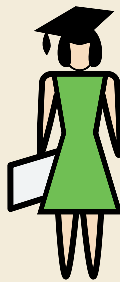
LIGHTBULB PRESS®

GUIDE TO SAVING FOR COLLEGE

- College and Grad School
- Student Aid



- 529 Plans

- Vocational and Technical Schools

- Tuition
- Savings Plans

VIRGINIA B. MORRIS

The Evangelical Covenant Church

GUIDE TO SAVING FOR COLLEGE

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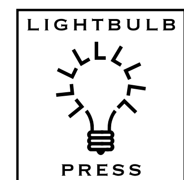


Paying for College

Once you fit all the pieces together, you'll have a clearer view of how funding your child's education works.

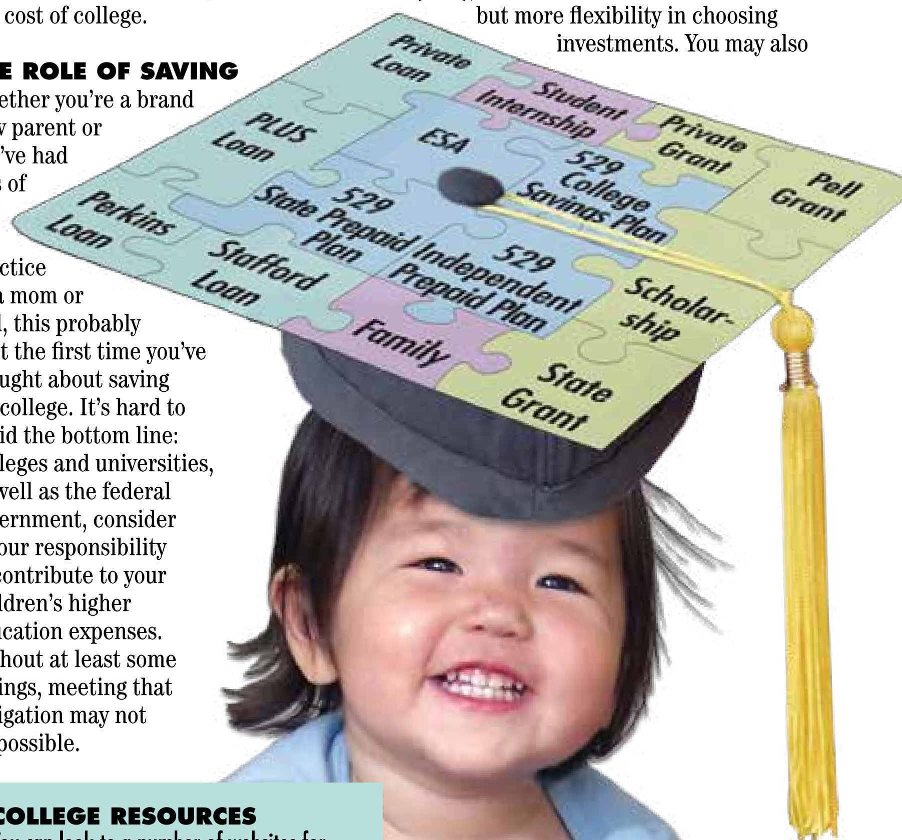
There's no doubt that the cost of higher education has increased dramatically in recent years. Yet, perhaps surprisingly, the number of students enrolling in all types of institutions has increased as well. One reason may be the recognition that a college education makes financial sense. Another may be the commitment—and sometimes sacrifice—that families are willing to make in order to pay for the opportunity that education provides. But a third, and possibly equally powerful factor, is that families can turn to a number of sources to help them cover the cost of college.

THE ROLE OF SAVING

Whether you're a brand new parent or you've had lots of practice as a mom or dad, this probably isn't the first time you've thought about saving for college. It's hard to avoid the bottom line: Colleges and universities, as well as the federal government, consider it your responsibility to contribute to your children's higher education expenses. Without at least some savings, meeting that obligation may not be possible.

But it's equally true that while saving may not be easy, there are a number of programs designed not only to encourage you to put money away for college but to provide tax benefits if you do. In fact, you may already have a plan to accumulate the money you anticipate needing.

Among the most widely available choices are those that share the **529** label: college savings plans, state prepaid tuition plans, and the private college prepaid plan. Another alternative is the **Coverdell education savings account (ESA)**, which has lower contribution limits but more flexibility in choosing investments. You may also realize tax savings in certain cases by paying college expenses with interest you earn on US savings bonds.



Better yet, you don't have to select just one method. You can create a savings plan that combines several of the options and takes advantage of their most attractive features.

IT'S A GRANT WORLD

It's the unusual person who doesn't enjoy receiving a gift. And the best gift a college student—and his or her parents—can receive is a grant or scholarship. Grants directly reduce the amount of your child's education expenses and, unlike loans, never have to be repaid. Grants make up about 40% of all financial aid that college students receive. About half of the grants in any year come from private institutions and individual colleges and universities, while others are provided by public institutions, including certain states and, in the case of **Pell grants**, the federal government.

One challenge may be determining the requirements a student must meet to qualify for a grant. Certain grants, such as Pells, are need based. Others are merit based, which means they're given in recognition of the student's achievement. Still others may take both the student's merit and need into account.

In most cases, students are offered grants after they've been accepted at a college or university, but sometimes a school or organization will offer a grant as an incentive to attract your child. You can check with the high school guidance office and organizations you belong to for a list of potential scholarships. You might also discover lists online—though few of these lists are really useful. Beware of sites that ask you to pay a fee to access their files: There's no reason to pay to find scholarships.

BUYING TIME

Unlike grants, higher education loans must be repaid. Like other loans, they accumulate interest, so that borrowers end up repaying more than the amount they actually spend on tuition, room, board, and other expenses. But the federal government offers both parents and students guaranteed loans that can reduce—though not eliminate—the costs of borrowing.

There is a trade-off. You and your child must complete a comprehensive federal loan application to qualify. But the good news is that federal loans have made it possible for many more students to afford a college education.

These federal loans—**Stafford** for students and **PLUS** for parents—are available directly from the government.

You can find detailed information on what loans are available and how to apply at www.studentaid.ed.gov, a US Department of Education website.

You can borrow money elsewhere as well, which you may opt to do if federal funding doesn't meet your needs. One of the issues you'll have to weigh in accumulating loans—even for a good cause—is the long-term responsibility they impose on you and on your child.

MAKING COMPROMISES

The other thing to remember about paying for college is that there are many routes to an undergraduate degree.

While some students finish their college education at one school within four years, many don't follow that pattern. For instance, students may begin at a local two-year public college and then transfer to another public institution or to a private college. They may attend school part-time throughout the year for five or six years rather than full-time during the fall and spring semesters for four years. Or they may select a school that expects students to combine time in class with paid internships.

Certain circumstances may also provide you with different ways to reduce the overall cost of your child's education. For instance, someone in your extended family might provide housing for your child to live off campus at a school he or she wants to attend, perhaps in return for doing certain chores. Or your child may accumulate advanced placement credits or take some required courses in the summer to reduce the length of time it takes to graduate.

Obviously, decisions such as these must be collaborative or the likelihood of their being successful is slim. But if you and your child can talk frankly about your shared goals and the financial realities, you can find a way to achieve what you both want.

COLLEGE RESOURCES

You can look to a number of websites for help in planning for your child's education.

- **www.collegeboard.com** Information on college costs, scholarships, and entrance exams.
- **www.studentaid.ed.gov** Guidance on the process of applying to and paying for college.
- **www.collegesavings.org** Valuable information about 529 savings and prepaid plans.

Planning for College

Preparing for college takes time—and money—but the rewards are well worth it.

Is providing your child with an excellent education something you care deeply about? For many parents that means paying for—or helping to pay for—an undergraduate degree, vocational school, or technical program after high school. And, if the child wants to pursue a professional or graduate degree, some parents support that schooling as well.

Part of making education a priority is understanding what it will cost and what you can do now to be ready to pay the bills when it's time for your child to enroll. A good place to start is by learning how many options you and your child have. They include not only the number and variety of schools he or she might attend, but the range of alternatives for saving and borrowing that are designed specifically for education.

A RANGE OF CHOICES

There are over 4,000 degree-granting colleges and universities in the United States, plus a number of certified vocational and technical schools offering specialized training programs.

The most basic distinction is between **public institutions**—those that are supported at least in part by state tax revenues, or, in a limited number of cases, by federal tax money—and **private institutions**.

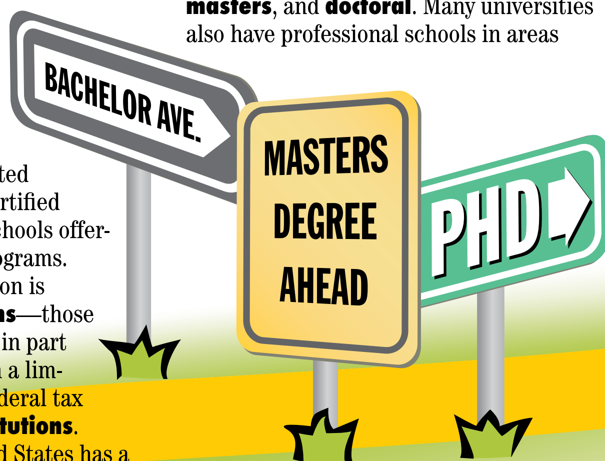
Every state in the United States has a public university system that includes one or more major universities, four-year colleges, two-year community colleges, and sometimes institutions with a specific focus, such as veterinary medicine, agriculture, or hotel management. The largest system, New York's, has a total enrollment of over 400,000 students.

Private colleges and universities, which are supported primarily by tuition and fees, investment portfolios, and fundraising efforts, are a presence in every state. There are also a small number of private two-year colleges and some for-profit institutions, whose financial structure resembles that of for-profit hospitals.

MAKING DISTINCTIONS

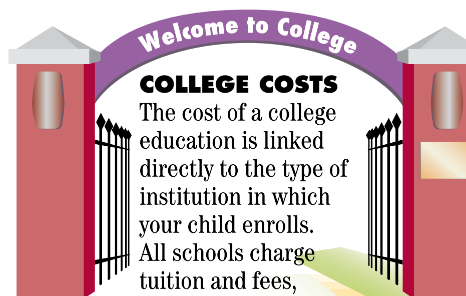
The differences between a college and a university are essentially those of size and scope. Most colleges grant four-year bachelor's degrees and sometimes a limited number of master's degrees in specific fields tied to the mission or the academic strengths of the school. College enrollments vary from a few hundred at the smallest schools to several thousand at larger ones.

Universities, both public and private, offer two and often three levels of degrees: **bachelors**—also called baccalaureate—**masters**, and **doctoral**. Many universities also have professional schools in areas like law, medicine, journalism, religion, and education. Enrollment can run to tens of thousands. The largest university in the country, Arizona State University, has an enrollment of over 70,000 students.



WORDS TO THE WISE

One thing to remember is that the net price you pay when your child enrolls is often lower than the price printed in the college catalog. More than 60% of students and their parents receive some financial aid, either through an individual school or from the government.



COLLEGE COSTS

The cost of a college education is linked directly to the type of institution in which your child enrolls. All schools charge tuition and fees, which help to pay for classroom instruction, certain extracurricular activities, and maintenance of the buildings and grounds. If students live on campus, schools will also charge for room and board, which covers a place to stay and some or all meals.

The average tuition cost for an in-state student at a four-year public college in the 2016-2017 academic year was $9,650. Attending a public school in a state other than the one where the student lives adds, on average, about $15,280 annually to the tuition bill at a four-year school. At a private college, the average cost was $33,480. Remember, though, that these are averages. The numbers don't report regional differences, which may affect your experience.

What may be more encouraging is that the percentage increases in in-state tuition and fees at public colleges were smaller than in the past. The least expensive way to attend college is at a public two-year school where tuition and fees average $3,520.

IN YOUR CORNER

If you're just starting to plan for college, it's important to remember that if higher education matters to you and your children, it's within your reach. Two things you can do to make a difference are stressing the academic achievement that helps kids get accepted and saving to help cover the cost.

