



## Sound Financial Bites 049- Paul Adams Episode Transcription

*“High-income baby boomers do not have a balance sheet that is strong enough to last the rest of their lifetime.”*

Hello! Paul Adams here. Welcome to Sound Financial Bites, where we help you with bite-size pieces of financial and life knowledge to help you design and build a good life.

Hello, and welcome to Sound Financial Bites. My name is Paul Adams, President and CEO of Sound Financial Group, and your host for today’s episode. I Am really looking forward to what we are going to talk about today. We’re going to have a touch of some conversation that’s going to involve some numbers. There’s not going to be that much. We’re not going to broach over all the way into an analytical-based episode, but I do want everyone listening today to be prepared to do some real thinking that’s going to clash against much of what we’re traditionally taught, to help us produce better outcomes and be able to design and build a good life for you.

You see, way too often what happens is these financial tactics are just recommended to us and we pick them up one at a time. What we’re going to help you do is organize that financial juncture and put it in a position where those tools are really there to affect the outcomes that you want in life.

The topic of today’s conversation is sending your money to college. You see, way too often when we look at being able to save and build assets we’re not thinking of it from the standpoint of what’s going to be the maximum use of money. In fact, what most of the financial sector would prefer us to do is to buy one product for each use. The whole market of college savings accounts that have come out are really targeted on exactly that.

Now, the idea being that what you should do is save money, put it away, and then the only thing that money should do is pay for college. Well, that may not be the most effective thing for you. Now, to start our conversation I want to be absolutely clear. You might have a 529 plan right now, unless you’re sitting down with a professional like me or someone in our team and you are taking a holistic look at everything you’re doing do not cash those accounts out as a result of having listened to this episode. Rather, what we want to do is make a concerted review of where our money is, what is it that we want that money to do for us, and then and only then should we make a selection of where that money should be by comparing and contrasting the alternatives.

Now, part of this conversation today is going to come right out of my book *Sound Financial Advice*, Chapter 6: Sending Your Money to College. The same name as this episode of the podcast series. Well, sending your money to college. Why am I sending my money to college? I’m sending my kids to college. Well, that may not be true. You’re definitely going to be sending some money to a college unless you get some amazing performance-based or merit-based scholarship aid or need-based loans. Some of your money is going to go to college or is going to go to your child to help pay for them going to college. Let’s start right there.

First and foremost, what it takes to send a child to college. Now, for a moment I’m just going to assume based upon who our audience is that as you think about college, you’re already thinking this is going to be a pricey endeavor. For the sake of the podcast, we’re just going to use \$50,000 a year. \$50,000 a year that’s going to be set aside every single year to help a child go to college. Well, the easy math on that is just going to be \$50,000 a year, we’re sending off to the college every single year, and we’re going to do that.

In this case, let’s say we have one of those children that manages to squeeze a four-year education into five years, certainly not uncommon anymore. We’re just going to estimate slightly



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on the high side for the sake of this conversation - that the total cost was \$50,000 a year across five years. That means we sent \$250,000 off to the college. Every time there was a tuition payment we paid \$50,000. Now, if you think college is going to be \$25,000 a year for your kids, all these numbers are still going to apply just divide them by two.

Now, let's imagine the parent could have kept that money on their balance sheet if they didn't have to pay for college. If instead of them having to pay for college, the child got total scholarships and college is now "free". We now have an impact to the parent's balance sheet of \$290,000. \$290,000. Now, this is in the face of most baby boomers, well over half of baby boomers out there. Even the high income earning ones do not currently have a balance sheet that is strong enough for them to be able to have enough income to last them the rest of their lifetime. And \$290,000 is out the window to college. Let me pause here for a moment.

Far too often what we end up doing when we're talking about saving money for college is we think of it like a moral imperative, like it is "The right thing to do", "I must pay for college." Maybe because you've been promising it to your child since they were like 10 years old. That could all be true, and you could currently be looking at it as a moral imperative. Here's where I might challenge you on that. If you think it's absolutely moral imperative you pay for your child's college, (1) you really should do some reading on the differences between colleges and how much actual annual income your child is likely to earn. Like bachelor's degree to bachelor's degree or master's degree to master's degree, what is it that the actual income differential is likely to look like if you're paying \$50,000 a year for a school or you're paying \$20,000. So, it's a problem. (2) is when it comes to moral imperative, and I have seen people get unbelievably like even upset if I bring this up. Now often I don't bring this up right in the face of somebody currently sending somebody to college because that's where most upset is going to come from is there, you know they've stocked all of their savings or they are tapping their own savings to send their child to college.

