



WEALTH MANAGEMENT, LLC

Is It Too Early to Start Saving for College?

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Having a baby is one of life's greatest moments. The excitement and joy is immediate. Soon though, thoughts about the future creep in. *Should I start saving for their education? How much will it cost to send my child to college? What type of educational savings account should I set up?*

These are the types of questions that we constantly receive from parents and grandparents. After all, we know that the cost of higher education is increasing at an alarming rate. According to a 2009 College Board report, four year public colleges raised tuition and fees by an average of 6.5 percent during the 2008 academic year. Private colleges rose 4.4 percent. The bottom line is that if family members do not take an active role in saving for their child's higher education, it can be painful when it comes time to write that first tuition check.

The two most common higher educational savings accounts are the 529 College Savings Plan and the Coverdell Education Savings Accounts (ESAs).

Both accounts work similar to Roth IRAs – individuals contribute after-tax dollars that grow tax-free, such as they do in a Roth IRA. Earnings can be withdrawn free of federal taxes for qualified higher education expenses. Through 2010, ESA assets can be used for both K-12 and higher education. It is unclear if this provision will be extended.

While ESAs have a maximum annual contribution of \$2,000, 529 accounts have contribution limits between \$100,000 and \$350,000 depending on the state. In 2010, the ESA contribution maximum will drop to \$500 if Congress does not extend the current limits. In order to qualify for an ESA contribution, your Adjusted Gross Income (AGI) must be less than \$95,000 for single filers and \$190,000 for married couples. With 529 plans, they do not have any income limitations for contributions.

We consider the following factors most critical to the decision-making process when balanced against each other:

1. What are the plan's investment options? Find those that allow for the most effective global diversification – and preferably are passively managed.
2. What are the plan's costs? The lower the costs, the less likely returns will be significantly eroded by fees.
3. What are the plan's tax benefits to the individual client? Enjoying both federal and state tax advantages can be an important deciding factor.

Given the high contribution limits and no income restrictions, we feel the 529 Plan is more flexible than the ESA. Consider state plans that offer passively managed and/or low-cost funds; passively managed options can include those provided by DFA, TIAA-CREF or Vanguard. As of this writing, West Virginia has the only 529 Plan that offers DFA passively managed funds via its Smart529 Select Plan. Its fees are on the high side but we feel the higher expected returns commensurate with risk taken as well as the diversification available from DFA's passive asset class based approach may well offset the higher fees. As such, when an investor's state plan doesn't seem to be in his or her best interest, West Virginia may be the next selection to consider.

It remains prudent to investigate *all* alternatives before selecting a college savings account. Three primary factors to weigh include: 1) the value of an investor's state plan tax benefits, 2) the costs of the plan and 3) the extent to which a plan offers passively managed, globally diversified investment options. In conclusion, it is never too early to start saving for college, given the continual rise in college tuition and fees.

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 2. Tamar Lewin, **College Costs Keep Rising.** www.nytimes.com, October 20, 2009.
 3. Greg Brown. **The Best and Worst 529 College-Savings Plans.** www.morningstar.com. April 23, 2009. Accessed May 11, 2009.

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