September 2015

10 Tips on Saving for College

Amy Shappell, CFP®
Steve Juetten, CFP®

Juetten
Personal Financial Planning, LLC

August 2015

Contents

The information provided in this report is taken from sources believed to be reliable and accurate; however, the reader is responsible for verifying all information before acting upon it. In addition, this report is for education purposes only and is not to be construed as financial or investment advice.

Introduction

If you're reading this, you are probably feeling a bit of anxiety at the thought of your child leaving the nest, and you're probably more than a bit concerned about how you're going to pay for those *huge* college bills.

Let's start with the good news. College graduates earn more money –on average 70% more per year when compared to high school graduates.[1] Additionally, a study commissioned by the CollegeBoard,[2] a non-profit organization that connects students with college success, found college education to be positively correlated with many other health and societal benefits, including reduced obesity rates, lower instances of smoking, and higher rates of volunteerism and voting.

Now, for the bad news – college is expensive. Table 1 shows that, for the 2014 – 2015 academic year, total published fees for four-year U.S. colleges ranged from $19k to $41k.

Table 1 Average Published Fees for Four-Year U.S. Colleges, 2013 – 2014 Academic Year [3]

	2014 – 2015 Tuition & Fees	% Increase from 2013 – 2014	2014 – 2015 Total Fees (Tuition, Fees, Room & Board)	% Increase from 2013 – 2014
In-State	$9,139	2.9%	$18,943	3.0%
Out-of-State	$22,958	3.3%	$31,701	3.3%
Private Non-Profit	$31,231	3.7%	$40,917	3.6%
Private For-Profit	$15,230	1.3%	--	--

The 2.9% increase in tuition and fees for in-state students at public four-year colleges and universities in 2014-15 is exactly the same increase as the prior year. But the ten-year historical rate of increase is about 5% - substantially higher than the general inflation rate and higher than the average increase in personal incomes.[4] A 4-year, public university degree is estimated to be priced at $202,270 for students enrolling in 2033 if tuition increases average 5% per year.[5] Meanwhile, the two most popular savings vehicles for college funds are savings accounts and the 'piggy bank/loose change jar'.[6]

In the face of these daunting facts, we have ten tips to calm your heart rate and help you figure out how you're going to pay those pesky college bills.

---

[1] "2009 U.S. Census: Median earnings for full-time workers at least 25 years old," U.S. Census Bureau.
Annual earnings, based on degree, were: high school diploma, $33,213; associate degree, $39,867; bachelor's degree, $56,472; master's degree, $74,248.
[2] "Education Pays, 201," CollegeBoard, < http://trends.collegeboard.org/sites/default/files/education-pays-2013-full-report.pdf >
[3] "Trends in Higher Education", CollegeBoard <http://trends.collegeboard.org/college-pricing/figures-tables/average-published-undergraduate-charges-sector-2014-15>
[4] "Tutorial – The real cost of higher education" < http://www.savingforcollege.com/tutorial101/the_real_cost_of_higher_education.php >
[5] "Savings Plan and Future Cost Estimation" <http://www.collegecalc.org/calculators/plan-and-save/plan-and-save/?cost=%2419%2C500.00&age=0&inflation=5&savings=0&return=7&years=4&submitted=true>
[6] How America Saves 2015 < https://salliemae.newshq.businesswire.com/sites/salliemae.newshq.businesswire.com/files/doc_library/file/HowAmericaSaves2015_FINAL.pdf>

Tip #1: Focus on the net price, not the sticker price.

Your child's education may be more affordable than you think. Most students don't pay the rates published by colleges and universities.

Colleges and universities routinely discount their fees. The net price is a college's sticker price for tuition and fees less the grants, scholarships and education tax benefits you receive. The net price you pay for a particular college is specific to you because it's based on your personal circumstances and the college's financial aid policies.[7]

The U.S. Department of Education requires schools to provide a 'net price calculator'. The aim is to show what schools with 'high sticker prices' might actually cost after assessing the impact of scholarships and grants. Keep in mind, though, the tools can be hard to use and they're not fully transparent in what they calculate.[8]

As of August 2014, over 2,000 schools have agreed to use the Department of Education's 'Financial Aid Shopping Sheet'[9], the goal of which is to provide clear and comparable financial information in a common format to guide a family in choosing a college. To access a school's net price calculator (and get more information on the costs of different colleges), go to http://collegecost.ed.gov/

We'll take a closer look at the many options and strategies for reducing college expenses and for paying those bills, so take a deep breath and read on.

Tip #2: Apply for financial aid (even if you don't think you will qualify).

It's true: some families will not qualify for financial aid. But how will you know until you try? Additionally, many people who think they will not qualify for any aid are surprised to find that they quality for government-subsidized loans. There are also a few sources of aid, such as unsubsidized Stafford and PLUS loans, that are available regardless of need. Since the form you need to fill out is free, take the time to apply. You may be pleasantly surprised at the outcome.

Federal Student Aid, an office of the U.S. Department of Education, administers the nation's largest source of student financial aid. Every year they provide more than $150 billion in new aid to more than 15 million postsecondary students. If they were to provide aid to every student who applies, each student would receive about $10,000 per year!

You will use the FAFSA (Free Application for Federal Student Aid) form to apply for federal and institution-specific financial aid. The same application is used for both types of financial aid, so you only need to complete this application once per year per child. To make the process easier, the FAFSA can be filled out entirely online at www.fafsa.ed.gov.

