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# Trust & Investment Management Group

## "The more I go through parenting, the more I say I owe my mother an apology."

**Ray Romano**

This month's blog is about college savings funds. Few moments in my life have been as special as witnessing the birth of my two sons. My role during the actual delivery process was twofold:

1) provide emotional support to my wife (hand holding, platitudes and corny jokes); and

2) secure the handoff of the newborn baby from the nurse's arms to my shaking limbs.

My memory is a little fuzzy, but I generally remember my first thoughts with each boy was something to the tune of, "Dreams can actually come true, why does he need to cry so loud, I wonder if the hospital McDonald's is open yet, and who in their right mind expects us to be able to care for this baby?"

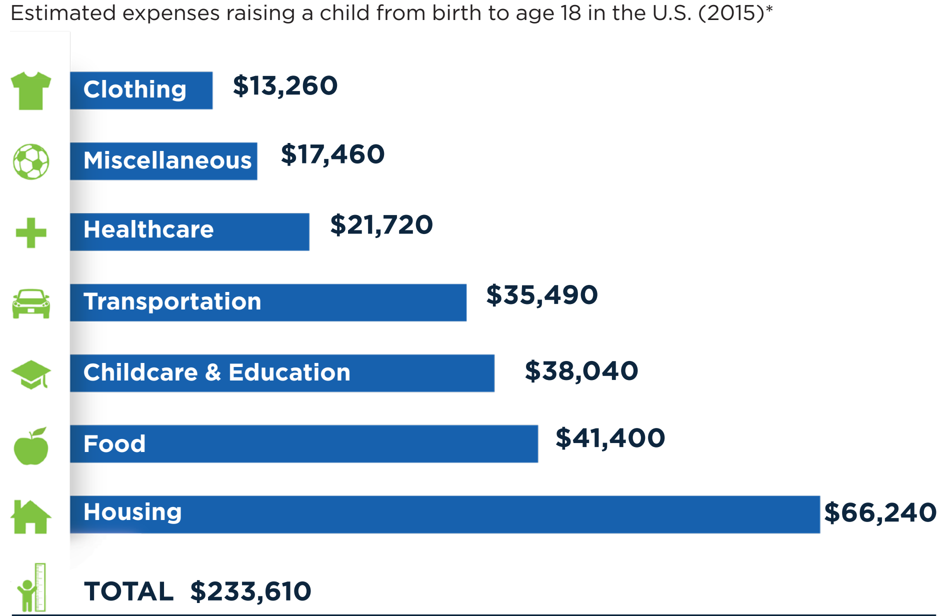
Well, it has not been easy, but I can proudly share that twelve and fifteen years later, my wife and I have managed to become competent in subject matters that range from diaper changes to driving lessons. All signs point to our kids being on a reasonable path to becoming respectable and responsible adult human beings.

The financial aspect of raising a family is no easy task. According to a U.S. Department of Agriculture report, the estimated expenses of raising a child from birth to age 18 in the U.S. is about $233,000. This is before you even scratch the surface of college tuition expenses.

At the front end, you need to feed (baby formula, bottles), clothe (diapers, onesies with the University of Michigan logo), shelter (cribs, playpen), transport (car seats, baby strollers), nurse (pediatrician visits, medications) and educate/entertain (music classes, swimming lessons) your child. I do not remember exactly what each of these items costs, but

### Raising A Child is An Extremely Expensive Undertaking

Estimated expenses raising a child from birth to age 18 in the U.S. (2015)*




*Based on a married couple with an average income before tax of $81,700

**Source:** U.S. Department of Agriculture's Expenditures on Children by Families. **2015.**

I do recall many tense debates with my wife about the economic utility of the $300 music classes for my scholarly two-year-old son where the 2008 equivalent of “Baby Shark” was the featured song each week.

> **Everything seems to cost more than you expect.**

On the back end is college. I recognize that not everyone will be fortunate enough to be able to set aside a significant amount, if any, for their child’s college. There are clearly systemic issues in the U.S. that have driven aggregate student loan debt from $250 billion in 2004 to $1.7 trillion today. Much has been written about this *(see the link to the Brookings Institute report below)*, and it is a major social and macroeconomic issue that needs attention. This is about doing the most with what is available to you.

## 529 PLAN BENEFITS

**TAX DEDUCTION**
Over 30 states currently offer a full or partial tax deduction or credit for 529 plan contributions.

**EASY ENROLLMENT**
Simply visit the plan’s website or contact your financial advisor.

**DONOR CONTROLS THE ACCOUNT**
The named beneficiary has no legal rights to the funds so you can assure the money will be used for its intended purpose.

