Three steps to reach your college financing destination

Whether you're an anxious parent anticipating your child's college expenses or a generous grandparent who will contribute financial help, one thing is certain: the costs of tuition, room, and board have substantially increased over time, and show no signs of slowing down.

College is a major financial commitment, like buying a house or preparing for retirement. Fortunately, there are a handful of savings vehicles to help you plan for this investment.

The following three steps will help you save effectively to meet college expenses down the road.

Step #1 – Choose Your Destination

It may sound like an old proverb, but it's true: to reach your destination, you must have one. A specific, realistic goal, such as: "By the time our child graduates from high school, we will have enough saved to pay in-state tuition, room, and board," enables you to build your savings and set a timeline to achieve your goal.

To determine the amount, estimate how much college will cost when your child reaches college age. Next, estimate how much you must set aside between now and then. Calculators such as those at **www.moaa.org/529** are easy-to-use tools to help you do that.

Step #2 – Choose the Right Vehicle to Get You There

A range of savings tools exists to help you prepare for college expenses. No one savings solution fits every family, so select what works best for you and consider combining different options. Here are some of the most popular:

Section 529 College Savings Plans: Offering the greatest flexibility, these state-sponsored plans allow you to contribute after-tax dollars to an investment plan. Distributions are tax-free when used for qualified higher education expenses. You can usually reside in a different state than the one sponsoring the program in which you participate.

Pre-Paid College Tuition Plans: These old-style Section 529 plans use after-tax dollars to pre-purchase tomorrow's tuition at today's prices. Some states allow a limited state income tax deduction for contributions.

Coverdell Education Savings Account (ESA): Originally known as the education IRA, ESAs limit non-deductible contributions to $2,000 annually for children age 18 and under. Money in an ESA grows tax-deferred, and withdrawals for qualified education expenses are tax-free.

TIP

Invest in Your Retirement First

Don't delay or minimize your retirement contributions until your child's college expenses are covered. And don't sacrifice your own security by refinancing your home or borrowing against your 401(k) to pay for college. One of the best gifts you can give your children is your own financial independence in retirement.

Uniform Gift to Minor (UGMA) and Uniform Transfer to Minor (UTMA) Accounts: Better known as "custodial accounts," they are actually owned by the child and managed by a custodian. For children 17 or younger, these accounts are subject to a "kiddie tax." A new tax law effective in 2008 raises that age from 17 to 24 for full-time students.

U.S. Savings Bonds: When used for qualified education expenses, interest on Series EE and Series I savings bonds purchased after Dec. 31, 1989, by someone 24 years or older is tax-exempt.

Step #3 – Start Your Savings Engine Now

The sooner you start saving, the more likely you'll reach your destination. Your savings plan is affected by your child's age when you start saving.

For example, to fully fund $12,000 of education expenses for each of four years, you must save the following amounts based on your child's current age:

Student's Current Age	Monthly Savings Necessary	Or This Lump Sum
Birth	$210	$27,625
7	$304	$33,725
14	$552	$41,100

The chart illustrates how an earlier start makes it easier to reach your goal, because your money works for you. Note that the chart assumes 5% annual tuition inflation, an 8% return on investment, and that the student will be 18 when enrolling in college.

TIP

All the Money Doesn't Have to Come From You

Thousands of scholarships offering "free" money are available. Begin your research as early as your child's sophomore year of high school.

A good place to start is www.fastweb.com. You'll also find a comprehensive list of scholarship search engines at www.finaid.org/scholarships/other.phtml

The Most Flexible College Savings Vehicle

A 529 College Savings Plan

A 529 college savings plan offers tax advantages, flexibility, and the ability to contribute large amounts of money to offset future college costs.

After-tax dollars grow tax-deferred in state-sponsored investment funds. Distributions are free from taxes when used for qualified costs associated with attending college, graduate school, many technical schools, and even some foreign colleges.

"The Vanguard 529 College Savings Plan from MOAA was simple to complete and fund for my two grandsons." – LTC Joseph Lee, USA (Ret), Annandale, VA

Anyone can open a 529 savings plan for any beneficiary—including you, your spouse, or your children. And you can transfer funds from one beneficiary to another, providing they are family members—including stepsiblings, stepchildren, in-laws, uncles, aunts, nieces, nephews, half-siblings, and others.

For more detailed information, see the 529 savings plan Q&A section on MOAA's Web site at **www.moaa.org/529**.

TIP

Use Your Military Benefits

Former military servicemembers often access education benefits through the Montgomery GI Bill. But a 529 plan can be a great help, meeting education expenses that military benefits might not cover. And the 529's flexibility means you can transfer funds to another family member.

Do Your Homework on the Student Aid Process

Federal financial aid formulas arrive at the expected family contribution (EFC) by considering income, assets, and number of children in school at the same time. There are legal steps you can take to reduce your EFC and improve your child's chances at receiving more student aid, many of which are at: www.finaid.org/fafsa/maximize.phtml.

Financial aid is typically awarded in one of three forms:

Grants

They don't have to be repaid, but grants are typically awarded only to students with extraordinary financial need.

Campus-Based Aid

Programs administered at the school level include Federal Supplemental Educational Opportunity Grants (FSEOG), Federal Work-Study (FWS) programs, and needs-based Perkins low-interest loans.

Loans

Available through commercial lenders, they include subsidized and unsubsidized Stafford loans, PLUS loans, and professional/graduate student PLUS loans.

College Savings Plans Compared

	Section 529 College Savings Plans	Pre-Paid College Tuition Plans	Coverdell ESAs	UGMA and UTMA Accounts	U.S. Savings Bonds
Tax-sheltered investment growth	Yes*	Yes*	Yes	No	Yes
Beneficiary flexibility	Yes	Yes	Yes	No	Yes
Federal tax on qualified withdrawals	No*	No*	No – if used for qualified expenses	Depends on child's age	No – if used for qualified expenses or if income limitations are met at time of withdrawal
State tax deductions	Varies by state	Varies by state	No	No	No
Controlled by	Establisher of account	Establisher of account	Establisher of account	Custodian, until child is of age	Owner
Impact on financial aid	Asset of parent or other account owner**	Asset of parent or other account owner**	Asset of parent or other account owner**	Asset of child	Asset of owner, depending on tax bracket
Usable at any institution	Yes	Yes	Yes	Yes	Yes
Can be used to cover cost of tuition	Yes	Yes	Yes	Yes	Yes
Can be used to cover cost of room and board	Yes, in most cases	Sometimes	Yes	Yes	Yes
Self-directed investments	Sometimes	Sometimes	Yes	Yes	No
Eligibility for use limited by income	No	No	Yes	No	Yes
Contribution limits	Lifetime contributions limited to $200,000-$300,000, depending on the plan	Varies by state	$2,000/year	None	$30,000 per bond type yearly for each individual, and $60,000 per bond type/year for married couples filing jointly

* Earnings on nonqualified withdrawals may be subject to federal income tax and a 10% federal penalty tax, as well as state and local income taxes. The availability of tax or other benefits may be contingent on meeting other requirements.

** Distributions for qualified educational expenses are not counted as parent or student income in the determination of federal financial aid eligibility. You should consult your financial advisor about the financial aid treatment of student-owned UGMA, UTMA, and 529 accounts.

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The Scholarship Fund

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