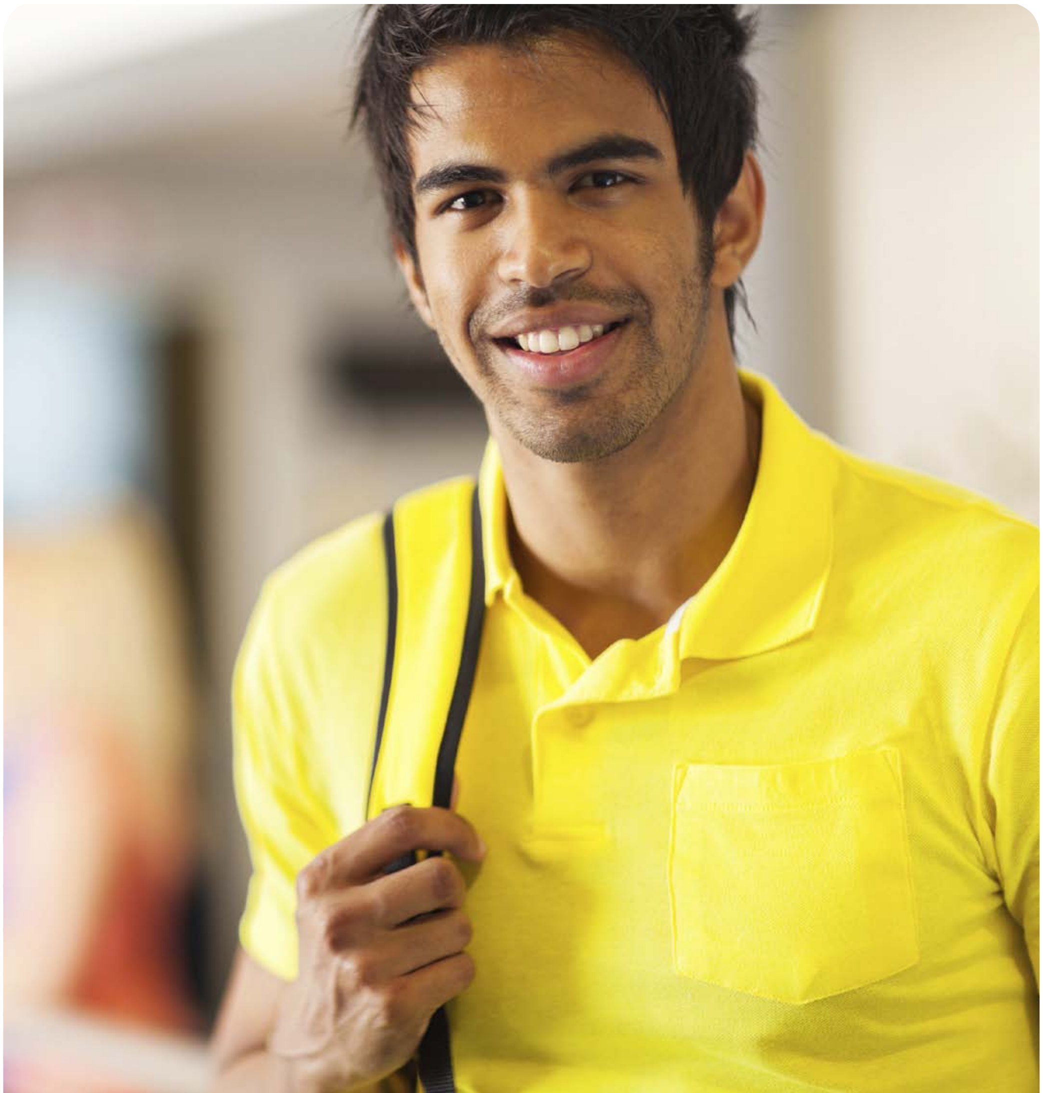


Paying for Your Child's Higher Education

Find the combination of savings, assets, and loans that fits your family

BY JUDY DAHL

As higher education costs soar, it becomes more important to plan ahead and determine how your child will afford to attend college. "College is becoming one of families' largest expenses, next to their homes," confirms Vince Passione, CEO and founder of LendKey, New York.

Indeed, public college costs increased 3.2% in 2013 and private college costs increased 3.7%. "Colleges have been doing a little better holding down the increases the past few years but tuition is still increasing faster than inflation," says Joseph Orsolini, president of College Aid Planners Inc., Glen Ellyn, Ill. "Since 1982, college costs have gone up nearly 500%, while incomes are up only 150%."

Paying for higher education is clearly a challenge for most families, and this Q & A aims to help you prepare.

