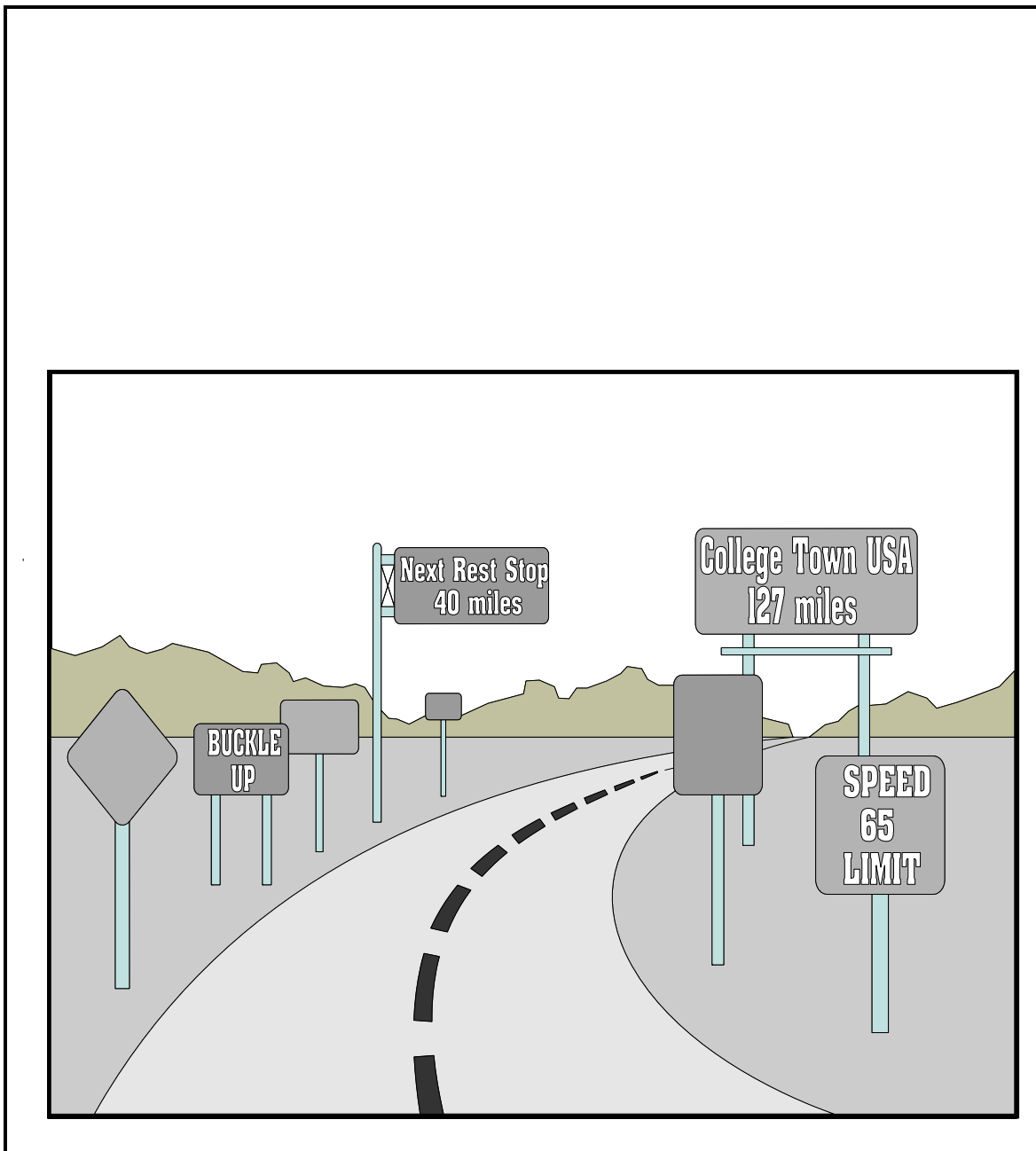


## College Knowledge 1

# “COLLEGE SAVINGS PRIMER”

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This “College Savings Primer” Section has been developed for all high school sophomores, junior and senior students planning on attending a 2- or 4-year College or university.

Attending any school of higher education requires several years of pre-planning. The more prepared and knowledgeable you are about all the available options, the smoother the transition from high school to college will be.

## ESTIMATING COLLEGE COSTS



**QUESTION:** What is the forecast for college cost increases?

You've seen the charts...a college education is expensive. All those benefits of personal growth, expanded horizons, and increased lifetime earning power come at a price, a price that increases every year. For the 2007/2008 academic year, the average cost of attendance for a 4-year public college is \$ **17,336.00**, while the average cost of attendance for a 4-year private college is \$ **35,374.00**. (Source: The College Board's 2007 Trends in College Pricing Report.) The trend of annual college costs outpacing inflation is expected to continue.

**QUESTION:** Why can't colleges keep their prices down?

There are many reasons why colleges have a hard time holding down their price increases to the rate of inflation. For one thing, higher education is labor intensive. For another, there are a variety of extra costs that colleges must absorb, like recruiting (these rising costs now average over \$ **1,500.00** per student enrolled at a private college), technology (all those computers and networks), and building maintenance costs. Couple this with the reality that parents increasingly expect more bang for the buck, everything from modernized career centers (so their offspring can find a job after college) to state-of-the-art recreational facilities and medical centers.

**QUESTION:** What expenses are included in the cost of college?

In the academic world, the cost of college is generally referred to as the cost of attendance (COA). Each college has its own COA.

**The COA consists of five items:**

1. **Tuition and fees:** These expenses are generally the same for all students.
2. **Books and supplies:** These expenses can vary depending on the courses selected.
3. **Room and board:** These expenses can vary depending on where the student lives (e.g., dorm, off-campus apartment, at home) and the meal plan chosen.
4. **Transportation:** This expense can vary depending on how far the student lives from the college. It can involve daily commuting expenses, three round-trip flights home a year, or anything in between.
5. **Personal expenses:** This category varies greatly among students. It can include telephone bills, health insurance, late-night pizzas, personal spending money, or even day-care bills.

Twice per year, the federal government recalculates the COA for each college and then adjusts the figures for inflation. The government then uses the COA figures to determine your child's particular financial need come financial aid time.

**QUESTION: Why you should start saving early?**

Next to buying a home, a college education is the largest expenditure most parents will ever make (and perhaps the biggest expenditure when more than one child is in the family picture). Faced with such a daunting task, you might be inclined to ignore the problem and wait until you are more financially settled before you start saving. But that would be a mistake.

