Pre-Paid Tuition Plans

Some colleges and states offer prepaid tuition plans that allow a family to pay tuition in advance. Since tuition costs increase 5-9% annually, this plan can offer significant savings. For instance, a family may buy shares worth a year's tuition seven years before their daughter goes to college, thus saving up to 63% on tuition costs.

Parents can either purchase shares that represent a certain percentage of tuition, or can purchase entire years worth of tuition.

Prepaid tuition plans are usually exempt from state and local taxes. The savings are subject to federal income tax, but not until they are redeemed, and the tax is charged to the student, not the parents. This means additional savings since the student is probably in a lower tax bracket than the parents.

However, prepaid tuition plans hurt a student's eligibility for federal aid. These plans are counted as resources, whose value is subtracted from the cost of attendance when determining financial need. 100% of the amount invested in a prepaid tuition plan is deducted from the cost of attendance in the federal aid formula. In contrast, only 35% of a student's assets and at most 5.6% of the parents' assets are deducted from the COA. In addition, although amounts saved in prepaid tuition plans reduce aid eligibility by 100%, they do not lower the parent contribution.

What's Cool:

- Low-risk investment.
- Tax exempt growth.
- Offers better returns than savings account or certificate of deposit.
- More affordable than mutual funds - many mutual funds have minimum investments of $2,000 or more and may charge substantial fees.
- Easy to manage.

Not Cool:

- Reduces financial need, and thus hurts eligibility for federal aid.
- Limits choice of school.
- Not necessarily the best way to save for college. It may be better to invest mutual funds - especially low fee "Index Funds" *if* you have at least 4 years to save.
- Prepaid tuition does not guarantee admission!

States that offer prepaid tuition plans include: Alabama, Alaska, Arizona, Colorado, Florida, Illinois, Indiana, Louisiana, Massachusetts, Michigan, Mississippi, Missouri, New Hampshire, Massachusetts, Michigan, Mississippi, Missouri, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, Wisconsin, and Wyoming.

For more information, please contact the financial aid office of the school you think you will attend. To learn more about aid and taxes, click here.

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Problems? Contact the webmaster.
Good luck finding Financial Aid!

FEATURE
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Sizing Up Pre-paid Tuition Plans

by LOREN STEFFY
from BLOOMBERG PERSONAL WEALTH

Rudy and Ginger Ramirez worried about how they would afford to send their two young sons to college. Not ones to play the market, they set up a savings account, though the interest it paid wasn't enough to keep up with rising tuition.

So they changed gears and bought a contract through the Texas Tomorrow Fund, a state-sponsored plan that allows the Houston couple to pay tuition at today's rates. The state invests the money and uses the returns to pay tuition at the college the boys, now 6 and 9, choose when they graduate from high school.

"Your tuition fee is set and it's not going to change, no matter what tuition is for everybody else," said Ginger Ramirez, a science teacher.

With higher education costs increasing as much as 10 percent a year in some states, pre-paid tuition and savings plans are gaining popularity.

Seventeen states besides Texas have such plans, 21 more offer some sort of state-sponsored savings program for college and several more are considering them, according to the National Association of State Treasurers.

Pre-paid plans allow parents to "lock-in" tuition rates. When their child is ready to go to college, the state pays the tuition, but not other expenses such as housing. In most states, the plans apply only to state institutions, though some will pay toward private or out-of-state schools as well.

While pre-paid plans offer piece of mind, financial planners say it's important for parents to understand what they're getting. As an investment, the plans offer weak returns. "They're not saving or investing. They're paying for something they're not going to use for 15 years," said Guy Cumbie, a certified financial planner in Fort Worth. "It's like paying now for a lunch they're going to eat next month because they know they're going to be hungry."

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TUITION PLANS

'Tuition Inflation Tool'

To be successful, most pre-paid plans must generate returns of 6 percent to 8 percent to stay ahead of rising tuition rates. That's below what most people could earn by investing in stocks or bonds, said Phil Johnson, a certified financial planner in Clifton Park, New York.

"A discriminating investor with a rational strategy can do better than the plans that offer these guarantees," he said. "If you want a more growth-oriented style, you're probably better off doing it on your own."

State officials are quick to point out that the plans aren't designed to compete with traditional investment strategies.

"This is clearly not an investment tool. This is a tuition- inflation tool," said Carmen Leuvanos, a spokeswoman with the Texas Comptroller's office, which administers the Texas Tomorrow Fund. "If your goal is to make sure tuition and fees are paid for, this is for you."

State governments favor the plans because they can invest the money, sometimes for 20 years or more.

Texas began offering its plan almost two years ago and since then has signed 65,000 contracts with a total value of $625 million. Of that, it has $230 million in hand that it invests in fixed-rate government bonds. It plans to hire an outside adviser in the spring to invest some of the fund in equities.

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FEATURE

TUITION PLANS

Payment Methods

Parents can pay for contracts in a lump sum, or opt for various installment plans. Under some monthly arrangements, paying for college can cost "less than a car payment," Leuvanos said.

Financial planner Cumbie recommends the plans for "non- investors" who don't like risk or for people who aren't disciplined to maintain a college fund on their own.

A pre-paid plan also may make sense if the student is going to start college in less than five years, he said. "If your investment time horizon is five years or less, you need to be really careful about stepping into equity markets," said Cumbie. In such cases, a pre-paid plan offers a better rate of return than parents could find with other "safe havens" such as certificates of deposit.

What happens if your child ends up not attending college? In Texas, parents have several options. They can transfer the tuition plan to another child with college aspirations or they can get a refund for the amount they've paid into the plan.

While many parents worry about rising tuition, Johnson said rates aren't increasing as rapidly as they did a decade ago.

Private schools in particular have curtailed expenses, with tuition rising about 3 percent to 5 percent a year, compared to 5 percent to 8 percent 10 years ago. Public school tuition is climbing between 6 percent and 10 percent, Johnson estimates.

To be sure, rising costs also figure into the price of a pre- paid contract. In Texas, for example, the cost of four years at a state school for a newborn increased 16 percent in the past year, to $11,000 from $8,300, Luevanos said.

Some states offer a different option. New York's plan, which takes effect in January, would allow parents to put as much as $5,000 a year in a college fund exempt from state taxes. In addition, federal taxes are deferred until the money is withdrawn.

While such plans don't guarantee tuition will be paid in full, financial planner Johnson said the state has a responsibility to ensure investors "don't take a bath."

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