- When should a family start saving for children's education?
- What if your income is limited?
- What other family needs should you take care of before saving for higher education?
- What's the best way to save?
- How much do you need to save?
- What if you haven't saved and your child is nearing college age?
- What steps should you take to secure financial aid?
- What if the financial aid you're offered isn't enough?
- What combination of savings, assets, and loans makes sense for your family?

When should a family start saving for children's education?

Ideally, you should start as soon as a child is born. "You'll write the checks ultimately," Orsolini says. "Do you want to write a bunch of small ones or one big one?"

What if your income is limited?

Start saving small amounts each month. "Even if it's $25 or $50, it's the act of saving consistently that counts," says Orsolini. "You'll be surprised how it builds over time."

No matter what your income, save before you spend, advises Jean Chatzky, author of "Money Rules." "I have automatic deductions from my paycheck to savings plans. The money comes out before you ever see or touch it, so you don't miss it. And if you get a raise, you can increase your savings before you get used to having the money."

She also recommends thinking of strategies to get every bit of fat out of your spending so you can save more. "It's a tedious process, but not complicated," she says. "Figure out where your money is going month to month. List all your expenditures, and figure out if there are ways to cut."

For example, if you carpool and arrange to drive only every other week, you save about $40 a month. "It's the same with every line item," Chatzky says.

What other family needs should you take care of before saving for higher education?

There's a hierarchy when it comes to savings needs, clarifies Chatzky. "You need emergency savings and to sock away money for retirement—there's no financial aid for that, but there is for college," she says. "Once those are out of the way, save for college in the tax-advantaged way that makes sense for you."

What's the best way to save?

Chatzky recommends 529 plans. Every state offers these tax-advantaged plans families can use to save for future higher-education costs. Plan managers invest the funds you contribute, and when you withdraw the money to pay for educational expenses, the earnings aren't subject to federal taxes. Many states exempt the funds from state taxes, too, and many have minimum monthly contributions as low as $15.

"Contributing to a 529 plan, often through automated transfers, is great," says Passione. "It makes you very disciplined."

Some states also offer [529 tuition prepayment plans] for state colleges, and a group of several hundred private schools offers a plan for [private colleges]. The plans let you lock in current tuition rates. "They have the benefit of holding and investing your money, and you get the benefit of the discounts," says Passione.

"Your own savings are good, but 529 plans are better," he adds. You can [compare different plans online].

Chatzky has 529 accounts for her children, but also cites [Roth IRAs] (individual retirement accounts) as a good option. You contribute after-tax dollars to these accounts, and then withdrawals for qualified expenses aren't taxed.

"I like these in particular for parents concerned that they're not saving enough for retirement, but who also want to help with their kids' education," Chatzky says. "If you put money in a Roth IRA, when your kids reach college age you can decide if you'll use it for college or retirement. If you're in that mindset, a Roth makes sense."

Another option is to contribute to a Coverdell Education Savings Account (ESA). Many financial institutions, such as credit unions, offer these accounts. In addition to tuition, Coverdell ESAs can be used for other education expenses as well.

Contributions to an ESA are not deductible, but amounts deposited in the account grow tax-free until distributed.

For more information about ESAs, use the [Internal Revenue Service website].

How much do you need to save?

In part, it depends on what you can afford. "Look at your fixed-cost obligations and see what's left over," Chatzky suggests.

"Then if you save at least 10% of your income for your emergency fund, retirement, and college, you're doing a good job," she continues. "If it's 15%, you're doing a great job.

And she points out, "If you have a windfall, it puts some wind in your sails and inspires you to save—the average tax refund last year was more than $3,000."

It also depends what colleges you pick. "The amounts of financial aid they offer can differ by as much as $15,000," Orsolini says.

For instance:

- A public university in your state generally has lower in-state tuition and offers financial aid plans.
- Out-of-state public schools usually charge the full sticker price.
- Private colleges have higher sticker prices, but typically offer more financial aid.

"There are 66 elite, Ivy League schools claiming to match 100% of a student's need, so if you're on the lower end of the income scale you'll get a lot of financial aid," says Orsolini. "If your family's income is higher, a state school will likely be a better deal."

Everyone's financial situation is different. He recommends using online calculators to predict costs.

What if you haven't saved and your child is nearing college age?

The best way to manage the financial impact is through school selection, Passione indicates. Some private universities cost more than $50,000 a year.

"Your children may already have picked schools and you don't want to skimp on their educations," says Passione. "But about half of kids don't know what they want to study and may not make good use of college at first."

Your child could start at a lower-cost community college and transfer after deciding on a major. "Or if they decide on a major up front they're more likely to graduate in four years and you'll save money," Passione notes.

And, although he says it's frowned upon in the educational field, the harsh reality is that students need to think about what they're spending on education compared with future earnings. "If a student studies art history and racks up $100,000 in student loans, it will be tough to pay off," says Passione.

