The Home Equity Playbook

**What is Home Equity?**

Home equity seems to be a very simple calculation — the total amount of mortgages owed subtracted from the current market value of a home. Here is a simple example:

Current Home Market Value $325,000

Existing Mortgage $225,000

Homeowner Equity $100,000

One side of the equation is well defined, and it is found on the monthly mortgage statement, the loan balance. The other side is less obvious — the current market value of the property. The most accurate measurement of market value requires a comparative market analysis from a real estate professional.

**Putting Home Equity to Work**

Home equity represents the largest single asset of millions of people, and because it represents so much of an individual’s net worth, it must be treated with respect. Home equity is not a liquid asset until a property is sold, or it is borrowed against.

There are two types of loans that tap into homeowner equity as collateral.

*Home Equity Loans*

Many home equity plans set a fixed period during which the person can borrow money, such as 10 years. At the end of this “draw period,” the person may be allowed to renew the credit line. If the plan does not allow renewals, the homeowner will not be able to borrow additional money once the period has ended. Some plans may call for payment in full of any outstanding balance at the end of the period. Others may allow repayment over a fixed period, for example, of 10 years.

A home equity loan, sometimes called a second mortgage, usually has a fixed rate and a set time to pay it back, generally with equal monthly payments.

*Home Equity Line of Credit*

A home equity line of credit is similar to a credit card. The lender sets a maximum amount you can borrow, and you can draw money as you need it, though many home equity lines of credit require an initial draw. The interest rate varies daily, and is usually prime plus a set number, but the required payment is usually interest only. Once the loan has been paid down, the payment is reduced, and it can be paid off and initiated as many times as a homeowner requires.

**How Much Equity can be Accessed?**

Since the financial institution is lending money and using a home as collateral, they will typically loan 80% of the home’s equity. The bank does not want to take the risk that if the house price drops, they would be carrying a loan for more than its market value.

Here are some good ways to use money from a home equity.

1. Invest in Your Home

Among the very best returns on your investment (ROI) include kitchen and bathroom remodels, adding square footage or an extra bath, enhancing curb appeal and repairing/keeping the existing structure sound.

2. Invest in your Children’s Education

Using your home equity to finance a child’s higher education may be the greatest pay off of all.

3. Supplement Retirement Needs

At retirement, when monthly income is reduced, a home equity loan could pay for a dream vacation or an unexpected major expense.

4. Augment the Impending Sale of a Home

If you’re planning to sell soon, a home equity line of credit may be the best way to finance improvements to maximize your selling price.

On the flip side, avoid buying luxury items, assets that depreciate like cars and boats, don’t make investments in financial markets, and do not pay routine monthly bills. You should treat a home equity loan as an investment and not as extra cash when making financial decisions.

**We Are Happy to Assist You**

If you would like an assessment of the market value of your home and the current equity you can access, give us a call for a comparative market analysis.