

Select Portfolio Management, Inc

26800 Aliso Viejo Parkway

Suite 150

Aliso Viejo, CA 92656

949-975-7900

800-445-9822

info@selectportfolio.com

www.selectportfolio.com



Should I take out a home equity loan to pay for my child's tuition?

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Question:

Should I take out a home equity loan to pay for my child's tuition?

Answer:

If you own a home and have equity in it, you may want to consider taking out a home equity loan as a source of funds for your child's private school or college tuition. A home equity loan is secured by the equity you have built up in your home and can be structured as either a revolving line of credit or a second mortgage.

With a revolving line of credit, your lender establishes a credit limit that depends on the amount of equity you have built up in your home and your ability to make payments. You can then access as much money as you need (up to the maximum amount allowed) whenever you need it by writing a check or using a credit card. Generally, interest rates are variable and tied to an index, but may be guaranteed for an initial period (e.g., two years). Your monthly payments will also vary, depending upon your outstanding balance.

If the home equity loan is structured as a second mortgage, you borrow a fixed amount (typically no more than 80 percent of the equity in your home) that is transferred to you in full at the time of the closing. You must then repay that amount over a fixed term, just like you do on your original mortgage.

The advantages of a home equity loan include tax-deductible interest and, in most cases, a more favorable interest rate than traditional loans. Keep in mind, however, that a home equity loan puts your home at risk because it serves as collateral for the loan. In other words, your lender can foreclose on your home if you fail to repay the loan. In addition, you may have to pay closing costs, points, and other fees to obtain the loan.

Before you take out a home equity loan, shop around and compare the interest rates on home equity loans with the cost of borrowing elsewhere (e.g., financial aid loan programs) to see if a home equity loan is the right choice for you.

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Advisory Services Offered Through Select Portfolio Management, Inc.

A Registered Investment Advisor

Securities Offered Through Securities Equity Group

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