

## COLLEGE FINANCIAL PLANNING

# Seeing the Whole Picture



**Making a 529 plan a vital piece of the financial picture**

## THE REST OF THE PICTURE – HOW FAMILIES PAY FOR COLLEGE

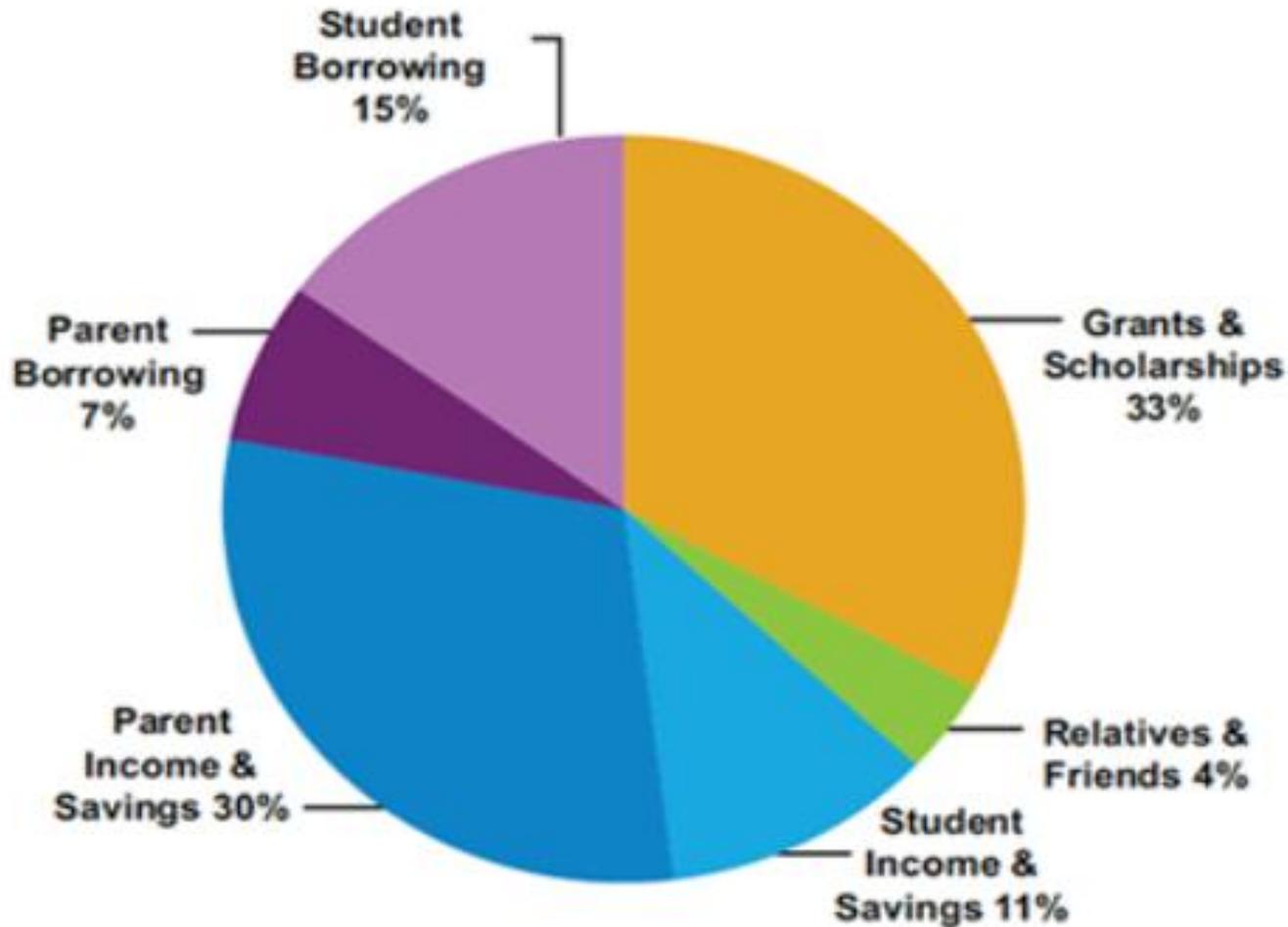
- Giles Baker, National Sales Manager, John Hancock Mutual Funds College Savings
- Mark Kantrowitz, Publisher of the FinAid and Fastweb web sites
- Joseph Russo, Director of Student Financial Strategies, University of Notre Dame

