FREEDOM MORTGAGE®

HELOC, cash out refinance or home equity loan?

Before you tap your home equity, decide which loan option is best for you.

Your home is your biggest asset. It can also be your best source of money to do things like pay for college, pay for home improvements, or pay down high-interest debt. That's because you can borrow against the value of your home equity to get cash when you need it.

There are three ways to do this. You can get a home equity line of credit also known as a "HELOC". You can get a cash out refinance, where you replace your current mortgage with a new mortgage for a higher amount and get the difference in cash at closing. Or you can get a home equity loan which is sometimes called a "second mortgage". There are advantages and disadvantages to each one. We'll explain the differences between these loans to help you choose the right one for your needs.

What is a HELOC?

Home equity lines of credit (or "HELOCs") work in many ways like credit cards. The lender gives you a line of credit based on the value of your home equity, and you can take cash from this credit line up to a maximum limit when you need it. You can take out money from a HELOC more than once, and you generally aren't required to take out a specific amount at specific times although you may be charged fees if you don't make minimum withdraws. Like credit cards, HELOCs give you an available line of credit to use when you need it.

Home equity lines of credit typically have long "draw periods" which is the length of time the money in a HELOC is available to you. For example, many HELOCs have draw periods of ten years which means you can take money from the credit line over the course of ten years.

HELOCs usually have adjustable interest rates. That means the amount of money the lender charges you for interest can rise or fall. The principal on HELOCs can be paid back over a period of time, often up to 20 years. You can make monthly and lump-sum payments on a HELOC. Some HELOCs allow you to just pay interest during the period when you are drawing money from them. Others may require you to make both interest and principal payments during the draw period. HELOCs may have balloon payments as well.

Any home equity line of credit payments you make will be in addition to your monthly mortgage payment. Keep in mind the debt on home equity lines of credit is secured by your house, which acts as collateral on the loan. HELOCs are a type of second mortgage and the lender may have the right to foreclose on your house if you can't make your HELOC payments, just as they might for other mortgages. Be sure you understand the conditions and requirements of a HELOC, and how you can pay back the money you borrow, before you choose one.

People sometimes choose home equity lines of credit when they are making home improvements but don't know exactly how much money they will need or when they will need it. People also sometimes choose HELOCs to pay educational expenses because it allows them to get money to pay tuition bills as the bills come due. In these cases, the flexibility of the HELOC is one of its advantages. Here are more important points about HELOCs.

Pros of a HELOC:

- Adjustable interest rates which might be lower than fixed-rate refinances or loans.
- You can have flexibility on how much money you take out and when you take it.
- There may be flexible interest-only payments during the draw period.
- You may not have to pay fees or closing costs.
- The interest you pay may be tax-deductible. Consult with a tax professional.

Cons of a HELOC:

- Interest rates could rise and make your payments higher.
- If the value of your home falls, your maximum credit limit may fall too.
- You might have to pay fees and charges if you don't draw money from your HELOC.
- Balloon payments might make paying off a HELOC more difficult.

What is a cash out refinance?

When you get a cash out refinance, you get a new mortgage. You pay off your current mortgage and replace it with a new one for a higher amount, taking out the difference in cash as a lump sum at closing. You get all the money at one time with a cash out refinance and cannot get additional money in the future from the loan. Because a cash out refinance involves getting a new mortgage, you will need to complete a new application, document your current finances, and pay a new set of closing costs.

Cash out refinances can be good choices if you know how much money you need. If you want to pay off higher interest debts and consolidate their loan payments you might choose a cash out refinance. If you are planning to complete home renovations and improvements, and know how much they will cost, you might also choose a cash out refinance. You may pay for college with cash out refinances too.

An advantage of cash out refinances is that you can also change the terms of your mortgage with them. For example, when interest rates are falling, you can use a cash out refinance to get money from your home equity and change your interest rate at the same time. You can switch from an adjustable rate to a fixed rate mortgage or change the number of years you have to pay back your mortgage with a cash out refinance too.

Pros of a cash out refinance:

- You get all the cash at closing.
- You make one payment on one loan.
- You can change other terms of your mortgage, like your interest rate.
- The interest you pay may be tax-deductible. Consult with a tax professional.
- Your interest payments won't change if you get a fixed rate mortgage.

Cons of a cash out refinance:

- Fixed interest rates might be higher than the adjustable rates on HELOCs.
- You'll need to complete a new application and pay new closing costs.
- You begin paying back the loan immediately.
- Your minimum monthly payment is likely to be higher.
- It may take longer to pay off your mortgage and your total interest costs may be higher.

What is a home equity loan?

A home equity loan is a second mortgage which allows you to borrow money against the value of your home's equity. With this type of loan you get the money as a lump sum and cannot get additional money from the loan in the future. Home equity loans typically have a fixed interest rate which means your interest and principal payments will stay the same each month.

People use the money from a home equity loan and cash out refinance in similar ways. A difference between these two choices is that you cannot change the terms of your current mortgage when you get a home equity loan. A home equity loan is a separate second mortgage with its own interest rate and its own terms.

Pros of a home equity loan:

- You get all the cash at closing.
- The interest you pay may be tax-deductible. Consult with a tax professional.
- Your interest payments won't change if you get a fixed-rate mortgage.

Cons of a home equity loan:

- Fixed interest rates might be higher than the adjustable rates on HELOCs.
- You'll need to complete an application and may pay fees and closing costs.
- You have two loan payments on two loans.
- You cannot change the interest rate or other terms of your current mortgage.
- You begin paying back the loan immediately.

Freedom Mortgage offers cash out refinances

Freedom Mortgage offers cash out refinances including cash out refinances on VA and FHA loans. We do not offer home equity lines of credit or home equity loans. The standards you need to meet to qualify for loans can vary from lender to lender, and the fees and interest rates lenders charge can vary too. Research your options and choose the one that best fits your needs.

Would you like to talk to us about a cash out refinance through Freedom Mortgage? Please visit our Get Started page or call our friendly Loan Advisors at 877-220-5533.

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