Will Your Family Be Ready to Meet Rising College Costs?

Foreword

If you are reading this booklet, you probably do not need to be convinced of the value of higher education. However, you might be surprised by the ways in which a college degree could affect a person's life.

Studies show that college graduates not only earn more but are also healthier, more satisfied with their jobs, and more active as citizens.[1] And college is a gift that keeps on giving, because college-educated parents are more likely to offer better preparation for their own children's educations.[2]

Of course, college is expensive, and costs have been rising at a substantially faster rate than general inflation.[3] Fortunately, in addition to taxable investment vehicles, there are tax-advantaged programs that may help you save for college: Coverdell Education Savings Accounts (ESAs), 529 plans, and even individual retirement accounts.

Each of these programs has its own benefits and restrictions, and all are worth considering as you develop your college savings strategy. The information here is designed to provide a foundation for understanding these savings programs and other funding methods. Your financial professional can help you evaluate which program or programs may be appropriate for your situation.

Sources:
1) TheConversation.com, April 30, 2018
2–3) College Board, 2016 (most current data available)

The Value of a College Degree

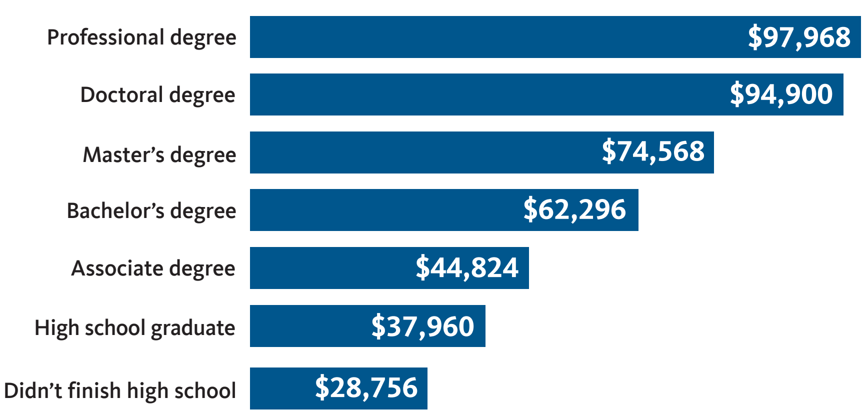
Making a Long-Term Investment

A recent study contends that a college degree could be a better long-term investment than stocks, bonds, gold, or real estate.[1] According to data from the U.S. Bureau of Labor Statistics, a worker with a bachelor's degree earns about 60% more annually than someone with only a high school diploma. People with advanced degrees typically earn even more (see chart).

Along with higher earnings, college graduates are more likely to remain employed, even during challenging economic times. In 2018, the unemployment rate for college graduates was only 2.2%, compared with 4.1% for high school graduates who had no further education.[2]

Sources:
1) *Forbes*, July 6, 2016 (most current data available)
2) U.S. Bureau of Labor Statistics, 2019

Median annual earnings by level of education



Source: U.S. Bureau of Labor Statistics, 2019 (2018 data for adults age 25 and older)

Enjoying a Happier, Healthier Life

Of course, earnings are only one way to measure the value of a college degree. Consider these facts as well:

- College graduates working in the private sector are more likely than high school graduates to be covered by employer-provided health insurance.[1]
- College graduates are more likely to volunteer in their communities.[2]
- College graduates are much more likely to vote. For example, about 76% of graduates with a bachelor's degree vote, compared with 58% of high school graduates.[3]
- Children of parents with higher levels of educational attainment are better prepared for school.[4]

Sources:
1) U.S. Census Bureau, 2018
2, 4) College Board, 2016 (most current data available)
3) U.S. Census Bureau, 2018

60% **of the fastest-growing occupations typically require some form of post-secondary education.**

U.S. Bureau of Labor Statistics, 2018
(employment projections 2016–2026, most current available)

Clearly, a college education can touch many aspects of graduates' lives — from expanding their minds to broadening their horizons and career opportunities — and the society in which they live. Attaining a college degree could be a life-changing accomplishment.

