

The Rising Cost of Tuition Fees

Benefits of Using RESP Accounts

Because of the escalating cost of tuition fees every year, the government of Canada has provided a means for parents to maximize the growth on their savings and investments through an RESP, or Registered Education Savings Plan. Money invested inside of an RESP will grow at a much faster rate than monies invested outside of an RESP.

The accelerated growth is due to the fact that RESP accounts are tax sheltered, which allows the money inside the RESP to grow tax free for up to 35 years. In addition to the tax shelter benefits, the contributions made to an RESP also attract [Government Education Grants](#) called CESG, which is an abbreviation for Canada Education Savings Grant. Lower income families may also qualify to receive Additional CESG and CLB, which are Canada Learning Bonds. At the very least, all families qualify for the Basic CESG which can total up to \$7,200 over an 18 year contribution schedule.

Tax Sheltered RESP vs. Non Sheltered Investment

Let's look at an example of \$2000 invested yearly over 18 years with a 6% return compounded annually. The total amount to be invested therefore = \$36,000 (\$2,000 x 18) Let's also assume that the investor is in a 30% income tax bracket.

example a:

This example shows an annual investment of \$2000 over 18 years in which the earnings on the investment were deemed to be direct income to the investor. Because the investor is in a 30% tax bracket he must pay taxes on the earnings each year at his marginal tax rate of 30%.

$$\text{Total Amount Invested} = \$36,000.00 / \text{Total After Tax Return} = \$54,437.01$$

example b:

This next example shows the same \$2000 being invested over 18 years except that the investment returns are considered to be capital gains. Therefore the investor is only obligated to pay capital gains tax on one half of the earnings each year, which leaves more money in the investors pocket.

$$\text{Total Amount Invested} = \$36,000.00 / \text{Total After Tax Return} = \$59,689.02$$

example c:

This third example shows what happens when a \$2000 investment over 18 years is tax sheltered inside an RESP. Because the investment is allowed to grow tax free, the investor pays zero tax on the earnings each year resulting in a significant increase to the overall account balance.

$$\text{Total Amount Invested} = \$36,000.00 / \text{Total After Tax Return} = \$65,519.98$$

example d:

In this last example we see the same \$2000 invested over 18 years tax sheltered inside an RESP, but with the \$7,200 Canada Education Savings Grant added to the equation. The CESG benefits combined together with the tax benefits have a profound effect on the growth of the account.

$$\text{Total Amount Invested} = \$36,000.00 / \text{CESG Contributions} = \$7,200.00 / \text{Total After Tax Return} = \$78,623.98$$

From the examples shown above we can see that the same **\$36,000** invested inside an RESP has provided an additional **\$24,186.97** toward a students education.

RESP Investment Options

The illustration above clearly shows the benefit of saving for a child's education inside of an RESP. The question that remains is what are the investment options, but that will vary depending on the RESP provider and the plan you choose. They may however include such things as mutual funds, stocks, bonds, Guaranteed Investment Certificates, (GIC's) or regular savings accounts, all of which carry different risks and rates of return.

... Stock Market

Generally speaking stocks carry the highest degree of risk and GIC's the lowest. The stock market offers no guarantees on investments, and although there is the potential to make great gains, there is also the potential to lose everything. Brokerage fees and commissions are also applicable. Unless you are an experienced investor, or have an advisor or broker that you can trust, it is probably best for the average person to consider a less riskier approach when it comes to RESP's.

... Mutual Funds

A mutual fund is a grouping stocks and/or other securities managed by a mutual fund company. Shares in the fund are sold to investors who may realize a gain or a loss depending on the performance of the fund. Mutual funds may be less riskier than investing directly into the stock market, but they still hold no guarantees. The fund company will deduct an MER Fee (management expense ratio) of between 2% to 3% a year on average from your account balance to manage the fund.

... Guaranteed Investment Certificate (GIC's)

By the very name itself, a GIC is a guaranteed investment and can be purchased through any financial institution. Even though a GIC is fully guaranteed, there is still a downside. The risk being that the ever [rising cost of education](#) coupled with inflation will erode any potential earnings of a GIC based RESP.

Visit any bank or credit union today and you will discover that the average GIC rate is less than 2%. According to Statistics Canada, the cost of tuition fees for colleges and universities increases every year at an average rate of 3.6%. That means a child born in 2009 who enters university in 2027 will end up paying about \$75,000 in tuition fees alone by the time they have completed four years of undergraduate studies.

GIC's vs. the Rising Cost of Education

A family makes a wise decision to start saving money in an RESP account for their newborn child. Because they are not big risk takers they decide to purchase GIC's for their child's RESP. Let's take a closer look at an RESP invested in GIC's earning 2% per year.

example:

Yearly Rising Cost of Tuition Fees = **3.6%**

GIC Annual Return on Investment = **2.0%**

Adjusted Return on GIC Investment = **(-1.6%)**

In other words a GIC investment paying 2% per annum adjusted for inflation is actually returning negative **-1.6%**. If it is the family's goal to save up **\$75,000** over the next 18 years the following yearly RESP contributions would be required (\$7,200 CESG per/yr has been factored into calculations)

% Rate	Contributions	Total Investment Required	RESP Account Balance
2.0%	\$3,100 per/year	x 18 yrs = \$55,800 investment	needed to reach \$75,000
3.0%	\$2,800 per/year	x 18 yrs = \$50,400 investment	needed to reach \$75,000
4.0%	\$2,525 per/year	x 18 yrs = \$45,450 investment	needed to reach \$75,000
5.0%	\$2,265 per/year	x 18 yrs = \$40,770 investment	needed to reach \$75,000
6.0%	\$2,025 per/year	x 18 yrs = \$36,450 investment	needed to reach \$75,000

From the table above it is clear to see that a family earning 2% in an RESP would need to invest approximately **\$20,000** more than a family earning 6% in an RESP to reach a target of **\$75,000**.