HELOCS On The Rise, A Cautionary Tale

by Steve Brown

The wellness industry has mushroomed in recent years as more and more people are looking for healthy and safe ways to relieve the pressures of their daily lives. There has been a growing interest in massage therapy, personal training, acupuncture, Tai Chi, Reiki, aromatherapy and other stress-reducing techniques as people seek to beat stress.

Just as the wellness industry has experienced a resurgence, some banks are seeing a renewed interest in home equity lines of credit and home equity loans. In total, HELOCs underwritten in Q1 this year climbed 8% to $13B from a year earlier, according to published reports. While HELOC origination levels are still well below what they were in their heyday, the increase is notable nonetheless.

Also of interest is a recent study from Pepperdine University which found that home equity lines of credit are playing a more significant role in financing lower middle market business M&A deals this year. In fact, HELOCs were used by buyers to finance 17% of small business deals ($2mm to $5mm in size) and also 17% of deals between $5MM and $50MM. Both were $0 for the same period in 2013.

For both small business owners and home owners, it is likely HELOCs will continue to grow as a source of funding given a rebounding economy. Done the right way with the right level of controls in place, HELOCs can also represent a growth opportunity for community banks.

Given the risks, larger banks have taken steps to protect themselves in this lending sector. For example, Wells Fargo recently said it would only offer interest-only HELOCs to customers with at least $1mm in savings and other liquid assets, while other customers would have to pay principal and interest on such loans. Given the size of Wells and its influence, we would expect other banks to follow suit.

To protect yourself in this sector, be sure all i's are dotted and t's are crossed. In underwriting floating rate loans, whether for HELOCs or in other sectors, it is important to assess whether potential borrowers will be able to meet the obligations of their loan, both rising interest payments and the repayment of principal in a rising interest rate environment. Loans should be structured according to the credit worthiness of borrowers with the future rate environment in mind. Banks may decide that new HELOCs should be extended only to select high-caliber borrowers with good-to-excellent credit scores and low debt.

In addition to careful assessment for new underwriting, be sure to consider the risks from HELOCs that are already outstanding and to assess any flow-through impact that could occur from problems within the portfolio. Regulators are well aware that a sizeable chunk of outstanding HELOCs were originated at the height of the real estate bubble and that the reckoning time has come for many borrowers to start paying down principal. Additionally, those loans with a floating rate structure should be assessed for the borrower's ability to withstand an increase in interest payments. Regulators have just released new Interagency Guidance on the subject and have outlined specific risk management practices that should be undertaken for existing HELOCs that are approaching their end-of-draw periods.

In the meantime, if you are looking for rest and relaxation in a safe environment in these last days of summer, there are numerous spas from which to choose. You don't have to get acupuncture to relax, but as with deciding which loan sector to expand, your wellness options can vary with some offering pain and others a more pleasant experience. Be sure to adequately prepare before jumping in.

BANK NEWS

Heavy Borrowing

Dealogic reports banks and other financial companies have issued $391B in debt this year so far, up 32% from the same period last year. New regulations, stronger financial health and lower yields are driving much of the action.

QM

A survey by FNMA finds 80% of lenders say they will only make Qualified Mortgage (QM) loans due to the risk of non-QM loans and 85% said regulations had increased their costs.

Ban Coming

The New York Times has reported that PricewaterhouseCoopers is close to announcing an agreement to pay $25mm and have one of its consulting units banned from taking certain assignments from New York regulated banks for 2Ys. The action stems from an investigation by the NY financial regulator into misconduct it reportedly should have surfaced related to work it performed for Bank of Tokyo-Mitsubishi and money movement to sanctioned countries such as Iran.

Competition

H&R Block has launched a new service focused on providing consulting, bookkeeping, payroll and tax services to small businesses. Block provides a scanner to customers that automatically uploads documents and integrates with the H&R Block bookkeeping system.

Biz Lending

The Wall Street Journal reports that FDIC data shows that as of Q1, banks held $585B in loans to small businesses, or about 18% below the peak of $711B in 2008. Meanwhile, the number of loans $1mm or smaller held by banks is down 14% since 2008.

Changing Behavior

A study by Deloitte finds 33% of smartphone users no longer download any apps in a typical month (vs. just 20% last year) and 90% of people said they never spend money on apps or other smartphone content.

Customer Needs

A Gallup poll finds 44% of investors use a dedicated financial advisor, 29% will talk to a friend or family member and 20% use a financial website when planning for retirement or getting investment advice.