

HELOC – An Ignored Financial Planning Tool

By: Matthew D. Kelly, CFP®

June 2019

When reviewing your financial picture, an important question to answer honestly is whether you're maximizing productivity. Many times, we hear rules of thumb which we purely take as fact and words to live by. Like most things, however, when it comes to finances, the right path hinges on your unique situation.

We've all heard some iteration of the saying, "keep six months of living expenses at the bank for emergencies." This statement shouldn't be construed as bad advice, and it would be irresponsible to simply dismiss it; however, it could be slowing you down. Enter the home equity line of credit – or HELOC.

Ins and Outs

To understand how it can be helpful, we first must learn the basic mechanics. A HELOC is a revolving line of credit rooted in the equity of your home. In other words, it's a credit card secured against your house. Some typical terms we see from our local bank contacts include:

- Lend up to 90% of home equity
- Interest variable at/around the Prime rate (5.50% as of May 2019)
- Interest only charged if borrowed against
- Minimal (if any) costs to establish
- Borrowing period of 7-10 years
- Payment is interest-only during the borrowing period (no required principal payments)
- Interest is tax deductible if used to "buy, build, or substantially improve" the home

Rethinking the Emergency Fund

So how can this help you? Once in place, the HELOC serves as your emergency fund; this, in turn, gives you the flexibility to either invest excess savings, pay down debt, or both. It's all about tradeoffs. If your savings account at the bank is earning 1.5% and you have a car loan that's costing you 3%, you're doubling your return with every dollar that you apply to the loan. Alternatively, if you invest those funds for conservative growth, you could potentially quadruple your return.

The economics of this strategy is straight forward. The application, however, requires that behaviorally you're comfortable with keeping less at the bank. If it's adding mental stress where none existed prior, it's not worth it.

Avoiding Contingency

Another benefit and one which many will gravitate towards is utilizing the HELOC as a bridge loan, specifically, when



changing residences. Many families don't have a substantial after-tax investment account to assist in a move. Their most significant assets are retirement accounts and their homes—neither of which are ideal. The home (as an asset) is illiquid, and retirement accounts come with strings attached such as taxes, penalties, and hampering future tax-deferred (or free) growth. Instead, many families will find themselves in dreaded contingency.

Contingency is the obligation to find a buyer of your current home in order to purchase your new home. If the buyer backs out or is unqualified for any reason, you may be unable to secure financing for the desired home's down payment—potentially missing out on your dream home. Having a HELOC alleviates this pressure. It allows you to borrow against your house to make a down payment in cash and avoid contingency altogether. The HELOC debt will be repaid when the home is sold.

When most people hear about establishing a home equity line of credit, they cringe. They believe it entails borrowing against their home which they've been diligently trying to pay off. Utilizing a HELOC in the ways outlined above is anything but that. It's leveraging one of your greatest assets to your advantage and increasing the tools at your disposal. It's also expanding flexibility, thereby allowing you to increase productivity.

There are many other applications of the HELOC. Reach out to a CERTIFIED FINANCIAL PLANNER™ to determine whether this strategy could be a good fit for you and your family.

