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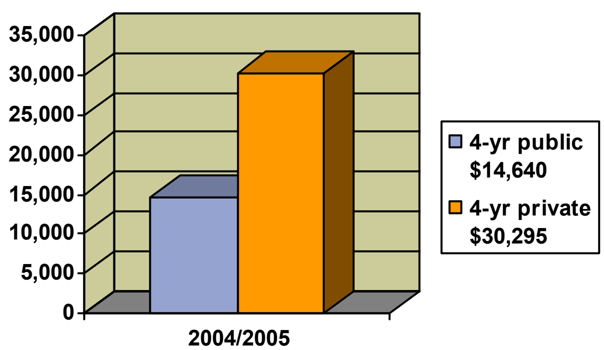
Saving for College

There's no denying the benefits of a college education: the ability to compete in today's competitive job market, increased earning power, and expanded horizons. But these advantages come at a price--college is expensive. And yet, year after year, thousands of students graduate from college. So, how do they do it?

Many families finance a college education with help from student loans and other types of financial aid, private loans, current income, gifts from grandparents, and other creative cost-cutting measures. But savings are the cornerstone of any successful college financing plan.

College costs keep climbing

It's important to start a college fund as soon as possible, because next to buying a home, a college education might be the biggest purchase you ever make. According to the College Board, for the 2004/2005 school year, the average cost of one year at a four-year public college is $14,640, while the average cost for one year at a four-year private college is $30,295.



Though no one can predict exactly what college might cost in 5, 10, or 15 years, annual price increases in the range of 5 to 8% would certainly be in keeping with historical trends. The following chart can give you an idea of what future costs might be, based on 2004/2005 cost data (the most recent cost figures available) and an assumed annual college inflation rate of 5%.

Year	4-yr public	4-yr private
2004/2005	$14,640	$30,295
2005/2006	$15,372	$31,810
2006/2007	$16,141	$33,400
2007/2008	$16,948	$35,070
2008/2009	$17,795	$36,824
2009/2010	$18,685	$38,665
2010/2011	$19,619	$40,598
2011/2012	$20,600	$42,628
2012/2013	$21,630	$44,760
2013/2014	$22,711	$46,997
2014/2015	$23,847	$49,347

Tip: *Even though college costs are high, don't worry about saving 100% of the total costs. Many families save only a portion of the projected costs--a good rule of thumb is 50%--and then use this as a "down payment" on the college tab, similar to the down payment on a home.*

Focus on your savings

The more you save now, the better off you'll likely be later. A good plan is to start with whatever amount you can afford, and add to it over the years with raises, bonuses, tax refunds, unexpected windfalls, and the like. If you invest regularly over time, you may be surprised at how much you can accumulate in your child's college fund.

Monthly Investment	5 years	10 years	15 years
$100	$6,977	$16,388	$29,082
$300	$20,931	$49,164	$87,246
$500	$34,885	$81,940	$145,409

Table assumes an average after-tax return of 6%. This is a hypothetical example and is not intended to reflect the actual performance of any investment.

College savings options--look for tax advantages

You're ready to start saving, but where should you put your money? There are several college savings options, but to come out ahead in the college savings game, you should opt for tax-advantaged strategies whenever possible.

529 plans

529 plans are one of the most popular tax-advantaged college savings options. They include both college savings plans and prepaid tuition plans. With either type of plan, your contributions grow tax deferred and earnings are tax free at the federal level if the money is used for qualified college expenses (note, though, that tax-free earnings are scheduled to expire at the end of 2010 unless Congress changes the law). States may also offer their own tax advantages.

With a college savings plan, you open an individual investment account and select one or more of the plan's mutual fund portfolios for your contributions. With a prepaid tuition plan, you purchase tuition credits at today's prices for use at specific colleges in the future--there's no individual investment component. With either type of plan, participation isn't restricted by income, and the lifetime contribution limits are high, especially for college savings plans.

Coverdell education savings accounts

A Coverdell account is a tax-advantaged education savings vehicle that lets you contribute up to $2,000 per year. Your contributions grow tax deferred and earnings are tax free at the federal level (and most states follow the federal tax treatment) if the money is used for the beneficiary's qualified elementary, secondary, or college expenses. You have complete control over the investments you hold in the account, but there are income restrictions on who can participate.

U.S. savings bonds

The interest earned on Series EE and Series I saving bonds is exempt from federal income tax if the bond proceeds are used for qualified college expenses. These bonds earn a guaranteed, modest rate of return, and they are easily purchased at most financial institutions or online at www.treasurydirect.gov. However, to qualify for tax-free interest, you must meet income limits and other criteria.

UGMA/UTMA custodial accounts

An UGMA/UTMA custodial account is a way for your child to hold assets in his or her own name with you (or another individual) acting as custodian. Assets in the account can then be used to pay for college. Because the assets are taxed at your child's rate, you may reap some tax benefit. However, when your child is under age 14, the kiddie tax rules apply, which means that all investment income over a certain amount ($1,600 in 2005) will be taxed at your tax rate. Another drawback: all contributions to the account are irrevocable.

A last word on financial aid

Many families rely on some form of financial aid to pay for college. Loans and work-study jobs must be repaid (either through monetary or work obligations), while grants and scholarships do not.

Most financial aid is based on need, which the federal government and colleges determine primarily by your income, but also by your assets and personal information reported on your aid applications. In recent years, merit aid has been making a comeback, so this can be good news if your child has a special talent or skill.

The bottom line, though, is don't rely too heavily on financial aid. Although it can certainly help cover college costs, student loans make up the largest percentage of the typical aid package. Generally, plan on financial aid covering the following percentage of expenses: loans--up to 50%, grants and scholarships--up to 15%, work-study--varies. The lesson: if you focus on your savings now, the less you may need to worry about later.

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