Rising College Costs

Like many significant opportunities, a college education can be expensive. Over the last 30 years, the cost of tuition and fees at both public and private institutions has risen consistently at a rate higher than general inflation.[1]

Considering the economic challenges that many states have faced over the last decade, it may not be surprising that the most dramatic increases have been at public institutions. Over 10 years — from academic years 2008–2009 to 2018–2019 — the cost of in-state tuition and fees at four-year public institutions rose at a 2.6% average annual rate beyond inflation. Private institutions have also experienced substantial increases.[2]

Tuition and fees are only part of the cost of a college education. For the many students who live away from home, room and board are substantial expenses. At public institutions, these costs can exceed in-state tuition and fees *(see chart below)*.

Other expenses generally include books, computers, transportation, insurance, and miscellaneous expenses associated with living away from home. These expenses can add thousands of dollars to the total cost of a college education. *(See estimated undergraduate costs at selected institutions on page 5.)*

Source: 1–2) College Board, 2018

Average published charges for undergraduates, 2018–2019

Type of institution	Tuition & fees	Room & board	Total
Public 2-year	$3,660	—	$3,660*
Public 4-year in-state	$10,230	$11,140	$21,370
Public 4-year out-of-state	$26,290	$11,140	$37,430
Private 4-year nonprofit	$35,830	$12,680	$48,510

*Public two-year costs do not include room and board charges.

College Cost Worksheet

Name of the child	Current age	Current annual college cost	x	Estimated future cost factor	=	Estimated future cost
Lisa (example)	8	$ 21,000	x	7.021	=	$ 147,441
		$	x		=	$
		$	x		=	$

Estimated inflation rate: 5%

Age of the child	Estimated future cost factor
1	9.879
2	9.408
3	8.960
4	8.534
5	8.127
6	7.740
7	7.372
8	7.021
9	6.686
10	6.368
11	6.065
12	5.776
13	5.501
14	5.239
15	4.990
16	4.752
17	4.526
18	4.310

Age of the child	Savings factor
1	0.039
2	0.042
3	0.046
4	0.051
5	0.056
6	0.063
7	0.070
8	0.080
9	0.091
10	0.105
11	0.123
12	0.147
13	0.181
14	0.232
15	0.317
16	0.488
17	0.952
18	1.000

Estimated future college cost	X	Savings factor	=	Annual savings required
$ 147,441 (Lisa)	x	0.08	=	$ 11,795
$	x		=	$
$	x		=	$

Estimated investment return: 5%

This hypothetical example is used for illustrative purposes only and does not represent any specific investment. Actual results will vary.

Although the average costs for tuition, fees, room, and board published by colleges are helpful in estimating the current cost of a college education, it may be more realistic to consider the total estimated costs at selected institutions (before any financial aid).

Total estimated cost for undergraduates, 2018–2019

Harvard College*	$73,800
Vassar College	$73,000
UCLA	$32,941
Ohio State University	$27,340
Florida State University	$22,992

*The cost for Harvard is for the 2019–2020 academic year.

Source: College Board, 2019 (includes in-state tuition, fees, room, and board)

Of course, the cost of college today is only a starting point in estimating the cost of college for your child. Although it's impossible to predict how costs might change in the future, it seems likely that they will continue to rise faster than the rate of general inflation.

The College Cost Worksheet on the previous page may be helpful in estimating the potential cost of four years of college based on current annual costs and the age of your child. It assumes a 5% annual inflation rate and a 5% annual investment return.

In the example, eight-year-old Lisa intends to begin her college education at age 18, live on campus, and attend a public state university where the current costs for in-state tuition, fees, room, and board are $21,000.

Multiplying the current annual cost by the estimated future cost factor for an eight-year-old child results in an estimated future cost of $147,441 for four years of college. Multiplying this by a savings factor of 0.08, also based on Lisa's age, indicates that it would require $11,795 in annual savings to fund Lisa's college education — not including additional expenses such as books and transportation.

Try plugging in the appropriate information for your own child(ren) to estimate what a four-year college education could cost.

Tax-Advantaged Funding Options

Fortunately, you can use tax-favored investments to help save for college. Each comes with different advantages and limitations. In some cases, it might be helpful to utilize more than one type of savings plan. Your financial professional can help you by further explaining the options and details and help you determine which plans may be appropriate for your situation.

Section 529 Plans

Section 529 plans are state-sponsored or college-sponsored programs designed to help families save for future higher-education costs. Each plan has its own rules and restrictions, which can change at any time.

