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PRIVATE WEALTH MANAGEMENT

SAVING FOR COLLEGE AND RETIREMENT

Note:

There's a difference between reducing your standard of living in retirement and drastically reducing your standard of living in retirement. Some financial professionals discourage the use of retirement funds for funding your child's education if paying college bills will leave you high and dry in your retirement years. Of course, individual circumstances vary.

What is it?

These days it's not uncommon for parents to postpone starting a family until both spouses are settled in their marriage and careers, often well into their 30s and 40s. Though this financial strategy can be advantageous, it can also present a dilemma--the need to save for college and retirement at the same time.

The prevailing wisdom has parents saving for both goals at the same time. The reason is that parents can't afford to put off saving for retirement until the college years are over, because to do so means missing out on years of tax-deferred growth. Moreover, because corporate pensions (and lifetime job security) are now the exception rather than the rule, individuals must take greater responsibility for funding their retirements.

First, determine your monetary needs

The first step is to determine your projected monetary needs, both for retirement and college. This analysis will reveal whether you are on a savings course to meet both goals, or whether some modifications will be necessary.

You've come up short: what are your options?

You've run the numbers on both your anticipated retirement and college expenses, and you've come up short. The numbers say you won't be able to educate your children and retire with the lifestyle you expected based on your current earnings. Now what? It's time to sit down and make some tough decisions about your expectations and, ultimately, how to compromise.

The following options can help you in that effort. Some parents may need to combine more than one strategy to meet their goals.

Reduce your standard of living now or in retirement

You may be able to adjust your spending habits now in order to have more money later. Consider making a written budget to track your monthly income and expenses. If your monetary needs have fallen far short of the mark, you will need to make a bigger spending adjustment than you would with a lesser shortfall. The following are some suggested changes:

- Move to a less expensive home or apartment
- Sell your second car and carpool whenever possible



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- Reduce your entertainment budget (e.g., bring your lunch to work, eat out once a month instead of every week, rent movies instead of going to the cinema)
- Get books and magazines from the library instead of the bookstore
- Cancel club memberships (e.g., golf club, health club)
- Set a limit on birthday and holiday gifts for family members
- Forgo expensive vacations
- Shop for clothes in the off-season, when they're likely to be on sale
- Buy used furniture and used big-ticket items
- Limit your child's extracurricular activities, like music lessons or hockey camp

Caution:

The more aggressive the investment, the greater the risk of loss of your principal. This strategy isn't for people who shudder at the slightest downturn in the stock market. If you'll have trouble sleeping at night, you may want to reconsider whether taking on greater risk in your investment portfolio is advisable.

If you're unable or unwilling to lower your standard of living now, perhaps you can lower it in retirement. This may mean revising your expectations about a luxurious, vacation-filled retirement. The key is to recognize the difference between the things you want and the things you need. The following are a few suggestions to help reduce your standard of living in retirement:

- Reduce your housing expectations
- Cut back on travel plans
- Own a less expensive automobile
- Lower household expenses

Work part-time during retirement

About 25 percent of retirees work part-time. You may find that the extra income enables you to enjoy the kind of retirement you had anticipated.

Increase earnings (i.e., spouse returns to work)

Increasing earnings may be another way to meet both your education and retirement goals. The usual scenario is that a stay-at-home spouse returns to the workforce. This has the benefit of increasing the family's earnings so there's more money available to save for education and/or retirement. However, there are drawbacks. The additional income may push the family into a higher tax bracket, and incidental expenses like day care and commuting costs may eat into your overall take-home pay.

In addition to a spouse returning to work, one spouse may decide to increase his or her hours at work, take another job with better compensation, or moonlight at a second job. Factors to consider here include the expectation of increased job pressure, less availability for child rearing and household management, the amount of extra income, the opportunity for advancement, and job security. Another way to create extra income is for a spouse to turn a hobby into a business.

Be more aggressive in investments

If your analysis shows that your current savings (and the accompanying investment vehicles) will leave you short of your education and retirement goals, one option is to try to earn a greater rate of return on your savings. This may mean choosing more aggressive investments (e.g., growth stocks) over more conservative investments (e.g., bonds, certificates of deposit,



Other ways to lower cost of college

In addition to reducing your education goals, there are other ways to lower the cost of college. For example, your child can choose a college with an accelerated program that allows students to graduate in three years instead of four. Likewise, your child may choose to attend a community college for two years and then transfer to a four-year private institution. The diploma will reflect the four-year college, but your pocketbook won't.

savings accounts). This strategy works better the more years you have until retirement. Of course, this strategy can increase risk exposure.

Reduce education goals

One of the realities parents may have to face is that they can't afford to fund 100 percent (or 75 percent, or 50 percent, as the case may be) of their child's college education. This is often an emotional issue. Parents naturally want the best for their children. For many parents, this translates into sending them to (and paying for) college (especially in cases where one or both parents didn't have such an opportunity).

Children pay more and/or assume more responsibility for loans

With college costs continuing to increase at a rate faster than most family incomes, and with perhaps more than one child in the family picture, chances are that more responsibility will fall on your child to help fund college costs. While this does not reduce the costs of higher education, it presents other opportunities for funding. This money can come from part-time jobs or gifts, though the majority of your child's contribution is likely to come from student loans.

Though student loans can be a financial burden in the early years when graduates are just starting out in their careers, many loan providers offer flexible repayment options in anticipation of this common situation. In addition, if your child meets certain income limits, he or she can deduct the interest paid on qualified student loans.

As a plus, students who take out student loans to pay for college oftentimes have a more vested interest in their education than students who receive help from their parents.

How do you decide what strategy is best for you?

This decision must be made on a case-by-case basis. What works for one family may not work for another family. In some cases, more than one strategy will be necessary to deal with the demands of educating children and retiring successfully. Factors influencing your decision may include the following:

- The amount of your financial need
- Your current income and assets and any expectation of significant future income (e.g., a bonus at work, exercise of stock options, an inheritance)
- The number of years you have until retirement
- Your willingness to reduce your standard of living (now or in the future) for the sake of your children
- The number of children in your family who plan on attending college
- The academic, athletic, or other notable skills of your child that may raise the possibility of a college scholarship

Can retirement accounts be used to save for college?

Yes. But should they? Probably not. A financial advisor may recommend against accessing your retirement accounts to pay college expenses as a preferred strategy. But if you must, there are some tax breaks available.

It's now possible to withdraw money from either a traditional IRA or Roth IRA before age 59½ to pay college expenses without



incurring the 10 percent early withdrawal penalty that normally applies to such withdrawals. However, any distributions of earnings and deductible contributions from a traditional IRA and any nonqualified distributions of earnings from a Roth IRA may be included in your income for the year, which may push you into a higher tax bracket.

Unfortunately, there's no similar college exception for employer-sponsored retirement plans, such as a 401(k) plan. So, if you're under age 59½, you'll pay a 10 percent early withdrawal penalty on any withdrawals. As with an IRA, any withdrawals are added into your income for the year, which may push you into a higher tax bracket. Nevertheless, saving in a 401(k) plan can be an attractive option for some parents because the company may match employee contributions. Additionally, many employer plans may allow you to borrow against your contributions (and possibly earnings) before age 59½ without penalty.

A benefit of using retirement accounts to save for college is that the federal government doesn't consider the value of your retirement accounts in awarding financial aid (the federal formula also excludes annuities, cash value life insurance, and home equity from consideration). However, most private colleges do consider the value of your retirement accounts in deciding which students are the most deserving of campus-based aid.

Regardless of your circumstances, it's advisable to consult with a financial advisor to discuss specific objectives and answer questions that may be raised by the content above.

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