



Extension News Column

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Mortgages on your home can save or can sink your financial boat. Your home may have multiple mortgages on it. So what is the difference between first and second mortgages?

First mortgages are the original notes on the house. As you pay on the principal of the note and as the value of your house rises, you build equity in your home. Second mortgages borrow against the equity in the home. Second mortgages also come at a higher interest rate than first mortgages.

If your house is worth \$200,000 and the original mortgage has been paid down to \$140,000, you have up to \$60,000 that you can borrow. Equity loans differ according to the lender. Some allow you to borrow up to 80% of the assessed value, some 100%, and some even allow you to borrow up to 125% (at a substantially higher interest rate). Ask your lender what their limits are. The second mortgage is exactly what it implies, the first mortgage takes priority over the second.

A second mortgage can be used to make home improvements, pay college costs, buy a business, or even pay off credit card debt (but be careful with this idea). The second mortgage usually comes with a higher interest rate, but can be a way to get money in a pinch.

If you are considering taking a second mortgage, proceed with caution. You are taking an asset and cashing out the value you actually hold in that asset. You have cashed in the equity in your home. Second mortgages are easy to get, because the bank considers it a secured loan--you are securing it with the deed on your home.

So what happens if you can't pay that second mortgage? You run the risk of losing the house. It may be appropriate to look for other ways to lay your hands on some money.

If you are doing repairs or a remodeling on your house, many people commonly get that money through a second mortgage or home improvement loan. You will continue to make a payment on your first mortgage, and will make an additional payment on the home improvement loan.

If you are considering taking a second mortgage to pay for college, consider looking at the student loans that are already available in the marketplace. That may be a more appropriate and less expensive way to finance college.

If you are considering this type of loan to pay off existing debt, you need to take a look at what got you there to begin with. The majority of people who do take a second mortgage, end up having the same amount of credit card or other debt within two to three years. If you do take a second mortgage, change your spending habits. Work aggressively to pay this note off.

There are tax advantages to taking out a second mortgage. All the interest is deductible if you use itemized deductions on your taxes. Consumer debt is not tax deductible.

A second mortgage may be a way to resolve financial issues, but make sure you ask questions and know all the answers before you proceed. In taking a second mortgage, you need to realize that you are putting at risk one of your safest assets and risking your future.