WALLET WISDOM

Victor Brock

Homeowners can tap into rising home equity

Homeowners are in luck: Many Hawaii home values have risen over the past few years and are continuing to trend upward. That means many people may have a lot of equity in their homes.

Those interested in tapping that equity may have heard troubling news the Tax Cuts and Jobs Act of 2017 no longer allows homeowners to deduct interest on home equity loans and home equity lines of credit (HELOCs).

However, that's not quite the case. The IRS recently issued an advisory that clarifies the rules for deducting interest on home-equity products used to buy, build or substantially improve their residence.

Rising interest rates

In the past few months, mortgage rates have climbed from about 3.5 to 4.5 percent, and many expect rates to keep rising. Not surprisingly, mortgage refinancing is slowing way down. If you have a lower interest rate, it may not make sense to refinance your entire balance into a higher interest rate. Tapping into your equity using home-equity financing may make more sense.

Rising mortgage rates coupled with low inventory could make homeowners think twice about upgrading to a new home. Homeowners may find it makes more sense to stay where they are and make improvements to their current residence. Experts are seeing more homeowners turn to HELOCs to fund these renovations.

Return of the HELOC

HELOCs began rebounding from the housing-market crash in 2011, and have grown in popularity since. TransUnion estimates 1.6 million HELOCs will be started in 2018.

A HELOC may allow for greater flexibility than refinancing or home-equity loans. A HELOC provides you with a set credit limit against which you can borrow over a period of time. The length of the time varies based on the terms of your loan.

Plus, a HELOC offers you the flexibility to reborrow the amount that you paid back while still within this time known as the draw period. You can borrow what you need and only pay interest on the portion of the loan that you use.

Most HELOCs have a variable interest rate, which fluctuates over time. Some lenders, such as Hawaii State FCU, allow borrowers to "fix" the rate on a portion or all of their line balances, which protects them from rising interest rates. Check with your lender to see if this option is available.

Tax advantages of HELOCs

While the 2017 tax reform law placed some limitations on tax deductions related to HELOCs, there are still a few benefits to take advantage of. Talk with your tax consultant before opening a HELOC.

In order to take a tax deduction on HELOC debt, the money must be used to buy, build, or make substantial home improvements or renovations. Homeowners should keep records of how their funds are used to maximize tax benefits.

Because interest rates on HELOCs are typically lower than other types of financing, they may be the best way to fund other needs, such as educational expenses or vehicle purchases, or to consolidate higher-interest debt.

HELOCs can be a smart solution for homeowners flush with equity who are looking to add value to their home and to minimize their overall interest expense. But remember to borrow responsibly when using your home as collateral.

Victor Brock is senior vice president, Consumer and Mortgage Lending, at Hawaii State FCU.