



Capital Management, Inc.

High Income Planning (HIP): Educational Funding

Situation

Bruce and Sarah Sutton are a married couple living in Houston, Texas. They have two young children: Hunter and Melissa.

The Suttons have been focused on building their retirement accounts over the past 10 years and have not yet begun to plan for their children’s higher education funding.

SUTTON FAMILY SNAPSHOT	
Bruce / Sarah’s Ages	43 /40
Hunter / Melissa’s Ages	10 & 8
Annual Household Income	\$300,000

The Sutton’s objectives include:

- Determine which universities to target and how much college will cost.
- Effectively save and invest to send their children to college.
- Develop an annual savings and distribution strategy.

SMS Educational Planning Process

Determine Target Educational Goals

Before making any recommendations to the Suttons, it is important for SMS to first understand the Suttons’ educational goals and objectives for their children. Do they desire to send each of their children to an in-state four-year program or are they expecting each to go to an out-of-state university or private university? While the children are still young, Hunter is a gifted student and has an interest in medicine and science and says he wants to be a doctor. If he continues along that path, are the Sutton’s willing to pay for a graduate program?

Bruce is an alumnus of The University of Texas-Austin and Sarah went to Texas A&M. They disagree on which is the superior university; however, they do agree that UT and A&M should be the target level of schools for both their kids.

Determine the Target Educational Costs and Calendar

Now that there are goals in place, SMS can determine the current and projected costs associated with attaining the Suttons’ desired level of educational funding. SMS can provide the Suttons with a customized educational spending calendar that helps them visualize the timing and expected college cash flows, factoring in the expected escalation of college costs over the years before their kids enter college. As shown in the table below, 2028 and 2029 will present the Suttons with significant challenges as college costs are projected to exceed \$90,000 per year for both years. The total cost of four years of college is projected to be \$372,153.

Estimate the Family’s EFC

SMS will estimate the potential that the Sutton’s children will receive any financial

aid. For the purposes of determining needs-based aid, each household should calculate their EFC (Expected Funding Contribution).

SMS determines that based on the Sutton’s projected level of income, their EFC is roughly \$100,000, which is well beyond the cost of even the most expensive universities. Even when both kids are in college, their EFC for each child will be \$50,000 to \$60,000 which is well over the cost of attendance for in-state universities. Given their situation, the Suttons will likely be responsible for 100% of their children’s college costs.

Evaluate the Family’s Savings Potential

At this point, SMS has a good estimate of future educational costs and the amount that the Suttons will likely be responsible for. The Suttons must determine how much of their current and future budgeted savings can be allocated to achieving their

Hunter and Melissa’s College Cost Calendar

Projected College Costs	2026	2027	2028	2029	2030	2031	TOTAL
Hunter	\$40,060	\$42,463	\$45,011	\$47,712			\$175,246
Melissa			\$45,011	\$47,712	\$50,575	\$53,609	\$196,907
Total College Costs	\$40,060	\$42,463	\$90,022	\$95,424	\$50,575	\$53,609	\$372,153

educational savings goals. SMS will provide the Suttons with two saving strategies: (1) fund each child's education by the start of college and (2) smooth cash flows by extending payment through college and leveling savings between both children.

Implement and Monitor the Savings Plan

As shown in the table below, SMS recommends the Suttons start a monthly automatic 529 savings plan consisting of about \$11,500 annually for Hunter and \$9,100 annually for Melissa. When Hunter graduates, the plan shifts to directing the entire \$20,600 annually to Melissa's account. This plan would provide a steady savings amount over the next 14 years with a more manageable savings requirement. SMS sets up the 529 plans with investment options appropriate for the timeframe the funds will be invested.

Comparison of 529 Savings Strategies

Year	College Years (Fall)		Savings Complete by Start of College			Savings Run Through End of College		
	H	M	Contributions for Hunter	Contributions for Melissa	Total Contributions	Contributions for Hunter	Contributions for Melissa	Total Contributions
2018			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2019			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2020			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2021			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2022			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2023			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2024			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2025			\$14,241	\$12,247	\$26,488	\$11,447	\$9,153	\$20,600
2026	X		\$10,680	\$12,247	\$22,927	\$11,447	\$9,153	\$20,600
2027	X		\$0	\$12,247	\$12,247	\$11,447	\$9,153	\$20,600
2028	X	X	\$0	\$9,185	\$9,185	\$11,447	\$9,153	\$20,600
2029	X	X	\$0	\$0	\$0	\$8,585	\$12,015	\$20,600
2030		X	\$0	\$0	\$0	\$0	\$20,600	\$20,600
2031		X	\$0	\$0	\$0	\$0	\$15,450	\$15,450
TOTAL			\$124,605	\$131,655	\$256,260	\$134,505	\$148,744	\$283,249

Notes: Assumes 5.65% rate of return, 6% college inflation, and monthly contributions starting in January 2018

On an annual basis, the Suttons will review their progress towards meeting their college savings goals with SMS. Have the target schools or projected college costs changed? Have their funding needs changed? Are the investments still consistent with the time horizon? By making small adjustments along the way, the Suttons can be confident in reaching their savings goals.

Planning Impact Summary

- Suttons have a high degree of confidence they will achieve their educational goals with a carefully thought out funding plan.
- Achieve over \$88,900* in projected tax-free earnings which is the equivalent of two years of college expenses.
- The Suttons pursue the smoother savings strategy which will be more manageable for their household budget.

*Earnings estimated as \$372,153 future value of 529 less \$283,249 of contributions = \$88,904