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High-Income Families and College Planning

Strategies for not going into debt.

If you're a high-income family, you're not alone if you find yourself borrowing money for your child's college expenses.

A study by the Pew Research Center revealed that the rate of borrowing over the past two decades has been much greater among graduates from more affluent families than among those from low-income families. In fact, the number of high-income families who are borrowing has doubled.

There's a myth—in part perpetuated by the "keeping up with the Joneses" mentality—that if you're wealthy you have college (even one with a $50k/year price tag) covered.

But even those who are well-off are scrambling for solutions to pay for the escalating cost of college. The scrambling becomes more frantic with each additional child.

Complicating matters? Because on paper your family is "too rich for financial aid," many high-income families are ironically "too poor for college." As a wealth advisor who has counseled high-income families, I offer the following advice for college financial planning—so you and your child aren't broke upon graduation.

Save from the Get-Go

When your child is cooing in the cradle, college is a distant land. It's common to feel like you have years to worry about saving for college. But the 18 years sneak up on you. And so does your first tuition bill, which currently averages about $33,000 a year.

Investing early in a 529 plan, a state sponsored tax-advantaged savings plan designed to encourage saving for future college costs, can help you pay the bill. I urge families to invest early in 529 savings plans, which operate much like 401ks or IRAs, in which you invest your contributions in mutual funds or other similar investment vehicles and the earnings grow tax-free.

There are many investment options to choose from, such as those that follow a fixed allocation or those that allow you to invest aggressively when a child is young and become more conservative as your child approaches college. Over time, you should see investment gains greater than those in a traditional savings account due to the tax-free growth. Some states even allow residents to deduct a portion of their contributions, and while 529 contributions are not deductible on a federal level, future distributions come out tax-free if the money is taken out to pay for qualified college expenses.

Currently, only 16% of American families invest in 529 plans. And many start investing too little or too late.

I urge families to take time to plug in the numbers using college-cost calculators. One family I counseled found that University of Illinois—a state college—would cost their now 1-year-old son $317,100 when he attends as an 18-year-old. While a sobering thought, the proper planning can make this more manageable. Investing $500/month with an estimated 5% return starting when the child is one would leave a shortfall of just $45,400. An investment of $800/month would likely cover the entire college bill.

However, this formula doesn't take into account several other factors. Actual returns could be higher or lower depending on the investments selected. Your child might receive merit-based aid or gifts from family. Or you might decide that your child should also foot some of the bill. The point is, if you plan to pay for your child's college tuition in full with cash, you must begin early and set aside a significant chunk of monthly cash.

Make Saving a Priority

No matter your income bracket, setting aside cash is hard. As a culture we are distracted by the short-term gratification of materialism. There are a bundle of articles on the broke high-income-earner phenomenon – the more money you make, the more opportunities for spending. Fancy cars, large homes with high property taxes, extravagant vacations, designer clothing, specialty youth training camps, and services like landscaping, housecleaning, and dog walking all add up.

None of these lifestyle choices are wrong; however, cumulatively they leave little room for saving for college. There are few families committed to investing $700 or $800/month for 18 years to fund one child—let alone two, three, or four. But if paying for your child(ren)'s college in full with cash is a priority, then financial priorities must shift.

Perhaps instead of taking an all-inclusive vacation every year, you opt for an all-inclusive every three years and allocate the saved money to a savings plan. Or maybe you buy a more modest, used car for your 16-year-old, and invest the difference in a 529. Simply, there are ways to save if saving is a priority. The key is to reorient from the short-view to the long-view.

Spend Down Your Child's Assets

This may sound like bad advice. But it is a strategy that might help your student financially through college.

An UTMA custodial account is a popular vehicle for college savings among high-income families for a variety of reasons, the most significant being tax savings and the lack of limitations on spending. A percentage of the account is tax-free and an equal percentage is taxed at a reduced "kid's" rate. To protect the funds as much as possible, the parent is typically the custodian of the funds until the child is an adult (18 or 21 years of age, depending on your state).

Unlike a 529 account, there are no limitations on how the funds can be used by the custodian prior to the assets being turned over to the child. However, this can quickly turn to a disadvantage when the child is handed over control of the assets, because he or she is not mandated to spend the savings on college, even if that was the intent of the account. A 529 account, in contrast, must be used for college expenses.

The larger issue, however, with using an UTMA for college saving is it is considered an asset of the child (not the parent) and is consequently counted against his/her financial aid. Specifically, assets registered in the student's name count 20% toward financial aid versus assets registered in a parent's name, which count for 5.64%. That means that 20% of these assets will be expected to be used toward funding college.

A better idea might be to spend down your child's UTMAs on items you would already spend money on—like braces, camps, study abroad programs, private school education, or a car for the student. Instead invest the money you would have spent on those expenses into a 529 account.

Negotiate for a Better Price

Picking a college is an exercise of prioritizing. Your stack-ranked list might look different than your child's. Often students get attached to a program, the campus experience, or the location, regardless of the tuition price tag. Deepening the divide between what a parent wants and what a student wants is the amount of merit award. The school your child has the deepest affinity for might offer the least amount in aid.

But what if you negotiated?

Say your child applies to a dozen schools, and narrows it down to a select three. Perhaps his first choice is School A, but School C offers a more attractive tuition package. Some schools will come down a little bit in tuition if you say, "You are my top school, but you are at x-amount of dollars more than this other school. Will you come down a bit, because I really want to attend your school?" Whether it's in writing or over the phone, try negotiating. They may come down a thousand or two, and every thousand helps.

What's the worst they can say? No?

Keep Talking

Whatever your strategy is for paying for college, it's important that parents and students are on the same page. That's why I suggest parents and children have proactive family meetings in which they first discuss how as a family they plan to pay for college, and second create a process for selecting a college based on what is realistic. Perhaps you pursue colleges that are known for giving generous merit-based scholarships. Perhaps you agree your child will work summers (and/or throughout the school year) to cover a percentage of the bill. Perhaps you suggest a plan for negotiating with schools.

The key is to plan in advance so that your choices now will poise your children for success in the years to follow college.