

The
Home
Loan
That
Is
Still
Hot

By Ruth Simon

As Interest Rates Slow Refinancings, Borrowers Turn to Home Equity Loans. **Assessing the Risks**

Rising mortgage rates have burst the refinancing bubble, but borrowers continue to pour into home equity lines of credit. The number of people refinancing has tumbled sharply since interest rates began climbing in June. Home equity lines, however, are tied to a different lending rate, the prime rate, which remains at a 45-year low. As a result, some homeowners who might otherwise have refinanced are looking to home equity lines as a means of getting cash out of their house. Banks are also beefing up their marketing efforts and rolling out a variety of new products designed to encourage more customers to use home-equity lines.

*“Home-equity is the
product of the moment.”*

As recently as December 2000, rates on home-equity lines averaged 10.27%. They are now averaging 4.71%. Meanwhile, the average rate on 30-year fixed-rate mortgages is 6.23%, says *HSH Associates*, financial publishers in Butler, NJ.

At *Bank of America Corp.*, home-equity volume has climbed 40% in the past four months. *Countrywide Financial Corp.* says its

home-equity business rose 28% from May to August. Online lender *E-Loan Inc.* says nearly one in five borrowers looking to refinance this summer wound up with a home equity line instead. "Home-equity is the product of the moment," says Chris Larsen, *E-Loan's* chairman and chief executive officer. Other lenders say the home-equity business is continuing to grow rapidly but hasn't jumped further in response to higher mortgage rates. *J.P. Morgan Chase & Co.* says its home-equity business is up 50% this year. *Wells Fargo & Co.* expects its home-equity portfolio to grow 30% this year as it has for the past four years.

For borrowers, home-equity lines of credit are a double-edged sword. The low rates make these loans an attractive option for homeowners looking to pay off other debts, such as credit cards, or finance a major expenditure like college education or home remodeling. Unlike credit card debt, interest on the first \$100,000 of a home-equity line generally is tax-deductible.

But rates on home-equity lines could move up quickly if the economy continues to rebound and the *Federal Reserve* raises short-term interest rates. (Mortgage rates, by contrast, move up and down in tandem with 10-year Treasury notes.) And unlike adjustable-rate mortgages, there's typically no cap on how much the rate on a home-equity line can increase in a single month.

"Home-equity lines make the most sense for people who plan to repay the loan over the next three years."

Thus, home-equity lines make the most sense for people who plan to repay the loan over the next three years. Borrowers should be particularly wary of using a home-equity line as an alternative to a fixed-rate mortgage. "While the adjustable rate is very favorable today, there is no assurance it will remain so over a long period of time," says Greg McBride of *Bankrate.com*.

Competition in the home-equity business is fierce and could get even fiercer as the refinance pipeline clears. "Some of the smallest institutions write some of the cheapest [home-equity] loans and lines," says Keith Gumbinger, an analyst with *HSH Associates*, who recommends checking your local credit union, savings and loan, bank and brokerage firm for good deals. Borrowers may also get a lower rate if they agree to have loan payments automatically deducted from their checking or savings account.

The rate isn't the only thing to consider. Some lenders charge small application fees on a line of credit and an annual fee, typically \$50 to \$75, to keep the line open. Borrowers who don't draw down their lines may face a "nonusage" fee, typically \$50.

Homeowners who pay off the line within the first three years may also be hit with an early termination fee of \$250 to \$600.

When mortgage refinancings were booming, many lenders routinely offered home-equity lines to customers when they took out a new mortgage. Now, with refinance activity down by two-thirds, some lenders are expanding their marketing of home-equity lines. This fall, *Bank of America* is mailing nearly five million direct-mail solicitations to current and prospective customers. The Charlotte, NC-based lender has also begun shifting some of its workers to home-equity lending from mortgages.

*E*Trade Group Inc.'s* mortgage unit has changed the focus of its ads to put more emphasis on home equity loans and home purchases. *E*Trade* customer-service representatives now pitch home-equity lines to customers who call the company's mortgage unit.

Lenders are also cooking up new variants of home-equity lines to lure more customers. In June, *Countrywide* introduced a "FlexSaver ARM" that allows borrowers to use a home-equity line of credit instead of a traditional mortgage. Unlike most home-equity lines, it carries a lifetime cap of 11.95%. *Bank of America* is testing a rewards program that will allow customers who use a credit card to tap their home equity to earn points that can be used for cookware, restaurant meals, golf clubs and other products.

Other lenders beefed up their home-equity sales efforts last year in anticipation of a falloff in refinancings. *J.P. Morgan Chase*, for instance, put special home-equity salespeople in its bank branches last winter and even tested out pitches for home-equity lines on the cardboard wrappers on take-out coffee. "I don't think we had to wake up one day and shift what we were doing," says *J.P. Morgan Chase* home-equity business executive Penelope Simon, "Most of us in the mortgage business knew this was coming." *

**Competition in the
home-equity business is
fierce and could get even
fiercer as the refinance
pipeline clears.**