SAVING OR BORROWING: WHICH MAKES BETTER FINANCIAL SENSE?

NAVIGATING THE ROAD TO COLLEGE

Admission

FALL 2014

COLLEGE-SAVINGS STRATEGIES FOR EVERY AGE

ENROLLMENT-BASED FUNDS SIMPLIFY SAVING

There is no substitute for a well-made financial plan

Among life's many competing financial demands, saving for college is one that too often gets put on the back burner. It's understandable: The goal can seem far in the future to parents of young children. The result is that many parents find themselves struggling to catch up with time running short. Families need a plan that makes saving for college easy.

In this issue of *Admission*, we hear from an expert in financial planning, who explains why 529 college savings plans are his go-to solution for families preparing for this important financial goal. With tax-free growth potential, automatic savings options, and estate-planning benefits, 529s can be a powerful way to save. We also examine the pros and cons of saving for college versus paying with loans, and explore specific investment strategies, including age-based portfolios.

I hope you find this issue of *Admission* helpful as you work with your financial advisor to create a well-rounded plan that balances your family's financial goals.

Andrew G. Arnott
President and CEO,
John Hancock Investments

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Q&A

Raymond Loewe
President of College Money

Put your college savings to work with a 529 savings plan

Paying for college is a top financial goal for many parents. However, it's not always easy to determine the best way to save for your child's higher education. We talked about this challenge with Raymond Loewe, president of *College Money*, a Marlton, New Jersey-based college-planning firm that has been helping families save since 1975.

Loewe offered advice about how to make the most of 529 college-savings plans, which provide a tax-advantaged way to save for college expenses.

Q How do 529 plans work?

A A 529 plan is designed specifically for college savings. Money is contributed on an after-tax basis, but any earnings are tax-free. As long as the funds are used to pay for a qualified educational expense, withdrawals are tax-free as well. Many states offer 529 plans, and you don't need to be a resident of a state to choose its plan.

Q Do I need to open a separate 529 plan for each of my children?

A Typically, parents open a plan for each of their children. The owner of a 529 plan has complete control over who the plan's beneficiary is—and can change it as needed. So if one child doesn't go to college or has extra money in his or her plan, it's possible to designate another child as the beneficiary.

Q When should I open a 529 plan?

A You can open a 529 plan as soon as your child is born. Making contributions to a plan early in your child's life allows you to save more and maximize your opportunity for tax-free, compounding growth.

Q When is it too late to start saving for college?

A It's never too late to start saving. In fact, we often suggest that parents keep making contributions even while their children are in college to continue taking advantage of 529 plans' tax-free growth and withdrawal features. Also keep in mind that in many cases, students end up attending college for more than four years, either to finish their undergraduate degree or pursue further education. Your child can continue to make use of 529 plan savings as long as he or she is attending a qualified institution.

(Continued on next page)

Q&A 529 savings plan (continued)

Q How much should I contribute?

A The more you can set aside and save, the better. However, for many families it's nearly impossible to save enough to cover the full cost of a college education. We recommend that you try to save a third of the amount of money you'll need for tuition, pay for a third of the tuition costs out of your income, and then borrow or fund the remaining third with grants and scholarships, if available.

If you contribute more to a 529 plan than your child needs, you can withdraw the extra money after your child graduates, paying income tax and a 10% penalty on the earnings, or save it to use for another educational purpose.

Q Who can contribute to my child's 529 plan?

A Anyone can contribute to a 529 plan, including family, friends, and grandparents. (See "Grandparents: Save Smart!" below for more information on this topic.)

Q How can I balance saving for retirement with saving for my child's college expenses?

A In general, we recommend saving for retirement first. If you have a retirement plan at work, put enough money into it to get your full company match and then start saving for your child's college expenses.

Q How should I invest the assets in my 529 plan?

A Each plan offers its own investment options, and you should choose the one that best matches your risk tolerance and time horizon. Among the most common options are age-based funds that automatically change their investment strategy as your child gets closer to college age. (See "Understanding Age-Based Funds" on page 8 to learn more.)

GRANDPARENTS: SAVE SMART!

As a grandparent, opening a 529 plan not only helps your grandchild pay for college, but it can also help you with your estate planning: Funds contributed to a 529 plan aren't considered part of your taxable estate.

