

Home-a-Loan: Part 3

MONEY FROM HOME: THE FACTS ABOUT HOME EQUITY LOANS

In this, the final installment of a three-part series of articles geared at raising the public's awareness of mortgages and mortgage related products, Johnathan Johannes of FirstCaribbean International Bank, examines the issues surrounding the newest mortgage product being offered in the Eastern Caribbean – Home Equity Loans.

What is a Home Equity Loan?

The standard Home Equity Loan is a loan that uses your home as collateral and it works much like a traditional loan. A Home Equity Loan is based primarily on the available equity in your home, however other qualifying criteria may apply. By definition, *Home Equity* is the part of your home that you actually own and it is this that guarantees your loan.

Home equity is calculated by taking the current value of your home and subtracting your current outstanding mortgage balance. For example, if your home is worth \$250,000 and you have an outstanding mortgage balance of \$100,000, then the equity in your home is equal to \$150,000 (**\$250,000 - \$100,000 = \$150,000**). A Home Equity Loan allows you to borrow money using you equity of \$150,000 as security for the loan.

It should be noted that many financial institutions set credit limits on a Home Equity Loan by taking a percentage (say 80%) of the home appraised value and subtracting from that the balance owed on the existing mortgage. For example:

Appraised Value	\$250,000
Percentage	80%
Percentage of Appraised Value	\$200,000
Less Outstanding Balance of Mortgage	\$100,000
Potential Credit	\$100,000

In determining your actual credit limit, your financial institution will also consider your ability to repay, by looking at your income, debts and other financial obligations as well as your credit history.

Advantages and Disadvantages of a Home Equity Loan

Since a Home Equity Loan is secured by your home, it poses less risk to a financial institution than does an unsecured personal loan or credit cards – this lower risk is then passed on to you, the customer, in the form of a lower interest rate.

However, the biggest drawback of a Home Equity Loan is the fact that your home is on the line and there is a possibility of losing your home if you default on your payments. When you borrow from your home's equity you are effectively reducing your ownership. You are actually trading in your ownership for cash that you will use for some other purpose. In addition to the interest you will pay on the loan, there are also costs associated with taking out a home equity loan – these costs are similar to those you paid when you first acquired your home.

Use Your Home Equity Loan Wisely

Because your home is on the line, you should practice financial responsibility when taking a Home Equity Loan. A Home Equity Loan can be used for anything from paying off high interest credit card debt, to home improvements, to buying a car, to financing further education. The ideal uses of a Home Equity Loan improve your financial situation, your home or your future. Your money will be invested in something that grows.

Some popular uses of Home Equity Loans are as follows:

Debt Consolidation – Using a Home Equity Loan to replace various credit cards and other high interest debt has several advantages. The fact that the interest rate you pay on your typical Home Equity Loan is lower than the interest rate you will pay on your average credit card by up to 7% or more. Note that a single payment on a Home Equity Loan can simplify paying several credit cards and staggered payment times.

A Home Equity Loan can also help make spiraling credit card debt more manageable as payments are spread over a longer period of time.

Home Improvement – A Home Equity Loan used for home improvements, repairs or upgrades can significantly increase the market value of your home. While Home Equity Loans in most cases decrease your home equity, when used wisely for home improvements, a Home Equity Loan can actually increase your home equity by increasing the market value of your home well beyond the value of the loan.

Education – A Home Equity Loan can be invested in your future by paying for an education. The invested money pays for itself with a higher paying job. It can also be used to pay for your children's education.

While most home equity lenders are reputable financial institutions operating within the law, you need to always protect yourself from abusive lending practices. Be cautious with regards to lenders that pressure you into applying for a loan or applying for more money than you need. Also, be wary of lenders who pressure you into accepting payments that you cannot make. You need to be extremely careful when borrowing money based on your home equity because although it is "money from home", your home is truly on the line.

Once again, it is important to note that the information contained in this article is intended to help you ask the right questions when considering a possible home equity loan, and should not be treated as a replacement for professional advice.

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