Illinois Statehouse News

College savings plans safe from state coffers

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By Melissa Leu

SPRINGFIELD — Wary Illinois investors are slowly making a return to college savings plans, despite recent economic woes and concerns about a troubled state budget.

More than 250,000 people are enrolled in Illinois' college savings plans — an increase from 232,000 participants in 2009, according to state audits.
"It's a longer term investment. The market has come back — almost all the way back. You just need to ride these things out," said Susan Carr-Templeton, an Illinois resident and financial adviser who invested in a savings plan for her two teenage children.

Roger Michaud, chair of the College Savings Foundation, said the increased participation is to be expected, considering the rise in college costs.
"Number one, investors and savers are probably a bit more confident in the market over the long term," said Michaud. "But more importantly, I think they are realizing that as their kid gets older, (they're) running out of time, and they're putting money to work."

Some investors, however, are less fearful of market volatility than they are about the safety of their investments in a state that is facing its largest budget deficit in history.

"I just don't know what could happen. Like if the rules get changed by the state — if they are out of money, and then I put all this money into the plan. Then all of a sudden it changes and it's not the same plan I originally invested in — that would bother me," said Matt Olech, an Illinois resident looking to invest in a savings plan for his unborn daughter.

Joan Marshall, chair of the College Savings Plan Network, an industry association of 529 plan advocates, said it is highly unlikely that states would tap into savings funds no matter how bad budget problems get.

“I don’t know of a single state where the state can take money from that plan,” said Marshall, who also heads the college savings plan in Maryland. “Nor would it be in the state’s interest to do that, because the state is setting up a commitment to allow that family to get tuition benefits in the future.”

About 9.5 million people in the United States currently contribute to some type of 529 plan, according to Financial Research Corp., an investment research firm. The 529 plans — named after a section of the Internal Revenue Code — are savings plans run by a state or educational institution as an investment vehicle to pay for future college costs.

Illinois offers three options: Bright Start College Savings Program, Bright Directions College Savings Program and 529 Prepaid Tuition Program.
Despite their names, Bright Start and Bright Directions work more like a 401k or educational IRA. Investors place money in mutual funds, which is then invested by program managers. Profits are tied to the market value of the option the investor selects.

The 529 Prepaid plan allows investors to save in advance the amount it costs to attend an in-state public college. Accounts are guaranteed to increase in value at the same rate as college tuition, effectively allowing parents to lock in current tuition rates.
Like many other states, some of Illinois’ plans are overseen by the state Treasurer who is tasked with ensuring the money is properly invested.

“The assets within our Bright Start and Bright Directions are held in a trust … so the assets held in trusts cannot be diverted to the state general revenue funds,” said Melissa Hahn, a spokeswoman for Treasurer Dan Rutherford.
Managed by the Illinois Student Assistance Commission, funds in Illinois’ prepaid plan also are placed in a trust. The state, however, is not required to make payments if the program were to run out of money.

Andrew Davis, executive director of the Illinois Student Assistance Commission, doesn’t anticipate that to happen anytime soon.

“The actual dollar side of our trust fund has never been bigger,” said Davis, who cited $1.1 billion in assets in January 2011.

“[Payments] go out and they are timely. They are accurate and they are fully every penny that the families have contracted for. I have every reason to believe that this will continue for many years to come,” Davis said.

The organization pays out about $60 million to $65 million every year in tuition benefits, Davis said.
Unlike college savings plans, however, contracts for prepaid plans have seen a slight decrease in the past three years, leveling off to about 3,000 per year.

Alan Wolan, a financial consultant for Coe Financial Group, doesn't consider 529 plans as his "first choice."Some of his clients have never made a profit or broken even on their investments.

"Its a very tough situation. For most of my clients who went through (market losses) and were close to college, I tried to allocate their funds much more conservatively with a lot more bonds, but it's pretty hard to recover," Wolan said.

Offered by every state, 529 plans are primarily marketed for their federal and state tax savings benefits.

Participants in both savings and prepaid programs receive a state tax deduction for contributions up to $10,000 per year for an individual and up to $20,000 per year for a married couple filing jointly.

After a nearly 67 percent personal income tax increase was signed into law last month, Illinois families can expect to see a little more tax savings. The measure raised the state's flat personal income tax rate from 3 percent to 5 percent. "Right off the bat, your money has gained notionally 5 percent this year. That's a really good savings plan, if instead of $95 invested, you have $100," said Craig Chapman, a finance professor at Northwestern University.

On the federal level, qualified withdrawals can be made without having to pay taxes on the earnings.

Morningstar, an investment research firm, rated Bright Directions and the Bright Start plans above-average.

"The ones that we rated above average and top, I'd say we have the most confidence in," said Laura Lutton, editorial director of mutual fund research at Morningstar.

But Lutton also issued a word of warning for potential investors, saying the market crash of 2008 was a "worst-case scenario for a lot of parents."

"Everybody is different, and everybody's tolerance for risk is different," Lutton said. "It's important for parents to honestly view their financial situation and decide how much risk they want to take with the 529 plan and choose accordingly."

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