The problem is that they are likely setting up their own personal balance sheet to fail them in their age old because they sent their child to school. Literally putting their child in the position where they are going to have to watch their parent's health and finan-- I say health because of how closely tied assets and the ability to get medical treatment are to your health especially in your old age. So, they are going to watch their parents both physically, healthwise deteriorate along with their financial situation deteriorating in their old age. I don't think most kids would say "Wow, I'm super glad I had no student loan debt and I took care of my parents in their old age instead of my parents being able to pay for their own care.

I just kind of put that out there upfront. That's the unsaid conversation most of the time when it comes to college. What I'd like you to do is just reflect on that for a moment. If you are one of those people that just - we must pay for college, start number one and it might just shift your mindset a little bit. (1) Do some web searching on looking at some white papers or some web pages that have done the comparison of college education cost and how much more the child is likely to earn over their lifetime. And you are really setting them up well to send them to these unbelievably -- I mean they are really neat institutions but does it produce that much for them in the long run? (2) Really reflect whether or not you taking care of yourself financially first before you're absolutely committed to paying for your child's college.

Whenever we ride on an aircraft, what is the thing that happens with every single briefing? It's as if we've been living in a cave for the last 30 years, we've never been in an aircraft before, what do they tell us? "Put on your mask before helping a child or helping anyone else with their." We

*"They are setting up their own balance sheet to fail them in their old age, because they sent their child to school."*



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need to be putting on our oxygen, making sure us as the parents are cared for financially before we go off the rails and maybe make significant and irrecoverable amount of sacrifice paid for child education. Okay, we got that other way. Let's go back to our cost.

So, \$290,000 were the cost. That is the cost to the parent's balance sheet today but that is not all of the cost to the parent's balance sheet. You see, that was paying \$50,000 a year for college for five years. Then, after paying for college for five years, we now have all of the lost opportunity cost because there's not just \$290,000 during the five years, there's all the growth that could have occurred on that person's balance sheet for let's just say 15 years that this person started at 45 paying for child education paid through age 50 and now there is a \$290,000 lost opportunity cost on that person's balance sheet. From age 50 to 65, that lost opportunity cost is just taking away in the background because that's real money that we lost. How big is that cost really? Well, as I calculate it here, I want you to think about also this lost opportunity cost doesn't stop right there. That lost opportunity cost continuous to tick even beyond age 65. I'm just starting by calculating it to age 65. We're not adding any more problems if you will, or any more lost opportunity cost to this, we're just going to calculate \$290,000 for an extra 15 years of lost opportunity cost to \$600,000 that's not on the parent's balance sheet. It's now on the financial or the educational institution's balance sheet of true lost opportunity cost because they paid for the child's college.

*“3 kids off to college? You have now a total of 1.8 million dollars that's not on the parent's balance sheet at age 65.”*

Now, if you have three kids and your objective is to send all three kids to school, in this easy mathematical case of \$50,000 a year for five years for each child, you now have a total of 1.8 million dollars that's not on the parent's balance sheet just at the age 65. Let's go a little further. Let's say we take those parents out to their likely mortality like the second debt of the two parents. Let's say the parents wouldn't have used the -- Oh, I don't need the money. This will go back to that little bit of research I asked you to do of what is the total amount of extra income your child is going to make because you sent them to the really really fancy school. You sent them to really really fancy school, you cost your child 3.3 million dollars of inheritance. Think about that. Per a child! If that school cost \$50,000 a year for five years starting at the parent's age 45, and then that lost opportunity cost is taking away on the parent's balance sheet from age 50 to age 100 it will be 3.3 million. What if it wasn't quite that long? What if we died at the age of 90? 2 million dollars. Remember it's a second debt when they are going to get their inheritance, so did spending a lot more money on college, putting it all in a 529 plan and letting a single use dollar do the job, is that worth 2 million dollars of inheritance one day that would land on the child's balance sheet helping them with their long term financial viability and maybe living an estate for generations. Was it worth that difference?

