HELOC end-of-draw analysis

Managing risk and anticipating consumer behaviors

An Experian perspective

Table of contents

HELOC end-of-draw analysis

The tale of housing and end of draw

The financial stakes are always high when it comes to housing. While the mortgage meltdown tied to the Great Recession has passed, the peak of loans originating during that housing bubble continues to be monitored and assessed.

Home-equity lending was hot during the housing boom, but lenders pulled back sharply as home prices tumbled. It has re-emerged as home values have recovered, but the end of draw still trails — and trends are now emerging around consumer behaviors and repayment.

Whether you are a lender seeing a peak in end-of-draw consumers within your portfolio or a financial institution with consumers with home equity lines of credit (HELOCs) from other players in the marketplace, understanding the peaks and valleys of end of draw is essential. This paper assesses spikes in end of draw and trends attached to originations and delinquencies, as well as consumer repayment behavior patterns associated with end of draw.

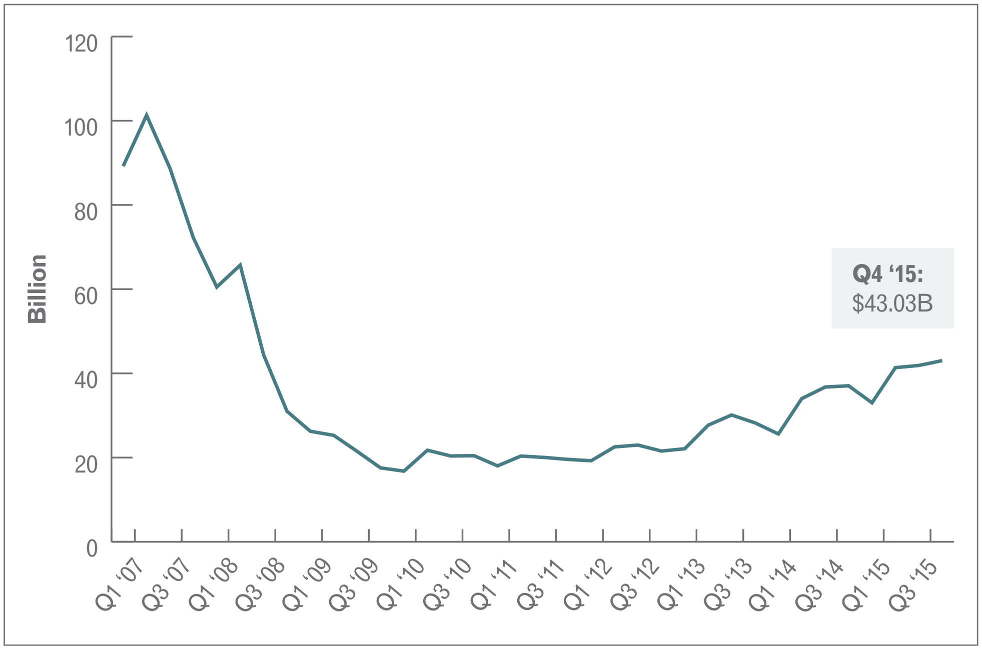
Home equity line of credit overview

Home equity lines of credit, commonly referred to as HELOCs, are loans extended for a certain dollar amount and term. The HELOC uses borrowers' equity in their home as collateral for the loan. HELOC loans generally are extended only to super-prime and prime borrowers who have enough equity available in their home (in Q4 2015, 94 percent of HELOC originations were made to prime/super-prime borrowers).

Homeowners taking out a HELOC leverage their home equity, typically in order to fund major purchases (home improvement, college expenses, etc.). The base structure of a HELOC is an initial period of time in which the consumer can draw from the line of credit. The home equity line of credit is available to the borrower for a fixed term, usually between five and 25 years. Typically borrowers will make minimum payments across the term of the loan (sometimes interest only). At the end of the HELOC term, the loan enters a repayment program. That repayment may be structured over time (amortized) or due in one lump sum (balloon payment).