However, if your grandchild uses funds from a 529 plan that is separate from one opened by his or her parents, it can affect financial aid eligibility. That's because federal aid guidelines assess the income students receive from sources other than their parents at a higher rate than parental assets. This could potentially reduce the amount of aid a student receives.

To avoid the possibility of limiting your grandchild's eligibility for aid, consider contributing money directly to a 529 plan opened by his or her parents. Alternatively, your grandchild could wait to use funds from your plan until the final year of college, after the last amount of financial aid has been awarded.

Away we go

Studying abroad can be an amazing experience of growth and self-discovery. But that experience doesn't come cheap: Program costs range, but they are typically equal to, and in some cases more expensive than, the cost of a semester at a student's home institution.

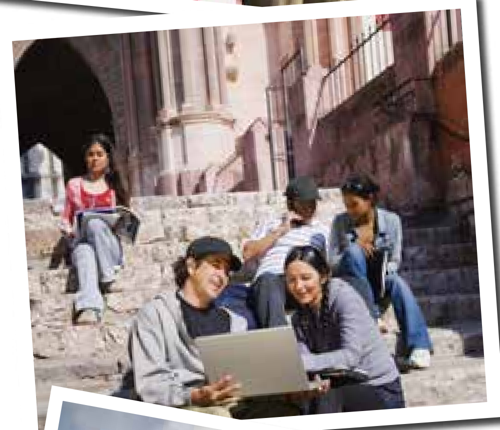
While scholarships and grants can help offset some of those costs, they might not cover every expense. Fortunately, you can use assets held in a 529 plan to defray certain expenses for a semester abroad.

How 529 plans can help

Withdrawals from a 529 plan are tax-free if they're used for qualified education expenses. Qualified expenses are those that the IRS considers essential to a program at an eligible institution. They include:

- Tuition
- Fees
- Course materials, such as textbooks
- Room and board, except as noted below.

Transportation and healthcare are not qualified expenses. Withdrawals used to purchase non-qualified expenses, such as plane tickets, international health insurance, or immunizations, for example, would be subject to taxes and a 10% penalty.



Limits on room and board expenses

Unlike tuition, there are limits to the amount of room and board that 529 plan funds can cover. If a student lives in housing run by either his or her college or international host institution, 529 plan funds can be used to cover the entire balance. If a student makes his or her own living arrangements, however, the school will determine an allowance—typically equal to the cost of the housing option that it would provide—that can be put toward rent. A student may spend more than that allowance on housing, but the extra amount likely won't be considered a qualified expense.

Just as students will have their own unique experiences abroad, each program will have its own unique details. It's a good idea to carefully evaluate a program's fees and expenses to determine how to make the best use of the savings in your 529 plan.

THE ROAD LESS TRAVELED

A study-abroad program is just one of the many educational opportunities a 529 plan can help fund. Assets can be used to cover expenses at any accredited post-secondary educational institution, including:

