A GUIDE TO HOME EQUITY LINES OF CREDIT

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WE'RE HERE TO HELP

A home equity line of credit lets you use the equity that's in your home to remodel a bathroom or kitchen, pay off a car loan, give your daughter her dream wedding, or consolidate bills. However, you are using your home as collateral so it's important to understand what you're doing.

As a community bank, it's natural that we're more in touch with our customers, more aware of their lives and more personally invested in their financial well-being.

We hope this guide will be a valuable resource, but we also want you to know that you can always turn to us with any questions or concerns you may have.

WHAT IS A HOME EQUITY LINE OF CREDIT

If you own a home, you can use the equity you've built from mortgage payments and your down payment as collateral to borrow money for everything from home renovations to buying a boat or paying off your credit card bills.

A home equity line of credit, or HELOC, is one way to do this. Through a HELOC, the bank agrees to lend you a maximum amount over a certain period or term. Many lenders set the credit limit by taking a percentage (say, 75%) of the home's appraised value and subtracting from that the balance owed on the existing mortgage.

Example:

Appraised value of home $100,000 x 75% of appraised value = **$ 75,000**

Less balance owed on mortgage – **$ 40,000**

Potential line of credit
$ 35,000

Once you've established your credit line, you can draw money from it as needed. Typically, you will use special checks. Under some plans, borrowers can use a credit card.

HELOC for Debt Consolidation

SCENARIO 1

$14,000 Credit Card Debt

15.7% Interest Rate

Total Interest Paid: $6,301, 5 Years

SCENARIO 2

$14,000 Home Equity Line

5.5% Interest Rate

Total Interest Paid: $2,049, 5 Years

TOTAL SAVINGS = $4,252

Calculations from: https://www.creditkarma.com/calculators/debtrepayment

Use a Home Equity Line of Credit for:

- Bill consolidation
- Home improvements
- Yard improvements
- Paying off a car loan
- Wedding costs
- An emergency fund

The good news is that you only pay interest on the monies drawn. So if you have a line of credit of $35,000 and draw $5,000 for new counter tops, you will only need to pay interest on that $5,000. An added plus is that the interest paid on the loan is often tax-deductible. Consult with your tax advisor to be sure.

Consolidate Debt

If you have other debt, especially credit cards with high interest rates, a home equity line of credit can be a tremendous relief, both financially and personally.

By using a home equity line of credit to pay off all your other bills, you consolidate that debt into one payment. In addition to being a lot simpler, it can eliminate service fees, reduce interest payments, and may even be tax-deductible.

Benefits of a Home Equity Line of Credit

- Borrow up to 90% of the fair market value of your home
- Interest rates are typically lower than credit cards and other loans
- The interest paid may be tax-deductible; consult a tax professional
- Only pay interest on the amount drawn

REFINANCE vs. HOME EQUITY LOAN vs. HOME EQUITY LINE OF CREDIT

Traditional Refinance

- Lower interest rates, but higher closing costs
- Lower payments
- More fixed-rate options

Home Equity Loan or Line of Credit

- Lower closing costs, but higher interest rates
- The ability to borrow up to 90% of the home's market value

When it comes to using the equity in your home as collateral for a loan, you have three options. Which option is right for you depends on a number of factors, such as how much equity you have, how long you plan to stay in your home and how much money you want to take out. Before you decide, understand the basics.

Refinance

When you refinance, you pay off your existing mortgage and create a new one, usually at a lower interest rate. It's not unusual for homeowners to use this process to pay off a second mortgage, get extra money for home improvements or pay off credit card debt.

Because this is a new mortgage, you could have a lot of fees and costs, including an application fee, loan origination fee, points, appraisal and inspection fees, and title search and title insurance. Altogether, these fees could add up to three to six percent of your outstanding principal.

Be cautious if you plan to be in your home for less than five years, as the difference in rate or costs may not cover these fees. You'll end up losing money, rather than saving it. Also, if you've been in your home for a long time, refinancing will change the amortization schedule, leaving you paying more

- Borrow a specific amount, with a fixed rate, term and monthly payment
- Great for debt consolidation, major home renovations or large one-time purchases
- Flexible repayment terms may be available
- Loan amounts starting at $5,000
- The interest you pay may be tax deductible*

Home Equity Line of Credit

- Access funds for large expenses, now and in the future
- Only pay interest on the funds drawn
- Flexible repayment options
- The interest you pay is typically tax deductible*
- Minimum line amount starting at $5,000
- Maximum line amount is $100,000

*Consult your tax advisor to see if you qualify

interest and less principal all over again. Finally, if your existing mortgage rate is better than the refinance rate, it's probably not a good idea to switch.

Home Equity Loans and Lines of Credit

Another way to get the money you need from your home is through a home equity loan or line of credit. These have a lot in common, but there are distinct differences.

Both are loans that are separate from your first mortgage and thus, require a separate monthly payment. Since you borrow against the equity you've built up through your original down payment and subsequent mortgage payments, the more you've paid, the more you can borrow.

Home Equity Loan Works just like a conventional installment loan and uses your home as collateral. As the borrower, you're given the entire sum of money up front and, then, make regular monthly payments. There is a set interest rate, which is charged on the entire sum, and a set term.

Home Equity Line of Credit There are two big differences here. The first is that you're NOT given the entire sum up front. Instead, you have a credit limit that you can draw from whenever you choose, in whatever amount you choose. These funds can be borrowed and repaid, borrowed and repaid. You only pay interest on the money you take out.

The other notable difference is that all HELOCs have a variable interest rate that is based on an index, such as the prime rate, which can change over time. To protect borrowers, the government caps the amount the interest rate can rise. In addition, depending on the terms and the lender, you may be able to convert from a variable interest rate to a fixed rate during the life of the plan, essentially creating a Home Equity Loan.