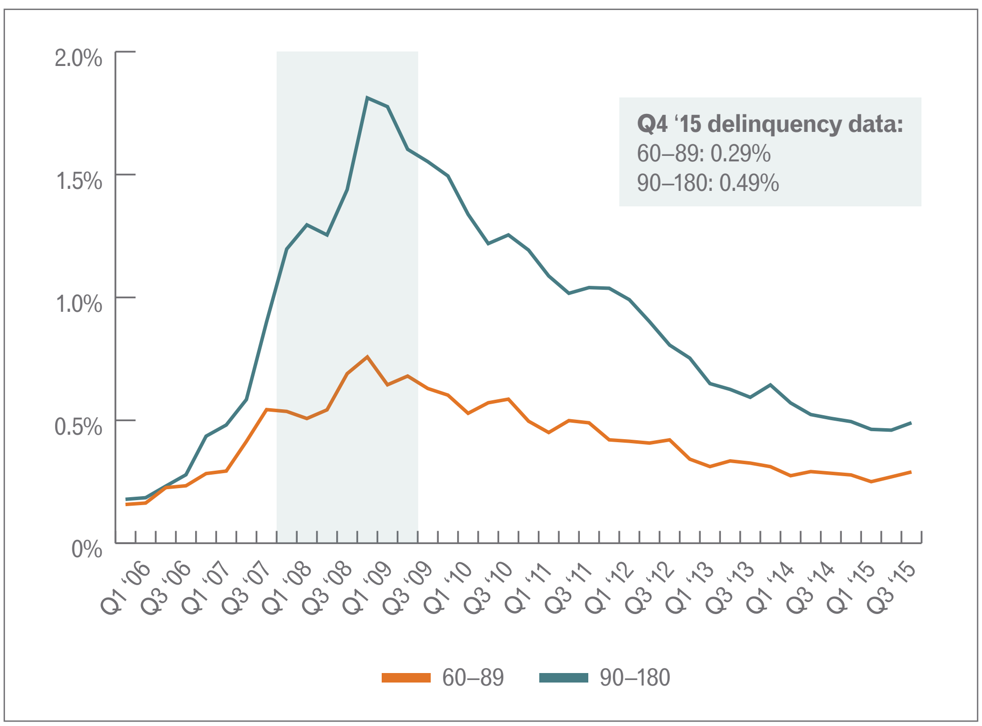
HELOC origination rebound post-recession

The top chart on page 2 shows the origination trend for home equity lines of credit on a quarterly basis from 2007 to 2015. As illustrated, HELOCs saw a big decline during the recession, since many borrowers had little to no equity. Since 2010, however, there has been an increase in HELOC originations as home prices have rebounded in many areas of the country. As of Q4 2015, originations are up 111 percent to \$43.03 billion from \$20.44 billion in the same quarter in 2010.



HELOC delinquency trends

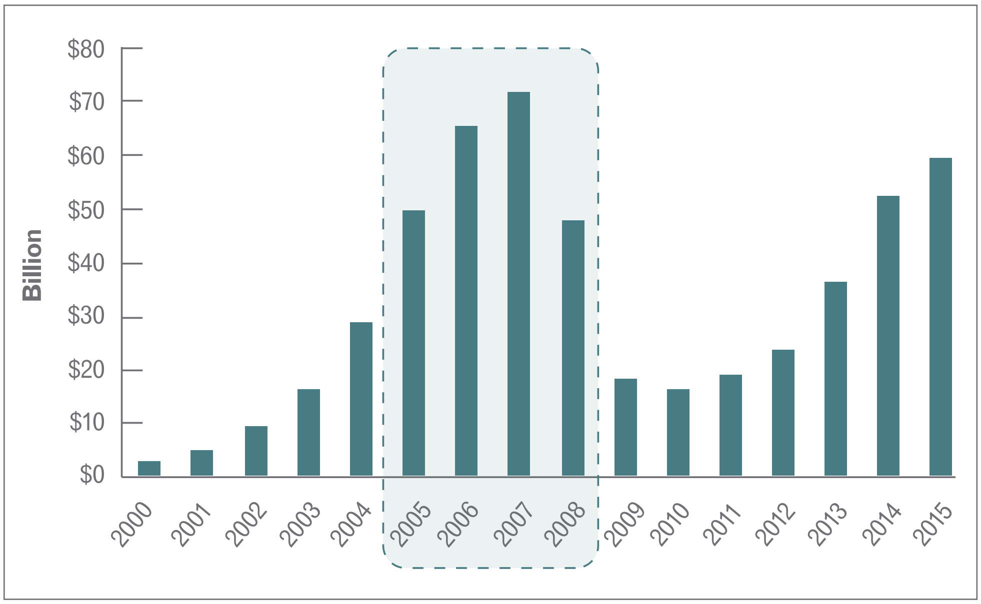
Similar to other products, delinquencies associated with HELOCs have come down from the high levels in 2009. The market is now near pre-recessionary levels of delinquency. The chart below shows both 60-to-89-day and 90-to-180-day delinquency rate trends from 2006 through 2015.



