



# The Personal Perspective

## Personal Finance Issues You Need to Know

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### Reevaluating Home Equity Lines of Credit

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With low interest rates over the past few years, it is no wonder that everyone know about Home Equity Lines of Credit (HELOC). Given the booming increase in real estate prices, they come with low interest rates, easy payment terms, and check writing draw down capabilities, they are an ideal, worry free loan, RIGHT? Well, don't answer yes so fast. These loans can easily come back and bite us when we least expect it. Let's look at how.

**Those Low Balloon Payments:**  
HELOC's are structured as interest-only loans, so of course banks will offer them to you free of charge. Minimum payments are enticingly small, giving people a false sense of optimism in choosing them. Consider that the national average of a HELOC is \$36,427, that works out to about a \$200 monthly payment. The downside here is that you are not paying down any principal.

**Rising Interest Rates:**  
If you have a HELOC, then no doubt you have noticed that interest rates have been going up, and so has your payment. Over the past two years, the

prime rate, which is the predominant measure used for a HELOC, has increased from 4% to 6.25% (at the time of publication). This has increased the average payment by about \$70.

If rate hikes, continue, as many experts suggest, the trend will continue to increase, even though they would be in small increments.

**You Lose Your Equity:**

Given the dramatic increase in property values, most everyone agrees that at some point prices will contract. By how much no one really knows and subject to debate and speculation. The underlying premise around the HELOC is that when you sell your home, your loan will effectively disappear. Let's say you bought your house for \$400,000 but it was recently appraised for \$500,000. Sell and you'll make a nice profit; now throw in a \$75,000 HELOC balance into the equation and by the time you are done with all the fees and commissions from a sale, you'd be lucky to break even.



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**You Borrow and Overspend:**

No question that HELOC offer better rates than bank loans and credit cards and allow you to deduct the interest. But whether or not it is a good deal depends on how you use the money. Paying for home improvements, debt consolidation, and education are the most common use for a HELOC. If you're going to pull money out of your home, make it count! Simply using it to fund your lifestyle and standard of living is a recipe for disaster. Who wants to pay for a really nice vacation for many years to come...not me and nor should you.

**Follow These Four Simple Rules:**

1. Start paying off the principal in advance by exceeding your minimum payment each month.
2. If you expect to take more than three years to pay off your HELOC, use a fixed rate Home Equity Loan instead of a HELOC.
3. Leave yourself an equity cushion of at least 20% for market fluctuations
4. Finally, if the outlook for your HELOC is longer than three years, consider a Home Equity Loan, which offers more flexibility.

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