Things To Look For in a College Savings Plan

Let's address the different type of college savings plans available today, including the things every parent should be looking for in a college savings plan… as well as the pros and cons of

each.

For starters, you want *guarantees* in your college savings plan. That is, you want to know your money is *going to be there* when you need it to be. The last thing you need is to discover — the day before you need access to it — you're going to lose 50% off the top.
You also want the money to be liquid. You want to be able to have access to it when you need access to it. You don't want it to be locked up in something where you can't get at it, or you have to wait six months… or even a year.

Tax favored status. Obviously if there are any tax advantages that are available in the plan, you want to take advantage of them. And that includes financial aid formulas. How is the college savings plan going to have an impact on financial aid? You've got to be aware of how the different accounts are going to affect you for financial aid. A lot of times, it depends on the type of school you're considering, but you want to be aware of them.

Now let's go through seven different plans that are probably the most common options parents have nowadays:

Mutual funds. You can put money that you're saving for college into stock or bond mutual funds. Of course, there is unlimited potential for growth, so that's one of the upsides. The flip side to that is that there is unlimited potential for loss, as well. You've got to know that if you're putting your money into mutual funds, the money may not be there when you need it to be, so you have to weigh out whether it's a risk worth taking.
Also be aware of this: Mutual funds typically will count against you in the financial aid formulas — whether they're held in the parent's name or the child's name.

529 plans. For the right family 529 plans aren't necessarily a bad thing. It's just that I find that many people choose these plans, thinking that they're the answer to saving for college. I personally don't think they are. 529 plans – depending on the type of fund that you buy inside the 529 – have the potential for great upside, and great downside.
Some of the downsides: There are typically high fees involved in 529 plans. You're only able to access the money for college; otherwise, you pay a penalty and taxes on top of it. Some of the pros: If you do use the money for college (on the assumption that everything works out and the money is there AND it's grown), then you can access the money tax-free. Just keep in mind: A lot of these plans haven't seen any kind of gains in them, so you have to weigh that out.

CDs. These are good in the sense that they are FDIC insured currently up to $250,000… so that no matter what happens, you are guaranteed to get the money. The downside though is that those do count against you for financial aid. And the money in a CD right now currently pays on the order of .5% interest, so they're not even keeping up with inflation by any stretch of the imagination.
That's one of the downsides of CDs. While they are extremely safe, today's returns are negligible, and they're going to count against you for financial aid. So, when you factor in today's low returns and the financial aid implications, you're almost going backwards.

Same thing with a money market account. Depending on where the money market is held, it could also be FDIC insured. These are paying pretty much zero, in essence zero right now. Once again, they are safe, and I like safe. That's good. It fits into the guarantees and liquidity, but they are going to count against you, and there is really no growth potential whatsoever.

Fixed annuities. These are good from the standpoint that they typically have a higher yield than a CD does. The money is typically protected from financial aid formulas. However, the money is locked up, and as is the case with most annuities, you're only able to access 10% a year when you need them, or else you face steep penalties to get out of them. Some annuities are different, but most of them work that way, so you've got to weigh the pros and cons of that.
Retirement accounts like a 401(k) plan. The money in a 401(k) plan doesn't count against you, so that's a plus. However, new contributions made to these plans (once your child hits typically their junior year in high school) will count against you. And you can't just go and take $100,000 and throw it into a retirement account… because there are limitations to what you can put in. And then when you do want to take the money out of them, you're going to be penalized for doing so. You're going to have to pay taxes on it — assuming your age is less than 59 ½ — and that income typically counts against you for financial aid as well.
So- retirement accounts are pretty tough, especially because the big one is the liquidity. *It's not liquid at all*.
Cash value life insurance. Cash value life insurance can be a good tool for the right person, depending on how it's set up. It offers guarantees. It offers liquidity. It offers tax-favored status, whether it's either tax deferred or potentially tax-free, depending on how it's set up. It is also protected from the financial aid formulas.
In all, it tends to be a good program, but you have to make sure it's set up correctly… that it's over funded so that's it's focused on maximizing the growth of the policy, not the death benefit. Some of the downsides of a cash value life insurance policy is — depending on how it's set up — you might pay some penalties to take money out prior to age 59 ½.

You're not going to have the upside potential of investing in a tech fund, but at the same time, it's slow and steady, you know exactly what you're getting. It's a safe way to save for college.

So there you have it. There are seven of the most common types of college savings plans out there.