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Retirement vs. college: A fair fight?

Navigating the Retirement Maze

"Secure the yellow oxygen mask to yourself before putting it on your children."

– Instructions on an airline safety card

When I meet with couples for their initial consultation, the conversation invariably turns to savings priorities. If they happen to have children, a major concern is the tradeoff between saving for their kids' college educations while putting away enough for their own retirement. With the average cost of tuition, room and board at some private four-year colleges approaching $60,000, it's understandable that this is a major source of parental angst.

Part of the problem is perceptual. Many parents feel that because their parents paid all of their college expenses, they should do likewise for their children. What they fail to consider is that tuition inflation has far exceeded the rate of wage growth since they entered college. To put this into perspective, a year of college in 1981 was less than half the income of an average family. Thirty years later, it had grown to 84 percent of that figure.

So comparing your parents' largesse to your own isn't valid here. Yet most parents want to make sure that their children don't exit college with a mountain of personal debt. It's a common dilemma these days.

Parental Priorities

Getting parents to the appropriate savings priorities often requires a reality check. I tell them: "You can borrow to send your kids to college. You can borrow to help them buy a house. You can't borrow for your retirement." Houses have asset value. Children have a lifetime of earning potential, referred to as "human capital." This is why lenders are willing to extend loans for those purposes. Retirees have, by definition, already expended all of their human capital, and so must make do with whatever savings and income sources that they have acquired up to that time. Shortchange your retirement savings, and either you'll have to work longer than planned (if you can find work), or settle for a less comfortable retirement. If they're still not getting the message, I ask them whether they look better in blue or orange "greeter aprons." Blunt, but effective.

I always look for ways for parents to get the most out of their retirement savings, including: maxing out their employer matching contributions, using Roth IRAs where appropriate, and employing the best Social Security claim strategy at retirement that maximizes that income stream. After they adequately address their retirement, they can then look at how to best finance college for their children.

College Finance 101

College affordability may seem like an oxymoron these days, but there are ways to mitigate the financial hit. In fact, the most important factor in determining college costs – total expenses minus financial aid – is the choice of the schools to which your child applies. I'll address getting the most college for your money in a future column, as there are ways to be an informed shopper of colleges and financial aid packages without settling for bargain basement offerings.

While you're saving for college, take advantage of all available ways to safely maximize those savings. These include:

- Make the most of 529 Plans – Easy to set up and fund, with no tax on the gains as long as it is used for qualified educational expenses. Most people believe that their state plan is the only one that they can use. There are a few states where using the state plan can result in a state tax break. For the rest, though, you should shop around for the best 529 Plan. Residents of Massachusetts can use any of 60 different plans nationwide, and Morningstar has rated them in a free report.
- Consider converting UTMAs to 529s – Before 529 Plans were available, many parents used Uniform Transfer to Minors Act (UTMA) accounts to save for college. However, UTMAs are considered the child's assets, which increase the "Effective Family Contribution." 529 Plans, even those funded by other family members, are considered parental assets. UTMAs also have the problem of the "kiddie tax" on excessive earnings. 529 Plan funds that aren't completely used can also be transferred to your other children.
- Kids should have skin in the game – Want your children to feel more invested in their college decisions? Get them to foot part of the bill. Summer earnings, a manageable amount of debt and school jobs should all be considered. After all, it's their lifetime in which they're investing, not yours.

College needn't be the "break the bank" experience that it might appear, nor should your retirement suffer because of it. A combination of ongoing planning, smart investing, and informed college choices can help keep you out of that "greeter's apron" in your retirement.

George Gagliardi is a full-service financial advisor with Coromandel Wealth Management in Lexington, where he helps clients develop and implement investment and retirement strategies. He can be reached at (781) 728-9001 or george@CoromandelWM.com. George is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor. *This article is intended for general information purposes only, and may not be appropriate for your specific circumstances. Investment advice is particular to each individual, and should only be given after an individual situation has been reviewed.*