Learn How to Get the Best Home Improvement Loan for Your Fixer-Upper

Description

You acquired a house a few years ago and have been doing some minor renovations. It's now time to tackle a major update. All of the original pipes must be replaced, and the plumber's estimate is shockingly high.

Ideally, you'd have enough money in a savings account to pay the expense of this pricey project without incurring additional debt. But that isn't always the case, especially when it comes to house repairs, which can be unexpected and quite costly.

A personal loan for home improvements could be the answer. Even if your lender does not clearly include a home improvement loan among the loans they provide, you may typically identify home repairs or renovation as the reason you are applying for a personal loan.

How do home improvement loans work?

The basic answer is that a home renovation loan functions similarly to any other unsecured personal loan. Because you did not put up any collateral to qualify, the lender is taking a higher risk by agreeing to front you the sum.

Your obligation under the agreement is to repay the borrowed money, plus interest, within a certain time frame. Read the tiny print, because some loans marketed as home renovation loans actually require the borrower to put up collateral, such as your home, which could be taken away if you are unable to repay the loan.

The lengthier answer is that any big financial decisions can have an impact on your total budget and financial strategy, so it's critical to weigh every financing option against your objectives, including your real estate objectives. Begin by asking your realtor or financial counselor the following questions:

How long do you intend to stay at the house? Is the project going to increase the house's value?

Should you design your dream place in your existing home or save up and do it later in your "forever home"?

If you decide that now is the time to start this project (or if the decision is made for you and a costly repair is required, whether you like it or not), keep these home renovation loan benefits and drawbacks in mind.

• Advantage: Usually no collateral. If you are unable to repay the loan, you will not be required to pledge collateral (your home or other assets) to obtain loan payback.

• Disadvantage: Higher credentials. Based on the lender's precise needs, a good credit score and a favorable credit history will make you more appealing. If you have bad credit, you may be denied a personal loan for home improvement.

• Advantage: Quick funding. If you are authorized, the money might be in your bank account within 24 hours (this is variable by a lender.)

• Disadvantage: Higher interest rates. Although the majority of unsecured personal loans have set annual percentage rates (APRs), they are often higher than other home improvement loans. Remember that the lender bears the majority of the risk in this transaction. Thus a higher APR helps ensure that they can recuperate at least some of their investment.

• Advantage: Making use of unspent monies. Lenders frequently offer personal loans in fixed increments and will decide how much to authorize based on your credit score and financial history. If you are accepted for a loan that is greater than the cost of your home improvement project, you might utilize the surplus to pay off the debt that may have a higher interest rate than the loan itself.

• Disadvantage: incurring debt. In the first place, can you afford a monthly loan payment? Before you apply, consider your financial situation. What you don't want is for this extra expense to become overwhelming. Even if your home is not in danger of foreclosure, your credit history may suffer if you fail to repay the loan.

Other types of home improvement loans

If a personal loan does not sound like the best home renovation loan for your financial position, you may be able to find other types of home improvement financing. The terms of each of these three loans are determined by home equity — the market value of the home less the amount still outstanding on the mortgage.

1. Home equity loan (also known as a second mortgage)

This is a secured loan, and the asset you're putting up as security is your home. You can apply for a loan for the precise cost of your home improvement project, up to a certain proportion of the amount of equity you've placed into the house. (Different lenders' terms and conditions will vary, and some states limit the amount of equity you can borrow.)

In Texas, for example, you may be allowed to borrow up to 80% of your property's value, combining your principal mortgage and home equity loan. So, if your house is worth $250,000, the total amount borrowed, including your primary mortgage and the home equity loan, cannot exceed $200,000.

If you are approved, you will receive the loan amount as a lump sum and will then begin repaying it with interest (typically a fixed APR). Because you put up collateral, your interest rate will be lower than if you took out an unsecured personal loan; nevertheless, if you fail to repay the loan, the lender may try to repossess your property.

2. Home equity line of credit (HELOC)

This is also a secured loan, with your home as security. The primary distinction is that this loan functions similarly to a credit card in that there is a defined limit, you can access the line of credit as needed, and you will only begin paying it back when you use it. Another distinction is that the interest rate on HELOCs is variable, so the amount you pay back might fluctuate depending on market conditions. Again, if you are unable to make these payments and default on loan, the lender may repossess your home.

3. Cash-out refinancing

This is when you take a part of the equity in your house and use it to pay for your home improvement project. In other words, you're taking out a new mortgage that is greater than your current one and then cashing out the difference.

Pay particular attention to the timing of this choice – if possible, try to do it while interest rates are lower than your current mortgage rate, as a cash-out refinance needs the entire current mortgage to be refinanced, so the overall financial impact could be large if rates are higher. If this is the case, you should probably look into other possibilities.

Depending on the lender, each of these alternatives may come with fees and closing costs that you must factor into your decision. Calculate which sort of home improvement financing will provide you with the finances you require to finish your project without jeopardizing your other financial goals.

Category

1. Finance

Date Created
December 2022
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