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Should You Use a Roth IRA to Pay for College?

With the cost of higher education soaring every year, parents find they have many competing demands for their savings, and it leaves some parents wondering if they should use their Roth IRA to pay for college expenses.

The Roth IRA is becoming a very popular way to save for retirement because of its tax-free growth of earnings. The additional benefit is that since contributions are made with after-tax dollars, you can withdraw the contributions at any time without having to pay penalties or taxes. This is why using a Roth IRA to pay for college expenses is attractive to many parents.

Before you start using your Roth IRA to pay for your child's education, make sure you understand the pros and cons so you make an informed financial decision.

Financial Planning First

Financial experts generally agree that you need to have a solid financial plan before making decisions about participation in any college savings plan, which includes:

- Making contributions to your work retirement plan to receive the full employer match.
- Saving as much as you can in retirement accounts; 10% to 20% of your income is generally recommended.
- Eliminating high-interest debt, such as credit cards.
- Having an emergency fund to cover 3 to 6 months of living expenses.

Retirement Planning Is a Higher Priority

Before saving for college, you will want to ensure you are on track with your retirement income goals. You can borrow money for college with a low-interest rate student loan, but you don't want to fund your retirement by accumulating debt. Research suggests that most people are not confident they will meet their retirement goals, which is why financial experts generally believe that retirement savings should be a higher priority than college savings.

If you put college savings ahead of retirement savings, you may need to delay your retirement because you don't have enough money to retire, sell investments or other assets earlier than planned, or live with financial stress when you should be focused on enjoying your retirement.

Should You Use Your Roth IRA to Pay for College?

For some parents, using a Roth IRA to pay for college allows them to save for retirement as well as use the account to help pay for college. The Roth IRA does have some unique benefits that make it an option to pay for college if you have your finances in order.

Pros

Here are some of the benefits of using a Roth IRA as part of your college savings plan:

- Original contributions can be withdrawn from the account without having to pay any tax or penalty. The earnings in a Roth IRA only grow tax-free if the account has been opened for at least five years and distributions happen after age 59 ½ . Since the contributions are made with after-tax dollars, they can be withdrawn at any time.
- You can develop a withdrawal strategy to use the contributions to pay for college expenses while allowing the earnings to continue to grow tax-free for your retirement.
- Typically Roth IRAs have more investment options than other types of accounts. Most 529 college savings plans have limited investment options. The Roth IRA is a type of retirement savings account that can contain various investments.

Cons

Here are a few of the cons of this strategy:

- Roth IRAs have income limitations. If you are married and filing a joint tax return, you are ineligible to contribute to these accounts if you earn more than $240,000 in 2024. For single filers, the income threshold is $161,000. However, if you are eligible to contribute to a Roth IRA, the downside risk of using it to pay for college

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Allie, Bob, & Sarah

Should You Use...

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expenses is that you will have to delay your retirement if you do not have other funds for retirement.

• The contribution limits for a Roth IRA are lower than college savings accounts, such as a 529 plan. In 2024, you can contribute $7,000 per year to a Roth IRA and $8,000 if you are over 50 years of age. Another issue with using Roth IRA contributions to pay for college is that the distributions count as untaxed income, so when you complete the FAFSA form for financial aid, it could reduce your child's eligibility.

529 Plans May Be a Better Option

If saving for college is your primary goal, the benefits of a 529 plan may be a better option, including:

• Earnings grow tax free and the money is not federally taxed when you take withdrawals to pay for college expenses. Many states offer a full or partial tax deduction or credit on 529 plans. Also, you can now take tax-free withdrawals up to $10,000 for private, public, or religious elementary and secondary schools per year.

• The owner, not the student beneficiary, is in control of the account to assure the money is used for college expenses. Starting in 2024, any unused funds can be transferred to a Roth IRA for the beneficiary.

• The account is flexible, allowing you to change your investments twice per year, and you can rollover your funds into another 529 plan once per year.

• Unlike the Roth IRA, 529 plans have no income limits, age limits, or annual contribution limits. There are lifetime contribution limits, which vary by plan.

• You do not have to report contributions on your federal tax returns, and you will not receive a form 1099 until the year you make withdrawals.

• In 2024, you can gift up to $18,000 per person and qualify for the annual gift tax exclusion. For example, if you and your husband have three grandchildren, you can contribute $108,000 and qualify for the gift tax exclusion. A lump-sum of $90,000 can be made up front to cover five years without triggering a gift tax.

Please call if you'd like to discuss this in more detail.

