HELOCs vs. Personal Loans - Transcript

Tom Mullooly: In episode 165 we talk about kicking the can a little further down the road. Stick around for this one.

Welcome to the Mullooly Asset show. I'm your host Tom Mullooly, and this is episode number 165, thanks for tuning in.

Article that we saw recently in the Los Angeles Times talked about HELOCs, home equity letters or home equity lines of credit are so 2007, and it really got us thinking about home equity loans and personal loans. And a couple of interesting points that I wanted to share from the article. Home equity loans doubled in volume between 2003 and 2006, that's definitely what a bubble looks like. In fact, home equity lines of credit were 5% of all, all bank assets 10 years ago in 2009. Now it's just about 2%. In fact, if you go back again, 10 years, 10% of all households in the United States, that's an incredible amount of numbers, 10% of all households in the United States had open home equity lines of credit. Today, that number is more like 4%. So here's the thing with mortgages and home equity lines of credit and things that people we never really talk about.

So I'm going to help share a few things with you that you need to know if you're considering refinancing a mortgage or a home equity line of credit. A 30 year mortgage, the rate that you get, it's often going to be fixed, but you can get a variable rate. If you're looking to refinance, you can get a good idea by looking at the 10 year treasury rate. That'll give you an idea of the neighborhood or the ballpark where the rates are going to be. So mortgage rates are tied to a 10 year investment, but home equity lines of credit or home equity loans, are based off of the fed funds rate. Now the Fed meets a couple of times a year to determine where they're going to set the fed funds rate. That's a short term rate, so it's based off of the fed funds rate and off of that is the prime rate.

So, that's where home equities are really based off. It's very, very different. Because now you can look at the mortgage market and you're going to see some rates today, we're recording this in November of 2019, you can get some rates into threes a lot in the 4% range or low fours. Home equity lines of credit and home equity loans, remember, they're based on prime plus a factor. So right now prime rate is 4.75% so, if you're getting a home equity loan and it's prime plus two, that's 4.75 plus two and whenever the primary changes, guess what your rate changes too.

But the story in the LA Times said that home equity lines are not as popular anymore and they're losing out to online lenders, people, these businesses that are making unsecured personal loans. And that's a very, very different market. I really wonder if they're comparing it correctly because let's look at a few things.

Personal loans, they're unsecured, meaning that they're not backed by a car or a boat or a home. You can get your money in a day or two. So in some ways they're kind of like borrowing off a credit card or what they used to call the payday loans. And the rates that you'll get on a personal loan, especially since it's unsecured, remember a secured loan, if you don't pay, they can just take your car away, right? But if it's an unsecured loan, you're going to have rates that are higher than what you'll find on a home equity line of credit.

Now these home equity loans, very different in the sense that it's actually considered something like a mortgage. There's an application process and that can typically take over a month, 45 days. It takes a while. You also have to get an appraisal and I think that's a big part why home equity loans are going away is because the appraisal has to be real and there has to be equity in your home. Not everybody has the equity after what happened 10 years ago in the housing market. Home equities will have a variable rate because it's tied to the fed funds rate and prime rate. And of course, you know one of the risks if you don't pay your home equity loan is you could lose your home. That's a really big risk.

But another big point that the article in the Los Angeles Times missed completely is that under the new tax law, the 2017 Tax Act, the deductibility for interest on home equity loans is a lot less than was previously permitted. So I'm wondering when I'm looking at this article, and we kicked it around here before we turned on the cameras, are we really comparing apples to apples or is it something different?

The amount that's borrowed in personal loans, these unsecured personal loans, likely not going to reach the levels that we're going to see that we had in home equity lines of credit. That's really going to be an issue. If you're going to start a business, it sure would be great to say, hey, I went to the bank, I re-mortgaged my house, and now I have a line of credit for $100,000 that I can draw off of. That's actually something you can start making plans with. These payday loans, these unsecured personal loans, they're for small amounts. Right now because of the internet, people can do a credit check on you very, very quickly. They can look at your income, look at your job history, and they can say, hey, without risk, we can make a loan for $5,000 or $7,500 to this individual. So it's going to be vastly different numbers and different scenarios.

But here's the point we want to make with both of these. If you're borrowing on an unsecured personal loan, if you're taking out a home equity loan for something, or even if you're borrowing from your retirement plan at work, there's usually an underlying symptom. This is a real problem. The underlying symptom typically is you're spending more than you're taking in and it's a little uncomfortable to talk about. No one really likes talking about this, but it's a real fact in 2019, there's plenty of households that are spending way more than they're taking in. By taking out these loans, you're taking on another payment and all you're doing really is you're just kicking the can further down the road. You're not really fixing the problem.

If you're in a situation like that or if you know someone's in a situation like that, get in touch with a financial planner. They can at least take a look at your cash flow and get you set on a better course. That's going to wrap up episode 165 thanks again for watching.