

WHAT YOU SHOULD KNOW ABOUT HOME EQUITY LINES OF CREDIT

If you are in the market for credit, a home equity plan is one of several options that might be right for you. Before making a decision, however, you should weigh carefully the costs of a home equity line against the benefits. Shop for the credit terms that best meet your borrowing needs without posing undue financial risks. And remember, failure to repay the amounts you've borrowed, plus interest, could mean the loss of your home.

What is a home equity line of credit?

A home equity line of credit is a form of revolving credit in which your home serves as collateral. Because a home often is a consumer's most valuable asset, many homeowners use home equity credit lines only for major items, such as education, home improvements, or medical bills, and choose not to use them for day-to-day expenses.

With a home equity line, you will be approved for a specific amount of credit. Many lenders set the credit limit on a home equity line by taking a percentage (say, 75%) of the home's appraised value and subtracting from that the balance owed on the existing mortgage. For example,

Appraised value of home	\$100,000
Percentage	x75%
Percentage of appraised value	= \$75,000
<u>Less balance owed on mortgage</u>	<u>- \$40,000</u>
Potential line of credit	\$35,000

In determining your actual credit limit, the lender will also consider your ability to repay the loan (principal and interest) by looking at your income, debts, and other financial obligations as well as your credit history.

Many home equity plans set a fixed period during which you can borrow money, such as 10 years. At the end of this "draw period," you may be allowed to renew the credit line. If your plan does not allow renewals, you will not be able to borrow additional money once the period has ended. Some plans may call for payment in full of any outstanding balance at the end of the period. Others may allow repayment over a fixed period (the "repayment period"), for example, 10 years.

Once approved for a home equity line of credit, you will most likely be able to borrow up to your credit limit whenever you want. Typically, you will use special checks to draw on your line. Under some plans, borrowers can use a credit card or other means to draw on the line.

There may be other limitations on how you use the line. Some plans may require you to borrow a minimum amount each time you draw on the line (for example, \$300) and to keep a minimum amount outstanding. Some plans may also require that you take an initial advance when the line is set up.

What should you look for when shopping for a plan?

If you decide to apply for a home equity line of credit, look for the plan that best meets your particular needs. Read the credit agreement carefully, and examine the terms and conditions of various plans, including the annual percentage rate (APR) and the costs of establishing the plan. Remember, though, that the APR for a home equity line is based on the interest rate alone and will not reflect closing costs and other fees and charges, so you'll need to compare these costs, as well as the APRs, among lenders.

Variable interest rates

Home equity lines of credit typically involve variable rather than fixed interest rates. The variable rate must be based on a publicly available index (such as the prime rate published in some major daily newspapers or a U.S. Treasury bill rate). In such cases, the interest rate you pay for the line of credit will change, mirroring changes in the value of the index. Most lenders cite the interest rate you will pay as the value of the index at a particular time, plus a "margin," such as 2 percentage points. Because the cost of borrowing is tied directly to the value of the index, it is important to find out which index is used, how often the value of the index changes, and how high it has risen in the past. It is also important to note the amount of the margin.

Lenders sometimes offer a temporarily discounted interest rate for home equity lines – an “introductory” rate that is usually low for a short period, such as six months.

Variable-rate plans secured by a dwelling must, by law, have a ceiling (or cap) on how much your interest rate may increase over the life of the plan. Some variable-rate plans limit how much your payment may increase and how low your interest rate may fall if the index drops.

Some lenders allow you to convert from a variable interest rate to a fixed rate during the life of the plan, or let you convert all or a portion of your line to a fixed-term installment loan.

Costs of establishing and maintaining a home equity line

Many of the costs of setting up a home equity line of credit are similar to those you pay when you get a mortgage. For example,

- A fee for a property appraisal to estimate the value of your home;
- An application fee, which may not be refunded if you are turned down for credit;
- Up-front charges, such as one or more “points” (one point equals 1 percent of the credit limit); and
- Closing costs, including fees for attorneys, title search, mortgage preparation and filing, property and title insurance, and taxes.