COMMUNITY SPOTLIGHT:
The Martha O'Bryan Center

The Martha O'Bryan Center (MOBC), since its founding in 1894, has been dedicated to empowering individuals in poverty through education, employment, and fellowship. Recognizing the interconnectedness of family well-being and academic success, it has evolved into a two-generational facility. The newly launched Family Success Network integrates early childhood development, family stability services, and career support, aiming to break the cycle of poverty. Key components include access to living wage jobs, comprehensive family services, and affordable early childhood education. By providing free, year-round access to education, employment coaching, health services, and family stability programs, the center aims to support Middle Tennessee's most vulnerable families. The network offers a range of services, from early childhood education to workforce readiness, health, and social-emotional support, with a focus on holistic family coaching. Moreover, Martha O'Bryan Center engages in systems change work to address broader issues such as the benefits cliff, college access, food insecurity, and youth programming, furthering its mission to uplift communities.

Facts:

- MOBC served over 8,000 individuals in 2023.
- MOBC served over 150,000 emergency meal in 2023.
- MOBC administered over 900 coaching sessions serving over 300 families in 2023.
- MOBC served over 700 students via Extended Learning or Summer Programs
- This year MOBC has 18 students from our Academic Student Unions receiving full ride scholarships to Belmont or Vanderbilt University!

A Note from Allie:

With summer in full swing, my husband, Jack, and I have enrolled our 2.5-year-old daughter, Lucy, in swim lessons. After three tearful lessons, Lucy turned a corner and now loves going to "swim school" every week. She especially loves the lollipop reward at the end! Lucy has learned to kick (a lot), float on her back, and jump in and find the wall on her own. We love getting to see her learn new things and are excited to watch her play in the pool, lake, and ocean this summer!

Personal Note

As you may recall from my previous newsletter, both of our daughters are getting married in 2024. We just celebrated Tate's wedding at Cheekwood in May. It was a wonderful celebration with an outdoor ceremony. We did experience a short late afternoon thundershower which lasted about 15 minutes as the bride and groom were getting ready to exit the garden. Luckily, my wife Cassie is an excellent planner, so we had dozens of white golf umbrellas on standby just in case. Tate, and her husband, Nick, maintained a great attitude despite the rain and everyone enjoyed a fantastic evening. The next wedding is coming up in August, when Sarah and Jake tie the knot. Hopefully their outdoor ceremony will remain dry, but we are already prepared and have experience handing out umbrellas quickly!

With the economic news continuing to flash headlines about inflation, I believe moving forward with our educational effort around bonds, and bond terminology, makes sense. In our most recent letter I left one term unexplained – and often it's the one you hear the most about in the media. I'm referring to a bond's **yield**. So, without further ado, let's answer: **What are bond yields and why do they matter?**

Super-quick refresher on four of the terms we defined last time, because they'll play a role here, too:

Par Value: This is the amount that must be returned to the investor when the bond matures – essentially, the original investor's principal. (Many bonds are issued at a par value of $1,000.)

Coupon Rate: This is the bond's interest rate, paid by the issuer at specific intervals. For instance, let's say you owned a $1,000 bond with a 10% annual coupon rate. The issuer would then pay you $100 in interest each year until maturity.

Maturity: This is the amount of time until the bond is due to be repaid. A 10-year Treasury bond, for instance, matures 10 years from the date it was issued.

Price: This is the amount for which the bond is traded in the secondary market. Sometimes, bonds trade at their par value, but they don't have to. For instance, imagine Fred bought a bond from the issuer for $1000, but trades it to Fran for only $950. The bond's par value is still $1000. The price, though, is $950, and is said to be traded at a **discount**. On the other hand, if Fred trades it for $1,050, then Fran would be buying it at a **premium**. And if Fran buys it for the same price that Fred originally paid – $1000 – she would be buying it **at par**.

Financial terminology can be slippery and hard to remember. (It's

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Municipal Bonds

We offer the following bonds subject to prior sale or change in price as of June 5, 2024.

Ref No	Issuer	Maturity Date	Coupon	Yield to Maturity	Yield to Call	Call Date	Rating	Price*
1	Tennessee HSG Dev AGY	07/01/39	3.000	4.500	4.500	07/01/28	Aa1 / AA+	83.710
2	Knoxville Elec - JJ	07/01/42	3.000	4.290	4.290	07/01/26	Aa2 / AA-	90.130
3	Memphis - Gen Impt	05/01/30	3.000	4.130	4.130	05/01/24	Aa2 / AA	94.160
4	Wilson Co Tn TH- Spec	04/01/37	3.000	3.890	3.750	04/01/29	AA-	101.090
5	Harpeth Vly TN Utility	09/01/35	4.000	3.750	3.520	09/01/29	AA+	102.270

Callable at 100% beginning of the call date above and every call date thereafter with 30 days notice.

