Education Savings Vehicles

Save early, save often and understand the alphabet soup of options

The cost of a college education increases every year, largely unbeknownst to you until you receive the bill. The pile of money you must save is staggering. If you have children, plan for college costs as soon as possible.

Children are costly even before college. Raising a child from birth to 18 runs some $233,610—or $14,000 a year—according to the U.S. Department of Agriculture, varying widely depending on where you live and how much you earn.[1]

These figures are based on housing, food, clothing, health care, education, child care, and miscellaneous expenses, including cell phones and computers. The bad news, especially if you're still in sticker shock: These prices do not include the cost of college tuition, which, on average, continues to grow at a rate that outpaces the increasing costs of other goods and services nationally.[2]

Planning Matters

It's never too early to start planning for your child's college fund. However, as with other types of financial planning, bear in mind that your child's college funding plan requires a disciplined approach that emphasizes consistency with your overall goals and objectives.

Here is where planning comes in: Work with a financial advisor to establish a goal and determine how much you need to (and can) save for your child's tuition. More than simple saving, this often means creating an investment plan, a strategy, and the right vehicle so that you can increase growth potential and steadily accumulate more for college.

Your biggest advantage for achieving this goal outweighs even the size of your paycheck: time. The sooner you start saving, the more time you have to grow your college fund through long-term compounding. Even the smallest contributions make a difference over many years.

For example, let's say you still have 15 years to save for your child to attend four years at a private college. To save $150,000 (this might not leave room for your kid's pizza and laundry money), and figuring a conservative return rate of four percent annually, you need to put away about $600 a month. In addition to starting early, remember that selecting the right investment vehicle is also significant.

College Savings Vehicles Matter

529 Plans

A 529 plan is a tax-advantaged savings plan authorized by Section 529 of the Internal Revenue Code and designed to foster saving for future college costs.

529 savings accounts allow you to set aside after-tax contributions that grow tax free, and the proceeds can be used for qualified educational expenses, such as tuition, room and board, and books. We can talk about the specific tax breaks/credits that our state offers residents.

Roth IRAs

A Roth IRA is a tax-advantaged Individual Retirement Account—you make contributions after tax, but then that money and your investment earnings grow tax free. But you should know that while withdrawals are allowed penalty free for qualified education expenses, they will generally be included as income when financial aid eligibility is determined.

Coverdell Education Savings Accounts

Coverdell Education Savings Accounts, loosely called Education Savings Accounts, Coverdell ESAs, Coverdell Accounts, or just ESAs were proposed under the Taxpayer Relief Act of 1997 and are governed by Section 530 of the Internal Revenue Code. They also offer tax-deferred growth and are designated for a child's educational expenses. It's important to note that there is a maximum contribution per child per year. See the IRS website for more details.

Regular Savings Accounts

According to Sallie Mae, nearly two-thirds of Americans use regular savings accounts to pay for college. Of course, with savings accounts providing very little interest, it's likely that these savings will lose out to college inflation rates.

Trusts/UTMAs/UGMAs

Before the introduction of 529s and ESAs in the mid 1990s, college savings vehicles were simple: Families established trust accounts in a child's name, and assets were transferred and invested until the child reached college age (or until age of trust termination as defined by state law). Today, establishing such accounts can still work. But there is a pretty big catch: Once the child becomes of age, they can do whatever they want with the assets—pay for college or run away to Key West.

Financial Advisors Matter

Again, it's never too early to begin your child's college funding plan. However, as with other types of financial planning, it's important to adopt a disciplined approach that integrates well with your overall goals and objectives.

Two more, very cautionary notes: Don't forget to examine the fees and expenses associated with all college savings vehicles—such as asset-based mutual fund fees (a sort of retainer scaled on the size of your investment), enrollment or maintenance fees, and commissions. And do not forsake saving for your retirement to save your children's college expenses.

After all, you and your kids can get student loans much easier than you can borrow money to fund your golden years.

1 Lino, Mark. "The Cost of Raising a Child." U.S. Department of Agriculture, 2020. February 18. [https://goo.gl/m9Bjjx]

2 "The Rising Cost of University Education - Most Expensive States." Self. [https://www.self.inc/info/rising-cost-of-university/]