

Your House Isn't the Cash Cow It Once Was

Home-equity loans have gotten riskier as home prices fall.

By Suzanne Barlyn December 19, 2007

Do you think of your home as a potential cash cow?

That's how many Americans viewed their homes in recent years, borrowing substantial amounts from their equity as values rose. But incurring significant home-equity debt may no longer seem like a good idea to those borrowers, now that values have declined in a stagnant real estate market.

The U.S. Census Bureau estimates that 68.2% of Americans own their homes. But the amount of equity in those homes dipped to 50.4% in the third quarter of 2007 -- the lowest level on record, according to the **Federal Reserve**.

"Everyone and their mothers are in over their heads," says Scott Reinhart, an Atlanta-based mortgage loan consultant for Lenox Financial.

Reinhart says he fields five to 10 calls daily from cash-strapped homeowners whose mortgages are nearly 100% of their home values. "They can't afford their payments, and there's nothing we can do to help them," he says. Lenders generally won't refinance properties with such high levels of debt.

We asked financial experts what homeowners should consider before borrowing from their equity in the present declining market, and what they should know about the equity line they may already have. Here's what advisers say:

Get an appraisal: Borrowing without knowing your home's value is like selling stock without knowing how many shares you own or how much they're worth. You can find an appraiser through the Web site of several industry organizations, such as the American Society of Appraisers in Chicago.

You'll need an appraisal to apply for a loan anyway, but you may not always see the report -- or be aware of your home's appraised value -- if a lender makes the arrangements for you, says Reinhart. Obtaining your own appraisal -- which generally costs about \$300 -- gives you a firm idea of the home's value before you begin the borrowing process. You'll also get a document that you can present to different lenders as you're shopping around for rates, he says.

An appraisal differs from the free market valuation services a realtor provides. An appraiser is certified in valuation techniques by a national organization and examines factors that don't necessarily impact sales appeal, such as a foundation crack, says Reinhart.

Wait out the urge and think through future expenses: "I would simply stay away from home equity unless the need is imminent," says Cicily Maton, owner of Aequus Wealth Management, a Chicago financial planning firm. Maton suggests that homeowners review their debt and spending first. "You have to be exactly aware of what you can afford. There's a great deal of readers who don't know where their money goes," says Maton.

She recommends thinking through the potential future expenses that can accompany home improvements or buying a larger house, such as increased utility or maintenance bills. "People get into an emotional state about what they think they love -- but they don't consider how much more a month it may end up costing to update a kitchen," she says.

Think about the purpose of your loan: "Too often, people use their home equity as an ATM machine. They run up credit card debt on items with short usage or life spans, such as meals or a computer," then borrow against their homes to pay off the cards, explains Brett Wilder, president and chief executive of The Financial Management Group in Cincinnati, and author of [The Quiet Millionaire](#).

He suggests trying to match the loan's purpose to the length of time for its repayment. That's what Dallas-area resident Jim Parker did when he applied for a 15-year fixed-rate home equity loan at 6.5% five years ago to finance the construction of his pool -- a backyard amenity that's common in Texas. Rates were at historic lows, so Parker wanted to lock in, he says. "I'm not planning to apply for another loan and am cash-flow positive," he says.

Cut back: People don't always want to hear the age-old financial planning advice that you should analyze your income and expenses of the past six months, says Ira Marks, a Lawrenceville, N.J.-based certified financial planner and CPA. But he says it's a necessary first step toward climbing out of -- or preventing -- a financial mess.

"People have certain expenses that they will not touch no matter how bad it gets, so sometimes it's difficult to advise clients that they're spending too much on something," Marks says.

Marks recommends looking for budget alternatives that can generate extra monthly cash, such as switching from whole life to term insurance and forgoing the future cash value. "But the key is that people first have to understand what they're spending money on before they borrow," he says.

Consider short-term debt alternatives: Homeowners in need of a short-term cash infusion may want to borrow from other sources, such as a family loan, says Steven T. Merkel, a certified financial planner and vice president with Financial Advisory Consultants in Naples, Fla.

A zero-percent credit card deal can help with seasonal purchases, such as Christmas presents, he says. Numerous lenders, including **Discover Financial Services (DFS)** and **American Express (AXP)**, are presently offering zero-percent deals on some cards. However, the strategy is advisable only for homeowners who can pay off the debt before the promotional rate expires and becomes higher than the rate on the equity loan, Merkel says.

Homeowners who are contemplating paying down their loan to recoup equity that has diminished as home values decline should compare what they owe, and interest rates, with other debts they may be carrying, such as credit cards.

That's because interest on home equity loans is tax deductible, in most cases, unlike interest incurred on other loans. "If you can still get the deduction on your home equity line and the rate is fair, you may think about paying off other debts first instead," says Merkel. "The rate

on an average credit card is usually higher."