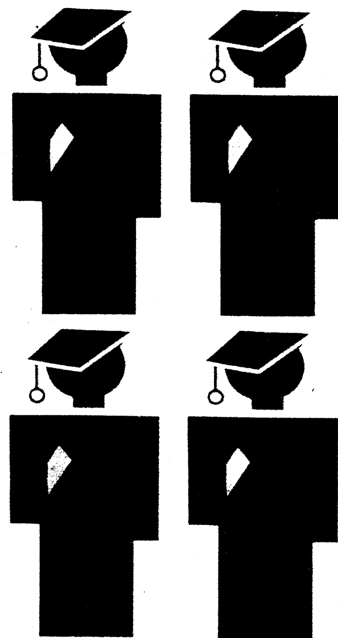
MONEY

4 Smart Ways to Pay for College

A guide to the best strategies

by Carmen Wong Ulrich

If you have a child or grandchild under 18, the price of college is likely on your mind: Freshmen headed to school this month face bills of up to $55,000 a year, and the cost of a four-year degree for a baby born today could reach $500,000. Parents should aim to save one-third of the total; scholarships, grants, and student loans should cover the rest. But whether your graduate-to-be is a toddler or a teen, the important thing is to start saving now. Even if your child is just a year away from college, it's not too late. He won't need all the money at once, so you have five years to contribute to a plan where your savings can grow tax-free. Here's a cheat sheet of the best plans.



1. The 529 Plan

THE PLAN Many families got burned when their 529 plans lost value in the stock market, but don't pull your money out now—the key is to keep your assets well-balanced, shifting from stocks (which hold greater earning potential but higher risk) to bonds (which tend to earn less interest but are more stable) as your child reaches college age. Every state offers at least one version of the 529, and you don't need to live there to sign up. When it comes to fees and investment choices, plans vary, so visit a site like SavingforCollege.com to compare your options. Most states also offer tax breaks for 529 contributions, but you often need to choose your state's plan to qualify.

Whether your future graduates are in preschool or high school, the time to start saving is now.

PROS There's no annual contribution limit, and accounts can hold up to $380,000 (the cap varies by state). Grandparents, aunts, uncles, even family friends can chip in, so consider asking them to skip the doll or video game and invest in your child's college fund as a birthday gift instead. If your kids decide against college, you can transfer their 529s to other college-bound relatives without taxes or penalties.

CONS Risk. By the time your child is a freshman in high school, less than 70% of your savings should be in stocks. Also, if the interest you earn isn't used for college expenses, you'll have to pay penalties and taxes.

2. Coverdell ESAs

THE PLAN Parents can invest up to $2000 in these education savings accounts (ESAs) each year. The money grows tax-free until you withdraw it to pay for school expenses.

PROS Coverdells tend to have lower fees and more investment options than 529 plans. The funds may also be used to pay for K–12 expenses like school supplies, uniforms, or tuition.

CONS Only couples earning less than $220,000 combined or single parents earning less than $110,000 are eligible. And unless Congress votes before January to extend Coverdells' current benefits, the contribution limit will drop to $500 per year and K–12 expenses will no longer be covered. (If that happens and you have a Coverdell, you can roll over the funds into a 529 plan without incurring a penalty.)

3. Roth IRAs

THE PLAN Although Roth IRA usually intended for retirement can use the funds without pe before age 59½ to pay for your c college tuition, housing, bool other expenses. You can invest $5000 a year (or $6000 if you' or older).

PROS Like a 529, your savings tax-free. Unlike a 529, the fund pay for your retirement if you ch

CONS Though it may be tempti raid your retirement fund to pay child's tuition, resist this urge. sider using your Roth IRA for lege only if you already have a si retirement fund elsewhere. As as you may want to help your you'll assist them more by taking of yourself first. Remember, they years to pay off student loans— you don't save enough for retire they'll have to take care of you. other drawback: For 2010, indi als must earn less than $120,0 qualify; married couples filing jo must earn less than $177,000.

4. Savings Accounts, Mor Markets, CDs & Bonds

THE PLAN Just go to a bank (or g line) and open up a savings or mo market account or buy a certific deposit (CD) or savings bond.

PROS Total flexibility. There no restrictions on how you us money—if your child doesn't college, you won't be stuck pa penalties or fees on your sav There is minimal risk, since money is not invested in stocks.

CONS With low risk come lov wards—the interest you'll earn savings accounts, money mar CDs, and bonds will almost cert be much less than with other p And with the exception of s tax-exempt bonds and money ket funds, you'll pay income tax your earnings.