529 Plans Aren't Created Equal. Which One is Right for Your Family?

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With college costs on the rise, families across the country are turning to 529 savings plans to sock away money. But these plans aren't created equal, which means you have to shop around before choosing one to invest in.

Families facing the prospect of thousands of dollars in college costs are looking for ways to save, and a popular one is through a 529 savings plan. Offered by most states and private financial institutions, 529 plans allow investments to grow tax-free, without being taxed when the money is used for college.

While the tax advantages of these plans are very appealing to families, the investments are not without risks. As many learned during the stock market crash of 2008, even with a seemingly safe investment vehicle, you can lose money. "With the last market crash, 93% of 529 plans tracked by Morningstar fell in value," says Pamela Yellen, president and founder of Bank on Yourself, a company that helps people reach their financial goals. "Almost one-third lost at least 40%."

Performance matters a lot with any investment. But when it comes to choosing a 529 savings plan, it's not the only thing you should consider. After all, not every plan is created equal – nor are the returns you can expect out of them.

You should treat 529 investments the same way you would any other investment, according to Travis Sollinger, director of financial planning at Fort Pitt Capital Group. "What are the forms of investments available and what are the costs?" are two major questions families should consider, he says.

Some state plans have perks

Investors can't protect themselves from another stock market crash. But they can choose a 529 plan that gives them the most benefits. That's why experts say your first stop when shopping around for plans should be with your state. "With a state plan, there could be a tax break, scholarship or some matching grant for contributions," says Stephen DeCesare, president of DeCesare Retirement Specialists. "You don't want to give them up unless the other boxes aren't checked."

The idea of getting an additional tax break or match from the plan sponsor in your state is nice. But if the plan has hefty fees, or is limited in the investment choices, then the extra perks may not be worth it. According to Sollinger of Fort Pitt Capital Group, when choosing a plan, you want to go with one that gives you choices – not one that is only offering you investments from one fund company. Sollinger points to the state of Virginia's 529 plan as an example of a closed one, because it only offers investment choices from one fund company. Other states, on the other hand, offer families a wider variety of investments to choose from, he says.

Fees can wipe out investment returns

Fees, or the costs to invest in the 529 plan, is another big factor investors have to think about. After all, the more it costs you to invest, the less that will ultimately go to your child's college costs. One way to cut down on the fees is to go with a direct-sold 529 plan, which eliminates the middleman (or in this case, the broker). Broker-sold 529 plans usually have higher annual costs and could include commissions that can account for 1 percent to 5.75 percent of your contributions, according to SavingForCollege.com. What's more, a lot of the direct-sold 529s invest in things that have low expenses, which means your fees will also be reduced as a result.

Minimum deposits vary

Choosing a 529 plan based on fees, performance and type of investments will ensure you are making a sound financial decision. But for cash strapped savers, those may not be the most important things. Being able to save, even if it's a small amount, could be the deciding factor – yet another reason you need to shop around. According to Betty Lochner, chair of the College Savings Plans Network, some plans have lower minimum deposit requirements than others. For instance, Lochner says, there are plans that require $250 to open an account, while others are as low as $25.

When it comes to saving for college, a lot of families will have to take out some form of financial aid in addition to what they can save from a 529 plan. And because they will need government loans, how the money in the 529 savings plan is treated matters. "Not all states exclude 529 plan accounts when you are being considered for financial aid," says DeCesare of DeCesare Retirement Specialists. "For people trying to qualify for financial aid, they should at least consider that." The good news: even if your state counts some of it as income, it's not a lot. College savings accounts fall under the parental asset category, and only account for maximum rate of 5.64%. So for every $5,000 you save, your expected family contribution when calculating financial aid can only increase $282.

Without retirement savings, a 529 may not make sense

Depending on who you talk to, one of the biggest factors when deciding on a 529 saving plan is if you should be doing it to begin with. Yes, you want to give your children everything. But if saving for college means you can't put money away for retirement, it may not be the best idea. "Retirement is something you can't borrow any money for," says DeCeasre. "You can borrow the money to send your kids to college."

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