How, when and why to save using RESPs

Whether you take the slow and steady approach or go for a lump sum, everyone's a winner with RESPs

by Jonathan Chevreau
November 14th, 2017

Presented by Assante Wealth Management

Never say no to offers of free money from the government. That's my motto, or at least one of them. And as far as free money goes, Ottawa's Registered Education Savings Plan (RESP) is among the most lucrative offers currently available to Canadians with kids.

You have to put some of your own money into an RESP of course, but for every $2,500 you contribute in a year, you will receive a 20% Canada Education Savings Grant (CESG), which means a $500 freebie each year you maximize contributions (within specified limits). As with the RRSP, investment income inside an RESP grows tax-free, although it generates no tax refund apart from the grant.

While there's no limit on how much you can put into an RESP each year (there is a lifetime maximum contribution amount of $50,000 per child mind you); you'll only receive the grant on the first $2,500 in contributions per year, or if you carry over unused contribution year from the year before, up to the first $5,000 in contributions.

So, when's the best time to contribute to an RESP? I believe the best way to maximize the grant and the time value of money is to start investing at least $2,500 a year as soon as your child is born. This provides both a savings discipline and a dollar-cost-averaging approach to investing in the markets.

Some may even wish to make the lifetime contribution of $50,000 in one, up-front lump sum. This may mean less grant money but if invested properly in growth vehicles could more than make up for the lost grant money. Either way, remember that with four years to go to university, you should cut back equity exposure by a quarter for each of the last four years, so it's mostly in cash by the time it's needed.

Karin Mizgala, CEO and co-founder of B.C.-based advice-only financial planners Money Coaches Canada, says RESPs are "a no-brainer for most people." The grant helps create discipline, especially if you opt for automatic RESP deposits through a pre-authorized chequing (PAC) arrangement. Mizgala says it makes sense to contribute regularly to an RESP for 14 or more years if you wish to maximize the grant.

There's more good news. While RESP rules were somewhat restrictive in the early days (if a child chose not to go on to higher education, some of the grant and growth in the plan had to be repaid) over the years, reforms have made it easier to designate alternate beneficiaries or roll RESP funds into a parent's RRSP. "I haven't found any clients where it's been too restrictive," Mizgala says. "You can do the $50,000 lump sum and then you're done or you can contribute regularly and systematically monthly or annually. Flexibility is not a big problem and you may as well get that grant."

How much should be invested? As much as you can! Canadian full-time undergraduates paid an average $6,373 in tuition fees for the 2016/2017 academic year, according to Statistics Canada. On top of that you can add the costs of residence, books and incidentals. Professional schools like medicine and dentistry are two or three times that figure.

All in all, it can easily cost $20,000 a year or $80,000 to send one child to university or college for four years; almost a quarter of a million dollars for a family with three children. But we haven't even considered inflation. Unfortunately, education costs are rising faster than inflation. The tuition costs cited by Statistics Canada in 2015/2016 were 2.8% higher than the previous year, which was 3.2% higher than the year before that. And in some provinces, like Ontario, costs rose 4%, or twice the rate of inflation.

Relying on cash flow from employment to pay these bills would be risky, even assuming one can count on having a job by the time the kids are university-bound. But if a couple saves $2,500 a year starting at the birth of each child, assuming they could earn a 5% rate of return after fees, the RESP balance would be $86,000 by the time the child reaches age 18, experts estimate.

Given these soaring costs of education, families need to pull together. Parents also need to impress on their kids that they should supplement the RESP with scholarships, grants, part-time work, and student loans.

Still, families may have to choose between conflicting priorities like mortgage pre-payments or saving in RRSPs and/or TFSAs. Check out, "How to prioritize your financial goals" for help in that department.