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The 3 Phases of Strategic College Planning

"If you fail to plan, you are planning to fail." While its author, Benjamin Franklin, most likely was not thinking about how to pay for college, its message can be applied to the way many of today's families handle this task.

For most families, the words "planning" and "retirement" go hand in hand, and for good reason. The amount of money you need to provide enough income throughout your retirement years can be enormous. But so can the cost of putting your children through college. However, many parents simply aren't planning for it.

According a recent study from the College Board, the average cost of a year of private school in the U.S. is now $43,921, including tuition, fees, and room and board. Not all families will need to save as much because not every student will go to a private college. However, no matter which type of school your child chooses, it's important to plan and as early as possible.

Developing a strategy to address future education expenses should be a priority, and it should coincide with your retirement planning. And, the earlier you start, the better. Parents can prepare in different ways at every stage of their child's life.

Phase 1: Birth through Elementary School

Save, save and save more. As soon as your child is born (or even before!), you can begin using one of many tax-favored education savings accounts. Two popular options are the 529 College Savings Plan and the Private College 529 Plan.

The 529 College Savings Plan is similar to a Roth IRA in terms of the tax advantages. You contribute after-tax dollars but don't pay taxes on the funds' earnings when you use the distributions for qualified education expenses. Some states will even offer a tax deduction on contributions.

The plans are flexible, allowing you to change beneficiaries if the stated beneficiary doesn't use the money. Also, schools treat the balances favorably when calculating financial aid. On the Free

Application for Federal Student Aid (FAFSA), money in a 529 plan is reported as parental assets rather than as the student's assets. That means the parental rate of 5.64% of the money, instead of a child's rate of 20%, would be included in your student's expected family contribution (EFC).

The Private 529 Plan has similar tax benefits to the standard 529 savings plan, but there are a few important differences. The private plan allows you to prepay for tuition, essentially locking in at today's rates. Your child can use the money at any of the more than 270 private schools in the program. All schools in the program guarantee tuition rates and pay all program fees. This means 100% of your contributions go toward the purchase of tuition certificates because the plan does not charge enrollment or annual fees to plan owners.

If your student chooses to go to a school outside of the program, you may be able to change the beneficiary to another qualified family member, roll the account into a state-sponsored 529 plan or request a refund (subject to limitations), provided certain requirements are met.

Families considering private school may benefit by having both a private college 529 account and a standard 529 plan. Proceeds from the private plan could be used to cover tuition, since it's prepaid, while the standard plan could hold money to pay for room and board, books and other college expenses.

Phase 2: Middle School

Remember it's never too late to begin saving. So even when your child reaches middle school, it isn't too late to save in a 529 account. This is especially true for the private plan, where you get protection from increases in tuition and, in a sense, guaranteed returns. If tuition increases at 6% a year, you are essentially making 6% a year on your investment.

However, another option at this Middle School stage would be to employ your child in a family-owned business, if you have one. Your child's income could be used to fund a Roth IRA in which the money would grow tax-free. This is a smart college-saving strategy, because your child's contributions can be withdrawn tax-free for college or other expenses. But note that this applies only to the contributions; any withdrawal of gains before age 59½ could incur taxes and a penalty. Of course, the job must be legitimate and the pay reasonable to satisfy IRS rules.

Here are some additional benefits of this strategy:

- Until age 19, your dependent child can earn up to $6,300 a year without having to file a tax return.
- As the business owner, you can deduct your child's salary.
- Since the income is earned, the "kiddie tax" on a child's unearned income of more than $2,100 does not apply.
- Your child gains valuable real-world experience.

Because the income up to a certain point isn't taxed, your child could essentially fund a Roth IRA with pretax dollars. If done over a number of years, this strategy alone could fund the majority of your child's education, and you can save on taxes, too.

Phase 3: High School

Once your child starts high school, you can begin to think about your financial aid options. You should calculate what you will be expected to contribute to your child's education expenses (your EFC) for financial aid. This will help you determine where your child will qualify for need-based aid and how much you will likely need to pay toward his or her education.

You can also begin researching schools to determine how your child's academic profile compares with those of current students. The more desirable your child is to the school, the more likely it is that he or she will be accepted and receive financial aid in the form of grants and scholarships.

Consider broadening your search to include higher-priced private schools as well. Many provide substantial amounts of need-based aid through grants. For example, the school that Benjamin Franklin helped start, the University of Pennsylvania, has a "no-loan" financial aid policy in which it meets 100% of a student's financial need with grants and work-study jobs. So even though the sticker price is well over $60,000 a year for tuition, fees, and room and board, the price you would end up paying could be extremely competitive with those of lower-priced public schools.

If your child does not qualify for need-based aid, you may want to shift your focus to merit-based aid like academic scholarships. This type of aid is based on your child's academic abilities, talents and other skills, rather than on your family's income or assets.

Start now

Sometimes the best plan is simply to talk with your children to see what inspires them. The perfect fit could be the local vocational school or community college, where they can obtain a good education at a fraction of the cost of a four-year school.

But for many families, the cost of their children's college education could be quite high. Regardless of how young your children are, you can begin building your college planning strategy today. Remember, every dollar you save can be one dollar less that your children have to take a student loan out for, and by planning ahead you can ensure that your college funding and retirement savings goals are met.

There are many strategies and options available when it comes to college planning for your children or grandchildren. We can help you determine which course of action would be most beneficial to your situation. Contact one of our financial advisors at (703) 669-3660 and start planning today.

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