Resetting bubble-era HELOCs could spell trouble

By Victor Whitman

In the lead-up to the recession, millions of people drew out equity from their homes to pay credit cards and do home improvements. These people soon could be paying a higher price for their borrowing when a new wave of home equity lines of credit (HELOCs) resets with higher monthly payments, according to a new study from RealtyTrac.

Roughly 3.3 million HELOCs are going to reset between this year and 2018, the company estimated. When they do reset, homeowners will have to pay higher, full-amortizing monthly amounts where they have been paying interest only with the typical HELOC.

What's worse, the company says, is that more than half of the HELOCs due to reset, or 1.8 million, are attached to properties that are seriously underwater in value. In other words, the total indebted amount is 25 percent or more higher than the current value.

Daren Blomquist, vice president of RealtyTrac, said underwater homeowners could have a hard time refinancing out of the HELOCs and could potentially run the risk of defaulting when the higher monthly payments hit.

"We are entering a period of higher risk over the next four years when it comes to resetting bubble-era HELOCs, especially given slowing home price appreciation that offers underwater homeowners less hope of recovering their equity in the short term," Blomquist said in a news release.

California has the highest number of resetting HELOCs at more than 400,000, followed by Florida, Illinois, Texas and New Jersey, RealtyTrac said. One California lender, however, doesn't foresee a potential crisis coming.

Matt Ostrander, chief executive officer of Parkside Lending in San Francisco, said that banks hold HELOCs in their portfolios and have no incentive to default on borrowers who have been paying the interest. A HELOC is not a loan, but a credit line that people can draw from or let sit unused. He noted that HELOCs were exempted from new federal ability-to-repay requirements, so banks can be flexible in modifying them.

"[HELOCs] are like a credit card in a way, but a gigantic credit card," Ostrander told Scotsman Guide News. "People pay those credit cards because they don't want their credit to be destroyed. What my guess would be is that this won't cause a crisis. This would just cause a refi or a modification wave for banks that hold those in their portfolios."

Ostrander also said the numbers of new HELOCs could start to rise as people gain equity in their homes. Typically people refinanced at low rates two years ago, he said, and HELOCs provide an opportunity to draw equity without modifying the primary loan.

As of the third quarter of last year, the total HELOC exposure for banks totaled $913 billion, of which $496 billion was outstanding debt and $417 billion was in unused lines, according to a January report from Keefe Bruyette & Woods that cited Office of the Comptroller of the Currency (OCC) figures. Although noting that credit quality of HELOCs had improved with the recovery, the company also warned of a potential payment shock on borrowers when the bubble-era HELOCs reset. It estimated that on a typical $50,000 HELOC with an interest rate of 3.25 percent, the average monthly payments would jump to $351 from $135, an increase of $216.

RealtyTrac estimated that the average homeowner will have to pay an additional $146 a month after a 10-year period of interest-only payments ends.

Blomquist noted that a wave of HELOCs reset in 2014 without many defaults. "The bad news is that a much lower 40 percent of those 2014 HELOC resets were on seriously underwater homes," Blomquist said.

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