Finally there are signs of life in the home equity line of credit, but a Novantas survey shows that a multi-faceted effort will be needed to revive the business. After an extended post-recession era of painful contraction, the home equity line of credit business is finally showing more signs of life. But will all lenders see a revival in both volumes and profitability? The answer is not as clear as many retail bankers might hope.

On the bright side, a recent two-year spike in origination growth eventually may pay off handsomely for the industry, given that this type of surge preceded hefty balance expansion 10 years ago. Property values are rebounding along with the job market, fostering an increasingly positive context for family borrowing.

However, current progress is still being restrained by payoffs and write-offs of residual recession-era credits, which caused net balances to again shrink in 2014, by 3.4%. Large banks with nonperforming HELOC loan ratios of at least 1.5% mostly accounted for the contraction, while a pool of smaller, less encumbered lenders managed to eke out some progress.

Meanwhile the pool of eligible borrowers is smaller going into the next expansion phase, and credit line utilization has lately slumped a bit. Also recent Novantas consumer research raises questions about the ultimate usefulness of some of the accounts being aggressively sold in the branch, and about the level of bank responsiveness to various accountholder groups, which view and use the HELOC quite differently.

In combination, these factors have left many institutions running in place. Account growth may look good in contrast with the recent rock-bottom, but balances are either growing with only weak profitability or not growing at all (Figure 1: Modest Outlook for HELOC Balance Growth).

The situation reinforces the point that banks will need to make a multi-faceted effort to revive the HELOC business. As highlighted by the Novantas 2015 HELOC Consumer Survey, many banks face three major performance challenges:

Marketing and sales. The HELOC product typically is over-pushed in the branch and to affluent segments, fostering idle accounts and raising questions about sales incentives. Elsewhere digital opportunities are lost through insufficient attention to online channels. Meanwhile many new customers remain uncertain about the range of applications of this type of credit, limiting its usage.

Product design. Many potential borrowers would respond to additional flexibility in financing projects, for example,
converting a HELOC-funded appliance purchase into a fixed-rate installment loan. Meanwhile banks need to revise fee and usage provisions to help them cope with the expense of maintaining a growing mountain of unused accounts.

**Pricing.** Recent Novantas consumer research highlights the need for differentiated pricing strategies — online vs. branch channels; with customer segments; and with credit usage scenarios (e.g., steady borrower vs. rare contingency). Overall, improved pricing skills are needed to drive volume in high-value segments while safeguarding margins.

**CUSTOMER PERSPECTIVE**

To flesh out the customer perspective, Novantas conducted a national consumer survey that included established HELOC customers, recent purchasers and prospects (Sidebar: HELOC Survey: By the Numbers).

Parsing current customers by frequency of draw and balance carry, one growth challenge became clear — more than a few people are holding accounts with no specific borrowing purpose other than standby credit. Comprising 14% of the survey set, these “Emergency Only” account-holders seldom use their home equity lines of credit, which are mostly originated for contingency use only. Even when lines are drawn upon, these customers try to quickly retire balances, with no intention of further borrowing (Figure 2: HELOC Customer Segmentation).

Many of these accounts are originated in the branch, fueled by cross-sell efforts with affluent checking customers. Reflecting the limitations of “push” sales in the branch, among survey respondents who said they had not been considering a HELOC but opened one anyway at the suggestion of the bank, fully 30% said they never use their lines. One implication is a need for a better customer dialogue on borrower intentions and purposes.

Also banks should be considering which pricing and fee levers would help to address these effectively dormant emergency accounts, which, with new liquidity and capital charges, are even less profitable. While utilization among emergency users is low, so too is price sensitivity, with implications for the terms under which this type of backup credit is provided. For some banks, modest fee provisions may be appropriate for accounts that sit unused for extended periods of time.

A different set of priorities apply to the “Revolver” customer segment. Comprising 28% of the survey set, these HELOC customers draw regularly on their lines, evocative of a credit card relationship, and generally carry significant balances. Generally profitable relationships, these tend to be younger borrowers with mixed credit ratings. Their financial

**Figure 1: Modest Outlook for HELOC Balance Growth**

The home equity line of credit outlook is a combination of robust origination growth on a lower base with continued older HELOC runoff and writeoff.
frame of reference tends toward cash management, which presents a different set of possibilities for marketing, product design and cross-sell.

