

Your College Savings Answers

Most parents want their children to start their adult life on the right foot—without debt.



hich is why many parents plan on paying for at least some, if not all, of their child's college education. College is not cheap and the price tag keeps rising—currently at twice the inflation rate.

With all the different savings plans, payment options, and colleges to choose from, the best

advice is the earlier you start planning, the better. "The earlier you start, the less onerous of a task it's going to be and the amounts you'll have to put away on a regular basis will be smaller," says Joseph Orsolini, certified financial planner, College Aid

The more you save,
the less you'll have to borrow.

College Costs

	Private	Public
Direct education expenses		
Tuition & fees	\$18,273	\$4,081
Books & supplies	807	786
Living expenses		
Room & board	6,779	5,582
Transportation	645	749
Personal expenses	1,173	1,643
Total costs	\$27,677	\$12,841

Source: College Board

Assumptions: Prices are based on 2002 college costs and prices are expected to increase at twice the inflation rate.

Nonresident tuition and expenses may be more.

Planners Inc., Glen Ellyn, Ill. "If you wait too long it ends up being a big cumbersome task and you're probably going to end up avoiding it altogether."

The more money you save earlier in a child's life, the more options you'll have and the less you'll have to borrow.

So where do you start? What investments are best? The answers ultimately are up to you, but this book can help you develop answers to those questions.

The Price You'll Pay

It's important to realize that very few students pay the full cost or "sticker price" of college. That's because many students receive some form of financial aid, according to the College Board, a national nonprofit membership association in New York that informs students about college opportunities.

Tuition at private and public universities has increased between 5% and 13% each year since 1980, according to the U.S. Education Department. To stay ahead of inflation, a college savings fund will have to outpace the rate of inflation by 7% or more.

How much a school costs first depends on if it's a private school, a public school, or a community college. Private schools usually are more expensive. The government and schools typically consider the parents to have the primary

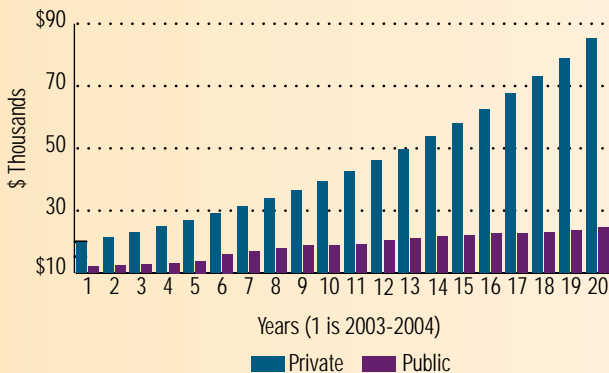
responsibility in paying for their children's education, which means financial aid only goes so far in covering college costs.

What exactly are the costs associated with attending college?

Direct costs usually include:

- **Tuition** = the amount of money that colleges charge for instruction and attendance.
- **Fees** = other costs such as athletic activities, special events, or facilities (for example, insurance or use of the gymnasium).
- **Room and board** = cost of housing and food. Most colleges offer a variety of on-campus and off-campus housing. Also, there usually is a variety of meal plans to choose from at most colleges.

Cost of College in the Next 20 Years



Source: CUNA's economic and statistics department
Assumption: Prices increase 8% per year.

- **Indirect costs** = books, supplies, transportation to and from the school, computer (many schools require a student to have a computer), and personal expenses such as phone bills, entertainment, and laundry.

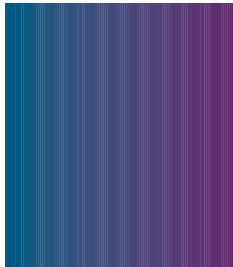
Think about where you want to send your child to school.

"To get a ballpark estimate of how much you have to save, you have to think about where you want to send your child to school—private vs. public," says Timothy M. Hayes, executive director, National Institute of Certified College Planners (NICCP), Rochester, N.Y. "Do you want to send

junior to a community college or do you want to send junior to Harvard—\$3,500 a year vs. \$35,000 a year?" Hayes says parents also should ask themselves, "Do you want to continue to save through the four-year period the child is in college?"

