Zynergy
Financial Planning

Saving for that Other Major Life Expense: Education

By Ryan Zacharczyk, CFP, CSA, CRPC

As summer comes to close and the cool chill of fall begins to take hold, there are a few certainties we can count on. The trees will begin to shed their leaves, warm coats will begin to make their appearance, and children will go back to school. Each year your little ones and perhaps not so little ones move one step closer to leaving the security of home and heading off to college. The question is, are you moving one step closer toward paying for it?

The issue of college funding is one of the greatest concerns of my clients with young children and for good reason. The average four-year private college will cost you about $103,000 by the time your child graduates, and that's not including room and boards. This has increased dramatically since 1990 when the average cost was around $37,000. This represents an increase of about 5.8 percent per year, well outpacing inflation. For those with young children, this creates a scary proposition. At the current rate of education inflation, a couple with a two-year-old can project spending more than $250,000 on that child's private college education. For many parents, planning for this type of expense represents a daunting and even impossible task. Fortunately, there are a few strategies that can ease the burden.

Strategy #1: Set your college savings goals

Determine what kind of educational experience you want for your child. Do you want to pay for a private elementary school or high school, a public or private university, perhaps even law school or an MBA? Once your goals are determined, there are various ways to get you there.

Strategy #2: Set up a college savings account

This is where most people have questions. There are many different ways to save for college, some better than others. There are options that offer some great tax benefits and allow you to remain in control of your child's savings. But first you need to decide in whose name you'll put those savings accounts and other assets. A mistake could make your child ineligible to qualify for financial aid. Titling assets in the name of the parents or grandparents is always more favorable for financial aid than putting the assets in the name of the child. It also helps to make sure that the money you save actually goes toward education by keeping you, and not your child, in control of the money. That way you know your child won't blow his savings on a hot new sports car once he reaches 18. I recommend the following two accounts to my clients.

Coverdell Education Savings Account

Money is deposited after taxes into a Coverdell, once known as an Education IRA, where it grows tax free when used for qualified education expenses. This account can be established with any financial institution and has a lot of flexibility from an investment standpoint because you can invest the savings in any way you see fit, for instance, in bonds or a mutual fund. It gives you the added benefit of being able to use your savings to pay for private elementary or high school. This is an advantage not afforded by the popular 529 college savings plan (discussed below).

The major downside of this account is the limits that are placed on the deposit. The most that can be contributed annually is $2,000. Given the projected cost of education 18 years from now, that is a small percentage of what will be required. Plus, the tax-free benefits that the Coverdell gives you are supposed to be phased out in 2010. So if you'll need the funds from this account after that date, you may lose some of the money to taxes. However, most experts anticipate Congress will make these tax advantages permanent before then.

529 College Savings Plan

Probably the most popular college savings vehicle, 529 plans are run by individual states and allow you to save money in a similar fashion to the Coverdell. The money goes in after tax, but then grows and is distributed tax free to pay for college costs.

The funds in the 529 are kept in the custodian's name, so they count less when applying for federal financial aid. The real benefit of the 529 is the annual contribution limit. Unlike the Coverdell, the maximum total lifetime

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contribution is over $300,000 in most states. You can contribute this in one deposit or 101 deposits. There are no other restrictions other than the lifetime contribution amount. This provides you with the ability to save a lot of money for your child's education expenses.

In addition, you can contribute to any state's plan in the country. You don't have to live in the state to use their plan, and where you contribute has nothing to do with your child's ultimate choice in where they go to school. So a family can live in New Jersey, invest in a plan run by Utah, and their child can go to school in Nebraska. There are no limitations. Do your research to make sure that you are opening an account in a state with the right plan for you. Go to www.savingforcollege.com to compare plans and learn more.

Strategy #3: Save early and often
This is the most obvious way to offset large education bills as they come due. Beginning to save when the child is young will provide you with the most important aspect of investing: time. Unlike retirement when we can discuss investments compounding for 30 years, with college you generally only have 15 to 20 years to let the money grow. As the child gets closer to college, you must begin to get more conservative, thus losing the ability to take a little risk to enhance performance.

Consider putting a portion of your child's gift money (birthdays, special events) away, especially when they are very young and won't miss it. Setting aside just $1,000 from the gifts you get after a child's birth can grow to almost $5,000 if well invested by the time the education bills begin to roll in. Let time do the work so you don't have to.

Although the ever-growing cost of college seems insurmountable, we should look at it with temperance. Economics is cyclical. College costs didn't always increase at this high rate and eventually, colleges will have to start making tough choices if they begin to price out their customer. They will either have to cut their costs or offer more grants. Either way, assuming that education will continue to increase at its current pace is unrealistic. I don't envision college education being only for the rich in 2025.

When considering college expenses, do your homework, create a plan, and then put away as much money as early as possible. This formula, although simplistic, will create the desired result. Then, when the crisp fall weather inevitably rolls in, you will feel confident knowing you are one step closer to funding your child's education.

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