WHAT YOU SHOULD KNOW ABOUT

# Home Equity Lines of Credit (HELOC)

## Borrowing from the value of your home

Consumer Financial Protection Bureau

An official publication of the U.S. government

## How to use this booklet

When you and your lender discuss home equity lines of credit, often referred to as HELOCs, you receive a copy of this booklet. It helps you explore and understand your options when borrowing against the equity in your home.

You can find more information from the Consumer Financial Protection Bureau (CFPB) about home loans at cfpb.gov/mortgages. You'll also find other mortgage-related CFPB resources, facts, and tools to help you take control of your borrowing options.

## About the CFPB

The CFPB implements and enforces federal consumer financial law and ensures that markets for consumer financial products are fair, transparent, and competitive.

**This pamphlet, titled What You Should Know About Home Equity Lines of Credit, was created to comply with federal law pursuant to 15 U.S.C. 1637a(e) and 12 CFR 1026.40(e).**

# How can this booklet help you?

This booklet can help you decide whether a home equity line of credit is the right choice for you, and help you shop for the best available option.

## After you finish this booklet:

- You'll understand the effect of borrowing from the value of your home
- You'll think through your borrowing and financing options, besides a HELOC
- You'll see how to shop for your best HELOC offer
- You'll see what to do if the economy or your situation changes

A home equity line of credit (HELOC) is a loan that allows you to borrow, spend, and repay as you go, using your home as collateral.

Typically, you can borrow up to a specified loan amount, which is usually a percentage of your equity. Equity is the value of your home minus the amount you owe on your mortgage.

**Consider a HELOC if you are confident you can keep up with the loan payments. If you fall behind or can't repay the loan on schedule, you could lose your home.**

## Compare a HELOC to other money sources

Before you decide to take out a HELOC, it might make sense to consider other options that could be available to you, like the ones below.

**TIP**

**Your line of credit might require you to live in the home as your primary residence. Usually a HELOC still allows you to rent out a smaller unit on your property.**

| MONEY SOURCE | HOW MUCH CAN YOU BORROW? | VARIABLE OR FIXED RATE? | IS YOUR HOME AT RISK? | TYPICAL ADVANTAGES | TYPICAL DISADVANTAGES |
|---|---|---|---|---|---|
| **HELOC** *You borrow against the equity in your home* | Up to a set limit, which is generally a percentage of the value of your home minus the amount you owe on your mortgage | Variable, typically | Yes | Continue repaying and borrowing for several years without additional approvals or paperwork; interest could be tax deductible | Repayment amount varies; repayment is often required when you sell your home |
| **SECOND MORTGAGE OR HOME EQUITY LOAN** *You borrow against the equity in your home* | Up to a set limit, which is generally a percentage of the value of your home minus the amount you owe on your mortgage | Fixed | Yes | Equal payments that pay off the entire loan | If you need more money, you need to apply for a new loan; repayment is often required when you sell your home |
| **CASH-OUT REFINANCE** *You replace your existing mortgage with a bigger mortgage and take the difference in cash* | Generally a percentage of the value of your home; the amount of your existing loan plus the amount you want to cash out | Variable or fixed | Yes | Continue to make just one mortgage payment | Closing costs are generally higher; it could take longer to pay off your mortgage; interest rate could be higher than your current mortgage |
| **PERSONAL LINE OF CREDIT** *You borrow based on your credit, without using your home as collateral* | Up to your credit limit, as determined by the lender | Variable, typically | No | Continue repaying and borrowing for several years without additional approvals or paperwork | Solid credit is required; you might need to pay the entire amount due once a year; higher interest rate than a loan that uses your home as collateral |

## Compare a HELOC to other money sources

**TIP**

**If you sell your home, you are generally required to pay off your HELOC in full immediately. If you are likely to sell your home in the near future, consider whether or not to pay the up-front costs of setting up a line of credit.**