HELOC end-of-draw analysis

HELOC end-of-draw spike

The chart below illustrates the large volume of outstanding loans that originated from 2005 to 2008. The majority of the loans that originated prior to 2005 are in the repayment phase (as can be seen from the lower number of dollars outstanding). The HELOCs that originated from 2005 to 2008 constitute $236 billion in dollars outstanding. This group of loans is nearing the repayment phase. This analysis examines what will happen to these loans as they enter repayment, and what will happen to these consumers on other loan products, in the next section.

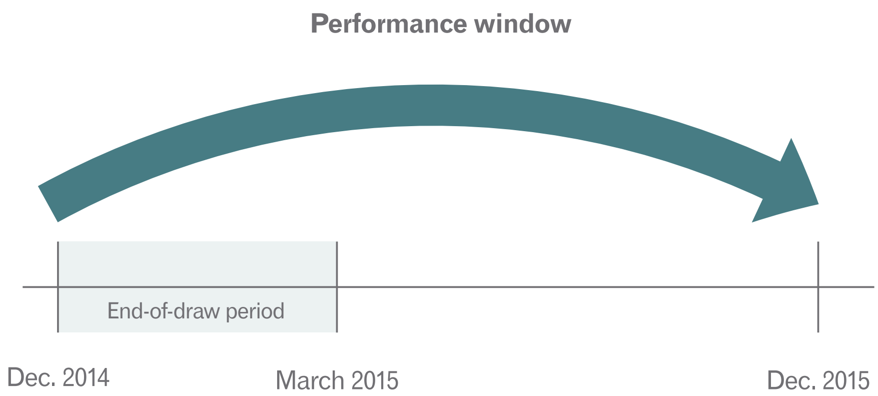


HELOC analysis methodology

In order to better understand the impact of HELOCs at end of draw, Experian® conducted a study.

The first step of the analysis consisted of identifying consumers who reached end of draw on their HELOC. HELOC end-of-draw behavior was classified in two ways:

- The first population identified as end-of-draw consumers are those revealing a large shift in their payment (20 percent or greater) between December 2014 and March 2015. This large shift signifies these consumers are now in the repayment phase (making payment on principle, not just interest). Experian eliminated consumers with a large balance increase over the same window to ensure only individuals in repayment on their HELOC were captured.
- The second end-of-draw population included consumers with a new special comment on their HELOC identifying them as "in repayment."



HELOCs at end of draw were accounts that had either:

- A payment increase of 20 percent or greater (and no balance increase) between December 2014 and March 2015, or
- A special comment code submitted by the lender indicating the credit line is no longer available as of March 2015

Account performance was reviewed from December 2014 through December 2015.

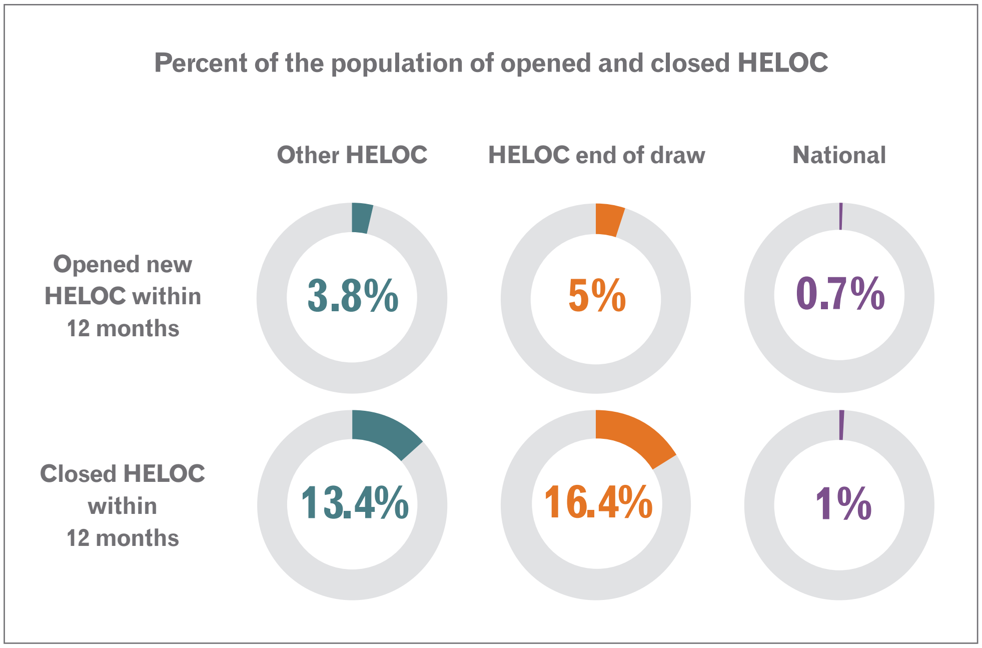
Once the analysis populations were identified, Experian reviewed consumer performance following HELOC end of draw (through December 2015). Consumers meeting the end-of-draw classification were compared to the consumer population that had a HELOC not classified as end of draw (i.e., one that did not have a payment change of greater than 20 percent or a new special comment indicating they hit repayment). These groups were evaluated to see if they were more or less likely to open or close a HELOC or other credit product. Additionally, they were analyzed for risk performance on their HELOC and other credit products, as laid out in the following sections.

