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Consumer Morsel

The 101 of 529

08 May 2023

Key takeaways

- 529 accounts have become an important source of funding for education but public data on contribution patterns is limited. As a result, we utilize Bank of America internal data on customer accounts outflow into 529 accounts and provide five observations on recent trends.
- Although student loans and grants remain the main ways to pay for education, there has been a 30% increase in Bank of America customers who actively put money into 529 accounts between March 2019 and March 2023. For a majority of those who invest in 529 accounts, they do so roughly twice each month, which could be concurrent to bi-weekly paychecks.
- Lower income households played catch-up in 529 plans participation over the last few years helped by fiscal stimulus and wage surges but the gap with higher income households remains notable. Specifically, there were five times more higher income households contributing to a 529 in March 2023 than the lower income and the median contribution size was also 2.8x more.

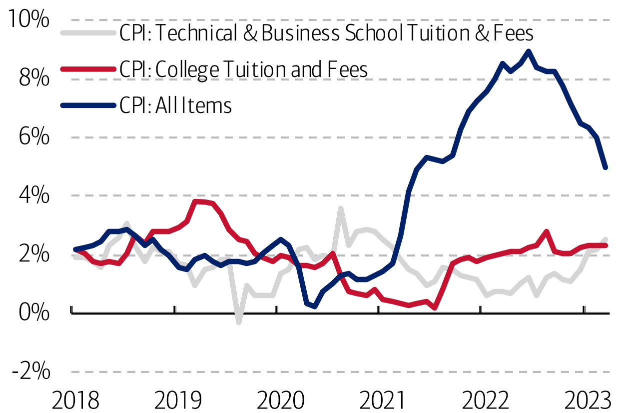
What is a 529 account?

The start of this month marked National College Decision Day, when first-year college applicants finalized their college choices for the upcoming Fall semester. College enrollment not only marks the start of a new chapter for students, it also represents a major financial milestone for them and their families.

According to CollegeBoard, the average estimated total costs for the 2022-2023 school year, which includes tuition as well as room and board, range from $27,940 for public four-year in-state students to $57,570 for private nonprofit four-year students. News reports suggest that annual costs at certain Ivy League schools exceed $90k. And education is only getting more expensive: according to the Bureau of Labor Statistics, while education inflation lags overall inflation, it still grew at around 2% year-over-year (YoY) the last several months (Exhibit 1).

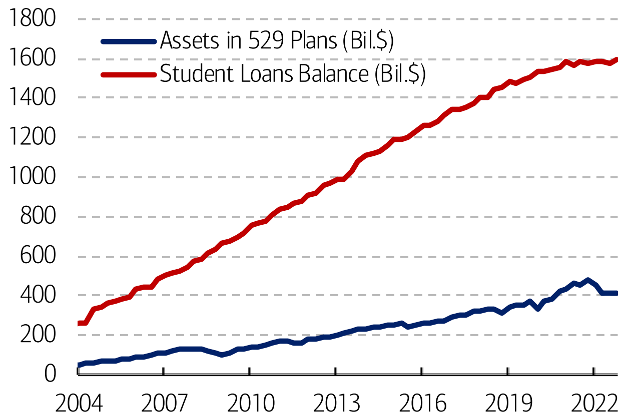
There are a few ways families can fund this expense including savings, loans and grants. According to the Federal Reserve, student loans and grants are the main sources of financing for education, but 529 plans are seeing the fastest growth. Between 4Q 2012 and 4Q 2022, total assets in households' 529 plans reached $411 billion, an increase of 112%. As a comparison,

Exhibit 1: Consumer Price Index: total and education services (seasonally adjusted, index, Jan 2018 =100)
Education inflation is growing at around 2% year-over-year (YoY) the last several months



Source: Bureau of Labor Statistics.

