



# Using Your Home Equity

## Using Your Home Equity

- What is it?
- How do you know if this strategy is right for you?

### What is it?

If you own a home and have equity in it, you might consider taking out a home equity loan as a source of funds for your child's private school or college tuition. Alternatively, you might decide to refinance your mortgage to one with a lower interest rate or a longer term in order to create more discretionary income each month that can be used for education purposes.

**Caution:** To qualify for a home equity loan or mortgage refinancing, you usually need a good credit history.

### *Mortgage refinancing*

Mortgage refinancing refers to the process of taking out a new home mortgage and using some or all of the proceeds to pay off an existing mortgage. The main purpose of refinancing is to save money by taking advantage of lower interest rates or to lower monthly payments by extending the term of the loan. By doing so, you free up money that can immediately be used for education expenses.

There are actually two types of refinancing: a no-cash-out refinancing and a cash-out refinancing. See the discussion Refinancing . A no-cash-out refinancing is when the amount of the new loan doesn't exceed the mortgage debt you currently owe, plus points and closing costs. You can generally borrow up to 95 percent of your home's appraised value with this type of refinancing.

A cash-out refinancing is when you borrow more than you owe on your current mortgage. You can then use the excess proceeds however you wish. Many people use this type of refinancing to pay off other outstanding loans. However, you are generally limited to borrowing no more than 75 to 80 percent of your home's appraised value with this type of refinancing.

Just as with your first mortgage, you can deduct the interest paid on any refinanced mortgage. However, you will have to pay closing costs (points, application fees, filing fees, and up-front costs) when you refinance your mortgage. And, of course, your home serves as collateral for the new mortgage, just as with your original mortgage.

### *Home equity financing*

Home equity financing uses the equity in your home to secure a loan. It is structured as either a loan or a line of credit.

With a line of credit, the lender establishes a credit limit, which depends on the equity in your home and your ability to make payments. You can then access as much money as you need (up to the limit), whenever you need it, by writing a check or using your credit card. Generally, interest rates are variable and tied to an index. Your monthly payments will also vary, depending on your

outstanding balance.

With a home equity loan (often referred to as a second mortgage), you borrow a fixed amount (typically no more than 80 percent of the equity in your home), which is transferred to you in full at the time of the closing. You must then repay that amount over a fixed term. If you repay the loan, the lender discharges your mortgage. If you do not repay the loan, the lender can foreclose on your home to satisfy the debt.

**Tip:** A home equity loan is more common when you have a single large expense, such as a tuition bill or a house remodeling project.

The advantages of home equity financing include tax-deductible interest and, in most cases, a more favorable interest rate than on an unsecured, personal loan, because your home secures the loan.

The major disadvantage of home equity financing is that your home is at risk because it serves as collateral for the loan. As such, the lender can foreclose on your home if you fail to repay the loan. In addition, you may have to pay closing costs and other fees in order to obtain the loan. However, many lenders may eliminate these costs in an effort to gain your business, so shop around.

To find out whether a home equity loan or line of credit would be best for you, see [Home Equity Loans and Lines of Credit](#) .

## How do you know if this strategy is right for you?

The majority of parents of private primary and secondary school children and college-bound children likely own a home, but chances are the parents of college-bound children have more equity built up in their homes. If so, they will be eligible for a larger amount of home equity financing. Compare the interest rate you can get on a home equity loan or line of credit with the cost to borrow elsewhere to see if home equity financing is advantageous. If you think there is any chance you will have difficulty paying the loan back in the future, you should think twice. A home equity loan or line of credit is secured by your house, and the lender can foreclose on it if you default.

The decision whether to refinance your mortgage is usually dependent on current mortgage rates. If the current rate is more favorable than the rate of your current mortgage, the decision to refinance will likely hinge on whether you expect to stay in your current home long enough to recoup the costs of refinancing. See [Refinancing](#) . You might also choose to refinance to a mortgage with a longer term in order to lower your monthly mortgage payment. For example, you now have a 15-year mortgage but will refinance to a 30-year mortgage.

**Caution:** Extending the term of your mortgage will increase the overall cost of your home due to increased interest payments.

This communication should not be considered as an offer to sell or buy any securities, provide investment advice, or make investment recommendations. This information is being provided with the understanding that it is not intended to be interpreted as specific legal or tax advice. Individuals are encouraged to consult with a professional in regards to legal, tax, and/or investment issues. Advisory Services offered through Investment Advisors, a division of ProEquities, Inc., a Registered Investment Advisor. Securities offered through ProEquities, Inc., a Registered Broker-Dealer and member NASD & SIPC. 2801 Hwy 280 S, Birmingham, AL 35223; 800-288-3035.