

Home Equity Loans - A powerful financial tool

The equity you have in your home can be a powerful tool in managing your overall financial situation. Your equity, the value of your home minus your existing mortgage, can serve as collateral for additional borrowing. While there are some risks with this strategy (as with any borrowing), home equity loans usually offer the attractions of lower rates, convenience and often tax benefits.

How does a home equity loan work?

Most institutions view home equity as good collateral and are often willing to lend you money against that equity. Lenders may issue you a special check or give you a "line of credit" that you can access as "overdraft protection" against your checking account. There are usually forms to sign and an approval process that is not too difficult. There may be some form of commitment fee.

The amount they will lend you depends on the amount of equity in your home and your other credit characteristics. A general rule of thumb is that they will lend up to an amount so the total debt against your home (including the first mortgage and any other loans where your home is pledged as collateral) is less than 80% of the current value of your home.

The interest rate charged will usually be variable and will be pegged to some published index, like the prime rate. There are also some institutions that offer low "teaser" rates initially and then raise the rates after a period. Check out the rate details.

Usually, you repay the loan in regular installments and with minimum repayments required. With some home equity loans, the minimum payments may only be the interest on the loan and you may be required to repay the loan at a certain date. You need to read the details carefully.

Attractions of Home Equity Loans

[Convenience](#) - Usually institutions make it easy to apply and their approval processes are fast. The process is often simpler than if you were applying for a new mortgage. Once you are approved, their commitment acts like a line of credit. You do not have to borrow it all at once.

[Interest rates](#) - The interest rates charged on home equity loans are usually greater than those on first mortgages but less than those on credit cards. Using the proceeds of a home equity loan to pay off credit card debt will usually save you money.

[Tax benefits](#) - For individuals that itemize their tax deductions, the interest paid on home equity loans can help save some income taxes. While there are some limits on this type of interest deduction, it may save you some tax. Consult with your tax advisor for more details.

Flexible uses

Even though you are borrowing against your house, there is no requirement that the money be used on your house. A home equity loan can be the source of funds for college tuition or even to buy a car. Compare the rates on an auto loan and a home equity loan the next time you are financing a car.

Beware of the risks

Borrowing against the equity in your home should be considered carefully. Even though there are benefits, these types of loans are like other loans - you pay interest and they must be paid off. Most people use home equity loans for "conservative" purposes and avoid making risky investments or extravagant spending with the proceeds.

Read and understand all the details before signing. Loan documents can be confusing and the easy process of getting this type of loan can mask the costs and risks.