# Information

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- Information on college costs and affordability
    - Myth, misinformation, hyperbole, bad experiences
    - Role of media
  
  - Rising college costs
    - Public and private
    - Concern is legitimate: families, government, institutions, media
  
  - How families pay
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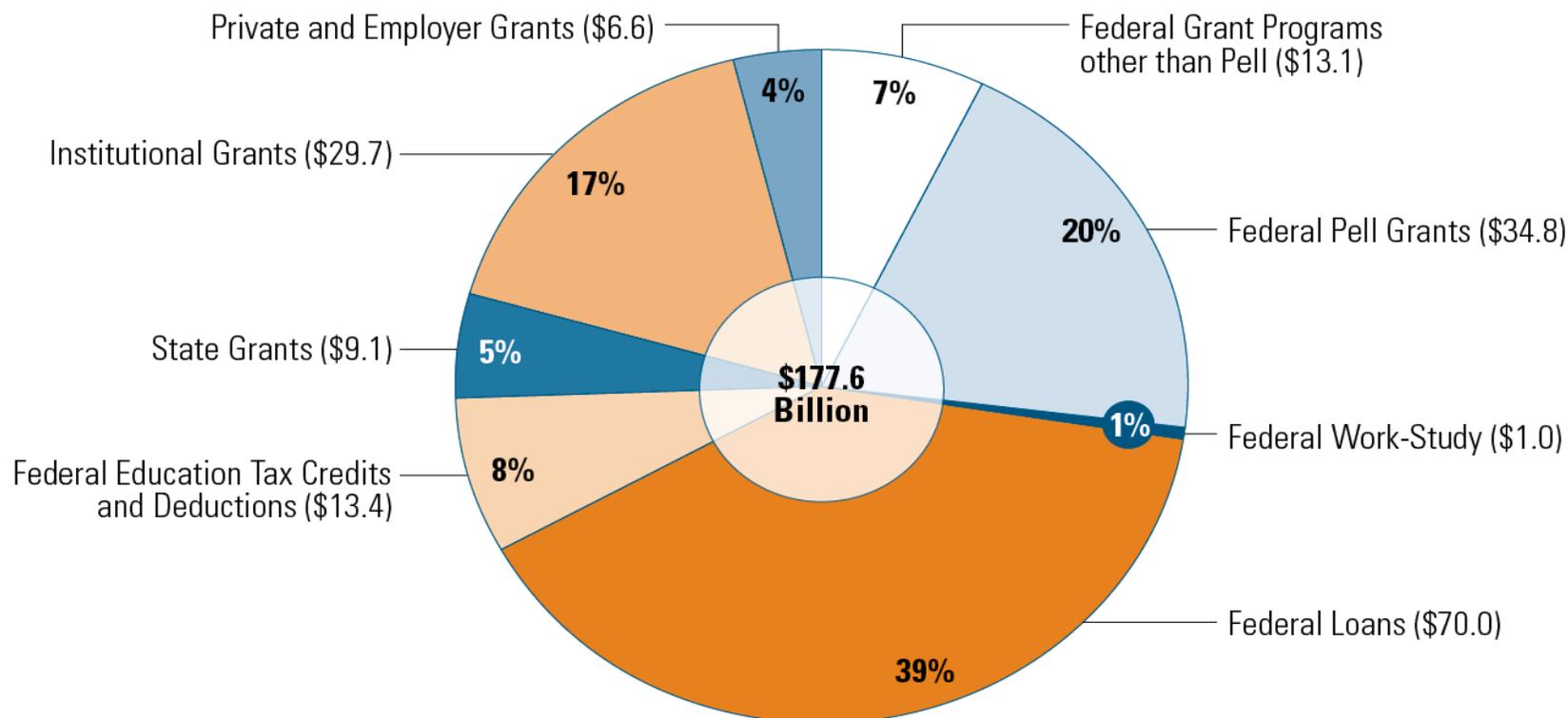
# How the Typical Family Pays for College: Average Percent of Total Cost of Attendance Paid from Each Source



SOURCE: *How America Pays for College 2011*, A national study by Sallie Mae and Ipsos, Figure 2

# Undergraduate Student Aid by Source and Type (in Billions), 2010-11

### Undergraduate Aid



■ SOURCE: The College Board, *Trends in Student Aid 2011*, Figure 2A.

