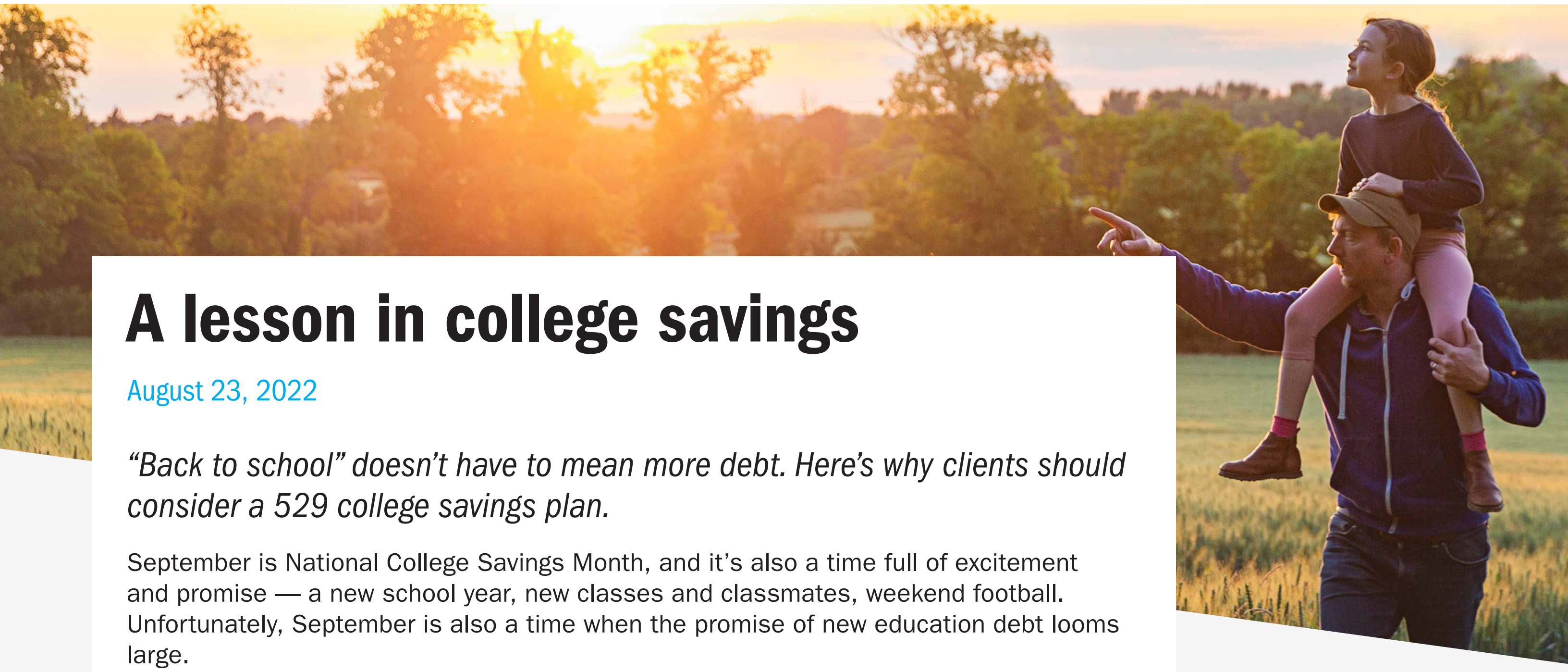


A lesson in college savings

August 23, 2022

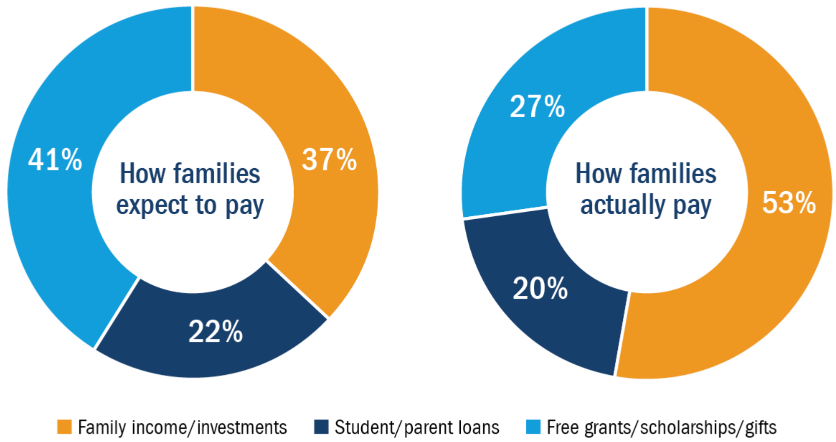
"Back to school" doesn't have to mean more debt. Here's why clients should consider a 529 college savings plan.

