When to start saving for your child's college fund

When is the best time to start saving for your child's college education? The answer is simple—how soon can you start?

Tuition costs are rising every year. The average cost of tuition and fees for the current school year is $30,094 for private colleges, according to the College Board. After adding in room and board, the cost of books, food and other expenses, the cost of a 4-year education can be a staggering sum.

For those planning on attending a public university, the price is still considerable. The average cost of attending a public university this year is $15,100. That includes just tuition and fees.

When should I start saving for college and how much is needed?

First, you'll want to estimate how much you think college will cost your child in the future. This is hard to predict, but it's not impossible to come up with a decent figure.

Unfortunately, the cost of college has been increasing every year. For public schools, that number has been growing at a rate of about 4% per year in the past decade. For private schools, the growth rate has been 2.3%.

If we use a conservative growth rate of 2%, then by 20 years the average yearly cost of tuition at a private school will be $44,718 and a public school will cost $22,437.This means that in the year 2034, four-year tuition at a private school would cost $178,872. Public schools would cost $89,751!

The answer: a 529 College Savings Plan

If you are worried about not having enough money for your child's education, a 529 College Savings Plan is a great option. This plans works much like a Roth IRA, as earnings on a 529 plan aren't taxed at withdrawal—when used for qualified education expenses for the designated beneficiary. This includes tuition, fees, books, and room and board.

Like a Roth IRA, your contributions are likely not deductible on your tax return, although your tax benefits depend on your state's plan. A state like Michigan, for example, offers a state income tax deduction up to $5,000 for individuals, or $10,000 for married couples filing jointly.

The IRS treats the amount you contribute to a 529 plan as a gift. You can contribute up to $14,000 for each designated beneficiary, but any amount over that limit could incur a federal gift tax.

In a 529 plan, you'll have several investment options to choose from. You can choose an individual or multi-fund portfolio. An individual fund will consist of a single mutual fund, while a multi-fund portfolio would have two or more mutual funds.

You might also want an age-based investment fund that becomes more conservative as your child nears college. For example, the fund might be aggressively invested in stocks for the first five years, then switch mostly to bonds beginning in year 10 as you near the time to make your withdrawal.

How much can I save in the 529?

Since your investment grows tax-deferred in a 529, the earlier you contribute to the plan, the more money you will have saved up for college.

Let's say you begin today and start a fund with $1,000, and you make annual contributions of $1,000 per year, or $83.33 per month, for 20 years. We will assume that you get an average annual rate of return of 7%, which is around the historical yearly return in the stock market.

In 20 years, you'll have a total of $44,865.18 in your 529 plan. This is a great start, but as mentioned previously, it is possible that the average yearly tuition cost of a public school will cost $22,473 in 20 years, based on the current cost and with a 2% yearly growth rate.

So, what if you upped your monthly contributions to $166 per month or $2,000 per year? This would make a huge difference. Under the same scenario, you would have $85,860.67 in your 529 plan. This amount would be enough to cover nearly all of tuition and fees of a 4-year public university in 20 years.

Hopefully, your child will decide to attend a public school. Otherwise, you'll still be short around $93,000 for a four-year private education.

Another option: A Coverdell Education Savings Account ESA

A 529 Savings Plan is geared toward saving for college expenses, but what if you need money for your child's primary and secondary school? That's where a Coverdell ESA comes into play.

A Coverdell ESA works the same way as a 529 plan. Your contributions are made with after-tax dollars and your earnings can be withdrawn tax-free when you use the money for qualified education expenses. However, money in a Coverdell ESA account can be used for not just college, but public and private K-12 education. This includes tuition, tutoring, room and board, etc.

There are a few things to understand about this account, however. First, the maximum contribution limit for a Coverdell ESA is $2,000 per year, per child. Next, your modified adjusted gross income for the year must be less than $110,000, or $220,000 for a joint return. Finally, no contributions can be made to a beneficiary's account after he or she reaches age 18, unless the person is a special needs beneficiary.

The bottom line? Start saving now

The cost of college is rising every single year, and that's not likely to stop anytime soon. While paying for college continues to be a problem for many Americans, a 529 Savings Plan and a Coverdell ESA could make the process a lot easier.

Steve Nicastro, NerdWallet