The key to sanity in the area of education planning is advance planning. The earlier in the process you become informed about the potential costs and your saving options, the greater chance you will start saving. Remember, the more money you save now, the less money you or your child will need to borrow later.

<b>MONTHLY INVESTMENT</b>	<b>5 YEARS</b>	<b>10 YEARS</b>	<b>15 YEARS</b>	<b>20 YEARS</b>
<b>\$ 100.00</b>	<b>\$ 7,348.00</b>	<b>\$ 18,295.00</b>	<b>\$ 34,604.00</b>	<b>\$ 58,902.00</b>
<b>\$ 200.00</b>	<b>\$ 13,043.00</b>	<b>\$ 54,884.00</b>	<b>\$ 103,811.00</b>	<b>\$ 176,706.00</b>
<b>\$ 300.00</b>	<b>\$ 36,738.00</b>	<b>\$ 91,473.00</b>	<b>\$ 173,019.00</b>	<b>\$ 294,510.00</b>

**Disclaimer:** The above example is for illustrative purposes only and does not represent the return of any investment. There is no guarantee that your investment will realize a return and there is a risk that you will lose your investment entirely.

**QUESTION: How much do you need to save?**

How much you need to save obviously depends on the estimated cost of college at the time your child is ready to attend. Often, these numbers are staggering. For many parents, the question of how much they should save becomes how much they can afford to save.

To determine how much you can afford to save for your child's college each month, you will need to prepare a budget and examine your monthly income and expenses (for help, see Budgeting). Don't be discouraged if you can save only a minimal amount at first. The key is to start saving early and consistently, and to add to it whenever you can from raises, bonuses, or unexpected gifts.

After you determine how much you can save each month, you will need to choose one or more saving options. There are many possibilities for college savings including:

- 529 plans
- Coverdell education savings accounts
- Custodial accounts
- Bank accounts
- Mutual funds

To help make your nest egg grow, you will want to maximize the after-tax return on your savings while minimizing risk. For additional information on where to put your money...refer to **“College Savings Options”** Page 1-7.

Finally, keep in mind that most parents are not able to save 100% of their child's college education (after all, do you know anybody who purchased a home entirely with his or her own savings?). Instead, parents generally supplement their savings at college time with a combination of personal loans, financial aid (student loans, grants, scholarships, and work-study), and tax credits to cover college costs.

### **2007/2008 COLLEGE COST OF ATTENDANCE (COA)**

For the 2007/2008 college year, the annual cost of attendance (known as the COA) for four-year public colleges is **\$ 17,336.00** and for four-year private colleges, **\$ 35,374.00**. The COA figure includes tuition and fees, room and board, books and supplies, transportation, and personal expenses. (Source: The College Board's 2007 Trends in College Pricing Report.)

### **Rising College costs**

The trend of annual college costs outpacing inflation is expected to continue. There are many reasons why colleges find it difficult to hold down price increases from year to year. The main factors are continually increasing salary, maintenance, energy, technology, and recruiting costs, along with the quest to provide students with more sophisticated dormitories, dining halls, recreation and health care facilities, career centers, and campus security.

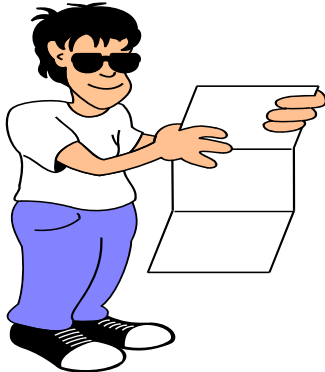


## COLLEGE SAVING OPTIONS

It is important for parents to start putting money aside for college as early as possible. But where should you put your money? There are many possibilities, each with varied features. For example, some options offer tax advantages, some are more costly to establish, some charge management fees, some require parental income to be below a certain level, and some impose penalties if the money is not used for college.

Following is a list of options to consider...

- 529 College savings plans
- 529 Prepaid tuition plans
- Coverdell education savings accounts
- Custodial accounts (UGMA/UTMA)
- Gifting
- Series EE bonds
- Traditional IRA's and Roth IRA's
- Employer sponsored retirement plans
- Employee stock purchase plans
- Cash value life insurance
- 2503(c) trusts
- Crummey Trusts
- Tax deferred annuities
- Other tax advantaged strategies
- Prepay mortgage
- CollegeSure CD
- Options unique to business owners



## FACTORS THAT MAY AFFECT COLLEGE SAVING DECISIONS

When investing for college, there are several factors to consider, including:

- Tax advantages
- Kiddie tax
- Financial Aid

## TAX ADVANTAGES

Money saved for college goes a lot further when it's allowed to accumulate tax free or tax deferred. To come out ahead in the college savings game, it's wise to consider tax-advantaged strategies.

**There are three (3) examples shown below for your review:**

**Example 1.)** Assume that every year you put money away in a non tax-advantaged investment that earns 9%. If your earnings are subject to a 33% tax rate (federal and state), your after-tax return is 6%.

**Example 2.)** Now assume you put the same amount of money every year into a tax-advantaged vehicle, such as a Coverdell education savings account that earns 9% per year. If you later withdraw the money to pay qualified education expenses, you have no tax liability. So, your after-tax return is 9%.

**Example 3.)** The result is that in some cases your return can be 50% greater with a tax-advantaged strategy like a Coverdell ESA than with an investment that offers no special tax advantages (although there is no guarantee that an investment will generate any earnings).

**Tip:** Due to provisions in the Jobs and Growth Tax Relief Reconciliation Act of 2003 that reduced the tax rates on dividends and long-term capital gains, the comparative advantage of tax-advantaged strategies over non tax-advantaged strategies is somewhat lessened. (However, the reduced tax rates for dividends and long-term capital gains are scheduled to sunset, or expire, beginning in 2011.)

## KIDDIE TAX

Many parents believe they can shift assets to their child in order to avoid high income taxes. For 2008, this strategy works best if the child is generally age 24 or older. If the child is under age 24, the kiddie tax rules apply.

**The two basic tax rules are as follows:**

1. For children age 18 or under age 24 if a full-time student, the first **\$ 900.00** of annual unearned income (e.g., interest, dividends, capital gains) is tax free, the second **\$ 900.00** is taxed at the child's rate, and any unearned income over **\$ 1,800.00** is taxed at the parents' rate. This latter tax is referred to as the kiddie tax. So, after the first **\$ 1,800.00** of investment income, a child under age 24 will end up paying the same tax as if the parents had retained the asset.
2. For children age 24 or older, the first **\$ 900.00** of annual unearned income is tax free, and all earnings over **\$ 900.00** are taxed at the child's rate. If the child is in a lower percent tax bracket, the child will pay less tax than his or her parents would pay on the same income.

