Tame your out-of-control equity line of credit

by Lynn O'Shaughnessy

If you owe money on your home equity line of credit or if it feels like you have a gazillion payments left on an adjustable rate mortgage, you are probably feeling the pain of higher interest rates.

Perhaps you obtained your loan when lenders were bragging that rates hadn't been so low since the Cuban missile crisis. Unfortunately, the killjoys swept up the confetti many months ago.

Yet many homeowners are surprised at how quickly their once-great loan packages have turned into aching charley horses. Someone who snagged a home equity line of credit with a 4 percent interest rate in 2004 could now be making payments with a rate that's doubled.

Not surprisingly, interest in refinancing has dropped as the rate miasma has repelled shell-shocked homeowners. But bunkering down in your overpriced tract home and adopting an attitude of abject hopelessness won't necessarily be your best strategy. In some cases, you'll be able to shrink your monthly payments so that you'll be able to fill up the tank of your SUV.This column provides strategies for those who have home equity lines; next time, I'll tackle the issue of refinancing a mortgage.

If you've got an out-of-control equity line, here's what you might want to do:

- Find a better home equity line of credit. Admittedly, many of you may rightly be perplexed about how you can locate a more attractive line of credit in this environment. These credit lines are tethered to the prime rate, which is currently at 8 percent. When the prime rate rises, financial institutions quickly tighten their customers' tourniquets. I wonder if some bankers must skip their morning detour to Starbucks to make sure the home-equity rate hikes are implemented before the next day's rush hour begins.

What distinguishes all these credit lines is each one's starting position. If you obtained a line of credit a while ago, your rate is probably tied to a formula that adds one or two percentage points to the base prime rate. So if your line of credit requires you to pay "prime plus one," your rate today would be 9 percent.

What is vastly preferable are credit lines that have positioned their starting gate farther back on the track. You should look for credit lines that offer a rate that remains a half or even three-quarters of a percentage point below the prime rate. To illustrate what a difference this can make, I plugged into a calculator a $75,000 balance that the owners aim to pay off in 10 years. If the line was shackled with a 9 percent interest rate, the monthly payments would be $950.07. But if the rate were 7.25 percent, the payments would drop to $880.51.

Why are home equity credit lines more attractive today? Chalk it up to competition. With the refinancing boom now more of a bust, lenders need loans with pizzazz to bring back the crowds. Not everyone, however, will qualify for one of these primo deals. You won't have a chance if your FICO credit score isn't at least 720. A request for a megaloan amount will also be a deal buster. Lenders reserve their finest offers to those who request a line that doesn't exceed 80 percent of the home's value minus the outstanding mortgage.

- Check credit line features. It can be nerve-racking having your household budget tied to a variable rate you can't control. The phenomenon reminds me of the dream in which you want to scream as your car flies off a cliff - substitute your own personal horror - but you've lost your voice. One way to address the helplessness is to obtain a credit line that allows you to lock in a fixed rate at any time. If you're interested in locking in the rate on the debt you've accrued, you'd call the lender and find out what the rate conversion would be. A credit line from JPMorgan Chase, for instance, allows a borrower to lock and then relock the rate five times during the first 10 years. With this feature, you won't be stuck with an outdated higher payment if rates go down.

- Think twice before rolling your credit line into a mortgage. Some homeowners with credit lines are seeking relief by rolling their debt into new 30-year fixed-rate mortgages. This may be a shrewd move by some, but for others it makes no sense. Before embracing this idea, you need to evaluate whether you really want to relinquish your current home loan. If you swap your old loan for a new one, you will undoubtedly get slapped with a higher interest rate. Do you really want to surrender a fixed 30-year loan with, say, a 5 3/8 percent interest rate for one that's 6 1/2 percent or higher? Probably not.

Something else to think about is the length of your indentured obligation to your lender. Every time you refinance a 30-year loan, you roll back its time schedule to three decades. If your home loan is tied to an adjustable rate and you want to refinance into a fixed loan, adding your home equity debt could be a wise decision.

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