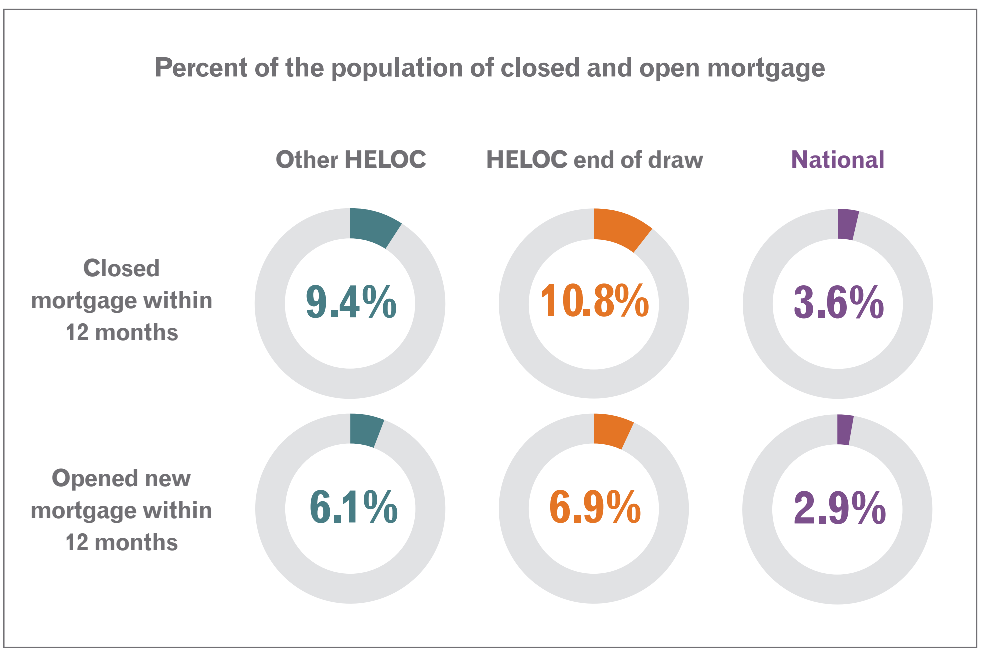
Are HELOC end-of-draw consumers more likely to open or close other loans?

Findings revealed that consumers with a HELOC at end of draw were more likely to both close and open other HELOC trades in the next 12 months. They also were more likely to open or close a mortgage in the next 12 months.

Other trade types (auto, bankcard and retail) were evaluated, but no significant shift was seen in open/close rates when comparing the end-of-draw group with the group with a HELOC not in the repayment phase. What can be seen is that consumers with a HELOC are more likely to close and open other trades, regardless of the HELOC end-of-draw status.

