Investing for College

How to Increase Your Child's or Grandchild's Lifetime Income by $1 Million - Or More

An Investment U White Paper Report
From the Investment U Research Team, originally published in 2004

In this special “White Paper” report, you’ll discover one of the most powerful tools at your disposal in your investing for college strategy, including the steps to help you finance your child’s or grandchild’s future education.

Of course, every family’s plan for funding a college education is different, and you’ll likely resort to a number of investing and expense-cutting methods that can help cover tuition and living costs for your child.

But the college-savings plan we’ll outline here is not only powerful—and overlooked by most American parents and grandparents preparing to put their offspring through college—it can be used by practically anyone.

And that’s important, because it means that YOU can use this plan to ensure that your child increases his or her lifetime income by $1 MILLION or more. How? Please read on . . .

Investing for College? Imagine Your Child...Ready for Dorm Life

Like almost every parent, you want your child to be among those who attend college after graduating high school. You’ve always considered it a done deal. A given. Investing in your child's future.

But it might not be if you don’t make a college investing plan now—and follow it religiously—for financing your child’s higher education.

By the time you finish reading this report, you’ll know all about the most effective tool for making sure the bills get covered, including not just tuition, but room, board and books, too. And this could mean the difference between seeing a dream realized or a dream deferred . . . or worse, a dream crushed altogether by rising tuition costs.

Why Working Your Way Through College Won’t Work In the Future

If you’ve ever figured that you’d leave your child’s college financing up to the child himself—or that you’d just rely on Uncle Sam to pick up the tab via grants and loans—then you’re making a very serious mistake. But it’s understandable.

It used to be that working your way through college was a sign of individual drive and motivation...the ultimate pursuit of achievement. Being an attendant at the gas station, working the car wash or taking odd jobs—while studying to be a doctor or scientist—was par for the course. You'd take the dough you earned and pay your room, board and your tuition, knowing that it was just a temporary part of your progress toward something greater—a professional career.

Well, if you have a child who was born within the past few years and you're expecting him to work odd jobs to pay for his college living expenses and tuition, say, 16 or 17 years from now, then think again. Chances are he'll miss out on college altogether and continue working those odd jobs until he retires—or dies trying to retire.

Because we don't know of any odd job that pays $40,000 a year.

That's the alarming figure experts agree will be the sum required to cover the average college student's room, board and tuition in the year 2021. And that's just for one year.

The total amount required for the average student to complete a four-year course of study at an accredited college in 2021, factoring in inflation through the four years of study, will be $160,340.

How do we arrive at that figure? Well, start by taking $12,841 (the national average for college room, board and tuition in 2003) and add to that 6% a year in college tuition inflation (the running average). You arrive at first-year projected education costs of $36,652.

Again, that's just for freshman year. The same college costs projected over the next three years:

- Sophomore year you're talking $38,851.
- Junior year you're talking $41,182.
- And senior year the cost will be, on average, $43,653.80.

That's a lot of lawns getting mowed. Not much chance of your son or daughter squeezing in any homework between all that other work—maybe manual labor—which they'll be doing just to pay the rent. So, unless you have a financial windfall or some tricks up your sleeve, investing for college is a must for your children.

And that's not even the whole story. Because right now, if you're like most parents or grandparents, you want to give your child the best chances of success for his or her life. You understand just how hard it is to get ahead—find a well-paying job, deal with the incredible ballooning costs of buying a house, and especially starting a family. So you really have to consider . . .

Who Wants Just an “Average” Education for Their Child?

These numbers we just showed you look pretty high. But let’s face it. This is just a small part of the overall story. These “average” costs factor in the many low-priced colleges and state universities—those institutions with tens of thousands of students, overcrowded classrooms, crazy schedules and sometimes "average" instructors.

Many of the parents we talk to through The Oxford Club simply don’t want their children being taught by 20-year-old “teaching assistants,” in institutions that—good as they may be—simply don’t prize the traditions and values that you know are an essential part of a quality education. One that will ensure your child’s success in life.

Bottom line is this: The average cost today for a top-level private college or university is over $30,000 a year.

