What are the best college-savings investments?

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5 ways to grow your money for the ever-higher costs of higher education

Many of the best-known college-savings tools are specifically earmarked, educational accounts — but it pays to think outside the box towards certain general investments too.

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- There are several types of college-savings investments — both specifically education-oriented plans and more general vehicles or accounts.
- College-specific investments include 529 plans and education savings accounts (ESAs). Other options include target-date funds, savings bonds, and Roth IRAs.
- Whatever the college-savings investment, good strategies include keeping it low-risk and liquid, starting early, and contributing consistently.

The price of higher education seems to get higher every day.

In its 2020 Trends in College Pricing and Student Aid Report, the College Board notes that, between 1990-91 and 2020-21, the average four-year public college's tuition and fees nearly tripled in price. Private institutions doubled in price.

Fast fact: Although the inflation rate has slowed in the last decade, from 2010 to 2020 higher-education costs still increased by 16% and 18%, for public and private schools, respectively.

For 2020-2021, the report said, the average estimated budget — which includes tuition and fees, room and board, and allowances for books and supplies, transportation, and other personal expenses — for full-time undergraduate students is about:

- **$27,000 a year** (or $150 per school day) at public institutions.
- **$55,000 a year** ($306 per school day) for private colleges.

If you multiply these annual costs by the four, five, or even six years it might take to earn a bachelor's degree, it's easy to understand why many families go deeply into debt seeking diplomas in the US.

The good news is there are many ways to save for college — and help your child avoid a mountain of student loan repayments in later years.

Here's a quick rundown of some of the most advantageous ways to invest for college. Many are specially earmarked for higher education. But it pays to think outside the college-plan box, too: Many general accounts and investments could also work well, given their tax advantages or their time-oriented pay-offs.

529 plans

"The most popular college savings option nowadays is clearly the 529," says financial advisor Sam Davis, a partner with TBH Global Asset Management.

A 529 plan is a state-run, tax-advantaged investment account used for education savings. Contributions grow tax-deferred within the account, and withdrawals are tax-free if they go toward the beneficiary's qualified education expenses, including:

- College costs (tuition, room and board, fees, books, supplies, equipment, computer hardware and software, and internet access)
- Vocational and trade schools
- Apprenticeship programs
- Student loan repayments

You make contributions with after-tax dollars, so there's no federal tax break when you add money to the account. Still, more than half of states allow some type of deduction, whether that's a flat dollar amount, a percentage of the contribution, or the entire amount.

While you can establish a 529 plan in any state, you won't qualify for that state's tax perks unless you are a resident.

With 529 plans, "the owner never relinquishes control of the assets, yet the assets fall out of the estate for estate tax purposes," Davis says. The ability to have successor owners and change beneficiaries also aid in the popularity of the 529."

There are no contribution limits with 529s. Still, since contributions are considered gifts, even when made on your own child's behalf, most people limit their annual contributions to the maximum gift tax exclusion sum: $15,000 (so, $30,000 for married couples) per child.

Coverdell education savings accounts

Coverdell education savings accounts (ESAs) are similar to 529 plans: Both are investment vehicles that offer tax-free growth and withdrawals when used for qualified education expenses. You open both at brokerages, banks, or other financial services companies (some, like Fidelity Investments, make a specialty of them). And both accounts can be transferred to another member of the beneficiary's family (handy if one kid decides to skip college).

Still, the two accounts have a few notable differences:

Education savings accounts vs. 529 plans

FEATURE	EDUCATION SAVINGS ACCOUNTS	529 PLANS
Contribution limits	$2,000 per year per child	No annual contribution limit
Age restrictions	No contributions once the beneficiary reaches age 18	None (in most states)
Time restrictions	Beneficiary must use the funds before age 30	None (in most states)
Income restrictions	Modified adjusted gross income must be below $110,000 ($220,000 for married filing jointly) to contribute	None
Investment options	Virtually any investment	Fixed set of investment options
Plan/sponsor custodian	Brokerages, banks, financial services firms	State 529 plans

Roth IRAs

Roth IRAs are traditionally designed for retirement instead of education expenses. Contributions (in 2021, up to $6,000 a year; $7,000 if you're age 50 or older) grow tax-free, and qualified withdrawals in retirement are tax-free.

