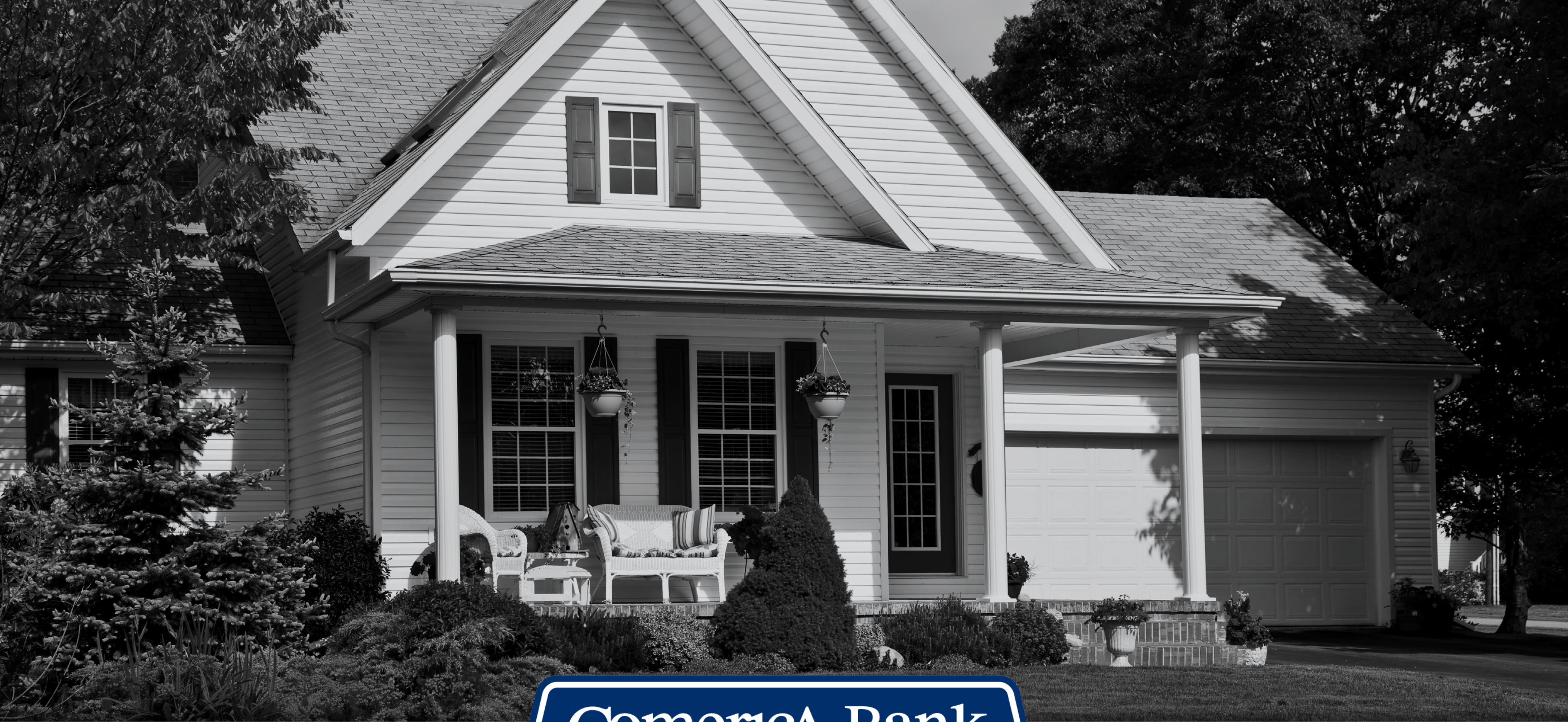

4 Smart Ways to Use a HELOC

Contents

Introduction

A home equity line of credit is a versatile account for homeowners. As with a credit card, homeowners can draw from their HELOC and use the funds to pay for various expenses. However, in this case, your credit limit is based on the equity you have built in your home.

Traditionally, financial institutions will offer customers access to 80-85% of the home equity they hold, which is the house appraisal value minus the outstanding mortgage amount. With current HELOC rates, homeowners may find such home equity financing more advantageous in terms of interest rates and tax considerations.

But since your home is the collateral securing your line of credit, it is imperative you be smart about the way you use a HELOC. Here are four ways to do that.

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1. Make home improvements

Many homeowners choose to maximize a HELOC through renovations to their house. A bathroom remodel, a bedroom addition or energy-efficient upgrade could be a wise use of a HELOC for a couple of reasons:

- It improves the livability of a home, which may be needed to modernize with the times or accommodate certain family needs.
- It may increase the value of the home, which you could profit from if you plan to sell the property later on.
- It matters during tax season when the interest you pay on HELOC funds may be deducted up to a certain amount.

In fact, home-related expenses are the only time when interest on such debt may be deductible. The Tax Cuts and Jobs Act of 2017 not only reduced the deduction — from interest on up to $1 million in home equity debt to $750,000 — but restricted its availability to only situations in which a HELOC is "used to buy, build or substantially improve the taxpayer's home that secures the loan," according to the IRS.

