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# SmartMoney

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# Saving for their future

Education With university fees likely to soar and private schools increasingly expensive, **Bina Brown** looks at how parents can pay for the education they want for their children.

**For students and their parents**, the numbers are chilling. A study by the National Centre for Social and Economic Modelling found the government's proposed changes to university fees could triple the cost of some university degrees and double the time it will take to repay a HECS-HELP loan.

For many parents already facing the prospect of paying $450,000 a child for 13 years of private schooling before their kids even ask for help through the university years (not to mention any gap year funding), it might be time to reconsider how to cope with this double whammy to the household budget.

One of the starting points of education belt-tightening could be spending less on primary school and possibly the early years of secondary school.

Parents of children attending private schools spend an average of $216 a week on fees, compared with $12 a week for government schools and $81 for Catholic schools. according to the national modelling centre,

In household budget terms, high-income families spend a whopping 26 per cent on childcare and education.

University fees vary greatly depending on the course and institution, but the National Centre for Student Equity in Higher Education says that in 2014 the average cost of a three-year commerce degree is $30,000.

Regardless of when parents choose to send their children to private schools, with interest rates as low as they are any savings in the early years will need to be invested in growth options to maximise returns, while minimising tax.

Choosing the right investment option within an education savings plan or insurance bonds, or choosing the right managed fund or share portfolio is likely to make all the difference.

**Karen Spiller**, principal of St Aidan's Anglican Girls' School in Brisbane and principal in residence at Bond University, says it is too early to tell what impact the proposed changes to university funding will have on private school enrolments. But rising school fees have already seen more parents choose private education only for their children's final years of school.

"The whole furphy that it is only the wildly wealthy that send their kids to private schools is exactly that," Spiller says.

"Every school would be a bit different but there might be a small percentage of parents

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ILLUSTRATION: SAM BENNETT

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## Saving for their future

at any school for whom the fees are no problem and it wouldn't matter that the fee went up every year.

"However, the vast majority of parents in independent schools would be working two, and possibly three, jobs to send their kids to the kind of school they want," she says.

Spiller says the typical set-up at her private girls' school was the mother working, either part time or full-time, to create discretionary income for the family to spend on independent school fees, travel or cars.

A less common but growing trend is grandparents contributing to the costs, Spiller says.

**Errol Woodbury** of Woodbury Financial Services gives one example where parents of children born this year could face school fees of $450,000, assuming the private school fees are $20,000 a year, indexed at 5 per cent, from kindergarten to year 12.

Assuming a return of 8 per cent a year (gross), parents of a child born this year would need to start contributing $1652 each month to meet the costs. "From this investment they will be able to draw the required school fees when they are due, starting when the child turns five," he says.

Woodbury assumes a tax rate of 15 per cent, which means the investment will be in the name of a parent with a low marginal tax rate.

"Once the final school fees are paid 13 years later, the investment should be exhausted. If the parent wants to contribute to university costs, options include starting the private school education later, increasing the monthly contribution or investing the funds so that the returns are higher. But that carries with it additional risks," Woodbury says.

Given how hard it is for many parents to pay for education with after-tax income, a savings strategy is necessary, he says.

Woodbury suggests starting with an estimate of what the total school fees might be. "We often see parents using the public system for primary school and then the private system from year seven.

"Parents need to work out how much education will cost over the years selected and then ask whether the amount can be funded as part of annual living expenses or how much will need to be saved to meet the target," Woodbury says.

Most parents prefer the flexibility of using the money for a second purpose, he says, making them reluctant to commit to some education schemes or investing the monies "on trust" for the kids.

"While these options have a purpose, they can limit flexibility," he says.

Prescott Securities financial adviser **Darren Wright** says saving as early as possible to take advantage of compounding will help regardless of when you choose to start at a higher fee paying school.

Some of the savings options with potentially higher returns, depending on your investment choice, are insurance bonds, managed funds and a diversified share portfolio.

Wright says one option for someone with a 10-year investment horizon could be an insurance bond. Starting when the child is two and saving $7000 a year could potentially deliver $100,000 by the time they are ready to start secondary school.

This assumes a 10 per cent annual return, which is not unreasonable from an Australian share fund paying 5 per cent a year in income and 5 per cent capital return.

The benefit of an insurance bond is that there is no tax paid after 10 years.

"You could either withdraw the whole $100,000 and put it in a savings account and start chipping away at it. Or you might take some out and reinvest the rest in a diversified share portfolio or managed fund and hope to get some growth and just draw down on it as you need," says Wright.

