Long Island Business NEWS
MAY 8-14, 2015 | VOL. 62 | NO. 20 | LIBN.COM

Putting your home to work

LIFOCUS Banking / Wealth Management

By KRISTEN D'ANDREA

As the cost of higher education continues to climb faster than the rate of inflation, many students and their parents are struggling to figure out how to pay for that degree.

Families that haven't put away enough in their savings or 529 plans – the total annual cost for the average four-year public school is $23,000 and about $46,000 for private schools, according to The College Board – may consider a home equity loan or line of credit in addition to, or instead of, a student loan.

When planning for education expenses, there is no single solution preferable for every family, according to Lawrence Sprung, president of Mitlin Financial Inc. in Hauppauge. Rather, several key factors should be considered when comparing student and home equity loans, he said.

One of the first steps families should take is figuring out what type of student loans they will be eligible for, Sprung said, noting the many different types of loans available, from subsidized to non-subsidized. Those qualifying for a subsidized loan, which does not accumulate interest while the student is in school, might consider it over a home equity loan, he said.

"Why not get access to free money for four years?" he asked. "You could keep the equity in your house, while not paying interest. And, it would give you another four years to save and accumulate that money to pay in full."

Another factor to consider is the impact taking out a home equity loan could have on student aid eligibility, Sprung said. For instance, parents who have $300,000 in equity in their home may take out a $100,000 home equity loan payable over 15 years, he said.

"That loan can have a negative impact," Sprung cautioned. Assuming the family only planned to use $20,000 to pay for school, the remaining $80,000 would still be figured into the financial aid package as additional assets. "The balance will be considered in the financial aid formula and impact it negatively," he said.

Interest rates should also weigh heavily when determining which type of loan to use for education expenses. Currently, interest rates for student loans, with the exception of government-subsidized loans, are higher than the rates for home equity lines of credit, according to Joseph DeSena, a financial advisor at Siena Wealth Advisory Group, a private wealth advisory practice of Ameriprise Financial Services Inc. in Melville. Direct PLUS loans – federal loans that graduate students and parents of dependent undergraduate students can use to help pay for education expenses not covered by other financial aid – currently have a fixed interest rate of 7.21 percent for the life of the loan. Parents with equity in their home may qualify for a line of credit with an interest rate in the 3 percent range, DeSena said.

Although the historically low interest rates on home equity loans may rise in the future, they will have to double before reaching the current rate for student loans, he said. Additionally, from an income tax perspective, the interest an individual pays on a home equity loan, which is deductible, offers a greater tax benefit than a student loan, DeSena said.

LAWRENCE SPRUNG: For those who qualify, a subsidized student loan has advantages.

Families can save about 60 to 70 percent in interest costs by choosing a home equity loan as opposed to a non-subsidized student loan, according to Michael Kresh, managing member and chief investment officer of Creative Wealth Management in Islandia. Another advantage: The loan payment period is longer with a home equity loan than a student loan.

"Paying it back will be easier; for the first couple of years you can pay interest only, whereas once you stop being a student, you have to amortize your student loan," he said.

Taking out a home equity loan does not necessarily mean parents are responsible for paying 100 percent of their child's education costs, Kresh said, noting families may agree that students are technically responsible for making the monthly payments on the loan. In that situation, however, if the student defaults on payments, the parents are responsible. Yet, in many cases, parents are cosigners on student loans, as well. For that reason, Kresh said, there is no real advantage to looking at a student loan.

Even those who may have the money to pay out-of-pocket for their student's higher education might reconsider making a direct payment, Kresh said, unless the money is coming out of the bank, where it's making 0 percent interest.

"If you're liquidating investments that may be earning 5 or 6 percent to pay for college you're losing money," he said. "It's cheaper to take a home equity loan and borrow the money than to write a check in that situation.

"Why liquidate a 7 percent return to save 2 to 3 percent?" Kresh asked. "Keep the money yourself. Be the banker.

"There are so many different variations on why a home equity line of credit makes more sense than either direct payment or taking out massive student loans," Kresh said. "It's just an easy decision."