Mesirow

They grow up so fast!

Tips to help your kids' college funds grow as fast as they do

Mesirow Wealth Management is a division of Mesirow Financial Investment Management, Inc., an SEC-registered investment advisor.

Starting a family is exhilarating and terrifying all at once. But once your family unit has settled into a groove, it's time to start planning for its future. For many, part of that future entails putting one or more kids through college.

It's a daunting task when you look at current tuitions and what those tuitions may look like 15 or 20 years from now. But that's no reason to feel it can't be done. This brochure is designed to help you answer three basic questions to get your planning started right:

1. **How much money will I need?**
2. **How much time do I have before I need it?**
3. **What are my most sensible investing options?**

With planning and discipline, you can give your kids' college funds a chance to grow as fast as they do.

While college fund goals vary in size and investment time horizon, one thing they nearly all share is the need to invest rather than save to achieve them. That means you may want to enlist the aid of a wealth advisor to help you understand what your most tax-savvy options are. With all that in mind, let's get started.

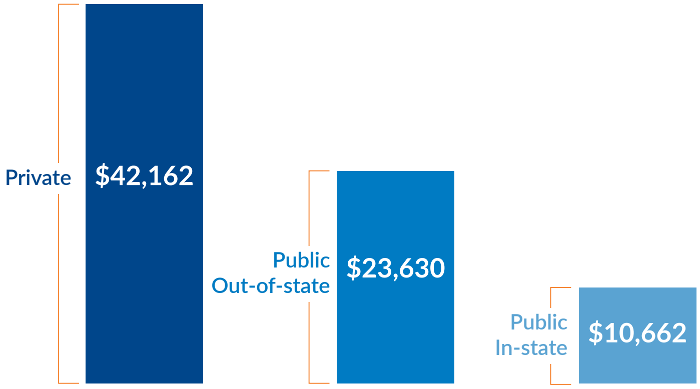
1. How much money will I need?

This is a fundamental metric for any investment plan, and unfortunately for college funding planners, one of the more difficult to answer because it depends on so many variables. Among them:

- State school or private?
- Community college or four-year?
- In-state or out-of-state tuition?
- University or trade school?
- How much might scholarships or grants help?

Chances are, your two-year-old isn't going to be much help in answering these questions, so that means you'll have to anticipate what you may need. Here are some parameters to consider:

AVERAGE ANNUAL COLLEGE TUITION AND FEES AT RANKED COLLEGES



Source: US News & World Report. Data for the 2023–2024 academic year.

These are 2023 dollars, of course, so you'll have to factor inflation into your plan. Not the CPI inflation rate, but the rate at which **tuitions** are increasing, which, unfortunately, has tended to be much higher.

A good rule of thumb is that tuition rates will increase at about twice the general inflation rate. On average, given the average annual inflation rate over the last couple of decades of 4%, that would translate to about 8% per year. At 8%, the cost of college doubles every nine years.[1] In 18 years, annual tuition at a private college would be about $150,000.

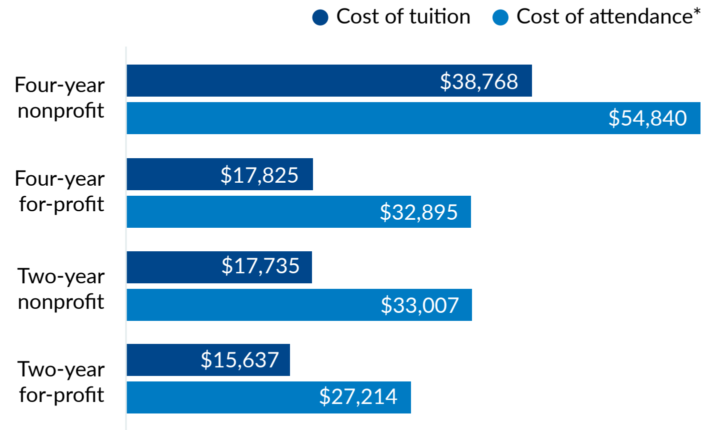
Given that lofty figure, it's no wonder that trade schools are seeing an increase in popularity.

Trade schools are often seen as a more cost-effective alternative to a life-advancing education, and the average cost to attend a single year at a four-year college would essentially pay for four years at a trade school.

Of course, you don't know if your child will be an electrician and go to trade school or want to be an electrical engineer and go to MIT. But for most families, the expectation is for each child to go to a traditional four-year college, often to the same one their parents attended.

And it's important to remember that tuition is only one component of college expenses. There's room, board, books, transportation, perhaps furniture (depending on living arrangements) and much more. Tuition is the floor, not the ceiling.

ANNUAL COST OF PRIVATE COLLEGE



*Cost of attendance includes tuition. It does not account for potential lost income nor student loan interest. | Source: Education Data Initiative.

Can you save too much for college?