September is National College Savings Month, and it's also a time full of excitement and promise — a new school year, new classes and classmates, weekend football. Unfortunately, September is also a time when the promise of new education debt looms large.

A college graduate with a bachelor's degree will earn nearly twice as much on average as someone with a high school diploma. Those with a professional degree will earn nearly three times as much.[1] This promise of a brighter future is likely why 63% of the students who graduate from high school each May are enrolled in higher education for the following fall semester.[2] It's also why, according to Sallie Mae, 94% of high school graduates at least *plan* to continue their education.[3]

Paying for college is probably one of the largest expenses a family will incur over the course of their student's life. According to the College Board, the average four-year, in-state, public institution costs more than $27,000 per year — an increase of over 25% from just a decade ago.[4] Most families plan to use a combination of funding methods to pay for college, but their expectations and reality don't seem to align. The charts below show the difference between funding expectations and funding realities:

College funding: expectation vs. reality



Source: Sallie Mae, *Higher Ambitions: How America Plans for Post-Secondary Education 2020*

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According to studies, families expect to pay for over 40% percent of college costs using scholarships, grants and other "free money" sources. However, data shows that only about 27% of college funding is actually coming from those sources — a difference of 14%. Given all the headlines and attention focused on snowballing student debt, it would be logical to conclude that people would be borrowing to cover college expenses. However, the data suggests that our 14% gap is actually being filled by family income and savings, not borrowing. In fact, on average, the percentage of funding that comes from family income and savings is nearly 16% more than expected. Moreover, families are paying nearly 19% more from income and investments than they were just a half-decade ago.[5]

Understanding this difference between perception and reality is valuable in developing a plan to pay for education. According to Sallie Mae, the use of education savings accounts like 529 plans is on the rise — increasing from 21% in 2018, to 37% in 2020.[6] However, those percentages also mean that most people are still paying for college using other, perhaps less advantageous, means.

Aside from being the only vehicle designed specifically for covering higher education expenses, a 529 plan offers many benefits, including the opportunity for tax-deferred investment returns, which allow for greater compounding. 529 funds can then be used tax-free to pay for qualified higher education expenses, both in-state and out-of-state, at public or private institutions. And expenses can include items like tuition, fees, room and board, as well as required equipment. Furthermore, recent changes have also allowed for qualified expenses related to apprenticeship programs,[7] and even the repayment of student loan balances.[8]

To aid in planning, families may want to explore using 529 calculators, including an expected family contribution (EFC) calculator, to develop a personalized estimate of the amount they may have to pay for higher education. The EFC is the result of the Free Application for Federal Student Aid (FAFSA) process that is used to determine federal financial aid eligibility. The FAFSA gathers information about a family's income and assets and calculates the EFC, which is then subtracted from the cost of the institution — and that determines the student's financial need. A family that isn't prepared to pay their EFC is likely to dip into other investments, use an increased portion of current income or increase borrowing to cover the shortfall. This can cause the family to delay or even forego other financial goals. Understanding the EFC — and saving enough to cover at least that amount — may go a long way toward providing greater peace of mind when planning for education costs.

[1]U.S. Bureau of Labor Statistics, Current Population Survey: Earnings and Unemployment Rates by Educational Attainment 2020

[2]National Center for Education Statistics, Immediate College Enrollment Rate 2020

[3]Sallie Mae, *Higher Ambitions: How America Plans for Post-Secondary Education 2020*

[4]College Board, *Trends in College Pricing 2021: Average tuition, fees, room & board and other expenses for the 2021/2022 academic year for an in-state, public institution*

[5]Sallie Mae, *How America Pays for College,* 2017 and 2021.

[6]Sallie Mae, *How America Pays for College,* 2017 and 2021.

[7]Apprenticeship program must be registered and certified with the Department of Labor.

[8]Subject to a lifetime limit of $10,000 per beneficiary

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