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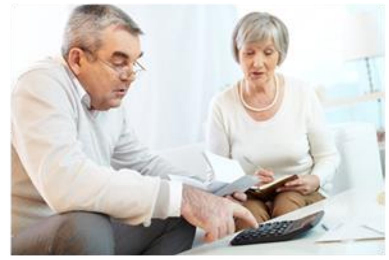

Getting the low-down on a home equity line of credit

A home renovation. A new car. That dream vacation. Investing to build your wealth. Consolidating your debts. There are a lot of credit options out there today for financing any of these things. One way to do it is with a home equity line of credit (HELOC). It's a secure line of credit for which your home is the collateral.

A HELOC is different from a home equity loan. With a loan, you get a single lump-sum amount that can be up to 80 per cent of your home's value. And you have to pay back the principal and interest on a fixed payment schedule.

Unlike a loan, a HELOC is revolving credit (similar to your credit card) with no fixed repayment. And you only pay interest on the money you use. Your credit limit depends on the purchase price or market value of your home. The maximum limit is 65 per cent of either.

Here's an overview of how HELOCs work.

HELOC with mortgage

There are two kinds of HELOCs. First, there's a HELOC combined with a fixed-term, amortized mortgage. The idea is that you finance your home purchase partly with the HELOC, and partly with the mortgage. You must have a minimum of 20 per cent for a down payment or in equity. The mortgage portion is often called a readvanceable mortgage. These mortgages have different brand names depending on the financial institution you deal with. The interest rate is usually based on the prime rate.

While there's no fixed repayment on the HELOC portion, there is on the mortgage amount. You have to make regularly scheduled payments on both the principal and interest.

You can combine this HELOC with other credit and loans, so you have a single payment. For example, you may be able to consolidate a car loan and a business loan into your HELOC and set up sub-accounts for them within it.

Standalone HELOC

The second kind of HELOC is a standalone one. You can use it as a mortgage substitute, but there's a higher down payment or equity required. It must be a minimum of 35 per cent. When you use the HELOC as a mortgage, you can pay back as much as you want when you want, with no prepayment penalties.

Uses and getting approved

How you use your HELOC is entirely up to you. It's a good financial option for managing unexpected expenses (a major car repair or funeral expenses that must be paid in full up front, for example); consolidating your debts or investing.

Getting approved for a HELOC is a one-time deal. Once you're approved, you can use the credit line whenever you want. There are several things involved in approval. You must have:

- A decent credit rating
- Proof of regular, stable income
- An acceptable debt ratio – debt shouldn't be more than 36 per cent of your income

If you already own your home and are applying for a HELOC, there are some additional requirements. You must:

- Have proof of home ownership
- Provide mortgage details – the balance owing and the amortization period
- Have the lender do a property value assessment
- Get a lawyer (a notary in Quebec) to register your home as collateral

HELOC fees

Getting approved for a HELOC doesn't come free. There are some fees involved:

- A home valuation by the lender is required – you'll be charged for it
- Legal fees for registering your home as collateral
- The financial institution charges credit-line administration fees
- You'll also have to pay a fee when the line of credit is discharged or cancelled

Weigh HELOC pros and cons

Talking with a professional financial advisor can help you decide whether a HELOC is the best option for your financial interests. HELOCs have both pros and cons.

First the pros:

- It's easily available credit
- Interest rates are lower than they are on loans
- You pay back only the interest on money used
- There are no prepayment penalties if you want to make lump-sum repayments any time
- There's a lot of flexibility in a HELOC
- It's a good way to consolidate debt

But, be aware of the cons. The main one – no fixed repayments – is both a pro and a con. It means you must have a lot of self-discipline in making regular payments back into the credit line. Otherwise, you're just depleting your account.

Another big thing to consider: HELOCs have higher credit limits than other credit. This means it can get very easy to spend more – which could keep you in debt longer.

Finally, remember your home is collateral for the line of credit. If you default, the bank can take your home regardless of whether you work out a payment plan with the institution.

Plan and talk before you decide

Is a HELOC right for you? Only you know. You have to figure out whether you need more credit for your financial interests, or whether a loan might be better. If you do decide on a HELOC, figure out a budget. That way, you'll know how much credit you need. (Do you really need the full 65 per cent of your home's value?).

And of course, you don't have to take out a HELOC with the first lender who offers you one. Shop around institutions for the best deal for you.

Talking with a professional financial advisor can help you make the best decision about a HELOC.

This is just an overview of HELOCs to help you increase your financial savvy about them. An advisor can help you understand all the details of HELOCs. The Financial Consumer Agency of Canada also has more detailed information about HELOCs.