Multiforte Financial Services director and adviser **Kate McCallum** says where clients are considering private school education, but are unsure (or sometimes a couple has divergent views), she suggests taking the time to be clear on what they want for their children, and thinking as broadly as they can about how they might achieve it.

"For some families it is about continuing a family tradition, or perhaps establishing one, and private schooling is a clear choice. Alternatively, if it is primarily about academic outcomes, they can consider selective schools or go with a good local school and then direct funds to specialist tutoring," says McCallum.

"I always remember a mum at my children's primary school saying $25,000 can buy a lot of personal tutoring," she says.

Rather than stop paying private school fees to focus on higher prospective university fees, parents who can afford it are likely to pay both, says social researcher **Mark McCrindle**.

McCrindle says parents stepping in to pay for areas that would once have been a mark of independence – such as a deposit on a home and costs while at university – are recognising the "down-aging" of young people.

"Young people are younger longer. They are more dependent later in life and therefore parents are prepared to spend money on them at an age where in the past they wouldn't," says McCrindle.

For most people the best way to save for private school or university education will depend on their tax position and how and when they need to access the investment.

> **For 13 years of private school, the parents of a child born this year will need to start putting away $1652 each month to meet the costs.**
> Errol Woodbury
> Woodbury Financial Services

Top: Iain Patrick and his children Amelia, 7, and Cameron, 4. A grandparent's gift invested in equities will pay a big slice of their school fees. PHOTO: DAVID MARIUZ

### Stashed and ready

A $4000 gift from a grandparent when Amelia Patrick was born was the seed of an education savings plan that is well on the way to covering at least half the anticipated high school expenses of the now seven-year-old and her younger brother.

"I set up a direct debit with Lifeplan in 2007 and my wife and I just contribute a small amount monthly," says their father, Iain Patrick. "It is flexible enough that if we got into strife we could stop that and if we needed the money we could access it."

So far there has been no need to change the plan and it is always thought of as being for Amelia and Cameron, now four.

"We think of it as money for the kids for high school and possibly uni, if they end up going there," says Iain.

With an investment horizon of about 12 years, the Patricks chose to put the money in equities which, thanks to the sharemarket recovery since the financial crisis coupled with ongoing contributions, has resulted in a quadrupling of the balance since the plan began.

"When the markets tanked in 2008 we just kept contributing and so the money has been working hard for us since then. We took a long-term philosophical view when the savings plan went backwards that we still had the same number of units and now we have about $17,000 saved, which is nice," Iain says.

The Patricks have been buying units in the Lifeplan Education Investment Fund, which differs from other managed investment funds in that the Tax Office treats it as a scholarship plan, giving it a couple of unique tax advantages.

While the money is invested there is no tax liability on the contributors or the student. Rather, the fund pays the tax at 30 per cent.

When it comes time to draw on the funds, the Patricks can choose to take the money as earnings or capital, taking advantage of the tax-free threshold of the nominated student and tax-free distribution of any capital.

Iain says their contributions to the fund would have to rise considerably for the fund to cover all the expenses of the private school education they plan for both children in high school, but having half makes it more tolerable from a household expenses point of view.

"If private school started tomorrow, we couldn't do it without sacrifices in other areas, but as the fund accumulates it is a situation we can consider," he says. **BB**

# Top-of-the-class savings strategies

**Options** There are a number of useful ways to prepare for the cost of schooling and university, writes **Bina Brown**.

### Education savings plans

There are two education savings plans that offer a tax-free investment for education: The Education Fund from the Australian Scholarship Group, and Lifeplan's Education Investment Fund.

Both are designed for saving for education, with the earnings on investments paid directly to the nominated child.

Earnings are taxed at the company tax rate of 30 per cent, but if the earnings are used for a broad range of education expenses, the ATO refunds all tax paid on them to the fund. This is what sets these apart from any other investment fund.

With the Lifeplan fund the savings plan can be started with a minimum investment of $1000 and monthly contributions of $100. The fund charges an annual fee of between 0.95 per cent to 1.74 per cent depending on where the funds are invested.

The funds are invested according to your timeframe and risk profile. A parent planning to use the funds for university may have a 20-year time frame and might choose an aggressive investment option to try to maximise the returns.

When it comes time to make withdrawals to pay for any expenses, they can elect to pay the child out of either earnings or capital, which can help with tax management.