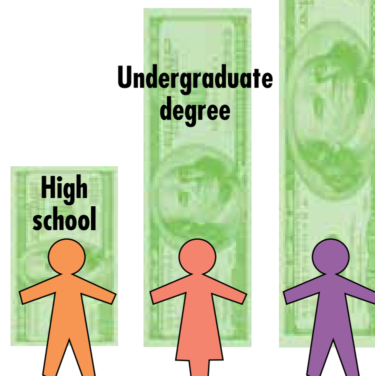
There's a general sense, from the local community to the federal government, that education is a good thing and that everyone is entitled to the opportunity. That doesn't mean there are no challenges. Prices are going up, as they have been for years. Public institutions in particular are struggling to compensate for reduced funding from the states. But you'll find that there are a number of financial incentives to help you pay for your child's education. Certain education expenses and education loan interest are tax deductible, and education tax credits may reduce the income tax you owe. But you must spend the money before those benefits help you.

COLLEGE TUITION + FEES	
4-year public in-state	$ 9,650
4-year public out-of-state	$24,930
4-year private	$33,480

*Source: The College Board, 2016

THE GI BILL

Special assistance in paying for higher education is available through the Post-9/11 GI Bill for veterans, their dependents, and, in some cases, their survivors. If you or your children may be eligible, view or download a copy of *Federal Benefits for Veteran, Dependents and Survivors* at www.va.gov/opa.



OUTWEIGHING THE COSTS

There's little question about the value of education in financial terms. Someone with an undergraduate degree earns, on average, about $1 million more over his or her lifetime than someone with just a high school diploma. And while there are still some extremely satisfying jobs that don't require a college education, there's little doubt that an undergraduate degree is an entry-level requirement for an increasing number of careers.

People with advanced degrees, including professional degrees, can expect an even higher level of financial security, on average earning up to three times more than the annual income of someone who has no formal education beyond high school.

Making the Most of Savings

Some ways of saving can be more effective than others.

One of the advantages of having a financial goal with a specific time frame is that it can be easier to make decisions about how to save your money. It might not seem that way when you first begin to think about paying for college. But when you have a clear sense of the amount you need and when you need it, certain alternatives make more sense.

SAVING EARLY AND OFTEN

It's no secret that the sooner you start putting money into a college fund and the more regularly you add to it, the greater the potential for meeting your goal. That's true not only because you're steadily increasing your principal but also because that principal can grow, thanks to the power of **compounding**.

When financial assets compound, any earnings the assets produce are added to the principal. The next round of earnings is paid on the new, larger principal. For example, in an interest-bearing savings account, the interest is usually compounded daily and added to your balance monthly. That combined total becomes the new base.

Similarly, in a mutual fund or through a stock dividend reinvestment program, earnings from dividends and, in the case of mutual funds, any capital gains from the sale of fund holdings, are reinvested to buy more shares. That's another form of compounding, since the more shares you own, the greater your earning potential.

COMPOUNDING THE BENEFIT

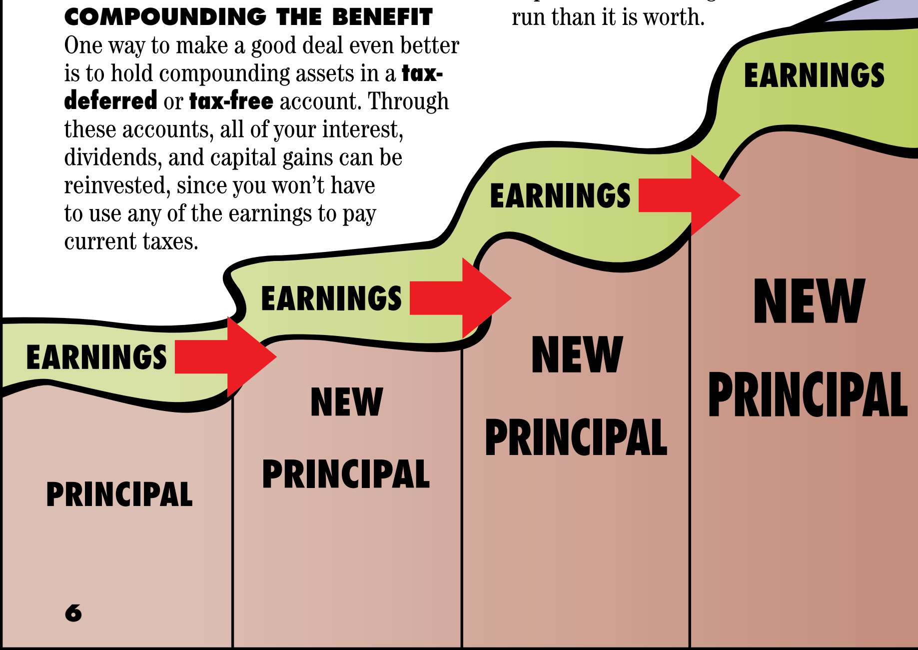
One way to make a good deal even better is to hold compounding assets in a **tax-deferred** or **tax-free** account. Through these accounts, all of your interest, dividends, and capital gains can be reinvested, since you won't have to use any of the earnings to pay current taxes.

By government design, most college savings plans offer the benefit of tax-free earnings if you use the money for qualified education expenses. That includes all three varieties of 529 plans—savings plans and both public and private prepaid tuition plans—and Coverdell education savings accounts (ESAs).

Taxes are also deferred on US savings bond earnings until you cash them, and you'll owe no tax at all if you qualify, based in large part on your income, to use the bond assets to pay college costs.

You might also think about using assets you hold in an individual retirement account (IRA), which may be tax deferred if it's a traditional IRA or tax free if it's a Roth IRA, to pay college costs. There is no penalty if you withdraw for that reason, even if you aren't yet 59½, but taxes are due on all the earnings and on your contribution as well if you deducted it. In most cases, though, it's not a good idea to plan on using an IRA. Remember, there are no scholarships for individuals whose savings fall short of their retirement needs.

Finally, you may be tempted to borrow against your employer sponsored retirement plan or take a hardship withdrawal. While owing college tuition within 12 months of a withdrawal does count as a hardship, be sure to weigh the consequences before taking this step. Withdrawing any money from a retirement account means depleting your own savings. That can be more expensive in the long run than it is worth.



SAVING OR INVESTING?

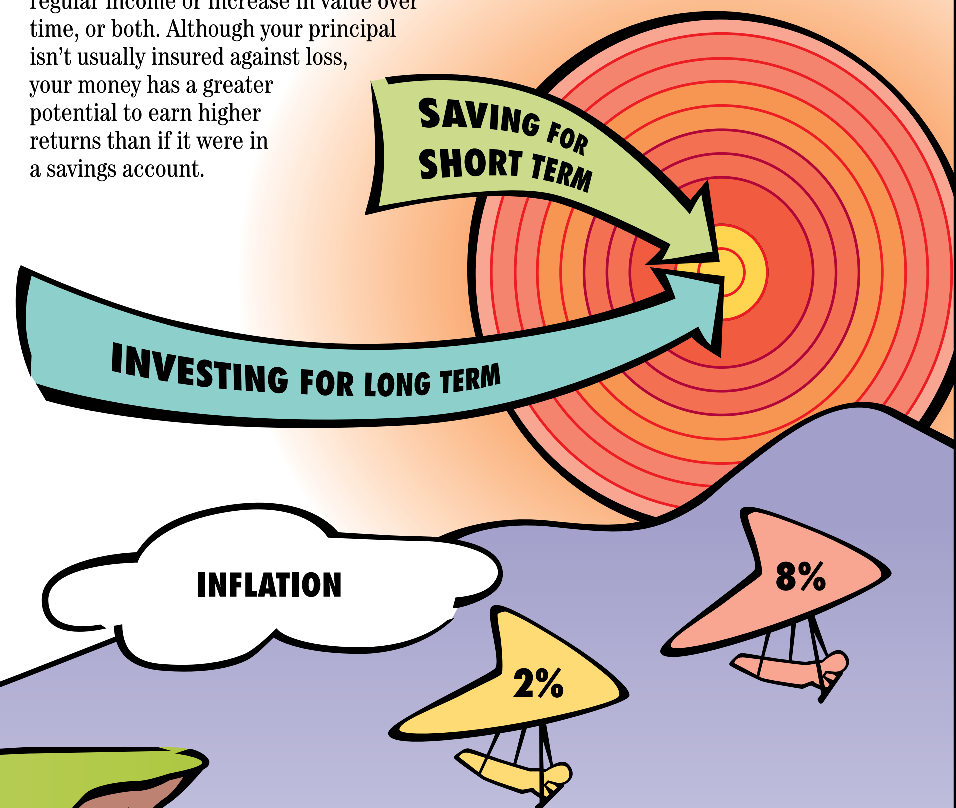
When you save or invest, you set aside money so that you'll have access to it in the future. Your money has the potential to compound either way. But apart from these similarities, saving and investing are distinctly different.

Saving is what you do to meet short-term goals. In most cases, you put most of the money you'll need to meet your goal into an insured account where the principal will be safe and where it will earn a small amount of interest.

Investing means buying something of value that you expect will either pay regular income or increase in value over time, or both. Although your principal isn't usually insured against loss, your money has a greater potential to earn higher returns than if it were in a savings account.

SETTING GOALS

The clearer sense you have of your financial goals, the easier it will be to make informed decisions about how to save—or better yet, invest—your money. If you know you would like to have $100,000 in 15 years, you'll make different decisions than if you expect to need $10,000 next year. What the added time provides is not only the opportunity to benefit from compounding but the advantage of enough time to make up for potential short-term losses.



THE QUESTION OF RISK

Inflation is the only real risk you take with saving, but it's a significant one. That's because rising prices—and college costs—can seriously undermine your buying power.

For example, suppose you put $3,000 in a savings account earning 2% interest. At the beginning of the next year, it would be worth $3,060, which currently covers a semester of room and board at your child's school. But if college costs increase 8% during the year—a lower rate than the average increase at public colleges—you'd actually owe $3,240 for room and board, which means you'd be $180 short. And if you intend to use the $3,000 eighteen years from now, your shortfall would be even more dramatic, since shortfalls compound in the same way that earnings do.

Investing also carries certain immediate risks. Your money is not insured, which means it can lose value if market performance in general or the performance of your individual investments falters. What keeps people investing, however, is that over time investments have historically produced much stronger **returns**—which are a combination of income and increases in value—than savings.

An Investment Overview

Smart investing is about making the investments that make sense for you.

No matter what your financial goals are, the basic investment principle remains the same: To realize a strong return, you have to take risks. That's because investments with the potential for growth also carry the risk of potential loss of value, especially in the short term.

And just as goals vary, everyone's timetable is different. So before you start investing, you'll have to decide what you want to accomplish and when you'll need the money. Then you can begin to assemble a portfolio that suits your needs.

INVESTING HELP

If you find the prospect of building and managing an investment portfolio intimidating, you can look to a couple of places for help. For a fee, investment professionals can provide expert guidance that can be especially helpful as you create and carry out a plan. And certain investment plans give you the option of using **age-based tracks**, which manage your portfolio for you based on your investing style and your child's age.

WHAT'S YOUR STYLE?

Depending on your time frame and how comfortable you are taking investment risk, you may be an aggressive, moderate, or conservative investor — or somewhere in between.

Aggressive investors typically have the time and money they need to take bigger risks with their investments. That way, they can invest for long-term growth expecting that they'll have the opportunity to make up for potential short-term losses.

Moderate investors are comfortable with a modest level of risk. Although they are interested in investment growth, they are also concerned with preserving their principal.

Conservative investors make choices that are insured or pay a guaranteed return, which means they don't put their principal at risk. When the time comes to withdraw their money, they can be sure that it will be there, rather than worrying about potential loss. But they do risk not having accumulated enough earnings to meet their goals.

BUILD YOUR PORTFOLIO

It's important for your portfolio to have elements of growth, income, and security at all times, no matter what your investing style is. That's why many investors build a portfolio from a combination of three asset classes:

- **Stock** and **stock mutual funds** have historically provided the strongest returns and the most growth, but they carry risk, too. In fact, there have been periods when stock lost value several years in a row.
- **Bonds** can provide reliable income if they're held until maturity. But because their market values and yields change, bonds and bond mutual funds produce better returns in certain years and weaker returns in others.
- **Cash** and **cash equivalents**, which include certificates of deposit (CDs) and US Treasury bills, usually provide the smallest, but most consistent, returns.