| MONEY SOURCE | HOW MUCH CAN YOU BORROW? | VARIABLE OR FIXED RATE? | IS YOUR HOME AT RISK? | TYPICAL ADVANTAGES | TYPICAL DISADVANTAGES |
|---|---|---|---|---|---|
| **RETIREMENT PLAN LOAN** *You borrow from your retirement savings in a 401(k) or similar plan through your current employer* | Generally, up to 50% of your vested balance or $50,000, whichever is less | Fixed | No | Repay through paycheck deductions; paperwork required but no credit check and no impact on your credit score | If you leave or lose your job, repay the whole amount at that time or pay taxes and penalties; spouse might need to agree |
| **HOME EQUITY CONVERSION MORTGAGE (HECM)** *A federally insured reverse mortgage; you must be age 62 or older, and you borrow against the equity in your home* | Depends on your age, the interest rate on your loan, and the value of your home | Fixed or variable | Yes | You don't make monthly loan payments—instead, you typically repay the loan when you move out, or your survivors repay it after you die | The amount you owe grows over time and cannot be canceled; you must live in the home, maintain it, and pay taxes and insurance; you might not have any value left in your home if you want to leave it to your heirs |
| **CREDIT CARD** *You borrow money from the credit card company and repay as you go* | Up to the amount of your credit limit, as determined by the credit card company | Fixed or variable | No | No minimum purchase; consumer protections in the case of fraud or lost or stolen card | Higher interest rate than a loan that uses your home as collateral |
| **FRIENDS AND FAMILY** *You borrow money from someone you are close to* | Agreed on by the borrower and lender | Variable, fixed or other | No | Reduced waiting time, fees, and paperwork compared to a formal loan | Forgiven loans and unreported or forgiven interest can complicate taxes, especially for large loans; can jeopardize important personal relationships if something goes wrong |

## How HELOCs work

When you apply for a HELOC, the lender first looks at how much equity you have in your home. They compare your home's current value to the total of your existing mortgage balance, if you have one. This helps them determine the amount of your line of credit.

### PREPARE FOR UP-FRONT COSTS

Some lenders waive some or all of the up-front costs for a HELOC. Others charge fees. For example, you might get charged:

- A fee for a property **appraisal**, which is a formal estimate of the value of your home
- An application fee, which might not be refunded if you are turned down
- Closing costs, including fees for attorneys, title search, mortgage preparation and filing, property and title insurance, and taxes

### PULL MONEY FROM YOUR LINE OF CREDIT

Once approved for a HELOC, you can generally spend up to your credit limit whenever you want. When your line of credit is open for spending, you are in the **borrowing period**, also called the **draw period**. Typically, you use special checks or a credit card to draw on your line. Some plans require you to borrow a minimum amount each time (for example, $300) or keep a minimum amount outstanding. Some plans require you to take an initial amount when the credit line is set up.

### MAKE REPAYMENTS DURING THE "DRAW PERIOD"

Some plans set a minimum monthly payment that includes a portion of the **principal** (the amount you borrow) plus accrued interest. The portion of your payment that goes toward principal typically does not repay the principal by the end of the term. Other plans allow payment of the interest only, during the draw period, which means that you pay nothing toward the principal.

If your plan has a variable interest rate, your monthly payments could change even if you don't draw more money.

### ENTER THE "REPAYMENT PERIOD"

Whatever your payment arrangements during the draw period—whether you pay some, a little, or none of the principal amount of the loan—when the draw period ends you enter a **repayment period**.

Your lender could set up the repayment period so that you pay back the full amount, often over ten or 15 years. Or, they could require you to pay the entire balance owed, all at once, which might be a large amount called a **balloon payment**. You must be prepared to make the balloon payment by refinancing it with the lender, getting a loan from another lender, or some other means. If you are unable to pay the balloon payment in full, you could lose your home.

### RENEW OR CLOSE OUT THE LINE OF CREDIT

At the end of the repayment period, your lender might encourage you to leave the line of credit open. This way you don't have to go through the cost and expense of a new loan, if you expect to borrow again. Be sure to check whether annual maintenance fees or other fees apply, even if you are not actively using the credit line.

## GET THREE HELOC ESTIMATES

*Shopping around lets you compare costs and features, so you can feel confident you're making the best choice for your situation.*

| | | OFFER A | OFFER B | OFFER C |
|---|---|---|---|---|
| **Initiating the HELOC** | | | | |
| Credit limit | $ | | | |
| First transaction | $ | | | |
| Minimum transaction | $ | | | |
| Minimum balance | $ | | | |
| Fixed annual percentage rate | % | | | |
| Variable annual percentage rate | % | | | |
| » Index used and current value | | | | |
| » Amount of margin | | | | |
| » Frequency of rate adjustments | | | | |
| » Amount/length of discount rate (if any) | | | | |
| » Interest rate cap and floor | | | | |
| **Length of plan** | | | | |
| » Draw period | | | | |
| » Repayment period | | | | |
| **Initial fees** | | | | |
| » Appraisal fee | $ | | | |
| » Application fee | $ | | | |