Some 529 plans are set up as prepaid tuition plans and some are structured as savings plans. With prepaid tuition plans, families can lock in today's tuition rates for future tuition costs at in-state public colleges and universities. Distributions are treated as scholarships and may reduce a child's eligibility for financial aid.

The money in a 529 savings plan can be used for all qualified higher-education expenses (including room and board), with typically more flexibility in choosing which college to attend. Funds in 529 savings plans can be used to pay tuition, fees, room and board, and supplies at eligible, accredited post-secondary schools, including colleges, universities, community colleges, and certain technical schools. A revision in the tax law now allows 529 savings plan funds to be used for K-12 tuition. *(Tax-free withdrawals for K-12 tuition are limited to $10,000 per year.)*

As with other investments, there are generally fees and expenses associated with participation in a 529 savings plan. There is also the risk that the investments may lose money or not perform well enough to cover college costs as anticipated. The tax implications of a 529 plan should be discussed with your legal and/or tax advisers because they can vary significantly from state to state. Most states offer their own 529 programs, which may provide advantages and benefits exclusively for their residents and taxpayers. These state benefits may include financial aid, scholarship funds, and protection from creditors. However, some states may not adopt 529 savings plan provisions for K-12 tuition.

You can contribute up to the normal annual gift tax exclusion ($15,000 in 2019) per student without triggering gift taxes. Alternatively, you could

529 SAVINGS PLAN ADVANTAGES

- Tax-deferred accumulation
- Withdrawals free of federal income tax when used for qualified education expenses
- High contribution limits (set by each state)
- No income eligibility restrictions
- Control of disbursements

529 SAVINGS PLAN LIMITATIONS

- Limited control of investments
- 10% penalty on nonqualified withdrawals of earnings (plus federal and state income taxes)
- Subject to market risk

contribute *five times* the normal gift tax exclusion ($75,000) in a single year for each student, as long as you don't contribute additional money for each student for four more years.

Before investing in a 529 plan, please consider the investment objectives, risks, charges, and expenses carefully. The official disclosure statements and applicable prospectuses, which contain this and other information about the investment options and underlying investments, can be obtained by contacting your financial professional. You should read this material carefully before investing.

Coverdell Education Savings Account

The tax-favored Coverdell Education Savings Account (ESA) is a popular college funding vehicle. Although the ESA contribution limit is not as high as it is for a 529 plan, you generally have more control over how your money is invested. Here are some key factors to consider:

- Contributions cannot be made after beneficiary reaches age 18
- Annual contributions limited to $2,000 per child
- Tax-deferred accumulation and tax-free withdrawals for qualified education expenses
- Investment flexibility
- Income eligibility phaseouts apply

If an ESA has a balance at the time the recipient reaches age 30 and the money is not rolled over to another qualified family member, the money must be withdrawn and distributed to the recipient (or to the recipient's estate if he or she dies prior to age 30). At that time, the beneficiary will be taxed on the remaining earnings and a 10% penalty tax will be applied. The 30-year age limit does not apply to beneficiaries with special needs.

As with other investments, there are generally fees and expenses associated with participation in an ESA. There is also the risk that the plan investments may lose money or not perform well enough to cover college costs as anticipated. Nonqualified withdrawals are subject to federal and state income taxes and a 10% federal income tax penalty.

Tax-Deferred Retirement Plans

- Traditional and Roth IRAs
- Employer-sponsored plans

If you are participating in a tax-deferred retirement plan, you have an opportunity to use some of these funds to help pay for college. Of course, you should remember that you would be reducing the money that will be available to you during retirement, which could result in a retirement income shortfall.

IRA withdrawals that are used for qualified higher-education expenses (such as tuition, fees, and supplies) are not subject to the normal 10% federal income tax penalty that applies to early distributions before age 59½, but withdrawals of tax-deferred assets are taxable as ordinary income. The money can be used not only for your children's higher-education needs but also for those of yourself, your spouse, and your grandchildren. And if you have a Roth IRA, withdrawals of regular contributions (not earnings) can be withdrawn at any time, for any reason, without any income tax liability or early-withdrawal penalty.

Another alternative is to borrow money for educational purposes from an employer-sponsored retirement plan, such as a 401(k). Most employer plans allow loans (up to a maximum of $50,000) but limit the amount to 50% of the participant's vested assets. If you choose this option, you must repay the loan (generally, over a five-year period), but you would be paying the interest to yourself, not a financial institution. One caveat is that if you lose your job, you may have to repay the loan immediately.

