Think it's Time to Tap Your HELOC for an Investment? Get Some Advice First

Any bank or mortgage broker who wants to loan you money for a home equity line knows it's in their best interest to lend right up to your credit limit. They make more money that way. Yet just because you qualify for a home equity line doesn't mean you need to use it, particularly as a bank for investment purposes.

Quite a few things need to go your way for you to use your home equity line effectively. There's plenty of risk in plowing loan money into investments that may suddenly lose their value if they mirror the Dow's drop over recent weeks. While home equity loan interest rates may cost you less than borrowing from your investment brokerage firm by purchasing investments in a margin account, you still need to be very careful.

To borrow home equity effectively, you need stable interest rates and rising home values that go with a strong economy. Remember that mortgage professionals are not investment professionals or financial planners – that's why they'll always encourage you to borrow if you have the flexibility to do so. For balanced advice, you should consult financial planner.

In all honesty, most planners would tell you that if you need to borrow from home equity, you may not be in the strongest financial position to make an investment in the first place.

It makes sense to go over a few home equity borrowing basics. There are two primary kinds of home equity debt. A *home equity loan* is a one-time, lump sum that is paid off over a particular amount of time with a fixed rate and number of payments. A *home equity line of credit* (also known as a HELOC), works more like a credit card because it has a revolving balance – interest is due on the outstanding balance and that rate may vary over time.

Here are the things you should discuss with a trusted financial adviser before you tap home equity to put in real estate, securities or any other form of investment.

- Will your investment deliver a greater after-tax return than you'll be paying for the loan on an after-tax basis?
- Does your home equity loan or line carry an adjustable rate? If so, a jump in interest rates may make what you owe even more expensive and further offset any gains you make in your investment. If rates fall, it's good news, but given current conditions, it makes sense to be cautious.
- How much is your property appreciating each year in your neighborhood on average? Is it enough to further offset the cost of your investment? Keep in mind that no one is predicting the type of double-digit property appreciation we saw before 2004.
- How will this loan work for you from a tax perspective? Keep in mind that home equity loans over $100,000 are generally not tax-deductible.

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- What if you need your home equity borrowing power later for an emergency (the real reason most of us should open a home equity line and then avoid using it)? Could you handle that emergency if your borrowing was strained to the maximum?
- How liquid is this investment? If you had a sudden major expense or lost your job, could you turn it into cash without major hardship?
- How are your other debts? Do you have significant balances on credit card or auto debt? That may raise the rate you pay on your loan – another potential cut in your investment profit potential. As long as you can deduct the interest, you might just be better off consolidating and paying off debt rather than taking a flyer on an investment.
- How close are you to retirement? From a cash flow perspective, will you be able to handle the loan payments assuming your investment using the home-equity funds doesn't work out?

Home equity is a good option for many important financial goals, but you have to balance risk against potential reward. In most cases, it is always good to hold home equity in reserve for a *real* rainy day.

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