

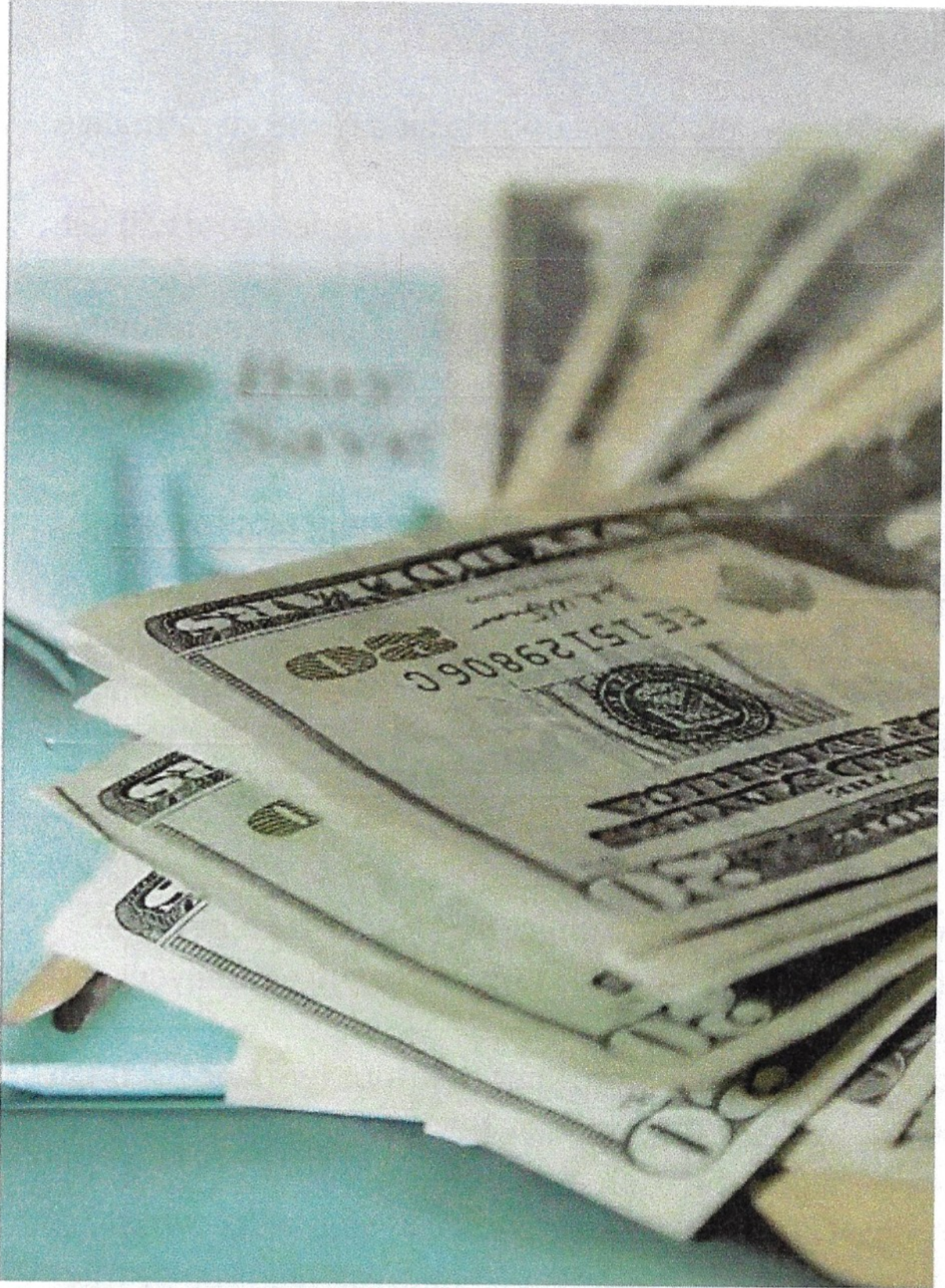
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Here's what to know about a cash-out refinance

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A cash-out refinance replaces your current mortgage with a new, larger one. It includes the remaining balance of your original loan plus an additional amount that you'll withdraw in cash. This cash comes from your home's equity.



