HELOCs Poised for **Billions** in **Growth**

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Once left for dead, demand for the home equity line of credit (HELOC) is rising again.[1] Three current trends are elevating HELOCs back to the consumer lending star status they were prior to the Great Recession.

Increasing Home Equity

Homeowners who stayed in their homes during the downturn and made mortgage payments have built up significant home equity. At the same time, rising home values have given homeowners additional equity to borrow against and to meet higher loan standards.

Homeowners with at least 50% equity grew to 9.9 million in Q1 2014.[2]

In some areas of the country, home values have increased dramatically. The number of homeowners with at least 50 percent equity grew to 9.9 million in Q1 2014 (19 percent of all mortgaged properties). This figure grew by 800,000 from the prior quarter. Even properties that were previously underwater are coming around. Approximately 8.5 million properties were set to resurface as of the first quarter of 2014.[2]

When Draw Periods End, Homeowners Will Want to Refinance

Prior to the downturn, HELOCs were relatively easy to obtain. Millions of borrowers used these loans to take vacations, pay for a child's education, and remodel their homes. Cash-out refinancing provided the ultimate consumer alchemy, converting drywall into American dreams. For those who borrowed during those peak years, a postal carrier may soon be arriving with a painful notice.

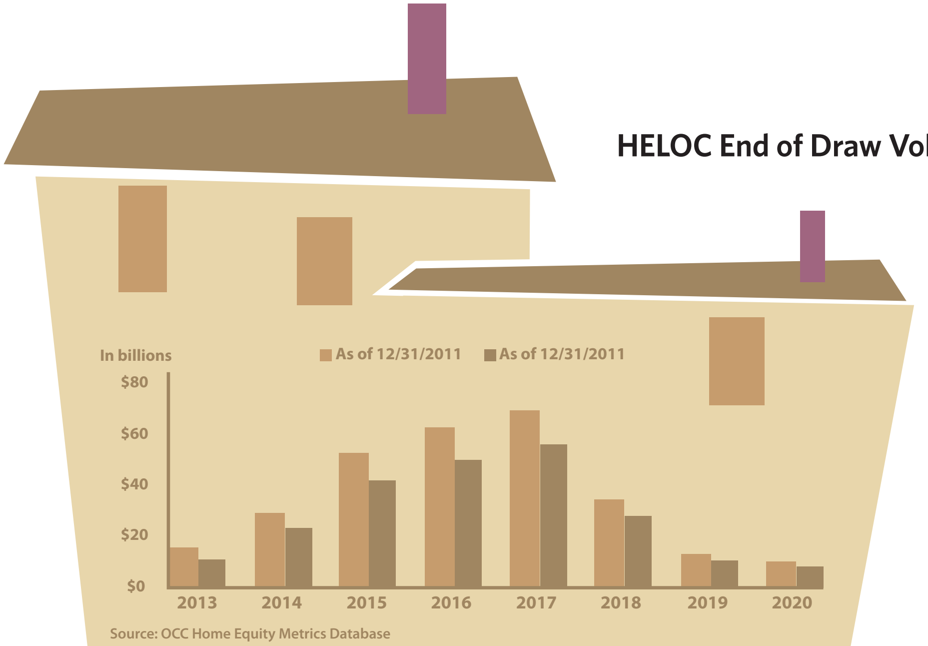
A typical HELOC allows a borrower to draw upon it for 10 years, during which only interest payments must be paid. Once that period expires, borrowers must begin paying both interest and principal. A recent report from the Office of the Comptroller of the Currency revealed the magnitude of the potential opportunity. By 2017, nearly $60 billion in loans will reach the end of their draw periods.[3]

[1] Wall Street Journal, *Home Equity Loans Make A Comeback*, March 8, 2014

[2] Realty Trac, *9.1 Million U.S. Residential Properties Seriously Underwater in First Quarter, Lowest Level in Two Years*, April 15, 2014

[3] Office of the Comptroller of the Currency, *Semiannual Risk Perspective*, Spring 2014

HELOC End of Draw Volume



Source: OCC Home Equity Metrics Database

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In addition, past HELOCs were typically issued with adjustable rates tied to the prime rate. With interest rates set to rise, the rate reset over the next several years may be steep. Current forecasts show rates doubling from current levels to 2018.

Projected Future Prime Rate Values: 2014-2018

	2014	2015	2016	2017	2018
JAN		4.75	4.75	5.50	6.25
FEB		3.75	4.75	5.50	6.25
MAR		3.75	4.75	5.75	6.50
APR		3.75	5.00	5.75	6.50
MAY		4.00	5.00	5.75	6.50
JUN	3.25	4.00	5.25	5.75	6.75
JUL	3.25	4.00	5.25	5.75	6.75
AUG	3.25	4.25	5.25	6.00	6.75
SEP	3.50	4.25	5.25	6.00	6.75
OCT	3.50	4.25	5.50	6.00	6.75
NOV	3.50	4.50	5.50	6.00	7.00
DEC	3.50	4.50	5.50	6.25	7.00

Source: Mortgage-X.com, *Prime Interest Rate Forecast,* July 14, 2014
Based on most recent 1-Mo T-Bill value greater than '0'.

