Integra Market Insights

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Issue #20 - "Education Savings: RESP vs TFSAs"

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'When I was your age, going to the movies cost a nickel!' Everyone has heard someone utter a sentence along those lines. As a follow-up to last-month's edition of IMI that discussed inflation, we will focus this issue on the best way to save for your child's education, the cost of which has more than triple in the last twenty years and whose rising costs are scheduled to outpace inflation, no matter which way you calculate it! At this pace, we're likely to utter the sentence 'When I was your age, going to College/University cost $5,000 per year' and look back on that as nostalgically as our grand-parents did a visit to the silver screen.

As of 2008, University graduates earned 70% more than high school graduates[1] and held an 82% employment rate compared to 55% without post-secondary studies[2]. The all-in cost of a 4-year degree for a child born today could be as high as $140,000[3]. With these statistics, it is understandable that parents, who want to give their child a head-start, want to help their children pay for their future studies. We all know that setting aside money monthly is the most important factor, but what is the best savings vehicle to ensure the best 'bang for your buck'; TFSAs, Self-directed RESPs or Group RESP plans.

Before we look at the numbers, let's look at the other factors that distinguish RESPs and TFSAs. In both cases, your invested dollars will grow tax free to allow for maximum compounding. The RESP benefits from a cash bonus from the government in the form of the Canada Education Savings Grant (CESG) that equates 20% of your contributions up to $2500 per year, per child. When it comes time for your child to draw from an RESP however, the grants and the growth on your dollars will be taxed in your child's hands, and thus may attract some taxation. The TFSA can be withdrawn without any such taxes, or limitations as to where the money can be spent while drawing from an RESP requires proof of enrollment. Given the TFSA's freedom to withdraw the money at any time along with its tax advantages, will the CESG offer enough of a 'bonus' to the RESP to make them worthwhile? Let's find out!

We have put together a spreadsheet that allows you to enter some basic information and will show you the difference between saving within an RESPs and TFSAs. The short answer is that in most circumstances, the RESP will provide the most money for education, so long as the child is not earning too much money while working and going to school. The TFSAs flexibility however, make it very attractive to those who have yet to use their room, will be paying dividends to their kids when they turn 18, or who do not want to commit all that capital for one limited use.

There exist other ways to save for your child's education that are less conventional than the RESP & the TFSA: Group RESPs and Critical Illness policies with return of premium riders. In the example we had above, an investor would visit an advisor and open an RESP for their child and manage the investment. In a group plan, children are grouped together and the money is managed by a third party. The pitch for these 'Group RESP Plans' is that if other children do not attend post-secondary, there may be additional grants available for those who do. In our opinion, this is tremendously unlikely and by no means worth the expensive fees these companies charge, not to mention the incredible hurdles you have to jump through to get access to your money. In most cases, I advise clients to stay away from these types of plans, or at least stop contributing as the fees combined with the limited investment options greatly erode your potential rates of return.

Another expensive option is to buy life insurance on your child and build cash value within that insurance, to be retrieved when needed. Although the life insurance component is an important benefit, as is often the case with these types of insurance policies, the cost of that benefit far outweighs the cost of separating the investment from the insurance.

Similar to retirement planning, developing a quality education savings plan takes time and a custom plan should be built for all individuals. There is no one size fits all answer that can address your specific needs. As such, if education savings is part of your financial needs, discuss it with a qualified financial advisor to help determine the best course of action to fit your goals.

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3.http://www.statcan.gc.ca/pub/75-001-x/2010101/pdf/11073-eng.pdf