TIPS FROM YOUR

FINANCIAL COACH

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Fall is in full swing, and so is school.

Here is what you should know about college and how to create a simple three-step solution.

As the warm summer months give way to the first early crisps of autumn, intrepid students and their proud parents look hopefully toward what the future holds for this year's crop of high school seniors. Some will enter the workforce right after graduation; some will serve our country in the Armed Forces. Many will look to further their education in pursuit of a trade or degree. Although most of them might cringe at the notion, the statistics say most students will probably do whatever their family members did:

- 60% of veterans under age 40 have an immediate family member who served in the military, compared with only 39% of all adults younger than 40.
- Around 70% of adults aged 22-59 who have earned a bachelor's degree have at least one parent holding a bachelor's degree.
- While 70% of second-generation students who enrolled in college made it to completion – including 82% when both parents had graduated – only 26% of those enrolled from first-generation households earned degrees.

As we grow up looking at the people around us, and we see that they have some Thing, or are doing some Thing, then by simple reason of "I've seen it done", that Thing gets filed under The Haveable, The Doable and The Achievable. And in many instances, we believe that makes all the difference.

To get an idea of the numbers:

To some, college is an aspiration, perhaps a family's generational dream. Others may see college as a given or an expectation… perhaps even an obligation. But every family knows an education does not come cheap.

At the University of Michigan in Ann Arbor, the annual in-state tuition and fees alone come to $16,736. Adding in housing, meals, books/supplies and personal/miscellaneous expenses, the estimated Cost of Attendance grows to $33,555/year (finaid.umich.edu, 2022). In-state at Michigan State is $26,426 (admissions.msu.edu, 2022), about the same as Central Michigan.

And with parents and students now being told to expect college costs to inflate as much as 8% annually (www.finaid.org, 2022) it gets harder every day to pretend to recall those halcyon days when, given enough drive and dedication, one could work their way through school throwing pizzas or flipping burgers. Those days are long gone…if they ever existed at all.

So, where's the money?

Interesting to note that according to Sallie Mae (Hanson, 2022), the funding for at least half of an average student's bachelor's degree comes from outside the family, via scholarships, grants or borrowing.

Some families will rely on outside funds more than others. Some families have only one education to fund while others may have four or five. Some families began saving early or have strong incomes and are not concerned with outside funding while others started saving late or not at all and their students may rely completely on outside funding. According to www.educationdata.org, most students fall somewhere in between with 83.8% of first-time, first-year undergraduate students receiving financial aid in some form, with each student borrowing an average of $11,836 per year for school. That's after scholarships, grants, and parental contributions.

But that's nothing new.

Over 43.0 million borrowers have federal student loan debt, across multiple generations. (Hanson, 2022) And while low rates and income-based payment limits help to keep the debt service manageable (payment plan options are numerous and income-based payments on Federal loans are usually capped around 10% of gross income), the average student loan payment is still an estimated $461 per month. That's a car payment! For a married couple, that's over $55,000 saved over five years. That's a down payment on a home!!

The average borrower takes 20 years to repay their student loan debt, and the interest accrued over the life of the loans is usually DOUBLE the principal borrowed. How do you feel about paying for that portion of the degree not once, not twice, but thrice.

More importantly, that $461/month represents the discretionary cash flow that might otherwise go towards other goals. The result: more and more people are postponing financial decisions because of the debt. More college graduates are living with their parents than ever before, and longer!And a 2020 survey found about "one-third of respondents between 18-34 said they might postpone marriage — or had already done so — until student debt is paid off". (LendKey Technologies, 2020).

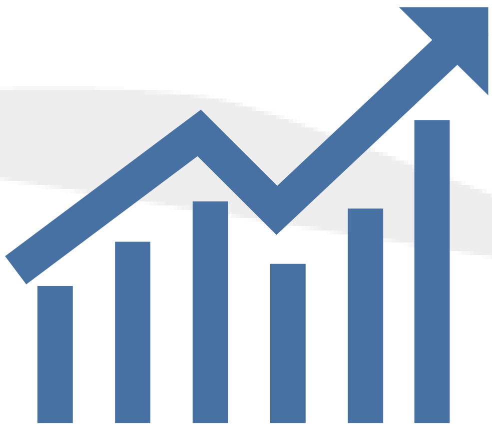
It's all relative (and related)

There are also ramifications for the general economy. Student loan debt limits the ability of young entrepreneurs to save for startup costs or support themselves during the lean early years. It also makes it more difficult to access business credit. Such conditions discourage risk-taking and stifle innovation, and would-be entrepreneurs are 11 percent less likely to start a business if they owe more than $30,000 in student loan debt. That may not seem like a daunting statistic but considering small businesses of fewer than 500 employees employ 47.3% of the national private workforce, the full long-term weight of this heavier burden (which has now been borne by multiple, successive generations of college-educated Americans and their parents) is only starting to be felt.

The Symptoms

The widespread student loan burden did not result from students borrowing more than they needed; after all, the schools themselves dictate how much a student can borrow. No, the widespread debt is the simple and inevitable outcome of education costs rising faster than everything else. Over the last 20 years, the cost of education has inflated over 6% (Hanson, 2022), compared to the 2.26% core inflation rate. (US Inflation Rate 1960-2022, 2022) At 6%, the cost of attendance will double roughly every 12 years.