Revolvers shop the product before buying and use more online research, shifting more emphasis to the web and mobile experience. Survey respondents from this segment expressed more confidence that they got a good rate, reflecting price sensitivity, yet from a bank perspective this discount orientation must be balanced with solid-but-less-than-perfect credit profiles that call for somewhat higher risk-adjusted pricing.

In a framework that considers borrowing frequency and balance carry, “Pay-Downs” comprise the smallest segment, about 8% of the survey set. These are people who have either worked down previous large balances or taken only modest draws over the life of the account relationship.

Largely derived from older customers and more stable households, these account relationships at best are only modestly profitable. Building awareness of non-housing-related HELOC uses, such as college tuition and auto finance may help, but the larger opportunity may be expanding other aspects of the banking relationship.

Finally, the heart of the traditional HELOC business revolves around “Periodic Borrowers” — 50% of the survey set. These are customers who carry higher balances, typically used for major home renovations but also for event-related needs such as emergency repairs, replacing major appliances or perhaps replacing a car. They represent a mix of older and younger borrowers and are profitable accounts.

In marketing, product promotion and sales, banks often act as if Periodic Borrowers comprise 100% of the accountholder base, when in fact they do not. This has extensive implications, but for the purposes of this article suffice it to say that segment-tailored strategies increasingly will be needed to rebuild the HELOC business, both in customer acquisition and to optimize various categories of accountholder relationships.

THREE PRIORITIES
Considering the various consumer profiles and behavioral patterns illustrated by the Novantas survey, banks should look to improve HELOC performance in three areas:

Marketing and sales. While the survey clearly shows that the branch continues to play a major role in attracting new accounts, the online space is having more influence on product research, particularly with younger customers.

Figure 2: HELOC Customer Segmentation

Periodic Borrowers come first to mind with HELOC, but may constitute only half of the customer base. To make the most of the business, it is important to understand the full range of customer profiles.

Pay-Downs (8%)
Margrily profitable. Includes people who have worked down prior large balances or who never borrowed much. May respond to education about the many borrowing purposes HELOC supports, fostering consolidation of balances held elsewhere.

Emergency Only (14%)
Unprofitable. A large set of dormant accounts, some held by people who have latent borrowing potential, many others held by people who passively responded to a sales offer but likely never will use their lines. Questions about sales, pricing, fees, terms.

Periodic Borrowers (50%)
Traditional HELOC customers who carry higher balances. They borrow mostly for home renovation, but also for other big-ticket items. A profitable segment that skews somewhat to older customers, but includes many younger ones as well. More oriented to the branch.

Revolvers (28%)
Generally younger customers with more of a cash management orientation. They borrow more frequently, shop online and are more price-sensitive. Credit ratings are mixed but the potential for long-term relationship profitability is high. Will respond to greater product flexibility.

Source: Novantas 2015 Home Equity Survey
Novantas conducted a national consumer survey centered on the home equity line of credit, including established customers, recent purchasers and prospects.

In terms of demographics, HELOC users break into a larger set of older users and a growing set of younger users. Among current customers, almost three-fourths are at least 45 years old, yet younger accountholders are more likely to draw on their lines.

The under-45 segment represents only 12% of seasoned accounts (more than three years old), but more than 40% of newer HELOCs on the books. This group skews toward higher income and more cash on hand, but credit ratings are mixed.

Looking at credit line utilization among households with more than $100,000 of annual income, 62% of the under-45 group had a line balance of more than $25,000. That compares with 44% of the more affluent 45+ group, and a low 30s range for either age group with income less than $100,000.

Among survey respondents who specified a purpose for borrowing, 42% said they expect to use HELOC funds for home-related purposes. Within this group, the breakout was 35% for home improvement and 7% for the purchase of an additional property.