SAVING FOR COLLEGE

WHY DIVERSIFY?

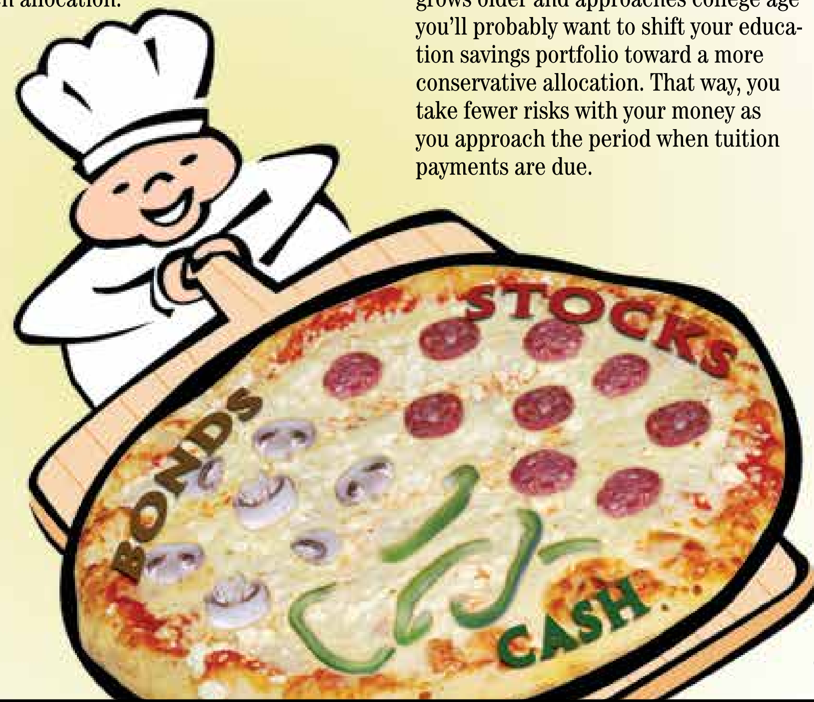
Each asset class behaves differently, depending on the economic climate. Stock tends to provide strong returns when bond returns are weak, and vice versa. And even within each asset class, you can expect your investments to react differently to changes in the market. For example, certain types of stock may perform better when other stocks falter. That's why it's important to diversify, or make several different investments within an asset class.

This variety may help protect your bottom line against poor management or other problems with individual securities or funds. But diversification, though important to investment success, does not guarantee a profit or protect you against losses, especially in a market downturn.

MIX IT UP

Your **asset allocation**, or the way in which you divide your portfolio among the basic asset classes, has a major impact on your portfolio's performance. Although no single allocation works for everyone, you can modify standard allocations to suit your personal investing style. Once you've decided on an asset allocation for your portfolio, you can **diversify** your allocation with a balanced variety of investments.

If you're investing through a particular college savings plan, you may have to build your portfolio from a limited assortment of stock and bond mutual funds and cash investments. But your investment choices will still provide a variety. So you can—and should—be sure to diversify within each allocation.



MANAGE YOUR PORTFOLIO

Investment values change over time. For example, a year after putting your portfolio together, you may find that your stock investments represent a substantially larger percentage of your portfolio than you initially intended.

If that's the case and your investing goals and style have remained the same, you may want to **rebalance** your portfolio and **reallocate** your assets so that your portfolio stays in line with your original allocation. You can do this by selling some investments in the asset class that's increased in value to buy investments in the lagging asset class. Or you can simply invest new money in the underperforming asset class.

Generally you should check once a year to see how far the actual allocation of your portfolio has drifted from what you intended, though you may want to wait to make changes until any asset class exceeds its allocation by 15% or more.

MAKE CHANGES

Since you can't accurately anticipate how your investments will perform over time, you can expect to make some adjustments to your portfolio. For instance, if you find that a certain stock consistently performs below your expectations, you can sell that stock to buy another one providing better returns. Just be sure to stick to the allocation model you're comfortable with and keep your overall portfolio diversified.

If your goals and style change—as they are likely to over time—you might want to reconsider the asset allocation you've been using. For example, as your child grows older and approaches college age you'll probably want to shift your education savings portfolio toward a more conservative allocation. That way, you take fewer risks with your money as you approach the period when tuition payments are due.

Tax-Free Investing for College

Certain plans make investing for college a little easier—on your mind and on your wallet.

The good news about investing for college is that it's encouraged by the tax code. That means that as long as you stick to the rules, you and your child can enjoy the benefits of tax-free earnings. A number of investment programs, such as Coverdell education savings accounts (ESAs), 529 savings plans, and 529 prepaid tuition plans, let you take advantage of this provision. That can mean having between 15% and 35% more money to spend, depending on your tax bracket.

HOW IT WORKS

ESAs and 529 plans let you, the account owner, set up investment accounts for a **beneficiary**, or recipient, that you designate.

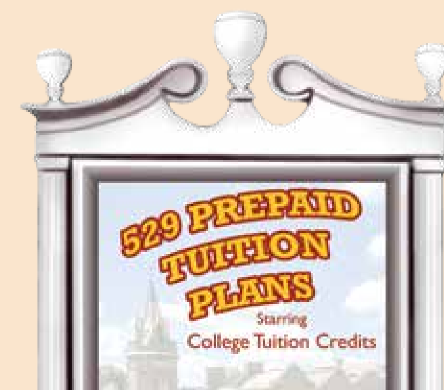
Within these investment plans, your earnings and any capital gains accumulate **tax deferred**, which means you put off paying taxes until your money is withdrawn. And you can withdraw your money **tax free**, or free of federal and sometimes state income taxes, as long as your beneficiary uses the money to pay for **qualified education expenses**, which may include tuition, books, fees, and room and board.

If you spend the money in your ESA or 529 plan on nonqualified expenses, you can expect to pay the consequences. Not only will you owe taxes on any earnings included in the amount you withdraw, but you'll have to pay the federal tax penalty—10% of your earnings. Plus, certain states may impose an additional 10% penalty, bringing the potential fee as high as 20% of the amount you withdraw.

Contributions to tax-free accounts must be made in cash. You can't move investments you already own into the account. You must sell them and invest the proceeds. This could mean you'd owe capital gains taxes on any profit.

Comparing Plans

Each tax-free investment plan operates a little differently, offering its own pros and cons. The first step toward choosing the plan or plans that work best for you is learning more about their advantages and limitations.



	Coverdell education savings accounts (ESAs)	529 savings plans	529 prepaid tuition plans
How it works	You invest your account assets in any combination of products available through the financial institution you choose as custodian of your account	You contribute to an account that's typically invested in age- or risk-based investment tracks, which are provided by your plan manager	Your contributions purchase tuition credits at current rates, and the plan invests your contributions to meet future college costs
Pros	• Accounts available through most financial services companies • Investment flexibility • Qualified with-drawals cover grades K through 12, as well as college and graduate school	• Over 100 plans available to choose from • Contribution limits can be more than $300,000 per account • Beneficiaries can be named in multiple accounts	• In some cases, including the private college plan, investments are guaranteed to cover future tuition credits
Cons	• Eligibility for making contributions phases out once AGI exceeds $95,000 (or $190,000 if you're married and filing a joint return) • Beneficiary must be under 18 to receive contributions • Beneficiary can only accept $2,000 in contributions per year • Beneficiary must make all withdrawals prior to turning 30	• Less investment flexibility due to available investment tracks • Some plans have higher-than-average fees that affect investment return	• Qualified education expenses include only tuition and mandatory fees at participating colleges and universities • Eligibility sometimes restricted by state residency requirements

GIFT TAXES

When you contribute money to an account in another person's name, your contribution is considered a gift. You can give up to $14,000 per year—or $70,000 once in five years to a 529 savings plan—before you may have to file a gift tax report and potentially pay gift taxes. But gift rules apply per donor and per beneficiary. So, in one year you could contribute $14,000 to one child's 529 account, and then contribute another $14,000 to another child's account without making a taxable gift. Or, you and other relatives could each contribute $14,000 a year to one child's account. Remember, though, that ESAs limit contributions to $2,000 a year.

PUTTING IT TOGETHER

When you consider how much college can cost, it makes sense for you to invest as much as you can afford—and to do so early. In fact, you can open more than one account and take advantage of the tax benefits of different plans. For example, if you reach the $2,000 annual contribution limit with your child's ESA, you can also open a 529 savings plan.

Other family members and friends can contribute to these accounts or open additional accounts as well. Just be sure that their contributions fall within the limits set by ESAs, since the $2,000 cap applies per beneficiary, not per giver.

ALL IN THE FAMILY

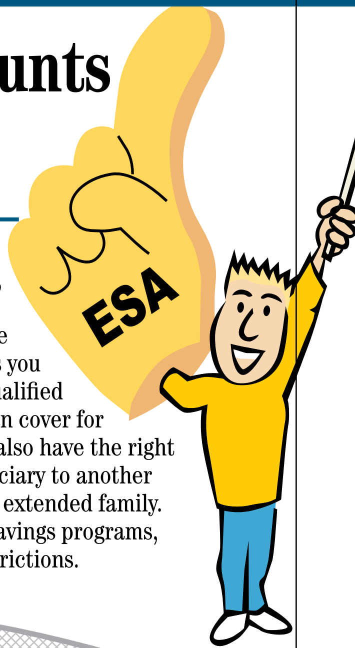
You can switch the beneficiary of your ESA or 529 plan, as long as your new beneficiary is a member of the same family, as defined by the tax code. That includes the beneficiary's spouse, child, grandchild, stepchild, sibling, stepsibling, parent, grand-parent, stepparent, niece, nephew, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, sister-in-law—or any of these relatives' spouses—as well as any first cousins.

Education Savings Accounts

If you're looking for flexible college savings, think about opening an ESA.

When you invest through a **Coverdell education savings account (ESA)**, you make an after-tax contribution and the account accumulates tax-deferred earnings. But as long as the money is used to pay qualified education expenses for the account's beneficiary, no income tax is ever due on those earnings.

In addition to their tax advantages, ESAs offer a lot of flexibility, both in the range of investments you can make and the qualified expenses that you can cover for the beneficiary. You also have the right to change the beneficiary to another member of the same extended family. But like all special savings programs, ESAs have some restrictions.



WITHIN THE LIMITS

There are three key ESA limits: on the amount of the annual contribution, on the amount you can earn during the year if you want to open or add to an ESA, and on the beneficiary's age.

1. The total contribution for any one beneficiary can be no more than $2,000 a year.
2. You can contribute $2,000 to an eligible beneficiary's ESA if you meet the **adjusted gross income (AGI)** requirements. That is, your AGI must be less than $95,000 if you're single — or $190,000 if you're married and filing a joint return.
   As your AGI increases above these levels, the amount you can give is phased out until your AGI reaches $110,000 — or $220,000 if you're married — at which point you are no longer eligible to contribute.
3. Anyone who's younger than 18 when an ESA is opened and younger than 30 when the money is spent is eligible to be a beneficiary.

GETTING STARTED

Most financial institutions that offer individual retirement accounts (IRAs) also offer ESAs. You can request an application directly from a bank, mutual fund company, credit union, insurance company, or brokerage firm, download an application from an institution's website, or work with your financial professional to choose an account provider.

Among the things to consider as you choose among providers are:

- **The account-opening and annual maintenance fees**
- **The range of investment choices that are available**
- **Transaction fees and sales charges**

You'll also want to investigate the provider's rules about who controls the account after the beneficiary reaches majority. In some plans, the **responsible party**—almost always the beneficiary's parent or guardian—oversees the account as long as it exists. In some plans, you have the right to turn over management to the student at the age of majority, which is between 18 and 21, depending on the state, and in others the student has the right to assume control at majority.

GO ESA

SPENDING THE MONEY

ESA withdrawals are completely tax free as long as the money is used to pay **qualified higher education expenses** for students enrolled in an eligible program. That includes grades K to 12, full-time or part-time undergraduate, graduate, or professional studies at colleges and universities as well as courses at vocational and technical schools. Qualified expenses include tuition, books, supplies, and equipment, for anyone in an eligible public, private, or for-profit institution, plus room and board if the student is enrolled at least half-time.

