BANK OF AMERICA

Perspectives Podcast

Episode 7: "Getting Schooled"

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[Music open]

Hayley Denker
Henry is going to be in kindergarten next year. Emily is in preschool. That's an expense. Rent, utilities, groceries, gas, saving for a house, saving for retirement.

Candace: That's Hayley Denker. Like many Americans, Haley is already thinking about the complicated tradeoffs involved in saving for college. Her husband, Tyler is right there with her.

Tyler Denker
It's like all this stuff in our own life comes up. And before you know it, the idea of saving for your children's college fund gets pushed down.

Candace: Like the Denkers, all parents want their kids to get the education that will set them up for success. But the world is changing fast, and the price of college is increasing just as fast. On top of that, the pace of technological change raises the question of whether the skills and the subjects that we study will even be relevant five years down the road. And that's what we'll be taking about today.

[Theme music]

Welcome to the ***Perspectives*** podcast. We take you beyond the headlines and the numbers so you can better understand our changing world and what it means to you and your financial future.

I'm Candace Browning, head of BofA Merrill Lynch Global Research. And with me is Chris Hyzy, Chief Investment Officer for Merrill and Bank of America Private Bank.

Chris: Hi, Candace.

Candace: And Rich Polimeni, head of Education Savings Programs for Bank of America and chair of the nonprofit College Savings Foundation.

Welcome, Rich.

Rich: Hello, Candace.

Candace: So, Chris and Rich, let's jump right in. You've heard the Denkers, should this be so stressful?

Chris: I think it's because of the mounting issues that everyone's faced with today. Saving for college, saving for retirement, saving for the bolt out of the blue you get hit with. And in many cases paying down your own student loan bills. So whether it should be high pressure or not, it's high pressure.

Candace: Rich, do you have any views?

Rich: I have a one child who just finished their freshman year of college and have a second child who's going to be a freshman in high school. So I can tell you it is stressful and it's for a couple of reasons. College costs are one of the largest expenditures that most families will face in the life, other than maybe their mortgage.

Secondly, we know that an individual with a college degree is more likely to be financially secure and successful. As a group, we know they have lower unemployment rates and we know they're much more involved in their community. ***(Source: "Education Pays 2016," The College Board, Dec. 2016.)*** Ultimately we want our children to have the best happy, successful life. So yes, it puts a lot of pressure on families.

Candace: So Chris, what are some of the ways that changes in the economy have actually been affecting the educational landscape?

Chris: Do you remember the days of a history major?

Candace: I was a history major…

Chris: That's why I'm bringing it up. (Laughter). That lends itself to big questions nowadays. Like what type of major am I thinking about going into college, that's going to lend itself to where the job growth is? Even though we had the similar pressures 20, 30 years ago, it's happening quicker.

So you have to make faster decisions because if you make the wrong decision, you may not be able to use the degree in the field that you went to college for and that field may not give you the income growth you need to pay down the student debt you created.

Candace: Well, Rich, with college so expensive now, you know, in some cases it's as much as $75,000 a year. How do we know if a college degree is even worth it?

Rich: Yeah. So with the student debt now at one point $1.6 trillion in this country, this is a question that many families have been asking over the past few years. ***(Source: Board of Governors of the Federal Reserve System, July 8, 2019.)***

The short answer is that even at today's high cost, a college education is still actually a good investment. According to the U.S. Census Bureau, someone with a college degree earns on average 75% more than someone that just graduates high school. When you consider that earnings difference over a 40 year working career that could equate to more than a million dollars over his or her lifetime. (***Source: U.S. Census Bureau, Current Population Survey, 2017 Annual Social and Economic Supplement***.)

So having said that though, people do need to think strategically about how much they pay for school. You got to make sure that you're not overextending yourself and that the school and the cost makes sense in relation to what your career goal or path is, right? You don't want to go and pay $75,000 for an education when you know your career that you're coming out to is going to pay $50,000 a year. So people need to be smart about it, but it is still a good investment.

Candace: Chris?

Chris: And with the way the economy is moving, vocational schools might be a big outgrowth again and understanding the skills of HVAC, components of the electronification of self-moving cars and other areas that don't require a high cost college for you to get a particular skill. And that's an area and opportunity that some should think about.

Candace: So from a purely financial standpoint, we know that college on the whole historically tends to pay off in the long run. We have some questions about the future, but we still think that that it will pay off. But what about all the debt that we've taken on to fund college?

Let's hear from Dena Higgens, a mom in Brooklyn, New York who's having to juggle her own student loan payments with all her other financial priorities.

