Should you tap into your home equity line of credit?

By Josephine Lim

1 Like 1 Tweet Email Link to story

There are many ways to access credit: credit cards, lines of credit, personal loans. Homeowners have another option: a home equity line of credit (HELOC), which allows you to tap into the appraised value of your home. But, like any other credit product, if you don't use and repay it responsibly, you'll find yourself in trouble.

HELOCs offer flexibility as a revolving, secured loan. New HELOC users can tap into 65 per cent of their home's appraised value, or 80 per cent if they combine a HELOC with a regular mortgage.

Since 1999, the use of HELOCs has risen significantly, especially during the recent recession. HELOC popularity is likely due to the fact that repayments and withdrawals are easy to make, according to the Bank of Canada's 2012 *Household Borrowing and Spending in Canada* report.

When's the right time to use a HELOC?

Because a HELOC is a loan secured by your house, the interest rate is lower than that of unsecured credit products, such as credit cards and lines of credit.

open in browser PRO version Are you a developer? Try out the HTML to PDF API pdfcrowd.com

You can access a HELOC for emergency funds or to extract equity from your home to grow your wealth faster, says Scott Plaskett, CEO and Senior Financial Planner, Ironshield Financial Planning. In fact, he suggests setting up a HELOC even if you don't plan to use it, because if you wait until you're in a cash crunch to apply, the bank probably won't give it to you.

"I encourage clients to set it up, not because I want them to use it, but so they have the availability of it should they want to use it in the future," Plaskett says. Of course, doing so may limit how much other credit you can get (since you would technically already have a large amount), but if you have the HELOC, you might not need other credit, anyway.

The first question you should ask yourself when considering a HELOC is what your objective is, and whether the HELOC is a solution to enhance your objective, Plaskett says. He says the best situation is when you invest the funds into something that'll be worth more than what you borrowed in the first place.

For example, if the house is paid off, but you need a new roof or some foundation work and don't have enough savings to do the work, that's a suitable situation for a HELOC, says Debbie Gillis, director of credit counselling with K3C Credit Counselling. It would allow you to get the funds without remortgaging the property.

Another example might be if your property is damaged and you're filing an insurance claim. Within the policy, you might be required to complete the work and provide proof before an insurance company will compensate you for the incident, says Gillis.

Homeowners also have the option of doing a debt flip, which is when you use a HELOC to create tax benefits, says Plaskett. For example, if you, the homeowner, have a $100,000 mortgage and $100,000 in investments, you can pay off the mortgage with your investments, then borrow that $100,000 back from a HELOC to put back into your investment portfolio. Your net worth will remain the same, but when you pay your mortgage, the interest is not tax deductible, while the interest on the investment is, which could allow you to pay less in taxes or reduce your chances of owing taxes at the end of the year.

Finally, you can use a HELOC to save on interest charges from other debt obligations. Credit cards, for example, typically have double-digit interest rates; the rate on a regular line of credit is usually the prime rate plus 5 per cent. A HELOC interest rate, on the other hand, is only the prime rate plus 0.5 per cent. You could pay off your high-interest cards and lines of credit with the HELOC and pay much lower interest overall.

open in browser PRO version Are you a developer? Try out the HTML to PDF API pdfcrowd.com

However, there are certainly wrong times to use a HELOC. For instance, you can use a HELOC to fund stocks, but Plaskett doesn't recommend it unless you're a sophisticated investor, as it's an aggressive, high-risk move. It can magnify your returns, but it can also magnify your losses, making it more difficult to break even.

And if you're using a HELOC for cash management rather than wealth accumulation, you're living beyond your means, Plaskett says. If you're not disciplined with your spending, a HELOC can make matters worse since you're increasing your debt obligations.

"If you have maxed it out, it can be difficult to bring it down," says Gillis. She's seen some HELOC users pay only the interest on their loan and nothing on the principal, then end up in a situation that requires strict repayment discipline on the user's behalf to pay down the debt.

"Remember, that's the equity in your house that you'll eventually want to have paid off some day," says Gillis. "It's not a revolving credit card."

Published: August 6, 2015

2015 creditcards.ca. All rights reserved.

open in browser PRO version Are you a developer? Try out the HTML to PDF API pdfcrowd.com