MANAGING AN ESA

Unlike some college savings plans, ESAs allow you to invest in any combination of stocks, bonds, mutual funds, CDs, or other products available through the financial institution handling your account. Although there are certain investments you can't make—such as life insurance or fine art—you can customize your ESA portfolio to suit your needs and the level of risk you're willing to take and change the investments as you wish. There are no taxes when you buy and sell, but you will probably owe transaction costs.

ESA FLEXIBILITY

ESAs give you more flexibility than most college savings plans. So you'll have an easier time adjusting your account.

- If you're unhappy with the financial institution holding your ESA, you can move the account to another institution tax free, although you'll probably owe transfer fees.
- You can switch beneficiaries as often as once a year without owing taxes, usually as long as your new beneficiary is under the age of 30 and a member of the same extended family.
- You can roll over one ESA into another one as often as once a year without owing taxes, as long as the ESA you're moving to has the same beneficiary or one who is a member of the same family. To roll over, you withdraw and then redeposit the money into the new ESA within 60 days or ask your financial institution to make a direct rollover.

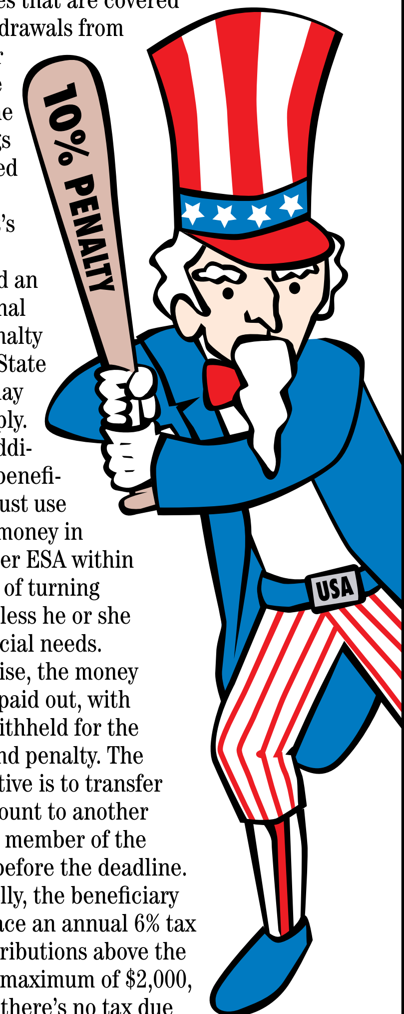
By adding $2,000 a year to an account opened the year a beneficiary is born, you can accumulate up to $36,000 in contributions, plus any earnings by age 18.

THE TAX PINCH

If money that's withdrawn from an ESA is used to pay nonqualified expenses or expenses that are covered by withdrawals from another tax-free plan, the earnings are taxed at the student's federal rate and an additional 10% penalty is due. State taxes may also apply.

In addition, a beneficiary must use all the money in his or her ESA within 30 days of turning 30—unless he or she has special needs. Otherwise, the money will be paid out, with some withheld for the taxes and penalty. The alternative is to transfer the account to another eligible member of the family before the deadline.

Finally, the beneficiary could face an annual 6% tax on contributions above the annual maximum of $2,000, though there's no tax due if the excess amount is withdrawn by the date taxes are due. That's why it's important for beneficiaries to check the contribution report they receive each year from all institutions holding an ESA in their names. It will include excess amounts.



529 Savings Plans

Once you know how 529 plans work, you'll be ready to pick the plan that's right for you.

Opening a 529 account couldn't be easier: You can enroll in a plan by simply completing a brief application and making a minimum contribution. Many plans allow you to enroll online through their websites, or you can complete an application with your financial professional.

But that doesn't mean you should enroll in a 529 plan blindly. Every plan is a little different, so you should research the key features of each plan you're considering. Then you'll be sure to find the plan that works best for you.

THE ROSTER

Several key players make each 529 savings plan work:

- Individual states **sponsor** 529 savings plans. They're also responsible for choosing a plan manager and determining the rules and limits surrounding their plan.
- The **plan manager**, which may be a mutual fund company, brokerage firm, or insurance company, handles all transactions and investments within your account.
- As **account owner**, you're responsible for naming a beneficiary, making contributions, choosing an investment track, and managing withdrawals.
- In most cases, your **beneficiary** can be any prospective vocational, college, or graduate student.

CONTRIBUTING

Contribution limits vary from plan to plan and often reach $300,000 or more. And, unlike ESAs, if you approach the contribution limit of one plan, you can always open another in the same beneficiary's name.

You can make contributions in lump sums or in regular installments. Both offer advantages and drawbacks, which may or may not suit your financial situation.

Making contributions in installments may put less strain on your overall budget. But the amount you end up with depends on how much you put in each month—and how your investments perform.

On the other hand, making lump-sum contributions creates a larger investment base, which means the potential for faster growth over a long period of time. But large contributions are usually not fully eligible for a state tax deduction, and annual gifts of more than $14,000 per beneficiary—or $70,000 once in five years—could result in your filing a gift tax return and potentially owing gift taxes.

Any earnings in your account are determined by how the assets are invested, what the return is, and what you pay in fees.

PROFESSIONAL HELP

You can open a 529 college savings plan directly or with the advice and assistance of an investment professional. Someone with experience in evaluating plans can help you analyze the investment tracks, compare pros and cons, and perhaps provide the encouragement you need to enroll. Some professionals work on a fee-only basis, while others earn a commission if you buy a specific plan through them.

If you buy directly, you assume responsibility for doing your own research and choosing the plan that's best for you. One advantage is that the overall cost is likely to be less.

THE SUN DOESN'T SET

A 529 savings plan beneficiary can use the assets in the plan at any qualifying institution, including graduate or professional school. There's no age limit. Or, at any point, you can switch the beneficiary to any member of the extended family.

STAY ON TRACK

When you contribute to a 529 savings plan, your plan manager pools your money with that of other plan participants to invest in a portfolio that's allocated according to a specific investment track. You can choose from among different investment tracks provided by your plan manager:

- Age-based tracks gradually move the portfolio from aggressive to conservative as your beneficiary nears college age. You can usually choose an aggressive, moderate, or conservative age-based track, which determines how your portfolio will be invested initially.
- Fixed tracks remain the same over time. While these tracks are often either 100% equity or 100% fixed-income, you can choose several different fixed tracks to allocate your assets.

Depending on the plan you choose, you may be able to switch investment tracks as often as once every 12 months or put new contributions in a different track. With certain plans, you may also be able to customize your account by choosing from among different investment options within each track. And if your plan's investments consistently perform below your expectations, you can switch plans once every 12 months.

MAKING WITHDRAWALS

Withdrawals from a 529 savings plan are tax free as long as they're used to pay for your beneficiary's qualified education expenses, which include tuition, books, fees, school equipment, room and board, as well as any technology needs.

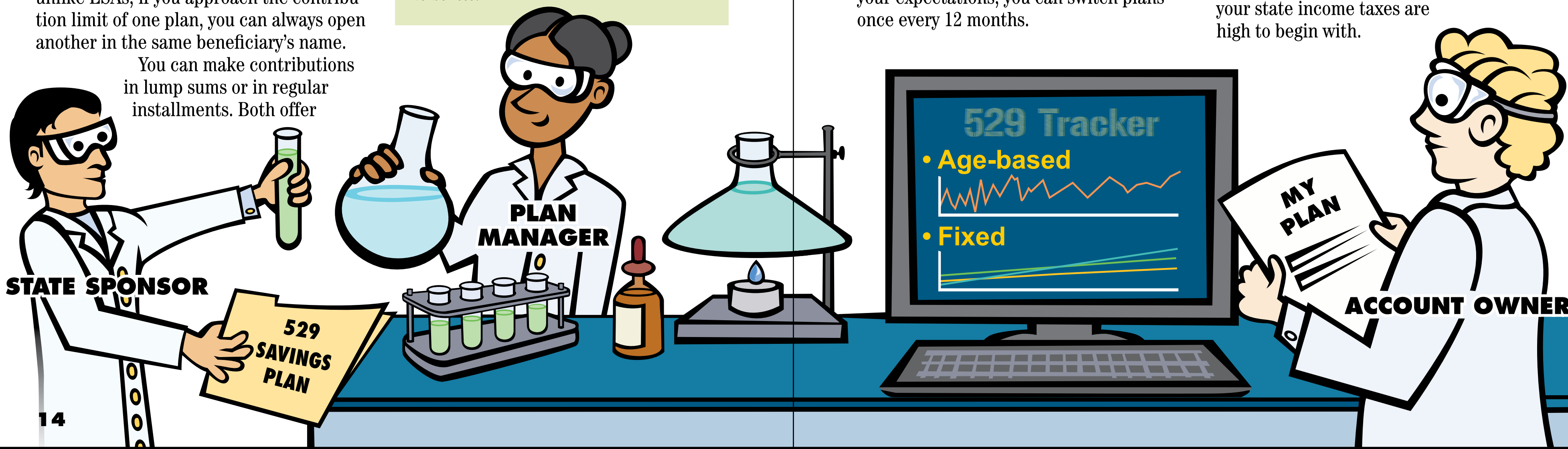
You can arrange to have your beneficiary's qualified expenses paid directly by your plan, or you can pay the expense yourself and request reimbursement later. Either way, it's up to you to match all qualified expenses with withdrawals when you file your federal income tax return each year. Your plan will provide an annual statement that details your contributions, earnings, and withdrawals for the year. If your withdrawals exceed your qualified expenses for the calendar year, you'll have to calculate the percentage of earnings on which tax and penalty payments are due.

CHOOSING THE RIGHT PLAN

Here are some questions that may help identify the plan that's best for you:

- Does the plan offer investment choices that suit your needs?
- How much will you owe in enrollment, sales, and annual fees?
- Can you deduct contributions from your state income tax?
- Will earnings be exempt from state income taxes if you invest in this plan?
- Does the plan accept out-of-state participants?
- How have the plan's investments performed in the past?
- How long are you required to hold an account?
- What are the minimum and maximum contribution limits?
- Can anyone contribute to the plan?

You may want to start by looking at the plans offered by your own state, since tax benefits may be especially appealing if your state income taxes are high to begin with.



529 Prepaid Tuition Plans

Prepaid tuition plans can pay off—just beware of the conditions that apply.

If you want to reduce your investment risk, you may want to consider choosing a **529 prepaid tuition plan**. A prepayment plan allows an account holder, typically a parent, the opportunity to lock in some or all of the cost of future undergraduate tuition and mandatory fees. Each prepayment plan works a little differently but typically involves purchasing credits at today's rates that can be redeemed starting when the plan beneficiary enrolls for his or her freshman year.

No prepayment plan guarantees that your child will be accepted at a participating school. So all plans make provision for changing the beneficiary to another member of the same extended family or arranging to have your accumulated account value refunded or rolled over to another qualified plan. If you use the plan assets for other qualified higher education expenses, there's no income tax or penalty due. However, your gains are capped and your return may be substantially less than you could have realized by investing in another way.

529 PREPAID TUITION PLANS

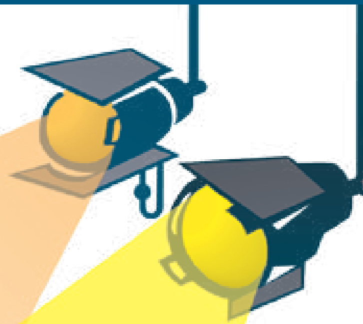
Starring

College Tuition Credits

THE MAIN ACT

When you contribute to a 529 prepaid tuition plan, you purchase credits, sometimes known as certificates, toward your beneficiary's college tuition at today's prices, or sometimes even at a small discount. If your beneficiary attends a school that's covered by your plan, those credits will usually count at full value toward his or her tuition.

For example, State X University requires 400 tuition credits for a four-year undergraduate degree. Suppose that tuition credits cost $100 each when you first open an account, meaning contributions totaling $40,000 would cover all four years of your beneficiary's tuition in advance. That might seem like a lot of money to pay upfront, but consider this: 18 years later, when your beneficiary is ready to attend State X University, credits could cost $200 each. That means you would have to pay $80,000 for four years of tuition—or twice as much as you'd pay if you bought the credits in advance.



