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Don't Count On Home Equity for College Tuition

As fall rapidly approaches, many parents are getting ready to send their kids off to college for the first time. If you are one such parent, you may have been wondering how you are going to pay for young scholar’s tuition? According to a survey from the College Board, during the 2006-2007 school year the average tuition cost for a four-year public college was $5,836. If your son or daughter chooses a private university however, you are looking at an average yearly cost of $22,218. Keep in mind those price tags do not include room and board or books!

Most parents do not have that kind of cash saved up. In fact, less than half of American parents have at least $5,000 or more saved for their children’s college expenses, according to a survey from the Rochester, N.Y.-based Next Step magazine. And only about 12 percent have saved up $25,000 or more for such costs.

When asked how they intended to pay for schooling, answers included taking out unsecured loans, going back to work, and getting a second job. But the most popular option (chosen by about a quarter of respondents) was to take out a home equity loan.

Homeowners have been taking advantage of their homes’ value for years, especially during the past five years as house prices skyrocketed in many places around the country. With ample equity in their homes and plenty of eager lenders, parents turned to these second mortgages for tuition help. During 2006, according to a report from the Consumer Banking Association, 3 percent of all home equity loans were used for college expenses. While that might not sound like a lot, that 3 percent accounts for almost $7 billion out of the $228 billion worth of home equity loans last year.

These loans were so popular for tuition because they typically offer much lower rates than are available with unsecured loans and the interest is tax deductible. Yet conditions in the mortgage market have shifted dramatically in the past few months, making home equity loans less of a sure bet for parents.

Risky loans made to poor credit borrowers during the housing boom are now coming back to bite them, as many have found themselves without the money to cover their upwardly-adjusting mortgage payments. As they have foreclosed in droves, the mortgage lenders have lost money and investors, causing many of them to cut back on all but their safest loan programs. Because home equity loans take second seat to first mortgages when it comes to liens, lenders like Cleveland-based National City Bank have ceased accepting applications for these loans.

The truth of the matter today is that home equity loans may only be a viable option for those with stellar credit and plenty of assets. It is certainly not the open-to-all mortgage loan it used to be.
If you can get one, it still may be a great way to pay for tuition fees because of all the financial benefits. If you are unavailable to qualify now however, you might also consider working out payment plans with your child’s school, or filling out the Free Application for Federal Student Aid (FAFSA) to see if you can get government, interest-deferred loans. And of course, you could always have your child shoulder some or all of his tuition responsibility, by getting a part-time job or applying for his own loans.