

FIGURING OUT THE FINANCIAL AID FORMULA

Few areas of financial planning are more complicated for parents than ensuring that their children will have enough money to pay for tuition, room, board, books, transportation and other related expenses. But the payoff – the likelihood that a good college education will expand their children’s opportunities to enjoy gratifying careers and higher lifetime incomes – is worth planning for.

What makes the task so complicated is that, on the average, college bills have been rising – and continue to rise – faster than after-tax personal income. Even more challenging, especially when college is still years away, is the uncertainty inherent in the never-ending kaleidoscopic changes among government and college financial aid programs and relevant federal and state income tax provisions – not to mention lower real after-tax returns on savings and investments.

Parents unable or unwilling to plan until a child is a high school junior may have to contend with less uncertainty, but, deprived of the prospects of many years of even average returns on their savings and investments, they have the disadvantage of having to cough up a lot of money out of assets and current income in a short time.

Those who start as soon as a baby is brought home from the hospital may maximize the benefits of compounding interest or equity returns – even if only at lower rates – over at least 18 years, but they are aiming at unknowable targets which even skilled financial planners can’t forecast with certainty. Among them: Will the baby grow up to be a prospect for Harvard – with its high costs – a community college, or a vocational school?

In the face of all the unknowns the best that parents and planners can do is start with what is known – such as the year in which the child is expected to start college – and split the others between the likely and the unlikely. The year provides not only the probable period for accumulating asset to meet college expenses, but also the probability and extent of other liabilities, including retirement.

In planning the financing of a child’s college education, it may be helpful for parents to know how the share of the total cost that they may be required to pay will be determined by the child’s school on the basis of:

- What they estimate, when filling out the federal student aid form, to be their “expected family contribution” (EFC), subsequently converted into an “official” EFC.
- What the school calculates to be the amount that the family is expected to pay and the amount of federal student aid for which the family is eligible, based on school policies as well as federal law. The calculation takes into consideration more than easily predictable things such as parents’ compensation and assets. For example:
 - Whether a family has other children who will be going to college – helpful to wealthy as well as poor families;
 - Whether a child is admitted to a high-cost private university or a state college;
 - Assets in the child’s name, which may reduce financial aid eligibility.

Whatever the family’s share, the rest – for over one-half of all undergraduate students – comes from financial aid:

- Federal programs, which provide two-thirds of all student financial aid through (a) grants, such as Pell grants, that are based on need, cost of attendance, and enrollment status, and (b) direct or guaranteed loans, such as Stafford loans, on which interest may be deferred until graduation and may be deductible from taxable income up to \$2,500 annually. The Free Application from Federal Student Aid (FAFSA) is a great place to start: www.fafsa.ed.gov.
- Loans and grants from universities and colleges. While most of their aid is in the form of loans, grants account for a growing share. Some base their aid on merit as well as need, which may also be helpful to upper-income families.
- Scholarships from a large variety of organizations ranging the alphabet from the American Legion to the YMCA. A great Web site for scholarship is www.fastweb.com.

Not knowing years earlier what loan and grant possibilities are likely to be, it is essential for parents to start early to accumulate the family’s share – after determining whether tax law would make accounts’ ownership by the child, parents, or other relatives more advantageous.

Aside from conventional taxable and tax-exempt investments, there are special tax-sheltered vehicles, such as 529 Plans and Coverdell Education Savings Accounts (ESAs). To learn more about all of your options, visit www.savingforcollege.com.

February 2006 – This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by TCS Financial Services, Inc., a local member of the FPA.