THE BRIGHT SIDE

Prepaid plans have some important tax advantages. The difference between the amount you pay into the plan and the cost of tuition those prepayments cover in the future—the equivalent of earnings on your investment—is not subject to federal income tax, provided that you redeem the credits to pay tuition and fees.

Another feature of prepaid plans, and one they share with any tax-deferred college savings vehicle, is that the value of the plan is considered an asset of the parent. This means that just 5.6% of the account value must be included in calculating eligibility for financial aid. In contrast, when assets are held in a student's name, 20% of the total value must be included.

What's more, the tuition credits you purchase increase in value at the rate that tuition increases. In recent years, that has averaged between 6% and 8% annually. In many years, that's been higher than the return in 529 college savings plans or other investment accounts.

THE POTENTIAL DRAWBACKS

Besides the minimal and potentially taxable return you'lll receive if you withdraw from the plan, there are a number of things you'll want to consider before you participate in a prepaid plan.

Just as there's no guarantee of acceptance, there's no assurance that your child will want to attend one of participating schools. On the opposite side, there's also the chance that your child will receive a total scholarship and not need the credits that you have paid for. At the very least these are strong arguments for considering a prepayment plan as just one part of your overall college planning and not making it the sole approach.

PRIVATE COLLEGE 529 PLAN

The Private College 529 Plan is the first prepaid tuition plan to be sponsored by a large group of private colleges and universities. This plan, which covers tuition at over 270 private schools, is guaranteed to cover your beneficiary's tuition, and allows you to buy credits at current tuition rates.

The Private College Plan assigns a separate value to tuition credits for each school. So, if your beneficiary decides to attend any of the colleges participating in the plan, you can easily transfer credits from one school to another. And, like most plans, if your beneficiary decides not to attend one of the participating schools, you can withdraw your money tax free from the account, as long as it goes toward higher education costs.

It's also possible that you could realize a stronger return than the private plan or any prepaid plan will provide by investing on your own, especially if you invest in accounts that you can draw on to meet college expenses, but that you could also use to meet other goals.

STAYING SOLVENT

Some, but not all, public plans and the private college plan guarantee your credits. Some states pledge their "full faith and credit," which is their ability to raise taxes to keep their plans solvent. In others, state law requires subsidies if necessary. The private plan and at least one state plan make honoring the prepaid credits the obligation of the participating institutions. But several states provide no guarantee.

There is some comfort in knowing that no plan participant has so far been unable to redeem his or her credits, despite the economic uncertainty of recent years that has affected investment returns and state budgets. But the possibility reinforces the necessity of reading the small print in your contract carefully before enrolling.

RESIDENCY REQUIREMENT

To participate in a state's prepaid tuition plan, either you or the plan's beneficiary must be a resident of the state.

Savings Bonds, Baccalaureate Bonds, CollegeSure CDs

Cut down on your risk by adding bonds and CDs to your college investing plan.

One way to offset some of the risk you take when you invest in stocks and most bonds is to put some of your money in US savings bonds, state-backed bonds, and FDIC-insured CDs. These investments limit the risk you take because they guarantee return of principal and at least some earnings. Better yet, certain bonds and CDs offer extra incentives—in the form of tax breaks or higher interest rates—for investors saving for college. Just remember that these bonds and CDs alone probably won't earn enough interest to cover the cost of college, since investments that carry limited risk also have limited potential return.

HOW SAVINGS BONDS WORK

When you purchase a **US savings bond** you lend money to the US government. Your loan earns interest that's free of both state and local income tax—and federal income tax, too, if you use your savings bond to pay for your beneficiary's qualified higher education expenses and meet certain requirements. But, you can neither trade nor resell savings bonds to other investors, as you can stocks and other bonds.

The US Treasury issues two types of savings bonds:

- **Series EE** bonds are sold online at www.TreasuryDirect.gov and pay a fixed interest rate. They are guaranteed to **mature**, or double in value, after you've held the bond for a certain period of time—20 years for bonds issued after June 2003.
- **Series I** bonds are sold online at face value, and earn interest that's partially indexed to the rate of inflation.

Both types of bonds can be redeemed any time after they've been held for 12 months, though you will forfeit three months' interest if you redeem your bond before five years pass. Just keep in mind that the longer you hold your savings bond, the more interest it will earn. And unlike assets in tax-free accounts that you must use for higher education expenses or face a penalty, you can use the income from savings bonds any way you like.

SAVINGS BONDS FOR COLLEGE

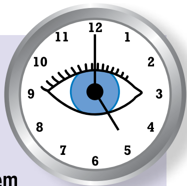
If you use your savings bonds to pay for tuition and mandatory fees, you may qualify for the full tax break. But as the owner of the bond you'll have to fulfill certain requirements first. You must have been at least 24 years old at the time you purchased the bond. And although you aren't required to declare your beneficiary until you cash in your bond, you must be sure of two things:

- If you're paying for your child's education, he or she must not be listed as an owner or co-owner
- If you're paying for your own education, you must own the bonds

In addition, your AGI must fall below an annually adjusted amount in the year you withdraw the savings for you to be eligible to use the money tax free. But the cap is high enough to allow many families to take advantage of the benefit and has gone up every year. You can find the income limit that applies for the year on the IRS website at www.irs.gov or in IRS Publication 970.

BACCALAUREATE BONDS

Certain states may issue **baccalaureate bonds**, also known as college savings bonds, which typically cost between $1,000 and $5,000 and have terms of 5 to 20 years. These are tax-free **zero-coupon bonds**, which means you receive no regular income payments and instead receive a lump-sum payment when the bond matures. In order to qualify for these bonds, you must be a resident of the state and use the bond to pay for tuition at in-state public schools. But there are no income caps limiting participation in the program. And certain states may offer you discounted tuition at qualified institutions.



AN EYE ON THE CLOCK

Make sure you time your bond and CD withdrawals wisely. If you redeem these investments before their terms are up, you may face a penalty or forfeit some interest. Plus, the earlier you redeem your bond or CD, the less interest it will have the opportunity to earn.

LOWER-RISK INVESTMENT OPTIONS

	US savings bonds (Series EE)	US savings bonds (Series I)	Baccalaureate bonds	CollegeSure CD
Cost	$25 to $10,000	$25 to $10,000	$1,000 to $5,000	$250 and up
Term	12 months to 30 years (with a penalty for redeeming before 5 years)	12 months to 30 years (with a penalty for redeeming before 5 years)	5 to 20 years	1 to 22 years
Rate	Fixed lifetime rate, based on adjusted market yield of 10-year Treasury note	Combination of fixed lifetime rate and inflation rate adjusted twice yearly	Fixed rate	Indexed to college costs according to Independent College 500® IC Index
Tax benefits	Free of state, local, and sometimes federal income tax	Free of state, local, and sometimes federal income tax	Free of state, local, and federal income tax	Tax-free if owned in an ESA or certain 529 plans

COLLEGE? SURE!

If you're investing for college, you may also want to consider a **CollegeSure CD**, which is issued by the College Savings Bank of Princeton (NJ). When you invest in these CDs, you purchase **units**, or one-year credits, toward future college costs at today's rates, plus a premium based on your beneficiary's age and the amount you invest.

Your account is indexed to average tuition, fees, and room and board costs, according to the Independent College 500 IC Index. You buy the CDs with after-tax income and the earnings can be withdrawn tax free if you own the CD in an ESA or participating 529 plan.

For example, suppose you invest $10,000 in a 15-year CollegeSure CD. Your investment pays for 0.25 units, which is worth $8,000 today. In 15 years, if 0.25 units are worth $18,000, you'll be able to withdraw that full amount.

Of course, when you first invest in your CD, it's hard to predict how much college will cost you. But you can be sure your investment will at least match indexed costs when your term is up. Like other CDs, CollegeSure CDs are FDIC-insured up to $250,000 per account.

In Your Child's Name

Investing in UGMA and UTMA accounts has its pros and more than its share of cons.

If you have investments you'd like to give to your child, you may want to consider opening a custodial account under the **Uniform Gifts to Minors Act (UGMA)** or the **Uniform Transfers to Minors Act (UTMA)**. Through these accounts, a custodian you appoint—which could be yourself—manages investments owned in a minor's name. Once the minor reaches the age of majority, he or she may assume full ownership of the account.

Establishing UGMA and UTMA accounts means designating specific investments for a child's benefit. By doing so, you may be able to reduce your estate and the taxes the estate could potentially owe. But these accounts also have certain drawbacks.

KNOW YOUR Gs and Ts

The major differences between UGMA and UTMA accounts concern the types of investments you can gift to each account and the age at which the child assumes control of the account.

UGMA accounts:

- Your investments are limited to cash and cash equivalents, securities, life insurance, and annuities
- Your child's age of majority is defined as 18 to 21, depending on the state

UTMA accounts:

- Your investments may also include real estate, artwork, patents, and royalties
- Your child's age of majority is defined as 18, 19, 21, or 25, depending on the state

The money in a custodial account must go toward your child's needs—and not your own.

CUSTODIAL ACCOUNTS

Most banks and brokerage firms offer custodial accounts. Anyone can establish an account simply by making a donation, naming a minor as account beneficiary, and appointing a custodian.

There are no limits to the amount you or other donors can contribute to a custodial account. In fact, you can contribute assets—such as stocks, bonds, or real estate, depending on the type of account you choose—in addition to cash. And unlike ESAs, anyone is eligible to contribute to an UGMA or UTMA account, regardless of his or her income. Just keep in mind that your contributions are irrevocable, which means that once money has been given it is owned by the child and cannot be transferred back to the original owner. And if you donate more than $14,000 in any year—or $28,000 if you're married and filing a joint return—to any one beneficiary you may have to file a gift tax return and eventually pay gift taxes.

Unlike 529 plans and ESAs, custodial accounts place few restrictions on your withdrawals. The general rule is: You can use a custodial account to pay for any expenses that benefit the child, as long as these expenses are not considered the basic essentials of living. In other words, you can use an UGMA or UTMA account to pay for education expenses, as well as certain noneducational expenses, such as a personal computer. But you may not use the account to purchase food, shelter, or clothing for your child, since these costs are regarded by the IRS to be parental obligations.

INCOME vs. CAPITAL GAINS

When you invest your money in a taxable account, you can expect to pay two types of tax:

- **Income tax** is due on any income that investments in your account produce. However, qualifying dividends are taxed at a lower rate than interest.
- **Capital gains tax** is due on any profit realized by selling your investments for more than you paid for them.

TAX ISSUES

The earnings and income from UGMA and UTMA accounts are taxed, not tax free as they are in an ESA or 529 plan. Once your child turns 19, or 24 if he or she is a full-time student, both the income and capital gains in the UGMA or UTMA account will be taxed at his or her rate, which might be as low as 10% or 15% for interest income and 0% for qualifying dividends and long-term capital gains income, depending on your child's total assets.

But, until the child reaches the age that applies to his or her situation, the income tax due on any taxable investment income is calculated at the parents' rate. That's another reason, from the college planning perspective, why these accounts have only limited value.

What's more, assets in a custodial account for which you are custodian are considered part of your estate until your child reaches majority. So estate tax savings would not apply if you were to die before he or she reached legal adulthood. So it's wise, before establishing an UGMA or UTMA, that you seek professional advice.

ADDITIONAL LIMITATIONS

There are other potential drawbacks to thinking of an UGMA or UTMA as a college planning strategy.

Once your child assumes control of a custodial account, he or she is free to spend the money. And while you may hope your goals and those of your child are similar, especially when it comes to paying for major expenses like college, your wishes may be ignored in favor of personal expenses, such as a new car.

And you may want to think twice before opening a custodial account if you think your child will apply for federal aid when it's time to attend college. Since UGMA and UTMA accounts are the property of your child, they may greatly affect chances of securing federal assistance. Students are expected to contribute 20% of their savings to their college educations in any year—as opposed to parents who are expected to contribute 5.6%.

MOVING YOUR ASSETS

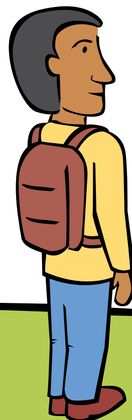
In certain cases, you may be able to move UGMA or UTMA assets into a 529 plan opened in your child's name. But your transfers must be made in cash, which means you'll have to liquidate the assets and pay capital gains taxes before moving the balance to a 529 plan. However, the rules governing assets that are transferred to a 529 plan have changed. They're still technically the child's but are considered as parental assets for financial aid purposes, which reduces the percentage—from 20% to 5.6%—that the government says should be used each year to pay college expenses.

