Cash-Out Refinacing

Cash-out refinacing is a kind of financial option, where you convert your home's equity to cash. You renegotiate the mortgage payments, by getting a new mortgage with better outcomes; lower interest rates, suitable time period and lower monthly costs.

Your house is used as collateral, meaning that you can get a new loan (mortgage) with your house as the security. Refinancing like this provides you with cash that you can use for bigger expenses, such as college costs, emergency fees, etc.

The lender usually assesses your mortgage’s current terms, credit profile and the balance to clear off the previous loans. Then, he or she gives you a new offer. Through this new offer, your mortgage payments will be paid in installments.

Normally, the refinancement does not provide you with any cash. You just notice the decrease in monthly mortgage costs, however in the cash-out refinancement, you do get funds — with mobility to spend as you like. Mostly, it is used for emergency purposes.

This does decrease your home’s equity. Which increases the risk that the lender has to deal with. As a result of this, the interest rates, closing costs and fees are higher than standard.

Home Equity Line of Credit (HELOC)

HELOC is a kind of loan that you can tap into for a specific time period. It’s like a credit card but for houses. If you want to draw money but are unsure how much it should be then HELOC is great for you. The way it works is that you have a specific time period called “the draw period” which is 10 years, where you can draw money — till a limit, from your line of credit.

HELOC has lower interest rates than some other types of home loans. And you only have to pay interest for money that you withdrew, rather than the approved loan.

You have to make minimum monthly payments to continue using HELOC. Usually, these payments are just for the interest rates that have accumulated. The money that you pay cycles back to the line of credit which you can use again.

After the drawing period is over, the repayment period begins which is 10-20 years. There you have to repay all the debt back and you can’t draw anymore from the

HELOC. At this point, your monthly payments start to increase because of the principal plus interest.

Different factors such as the equity of your house, the debt you have, and the credit score all play a role in your approval for HELOC. The equity should be kept at least 20% of the house, 620 credit score (minimum) and the debt-to-income ratio (DTI) of 43% or less.

Home Equity Loan

Home equity loan is a second mortgage that offers you a lump sum of cash that you borrow against your equity of the house. Unlike cash-out refinancing, home equity loan do not replace your old mortgage. Instead you have to pay this second mortgage along with the previous one.

Most lenders require that you keep at least 20% of the house equity to secure a home equity loan and most lenders allow you to 80% of your home’s equity for the loan. If you wish to calculate your home’s equity, then simply subtract the value of the home from the mortgage.