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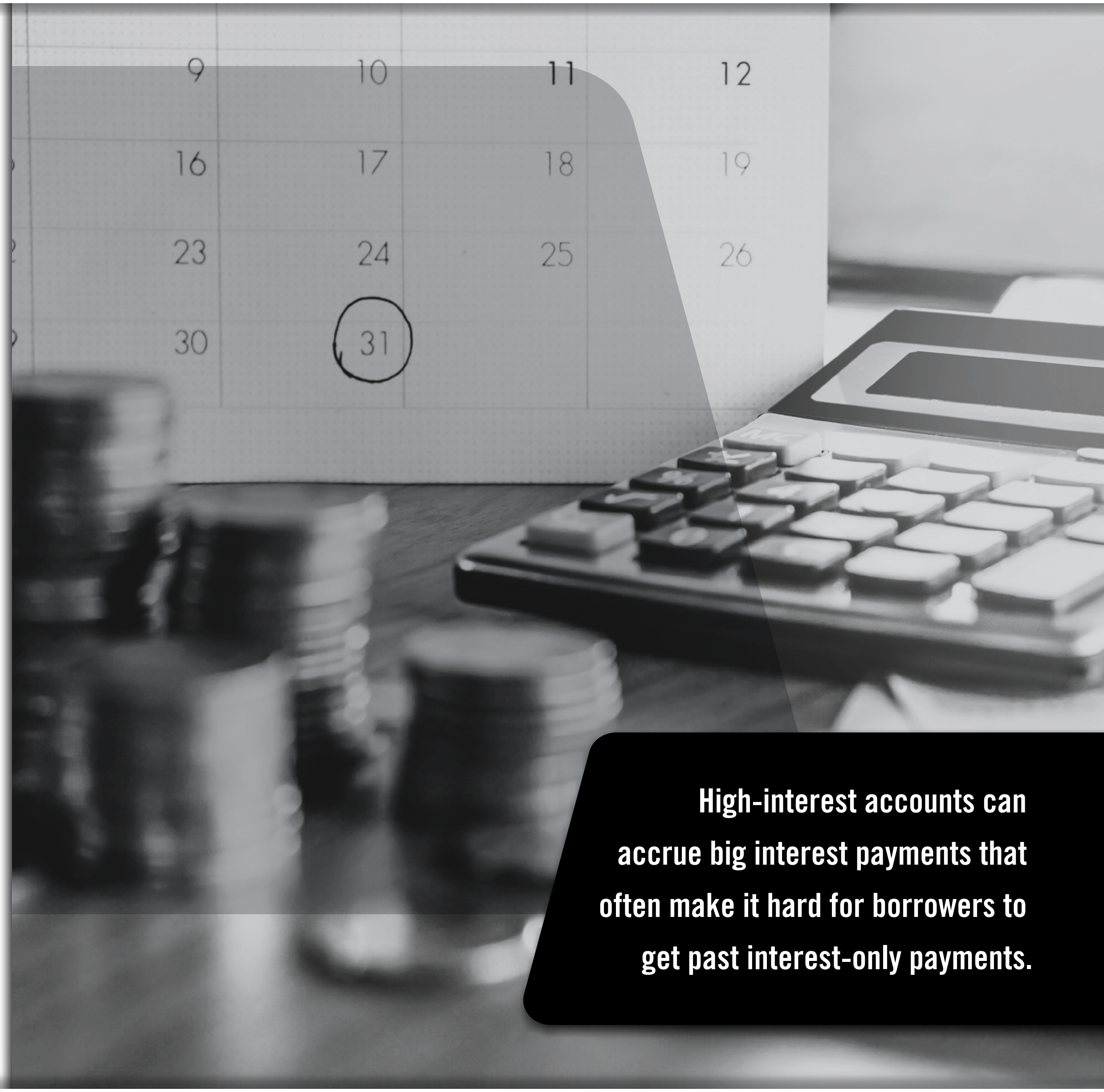
2. Pay down high-interest debts

While you cannot deduct interest on HELOC draws used for anything other than a home, there are still situations in which the financing makes sense. Current HELOC rate trends mean homeowners with substantial equity can access lower interest rates when compared to credit card options.

If you have high-interest debts, using a HELOC to chip away at the outstanding premium may make sense by simplifying your payments and reducing your interest expenses. High-interest accounts can accrue big interest payments that often make it hard for borrowers to get past interest-only payments. A low-interest-rate HELOC can replace some of that debt and at the least cost you the same in the near term, but generate significant savings in the long term.



