FINANCING AN ADU

Despite their small size, ADU construction can be expensive, especially for owner-occupants on a tight budget. Few property owners can pay entirely out-of-pocket for ADU design and construction. Most will need to get some sort of financing from a bank or other financial institution in order to build an ADU. Most likely, property owners will need a mix of cash and one or more financing sources to complete their ADU project. For ongoing updates on ADU financing, see Boston's general ADU web page.

Each property is different and each owner has a unique financial situation. Homeowners should consider their own financial position and unique circumstances before proceeding, and may benefit from using financial advisory services. Nothing in this guidebook is intended as financial advice.

Some typical ADU financing strategies include the following. Each of these options has pros and cons, and each carries risks.

- **Boston Home Center's ADU Loan Program.** The City offers gap funding to eligible Boston homeowners of one- to three-unit properties who wish to build an ADU. The loan can fund interior improvements, additions, or detached structures to create an ADU. The loans are interest-free and offer funding up to $50,000, covering costs not covered by cash or other loans. The loan amount is determined by the estimated cost of the project. Borrowers make no monthly payments, and the balance does not become due until the owner sells, transfers ownership, or undertakes a cash-out refinance of the home. Households are eligible for this program if they earn no more than 135% of Area Median Income (as of 2024, roughly $154,000 for a single-person household or $176,000 for a two-person household) and meet other financial criteria.

Triple-decker homes in Roxbury.

"Affordablity appears to be an after thought during the last discussion. Let's have ADU policy prioritize it beyond offering loans. It should inform ADU policies."

GOLDMAN • JAMAICA PLAIN

A South Boston streetscape.

"I could build an ADU for my lifelong South Boston elderly parents. My parents are financially squeezed to the limit. An ADU for them would ease their fears and anxiety."

JASON • SOUTH BOSTON

- **Home Equity Loan.** Property owners who have accrued significant equity in their home (i.e., the value of their home subtracting what is owed on a mortgage) can take out a loan on that equity. For instance, if a couple has owned a home for 20 years and has been paying a standard 30-year mortgage in that time, they have likely gained significant home equity, due to both their mortgage payments and the appreciation in home values over the last 20 years. A home equity loan is a loan on that value, and like a mortgage, the home is used as collateral. Typically, home equity loans have fixed-rate payments with long repayment periods, and both principal and interest are repaid throughout the loan term. This can mean that initial repayments may be larger than other financing options, but payment amounts will be predictable.

- **Home Equity Line of Credit (HELOC).** Property owners with significant home equity in their home can also consider HELOCs. Like home equity loans, HELOCs tap into the value of a home (subtracting what is owed on a mortgage), but they are structured differently. HELOC borrowers can draw down their borrowed funds as needed (like a credit card), without taking on a big repayment up front. Homeowners who want to build ADUs but are unsure if their ADU will be permitted may find this advantageous. However, HELOC interest rates typically adjust based on prevailing interest rates, so there is a risk that payments on borrowed funds can increase. HELOC repayments also typically jump up after a number of years, as principal repayment is often deferred.

- **Cash-Out Mortgage Refinancing.** Property owners with a mortgage and significant equity can also choose to refinance their mortgage to put that equity to work building an ADU. This option is similar to home equity loans and HELOCs, but instead of additional secondary debt, a refinancing wipes out the primary mortgage and creates a new one. Mortgage refinancings typically offer better interest rates than home equity loans, but loan closing costs may be greater than other options. Mortgage refinancing was a popular strategy to make home improvements in previous decades. As of 2024, mortgage interest rates are much higher than they were in previous decades, and the new interest rates will apply to the entire mortgage value, not just the new equity. This potentially makes refinancing more costly and less attractive than other options, depending on one's unique circumstances.

- **Personal Loans.** Personal loans are loans based on a borrower's income and credit history, but that which don't use collateral to secure the loan. Compared to home equity loans or HELOCs, personal loans are usually smaller in size and have higher interest rates and fees. For these reasons, personal loans may be best suited to fill gaps in ADU funding if other options are not available.