Home Equity Lines of Credit

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This booklet was initially prepared by the Board of Governors of the Federal Reserve System. The Consumer Financial Protection Bureau (CFPB) has made technical updates to the booklet to reflect new mortgage rules under Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). A larger update of this booklet is planned in the future to reflect other changes under the Dodd-Frank Act and to align with other CFPB resources and tools for consumers as part of the CFPB's broader mission to educate consumers.

Consumers are encouraged to visit the CPFB'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.

WHEN YOUR HOME IS ON THE LINE:

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	**x 75%**
Percentage of appraised value	**= $75,000**
Less balance owed on mortgage	**- $40,000**
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) or 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 unusually low for a short period, such as 6 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. And 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 payment 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 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.

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.

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 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.

DEFINED TERMS

This glossary provides general definitions for terms commonly used in the real estate market. They may have different legal meanings depending on the context.

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 the interest rate, points, broker fees, and other credit charges that the borrower is required to pay. An APR, or an 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 ARM 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 the 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.

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.

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.
Consumer Financial Protection Bureau (CFPB)
P.O. Box 2900
Clinton, IA 52733
(855) 411-2372
www.consumerfinance.gov
www.consumerfinance.gov/complaint

Federally Insured state-chartered bank members of the Federal Reserve System
Board of Governors of the Federal Reserve System (FRB)
Consumer Help
PO Box 1200 • Minneapolis, MN 55480
(888) 851-1920
www.federalreserveconsumerhelp.gov

Brokerage firms, mutual fund companies, and investment advisors
Securities and Exchange Commission (SEC)
Complaint Center
100 F Street, N.E.
Washington, DC 20549
(202) 551-6551
www.sec.gov
www.sec.gov/complaint/select.shtml

Agricultural Lenders
Farm Credit Administration
Office of Congressional and Public Affairs
1501 Farm Credit Drive
McLean, VA 22102
(703)883-4056
www.fca.gov

Small business lenders
Small Business Administration (SBA)
Consumer Affairs
409 3rd Street, S.W.
Washington, DC 20416
(800)U-ASK-SBA or (800)827-5722
www.sba.gov

Commodity brokers, commodity trading advisers, commodity pools and introducing brokers
Commodity Futures Trading Commission (CFTC)
1155 21st Street, N.W.
Washington, DC 20581
(866) 366-2382
cftc.gov/ConsumerProtection/index.htm

National banks and federally chartered savings banks/associations
Office of the Comptroller of the Currency (OCC)
Customer Assistance Unit
1301 McKinney Street, Suite 3450
Houston, TX 77010
(800) 613-6743
www.occ.treas.gov
www.helpwithmybank.gov

Federally insured state chartered banks that are not members of the Federal Reserve System
Federal Deposit Insurance Corporation (FDIC)
Consumer Response Center
1100 Walnut Street, Box#11
Kansas City, MO 64106
(877) ASK-FDIC or (877)275-3342
www.fdic.gov
www.fdic.gov/consumers

Fannie Mae, Freddie Mac, and the Federal Home Loan Banks
Federal Housing Finance Agency (FHFA)
Consumer Communications
Constitution Center
400 7th Street, S.W.
Washington, DC 20024
Consumer Helpline
(202) 649-3811
www.fhfa.gov
www.fhfa.gov/Default.aspx?page=369
ConsumerHelp@fhfa.gov

Federally chartered credit unions
National Credit Union Adminstration (NCUA)
Consumer Assistance
1775 Duke Street • Alexandria, VA 22314
(800) 755-1030
www.ncua.gov
www.mycreditunion.gov

Finance Companies, retail stores, auto dealers, mortgage companies, and other lenders, and credit bureaus
Federal Trade Commission (FTC)
Consumer Repsonse Center
600 Pennsylvania Avenue, N.W.
Washington DC 20580
(877) FTC-HELP or (877-382-4357)
www.ftc.gov
www.ftc.gov/bcp

Fair lending and fair housing issues
US Department of Justice (DOJ)
Civil Rights Division
950 Pennsylvania Avenue, N.W.
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

Fair lending and fair housing issues
Department of Housing and Urban Development (HUD)
Office of Fair Housing / Equal Opportunity
451 7th Street, S.W.
Washington, DC 20410
(800)669-9777
www.hud.gov/complaints

Home Equity Check List

Ask your lender to help fill out this check list.

Basic Features	PLAN A	PLAN B
Fixed annual percentage rate		
Variable annual percentage rate		
Index used and current value		
Amount of margin		
Frequency of rate adjustments		
Amount/length of discount (if any)		
Interest rate caps and floor		
Length of Plan		
Draw period		
Repayment period		
Initial fees		
Appraisal fee		
Application fee		
Up-front charges, including points		
Closing costs		
Repayment Terms		
During the draw period		
Interest and principal payments		
Interest only payments		
Fully amortizing payments		
When the draw period ends		
Balloon payment?		
Renewal available?		
Refinancing of balance by lender?		

IMPORTANT TERMS OF OUR HOME EQUITY LINE OF CREDIT

This disclosure contains important information about our Home Equity Line of Credit. You should read it carefully and keep a copy for your records.

Availability of Terms – All of the terms disclosed below are subject to change.

If these terms change (other than the annual percentage rate) and you decide, as a result, not to enter into an agreement with us, you are entitled to a refund of any fees that you have paid to us or anyone else in connection with your application.

Security Interest – We will take a mortgage on your home. You could lose your home if you do not meet the obligations in your agreement with us.

