



Borrow at a lower rate with a home equity line of credit

Once you own a home and have built up some equity in it, you may be eligible for a home equity line of credit. Essentially, that's a line of credit secured by your home for a specified maximum amount.

The bank will lend you a percentage of the appraised value of your home, and you can use the credit as you see fit, provided that you make regular minimum interest payments. People use home equity lines of credit to fund everything from home renovations to their children's education.

The key advantage of this kind of credit is that it generally comes with a much lower interest rate than you could get with an unsecured line of credit, a personal loan or a credit card. It's a reasonably inexpensive way to borrow money.

HOW IT WORKS

According to Canadian regulations, a primary mortgage combined with a home equity loan on any given residence generally can't exceed 75 per cent of the home's market value. You can borrow up to 95 per cent, but you would then be required to purchase high-ratio insurance (from the Canadian Mortgage and Housing Corporation or GE Capital). So if your house is currently worth \$400,000 and you have a \$200,000 mortgage remaining, the maximum home equity loan you can have is \$100,000. (That's 75 per cent of \$400,000, less the \$200,000 you still owe.)

Now that you understand how the plain and simple version works, here's a novel twist.

"These traditional home equity lines of credit have spawned a second generation," says David Dobbin, product director of mortgage products with Manulife Bank. "Today's home equity lines of credit can incorporate your mortgage, so your borrowing room increases as you pay down your principal. What's more, it can also function as a full banking account. That is,





all of your income is deposited into your line of credit, and works to pay off the debt.”

Essentially, your mortgage is one big line of credit and you can pay it off as quickly as you like. These types of accounts provide you with monthly statements, chequing privileges, online banking and debit cards. All of your income is deposited into the same single account, reducing the amount you owe with every deposit. Rather than making regular fixed mortgage payments, the difference between your income and your monthly expenses is your payment. The only requirement is that you must pay at least the interest owing each month.

“For people who have any money left over at the end of the month, this is one way to pay a mortgage off much more quickly, since their paycheques work to reduce the amount of the loan – and the associated interest – from the day they’re deposited,” says Dobbin. “Plus they get the flexibility of credit to use as needed.”

And, says Dobbin, once the debt is gone, the account continues to offer an attractive interest rate on any positive balance.

HOW MUCH INTEREST WILL YOU PAY?

The chart below shows you how inexpensive it may be to use a home equity line of credit compared to an unsecured line of credit or a credit card. If you borrow \$10,000 and pay it back over five years, here’s how the interest you pay will stack up:

Type of loan	Monthly payments	Interest paid over 5 years
Home equity line of credit (4%)	\$ 184.17	\$ 1,049.91
Unsecured line of credit (7.5%)	\$ 200.38	\$ 2,022.77
Credit card (18%)	\$ 253.93	\$ 5,236.06

So, if you are looking for payment flexibility, lower interest costs, and the ability to borrow back whatever you’ve paid down, a home equity line of credit may be the best option.

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