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What to Know Before Doing a Cash-Out Refinancing on Your Home

Check the costs and estimate monthly payments to see if you can afford the new mortgage's terms

BY LORI IOANNOU

Note

U.S. HOMEOWNERS are sitting on an average of nearly $300,000 in home equity, according to the Federal Reserve, and many are deciding it's time to put some of that money to use.

One increasingly popular way to tap that wealth is through a cash-out refinancing. These loans are up 13% year-over-year and are expected to account for more than 40% of all mortgage refinancings in 2026, according to the Federal Housing Finance Agency.

Note

In a cash-out refi, an existing mortgage is replaced with a larger mortgage at a new interest rate—often extending the repayment term by several years. The new loan pays off the existing mortgage balance, and the homeowner receives the difference between the new and old mortgage amount as a lump sum of cash at closing.

"For consumers who need a large sum of money to consolidate debt, pay for college, do renovations to improve their home's value, or launch a business, borrowing against their home at the current cash-out refinance rates is a much cheaper option than personal loans and credit cards," says Bill Banfield, chief business officer at Rocket Mortgage.

Yet while a cash-out refi may sound tempting, it's important to calculate if it's worth it—especially if the new mortgage rate will be higher than your existing rate.

How it works

To qualify for a cash-out refi, homeowners typically must have at least 20% home equity, have owned the home for at least six months and have a credit score of 620 or higher, say mortgage lenders.

Consider this example for a homeowner whose house is valued at $600,000 and has a remaining mortgage balance of $300,000, leaving $300,000 in equity. For a cash-out refi, the loan amount is typically limited to 80% of the home's appraised value—meaning the homeowner must leave at least 20% of the home's value untouched.

So, in this example, that means the homeowner would need to keep $120,000 of equity intact, but could take out a maximum of $480,000 (80% of $600,000) minus the $300,000 payoff of the first loan balance, leaving the homeowner with $180,000 in cash—less closing costs.

These products are commonly fixed-rate loans with 15- and 30year repayment terms, although lenders offer a variety of products including adjustable-rate cash-out refinancings and hybrid cash-out refinancings that provide an initial period of a low fixed-rate interest rate often for five to seven years, followed by an adjustable-rate mortgage.

And they are offered at much lower rates than personal loans and credit cards. The average 30year fixed cash-out refinance rate on Aug. 3 was 6.91% for a 30-year mortgage and 6.27% for a 15-year fixed cash-out refinance respectively, Bankrate reports. That compares to the average personal loan interest rate of 12.41%.

"The rate you get will depend on your credit rating, the amount of equity you own, and the type of home you are refinancing," says Keith Kampe, home lending manager at Flagstar Bank. "Generally, you get better terms if you are refinancing your primary residence, own a lot of home equity and have a high credit rating."

There could also be tax benefits with a cash-out refinance if you use the money for capital home improvements. Interest on the cash-out amount is tax deductible if you use the funds to buy, build or improve your primary or second home, according to mortgage bankers.

Note

Do the math

Be aware this type of loan has its downsides. “The biggest risk is taking on too much debt and then defaulting on the loan,” says Erik Schmitt, managing director and head of consumer home lending at JPMorgan Chase. “A cash-out refinance is a secured loan that uses your home as collateral. That means if you default on the loan, the lender can foreclose on the property.”

When reviewing this loan option be sure to estimate your monthly payments to determine if you can afford this increased debt burden, say mortgage bankers. “As a rule of thumb your debt-to-income ratio needs to be 45% or less,” says Kampe.

Note

For example, if you had an annual salary of $85,000, 45% of that would be $38,250 a year, which breaks down to $3,187.50 per month. That means that would be the maximum amount of debt you should take on including the cash-out refinance.

There are also closing costs and other fees to consider when doing a cash-out refi. These can range from 2% to 6% of the total loan amount depending on state and local transfer taxes, title search and insurance costs, required escrow reserves and legal fees, according to Bankrate. These can be taken out of your total loan amount at closing or rolled into the loan if you don't want to write a check at closing.

If you need the cash quickly, check to see how long the process will take. A cash-out refinance can be as fast as seven days or as long as 45 days depending on the lender and how quickly you provide the documentation, says Schmitt.

Keep in mind there are other ways to tap home equity, say mortgage lenders. For example, if you don't want to reset your existing low mortgage rate you can opt for a home-equity line of credit. It is a revolving, open line of credit with a set limit that you can draw from as needed. Unlike a cash-out refinance, these lines of credit generally have higher variable rates tied to the prime rate. *Lori Ioannou is a writer in New York. She can be reached at* reports@wsj.com.