According to Hayes, "A parent wanting to have enough money in 17 years to send their child through four years of state college in today's dollars of \$12,000 a year, where we expect that cost of college will inflate by 5% per year, will have to save \$335 a month—based on a 6% annual after tax return.

By continuing to save through the college cycle, while the child is attending college, the parent could lessen the amount they'd have to contribute on a monthly basis starting today."





Savings Options

529 plans

529 plans (named after the section of the federal tax code that governs them) are state-sponsored college savings plans. Every state now has at least one 529 plan available—a few offer more than one. Each state determines the maximum amount you may contribute annually per child. A financial services firm such as Merrill Lynch, T. Rowe Price, or TIAA-CREF manages most state plans.

The money saved in most 529 plans may be used at any school you choose and for all qualified higher education expenses, including room and board. Most plans offer a menu of age-based portfolios, and some also offer a small selection of stock and bond funds.

There are two types of 529 plans: prepaid tuition plans, and college savings plans. Prepaid tuition plans let parents lock in future tuition at any in-state public college at today's prices. College savings plans allow parents to use their plan funds for college expenses at any college.

529 prepaid tuition plans

Prepaid tuition plans are low-risk, tax-advantaged programs designed for students who plan on attending an in-state school. Earnings are indexed to the average tuition cost increases—meaning you can lock in tuition at today's rates. You can transfer the value of your prepaid tuition plan to private and out-of-state schools, although you may not get full value depending on the particular state.

College Savings Add Up

Annual amount saved*	\$1,200
Annual rate of return	3%

Time period (years)	Total amount saved	Value at end of period	Interest earned
5	\$6,000	\$6,562	\$562
10	12,000	14,169	2,169
15	18,000	22,988	4,988
18	\$21,600	\$28,940	\$7,340

* Deposit made at beginning of each year
 Source: CUNA's economic and statistics department

Two types of prepaid 529 tuition plans

According to the College Board, a “units” plan allows you to buy units of tuition. For example, a unit may equal 1% of state college tuition or a set number of credit hours. A “contract” plan lets you purchase contracts for one to five years of tuition. Amounts of tuition (contract or units) may be purchased through a one-time lump sum purchase or monthly installment payments. The program pools the money and makes long-range investments so that the earnings meet or exceed college tuition increases in that state.

Pros:

1. Accounts usually are guaranteed by state governments to at least **match in-state college tuition** increases.
2. Prepaid tuition plans are **considered a safe investment option**, especially for families that know where their children will attend college. They usually outperform typical savings accounts or share certificates/certificates of deposit (CDs).

Other Types of Saving Vehicles



- **Bonds**—When you buy a bond, you are lending money to the corporation, government, or entity that issues the bond. In return, you generally get a specified interest rate, which, depending on the type of bond, is paid either at specific periods during the life of the bond or when the bond matures. The principal is repaid at maturity.

- **Savings bonds**—Savings bonds are issued as savings certificates to individual investors in small amounts. Savings bond

certificates bear face value denominations ranging from \$50 to \$10,000. You can purchase savings bonds through a variety of government offices and financial institutions. Besides being easy to acquire, savings bonds offer another attractive feature: Unlike stock purchases, they involve no transaction costs.

According to Joseph Orsolini, certified financial planner, College Aid Planners Inc., Glen Ellyn, Ill., you should purchase

Cons:

1. Participation in the plan often is **restricted to state residents or alumni**.
2. The principal, plus earnings, typically only **covers in-state public universities**.
3. **Prepaid plans are considered a conservative investment**. Long-term college savers may want to consider other investing options.
4. Canceling or pulling out of a prepaid tuition plan can **result in high penalty fees, cancellation costs, and/or loss of interest**.
5. **Prepaid tuition plans are not financial-aid friendly**. Money held in a prepaid plan is considered the student's resource (treated like scholarships) and may reduce financial aid dollar for dollar.
6. For some prepaid plans, the **funds can only be used for tuition and fees**. Expenses such as room and board, course fees, and books, may not be covered.
7. Although prepaid plans are, in most cases, guaranteed by the **states, they are not immune to tuition increases at state schools**. When tuition and fees at state schools increase more than the plans had anticipated and investments fall short, the plans run actuarial deficits. This could cause plan participants to have to make up the difference on their own or it could increase the cost to participate in a state's plan.

savings bonds in the parent's name, not your child's. It will lessen the effect on a student's eligibility for financial aid.