In addition, you may be subject to certain fees during the plan period, such as annual membership or maintenance fees and a transaction fee every time you draw on the credit line.

You could find yourself paying hundreds of dollars to establish the plan. If you were to draw only a small amount against your credit line, those initial charges would substantially increase the cost of the funds borrowed. On the other hand, because the lender’s risk is lower than for other forms of credit, as your home serves as collateral, annual percentage rates for home equity lines are generally lower than rates for other types of credit. The interest you save could offset the costs of establishing and maintaining the line. Moreover, some lenders waive some or all of the closing costs.

How will you repay your home equity plan?

Before entering into a plan, consider how you will pay back the money you borrow. Some plans set a minimum monthly payment that includes a portion of the principal (the amount you borrow) plus accrued interest. But, unlike with typical installment loan agreements, the portion of your payment that goes toward principal may not be enough to repay the principal by the end of the term. Other plans may allow payment of *interest only* during the life of the plan, which means that you pay nothing toward the principal. If you borrow \$10,000, you will owe that amount when the plan ends.

Regardless of the minimum required payment on your home equity line, you may choose to pay more, and many lenders offer a choice of payment options. Many consumers choose to pay down the principal regularly as they do with other loans. For example, if you use your line to buy a boat, you may want to pay it off as you would a typical boat loan.

Whatever your payment arrangements during the life of the plan -- whether you pay some, a little, or none of the principal amount of the loan -- when the plan ends, you may have to pay the entire balance owed, all at once. You must be prepared to make this “balloon payment” by refinancing it with the lender, by obtaining a loan from another lender, or by some other means. If you are unable to make the balloon payment, you could lose your home.

If your plan has a variable interest rate, your monthly payments may change. Assume, for example, that you borrow \$10,000 under a plan that calls for interest-only payments. At a 10% interest rate, your monthly payments would be \$83. If the rate rises over time to 15%, your monthly payments will increase to \$125. Similarly, if you are making payments that cover interest plus some portion of the principal, your monthly payments may increase, unless your agreement calls for keeping payments the same throughout the plan period.

If you sell your home, you will probably be required to pay off your home equity line in full immediately. If you are likely to sell your home in the near future, consider whether it makes sense to pay the up-front costs of setting up a line of credit. Also keep in mind that renting your home may be prohibited under the terms of your agreement.

Lines of credit vs. traditional second mortgage loans

If you are thinking about a home equity line of credit, you might also want to consider a traditional second mortgage loan. This type of loan provides you with a fixed amount of money, repayable over a fixed period. In most cases, the payment schedule calls for equal payments that will pay off the entire loan within the loan period. You might consider a second mortgage instead of a home equity line if, for example, you need a set amount for a specific purpose, such as an addition to your home.

In deciding which type of loan best suits your needs, consider the costs under the two alternatives. Look at both the APR and other charges. Do not, however, simply compare the APRs, because the APRs on the two types of loans are figured differently:

- The APR for a traditional second mortgage loan takes into account the interest rate charged plus points and other finance charges.
- The APR for a home equity line of credit is based on the periodic interest rate alone. It does not include points or other charges.

Disclosures from lenders

The federal Truth in Lending Act requires lenders to disclose the important terms and costs of their home equity plans, including the APR, miscellaneous charges, the payment terms, and information about any variable-rate feature. And in general, neither the lender nor anyone else may charge a fee until after you have received this information. You usually get these disclosures when you receive an application form, and you will get additional disclosures before the plan is opened. If any term (other than a variable-rate feature) changes before the plan is opened, the lender must return all fees if you decide not to enter into the plan because of the change. Lenders are also required to provide you with a list of homeownership counseling organizations in your area.