# Return on Investment

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- Importance of college / the American Dream
  - Recognized
  - Benefits to individual and society

# The Array of Higher Education Benefits

Category	Public Benefit	Private Benefit
<b>Economic</b>	Increased tax revenues	Higher salaries and benefits
	Greater productivity	Employment
	Increased consumption	Higher savings levels
	Increased workforce flexibility	Improved working conditions
	Decreased reliance on government financial support	Personal/professional mobility
<b>Social</b>	Reduced crime rates	Improved health/life expectancy
	Increased charitable giving/community service	Improved quality of life for offspring
	Increased quality of civic life	Better consumer decision making
	Social cohesion/appreciation of diversity	Increased personal status
	Improved ability to adapt to and use technology	More hobbies, leisure activities

*Note.* For a detailed discussion of the public and private benefits of higher education, see the Institute for Higher Education Policy's *Reaping the Benefits* (1998), available at:

<http://www.ihep.org/assets/files/publications/m-r/ReapingTheBenefits.pdf>.

- Planning and saving for college
    - Growth of 529 plans
    - Incentives
  
  - 529s compared to other college savings
    - Income caps, annual limits, transferability
  
  - How 529s fit in world of financial aid
    - The Golden Rule
    - Treatment of 529 distributions
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# Relativity of Need versus Aid

## Concept: Financial Need—It's Relative

*College COA – Expected Family Contribution = Financial Need*

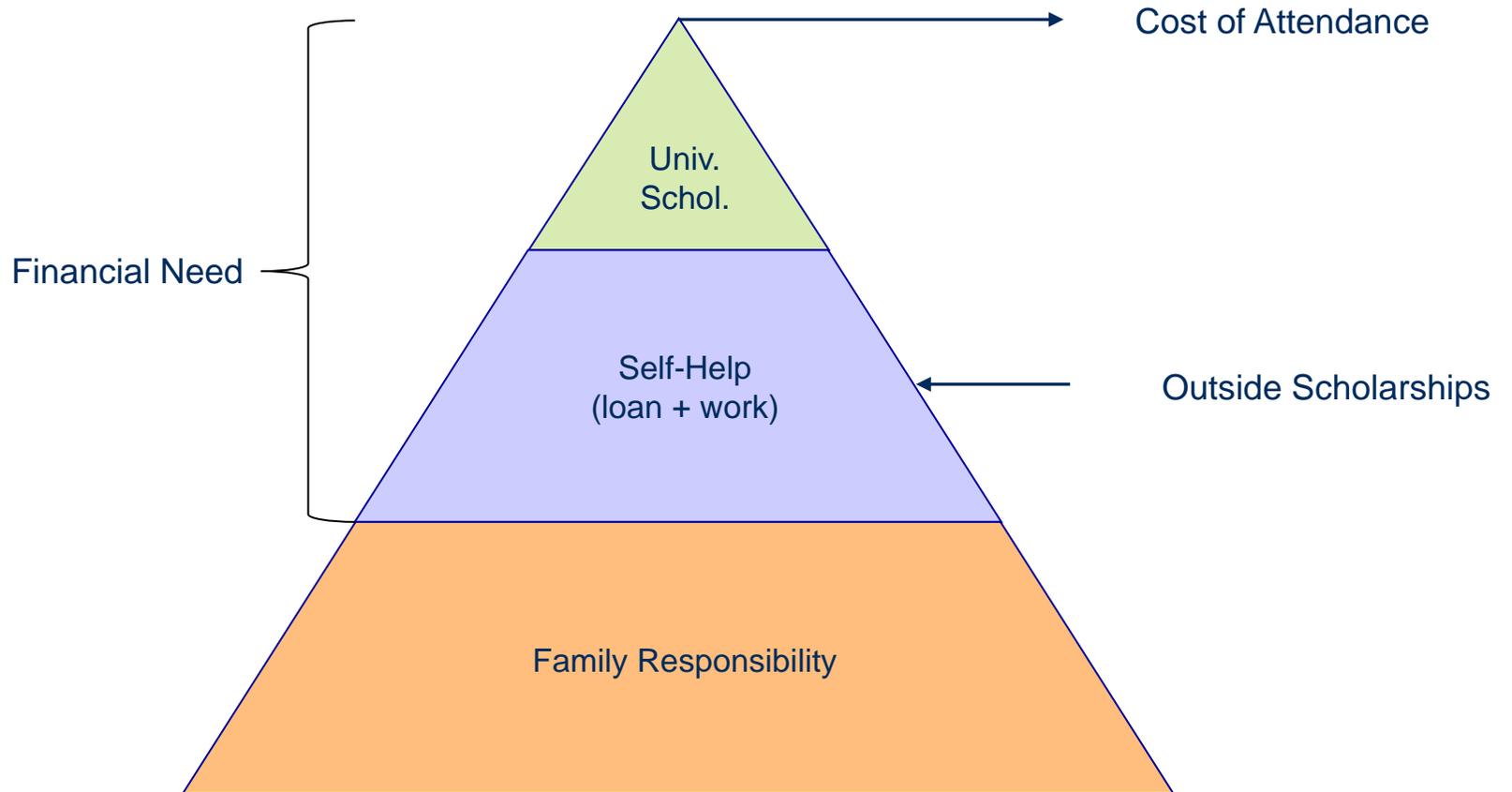
School	A	B	C
COA	\$10,000	\$25,000	\$50,000
— <u>EFC</u>	<u>\$10,000</u>	<u>\$10,000</u>	<u>\$10,000</u>
FN	\$— 0 —	\$15,000	\$40,000

