How to Pay for Your Remodel

REMODELING 101

How to Pay for Your Remodel: 11 ways to find the money you need

You’re ready to remodel: You’ve got a clear vision for the project, you’ve chosen a contractor, you’ve drawn up a budget and you know how much everything will cost. Now, how are you going to pay for it?

If you’ve considered launching a crowdfunding campaign or begging your in-laws for a loan, don’t fret. There are easier ways to make your remodeling dreams come true – even if you didn’t win last week’s lottery.

Here are 11 options:

1. Home equity loan.

You can get a fixed-rate, fixed-term loan for home improvements by tapping your home's equity. With a home equity loan, or second mortgage, you repay monthly, just like a first mortgage, for a stated period, typically up to 15 years. Most loans are for up to 80% of your home's appraised value, though some lenders may go higher. Your credit history, the balance of your current mortgage and your ability to repay the loan will determine your eligibility for this loan and repayment begins immediately.

2. HELOC.

A home equity line of credit, or HELOC, is a revolving line of credit, much like a credit card, but it uses your house as collateral. With a HELOC, you can borrow money when you need it and pay back only that amount, plus interest. For example, if you have a $45,000 line of credit but spend only $10,000, that's what you'll repay. Lenders base your credit limit on 80% of your home's appraised value, minus what's owed on your mortgage. As a rule, you'll have 5 to 10 years to draw funds, often paying interest only during that time. You'll then have 15 to 20 years to repay the loan in full. Keep in mind that HELOCs are ARM mortgages, so interest rates will vary, but there are usually no closing costs.

3. Cash-out refinance.

This option replaces your existing mortgage with a new loan for an amount higher than you currently owe on your home – and you pocket the difference in cash; borrowers typically must have at least 15% equity in their homes. Here's how a cash-out works: Let's say your house is worth $450,000 and you owe $200,000 on your mortgage. You need $60,000 to remodel your kitchen and bathroom, so you take out a new loan for $260,000, which is the sum of the $200,000 you owe plus $60,000 for your project. Fees and closing costs will apply and you may wind up with a different interest rate (higher or lower) than you previously paid.

4. Cash.

If you've got piles of money at your disposal, then cash is still king and a great way to finance your remodel without the need for approvals, appraisals or tedious paperwork. But unlike most home improvement loans, cash is not tax-deductible and investing it instead in a high-interest-bearing financial instrument could be a better deal in the long run. Still, if you've got it, cash is definitely an option.

Rehab loans/mortgages. For more extensive projects, such as rehabs and renovations, the federal government has two mortgage programs that lend money based on the value of the home post renovation.

5. Fannie Mae's HomeStyle Renovation Mortgage.

This conventional mortgage allows people to buy a home and fix it up with a single loan. You'll need a credit score above 660 (or 740+ for best rates) and you'll pay PMI for down payments under 20%, though you need put down only 5%, based on the value of the home after improvement. Borrowers get 12 months to complete the work on the home, and almost any type of repair or upgrade is allowed, including new roof, HVAC system, energy-efficient windows and doors, flooring, insulation, plumbing and electrical work, etc. Even luxury items such as an outdoor kitchen, landscaping or swimming pool are OK. You can borrow the lesser of the appraised market value of the post-renovated home or the purchase price plus renovation costs, up to $417,000 for a single-family home.

6. FHA 203(k) loans.

FHA rehab loans help people buy and repair fixer-uppers or improve a home they already own. Borrowers must work with a consultant who'll review your renovation plan and monitor the work, which must be complete within six months. Credit thresholds are slightly more lenient than Fannie Mae's program, requiring credit scores above 640 and down payments as low as 3.5%, though PMI remains in force for the life of the loan. Still, this is a great way to get into a home you want and make it your own. FHA offers two types of 203(k) loans:

a. Regular 203(k) loan: This loan is for homes that need structural repairs and can be used for almost any kind of fix or upgrade, including rebuilding a tear-down as long as the original foundation remains. You can borrow more than the home's worth provided the renovation boosts its appraised value. In practical terms: you can mortgage up to 110% of the home's appraised value post-repair or the price of the house plus renovation costs, whichever is less.

6. FHA 203(k) loans. (continued)

b. Streamlined 203(k) loan: This loan is for projects that don't involve structural changes. The loan covers a wide range of repairs or replacements (roofs, gutters, downspouts, HVAC systems, plumbing and electrical systems, windows and doors, etc.), as well as work to remodel your kitchen (and new appliances) or bathroom (and new fixtures), finish your basement or even paint your house. You can borrow the purchase price of the home plus up to $35,000 for improvements.

All the usual FHA rules apply to these loans. To find an FHA 203(k) lender, go to the Housing and Urban Development's online search tool and check the 203(k) box at the bottom of the page.

One more thing: If you can't live in your house during renovations, both Fannie Mae and FHA loan programs allow borrowers to finance up to six months' mortgage payments on the new home.

7. FHA Title I loan.

This loan, not a mortgage, allows homeowners to borrow up to $25,000 for home improvements. Approved banks and other lenders can make Title-1 insured loans.

8. Personal or unsecured loan.

Bank or credit union loans are easy to apply for, don't use your house as collateral and offer higher amounts than credit card limits. For projects between $15,000 and $50,000, a personal or unsecured loan may be the way to go. But pay attention to interest rates, which tend to be higher than home equity loans or HELOCs.

9. Low-rate credit card.

A 0%-interest or low-rate credit card can be a good way to pay for smaller projects (those under $15,000) that can be paid off while the low-interest rate applies, typically 12 to 18 months.

10. Contractor financing.

Some contractors offer financing through lenders with whom they have a working relationship. Likewise, some installers (of windows, roofs, siding) offer financing, but check their interest rates and terms, which may be higher than other loans.

11. Security-backed line of credit.

Borrowers with investment portfolios worth $200,000+ may qualify for a line of credit backed by those securities – called a Securities Backed Line of Credit, or SBL -- and possibly for an amount higher than with a conventional HELOC.