High tax rates apply to children under 18 – any interest above $416 up to $1307 is taxed at 66 per cent – so generally earnings are paid up to this threshold. If more is needed to pay the fees then it comes out of the capital tax-free.

Once the child turns 18 and the tax-free thresholds change considerably it may be more advantageous to draw more capital and preserve the earnings for future education-related expenses.

As long as the funds are used for education – which could be fees, uniforms, books, accommodation expenses – then the tax paid is refunded.

If the funds aren't used for education expenses then the balance is treated as an insurance bond – which can carry different tax advantages but also comes with additional rules (see insurance bond).

In the case of the Australian Scholarships Group Education Fund the earnings of the investments of all parents are pooled to benefit only the children who enter and successfully complete eligible tertiary education.

Contributions are based on the age of your nominated child when you enter the fund, starting from $11 a week and increasing throughout the contribution period.

There is no choice of investment options. The Education Fund uses an investment strategy they describe as conservative-balanced. But the conditions are very tough.

If the nominated child does not complete the required study none of the earnings are paid. If a person decides not to continue with the fund then only the contributions less fees are returned. There are some children, perhaps, for whom this savings plan might be too risky.

ASG also has a Supplementary Education Program for parents looking to save tax-effectively for private school education, starting at $15.62 a week.

### Mortgages and offsets

Using a redraw option on a mortgage can be one way of accessing funds to pay school fees but it is important to look at the financial impact over the longer term, Prescott Securities financial adviser **Darren Wright**, says.

"Drawing off debt can be an option for someone who hasn't saved up front, but at the end of the school years there will be a bigger mortgage that still has to be funded," he says.

Multiforte Financial Services director and adviser **Kate McCallum** says that the mortgage can be used as a savings option of sorts.

It means setting up an offset account and creating a sub-account where everything that is saved into it is for children's education.

"The sub-account idea helps to earmark the funds for schooling, while still allowing for the funds to offset the interest costs of the mortgage; this is far more tax-effective for most people than having funds in investments or savings as any earnings are taxed at marginal tax rates-and the highest will be 49 per cent from 1 July," McCallum says.

**Errol Woodbury** also finds clients opting for offset accounts.

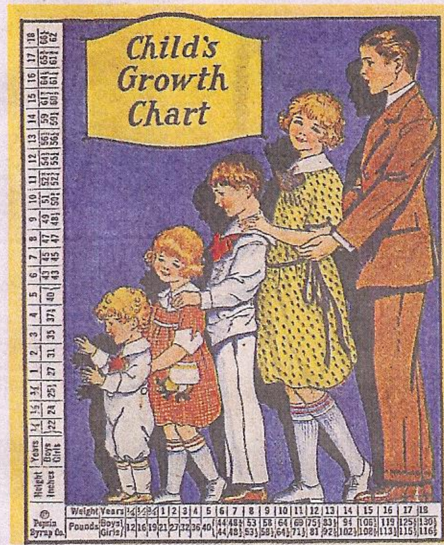
"They work out how much they will need to save to hit the target. If they are on the top MTR of 49 per cent from July 1 and the interest rate of the loan is say 5.5 per cent, by putting the saved amount in the offset, they will receive an equivalent gross return of 10.8 per cent risk free (in other words, this is the return they would need to receive in an alternative investment). However discipline is required to ensure funds are there when needed," Woodbury says.

### Family trusts

Using a family trust to pay for education expenses is about having the most tax-effective structure.

Depending on the pending ages of kids and stages of life, family trusts are often used for education as it can help legitimately distribute investment income and take advantage of lower marginal tax rates for certain members of the family, Woodbury says.

Children under the age of 18 are taxed at minor tax rates from a discretionary family trust (up to 66 per cent a year). So with this form of trust, the distributions may work for Year 12 or supporting university education and or living expenses.




The distributions could go to a low-income-earning spouse who then pays the school fees.

McCallum says that with testamentary trusts, which are created as a result of an individual's death, minor children can receive income at adult tax rates, and so gain access to the normal tax-free threshold.

"So this provides even more flexibility where a grandparent wishes to provide for grandchildren's education," she says.

### Salary sacrificing

Education costs are one of the many items – along with cars and super – that some employees can have salary packaged.

Salary packaging is an arrangement between you and your employer where you pay for some items or services straight from your pre-tax salary. It reduces your taxable income and so reduces the amount of income tax you pay.

Your employer pays fringe benefits tax (FBT) on the benefits provided to you. The main condition is that any salary packaging arrangement must be put in place before you earn the income. It can never be retrospective. Salary packaging is usually more effective for people on mid-to-high incomes.

