

BEST USES FOR A HOME EQUITY LINE OF CREDIT (HELOC)

By: Mia Taylor - August 13, 2021

Tapping into the equity in your home can be a great way to pay off debt, cover the cost of home renovations or even pay for a vacation or medical bills.

One of the most common ways homeowners can access equity is through a home equity line of credit or HELOC. Secured against the value of your home, a HELOC is a line of credit you can borrow from as needed and repay in installments over a certain period of time—much like a credit card. Here are some of the best uses for a HELOC and how to decide if one is right for you.

Is a home equity line of credit a good idea for me?

When making a significant financial decision like opening a HELOC, do your research to understand all the fees and loan terms as well as the impact of loan repayment requirements on your monthly budget. Here are some factors to consider when deciding whether a HELOC may be right for you:

- **Variable interest rate:** Unlike other types of loans that allow you to lock in a specific interest rate, most HELOCs include a variable rate, meaning your monthly repayment amount could increase suddenly and unexpectedly. Make sure your household budget can handle this potential fluctuation. "Ask yourself whether you feel comfortable having an adjustable rate that can rise if interest rates rise, potentially increasing your monthly payments in the future," says Matt Hackett, operations manager for mortgage lender Equity Now.
- **Funding needs:** HELOCs offer the flexibility of borrowing what you need, only when you need it, making them a good choice for those who lack a defined borrowing goal or those who require ongoing access to funding. "A HELOC is great if you're unsure how much money you need to borrow, or you need different amounts at different times," says Yu Weismantle, lending product manager for Alliant Credit Union.
- **Responsible borrowing:** Opening a HELOC provides access to a line of credit that you can draw from again and again for as long as 10 to 15 years. Managing the use of this type of fund requires discipline and a plan for repayment or you can easily get in over your head. "For fiscally responsible people, these can be amazing tools. For folks with less financial discipline or security, they can be devastatingly bad," says Ryan Cicchelli, founder of Generations Insurance & Financial Services.

7 common uses of a home equity line of credit (HELOC)

A HELOC can be a useful and cost-effective way to pay for some of life's major expenses. Here are some of the most common to consider.

1. Home improvements

One of the most popular reasons for opening a HELOC is home renovations. Because a HELOC allows for accessing large amounts of money over time as needed, it can be especially useful for costly, ongoing projects.

"A HELOC is ideal for renovations because they offer a high line of credit, low-interest rate and withdrawal flexibility," says Weismantle. "And, once you're done, you can have a long payment term."

Home improvements can also increase the overall value of your home, making this type of use of a HELOC a wise in-

vestment.

2. Education

If mortgage rates are lower than student loan rates, a HELOC can be a good way to pay the cost of college tuition. Be sure your lender allows HELOCs to be used for this purpose. You'll also want to investigate all possible student loan options before taking this route, as defaulting on a HELOC could mean losing your house. A student loan on the other hand is not secured by your home.

3. Emergencies

It's always a good idea to have an emergency fund that includes three to six months of living expenses. If you do not have this type of cash set aside and an emergency arises, a HELOC can provide an option for accessing cash. When using a HELOC for this purpose, however, it's a good idea to have a repayment plan or you could easily slip into deeper debt.

4. Paying off or consolidating debt

HELOCs generally offer a lower interest rate than unsecured debt making them a good choice for paying off credit cards or consolidating multiple types of high-interest unsecured debts. However, you will want to be careful when doing this. "Using a HELOC to consolidate debt is only a reasonable option if the individual has dealt with their spending issues; otherwise, digging a bigger hole of debt is a likely outcome," says Steve Sexton, CEO of Sexton Advisory Group.

5. Real estate down payment

It's not unusual for homeowners to access the equity in their homes in order to buy additional real estate, perhaps as a rental investment or vacation getaway. Similar to using a HELOC for education expenses, however, you'll want to investigate all your borrowing options and make sure accessing your home's equity is the most cost-effective way to achieve your goals.

6. Special events

Whether it's a child's wedding or a bucket-list vacation, if you don't have the money set aside to pay for these expenses in cash, a HELOC can offer a more competitive interest rate than a credit card. Using a HELOC for such costs can also give you a longer repayment timeline, often as long as 20 years.

7. Building credit

Opening a HELOC can be a way to build your credit profile, in much the same way you might use a credit card for such a goal. Again, the key is responsible use. "You can do this by only drawing funds that you feel secure in repaying relatively quickly, making timely payments and not digging in too deep," says Cicchelli.

Alternatives to a home equity line of credit (HELOC)

Depending on your funding needs, current interest rates, and your timeline, a HELOC may not be the best choice for everyone. Here are some additional funding options to consider.

Home equity loan

Similar to a HELOC, a home equity loan is secured by your home and usually offers a more competitive interest rate than unsecured loans. However, there are some noteworthy differ-

ences between HELOCs and a home equity loan that may make this option a better choice for you.

Home equity loans provide loan proceeds immediately, in one lump sum, as opposed to a line of credit that you can tap into again and again and pay back during a specified draw period.

"Home equity loans do not have a draw period so they may be better suited to those who have an immediate need or those who have certainty over how much cash they need," says Nicole Straub, general manager of Discover Home Loans.

Another notable difference between a HELOC and a home equity loan is the interest rate. HELOCs typically come with a variable rate, while home equity loans include a fixed interest rate, allowing borrowers to have consistent, predictable monthly payments for the life of the loan. This option may be more suitable for those who need stability in their monthly budget.

Cash-out refinance

A cash-out refinance replaces your existing mortgage with a new one that's larger than your outstanding loan balance. As part of the refinance process, you receive a one-time, lump-sum cash payment for the difference between your current mortgage and the new larger mortgage.

"While a traditional refinance loan will only be for the amount that you owe on your existing mortgage, a cash-out refinance loan will increase the amount of the loan, allowing you to pay off your existing mortgage and use your home's equity to take an additional lump-sum payment in cash," says Straub.

It's important to keep in mind with a cash-out refinance that you will pay more in interest after completing a cash-out refinance because you've increased the amount of the mortgage loan.

Personal loan

Personal loans may be a good approach for those who don't feel comfortable using their home as collateral for a loan. They can also be a better choice if you only need to borrow a limited amount of money. The proceeds from personal loans may also be available more quickly than a HELOC. Some lenders can even make funding available as soon as the next business day.

Personal loans also offer fixed interest rates that never change.

"Personal loans are easier to budget for because the monthly payment stays the same," says Straub.

The bottom line

There are many cases in which a HELOC can provide a smart way to leverage the equity in your home to achieve other financial goals or pay for large expenses. Before opening a HELOC however, it's always a good idea to shop around and crunch the numbers, ensuring that a HELOC is truly the most cost-effective option. In addition, you should have a repayment plan and be able to manage a HELOC responsibly.

Ryan Cicchelli, founder of Generations Insurance & Financial Services, is committed to providing clients with financial security through a personalized, friendly approach. Ryan's top concern is helping clients make informed decisions about all things related to healthcare and retirement.

To contact Ryan, call 231-878-7074 or visit www.GenerationsIFS.com.



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