College and Ways to Pay For It

August 2021

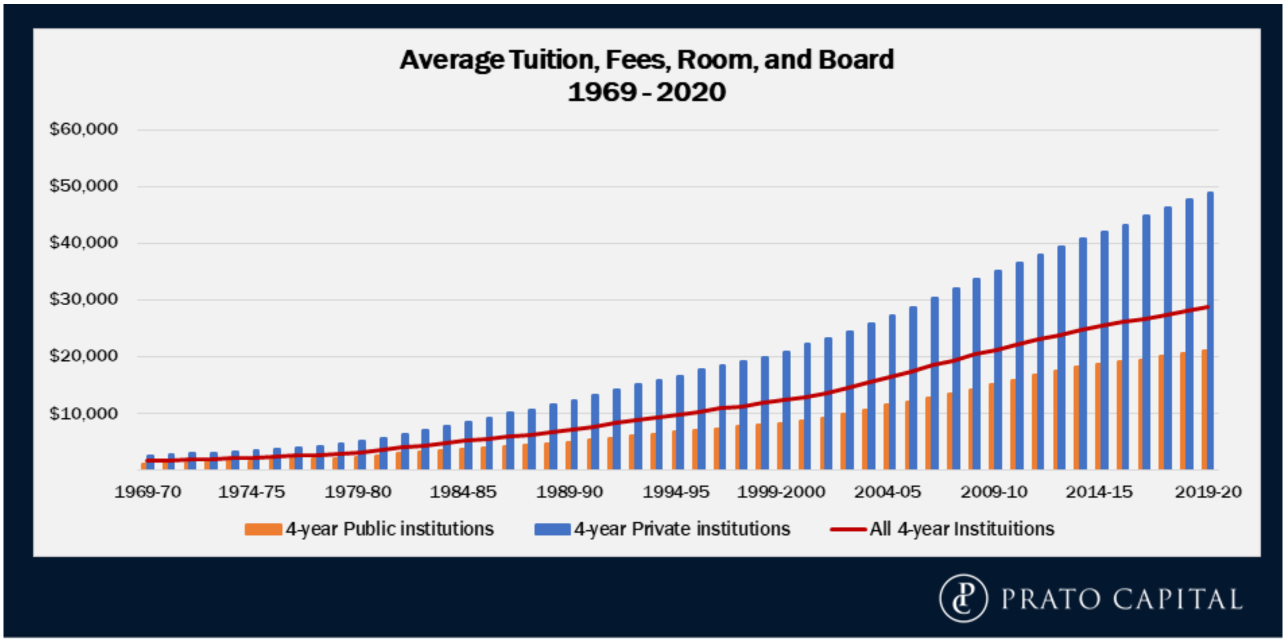
August is the traditional month that many recent high school graduates are leaving for their first year of college. It is an exciting period of their lives but can be a stressful time for many parents as tuition bills start to roll in.

Rising Costs of Higher Education

News reports for years have discussed the rising costs of attending college. But, until one of your children attends college and you receive the first bill for tuition, room and board, fees, books, and other expenses, it is very hard to comprehend just how expensive it really is. At some schools today, the price for 4 years of tuition, room and board and the various fees cost more than the average price of a new home.

Inflation in the US economy has caused consumer costs to rise about 3.8% annually over the last 50 years. College costs have increased at almost twice that rate. **Figure 1** below illustrates the rising cost of both private and public 4-year institutions since 1969[1]. In 2020, the average annual cost of attending a 4-year public institution was $21,035 and a private institution was $48.965. The red line in the illustration below shows the average cost of both public and private institutions nationally. If this rate of increase continues, the cost of attending a university will approximately double by 2030, just 9 years from now. And by 2040, the cost will double again. This means when an 9-year-old child attends college, an average priced public university can cost about $42,000 per year. Sending this child to an average priced private university in 10 years can cost almost $100,000.

