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Banks Working With HELOC Borrowers To Prevent Potential Loan-Default Disaster Before It Happens

By Kate Cox December 30, 2013

(jbjelloid)

The housing bubble that imploded spectacularly in 2008, taking a big chunk of the U.S. economy with it, has a second wave waiting to strike in the form home equity lines of credit

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(HELOCs). Having learned from the lesson that preventing a disaster rather than recovering from one might, in fact, be a better way to go, lenders — at the urging of regulators — are now working proactively with borrowers to stave off potential doom before it happens.

A HELOC allows homeowners to borrow against the equity built up in their home. Rather than paying out in a lump sum, a HELOC is a line of credit against which a homeowner can draw for a set period of time before entering repayment.

The trick is that most HELOC loans gave a ten-year draw period, followed by a twenty year repayment period–and we're about to hit the end of that initial ten-year period for HELOCs issued during the housing boom.

As the Wall Street Journal reports [it's stuck behind a paywall; sorry], loans issued between 2004 and 2008 will be entering repayment between 2014 and 2018, and quite a lot of money is at stake. The WSJ says that $208 billion worth of HELOCs will be due to start repayment in that four-year span–as compared to $20 billion in 2012 and 2013. That is indeed a tenfold increase.

Bank of America and Wells Fargo are the two largest HELOC lenders in the country, and HELOCs make up approximately 10% of loans at each of those banks. At urging from the Office of the Comptroller of the Currency (OCC), which oversees banks, and hoping to prevent a large wave of defaults in the coming years, the two megabanks and some other lenders are proactively offering refinancing opportunities to some of their borrowers.

The idea is that since interest rates are currently very low, it's a good time for borrowers to consolidate debt at a rate that will be easier for them to repay in the future. The challenges, though, are twofold. The first is that for a refinance to be viable, the home needs to be worth more than the mortgage

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For borrowers who saw their home values plummet in the last few years and who still have so-called underwater loans, the strategy won't work. The second complication is that lending standards have gotten significantly tighter over the past few years, and someone who qualified for a loan in 2007 might not qualify again in 2013.

For customers who do qualify, though, banks are reaching out as much as three years before the end of the draw period to offer refinancing deals, and sometimes even discounts. Will enough of that outstanding $208 billion be refinanced and repaid to prevent rocky times in the next few years? Only time will tell.

A Home Loan That Could Bite [Wall Street Journal]

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