Those are opening comments to start our conversation around college savings. (1) Do we need to pay as much as everybody would have us believe? (2) What's the real cost, and we just kind of uncover that that \$290,000 for the \$50,000 a year payment that we're going to make for five years to an institution including the lost opportunity cost at 5% a year because we could've had the money instead of the institution having the money. Last but not the least, a tremendous impacting cost, \$600,000 per child for our fictional couple that paid for school for them at age 65 and maybe millions at the parent's ultimate passing per child. It's a lot of money. It's a highly consequential conversation that I think oftentimes people promise their kids they're going to pay for college or sometimes I would offer this, I think there are many times that it is a pride point for the parents that they paid for their child to go to one of these schools. And so, there are times when there is no difference in the pride and consumption that we're in in paying for a child's college than it was to pay for a really cool car. It's okay to pay for really cool car. It's also okay to pay for a tremendous college education for your child though that shouldn't be done at the



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expense of your ability to take care of yourself. You shouldn't buy the crazy expensive car if you're not able to take care of yourself in the long run nor should you buying a really fancy college education. Both of those things that they compromise your personal financial well being should be delayed or we need to modify strategy.

The strategies I'm going to talk about to modify the way you pay for college will still work for that person that wants to pay \$50,000 a year for college for their kid and we can create some actual amelioration. We can tap down the total amount of lost opportunity cost to that person that does want to pay \$50,000 a year, but the bigger thing most people forgot, there are many many people who have already promised their child they will pay for college and yet that same person doesn't know the simple math we've talked about in our past episode of 46595. They don't even know how much in assets it takes out of 4% distribution rate to just produce the income they make today, let alone their really wonderful vision of a future of what retirement is going to look like like travelling around the world and being on a cruise ship or paying for grandkids college. They haven't even done the math yet of what that's going to impact and are already promising to spend more money on things like college.

Let's set that aside for now. Too often it's not disclosed to us how expensive college really us both to us today, maybe ultimately for our child and their ability to earn inheritance, and maybe and most importantly also expensive for the child because they didn't really learn how much the cost was. Like many time they may not learn how big the cost was until they're caring for that parent on their old age because the parent wasn't able to care for themselves.

Okay. Let's talk about minimizing that cost. Most of the tools we're going to buy to pay for college right now, the tactics like the 529 plans, educational IRAs, those are all predicated on this existing mindset that what you should do is put your money in one place and that one thing, that one place, the 529 plan in this case, is going to pay for college. That's it. In fact, there's even tax advantage. You put money in there. If it grows, it will grow without any impact of taxes on it and you can ultimately take tax free distribution. But, there's couple of problems. For any of you that have invested for any significant amount of time, one thing is you'll know and certainly we talk with our clients about it that even it's out there in cultural common sense is you don't want to be investing for short term stuff. You need to be investing for the sake of building large amounts of capital to put you and your family in the position to those capital amounts, that capital work that will produce cash flow. It's all cash flow again.

When it comes to college savings, if we started saving for that child when they are 10, or even if we started saving for them when they were first born, we're not likely to be putting the largest amount of contributions because of how the parent's income grows. The largest contributions are not going to show up until after age 10 probably anyway. So, we're effectively putting money aside that's going to have to be liquidated, meaning it's going to come out of the market in less than 10 years. I'm not talking about an income out of the market which could be fine in less than 10 years, we're literally going to liquidate the account over a five year horizon of time with the sole purpose of paying for this college and yet we're going to have the money at risk. So, we're not likely on this money, it wouldn't be wise to go full throttle on and be a hundred percent aggressive because if you did you're likely to put yourself in a position that will jeopardize the very important thing that you said was important to you initially which is why you set up the 529 plan. You set up the 529 plan for the express purpose of paying for college and then let it all be at risk because you throttled on the aggressive investing strategy. There are many people both during the tech bubble that that significantly impacted their abilities to send their child to college. And because it will save specifically to send the child for college and they needed to pull it out for



