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Your Money

Sandra Block

Deficit bill gives prepaid tuition plan users a break

Tucked deep in the deficit-reduction bill President Bush signed last week is a Valentine for parents who use "prepaid tuition" plans to save for college.

The change will make it easier for families who use these plans to qualify for financial aid. But that doesn't mean these plans are a sweet deal for everyone. (**Your future:** [USA TODAY's Financial Planning for Retirement Seminar](#))

With a prepaid tuition plan, you lock in future tuition costs at state colleges and universities by paying a lump sum or making payments. At a time when annual tuition costs are rising at double-digit rates, that's an appealing feature.

Recommended 529 savings plans

Direct-sold

Plan	Primary fund manager	Phone
Alaska T. Rowe Price	T. Rowe Price	800-369-3641
Nebraska College Savings	Various	888-993-3746
Utah Educational	Vanguard	800-418-2551

Broker-sold

Colorado Scholars Choice	Smith Barney	888-572-4652
South Dakota College Access	Pimco	866-529-7462
Virginia CollegeAmerica	American Funds	800-421-0180

Source: Morningstar FundInvestor

Unlike with 529 college savings plans, which let you invest in stocks and bonds in a tax-advantaged portfolio, with prepaid plans "you don't have to worry about the market crashing two years before your kid goes to school," says Kerry O'Boyle, analyst for investment research firm Morningstar.

The change in financial aid treatment makes prepaid plans even more attractive, says Joe Hurley, founder of SavingforCollege.com. In the past, federal aid to a family was reduced, dollar-for-dollar by the amount the family withdrew from a prepaid plan. Under the new law, the formula will treat prepaid plans the same way it treats 529 college savings plans — as

the parents' asset. Under the federal aid formula, only 5.64% of parents' assets are considered available for college costs.

What's not to love? Well, plenty. Some potential drawbacks:

- You may not be eligible.** State prepaid tuition plans are restricted to residents, and only 13 states offer prepaid plans (see box). Five states — Kentucky, West Virginia, Texas, Ohio and Colorado — have closed or suspended their plans in recent years because their investment returns weren't keeping pace with tuition inflation.

- Prices have risen.** To protect themselves from future tuition increases, states that still offer prepaid plans have raised their prices. As a result, you can expect to pay a premium over current tuition costs. If you invest when your child is a toddler, you might still come out ahead. But if your child is, say, a sophomore in high school, tuition prices might not rise fast enough to justify the premium.

- The guarantee is limited.** Prepaid plans guarantee the cost of tuition at a state college or university. If your child attends a private college, or goes out-of-state, you'll receive an amount of money based on the cost of in-state tuition. That may not be enough to cover tuition at an out-of-state or private school.

One alternative for students interested in attending a private school is the Independent 529 Plan

(www.independent529plan.org). Such a plan lets you lock in future tuition costs at more than 250 private colleges and universities. One downside: If your child doesn't attend any of the participating schools, your return is limited to your initial investment, plus or minus 2% a year, depending on the performance of the plan's investments.

•**Tuition accounts for only about half the cost of attending college.** Unless your child plans to live at home, you'll need money for room and board, as well as textbooks and other costs. For that reason, you should supplement a prepaid plan with other savings, says Diana Cantor, executive director of the Virginia College Savings Plan.

Where you can prepay

States offering prepaid tuition plans:

Alabama
Florida
Illinois
Maryland
Massachusetts
Michigan
Mississippi
Nevada
Pennsylvania
South Carolina
Tennessee
Virginia
Washington

Source: SavingforCollege.com

A 529 savings plan, for example, could provide funds for non-tuition expenses. Withdrawals from 529 savings plans are tax-free if the money is used for college expenses.

Alternatives to prepaid

Prepaid plans appeal to families who don't want to take risks with their college savings. But if you're not eligible for a prepaid plan, or if you think your state's offering is too pricey, there are other ways to play it safe.

Many 529 savings plans have added conservative options to their portfolios. For example, Ohio recently added a federally insured bank savings account and certificate of deposit to its 529 plan. Unlike with prepaid plans, you don't have to be a resident to invest in a state's 529 plan.

In addition, most 529 plans offer age-based portfolios, which shift money to low-risk bonds and money market funds as your child gets closer to her first year of college. Many also offer age-based portfolios tailored for aggressive, moderate or conservative investors, allowing you to pick one that matches your appetite for risk.


When selecting a 529 savings plan, check out your own state's plan first, because many states offer state tax deductions and other incentives for residents. But pay attention to other factors, too, such as expenses and the quality of the funds in the plan's portfolio. A state tax break might not be enough to overcome a poor-performing plan with high fees.

Morningstar FundInvestor, a monthly newsletter, recently released its annual list of best and worst plans. We've listed the top picks in a box on this page.

Sandra Block covers personal finance for USA TODAY. Her Your Money column appears Tuesdays. [Click here](#) for an index of Your Money columns. E-mail her at: sblock@usatoday.com.

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