

How to Use Your Home's Equity For Your Financial Future

What is Home Equity?

Home equity is the difference between your home's current market value and the remaining balance on your mortgage. For example, if you purchase a home for \$200,000 with a \$20,000 down payment, you have \$20,000 in equity. As you continue to make payments, your loan balance decreases and your equity increases. Additionally, if your home's value rises over time, your equity can grow even further. For instance, if your home increases in value to \$220,000 while your mortgage balance drops to \$150,000, your equity would increase to \$70,000.

As a homeowner, your property can serve as a valuable tool for building long-term financial security. With each mortgage payment, you gradually increase your equity. Equity is the portion of your home that you truly own. Over time, this equity can be accessed to help achieve important financial goals, such as improving your home, consolidating debt, or covering significant expenses.

How Can I Access My Home's Equity?

There are a few ways to access the equity in your home, with the two most common being home equity loans and home equity lines of credit (HELOCs).

- **Home Equity Loan:** This option provides a lump sum of money that is repaid over a fixed term with consistent monthly payments. Home equity loans are often used when there is a need for a large, single-time payment. Because the loan is secured to your home, interest rates are often lower than those of unsecured loans or credit cards.
- **Home Equity Line of Credit:** A HELOC functions more like a revolving line of credit, using your home as the collateral.



You can borrow the funds as needed, up to an approved amount, and pay interest only on the amount used. HELOCs often have variable interest rates and provide greater flexibility compared to traditional home equity loans.

A home equity loan is generally best suited for projects with a defined cost, such as a kitchen remodel. If you know you are remodeling your kitchen and the cost is \$20,000, with a home equity loan you can receive the entire \$20,000 upfront.

In contrast, a HELOC is best suited for situations where the total amount of money needed is not immediately known. When expenses are unknown or ongoing, HELOCs allow you to draw funds as needed. With HELOCs you only pay interest on the money you use.

It is important to note that both options use your home as collateral. As a result, failure to repay the loan could put your home at risk.

The Three Best Uses of a Home Equity Loan

Home equity loans are most effective when used for purposes that can improve your financial position over time rather than on everyday expenses.

1. Financing Home Improvement Projects

Some of the most common uses of home equity loans are home renovations. Projects such as kitchen or bathroom remodels can range from \$10,000 to \$50,000 or more, depending on the scale. These improvements not only enhance your living space but may also increase your home's overall value.

2. Consolidating or Paying Off Debt

Using home equity to consolidate higher-interest debt, such as credit cards, auto loans, or personal loans, can be a strategic financial move. By combining multiple debts into one single loan with a lower interest rate, you may reduce your overall interest costs and simplify repayment with one consistent monthly payment.

However, this strategy is most suitable for individuals who are disciplined in managing their finances and committed to avoiding accumulating additional debt.

3. Covering Unexpected Expenses

Unexpected expenses, such as significant medical bills or an immediate repair, can place a strain on your finances if you have yet to build a significant emergency savings fund. In these cases, a home equity loan may provide a lower-interest alternative to other borrowing options, helping you to manage costs without disrupting your long-term financial goals.

Non-Effective Uses of a Home Equity Loan

While accessing your home's equity can be beneficial, it should be approached with caution. Because your home is serving as collateral, borrowing against it comes with inherent risks. Below are five situations where a home equity loan might not be the best option.

1. Purchasing a Vehicle

When purchasing a vehicle, applying for an auto loan is typically a better option than using a home equity loan. Interest rates are often comparable or lower to those on home equity loans. With an auto loan, the loan is secured by the vehicle rather than your home which reduces overall risk. Additionally, auto loans usually have less paperwork and fewer fees.

2. Paying for a Vacation or Non-Essential Expenses

Using your home's equity to fund discretionary spending, such as vacations or luxury purchases, is not recommended. These expenses do not provide long-term financial value and can lead to unnecessary debt.

3. Paying for Education Expenses

While a home equity loan may be considered in certain circumstances, such as when mortgage rates are significantly lower than federal student loan rates, this approach carries added risk. For families with multiple children attending college at different times, a home equity line of credit may offer flexibility, but should still be evaluated carefully against other education financing options.

4. Starting a Business

Although it is possible to use home equity to fund a new business venture, doing so places your home at risk if the business does not succeed. Dedicated business financing, such as loans from a financial institution or programs offered by the U.S. Small Business Administration (SBA) are generally a safer and more appropriate alternative.

5. Covering Recurring or Everyday Expenses

Relying on home equity to manage routine expenses can create long-term financial strain. While it may provide temporary relief, it does not address underlying budgeting challenges and increases the risk of default. Because the loan is secured by your home, missed payments could result in foreclosure. Instead, try to explore alternatives such as credit cards or a personal loan with a fixed repayment term.