Have a strategy when paying for child's college

By Cindy Szymanski, CFP®

This time of year, many parents with children in college are trying to determine how to pay the upcoming fall semester tuition, as well as room and board. We talked to Cindy Szymanski, CFP®, a Financial Advisor at Bloom Asset Management in Farmington Hills to find out which college funds parents should use first when paying for college costs.

Q. Many parents have done a good job of saving for their children's college education, but often they have put the funds in a variety of savings accounts or investments. When paying bills, is there a good method for determining which investment account to draw from first?

A. It is important to have a strategy when paying college bills because you will need to pay them for four years or longer, depending on how many children you have attending college. In general, it makes most sense to draw money from investments that have the least chance for growth first, and keep investments with better growth potential invested until you have to use these funds.

For example, if you have a lot of money in a savings or money-market account, that is the first place to tap into for college costs because you aren't really getting a good return with those investments. If you have a 529 plan, that would be the next place to withdraw funds from when you run out of cash because not only does your investment earnings in this fund grow tax free, distributions to pay for the beneficiary's college costs also come out federally tax-free. As a last resort, you would want to sell shares of stocks, mutual funds or even company stock options to help fund college costs. However, those are subject to taxes, so it is best to take funds from investments that are more tax-effective first before tapping into your other investments.

Q. What about borrowing money from the various college loan programs available to parents?

A. In the past, the rates on many federal loan programs for parents were so low that it was a good strategy because people were earning more on their investments, but that isn't the case today. If you have equity in your home, one viable strategy could be to take out a home equity loan. Rates are historically low and you would get the added benefit of being able to possibly deduct the interest on your income tax return.

One Federal loan program that many parents use is the Direct PLUS Loan, but the current interest rate is around 6.4% and the repayment period begins at the time the PLUS loan is fully disbursed, with the first payment being due within 60 days after the final disbursement. Keep in mind, that there are a variety of student loans out there and you will need to do some research to choose the best option for you.

If borrowing is necessary and you cannot obtain a lower rate than the PLUS loan, a better strategy may be to have the student take out a student loan such as a Direct Stafford Loan first, which would be unsubsidized (you pay all the interest, although you can have the payments deferred until after your child graduates). To receive a subsidized Stafford loan you must be able to demonstrate financial need. The interest rate for the Stafford loan for undergraduates is currently around 3.4%, which is much lower than the PLUS loan. It is around 5.4% for graduate students. All students are eligible for the Stafford loan. Once funds from this loan are exhausted, you could then apply for the PLUS loan or other loans available to you. This would allow your investments to grow so you have more money to use after they graduate.

In her role as a financial advisor, Cindy provides financial planning and investment portfolio management services for Bloom Asset Management clients. She was previously the director of client services and a client relationship manager at Bloom Asset Management. Szymanski has more than 20 years of experience in the financial industry, and also holds the designation of Certified Financial Planner (CFP®). If you have any questions regarding investments or financial planning, please email her at cindy@bloomassetmanagement.com.