Usually, the term of a home equity line of credit ranges between five to twenty-five years. The full principal plus interest is due at the end of the term.

Not all HELOCs have the same rules. 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. Talk with your banker to get all the details.

WHAT IS A VARIABLE RATE?

A variable rate is based on a publicly available index (such as the prime rate published in some major daily newspapers or a U.S. Treasury bill rate). 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. Variable-rate plans secured by a home must, by law, have a ceiling (or cap) on how much your interest rate may increase over the life of the plan. In addition, some variable rate plans limit how low your interest rate may fall if the index drops.

HOME EQUITY CALCULATOR

Determine the amount of equity available in your home.

Your home's appraisal value multiplied by 90%	$__________ x.90
Equals	$__________
Now subtract the amount you owe	$__________
This is the amount of equity you may be eligible to receive with a HELOC from Prospect Bank	$__________

REPAYING THE LOAN

In determining your actual credit limit, the lender will also consider your ability to repay the principal and the interest by looking at your income, debts, financial obligations and credit history. Before entering into a plan, you need to consider how you will pay back the money you borrow, as well.

During the loan

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.

Paying it off entirely

Many HELOC plans set a fixed period during which you can borrow money, such as 7 years. Depending on the lender, at the end of this "draw period," you may be allowed to renew your credit line. However, if your plan does not allow renewals, you will need to pay off your existing line then take out a new one.

If you sell your home, you will need to pay off your home equity line of credit in full, immediately. You can do this on your own or at closing. It's important to note that when the market permits, many people work their HELOC balance into their home's asking price.

Understand the risks

Because the underlying collateral of a home equity line of credit is your home, it comes with risks. To keep you safe, lenders check your credit and financial health, and make sure that you maintain a certain level of equity in your home. At the same time, the government ensures that variable interest rates cannot go too high. Still, it's important that you fully understand the following:

- You can lose your home for missing payments.
- The maximum amount borrowed is a portion of your home's value, which is determined by the market. If the market takes a downturn, you can owe more than your house is worth.

QUESTIONS TO ASK YOUR BANKER

If you are interested in getting equity out of your home, look for the financing option that best fits your situation.

Home Equity Plan Checklist

To help you get the answers you need, we've created this checklist. Use it when you're talking with one of our loan officers.

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		
During the draw period *Interest and principal payments*		
Interest-only payments		
Fully amortizing payments		

WHAT YOU MAY NEED FOR THE LOAN APPLICATION PROCESS

There's nothing more annoying than starting the lending process, then realizing you don't have everything you need to complete it. Use the following list to make sure you're prepared. Keep in mind that while most lenders have the same core requirements, they may vary on other specific items.

Personal Information for Applicant and Co-Applicant:

- Full legal name, Social Security number, date of birth
- Current address and previous, if less than two years
- Current employer and previous, if less than two years, including main office phone number
- Government issued photo ID (Driver's license, US passport or state-issued ID)

Required Income Documentation

- Most recent pay stub showing 30 days YTD income
- Most recent 2 consecutive years W-2 forms
- If receiving any commission income – all items above AND most recent 2 years personal Federal Tax Returns; signed and dated

Required Property Information

- Homeowners/Condo/Townhome Insurance declaration page *(must include premium, deductible, coverage amount)*
- If taxes and insurance are currently being escrowed – most recent mortgage statement
- If taxes and insurance are currently NOT being escrowed – current year property tax statement
- If property is in a flood zone – Flood Insurance Declaration
- If property is a condominium – Master Insurance Policy for Condominium Association

Additional Information, *(if applicable and may be required during the review process)*

- Signed current year tax return extension
- Trust agreement *(all pages must be submitted)*
- 30-day payoff statement for all required payoffs
- Power of Attorney *(must be recorded in same county as property)*

You may fall into one or more of these categories, if you do, there are additional items you may need.

If you are SELF-EMPLOYED

- Most recent 2 consecutive years W-2's, most recent 2 years personal Federal tax returns, including all schedules; signed & dated
- If ownership is 25% or greater – All items above, plus:
  - Most recent 2 years business Federal Tax Returns with all schedules; signed & dated
  - Year-to-date Profit and Loss statement
  - Balance sheet

If you receive SUPPLEMENTAL or RETIREMENT INCOME

- Most recent 2 consecutive years W-2's, most recent 2 years personal Federal tax returns, including all schedules; signed & dated
- If receiving any Social Security income –Social Security income award letter *(current or most recent year)*
- If receiving any pension income –Pension award letter and/or documentation demonstrating all sources of income
- If receiving any investment income –Most recent investment statements
- If receiving rental income –Most recent 2 consecutive years personal Federal Tax Returns, including all schedules; signed & dated as well as current lease agreement required for each unit

GLOSSARY

Sometimes, just talking about home equity lines of credit can be confusing. Here's a glossary to help you translate.

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 a lifetime 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.

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.

Good Faith Estimate

Under the Real Estate Settlement Procedures Act, for certain real estate transactions (HELOC's are exempt) 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.

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.

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 one 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. 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.

WHAT PROSPECT BANK HAS TO OFFER.

To begin with, as community banks, we know our customers and we put you first.

It's this approach that makes it easier to ask questions—and get answers. It's also why our customers feel more secure borrowing from us.

Call or visit one of our offices today to see what products in this guide we have to offer you!

Our branch offices are located right where you need them, and our loan officers are ready to guide you through the entire process.

Visit BANKPROSPECT.COM/HELOC to learn more

Contact us at 877.465.4154

Sources

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http://files.consumerfinance.gov/f/201204_CFPB_HELOC-brochure.pdf

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