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# When to Use Home Equity and When Not To

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With home prices rising (http://www.houselogic.com/news/home-thoughts/more-us-homes-selling-even-though-prices-rise/) in most areas of the country, a lot of us are building home equity again. And when equity builds, it's tempting to tap it.

Used wisely, home equity can send your kids to college or launch a business. But there's a real risk to using home equity loans (http://www.houselogic.com/home-advice/equity-loans/drawbacks-home-equity-loans/) - they can make you more susceptible to foreclosure.

A recent Federal Reserve study found 30% of Los Angeles homeowners who lost their houses during the foreclosure (http://www.houselogic.com/home-advice/facing-foreclosure/facing-foreclosure-what-do-right-now/) crisis wouldn't have defaulted had they not cashed out their home equity (http://www.houselogic.com/home-advice/equity-loans/home-equity-line-tips/).

The researchers said borrowing against your home equity (http://www.houselogic.com/home-advice/equity-loans/equity-loan-options/)

causes problems for a few reasons:

•Your payments go up (if your total mortgage gets bigger).

•If home prices fall, you have less equity to lose. That might make you more tempted to walk away from your home.

•If you're hit by a financial whammy, your financial cushion is thinner.

**When to Use Home Equity**

Despite that Federal Reserve study, home equity can be a smart tool when you want to build family wealth. During the past two decades, I've repeatedly used home equity to buy and renovate rental properties (http://www.houselogic.com/home-advice/taxes-incentives/should-i-rent-or-sell-my-house/). When the value of a rental property rises, you can refinance, pull cash out, and buy another rental property - although with credit so tight, that's been tougher to do lately.

**Related**: There's no surer way to wealth than home ownership (http://www.houselogic.com/blog/why-home-ownership-matters/facebook-ipo-home-equity/).

During part of those same two decades, my husband worked as a loan officer. A lot of his clients repeatedly refinanced to pull equity from their homes to pay off credit card bills. Although I enjoyed the income those deals created for my family, I think his clients were foolhardy for financing clothes and dinners into years of home loan payments.

Thinking about cashing out your home equity to buy something? Answering two questions can tell you if you're unnecessarily putting your home at risk:

**Question #1: Is the item you plan to buy with your equity going to go up in value (appreciate) or lose value after you buy it (depreciate)?**

If it's an appreciating asset, it makes sense to use home equity to buy it. You're buying something with a future payoff. Things I would put into the appreciating asset category:

•Training or education (It makes you more valuable in the workplace.)

•Buying rental real estate (http://www.houselogic.com/home-advice/home-thoughts/how-rent-your-home/)

•Improving your home (Check the cost vs. value (http://www.houselogic.com/home-topics/cost-v-value/) of certain remodeling projects.)

•Starting or buying a business (if you're ready to gamble your house on its success)

If it's a depreciating asset, don't use home equity to buy it. Things I would put into the depreciating asset category:

•Anything you eat

•Stuff you wear

•Most vehicles

•My husband's Harley (although he'll argue it holds its value)

**Question #2: Will you still be using the item 10 years from now?**

Whatever you're buying should last at least as long as your payments.

There are probably some items of clothing that you could arguably still be wearing 10 years from now, say, Frye boots. I might believe you'll still be driving a car 10 years from now. My 8-year-old Subaru Legacy wagon is still going strong. But, there are two reasons you're better off with an auto loan than a home equity line (http://www.houselogic.com/home-advice/equity-loans/home-equity-line-tips/), even though you'll probably pay a higher interest rate on a car loan.

The length of your car loan is going to match the lifespan of your car (unless you own my car, in which case your car will keep going long after you pay off the loan).

If an adverse life event causes you to crash and burn financially and you can't make the car loan payment, the bank will repossess your car. If you pay for the car with a home equity line and fail to make the payment, you could lose your home.

Now that I've completely bummed you out thinking about your car being repossessed, let me share with you one last great motivation to avoid spending your home equity:

When you grow old and can't take care of yourself anymore, your kids can sell your house and use that equity to put you in a beautiful nursing home. Spend it all now and you're going to end up having to move in with them.

*What's your take on equity loans? What have you financed with the funds?*