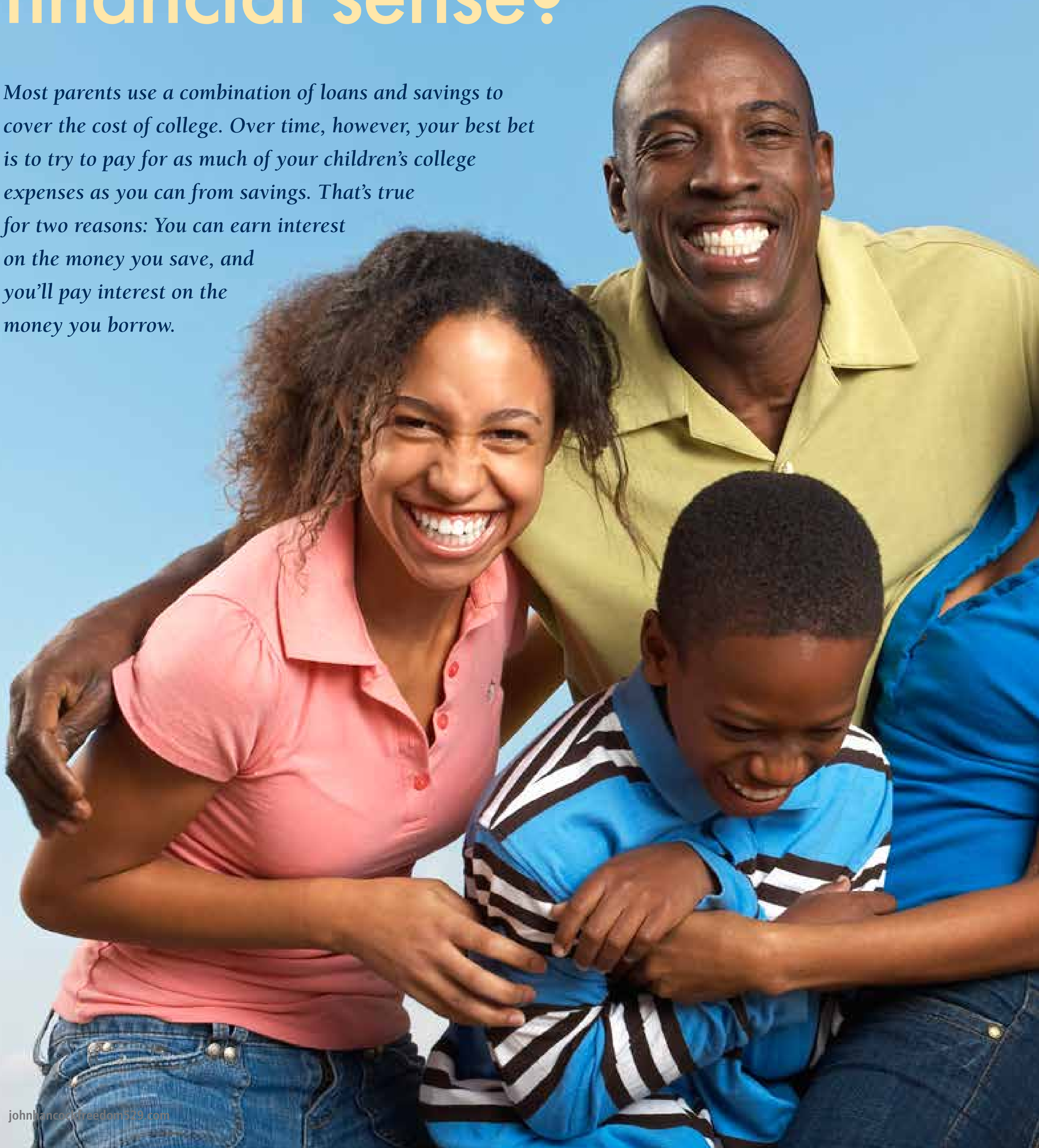
- Culinary institutes
- Cosmetology schools
- Arts conservatories
- Graphic/computer design programs
- Technical training programs.

* The chart refers to the number of students, both undergraduate and graduate, who studied in that country in the 2011/2012 school year, which are the most recent numbers available.

Source: Institute of International Education. (2013). "Top 25 Destinations of U.S. Study Abroad Students, 2010/11 - 2011/12." Open Doors Report on International Educational Exchange. [http://www.iie.org/opendoors]

Saving or borrowing: Which makes better financial sense?

Most parents use a combination of loans and savings to cover the cost of college. Over time, however, your best bet is to try to pay for as much of your children's college expenses as you can from savings. That's true for two reasons: You can earn interest on the money you save, and you'll pay interest on the money you borrow.



The advantage of compounding

If you start a regular savings program early in your child's life, even a small monthly deposit can grow into a substantial college fund by the time he or she reaches college age, thanks to the power of compounding. For example, let's say you start setting aside $100 a month in a college savings account when your child is born. Assuming an average annual return of 6%, you'll have amassed more than $38,000 by the time he or she turns 18.

Tax advantages, too

The tax advantages of 529 college savings plans make them a popular choice for parents saving for future educational costs. These plans provide tax-free growth of your earnings and tax-free distributions on money used for qualified expenses. (One word of caution: Withdrawals used for nonqualified expenses may be taxed and subject to a 10% penalty.) While 529 plan contributions can't be deducted from your federal tax return, they are deductible from many state returns.

