Demming Financial Services Corp.

Borrowing from Your Home's Equity

Home equity lines of credit are the most consistently low-cost way to borrow money. HELCOs are contingent upon net equity in one's home, less any primary mortgage. They can be up to 80-100% of available equity in a home. Interest is generally tax-deductible up to $100,000, with extensions for utilizing the funds for home improvements or investment purposes. However, tax deductibility will be reduced if a borrower is subject to the Alternative Minimum Tax.

Interest rates can vary. Thus, as the prime lending rate fluctuates, so does the actual cost of the loan. We recommend prime minus 1% with prime minus ½% also an acceptable cost of borrowing.

For example, with today's prime rate of 7.75% minus the 1% the interest rate is 6.75%. A borrower can pay interest at that rate, plus any principle payment they choose. Thus, a $50,000 home equity line would cost 563% per month (6.75% divided by 12 months), or $281.25, of interest alone, with any larger payment applied to principal.

The higher one's marginal tax rate, the lower the effective cost of borrowing. To illustrate:

1. If a borrower were in the 25% tax bracket, the annual cost would lower to 5.063% net after tax, assuming one could itemize. [6.75% minus the 25% tax benefit (or 1.687%) equals 5.063%]
2. Similarly, for a borrower in the 35% tax bracket, the annual cost would lower to 4.388% net after tax, assuming itemization.

The bottom line is that home equity lines of credit are the most consistently low-cost way to finance short-term cash needs, including car purchases.