Saving for College

Empty your nest, not your savings

Special Report

Do you dream of your child becoming a doctor? Or the next great lawyer? Of course, a well-paying, rewarding job is all you really want for your child's future. The key for either scenario can be a college education. But can you afford it?

Finding a way

College costs have skyrocketed, but many people feel telling their kids, "Sorry, we can't afford it," isn't an option. Understanding the different ways to fund a college education may help.

Price check

So what will college cost when the kids are ready to leave the nest? The average annual price of a four-year private college today is $45,777 (includes tuition, fees, room and board); while the average annual price of a four-year public college, for in-state students, is $25,360.[1]

To estimate your potential costs, you can multiply that by four years – and by each child. In addition, tuition increases have averaged 3.2% for private, and 2.1% for public college over the last 10 years.[2] At that rate, in 2030, about the time a five-year old child today will be entering college, the total four-year cost will be $275,768 for a private college and $132,906 for a public college![3]

To accumulate enough money to foot such a bill, you may wish to begin setting aside money immediately – right after your child is born. As the following chart shows, to net $50,000 towards college costs, you may wish to save $100 a month beginning at birth. The longer you wait, the more you would have to put away each month to reach that same $50,000.

1 How Americans Pay for College 2015: A national study by Sallie Mae and Ipsos
2 Average Rates of Growth of Published Charges by Decade; Collegeboard.org
3 FinAid, College Cost Projector, www.finaid.org/calculators/costprojector.phtml

If savings begins when child is:	Born	Age 4	Age 8	Age 12	Age 16
Amount you need to save monthly to have $50,000 at age 18	$131	$193	$308	$582	$1,969

Assumes 6% compound annual interest. Hypothetical example, not guaranteed, and not intended to represent the performance any specific product.

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Save and study plans

The government has established a number of programs and tax laws to make saving for college easier. A few popular options include:

- **529 Plans** – These state-sponsored investment plans offer tax-deferral and income tax-free withdrawals (for qualified expenses). In addition to tuition, room and board, the money can be used for other eligible expenses, such as books and supplies. Contribution limits vary by state and there are generally fees and expenses associated with participation in Section 529 plans. Some state plans even allow you to deduct contributions from state income taxes. If the account's beneficiary (the child) decides not to attend college, the money can be put towards another family member's education; otherwise, it's taxed at your normal rate. Remember, withdrawals for non-qualified educational expenses are subject to a 10% federal tax penalty and are taxed as ordinary income.

  Before investing in a Section 529 plan, you should consider whether the state you or your designated beneficiary reside in or have taxable income in has a Section 529 plan that offers favorable state income tax or other benefits that are only available if you invest in that state's Section 529 plan.

- **Coverdell Education Savings Account** – This account provides tax-deferred earnings and income tax-free withdrawals (for qualified expenses); but participants must meet specific income requirements and you can only contribute up to $2,000 annually. If your income exceeds the maximum, however, grandparents and other relatives can set up a Coverdell in your child's name. The fund is transferable to another child if a first child does not go to college; however, taxes and penalties apply if it's not used for college.

- **Uniform Gifts (or Transfers) to Minors Act** – UGMAs/UTMAs allow you to transfer up to $14,000 a year to an account held in a child's name; although you (or the donor) are the custodian of the account. The money is taxed at the child's rate and is no longer part of the adult's taxable holding; it may be able to reduce your income tax bill. The gift must be sizeable for any real tax benefit. Once given, it can't be taken back; and the child can use the money for anything – not necessarily college – once he or she reaches adulthood.

- **Tax Credits** – Families that qualify can earn income tax deductions (tax credits) for college costs. The Hope Scholarship Credit provides up to $2,500 per year, per student during the first four years of college[4]; while the Lifetime Learning Tax Credit provides up to $2,000 per tax return and there is no limit on the number of years you can claim the credit. To qualify, families must meet certain income requirements: $52,000 for single head-of-households and under $104,000[5] for joint returns.

An age-old strategy

Whatever investment vehicle you choose to save for your child's education, you may wish to keep your investment strategy consistent with the child's age and number of years until college: more aggressive during a child's early years, when there will be more time for money to compound and grow; and more conservative as the child approaches college age. You may wish to consider these approaches:

- **Pre-school years** – Choosing investments that may perform best over time, such as stocks or stock funds. While riskier than bonds and money markets, over time, stocks can potentially produce higher returns.
- **Grade-school years** – Shifting to a more balanced approach to risk and return, with an investment mix of stocks and some conservative bonds.
- **High-school years** – Shifting to shorter-term, more conservative investments, such as CDs, money markets or bonds.

Before making investment related decisions, it may be helpful to consider some of the possible risks. While bank certificates of deposit are FDIC insured up to applicable limits and offer a fixed rate of return, stocks or stock funds and principal will fluctuate with market conditions. Generally speaking, stocks may offer greater growth potential in comparison to bonds, but carry more risk. The principal value of a bond varies inversely to the rise and decline of interest rates. Bonds typically offer a fixed rate of return, if held to maturity. However, bonds may contain a call feature that may be exercised prior to maturity. Investments are not guaranteed and are subject to investment risk including the possible loss of principal. The investment return and principal value of the security will fluctuate so that when redeemed, may be worth more or less than the original investment.

Going to the source

Most schools offer some type of financial support for students who qualify, such as:

- **Financial aid** – Factors considered include parents' annual income, assets, number of dependents, other family members in college and unusual circumstances.
- **Loans** – Students must repay the loan through a payment schedule for many years after graduation (which could become a financial burden and affect credit rating).
- **Athletic and academic scholarships** – Awarded to students based on a variety of achievements and qualifications.

Other sources of aid from schools include work-study programs, merit awards for academic achievement, activities awards for involvement in various student activities and assistance for disabled students. You can contact each school for its specific programs and policies.

4 Hope Scholarship Tax Credit http://www.finaid.org/otheraid/hopescholarship.phtml
5 Lifetime Learning Credit https://www.irs.gov/Individuals/LLC

Other ways to pay

There are several other ways to pay for college. The following methods may negatively impact your own ability to save for retirement:

- **Retirement plans** – Some tax-deferred savings plans, like IRAs, allow you to access money for educational expenses without penalty; however, income limits and withdrawal restrictions often apply, and you would have to pay income tax on the money. If you deplete your retirement savings, you might have to work longer to rebuild your nest egg, or live on less in retirement.
- **Home equity loan** – The rates on home equity loans are low and interest is tax deductible. Taking out such a loan may mean you will still owe money for your home at the age when you were planning to retire. Since the loan is secured by your house, you risk losing your home if you can't pay it back.

Planning your kids' future – and yours

Saving for college doesn't have to come at the risk of your own financial future, Planning your kids' future may have an impact on your ability to pay for their educational expenses.

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