[7] Focus on Net Price, Not Sticker Price, CollegeBoard <https://bigfuture.collegeboard.org/pay-for-college/paying-your-share/focus-on-net-price-not-sticker-price>
[8] "Paying for College," US News, <http://www.usnews.com/education/best-colleges/paying-for-college/articles/2011/12/15/10-things-you-need-to-know-about-net-price-calculators>
[9] http://www2.ed.gov/policy/highered/guid/aid-offer/index.html

Deadlines vary by state and academic year, but FAFSA forms are generally due on or near June 30th if you plan to attend college the following fall. **However, the sooner you file after January 1st, the better, as aid is distributed on a "first come, first served" basis.** Most schools have a priority filing deadline much earlier than June 30th. Students who apply by the priority filing deadline get first consideration for available scholarship and grant resources, which means that fewer funds are available for later applicants. Submit *estimated* data by the priority filing deadline, if not all information can be gathered in time, and update after all data are available.

Make sure you choose the date to submit the FAFSA carefully, as assets and student marital status are specified as of the application date. For example, if you receive an annual bonus or are expecting to receive company stock that will substantially increase your assets, submit the FAFSA before those assets hit your personal balance sheet. If you need help with when to time an asset acquisition or how to classify assets, seek the help of a CPA or qualified financial planner.

Dependent children of unmarried and same-sex parents may seem some impact to federal financial aid. Beginning with the 2014-2015 school year, the FAFSA will collect information on both legal parents, regardless of marital status or gender. The Department of Education states that "most students will be unaffected," but the change could dramatically impact federal aid packages for some students, says Barmak Nassirian, director of federal policy analysis for the American Association of State Colleges and Universities.[10]

Students planning to attend private colleges should consider completing the CSS/Financial Aid PROFILE® form. Many colleges, universities, graduate and professional schools, and scholarship programs use the information collected on PROFILE to help them award non-federal student aid funds.

To determine how much federal financial aid your student qualifies for, the Department of Education and your student's institution of choice will use the information on your FAFSA application and a complicated, government-mandated formula to determine your family's Expected Family Contribution or EFC. This is the amount that your family is expected to pay for your child's college education. Your student's financial need (and hence his or her financial aid package) is determined by taking the total cost of education and subtracting his or her Expected Family Contribution.

The EFC calculation is complex and has a direct impact on the amount of financial aid your student will quality for. To help you maximize your student's financial aid award, use the information below from www.finaid.org to help understand the complexities of the EFC calculation.

- The EFC calculation assumes a significantly higher contribution for student assets and income as compared to assets and income of the parents, so save money in the parent's name, not the child's. Alternatively, you can use a savings vehicle that is treated like a parent asset, such as a 529 college savings plan, prepaid tuition plan or Coverdell Education Savings Account (all discussed later). In addition, a 529 college savings plan owned by someone other than a parent (i.e., a grandparent or other relative) that will be used for the student's education expenses has no impact on financial aid eligibility because it is not counted in the EFC calculation.

10 "10 timely tips to pay for college in 2014," <http://www.bankrate.com/finance/college-finance/college-tips/>

- If grandparents (or other relatives) want to give money for education expenses, ask them to wait until the child graduates and then pay off student loans. If they can't wait, have them give the money to the parents, not the child, so that the money is assessed at the lower, parent rate in the needs-analysis process. Another alternative is to ask grandparents to pay the school directly to cover the child's educational expenses without impacting financial aid eligibility. (Payments made directly to the college are also not subject to gift tax limitations.)
- Because the EFC requires students to contribute a higher portion of assets and income, it also makes sense to use the student's assets and income for college expenses *first*, before tapping into the parents' assets. For example, if the student has assets in her name, she could use them for summer band camp or soccer camp in her junior year of high school so they don't show up in the EFC.
- Consumer debt is not counted in the needs-analysis formula, so there is no benefit to having a credit card balance or carrying excessive debt. You will be best served by paying off consumer debt, such as credit card, auto loan balances and/or a home equity line of credit.
- Maximize contributions to retirement funds. Retirement funds and pensions are generally not considered as assets available to pay for education expenses, so you can shelter a considerable portion of your assets by making the maximum contributions to these funds in the years before you submit your first FAFSA form. This helps lower your available net worth in the eyes of the EFC so you increase your chances of getting more financial aid.
- Trust funds are generally ineffective at sheltering assets. Schools will generally assess the entire trust as if it were a student asset, regardless of any restrictions on the principal. If the student can't spend down the principal of the trust, then the account will represent an annual drain on the student's finances by increasing the student's annual financial aid contribution.

Additionally, if you feel that your family's financial circumstances are unusual, make an appointment with the financial aid administrator at your school to review your case. Sometimes the school will be able to adjust your financial aid package to compensate for changes using a process known as Professional Judgment.

To get an idea of your family's EFC before your submit the FAFSA, there are many useful calculators on the Internet that can be utilized to estimate your EFC (none are 100% accurate and things do change so make sure you stay up to date). Visit http://www.finaid.org/calculators/ for calculator options.

Tip #3: A dollar not spent is a dollar saved!

Whether or not your child qualifies for financial aid, there are many ways to reduce the overall cost of education for your student. The decision that has the most impact on overall college costs is which school your student will choose to attend. There are six primary options:

- Attending a two-year college or vocational program
- Attending a two-year college and then transferring to a four-year program
- Attending a public, in-state, four-year school
- Attending a public, out-of-state, four-year school

- Attending a private, non-profit, four-year institution
- Attending a private, for-profit, four-year institution

As Table 2 illustrates, the difference between just tuition and fees for these different institutional options is vast and worthy of consideration given your student's interests and your family's ability to contribute to education expenses.