When you open a home equity line, the transaction puts your home at risk. If the home involved is your principal dwelling, the Truth in Lending Act gives you 3 days from the day the account was opened to cancel the credit line. This right allows you to change your mind for any reason. You simply inform the lender in writing within the 3-day period. The lender must then cancel its security interest in your home and return all fees -- including any application and appraisal fees -- paid to open the account.

The Home Ownership and Equity Protection Act of 1994 (HOEPA) addresses certain unfair practices and establishes requirements for certain loans with high rates and fees, including certain additional disclosures. HOEPA now covers some HELOCs. You can find out more information by contacting the CFPB at the website address and phone number listed in the Contact information appendix, below.

What if the lender freezes or reduces your line of credit?

Plans generally permit lenders to freeze or reduce a credit line if the value of the home “declines significantly” or, when the lender “reasonably believes” that you will be unable to make your payments due to a “material change” in your financial circumstances. If this happens, you may want to:

- **Talk with your lender.** Find out what caused the lender to freeze or reduce your credit line and what, if anything, you can do to restore it. You may be able to provide additional information to restore your line of credit, such as documentation showing that your house has retained its value or that there has not been a “material change” in your financial circumstances. You may want to get copies of your credit reports (go to the CFPB’s website at consumerfinance.gov/askcfpb/5/can-i-review-my-credit-report.html for information about how to get free copies of your credit reports) to make sure all the information in them is correct. If your lender suggests getting a new appraisal, be sure you discuss appraisal firms in advance so that you will know they will accept the new appraisal as valid.
- **Shop around for another line of credit.** If your lender does not want to restore your line of credit, shop around to see what other lenders have to offer. You may be able to pay off your original line of credit and take out another one. Keep in mind, however, that you may need to pay some of the same application fees you paid for your original line of credit.

Glossary

Annual membership or maintenance fee - An annual charge for access to a financial product such as a line of credit, credit card, or account. The fee is charged regardless of whether or not the product is used.

Annual percentage rate (APR) - The cost of credit, expressed as a yearly rate. For closed-end credit, such as car loans or mortgages, the APR includes interest rate, points, broker fees, and other credit charges that the borrower is required to pay. An APR, or equivalent rate, is not used in leasing agreements.

Application fee - Fees charged when you apply for a loan or other credit. These fees may include charges for property appraisal and a credit report.

Balloon payment - A large extra payment that may be charged at the end of a mortgage loan or lease.

Cap (interest rate) - A limit on the amount that your interest rate can increase. Two types of interest-rate caps exist. *Periodic adjustment caps* limit the interest-rate increase from one adjustment period to the next. *Lifetime caps* limit the interest-rate increase over the life of the loan. By law, all adjustable-rate mortgages have an overall cap.

Closing or settlement costs - Fees paid when you close (or settle) on a loan. These fees may include application fees; title examination, abstract of title, title insurance, and property survey fees; fees for preparing deeds, mortgages, and settlement documents; attorneys' fees; recording fees; estimated costs of taxes and insurance; and notary, appraisal, and credit report fees. Under the Real Estate Settlement Procedures Act, the borrower receives a good faith estimate of closing costs within three days of application. The good faith estimate lists each expected cost as an amount or a range.

Credit limit - The maximum amount that may be borrowed on a credit card or under a home equity line of credit plan.

Equity - The difference between the fair market value of the home and the outstanding balance on your mortgage plus any outstanding home equity loans.

Index - The economic indicator used to calculate interest-rate adjustments for adjustable-rate mortgages or other adjustable-rate loans. The index rate can increase or decrease at any time. See *also* Selected Index Rates for ARMs over an 11-year Period (consumerfinance.gov/f/201204_CFPB_ARMs-brochure.pdf) for examples of common indexes that have changed in the past.

Interest rate - The percentage rate used to determine the cost of borrowing money, stated usually as a percentage of the principal loan amount and as an annual rate.

Margin - The number of percentage points the lender adds to the index rate to calculate the adjustable-rate-mortgage interest rate at each adjustment.