**Tip:** One way parents may avoid the kiddie tax is to put their child's savings in tax-free or tax-deferred investments so that any taxable income is postponed until after the child reaches age 24 (when the child is taxed at his or her own rate). Such investments can include Series EE bonds (may also be called Patriot bonds) or tax-free municipal bonds. Alternatively, parents can try to hold just enough assets in their child's name so that the investment income remains under \$ **1,800.00**

## FINANCIAL AID

Whether or not a child will qualify for financial aid (e.g., loan, grant, scholarship, or work-study) may affect parental savings decisions. The majority of financial aid is need-based, meaning that it's based on a family's ability to pay.

Predicting whether a child will qualify for financial aid many years down the road is an inexact science. Some families with incomes of \$ **100,000.00** or more may qualify for aid, while those with lesser incomes may not. Income is only one of the factors used to determine financial aid eligibility. Other factors include amount of assets, family size, number of household members in college at the same time, and the existence of any special personal or financial circumstances.

If a child is expected to qualify for financial aid (and most do), parents should be aware of the formula the federal government uses to calculate aid...called the federal methodology...because there can be a financial aid impact on long-term savings decisions. The more money a family is expected to contribute to college costs, the less financial aid a child will be eligible for.

Briefly, under the federal methodology, parents are expected to contribute 5.6% of their assets to college costs each year, and students are expected to contribute 20% of their assets each year.

**Example:** For example, \$ **20,000.00** in your child's savings account would translate into a \$ **4,000.00** expected contribution ( $\$ 20,000.00 \times .20$ ), but the same money in your account would result in a \$ **1,120.00** expected contribution ( $\$ 20,000.00 \times .056$ ).

Also, the federal methodology excludes some parental assets from consideration in determining a family's total assets, which may include:

- Retirement accounts (e.g., IRA, 401(k) plan, 403(b) plan, Keogh plan)
- Home equity in a primary residence or family farm
- Cash value life insurance
- Annuities

Thus, all options being equal, parents may choose to put their money into one or more of these nonassessable assets.

**Caution:** Although the federal government excludes these assets, individual colleges have discretion whether to consider them in determining a family's ability to pay college costs.

**Caution:** For more information on how a child's financial aid eligibility is determined and to learn about the process of applying for aid...refer to "Applying for Financial Aid" Page 1-11



## **COLLEGE SAVINGS STRATEGIES TIME FRAMES TO CONSIDER**

Time frame is a very important consideration. Is the child in preschool or a freshman in high school? Obviously, most college savings strategies work best when the child is many years away from college. With a longer time horizon, parents can be more aggressive in their investments and have more years to take advantage of compounding.

When the child is a baby up until about middle school, most professional financial planners recommend putting more money into equity investments because historically, over the long term, equities have provided higher returns than other types of investments (though past performance is no guarantee of future results). Then, as the child moves from middle school to high school, it's usually wise for parents to start shifting a portion of their equities toward shorter-term, fixed income investments.

If the time frame is only a few years, parents will be limited in their choice of appropriate strategies. For example, if the child were in high school, equities normally would not be a preferred strategy due to the short-term volatility of these investments. Similarly, parents would not have enough time to build up cash value in a life insurance policy.

## **AMOUNT OF MONEY AVAILABLE TO INVEST**

The amount of money parents have to invest at a particular time might affect their savings strategies. For example, if parents have only a small amount of money to invest, trusts probably aren't the best option because they are typically more costly to establish and maintain than other college saving options. In this case, a Coverdell ESA may be more appropriate.

## **CONTROL ISSUES**

Generally, when parents give money or property to their child, they lose control of those assets. Such a loss of parental ownership can take place immediately, as in the case of an outright gift of stock certificates, or it may be delayed, as in the case of a custodial account or trust. In any event, parents must assess their personal feelings about relinquishing control of assets to their child. Some children may not be mature enough to handle such assets, whereas others can be counted on to use them for college costs.

## **DISCUSSING A COLLEGE FUNDING PLAN WITH YOUR CHILD**

As college expenses continue to rise relative to the means of the average family to pay such costs in full, parents may find it helpful to sit down with their older children and discuss ways to pay for college. For example, parents may want to discuss the following four (4) topics, including:

1. Whether they intend to fund 100% of college costs or whether they expect their child to contribute and, if so, in what amount. For example, parents might convey their expectation that their child contribute a certain percentage of all earnings from a part-time job or a portion of all gifts.
2. Whether the child will play a role in the savings strategy. For example, parents who want to gift appreciated stock to their child should convey their expectation that the child will apply all of the gains to college costs.
3. Whether any money will need to be borrowed, and if so, how much and in whose name the loan(s) will be obtained. The amount that needs to be borrowed may affect the type of college the child applies to (e.g., public or private, top tier or middle tier).
4. Whether there will need to be shared financial responsibility during the college years. For example, the child may need to participate in a work-study program or obtain outside work during the college years.

Communicating these expectations ahead of time can prevent unpleasant surprises and help parents and their children better plan for the expenses that lie ahead. Also, an open discussion can give children an increased awareness of the financial burden their parents may be undertaking on their behalf.

### **DILEMMA OF SAVING FOR COLLEGE AND RETIREMENT DECISIONS**

For many parents, especially those who started families in their 30's and 40's, the problem of saving for college and retirement at the same time are a nagging reality. Most financial planning professionals recommend saving for both at the same time. The reason is that parents typically can't afford to delay saving for their retirement until the college years are over, because doing so would mean missing out on years of tax-deferred growth and, possibly, employer-matching 401(k) plan contributions.

The key to saving for both is for parents to tailor their monthly investment to the particular investment goal...college or retirement. Parents will then need to determine their time frames and liquidity needs for each goal, which may require the assistance of a financial planning professional. For additional information...refer to "**Saving for College and Retirement Decisions**" Page 1-11

### **APPLYING FOR FINANCIAL AID**

#### **QUESTION: What is financial aid?**

Financial aid is money given by colleges and federal and state governments to help students pay for college or graduate school. This money is in the form of loans, grants, scholarships, and work-study. Loans and work-study must be repaid either through financial obligation (loans) or service to the college (work-study). By contrast, grants and scholarships do not have to be repaid.

#### **There are two types of financial aid:**

- **Need-based:** Which is based on your family's ability to pay.
- **Merit-based:** Which is based on a student's academic, athletic, or special talent.

Most financial aid is need-based, and the discussion here focuses on need-based aid.

## **WHO OFFERS FINANCIAL AID?**

There are many players in the financial aid arena. Along with you (and your own savings and loans), think of these financial aid providers as pieces of a puzzle that must fit together to create a fully-funded college education.

