

**HELOC**

**VS**

**HOME  
EQUITY  
LOAN**

**VS**

**REFINANCE**

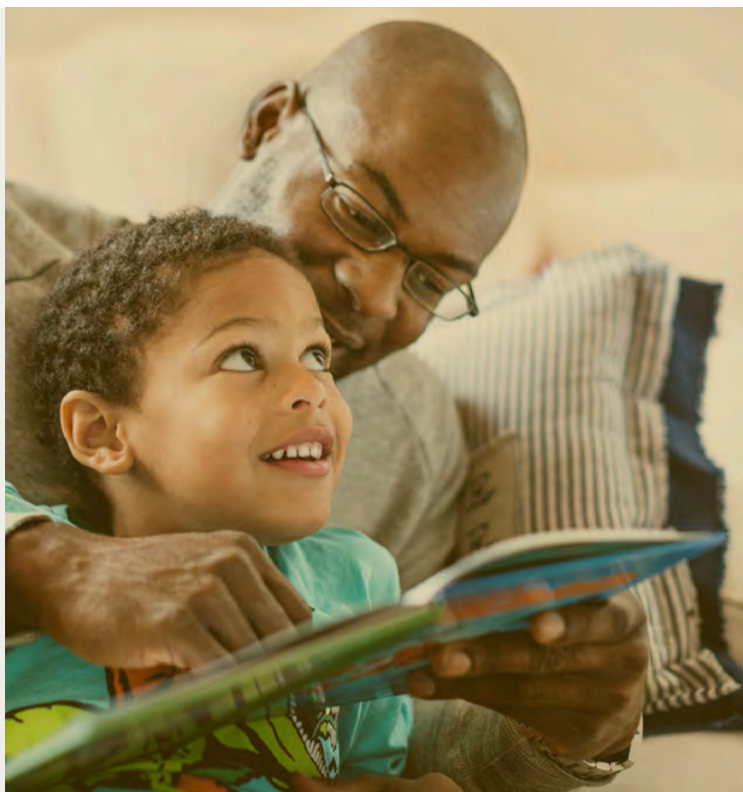
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**HOW TO DETERMINE  
WHICH LENDING OPTION  
BEST FITS YOUR GOALS**

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## For most of us, our home is one of the most valuable things we own.

Fortunately, many lending products allow you to leverage the value of your home to either save money or help cover other major expenses, such as school tuition or renovations.

Equity gives you the power to tap into the sizable investment you made when buying your home and the thousands of dollars you've put toward

mortgage payments. If you're a homeowner in need of cash, borrowing against your home equity certainly offers a variety of lending options. But how do you know which one to choose?

Choosing the type of home equity financing that's right for you depends on your circumstances and how you plan to spend the cash. Do you need the money all at once to cover a big expense like a wedding or renovation, or do you simply want a safety net of cash you can draw on as needed? Maybe you're looking to take advantage of lower interest rates and gain some extra spending money by refinancing your mortgage.

Lenders commonly offer three popular tools that allow you to borrow against your home equity at an interest rate that's lower than what's possible with unsecured financing. Homeowners can choose between a home equity loan, a home equity line of credit (HELOC) or a cash-out refinance.

Throughout this guide, we'll address whether you should consider home equity financing, and then we'll dive into the differences between equity-based loans. We'll also teach you about important factors you should take into consideration as you evaluate each product and share tips on how to find the ideal lending partner for your needs.

## Why Consider Home Equity Financing?

Using your home as collateral allows you to secure a low interest rate when taking out a home equity loan or credit line compared to other personal financing options.

Depending on current interest rates, it might be an advantageous time to consider refinancing your mortgage to lock in a lower rate or to consolidate high-interest debts with a home equity loan. You can also take advantage of favorable interest rates by applying for a HELOC, which could provide easy access to cash you can use to cover future expenses.

Home equity financing grants you the freedom to choose how you spend the money. For example, funds can be used to pay for a nearly anything, from home improvement projects, education expenses and unexpected car maintenance to medical bills, debt consolidation and even to buy an RV or take a dream vacation.

