

# COLLEGE SAVINGS INCENTIVES

## OVERVIEW

Post-secondary education is one of the best investments an individual can make in his or her economic future. A college degree means higher earning potential (up to 75% higher<sup>1</sup>) and can be a stepping-stone to building wealth and achieving economic security. College graduates are, for example, more likely to have jobs that provide health insurance and offer retirement plans.<sup>2</sup>

Yet escalating costs discourage many from pursuing post-secondary education. For low-income families, the net out-of-pocket cost of a four-year public university education (even after grant aid) is estimated to be as high as 39% of total income.<sup>3</sup>

One way to make post-secondary education more affordable and increase participation by lower-income individuals and families is to create incentives for them to save for college. Twelve states currently offer financial incentives to save in 529 college plans. These plans (named for the relevant section of the federal tax code) are state-sponsored, tax-preferred savings plans for qualified post-secondary education expenses.

## WHAT STATES CAN DO

Each state offers its own 529 plan through a designated financial institution. States have the flexibility to design many features of the plan, including whether to offer incentives to lower-income residents – or all residents – to encourage participation. These incentives can take the form of a match on individuals' deposits to their 529 accounts or a tax credit that reimburses account holders for the deposits they have made.

In addition, states can automatically open accounts for all newborns; ensure that saving in the accounts is easy and incurs minimal costs to families; seed the accounts with initial deposits; and provide benchmark deposits when savers reach particular milestones. States can also track and publicly report 529 account ownership by income as a means of gauging the participation levels of lower-income families in college savings programs. States can make these policy decisions either through regulation or legislation.

## ELEMENTS OF A STRONG POLICY

Based on research by CFED, the Center for Social Development, the New America Foundation and others, CFED considers a state's college savings incentive policy strong if it meets the following criteria:

- 1. Are accounts automatically opened for all children at birth?** States should automatically enroll all newborns into the college savings 529 plan.

<sup>1</sup> Over 40 years, the projected earnings for those with a bachelor's degree are 75% higher than for those with only a high school diploma. Clancy, M., Han, C., Mason, L. & Sherraden, M. (2006, April). *Inclusion in College Savings Plans: Participation and Saving in Maine's Matching Grant Program*. St. Louis, MO: Center for Social Development.

<sup>2</sup> Clancy, M., Cramer, R. & Parrish, L. (2005, February). *Section 529 Savings Plans, Access to Post-Secondary Education, and Universal Asset Building*. Washington, DC: New America Foundation.

<sup>3</sup> Based on tuition and fees net of grant aid, plus room and board and other costs at four-year public universities for academic year 2003-2004 for families with incomes of no more than \$40,000. *Trends in College Pricing 2007*. (2007). NY: The College Board, p. 18. Retrieved April 1, 2009 from [www.collegeboard.com/prod\\_downloads/about/news\\_info/trends/trends\\_pricing\\_07.pdf](http://www.collegeboard.com/prod_downloads/about/news_info/trends/trends_pricing_07.pdf).

2. **Does the state incentivize 529 college savings for some or all residents?** States should provide a match or tax credit on college savings for as many children as possible, but at least for children in families with low and moderate incomes.
3. **Is there potential for meaningful account balances after 18 years?** States should design incentives so that they result in meaningful savings by the time many young adults are ready for post-secondary education. Even with the assumption that college costs will increase rapidly – 5% per year for the next 18 years, or 90% more than present costs – savings accumulations of \$6,000 would pay for at least one year of a child’s net costs at a four-year, public university.<sup>4</sup> Therefore, for the purposes of this policy measure, an account balance of at least \$6,000 at age 18 is considered “meaningful.”

The potential for a meaningful account balance after 18 years is influenced by whether a state makes an initial deposit to seed the account, the amount of that deposit and the structure of state matches or tax credits for individuals’ deposits. The presence of a state match or tax credit and its rate and duration will greatly impact the final balance of an account.

4. **Does the state minimize barriers to saving?** States should ensure that saving is as easy as possible, and that accountholders’ investments are not whittled away by high fees and service charges. To do so, states should ensure that:
  - **Small deposits are permitted.** Many 529 programs have a minimum deposit requirement (often in the \$15 to \$25 range), which can be a barrier for very low-income families who may only have a few dollars at a time to deposit. States should allow deposits of any size to 529 accounts, no matter how small.
  - **The 529 plan offers a no-cost investment option.** States should minimize fees and service charges in their 529 plan, and should offer a basic investment option with no fees for enrollment, account maintenance, program management or other investment costs.

## WHAT STATES HAVE DONE

Twelve states currently incentivize deposits into 529 college savings plans for some or all of the state’s children. They are: Arkansas, Colorado, Indiana, Kansas, Louisiana, Maine, Michigan, Minnesota, North Dakota, Rhode Island, Utah and Vermont. The details of each state’s policy vary and, therefore, provide different incentives for low- and moderate-income families to participate. Three states – Illinois, Kentucky and Oklahoma – have established task forces or legislative study commissions to explore incentives for college savings as an incremental step toward establishing matched 529 policy.

<sup>4</sup> CFED analysis, derived from: *Trends in College Pricing 2006*. (2006). NY: The College Board. Retrieved from [www.collegeboard.com/prod\\_downloads/press/cost06/trends\\_college\\_pricing\\_06.pdf](http://www.collegeboard.com/prod_downloads/press/cost06/trends_college_pricing_06.pdf). The College Board reported net 2008 college costs (tuition and fees less grants and federal tax benefits) at a four-year public university as \$2,900 per year. Estimating a 5% increase per year, we project the net cost to rise to \$5,510 per year in 18 years.

<sup>5</sup> The matched 529 programs in Arkansas and Utah are currently operating on a pilot basis.

For more information on this policy measure, College Savings Incentives, and more, go to <http://scorecard.cfed.org>.

In the 2009-2010 Assets & Opportunity Scorecard, the 50 states and the District of Columbia were rated on their existing incentives for college savings. The ratings were based on all four criteria above.