## **FEDERAL GOVERNMENT FINANCIAL AID**

The Federal government is the largest dispenser of need-based financial aid for higher education. The federal government funnels money to colleges and banks, and directly to students for loans, grants, scholarships, and work-study programs.

## **COLLEGE BASED FINANCIAL AID**

Colleges constitute the second largest provider of financial aid. The money can come from the college's own reserves (private colleges generally have greater endowment funds than public colleges), or from federal and state government agencies. Colleges may also direct students to a particular bank that coordinates loans with that school. Colleges that accept a student who is eligible for financial aid will create a financial aid package for that student.

## **STATE GOVERNMENT FINANCIAL AID**

Most states offer financial education assistance to state residents, to students attending in-state public schools, and to colleges and banks located within their borders.

## **OTHER PLAYERS OFFERING FINANCIAL AID**

A vast number of corporations, foundations, and associations of all kinds offer merit financial aid. Most organizations seek students with specific qualifications, backgrounds, and future plans...for example, a Nebraska high school graduate who plans to major in pre-med. In recent years, the Internet has become a valuable tool to search for grants and scholarships.

## **OVERVIEW OF THE FINANCIAL AID PROCESS**

To understand how the financial aid process works, it's important to understand how your child's financial need is determined. This process is called needs analysis. Under needs analysis, household and financial information submitted on your child's financial aid application is used to calculate your family's expected contribution to college costs.

Two primary formulas are used to calculate the expected family contribution (EFC): the federal methodology and the institutional methodology (these formulas will be discussed later in greater detail).

The EFC is the minimum amount that a family is expected to contribute toward their child's college costs. The difference between the cost of attendance at your child's college (a variable) and your EFC (a constant) equals your child's financial need. (The cost of attendance at a particular school includes tuition, fees, books, supplies, room and board, transportation, and personal expenses; see Estimating College Costs.)

**Example:** If the cost of attendance at State University is \$ **20,000.00** per year and your family's EFC is \$ **8,000.00**, then your child's financial need would be \$ **12,000.00**

Colleges aren't obligated to meet 100% of your child's need. If a college meets only part of your child's financial need (as is the practice at many colleges), then you have been "gapped" by the college. The remaining portion is called unmet need, and you are responsible for meeting it.

**Example:** Assume that your child's financial need is \$ **12,000.00** State University offers your child \$ **10,000.00** of financial aid.

The result is an unmet need of \$ **2,000.00** So, your family would be responsible for both the EFC of \$ **8,000.00** and the unmet need of \$ **2,000.00**

## THE 2 FORMULAS FOR CALCULATING EXPECTED FAMILY CONTRIBUTION

The two primary formulas for calculating a family's EFC are the federal methodology and the institutional methodology.

### FEDERAL METHODOLOGY

The federal methodology is used by the federal government to calculate your EFC to determine eligibility for federal financial aid programs. The federal methodology is also used by colleges when federal funds are being distributed.

It is codified in the federal government's aid application, called the Free Application for Federal Student Aid, or FAFSA. Congress may modify the federal methodology slightly from year to year.

### INSTITUTIONAL METHODOLOGY

The institutional methodology is an alternative to the federal methodology. It is administered by the College Scholarship Service, a private company that provides educational services to colleges and the public. The institutional methodology is used by some 3,000 colleges to calculate your EFC when the College's own private funds are being distributed. So, a college may use the institutional methodology to distribute its own funds and the federal methodology to distribute any federal financial aid funds at its disposal. You submit your information for the institutional methodology on the **PROFILE** form application rather than on the **FAFSA**.

In some instances, a college will not use the institutional methodology when distributing its funds, but will use its own individual formula. In this case, you will need to obtain the college's particular financial aid application form.

There are differences in the way the EFC is calculated under the federal methodology vs. the institutional methodology (discussed in greater detail below). As a general rule, the institutional methodology digs deeper into a child's financial background than the federal methodology because colleges want to make sure that their own funds go to the neediest students.

### **QUESTION: How exactly is my EFC calculated under the federal methodology?**

The federal methodology examines your family's income, assets, and household information to calculate the EFC. Since most students are dependent, the discussion here focuses on dependent students and their parents, except where noted. To determine your dependency status, review the section below entitled "**What are the Steps in Applying for Financial Aid?**"

## INCOME COMPONENT

The income component of the federal methodology consists of the adjusted gross income (AGI) of both parents and student from the previous tax year, plus any untaxed income and benefits, minus any applicable deductions. For independent students, only the student's AGI and untaxed income and benefits are counted, along with those of a spouse, if any. The previous tax year is known as the base year. For example, the base year for the 2007/2008 academic year is 2006.

The AGI figure is simply taken from a line on your federal tax return. The untaxed income and benefits portion is a bit trickier. The major untaxed income and benefits that must be added back to your income for financial aid purposes include (see the FAFSA for others) deductible retirement plan contributions made in the base year, tax-exempt interest income (e.g., municipal bond interest), untaxed Social Security benefits, child support received, earned income credit, workers' compensation, and disability payments.

After a total income figure is determined, certain deductions can be taken. One example of a deduction is any federal and state taxes you paid in the previous year, including Social Security taxes (see the FAFSA for more deductions).

Perhaps the two most important deductions, however, are the income protection allowance and the employment expense allowance. The income protection allowance is an allowance for shelter, food, clothing, car maintenance, insurance, and basic medical care. For parents, the allowance depends on the total number of household members and the number of children in college. For the 2007/2008 year, the income protection allowance for a family of five with one child in college is **\$ 27,910.00**. For students, for the 2007/2008 academic year the allowance is a standard amount **\$ 3,080.00**.

The employment expense allowance is an allowance for parents only for employment expenses. For the 2007/2008 year, it is capped at **\$ 3,300.00**.

In addition, the FAFSA will ask you for the amount of any education tax credits ( Hope credit and Lifetime Learning credit) you took in the base year in order to provide offsets for them.

A family's total financial aid income (AGI plus untaxed income/benefits minus deductions) is assessed at a 50% flat rate under the federal methodology.

**Example:** The "Smith's" total financial aid income is **\$ 40,000.00**. They will be expected to contribute **\$ 20,000.00** to college costs.

## ASSETS COMPONENT

The federal methodology counts some assets and excludes others in arriving at your EFC (these assets are called assessable or non-assessable assets). Your assets for financial aid purposes are those you own at the time you sign the FAFSA. The more assessable assets your family has, the more money your family will be expected to contribute toward college costs.