Table 2 Average Published Tuition and Fees for U.S. Colleges, 2014 – 2015 Academic Year [11]

Two-Year Colleges	Four-Year Colleges	2014 – 2015 Tuition & Fees
Public (e.g., Community College)		$3,347
	Public, In-State (e.g., University of Washington)	$9,139
	Public, Out-of-State (e.g., University of California-Berkeley)	$22,958
	Private, Non-Profit (e.g., Seattle University)	$31,231
	Private, Non-Profit – Ivy Leagues (e.g., Harvard College, Stanford University)	$45,799[12]
	Private, For-Profit (e.g., University of Phoenix, Art Institute of Seattle)	$15,230

Note: You can find cost information specific to your student's top school choices with a quick Internet search featuring the institution's name and the word "tuition" (e.g., Stanford tuition). Make sure you include all expenses in your research, including tuition, fees, supplies, computer and software costs, living expenses, transportation costs, etc.

No matter what institution your student decides to attend, there are several ways you and your student can help make the college experience more affordable and therefore make it easier to save for college costs. Below are some helpful hints on how to keep college costs down.

- While your student is in high school, encourage him or her to take courses for which he or she may be able to earn college credit (such as Advanced Placement® or International Baccalaureate (IB) classes). Credits taken in high school are credits that don't have to be taken (or paid for) in college. A satisfactory score on a College Level Examination Program (CLEP) exam may also earn your student credits at numerous colleges.
- Consider having your student apply to an honors program at a public school. More and more public schools are starting, expanding, refining and promoting honors programs, and particularly honors colleges, that give students some of the virtues and perks of private schools without some of the drawbacks, such as exorbitant tuition and an enclave of extreme privilege. [13]

[11] "Trends in Higher Education," <http://trends.collegeboard.org/college-pricing/figures-tables/average-published-undergraduate-charges-sector-2014-15>
[12] Calculated as average 2015 – 2016 undergraduate tuition for Harvard College and Stanford University.
[13] "A Prudent College Path," New York Times <http://www.nytimes.com/2015/08/09/opinion/sunday/frank-bruni-a-prudent-college-path.html?_r=0>

- Help your child plan to graduate from college on time! Needing longer to graduate increases overall costs significantly. Some colleges are also offering ‘fast-track’ three-year degree programs, which can cut college expenses by 25%.[14]

- Choose a less expensive room and a cheaper meal plan if your student is going to live on campus, or investigate living off campus. Also, consider trying for a position as a resident adviser — and the free room and board that comes with it. (Note: This is probably not feasible in a student’s first year, but is something to consider in future years. One of the authors was a resident adviser for two years, enjoyed the experience, and it looked good on his resume!)

- Choose a nearby college so your child can live at home and you save money on room and board. But don’t forget to consider the additional costs of car insurance and maintenance, gas, and parking.

- Shop for books and supplies carefully; look for used books, e-books or book rentals, and check online for discounts.

- Use discount airline fares and other inexpensive travel methods like trains and carpools for trips to and from an out-of-the-area college, and avoid extra trips.

- Find out whether your student’s college of choice offers a monthly payment plan or other creative financing options, such as combining loans with a monthly payment. Sometimes it’s easier on your personal cash flow to pay a smaller amount monthly rather than have to come up with a large amount once or twice a year.

Tip #4: Grant and scholarship money don’t have to be paid back!

Every dollar your son or daughter gets in grant or scholarship funds is a dollar you don’t have to pay. A few options to consider:

Federal Grants

- **Pell Grants** are granted on a need-basis, and the grant amount depends on your family’s EFC and several other factors. Only undergraduate students who have not earned a bachelor's degree are eligible for Pell grants. The maximum award amount for 2015-2016 is $5,775.

- **Federal Supplemental Educational Opportunity Grants (FSEOG)** are for undergraduates with exceptional financial need, with Pell Grant recipients taking priority. Annual awards range from $100 to $4,000, depending on funds available at the educational institution.

- **Teacher Education Assistance for College and Higher Education (TEACH) Grants** are for undergrad or grad students who are or will be taking course work necessary to become a primary or secondary school teacher. Recipients must sign an Agreement to Serve, promising to teach full-time for four complete academic years (within eight years of degree completion) at a low-income elementary or secondary school or educational service agency. If recipients fail to carry out their service obligation, grants must be repaid as a Direct Unsubsidized Loan (discussed later) with interest accrued from the date the grant was distributed. The maximum

[14] http://www.naicu.edu/special_initiatives/affordability/about/new-three-year-degree-programs-since-the-economic-downturn

award amounts for 2015-2016 are $3,728 per academic year with awards not to exceed $16,000 for undergraduate degree programs and $8,000 for graduate degree programs.

- **Iraq and Afghanistan Service Grants** are for students who are not Pell-eligible and whose parent or guardian died as a result of military service in Iraq or Afghanistan post-9/11. At the time of the parent's death, the student must have been younger than twenty-four years old or enrolled at least part-time in college. The maximum award amount for 2015-2016 is $5,775, but this has been reduced by 6.8% due to the sequester, resulting in a maximum award of $5,382.30.

So, what if your student doesn't qualify for federal grants? Then **scholarships** are for you! There are several things to keep in mind with scholarships, and the most important is to start early.

1. Start with a personal inventory. Have your student give some thought to his or her academic, extracurricular, and career plans. The answers to these questions help determine scholarship eligibility. Dig deep!
    - What has your student done and been involved in? Don't overlook outside-of-school experiences that might demonstrate service learning / volunteerism, leadership or entrepreneurship.
    - What subject does your son or daughter plan to major in?
    - What career does he or she plan to pursue?
2. Apply for local and personal scholarships first. While the payoff is typically less than for national scholarships, the odds are also much better.
    - Check with your child's high school counselors for scholarships from your student's school, town, county, or state.
    - Look into the scholarships at your place of employment that may be available to children or grandchildren of employees or members.[15]
    - Explore such organizations as religious, community service, fraternal, military, union, and professional for other scholarship opportunities.
3. Pursue national scholarships such as those sponsored by the National Merit Scholarship Corporation, Gates Millennium Scholars, Intel Science Talent Search, the Coca-Cola Scholars Foundation, and the Robert C. Byrd Honors Scholarship Program.[16]
4. Don't forget about tuition assistance programs. Your student's employer, such as fast food chains, department stores, and supermarkets, may very well give scholarships or have tuition assistance programs. Also, make sure to check with your employer, as their tuition assistance program may extend to children of employees.
5. Some institutions offer scholarships to children of graduates. If your student will be attending your alma mater, make sure to check the institution's website and with the financial aid office to see if there are any scholarships available for children of grads, and what is required to qualify.