Now, apply the same inflationary principles to that figure, and you'll find that investing for college means easily looking at more than $220,000 needed to fund your child’s higher education.

Are You Ready to Gamble With $1 Million of Your Child’s Future Earnings?

But you might be wondering something else: Will my kid even need to go to college? A lot of really wealthy, successful people either didn’t go to college, or they dropped out without taking a degree. Bill Gates, for example, dropped out of Harvard...to become one of the most successful businessmen of all times, worth more than $30 billion today.

Yet a full 70% of high school students now go on to some form of higher education, whether at a traditional four-year institution or some other two-year vocational college. And members of that 70% chunk wind up out-earning their non-collegiate counterparts by a great margin.

According to the Census Bureau’s report, “The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings,” students who earn their college bachelor’s degree average about $45,678 in yearly income afterwards. While high school graduates average a comparatively pathetic $24,572.

Over the course of a lifetime, the difference between what these two are earning could amount to as much as $1 million—or more.

According to a recent study by the U.S. Department of Labor Statistics, the average weekly earnings of American workers are directly related to their education levels, as follows in the chart below:

Education Level	Size of Average Weekly Paycheck (2000)
College Graduate	$896
Community college graduate	$598
High school graduate	$506
No high school degree	$360

So, you could count on your child hitting the lottery—like Bill Gates did when he dropped out to found Microsoft—or you could hedge your bets, plan on investing for college, and make arrangements for funding your child's future education.

And that brings us back to the two most important questions . . .

How Much Will I Need To Start Investing for College? And When Should I Begin?

One rule of thumb commonly used in college-education investing and planning is called the "One-Third Rule." It suggests that parents plan on paying on the following basis:

- One-third of college expenses from savings and investing
- One-third from earnings concurrent to the child's enrollment
- One-third using a combination of student loans, grants and scholarships.

The idea is to spread the burden among past, present and future. While this has a nice symmetry to it in an abstract sense, it doesn't make much sense otherwise.

To begin with, taking on loan debt should always be questioned—particularly if that debt doesn't serve to finance tangible assets like real estate. And don't fall into the trap of thinking your family can just take out a stack of student loans because they'll be easy for your kid to pay off using his new "college education." It often doesn't work like that.

In fact, enormous student-loan debt is a common hindrance to young people's post-graduate financial progress, making it harder for them to use their credit for smart investments like their first home—because they're strapped with monthly student-loan payments from the get-go.

Here's what one report in the American Prospect had to say about financial-aid debt:

"While society urges the young to save and invest in the future, the new structural realities—rising tuition, declining federal aid, high college debt, overly easy credit-card access, low salaries and high housing costs—combine to make young people net debtors, not net savers."

The report continues..."Though seldom appreciated as such, debt is another of the many social and cultural factors that make young people today defer growing up. Nellie Mae reports that a substantial portion of college graduates say their debts have delayed purchasing a home—even with today's low interest rates—and a small percent have even put off having kids."

Imagine a student loan affecting when you're going to make such an important decision as having a child.

In fact, the debt-based financial culture we've all come to accept could lead your child into becoming just another "indentured servant" to the big student-loan houses like Fannie Mae and Nellie Mae—and woe be unto thee who is late with a payment. With penalties, a $25,000 loan debt can metastasize into a $75,000 loan debt with stunning quickness.

That's enough money to cover a modest first home. Or a decent amount to put into an investment portfolio.

Which is why our Investing for College white paper report focuses only on the single best college-funding strategy available today. Using student loans should be considered a last resort.

In terms of when to get started investing in your child's college education, the answer is: Right now. It doesn't matter if your kid (or kids) is 10 minutes old or 10 years old, it's never too early or too late to start investing for college. So where do you get started?

DO THE MATH: The Dollar-Value of Higher Education Pays Off Big

Ever wondered whether attending college is really worth the time and trouble? A recent survey by the U.S. College Board provides a startling answer.

According to the survey, students who attend college for a minimum of two years will, on average, earn $250,000 more (over a lifetime) than those who don't continue their education past high school.

A quarter of a million bucks, in return for only two years of study? You don't need a Ph.D. in Calculus to do the math on that one.

