The Other Way to Save for College

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For years, college costs steadily climbed at a rate that made parents gasp in horror. If it was possible to travel in a time machine and go back to the early 1990s, you would find that a private four year university tuition was $12,901 on average, compared to $32,026 in 2010-2011. (*) That rate of inflation is an eye popping 4.65% annually that tripled the cost of tuition over that time period. Did I forget to mention room and board? Meals? Travel? Oh right, all of those are extra as well.

These ever spiraling costs of higher education spark endless headlines and cause a great deal of anxiety as the total cost of student indebtedness reached $1.2 trillion in 2013. Long form that number is: $1,200,000,000,000. (**) It makes people wonder how students will be able to pay all of that debt back.

The question becomes: Is there a better way to save for college? Answering that question leads us into the push/pull battle of saving for the children, versus saving for retirement, versus saving for the family. All three competing interests are locked in an eternal debate. Too often we see people opening up a college funding account, starting monthly saving, stopping when things are tight, starting again for a stretch and on balance – saving without a goal in mind. Is there a better way?

More and more often we find ourselves recommending an alternative approach to the typical 529 Plan. We turn the focus from stashing money into a college funding account, to using those dollars to pay down debt. Rarely would an adviser recommend this strategy since it involves managing fewer assets. When an advisor doesn't manage assets, the advisor doesn't charge a fee. Thus, most advisors don't recommend it.

Why would you pay down mortgage debt in a low interest rate environment? Depending upon when you started your mortgage, your interest rate will vary. But from 2008 to today, mortgage rates have varied from 6.5% to a rate in the range of 3.5%. (***) Let's look at a scenario of a common situation and see why our alternative approach to college funding makes sense.

Facts about College Savings:

- Family with two children ages seven and four with no college savings account started.
- We project the seven year old child will attend a state university, which is currently $30,000/year including room and board, and the four year old child will attend a private university, which is currently $60,000/year including room and board. All figures are in today's dollars.
- We increase the cost of college by 4.65% per year.

- We project to earn a steady 6% annually in the college funding account.
- Total needed for the seven year old to attend a public four-year university: $164,599 total, which is $879 per month.
- Total needed for the four year old to attend a private four-year university: $486,105 total, which is $1,496 per month.
- Source: www.savingforcollege.com

What if we directed those monthly projected college savings to the mortgage? What would that look like? Does it make sense? Let's look at the numbers.

Facts about Home Mortgage:

- Home Value: $500,000
- Home Mortgage: $300,000 for a 30 year loan
- Interest and Payment: 5.00% interest and Base Payment is $1,610.46
- Add the college savings amount to your monthly mortgage payment is $2,375
- The mortgage is paid off in seven years and six months, three years before the oldest child is supposed to go to school.
- The total interest paid over the life of the loan is $60,737, and if you didn't accelerate payments the total interest you would pay the bank is $279,767.
- Source: www.usmortgagecalc.com

Why do this?

- Accelerating the payments saves $219,000 in mortgage interest over the life of that loan.
- The interest of 6% projected in the 529 is what we *HOPE* to earn, whereas the interest saved in finance charges to the bank is *GUARANTEED* return.
- At the time the mortgage is paid off, start directing those monthly savings into an investment account or a 529 plan.
- Use the free cash flow to make tuition payments, plus the savings account you started once the loan is paid off.

- Use the equity in your home to make tuition payments not covered by free cash flow and saved dollars, and the interest charged by the home equity line of credit on your home becomes *TAX DEDUCTIBLE* to you (assuming tax policy stays the same in the future as it is today).

- Paying off and paying down the mortgage can also allow for additional flexibility should someone in the family become injured or lose a job.

- Put the control of when and how to finance college in your hands.

So, there's another way to save for college. Talk to your financial adviser and tax professional to see if this approach is best for you, or your children who are starting to save money for your grandchildren's college education.

*Source: www.statisticbrain.com

**Source: www.forbes.com/sites/specialfeatures/2013/08/07/how-the-college-debt-is-crippling-students-parents-and-the-economy/

***Source: http://www.freddiemac.com/pmms/pmms30.htm

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