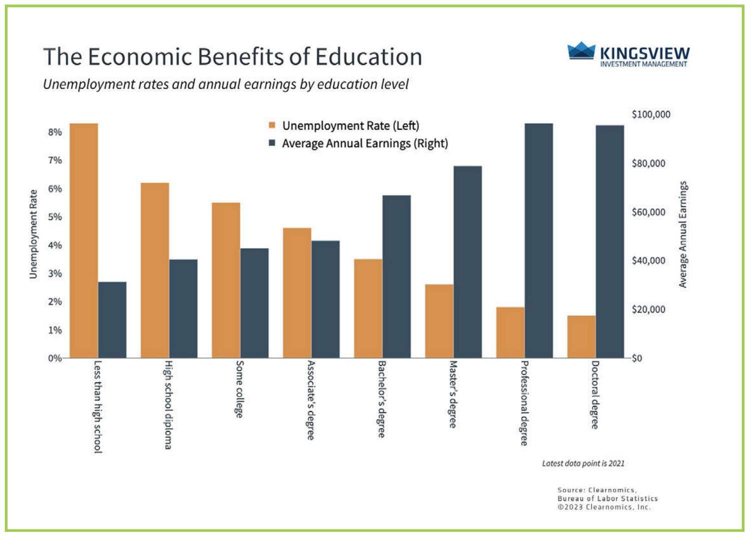
Portfolio Manager Insights

Why College Planning Is a Core Part of Any Financial Plan
Weekly Investor Commentary | July 12, 2023
Investment Committee

Celebrating as a family member graduates high school and attends college is a joyous event and the culmination of years of hard work. However, paying for college remains a significant source of stress for many households. It's no secret that the cost of college has risen much faster than inflation over the past 40 years, increasing the financial burden on families as they set money aside and on graduates once they enter the workforce. And yet, there are numerous professional and personal benefits to pursuing higher education for those who wish to do so. Weighing the costs against the benefits, while considering personal priorities and the broader economic picture, makes college planning a complex topic.

This is why saving for college is a core component of any financial plan alongside other major goals such as retirement or buying a home. With all of the market and economic uncertainty of the past decade, customizing a financial plan to each individual or household's needs, ideally with the guidance of a trusted advisor, has never been more important. **What should those planning for college consider today?**

THERE ARE MANY ECONOMIC BENEFITS TO ATTAINING HIGHER LEVELS OF EDUCATION



The rapid increase in the cost of education has led many to question whether college is still worth the investment. An important reason tuitions have risen so rapidly is that the economic benefits of college and advanced degrees have grown even faster. According to the Bureau of Labor Statistics, job prospects improve as educational attainment increases. For example, the accompanying chart shows that unemployment rates were 6.2% for high school graduates but only 3.5% for those with 4-year bachelor's degrees. Similarly, the median annual earnings of those with high school diplomas was $40,450 compared to $66,700 for college graduates. Not surprisingly, these patterns continue for advanced degrees as well.

Of course, these statistics are averages that don't consider individual circumstances or differences within each education level. Pursuing college and advanced degrees may not be for everyone, and there are many personal factors that must be considered. For instance, today's very low unemployment rates may make the opportunity costs of attending a 4-year college less attractive to some, including those who attend trade schools or benefit from on-the-job training. In contrast, poor economic periods such as during the global financial crisis may make the benefits of college more pronounced.

Additionally, these particular statistics don't consider the choice of college major or type of employment. It's clear that those studying highly employable subjects, such those related to engineering and financial services, will likely have greater job prospects. Regardless, the broad data make it clear that there are many economic benefits to higher education.

The other side of the equation is that the sticker price of a college education has increased 800% over the past 40 years. Even after adjusting for inflation, the cost of college has increased dramatically across all types of institutions, as shown in the accompanying figure. The real, inflation-adjusted cost of a private 4-year college degree rose 176% from 1981 to 2021, while public universities saw prices climb 252%. The cost of 2-year degrees has increased more modestly but has still easily exceeded inflation in most years.

