

New incentive to save for college

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During tough economic times, socking money away for the kids' college fund may be the last thing on parents' minds. But efforts are under way to turn saving into something too good to refuse.

Dickinson College, a liberal arts school tucked away in Carlisle, Pa., recently announced a guaranteed interest rate much higher than previously available through the Independent 529 Plan (I-529), which offers prepaid tuition accounts for 274 private colleges and universities (a list that's growing).

In effect, those who pay for a portion of tuition now will be guaranteed to earn enough interest to cover that same portion in the future, plus an additional return on their investment – 4 percent, in Dickinson's case.

Savings in the I-529 and state-sponsored 529 plans also offer significant tax advantages. To encourage participation, 12 states currently have a 529 matching-grant program or pilot, typically geared to lower-income families. Several states also offer scholarships or discounts linked to their 529 plans.

Dickinson officials hope their move will inspire copycats within the I-529, which in turn could motivate more parents to save. Parents' preparation is the "third leg of the stool" when it comes to the accessibility of higher education, says Robert Massa, Dickinson's vice president of enrollment. But it's been getting a lot less attention lately, he says, compared with the two other legs – the need for reining in college costs and for boosting financial aid from colleges and the government.

"If parents don't save, the first two legs of the stool ... cannot sustain the price; parents have to do their share," Mr. Massa says.

Parents of high school seniors are prepared to meet only about 13 percent of the average total cost of four years of college (about \$100,000), according to Fidelity Investments, which manages several state 529 plans. Parents of 15- to 18-year-olds are on track to cover a quarter of the costs, but those who have college savings accounts are on track to cover nearly half. Many parents mistakenly believe savings count heavily against them in calculating financial aid.

If a managed fund yields investment growth higher than the growth of tuition, a state-sponsored savings plan could be more beneficial than a prepaid plan. But prepaid plans are attractive in a volatile market, says Nancy Farmer, president of the Independent 529 Plan in Boston. The plan was launched in 2003 and now manages 5,500 accounts.

Dickinson has committed to its 4 percent offer for investments made in the next two years, and then it will reassess. The rate is only guaranteed if the student attends Dickinson, which can be hard to predict if you're opening an account for a toddler or even a preteen.

The I-529 account can be used at the other schools on the list, including places such as Vanderbilt and the University of Chicago, but the interest rate would be whatever that college was offering at the time of the investment. If the student opts for a school not on the list, the account will be transferable but will have less value.

Currently I-529 discount rates range from 0.5 percent to 2 percent, with the most selective institutions setting the lowest rates because they can attract students without offering more. Before Dickinson announced its new 4 percent rate, it offered 1 percent.

Anything that helps college savings accumulate is positive, but higher interest rates may not be the most effective incentive, says Michael Sherraden, director of the Center for Social Development at Washington University in St. Louis, which researches and advocates for savings accounts and matching grants.

The Center's latest project, SEED for Oklahoma Kids, will spend seven years tracking the savings behavior of about 2,700 families with babies, half of which received \$1,000 in a 529 plan and will get some matching dollars for putting in their own money.

Previous research has shown that "having an account appears to have positive effects on the [parents' and children's] orientation toward college," Mr. Sherraden says. A measure introduced in Congress last year would create savings accounts for children nationwide.