College funding

The *Higher Education Price Index* is an annual report that documents the relentless rise in the costs of college in the USA. The report for 2011 shows that, once again, higher education costs are growing faster than inflation, 2.3% versus 2.0%. The cumulative effect of this price growth can be discouraging for those who are trying to build a college fund. According to the report, if we set 1983 equal to 100, the consumer price index for 2011 would be 225.3, and the higher education price index would be 288.4. That is, although prices generally have a bit more than doubled in that period, college costs have nearly tripled.

On the other hand, in its annual report, *How America Pays for College*, the student loan specialist organization Sallie Mae reveals that in the 2010-2011 academic year, students paid on average 9% less than they did the year before. A combination of factors led to this result:

- a shift by some families to lower-cost schools;
- an increase in scholarships and grants for funding;
- an increase in the number of lower-income students going to college;
- a sharp rise in the number of federal Pell grants.

Most of the Pell grant growth was found in middle-income families, whose participation rate went from 30% to 49%. Some 26% of students from higher-income families received Pell grants, up from 12%. The proportion of families overall who apply for federal financial education aid has grown to 80%.

Better choices

The heavy reliance upon debt to meet college expenses is unfortunate, both because it may reduce the choices available to the student and because the total cost of the loans is much higher with that strategy. The better course is to save early, earning interest before the expenses are incurred, instead of paying interest on the loans as they are paid off after the education is complete.

Parents or grandparents who are accumulating funds to help a future college student should explore three approaches that carry with them the benefit of tax deferral and potential tax freedom for investment earnings (but no tax deduction for contributions):

- Coverdell Education Savings Accounts;
- 529 plans; and
- Roth IRAs.

Each of these choices has advantages and disadvantages to be weighed—consult with your tax advisors to learn more. But the most important factor influencing the success of a savings program is starting early. If the tax advantages of these accounts spurs earlier or more systematic habits of setting aside money for education, so much the better.

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