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Can you still refinance for home improvements?

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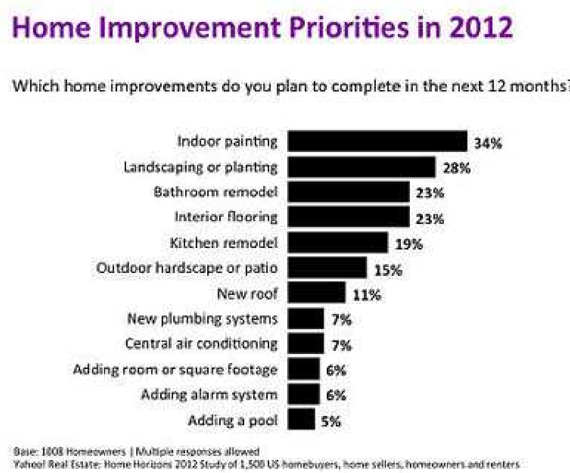
Many people scrimped during the recession by postponing home improvements. But if you have a baby on the way, drafty windows or a leaky roof, you may not be able to wait any longer.

How are you going to pay for them?

A few years ago, if you didn't have enough cash on hand, the obvious answer would be to refinance to draw out equity. But now, unless you have a stable job, good credit and don't owe more on your house than it's worth, it could be tough to find funding.

That's because most remodeling projects don't return what you paid for them on resale, according to Remodeling magazine. Since property values also have been sinking since the housing bubble burst, lenders are hesitant to take on more risk, unless both the home's equity and the borrower's ability to repay strongly support the gamble. As Cameron Findlay, chief economist for LendingTree, points out, once a borrower has become delinquent on a home loan or even a credit card bill, qualifying for a refinance becomes "exponentially more difficult." Frank P. Donnelly, president of the Mortgage Bankers Association of Metropolitan Washington, says that most people who pull out cash from their homes to remodel or renovate need to have credit scores of 700 or above; if you refinance your first trust, you'll need a minimum score of 620.



Even if you do qualify, it may be hard to pay for anything more than a bare-bone redo, because traditional refinancing isn't yielding much money. According to the latest statistics by Freddie Mac, the median home plunged about 23% in value between 2007 and 2011. The value of homes of people who sought cash-out refinancing in the fourth quarter of 2011 didn't drop nearly as much, but still fell about 4%.

So while many people are refinancing to take advantage of low interest rates or reduce the term or principal of their mortgages, not many are trying to extract their shrinking equity, Freddie reports. Rather, cash-out borrowers represent only 15% of all refinances, the lowest level in 26 years. In the fourth quarter, homeowners with conventional prime-credit mortgages took out an estimated $5.5 billion in net home equity, compared with $9.9 billion a year earlier. That's the lowest level in 16 years, and just a fraction of the $83.7 billion drawn from homes during the peak period for cashing out, the second quarter of 2006.

If you simply must redo your home now, despite dwindling equity, here are some options:

Cash-out refinance: A conventional refinance allows creditworthy borrowers to a loan of up to 80% of their home's appraised value without paying mortgage insurance, which protects the lender if a buyer defaults or dies. "There's no limit on the cash out, although from an underwriting standpoint it will be a bit more scrutinized if the funds exceed $150,000," says Scott Sheldon, senior loan officer with Sonoma County Mortgages in Santa Rosa, Calif.

The Federal Housing Administration insures loans for up to 85% of the value of a borrower's primary residence, but you'll have to pay mortgage insurance. If your loan is owned by Fannie Mae or Freddie Mac and is underwater, but you're current with your payments, you may be able to refinance through the Home Affordable Refinance Mortgage. The loan must be less than 125% of the home's current value for a fixed-rate loan, and 105% for an adjustable rate.

FHA 203(k) refinance: If you aren't doing any structural improvements and are creditworthy, you can do an FHA "streamlined" 203(k) loan that allows you to refinance up to 110% of the home's value after the proposed improvements are made. With a limit of $35,000 for improvements, this loan is ideal for owners who need to replace the roof or floors or add new windows, says James Barath, a certified mortgage planner with GVC Mortgage in Crown Point, Ind.

If the renovations require structural modifications, owners can turn to the full FHA 203(k). There is no limit to the cost of repairs or renovations with the exception of FHA loan limits, which vary by county.

Title 1 loan: If you have limited equity, check into an FHA-insured Title 1 loan, which can be used for any improvement that can make the home more functional or accessible, including built-in appliances, wider doors and solar-energy systems. They can't be used for luxury items like swimming pools and built-in barbecue grills. If you do the work yourself, you can only finance the materials.

You don't need to change your existing loan to get one, and you don't need security for any loans for less than $7,500. The maximum loan amount for a single-family home is $25,000; for a multifamily one it's $60,000 ($12,000 per dwelling unit).

A Title 1 loan can be used to replace home appliances. (Photo: roger_mommaerts / Flickr)

Home equity loan or line of credit: Long popular with homeowners, fixed-rate home equity loans and variable-rate home equity lines of credit, or HELOCs, allow you to extract equity using your home as collateral. But they've become harder to find as home values have fallen, Barath says. Those banks that still make these loans have raised their credit requirements and dropped the amount they're willing to lend, he adds.

Grants: Depending on your income, age, and whether or not you're a first-time buyer, you may be eligible for grants offered by nonprofits, government agencies or other entities. Brian Allen, senior mortgage banker at Access National Mortgage in Rockville, Md., says that one such program is offered by the Federal Home Bank of Atlanta. It provides $5,000 to $15,000 to help fund repairs and rehabilitate homes, including foreclosures.

Unsecured loans: If all else fails, you can turn to a personal line of credit or plastic. But because these loans aren't secured by your home, you'll be paying a much higher interest rate, and won't be able to deduct the interest on your taxes. However, some credit card companies and big-box retailers offer special cards to pay for home improvements. Bonus: Some give points or rebate cash.

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