explains Kathy Ripp, CUNA Credit Union financial service representative.

They prefer a home equity loan: a lump-sum second mortgage, typically with a fixed rate and repayment period of five to 15 years. “Home equity loans are appropriate if you need a set amount for a specific purpose and aren’t looking for a future draw,” Ripp says.

In her book, “Making the Most of Your Money” (ISBN 0671659529), financial columnist Jane Bryant Quinn suggests you fit your payment schedule to the purchase: Pay off a debt consolidation loan in a year and a half, an auto loan in three to four years, and a home improvement loan in seven.

While ORNL Federal offers a 10-year repayment on its home equity loans, members typically opt for five years. “Most members are very conservative when it comes to borrowing against their houses,” ORNL Federal’s Glenn says. “They want access to the equity, but they want to pay it off as soon as possible.”

While there may be lucrative benefits to using the equity in your house to finance big-ticket items, Quinn emphasizes you should do so only if you:

- Can comfortably afford the larger mortgage;
- Are sure of your income, or have other assets you can use to repay the loan if your income drops; and
- Expect the investment—education, home improvements, buying property or stocks—to yield more than your loan costs.

Debtor’s top reasons for being delinquent—for all credit—are other financial obligations, unemployment, and reduced income, according to *USA Today*. The last thing anyone wants is to put their house at risk during uncertain financial times, something that’s an issue for bank regulators today.

The risk

A former Comptroller of the Currency issued warnings about lax bank lending policies as a result of a survey of federal examiners for the nation’s 40 largest federally chartered banks. The survey said, “Banks are allowing borrowers to post less collateral, pay smaller initial fees, and spread their repayments over more years, particularly for home equity loans.” Federal Reserve Chairman Alan Greenspan also warned banks that lending standards are slipping and consumers are overextending themselves.

“We won’t put our members at risk,” says CUNA Credit Union’s Ripp. Delinquencies on home equity loans and lines of credit are very low at credit unions.

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Home Equity Loans

Put Your House to Work

If you're thinking about sprucing up your house or buying a new car, consider a home equity loan. The National Realtors Association reports the value of existing family homes rose last year. And home equity lending makes sense for homeowners who refinanced at the beginning of the last decade, opting for shorter loan terms to build equity faster.

You can deduct home equity interest on loans up to $100,000 (consult your tax adviser; some limitations apply). That may be one reason home equity credit now represents more than half of all consumer credit, according to a survey the Center for Financial Services Studies at the McIntire School of Commerce at the University of Virginia conducted for the Consumer Bankers Association.

When you figure in the tax deduction, the rate on a home equity loan—typically favorable to begin with—is even better. For example, the after-tax rate for someone in the 25% tax bracket is 4.2% on a 5.5% home equity loan. You'd be hard-pressed to find a better rate than that on a conventional loan even at a credit union.

Your savings may be offset somewhat by fees. Because your house serves as collateral, you may be looking at an appraisal fee, title search or insurance fee, recording fee to record the lien on the title, credit report fee, flood determination fee, and an application fee. And some lenders charge annual fees and transaction fees on home equity lines of credit.

According to a survey conducted by LendingTree, the most popular uses for home equity loans in 2004 were home improvement (38%), debt consolidation (32%), home purchase (5%), auto purchase (4%), college tuition (3%), and small-business expenses (2%).

You can tap the equity in your home via a home equity line of credit (open-end credit) or a loan (closed-end credit).

The line of credit

A home equity line of credit, like a credit card, gives you a predetermined borrowing limit and allows you to access money when you need it.

A home's equity—the amount your house is worth that's more than your housing loans, both mortgage and equity—determines the credit line. While the industry standard is up to 80% loan-to-value, more lenders are offering 100% home equity lines of credit.

"Borrowing against the equity of your home is one of the smartest ways to borrow money."

"Borrowing against the equity of your home is one of the smartest ways to borrow money if the interest is tax deductible for you. It's best if you can leave some equity in your home, however, 100% home equity loans are very common," says Kim Sponem, president and CEO of CUNA Credit Union in Madison, Wis.

Members also need to understand interest-only equity lines of credit, says Tom Minor, vice president of real estate lending for Commonwealth Credit Union in Kankakee, Ill. "Some lenders are making interest-only home equity loans. So after five or seven years of making payments, borrowers may end up with a $20,000 loan balance when the note comes due. With that kind of a balance, most have to refinance the loan."

Members also should be wise to teaser rates, says Bob Glenn, senior vice president of loan administration, ORNL Federal Credit Union in Oak Ridge, Tenn. "In our area, competitors offer low teaser rates for the first six months and then bump rates to prime plus three," he explains. "Or they'll advertise one home equity line of credit rate, not noting that rates increase as loan-to-value increases."

Home equity lines may offer shorter repayment periods—typically five years—than fixed-rate home equity loans, which often go out as many as 15 years. This typically increases monthly payments. Members unable to afford the higher payment with the line of credit may find fixed-rate home equity loan payments more manageable. The trade-off is higher total interest expense.

Because of the draw option, credit lines are good for recurring expenses such as college tuition. Generally, the minimum withdrawal on a home equity line of credit is $300 to $500.

"A line of credit offers members convenient, easy access to their money when they need it," Glenn says.

The loan

Still, some people just don't want a line of credit on their homes. "Some members aren't comfortable with the line of credit because it's too accessible,"