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Advice for a Couple That Has Way Too Much Credit-Card Debt

The Smiths are carrying debt on personal and business credit cards, a mortgage and student loans. A financial planner offers them a way to better manage it all.

A home-equity line of credit could be a short-term solution for Shane and Toni Smith (pictured with their children) to tackle their credit-card debt. PHOTO: TIFFANY DOOLITTLE

By Lisa Ward

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Shane Smith and Toni Smith live in Paradise, Calif., a town ravaged last year by wild fires, in which they suffered a small amount of property loss. The Smiths have three children, ages 12, 8 and 6, and are considering expanding Mr. Smith's chiropractic business to the Caribbean and buying a second home there.

The Smiths earn about $128,000 annually. Mr. Smith, 42, brings in about $88,000 after taxes. Ms. Smith, 46, earns $40,000 from the In-Home Supportive Services program run by the California Department of Social Services, which pays her to act as a caretaker for their 8-year-old, who has Down syndrome.

The couple's home is valued at about $750,000 and has a $275,000 mortgage outstanding. Mr. Smith values his business at about $200,000, though it carries some debt; about $20,000 on a business credit card and $24,000 on a business line of credit. The couple owe $130,000 in student loans with a 1.8% interest rate; and about $18,500 in credit-card debt across four additional cards.

The Smiths own their cars outright and have $24,000 in a savings account.

Mr. Smith has a whole-life insurance policy, which has a guaranteed death benefit of $750,000 and allows him to borrow or withdraw against some of those funds in an emergency. The couple also has two term-life policies that pay out $750,000. A special-needs trust, created for their child with Down syndrome, is the beneficiary of all three insurance policies.

Their monthly family expenses include: $1,950 for the mortgage, home insurance and property taxes; $850 for the life-insurance policies; $700 for credit-card bills and paying down the debt; $365 to repay student loans; $1,300 for groceries and eating out; $600 for utilities, including cellphone and satellite TV; $195 on gas; $220 on school fees; and $165 for car insurance.

Advice from a Pro: Bill Lalor, a certified financial planner at Massey Quick Simon & Co. in Morristown, N.J., suggests that before looking into buying a second home or expanding the business, they should try to set up a multiyear plan to pay down debt and build up their savings.

First on the list should be tackling the credit-card debt, he says. A home-equity line of credit could be a short-term solution. Mr. Lalor thinks they'll be approved because they have a lot of equity in their home and their debt-to-equity ratio seems reasonable. That would lower the interest rate they are paying on that card debt to about 6% from about 19%. A $50,000 or even $100,00 home-equity line of credit would also provide emergency funds, though Mr. Lalor emphasizes this should be an interim solution. They should not plan on carrying the home-equity loan over an extended period.

Mr. Lalor also suggests consolidating the business debt into a business line of credit with the lowest rate possible. He says $40,000 in debt on a business valued at $200,000 is high.

If the 1.8% rate on the student loans is fixed, Mr. Lalor advises against rushing to repay that debt.

He also advises against cashing out of the whole-life policy as a way to fund an emergency because the death benefit is so critically important to the child with Down syndrome. He thinks the whole-life insurance makes sense because it will fund the special-needs trust.

The Smiths should build about six months' worth of expenses, or about $35,000, in an emergency fund. They should look at their budget and credit-card statements to find an additional $250 to $500 a month to add to the fund.

The Smiths also should explore setting up a tax-advantaged retirement account through the business, such as a solo 401(k) or SEP IRA. Or they could open traditional IRA or a spousal IRA separate from the business, he says. With all of these accounts, contributions are tax deductible federally and the money can grow tax-deferred.

With the solo 401(k), Mr. Smith can save more because he can make contributions as an employee and employer. However, Mr. Lalor says, opening a traditional IRA or spousal IRA might be easier, as a 401(k) or SEP IRA usually requires hiring an accountant.

"If they are able to save more money pretax," Mr. Lalor says, "it's likely to have less of an impact on their cash flow."

Finally, Mr. Lalor recommends the family shop around for more comprehensive health insurance. If Mr. Smith buys a policy through his business, he may be able to offset the premiums with a tax deduction since it could be considered a business expense.

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