Dynamic Chiropractic

Home Equity vs. Education

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Many families today plan to fund their kid's education by using the equity in their home via a home equity loan. I'm sure you have all seen this idea touted in many financial columns and magazines. It can be a way to launch your children into the world with an education and, at the same time, put you into financial jeopardy. Let's explore this premise further.

The average basic four-year college degree runs around $40,000 today. If you were to borrow $40,000 as a home equity loan, you would have some interest to pay. That may be the understatement of the year. For illustrative purposes, we will use an interest rate of 10 percent. Most home equity loans range from one to two percent over the prime rate. Ten percent of $40,000 is $4,000 in interest alone, per year. That works out to be around $333 per month. Yes, the interest is still deductible, but it still has to be paid, and we are only talking about one child's education right now.

This loan could use most of the equity that you have managed to accumulate, assuming you don't already have an outstanding balance. In most cases, that is a wrong assumption. What if you do, and what if your property has not appreciated that much in value? Worse yet, what if it has depreciated in value, like homes have recently? Then what?

What about the $40,000 debt that you now have to pay for just one child's education? Even if you pay $1,000 per month, it will take you more than five years to pay off this loan. That's assuming you can afford $1,000 per month, and if you could afford that, then you could pay for your child's education out-of-pocket. What if the interest rates go up and believe me, they will. You might be forced to refinance your house so that you can afford to make the total payments. What about closing costs? This is assuming that rates are reasonable at that time and that you want to take on a long-term debt at a time when you should be trying to eliminate debt. Boy, these assumptions do come back to haunt you.

Okay, then what do you do? You may be pondering that question about now, and I hope you are because I am about to answer it.

First of all, I am not so convinced that home equity loans solve any problems without creating problems of their own. You can't fill in one hole by digging another hole to use that dirt to fill in the first hole. All that does is literally shift the problem, and to me that is what most people do with home equity loans, dig themselves a deeper hole. Is that what you want? I am sure you can now see the flaws in this procedure, but I still have not shown you how to solve the problem. Let me state right here and now, I am not sure if I can. I'm sure that last statement didn't give you much peace of mind, but it wasn't intended to. In previous columns, I have discussed the different ways to fund a college education under the current tax laws. Drop me a line and I will send you copies of those articles.

Here is a very basic idea that works every time if you have two very important ingredients -- enough money and enough time. You need both. Believe me, it will work, but if your kids are no longer babies, the task becomes more difficult. If you didn't realize it already, college is not cheap.

If you have a newborn, don't spend all your money on diapers, because to cover the cost of a state university, you must now start saving $115 per month for the next 18 years. That assumes a six percent return. Does the return sound low to you? Keep in mind taxes take a toll, so a net of six percent would be wonderful. You say that nothing is too good for your children and you want them to attend a private university? Better increase that monthly savings to $257.

What's that? Your child is now four years old? I'm sorry you didn't get around to reading my articles earlier -- now it will cost you $140 per month for a state school, and $312 for private. An 8-year-old will run you $184 and $411. If you have a pre-teenager, age 12, forget the designer jeans; the bill is $287 per month for the state school and $641 for a private university. Enough of the bad news. I think you can now see that this is a project that you needed to begin yesterday.

If you are among those who didn't plan ahead, then a home equity to supplement what you can afford is a workable solution. There are other ideas that can be used for both long-term planning and stop-gap measures. My advice is to explore them all. Don't just jump at the home equity idea because it looks so easy. It may be easy but remember it's not cheap, and in the long run, it could be very harmful to your financial health.

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Please include a self-addressed, stamped envelope. Thank you.

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