



Financial Services Communications & Strategy

jmarsh@marshcomm.net ▲ www.marshcomm.net ▲ amus@marshcomm.net

Work Samples Series

The Assignment:

MarshComm was asked to write a series of consumer-focused articles to be used by RBC Mortgage loan officers for placement, in their name, in local publications or used with prospects and clients as direct-marketing pieces.

The articles provide useful advice and information to consumers as a means to position the loan officers as industry experts and, as such, to help increase their business.

The series focused on providing detailed information and background on mortgage products and services to help consumers understand their options and make the right choice for them.

The Benefits and Usefulness of a Home Equity Line of Credit

Understanding their many uses – and how HELOCs work – can help you decide whether to take advantage of today's historically outstanding rate environment

The Great Mortgage Boom has been underway for more than a year now. Mortgage rates that dipped to 35-year lows have garnered loads of press attention and have fueled a tsunami of refinancings and first-time home purchases.

Lost in this focus on mortgage rates is the fact that many homeowners are also taking advantage of incredibly favorable home equity lending rates – especially on home equity lines of credit (HELOCs). The rate that underlies a typical HELOC, the Prime rate, remains at its lowest sustained level in more than 40 years. In fact, in November the Prime rate dipped to 4.25 percent – its lowest level since 1958 – and many HELOCs are available today to borrowers with impeccable credit at or sometimes even below Prime.

Combine that incredibly low rate with the fact that interest on home-equity loans – as with their mortgage cousins – is tax-deductible. Up to \$100,000 of interest on a home-equity loan is tax-

deductible if you're married and filing jointly (\$50,000 if you're married but filing separately). Now you can begin to see the real beauty of a HELOC. Understanding more about how useful a home equity loan might be for you – and how home equity lending works –can help you decide whether to take advantage of today's historically outstanding rate environment.

Home Equity's Usefulness

Borrowing against the equity you have built in your home can be a smart, useful financial tool for a variety of purposes: debt consolidation, home improvements, education, major purchases and unexpected expenses, among many others.

By far the most popular use for home equity loans (HELs) and HELOCs is debt consolidation. Fully 40 percent are used for that purpose, and it's crystal clear why. Americans carry a lot of personal debt, much of which is at interest rates more than three or four times the Prime rate. For example, national statistics show that the average household has approximately \$7,000 in credit card balances and is paying an average interest rate of 14 percent on their credit cards. If that same \$7,000 balance was consolidated into a HELOC at 4.25 percent, the annual savings in finance charges would be more than \$680.

Home improvements are the second most popular use for home equity borrowing. Again, it's easy to see why. Tapping your equity for home improvements can actually increase the fair market value of your home. Improvements to kitchens and adding bathrooms increase value the most. One caveat, though: Don't assume every "improvement" will increase your home's value. Swimming pools, for example, often do not increase a home's value at all.

Using home equity to pay for an education – whether it's your child's college education, or to help advance your career – may well pay for itself a number of times over in added earnings potential. Many people use their home equity to buy automobiles or appliances and, as every homeowner knows, unexpected household expenses – a new HVAC unit or hot water heater – are nearly inevitable. A HELOC comes in very handy for these and many other things.

Home Equity Backgrounder

Equity is the difference between your outstanding mortgage balance (what you still owe) and your home's fair market, or appraised, value (what your home is worth). For example, if your home is appraised at \$200,000 and you owe \$125,000 on your mortgage, you have \$75,000 in equity in your home.

Lenders typically will cap home equity loans at 80 percent of your loan-to-value (LTV) ratio, though some will go as high as 125 percent. Using the above example, if you owe \$125,000 on your mortgage, and your lender caps your equity loan at 80 percent LTV, you could borrow up to \$35,000 (that's \$125,000 plus \$35,000, or \$160,000, which is 80 percent of the \$200,000 fair market value in this example).

Banks love home equity loans because they are "secured" by the borrower's home itself, typically your biggest single asset, and one you will protect to ensure that the loan does not default. Because your home serves as the collateral for the loan, banks are able to offer rates much lower than typical "unsecured" consumer loans, such as credit cards. No matter how favorable the rate, you should avoid any temptation to borrow up to the full value, or more, of your home; the risks are just too high.

In addition to a home equity line of credit, you have two other basic options to tap the equity in your home: a home equity loan (HEL), or a cash-out refinancing. A HEL is a closed-end, or term, loan for a set amount and with a fixed interest rate, to be repaid over a certain period, typically five to 15 years. A HEL gives you the borrowed funds in a lump sum at the beginning of the term, and you make equal monthly payments over the term until the loan is repaid.

According to Bankrate.com, the national average rate for a \$30,000 HEL on Nov. 1 was 6.91 percent. A HEL offers one of the best fixed-rate loan options available. However, considering the typical fees and costs of up to \$1,000 to take out a home equity loan, and in light of the current low-rate environment, a HEL simply can't compete against a Prime-based HELOC – with a national average rate of less than .5 percent above Prime.

A cash-out refinancing, the other option, is much as it sounds: You refinance your mortgage and take out some of the equity in cash to use as you wish. Again, though, because of the fees and costs involved with refinancing, you should really only consider this option to tap your equity if you already planned on refinancing.

A HELOC's Advantages

In nearly all situations these days, a HELOC is the way to go. A HELOC works like a credit card. You can borrow up to a certain amount during the term of the loan (typically, 10 years), tapping your available funds only when you need them. Another advantage is that there typically are no, or only minimal, front-end costs to get a HELOC.

The flexibility of a HELOC also sets it apart from other home equity options. Most lenders provide you with personalized checks to tap your line whenever you need it, and some lenders provide a credit card as well.

In today's competitive lending environment, if your credit is spotless, you can often find interest rates at, or even a tick below, the Prime rate (again, currently 4.25 percent). HELOC rates are variable; that is, they move in lock-step with the Prime rate. If the Prime falls, your interest rate falls; conversely, if the Prime rises, so does your rate. However, most variable-rate lines of credit limit how often, and how much, the rate can increase in any given year. And by law, variable-rate loans must have a cap, or an absolute limit, on how high their interest rate can go during the term of the loan.

For further peace of mind on this issue, it's important to realize that the Prime rate recently dropped a half point after remaining unchanged for almost a year. It will only begin to rise when the economy heats up, something most economists don't foresee within the next year.

You should also keep in mind the difference between that 6.91 percent national average rate for a \$30,000 HEL and the 4.25 percent Prime rate – nearly 2.7 percent. That's a significant, money-saving difference when borrowing a large amount. For example, if you took out a \$30,000

HEL at 6.91 percent, the annual interest would be \$2,073. But if you borrowed that same \$30,000 from a 4.25 percent HELOC, the annual interest would be \$1,275, a savings of nearly \$800 a year.

Once you tap your funds, whatever principal amount you repay becomes available to you to borrow again. For example, if your HELOC is \$30,000 and you borrow \$20,000 of it, you then have \$10,000 available. As you pay back the \$20,000 you borrowed, the principal amount you pay back is then added to your available funds. So you can borrow and repay as much as you want during the term of your HELOC.

In the final analysis, a HELOC is a smart, useful, flexible financial tool. And considering that the Prime rate is at a 44-year low, there's little reason not to take advantage – and take one out – today.

#