What steps should you take to secure financial aid?

Start by completing the Free Application for Federal Student Aid (FAFSA) at the beginning of your child's senior year of high school. You can [apply online].

"It triggers the entire financial aid process," Orsolini says. "The government specifies your [expected family contribution] (EFC), which is used as a benchmark determining eligibility for many state and federal aid programs."

Your EFC gives you an idea up front of how much you'll spend out of pocket. And high-school guidance counselors should be able to advise your children about school costs.

Colleges you apply to will put together financial aid packages and send you award letters. They may include federal need-based grants, called Pell grants, or low-cost, need-based federal Perkins loans. They also may include federal Stafford loans, which have slightly higher interest rates. Schools also may offer need- or merit-based grants. Be aware, too, that you don't have to accept all the elements of an aid package; you can pick and choose to help manage your debt.

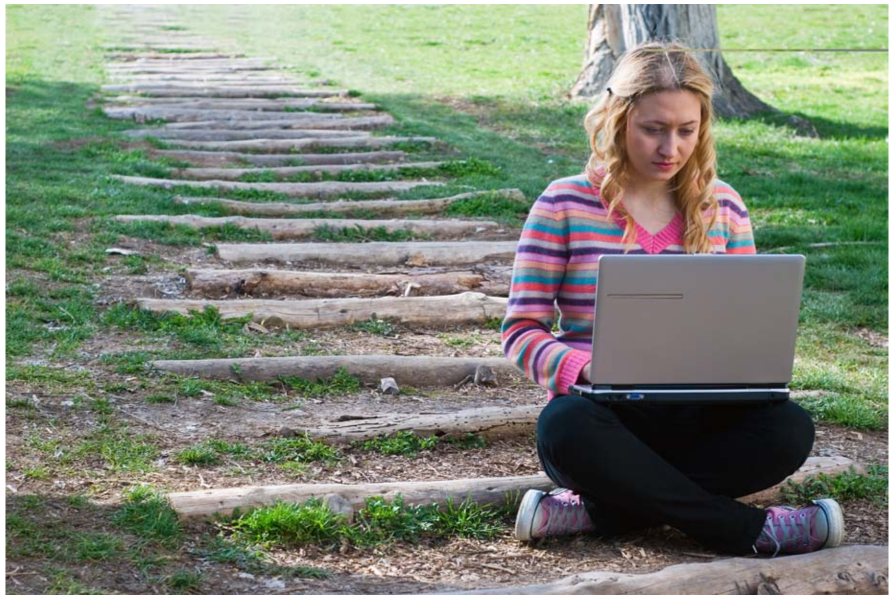
"You won't know what a college will offer until you see how much they want your child," says Chatzky. "If they want a student, they're more likely to offer merit aid in addition to need-based aid."

The amounts colleges offer individual students can vary widely. "That's why you should apply to at least three schools," Orsolini says.

What if the financial aid you're offered isn't enough?

In addition to your savings, you should take advantage of all "free money" you're offered—scholarships and grants.

If that's not enough, use federal Perkins or Stafford loans. Then parents can apply for federal PLUS loans. Parents don't need to repay federal loans until after the student has graduated.



Only after exhausting these sources, you can seek private loans from financial institutions. Each lender sets its own interest rates, fees, and terms, which can differ significantly, so compare several. Start with your credit union—chances are, it offers the best deal.

What combination of savings, assets, and loans makes sense for your family?

There's no one-size-fits-all solution; it depends on your family's circumstances and your children's educational goals. "Don't put pressure on yourself to pay for 100% of their educations unless you're truly able to save," says Chatzky.

"If you can save a third of the expected costs, you're doing well. You may be able to pay another third from current cash flow while they're in college—you'll probably be at the height of your earning power—and you can make your child responsible for a third from financial aid," she continues.

"Then it's a family decision," Chatzky says. "How important is a certain college? It's OK to say, 'If financial aid doesn't cover your No. 1 school, we'll look at state schools, or you can go to a community college for two years and then transfer.'

"Or sit down with your child and look at a financial aid package," she advises. "Say, 'This is how much you'll owe each month after you graduate and this is what you'll have to earn to afford it.' Your child may decide to attend the state school with the best financial aid."

To get information about paying for college, start with your child's high-school guidance counselor. Also see the online resources listed at the end of this Turning Point.

SKIP SCHOLARSHIP SCAMS

Be careful finding information about scholarships. If you have to pay money to get money, it's probably a scam.

Every year, several hundred thousand students and parents are defrauded by scholarship scams.

Useful resources

SavingForCollege.com

College Board

College Savings Plans Network

Financial Aid information

Information about federal educational tax credits

An introduction to 529 plans

National Application Center

Free Application for Federal Student Aid, FAFSA4caster

American Association of Community Colleges