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THE DEBT TRAP

Downturn Drags More Consumers Into Bankruptcy

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The economy's deep troubles are pushing a growing number of already struggling consumers into bankruptcy, often with far more debt than those who filed in previous downturns.

Plummeting home values, dwindling incomes and the near disappearance of credit have proved a potent mixture. While all the usual reasons that distressed borrowers seek bankruptcy — job loss, medical bills, divorce — play significant roles, new economic forces are changing the calculus of who can ride out the tough times and who cannot.

The number of [personal bankruptcy](#) filings jumped nearly 8 percent in October from September, after marching steadily upward for the last two years, said Mike Bickford, president of Automated Access to Court Electronic Records, a bankruptcy data and management company.

Filings totaled 108,595, surpassing 100,000 for the first time since a law that made it more difficult — and often twice as expensive — to file for bankruptcy took effect in 2005. That translated to an average of 4,936 bankruptcies filed each business day last month, up nearly 34 percent from October 2007.

Robert M. Lawless, a professor at the [University of Illinois](#) College

of Law, pointed to the tightening of credit by banks as a significant factor in the increase in October. As banks have pulled back on lending, he said, consumers have been finding it more difficult, and in many cases impossible, to use credit cards, refinance their home mortgages or fall back on their home equity lines to get them through a rough period.

“A credit crunch can drive people into bankruptcy today rather than later as sources of lending dry up,” Professor Lawless said. “With the consumer credit tightening and the economy in a nosedive, this pop could just be the beginning of a long-term rise in the bankruptcy filing rate to levels that are even higher than we had before the 2005 bankruptcy law.”

Not only are filings up, but recent filers have had much more credit card debt, often run up in an attempt to keep current on a mortgage that now exceeds the value of their home, bankruptcy lawyers said in interviews.

A recent study found that the typical family who filed for bankruptcy in 2007 was carrying about 21 percent more in secured debts, like mortgages and car loans, and about 44 percent more in unsecured debts, like credit cards and medical and utility bills, than filers in 2001.

Their incomes, meanwhile, remained static over those six years, according to the study, which used data from the 2007 Consumer Bankruptcy Project, a joint effort of law professors, sociologists and physicians. Researchers surveyed 2,500 households nationwide that filed for bankruptcy in February and March 2007.

“Earlier downturns followed strong booms, so families went into recessions with higher incomes and lower debt loads,” said Elizabeth Warren, a professor at [Harvard](#) Law School and, along with Professor Lawless, part of the Bankruptcy Project team. “But the fundamentals are off for families even before we hit the recession this time, so bankruptcy filings are likely to rise faster.”

Not surprisingly, filings are increasing most rapidly in states where real estate values skyrocketed and then crashed, including Nevada, California and Florida. In Nevada, bankruptcy filings in October were up 70 percent compared with last year. In California, bankruptcies jumped 80 percent in the same period, while Florida’s filings rose 62 percent.

In those regions, some people are trying to rescue their homes through bankruptcy proceedings, but many are just as relieved to walk away, shedding layers of debt that otherwise would have taken decades to pay off.

Tony and Carrie Forsyth, both 30, chose not to walk away from their house in Florida. The couple said they thought their financial situation would improve in 2006, when Mr. Forsyth accepted a promotion from his employer, a Michigan food distributor, that required them to move to Florida. But they could not sell their home in Ypsilanti, Mich., so they decided to rent it out.

In June 2006, the couple headed south and bought a house for \$220,000 in Tamarac, Fla., with no money down. Five months later, their tenants in Michigan stopped paying, and the family had to carry two mortgage payments, just as the adjustable-rate mortgage on their Michigan home reset to a higher interest rate.

They lost the Michigan home to foreclosure in February 2007.

By that time, however, the couple, who have two young daughters, were using credit cards to pay for food, utilities and clothes. After accumulating about \$20,000 in debt, they said, they realized that bankruptcy was the only way they could remain in their Florida home, whose value, meanwhile, had plunged 25 percent. They filed for Chapter 13 bankruptcy protection this year, which permitted them to keep the house, and they agreed to repay a portion of their debts over the next three years.

