



## A Way to Save for College

By Robert Huebscher

May 29, 2012

Funding your child's education is perhaps the most important investment you will make, but unfortunately, the investment industry offers few helpful options. Conventional 529 plans are saddled with high fees and force participants to take on an inappropriate degree of risk, as I've [written](#) in the past. But a good alternative is now available for funding a private college education.

Over lunch last week, Nancy Farmer, the president of [Private College 529 Plan](#), explained how her offering works.

### How it works

In short, participants' contributions earn credits at any of the 273 participating schools, all of which are private. Credits are based on the current tuition at a specific school. Let's say your child ultimately attends Boston University, and that school's tuition was \$30,000 at the time of your contribution. A \$10,000 contribution pays for one-third of one year's tuition costs at BU at the time your child is in college.

Your contribution has effectively grown at the rate of increase in that school's tuition. According to Farmer, private school tuition has been increasing at approximately 5% annually, and [data](#) from the College Board confirms her statement.

That's a great deal – if your child attends a college in Farmer's plan at the time of your investment, or a college that was added subsequently. You've perfectly matched the asset (your 529 plan investment) with the liability (the cost of tuition), and eliminated any risk. Conventional 529 plans fail miserably in this respect; they lead participants to an equity-centric asset allocation that must perform well over the relatively short time college funds are invested (about 10 years), and they don't match assets with liabilities.

Another problem with conventional 529 plans is that you can change your asset allocation only once a year. With this plan, you don't need to change (or even monitor) your asset allocation.

Farmer's list of 273 schools includes one Ivy League institution (Princeton) and many other prestigious schools, among them some of the top research universities (MIT, Stanford) and also small liberal arts colleges (Amherst, Wesleyan and Wellesley, for example). She said the most popular school among participants so far has been Notre Dame.



The participating schools guarantee the tuition credits. If Farmer's organization goes out of business, the worst case is that your credits can be applied at those schools that were participating at the time you made your contribution.

### **The limitations and problems**

Farmer said that the first question she usually gets – and I was no exception – is whether one's alma mater is on her list. In my case, it wasn't, and that raised the obvious next question: What happens then?

Participants can roll their contributions, plus any earnings, into another 529 plan. The plan's assets (now about \$220 million) are managed by Oppenheimer Funds, in an equity-centric portfolio. Your earnings are based on the fund's performance after fees, with an annual cap of 2% and floor of -2%. The fund's historical performance, since its inception in 2009, has been 5.16% annually. (The plan has been around since 2003, but the fund was managed by TIAA/CREF prior to 2009.)

There are no fees to participants, other than the fees charged by Oppenheimer, which come into play only if you rollover or withdraw your funds. Withdrawing your funds subjects you to the same penalties as with any 529 plan – your withdrawal is taxable, and there is a 10% Federal penalty.

Farmer's organization, which consists of her and two other employees, is compensated with fees paid by the fund. The participating schools are also paid based on the performance of the fund – essentially, they are betting that the fund will outperform the rate-of-increase in their tuition.

The plan is limited to tuition costs; you cannot use it for room and board or other incidental charges. Farmer said she is working to address this limitation. It also can be used only for undergraduate education.

### **Is this right for you?**

My complaints with the wider universe of 529 plans relate to their investment options, and not to the structure of a 529 account. Saving for college through a 529 plan offers many advantages, such as the ability to accelerate gifting. You can contribute up to \$65,000 to a plan, which is five-times the annual gift limit (\$13,000). It is also helpful that the account owner retains control over the assets, and there is broad flexibility to use the assets for nieces, nephews and grandchildren.

Farmer said that the typical participant in her fund is a married couple, has two children, and a post-graduate degree. About three-quarters of the participants had some private school undergraduate education. The average age of the beneficiaries has varied



between nine and 12 years old. Much of her business comes through advisors, and often their clients are the grandparents of the beneficiaries.

This plan shouldn't be the exclusive vehicle for one's college savings, since you want to protect against the possibility that the beneficiary doesn't attend one of the 273 schools or doesn't go to college at all.

But if you plan to send your children to private colleges, allocating perhaps a third of the anticipated cost to this plan is a good idea. The remainder should be invested in individual zero-coupon bonds that mature when tuition payments are due, providing the same asset-liability matching that this plan offers.

Now is the time to decide. College tuition rates are set in July, and it's not too late to lock in 2011 tuition rates.

[www.advisorperspectives.com](http://www.advisorperspectives.com)

For a free subscription to the Advisor Perspectives newsletter, visit:  
<http://www.advisorperspectives.com/subscribers/subscribe.php>