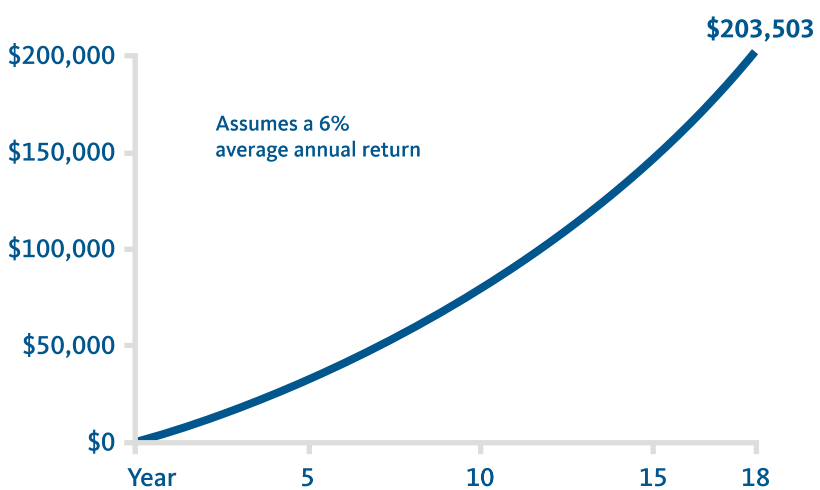
Withdrawals from traditional IRAs and most employer-sponsored retirement plans are taxed as ordinary income. Distributions taken prior to age 59½ may be subject to a 10% federal income tax penalty (with some exceptions, such as the IRA higher-education exception described earlier). For a qualified tax-free and penalty-free withdrawal of Roth IRA earnings, distributions must meet the five-year holding requirement and take place after age 59½.

Only about 42% of students graduate from college in four years.

U.S. Department of Education, National Center for Education Statistics, 2018

Making a Consistent Commitment

A commitment to save on a regular basis can pay off over time. Take a look at this hypothetical example of a couple who were committed to saving 5% of their $100,000 annual income each year for their children's college educations (this example factors in a 3% increase in the family's income each year). After 18 years, their college fund could reach $203,503.



This hypothetical example is used for illustrative purposes only and does not reflect the performance of any specific investment. Taxes and investment expenses are not considered. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

Other Methods to Help Fund a College Education

Taxable Investments

- Savings accounts
- Money market funds
- CDs
- Stocks
- Bonds
- Mutual funds

You don't want to gamble with your child's education, so generally you want to choose investment vehicles that have risks with which you are comfortable. Remember that the more potential for growth offered by an investment, the more risk it may carry.

Generally, if you start saving for college when your child is young, you have a longer time horizon and may choose to take a more aggressive approach to investing. If you have a shorter time frame, you may want to take a more conservative approach.

Taxable accounts offer savings opportunities that aren't constrained by the contribution limits of tax-advantaged accounts.

Savings accounts, CDs, and money market funds are relatively safe ways to save money for college, but the potential for growth is very limited. The Federal Deposit Insurance Corporation insures CDs and bank savings accounts at FDIC-insured institutions for up to $250,000 per depositor, per institution. CDs generally provide a fixed rate of return.

To increase performance potential over time, you may choose to invest in stocks, bonds, and mutual funds. Considering the wide range of mutual fund options available, investing in them can take some of the guesswork out of investing.

The return and principal value of stocks, bonds, and mutual fund shares fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Bonds are subject to interest rate, inflation, and credit risks. As interest rates rise, bond prices typically fall. If not held to maturity, bonds may be worth more or less than their original cost. A bond fund's performance can be affected by the risks associated with the underlying bonds in the fund.

Money market funds are neither insured nor guaranteed by the FDIC or any other government agency. Although a money market fund attempts to maintain a stable $1 share price, you can lose money by investing in such a fund.

