

Paying for an extension.

Extending your home could add thousands of pounds to its value. But how you pay for it can make the difference between a successful project and a financial disaster? Here's our guide to the key ways to pay for an extension.

Using savings

This makes the most sense in today's low interest rate times. Many savings accounts pay less than inflation once tax has been taken into account. So the longer you leave money there the less it is worth in real terms. Putting it to better use is a good idea - and is far better than taking on extra borrowing.

Using investments

Cashing in an investment, even in bad times, can be a bad idea - it may be a fund you bought when shares were high, so you won't want to sell it when they are low. On the other hand your investment may have risen in value recently and you believe it has further to go. That said, if you reckon your investment isn't going to regain its former glory for many years, or you have already made a healthy return, then it may be worth cashing in - especially if the alternative is expensive borrowing.

Personal loans

There always seems to be a price war in this market, with everyone from internet providers to supermarkets trying to muscle in on the more established lenders. Personal loans have advantages; you can shop around and you don't have to stick to your existing bank or mortgage company; you'll get a fixed interest rate, so you know what your payments will be; the money is normally available in a matter of days. But beware. There can be penalties of up to two months' interest if you want to repay the money early, so look for a lender with no early redemption fees. You may also be pressured to take out insurance cover, and its costs can wipe out any savings you make on a low interest rate. So when you shop around always look at the repayment figures in pounds and pence, not just the interest rate. That way you can make sure you're not being ripped off by unnecessary and expensive insurance premiums.

Using a home improvement loan

These half-way house deals tend to be cheaper than personal loans but more expensive than mortgages. You get them from a mortgage lender (not necessarily your own lender) and have the money secured on your home - so it's vital that you keep up the repayments. Interest rates are

variable and you may have to pay a fee of around £100 to have your home valued before the loan is approved.

Re-mortgaging

This can be the cheapest option. Mortgage rates tend to be far lower than any other borrowing and you should be able to repay the extra penalty-free whenever you want.

There are two ways to get the job done. The traditional way is to decide how much you need, and ask your lender for a further advance. This can trigger some costs - possibly even valuation and arrangement fees.

Alternatively, you could take advantage of newer flexible mortgage terms. These normally give you a 'lending limit' often far higher than the value of your mortgage. If you have a current account mortgage you can simply write a cheque for the extra money you need at any time. The extra benefit of this arrangement is that you pay interest only on the money as you need it, rather than withdrawing the whole amount on day one.

Here again there may be home valuation fees to pay, averaging £100, before you can extend your mortgage, so these need to be factored into the equation when you work out the cheapest way to borrow.

Using credit cards

This can be expensive - unless you play your cards right. Get into debt on a standard card and you can find yourself paying more than 20% interest.

So if you are going to use plastic choose a card that offers 0% interest deals for six months or so, giving you a chance to clear the debt before the special rate expires. If you are brave enough - and keep a close eye on the calendar - you could try moving your debt from one special offer card to another, but beware balance transfer fees.

Take out an overdraft

This is another potentially expensive option, especially if you don't ask for permission first. Agreed overdrafts vary widely in the charges they incur - from less than 10% interest with no fees to more than 19% as well as monthly charges.

Unauthorised overdrafts can rack up interest at more than 33% a year. So don't write cheques for building work unless you are sure you have the money in your account.

You could switch to a better value current account anyway. Better deals tend to come from existing and former building societies and internet players rather than the High Street banks.