- **Share certificates/certificates of deposit (CDs)**—This is a special type of deposit account that pays a higher rate of interest than a regular savings account. Typically, you invest a fixed amount of money for a specific amount of time and receive a fixed amount of interest in return. CDs are insured by the National Credit Union Administration (NCUA) or the Federal Deposit Insurance Corporation (FDIC), though there is a maximum or ceiling.
- **Brokered CDs**—These are sold through brokerage firms and often have a higher interest rate than those issued by other financial institutions. Additionally, brokered CDs may be callable (the broker can "call" it due), which makes it a riskier investment. Although these CDs are sold through brokerages, they are issued by credit unions or banks.
- **Callable CDs**—Some long-term, high-yield CDs have a callable feature, which means the financial institution that issues

the CD has a right to terminate, or call, the CD after a set period of time—usually one year. You, the investor, don't have the same right. A CD often is called when interest rates fall so that it can be reissued at a lower interest rate.

- **Money market funds**—Usually offered by brokerages and mutual fund companies, these funds invest in highly liquid, safe securities such as CDs or government securities. However, money market funds usually are not NCUA or FDIC insured.

- **Money market deposit accounts**—These usually are offered by banks and some credit unions. They typically require a minimum balance and permit a limited number of transactions.

- **U.S. government bills or notes**—These can be bought directly, and commission-free, online at www.treasurydirect.gov. Treasury bills are backed by the government and are considered the safest investments. They are exempt from federal and local taxes. Treasury bills mature in less than a year and Treasury notes mature in between two years and 10 years.

Each prepaid tuition plan has its own set of rules and restrictions, which are subject to change. Make sure to request the most recent plan details from plan administrators and read the fine print.

What to look for in a prepaid tuition plan:

- **Flexibility**—Can you transfer the value of your plan to other states' schools and private schools?
- **Refund/Cancellation policies**—Can you get all of your money back plus interest?
- **Guarantee**—Is the plan guaranteed by the state to cover future educational costs?
- **Coverage**—What costs are included in qualified expenses?
- **Restrictions**—Is it open enrollment or annual enrollment and is there an age limit for participating?
- **Return**—Is there a minimum return?

Who should invest in a 529 prepaid tuition plan?

- Families that know which school their child will attend and it's a public in-state school.
- Families looking for a safe, conservative investment with a probable guaranteed return.
- Families with less than 10 years to save until their child reaches college-age.

■ 529 savings plans:

Savings plans allow participants to save money in a special college savings account on behalf of a child. Contributions can vary, depending on the individual's savings goals, and plans offer a variable rate of return—some programs guarantee a minimum rate of return. Typically, parents open a 529 savings plan, choose an investment strategy to fund the account, and then make withdrawals when it's time to pay a child's college expenses. A popular type of 529 savings plan begins with some aggressive investments and grows more conservative the closer the student gets to reaching college.

Pros:

1. **Earnings from a 529 savings plan are exempt from federal taxes**, as are withdrawals, as long as they are used for college expenses (this tax-free status on 529 plans ends in 2010, unless Congress extends it). Some states exempt earnings from state income tax also, and some states allow families to deduct the full or partial amount of their contribution from their state income taxes.
2. **529 savings plans have high lifetime contribution limits**—Some limits are as high as \$250,000 per beneficiary.
3. **Investment minimums are low**—Some plans allow you to save as little as \$25 a month (automatic deposit or payroll deduction is available).
4. **529 savings plans are more portable**—Plans are open to residents and nonresidents alike. If you don't like your state's plan,