[Golden1 podcast: home equity loans]

"Is using home equity a good idea?"

HOST

Hi, welcome to this episode of the Golden1 podcast!

On today's show, we're going to explore a topic on the minds of many homeowners: home equity. Specifically, should you use it to free up extra cash?

Like a lot of financial decisions, there is no easy answer – it really depends on your particular financial situation. But by the end of this podcast, you'll know the steps required to access it, and have some new insight about whether or not it's a good idea.

So first thing's first: Home equity is when your home is worth more than you owe on it. How do you determine that? Subtract the market value of your home from your outstanding mortgage balance -- that number is the part of your home that you own outright, i.e., your equity.

Now about that term, "market value." There are two ways to figure this out. The easier – and cheaper – way is to use a home value calculator, which can be found on many real estate websites. This will weigh the other home values in your area, among other factors. For a more precise analysis, you can pay a professional appraiser who will make a determination based on things like square footage, your neighborhood, and more.

Once you figure out your equity, you're ready for the next step: applying for a second mortgage (assuming of course that you already took out a mortgage when you bought the house). This is how you convert your equity to cash.

Second mortgages come in two flavors: a home equity loan, and a home equity line of credit. Home equity loans usually come with fixed interest rates and monthly payments, so you won't have to worry about sudden changes to your payment schedule.

Home Equity Lines of Credit, or HELOCs, kind of work like credit cards. You can withdraw money up to your limit at any time during a draw period. During this time, you're only required to pay interest, although like credit cards, it’s better to contribute towards the principal balance so that you pay less over the life of the loan. Once that draw period is up, your lender will give you options about further repayment. In contrast to home equity loans, the interest on HELOCs is variable, meaning it changes over time. For some homeowners, this can be a bit nerve-racking, since unpredictable rates are hard to plan for.

At this point you might be asking yourself which loan is right for you. The answer depends on what you need the money for. Home equity loans are often used for a one-time expense, like paying off credit card debt. HELOCs, on the other hand, may be a good solution if you need access to extra money over a longer period of time. However, no matter which way you go, talk to your lender about the total cost of the loan. You’ll want to know things like APR, closing costs and any associated fees.

Also bear in mind that you shouldn’t borrow more than you have in equity. It’ll put you upside down on the house, meaning you’ll owe more than the home is worth. And if you’re not careful, this can put you on the path to foreclosure in extreme cases.

So we’ve covered what home equity is and the two main types of loans you can get to access it. But does it make financial sense for you? Here are some considerations to weigh as you make your decision...

First, you should probably only apply for home equity loans if you have a specific purpose in mind. Typically, they have lower interest rates than personal loans and credit cards, which makes them a good option for paying off debt, doing home repairs, starting a business, or funding a big expense like college. But if you want extra cash just because it would be nice, try reviewing your budget and making some adjustments instead.

You should also only take out a home equity loan if you’re confident that you can pay it back. And this brings us to the biggest drawback of these types of loans... If you can’t keep up with the payments, your lender can foreclose on your home, and resell it to recover any unpaid funds.

Another thing to think about is having to maintain an additional line of credit. Let’s say you already have credit cards and a car loan. Will adding another big monthly payment to the mix break your budget? Make sure you crunch the numbers before taking the leap.

Choosing whether or not to tap into your home’s equity is a big decision. Under the right circumstances, it can be a smart call for you and your finances – just make sure you’re prepared.

And with that, we’ve come to the end of our show. Join us next time for the Golden1 podcast. Thanks for listening!

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