

529 Savings Plans Battered in Downturn; Parents Reconsider Investment Strategy

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The global financial crisis that has shaken retirement accounts and stock portfolios has claimed yet another casualty: college savings funds.

Many 529 college savings plans across the country have posted losses this year, forcing families whose children are close to college to reconsider their strategies. The state-sponsored savings plans take contributions from parents and spread them among a variety of investments such as stocks, bonds and money markets.

Boston-based Financial Research found that, as of the second quarter, the value of 529s declined 7.6 percent, according to preliminary figures from its survey of asset managers.

In the District, the value of the various funds offered dropped about 26 percent compared with last year, said Lasana Mack, the D.C. Treasurer. Most of Virginia's 19 portfolios have posted losses this year, from as little as 2 percent to as much as 30 percent. The same is true for most of Maryland's 13 investment funds, which incurred losses from 2 to 24 percent for the year through Sept. 30.

"This has clearly been a challenging environment for the past year, really, so performance has not been what we would have liked or what we have seen historically, but I think it's consistent with the rest of the market," said Mary Morris, executive director of the Virginia College Savings Plan.

The plans have gained in popularity over the years, holding \$110 billion in assets in the second quarter, according to Financial Research. Parents have flocked to them because they offer potential growth while providing tax-free earnings. The trade-off, however, is that they can quickly dwindle if they are exposed to stocks during an economic downturn.

Paul Nathanson, a partner at a public-policy-oriented public relations firm who lives in Burke, has a 529 plan for each of his two daughters. One is 15, the other is 11. He'd had enough in his older daughter Rachel's fund to put her through four years of an in-state college, but as of Sept. 30, even before the record stock market declines this month, Rachel's fund was down 12 to 13 percent.

"The 529 plan I have is not going to pay for four years of college, especially now," he said. "I realize that I'm going to have to find money elsewhere."

Nathanson acknowledged that he is lucky compared with others. Rachel is just a sophomore in high school. In the next two years, the market could turn around and he could recoup what he lost and then some, he reasoned.

That's what financial advisers are telling their clients. Pulling money out now would lock in the losses. Furthermore, as with 401(k)s, there are tax penalties for withdrawing money from a 529 for anything other than the original intent. The money becomes taxable income, and you pay a 10 percent penalty.

"We remind people that investments for college are meant to be for the long-term," said John Trader, public relations and marketing manager of the College Savings Plans of Maryland. "It's important to stay the course."

A majority of parents have age-based plans. The younger the child is, the more money is invested in equities, up to 100 percent under some plans. Every couple of years, the money shifts to more conservative investments. The closer the

child gets to college, the more money is invested in bonds and the like.

"If your child is 4 or 5 years old, you can think about changing your investment strategy, but the markets run in cycles and you have time," said Douglas Chittenden, vice president of product management for TIAA-CREF, which runs many 529s. "But if you have an older child and you are using the money to pay a bill soon, you might consider rebalancing."

In recent months, fund managers have noticed an uptick in the number of parents shifting to safer investments. Typically, Chittenden said, 20 or 30 people rebalance their TIAA-CREF portfolios in a given week. Two weeks ago, 700 people rebalanced, he said.

But a number of parents are running into a hurdle: an Internal Revenue Service rule that limits asset re-allocations to once a year. Now many parents who have already rebalanced are stuck, and the College Savings Plan Network, which represents state 529 officials and fund managers, is thinking of asking for semi-annual or quarterly changes.

"Because the market is down, you've got a lot of parents that are nervous that their assets are in a portfolio that is not as conservative as it should be," Trader said.

In the meantime, there are ways around the rule, advisers said. For one, parents can roll the money into a new plan, which would allow for immediate asset reallocation. States offer a variety of plans with different time horizons and risk tolerances. Switching the plan to another child would also allow changes. If your child is set to start college within the next year, you could find other ways to pay for the first year or two, then tap into the fund once the market has recovered. One more option would be to keep the current allocation intact but earmark future contributions differently, advisers said.

But such need for maneuvering has raised the question of whether parents should be relying on the whims of the stock market to finance their children's education.

"This downturn is going to force people to take a step back and assess how they are saving," said Larry Glazer, founder and managing partner of Mayflower Advisors in Boston. "If you look at education funding, the problem for most people is they haven't saved enough, college is so expensive. To compound that, you have difficult investing environments."

Steven Roy Goodman, a college admissions consultant in the District, said parents should always supplement their 529 plans with other savings, in good times and bad. Think about a certificate of deposit or municipal bond, he said.

Shaun Dakin, who runs a nonprofit organization and lives in Falls Church, said he would heed that advice. His nearly 5-year-old son's 529 plan is heavily invested in stocks, so it has taken quite a hit. Thankfully, he said, college is 13 years away, enough time for him and his wife to find other ways to save money.

"We're just continuing to plug away," he said. "We'll cross our fingers that things don't go to hell in a handbasket in 10 years. Obviously there's no promise. It is what it is."

Credit: Washington Post Staff Writer

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