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Lending

Home Equity Loans: The Next Commodity

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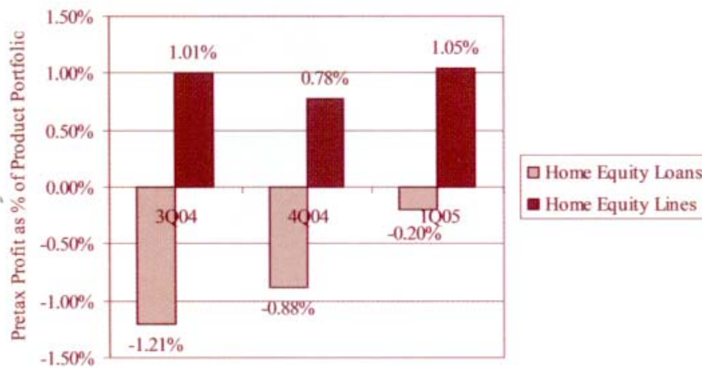
The hot growth of home equity products has raised eyebrows. Banks have pursued these loans with vigor, while regulators have



Source: The Kafafian Group, Inc.

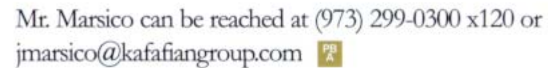
cautioned them against doing so. Meanwhile, monolines (credit card companies that focus on one line of business) and national players have jumped in with both feet, and consumers have borrowed.

This has resulted in heightened competition. Consumers are assailed with offers from the airwaves, the newspapers and their mailboxes. What once was the domain of local banks has become national.

With all of this attention on home equity, one seemingly important issue is missing – profitability. Although individual banks' situations vary, the accompanying table, derived from The Kafafian Group community bank peer group database, demonstrates that home equity products are barely breaking even, if at all. In other words, it takes a lot of loans to make an impact. So why all the fuss?

Spread and volume drives monolines and national players. During 1Q05, home equity loans made a spread of 2.47 percent using a market rate for the same term, and lines were 2.52 percent. As the law of economies of scale goes, generating volume lowers the cost per loan. Therefore, those with the ability to obtain volume can make home equity loans profitable.

For community banks, most of the operating expense tied up in originating and maintaining home equity products are in their branch networks, which, on the margin, are fixed costs. Therefore, it is important that community bankers drive as much revenue through their branches as possible.



If the goal is revenue, home equity clearly generates greater spread than other popular branch-originated products, such as CDs.

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