The following six (6) assets are not included in the federal methodology:

1. Retirement accounts (e.g., 401(k)s, IRAs)
2. Annuities
3. Cash value life insurance
4. Personal items (e.g., car, clothes, furniture, household items)
5. Home equity in primary residence
6. Family farm

Assessable assets are all other assets of the parents and student. These include items such as checking and savings accounts, money market accounts, certificates of deposit, stocks, bonds, mutual funds, U.S. savings bonds, tax-exempt bonds, custodial accounts, trusts, limited partnerships, vacation homes, investment properties, and business and farm assets. After total assets are determined, you can then offset these assets with any investment or real estate debt (e.g., a mortgage on an investment property or a margin account loan with your broker).

**Example:** Assume the “Smith” Family has IRAs worth \$ **50,000.00**, an annuity worth \$ **250,000.00**, \$ **60,000.00** in home equity, and a checking account worth \$ **1,000.00** their total assets under the federal methodology are \$ **1,000.00**

An important note to keep in mind is that the federal government does not care about any consumer debt you may have. In other words, your assessable assets are not reduced by the amount of your outstanding consumer debt.

**Example:** Assume the “Jones” Family has \$ **100,000.00** in stocks, an IRA worth \$ **50,000.00**, and \$ **75,000.00** in long-term debt. Their total assets are \$ **100,000.00** under the federal methodology.

**Example:** Assume the “Hank” Family has \$ **20,000.00** in U.S. savings bonds, an IRA worth \$ **150,000.00**, a \$ **300,000.00** cash value life insurance policy, and no consumer debt. Their total assets are \$ **20,000.00** under the federal methodology.

**Technical Note:** Regarding trust funds and custodial accounts, the income is valued as of the base year (the year before the FAFSA is submitted) and the assets (corpus) are valued as of the date the FAFSA is signed. If a trust has more than one beneficiary, only that portion attributable to the student or parent is reportable. You may need to consult a financial professional to determine income and asset values for trust funds and custodial accounts.

When a family's total assessable assets are determined, the federal methodology gives parents an asset protection allowance that allows them to exclude a certain portion of their assets from consideration (students don't get an asset protection allowance). The asset protection allowance varies depending on the age of the older parent at the time the student applies for aid (the older the parent, the greater the allowance). For example, for the 2007/2008 academic year, the asset protection allowance for a family where the older parent is age 49 is \$ **47,900.00**.

When a final asset figure is reached for parents and student, parents must contribute a maximum of 5.6% of their assets toward college costs and the student must contribute 20% of his or her assets toward college costs.

**Example:** The sum of \$ **50,000.00** in your child's bank account equals a \$ **10,000.00** expected contribution to college costs (\$ **50,000.00** x 20%), whereas the same \$ **50,000.00** in the parents' account equals a \$ **2,800.00** contribution (\$ **50,000.00** x 5.6%).

**Tip:** There is one situation in which the federal methodology does not factor in any assets of parent or student. This is when the parents' AGI (or an independent student's AGI) is below \$ **50,000.00** and the parents are eligible to file a 1040EZ or 1040A. In this case, the EFC is calculated using only income under the Simplified Needs Test. The result is generally a lower EFC and thus more financial aid.

**Caution:** Although you qualify for the Simplified Needs Test under the federal methodology, colleges and your state may still require you to list your assets in order for you to be eligible for college or state funds.

## HOUSEHOLD COMPONENT

If the parents are both living and married to each other, the income and asset information for both parents is listed on the FAFSA. If the parents are living together but not formally married, they should file the application as if they are separated (see below), unless their state recognizes common law marriage.

If the parents are separated (living apart for an indefinite period) or divorced, then only the income and assets of the parent with whom the child lived the majority of time during the past 12 months is listed on the application. If the parent has remarried, then the stepparent's income and assets are listed on the application as though this person were the natural parent; the noncustodial parent's income and assets are not listed.

**Tip:** Under the federal methodology, the federal government does not recognize legal agreements that absolve a stepparent from contributing to college costs or that make the noncustodial parent responsible for College costs. Under the institutional methodology, however, Colleges may inquire about the resources of the noncustodial divorced parent or ignore the resources of the stepparent.

On a related note, legal guardians are no longer included on the FAFSA, which means their income and assets are not automatically included. A student whose parents are deceased will be considered an independent student, regardless of any legal guardianship. By contrast, a student whose parents are living will file as a dependent student, but the FAFSA will reflect the financial information of the appropriate parent(s) rather than the legal guardian, unless the financial aid officer exercises "professional judgment."

The federal methodology also requires you to list the number of people in the household whom the parents will support between July 1 and June 30 of the upcoming college year. This includes the student, parents, siblings, an unborn child, and others who get more than half their support from the parents and who will continue to get this support in the upcoming college year. From this number, students must also report the total number of household members enrolled in college in the same year. The student is always counted. In addition, parents and other siblings are counted if they are enrolled at least half time in a program leading to a degree or certificate.

**Tip:** If additional household members are in college, the EFC is greatly reduced. Specifically, the parents' total EFC is divided by the number enrolled in college.

**Example:** Assume the "Smart" Family's EFC is \$ 12,000.00. They will have two children enrolled in college in the same year, a freshman and a sophomore. As a result, their EFC for each child is \$ 6,000.00

## STEPS TO REDUCE YOUR EFC UNDER FEDERAL METHODOLOGY

There are legitimate steps you can take to position your income and/or assets in such a way as to enhance financial aid eligibility under the federal methodology. The idea is to lower your EFC, which, in turn, raises your child's aid eligibility.

Examples of these strategies include deferring income and bonuses, avoiding the sale of investments that will result in capital gains in the base year, and paying down consumer debt. It should be noted that these suggestions are legal and are not meant to subvert the financial aid system in any way. To implement these suggestions, you should become familiar with them at least a couple of years before the year you complete the FAFSA.

For additional information on these steps...refer to the discussion "Positioning Your Income/Assets to Enhance Financial Aid Eligibility" Page 1-24.

## THE INSTITUTIONAL METHODOLOGY VS. THE FEDERAL METHODOLOGY

There are several differences in the way the EFC is calculated under the federal methodology (FM) vs. the institutional methodology (IM).

