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 Federal Trade Commission's website, at www.ftc.gov/freereports, for information about free copies) 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.

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 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 (www.federalreserve.gov/pubs/arms/arms_english.htm) 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.

Where to go for help

For additional information or to file a complaint about a bank, savings and loan, credit union, or other financial institution, contact one of the following federal agencies, depending on the type of institution.

Consumer Financial Protection Bureau (CFPB)
P.O. Box 4503
Iowa City, IA 52244
(855) 411-2372
www.consumerfinance.gov
Regulated Entities: Insured depository institutions and credit unions (and their affiliates) with assets greater than $10 billion, and nondepository institutions such as mortgage originators, mortgage brokers and servicers, larger participants of other financial services products, private education loan providers, and payday lenders

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

National Credit Union Administration (NCUA)
Consumer Assistance
1775 Duke Street
Alexandria, VA 22314-3428
(800) 755-1030
www.ncua.gov
www.mycreditunion.gov
Regulated Entity: Federally chartered credit unions

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

Farm Credit Administration
Office of Congressional and Public Affairs
1501 Farm Credit Drive
McLean, VA 22102-5090
(703) 883-4056
www.fca.gov
Regulated Entity: Agricultural 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
Regulated Entity: Small business lenders

U.S. Department of Justice (DOJ)
Criminal Division
950 Pennsylvania Avenue, N.W.
Washington, DC 20530
(202) 514-3301
www.justice.gov/criminal
Regulated Entities: 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
Regulated Entities: Fair lending and fair housing issues

More Resources

For more resources on mortgages and other financial topics, visit www.federalreserve.gov/consumerinfo.

Home Equity Plan Checklist

Ask your lender to help fill out this checklist.

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 cap and floor		
Length of plan		
Draw period		
Repayment period		
Initial fees		
Appraisal fee		
Application fee		
Up-front charges, including points		
Closing costs		

REPAYMENT TERMS	Plan A	Plan B
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?		

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HOME EQUITY EARLY DISCLOSURE

IMPORTANT TERMS OF OUR HOME EQUITY LINE OF CREDIT PLAN

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

AVAILABILITY OF TERMS: All of the terms described 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 pay to us or anyone else in connection with your application.

SECURITY INTEREST: We will take a security interest in your home. You could lose your home if you do not meet the obligations in your agreement with us.

POSSIBLE ACTIONS: We can terminate your line, require you to pay us the entire outstanding balance in one payment, and charge you certain fees, if (1) you engage in fraud or material misrepresentation in connection with the plan; (2) you do not meet the repayment terms of this plan, or (3) your action or inaction adversely affects the collateral or our rights in the collateral.

We can refuse to make additional extensions of credit or reduce your credit limit if (1) any reasons mentioned above exist; (2) the value of the dwelling securing the line declines significantly below its appraised value for purposes of the line; (3) we reasonably believe that you will not be able to meet the repayment requirements due to a material change in your financial circumstances; (4) you are in default of a material obligation of the agreement; (5) government action prevents us from imposing the annual percentage rate provided for in the agreement; (6) the priority of our security interest is adversely affected by government action to the extent that the value of the security interest is less than 120 percent of the credit line; (7) a regulatory agency has notified us that continued advances would constitute an unsafe and unsound business practice, or (8) the maximum annual percentage rate is reached.

MINIMUM PAYMENT REQUIREMENTS: You can obtain credit advances for 10 years. This period is called the "draw period." At our option, we may renew or extend the draw period. After the draw period ends the repayment period will begin. The length of the repayment period will be 15 years. You will be required to make monthly payments during both the draw and repayment periods.

During the draw period your monthly payment will equal the finance charges (interest) that accrued on the outstanding balance during the preceding month. Your payment will include any amounts past due and any amount by which you have exceeded your credit limit and all other charges.

At the beginning of the repayment period we will recalculate your payments. Your payment will be set to repay the balance at the current annual percentage rate over 15 years. Your payment will be rounded up to the nearest dollar. Each time the annual percentage rate changes, we will adjust your payment to repay the balance within the original 15 years. Your payment will include any amounts past due and all other charges. Your payment will never be less than the smaller of $50.00 or the full amount that you owe.