An equally large group (43% of the total) said they were using their HELOC for purposes other than dwellings themselves. Here the breakout was 25% for event-based large borrowings (such as tuition, a car or a major contingency), with an additional 18% citing cash management purposes. The remaining 15% of purpose-associated respondents said their HELOCs were for emergency — just in case.

Importantly, utilization differs sharply by stated purpose of acquiring a HELOC: 44% of emergency-designated HELOCs remain unused, compared with 6% to 12% idle rates for credit lines associated with other purposes (clearly, pushing HELOCs with “just in case” marketing will lead to low utilization). Overall, substantial subsets of each group cited multiple actual uses for line draws.

As more fully detailed in the main article, a simple split of HELOC users by the frequency of draw (regular, occasional, never) and size of draw (over $2,500, some amount less than that, none) reveals four behavioral groups. These include Revolvers (28% — oriented to cash management); Periodic Borrowers (50% — traditional users with higher balances); Pay-Downs (8% — limited or dwindling balances); and Emergency Only (14% — strictly for standby purposes).

More than any other financial product, HELOCs are linked to the demand deposit account. They are not heavily shopped and sales are branch-driven. Fully 72% of HELOCs are originated at the consumer’s primary (DDA) bank, so the first-mortgage originators are not automatically winning the business. DDA loyalty should not be taken for granted, however: banks should work harder to understand and influence how prospects arrive at their consideration set for HELOC providers.

More than 60% of users said they shopped at only one bank before applying, with another 24% shopping at only two banks. In terms of which channels were used to shop (multiple channels permitted), 53% of respondents cited the branch, compared with 23% going to the bank’s website and 14% using an online comparison service.

There were identifiable differences in price sensitivity among surveyed HELOC users. Emergency users — while their utilization rates are low — are less price-sensitive. Conversely, frequent-using Revolvers shop the product before buying, use more online research and are more confident they got a competitive rate. This makes younger HELOC users somewhat more price sensitive, but also with somewhat higher credit risk pricing.

Lastly, the survey respondents who identified themselves as prospects roughly shared the same demographic profile as younger current accountholders. Many of these prospects said they were hesitant to use HELOCs, however, with the dominant reason (cited by 40%) being a concern about putting their home at risk with such borrowing.

—Lee Kyriacou and Jenny Cheng
purchase funnel that leads from online awareness, research and consideration to branch transaction fulfillment needs to be understood and carefully nurtured, including the preparation of branch staff (Figure 3: Online Preferences).

Educating prospects on HELOC’s value for cash management and event-based borrowing is useful in all cases, but especially helpful with younger borrowers. Attracting younger, cash management-oriented Revolvers will help to boost utilization and foster longer balance duration over the life of the relationship.

In sales conversations with Revolvers, a strong selling point is that the HELOC offers a far more attractive rate than credit card or consumer installment financing. However, care must be taken in the sales dialogue to respect strong borrower sensitivity about not wanting to put their homes at risk, suggesting a balanced presentation that emphasizes attractive credit availability within a responsible context.

Also in branch sales conversations, asking about the prospective use of the HELOC helps to identify Emergency Only users whose utilization potential is quite low.

Product design. Enhanced options for debt control have the potential of attracting and expanding Revolver usage of the HELOC. Many banks already offer the ability to convert a HELOC to a fixed-rate installment loan and should explore options to provide additional financing flexibility.

But to make reticent borrowers truly comfortable with using equity in their home without risking their home, banks need to incorporate both control and flexibility in the product feature mix. Examples include borrowing for new furniture and specifying both the payment and the number of months to pay off, or an ability to place balance limits on cash management draws from a HELOC credit card.

Turning to design adjustments for little-used accounts, an up-front annual fee may chase away Emergency Only users. More feasibly, a modest fee following a full year of account inactivity may help to shore up account economics without disaffecting the true emergency users with latent potential for utilization (as opposed to those who never intend to use the line).

Another approach to limiting the cost of maintaining idle accounts is a dynamic line. Under this arrangement, a relatively low initial line is offered to those expecting to use the HELOC only in emergencies, but with an automatic review of the credit limit following a draw. This way the bank reduces the capital charge required to support standby credit while assuring customer responsiveness when circumstances change.