## Concept: Financial Need—It's Relative

*College COA – Financial Aid = Cost to Family*

School	A	B	C
COA	\$10,000	\$25,000	\$50,000
— <u>FA</u>	<u>0</u>	<u>\$15,000</u>	<u>\$40,000</u>
Cost to Family	\$10,000	\$10,000	\$10,000

# Financial Aid Policy



# Government Focus on Consumer Right to Know

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- New consumer agency, Consumer Financial Protection Bureau
  - Senator Grassley investigation
  - Net Price Calculator
  - Standardized award letter
  - Scorecard
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# Net Price Calculators on College Web Sites

- New federal requirement effective 10/29/2011 to estimate bottom-line cost
- Net price is the amount to be paid from savings, income and loans to cover college costs
- Problems: accuracy, comparability, ease of use, ease of interpretation and may be hard to find
  - Tradeoffs between accuracy and simplicity
  - Some calculators use older data than others

COA = Cost of Attendance

Financial Need = COA – EFC

Financial Aid = Gift Aid + Self Help

□ Gift Aid = Grants, Scholarships, Tuition Waivers

□ Self-Help Aid = Loans, Student Employment

Net Cost = COA – Financial Aid

Net Price = COA – Gift Aid

Unmet Need =  
Financial Need – Financial Aid

# Good Consumer Questions: College Quality

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- Reputation in major, academic quality
  - Faculty-student ratio, classes taught by faculty or adjuncts or graduate students
  - Retention, graduation, on-time graduation, average time to graduate
  - Job placement rate, salaries, acceptance rate to graduate/professional school
  - Accreditation ok to sit for licensing exams? What is the pass rate?
  - Satisfaction level
  - Cohort default rate, loan repayment rate (coming soon)
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# Good Consumer Questions: College Cost

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- Does the college meet the full demonstrated financial need for all four years, or is there unmet need (a gap)?
- How much on average do the college costs increase per year?
- Does the college practice front-loading of grants? Will the grants be similar in subsequent years, assuming similar financial circumstances?
- What is the college's outside scholarship policy? How does the college reduce the financial aid package when a student wins a private scholarship?
- How does one appeal for more financial aid if the financial aid award is insufficient or the family's financial circumstances have changed?
- What percentage of students graduate with debt and what is the average cumulative debt at graduation?