HELOC end-of-draw analysis

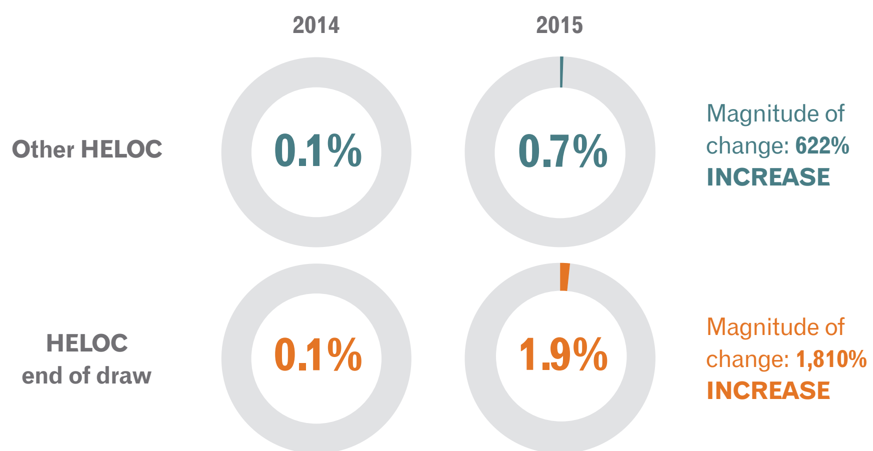




Evaluating risk performance

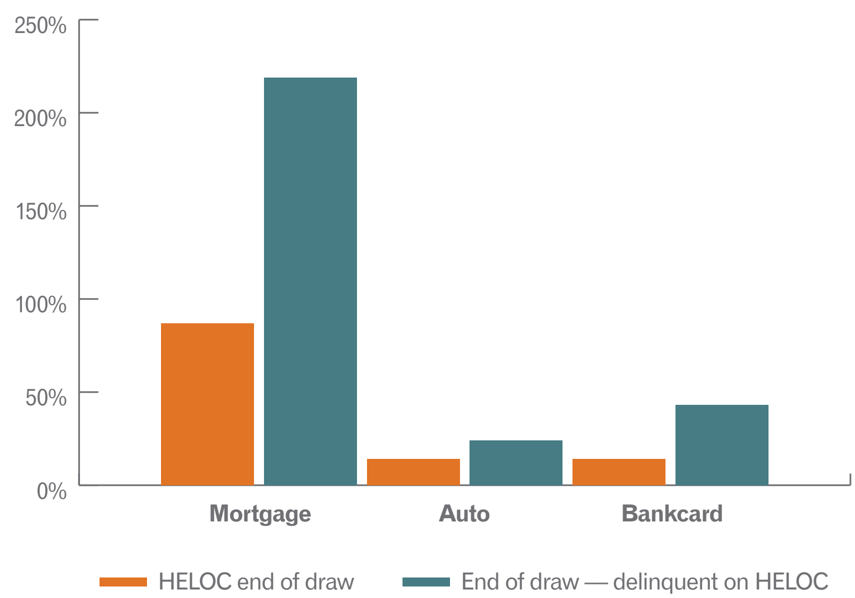
The next evaluation looked at the downstream risk impact for the population with a HELOC at end of draw. That particular group had a significant increase in bad rates on their HELOC trade — 90 days past due (DPD) or worse — compared with the population that had no HELOC at end of draw over the performance period.

Percent of the population of opened and closed HELOC with delinquency



Lastly, consumer performance was assessed to see if the risk associated with the HELOC trade impacted other kinds of credit. Findings revealed consumers who were delinquent on their HELOC also were more likely to be delinquent on other trades (see the chart below).

