PERSONAL FINANCE

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Take a bite out of the college funding dilemma

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For parents, providing children with a good college education at a formidable university is still an investment worth making.

According to the National Center for Education Statistics, the median earnings of young adults ages 25 to 34 with a bachelor's degree ($49,000), were 66 percent higher than the median earnings of young adults who only completed high school ($30,000).

But any investment worth making is also worth doing right. The approach to college funding has changed considerably over the past 20 years, so "giving it the old college try" will likely lead to a failing grade. Here some tips to help parents pass with flying colors.

Step 1: Get clarity on how much it will actually cost. According to www.collegeboard.org, the average cost of a 4-year public (in-state) education is $21,447 a year. Any public or private university website should have a cost estimator and information about which type of money (need-based or merit) it awards. Understanding the college's financial aid policy is important in case aid becomes necessary.

Step 2: Determine your available resources. These include 529 plans, other savings, cash flow, family help, potential tax benefits and the child's expected contribution.

For most parents, savings in 529 Plans earmarked for education should serve as the primary source of funding. The 529 Plan was introduced in 1996 and has revolutionized the college saving game. Contributions to 529 Plans may be tax deductible, depending on your state's tax rules, earnings grow tax deferred and withdrawals for qualified education expenses are tax free.

As a general rule, we recommend funding 70 percent of the education goal for each child through 529 Plans and then cover the rest from other resources. Why only 70 percent? Because we don't want to risk overfunding the 529 Plan. Withdrawals from 529 Plans for any other purpose — other than for qualified education expenses — result in the earnings being taxed plus a 10 percent penalty.

Shall overfunding occur, the rules allow for tax-free transfers between accounts of siblings and certain extended family.

Don't rely too heavily on cash flow to cover college needs. It's hard enough to stay within a budget, and adding a monthly line item to support Johnny while in college could break it. The ramifications could be using credit cards more or sacrificing retirement savings at a pivotal time. Parents will then have to decide what is more important--retirement or education.

There are a variety of tax benefits for education expenses. Start by determining whether you are eligible for tax credits through the American Opportunity Credit or the Lifetime Learning Credit. These can provide up to $2,500 of tax savings depending on several factors including the claimant's income, amount of education expenses and the student's eligibility.

There are also deductions available for tuition, fees, and student loan interest depending on eligibility. It's important to note that no double benefit is allowed. Meaning, tax filers can't claim a tax credit, tax deduction, and reimburse themselves from a 529 Plan for the same dollar of education expenses.

Once personal resources and tax credits are exhausted, then you can factor loans into the equation. As a rule of thumb, students should not take out more in loans than their expected first-year salary in their chosen field.

Loans can either be federal or private. The best type of loans are direct federal loans because they can be subsidized (no interest while in school) or unsubsidized (interest accrues while in school). Subsidized loans are awarded based on need, while unsubsidized loans are awarded to those that apply up to a set amount. Regardless, you must file the online Free Application for Federal Student Aid, or FAFSA, to be considered for these loans.

Parent PLUS loans and private loans are available, but should only be used as last resort to fund small gaps. These loans charge higher interest rates than federal student loans and may charge origination fees.

Step 3: Determine whether the goal is attainable by using a savings calculator or meeting with a CERTIFIED FINANCIAL PLANNER™ professional. If the goal is unattainable, then it will need to be recalibrated. Before you pull the plug too soon though, keep in mind that the "sticker price" for many private colleges is overstated by nearly 50% after factoring in the financial aid that first-time, full-time freshman receive. Therefore, being an informed consumer can really pay off here.

College is still a good investment. The key is to develop a plan early in the game, know capabilities and limitations, and most importantly target schools that best meet the student's needs given the financial situation.

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