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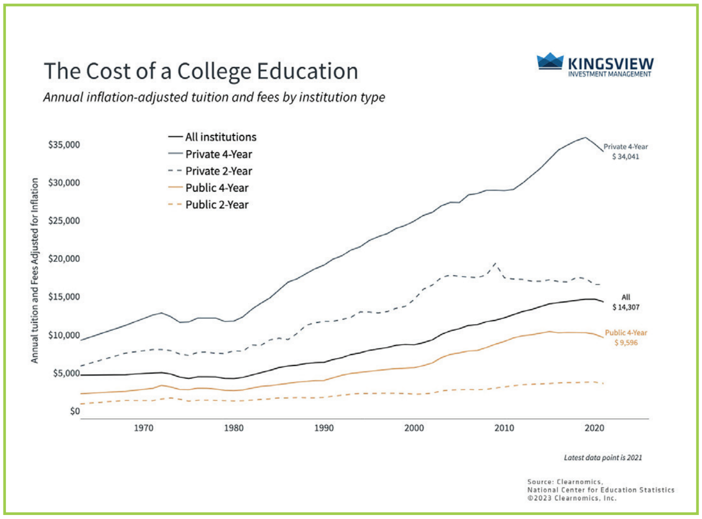
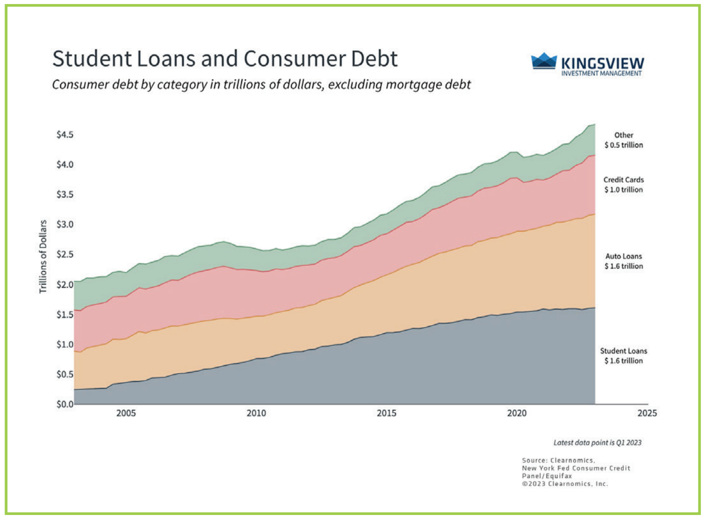
Unfortunately, these inflation rates for education have also outpaced wage gains. Thus, those saving for college will need to save earlier, save more, take advantage of investment returns, and borrow. Certain investment vehicles with tax benefits, such as 529 plans, have been created to encourage earlier college savings in order to take advantage of compound returns over time. Recent data by Sallie Mae suggest that the average household pays for 43% of the total cost of college with the parents' income/savings, 11% through the student's income/savings, 29% via scholarships, grants and relatives, and 18% through borrowing. Thus, how families and students decide to pay for and finance the cost of college requires a thorough understanding of their particular circumstances.

THE COST OF A COLLEGE EDUCATION HAS RISEN MUCH FASTER THAN INFLATION



STUDENT LOANS ARE A MAJOR BURDEN ON CONSUMERS



Unfortunately, borrowing for college often results in high levels of student loan debt upon graduation. At the individual level, this is a burden on graduates that must be factored into every financial and career decision. In the worst case, it may mean that graduates are unable to take as many risks or pursue their true passions if it means they are unable to generate the steady income needed to repay their loans.

At the aggregate level across the economy, student loans have ballooned over the past 20 years to $1.6 trillion, outpacing other non-mortgage consumer debt. This has led to macroeconomic concerns with some comparing the size of student loan debt to the subprime crisis prior to 2008. While it's difficult to say exactly how this will impact the economy, there are important differences to subprime loans such as grace periods, forbearance, parent cosigners, and more. Still, it's possible that high levels of student debt could act as a drag on the economy due to its influence on career decisions, reduced consumer spending, and more.

Of course, the student debt crisis has become a key political issue. The current administration recently sought to cancel up to $20,000 in federal student loans for qualified borrowers. However, the Supreme Court has ruled that this is an overstep of the executive branch and invalidated the action. Politics aside, this has resulted in uncertainty for those with student loan bills coming due.

The bottom line? Higher education continues to be extremely valuable from a financial and economic perspective. Deciding how to pay for college is an important component of any financial plan. Saving early, making appropriate investments, and using attractive vehicles, ideally with the guidance of a trusted advisor, can help to increase the odds of financial success.