[15] "Free Money for College," *OSI* [*Of Special Interest*] newsletter, Spokane Teachers Credit Union, Winter 2011, 14-17.
[16] "Where the Scholarships Are," CollegeBoard, <http://www.collegeboard.com/student/pay/scholarships-and-aid/8936.html>

6. Use a free scholarship search service. Don't pay for scholarship information. There are many reputable, effective services that offer this information for free. A few good scholarship search services include Scholarship Search, Fastweb, and Sallie Mae.
7. Contact your state's Department of Higher Education to see if your state has a scholarship program for residents — the awards are usually limited to students who attend college in-state. For example, the State of Florida offers Bright Futures Scholarships to qualified Floridians who decide to attend in-state colleges and universities.[17]

As you and your student complete the scholarship process, keep an eye out for "scholarships" that seem too good to be true—it could be a scam aimed at separating you from your money. According to the Federal Trade Commission and the College Board, these are some of the most prominent "lines" used in scholarship scams. If you hear any of these telling quotes, you may be getting scammed.[18]

- "The scholarship is guaranteed or your money back."
- "You can't get this information anywhere else."
- "I need your credit card or bank account number."
- "We'll do all the work."
- "The scholarship will cost money."
- "Millions of dollars in scholarships go unclaimed every year**."**

If you have any questions about an offer's authenticity, check with your school's counselor or financial aid office.

Tip #5: Get someone else to pay.

So, you tried for federal grants and scholarships and weren't as successful as you'd like to have been? Don't despair! There are more options, including getting someone else to pay for your student's education. These programs usually require a service commitment from your student that ranges from one to four years. A few of these programs include:

- **AmeriCorps**
  - **Volunteers in Service to America (VISTA)** –After completing their term of service (usually one full year at a non-profit organization or local government agency), AmeriCorps members are eligible to receive a Segal AmeriCorps Education Award, which is tied to the amount of the Pell Grant (the maximum is $5,775 for 2015-2016). The Segal Award can be used toward graduate education or for repayment of student loans.
  - **TEACH for America** – Two years of teaching in a low-income, urban, or rural public school. Corps members may be eligible to receive an AmeriCorps Education Award ($5,775 annually) at the end of each teaching year (total of $11,550) to be used toward repayment of qualified student loans or future graduate school costs.
- Many **Peace Corp** participants qualify for some kind of loan deferment while on assignment abroad. Specifically, federal loans, including Perkins, Direct and Consolidation Loans (discussed

[17] Ibid.
[18] "How to Spot Scholarship Scams" CollegeBoard, https://bigfuture.collegeboard.org/pay-for-college/grants-and-scholarships/how-to-spot-scholarship-scams

later) qualify for this and some commercial loans might also (it's best to check). Additionally, participants with Perkins loans also qualify for cancellation of some of their loan commitment (15% after one year and an additional 20% upon completion of each of the third and fourth years).

- **The National Health Service Corps (NHSC) Loan Repayment Program** offers loan repayment programs to licensed primary care health professionals. In exchange for two years of full-time service in a community-based site in a high-need area, participants receive up to $50,000 towards student loans. After completing your initial service commitment, participants can apply to extend their service and receive additional loan repayment assistance. They also offer scholarships and provide cost-sharing grants to more than 30 states to operate their own loan repayment programs.
- **NHSC Students to Service Loan Repayment Program** provides up to $120,000 to medical students (MD and DO) in their final year of school in return for a 3-year full-time commitment as a primary care provider in a Health Professional Shortage Area.
- **ROTC** programs (Army, Air Force, Navy, and Marine Corps) require a four-year commitment after graduation. In exchange, these programs offer a varying amount of financial support, up to full tuition, and with additional allowances for living expenses, books, and supplies.

A note of caution: Always consider the restrictions and commitment you are making when you or your student accept money from an institution or organization. This is particularly important for attractive-sounding programs where someone else pays, like ROTC. However, ROTC, in particular, comes with a four-year, full-time service commitment, so you, your child, and your family must be smart consumers and understand any commitments that might come along with education dollars.

Tip #6: Not all education savings vehicles are created equal.

There are three primary savings vehicles for education expenses (beyond the loose change jar), each with its own advantages and disadvantages. Coverdell Education Savings Accounts and Custodial Accounts for Minors continue to be useful tools, but due to favorable tax treatment and lack of income restrictions, Section 529 plans have eclipsed both options in popularity in recent years.

Coverdell Education Savings Accounts (ESA) were formerly known as Education IRAs. A Coverdell ESA lets families put away $2,000 per beneficiary, per year and use the money — tax-free — to pay for education expenses. You can use Coverdell funds to pay for elementary, secondary, or college education costs. ***However, for the college financial aid process, Coverdell accounts are counted as student assets,*** which can reduce federal financial aid eligibility significantly under current financial aid formulas. Additionally, there are income restrictions to make full contributions to a Coverdell account — $110,000 for a single filer and $220,000 for married couples filing jointly. Talk to your tax advisor or financial planner for help with this, or you can open a Coverdell ESA at many discount brokerage firms like TD Ameritrade and Fidelity.