> **Dena Higgens:**
> I still have about $40,000 worth of debt. It was closer to 60 at one point. And with the amount of money I pay per month to pay that off that could be money that we're putting towards our children's future. That's money that could go toward purchasing a home, that's money that could be in our savings account.

Candace: Dena is far from alone. As a nation, we currently owe a collective $1.6 trillion in student debt. ***(Source: Board of Governors of the Federal Reserve System, July 8, 2019.)***

So Rich how can parents know how much debt is too much for them or just the right amount? Is there a kind of a rule of thumb they can follow?

Rich: So a couple things the parents need to consider. First of all, just be realistic about what they are able reasonably to afford paying back. But as a rule of thumb, assuming the parent is using the standard 10-year repayment plan, which is generally what is done under the Federal Parent Plus loan program, they shouldn't borrow more than their annual income to cover all of their children's college costs.

So for example, if the family is making $150,000 a year, they should take out no more than 150,000 in the Federal Parent Plus loan program.

Candace: Okay, so that's the parents.

Rich: Correct.

Candace: But is it better for actually the students or the parents to take out the loans?

Rich: We always recommend that the students first max out any federal student loan available before a parent takes out a loan in their name. This is true, even if the parent is planning on helping the child pay back that loan. And the reason for this is simple. The government subsidizes the student loans so that the fees and interest rates are much lower than the Federal Parent Plus loans.

So for example, loans being originated this year for the 2019-2020 academic years, the interest rate on the federal student subsidized loans are 4.53% versus for the parent it's 7%. So that's a big difference. (***Source: U.S. Department of Education, 2019.***)

Candace: That's a huge difference. Wow. So we know it's very expensive to go, currently. Let's talk about how expensive it's going to be in the future. So we heard from the Denker's, they've got their car, their rent, their kids' school, and adding college savings to that list of financial demands is really hard. In the past 30 years, the cost of a private, four-year college education has grown nearly eight times faster than wages.

So Chris, how can parents today balance all those types of competing goals and expenses? Do they need to take on riskier investments with their college and retirement funds in the hopes that they're potentially going to get a bigger return?

Chris: Like all planning, it's important to put things down on paper and understand not just the monthly expense and the monthly income that's coming in so you can gauge exactly where you are in that planning process. But it's also important to know how are you going to fund those expenses, as Rich was talking about, in what manner, in what structure, and most importantly, do you understand, is it a fixed or variable expense?

Once you have all of that down you take those same concepts into the portfolio dynamics. You maintain a disciplined plan within investments: A diversified portfolio across all assets.

And what we see time and time again, is this potential to have a start stop mentality to investing. If you have a start stop mentality to investing, you create gaps in your funding mechanism for what is a high-pressure expense.

Candace: So is there in fact a magic number? I mean to parents of young kids really need to save, I heard $400,000 once. Is there a magic number that parents of young children should be aiming for?

Rich: The magic number is a lot. (Laughter.) No, there really isn't a magic number as each family circumstance will be different based on several factors such as the type of school that they're saving for and the potential financial aid that that child might be qualified for.

The average family covers college costs from a variety of sources. About 35% is covered from grants and scholarships, and that's good news, right? Because grants and scholarships are the things we don't pay back. It's like federal Pell grants as well as school and some state aid and so forth. Another 34% is covered from parents' and students' savings and income. Then about 27% comes from borrowing***. (Source: "How America Pays for College," Sallie Mae® and Ipsos, 2017.)***

So the good news is that parents shouldn't get caught up in the sticker shock as most families don't actually pay the full posted tuition cost. Instead, it's more important to set a realistic goal based on what they can reasonably save.

So a good starting point is to assume that you'll need to cover about 65% of the costs, from some combination of savings and borrowing. And again, the goal is to make the borrowing the lower of the part.

Chris: And I think Rich brings up a fantastic point. Sticker shock can create complacency. It could be so mesmerizing that you don't do anything and then you have to do something pretty drastic. If you don't have children at this point, still start.

From my perspective it gets down to planning, right at the outset. Time is in your favor. Use it at its best. Start now as small as you want to go, start. And do it consistently. Um, because time is in your favor. You're going to wake up a year from now, two years from now, three years from now. And if you did start, you say, “Wow, look what I've been able to accumulate in a consistent basis.” And if you don't start, you start to procrastinate again.

Candace: And time is the one thing you can't get back.

Chris: You can't get back time. We know that really well.

Candace: So we've been talking a lot about the intricacies of debt specifically, but let's talk a little bit about behavior and people. Are parents just obligated to make it work no matter what? Like what kinds of conversations should we actually be having with our children as we start talking about the cost of college?