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| | | OFFER A | OFFER B | OFFER C |
|---|---|---|---|---|
| » Up-front charges, including points | $ | | | |
| » Early termination fee | $ | | | |
| » Closing costs | | | | |
| During the draw period | | | | |
| » Interest and principal payments | $ | | | |
| » Interest-only payments? | $ | | | |
| » Fully amortizing payments | $ | | | |
| » Annual fee (if applicable) | $ | | | |
| » Transaction fee (if applicable) | $ | | | |
| » Inactivity fee | $ | | | |
| » Prepayment and other penalty fees | $ | | | |
| During the repayment period | | | | |
| » Penalty for overpayments? | | | | |
| » Fully amortizing payment amount? | | | | |
| » Balloon repayment of full balance owed? | | | | |
| » Renewal available? | | | | |
| » Refinancing of balance by lender? | | | | |
| » Conversion to fixed-term loan? | | | | |

**My best HELOC offer is:** _____

## How variable interest rates work

Home equity lines of credit typically involve variable rather than fixed interest rates.

A variable interest rate generally has two parts: the index and the margin.

An **index** is a measure of interest rates generally that reflects trends in the overall economy. Different lenders use different indexes in their loans. Common indexes include the U.S. prime rate and the Secured Overnight Financing Rate (SOFR). Talk with your lender to find out more about the index they use.

The **margin** is an extra percentage that the lender adds to the index.

Lenders sometimes offer a temporarily discounted interest rate for home equity lines—an introductory or **teaser rate** that is unusually low for a short period, such as six months.

## Rights and responsibilities

Lenders are required to disclose the terms and costs of their home equity lines of credit. They need to tell you:

- Annual percentage rate (APR)
- Information about variable rates
- Payment terms
- Requirements on transactions, such as minimum draw amounts and number of draws allowed per year
- Annual fees
- Miscellaneous charges

You usually get the disclosures when you receive a loan application, and you get additional disclosures before the line of credit is opened. In general, the lender cannot charge a nonrefundable fee as part of your application until three days after you have received the disclosures.

If the lender changes the terms before the loan is made, you can decide not to go forward with it, and the lender must return all fees. There is one exception: the variable interest rate might change, and in that case if you decide not to go ahead with the loan, your fees are not refunded.

Lenders must give you a list of homeownership counseling organizations in your area. You can talk to a counselor about how HELOCs work and get free or low-cost help with budgeting and money management.

## Right to cancel (also called right to rescind)

If you change your mind for any reason, under federal law, you can cancel the credit line in the first three days. Notify the lender in writing within the first three days after the account was opened. The lender must then cancel the loan and return the fees you paid, including application and appraisal fees.

**TIP**

**Some HELOCs let you convert some of your balance to a fixed interest rate. The fixed interest rate is typically higher than the variable rate, but it means more predictable payments.**

## If something changes during the course of the loan

HELOCs generally permit the lender to freeze or reduce your credit line if the value of your home falls or if they see a change for the worse in your money situation. If this happens, you can:

- **Talk with your lender.** Find out the reason for the freeze or reduction. You might need to check your credit reports for errors that might have caused a downgrade in your credit. Or, you might need to talk with your lender about a new appraisal on your home and make sure the lender agrees to accept a new appraisal as valid.
- **Shop for another line of credit.** If another lender offers you a line of credit, you could use that to pay off your original line of credit. Application fees and other fees generally apply for the new loan.

**WELL DONE!**

For most people, a home is their most valuable asset. A HELOC can help you make the most of this asset, when you understand the ins and outs and know what to expect.

# What you should know about Home Equity Lines of Credit (HELOC)

## Ask yourself

- Have I considered other sources of money and loans, besides a HELOC?
- Have I shopped around for HELOC features and fees?
- Am I comfortable with the worst-case scenario, where I could lose my home?

## Online tools

**CFPB website**
cfpb.gov

**Answers to common questions**
cfpb.gov/askcfpb

**Tools and resources for home buyers**
cfpb.gov/buying-a-house

**Talk to a HUD-approved housing counselor**
cfpb.gov/find-a-housing-counselor

**Submit a complaint**
cfpb.gov/complaint

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