Custodial Accounts for Minors (Uniform Transfers to Minor Act/Uniform Gift to Minors Act) are often abbreviated to simply UTMA or UGMA. In a nutshell, a UTMA/UGMA account is a custodial account that belongs to a minor. Specifically, this type of account can be used to transfer assets to a minor until he or she reaches the age of majority (between 18 and 25, depending on the state and account type). While annual gifts of up to $14,000 per individual are allowed, the 'kiddie tax' rules regarding unearned income changed in 2006; now, unearned income for minors under the age of 18 (it used to be 14) is taxed at the parent's tax rate. Specifically, children under 18 pay no tax on the first $950 of unearned income and only 10% on the next $950. However, all investment income above $1,900 is taxed at the parents' tax rate, limiting the tax advantages of putting investment earning assets in a child's name.

UTMA accounts can be used for any purpose except a parental obligation (i.e., expenses a parent is normally expected to provide for his or her child, such as food, clothing, medical care, and shelter). Additionally, funds in a UTMA are an irrevocable gift to the child. Because these assets belong to the child, when it comes to financial aid calculations, these assets are assessed at the higher student rate for the EFC calculation.

While these are valid savings vehicles for college expenses, we tend to favor 529 plans (discussed below) over UTMA accounts. One downside of a UTMA account is that it legally belongs to the child at the age of majority, and the parents have no legal say over what the child does with those funds. In contrast, with a 529 plan, the account holder retains a legal right to the funds indefinitely, independent of who is named as beneficiary on the account.

Section 529 Savings Plans (or Qualified Tuition Programs, aka QTPs) are one of the most advantageous ways to save for education expenses (especially for affluent families) due to their favorable tax treatment and lack of income restrictions. As discussed by www.finaid.org and by the Financial Industry Regulatory Agency (FINRA) in their publication titled "Smart Saving for College – Better Buy Degrees," the basic traits of 529 plans include:

- The earnings of these plans grow tax-free, and withdrawals are also tax-free when used for qualified education expenses. Some states allow you to deduct some or all of your 529 contributions from your state income tax obligations.
- 529 plans provide favorable gift tax provisions because they include an accelerated gift option. This allows you to provide gifts above $14,000 per beneficiary ($28,000 for married couples) by averaging the gift over a five-year period without incurring the federal gift tax. As a result, an individual can contribute up to $70,000 per beneficiary in one year and a couple up to $140,000 per beneficiary without incurring gift tax. (Be aware: If you give the full amount, you will not be able to give any gifts to the same individual during the five-year period without incurring the gift tax or using up a part of your lifetime exclusion. Be sure to consult your tax advisor or Certified Financial Planner.)[19]
- There are no income limitations or restrictions on contributions or withdrawals.
- The account owner retains control over the assets for the life of the account.

[19] "Section 529 Plans," FinAid, <http://www.finaid.org/savings/529plans.phtml>

- Because the account is treated as an asset of the account owner and not as an asset of the beneficiary, it receives more favorable treatment when it comes to assessing the need for financial aid.
- Assets can be transferred tax-free to another plan beneficiary as long as the new beneficiary is a family member of the previous beneficiary. So, if you set up a 529 account for your son and there are assets remaining when he graduates from college, you can transfer the account to your younger daughter without tax consequences.
- You can get your money back if you overfund the account or the beneficiary decides not to attend college – although you will pay income tax and a 10% penalty unless you qualify for an exception (for example, death or disability of the beneficiary).
- Unfortunately, 529 plans are not necessarily protected from creditors of the account owner or beneficiary. Such protections vary from state to state. For example, Medicaid might be able to use the funds if the account owner needs nursing home care and has no other funds available.[20]
- No long-term information on investment performance is available, as these accounts have only been around for a few years.

While the traits described above apply to all 529 plans, there are actually two types of 529 plans: prepaid tuition plans and college savings plans. Each of these account types has additional advantages and disadvantages to consider.

529 Prepaid Tuition Programs

Almost every state now offers a prepaid tuition program, which allows you to lock in the tuition price being charged at the state's public universities in the year when you enroll in the program. Earnings are guaranteed by the state to match in-state public tuition inflation.

529 prepaid tuition plans do have several advantages:

- Low risk. Guaranteed in-state tuition for your student means peace of mind for parents or other account owners.
- They're backed by the credit of the state.
- A better return than a bank savings account or a CD. (The one exception to this is the CollegeSure CD from College Savings Bank, which is similar in many ways to prepaid tuition plans.)[21]

Prepaid tuition programs also have specific restrictions. Both www.finaid.org and FINRA's "Smart Saving for College – Better Buy Degrees" report have great discussions of these limitations:

- A waiting period of up to several years to use your tuition package after its initial purchase. The specific time period will depend on the plan and state.

[20] "Section 529 Plans," FinAid, <http://www.finaid.org/savings/529plans.phtml>
[21] "Section 529 Plans," FinAid, <http://www.finaid.org/savings/529plans.phtml>

- Many states' prepaid tuition plans are limited to tuition and fees and do not include savings for room and board or other expenses.
- Prepaid tuition plans are generally geared toward in-state public colleges and likely will not meet the full cost of private or out-of-state colleges.
    - If your student decides to go to school out of state, most programs allow funds to be transferred to private or out-of-state schools. The net effect of how this works is your prepaid credits will be transferred to your student's out-of-state school, and you will be required to pay the difference between the value of your credits and the current price of tuition at your student's school of choice.
- A ten-year time limit from the date of expected college entrance or high school graduation. Another (although less common) limit is a requirement that the funds be used by the time the beneficiary reaches age thirty.
- Pre-paid tuition plans have a lower maximum contribution limit than for section 529 college savings plans and, as a result, you may not be able to set aside as much as you'd like to for a more expensive out-of-state school or graduate school.
- Prepaid tuition plans may offer a return on investment that is not as good as other investments. A family with financial savvy and discipline might be better off investing the funds on their own through a section 529 college savings plan.
- The enrollment period may be limited. If you miss the enrollment period, you won't be able to contribute until next year when the unit cost will probably be higher.
- In many states, the account owner or the beneficiary must be a state resident when the account is opened.

