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Borrowing on Your Home Equity

If you own a home, you may be able to use the equity in your home as a source of financing. Home equity is the financial difference between what your home is worth and the amount of money you still owe as debt on that home. For example, if your home is worth $100,000 and you owe $75,000 on your mortgage, then you have $25,000 of equity in your home.

If you use this ability to borrow wisely, you'll have a whole new level of flexibility to achieve your financial goals.

Home equity loans and lines

Two common ways homeowners borrow against their home's equity are home equity loans and lines of credit:

> Home equity loans are usually installment loans. A loan is an agreement between a borrower and a lender, where the borrower agrees to repay money with interest over a period of time. With an installment loan, the borrower agrees to repay the lender in equal amounts, over a fixed period of time. There can also be other types of home equity loans, such as loans that are interest-only for a time and then have increased payments, or loans with large balloon payments at the end. A home equity loan is secured by your home.
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> A line of credit is an arrangement by which a lender extends a specific amount of credit to a borrower for a certain time period. As long as the borrower repays the principal with interest, he or she can continue to borrow against the line of credit during the agreed upon time period. A line of credit (also called a credit line) can be unsecured or secured. A home equity line of credit is secured by your home.

Some lenders offer flexible payment options and terms on home equity loans and lines, as well as lower interest rates than certain other types of financing. In addition, the interest you pay on a home equity loan or line of credit may be tax deductible. Consult your tax advisor to determine whether any interest you pay may be deducted from your income for federal or state tax purposes.

Your home is the collateral

Like a mortgage, home equity loans and lines of credit use your home as collateral. That means that the lender has a right to sell your home if you don't repay as agreed. If you borrow against your home's equity, be sure to make your payments on time and in full. Otherwise, you may risk losing your home.

Uses of the funds

Two of the most popular uses of home equity financing are home improvements and paying off high-interest debts. Paying for major expenses like a wedding, your own or a child's education, and medical expenses are among the many possibilities.

Borrowing on your home equity (continued)

How much you can borrow

Lenders typically determine how much you can borrow by taking your home's appraised or fair market value, and subtracting the balances of any outstanding mortgages and liens on the property. In general they will also look at your income to determine how much you can afford to repay.

Loan terms and credit line draw periods

Many lenders offer home equity loan terms between 5 and 30 years. Many home equity lines of credit have a draw period (the time period in which the borrower may access and use a line of credit) of 10 years. During the draw period, you may be able to apply to renew your line of credit. If you do not renew, you will likely make principal and interest payments for 20 or 30 years, depending on your account balance, to repay what you owe.

How you are billed

Home equity loan payments are generally due monthly. For home equity lines of credit, you will usually receive a bill each month that you carry a balance. Some lenders offer online statements. Some offer discounts if you set-up automatic bill payments.

Minimum payment terms

For the many home equity loans that are structured like installment loans, your monthly payment stays fixed for the life of the loan and the amount you borrow determines your payment amount. Other kinds of loans may have payments that change over time.

For home equity lines of credit, your minimum payment during the period you access funds (i.e. the draw period) is typically equal to one month's accrued interest on your outstanding balance, plus any assessed fees (e.g. late fees). After the draw period ends, your repayment period will usually consist of monthly payments of principal and interest.

Shop around

Remember: borrowing on your home equity is a major decision. Be sure to shop around to compare what's offered by different lenders, and work with a lender you know and trust.

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