Regarding the institutional methodology (IM), **some of the negatives are:**

- The IM formula does not recognize a simplified needs test for parents whose incomes are below **\$ 50,000.00**.
- The IM formula requires a minimum student contribution from the student's income and does not give students an income protection allowance.
- The IM formula includes home equity and family farm assets in its calculations (and may require parents to borrow against it before aid is distributed).
- The IM formula requires parents to report any savings accounts in the names of the student's siblings (to discourage the shifting of assets among siblings) and requires students to list any retirement accounts they have.
- The IM formula requires parents to report how much they contribute to flexible spending accounts for child care and medical care.
- The IM formula requires parents to report how much money they expect to earn in the coming year. Similarly, students must report any outside scholarships they expect to receive and any relative's contributions.
- The IM formula (at a college's discretion) may only allow dependent children (not parents) to be counted as members of the household enrolled in college.
- The IM formula (at a college's discretion) may not allow losses from tax return Schedules C, D, E, or F that lower AGI and may not allow certain depreciation expenses.
- The IM formula (at a college's discretion) may require business or farm balance sheets for the prior 2 years, and detailed projections of future income.

**On the positive side:**

- The IM formula includes an allowance against income for any unreimbursed medical expenses that exceed 4% of the parents' financial aid income.
- The IM formula (at a college's discretion) may have an allowance against income for the private school tuition of other household members and for a parent's own student loans.
- The IM formula (at a college's discretion) may consider a noncustodial parent's assets and income.



## 6 STEPS IN APPLYING FOR FINANCIAL AID

### There are 6 steps in the financial aid application process

**Step 1.)** The first step is for your child to apply to and be accepted by (hopefully) a number of colleges. This allows your student to compare and negotiate financial aid awards from several colleges. Keep in mind that the financial aid timeline and the admissions timeline are different.

For additional information on the admissions timeline ...refer to the discussion “Applying to College”

**Caution:** From a financial aid perspective, it is often recommended that students not apply to college on an early-decision basis. The reason is that if a college knows the student is committed to the college, it may be less inclined to award a favorable financial aid package. In addition, the student will have to examine and respond to the financial aid award before receiving awards from other schools.

**Step 2.)** The next step is to file the appropriate financial aid applications by the stated deadlines. Unfortunately, you must apply for financial aid at each school before you learn whether you have been accepted for admission at that school. Note that students must reapply for financial aid each year.

The two basic financial aid applications are the (1) FAFSA and (2) the PROFILE. The FAFSA is used by the federal government and colleges when federal financial aid funds are being distributed; it calculates your EFC under the federal methodology. The PROFILE is used by most colleges (approximately 3,000) when their own funds are being distributed; it calculates your EFC under the institutional methodology. In addition, some colleges use their own institutional aid forms in place of the PROFILE. If so, you will need to obtain a copy of that application from the financial aid officer at that particular college.

There are actually three different types of FAFSAs: (1) for dependent students, (2) for independent students without dependents (a spouse is not considered a dependent), and (3) for independent students with dependents. The federal methodology will vary slightly depending on what form is used. The main difference is that the dependent student FAFSA uses both parent and student financial data to arrive at the EFC, and the two independent student FAFSAs do not use parental data to arrive at the EFC.

To fill out the correct FAFSA, you must first determine your child's dependency status. A dependent student is one who is at least partially dependent on his or her parents for support. If your child is just graduating from high school or less than 24 years of age, most likely he or she will be classified as a dependent. By contrast, an independent student is not dependent on parental support. The federal government considers you independent if you meet any one of the following conditions;

- You are 24 years of age by December 31 of the award year
- You are an orphan or a ward of the court, or were a ward of the court until age 18
- You are married or have legal dependents other than a spouse
- You are a graduate or professional student
- You are a veteran of the U.S. Armed Services
- You are an active member of the armed forces
- You are deemed independent in the professional judgment of the financial aid administrator (FAA) based upon documented unusual circumstances

**Tip:** Most states and colleges go beyond this federal test when determining whether you are truly independent. For example, they may ask for written proof that your parents are unable to provide you with any financial support whatsoever. Once you have determined your dependency status, you can then obtain the correct FAFSA. The FAFSA is available at high school guidance offices or college financial aid offices. The earliest date it can be filed is January 1 in the year your child will be attending college. This is because the application relies on your previous year's tax return. The federal deadline for filing the FAFSA is June 30, but many colleges have an earlier deadline. There is no fee for submitting the FAFSA.

**Tip:** Parents should submit the FAFSA as close to January 1 as possible because many financial aid programs operate on a first-come, first-served basis. Because most parents have not yet completed their federal income tax returns by early January, it is recommended that parents hire a professional tax preparer to complete an estimated income tax return, a practice the federal government considers acceptable. However, parents will still need to complete their final income tax return as soon as possible because the college will likely require a copy at the time it prepares the student's financial aid package.

When it's complete, a FAFSA can be filed in four ways: (1) manually completing the form and mailing it to the regional processor listed on the form, (2) filing electronically through the college (not all colleges have this capability), (3) filing electronically using the U.S. Department of Education's FAFSA Express software (this software can be downloaded from the Internet at [www.ed.gov](http://www.ed.gov), and (4) filing on the Internet by contacting [www.fafsa.ed.gov](http://www.fafsa.ed.gov)

Paper FAFSAs take approximately four to six weeks to process; electronic FAFSAs take only one week. However, if you file an electronic FAFSA, you still need to print out the certification page, sign it, and mail it to the designated processor within 21 days of transmitting your data (or the processing of your application will be delayed).

The PROFILE is available at high school guidance offices, college financial aid offices, or on the Internet at [www.finaid.org](http://www.finaid.org). Like the FAFSA, there are three different PROFILE applications that depend on whether you are a (1) dependent student, (2) independent student without dependents, or (3) independent student with dependents. You determine your dependency status the same way as for the FAFSA. Also like the FAFSA, each college may have its own deadline for filing the form.

Unlike the FAFSA, there is a processing fee for filing the PROFILE application. In addition to the FAFSA and PROFILE forms, you will also need to submit any other financial aid applications (college or state) to the appropriate institutions at this time.

**Step 3.)** 4 to 6 weeks after the FAFSA is filed (one week if you filed your FAFSA on-line), your family should receive a Student Aid Report or SAR (or Acknowledgment Report when the PROFILE is filed). This form indicates your EFC in the upper right-hand corner of page one of the report. For example, "EFC6000" means that your expected family contribution to college costs is \$ **6,000.00** The SAR will also be sent to each college you listed on the FAFSA.

You should review the SAR to make sure the EFC was calculated using accurate information. Any corrections should be made immediately and sent back for reprocessing (e.g., updating estimated tax information, arithmetic errors, or clerical errors).

**Tip:** If there is an asterisk (\*) next to the EFC reported on the SAR, your family has been chosen for verification. Verification can range from providing tax returns and household information to providing appraisals for certain assets listed on the FAFSA. Don't take it personally if you are chosen...nearly 30% of all FAFSAs are verified.