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the tax benefits, even if it wasn't the best time to liquidate those investments they had to, because even if the investments rebounded later they will be paying taxes and penalty to take it off if it wasn't in the same tax year as the money being paid to the institution. It's the only way it comes out tax free is if you have qualified educational expenses that come out of the 529 plan that go pay those same educational expenses in the same year. It's not even a great idea to build much of an aggressive portfolio, one that's likely to get real market rates of return because that portfolio could take a hit - we saw that in 2008,2009 - again, portfolio takes a hit and the parents had to pull it out anyway. They don't have a choice. Even if they wanted to stay the course their significant tax consequences they are trying to wait to make the distributions later. But, it's all predicated on you are going to save money up for a single purpose and let that money go to that purpose.

Well, there are some different things that can be done. (1) I'm going to give you just a little bit different view. Our different view here is going to be what if instead of just saving up money for college every single year, what if instead we taught the child what it is to apply for loans for the five year horizon of time? We never set up a 529 plan, we still saved up capital on our balance sheet that we desire to help our child pay for school, we build that money up on our balance sheet. As a result of building it up on our balance sheet, we're now in a position that we can pay for college if we so choose for a child, but instead of saying it's going to come out of this 529 plan and whatever the market's rate of return was for that 529 plan, what we are going to do instead is build it up on our balance sheet. Do you know where we're going to take the money from to pay for college? Wherever is most effective at the time.

One of the most effective things to do at that time might be to teach the child how to get student loans. Depending on yours and the child's situation you may be able to qualify for loans that actually gets some subsidy, some subsidy on interest at least during the schooling years. You may qualify for some really low interest loans. I was looking just today. I saw that even the non-subsidized loans are at five and a half but the subsidized loans can be as low as three and a half percent interest plus the interests paid by the US government during the time that you are in school or in a qualified deployment period. That is a big deal. Why would we liquidate money off of our balance sheet just right away to pay to college if somebody else is going to carry that for us at low interest rates. That's part one.

Part two: Now, that money stays on our balance sheet so now imagine we have the \$250,000 saved up, it's already on our balance sheet at the beginning of the child's college career. We are responsible. We saved it up. Life is good. Now, five years later how much in our assets do we have if we achieve the same 5% of return? If we achieve the same 5% rate of return, now we have \$319,000 on the parent's balance sheet that could now go toward college.

Now, this next piece is not a major mathematical breakthrough at all but it could be a significant difference in the way you and your child relate to paying for the college. And it's this. Imagine if what your parents did is they sat down with you and said "We're going to go ahead and borrow money. We're going to help you. We're going to borrow money to pay for your college." As a result of helping the child go through and their parents if they helped you go through and pay for college, at the end of your college career, what if they sat down with you and said "Okay. You've been working with these debts. You've learned how we applied for it." You've been working with the institution which the children will learn untold things about money and finance and debt and the problems with debt during that process. And so, now at the end of four or five years, imagine your parents are sitting down and with you and saying "Hey, here's the option. You've got \$250,000 with the debt. Now, we've saved up money. We have the quarter million dollars on our



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balance sheet to help you with it, what would you like to do? If you want, what we can do is we can take and just write one check and pay the institution out altogether. That's option one. Option two is we'll pay off part of the debt and you carry the rest but we're then going to give you \$50,000 over the cash." So, what we're going to do, mom and dad, we love you. There could be some gifting stuff so I don't want to ignore that but there could be gifting issues that you'd have to work through. You want to check with a professional before you actually make this transfer, but effectively say I'm going to give you \$50,000, and then we're going to pay out \$200,000 worth of debt and you are now going to carry \$50,000 worth of debt over a very nice long term that you can pay off at your convenience that may be tax deductible to you as the child and you've got \$50,000 on your balance sheet. It might give you a down payment on a home when you settle somewhere, allow you to get a good car that you can pay cash for, and/or just get your some business suits, all the things that kid needs to launch into their career after college, or if you got that big entrepreneurial idea and you're going to be building the next amazing company out of your garage, then we'll give you a quarter million dollars and your job is to carry all the student loan debts. It's your responsibility. Think about that. Think about what that would have meant for you if your parents would've given you that option that we're going to go ahead and give you the money.