Minimum payment - The lowest amount that you must pay (usually monthly) to keep your account in good standing. Under some plans, the minimum payment may cover interest only; under others, it may include both principal and interest.

Points (also called discount points) - One point is equal to 1 percent of the principal amount of a mortgage loan. For example, if a mortgage is \$200,000, one point equals \$2,000. Lenders frequently charge points in both fixed-rate and adjustable-rate mortgages to cover loan origination costs or to provide additional compensation to the lender or broker. These points usually are paid at closing and may be paid by the borrower or home seller, or may be split between them. In some cases, the money needed to pay points can be borrowed (incorporated in the loan amount), but doing so will increase the loan amount and the total costs. Discount points (also called discount fees) are points that you voluntarily choose to pay in return for a lower interest rate.

Security interest - If stated in your credit agreement, a creditor's, lessor's, or assignee's legal right to your property (such as your home, stocks, or bonds) that secures payment of your obligation under the credit agreement. The property that secures payment of your obligation is referred to as "collateral".

Transaction fee - Fee charged each time a withdrawal or other specified transaction is made on a line of credit, such as a balance transfer fee or a cash advance fee.

Variable rate - An interest rate that changes periodically in relation to an index, such as the prime rate. Payments may increase or decrease accordingly.

More information

For more information about mortgages, including home equity lines of credit, visit consumerfinance.gov/mortgage. For answers to questions about mortgages and other financial topics, visit consumerfinance.gov/askcfpb. You may also visit the CFPB's website at consumerfinance.gov/owning-a-home to access interactive tools and resources for mortgage shoppers, which are expected to be available beginning in 2014.

Housing counselors can be very helpful, especially for first-time home buyers or if you're having trouble paying your mortgage. The U.S. Department of Housing and Urban Development (HUD) supports housing counseling agencies throughout the country that can provide free or low-cost advice. You can search for HUD-approved housing counseling agencies in your area on the CFPB's web site at consumerfinance.gov/find-a-housing-counselor or by calling HUD's interactive toll-free number at 800-569-4287.

The company that collects your mortgage payments is your loan servicer. This may not be the same company as your lender. If you have concerns about how your loan is being serviced or another aspect of your mortgage, you may wish to submit a complaint to the CFPB at consumerfinance.gov/complaint or by calling (855) 411-CFPB (2372).

When you submit a complaint to the CFPB, the CFPB will forward your complaint to the company and work to get a response. Companies have 15 days to respond to you and the CFPB. You can review the company's response and give feedback to the CFPB.

Contact information

For additional information or to submit a complaint, you can contact the CFPB or one of the other federal agencies listed below, depending on the type of institution. If you are not sure which agency to contact, you can submit a complaint to the CFPB and if the CFPB determines that another agency would be better able to assist you, the CFPB will refer your complaint to that agency and let you know.

Consumer Financial Protection Bureau (CFPB)

P. O. Box 4503

Iowa City, IA 52244

(855) 411-CFPB (2372)

consumerfinance.gov consumerfinance.gov/complaint

Regulated Entities: Insured depository institutions and credit unions with assets greater than \$10 billion (and their affiliates), and non-bank providers of consumer financial products and services, including mortgages, credit cards, debt collection, consumer reports, prepaid cards, private education loans, and payday lending

Board of Governors of the Federal Reserve System (FRB)

Consumer Help

P.O. Box 1200

Minneapolis, MN 55480

(800) 851-1920

federalreserveconsumerhelp.gov

Regulated Entities: Federally insured state-chartered bank members of the Federal Reserve System

Office of the Comptroller of the Currency (OCC)

Customer Assistance Group

1301 McKinney Street

Suite 3450

Houston, TX 77010

(800) 613-6743

occ.treas.gov helpwithmybank.gov

Regulated Entities: National banks and federally chartered savings banks/associations

Federal Deposit Insurance Corporation (FDIC)

