Is a HELOC a Good Idea?

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Our homes are our biggest asset, and in a cash crunch they could provide some much-needed relief. A home equity line of credit, aka a HELOC, can put money in your pocket.

Here's all of our coverage of the coronavirus outbreak, which we will be updating every day.
A HELOC is a second mortgage that allows you to borrow against the equity in your home up to a certain amount based on the home's value and how much you still owe on the primary mortgage.

A variety of lenders issue home equity lines and each bank has different criteria, fees, and payback options. Here are some basic facts about these loans to help you decide if a HELOC is a good idea.

Reasons to Take Out a Home Equity Line of Credit

The main purpose of a HELOC is to use the money to increase the value of your home.

"Ideally you're supposed to use it to remodel your house, so it's the ability to go in and buy a home, borrow against that home, and remodel it and make it yours," says Mary Bell Carlson, a CFP and AFC, known as the Chief Financial Mom. "Now they get used for everything under the sun."

Due to historically low interest rates, Carlson says many people are using HELOCs to pay off high-interest credit card debt. The rates on most equity lines are much lower than on most credit cards after introductory offers. But it's important to keep in mind that during the terms of the loans, the rates on HELOCs often adjust and can increase.

During the COVID-19 crisis, people are looking to their homes to get money to pay bills if they've lost income.

"More than likely it's probably one of the least expensive borrowing techniques you can receive at this time," Carlson says.

But she has a warning: "When you take money out [of equity] and borrow it for any reason — whether it's for actually redoing your home or whether it's for paying off credit card debt or for an emergency fund during a time of crisis — you are now taking an unsecured debt and you're now securing it."

That means if you don't pay, your home is at risk of foreclosure.

"If you don't pay your equity lender, they can absolutely come and take your house," she said. "There's actually teeth to their bite where with (debt collectors) they're just annoying."

Getting a Home Equity Line of Credit

Even with the risk, a lower interest loan against the equity of your home can be a way to get through this current financial crisis.

The amount you can borrow depends on the current value of your home, how much you owe on your current mortgage, your debt to income ratio, your credit score, and other criteria depending on the lender.

But just because you have been paying on a mortgage doesn't necessarily mean you have built equity. Equity is the difference between what your home is worth and what you owe. It builds over time as you pay down your mortgage.

"If you're someone who put zero or 1% or 2% down and just purchased your home recently, you don't have the ability to borrow against it," Carlson says. An interest-only loan could also mean a lack of equity because you have not been paying down the principal, just the interest, she added.

Carlson has some advice when thinking about a HELOC.

- **Consider the fees and costs:** Most likely, you will need an appraisal to determine your home's current value and you might also need a title search. Those cost money, and there are also extra fees banks charge.
- **Shop around:** You don't have to use the company that holds your first mortgage for the HELOC. Different banks offer different rates, so do your homework and find the best one.
- **Know your debt-to-income ratio:** Take a look at your net income and make sure you will have the money to pay both mortgages and enough left over for living expenses.
- **Longevity:** Think about how long you plan to stay in your house. The money from a HELOC needs to be paid back before selling the home, so if you plan to move in the near future, it might not make sense to borrow against the equity.

"Home equity lines of credit can be a very low cost borrowing alternative, if needed," Carlson says. "So if you don't have savings or reserve funds and are in need during this economic downturn and crisis, it can be a suitable borrowing technique."