**Step 4.)** After you (and the colleges) receive the SAR, the college's financial aid administrator (FAA) goes to work. The administrator subtracts your EFC from the cost of attendance at that particular college to arrive at your child's financial need. The FAA then attempts to create a financial aid package to meet that need. The package will include various combinations of loans, grants, scholarships, and work-study programs (the type and order of financial aid resources typically used to fulfill a student's financial need is discussed in greater detail below).

**Tip:** Your goal is to have your child's financial need met with the highest amount of gift aid (scholarships and grants) and the least amount of self-help aid (loans and work-study). Private colleges tend to provide more gift aid than public colleges so they can better compete with their less expensive counterparts. As a guide, the average financial aid package consists of 60 percent loans that must be paid back. Unfortunately, as college becomes more and more expensive, the trend is to meet a student's financial need with a higher percentage of loans than gift aid.

**Caution:** As mentioned previously, colleges are not obligated to meet all of your child's financial need. Colleges have limited financial aid budgets and tend to offer the most aid to those students who meet their specific enrollment goals (e.g., improve the women's hockey program or the debating team). If the college does not meet all of your child's needs, then you have been "gapped" and you are responsible for the shortfall.

**Step 5.)** Sometime in March or April, the FAA notifies the student of the financial aid package in an award letter (the student must first be accepted to the college). The award letter states the specific amount and type of financial aid being offered, and a date by which the letter must be returned.

You may accept, decline, or attempt to renegotiate any part of the financial aid award. It is important to reply by the required date because otherwise your child's award will be cancelled and the money freed up for some other student. Note that accepting the award does not commit your child to attending that school; it just safeguards the award.

Ideally, students will want to have all of their award letters from various colleges on hand before making a decision. This is sometimes easier said than done, however. The financial aid process and the admissions process operate on different schedules, and occasionally students must make a decision to enroll at a particular college before they know the contents of their award letter. Similarly, a student may not have received all of his or her outstanding award letters before being called on to make an acceptance decision at a college from which an award letter was received. In either case, the student or parent should contact the appropriate FAA to see if you can expedite the consideration of the aid package.

**Step 6.)** If you want to appeal all or part of your child's financial aid award, follow the instructions in the award letter. This usually involves a polite business letter to the FAA and a follow-up telephone call or meeting.

The process of renegotiating your child's financial aid package has been much publicized as of late, with descriptions ranging from haggling to dialing for dollars. Rare a decade ago, negotiating is now so much part of the picture that some colleges have set aside funds specifically for maneuvering at season's end. Some educational professionals have criticized this process on the grounds that those parents that yell the loudest reap the biggest rewards. This is not necessarily true. In fact, you'll do much better if you approach the FAA without carrying a big stick.

Your chances of successfully renegotiating your child's aid package are best if you can document a special circumstance that affects your ability to pay the EFC (rather than a simple plea of inability to pay). Such special circumstances may include the recent death or disability of a parent, divorce, prolonged unemployment, unusually high medical expenses, or a natural disaster that destroyed certain assets. In addition, more obscure circumstances may be the reason for negotiation. For example, your income on last year's tax return may have been higher than usual because you converted a traditional IRA to a Roth IRA or because you received a one-time windfall, such as a special bonus, insurance settlement, or inheritance. Make sure to document any change with the appropriate paperwork.

In addition to a special family circumstance, many parents and students attempt to play one college's aid package against another college's aid package. This strategy has the best chance of success if College A and College B are direct competitors and you have the qualities that College A is looking for. If College A is an Ivy League school and College B is a small state university, chances are that one will not be persuaded by the aid package of the other. As a matter of fact, public institutions rarely haggle, so your best chances for a deal will be at one of the approximately 1,600 private colleges.

Keep in mind that the college market, like the housing market, can be a seller's market or a buyer's market, and that this can affect the negotiation process. Currently, there are more students than college spaces as the children of the baby boomers reach college age.

## **TYPES OF FINANCIAL AID PROGRAMS**

There are several types of financial aid programs (for additional information, review “**Financial Aid: Loans, Financial Aid: Grants, Financial Aid: Scholarships, Financial Aid: Work-Study**” Page 1-21). The most common financial aid programs are those offered by the federal government. The main federal programs are as follows:

## **PELL GRANT & SUPPLEMENTAL EDUCATIONAL OPPORTUNITY GRANT (SEOG)**

The Pell Grant is available to undergraduate students. It is an entitlement program, which means the grant is available to all students who qualify.

The SEOG is reserved for undergraduate students with the most financial need (Pell Grant recipients are given priority). The SEOG is a campus-based program, which means that each college receives a limited amount of money for this program and the FAA at each college decides which students will receive this grant. Once the funds are awarded, there are no more until the following year. This is an example of a first-come, first-served program.

Also, starting in 2006, two new federal grant programs became available to full-time undergraduate students who qualify for a Pell Grant and meet other requirements. Grants available to first- and second-year students are called Academic Competitiveness Grants, and grants available to third- and fourth-year students are called National Science and Mathematics Access to Retain Talent (SMART) Grants and are available only to those students majoring in certain subject areas. Both grant programs are scheduled to sunset at the end of fiscal year 2010.

For additional information...refer to the discussion “**Financial Aid: Grants**” Page 1-22.

## **STAFFORD LOAN, PERKINS LOAN AND PLUS LOAN**

The federal Stafford Loan is a low-interest loan made to both undergraduate and graduate students. Your lender can be either the federal government or a private financial institution, depending on which lending program a particular college participates in. The interest rate is set each June.

A Stafford Loan may be subsidized or unsubsidized, depending on whether you have a financial need. With a subsidized federal Stafford Loan, the federal government pays the interest on the loan while you are in school, during deferment periods, and for six months after you leave school. Like the Pell Grant, the subsidized Stafford Loan is an entitlement program and is thus available to all students who qualify. With an unsubsidized federal Stafford Loan, you (not the federal government) are responsible for paying the interest during the school year and deferment periods. Regardless of whether the loan is subsidized or unsubsidized, there are limits on the amount of money that can be borrowed each year, as well as limits on the total debt that may be incurred.

A Perkins Loan is a low-interest loan available to both undergraduate and graduate students with the lowest EFCs. Like the SEOG, the Perkins Loan program is campus-based, which means each college receives a certain amount of money for this program, and you borrow the money directly from the college. When the funds run out, there are no more until the following year. This loan is subsidized; that is, the federal government pays the interest while you are in school, during deferment periods, and for nine months after you graduate.