529 College Savings Programs

These programs allow you to save money for college through state-sponsored investment accounts. As the account behaves just like an investment account, there are few restrictions on how you can use the funds. The funds can be used for a broad range of educational expenses (including tuition; room and board; mandatory fees; books; or computers if required by the school) at any accredited college or university in any state and some foreign schools. Typical investment options include a time-based approach in which the investments are chosen for the account holder and are more aggressive when the child is younger and become more conservative as the child approaches college age. Investments are managed by an investment company like Vanguard, Fidelity, Schwab, or T. Rowe Price.

As discussed by www.finaid.org and FINRA, additional advantages of 529 savings plans include:

- Use your funds immediately, if needed. There is no waiting period.
- Very high cumulative contribution limits — typically around $235,000 per beneficiary and as high as $305,000 per beneficiary, depending on the state and plan.
- Flexible investment options, such as age-based asset allocation strategies and risk-based asset allocation strategies. Many offer a choice of professionally managed funds and index funds.

- Enrollment at any time.
- No date by which funds must be used, not even the graduation date of the initial beneficiary.

The disadvantages of 529 college savings plans include:

- The plans may have limited investment options.
- Because the 529 savings plan behaves like an investment account, the assets may be at risk, just like a regular investment account. There are no guarantees. If money is mismanaged or there is a significant market setback, the account could lose value.
- Fees, expenses, and sales charges may be higher than what you would pay if you invested the money yourself. Some plans charge management fees as high as 2% and/or excessively high sales loads as high as 5-6%.

When evaluating 529 savings plan options, we recommend comparing plans based on total cost – account costs, management costs, and underlying fund costs. Be sure to evaluate advisor fees, program fees, program manager fees, expense ratios, sales loads, and any other fees or expenses listed when selecting a savings plan. We like the Utah Education Savings Plan with 0.18% cost, New York's plan with 0.25% cost and Iowa's plan with 0.35% cost, all of which use underlying Vanguard funds to keep investment fees low so more of your dollars go to work for you. For valuable research on 529 savings plans, check out www.savingforcollege.com and their 5-cap ratings at http://www.savingforcollege.com/5_cap_ratings/.

Which 529 option is better – the prepaid tuition program or the savings plan?

This is not an easy question; we've already seen that both plan options have positives and negatives. The prepaid tuition program guarantees your student an in-state public university education. However, the prepaid tuition program doesn't provide adequate flexibility. The program doesn't allow your family to save for college expenses beyond tuition and fees, and if your student decides to go to college out-of-state, your prepaid tuition will transfer but almost surely not cover the cost of tuition at your student's chosen school.

The 529 savings plan option, on the other hand, has significantly more flexibility due to its ability to save for a wider variety of educational expenses, but there is no guarantee that your contributions will be adequate to pay for college costs since the ultimate value is tied to investment returns. With a 529 savings plan, the account holder is subject to risk, and there is always the possibility that the savings plan will lose value as the market inevitably experiences setbacks.

When you're considering which 529 option to choose, it makes sense to use both plan types for their strengths and to off-set each other's weaknesses, especially if your student is considering an in-state school for their college education. One rule of thumb is to split your available college savings 50/50 between a pre-paid tuition program and a 529 savings plan. Using both plan options gives the worried parent some measure of security and flexibility.

Tip #7: See if tax credits can help ease the burden of higher education.

For those who qualify, tax credits—while not huge—can help with college expenses by reducing the tax bill. To claim an education-related tax credit, the student must be listed as a dependent on the filer's tax form. If the student is not listed as a dependent on another person's tax form and the student pays his or her own college expenses, the student can claim the tax credit.

There are two tax credits that might be helpful to you. The first is the **American Opportunity Tax Credit** (AOTC) which has been extended through 2017. With the AOTC credit, families who owe very little tax may be able to get some of the credit paid back to them directly. Also, the credit can now be applied to course-related books and supplies, in addition to tuition and fees. The credit applies to students in their first four years of undergraduate study who are enrolled at least half-time. The second is the **Lifetime Learning Credit**, which must be used for tuition and fees. This credit is available for undergraduate or graduate programs and for courses (even a single course) to acquire or improve job skills.[22]

Tip #8: Consider having your child contribute.

While research shows that students who attempt to juggle full-time work and full-time college often struggle, those who work a moderate amount largely do better academically.[23] In addition, having students contribute to their education ensures they are invested in the educational process.

One option for student work is a **federal work-study** job, which is a job designed for undergrads or grad students. These jobs are usually need-based and awarded as part of your student's financial aid award letter. However, if a work-study job was not mentioned in your son or daughter's award letter, have him or her take the letter to the financial aid office of the college and investigate. If your student does not qualify for work-study, there are usually many non-work-study employment opportunities on a college campus that are part-time and flexible. Have your student do some research using on-line job boards in the community where the college is located to identify possible job opportunities. In addition, work-study income is not included when financial need is determined each year, which may increase a student's eligibility for other types of financial aid, such as scholarships, grants, and subsidized loans.

Internships are another option. Usually available during summer breaks (but also offered during the academic year), internships are a great way for students to earn money and get experience in their field of study. In addition to the obvious monetary benefits, internships help students make professional contacts and get pertinent experience they can put on their resumes when looking for their first post-college jobs.

