Tips

For Considering a

Prepaid College Plan

Your children (or grandchildren) may be small, but your dreams for them are big. You'd like to give them the opportunity to attend college, but the rising cost of higher education appears to be putting those aspirations further out of reach.

Costs to attend public or private colleges rose nearly 3.6% this year, according to The College Board's annual report, while inflation ticks up only at a rate of about 2% per year. Add to the bad news the fact that the average annual cost at public 4-year colleges increased by $300 for in-state students and by $800 at private colleges. Trends indicate those numbers will only continue to increase.

According to a recent survey of college costs, the average bill to attend an in-state public college for the 2017-2018 academic year was $25,290. At a private college, the cost was $50,900. Multiply those numbers by 4 (for a 4-year degree) and we easily move into the 6-digit range. Mix into all this financial confusion the rapidly rising levels of graduates' college debt. Nearly three-quarters of graduating students have student debt. Nearly 90% of graduates from for-profit colleges have student loans.

America holds more than $1.48 trillion in student loan debt among about 44 million borrowers. The total U.S. credit card debt is $620 billion by comparison. What can you do to help pave the way for your children or grandchildren for a smooth and cost-effective transition to the college years—without the huge debt burden? Many parents are looking at prepaid college plans to prepare for their children's future.

Here are what prepaid college plans look like from both sides:

Why They're Good:
Prepaid plans put rising college costs within reach of those footing the bills. Ongoing increases in costs may hit 8% in some states, which means children born today may face annual bills of nearly $80,000 by the time they're ready for college. For private colleges, the bill may exceed $150,000 per year.

The 529 college savings plan exempts holders from federal taxes if the money is used specifically for qualified college expenses. Holders may also qualify for state tax exemptions. Prepaid plans are guaranteed to keep pace with inflation rates. Some states guarantee against default of plans; some even assume the financial risk in state-run plans.

In short, college prepaid plans are generally safe from wild market fluctuations, skyrocketing tuition and college costs, and hyperinflation. And if your children or grandchildren pursue other plans, earnings on your investment still beat Treasury bills or CDs, although they don't match responsible stock market investments.

Why They're Bad:
Money in state-run prepaid tuition plans can only be used for tuition and fees at in-state public colleges. Prepaid tuition plans don't cover room and board. Separate prepaid savings plans cover books, room, and board. Prepaid and saving plans may keep pace with rising tuition rates and inflation and, between the two, cover all of college costs. But money invested in the stock market generally performs better.

Access is limited, and availability and requirements can get confusing. All 50 states offer some form of college saving plan; 16 provide both the prepaid tuition plan and the college savings plan; Washington offers only the prepaid tuition plan. Thirty-three states have only the college savings plan; 12 states incorporate aspects of prepaid tuition plans in their college savings plans. (529 plans include both prepaid tuition plans and college savings plans.)

Parents or grandparents have limited control over contributions. Many plans only return original investments with low rates of interest if the student decides not to go to college or goes to college out of state. Massachusetts's return rate is at or below 3%.

What Do You Do?

Do the detective work. College savings plans do not exist in an equal opportunity investment world. Get out there and do the legwork. Working with a financial professional is an excellent first step in making your decision.

Here are some tips to help you decide:

Is the plan safe? The theory goes that plans keep pace with tuition increases. The reality, however, is sometimes different. Get assurances before you commit by examining the plan's annual financial audits.

Take a hard look in your own financial backyard first. If you still have debt or haven't saved for retirement, you may want to think twice before committing to a prepaid plan. While the idea of helping your children or grandchildren with college is noble, you ought to consider the financial burden you may place on them in the future for your own lack of preparation.

Take a very close look at the plan. Find out exactly what it covers. Many plans don't cover room, board, and other expenses. If you go with a tuition plan, you may have to find ways to cover the other expenses.

How about those taxes? You may be able deduct contributions to prepaid plans in some states by taking advantage of credits and other provisions.

Contribute early and often. Prepaid plans caught the interest of those interested in investing in their children's or grandchildren's higher education as an affordable way to cover rising college costs. By contributing early and making installment payments, investors are able to lessen the financial impact and lock in tuition costs at present-day rates.

Don't cancel early. If your child gets a full scholarship or decides against going to college, the worst that can happen is you lose interest earned; you don't lose the principal. However, if your child decides later to go to college or loses the scholarship, you're prepared to help.

Consider switching plans. Your child may decide to go to a 2-year community college, which are usually less expensive. See if you can downgrade the plan to cover community college expenses or retain the plan until the student transfers to a 4-year institution.

If you have any questions about prepaid college plans, we are always here to talk. Contact us today!

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