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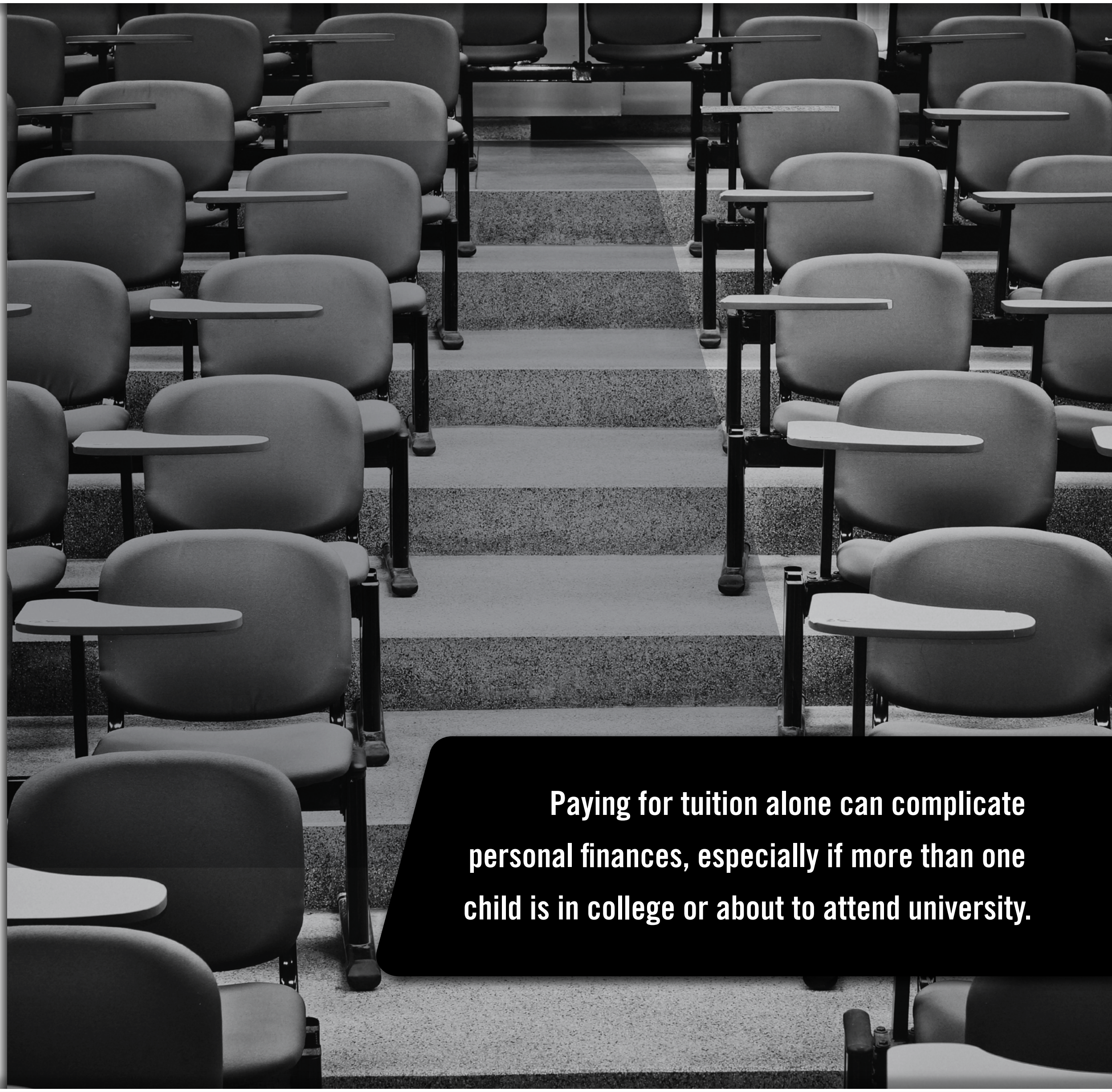
3. Defray the cost of college

Higher education is getting increasingly expensive. Paying for tuition alone can complicate personal finances, especially if more than one child is in college or about to attend university. Room and board, textbooks, technology, meal plans and other expenses can further inflate the cost.

Many turn to student loans to pay for higher education, but a HELOC may lessen the cost burden, predominantly through lower interest rates. One strategy is to draw from the HELOC to meet tuition costs, and then pay that sum back over the length of the credit line's repayment period.

It is important to not over leverage a HELOC in paying for education. Student loans have grace periods and certain protections (if government loans), but defaulting on a HELOC could put your home at risk.



4. Create an emergency savings fund

Sometimes the best way to use HELOC funds is not at all. Having a home equity line of credit open and ready to draw from can help households stay prepared. A 2018 Bankrate® survey found just 39% of Americans could cover a $1,000 expense.

Saving HELOC balances to be used for a rainy day could make good financial sense. HELOCs offer low upfront costs and can provide much-needed liquidity. Instead of having to fret to meet an immediate and large cost, homeowners can leverage their HELOC's draw period – often 10 years – to serve as a standby in case of emergency.

It is an inventive use of a HELOC, but going through the application and qualifying process beforehand means you can get cash quicker and when you need it.

HELOCs offer low upfront costs and can provide much-needed liquidity.

Conclusion

There are smart uses for a HELOC, but there are also unwise ways to use HELOC funds. One-time purchases, such as appliances or entertainment systems, that only depreciate can be risky when your home is securing that debt.

When used correctly, a HELOC can provide homeowners with liquidly, comparatively low interest rates and potentially even tax benefits.

Want to learn more about how a home equity line of credit works or whether one is right for you? Contact the experts at Comerica Bank to get more knowledge and advice.

Sources:

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