Tip #9: Make sure you're getting a good deal on any loans.

[22] "College Tuition Tax Credits," CollegeBoard, <http://www.collegeboard.com/student/pay/ways-to-pay/446.html>
[23] "Working May Help Your GPA," BU Today <http://www.bu.edu/today/2009/working-may-help-your-gpa/>

Government-backed loans are usually the best deal, and there are loans designed for students as well as loans designed specifically for parents. All government loans are now distributed directly through the U.S. Department of Education.

When considering federal student loans, there are many options – some that require demonstrated financial need and some that do not. Federal *student* loan programs include:

- **Federal Perkins Loans** are student loans with a fixed 5% interest rate. Loans are for undergrad or grad students enrolled at least half-time and who have demonstrated financial need on their FAFSA.
- **William D. Ford Direct Stafford Loans** - These loans carry generous repayment terms – from 10 to 25 years, depending on the repayment plan the borrower selects.
    - **Direct Subsidized Stafford Loans** are for undergraduate and graduate students enrolled at least half-time who have proven financial need. Awards are up to $5,500, depending upon eligibility. These loans carry low, fixed-interest rates (4.29% for undergraduate loans distributed between July 1, 2015 and June 30, 2016, although these rates change every year, so watch them!) Best of all, the government subsidizes the interest payments (i.e., pays the interest) while the student is in school, as well as during any grace or deferment periods.
    - **Direct Unsubsidized Stafford Loans** are also for undergrads and grad students enrolled at least half-time, but these loans do not require financial need. Annual awards range from $5,500 - $12,500 (less any subsidized loans received during the same period). Interest rates are currently the same at 4.29% (though these can also change, so pay attention to award letters) as for subsidized loans, but the rates are also fixed for the life of the loan. Because the loan is unsubsidized, the borrower is responsible for paying interest from the date the loan is disbursed. Your student should think about paying the interest that accrues while in school and during grace periods to avoid having these amounts added to the principal of the loan (and thus considerably increasing the total cost of his or her education).

The primary option for federal *parent* loans is the Direct PLUS Loan. **Direct PLUS Loans** are loans for parents of undergraduates, as well as for graduate and professional students enrolled at least half-time. While financial need is not required to qualify for this type of loan, borrowers must have decent credit history. Loans are unsubsidized (borrowers are responsible for all interest) and fixed interest rates are 7.21% as of 2014.

Upon graduation, if your student has multiple federal student loans, he or she may want to consider a **Direct Consolidation Loan**. This loan alternative allows your student to consolidate multiple federal student loans. The new interest rate will be a fixed rate based on the weighted average of the loans being consolidated, then rounded up to the nearest 1/8%. Note that parent loans *cannot* be consolidated with student loans and then become the student's legal responsibility to pay.

If, after federal loans, your family still has a gap to cover the education expenses, an alternative is to use **private loans**. Based primarily on credit worthiness, these loans are made by private banking institutions and usually carry significantly higher interest rates when compared to federal loan options. Be a smart consumer and consider your options carefully.

- Make sure you read the fine print on the application and in all the documents you receive (sometimes they are different).
- Never sign anything before you have all the information. Did the lender include all the features that were advertised for your loan?
- What is the interest rate on the loan?
  - Is it fixed or variable?
  - If it's variable, what index does it track to?
  - How has that index behaved over time?
  - Compare the index behavior between different loans if the indexes are different. Does this make a difference for which interest rate has been better historically?
  - What is the floor rate? Often times your rate will not fall below a certain level, even if the index your loan is priced to falls well below that rate.
- What are all the fees? Verify there is no prepayment penalty!
- How will additional payments be applied to your loan? Ideally, additional payments should be applied to loan principle and not to future payments, late fees, or interest.
- Confirm how often interest rate adjustments occur, how you will be notified, and when.
- How will the lender handle a missed or late payment?

Also, make sure you investigate options from credit unions and neighborhood banks—don't just look at large lenders. Student Lending Analytics (http://studentlendinganalytics.com/ratings.html) compiles independent ratings on private lenders; it could be a helpful resource during your research process.

Finally, a note on co-signing a private student loan: When you sign on the dotted line as a co-signer, you are on the hook. If the borrower passes away, the lender of a private loan can still demand payment from any co-signer. If you decide to co-sign a private college loan, think about purchasing a twenty-year term life insurance policy on the student to ensure you would be fully protected from the debt in the most unfortunate of circumstances.[24]

A home equity line of credit (HELOC) may offer an additional source of funds, if you have adequate equity in your home. A HELOC is based on the appraised value of your home – you are borrowing against the equity. The line of credit is based on a percentage of your home's appraised value, subtracting any outstanding balance left from primary mortgage. Most lenders require at least an 80% loan to value ratio to receive the lowest interest rate. A HELOC may offer a lower interest rate than other loan options available for education financing, and the interest you pay may be tax deductible under certain circumstances.

[24] Orman, Suze, "Fiscal Prudence 101," *The Costco Connection* January 2011, 19.

However, there are downsides to a HELOC as well. The interest rate is variable which means that if interest rates rise, you could be stuck with much higher payments in the future (although many HELOCs can be converted to a closed end home equity loan with a fixed rate). In addition, if you are unable to make payments on the loan, you are at risk of losing your home. Many HELOCs also include a 'call provision', which means that under certain circumstances, the lender could, in essence, demand immediate repayment of some or all of the loan.

Crowdfunded loans are a new alternative to Federal or private student loans: www.upstart.com allows a student to obtain unsecured funding through fixed rate loans, offering crowdfunded loans in exchange for repayment over three years.[25] The catch with crowdfunded finance is that not everyone gets their campaign fully funded, and repayment terms start while you're still in school. Students (and parents) should make sure to read the site's fine print and compare online financing options to loans offered through the federal government, banks and credit unions.