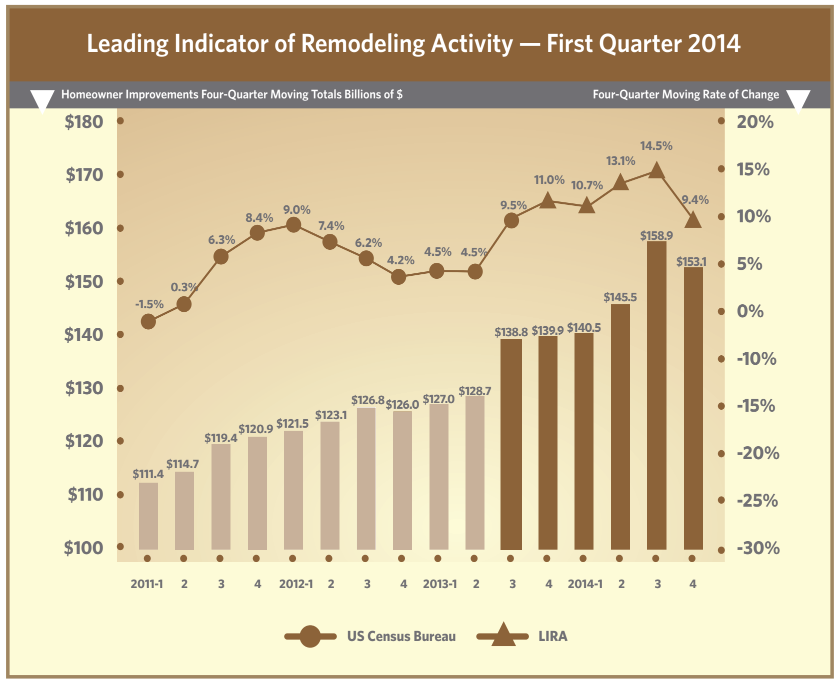
[3] Office of the Comptroller of the Currency, *Semiannual Risk Perspective*, Spring 2014

New HELOC Originations Growing

Homeowners like the flexibility of HELOCs. They provide a revolving line of credit, enabling an account holder to borrow, pay down balances, and reuse the available credit over and over again. HELOCs are also less expensive than personal loans, because they are secured by collateral.

These benefits have generated renewed interest in HELOCs among homeowners. Total second mortgages authorized nationally climbed to an estimated $60 billion last year from a low of $49 billion in 2010.[4] Home equity lending surpassed 2009 levels in 2013, with $111 billion in HELOCs opened.[5]

With real estate markets firming, many of these loans are being used for remodeling in anticipation of selling. Harvard's leading indicator of remodeling activity shows a clear increase in activity since 2011.



Source: Harvard University, Joint Center for Housing Studies. Note: Third and fourth quarter 2013 estimate is based on the Leading Indicator (LIRA) because data collection for home improvement spending by the Census Bureau was impacted by the October 2013 government shutdown.

What's more, HELOC loans used for home improvement may be tax deductible, depending on an individual or couple's personal income and other factors.[6]

[4] L.A. Times, *Owners Again Borrowing Against Homes as Housing Market Recovers*, February 20, 2014

[5] Credit.com, *HELOCs Made a Comeback in 2013*, March 6, 2014

[6] The American Taxpayer Relief Act of 2012 included a provision that phases out both the personal exemptions and itemized deductions for higher income taxpayers. Harland Clarke does not offer tax advice. Information contained within this document does not constitute tax advice. Please consult with a tax attorney.

First Come, First to Lend

The race has already begun to capture this market. Mailings for home equity products increased 38 percent in Q1 2014, according to Comperemedia Mortgage and Loan Trends. Most of the outreach has been to existing customers. Yet, we see a competitive ramp-up among banks for customers in all lending categories, including HELOCs.[7]

This outreach is indicative of changes in technology and risk management that have taken place during the past several years. Using data analytics and predictive modeling, more banks may be in position to cherry-pick potential HELOC customers that may have been overlooked, offering them customized product offers.

With draw periods expiring, millions of HELOC customers will find themselves paying substantially more for the same loan and will want to lower payments.

Financial institutions that haven't been actively pursuing HELOC business may want to give it another look. With home values and home equity increasing, more consumers are looking to increase the value of their homes and to increase their purchasing power after five years of tight budgets and credit freezes. What's more, with draw periods set to expire, millions of current HELOC customers will find themselves paying substantially more for the same loans and will look to lower their payments.

Those who start marketing now — supported by predictive analytics and modeling that helps identify and target consumers shopping for equity loans — will be best positioned to take advantage of the opportunities presented.

[7] Standard & Poors, *A Steep Drop In Mortgage Banking Activity Dampened U.S. Large Regional Banks Results In the Fourth Quarter*, February 2014

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