

Free consultation with an equity loan specialist



For toll-free numbers when overseas, visit navyfederal.org/overseas/

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What You Should Know About Home Equity Lines of Credit.

By using the equity in your home as collateral, you may qualify for a sizable amount of credit, available for use when and how you please, at an interest rate that is relatively low. And, depending on your specific situation, you may be allowed to deduct the interest because the debt is secured by your home.*

Because the home is likely to be a consumer's largest asset, many homeowners use the home equity credit for major items, such as education, home improvements, medical expenses or vehicle purchases—not for daily expenses. If you are in the market for credit, a home equity plan may be right for you. Or perhaps another form of credit would be better. Before making a decision, 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 risk. 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. With a home equity line, you are approved for a specific amount of credit—your credit limit, the maximum amount you may borrow at any one time under the plan. Under the plan, you have access to the credit for a set period of time, or "draw period," such as 10 years.

Many lenders set the credit limit on a home equity line by allowing a percentage of the home's appraised value and subtracting from that the balance owed on the existing mortgage. For example:

Potential credit	\$35,000
Less balance owed on mortgage	-\$40,000
Percentage of appraised value	\$75,000
Percentage	x 75%
Appraised value of home	\$100,000

*Consult your tax advisor.

In determining your actual credit limit, the lender will also consider your ability to repay, by looking at your income, debts, and other financial obligations as well as your credit history.

At the end of your "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 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) and to 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. The APR for a home equity line is based on the interest rate alone and will not reflect the closing costs and other fees and charges, so you'll need to compare these costs, as well as the APRs, among lenders.

Interest rate charges and related plan features

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); the interest rate for borrowing under the home equity line changes, mirroring fluctuations 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 as well as the amount of the margin.

Lenders sometimes offer a temporarily discounted interest rate for home equity lines—a rate that is unusually low and may last for only an introductory 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 interest rates drop.

Some lenders allow you to convert from a variable interest rate to a fixed rate during the life of the plan, or to convert all or a portion of your line to a fixed-term installment loan.

Plans generally permit the lender to freeze or reduce your credit line under certain circumstances. For example, some variable-rate plans may not allow you to draw additional funds during a period in which the interest rate reaches the cap.

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 buy a home. Please check with Navy Federal to learn which fees would apply to you. 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)
- Closing costs, including fees for attorneys, title search, and 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 an 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. 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 minimum payments that cover a portion of principal (the amount you borrow) plus accrued interest. But (unlike with the typical installment loan) the portion 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 alone 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 plan ends.

Regardless of the minimum required payment, 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 percent interest rate, your monthly payments would be \$83. If the rate rises over time to 15 percent, 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 upfront 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. A second mortgage provides you with a fixed amount of money repayable over a fixed period. In most cases the payment schedule calls for equal payments that will 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.





Annual membership or maintenance fee

An annual charge for having the line of credit available. Charged regardless of whether or not the line is used.

Annual percentage rate (APR)

The cost of credit on a yearly basis expressed as a percentage.

Application fee

Fees that are paid upon application. May include charges for property appraisal and a credit report.

Balloon payment

A lump-sum payment that may be required when the plan ends.

Cap

A limit on how much the variable interest rate may increase during the life of the plan.

Closing costs

Fees paid at closing, including attorneys' fees, fees for preparing and filing a mortgage, fees for title search, taxes, and insurance.

Credit limit

The maximum amount that may be borrowed under the home equity plan.

Equity

The difference between the fair market value (appraised value) of the home and the outstanding mortgage balance.

Index

Published rate that serves as a base for the interest rate charged on a home equity line and also as the base for rate changes used by the lender.

Interest rate

The periodic charge, expressed as a percentage, for use of credit.

Margir

The number of percentage points the lender adds to the index rate to determine the annual percentage rate.

Minimum payment

The minimum amount that you must pay (usually monthly) on your account. Under some plans, the minimum payment may cover interest only; under others, it may include both principal and interest.

Points

One point is equal to 1 percent of the amount of the credit line. Points must usually be paid at closing and are in addition to monthly interest.

Security interest

An interest that a lender takes in the borrower's property to ensure repayment of a debt.

Transaction fee

A fee charged each time you draw on your credit line.

Variable rate

An interest rate that changes periodically in relation to an index. Payments may increase or decrease accordingly.

Where to Go for Help

The following federal agencies are responsible for enforcing the federal Truth in Lending Act, the law that governs disclosure of terms for home equity lines of credit. Questions concerning compliance with the act by a particular financial institution should be directed to the institution's enforcement agency.

State Banks That Are Members of the Federal Reserve System

Federal Reserve Consumer Help

PO Box 1200 Minneapolis, MN 55480 888-851-1920 (voice) 877-766-8533 (TTY) 877-888-2520 (fax) email:

ConsumerHelp@FederalReserve.gov www.FederalReserveConsumerHelp.gov

Federally Insured State Non-Member Banks and Savings Banks

Federal Deposit Insurance Corporation

Consumer Response Center 2345 Grand Boulevard, Suite 100 Kansas City, MO 64108 877-275-3342 www.fdic.gov

National Banks and National Bank-Owned Mortgage Companies

Office of the Comptroller of the Currency Customer Assistance Group 1301 McKinney Street, Suite 3450 Houston, TX 77010 800-613-6743



Federally Insured Savings and Loan Institutions and Federally Chartered Savings Banks

Office of Thrift Supervision Consumer Programs 1700 G Street, N.W., 6th Floor Washington, DC 20552 800-842-6929 www.ots.treas.gov

Federal Credit Unions

National Credit Union Administration Office of Public and Congressional Affairs 1775 Duke Street Alexandria, VA 22314 703-518-6330 www.ncua.gov

For state-chartered credit unions, contact your state's regulatory agency.

Mortgage Companies and Other Lenders

Federal Trade Commission Consumer Response Center 600 Pennsylvania Avenue, N.W. Washington, DC 20580 877-FTC-HELP (877-382-4357, toll-free) www.ftc.gov

Other Information Sources

U.S. Department of Justice
Civil Rights Division
950 Pennsylvania Avenue, N.W.
Housing and Civil Enforcement
Section, NWB
Washington, DC 20580
202-514-4713
www.usdoj.gov/crt/housing/index.html

Federal Housing Finance Board 1777 F Street, N.W. Washington, DC 20006 202-408-2500 www.fhfb.gov

Toll-free in U.S. 1-888-842-NFCU (6328)

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Department of Housing and Urban Development

451 7th Street, S.W. Washington, DC 20410 800-669-9777 (voice) 800-927-9275 (TTY) www.hud.gov

Office of Federal Housing Enterprise Oversight (OFHEO)

1700 G Street, N.W., 4th Floor Washington, DC 20552 202-414-6922 www.ofheo.gov

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	<u>%</u>	C
 Index used and current value 	<u></u>	•
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?		