Making up the difference

Even with a dedicated savings plan, many families will need to borrow at least some money to pay for college. There are many options available, including federal student loans and private loans. Federal student loan programs are designed to make repayment easier for students and their families by offering interest rates that are lower than regular bank loan rates and providing practical repayment and loan-consolidation options.

Despite these benefits, a loan is still a loan, which means that you'll end up paying back both the amount you borrowed as well as interest. Clearly, saving is the better bet because it allows interest to work for you (by growing your initial investment) rather than against you (increasing the total amount you owe).

Involving your child

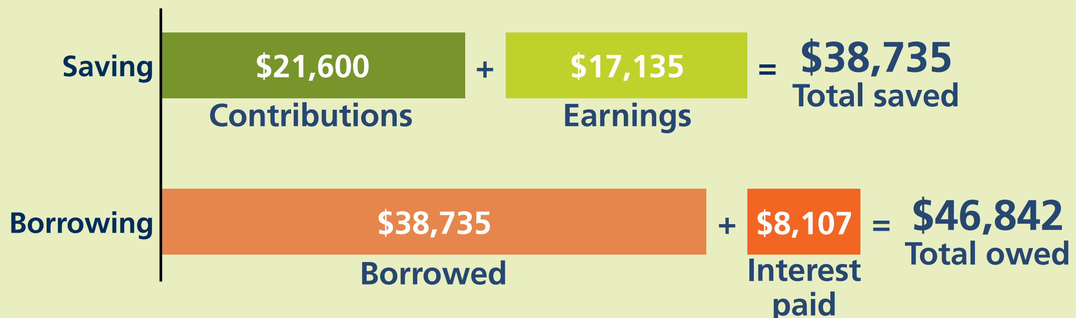
Whatever the combination of savings and loans you use to cover college costs, it's important to include your child in the process of funding his or her education. Consider opening a savings account in your child's name and encouraging him or her to contribute a portion of any birthday money or job earnings.

This approach gives you the opportunity to teach your child about financial concepts like interest rates, compounding, and credit, and explaining the importance of saving for the future. Your child gains not only a potentially larger account balance, but also a sense of ownership over his or her college education.

Put compounding to work for you

Saving for even a portion of your child's college education is better than borrowing. For example, if you saved $100 per month for 18 years, you'd have over $38,735 to put toward eligible college expenses.* Your contributions would total $21,600, and you'd have earned more than $17,000 in interest.

But if you borrowed $38,735, you'd have to pay back more than $46,000: the original loan amount plus more than $8,000 in interest.**



* Assumes a 6% annual return over 18 years.

**Assumes a 10-year term on the loan with an annual interest rate of 3.86%.

That's a

*With the average cost of four years of private college exceeding $160,000, it's never too early—or too late—to save for your child's education.**

Your family's needs and circumstances will change as your child grows, so it's important to have a flexible savings strategy. Understanding how to save at each stage of your child's life can help ensure that you'll be financially prepared to help make the dream of a college education a reality.

START SAVING EARLY

Newborn to preschool

Thanks to the power of compounding, time really *is* money. Compounding is the concept of earning money on your investments, and also on your earnings. It can help even a small amount grow significantly over time. For instance, in 18 years a $1,000 investment could grow to more than $2,800, assuming a 6% average annual return. And if you added monthly contributions of $50 to your initial $1,000 investment, your savings would grow to nearly $22,000 over the same time period.

Maximize the benefits of compounding by opening a 529 college savings plan account as soon as your child is born, establishing a regular contribution amount, and sticking to it. To give your savings an extra boost, consider depositing financial gifts that your child receives for birthdays or holidays in the account, too.

Starting to save early also allows you to invest more aggressively. With college almost two decades off, you have more time to exchange short-term dips in the market for potentially higher long-term returns.

STAY THE COURSE

Kindergarten through eighth grade

If you haven't already done so, open a 529 plan account for your child and begin making regular contributions; these are the prime years for making progress toward your savings goal. Consider setting up automatic deductions from a bank account or authorizing payroll deductions, if available from your employer, to simplify the contribution process and help you save consistently.