# Recent Trends in College Affordability

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- Need-based grants are failing to keep pace with increases in college costs
- Federal and state governments are cutting student aid spending to reduce budget deficits
- College costs continue to rise
  - Public college tuition inflation is driven by cuts in state appropriations (effectively taxing students)
  - College discount rates are increasing, putting pressure on college student aid budgets
- Family income is stagnant due to the economy
- More families are demonstrating financial need

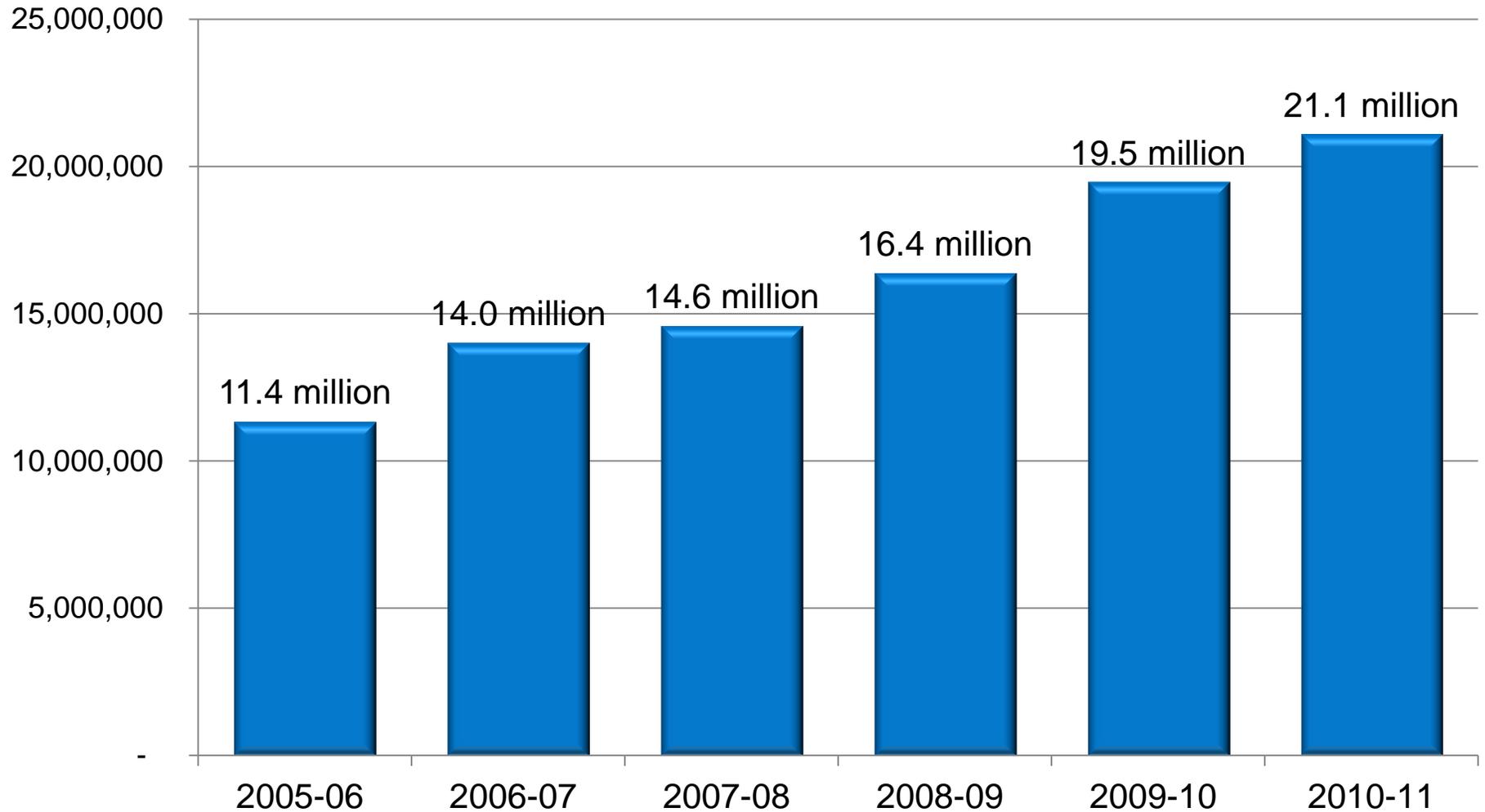
# Growth in Student Loan Debt

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- Student loan debt continues to grow faster than income, driven by the failure of grants to keep pace with increases in college costs
- Total student loan debt outstanding exceeded credit card debt outstanding in June 2010
- Total student loan debt outstanding will reach the \$1 trillion mark in early 2012
- One-third of students are graduating with more than \$20,000 in debt, eligible for 20-year or longer repayment terms
- More students are graduating with excessive debt (monthly loan payments exceed 10% of gross income), 12.4% in 2007-08 up from 2.4% in 1992-93