You'll receive the cash in a lump-sum payment. You can use this money for any purpose, including home remodeling, debt consolidation, college tuition or other financial needs.

How does a cash-out refinance work?

A cash-out refi is similar to a regular refi (also called a "rate-and-term" refi). You'll replace your existing mortgage with a new one at a new interest rate, and sometimes a new term length. The difference is

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that your new loan is for a larger amount, rather than just the remaining balance of your original loan. That larger amount includes cash withdrawn from your home's equity. In other words, when you use a cashout refinance, you exchange some of your home's equity for cash. This reduces the equity you have in your home.

Cash-out refi example

Let's say you still owe \$100,000 on your home, and it's currently worth \$400,000. That means you have \$300,000 in equity. For a cash-out refinance, your loan amount is typically limited to 80% of the home's value — meaning you must leave at least 20% of your home's value untouched. So in this example, that means you'd need to keep \$80,000 of your equity intact, but you could take out \$220,000. If you want to withdraw the maximum amount, you'd take out a new mortgage for \$220,000, which you'd repay at a new interest rate and, potentially, a different term.

Cash-out refinance requirements

Just as you would with any mortgage, you'll need to meet qualifying criteria for a cash-out refinance.

For a conventional loan, these requirements include:

- Credit score: You'll generally need a credit score of at least 620 to qualify. But a higher score will get you a more competitive interest rate.
- Debt-to-income (DTI) ratio: This measures your monthly debt payments — including the refinanced mortgage payment — against your gross monthly income. Lenders often cap this at 43%.
- Equity: Most lenders require you to maintain 20% equity in your home after you've taken cash out, so you'll need more equity than that to make a cashout refinance worthwhile.
- Seasoning: Conventional cash-out refis typically come with a six-month seasoning requirement, meaning you must have owned the home for at least six months.

Cash-out refinance fees

The closing costs on a cash-out refinance — and any type of refinance — are almost always less than the closing costs on a home purchase. For a cashout refi, the lender typically charges an appraisal fee and might charge an origination fee, often a percentage of the amount you're borrowing.

How to get a cash-out refinance

Here are the basic steps to secure a cash-out refi:

- Determine how much you can withdraw: You'll do this by calculating 80% of your current home value, or multiplying the figure by 0.80. Then subtract your current mortgage balance from your result. The answer is the amount you may be able to cash out.
- Figure out your goals: Clarify how you'd like to use the funds from your cash-out refinance. A financial adviser can help you decide if a refinance would help you meet your financial goals and if the new payment would be affordable.
- Shop around for the best terms: Each lender has its own qualifying criteria, as well as its own set of closing costs and fees. Comparing rates and terms from a few different lenders can help you get the best deal available.
- Apply for the loan: Once you've chosen a lender, apply and go through its underwriting process. Be ready to provide proof of income, like financial statements and tax returns. Keep in mind that, as part of this process, your home will need to be professionally appraised. The mortgage lender needs to

know what your home is worth to calculate how much equity you have, and from that, how much you can borrow.

- Close on the loan: After the closing, you'll receive the lump sum of cash from your new lender.

How much cash can you get with a cash-out refinance?

With a conventional cash-out refinance — the most common kind — you can typically borrow up to 80% of your home's value. However, this threshold varies depending on the property type. With a multifamily home, for example, you can often only borrow up to 75%.

For an FHA cash-out refinance, you might be eligible to borrow up to 80% of the value of your home.

And with a VA loan cash-out, you could potentially qualify to tap all of your home's equity.

Ways to use the money from a cash-out refinance

You can use the money from a cashout refinance for almost any purpose. However, many borrowers use the proceeds for expenses such as:

- Major home improvement projects: You could use a cash-out refinance to remodel your kitchen or put an addition on your house, for example.

- High-interest debt consolidation: Refinance rates tend to be lower than the rates on other forms of debt, like credit cards. You can use a cash-out refinance to pay off these debts. Then you'll repay the cash-out refinance with one, lower-cost monthly payment.

- College tuition: Tapping home equity to pay for college can make sense if the refinance rate is lower than the rate for a student loan.

- Investments: Some people purchase an investment property using a cashout refinance. Others use the funds for goals like starting a business.