Chris: I think the first and foremost is really as the value of education in and of itself. Education is not necessarily coming out with a degree that everybody expects you to have. It's about your preferences, your interests. And it's about following your passions. And there's a number of different ways to do that that aren't as costly as the 75,000 dollar ticket that a lot of the private colleges have on an annual basis.

And I think the obligation by parents is to understand that our children know that education, education, education is what drives and allows a society to thrive. And that doesn't necessarily mean it's all college.

Candace: Well that sets us up very well for the next thing that I want to talk about, which is, you know, adding to the complexity of all this is this pace of technological change and that really impacts the types of skills that employers are looking for.

That's important for students entering college now, but it's also really important for those of us, like myself, who are in mid-career. One estimate says that 42% of today's required work skills could be irrelevant in just five years. ***(Source: “The Future of Jobs Report 2018,” World Economic Forum.)***

So let's talk a little bit about that. You know, how is technology changing the workplace?

Chris: We're seeing it virtually by the minute. And we often talk about when you get up in the morning, five years from now, what is your day going to be confronted with? How is it going to change versus what you do today? And the standpoint of the skill set that's needed potentially is not necessarily what four-year colleges can only provide.

We talked about vocational opportunities in some of the schools that may be an outgrowth of this. Also what about large private corporations that ultimately create educational opportunities through private corporate schools and giving the skillset? Because we've heard time and time again that companies can't find the workers for the skills they need.

So is it possible that the private sector becomes an educational route where they start to teach young individuals, older individuals, etcetera, and then ultimately provide them an employment opportunity? I think that's something that can be explored.

And last but not least, think of all of the intricacies and the administration of what technological change ultimately begets. Just because we're getting more technologically savvy and innovative year in and year out, that doesn't mean that there's less and less jobs, actually potentially could mean there's much more jobs.

Candace: So Rich, does that all mean that we're going to see a greater shift towards a more lifelong learning approach to education rather than the four year college degree? And if that's the case, could that change how we perceive college? And also how do we finance this lifelong education?

Rich: So the short answer is absolutely; there has been a shift in attitude about what education is. People don't just see it as this four year thing and I'm done. It is sort of lifelong and ongoing. Um, we are seeing individuals change jobs and careers much more than they did in the past.

Additionally, even if you don't change your career, due to the rapid changes in industry, in technology, it may be necessary for individuals to get some sort of additional training every few years just to keep up with their current role.

Vocational, technical school, apprenticeship programs, ongoing certificate programs, people now view these in the same way, in many cases, as they do a traditional four-year college education. These programs can often be accomplished in less time with less costs and often lead to very good paying careers as well.

And the way people are saving for it is, you know, just like they're saving for their children's own education. They can use things like a 529 college savings plan. There's no age or income limitation. So anybody, regardless of income, regardless of age, can open a 529.

So if I thought a few years from now, I might want to change careers and I might want to plan for some additional education, I can open a 529 for myself today. And then when I'm ready to get that additional education, I can take that money out tax free as well. So it's a great benefit

Candace: I guess I better open up one of those so that I can get a degree in something other than history. (Laughter.)

Chris: History is always in demand. Absolutely. Without history we don't have history and we don't have the future.

Candace: Okay. Well I think we've covered a lot of ground today. I certainly feel more educated about education. So Chris and Rich, what do you think are the most important points for our listeners to actually take away from this conversation? If you had to summarize it?

Chris: I think we've said this a little bit, but start now. Have a disciplined plan. Understand that there's tradeoffs. Time is on your side, don't overreach, both in the expense side and investments side of the equation.

And every once in a while exhale and just sit back and understand that this is the long-term future, it's not one size fits all. Not everybody has to do X, Y and Z. Do what's right for you, your family, and be consistent with it. And when you look back on it, that's the greatest education anyone can get.

Candace: Rich?

Rich: Again, don't get overwhelmed by the sticker shock. It really is about just saving what you can. Create a plan and use a tax efficient vehicle like a 529 college savings plan, which by the way, in many states you also get a state income tax deduction for those contributions.

Every couple of years, as you get pay increases, increase that automatic contribution, you get bonuses put a little bit more in. Most people are paying for either a preschool or some sort of daycare or childcare. So when that expense stops reallocate that money to the college savings or the education savings fund. You won't miss it, you've been paying it all along. It's the easiest way.

Candace: Well that's great. Thank you both so much for your insights.

You've been listening to ***Perspectives***. I'm Candace Browning, head of BofA Merrill Lynch Global Research.

My co-hosts have been Chris Hyzy, Chief Investment Officer for Merrill and Bank of America Private Bank, and Rich Polimeni, head of Education Savings Programs for Bank of America.

We hope listening to ***Perspectives*** inspires you to make the most of your financial life.

What would you like the power to do?

Thanks again for joining us.

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