In addition to the bonds listed, we have several other corporate bonds available. If you are looking for a specific bond or maturity, please feel free to contact me with your requests.

We are also interested in buying corporate bonds. If you have bonds for sale, please call me for a bid and details on how you can convert your present bonds to cash or alternative investments.

Finally, new bonds are coming to market every day. If you give me a call, I will be more than happy to go over current market offerings and conditions with you.

**Prices Subject to Change*

Although the information and statistics are not guaranteed, they have been obtained from reliable sources and are believed to be accurate. All put/call information may not be displayed and &Partners assumes no responsibility for such undisclosed features or omissions. All are subject to market conditions and/or prior sale.

like mental soap.) But keeping all these terms in mind, the definition of a bond's **yield** is this: *The return – or amount – an investor expects to gain until the bond matures.*

Simple, right? Now we can wrap this up and go about our day.

Except, not quite. While that may be the definition, the actual *ramifications* of yield go a bit deeper. To understand this, we first need to understand the most basic way yield is calculated.

A bond's current yield can be found by dividing the bond's annual interest rate payment (coupon rate) by its **price.** For example, imagine Fran buys a bond with a 10% coupon rate for its original $1000 price. The bond's yield would be 10%, too.

Now imagine that Frank buys that same bond from Fran a year later – but for $75 more. Since the bond is being traded for *more* than its par value – in this case, $1,075 – the yield would go down to 9.3%. After all, if Frank pays more than Fran for the same level of interest rate, he's getting a lower return on his investment than Fran did, who paid less. However, if the bond trades for less than par – say, $975 – then the yield goes *up* to 10.25%.

In other words, yields and bond prices are **inversely related**. If the price of a bond goes up, its yield will go down. If the price goes down, the yield goes up. Make sense?

Essentially, by comparing the current yield of different bonds, you can see which bonds are expected to give *more* or *less* of a return on your investment. The higher the yield, the better the expected return.

Now, that doesn't mean an investor should just look for bonds with the highest yields and call it a day. That's because high-yield bonds tend to come with more *risk* than low-yield bonds do. As we covered in my last letter, issuers with lower credit ratings will often pay higher interest rates, since there is some risk they won't be able to repay the principal by the time the bond matures. Investors must always balance risk versus reward when choosing where to put their money, and that holds true for bonds, too.

So, that's yield in a nutshell. Now, you may be wondering, "Why do I hear so much about bond yields in the media?" Well, many analysts and economists use yields to project which direction interest rates will move in the future…and by extension, the overall economy. You see, when interest rates are expected to rise, bond prices tend to go down. (That's because an existing bond's coupon rate will no longer be as attractive as that of a new bond, meaning the owner would need to sell the bond at a discount.) And when interest rates are expected to fall, bond prices rise. For that reason, when yields rise across the entire bond market, analysts often see it as a signal that interest rates may rise soon, too. (Furthermore, when the yield on **short-term** bonds rises above that of **long-term** bonds, this can indicate that investors are concerned about a possible recession.)

Now, we covered a lot of concepts in a very short amount of time. Hopefully, it all made sense. To be honest, we're just barely scratching the surface of this topic – but this is precisely why I started writing this series on bonds.

The world of investing can be a complicated one. Sometimes, it's more complicated than it needs to be. You will often see terms like "yield" thrown about in the media without any explanation or context. Many investors, even experienced ones, can find all this lingo to be confusing, even intimidating. That's not how investing should be! You don't need a PhD to understand this stuff. You just need to break it down and translate it into plain English. *Everyone,* regardless of their level of education or experience, has the right to invest with confidence in their own future. (Furthermore, smart investors don't actually need to think about terms like "yield-to-worst" that much. Far more important is understanding **what you want to accomplish, and what steps you need to take to get there**.)

A Note from Sarah:

It has been a crazy few months! I moved into a new home, my sister got married, and I'm finalizing plans for my own wedding! Also, Jake and I just started pre-marital counseling with our pastor to prepare for our upcoming nuptials. We have been dating for a few years, and it has been interesting to see how much we already know about each other. It's even more interesting learning new things about each other. From how we were raised, to how we hope to raise our own family someday. I think that marriage will be an amazing experience and adventure, and I'm so excited to take it on with Jake. I know it will be hard work, but I'm so excited for what's to come. Counting down the days until August 9th!

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