Tip #10: Dip into your retirement funds only as a last resort

Should you use your retirement funds to pay for your child to go to college? The simple answer is: avoid it if you can. The reason? You or your child can borrow funds to pay for college expenses, but you can't borrow to pay for retirement. Chances are your son or daughter will have time to pay off his or her college bills and still save for retirement.

What if you have no other choice?

You may withdraw your contributions from a Roth IRA to pay for college expenses without having to pay either income tax or the ten percent early withdrawal penalty (as higher education is a qualified expense). Any investment earnings in your Roth IRA are also available for withdrawal without the ten percent penalty, but subject to regular income tax. You may withdraw investment earnings tax-free if you're over 59½ and you've had your Roth IRA for at least five years.[26]

Remember that, as part of the financial aid process, retirement accounts are generally not counted as assets (and hence are not included in the EFC calculation). Unfortunately, as soon as you take a distribution from a retirement account, those distributions will count as taxable income for the financial aid process, reducing next year's financial aid eligibility. Yes, even the tax-free return of your Roth IRA contributions is treated as income in the financial aid formula.[27]

Alternatively, you could consider borrowing from your 401k plan to pay for college expenses. In terms of positives, you are essentially borrowing from yourself, so although you have to pay the money back with interest, the interest is basically returned to you in the form of disbursements when you retire. Additionally, the loan will have no impact on your student's eligibility for financial aid. However, there are three drawbacks to a 401k loan. The first was discussed above — you will do long-term harm to the productivity of your retirement account and may impact your ability to retire. Second, your

[25] Upstart.com < http://upstarthelp.upstart.com/questions/83440-what-are-my-payment-obligations>
[26] "Retirement Plans and Saving for College," FinAid, <http://www.finaid.org/savings/retirementplans.phtml>
[27] "Financial aid basics," FinAid <http://www.savingforcollege.com/financial_aid_basics/financial_aid_and_your_savings.php?

contributions to your 401k plan were pre-tax, but you must repay your loan in after-tax dollars, which makes the loan considerably more expensive. Third, if you quit your job or are terminated, the loan must be paid back in full, immediately (usually within 60 days). If you cannot repay the loan, then it is considered ordinary income and you have to pay taxes on it. To make matters worse, if you're under 59½, you also have to pay an early withdrawal penalty of 10% on the loan amount.[28]

If you can avoid using your retirement savings to pay for your child's education expenses, do so. If it cannot be avoided, carefully consider the positives and negatives of using money taken out of your retirement savings plans vs. taking out a loan. Finally, if there is *any* possibility that you may lose your job, don't take the chance on a 401k loan.

Conclusion

What does all this mean for you and your family?

Take heart. Funding your child's or grandchild's education is possible, but it does require forethought and planning.

If you have 5 - 10 years (or more) until your student will go to college, SAVE, SAVE, SAVE! Consider using a Section 529 Savings Plan and make sure to research whether a prepaid tuition plan or a savings plan would better suit your family's needs.

- If you decide to use a 529 savings plan and if you live in a state in which 529 contributions are state-income-tax-deductible, consider this plan first. If you live somewhere in which state income tax is not a factor, then concentrate your research on plan costs and not on investment criteria. How much you save is much more important to your long-term success than how your investments perform. Additionally, consider a moderate asset allocation that is more aggressive early on and more conservative as your child ages. For additional information, check out http://www.savingforcollege.com/5_cap_ratings/ for valuable 529 savings plan ratings from Savingforcollege.com.

If you have 2 - 3 years until your son or daughter heads off to college, start evaluating your investments and have some frank conversations with your child about your ability to contribute to education expenses. Also, encourage your student to get involved in school and in the community – what they do in these years will serve as the basis for scholarship and college entrance essays in a few years. In addition, if your student is ready, consider having him or her take college level courses in high school. This will make your child more competitive to colleges, as well as reduce the total cost of his or her higher education.

If your child is a senior in high school, start the scholarship search and application process NOW! The ideal time to start this process is in the fall of your student's senior year, which will give him or her lots

[28] "Borrowing from Your 401k," CollegeBoard, <http://www.collegeboard.com/parents/pay/loan-center/37050.html>

of time to search for appropriate scholarships and complete the application process (and dreaded essay writing).

When your student gets his or her college acceptances and financial aid awards, make sure you consider the total cost of your child's education, and don't evaluate pieces in isolation. Many pricy institutions also have more financial aid dollars to help students (although many times these institutions will still be more expensive than public, in-state options). It may be worth negotiating with the college your child most wants to attend, if she or he has received a better aid package from another college.

Above all, college is an investment in your child and in your family's future. And while higher education is expensive, the benefits far outweigh the costs. Remember that there are many options and strategies available to you for reducing the total financial burden created by higher education. Do your research, be a smart consumer, and get started today!

About the Authors

Steve Juetten, CFP® is a fee-only financial advisor and father of an 18 year-old son who is starting college. Having served clients for more than ten years as a comprehensive financial guide, Steve is familiar with the hopes, dreams, fears and ambitions of parents and grandparents when it comes to saving for college. You can contact Steve at steve@finpath.com or by calling him at 425-373-9393.

Amy Shappell, CFP® is also a fee-only financial advisor and is the mother of two children: a recent college graduate and one in her third year of college. A veteran of more than ten years working with clients as a financial advisor, Amy's mission and commitment is to help clients develop a clear vision for their lives and then educate and empower them to make smart financial decisions to make that vision come true. Her email is amy@finpath.com and phone number is 425-333-7526.

Visit our web site at www.finpath.com**.**