### Insurance bonds

Insurance bonds are essentially packaged investment products offered by insurance firms, which can be particularly useful for long-term investments such as children's education costs. The bonds are usually invested in a range of managed funds, offering varied investment options from cash to shares to suit different risk profiles.

Once you make an initial investment, your money is invested for your specified purpose until a maturity date, usually 10 years away.

As an individual, you will not need to declare income or capital gains on your tax return if you hold the investment for 10 years or more, because they are paid within the bond by the insurance company at the company tax rate of 30 per cent (which can be even lower if dividend imputation credits are available).

When the investment reaches maturity and is redeemed, the individual is not liable for any income or capital gains tax.

Individuals can contribute to the initial investment as long as they don't exceed 125 per cent of contributions made the previous year.

For example, a $10,000 investment in year one means you could only invest up to $12,500 the following year. Exceeding the 125 per cent limit restarts the 10-year period until maturity.

The money can be withdrawn at any time, but withdrawing before the 10 years means you will be required to include the growth component as part of your assessable income for taxation purposes.

### Savings options

Savings vehicles that can be used to fund a child's education include savings accounts, term deposits, direct shares or listed investment companies and managed funds.

Which one someone might choose will depend on the time frame, their own level of discipline, along with risk and tax considerations. Ideally the investments would be in the name of a low-income-earning spouse to reduce the tax liability on any investment income or capital gains.

Prescott Securities financial adviser Darren Wright says if the funds are needed straight away then a high-interest savings account may be the best option.

A time frame of three-to-five years means a listed investment company, or regular savings into a managed fund, may provide the opportunity for better returns from a diversified portfolio of listed companies, but the investment may vary according to the market, Wright says.

"For any short term requirement, cash in a high-interest account is the best riskless investment," he says.

There is little point in saving in an ordinary bank account if the interest earned is going to be taxed at a person's marginal tax rate and family members can dip into the account for other purposes, like holidays.

# More than a matter of degrees

**University fees** **Bina Brown** considers the heavy financial impact of the government's proposed tertiary changes.

**First it was helping** with a deposit on a house; now it looks like parents may have to help meet some of the costs of getting a university education.

It's either that or watch your children take years to move out of home and rid themselves of debt.

Under the government's deregulation proposal, if universities alter their student fees only to maintain their current levels of total funding per student (that is the government and student contributions combined), the cost of almost half of undergraduate degrees would rise by more than 15 per cent, the National Centre for Student Equity in Higher Education calculates.

Student fees for engineering, science and social sciences degrees would rise more than 50 per cent and fees for agriculture, medicine and veterinary science more than 30 per cent, it says.

Fees for degrees in nursing and education would go up more than 15 per cent.

Fees for about a third of all undergraduate courses would rise up to 10 per cent.

Fees could increase further if universities raise them by more than the Commonwealth reduces its support, the centre predicts.

Add to all this the government's proposed new repayment schedule and plan to raise the interest rate on HECS debt from CPI to the 10-year bond rate, and many students could be saddled with debt for years longer.

Currently, a graduate with a $15,000 debt earning $60,000 would take six years to pay it off at the minimum rate of repayment.

If that debt rises under a deregulated fees environment to $30,000 and the interest rate rises in line with the bond rate, it would take 13 years to pay off.

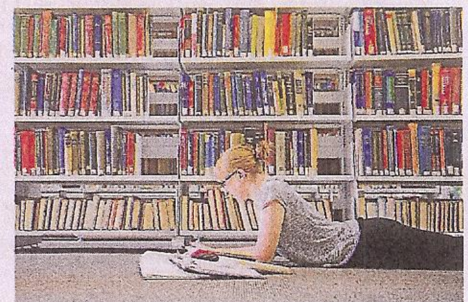
For a debt of $75,000, it would take a graduate earning $60,000 31 years to repay it at the minimum interest rate. A graduate earning $200,000 would take six years.

Despite these calculations, the HECS arrangements remain a better option than parents paying their children's university costs, says Multiforte Financial Services director and adviser Kate McCallum.

This is because the 10-year bond rate it is still lower than the interest rate on a mortgage; and also lower than the likely return of an investment portfolio, says McCallum.

"The second reason is more psychological," she says.

"It helps to engage the student in the decision to go to uni in a very real way; and encourages financial independence."



University students face long years of debt after graduation. PHOTO: GETTY IMAGES