Keep Your Children Out of Debt

Have you ever thought about what your son, daughter, grandchild, etc. is going to do or accomplish when he/she grows up? You may be thinking, I just hope they make it through the next grade, but in today's job market most students go to post-secondary education out of necessity and parents/guardians are beginning to think about it earlier in life. Why? Take a look at the numbers.

In eight years the cost of a four year degree with living costs factored in will be $75,000, according to Human Resources Development Canada. When today's newborns turn 18, a four-year degree could cost more than $80,000. That means if you started saving today for your newborn's education, you would have to invest about $4000/year.

There are many calculators on the Internet you can use to estimate your education savings. For example, try http://lifeeventsplanner.cuis.com to find out exactly how much you need to save.

OK. So you realize you need to put away a lot of money, which more likely than not, you can't afford. What do you do? Take heart in the fact that your education savings will probably be a mix of your child's summer work savings, your own savings, student loans, bursaries, scholarships (well, you can always hope), and gifts from family and friends.

The best news is, it is never too early or too late to start saving. One of the most popular ways to save is with an RESP (registered education savings plan). This is a government approved savings plan that allows your savings to grow tax-free until the beneficiary is ready to go to post-secondary education.

You have probably heard of some pros and cons regarding RESPs. It is true that in the past these plans were restrictive, but today you have much more flexibility. For example, you can now, depending on the plan you choose, change the plan's beneficiary or transfer the money into your RRSP if the beneficiary chooses not to pursue post-secondary education.

One reason many parents save with an RESP is - free money. In fact, through an RESP you can collect as much as $7200 in government grant money.

Here's how it works. The government pays you 20% of what you contribute to an RESP each year to a maximum of $400 a year per child. The minimum RESP contribution is $25/month or $300/year. In order to qualify for the Canada Education Savings Grant, you must have an RESP in place by the end of the year in which your child turns 15.

If you choose to invest in the RESP Diploma Education Savings Plan you also have access to an education bonus that can reach up to an additional 15% of your contributions when your child's ready to start his/her post-secondary education.

Now that I have got your attention with government grants and bonuses, here are some of the finer details of how an RESP works.

RESPs have been available in Canada for more than thirty years. They are not tax deductible, but like RRSPs the interest you earn accumulates tax sheltered until the funds are withdrawn. When the student withdraws the funds, he/she is taxed on the earnings. This is a great financial strategy because a student's rate of taxation is usually much lower than the contributor's.

Contributions to an RESP for a given year must be made by December 31. No catch-up is allowed if you miss a contribution. The maximum annual contribution to one or more RESPs is $4000 per year to a lifetime of $42,000 per beneficiary. You can make your RESP deposits once a year or you can make them monthly.

There are two types of RESPs: individual and family. In an individual RESP, the beneficiary can be anyone (child, grandchild, relative, spouse or friend). A family RESP may have one or more beneficiaries, but they all have to be related to you by adoption or by blood as defined in the Income Tax Act. In a Family Plan the beneficiary must be under 21 years of age when the contributions are made on his/her behalf.

In order to receive your RESP payments, the beneficiary must be enrolled on a full-time basis in a qualifying education program (this includes correspondence courses).

Some RESPs are limited by the type and numbers of investment vehicles while others allow any combination. Deposit protection insurance is usually available if you have guaranteed investments. Annual fees and set up charges are common.

If the beneficiary does not go to post-secondary school, you may be able to name someone else beneficiary instead, depending on the plan. If you have contribution room, you may transfer up to $50,000 without any tax consequences to your RRSP or spousal RRSP. You can also simply withdraw the funds and pay taxes on the interest. However, the Canada Education Savings Grant payments must be returned to the government.

Finally, the RESP must be closed after 25 years. In the event that the contributor dies, RESP instructions can be left in a will.

As I mentioned before, savings will not be the only way you help finance your child's education. If the student is eligible she/he can get a student loan from the government. Many financial institutions offer their own student loans; however, the student will most likely need a co-signer. At OMISTA students are eligible for up to $6500/year and up to a total of $26,000. If they go on to post-graduate school, they are eligible for additional funds.

You may be surprised, but another way you can help your child stay out of debt is by giving

them a credit card before they go to college/university. It sounds contrary to popular advice, but this is why it works.

I wouldn't advise giving them one in their own name, but a joint credit card with a maximum limit of $500 or $1000. You would have to explain to them how a credit card works, what it can be used for and why it is important to pay on time.

If you decide not to give them a credit card, they will probably get one on their own when they go to college/university. Most credit card retailers offer gifts to first year students who apply. It is tempting for students to do so because in their eyes who would turn down a free gift and money!

Problems occur when they are tempted to use the credit card for non-emergency purposes like late night pizza cravings. If the student is able to make their payments on time, that's great! But many students just pay the minimum balance so they pay interest or worse, are not able to make the payments and the only thing they are left with is their free gift, a lot of bills and bad credit. Later when they apply for a loan, they may be declined because of the bad credit they accumulated in university/college.

By giving them a joint credit card before they go to university you can keep an eye on their spending and they won't be as tempted to get their own.

One last thing you can do is some research. Get your child to create a budget for college/university and one for when they graduate. It should include what they think their expenses will be during school and when they graduate (including loan payments). You may need to help them with this since you probably have a better idea of how much things cost. There are helpful guidelines and up to date budgeting information at most university websites. For example, the University of New Brunswick's website – www.unb.ca has information on tuition, fees, bursaries, scholarships and student loans.

The next step is to find out what their job prospects are and what kind of employment and pay cheque they can expect when they graduate. Be sure to get statistics for the area where they want to live and work. This information will help them decide if they can afford their education. They may discover their salary will not be enough to pay off their debt or there may not be many jobs in their field. But it is better to find this out now then when they graduate.

So go ahead and give your loved ones some money to help them through post-secondary education, but give them a piece of your mind too. Not many schools teach financial planning so the best financial advice they will get will probably come from you. If you don't feel comfortable talking to them about financial matters, talk to any of our financial service officers at OMISTA. We would love to set them on the right financial track.