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How Do You Repay a Home Equity Loan?

Taking out a home equity loan can be a great way to take pull out some much needed cash. Maybe your project is debt consolidation, or maybe it is time to finally remodel the kitchen. Or perhaps you could really use some help in financing your child's college tuition. Whatever the reason, your home may be one of the best resources for getting a good deal on a loan. Before you jump head first into a home equity loan or home equity line of credit (HELOC), you need to consider how you are going to be able to repay this loan in addition to your original mortgage.

A home equity loan means borrowing against the portion of the home that you already own. You can determine the amount of equity you have by subtracting the amount you still own on your mortgage from the value or current market price of the home. Lenders will let you create a new loan, using your house as collateral, and let you borrow up to a certain percentage of your equity. You can get this money upfront with a home equity loan, or you can withdraw it like you would from a checking account, with a home equity line of credit.

There are several options that you have in terms of repaying this 'second mortgage.' Typically mortgage lenders allow for repayment over a period of between five and fifteen years. With a home equity loan, the interest rate is generally fixed and your repayment scheduled will be fully amortized. This means that you will repay a part of the interest and principal with each monthly payment and at the end of the term you will have completely paid off the balance.

HELOCs usually come as adjustable rate mortgages (ARMs.) This means that your interest rate is subject to change over the course of the loan. Sometimes lenders will allow you to make interest-only payments, meaning you only pay the interest due on the loan that month, not any part of the principal. While this will save you money on monthly payments, it s not decreasing your loan balance at all. When the interest-only period is up, you will have much larger payments to make.

Some ARMs also allow for you to make monthly payments that are even less than the interest due. In this case your balance actually increases each month, even though you are making payments. At the end of the loan term, you will have a sizeable amount left to pay, often called a balloon payment. If you decide to go this route, you will enjoy very low payments, but you must be prepared to come up with a chunk of several thousand dollars at the end of the loan term.

Of course it you do make feasible repayment plans and are unable to make the balloon payment at the end, you may risk losing your home. In this situation you may be forced to refinance into a new loan to cover the balance of your home equity loan, or in a worst case scenario, you may have to try to sell your home in order to pay off that second mortgage. Home equity loans can still be a very helpful financial move; the key is to be prepared with a viable repayment strategy before you sign the paperwork!

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