A Chapter 7 bankruptcy, by contrast, provides filers with what is known as a “fresh start” because debts are forgiven. In this case, assets are liquidated, though the states allow for various exemptions. To qualify for a Chapter 7, filers need to pass a means test to determine whether they are unable to repay their debts.

Filers who are deemed able to repay a portion of their debts must file for Chapter 13 bankruptcy. Some debtors choose Chapter 13 because it permits them to save their primary homes from foreclosure, though they are required to catch up on their mortgage payments.

Mr. Forsyth said declaring bankruptcy was a difficult step. “Because of our Christian background, it didn’t feel right,” he said. “But there was no other way for us to live and support our family unless we went that route.”

Mrs. Forsyth added: “We are just rolling with life. You have to eat. You have to have diapers.”

The Forsyths are emblematic of the new forces that have led to the sharp rise in bankruptcy filings. “Historically, a person would get behind in his mortgage because of a temporarily catastrophic financial event, such as job loss, divorce, illness,” said Chip Parker, a bankruptcy lawyer in Jacksonville, Fla. “However, when these adjustable-rate mortgages started resetting from their teaser rate and clients couldn’t refinance their way out of trouble, they were getting behind even though there was no catastrophic event.”

Bankruptcy lawyers report that they have been having more consultations with middle-class families with six-figure incomes — including many who either bought a home during the boom or pulled out most or all of their available home equity just keep to up with the cost of living. Also caught up in the bankruptcies are real estate investors, who hoped to flip properties they had bought near the height of the market.

“There are a lot of foreclosures that haven’t taken place yet because people still have available credit,” said Jeffrey H. Tromberg, a bankruptcy lawyer in Fort Lauderdale, Fla. “We don’t see them until they’ve maxed out their credit cards.”

A similar pattern has emerged in Las Vegas, where more people are filing for Chapter 7 bankruptcy protection because it makes more financial sense to walk away from their homes. Real estate values have plummeted, and now the local economy is also suffering. Car salesmen and casino dealers are being laid off. Valet parking attendants and masseuses are collecting less in tips.

“My clients are basically good people that got into a home the best

way they could and can no longer meet their obligations because their income has gone down,” said Roger P. Croteau, a lawyer in Las Vegas who concentrates on bankruptcy. “There is no equity to pay off their credit cards, and they are maxed out. They haven’t saved enough because of housing costs.”

Ellen Stoebling, a bankruptcy lawyer in Las Vegas, added: “People are using their cards to try and hold onto their property for as long as possible in hopes they can somehow talk some sense into their lender and stay in the property.”

The problems are not limited to people with adjustable-rate mortgages and homes that are now worth less than they owe. Job losses are also playing a role. Bankruptcies are also up sharply in Delaware, Rhode Island and Indiana, where the unemployment rates have been climbing.

And, of course, some people continue to seek bankruptcy for the usual reasons.

Lisa Marquis, a 35-year-old mother of five in Indiana, has no medical insurance but has undergone 21 operations in the last nine years, some related to emphysema and other respiratory diseases, and others related to accidents and several miscarriages.

Mrs. Marquis cannot work, but her husband earns \$13.50 an hour as a truck driver — a salary that makes them ineligible for [Medicaid](#) but unable to pay their medical bills. Earlier this year, the family had to leave the mobile home they owned because the mold there was making it hard for her to breathe; they moved into a house where they paid more than \$600 a month in rent. Mr.

Marquis was spending three days a week in court fending off angry creditors, cutting down on the number of hours he could work.

In April, facing more than \$114,000 in medical bills and less available overtime work, the Marquises filed for Chapter 13 bankruptcy — the third time in less than 10 years that Mrs. Marquis had to file for protection because of medical bills. Because the latest filing is a Chapter 13, they have agreed to pay some of their debts.

“We could have waited to do a 7,” Mrs. Marquis said. “I want to pay my debts. I didn’t want to cheat people who helped to save my life.”

Despite the rise in bankruptcies, academics and lawyers say they believe that many others have been discouraged from filing because of the 2005 bankruptcy law.

Ms. Warren, the Harvard law professor, said many borrowers had been left with the mistaken impression that they could no longer file. And, she argued, “the widespread perception that bankruptcy is not available to help families makes this economic crisis worse.”