However, Roth IRAs have a unique feature not shared by other retirement accounts: You can withdraw your contributions (but not earnings) at any time, for any reason, with no tax or penalty. That's because you've already paid tax on that money. That means you can withdraw your contributions and use that money for qualified higher education expenses, including tuition and fees, room and board, books, supplies, and equipment.

Still, it's important to note that doing so can affect financial aid eligibility. Roth IRA balances aren't reported on the FAFSA (Free Application for Federal Student Aid) or the CSS Profile, whether it's you or your child who owns the account. But distributions are reported as income on both applications, which can affect how much financial aid your child receives the next year.

You should also be sure to consider the long-term effects of tapping any account that's meant for your post-employment years.

"Many families we work with have children who are starting college as the parents are retiring," says Davis. "For these families, we believe it's increasingly important to make sure there is a conservative and well-funded educational plan. It would be terrible to take a large market hit while having to fund the educational shortfall from assets that are temporarily undervalued."

Target date funds

Target date funds provide diversification in a single investment. They are often mutual funds and hold a mix of stocks, bonds, and other assets. The portfolio is automatically rebalanced to a more conservative mix as you get closer to the target date. While target-date funds are an easy and popular way to save for retirement, the strategy also helps build college savings.

One way to invest in a target-date fund is through a 529 plan that offers these investments, such as the Vanguard 529 College Savings Plan. This fund is diversified among stock, bond, and cash investments, in proportions that meet your child's enrollment timeline. In general, educational target-date funds are designed to keep pace with the rising cost of education while preserving capital as the enrollment date nears.

"It seems that more and more families use target-date funds within 529 plans," says Davis. "The reason for that is clear: You forgo some return but reduce your risk as your child nears college. Mind you, most 529s that are target date invest in short-term cash instruments, treasury bonds, corporate debt, and very little stock as the child gets older. This is certainly prudent, but it does reduce the potential return of the account."

Savings bonds

Savings bonds might not be the first investments that come to mind when saving for college, but they can be a reasonable addition to the overall plan. "An often-overlooked fact is that EE and I bonds can be cashed in, tax-free if used for qualified educational purposes," says Davis.

Of course, interest rates are nothing to get excited about: The rate for a 10-year bond that matures in April 2021 is an annual 0.10%. Still, "Savings bonds may make sense for more conservative investors," says Davis. "Unfortunately, the [current] interest-rate environment does not provide a very adequate return in relation to recent tuition inflation."

That might change in the future. But for now, consider savings bonds a low-risk way to save for college — and one that you can time to come due for the enrollment date — but it's not an investment that will enjoy substantial growth.

Quick tip: Another US government-issued bond ideal for investors wishing to play it ultra-safe: zero-coupon bonds. A "zero" doesn't pay periodic interest, but instead sells at a deep discount, paying its full face value when it comes due. That makes it ideal for long-term, targeted financial needs at a foreseeable time — like college. If a zero's held to maturity, you're guaranteed the full face value, plus you'll have paid less now for more later.

Tips for saving for college

No matter what vehicle you choose to invest in, here are a few general college-savings strategies to keep in mind:

- **Start early.** The sooner you start saving for college, the more time and opportunity for your investments to grow. Every dollar you save is one less dollar you or your child might need to borrow, and repay with interest.
- **Be mindful of risk.** Retirement savers generally move out of higher-risk investments and into lower-risk ones the closer they get to retirement. Use the same approach with college savings: You have time to bounce back from a market downturn when your kids are little, but you don't want that risk when the tuition bills start coming in.
- **Invest consistently**. Set up regular, recurring contributions — whether it's $50 a month or $500. Doing so makes it a habit and reduces the risks associated with trying to time the market.
- **Make sure it's liquid**. Since timing is important, liquidity is key for these investments. Be sure you can access the money when you'll need it by freshman year.

The financial takeaway

College is expensive, and it's projected to get even more so. But there are several types of college-savings investments — both specifically education-oriented plans and more general vehicles or accounts that can help alleviate the bite. They offer different advantages and have different degrees of flexibility.

No matter where you put your money, keep in mind the best savings strategies. You'll want a low-risk and targeted growth investments. Keep your contributions consistent, and make sure funds will be available when you need them.

Perhaps the best college-savings plan of all: Start early — so you can take advantage of time and the power of compounding.

By Jean Folger

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