Turning to usage incentives, introductory rates can help,

Figure 3: Online Preferences

HELOC prospects prominently include online research as they shop for providers and products. There is a growing preference to submit applications online as well, especially among younger prospects.

\[\text{Preferred Channel to Make an Application for HELOC}\]

\[\begin{align*}
\text{Ages} & \quad \text{DIGITAL}^1 \quad \text{BRANCH} \\
21-34 & \quad 76\% \quad 22\% \\
35-54 & \quad 58\% \quad 36\% \\
55+ & \quad 39\% \quad 52\%
\end{align*}\]

\[^1\text{Includes computer, tablet and smartphone.}\]

Source: Novantas 2015 Home Equity Survey
especially in the first months after a line is opened. Such offers can include controls to manage pay back, and hence need not look like credit card balance come-ons. While the objective is to encourage balance formation, these relationship expansion tools can also help with customer acquisition, particularly with Revolvers.

Pricing. Along with low utilization potential except in unusual circumstances, Emergency Only borrowers have relatively lower price sensitivity, hence the very lowest rate offer should be avoided. By contrast, price sensitivity is much more likely with potential Revolvers, as well as with Periodic Borrowers who may be shopping around for credit to meet immediate needs.

For online HELOC shoppers, highly competitive pricing is more likely to be required, as with mortgage shopping. Prominent displays of “rates as low as” make a difference online. In the branch, by contrast, the emphasis is on consultative sales.

A pricing balance needs to be struck with younger users, who may be somewhat overburdened with debt and not quite as meticulous in meeting repayment schedules (impacting credit scores), yet offer the potential of higher HELOC utilization and longer balance duration. Offering better risk-adjusted rates, whether online or in the branch, often is well-justified given the potential for extended relationship profitability.

KEY MANAGEMENT QUESTIONS

In translating these findings into business line priorities for 2015, HELOC executives should be asking five key questions:

Are we on top of portfolio dynamics? Origination volume may be rosy, but progress in booking profitable accounts might be something different. Based on a deeper look at portfolio trends, it may be time to revise customer acquisition strategies to more accurately target prospects who have true utilization potential.

Are branch sales reps fully up to speed? Branch sales productivity is fundamental to profitable HELOC growth, with a huge chunk of today’s originations still occurring on-site. A well-prepared platform banker can identify high-potential prospects; market the product in accordance with the borrower’s intended purpose for the line; and provide appropriate guidance to cultivate line utilization. HELOC-specific training programs and analytic support are needed.

Are we prepared for digital customers? Though still dominant today, the branch role in HELOC marketing and sales is fated to shrink as customers flock to online channels for product research and gain increasing confidence to purchase more banking products remotely. A convenient and compelling online shopping experience is an increasing requirement for marketing success, particularly with younger customers.

Do we understand borrower purposes? As illustrated by Revolvers, Periodic Borrowers and Emergency Only accountholders, the home equity line of credit is viewed and used quite differently among major customer groups. These differences have important implications for needs-related product design and positioning, utilization potential, risk and price elasticity of demand. A superior ability to assess customers holistically and structure products accordingly confers competitive advantage. Banks will need to reflect these differences in their sales process.

Do we have the right tools for precision pricing? The three fundamentals of precision pricing are: 1) refined profitability modeling assumptions; 2) improved pricing segmentation; and 3) an approach based on elasticity of demand.

Profit models should reflect the new liquidity and capital adequacy guidelines required by regulation, and be grounded in behavioral economics. To assure profitable growth, pricing needs to move from one-size-for-all to segment-specific price points, supported by an optimization framework that includes calculations of segment-level price elasticity of demand. As with other areas of retail banking, some HELOC players are taking fuller advantage of advanced pricing capabilities to capture profitable market share, while others fall further behind.

Lee Kyriiacou is a Managing Director in the New York office of Novantas, Inc. Also contributing was Jenny Cheng, a Senior Associate in the New York Office. They can be reached at lkyriiacou@novantas.com and jcheng@novantas.com, respectively.