PACIFIC WEALTH MANAGEMENT®

Know Your Options and Look for Value When Budgeting for Future Education Expenses

Paying for college is one of the most daunting expenses that parents face. Every year, tuition costs rise, along with prices for room and board, books, and electronics. In 2021-2022, the average cost of a year at an in-state public university was approximately $27,000, while a year at a private institution was more than $55,000. In ten years, those figures are projected to increase by 50%; in 18 years, those numbers are projected to double. Many parents feel that there will *never* be enough money to pay for college.

While the costs are difficult to fathom, there are many savings vehicles to help parents save for a child's education. Depending on a family's income and assets, one strategy may be better than another. To identify the best strategy for you, it is important to understand eligibility requirements and the parameters of each college savings opportunity. The chart below is not exhaustive but provides an overview of the most common savings strategies:

	529	**Coverdell ESA**	**Custodial**	**Taxable Account**
Contribution limit	$235k-$550k per beneficiary; varies by 529 plan	$2k/beneficiary	No limit	No limit
Income limit	No limit	$110k (single)/$222k (MFJ)	No limit	No limit
Gift tax exemption	$17k per account owner per year for 2023	$17k per account owner per year for 2023	$17k per account owner per year for 2023	N/A
Tax free compounding	Yes	Yes	Limited to the first $1050 of account income	No
Tax free withdrawals	Yes, for qualified educational expenses	Yes, for qualified educational expenses	Limited to the first $1050 of account income	No
Beneficiary	Named beneficiary, but owner can change to another qualified family member	Named beneficiary, but owner can change to another qualified family member	Named beneficiary only	Anyone
Control	Account owner	Custodian	Custodian until beneficiary reaches age of majority	Anyone

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What makes 529 and Coverdell ESAs (Educational Savings Accounts) so attractive is that they allow for tax-free withdrawals when they are used for qualified education expenses, such as tuition, fees, books, room and board, and supplies. When someone draws from those accounts for non-qualified expenses, that person will pay tax on the growth plus a 10% penalty. Custodial and taxable accounts allow for greater flexibility as to how funds are spent, but they are less tax-efficient when the goal is to pay for education.

As it pertains to the beneficiary and account control, the 529 plan offers the most flexibility. The account owner maintains control of the account and designates the beneficiary. The owner can change the beneficiary to another qualified family member at any time. Coverdell ESAs offer similar flexibility with regard to beneficiary changes; however, any remaining assets must be distributed by age 30 and may be subject to taxes and penalties. Assets in custodial accounts are controlled by the custodian and must be used for the named original beneficiary.

In addition to selecting the best type of college savings account, you should also invest strategically for the time-horizon that you have. If you begin saving early, you could have an 18-year time horizon. Allocating mainly to equities, as opposed to fixed income or cash, should deliver the highest return, but comes with the highest risk. Such a strategy will allow time for the account to weather any market volatility while likely growing enough over the investment period and maximizing the tax-free benefit. As a student approaches the college years, you will probably want to begin reducing your equity exposure and allocating more to fixed income and cash.

Remember also that fees matter. Consider investments with low maintenance costs and low internal expenses to reduce the chances of unnecessarily high fees compromising your returns.

The tax-advantaged and taxable savings opportunities are not the only way to save but can be most appropriate for higher income families. When someone's income meets eligibility requirements, scholarships and grants may be available. Students may also apply for a loan and complete the Free Application for Federal Student Aid (FAFSA) by visiting studentaid.gov. In addition to student loans, parents may consider a Parent-Plus loan for which there is no income eligibility requirement.

Students should apply to college with an eye towards value. They should remember that their chances of reducing college costs are better at financially friendly institutions that have a history of offering financial aid. The most expensive school may not be the best overall fit. Evaluating

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college opportunities with your student is a productive exercise that facilitates illuminating conversation about expectations--of both the college and your student. For example, parents may want to clarify to students that they are expected to graduate in four years. They may also want to discuss what a student expects and desires from the college experience so that the student spends savings in a way that will ultimately be productive.

The best way to navigate college expenses will be different for each family; however, a universal rule is to start saving as early as possible and to know your options for doing so. Contact us to discuss your goals for education savings and how they fit into your comprehensive financial plan.

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