This is also a good time to assess your risk tolerance and make sure your assets are invested accordingly. With several years or even a decade before your child goes to college, a moderate investment strategy is often appropriate. Your objective at this stage is growing your investments to meet your savings goals while protecting what you've already saved.

great age

CHECK YOUR PROGRESS

High school

With college fast approaching, it's time to evaluate your savings progress. If you're on track, congratulations! If you haven't accumulated as much as you'd like, look for ways to save more: Create a household budget to prioritize expenditures. Eat more meals at home. Cancel expensive premium cable channels. All these changes will give you a little more to stash away in your 529 account. Encourage your child to contribute as well by saving a portion of any income from a part-time job.

High school is also the time to explore financial aid options with prospective schools; full-time undergraduates received an average of $13,730 in financial aid during the 2012–2013 school year.** (Websites such as StudentAid.ed.gov can provide more information.) Money from grants, scholarships, loans, and work-study programs can help close the gap between your savings goals and your actual savings.

PUT YOUR SAVINGS TO WORK

The college years

You've spent years accumulating college savings—now it's time to use them. Work with your financial advisor and the financial aid officers at your child's school to determine which expenses can be paid with assets from your 529 plan, and at what point during the year you should make withdrawals to pay them.

Be aware that 529 plan withdrawals can affect your child's financial-aid eligibility: If a student receives a distribution from a 529 plan established by another family member, that money must be reported as additional income on financial aid applications. That could reduce the amount of assistance your child receives. (See "Grandparents: save smart!" on page 2 for more information on this topic.)

Finally, continue contributing to your child's 529 plan while he or she is in school. It will help you build more tax-free savings, and help your child graduate with both a diploma and less debt.

*Trends in College Pricing, 2013, The College Board.

**Trends in Student Aid, 2013, The College Board.

HOW MUCH WILL COLLEGE COST?

If you haven't set a target savings goal for your child's college education, use one of these online calculators to help you determine how much you'll need.

- The College Savings Planner from John Hancock Investments at JohnHancockFreedom529.com.

- The Net Price Calculator Center from the U.S. Department of Education at collegecost.ed.gov.

enrollment-based funds

Some people have both the time and inclination to make investing a priority. But if you're daunted by the prospect of keeping an investment strategy up to date, never fear: Enrollment-based funds, a type of automatically adjusted investment product, are made for investors like you.

The majority of 529 plans offer enrollment-based funds, also know as age-based funds, as an investment option, providing a way to balance security and growth without too much hands-on investment work.

JUST THE RIGHT AMOUNT OF RISK

Enrollment-based funds are designed around a simple principle: The risk and return potential of your investment strategy should be higher when you have time to ride out market fluctuations, and lower as you approach the time when you'll need access to your money.

Enrollment-based funds in 529 plans adjust their asset allocation—the mix between stocks, bonds, and cash—automatically as your child approaches college age. Although each plan takes a unique approach to the timing of asset allocation adjustments, in general, the enrollment-based fund you choose when your child is a toddler will likely have a relatively aggressive investment strategy. The fund may be heavily weighted toward stocks, which carry more short-term risk but offer the potential for greater gains over the long term.

ASSETS AT THE READY WHEN YOU ARE

As high school graduation nears, the enrollment-based fund you chose for your child will gradually shift to a more conservative investment strategy to protect the assets you've amassed. The fund makes these adjustments automatically to help ensure that your savings account can grow when you need it to grow, and remain more safely invested when you need access to it. The added benefit? You don't have to think about tinkering with your portfolio.

WONDERING WHY "AUTOMATIC ADJUSTMENTS" SOUNDS FAMILIAR?

If you're saving for retirement, you may be familiar with another type of automatically adjusted investment product: target-date funds. These funds are designed to shift from a more aggressive asset allocation strategy to a more conservative strategy as they approach the target retirement date in the fund's name. For example, a 2040 fund would invest primarily in stocks today, but gradually transition to more bond and cash investments as the year 2040 approaches.

GIVE IT THE OLD COLLEGE TRY

College is a time to engage with influential professors, study interesting subjects, and make new friends. It's also the beginning of the journey toward a career—in business, medicine, science, or design, to name just a few of the many exciting options students may explore. See if you can find these words associated with the college experience that will be on your child's mind as his or her journey begins.

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