Now, the offset that's interesting, if the money was on the parent's balance sheet and it just grew over the five years instead of sloughing off for the institution every single year, we now have \$319,000. Even if we pay the entire quarter million dollars to the child or paid off the debt for them entirely even if we still paid for college, we now have picked up 70,000 simply from the control of money rather than paying it out every single year. We control the capital and it grew 70,000, that means we offset - I'm doing it on top of my head - 22% of the total cost of college was totally offset simply because we controlled our money.

Now, if you get a chance and you don't have a copy of my book just send in email to [info@sfgwa.com](mailto:info@sfgwa.com). We'll send you a copy of my book since it's just a particular subject of today's conversation and let you see the math right from the book in this chapter about sending your money to college in a way that if you chose to, if you have proclivity and you understand real estate and you wanted to invest in real estate you could literally take that quarter million dollars and put it down on a fourplex near the college campus. Your child becomes a property manager. They learn how to advertise them, how to work with tenants, and how to handle the lease, and how to collect rents, and how to get the carpets redone or shampooed over the summer, all that stuff your child gets the opportunity to learn.

As a result of your child learning what it is to handle all of those things, we also get the opportunity to pay them. We're shifting money to child's tax bracket from this investment because they are the property manager. Then we end up with the ability to effectively deduct part of the child's education by the child paying for it. At the end of five years maybe it's a piece of real estate we want to continue to hold or maybe at the end of the five year college career of our child we decide to sell the property and move all that money back to our balance sheet. Depending on the performance of that piece of real estate or the students that are staying there, they effectively help pay the mortgage for five years. We've got some great tax write offs through straight line appreciation on that property. Hopefully build some equity as long as we bought it well.

Again, if you have proclivity for that you also had positive cash flow from all of the students that your child was having to do some cat hoarding, if you will, in working with the tenants but what better leadership training to go through to college, have to learn to balance the books on this



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fourplex that they are in business with with their parent and the real skills that can be built from that and maybe offset 100% of the college cost for our child. You see, the thing that doesn't make sense from the traditional financial model where the institutions would love to get your money and they want it to be used for a single purpose, they wanted to build up as a tactic for you so that you just buy products one at a time instead taking this 30,000 point of view and saying giving you your particular situation knowledge likely there may be other things you could do, might be just building it up, building the same amount of money for college elsewhere in your balance sheet. It might be a passive structure investing portfolio. It might be a business venture. It might be your real estate, but each of those things opens up some kind of new opportunity where we can produce a strategy together that would actually give you some cost recovery of having sent your child to college, maybe even held properly might even help you qualify for some of the favorable interest rates or student aid or scholarships that wasn't going to be available otherwise if we didn't hold our assets properly.

I want to encourage you to take the time, (1) as we complete the podcast today, know what it's going to take for you and your family to have enough money to be okay in your old age. Okay? That's number one. Before we start paying for kid's college, we ought to make sure that we're going to be okay. Then, (2) start thinking of the most effective ways to pay for college including what kind of institutions they should be sent to. (3) That might mean examining your own internal motivations about: Do I want to send my child there because of my own pride? That's okay. It's totally fine to do that, just like it's okay to buy a super expensive car as long as it's still a financially responsible decision.

The reason we need to take care of the cars we buy or the colleges we send our kids to in part is because our kids are going to be affected by whether or not we're able -- are we going to be reliant on them on our old age? Are they still going to be able to come to us for the sage financial career relationship advice? Spiritual advice - many children will turn to their parents for faith. Do we hamper our ability to speak to any of those areas because we effectively bankrupted ourselves in our old age and now we're reliant on our kids, and there are certain things that are off limits because we -- Gosh, I can't say that to my child because I need them to help me with my rent next month. We got to get all that stuff cured before we pay for college. Even if it's not totally handled let's make sure that we're on a glide path to build that future where we got financial security before we start making promises for everything we're going to pay for for the kids. Then last, let's work on the amelioration of that expense in being able to be as effective as we can and recover some of those lost opportunity cost.

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