Such an obviously unsustainable rate of inflation is indicative of a nation living in denial and borrowing more money every year. One might not be far off the mark to say that the growing and widespread debt is, effectively, the financial manifestation of that denial.



But what is causing education costs to consistently inflate at nearly 3x the rate of everything else?

The Reality

In a 2015 report (Lucca, Nadauld, & Sehn, 2015), the Federal Reserve Bank of New York found that 60% of any increase in borrowing limits for subsidized federal loans flowed directly into increased tuition. That means that when the government makes $1.00 more available to borrowers, the schools increase tuition and fees by 60 cents.

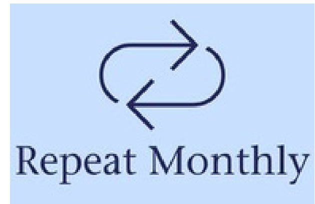
This is not shocking: at a macroeconomic level, if you increase the supply of dollars chasing a unit of demand, price must necessarily increase as it seeks equilibrium. In addition, as prices rise, production (new schools, expanded departments) should increase until new capacity soaks up the excess liquidity.

We saw exactly that with the ascent of for-profit schools in the 1990s and early 2000s after the myriad subsidized loan programs were consolidated, streamlined, and expanded.Private equity firms saw underutilization of expanded government funding and the development of the nascent for-profit model was accelerated and expanded to soak up that liquidity, regardless of whether a quality product was offered.

The Point

We want the kids to go to college. And while we can all agree that the less debt they graduate with, the better shot they have at success, we can't fix the systemic issues overnight, if at all.

So, what can WE do about it? Great question with an easy, three-step solution.



That's what we can do today. The trick is to keep doing it.

And if it makes sense to save, then it makes sense to save the right amount, and in the right place. The right amount is a function of time, cost, and investment return. The right place depends on many factors related to your unique situation.

Here are some possible options for the right place:

- Coverdell Education Savings Accounts (ESA), formerly known as Education IRAs, offer tax-deferred growth and tax-free withdrawals for qualified education expenses. However, the annual contribution limit of $2,000 is ineffectual and they have income limits and offer no current-year tax breaks.

- For the most part, Coverdell ESAs have been replaced with state-sponsored 529 Savings Plans offering the same tax-deferred growth and tax-free withdrawals as the Coverdell ESA, but with much higher contribution limits. Furthermore, the owner of the account retains control over the funds until distributed and the beneficiary can be changed at any time. That means that a family can set up a plan for each child or a single plan to cover successive students and/or split later. Some states allow the deduction of some contributions and the tax deferred growth, given time, can be very effective in accumulating funds for college.

- A heretofore popular and effective strategy was to purchase some blue-chip stocks or mutual funds in a regular non-qualified brokerage account or direct investment program when the kids are young and then gift the investment years later to the student who could then sell it the appreciated assets at their lower tax rate. This strategy lost most of its luster when they added the Kiddie Tax that pulled dependent children's passive income back into the parents' return. Still, money accumulated in an after-tax account remains the most flexible option, allowing savers to redirect these assets to any of their financial goals with no penalties or additional taxation if used for non-education purposes.

- Custodial accounts (owned by a minor under the UTMA/UGMA laws with a named custodian) are more common than they should be. These after-tax accounts allow minors to own assets, albeit under control of a custodian, in their own name. The same Kiddie Tax rules apply, so there is no tax break, and assets owned directly by the applicant are the least favorable type of asset on the Financial Aid Form. Furthermore, the minor automatically gains full control of the assets upon reaching the age of majority per their state of residence (often at age 18), at which time the money can be used at their discretion, with no guarantee or tax incentive to use money for educational purposes. And sudden access to money at an early age may itself come with its own issues.

In Conclusion

Few would disagree that it is preferable to graduate with as little debt as possible. Less debt offers an easier road to financial self-sufficiency (out of the house!), while starting your career already in the hole is inefficient, demoralizing, and often paralyzing.

We have little control over what the government will do with financial aid funding. We have no control over what schools will do with their prices. Based on what pricing has done in the past, it is entirely appropriate to expect additional education funding to continue fanning the flames of inflation, and there is nothing to suggest categorical loan forgiveness programs will not produce similar results.

All we can do is accept that education costs are likely to keep inflating at a faster pace than everything else, and act accordingly: try to get ahead of the game by starting a savings program earlier. If you're late to the game, you'll need to save more aggressively, and if you plan to fund some or all education costs via cash flow, you may be well-served to review your current budget to identify ways to reduce spending now.

Most importantly, do not change your savings plans in response to the recent loan cancellation plan. The legality of this proposal is debatable, and opponents are numerous. Furthermore, what may be offered to future borrowers is completely unknown, so the best practice is to just keep saving.

You can also prepare your family and students to navigate the financial aid and application processes. Getting familiar with the jargon used by schools and FAFSA (Free Application for Federal Student Aid) will help you compare the pre-set financial aid packages many schools offer. And knowing the different types funding for which you may be eligible will be helpful when creating a list of schools.

Sending the kids off to college is an occasion for great excitement and great trepidation. And the planning we do today is designed to maximize this excitement and temper this trepidation.