

Prepay Your Way to College

A plan that's simple, provides peace of mind--and gives buyers equal access to federal student aid. What's not to like?

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How have your investments done since the 2000 market bust? **Up 40 percent?** Probably not. But I'll tell you where **you might have gotten that kind of return: from a conservative, prepaid college-tuition plan**--the type stockbrokers scorn but savers love. **New rules on financial aid for families with prepaids make them even bigger winners** that is, if you can get them. Fewer than half the states maintain plans, and new ones aren't in the works. The country is stepping away from that kind of middle-income student support. But I'm getting ahead of myself. First, some background.

Almost all states offer college-savings programs known as 529s. Gains on your account come free of federal tax when used for higher education. Half the states give you breaks on state taxes, too. **There are two types of 529s:**

Savings plans. With these, you invest in various mutual funds and use the proceeds for expenses at any accredited school. In the very long run, stock-owning mutual funds do well. Over shorter terms, you're taking some risk. Bond funds are safer but don't keep up with college inflation. Most states offer savings plans; you can also join the plan of another state, restriction free.

Prepaids. These plans provide guarantees. You buy a certain number of credit hours or semesters at today's prices. They'll be honored in the future, when your child goes to school, no matter how much college costs at the time. Most prepaids cover tuition and fees but not room and board (only Florida has a dormitory plan). **The guarantees apply only to in-state public colleges and universities.** But you can transfer the dollar value of your savings to a private college or an out-of-state school. You or the beneficiary usually has to live in the state to join the plan.

Currently, 18 states maintain prepaids. Four plans (Kentucky, Ohio, Texas, West Virginia) are closed but may reopen. **There's also a prepaid for private colleges called the Independent 529 (Independent529plan.org). It sells future tuition at a discount, usable at more than 250 schools.**

Why do I like prepaids and wish more states would get onboard?

First, prepaids are simple. You put up some money and buy a fixed amount of future education. Period. You also know the exact dollar figure you need to save.

Second, guarantees give you peace of mind. You don't have to worry when stocks go down--a matter of special importance to people who can't afford to risk losing any money they've saved. The states stand behind their prepaids, directly or indirectly. You'll receive the value of all the credits you bought.

Third, buyers of prepaids now enjoy equal access to federal student aid. Formerly, the aid formulas favored the savings plans. But starting this year both types of 529s are being treated alike.

Finally, investments in prepaids are showing spectacular gains. The return on your money equals the increase in your state's college-tuition rate. **Average rates for four-year schools are up 40 percent** since 2001--hence, a 40 percent return for the average plan. Some states charge you more than the current tuition cost to build up a financial reserve. That lowers your investment return, but you'll still do well--**especially if you start when your child is young**, says Joe Hurley of **Savingforcollege.com (the go-to site for information on every state's 529).**

So how come more states don't offer prepaids? The issue is how to keep them financially sound. When a state decides how much to charge for its plan, it estimates how fast tuitions will rise. Since 2000, inflation at four-year public schools has averaged 7 percent a year--well above its historical 4.5 percent rate, the College Board reports. That's more than the prepaids expected. Ohio's plan closed in 2003 after tuition hikes in the 10 percent range eroded its reserves, says director Jackie Williams. Ohioans, she adds, would like it back.

Tuitions are soaring because the states aren't giving their colleges as much support. Enrollments are up an unprecedented 14.4 percent since 2001, says Charles Lenth, of the State Higher Education Executive Officers association. **Last year, however, the states provided an average of just \$5,825 per student in public institutions, down from \$7,117 in 2001, and a 25-year low.** That figure will probably rise, Lenth says, but states are generally content with requiring students to pay more.

Even so, most of the states with prepaids have steered them successfully through these shoals. "All we need is for tuitions to be predictable," says Betty Lochner, head of the fast-growing plan in Washington. Virginia's plan closed in 2004 and reopened in 2005 at a higher price. Florida's \$6.5 billion plan is so large that its very existence stops the state from letting tuitions run away. **The outlook, however, is high costs for parents and students.** States should give them prepaids, so they can save without risk.

P.S.: A bit of good news for investors in both types of 529s--your federal tax exemption was slated to expire after 2010. Last week Congress made it permanent. College tax breaks are here to stay.