Navigating Through the Sea of College-Investing Options—
And Finding the Top Choice To Fund Your Child's Education

It's clear that funding your kid's college education isn't something you roll out of bed and just do. Investing to this end takes planning and it takes commitment.

But it also takes a discerning eye to keep from getting you or your child into trouble—for example, the taxman coming around to take his cut when your child tries to remove funds from an unwise trust that was set up for him years before.

These days, there's so much talk about 529 plans, Coverdell accounts, 2503(c) accounts, Series I and EE savings bonds, IRAs, UGMAs and UTMAs and 401(k)s that it's sometimes hard to know where to start.

While it's always best to consult with your tax advisor or financial planner, we're going to get you started in the right direction. Let's take a look at the best investing for college instrument available today.

The Beauty of 529 Plans

"An investment in knowledge always pays the best interest." ~ Benjamin Franklin

It's a documented fact: Today's Section 529 Plans are the safest, most reliable and cost-effective method for financing what will undoubtedly be the sky-high tuition and fees required for your child's future college education.

As you're about to discover, the 529s have some huge advantages going for them. They're safe, for one thing. And they're also very well managed, in most cases. In addition—and this is crucial—they offer some huge tax advantages that can put thousands of dollars in your pocket, 10 or 15 years down the road.

Another plus: As of 2004, the 529 Plans may be the best-kept secret in today's increasingly difficult college investing landscape. Although they were launched nearly a decade ago by the federal government as a way to support and encourage higher education—and although most of the funds have enjoyed an excellent track record—only a relatively small percentage of the U.S. public even knows about them.

Indeed, fewer than 10% of U.S. parents and grandparents now saving for college education for their offspring are currently enrolled in the plans.

The good news: These innovative, highly successful college investing programs are currently wide-open and ripe for the picking. But before taking advantage of them, we need to know a little more about how they actually work.

The Inside Scoop on "Qualified Tuition Programs"

Named for the section of the U.S. Tax Code that authorizes them, state-run 529 Plans (also known as "Qualified Tuition Programs") are simply investing funds that grow on their own until they're used to pay college or university expenses, 10 or 15 or even 20 years down the road.

Increasingly, they're an important weapon in the battle against runaway "tuition inflation"—because they offer their owners a slew of tax advantages and other powerful financial incentives.

All 50 states now operate 529s for their residents—and many also allow participation by non-residents. (Keep that very important fact in mind for later.)

So how do the plans work, exactly? Although the individual features of the 70 current U.S. state 529s (some states operate more than one—Nevada has six) vary greatly in terms of tax advantages, associated fees and eligibility rules, the basic design is simple.

Key point: There are two types of 529s—the "Prepaid Tuition" plans and the "College Savings" plans. Here are the important differences between them:

- Prepaid Tuition plans allow the contributor to pay college, university or vocational school tuition at current prices, by "locking in" the future charges that will apply to a specified number of academic periods of course units. Whether the beneficiary attends the institution of higher learning in five, 10 or even 18 years, this type of plan guarantees that the contributor won't pay a dollar more in tuition and related fees than he or she would pay if the student enrolled today.
- College Savings plans are simply college investing accounts that allow contributors to pay for higher ed expenses down the road—usually without any tax penalty on the earnings of the fund, and without any penalty-qualified "withdrawals," when it's time to begin paying college bills. Essentially, these plans are "educational IRAs," and operate in the same manner as retirement accounts.

Next question: What are the advantages to be gained by enrolling in a state-run 529 Plan, for both the contributor and the student? Here they are, one by one:

Tax-deferred earnings: The earnings on the investments you hold in a 529 Plan accrue without any taxes being taken out each year. That's a huge benefit, when you consider the power of "compounding" earnings, and the fact that it's possible to set up a 529 Plan a full 18 years before your student is graduating high school. (To understand the power of compounding profits, take one penny—say, one penny you save in capital gains taxes each year—and double it every day for a month. Within 30 days, you'll have about $10 million! Do the math yourself and see.)

529 Plans can be used at virtually any accredited college, university or vocational school in the U.S. It's true: Several recent surveys show that they're remarkably

flexible in this regard. With a bit of careful planning, you can easily gain the peace of mind that comes from knowing your student will be able to use your dollars at the school of his or her choice.