### Ideal loan candidates

Now's a good time to consider a HELOC, home equity loan or refinancing if you fit into one of the following scenarios:

- Have you improved your credit score since the last time you took out a loan? You could qualify for a lower rate and better payment terms.
- For those saddled by high-interest debts, explore consolidating your accrued debts with a lower rate available through a HELOC or home equity loan.
- If you've made consistent mortgage payments, you could qualify to drop your private mortgage insurance (PMI). Doing so could allow you to apply for a mortgage refinance while rates remain historically low.

### Determining loan-to-value ratio

Home equity equals the difference between your property's value and the amount you still owe on it, known as a loan-to-value (LTV) ratio. The loan amount includes any liens against the property, such as a second mortgage.

Over time, your home will likely appreciate — or increase in value — depending on your local real estate market. Only a real estate appraiser can determine your home's current value. When applying for a home equity loan, line of credit or refinancing, the lender will typically send an appraiser to evaluate your property in person and decide its current value.

That appraisal establishes your LTV percentage, which is used to determine your eligibility during the application process and the interest rate you'll receive if approved. In most cases, the lower your LTV, the better the interest rate.

## How a HELOC Works

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If you're in need of some supplemental cash, you may want to consider a home equity line of credit, which means borrowing against the equity in your property to secure a revolving line of credit. This open-ended borrowing option features a long draw period, where you can withdraw money as you need it.

What sets a HELOC apart from other types of loans? You pay interest only on the amount you withdraw. A HELOC works a lot like a credit card and has a set credit limit assigned. It offers convenience and flexibility, as you can access the funds at any time and only pay back what you use. You can pay down your balance, then use it again during that draw period.

Expect the application for a home equity line of credit to be similar to the home mortgage approval process — your annual income, debt-to-income ratio and credit score all play important roles. An appraisal determines your home's equity, another key factor in the HELOC application process.

### **Pay off your mortgage or fix up an investment property**

A HELOC could serve as a solid financing option if you've built up equity in your home and you want to use your HELOC to pay off your mortgage. To use a HELOC for this purpose, homeowners must build enough equity to cover the amount owed on the original home loan. Typically, a financial institution will lend up to 80% to 85% of a home's value.

Since HELOCs are secured loans, homeowners can expect lower interest rates than what they pay on a mortgage loan. Lower interest means more savings and potentially paying off the loan quicker.

You can also obtain a HELOC on an investment property. Consider using the money to improve the property's value or expand your real estate portfolio.

### **HELOC interest rates**

The vast majority of HELOCs come with variable interest rates. That means the rate fluctuates with overall economic conditions and baseline interest rates set by the Federal Reserve Board, also known as the Fed. The term of a HELOC can last up to 30 years, so fluctuation is almost certain. Variable rates offer a better option than loans with adjustable rates, which can increase significantly over time.

In recent years, more lenders have added an option with increased long-term stability: fixed rate HELOCs. When borrowers set up a fixed rate HELOC, they can lock in whatever interest rate the Fed and other economic variables dictate at that time. The lower the fixed rate, the more valuable it is as a shield against future increases.

However, it's important to remember that a fixed rate HELOC can also work against your financial best interests. For example, a fixed rate HELOC set up when Fed rates are high may prevent borrowers from benefitting when rates fall.

### **HELOCs**

Some lenders offer added flexibility with what they market as a fixed rate HELOC but could also be promoted as a hybrid HELOC.

Under the hybrid option, sometimes referred to as a convertible HELOC, a lender might allow a borrower to lock in a fixed rate for a particular draw or set of draws on the line of credit. This protects you from rate increases on outstanding debt, but it leaves future draws subject to interest rate fluctuations.

### Three potential HELOC advantages

- A HELOC offers flexibility, as this revolving line of credit can be accessed over time as needed.
- Borrowers can easily access the line of credit when they need it by using several convenient methods, such as a bank card, checks or online transfers.
- You can also use the funds for debt consolidation or unexpected expenses, like car repairs or medical bills.