Exhibit 2: Total student loan balance and households' asset in 529 plans ($ billion)
Between 4Q 2012 and 4Q 2022, total assets in households' 529 plans reached $411 billion, an increase of 112%



Source: Federal Reserve Board

student loan balance, while taking up a much bigger share in terms of nominal value, grew by 65% over the same 10-year period (Exhibit 2).

What exactly is a 529? Simply put, it is a type of investment account that offers tax-free earnings on contributions that are designated for educational expenses. While contributions are not tax-deductible at the federal level, some states may offer deductibility. Contributors can withdraw money from the accounts to pay for qualified education expenses such as tuition for college or vocational and trade schools.

Unlike other types of investment accounts such as Roth IRAs, there is no annual contribution limit to a 529 plan. However, if contribution exceeds a certain amount ($16,000 in 2022), families might need to file a gift tax return and potentially pay taxes on the contribution amount.

While 529 accounts have become a popular vehicle for financial planning, there is little public data on contribution patterns. As a result, we utilize Bank of America internal data on customer accounts outflow into states' or financial companies' 529 accounts and provide five observations on contribution patterns.

Observation #1: number of households contributing to 529s grew by 30% since 2019

In a 2016 note, the Federal Reserve suggested that only 2.5% of all US households had a 529 savings account. But according to more recent Bank of America internal data, households are increasingly investing in such plans.

Our analysis focused on Bank of America customers who have a direct deposit relationship, which means they have an active checking or savings account. In March 2023, the number of households that were actively adding funds to their 529 plans was 30% higher than that of March 2019. Similarly, the contribution amount per household also drifted higher over that time period with median value 20% higher in March 2023 than the annual average in 2019.

However, there are two caveats. First, our analysis only captures households that are actively putting funds into 529 plans but not those who own a 529 plan but are not putting money in it either because they have reached their savings target or choose to not add funds for other reasons. Second, our methodology does not include contributions other than those made directly from Bank of America deposit accounts to a 529 account. Still, we believe the data provides useful insights, especially for intra-period comparisons.

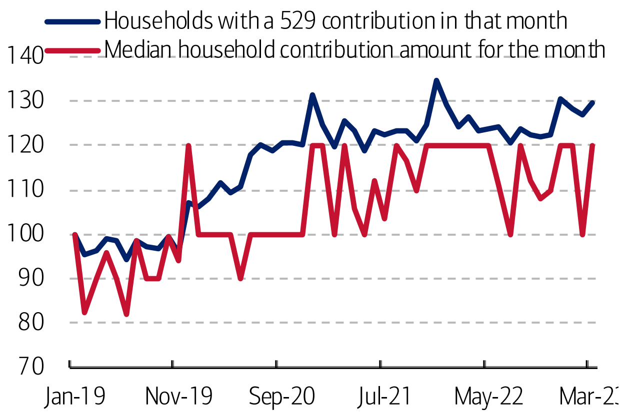
Observation #2: the average household contributes to a 529 account twice per month

In 2022, the average household contributed to their 529 accounts roughly twice a month with some minor variations across the months (Exhibit 4). In our view, this could reflect households that receive bi-weekly paychecks. Meanwhile there seems to be a jump in the number of households adding funds to 529 accounts in December of each year. This could be due to certain households contributing to 529 plans once a year at yearend, potentially for tax planning purposes.

Moreover, there has also been a slight uptick in the average number of monthly contributions compared with 2019. This reflects households increasing the frequency of their contributions on the back of higher bank savings and wages. (For more on bank savings, please see Consumer Morsel.)