Possible Actions – Under certain circumstances, we can (1) terminate your line, require you to pay us the entire outstanding balance in one payment, and charge you certain fees; (2) refuse to make additional extensions of credit; (3) reduce your credit limit and (4) as specified in the initial agreement, implement certain changes in the plan.

If you ask, we will give you more specific information concerning when we can take these actions.

Minimum Payment Requirements – You can obtain advances of credit for **10 years** up to your maximum line of credit. Payments will be due monthly. Your minimum monthly payment will equal all accrued interest as of the closing date of the billing cycle, provided the payment shall not be less than **$50.00**, plus any amounts past due.

After the draw period ends, you will no longer be able to obtain credit advances and must pay the outstanding balance over **10 years** (the "repayment period"). During the repayment period, payments will be due monthly. Your minimum monthly payment will equal **1/120th** of the principal balance that was outstanding at the end of the draw period plus the finance charges that have accrued on the remaining balance, however, in no event shall the principal and interest payment be less than **$50.00** monthly.

Minimum Payment Example – If you made only the minimum monthly payments and took no other credit advances, it would take **20 years** to pay off an immediate credit advance of $10,000 at an **ANNUAL PERCENTAGE RATE** of **3.25%**. During that period, you would make **120** monthly payments of **$50.00****, followed by **120** monthly payments varying between **$74.94** and **$56.44**

Fees and Charges – If property is titled in a trust, the bank may charge up to $600 for closing fees to cover attorney review and other charges. The consumer may receive, upon request, a good faith itemization of such fees.

Early Termination Fee – If Borrower terminates this Agreement and requests a discharge of the mortgage within **36** months from the date of this Agreement, Borrower shall then be obligated to pay Lender an Early Termination Fee of **$500.00**

Property Insurance – You must carry insurance on the property that secures this line of credit.

Minimum Draw Requirements – **$100.00**.

Tax Deductibility – You should consult a tax advisor regarding the deductibility of interest and charges for the line.

Variable Rate Information – The line has a variable-rate feature, and the annual percentage rate (corresponding to the periodic rate) and the minimum payment can change as a result.

The annual percentage rate includes only interest and not other costs.

The annual percentage rate is based on the value of an index. The index is the Prime Rate published in the Money Rates section of The Wall Street Journal (if more than one Prime Rate is published, the higher rate shall be used), as most recently published on the last business day of the immediate preceding month. To determine the annual percentage rate, we may add a margin, if disclosed below in the "Margin" column of the Historic Example, to the value of the index.

***The initial annual percentage rate is discounted and not based on the index and margin used for later rate adjustments, and will be in effect until the beginning of the **13th** monthly billing cycle.

Ask us for the current index value, margin, discount if applicable and annual percentage rate. After you open a credit line, rate information will be provided on periodic statements that we send you.

Rate Changes – The annual percentage rate will change at the beginning of each monthly billing cycle. If allowed by law, the maximum **ANNUAL PERCENTAGE RATE** that can apply will never be more than **18.0%** per annum.

The minimum **ANNUAL PERCENTAGE RATE** that can apply is the initial rate at closing.

Other than as disclosed in this paragraph, there are no annual or more frequent periodic limitations on changes in the Annual Percentage Rate.

Maximum Rate and Payment Examples – If you had an outstanding balance of $10,000 during the draw period, the minimum monthly payment at the maximum **ANNUAL PERCENTAGE RATE** of **18.0%** would be **$152.88**. This annual percentage rate could be reached at the start of the **13th** month of the draw period.

If you had an outstanding balance of **$10,000** at the beginning of the repayment period, the minimum monthly payment at the maximum **ANNUAL PERCENTAGE RATE** of **18.0%** would be **$236.21**. This annual percentage rate could be reached at the start of the **1st** month of the repayment period.

Historic Example – The following table shows how the annual percentage rate and the minimum monthly payments for a single $10,000 credit advance would have changed based on changes in the index over the past 15 years. The index values are from the last business day in the Index month of each year. While only one payment amount per year is shown, payments would have varied during each year.

The table assumes that no additional credit advances were taken, that only the minimum payments were made each month, and that the rate remained constant during each year. It does not necessarily indicate how the index or your payments will change in the future.

YEAR	REPAYMENT PERIOD STARTS	NOVEMBER INDEX MONTH	MARGIN This is a margin we have used recently	*ANNUAL PERCENTAGE RATE Rounded, if applicable	MINIMUM MONTHLY PAYMENT
2006		8.25%	0.00	7.25%***	61.58
2007		7.50%	0.00	7.50%	63.70
2008		4.00%	0.00	7.25%*	61.41
2009		3.25%	0.00	7.25%*	61.58
2010		3.25%	0.00	7.25%*	61.58
2011		3.25%	0.00	7.25%*	61.58
2012		3.25%	0.00	7.25%*	61.41
2013		3.25%	0.00	7.25%*	61.58
2014		3.25%	0.00	7.25%*	61.58
2015		3.25%	0.00	7.25%*	61.58
2016	X	3.50%	0.00	7.25%*	144.74
2017		4.25%	0.00	7.25%*	138.75
2018		5.25%	0.00	7.25%*	132.59
2019		4.75%	0.00	7.25%*	126.43
2020		3.25%	0.00	7.25%*	120.17

* The Annual Percentage Rate has been adjusted to reflect any applicable interest rate caps.
** Minimum Payment Amount
*** Initial Discounted Fixed Rate for 12 months used recently