HELOC end of draw and delinquency relationship to other loans or debt

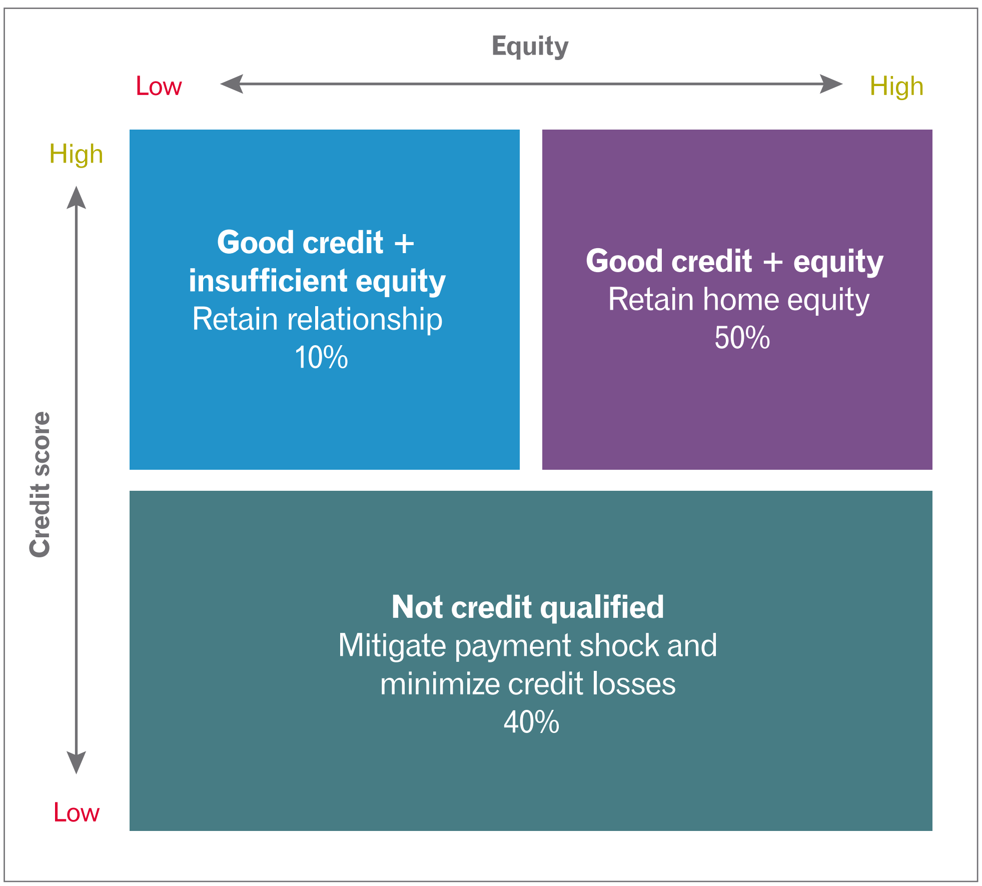


HELOC end-of-draw analysis

Targeted solutions for every HELOC end-of-draw consumer

It is important to understand where consumers sit when they are nearing end of draw, both from a credit and equity perspective, to determine the best account treatment. The picture below describes a simple segmentation schema that looks at both credit score and equity. By segmenting the population, lenders can identify consumers who may no longer be credit qualified and can in turn work to mitigate payment shock, identifying opportunities to retain those with the best credit quality.

- **Consumers with good credit but insufficient equity (blue box):** Lenders can work with borrowers to extend the terms or provide payment flexibility.
- **Consumers with good credit and sufficient equity (purple box):** Lenders can work with borrowers to refinance into a new loan, providing more competitive pricing and a higher level of customer service.
- **Consumers who are not credit qualified (teal box):** A loan modification and credit education program might be best to assist borrowers in understanding any upcoming payment shock while minimizing credit losses.



Understanding consumer payment stress as a result of HELOC, whether you hold the loan or not

Further segmentation can be done with additional credit attributes to identify customers who have a HELOC with another company and might be nearing end of draw. This can help lenders understand which members may be coming into a possible payment shock situation.

Identifying if a borrower has a HELOC and if that HELOC is nearing end of term — as well as key characteristics about the loan (balance, payment, etc.) — is important so lenders can determine potential payment stress that may impact any other credit products (bankcard, auto, retail).

Consumers who have the ability to pay also may be a potential opportunity, as they might seek another HELOC as their loan comes to the end of the term or they may shop for other credit products, such as a personal loan, during that period of time.

Whether you are a lender seeing a flood of end-of-draw consumers surface within your portfolio or one that may have consumers with HELOCs on someone else's books, these findings illustrate the need to monitor your portfolio and manage consumer behavior tied to end of draw proactively. Repayment and loyalty success could mean all the difference.

Advise end-of-draw consumers to review their repayment requirements, and provide options they may want to consider as they navigate a payment increase.

The Experian difference

Experian is the leading global information services company, providing data and analytical tools to clients around the world. We help businesses manage credit risk, prevent fraud, target marketing offers and automate decision making. Experian supports clients across many different markets, including financial services, retail, telecommunications, automotive, insurance and the public sector.

Contact us to learn how Experian's industry-leading credit and marketing information, expert analytics and consulting can help you identify profitable new customers, segment existing customers according to risk and opportunity, manage loan portfolios, and undertake effective collections actions while detecting and preventing fraud.

Contributing authors:

Kelley Motley, Joyce Hwang, Clara Gharibian

1 888 414 1120
www.experian.com

Experian
475 Anton Blvd.
Costa Mesa, CA 92626
T: 1 888 414 1120
www.experian.com

A world of insight

07/16 • **1224/2980** • 7669-CS