Figure 1: Average Annual Cost for 4-Year College



Since the figures above are just a national average, costs do vary considerably, with many colleges and universities priced well above this average. For 2021-2022 school year, the cost of attending the University of Chicago is $82,848 and Notre Dame University is now $78,347 per year. The annual cost to attend the University of Connecticut is $31,782 for in-state residents and $54,450 for out-of-state, and Penn State will cost $36,278 and $53,856 for in-state and out-of-state residents respectively[2]. These are a few examples of just how expensive it is for college today.

Savings Plans

What is the best way to save for college? The ‘best’ option can be different for everyone due to different financial situations and competing financial goals.

529 plans, Coverdell Education Savings Accounts, and Custodial Accounts are the best known and most popular ways to save for college. The 529 and Coverdell plans are tax-deferred, meaning the investments grow tax free when withdrawals are made for qualifying education expenses. Listed below are some of the highlights of each program, please call us for more detailed information about each of the plans.

- 529 plans are very popular plans that allow investments to grow tax-free, and allow tax-free withdrawals for qualified education expenses, such as tuition, room and board and assigned textbooks. Withdrawals can be used at any college or university, and some trade schools. Withdrawals can also be made for K-12 public, private, or religious school tuition up to $10,000 per beneficiary per year.
  Investments can be made to any state 529 plan, not just the state of residency, and some states allow a tax deduction for 529 contributions. Withdrawals from any state plan can be used to pay for education in any other state.
  There is no income limit for starting a 529 plan and contribution limits vary by state, but many plans allow total contributions up to $300,000 - $400,000 per beneficiary.
  For some individuals, a 529 plan may have some estate planning benefits.

- Coverdell Education Savings Accounts are another tax deferred savings account for education expenses. Differences from a 529 plan include more investment options and withdrawals over $10,000 for K-12 public, private, or religious school tuition are allowed.
  However, there are contribution limits based on income and contributions are limited to $2,000 per year per beneficiary. This means that if a child is the beneficiary of multiple Coverdell accounts, the combined total contribution can not exceed the $2,000 limit.
- Custodial Accounts, Uniform Gifts to Minors Act (UGMA) and Uniform Transfers to Minors Act (UTMA), may be an appropriate savings option for some. The UGMA is an account holding financial products like cash, stocks and bonds and the UTMA can hold any type of asset, that could include real estate as well as stocks and bonds. All assets transferred into a custodial account are considered an irrevocable gift to the minor. Once the minor reaches a certain age, and this age varies by state, control of the account must be transferred to them. Once the account transfers to the minor, the assets of the account can be used for any purpose, not just education.
  There are no limits on how to invest in custodial accounts.
  Contributions are not tax-deductible. Earnings are generally taxed at the minor's tax rate, rather than the parent's rate. For some, this can be a significant savings.
  Since the money in a custodial account is the minor's, UGMA/UTMA assets can have a significant negative impact on any potential financial aid.

Since these plans involve investments and taxes and can have significant impacts to a financial plan, we ask our clients to call us for more details of each plan and discuss which option may be the best fit for their financial situation.

Planning for those Tuition Bills

For all the savings plans discussed above, each has advantages and disadvantages. To find the right college savings plan and the proper balance of other savings needs, it is best to discuss these choices with us at Prato Capital in the context of a complete Financial Life Plan (FLP) that includes all financial goals, not just college savings. It is important to look at the whole financial picture and not just concentrate on specific financial goals like saving for college at the expense of other goals, like retirement. The FLP can help provide the complete financial picture.

Conclusion

For many parents, saving for college can be difficult but investing in your child's education is a goal that should be set just like any other financial goal. Having a valid financial plan, like we offer at Prato Capital with our FLP, can help find the right balance of different financial goals and the available resources.

As parents, we are always proud of our children's achievements and our job is to help them succeed in every way they can. Helping them with their education is one of the best ways to provide them with the tools for success throughout their lifetime.

At Prato Capital, we look forward to discussing how we can help you save for your children, grandchildren or even those yet to come.

"An Investment In Knowledge Always Pays The Best Interest." - Benjamin Franklin, 1758

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[1] National Center for Education Statistics, https://nces.ed.gov/programs/digest/d20/tables/dt20_330.10.asp, July 23, 2021.
[2] Data from the websites of The University of Chicago, Notre Dame University, The University of Connecticut and Penn State University.