### Three potential downsides of HELOCs

- It's a secured loan, meaning you're putting up your home as collateral. If you default on your debt by consistently missing payments, you could lose your home.
- Home equity lines of credit often come with variable rates, meaning interest rates can fluctuate with the U.S. prime rate.
- You're reducing the available equity in your home by securing a HELOC. When you borrow against your home, you're drawing from the total available equity. As you work toward paying off your mortgage, you'll slowly build equity back up. You should carefully consider spending HELOC funds on items like a luxury vacation as you may need that equity later to cover urgent, non-negotiable expenses.



## How Does a Home Equity Loan Differ from a HELOC?

As you research various borrowing options, you may wonder how a home equity loan compares to a HELOC.

Home equity loans provide a lump sum of cash for large, one-time investments instead of a little at a time. It's a fixed rate installment loan, versus the variable rate of a HELOC, where you receive the entire payment upfront. Unlike an open-ended HELOC, a home equity loan includes a fixed term with fixed monthly payments and a fixed maturity date.

Homeowners often use home equity loans to consolidate higher-interest debt. By reducing their interest rates, they can save thousands of dollars over the loan's term. And by combining their debts into one fixed monthly payment, borrowers can also simplify the process of managing and tracking their debt.

### How much money can I borrow with a home equity loan?

The amount of equity in your property determines the minimum and maximum amount of a home equity loan. For instance, if the appraised value of your home equals \$300,000 and you owe \$50,000 on the mortgage, your total home equity would total \$250,000.

Consider spending the funds from a home equity loan on large investments that are likely to yield positive returns, such as certain home improvements or further education. They can also help cover unexpected financial events, such as a medical emergency.

Much like qualifying for a mortgage or HELOC, expect to present lenders with various records when applying for a home equity loan including proof of employment, outstanding debt and assets owned.

### Top three benefits of a home equity loan:

- 1 Borrowers receive fixed rates with predictable monthly payments over a fixed term and receive the distribution in a lump sum.
- 2 Interest rates are lower than what's typically offered for unsecured loans, such as credit cards or personal loans.
- 3 A home equity loan does not change your current mortgage rate, and interest may qualify as a tax deduction. Consult your tax advisor to learn more about tax-deductible interest.

### Three potential downsides about home equity loans:

- 1 Since you use your home as collateral for a home equity loan, foreclosure is possible if you fail to make the monthly loan payments.
- 2 A home equity loan means taking on another payment each month if you're not using the lump sum to consolidate other outstanding debt.
- 3 It's important to honestly evaluate your spending habits and address any questionable financial decisions that may have contributed to debt accumulation in the first place, so you can avoid making the same budgetary mistakes in the future.

# Mortgage Refinancing Options

When interest rates are low, it could be an opportune time to consider refinancing your current mortgage loan to lock in a lower rate. That move could shorten the term of your loan and save you thousands of dollars in the long run.



## Cash-out refinancing

If you need extra money now and are looking to refinance your mortgage, a cash-out refinance could provide an attractive alternative to a traditional refinance by giving you access to a lump sum of cash at the same low, annual percentage interest rate. You could use the extra money to pay off a vehicle, personal credit loan or other sizable expenses.

Interest rates for a cash-out refinance are often higher than what's offered for a traditional refinance. But cash-out refinances sometimes offer flat-rate fees that are often significantly lower than the closing costs on a traditional mortgage.

Cash-out refinancing provides an alternative to a home equity loan, also known as a "second mortgage." That's because it's a lien on your home, like your existing mortgage. Before refinancing, make sure you understand how much in closing costs you'll owe, as each lender handles those fees differently and the total could rival what you paid at the initial mortgage closing.

If you don't qualify for a conventional cash-out refinance because of your credit score or income, you may want to see if you qualify for a Federal Housing Administration (FHA) or Veterans Affairs (VA) refinance loan. While these government-backed loans require borrowers to meet special eligibility requirements, they're an attractive, flexible lending option for those who qualify. Both types of loans offer cash-out refinancing options for those with enough equity built up, although it resets the mortgage term and means you'll pay more in interest over those extra years.

