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Category: College Savings

Facing the Cost of College

"Can Just In Time Savings Work?"

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Parents are facing an enormous cost when raising a child. For many, the costs do not end once the child graduates high school. The world of higher education becomes the focus and the question becomes how to pay for it. At the end of this article you may come to the same conclusion as I have, and that is to start early, save often, even before the gleam of being a parent if possible.

As far as available options, parents have the choice of saving in advance, paying as-you-go, loans, military, family assistance, tax credits, scholarships, grants, and investing in products designed for higher education. From conversations I have had with parents, most would like their child to have an advanced degree and for them to graduate without significant debt. While some want their children to have a vested interest in the education through some type of financial contribution, many parents hope for the opportunity to provide this for their children.

Like all things, higher education costs continue to rise. According to the College Board Annual Survey of Colleges, the in-state tuition and fees have risen from $3,508 in 2000 to $9,410 in 2015. Consider room and board as well and the average annual cost is now $19,548 for a four year public college. For most parents, this expense is not something they can pay as-you-go. While 'just-in-time' inventory replacement may work for stores or manufacturing, 'just-in-time' savings for college costs may result in less flexibility and potentially higher student loan amounts upon graduation.

You may wonder whether having a college degree or other advance degree is beneficial. The US Census Bureau found those with a college degree earned substantially more over their working years than those with only a high school diploma. Deferring the potential gender bias to another time, the Bureau reported men earned an additional $1,065,012 and women an additional $545,748 over their careers of 39 and 28 years respectively. These figures do not take into consideration the effect of inflation.

Congress created two methods to assist parents in meeting these costs. Both methods work best with a longer timeline so that time value of money is assisting in meeting the need. The plans are 529 Savings Plan or the 529 Prepaid Tuition Plan, where 529 refers to the Internal Revenue Code section. Most states offer these plans and are generally the administrator of the plans. While residents of any one state may invest in a plan offered by other states, there may be additional benefit to investing in the plan offered by your home state.

Doug's Insights

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Contributions to 529 plans are not deductible, but the growth of the investments is tax deferred. When the future value is finally withdrawn, the appreciation is not taxed provided the funds are used for qualified expenses in the year of the withdrawal. Generally, funds from a 529 plan can be used to pay for tuition, fees, books, and room and board. Prepaid plans work in a similar fashion. When their funds are applied to tuition and fees, there is no tax on the appreciation. Some prepaid plans do not cover room and board, so parents must still consider these expenses which are often high.

For those who live in states without a state income tax, like Tennessee or Texas, those residents are not missing out on in state benefits and thus can select among all states for the plan that's best for them. Prepaid tuition plans are generally state specific, although most permit the funds to be used for colleges in other states subject to some restrictions. Most prepaid plans permit the enrollee to purchase various amounts of future education for those colleges and universities within their state. The TN Baccalaureate Education System Trust (TN BEST) Prepaid Tuition Plan was terminated in November 30, 2015. Texas still offers a prepaid plan through the Texas Tuition Promise Fund. For those without a prepaid plan, the savings option is still available and can be very beneficial.

Most 529 Savings Plans offer a variety of investment options. Some of the choices are age based, and thus become more conservative as the child nears the age when the funds will be used for college. Other options permit the investments to be managed by the parent or advisor and can be invested in conservative to more aggressive funds based upon economic conditions, risks and objectives of the owner of the account.

While a 529 account can be funded with the child's money and thus must be used for that child's benefit, when the account is opened by an adult with their funds and for the benefit of a child, the ultimate beneficiary of the funds can be changed. In the event the oldest child receives scholarships or uses military benefits for their education, a parent can change the beneficiary of the 529 account to another child, themselves, or even retain the funds to be used for future grandchildren.

Consistency, planning, and starting early are ways to add to the flexibility in meeting the rising cost of college.