Exhibit 3: Share of households with a 529 contribution and median household contribution amount (index, January 2019 =100 for each series)

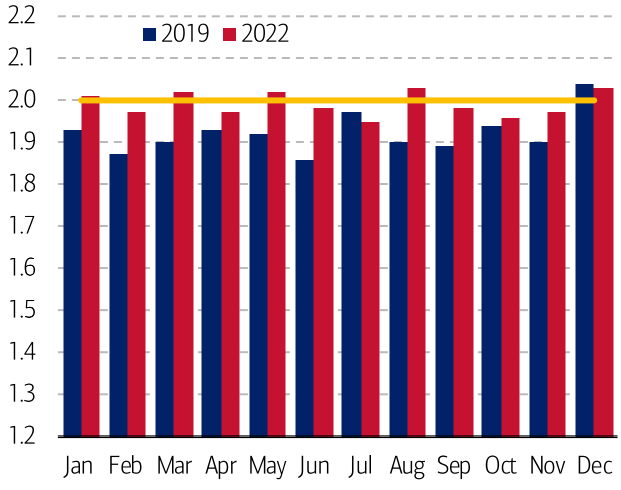
There has been a 30% increase in the number of Bank of America customers who actively contribute to a 529 plan



Source: Bank of America internal data. Note: For "Household with a 529 contribution in that month", we index *the share* of all Bank of America customers that contributed to 529 in January 2019 to 100.

Exhibit 4: Average number of 529 contributions per household by month in 2019 and 2022

An average household that contributed to 529 accounts did so roughly twice a month



Source: Bank of America internal data

Observation #3: lower income sees the fastest growth in participation

The good news is that over the last few years lower income households saw the biggest percentage increase in the number of households participating in 529 investments. After accounting for sample size, there was a nearly 50% increase in the numbers of lower income households (<$50k) making 529 contributions in March 2023 versus March 2019, compared with the 30% increase for the higher income customers (>$250k).

Lower income households have seen additional financial gains over the last few years. First, fiscal measures in 2020 and 2021 such as stimulus payments and expanded child tax credits increased their income. The subsequent surge in wages that started in 2022 has also been more notable in lower paid industries such as retail and leisure/hospitality. The combination of these factors likely enabled some lower income households to put some of this money into a 529.

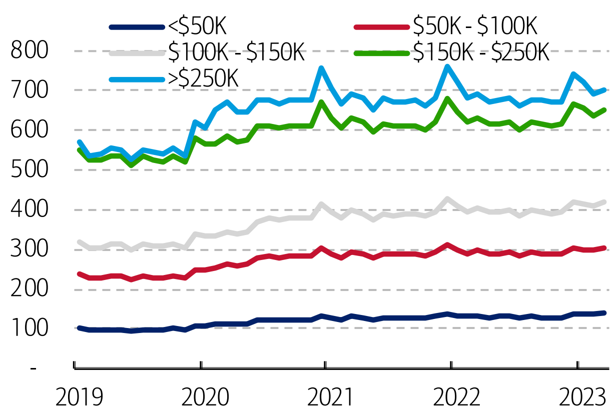
Observation #4: higher income households still have the highest participation in 529s

Despite the fast growth, contribution to 529 plans remain rarer for lower income households than wealthier ones.

Looking at the income breakdown, we find that higher income households have the highest share of those who invest in 529 accounts. In March 2023, the share of households with annual income over $250k was five times higher than that of households with annual income less than $50k (Exhibit 5). This doesn't come as a surprise as higher income households usually have more disposable income and are more likely to be familiar with various investment accounts.

Exhibit 5: Households with 529 contributions by income (index, January 2019 for <$50k =100)

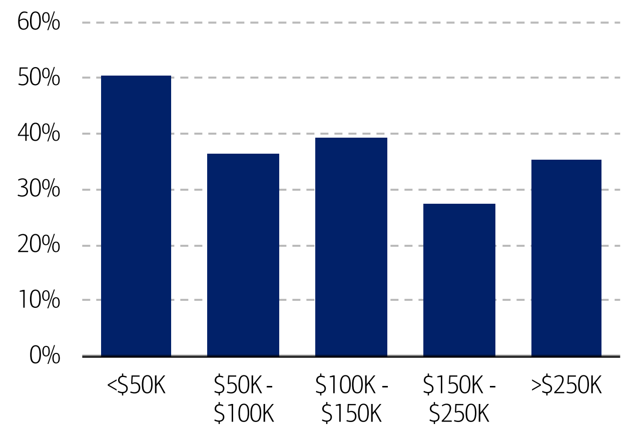
In March 2023, the share of households with annual income over $250k was five times higher than that of households with annual income less than $50k



