheck. An unexpected visit to the dentist, car repairs, or an increase in school fees can be a financial emergency. The result is continual financial chaos.

This approach to finances ignores the benefits of long-term planning. As a result, many of these members are unable to achieve long-term dreams like home ownership, sending children to college, starting a business, or funding a comfortable retirement. When

King asks clients about these dreams, their typical response is, "I don't have to worry about that yet."

Another attitude that may be displayed by young and even middle-aged consumers in this category is the "Mom and Dad" syndrome. This reflects a continual reliance on parents to provide money to fund large purchases through co-signing loans, making a gift of the sum required as a down payment on a large purchase, or even making payments for them. Relying on parents is used as a substitute for working toward financial goals and achieving true independence.

## **A Problem of Attitude?**

Real problems often create hardship for members. Their earnings may make it difficult to manage expenses. Economic conditions may limit their opportunity or remove sources of earnings. Lack of health insurance may expose them to high expenses.

These are real problems that members must cope with every day. But financial problems also can be created or compounded by inattention and poor choices. While some financial problems are due to circumstances beyond the members' control, many other problems arise because of member attitudes.

Financial counseling helps members learn how to change their attitude and manage their finances. By learning to restrain their expenditures, monitor their debt, and control their payments, members learn to maintain control over their finances, rather than letting their finances control them.