



PENNSYLVANIA ASSOCIATION OF COMMUNITY BANKERS

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Consumer Tips July 2008 – What Is a HELOC and Do You Need One?



HELOC: *home equity line of credit.* This type of loan, which became popular in the mid-1980s, is a revolving credit in which your home serves as collateral.

By using the equity you have accumulated in your home, you may qualify for a sizeable amount of credit which you might in turn use for education, medical bills, home improvement or other high-dollar expense. Before taking a home equity loan, be sure you carefully weigh the pros and cons, the costs and the benefits.

With a home equity line of credit, you can use the credit wherever and whenever you choose. While the interest rate is relatively low, be sure you understand the credit terms and that should you fail to repay the amounts you borrowed, you could lose your house.

To determine your credit limit, your lender will determine the appraised value of your house and then subtract from that value the amount you still owe on your existing mortgage. The lender will also consider your credit worthiness by examining your income, credit history and other financial obligations.

Once you've been approved for a home equity line of credit, you will be allowed to borrow up to your credit limit whenever you want. The lender will probably provide you with special checks or a credit card to use when drawing on your line of credit.

Many home equity loan plans set a fixed period, called the "draw period", during which you may borrow money. At the end of this period, for example 10 years, the lender may call for payment in full of any outstanding balance. You may also ask your lender for a repayment plan over a fixed period, so that you do not have to pay the loan in full at one time.

Generally, with a home equity line of credit, the interest rate is variable, rather than fixed. Federal law requires a ceiling on how high your payment can go, and customary usage provides a cap on how low your interest rate may fall if interest rates drop. At some point during the life of the loan, many lenders will allow you to convert from a variable interest to a fixed interest rate for the life of the loan.

Keep in mind that there are upfront expenses in establishing a home equity line of credit. However, because your home serves as collateral, the lender's risk is lower than most other forms of credit, so the annual percentage rates are lower. When repaying your home equity loan, you may choose to pay down the principal regularly as you do with other types of loans.

Establishing a HELOC

- Fee for property appraisal to determine the value of your home
- Application fee (may or may not be refunded if your loan is denied)
- Closing costs including attorney fees, title search or title insurance and taxes
- You may also be responsible for other fees such as an annual maintenance fee and a transaction fee for each time you draw on your line of credit
- Other upfront charges (discuss with your lender)

If a home equity line of credit is not for you, you might also consider the traditional home equity loan. This type of loan provides you with a fixed amount of money up front with an equal payment schedule.

Before making any decisions, be sure to discuss your options with your local community banker. Your home is one of your most important possessions and you don't want to risk losing it. Ask your community banker to compare your options and help you determine the loan best suited for your needs and ability to repay.

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