SAGE Scholars

Ten Minute Professor

College Funding: 5 Ways to Save For College

Your decisions now will impact your future finances.

By SAGE Scholars

1. Specific college-savings vehicles

Sponsored by states, 529 plans are the most popular method of college savings. More than 12 million 529 accounts have been opened. Any investment growth is tax-free if the money is used for qualified higher-education expenses. Your investment contribution may also be deductible from income on your state tax return. There are 2 types of 529 investments:

- Prepaid 529s

These simply guarantee you future tuition at today's price. For example, if you're a resident of Pennsylvania, you can purchase 1 year's undergraduate tuition at Penn State. Even if your student is 14 years away from college, you will own the equivalent of 1 year of tuition at Penn State 14 years from now. The funds can be applied to any college's tuition bill. The risk of investing your money well enough to cover future tuition increases is assumed by the sponsoring state. Prepaid plans are a safe, conservative way to save for college. 19 states offer prepaid plans but only 11 of those are open to new investors, where investments are generally limited to residents of that state. In the long run, stock market investments have historically increased at a greater rate of return than the inflation rate of college tuition. However, in the period from 2000 to 2010, prepaid 529 returns significantly exceeded than the return on the benchmark S&P 500.

- Mutual fund 529s

Nearly every state offers a mutual fund-type 529 investment. These plans do not guarantee future tuition and are subject to market risk. Families may be able to invest:

1) Directly in investments managed by a company selected by the state

2) Through a financial advisor affiliated with a state-selected fund manager

3) Both

Many investment options exist. Some states offer age-based portfolios and other variations designed to allow you to invest according to your risk tolerance.

- Coverdell Education Savings Accounts

  If you have an annual income below $110,000 (single) or $220,000 (married couple), you are eligible to contribute, tax free, up to $2,000 per beneficiary per year in almost any investment (except life insurance). As with 529s, Coverdell account withdrawals are tax-free if used for qualified education expenses at any eligible institutions, kindergarten through graduate school.

2. Other investments

Many people don't want to tie up their assets in college-specific investments. These folks may prefer to fund college costs by selling a losing mutual fund or by refinancing their home with the deductible interest.

3. Don't

Strangely, this is a form of savings. Here's why: if you don't save, you'll probably have to borrow, and borrowing is nothing more than deferred saving.

4. Cash-value life insurance

Most financial advisors recommend a variety of cash-value life insurance investments (whole life, indexed universal life, etc.) for 2 reasons:

a) Certain types have guaranteed returns, so the cash value grows and isn't wholly dependent on the fluctuations of the stock market

b) Borrowing from the cash value to fund college costs can done at very favorable interest rates as a tax-free event

Unlike other investments, the cash value of the policy is not included in financial aid calculations derived from the FAFSA. Plus, there's a death benefit—which every parent should have as part of a college savings plan. The use of cash-value life insurance as

a college funding vehicle is often recommended for grandparents as an intergenerational funding method.

5. Tuition Rewards®

Earn scholarships, in the form of guaranteed discounts, provided by participating colleges. Almost 400 private colleges across the country have joined with SAGE Scholars to offer Tuition Rewards points. Tuition Rewards points are accumulated like frequent-flyer miles and can result in a discount of up to 1 full year's tuition over 4 years of college. Families must:

a) Invest in any of a variety of qualifying financial vehicles

b) Identify children, grandchildren or other loved ones as potential beneficiaries

Which Ways are Best for You?

Each family has unique circumstances—different finances, sources of income, academic aspirations, career goals, and so on. It makes sense to seek college preparation, selection, and funding advice from specialists. Be cautious—many purported experts aren't. Seek referrals. Be particularly skeptical of any college funding specialist who seems only to offer a single type of investment as a catch-all solution.