Consumer Response Center

1100 Walnut Street,

Box #11

Kansas City, MO 64106

(877) ASK-FDIC or (877) 275-3342

fdic.gov fdic.gov/consumers

Regulated Entities: Federally insured state-chartered banks that are not members of the Federal Reserve System

Federal Housing Finance Agency (FHFA)

Consumer Communications

Constitution Center

400 7th Street SW

Washington, DC 20024

Consumer Helpline (202) 649-3811

www.fhfa.gov www.fhfa.gov/Default.aspx?Page=369 ConsumerHelp@fhfa.gov

Regulated Entities: Fannie Mae, Freddie Mac, and the Federal Home Loan Banks

National Credit Union Administration (NCUA)

Consumer Assistance

1775 Duke Street

Alexandria, VA 22314

(800) 755-1030

ncua.gov mycreditunion.gov

Regulated Entity: Federally chartered credit unions

Federal Trade Commission (FTC)

Consumer Response Center

600 Pennsylvania Avenue NW

Washington, D.C. 20580

(877) FTC-HELP or (877) 382-4357

ftc.gov ftc.gov/bcp

Regulated Entities: Finance companies, retail stores, auto dealers, mortgage companies and other lenders, and credit bureaus

Securities and Exchange Commission (SEC)

Complaint Center

100 F Street, N.E.

Washington, D.C. 20549

(202) 551-6551

sec.gov sec.gov/complaint/select.shtml

Regulated Entities: Brokerage firms, mutual fund companies, and investment advisers

Farm Credit Administration Office of Congressional and Public Affairs

1501 Farm Credit Drive

McLean, VA 22102

(703) 883-4056

fca.gov

Regulated Entities: Agricultural lenders

Small Business Administration (SBA)

Consumer Affairs

409 3rd Street SW

Washington, DC 20416

(800) U-ASK-SBA or (800) 827-5722

sba.gov

Regulated Entity: Small business lenders

Commodity Futures Trading Commission (CFTC)

1155 21st Street, N.W.

Washington, DC 20581

(866) 366-2382

cftc.gov/consumer-protection

Regulated Entity: Commodity brokers, commodity trading advisors, commodity pols, and introducing brokers

U.S. Department of Justice (DOJ)

Civil Rights Division

950 Pennsylvania Avenue NW

Housing and Civil Enforcement Section

Washington, DC 20530

(202) 514-4713 TTY-(202) 305-1882 FAX-(202) 514-1116

To report an incident of housing discrimination: 1-800-896-7743

fairhousing@usdoj.gov

Regulated Entities: Fair lending and fair housing issues

Department of Housing and Urban Development (HUD)

Office of Fair Housing/Equal Opportunity

451 7th Street SW

Washington, DC 20410

(800) 669-9777

hud.gov/complaints

Regulated Entities: Fair lending and fair housing issues

Home Equity Plan Checklist

Ask your lender to help fill out this checklist.

BASIC FEATURES

	Plan A	Plan B
Fixed annual percentage rate	<input style="width: 100px;" type="text" value="%"/>	<input style="width: 100px;" type="text" value="%"/>
Variable annual percentage rate	<input style="width: 100px;" type="text" value="%"/>	<input style="width: 100px;" type="text" value="%"/>
- Index used and current value	<input style="width: 100px;" type="text" value="%"/>	<input style="width: 100px;" type="text" value="%"/>
- Amount of margin	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
- Frequency of rate adjustments	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
- Amount/length of discount (if any)	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
- Interest-rate cap and floor	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>

Length of plan

Draw period	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Repayment period	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>

Initial fees

Appraisal fee	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Application fee	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Up-front charges, including points	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Closing costs	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>

REPAYMENT TERMS

During the draw period

Interest and principal payments	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Interest-only payments	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Fully amortizing payments	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>

When the draw period ends

Balloon payment?	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Renewal available?	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>
Refinancing of balance by lender?	<input style="width: 100px;" type="text"/>	<input style="width: 100px;" type="text"/>