MINIMUM PAYMENT EXAMPLE: If you made only the minimum monthly payment and took no other credit advances it would take 24 years 10 months to pay off a credit advance of $10,000 at an **ANNUAL PERCENTAGE RATE** of 3.25%. During that period, you would make 120 payments of $24.93 to $27.60, followed by 177 payments of $71.00 and one (1) final payment of $45.21.

FEES AND CHARGES: You must pay certain fees to third parties to open the plan. The fees/closing costs generally total between $250.00 and $1,300.00. If you ask, we will provide you with an itemization of the fees/closing costs you will have to pay third parties.

The credit union may pay the fees/closing costs. However, if you close your home equity plan within two (2) years of the opening date, you will have to reimburse the credit union for all fees/closing costs paid on your behalf.

PROPERTY INSURANCE: You must carry insurance on the property that secures this plan. If the property is located in a Special Flood Hazard Area we will require you to obtain flood insurance if it is available.

REFUNDABILITY OF FEES: If you decide not to enter into this plan within three business days of receiving this disclosure and the home equity brochure, you are entitled to a refund of any fee you may have already paid.

TRANSACTION REQUIREMENTS: The minimum credit advance that you can receive is $25,000.00 for the first advance and $250.00 for each subsequent advance.

TAX DEDUCTIBILITY: You should consult a tax advisor regarding the deductibility of interest and charges for the plan.

VARIABLE RATE FEATURE: This plan has a variable rate feature and the annual percentage rate (corresponding to the periodic rate) and the minimum payment may change as a result. The annual percentage rate includes only interest and no 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 column of the *Wall Street Journal.* When a range of rates has been published the highest rate will be used. We will use the most recent index value available to us as of 10 days before the date of any annual percentage rate adjustment.

To determine the annual percentage rate that will apply to your account, we add a margin to the value of the Index. The margin you receive will be based on your creditworthiness. The initial annual percentage rate may be "discounted" - it may not be based on the index and margin used for later rate adjustments. If we are offering an initial discounted rate it will not be in effect for more than 12 months. Ask us for the current index value, margin, discount availability and annual percentage rate. After you open a plan, rate information will be provided on periodic statements that we send you.

RATE CHANGES: The annual percentage rate can change on the first day of each month. There is no limit on the amount by which the annual percentage rate can change during any one year period. The maximum **ANNUAL PERCENTAGE RATE** that can apply is 18.0% or the maximum permitted by law, whichever is less.

MAXIMUM RATE AND PAYMENT EXAMPLES, Draw Period: If you had an outstanding balance of $10,000, the minimum payment at the maximum **ANNUAL PERCENTAGE RATE** of 18.0% would be $152.88. This annual percentage rate could be reached at the time of the 13th payment.

MAXIMUM RATE AND PAYMENT EXAMPLES, Repayment Period: If you had an outstanding balance of $10,000, the minimum payment at the maximum **ANNUAL PERCENTAGE RATE** of 18.0% would be $162.00. This annual percentage rate could be reached at the time of the 1st payment.

HISTORICAL EXAMPLE: The following table shows how the annual percentage rate and the minimum 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 of January of each year.

While only one payment per year is shown, payments may have varied during each year.

The table assumes that no additional credit advances were taken, that only the minimum payments were made, 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.

WALL STREET JOURNAL PRIME RATE INDEX TABLE

Year (as of the last business day of January)	Index (Percent)	Margin[1] (Percent)	**ANNUAL PERCENTAGE RATE**	Monthly Payment (Dollars)
2007	8.250	0.00	4.990[2]	42.38
2008	6.000	0.00	6.000	50.96
2009	3.250	0.00	3.250	27.60
2010	3.250	0.00	3.250	27.60
2011	3.250	0.00	3.250	27.60
2012	3.250	0.00	3.250	27.60
2013	3.250	0.00	3.250	27.60
2014	3.250	0.00	3.250	27.60
2015	3.250	0.00	3.250	27.60
2016	3.500	0.00	3.500	29.73
2017	3.750	0.00	3.750	73.00
2018	4.500	0.00	4.500	77.00
2019	5.500	0.00	5.500	81.00
2020	4.750	0.00	4.750	78.00
2021	3.250	0.00	3.250	72.00

[1] This is a margin we have used recently; your margin may be different.
[2] This **ANNUAL PERCENTAGE RATE** reflects a discount that we have provided recently. Your plan may be discounted by a different amount or may not be discounted at all.