**NO INCOME LIMITS**
529 plan has no income limits, age limits or annual contribution limits.

**USED FOR ALMOST ANY SCHOOL**
529 plans can be used for undergraduate, graduate, technical, or trade schools in the U.S. and some accredited schools abroad.

**YOU CAN CHOOSE THE INVESTMENT**
Plans offer a variety of investments, including mutual funds, exchange-traded funds and fund of fund portfolios.

**Source:** An Introduction to 529 Plan. **529funds.com.**

Like everything else in life that requires planning, there are the known knowns and known unknowns. It is helpful to understand these in advance, stay focused on what you can control and size up the uncertainties to know how to build a flexible and incremental approach to help you along the way.

### Known Knowns.

Similar to retirement savings, your best friends in the college savings journey are time, compound interest and tax-advantaged investment accounts. Here is a simple example to remind you of the power of the math in a tax-advantaged account. If you invest $100 today in an S&P 500 index fund that grows 6% per year, it will be worth $286 in eighteen years. If you are in a 529 plan, you will be able to withdraw and spend the full $286 on tuition bills. If you are in an account where you are required to pay capital gains taxes on your investment earnings, your same investment would be worth 13%, or $37, less. When you add a zero or two to your contribution amounts, that can make a material difference in the size of your future college savings nest egg.

529 plans are the most common college savings plan because of their relative simplicity, as well as the various levels of income tax breaks. While your contributions are after-tax dollars, investment earnings in a 529 plan grow tax-free and there are no capital gains or income taxes on withdrawals provided the funds are used for qualified education expenses. Another sweetener offered by many state plans for their residents is an annual tax deduction for yearly 529 contributions. For example, in Michigan, individuals can deduct up to $5,000 and married

couples filing jointly up to $10,000 per year on their annual contributions.

529 plans are also a great tool for Grandma and Grandpa to contribute their fair share if they so wish. There is an annual gift tax exclusion of up to $15,000 per individual which means each grandparent can transfer this money out of their estate, tax free, to each grandchild. There is also a 5-year gift tax averaging, or superfunding, whereby an individual may contribute as much as $75,000 to a 529 plan and recognize the tax deduction evenly over the next five years.

The hook on 529 plans is that the funds must be used for qualified education expenses which includes items such as tuition, housing, books and up to $10,000 per year in K-12 tuition expenses. If you have serious concerns that your child will not go to college, then you may want a more flexible account type. The most common other types of accounts that people utilize are custodial accounts, brokerage accounts and Roth IRAs. Each offer their own relative benefits and drawbacks such as level of control, investment options, management fees and tax treatments. Lastly, if you need to withdraw the 529 plan assets for spending outside of qualified expenses, it is still your money, but you will need to pay a 10% penalty on the balance, as well as pay taxes on the investment gains.

### Known Unknowns.

The most obvious known unknown is the final bill you or your child will owe when they receive their diploma. There are many factors that go into this (in-state versus out-of-state, public versus private, scholarship money and tuition inflation trends, just to name a few of the bigger ones). You also do not really know your family income trajectory over the next ten plus years nor the investment returns your accounts will generate. To pile on, you need to balance your budget priorities across all the different mouths to feed - current life spending, retirement savings, college savings and who knows what else.

Most, if not all, experts advise not saving money for your kids' college at the expense of your retirement goals. The financial aid system is available to fill the funding gap for college, but there is no similar backstop for retirement savings. You will need to develop a plan that leaves you the flexibility to account for potential income setbacks along the way to make sure your retirement plan is secured first.

I know how proud a day it was for me as a college graduate when my parents, my brother and my grandparents were in the crowd cheering loudly for me and my classmates on graduation day. While the investor in me is still a little suspicious about the ultimate return on investment from the gobs and gobs of money we will have spent on our children, the human in me is beaming with pride and excitement to be able to experience that moment as a parent someday and provide the gift of education to our children.

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**I know this may sound like "a riddle, wrapped in a mystery, inside an enigma,"† but fear not because there are many best practices in addition to reams of published literature at your fingertips to help navigate all of this.**

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College savings calculator tools (savingforcollege.com, for example) can help you estimate cost assumptions, and compound interest (NerdWallet.com, for example) can help you determine your contribution amounts and visualize how different market returns can drive investment earnings.

***Sources:***

1. *Brookings Institute. www.brookings.edu. "Who owes all that student debt? And who'd benefit if it were forgiven?"*
2. *Nerdwallet.com*
3. *Savingforcollege.com*
4. *U.S. Department of Agriculture. www.usda.gov "The Cost of Raising a Child"*
5. *†Winston Churchill. The Russian Enigma. Oct. 1, 1939.*

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**Mike Davidoff, CFA®**
Vice President, Senior Investment and Business Development Officer

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