Clearly, the target range for a child's college education fund can vary a lot. So it's wisest to set your goals higher and overshoot than to set them lower and then need to rely on hefty loans to make up the difference. Some options, like 529 plans, allow you to enjoy a tax benefit and deploy what you don't use in other ways. We'll get to those a little later.

For now, do your best to anticipate where you think your children may go, based on where you live and what educational opportunities are available to them. You can find a number of useful college tuition calculators online, many of which allow you to choose and compare schools. One we like is at USA.gov.

2. How much time do I have before I need it?

This question is much easier to answer than the first. It's just based on the child's age. But there's still much to be gained by the answer, because how much time you have will largely dictate how to invest your funding money.

As in most investment-related goals, the earlier you start the better.

- Longer time periods allow you gain a bigger benefit from the compounding interest of reinvested dividends and capital gains.
- Longer time periods may allow you to invest more in securities like stocks that offer higher return potential but are more volatile, and thus are better suited for longer investment time frames.

A college fund for a one-year-old will likely be more stock heavy than a college fund for a 10-year-old. There may be inheritances, gifts from relatives or other factors at play that can impact the make-up of your college fund, too.

Your wealth advisor is an invaluable resource in helping you construct a portfolio that considers your income, tax situation, family dynamics and goals. But one of the few infallible investing axioms is: start now! That gives you the best chance of success.

3. What are my most sensible investing options?

Investing for college is largely like investing for any other longer-term goal — establish a target amount and construct a portfolio based on your time horizon and risk tolerance. But it's different in that there may be other sources of financing:

- **529 plans**
- **Grants and scholarships**
- **Gifts**
- **Student loans**

529 plans

On of the most powerful tools that college savers have in their toolbox is 529 plans. Introduced by Congress in 2001, these specialized savings accounts offer a unique combination of tax advantages, investment growth, and flexibility, making them an ideal choice for families and individuals looking to invest in the future of education.

Investments in a 529 plan grow tax-free, so any investment income or capital gains will not be taxed if withdrawals are used for qualified education expenses. While there isn't a federal tax deduction for contributions, many states offer tax deductions or credits on state income tax for contributions to their state's 529 plan.

It's important to understand the specifics of funding, paying, the timing and handling of distributions, and managing leftover funds in these accounts to maximize the tax advantages offered by 529s.

Funding a 529 plan can start with as little as a few dollars and grow substantially over time, thanks to the power of compounding interest and strategic contributions.

WAYS TO FUND 529 PLANS

- **Consistent contributions:** Like any long-term investment plans, 529 plans thrive on consistency. Regular, scheduled contributions can turn modest sums into significant savings, thanks to the compound interest effect. Setting up automatic transfers from a checking or savings account ensures you stay on track without thinking about it.
- **Gift contributions:** Transform birthdays, holidays, and graduations into opportunities for educational investment. 529 plans often allow for gift contributions, which means relatives and friends can contribute directly to your child's future education.
- **Lump-sum contributions:** Windfalls, tax refunds, or bonuses present a golden opportunity to boost your 529 plan balance. As mentioned above, you can gift up to $18,000 per recipient in 2024 without those contributions counting toward your lifetime gift tax exemption. So, if you have three kids and three 529 plans and are a single parent, you can contribute $18,000 each, or $54,000 total, in a year without having to report those contributions to the IRS. You can also frontload up to five years' worth of contributions. By doing so, you can only contribute for the following four years if the annual exclusion increases, permitting a slight increase to the gift over the subsequent four years.

WHAT CAN 529 PLANS BE USED FOR?

The timing of distributions from a 529 plan is crucial to ensure they align with the payment of qualified education expenses. To avoid penalties and taxes, 529 distributions must be used for qualified expenses in the same tax year the expenses are incurred. Qualified Expenses include:

- Tuition and fees for the total amount of college or vocational school tuition. Some states also allow K–12 tuition for public, private, or religious schools up to $10,000 per year.
- Books, supplies, computers, software, internet access and equipment required for enrollment or attendance at an eligible educational institution.
- Room and board if the student is enrolled at least half-time.
- Student loans, with a lifetime limit of $10,000.

HOW CAN YOU MAKE WITHDRAWALS?

When it's time to pay for education expenses, you have two primary options for making payments from your 529 plan:

- **Direct payment:** Many 529 plans allow direct payment to the educational institution. Direct payments simplify the process and ensure the funds are used for qualified expenses.
- **Reimbursement:** If you've already paid out-of-pocket for qualified expenses, you can reimburse yourself from the 529 plan. Keep meticulous records of expenses and withdrawals for tax purposes.