If Your Savings Fall Short

A number of resources can help you pay for your child's education.

If you fear that your savings won't meet your child's college expenses, don't despair: You're not alone. In fact, over 60% of students and their families receive additional help when it comes to financing higher education.

There are multiple resources that can provide financial assistance—including the federal and state governments, colleges and universities, and various private organizations.



LOANS 101

When you take a loan you borrow the **principal**, or base amount, from a direct or third-party lender for an extended period of time, or **term**. Over the term, you repay the principal, plus interest and fees, in regular installments. Lenders are required by law to publish their loans' **annual percentage rate (APR)**, which consolidates a loan's annual interest and fees in one figure. Depending on the type of loan, your interest rate may be **fixed**, which means it remains the same throughout the term of your loan, or **variable**, which means the rate may increase or decrease over time.

TYPES OF FEDERAL AID

Perkins Loans

Stafford Loans

PLUS Loans

STUDENT LOANS

One of the most popular solutions to a savings shortfall is borrowing money. And certain loans are designed specifically to help you pay for education.

Federal loans, which are administered by the government, offer advantages over regular commercial loans, such as capped interest rates, waived lending fees, and, in some cases, subsidized interest, all of which can greatly reduce the overall cost of a loan. These include **Perkins** and **Stafford loans**, which are granted directly to the student, as well as **Direct PLUS loans for parents**, which are granted to students' parents or legal guardians.

You can also look to the student's state of residence and colleges where he or she applies for additional financial assistance, which may include grants, loans, and scholarships. Guidance and financial aid offices should be able to provide you with the information you need.

USING YOUR HOME EQUITY

If you have built enough equity in your home by paying off a good portion of your mortgage, you might consider borrowing against your equity. These loans, which are provided by a number of banks and financial services companies, allow you to borrow a lump sum or write checks against a line of credit, using your home as **collateral**, or insurance.

Most home equity loans carry variable interest rates, which are often lower than rates you'd find with a regular loan. And you can usually deduct the interest you pay on a home equity loan on your income tax return. But keep in mind: If you default, or fail to meet your payments, you could lose your home through foreclosure.

STUDENT LOAN

DIPLOMA

SCHOLARSHIPS AND AWARDS

A number of public and private organizations offer various scholarships and awards for prospective students. The extra money that these awards provide can help cover part or all of your child's college costs, depending on what types of awards—and how many—he or she qualifies for.

Most scholarships are awarded according to a student's financial need or merit—or a combination of both. But that doesn't mean that your child must be at the top of his or her class to qualify for aid. If your child excels in a particular activity, such as music, art, or athletics, he or she may be eligible for specific awards.

Other scholarships might focus on students' ethnic backgrounds, or ancestry, or their career plans. And your family's current or former employers, religious affiliations, community organizations, schools, or athletic teams may offer more specific scholarships for members and their families.

TAX CREDITS

As long as you, your spouse, or independent child is enrolled in a qualifying program, you may be able to use one of two tax credits:

- The **American Opportunity Tax Credit (AOC)**, which replaced the Hope Tax Credit, lets students or their parents subtract up to $2,500 each year from the income tax they owe, provided they paid that amount in tuition, fees, and textbooks. The credit is available for four years of undergraduate or graduate education provided the student is enrolled at least half-time in a degree-granting program or other recognized education credential. Up to 40% of the credit may be refundable—or sent to you as a payment—if the credit reduces the amount of tax you owe to less than $0. Qualifying expenses include tuition, fees, and course materials. If more than one dependent qualifies, you may claim the AOC for each one.
- The **Lifetime Learning Credit** allows you to deduct up to 20% of the first $10,000 you spend on qualifying education expenses per year. The study doesn't have to lead to a degree and there's no limit to the number of years it may be claimed.

These credits, which you subtract directly from the taxes you owe, can be claimed as long as your income meets the requirements. Congress establishes those amounts each year, with full credit available to those tax-payers whose modified adjusted gross income is less than the cap. You can find the amount for any year you might be eligible on the IRS website, www.irs.gov.

To use either credit, you must report the total tuition and fees paid for the year, in addition to any scholarships, grants, and untaxed income you use to pay these costs. You report these figures, which your child's school will list on a 1098-T receipt in January of each year, on IRS Form 8863 when you file your taxes for the previous year.

401(K) LOANS

Borrowing from your 401(k) or similar plan has good and bad points. On the plus side, you won't owe income tax on the amount of the loan as long as you pay it back. On the other hand, unlike a home equity loan, the interest you pay is not tax deductible. And if you should leave your job, the outstanding balance is likely to be considered a withdrawal if not repaid in full within 30 to 90 days.

Form 8863 (Hope

CLAIMING CREDITS

If you have more than one child you may or may not be able to claim more than one credit. The AOC applies per child, which means if you have two children who qualify, you can claim the credit twice. On the other hand, the Lifetime Learning credit applies per household, which means you can only claim one credit per year, no matter how many of your children attend school.

Understanding Federal Aid

The government can—and will—help you pay for college.

Most prospective students and their parents turn to the federal government to help them pay for college through loans, grants, or other financial aid programs. The government lends over $120 billion per year through its federal loan programs, which include Perkins, Stafford, and PLUS loans. Federal grants and work-study programs provide additional support for students in need of further assistance.

STAFFORD LOANS

Stafford loans which may be subsidized or unsubsidized, are available directly from the federal government.

Students must sign a master promissory note (MPN) when they take their first Stafford loan and must complete entrance and exit counseling about their rights and responsibilities as borrowers. The MPN can be used for additional Stafford loans the students take while finishing their degrees. The exit counseling is required when the student graduates, leaves school, or is no longer enrolled at least half-time.

Subsidized Stafford loans are awarded based on the student's financial need. The government pays the interest throughout enrollment—which must be at least half time—in college or graduate school. Once the student graduates or stops attending school, he or she will be responsible for covering any interest that accrues from that point on as well as repaying the principal.

Unsubsidized Stafford loans, which are not based on financial need, begin to accrue interest as soon as the money has been fully disbursed, but the student can defer payments until six months after graduating or withdraw from school.

There are annual limits on the amount a student can borrow in subsidized and unsubsidized loans combined, and a student can't borrow more than the cost of attendance minus other financial aid. There's also an aggregate limit. Interest rates vary, with a lower rate for undergraduate subsidized loans than for unsubsidized, graduate, and professional degree loans.

PERKINS LOANS

Your child may qualify for a Perkins loan if you demonstrate sufficient financial need. These loans, which are provided by undergraduate and graduate schools, carry an interest rate of 5% and charge no lending fees.

The amount of a Perkins loan depends on your child's level of need and the school he or she attends. Each school has an allowance to cover its Perkins loan recipients, so the amount your child receives may depend directly on the amount of money the school has available at the time you apply. The maximum an undergraduate can borrow is $5,500 per year, or a total of $27,500. If your child attends graduate school and is funded for a full loan, that amount increases to $8,000 per year, up to a total of $60,000, which includes any undergraduate funding.

	Borrower	Lender	Maximum loan for undergraduate students	Interest rate	Fees	Repayment begins
SUBSIDIZED STAFFORD LOANS	Students who demonstrate financial need	Federal government	Students can borrow varying amounts each year. The total amount during undergraduate enrollment is capped at $31,000	Fixed rate, begins to accrue after student has left school, or cut attendance under half time	Up to maximum 1.073% deducted from the loan until 10/1/17	No later than 6 months after student has graduated, left school, or cut attendance under half time
UNSUBSIDIZED STAFFORD LOANS	Students	Federal government	Students can borrow varying amounts each year. The total amount during undergraduate enrollment is capped at $31,000	Fixed rate, set each year on July 1, begins to accrue when loan is made	Up to maximum 1.069% deducted from the loan until 10/1/17	No later than 6 months after student has graduated, left school, or cut attendance under half time
PERKINS LOANS	Students who demonstrate financial need	College or university backed by federal government	$5,500 or up to $27,500 as an undergraduate	Fixed rate, begins to accrue 9 months after student has graduated	None	No later than 9 months after student has graduated or left school
PLUS LOANS	Parent or legal guardian with good credit history	Federal government	Cost of education minus other aid	Fixed rate, begins to accrue when loan is made	Up to 4.276% deducted from the loan until 10/1/17	Within 60 days after loan has been fully disbursed

PLUS LOANS

The federal government also lends money to students' parents through the Parent Loan for Undergraduate Students (PLUS) program. These loans allow parents to borrow money to cover the full cost of their dependent students' education—or whatever costs have not been covered by other loans—regardless of financial need. If you take a PLUS loan, you will owe a fixed interest rate that's reset annually, plus a monthly fee. Your payments will begin within 60 days after the lender transfers the loan amount to the student's school, typically at the beginning of each academic term.

SCHOOL-BASED AID

Several programs, including Perkins Loans and work-study assignments, are handled directly through the school the student attends though the money comes from the federal government. It's essential to apply for this assistance as early as possible to increase chances for aid.

OTHER FORMS OF FEDERAL AID

Students can also apply for other federal programs to help cover the cost of their education. However, funds are limited.

- **Pell grants**, which do not have to be repaid, are awarded to undergraduate students who demonstrate sufficient financial need. The students' level of need and cost of attendance determine how much they will be granted. The maximum grant is up to $5,920 for the 2017-2018 award year.
- **Federal Supplemental Educational Opportunity Grants (FSEOGs)** are awarded to undergraduate students who demonstrate exceptional financial need. Students who qualify for FSEOGs may not receive funding, since FSEOGs are awarded based on the amount of funding the school can provide. However, those who have received a Pell grant may be more likely to receive funding through the FSEOG program as well. The maximum grant is up to $4,000 per year.
- **Federal work-study** provides jobs for students who demonstrate sufficient financial need. Students may work up to 40 hours per week and must earn at least the federal minimum wage for their services.

Applying for Aid

Applying for financial aid may take time, but it's worth it in the long run.

With student loans, applying for financial aid typically means submitting your financial information for review by filling out the **Free Application for Federal Student Aid (FAFSA)**. Most state and federal funding programs—as well as many university-sponsored grants, scholarships, and nonfederal aid—require that students fill out the FAFSA, which assesses each student's eligibility for federal aid by evaluating his or her family's total assets. So if you're seeking any financial assistance for your child's education, the FAFSA is the perfect place to start.

IT DEPENDS

When your child applies for federal aid, he or she will be classified as a dependent or independent student, which helps dictate the information required on the FAFSA.

Independent students' financial aid eligibility is determined by assessing their own financial records. Students who are 24 or older are automatically considered independent. If students are under 24, they may be classified as independent if they are:

- Graduate students
- Married
- In charge of legal dependents
- Veterans of the US Armed Forces
- Orphans or wards of the court
- Specially classified as independent by a financial aid administrator

Dependent students' financial aid eligibility is determined by assessing their own financial information, as well as that of their parents or legal guardians. They include students who are 23 and younger and do not qualify as independent students.

HOW THE FAFSA WORKS

Most lenders use the FAFSA to evaluate a student's financial situation and determine his or her eligibility for financial aid. For example, a student may be required to apply for financial aid—along with admission—at school. The school may approve the student for various financial aid programs, but it must use the FAFSA to confirm the student's eligibility before granting any money.

Here's how the FAFSA works:

WHERE TO GET STARTED

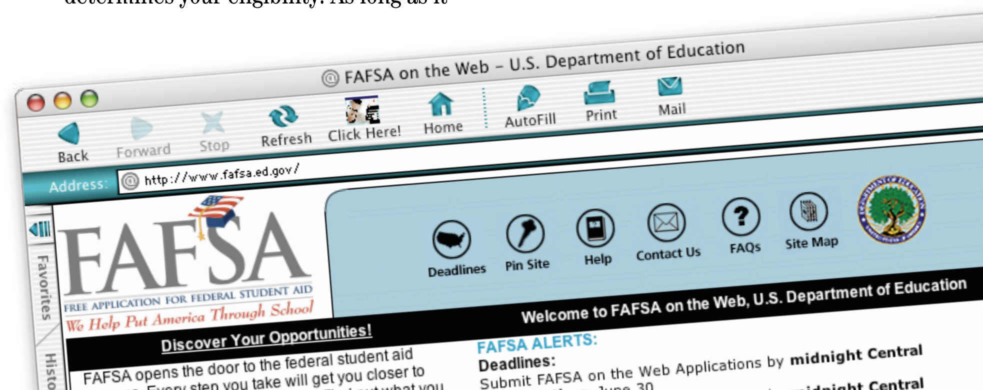
If you're not sure which applications you need—or where to find them—you might begin by asking your child's high school guidance office for advice. Or you can inquire at each college's financial aid office about different applications and procedures. If they can't provide you with all the paperwork you need, they can at least point you in the right direction.

