Five good reasons to preserve your home equity

With interest rates on an "upward trend", homeowners are once more being encouraged by all and sundry to use the equity they have in their homes to pay off or reduce higher-interest rate debt such as car finance, credit card balances and personal loans.

Which would be fine, says Berry Everitt, MD of the Chas Everitt International property group, if the economy was robust and home prices were rising fast. "As it is, however, the economy is fragile and the rate of home price growth has been slowing down for several months, so a much more conservative approach is indicated."

Writing in the latest Property Signposts newsletter, he says that tempting as it may be to "consolidate" all their debts into a home loan, consumers need to remember what happened to homeowners who did this when interest rates began rising just before the global economic crisis in 2008.

"As property values slumped following that crisis, many of these owners ended up owing more on their homes than those properties were worth – and had to 'pay in' if they wanted or needed to sell them. So caution is advised, even though we're not expecting another slump at the moment."

Another very good reason for not using your home equity in this way, Everitt says, is that you will be turning short-term debt into long-term debt - and will need tremendous discipline to increase your monthly home loan repayments enough to avoid paying for that car or other purchases over 10 or 20 years instead of three or five years as originally intended.

"Indeed, we have often seen that what happens when homeowners do this, they actually go right out and incur more short-term debt instead of using any extra cash they have to pay down their home loan as soon as possible."

He says a third reason to keep your home equity intact – and in fact increase it whenever possible – is that is that you might need it for a genuine emergency. "Most people are not able to save much these days, and it can be very useful to have equity in hand if you face a sudden medical or other family crisis."

Fourth, Everitt notes, it is also most useful to have equity in your existing home if you are thinking of selling and moving to another property. "It will be much easier to get a loan for the new home if you have a deposit, and your equity can provide this. And of course the bigger the deposit, the lower your repayments will be on the new loan, which is really worth thinking about in the light of rising interest rates.

"And that brings us to the final reason for preserving your home equity now, which is that you need to be prepared for the possibility that interest rates could start to rise more rapidly than expected. A bigger equity stake in your home (and thus a smaller home loan balance) is what cushions you against the impact of such increases, and lowers the risk of you losing your home because you can't make the monthly bond repayment."