MANAGING LEFTOVER FUNDS

Several strategies allow you to manage leftover funds in a 529 plan, each with its implications:

- **Change the beneficiary:** The flexibility of 529 plans lets the beneficiary be changed to another family member, such as a sibling, cousin, or even the account holder themselves, for further education pursuits.
- **Transfer to a Roth IRA:** Effective January 1, 2024, 529 account funds may be transferred to a Roth IRA if the account has been maintained for at least 15 years and the amount being transferred was contributed at least five years prior. The Roth IRA also must be that of the 529 account's designated beneficiary since 529 plans are considered part of the beneficiary's estate. While the aggregate transfer amount is capped at $35,000, the Roth IRA annual limit ($7,000 in 2024 for those under 50) still applies.
- **Non-qualified withdrawals:** You can make non-qualified withdrawals, but these will be subject to income tax and a 10% penalty on the earnings portion of the withdrawal. This option should be the last resort.

A 529 plan is a versatile and beneficial tool for financing education, but maximizing its benefits requires understanding and strategic planning. By carefully managing contributions, timing distributions correctly, and wisely handling any leftover funds, families can make the most of their 529 plans. Whether you're planning for your child's future education or managing current educational expenses, a well-considered approach to your 529 plan can provide significant financial advantages and peace of mind.

Grants and scholarships

Scholarships and grants should be your first option to reduce your out-of-pocket college costs. Unlike federal and private student loans, you don't have to pay them back. Scholarships, in combination with grants, were the second-largest source of financial aid during the 2022–2023 academic year, covering an average of 29% of students' college costs.[2]

Grants can be from the federal government or from states.

SCHOLARSHIPS

$7,822
Average scholarship amount per student

61%
Amount of American families that used scholarships to pay for college in 2022–2023

GRANTS

$10,680
Average grant amount received by full-time undergraduate students in 2021–2022

57%
Amount of American families that reported using grants to help pay for college costs in 2022–2023

Some scholarships are merit-based, earned by meeting or exceeding certain standards set by the scholarship-giver based on academic achievement or a combination of academics and a special talent, trait, or interest. Some merit-based scholarships offered by colleges and universities require applicants to file the Free Application for Federal Student Aid (FAFSA). So even if you don't think you'll need to take out student loans, it's still often recommended that students from higher-income households also fill out the FAFSA.

Of course, it's wise not to count on grants or scholarships to help you reach your funding goal. But they can help make up a shortfall.

Gifts

As mentioned above, 529 plans often allow for gift contributions. In addition, the IRS waives the gift tax for gifts that are used to pay tuition expenses. There's no limit on how much you can pay but the caveat is that you must give the money directly to your student's school. Be sure to consider all your options, however, as gift tuition payments may impact the student's need-based aid.

And as always when it comes to taxable vs nontaxable gifts, it's a good idea to consult with your financial planner to make sure you're being tax efficient.

Parents, grandparents or others can also help out with a cash gift, for those many college expenses beyond tuition. Gifts up to a certain amount are not subject to the gift tax. For 2024, the annual limit is $18,000. If you and your spouse both gift money to your child, the annual exclusion $36,000 in 2024.

Student loans

If your college savings fund falls short of the goal you set, you can use student loans to make up the difference. Some high-net-worth households still take out loans, not necessarily because they planned badly but because a child needed more than four years to finish college or decided to continue post grad studies.

Many students borrow to fund a portion of their college expenses. In the 2020–2021 academic year, 54% of bachelor's degree students who attended public and private four-year schools graduated with student loans, according to the College Board. These students left school with an average balance of $29,100 in education debt.[3]

You have a choice of federal loans and private loans. Unlike federal student loans, private student loans are issued based on credit. If that's the way you end up going, you'll be able to shop lenders and compare quotes to ensure you're getting the best terms and interest rates available for your situation.

Currently, you can take a tax deduction for the interest paid on student loans. This benefit applies to all loans (not just federal student loans) used to pay for higher education expenses. So as with all other financial matters than affect your taxes, it's a good idea to consult with your financial planner or accountant, so you can formulate the most tax-efficient plan.

You don't need to go it alone

Like any long-term savings goal, you have the best chance of achieving your college funding objectives if you start now and proceed according to a realistic, well-devised plan. And remember, you don't have to figure it out on your own. In fact, it's probably best that you don't, given the wide array of investing and tax-advantaged saving options at your disposal. A Mesirow Wealth Advisor can work with you to craft a college funding plan that works within your budget, can help you save on taxes and that can pursue your college savings goals without you having to think about it. Once your plan is in place, you can enjoy the peace of mind that comes with having taken the steps necessary to provide for your children's future. And that has value, too! It's an easier process than you might think when you have a professional to guide you. We encourage you to contact us today!

To learn more, visit mesirow.com/wealthmanagement, call 847.681.2300 or email wealth@mesirow.com.

About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with locations around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Global Investment Management, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture.

Mesirow Wealth Management is the firm's founding capability. We are the initial namesake business of Norman Mesirow, whose vision was to serve with purpose, applying the highest standards of professionalism in advising individuals and families on their most important life goals.

We look forward to having an opportunity to serve you and your family.

1. https://finaid.org/savings/tuition-inflation | 2. https://www.bankrate.com/loans/student-loans/scholarships-facts-and-statistics/#grants | 3. College Board