WHERE CREDIT FITS

Many banks and private lenders will evaluate your credit history before approving you for certain loans, such as a home equity loan. The federal government does the same when you apply for a PLUS. That way, they can make sure you have repaid enough past debts in time and in full. Your **credit score**, which is an evaluation of your credit history and outstanding debt, determines your eligibility: As long as it meets or exceeds lenders' standards, you may qualify for a loan—or for a lender's lowest interest rates.

EFC: KNOWING WHAT COUNTS

You may wonder how the amount you save for your child's education affects your estimated family contribution and eligibility for financial aid. While the calculations can be complex, the answer is encouraging. Savings in plans that are considered parents' assets—which now include 529 college savings plans, 529 prepaid plans, and Coverdell ESAs—have only a modest impact on eligibility for aid. That's because the government's formula assumes that 5.6% of parental assets should go toward college costs. In contrast, it counts 20% of a student's assets toward the EFC.



1 Between January 1 and June 30—or earlier, depending on the school he or she is applying to—the student must fill out and submit a complete FAFSA either online at **www.fafsa.ed.gov**, on paper, or through certain schools' financial aid offices.

2 Three to five days after submitting the application, the student will receive a **student aid report (SAR)**, which compiles the information submitted in the application and lists the student's **expected family contribution (EFC)**. The EFC is a dollar amount which describes how much money the family is expected to provide to cover the cost of the year's education.

3 Students' SARs are automatically evaluated for certain federal funding programs, such as Perkins loans, Pell grants, and Stafford loans administered by the federal government. These programs use the students' SARs to determine how much money—if any—they are eligible to borrow. And, if the EFC falls below a certain amount, students may qualify for a federal Pell grant, as long as they meet all the other requirements.

4 Students may also have to submit copies of their SARs, in addition to separate applications, to banks and credit unions to qualify for private lending programs.

5 The following year, students may use a **renewal FAFSA**, which recalls the previous year's answers so students can update their applications, rather than fill them out all over again.

You should have an idea of which programs you and your child may apply to for financial aid before you submit a FAFSA, since certain funding plans may impose deadlines that are earlier than June 30. And keep in mind that overall, the sooner your child submits an application, the better chance he or she will have of getting federal money.

FILLING OUT THE FAFSA

The FAFSA is a thorough application that requires in-depth financial information, so you and your child should take the time to gather the right resources needed to complete it. Dependent students should make sure they have the following documents available for themselves and for their parents or legal guardians:

- Social Security card
- Driver's license
- W-2 forms and other earnings receipts
- Tax return for the past year
- Record of untaxed income (including Social Security, welfare, and veterans benefits) for the past year
- Record of any child support paid over the past year
- Records of additional financial support, including student grants, scholarships, and fellowship aid awarded to the student over the past year
- Stock, bonds, and other investment assets currently owned
- Business records for the past year
- Current bank statements

Repaying Student Loans

Sooner or later, all loans must be repaid.

As you or your child arrange to borrow money, you should consider how the loans will be repaid. In certain cases, students can defer repayment until they have graduated or left school. When repayment begins, they must opt for a specific payment plan to suit their financial situation or needs.

Regardless of how you or your child choose to repay the loans, it's important to make all the payments every month. Otherwise, you'll face consequences that could seriously damage your credit record—or worse.

WHEN REPAYMENT BEGINS

Depending on the types of loans students take, they may be able to defer payments until after graduating or leaving school. During this **grace period**, interest still accumulates on the loan, unless the loan is subsidized by the federal government.

For Perkins and Stafford loans, repayment begins soon after the student is no longer enrolled at least half time. With a Perkins loan, payments start nine months after the student has left school, and with a Stafford loan, payments start six months after he or she has left.

With other loans, such as home equity loans and PLUS loans, your payments will probably begin immediately after the loan has been fully paid out to you.

IF YOU DON'T PAY

Missing student or PLUS loan payments can have a serious impact on your finances and your lifestyle. Making late, or **delinquent**, payments may result in extra fees. And if you miss payments for 270 to 360 days, you'll be in **default**.

If a student defaults on a loan, he or she will lose eligibility for future federal aid. In addition, anyone who defaults can expect the following consequences:

- You'll immediately owe the entire balance of the loan
- Your wages will be **garnished**, or partially withheld by your employer
- The default will show up on your credit record, damaging your chances of qualifying for other loans or forms of credit
- Your account may be referred to a collection agency
- You may be subject to legal action
- You may have to pay collection fees, which may reach 25% of your outstanding balance
- You may lose your professional license
- You may lose federal and state tax refunds that are due to you
- You may lose federal and state payments you might otherwise qualify for

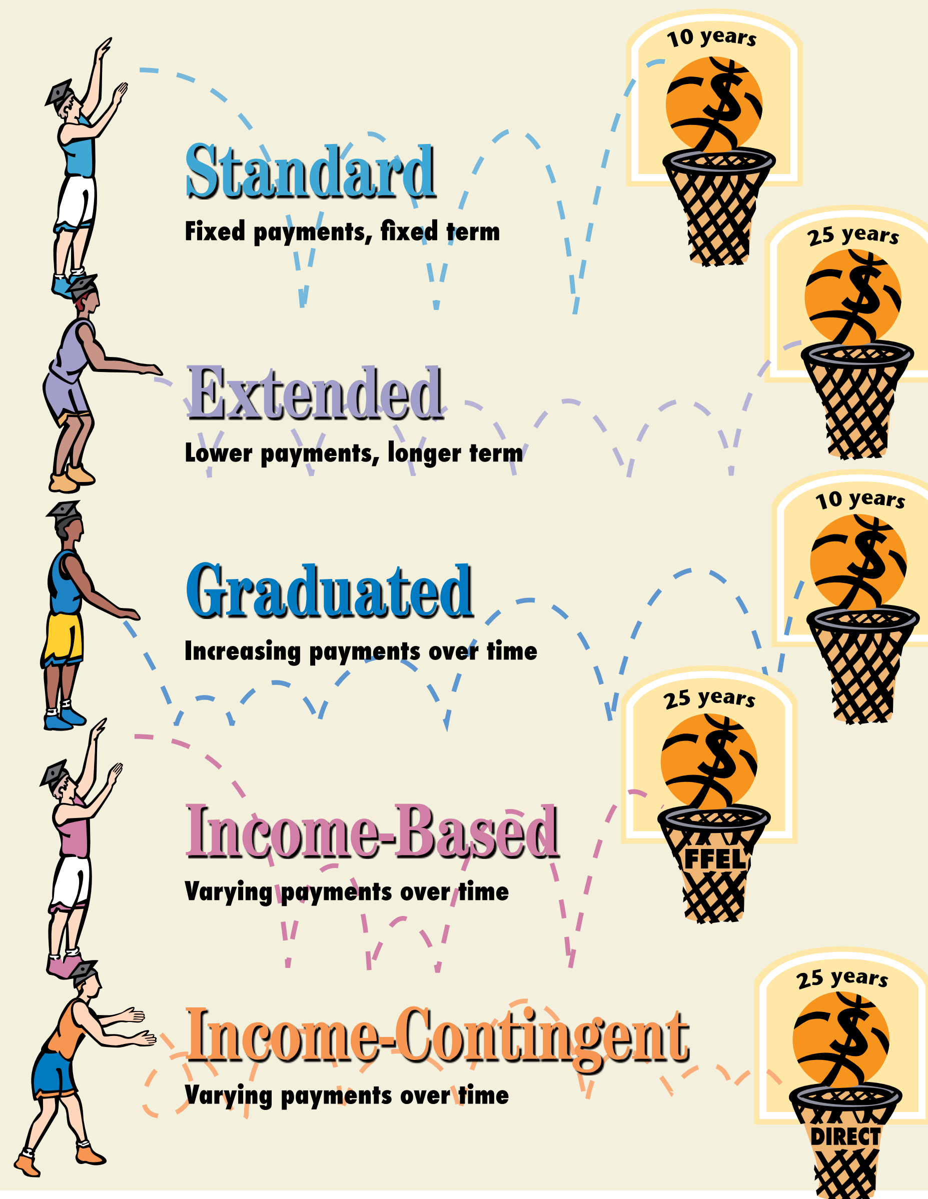
REPAYING A STAFFORD LOAN

If your child borrows money through a Stafford loan, he or she can opt to repay the loan through one of several repayment plans. Switching between plans is usually possible and may be smart in some cases.

- With **standard repayment**, students make fixed payments of at least $50 a month for a period of time that's determined by the amount of money they've borrowed overall. Standard repayment plans last up to 10 years and typically will let students pay their debt off more quickly and with less overall cost than other repayment plans.
- With **extended repayment**, students also make fixed payments of at least $50 a month. But unlike standard repayment plans, these plans may last up to 25 years, making each payment more manageable. Just keep in mind that these plans cost more in interest over time.
- With **graduated repayment**, monthly payments begin small and increase gradually and the loan is repaid in 10 years. This plan may be appealing if students expect to have a higher income in the future.
- With **income-based repayment**, the monthly payment is capped at an amount considered affordable. Balances remaining after 25 years can be cancelled. If you work in a qualifying public service job for ten years, the balance can also be cancelled. No income tax is due on cancelled amounts.
- With **income-contingent repayment**, monthly payments are adjusted according to students' income. There is no minimum monthly payment, and students can take up to 25 years to repay the loan, after which any unpaid amount is discharged, or forgiven. They will, however, owe income taxes on the amount that's forgiven.

AVOIDING DEFAULT

There are several measures you can—and should—take to avoid defaulting on a federal loan. You can request loan **forbearance**, which means your payments may be reduced or postponed for a short period of time. Your balance will continue to accumulate interest, but you'll have more time to get a handle on your finances while your payments are reduced. Or, if you qualify, you may receive a **deferment** for up to three years or while you are enrolled at least half time. No interest is due on deferred subsidized loans but does accrue on unsubsidized loans.



You should avoid default at all costs, if you can. But if you do default you can contact the loan administrator to discuss your options. Your best option is probably loan **rehabilitation**, which means demonstrating your ability to meet your payments for 12 months or more. By doing so, you may be able to restore your credit record. And students may be able to restore their eligibility for future student loans.

LOAN CONSOLIDATION

Whether or not you're having trouble repaying your loans, you may want to consider consolidating your loans into a single loan. This may lower your monthly payments and extend the term, which increases the overall cost of borrowing. The advantage is being able to make just one payment a month. But there are some potential drawbacks as well, which you should investigate before acting.

Putting It All Together

As your child grows older, your college savings should take shape too.

When your children are growing up, college may seem ages away. After all, you have about 18 years before he or she enrolls in school. Still, there's no better time than these years to start investing your money. And the earlier you start, the better chance you have of building enough assets to cover the cost of higher education.

TOTS TO TEENS

You may want to begin by opening college investment accounts that have tax benefits, such as an **ESA** or **529 plan**. By contributing steadily to both accounts—and encouraging other family members to contribute as well—you can build a solid foundation to meet your child's college costs.

You'll want to keep your eye on how well your accounts are helping you meet your goals, in the context of what's happening in the financial markets. You can always alter the investment mix in an ESA and make changes within your current 529 plan or even switch to another plan if you are not satisfied with the results. You'll want to check with your tax adviser about any potential tax issues before you act.

While you can use the money in your child's ESA to pay for education costs that come up before he or she reaches college age, you'll want to be sure to weigh the pros and cons of holding onto that money until college versus spending it right away.

COLLEGE ON MY MIND

It's important to talk to children about college and college savings so that they begin to understand what it means to plan ahead. That way, your child will not only appreciate what it takes to pay for school, but also recognize the importance of saving and investing as a family.

