

# HOME EQUITY CREDIT LINES



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## INTRODUCTION

Credit lines against the equity in homes have become a popular source of consumer credit. Lenders offer a variety of home equity credit lines.

Most loans come with variable interest rates, some come with low introductory rates, and a few come with fixed rates. You may find most loans have large one-time up-front fees, others have closing costs, and some have continuing costs. Some loans have large balloon payments at the end of the loan.

Review the home equity contract carefully **before** you sign it. Be sure to ask questions about the terms and conditions of your financing.

## IS IT FOR YOU?

If you need to borrow money, a home equity line may be one source. Initially, it may provide you with large amounts of cash at a relatively low interest rate. It may provide you with certain tax advantages unavailable with other loans.

At the same time, home equity lines of credit require you to use your home as collateral. This may put your home at risk if you are late or cannot make your monthly payments. Those loans with a large final payment may lead you to borrow more money to pay off this debt. If you sell your home, you may have to pay off your credit line at that time.

Remember, there are other ways to borrow money, i.e., second mortgage installment loans. Although these plans place an additional mortgage on your home, second mortgage

money is usually loaned in a lump sum, with fixed interest rates and payment amounts.

## HOW MUCH CAN YOU BORROW?

Depending on your credit-worthiness and your amount of outstanding debt, home equity lenders may let you borrow up to 85% of the appraised value of your home minus the amount you still owe on your mortgage. Ask the lender about the length of the home equity loan, whether there is a minimum withdrawal requirement when you open your account, and whether there are minimum withdrawal requirements after your account is opened.

## HOME EQUITY INTEREST RATES

Interest rates for loans differ, so it pays to check with several lenders for the lowest rate. Compare the annual percentage rate (APR), which indicates the cost of credit annually. The advertised APR for home equity credit lines is based on interest alone. For a true comparison of credit costs, compare other charges, such as points and closing costs, which will add to the cost of your home equity loan. This is especially important if you are comparing a home equity credit line with a traditional installment (or second) mortgage where the APR includes more of the total costs of the loan than does the APR in a home equity loan.

## UP-FRONT CLOSING COSTS

When you take out a home equity line of credit, you pay for many of the same expenses as when you financed your original mortgage. These include items such as an application fee, title search, appraisal, attorney fees, and points. These expenses can add substantially to the cost of your loan, especially if you ultimately

borrow little from your credit line. You may want to negotiate with lenders to see if they will pay some of these expenses.

### **CONTINUING COSTS**

In addition to up-front closing costs, some lenders require continuing fees through the life of the loan. These may include an annual membership or participation fee, which is due whether or not you use the account, and/or a transaction fee, which is charged each time you borrow money.

### **TERMS DURING THE LOAN**

As you pay back the loan, your payments may change if your credit line has a variable interest rate, even if you do not borrow more money from your account. Find out how often and how much your payments can change. Determine whether you are paying back both principal and interest, or interest only. Even if you are paying back some principal, ask whether your payments will cover the full amount borrowed or whether you will owe an additional payment of principal at the end of the loan. Ask about penalties for late payments and under what conditions the lender can consider you in default and demand immediate full payment.

### **BEWARE OF “BALLOON” PAYMENTS**

Ask whether you might owe a large payment at the end of your loan. If so, and you are not sure you will be able to afford this “balloon” payment, you may want to renegotiate your repayment terms. When you take the loan, ask about the conditions for renewal of the plan or for refinancing the unpaid balance. Ask the lender to agree ahead of time and in writing to refinance any end-of-loan balance or extend your repayment time, if necessary.

### **SAFEGUARDS AND CANCELLATION**

One of the best protections you have is the

Federal Truth in Lending Act,<sup>1</sup> which requires lenders to inform you about the terms and costs of the plan at the time you are given an application. Lenders must disclose the APR and payment terms and must inform you of charges to open or use the account, such as an appraisal, a credit report, or attorney fees. Lenders must also tell you about any variable-rate feature and give you a brochure describing the general features of home equity plans.

The Truth in Lending Act also protects you from changes in the terms of the account (besides variable-rate features) before the plan is opened. If you decide not to enter into the plan because of a change in terms, all fees you paid earlier must be returned to you.

Because your home is at risk when you open a home equity credit account, you have three business days to cancel the transaction for any reason. To cancel, you must inform the lender in writing. If you notify the lender through the mail, be absolutely certain that your letter is postmarked no later than midnight on the third day. Consider sending the letter by certified mail with a “return receipt requested.” Following that, your credit line must be canceled and all fees you have paid must be returned. If you did not receive the required disclosures when you opened the line of credit, your right to cancel the contract extends for three years from the date you concluded the deal. However, if the lender provides you with the correct required disclosures *after* the deal is completed, you then only have three days from the date you receive the materials to cancel. If you are attempting to cancel a home equity line of credit you should immediately send your written notice and contact the legal office for assistance.

**\*This handout is general in nature. It is not a substitute for legal advice from an attorney regarding individual situations. (August 2021)**

For additional information on this and other legal topics, see the Air Force Legal Assistance Website: <https://aflegalassistance.law.af.mil>

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<sup>1</sup> 15 U.S.C. 1601 et seq. (2010).