

**WHEN YOUR HOME IS ON THE LINE:
WHAT YOU SHOULD KNOW ABOUT HOME EQUITY LINES OF CREDIT**

More and more lenders are offering home equity lines of credit. By using the equity in your home, 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. Furthermore, under the tax law -- depending on your specific situation -- you may be allowed to deduct the interest because the debt is secured by your home.

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 this 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. Because the home is likely to be a consumer's largest asset, many homeowners use their credit lines only for major items such as education, home improvements, or medical bills and not for day-to-day expenses.

With a home equity line, you will be approved for a specific amount of credit -- your credit limit -- meaning the maximum amount you can borrow at any one time while you have the plan. Many lenders set the credit limit on a home equity line by taking a percentage (say, 75 percent) of the home's appraised value and subtracting from that the balance owed on the existing mortgage.

For example:

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

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

Many home equity plans set a fixed period during which you can borrow money, such as 10 years. At the end of this "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 the home equity line of credit, you will be able to borrow up to your credit limit whenever you want. Typically, you will be able to 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, 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 you'll pay to establish 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 rates. The variable rate must be based on a publicly available index (such as the prime rate published in some major daily newspaper 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 what 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 six 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 also how low your interest rate may fall if interest rates drop.

Some lenders may permit you to convert a variable rate to a fixed interest 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.

COST OF ESTABLISHING AND MAINTAINING A HOME EQUITY LINE

Many of the costs in setting up a home equity line of credit are similar to those you pay when you buy a home. 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 one 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 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 the 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 payments 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 can 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 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 monthly. If the rate rises over time to 15 percent, your monthly payments will increase to \$125 per month. 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 throughout the plan.

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 house in the near future, consider whether it makes sense to pay the upfront costs of setting up an equity 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 that loan period. You might consider a second mortgage loan 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 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 cost 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 changed term.

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 three 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 creditor in writing within the three-day period. The lender must then cancel its security interest in your home and return all fees -- including any application and appraisal fees -- paid in opening the account.

GLOSSARY

Annual Membership or Participation 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 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.

Margin.

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 be "interest only, under others, it may include both principal and interest.

Points.

One point is equal to 1 percent of the amount of your 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 credit term disclosure for home equity lines. Questions concerning compliance with the act by a particular financial institution should be directed to its enforcement agency.

State Banks that are Members of The Federal Reserve System

Division of Consumer and Community Affairs
Mail Stop 801
Federal Reserve Board
Washington, D.C. 20551
(202) 452-3693

National Banks

Compliance Management
Office of the Comptroller of the Currency
1301 McKinney St., Suite 3710
Houston, TX 77010
(800) 613-6743

Federally Insured Non-Member State-Chartered Banks And Saving Banks

Office of Compliance and Consumer Affairs
Federal Deposit Insurance Corporation
550 Seventeenth Street, NW, Room PA-1730, 7th Floor
Washington, DC 20429
(800) 934-FDIC; (202) 942-3100

**Federally Insured Savings And Loan Institutions
And Federally Chartered Savings Banks**

Consumer Programs Division
Office of Thrift Supervision
1700 G street, NW, 6th Floor
Washington, DC 20552
(202) 906-6237 or (800) 842-6929

Mortgage Companies and Other Lenders

Consumer Response Center
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580
(202) 326-3758 or (877) FTC-HELP

Federal Credit Unions

Office of Public and Congressional Affairs

National Credit Union Admin.
 1775 Duke Street
 Alexandria, VA. 22314
 (703) 518-6330

Home Equity Plan Checklist

Ask your lender to help you fill out this check list.

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		
Draw period		
Repayment period		
Appraisal fee		
Application fee		
Up-front charges ,including points		
Closing costs		
Interest and principal payments		
Interest-only payments		
Fully amortizing payments		
Balloon payment?		
Renewal available?		
Refinancing of balance by lender?		

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