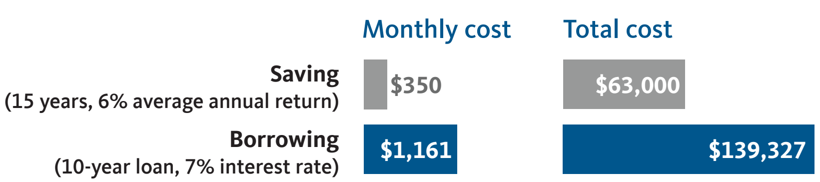
Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

Federally Sponsored College Loans

- **Federal Perkins Loan** — A fixed, low-interest federal loan available to both undergraduate and graduate students with exceptional financial need. Loan payments are delayed while the student is in school.
- **Direct Loan** — Direct Subsidized Loans are made to eligible undergraduate students who demonstrate financial need. Direct Unsubsidized Loans (available to undergraduate, graduate, and professional students) are not based on financial need, and interest accrues while the student is in school.

- **Direct PLUS Loan** — Available to graduate or professional degree students (enrolled at least half-time) and parents of dependent undergraduate students to help pay for expenses not covered by other financial aid. Parents can borrow up to the total cost of attendance (minus any aid received). Borrowers are fully responsible for paying the interest, regardless of loan status.

Although college loans may have lower interest rates and more generous repayment terms than private-sector loans, the cost of borrowing can still be very expensive compared with the cost of saving. Consider the hypothetical example below, which compares a savings program to accumulate $100,000 over 15 years with a $100,000 loan borrowed by the student at age 18 (which has a 10-year payoff period). The total out-of-pocket cost would be $63,000 for saving and investing versus $139,327 for borrowing.



This hypothetical example is used for illustrative purposes only and does not represent any specific investment or loan. Actual results will vary.

Grants and Other Financial Aid

During the 2017–2018 academic year, undergraduate and graduate students received more than $184 billion in student aid. Of this aid, about 60% came from grants (from all sources, including the federal government, states, and private grants), 30% came from loans, 8% came from education tax benefits, and less than 1% came from work-study.[1] Grants are desirable because they are free and don't have to be repaid.

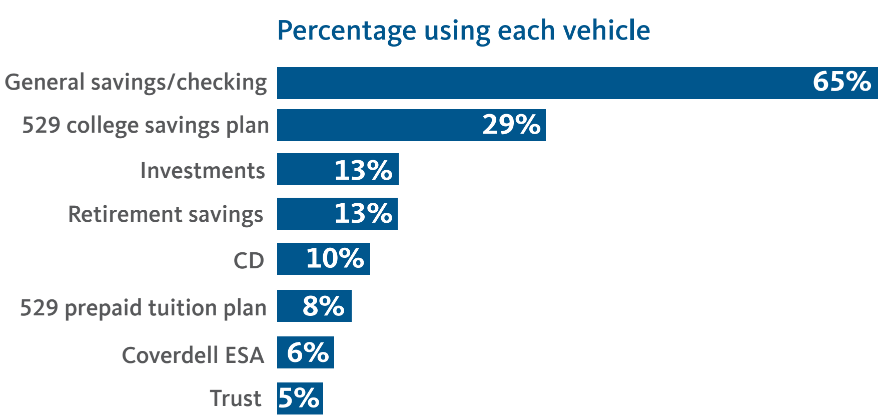
By far the largest provider of grants is the federal government, but grants are also available from states, colleges and universities, and the private sector.[2] The term "scholarship" is often used for funds given to a student for special accomplishments such as high academic achievement, athletic skills, and other special talents.

Most financial aid — grants, low-interest or subsidized loans, and work-study — is based on financial need. Families in higher income tax brackets may be ineligible for need-based aid. Because you probably don't know now whether your child will receive financial aid, it may be wise to focus on developing a consistent college savings program.

Source: 1–2) College Board, 2018

How Will You Save?

The chart below shows the many ways in which families save for college. As you can see, it typically requires a combination of savings vehicles to accumulate sufficient funds to pay college costs. Considering the lifetime benefits of a college education, it may be worth making a commitment.



Source: Sallie Mae, 2018

Now Is the Time to Begin

College can be an important investment in the future of your loved ones.

The earlier you begin saving for college, the more time you typically have to pursue potential investment returns. Regardless of when you start, there are a variety of college funding vehicles that may be appropriate for your specific time frame and situation.

Your financial professional can help you estimate the savings you may need and work with you to develop a college funding strategy that is appropriate for your goals, time frame, and financial situation.

Preview

This material was written and prepared by Broadridge Advisor Solutions.