This type of refinancing is one of the cheaper ways to pay for large expenses, in part because the collateral involved — your home — translates to lower risk for lenders. In a pinch, you're far more likely to pay your mortgage than your credit card bill, for instance.

Pros and cons of cash-out refinancing

Pros

- Could qualify for better terms: If market rates have decreased — or your finances have improved — since you first took out your mortgage, a cash-out refinance could result in lower rates.

- Lowering your cost to borrow: Cashout refinances often have lower rates than home equity loans, personal loans and credit cards.

- Improving your credit: If you use your equity to consolidate debt, your credit utilization ratio — the amount of your outstanding balances compared to your overall credit limits — could drop. This can help boost your credit score.

- Taking advantage of tax deductions: If you use the cashed-out funds for home improvements and itemize your taxes, you could deduct the interest. Cons

- Your interest rate might actually go up: If interest rates have risen substantially since your original mortgage,

you'll pay more on your new loan, even with good credit. Since the new mortgage is bigger, you'll be charged more in interest, too.

- You could prolong repayments: If you're using a cash-out refi to consolidate debt, make sure it's the best option and that you couldn't otherwise pay the debt off sooner for less. "Unless you can lower your

interest rate or shorten your loan term, it may be more practical to consider a home equity loan or line of credit for smaller or more specific borrowing needs,” says Stephen Kates, financial analyst for Bankrate.

- You increase the risk of losing your home: A cashout refinance increases your mortgage balance. Failing to repay the loan means you could lose your home to foreclosure. Don't take out more cash than you really need, and make sure you're using it for a purpose that will improve your finances instead of worsening your situation.

Is a cash-out refinance a good idea for you?

Ultimately, it depends on your personal situation. You might benefit from a cash-out refi if:

- You can qualify for a lower rate: If mortgage rates have decreased since you first took out your loan, or your credit has improved — or both — you may be able to get a lower rate when you refinance. If so, a cash-out refinance might make more sense than other methods of tapping your home equity.

- You need the funds to improve your long-term financial outlook: A cash-out refinance can be a good idea if you're using the money to build wealth, for example, by adding value to your home or by funding your education.

On the other hand, even if you can qualify for and afford a cash-out refinance, it's not ideal if you need to borrow a relatively small amount of money or if you don't use the money to build wealth — for example, if you use it to pay off credit card debt, but then accumulate more.

Alternatives to a cash-out refinance

If a cash-out refi doesn't work for you, here are some alternatives to consider.

- HELOC: A home equity line of credit, or HELOC, allows you to borrow money when you need to with a revolving line of credit, similar to a credit card. HELOC interest rates are variable, fluctuating with the prime rate. To get a HELOC, you must meet certain requirements.

- Home equity loan: A home equity loan is a second mortgage that provides a lump-sum payment. Unlike a HELOC, home equity loans have a fixed rate, and you start repaying them immediately.

Bankrate's home equity loan calculator can show you how much you might be able to borrow.

- Personal loan: A personal loan is a shorter-term loan that provides funds for virtually any purpose. Personal loan interest rates vary widely and can depend on your credit, but they're typically higher than rates for loans that are secured by your home. You'll usually repay the loan on a monthly basis, like a mortgage. Personal loans often require less paperwork than a refinance and can sometimes be approved and funded the same day you apply, but they tend to have smaller limits than other loan types.

- Reverse mortgage: A reverse mortgage allows homeowners who meet equity and age requirements to withdraw cash from their homes. The balance doesn't have to be repaid for as long as the borrower lives in and maintains the home and pays their property taxes and homeowners insurance.

FAQ

- How will my monthly mortgage payment change after refinancing? Your payment could change depending on a couple of factors: the rate you receive and how much equity you're pulling out. If you're refinancing to a much lower rate, you could end up with a similar payment, even with taking on a larger loan. Conversely, if the rate is similar to or higher than your current one, your payment will go up. Your payment could also increase if you shorten the loan term — from 30 years to 15 years, for example.

• Does cash-out refinancing hurt your credit? It might. A cash-out refinance can hurt your credit score because you will owe more money, which impacts your credit utilization ratio, one of the biggest contributors to your overall credit score. Opening a new loan also shortens your average credit account age, which can lower your credit score.