An FHA loan provides a good refinancing option for homeowners with limited equity in their existing home or for those with poor credit but comes with a higher interest rate than conventional refinancing and requires the added cost of private mortgage insurance (PMI). However, if you're a veteran or active member of the military, the VA refinance loan offers exceptionally competitive interest rates and requires no down payment.

Evaluate your savings situation and consult a home equity lending expert to see if cash-out refinancing or an alternative refinance loan makes sense for you.

## Traditional refinancing

If your home value holds steady or increases over time, you may want to consider refinancing your mortgage with a traditional refinance loan to lower your monthly payments or shorten the term of the mortgage, or both. The best time to refinance is when interest rates dip below your current mortgage rate.

By locking in a lower fixed rate, you can reduce your monthly payments and ultimately shorten the life of the mortgage loan, if you choose to do so, when refinancing. Unless you have enough available equity to make that happen, you may need to invest a down payment toward the loan to secure better terms. You can reset back to the original mortgage term, most commonly 15 or 30 years, or opt for a shorter term so you pay off the loan quicker and spend less money overall on interest.

Typically, the lowest-cost refinance loans available, conventional refinancing requires homeowners meet certain financial thresholds, such as a credit score above 620. To qualify for a traditional refinance, your home's current market value must be higher than your current home loan balance.

Some lenders also offer refinance loans with adjustable rates, which feature a lower interest rate and lower payments than comparable fixed-rate loans during the initial rate period. However, that rate can increase considerably as market conditions change and leave homeowners with an interest rate that's higher than the original mortgage loan's rate, raising the total amount of interest paid on the loan.

Evaluate your savings situation and consult a home equity expert to see if refinancing makes sense for you.

## How Do I Choose?

When evaluating all of the options for borrowing against your home equity, it comes down to timing and the amount you want to borrow. Base your decision on your purposes for financing and how long you think you'll need access to the funds.

### Ask yourself these three questions:

1

How long will I need to use the money?

2

What will I spend the money on?

3

How long will it take for me to pay it back?

# Applying for Home Equity Financing

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## Before submitting an application

Prior to applying for any type of home equity financing, you should first meet with a financial advisor to help you determine the best loan product based on your circumstances and goals.

We also recommend meeting with a financial advisor or an accountant to discuss the potential tax benefits of various home equity products. Interest on a HELOC or a home equity loan may be tax deductible if you use the funds for home improvements. To qualify, the money must be spent on the property that provided the equity to source the loan.

Homeowners are also encouraged to share with potential lenders their financial ambitions and what they hope to accomplish with the money, so their lender can suggest the best borrowing solutions for their particular situation.

## What does loan approval require?

To qualify for a HELOC, home equity loan or refinance, a homeowner must meet minimum standards including an acceptable personal credit score, home value and proven ability to repay debt.

Many banks offer an online application to get started. To ensure a smooth application process, prepare all required documents beforehand.

When applying for a loan or line of credit, you typically must provide the lender with complete income and employment documentation as well as any other pertinent debt and asset information. These records help determine which borrowing solutions you qualify for and your available rates and terms.

## Should I use the same lender that provided my mortgage?

Obviously, choosing the right lending institution to reach your financial goals proves pivotal to the process.

Many homeowners build trust with lenders who helped them in the past, which can give a customer peace of mind when seeking another loan with the same bank. Choosing the same lender can also be beneficial if documentation from a prior loan can be used to apply for a new loan, but this usually only applies when the timing of the two loans is fairly close.

However, homeowners should still examine all potential lending institutions to ensure they aren't missing out on a more appealing product offered by a different lender. Rates, terms and fees all vary by bank.

## How does the application process compare?

Compared to securing an initial home mortgage loan, the application process for a HELOC, home equity loan or cash-out refinance is relatively simple and often more affordable. Most HELOC and home equity loans require zero closing costs.

Unlike making a major purchase or buying a house, these three equity solutions don't involve third parties, so the process is only between you and your banker.

Applicants need to provide income documentation and have their home assessed for its current collateral value. Depending on the institution, you might need to submit other documentation as requested.