Source: Bank of America internal data

Exhibit 6: % increase in the number of households that contributed to a 529 account between March 2019 and March 2023 (adjusted)

There was a 50% increase in the number of lower income households making 529 contributions in March '23 vs. March '19



Source: Bank of America internal data. Note: this calculation is adjusted for the change in sample size.

Observation #5: higher income households contribute 2.8x more to 529 accounts than those with lower incomes

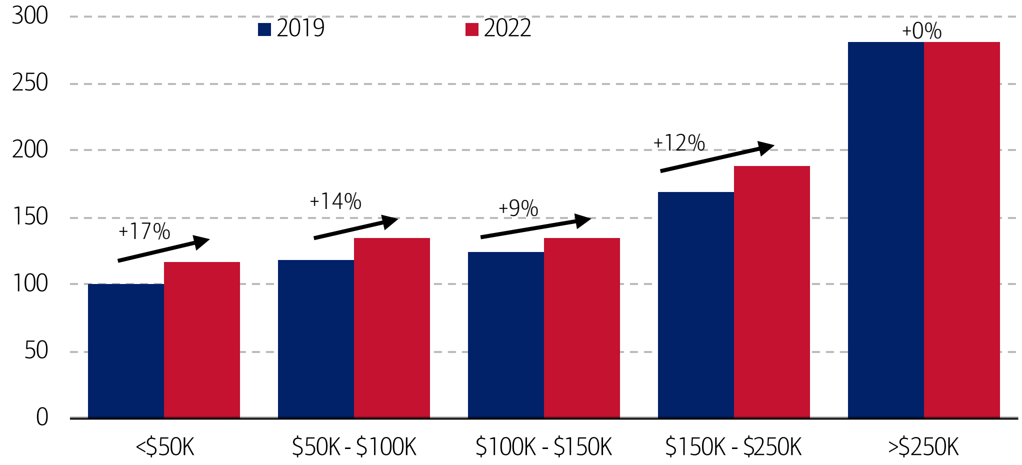
Last but not the least, it is also important to see the size of 529 contributions. As Exhibit 7 shows, all income groups but the top one saw an increase in their median annual 529 contributions between 2019 and 2022. This was led by a 17% jump for lower income households (<$50k). By contrast, there was no change in contribution size for those households making over $250k annually.

A key difference between 529 plans and retirement plans like Roth IRAs is that families usually stop contributing to the former once they reach a certain amount that they think will be enough to cover education expenses. We therefore think because higher income might already by contributing what they consider enough, they do not need to increase funding even if their disposable income rises.

In terms of contribution levels, as expected, the median value increases along the incomes with higher income households investing 2.8x more than lower income households per year.

Broadly speaking, our data suggests that lower income households played catch-up in terms of 529 accounts participation over the last few years but the gap with that of higher income households remain notable.

Exhibit 7: Median annual contribution value to 529 accounts by income group (indexed value, <$50k 2019 annual contribution =100)
All income groups but the top one saw an increase in their median annual 529 contributions between 2019 and 2022



Source: Bank of America internal data

Methodology

Selected Bank of America transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on aggregated and anonymized selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available

Customers referenced in this report refer to those with an active checking or savings account with Bank of America. 529 contributions are derived from customer checking and savings account outflow into a 529 account that is either offered by state governments or financial companies. Household contribution data is derived by anonymizing and aggregating data from Bank of America accounts in the US and analyzing that data at a highly aggregated level.

Data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions.

Additional information about the methodology used to aggregate the data is available upon request.

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Disclosures

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