# Growth in the Number of FAFSAs

## Number of Financial Aid Applications



# 2011 College Decision Impact Survey

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- Greater emphasis on bottom line costs and return on investment
- Two of three top reasons for choosing college were about money
  - Quality of major (44.6%)
  - Scholarship or financial assistance (43.2%)
  - Total costs (40.8%)
- More likely to switch preference from non-profit to public (24%) than public to non-profit (9%). In both directions, money was a primary driver of switch.
- 37.3% of high school seniors did not enroll at their first-choice college.
  - A third (34.8%) did not get into 1<sup>st</sup> choice college
  - A third (31.2%) said they could not afford 1<sup>st</sup> choice
  - A tenth (11.4%) got a better aid offer elsewhere

## Issue: Grandparent-owned College Savings Plans

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- If a grandparent (or other third party) owns a 529 college savings plan, it might hurt eligibility for need-based financial aid
- Solutions:      Transfer ownership to student/parent  
                            Wait until senior year to take a distribution

### Asset Treatment

- 529 plans owned by the student or parent (including those where a sibling is the beneficiary) are reported as a parent asset on the FAFSA → reduces aid by up to 5.64% of asset value
- All other 529 plans are not reported as an asset on the FAFSA

### Income Treatment

- Distributions from 529 plans owned by the student or parent are ignored on the FAFSA
- Distributions from all other 529 plans are treated as untaxed income to the beneficiary on the FAFSA → reduces aid by up to 50% of the amount of the distribution

## Issue: Education Tax Benefits

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- The Hope Scholarship Tax Credit (the American Opportunity Tax Credit) allows a tax credit of up to \$2,500 per student per year based on the first \$4,000 in college tuition, fees and course material (textbook) expenses
  - 100% of the first \$2,000 in college expenses, 25% of the second \$2,000
  - Tax credit is 40% refundable (\$1,000)
  - Limited to first four years of postsecondary education
- Coordination restrictions prevent families from using the same educational expenses to qualify for both a tax-free distribution from a 529 college savings plan and the Hope Scholarship Tax Credit – you can't double dip
- Thus families must reserve \$4,000 in college tuition, fees and textbook expenses each year to be paid with cash or student loans

## Myth: Penalty for Saving

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- FAFSA ignores money in qualified retirement plans, net worth of family home and small businesses owned and controlled by the family
- Part of parent assets protected by asset protection allowance, about \$45,000 to \$50,000 for typical parents of college-age children (age 48)
- < 4% of dependent students have any contribution from parent assets
- Remaining parent assets assessed on a bracketed scale, with a top bracket of 5.64%. \$10,000 in parent name reduces aid eligibility by at most \$564, still leaving parent with at least \$9,436 and more flexibility in college choice.
- Student assets assessed at a 20% rate with no asset protection allowance
  - Solution: Move student UGMA/UTMA bank/brokerage accounts into a custodial 529 plan (owned by student), treated as a parent asset.

# College Savings Rules of Thumb

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- Every dollar saved is about a dollar less the family will need to borrow.
- Every if the family starts saving late, just avoiding debt will save money, since every dollar borrowed will cost about two dollars by the time the student pays back the loans.
- It is cheaper to save than to borrow.
  - If you save \$200 a month for 10 years at 6.8% interest you will accumulate about \$34,433
  - If you borrow \$34,433 at 6.8% interest and repay it over a 10-year term, you will pay \$396 a month
- College costs increase by a factor of 3 over any 17-year period. So if we aim to save 1/3 of future college costs, the college savings goal should be the cost of four years of college the year the child was born

# Scholarship Tips

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- Every dollar you win in scholarships is about a dollar less you'll have to borrow
- Start searching for scholarships ASAP, even before the senior year
- When using a free online scholarship matching service like Fastweb.com, answer the optional questions to match about twice as many scholarships on average. The optional questions are there to trigger inclusion of specific scholarships.
- Apply to every scholarship for which you are eligible, since there's an element of chance, not just skill. After the first half dozen applications, you will find yourself able to reuse essays with minor tweaks.
- If you have to pay money to get money, it's probably a scam.