When someone contributes to your child's investment accounts or donates a savings bond, you can explain—in basic terms—how each of these items works and how it can help meet costs later on. You can also encourage your child to contribute some birthday or allowance money to his or her education investment accounts each year.

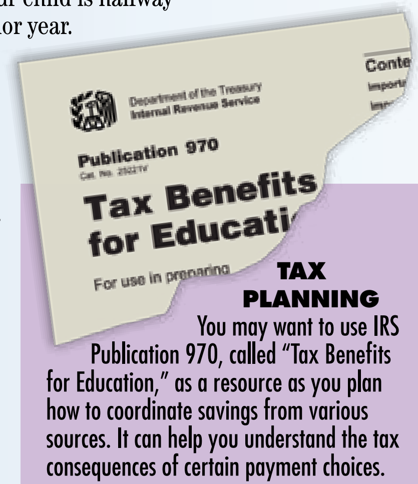
HOW OTHERS CAN HELP

Keep in mind that most investment accounts will accept contributions from multiple donors. So, if relatives are interested in donating to your child's education, you can encourage them to contribute directly to the child's accounts. Most accounts require that donations be made in cash, while UGMA and UTMA accounts accept donated assets.

HIGH SCHOOL

During junior and senior years, your child will be busy preparing for ACTs and SATs, visiting schools, drafting personal statements, researching scholarships and grants, and applying to school. As a parent, you'll have your work cut out for you, too.

You can start by assessing your total college funds when your child is halfway through his or her junior year. At this point, you will probably have a better idea of what kinds of schools—public or private, two- or four-year, or perhaps a technical or vocational program—he or she is interested in. So you can take a look at your account balances and compare that figure against your estimates for the cost of the particular schools.



TAX PLANNING

You may want to use IRS Publication 970, called "Tax Benefits for Education," as a resource as you plan how to coordinate savings from various sources. It can help you understand the tax consequences of certain payment choices.

Any time after your child turns 13, he or she can create a password-protected MyFSA account at www.studentaid.ed.gov to calculate approximate college costs and your estimated family contribution (EFC). Or, at the same URL, you can use the FAFSA4caster to estimate your EFC.

If you anticipate that your savings will fall short of your child's college costs, you should start exploring your financial aid options.

- Make sure your child submits schools' financial aid applications along with his or her admissions applications well before the deadline.
- Inquire about local scholarship and grant opportunities at the high school guidance office. In January, be sure both you and your child begin gathering the materials needed to complete the **FAFSA** in time.
- Once your child starts receiving acceptance letters, approach schools' financial aid offices for advice about how you might apply for other aid opportunities.

Remember that the earlier your child submits aid applications and materials, the better chance he or she has of being offered financial aid.

WHAT TO SPEND FIRST

When it comes to making actual payments toward your child's education, you'll have to plan how and when you'll use your investments, savings, and tax credits to pay for school.

Generally, the best approach is that you hold onto college investments with higher potential for growth and start by spending low-risk and low-yield investments, such as **savings bonds** and **CollegeSure CDs**. Since these investments are the least likely to increase in value during the time when your child remains in school, it makes more sense to spend them early. That way, you can hold onto 529 or ESA accounts, which have higher potential for growth, for a longer period of time.

Another common strategy is to withdraw from accounts designated specifically for education expenses first and hold onto other funds, such as savings bonds, until later. That way, if you have funds left over when your child graduates, you can spend that money without owing penalties.

If you're eligible, don't forget to claim tax credits for your education expenses, too. You can claim a **American Opportunity Tax Credit** during the first four years of your child's education and a **Lifetime Learning credit** for additional years.

529 prepaid plan allows you to purchase college credits in advance, for use at participating colleges and universities. No income tax is due on the increased value of the credits as long as you use them toward tuition payments.

529 savings plan is a state-sponsored college investment plan that lets you build tax-deferred earnings and make tax-free withdrawals, provided you use the money to pay for qualified higher education expenses.

Asset allocation is a strategy for helping to manage investment risk. It means dividing your assets among different broad categories of investments, including stocks, bonds, and cash. It does not guarantee that you'll reach your goals or prevent losses.

Beneficiary is the person in whose name a savings or investment account is opened.

Compounding occurs when investment earnings are reinvested and added to your principal, to form a larger base on which future earnings may accumulate. The larger your investment base, the faster it has the potential to grow, though earnings are not guaranteed in uninsured investment accounts.

Coverdell education savings account (ESA) is a self-directed investment account that lets you build tax-deferred earnings and make tax-free withdrawals, provided you use the money to pay for qualified education expenses, including those incurred K through 12.

Diversification is an investment strategy for offsetting risk that involves choosing a number of different stocks, bonds, or mutual funds in different subclasses within an asset class. There's no guarantee you'll reach your goals or avoid losses.

Expected Family Contribution (EFC) is the amount that the government calculates you and your child together can afford to contribute to a year of higher education. The EFC is based on income, assets (not including your home equity), size of household, tax obligations, and other factors that your child reports each year on the FAFSA.

Gift-tax exclusion allows you to make annual tax-exempt gifts of up to $14,000 each to as many recipients as you choose. That means you can contribute up to that amount to college savings plans each year without any tax consequences. Married couples can contribute twice that amount.

Inflation risk occurs if earnings on the investments you select accumulate at a rate that's equal to or lower than the rate of inflation. You will not have the same purchasing power in the future as you do today. That's a particular problem if expenses you plan to cover, such as future college costs, continue to increase at a faster rate than overall inflation.

Loan is a form of financial aid, often from the federal government but sometimes from colleges and universities or from banks, that must be repaid with interest after graduating, leaving school, or enrolling less than half time.

Market risk occurs because investments change value all the time, moving up or down in response to economic and political factors that affect investor confidence. This means that it is possible to lose as well as make money when you invest, especially within a relatively short period of time.

Qualified education expenses are college costs for which you are allowed tax-free withdrawals from your 529 or ESA account. These typically include tuition, books, school supplies, and room and board under certain circumstances.

Roll over means you move assets from one investment to another, one account to another, or from one beneficiary to another. For example, you might roll over assets in one state's 529 savings plan to a plan offered by a different state. When you move between two tax-deferred or tax-free plans, there is no tax on any earnings in the account but there may be fees.

Scholarship is a form of financial aid, often but not always from the institution the student attends, which doesn't have to be repaid. Scholarships may be available on the basis of need or merit, or both.

Tax credit is a direct reduction in the amount of tax you owe.

Tax deferred means income tax on earnings, and in some cases on contributions, is postponed until you begin withdrawing from the account in which the investment is held.

Tax free means you do not owe income tax on your investment earnings at any time, though you must follow withdrawal rules on certain tax-free investments, including 529s and ESAs.

Evangelical Covenant Church Resources

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Phone: (773) 299-7263
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Web: http://financialleadership.covchurch.org/

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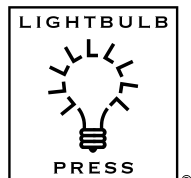

GUIDE TO SAVING FOR COLLEGE *helps parents explore the many ways to save and pay for college, from tax-free investment accounts to federal student loans. This concise and lively guide explains what you can expect to pay for college, how to make the most of your college savings, and what you can do if your savings fall short. It will also help you sort through the ins and outs of all the college savings plans and federal aid programs available to you and determine which might work best for you and your family.*

SAVING FOR COLLEGE

Planning for College

Preparing for college takes time—and money—but the rewards are well worth it.

Is providing your child with an excellent education something you care deeply about? For many parents that means paying for—or helping to pay for—an undergraduate degree, vocational school, or technical program after high school. And, if the child wants to pursue a professional or graduate degree, some parents support that schooling as well.

Part of making education a priority is understanding what it will cost and what you can do now to be ready to pay the bills when it's time for your child to enroll. A good place to start is by learning how many options you and your child have. They include not only the number and variety of schools he or she might attend, but the range of alternatives for saving and borrowing that are designed specifically for education.

A RANGE OF CHOICES

There are over 4,000 degree-granting colleges and universities in the United States, plus a number of certified vocational and technical schools offering specialized training programs.

The most basic distinction is between **public institutions**—those that are supported at least in part by state tax revenues, or, in a limited number of cases, by federal tax money—and **private institutions**.

Every state in the United States has a public university system that includes one or more major universities, four-year colleges, two-year community colleges, and sometimes institutions with a specific focus, such as veterinary medicine, agriculture, or hotel management. The largest system, New York's, has a total enrollment of over 400,000 students.

Private colleges and universities, which are supported primarily by tuition and fees, investment portfolios, and fundraising efforts, are a presence in every state. There are also a small number of private two-year colleges and some for-profit institutions, whose financial structure resembles that of for-profit hospitals.

MAKING DISTINCTIONS

The differences between a college and a university are essentially those of size and scope. Most colleges grant four-year bachelor's degrees and sometimes a limited number of master's degrees in specific fields tied to the mission or the academic strengths of the school. College enrollments vary from a few hundred at the smallest schools to several thousand at larger ones.

Universities, both public and private, offer two and often three levels of degrees: **bachelors**—also called baccalaureate—**masters**, and **doctoral**. Many universities also have professional schools in areas like law, medicine, journalism, religion, and education. Enrollment can run to tens of thousands. The largest university in the country, Arizona State University, has an enrollment of over 70,000 students.

BACHELOR AVE.
MASTERS DEGREE AHEAD
PHD
PRIVATE
PUBLIC

WORDS TO THE WISE
One thing to remember is that the net price you pay when your child enrolls is often lower than the price printed in the college catalog. More than 60% of students and their parents receive some financial aid, either through an individual school or from the government.

SAVING FOR COLLEGE

Welcome to College

COLLEGE COSTS

The cost of a college education is linked directly to the type of institution in which your child enrolls. All schools charge tuition and fees, which help to pay for classroom instruction, certain extracurricular activities, and maintenance of the buildings and grounds. If students live on campus, schools will also charge for room and board, which covers a place to stay and some or all meals.

The average tuition cost for an in-state student at a four-year public college in the 2016-2017 academic year was $9,650. Attending a public school in a state other than the one where the student lives adds, on average, about $15,280 annually to the tuition bill at a four-year school. At a private college, the average cost was $33,480. Remember, though, that these are averages. The numbers don't report regional differences, which may affect your experience.

What may be more encouraging is that the percentage increases in in-state tuition and fees at public colleges were smaller than in the past. The least expensive way to attend college is at a public two-year school where tuition and fees average $3,520.

COLLEGE TUITION + FEES	
4-year public in-state	$ 9,650
4-year public out-of-state	$24,930
4-year private	$33,480

*Source: The College Board, 2016

IN YOUR CORNER

If you're just starting to plan for college, it's important to remember that if higher education matters to you and your children, it's within your reach. Two things you can do to make a difference are stressing the academic achievement that helps kids get accepted and saving to help cover the cost.

There's a general sense, from the local community to the federal government, that education is a good thing and that everyone is entitled to the opportunity.

That doesn't mean there are no challenges. Prices are going up, as they have been for years. Public institutions in particular are struggling to compensate for reduced funding from the states. But you'll find that there are a number of financial incentives to help you pay for your child's education. Certain education expenses and education loan interest are tax deductible, and education tax credits may reduce the income tax you owe. But you must spend the money before those benefits help you.

THE GI BILL
Special assistance in paying for higher education is available through the Post-9/11 GI Bill for veterans, their dependents, and, in some cases, their survivors. If you or your children may be eligible, view download a copy of *Federal Benefits for Veteran, Dependents and Survivors* at www.va.gov/opa.

POTENTIAL EARNINGS
High school
Undergraduate degree
Advanced degree

OUTWEIGHING THE COSTS

There's little question about the value of education in financial terms. Someone with an undergraduate degree earns, on average, about $1 million more over his or her lifetime than someone with just a high school diploma. And while there are still some extremely satisfying jobs that don't require a college education, there's little doubt that an undergraduate degree is an entry-level requirement for an increasing number of careers.

People with advanced degrees, including professional degrees, can expect an even higher level of financial security, on average earning up to three times more than the annual income of someone who has no formal education beyond high school.

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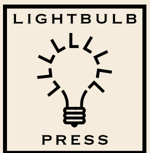

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