



# Investment Insights

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## Home Equity: A Good Safety Net

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For many of my clients here in the Bay Area, one of their largest assets is the equity they have in their primary residence. Home prices have risen dramatically over the past few years, creating millions of dollars in equity for homeowners. According to Data Quick, the average home price in Alameda County has risen over the past four years from below \$300,000 to over \$400,000. When I examine a client's net worth statement, home equity often represents over 50% of their net worth.

For those who have owned their homes for many years, a substantial portion of the value of their home is equity as their mortgage balance is very low relative to the high valuations in today's marketplace. Although this represents a large piece of their asset base, it is commonly viewed as an illiquid asset, meaning that equity isn't available unless the home is sold. From a financial planning standpoint, this means that the remainder of the client's assets must be kept in a relatively liquid investment to meet any unforeseen cash needs. Of course, with interest rates at or near 40 year lows, the returns on short-term savings are barely keeping pace with inflation. If there were a way to have access to the substantial amount of equity one has in a home, on short notice, it would free one up to commit other assets to a more diversified, potentially higher-yielding investment portfolio.

The good news is that with the advancement in home lending, such a vehicle exists, and is relatively inexpensive and simple to establish. This vehicle is a home equity line-of-credit. Equity lines can be established through your existing mortgage holder, or by visiting a local bank or lender. An equity line is almost like a credit card, with the credit limit determined by the equity you have in your home, and the loan secured by the equity you have in your home. Typically, the interest rate charged on any borrowed money is fixed to a common index like the Prime Rate, and is adjusted as that index rate changes. The beauty of an equity line is that you need not borrow against the line to keep it open. In essence, it provides a "safety-net" for your financial situation should you need to access a lump-sum of money on short notice. Much like a credit card, you must be careful not to abuse the available credit. But if you are concerned about the possibility of a large expense suddenly surfacing, an equity line can be a great resource to have in your arsenal.

As an example of how an equity line can work to your advantage, consider the following situation. I have a client who knew at some point in the next two years he would need to buy a new car. He wasn't sure when the need would arise, but he wanted to be sure that he had capital available to meet that need when it happened. He could choose to hold a portion of his investment portfolio in cash to meet that need, but it could be earning almost no interest for a couple of years. Instead, he established an equity line, which gave him the peace of mind of knowing that at a moment's notice, he could access it to purchase the car. He would then have time to review his assets and determine the best place tax-wise and value-wise to draw out money to pay off the loan. When the need came up, we were able to determine a strategy to liquidate a portion of his investment portfolio in a thought-out manner to cover the loan.

A couple more points about home equity loans: first, rates are near 40-year lows, so the interest rates on equity lines are quite low. Also, some company's equity line offerings have drawbacks like pre-payment penalties, so you should review thoroughly all features of proposed loans you receive.

I would recommend speaking to your tax advisor, attorney, and a knowledgeable and trustworthy loan officer about how Home Equity Lines of Credit fit into your situation. You can also view the Federal Reserve Bank's website to learn more, <http://www.federalreserve.gov/pubs/homeline/>, or call them at 202-452-3245 to order the informational booklet. I've found personally and in my practice that any vehicle that works to improve the financial peace of mind and comfort of a client is something worth looking in to.

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