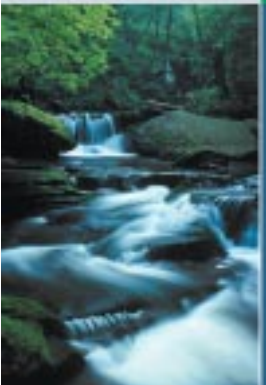


## What You Need to Know Before You Refinance Your Home to Pay Off Debts

Consolidating your debt with the equity in your home can be a terrific money-saving strategy. The interest rate may be much lower than you're paying on your other bills and, if you itemize on your tax return, you can usually deduct the interest you pay – making the effective rate of the loan even more attractive.



► Myvesta is a nonprofit consumer education organization. We provide a wide range of educational materials to assist those in financial need. Visit us on the Web at [Myvesta.org](http://Myvesta.org).



*But what seems like a smart strategy can turn into a tragedy — even resulting in the loss of your home — if you're not careful.*

Here's how to make a debt consolidation loan work for you.

First, get an idea of how much equity you have in your home. While a lender will want to get an appraisal of your property before approving a loan, you can do your homework by talking to a couple of local real estate professionals who can give you a ballpark estimate of your home's value based on comparable home sales in your area. (Be aware: a real estate professional may quote a high price, in an effort to get you to list a sale with her.)

You'll also want to get a copy of your credit report to make sure everything is up-to-date and accurate, and to make sure you are aware of any problems that may cost you more in terms of the interest rate or fees.

Since a mortgage lender will review a copy of your report from all three major credit reporting agencies, you should do the same. You can get a consolidated credit report from Myvesta.org.

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Once you have information on your home's value and your credit situation, you can consider whether a home equity loan or refinancing your

mortgage makes more sense. Here are the pros and cons of each:

### **Tapping Home Equity:**

With a home equity *loan*, you borrow a fixed, lump sum amount and pay it off in equal payments. With a home equity *line of credit*, you borrow up to the total amount for which you are approved, whenever you need it. As you pay down the loan, that money you paid

off will again become available for you to use. Either type of loan can be referred to as a "second mortgage." Approval is often quick — a couple of weeks at most — depending on how busy lenders are.

Some lenders will allow you to only borrow up to a total of 80 percent of the appraised value of your home, minus any amount you owe on your first mortgage. Other lenders, however, will allow you to borrow 100 percent or more of your home's value, minus your first mortgage. (You may pay a higher interest rate or fees for these higher "loan-to-value" loans.)

Although any amount above the value of your home is technically unsecured, we urge you strongly not to borrow to the hilt against your home. If any unforeseen circumstances come up, forcing you to sell your home, you may be unable to command the price you need to pay off your loans and may face foreclosure.

### **Refinancing:**

Another popular option with many consumers is to refinance their first mortgage and take cash out to pay off other bills.

For example, let's say your home is worth \$150,000 and your mortgage balance is \$80,000. You may be able to refinance that \$80,000 loan with a loan for \$120,000 (or more) and use the difference to pay off your other debts. (Forget about taking a vacation with some of your mortgage money, though. That's going just a little too far.)

The main attraction in going this route is that you may be able to get a lower payment and interest rate than with your current debts, or even a home equity loan. That's because, in most cases, you're stretching the debt out for 30 years.

The downside is that by refinancing your mortgage, it will take you longer to pay off your house and it may be more expensive in

the long run than you realize. That's because you'll essentially be starting over again with your mortgage.

If you currently have 24 more years of payments on your mortgage, for example, you'll now add six more years to that. By the time they've paid for their mortgage, most people have paid for their house two or three times over! So think carefully before you stretch out your house payments.

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If you are considering refinancing to include your debt and your new loan will total more than 80 percent of your home's value, you may be required to pay private mortgage insurance, or PMI. This can easily add \$100 or more to your monthly payment and it is not tax deductible. So, even with a lower interest rate on the refinanced loan, you may pay more. Be sure to consider PMI and the total cost of your loan when you are weighing your options.

*The biggest drawback to using a home equity loan or a new mortgage to pay off debt is the added risk you take if you can't make the payments.*

If you can't make your payments on your credit cards, your account will be turned over to collections, and (much later) you may eventually be sued for repayment of these debts.

If you miss a few mortgage or home equity loan payments, however, you could literally lose your house. Please think carefully before taking that risk.

## Other Alternatives

Before you put up your home as collateral for your loans, think about your options.

- ▶ Can you consolidate your debt onto a low-interest credit card?

- ▶ Will your local bank or credit union give you a low interest rate, unsecured debt consolidation loan?
- ▶ Do you have cash value in your life insurance policy you can leverage to pay off debt?
- ▶ Have you tracked your expenses to find places where you can cut back?

The more desperate you are to get a loan, the easier it is to make poor choices.

When interest rates are attractive, many people rush to borrow or refinance. Think carefully of the implications to ensure you make the most of all your options

## About Myvesta...

Myvesta<sup>sm</sup> is dedicated to helping people create healthy financial lives. The organization provides a wide range of materials to inspire and inform people so they can break down their barriers to financial and personal success. For more information visit [Myvesta.org](http://Myvesta.org) online.

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