### What misconceptions about these loans exist?

These common misconceptions about HELOCs, home equity loans and home refinancing could impact which option you choose:

- Home equity lines of credit aren't just for home improvements. You can use the funds for a wide range of expenses.
- Many borrowers assume closing costs come as part of any home financing. Depending on the type of loan and the lender you select, you may pay little to no out-of-pocket expenses.
- Refinancing doesn't have to be a hassle. Some borrowers may assume they need to crunch numbers and handle paperwork on their own. Lenders can provide expert advice to help you navigate the process and ensure the greatest savings.

### How do bank lending practices differ?

Banks can differ significantly on the loan terms and interest rates they offer. Out-of-pocket fees also vary for each of these banking solutions.

Compare all three of these components when selecting a bank, so you can make a well-rounded comparison. Don't simply compare one aspect of the offer and overlook other valuable differences.

### Try these tips for evaluating potential lenders

- For referrals, ask friends, family or local real estate agents who keep tabs of your area's best mortgage lenders.
- Trim your list to the three best lenders, then research the interest rates, types of loans, loan terms and closing fees those banks offer. Compare all relevant information equally.
- Research the reputation of lenders, focusing on client satisfaction, dependability and the lender's financial history.

### If you're considering a HELOC...

- You secure a home equity line of credit using the equity you've built up in your home.
- Homeowners can borrow up to 80 to 90% of their home's equity.
- Benefits of a home equity line of credit include flexibility and low or no closing costs.

### If you're considering a home equity loan...

- Like a home equity line of credit, a home equity loan is secured by your home's equity.
- Unlike a home equity line of credit, you can't choose to withdraw only what you need. A home equity loan gets paid in a lump sum.
- A home equity loan allows you to borrow a specific amount for a set term. The loan amount generally equals a percentage of your home's equity.

### If you're considering a refinance...

- Mortgage refinancing can be easier to obtain than a home equity line of credit or a home equity loan, as it replaces the original mortgage loan.
- HELOCs and home equity loans are considered second mortgages, increasing your overall debt, while refinancing often serves to lower your debt burden.
- Cash-out refinancing can be used to consolidate debt, improve your credit score, increase your home's value or pay off major expenses.
- A borrower can take advantage of a cash-out refinancing's fixed, low-interest rates over the life of the mortgage loan.

### Four Key Takeaways

- 1 Make sure you understand how the loan works and the specific repayment terms. Also be sure to thoroughly compare multiple lenders' offers to ensure you're choosing the right solution for your needs.
- 2 Home equity continues to provide homeowners a popular avenue for accessing cash, using the value built in their home over the years and putting those funds toward more immediate needs.
- 3 The traditional mortgage refinance fluctuates in popularity, depending on interest rates and the real estate market. However, it will always provide an option for homeowners looking to lock in a lower fixed rate or reduce monthly mortgage payments.
- 4 Potential benefits of all three lending solutions include saving money in the long term, peace of mind, ease of access and convenience.

## How Do I Choose?

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### Home equity loan vs home equity line of credit

When compared to home equity loan, a home equity line of credit (HELOC) provides borrowers with an open-ended loan, or credit with no fixed end date, allowing borrowers to use as little or as much money as needed. A home equity loan, on the other hand, is an installment loan that issues the entire loan amount upfront with fixed-monthly payments.

HELOCs are better for borrowers who need access to money over an extended period of time, while home equity loans are better suited to borrowers who need to cover a sizable one-time expense.

### HELOC vs refinance

When compared to a HELOC, a refinance essentially means replacing a current mortgage with a new one that generally offers a lower interest rate, whereas a HELOC functions like a second mortgage.

HELOCs are best suited for borrowers who need access to cash over a period of time, while refinancing is an effective solution for homeowners who want to save on mortgage payments by securing a lower interest rate.

### Home equity loan vs refinance

When comparing a home equity loan to a refinance, it's important to note that a home equity loan provides a lump sum of cash by leveraging the value of the borrower's home. Refinancing is used to pay off the borrower's current mortgage in exchange for a new one, often at a lower interest rate. A cash-out refinance replaces an old mortgage with a loan amount that's higher than the original loan, providing the difference in cash to the borrower.



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