Citi Personal Wealth Management

FINANCIAL EDUCATION SERIES 2010

# Getting the Kids Educated: Financial Help Is on Its Way

**A college education can be one of life's most expensive goals, ranking right up there with paying for retirement and buying a home. But fortunately, college is also the goal you will likely get the most financial help with. Where to start? Think of college funding as a two-step process.**

First, you spend 18 years or so socking away money every month. To make this less painful, there's a raft of tax breaks available, including those for 529 college savings plans and Coverdell education savings accounts.

Withdrawals from both accounts are tax-free at the federal level when used for qualified education expenses. (See offering statement disclosure on page 2.)

Second, as your children approach college age, you need to figure out how to pay the bills. To that end, you should apply for federal financial aid, in the hope of getting grants and subsidized loans.

The colleges themselves – especially private colleges – are another big source of aid. In fact, many private colleges have begun drawing more heavily on their endowments and some are now committed to offering aid packages that don't include student loans.

## SAVING SENSIBLY

Sound encouraging? While much help is available, you need to tread carefully – for four reasons.

First, your children's education shouldn't necessarily be your top financial priority. Instead, first make sure you are saving enough for your own retirement. Your children can likely take out loans to cover college costs – but, when it comes to paying for retirement, you will need to pony up cold, hard cash. In particular, you should be making the most of your employer's 401(k) retirement savings plan, which will offer tax savings and possibly a matching company contribution.

Second, think carefully about which investments you buy with your kids' college savings. Some parents invest heavily in stocks, figuring their children are young and can afford to take a lot of risk.

But remember, what counts is time horizon. The time horizon for your kids' college savings may be shorter than the time horizon for your retirement nest egg, and thus you may want to invest their college money less aggressively.

Third, don't necessarily aim to save the full cost of college, whether it's roughly $200,000 for four years at an elite private institution or the $65,000 average cost for an in-state student at a public college. If you set out to accumulate the full cost of your children's college education, you may get discouraged and give up – or, alternatively, you might bulldoze ahead, save too much for college and shortchange other goals.

This might have you scratching your head. How could you possibly save too much? That brings us to the fourth and final issue: There are other ways to pay for college, including college financial aid. Indeed, where you stash college savings could affect your family's aid chances.

## AIDING YOUR CHANCES

Currently, money in a child's custodial account, such as those set up under a state's Uniform Transfers to Minors Act, will typically be deemed the child's asset in the financial aid formulas. That means this money will badly hurt aid eligibility. By contrast, Coverdell accounts and 529 plans will usually be considered parental assets, so they're less damaging to your aid chances.

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But the formula used to distribute the federal government's financial aid could change between now and when your toddler turns 18. Moreover, many private colleges use a different formula when doling out their own money – and they could choose to treat all college accounts as a child's assets.

The bottom line: If you suspect you will receive little or no aid, make the most of 529s and Coverdells. But if your family will likely qualify for a heap of aid, consider taking a pass on these college accounts and instead keep college savings in a regular taxable account held in your own name. That way, you can be fairly sure the money won't do too much damage to your financial aid chances.

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The downside: You will miss out on the tax benefits of a Coverdell or 529.

## PAYING THE TAB

How much financial aid you eventually receive will depend on your EFC, or "expected family contribution." The EFC is how much colleges and the federal government think you can afford to pay each year based on your income, your assets and other factors.

College financial-aid officers will take their college's annual cost, subtract your EFC and then they will make up the difference with financial aid. Suppose your EFC is $25,000. If a college charges $25,000 a year, you will probably get little or no aid. If a college costs $45,000, you may get $20,000 in aid. In other words, a more expensive college should theoretically cost your family no more. The implication: You shouldn't dissuade your children from applying to more costly institutions.

Of course, much will depend on the composition of the aid packages your kids receive. A $20,000 aid package might sound great – but it isn't so great if it consists mostly of loans, with very little grant money awarded.

Still, your children may need to borrow some money. Start with the federal government's Stafford and Perkins loan programs. Even if your family isn't eligible for aid, your children could take out unsubsidized Stafford loans, which charge a relatively low interest rate. You can also defer payments on these loans until after graduation.

To be eligible for Stafford loans, you need to file the FAFSA, or Free Application for Federal Student Aid. That means you may want to file the FAFSA – even if you are confident you won't be eligible for aid.

### EDUCATING YOURSELF

- Explore college savings options at **www.savingforcollege.com**.
- Get a handle on your family's aid eligibility by heading to **www.collegeboard.com** and using the EFC Calculator to compute your "expected family contribution."
- Learn more about financial aid at **www.finaid.org**.

Citi Personal Wealth Management is committed to your long-term financial success. You can expect professional advice tailored to your needs, convenient access to Citi's global resources, and a broad range of diverse investment products.

For more information, please contact your Citi Personal Wealth Management advisor.



Sourcing: Approximate cost for public colleges based on *Trends in College Pricing*, a 2010 report from the College Board. Investors should consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's qualified tuition program.



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