No low-family-income requirements. This is crucial for any college funding option you might pursue. Why? Because if you've got enough money for investing in a 529, it's unlikely that you're "poor enough" to qualify for most other college-funding alternatives (such as scholarships and work-study programs) geared toward lower-income beneficiaries.

Investment choices. With most 529 Plans, you'll enjoy a wide range of options in determining the specific investments held in your plan of choice—instead of being yoked to an index fund or a simple carbon copy of a larger mutual fund. This means that you can "play it safe" with a conservative fund, if you wish, or "get aggressive" by choosing a 529 that places more of its dollars in corporate securities, let's say, than in municipal bonds or conservatively hedged mutual funds.

High contribution limit and incredible tax advantages: Believe it or not, you can contribute to your student's 529 Plan up to $246,000—and still face no tax penalties on growth or withdrawals, whatsoever. Although it's true that your contributions must be in after-tax dollars, the savings to be had from tax-breaks on this scale aren't mere "window dressing"—they could actually put thousands of dollars in your pocket, over time.

Put another way, investing $100,000 into a college 529 plan for 10 years at a modest 5% growth-rate will yield earnings of $50,000. In a typical tax-bracket of 20%, you save a cool $10,000 via your 529 Plan—even as your kid enjoys an all-expenses-paid education.

Low start-up investment: Most plans require very modest contributions, especially in the early years—and some of them require no more than $50 a month from their members.

The ability to invest through payroll deductions: You can set up your payroll to automatically add to your 529 Account in painless increments. You're investing money in your student's future college education before you even get a chance to miss it.

Tax advantages at the state level: Many states allow contributors to deduct some or all of their 529 deposits from state taxes. In some states with high tax rates, the savings can be huge. Example: In New York, where tax laws allow parents to deduct up to $10,000 a year in 529 Plan contributions, a couple in the top tax bracket can save up to $1,000 a year in city and state taxes—in addition to all of the other financial breaks offered by their 529.

529s minimize the chances of jeopardizing other forms of college financial aid: The good news for parents who rely on a 529 Plan to finance a child's future college education is that in most cases, it won't prevent the student from seeking other forms of financial assistance, if necessary. That's because under current formulas for determining higher-ed financial aid, 529 savings are usually regarded as parental assets, rather than student assets. Typically, college-aid administrators weight parental assets less heavily than they do funds controlled by the applying student.

Okay, if you're sold by now on the value of using 529 Plans for your child's college investing strategy, what's the best way to proceed? How should you go about finding the plan that's perfect for you and your future college student?

According to the experts at FinAid!, one of the nation's premier higher-ed financing consulting firms, the key to success with a 529 is thinking your way through the many options, fees and eligibility wrinkles available at each of the plans. "The most important factors affecting return on investment," say the gurus at FinAid!, "are the amount of time invested, the family's tax bracket, the amount of any fees and sales charges, the amount invested, and the availability of state income tax deductions for contributions . . .

The Top Five 529 Plans in America Today

Although the approximately 70 plans now available in the 50 states (some operate more than one) offer a bewildering array of investing mechanisms, eligibility requirements and service fees, you can simplify the task of choosing one by examining their national ratings.

One of the nation's most highly regarded mutual fund-trackers is Morningstar—a blue chip financial fund analyst with impeccable credentials. Based on the latest data from their continuing surveys, here are four key recommendations that will help you sort out your 529 options.

1. Based on their low fees, flexible eligibility requirements and other key financial factors, the Top Five 529 Plans in America today are the state plans available in: (Remember: You don't have to be a resident of these five states in order to participate in their plans.)

- Utah
- Nevada
- Virginia
- Michigan
- Alaska

2. The best-managed state 529 Plans as of 2004 are those operated by:

- Vanguard
- American Funds
- TIAA-CREF
- T. Rowe Price

3. The least productive and flexible state plans in 2004 are the 529s in the following states, according to Morningstar:

- Wisconsin
- Arizona
- Wyoming
- Ohio

4. Be careful to check out the financial bona fides of the management firm that runs the state plan you're interested in. While the top-rated fund-managers on our list (see Recommendation Two) have not been tarnished in the recent U.S. mutual funds scandal, other state fundoperators—such as Strong and Putnam—are now facing federal scrutiny for alleged fiscal mismanagement.

