A HITCHHIKER'S GUIDE TO PLANNING FOR COLLEGE EXPENSES

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In July of 2006, Merriam-Webster added the term "sandwich generation" to its dictionary. The term describes those of us "sandwiched" between caring for elderly parents and our own children at the same time. The complement to this article, "A Hitchhiker's Guide to Planning Your Parents' Retirement," addresses some of the issues you might face as your parents age, quoting a central idea in *The Hitchhiker's Guide to the Galaxy*: "Don't panic." Here, we'll focus on how you can prepare for future tuition bills, help your children to understand money, and teach them the importance of saving.

> *"You know," said Arthur, "it's at times like this, when I'm trapped in a Vogon airlock with a man from Betelgeuse, and about to die of asphyxiation in deep space that I really wish I'd listened to what my mother told me when I was young."*
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> *"Why, what did she tell you?"*
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> *"I don't know, I didn't listen."*
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> —*The Hitchhiker's Guide to the Galaxy,* Douglas Adams

TEACH YOUR CHILDREN WELL

Experience is an invaluable resource. Your best plans can be laid to waste if you fail to teach your children how to save money—or if they fail to listen. You can budget for college tuition costs, but what if your child runs up a massive bill on your credit card or wastes your careful savings on expensive trips? There are tools you can use to prevent abuses, but the best one is to teach children how to deal with money.

An excellent place to begin is to give your children an allowance at an early age. Exposing your children to the idea of saving can change their lives. Urban legend has Einstein describing compound interest as the most powerful force in the universe. You may want to expose your kids to its power while some lesser phenomena—like "lava" shooting from a papier-mâché volcano—still fascinate them.

GET YOUR OWN HOUSE IN ORDER

Parents want the best for their children, but in some cases, saving as aggressively as possible for your children's college might not be the best thing to do. You may find repaying high-interest debt or saving in other vehicles more advantageous than investing in a 529 savings plan. Speak with a financial adviser or college financial aid counselor about how college aid formulas treat college savings plans compared with conventional savings. In addition, consider purchasing a life insurance or disability policy. One of the largest risks to your family is the loss of income resulting from a wage earner's death or disability.

EVALUATE THE SAVINGS OPTIONS

In the United States, a popular vehicle for college-specific saving is the 529 plan, of which there are two types: pre-paid tuition and college savings plans. Earnings on 529 plans are not subject to federal tax and may not be subject to state taxation either. Some state plans offer additional benefits—such as matching grants or a tax deduction—to residents of those states. Tax penalties apply if 529 plan money is not used for educational expenses and may apply if you move to an out-of-state plan after taking an in-state tax incentive.

PRE-PAID TUITION PLANS

Pre-paid tuition plans allow you to lock in the cost of tuition at eligible colleges. A national consortium of private colleges has formed a 529 plan, but most pre-paid tuition plans are sponsored by state governments and have residency requirements. These plans typically cover over only tuition and mandatory fees. Some do allow the use of funds for other expenses, but make sure you check the terms. Pre-paid tuition plans also impose an age limit on beneficiaries and have a limited enrollment period each calendar year. The price of the plan is based on the beneficiary's age and the number of years of tuition paid.

Pre-paid plans offer certainty of college costs with an associated trade-off: They reduce your child's flexibility when choosing which school to attend. Some states offer transferability of benefits, and some offer a potential for partial refunds if the beneficiary (or an eligible sibling) does not attend college.

COLLEGE SAVINGS PLANS

College savings plans allow you to use funds for all “qualified higher education expenses,” which include not only tuition and fees but also room and board, books, and computers. These plans have high contribution limits (some as high as $200,000 per beneficiary) and do not place limitations on the age of the participants. Unlike pre-paid plans, they do not guarantee tuition and related costs and are subject to market risk.

Some college savings plans are available only through brokers or financial advisers and can be expensive. Evaluate both broker fees and management fees on underlying investments. Read the prospectus carefully and compare the 529 plan you are considering with other plans, as well as other investment options.

OTHER OPTIONS

Many parents also use brokerage accounts established under the Uniform Gift to Minors Act (UGMA) or Uniform Transfer to Minors Act (UTMA) to save for college expenses. Speak with a financial professional about the tax advantages associated with earnings in the child’s name.

These assets become the property of the child upon reaching adulthood, and for that reason can be problematic, as the party (parents, grandparents…) funding the account will lose control. If you would prefer to retain ownership of the funds, you can work with your adviser to set money aside in a manner that leaves you in control. Speak with an adviser about how financial aid formulas treat funds that are child-owned compared with parent-owned.

FINANCIAL INSIGHT

A good tool for comparing state programs can be found at the College Savings Plans Network website: CollegeSavings.org. Use the “Compare 529 Plans” feature to assess fees (including brokerage fees), locate contacts, and identify underlying managers.

WHAT IF I STILL NEED HELP?

If you find that your savings haven't grown as fast as you'd expected—or you simply haven't saved enough—don't despair. There are a number of programs that exist to help cover college costs. Consult financial aid professionals at one or more of the universities your child might attend. They will be able to answer questions about your specific situation and determine what types of financial aid may be available.

Remember to evaluate college planning in the context of your overall finances. It is usually helpful to lay out an investment policy statement, which clearly articulates a financial plan. Learn more about the investment policy statement, and review other CFA Institute investor education materials at www.trustcfa.org.

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