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Home Equity Mortgage vs. Refinance Home Loan: Interest Rates

There are great resources available for homeowners who need extra funds for important projects. These include using the home as collateral for either home equity mortgages or refinance home loans. Both of these loans can be very useful in financing things like debt consolidation, home improvement, or college tuition. Home equity mortgages allow homeowners to borrow funds up to 85% of their existing equity, and sometimes even up to 125%. Refinance home loans create an entirely new loan to pay off the original mortgage loan plus some, in order to pull out the extra sum at the loan's closing. Which one is best for you however, will depend on several factors, and especially upon the interest rate you can get with each loan.

Home equity mortgages will often have higher rates than refinance loans. This is partly because they are riskier investments for the lender. Refinance home loans are packaged up with other home loans and resold to bond traders as secondary market securities. Because the securities include small parts of many different loans, the risk of loss with any one foreclosure will be smaller to the lender. Home equity mortgages though, are generally handled by the original lender, and even if they are not, the loan will usually be kept by the lender and not resold. This loan becomes a second lien on the home and therefore more risky.

The way the loans are handled is not the only or even most important factor determining the interest rate you'll receive. Interest rates in both home equity loans and refinance home mortgages are heavily influenced by secondary markets. As stated above, refinance loans are affected by bond securities trading, which is influenced by general concerns and predictions for the future economy. This will be partly influenced as well by the Federal Reserve target rate movements. Home equity mortgages however are more heavily manipulated by the Treasury bond market, which is much more closely tied to the Fed's federal funds rate. Generally, when the economy is slow, the prime rate will stay low and home equity interest rates will be lower than refinance rates. In a prosperous economy though, the opposite will usually be true.

Interest rates are also affected by issues more within your control. You can typically qualify for lower rates on both types of loans by applying for a smaller amount of money. This will decrease the lender's risk and allow them to drop the rate. You will find a similar situation with the loan's term. You can get a lower interest rate on either a home equity mortgage or a refinance home loan by decreasing the length of time you agree to pay back the money. With a refinance loan this would mean going with a 15-year loan rather than a 30-year loan, and with a home equity mortgage you could try a 5-year loan instead of a 10-year loan.

There are several differences between home equity loans and refinance home mortgages, but the interest rate can often be the determining factor for many borrowers. You can find the best rate by monitoring the direction of the economy and by evaluating just how much money you really need to borrow. Consult your financial advisor to help you analyze the pros and cons of either type of loan for your situation.