Even a 0.5% Difference in Fees Can Have a Big Impact

Remember, also, that you should carefully analyze your own state's plan—along with the plans offered by several other states—before you get down to the business of finding the 529 Plan that's right for your student. In many cases, say the experts, it makes sense to go ahead and find an agent or consultant to help you wade through the complexities of the various plans.

Selecting a 529 for Your College Investing Plan:
The 12 Most Important Questions You Should Ask

Okay, now that we've seen just how valuable this little-used tool can be in managing the sky-high costs of a typical college education, it's time to address the $64,000 question:

What's the best way to identify the perfect 529 Plan for your future student's higher-education situation?

The answer can be found in that famous American supermarket phrase: Shop and compare!

Remember: All 50 of the state 529 Plans are required by law to publish and distribute free-of-charge brochures that outline plan features in exquisite detail.

Start by getting your hands on a copy of your own state's 529 Plan brochure—since many of the states offer significant financial breaks and tax advantages to their own residents. (To order your free copy of any state's 529 Plan brochure, simply call the National Association of State Treasurers, toll-free, at 1.877.277.6496.)

Next step: With state brochures at the ready, let's eyeball the answers to a dozen key questions (in order of importance), en route to...

12 Steps for Selecting The Perfect 529 To Meet Your 'Investing for College' Needs

1. Are the prepaid or savings tuition benefits that will accrue under my proposed 529 Plan guaranteed by the state that provides them, regardless of how the Plan's investments perform in future years?

2. Is there a limit on the total amount I can invest in the Plan—so that I can feel confident about being able to fully fund my future student's education with this financial strategy?

3. Does the plan I have in mind permit withdrawals for all of the colleges, universities or vocational schools that my future student might choose to attend—or is it "school-specific," meaning that the beneficiary will be permitted to attend only the school named in the Plan?

4. Are there any age limits applicable to either the contributor or the beneficiary that could unexpectedly interfere with later withdrawals?

5. What is the plan's refund policy, if my student doesn't seek a higher education? (Most states will repay the in full, with interest and earnings, regardless of circumstances.)

6. What are the specific risks associated with the forms of investment (mutual funds versus corporate securities, for example) employed by the 529 Plan I have in mind?

7. What's the performance record during recent years of the various investment mechanisms employed by the plan (obviously we're looking for stability and a pattern of steady growth, here)?

8. Does my own state offer me any specific tax advantages for my contributions to the 529 Plan, or for later withdrawals—or can I find more appealing tax advantages in another state?

9. Can I change the named beneficiary at any point during the life of my 529 Plan, if I wish to do so?

10. Can I invest in a particular 529 Plan by depositing funds directly with the state that manages it—or will I be required to pay fees (how large?) to an independent broker or agent?

11. Will my 529 Plan benefits be fully “indexed” to increases in school tuition in the years ahead—or will I face the risk of a future tuition-shortfall caused by “tuition inflation?”

12. Are there any hidden fees or costs associated with my 529 Plan that will kick in at the time of withdrawals, which could unexpectedly reduce the funds available for my beneficiary’s education?

Logging On and Getting the Help You Need

Your child’s or grandchild’s college education is perhaps the most important investment and gift you can give them. It’s the gift of a lifetime of success, financially, personally, and family-wise.

A debt-free college education is a gift that your son or daughter, grandson or granddaughter will thank you for the rest of their lives. Rest assured...when they buy that first new car, move into their first home, and bring to life their first child, they’ll know that you’ve helped make this all happen.

In this Investing for College white paper report, we’ve talked about just how expensive a college education can be. But there’s one “university” you can send your child or grandchild that can help you learn how to average double-digit gains in any market. It’s The Oxford Club’s Investment U Course: a real investment education that they won’t get in college (just visit www.investmentu.com to order this unique course – and the 141 investing secrets it contains).

Good investing,

The Investment U Research Team

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