The PLUS Loan is a non-need-based program; that is, you can qualify without financial need. The loan is for parents with good credit histories who want to help pay for their child's education and for graduate and professional students. Borrowers are eligible to borrow up to the full cost of their education, minus the EFC and any other financial aid received. This loan is obtained through financial institutions.

For additional information on these loans ...refer to the discussion “**Federal Student Loans**” Page 1-11.

## WORK STUDY

The federal work-study program is a need-based program that subsidizes jobs for both undergraduate and graduate students. Like the SEOG and Perkins Loan, the federal work-study program is campus-based. The funds are distributed on a first-come, first-served basis. Often, these jobs involve community service work and can be related to your course of study.

For additional information...refer to the discussion “**Financial Aid: Work-Study**” Page 1-23.

### **QUESTION: Do colleges award financial aid resources in a specific order?**

Generally, yes. Colleges usually fulfill a student's financial need by awarding financial aid resources **in the following order:**

1. Federal Pell Grant (for those students who qualify).
2. State Grant
3. Federal Stafford Loan (subsidized).
4. Company and organization scholarships and grants, military financial aid programs, or any other outside financial aid resources
5. Perkins Loan, SEOG, or federal work-study (funds for these programs are allocated to colleges by the federal government for allocation to students; whether a student receives any of these funds depends on timing of application, financial need, and availability of funds).
6. College Grant or tuition discount (at the college's discretion).

Although this is the typical order, it may vary according to the availability of funds at a particular college and/or the particular student's merit. The more merit a student has, the better types of financial aid he or she will likely receive (e.g., less loans, more grants).

### **QUESTION: Should you apply for financial aid even if you don't think your family will qualify?**

Generally, yes. No matter how high your income or asset base is, your family should apply for financial aid. At the very least this means filing the FAFSA. In addition, you may choose to file the PROFILE or other individual College application.

#### **There are a 3 reasons for this suggestion:**

**First**, it can be difficult to predict whether your child will qualify for financial aid without actually filing the FAFSA because the federal government's eligibility criteria for certain aid programs may change unexpectedly from year to year.

**Second**, some financial aid programs are not based on need...such as the federal government's PLUS Loan and certain state programs...yet you must still file a FAFSA to be eligible to borrow funds.

**Third**, you really lose nothing (except a few hours of your time) for filing the FAFSA because it is a free form that costs nothing to process.

Although the PROFILE application does have a processing fee, it is a small investment to make for the opportunity to learn whether your child qualifies for a college's own aid programs. The worst that can happen is that you discover you don't qualify for any financial aid. In that case, you won't be left wondering whether you should have applied. Considering that your child may be awarded gift aid that you won't have to repay, the investment of your time may well be worth it.



## POSITIONING INCOME/ASSETS TO ENHANCE FINANCIAL AID ELIGIBILITY

**QUESTION:** What does it mean to enhance your financial aid eligibility?

If you qualify for federal financial aid, there are a number of strategies you can try to implement to enhance the amount of aid your child will receive. The idea is to lower your expected family contribution (EFC), which in turn raises your child's aid eligibility. Although some of these strategies can be employed as late as the base year...the year prior to the year you fill out the Free Application for Federal Student Aid form (FAFSA)...others can be implemented years before your child will be starting college.

**Disclaimer:** It is important to note that these strategies are perfectly legal and are not in any way meant to undermine the federal financial aid process. These strategies simply examine the federal methodology and take advantage of its rules regarding which family assets and income are included in determining a student's financial aid eligibility.

## STRENGTHS

**You increase your child's eligibility for federal financial aid**

By implementing strategies that lower your assessable income and assets under the federal formula for financial aid, you decrease the amount of money your family is expected to contribute to college costs. A decrease in your EFC, in turn, means your child will be eligible for more financial aid. This translates into less current out-of-pocket costs for you.

For more specific information on what types of income and assets the federal formula considers...refer to the discussion “**Applying for Financial Aid**” Page 1-18.

### **You may reap incidental financial benefits that are important to you**

By implementing certain strategies tailored to the federal methodology for financial aid, you not only increase your child's aid eligibility but also may place yourself in a better financial position.

For instance, by paying down your mortgage, you not only increase your child's federal aid eligibility because home equity is not counted as an asset under the federal formula, but you also benefit by saving on mortgage interest and owning your home sooner.

## **TRADEOFFS**

### **Colleges don't use the same formula as the federal government in determining aid eligibility**

The primary drawback of implementing specific strategies to take full advantage of federal financial aid is that you increase your chances for aid under the federal system only. Colleges have their own formula for determining which students are most deserving of campus-based aid, and this formula may not recognize a strategy that is successful under the federal methodology.

For instance, under the federal methodology, the federal government does not consider your home equity in calculating your total assets. However, most colleges do consider home equity in determining a family's ability to contribute to college costs, and some may even expect parents to borrow against it.

### **The increased financial aid may consist entirely of loans**

If you are successful at reducing your total income and assets under the federal methodology and thus increasing your child's financial aid package, there is no guarantee that a portion of the increased aid package will consist of grants or scholarships (which do not have to be paid back). Instead, your child's additional aid package could consist entirely of loans that will need to be paid back by you or your child.

### **You may not want to disrupt an otherwise sound investment program**

It is generally not a good idea to drastically change your overall financial planning scheme for financial aid reasons only. Ideally, any changes you make should be in line with your overall financial planning picture.

## **STRATEGIES TO REDUCE AVAILABLE INCOME**

There are a number of steps you can take to reduce your adjusted gross income (AGI) under the federal methodology for determining financial aid. The lower your AGI, the less money you will be expected to contribute toward college costs and the higher your child's aid eligibility.

**Tip:** Remember, you apply for financial aid each year. Thus you should consider the following strategies for each of the years you will be applying for aid, not just for the initial application.

For additional information on how to apply for aid...refer to the discussion “**Applying for Financial Aid**” Page 1-18.

### **Time the receipt of discretionary income to avoid the base year**

Your income in the base year will directly affect your child's financial aid eligibility in the following year. Although it is highly unlikely you will be able to defer your weekly (or monthly) paycheck, it may be possible to defer other types of discretionary income beyond the base year.

**For example, if possible, you should try to:**

- Defer receiving employment bonuses until after December 31 of the base year.
- Avoid selling investments that will have taxable capital gains or interest, such as mutual funds, stocks, or savings bonds, until after December 31 of the base year. To avoid taking an untimely distribution from an investment that is earning a favorable rate of return, use the investment as collateral for a low-interest loan instead.
- Sell investments that can be taken at a loss during the base year, as long as the investments are not expected to recover.
- Avoid pension and IRA distributions in the base year.
- If you are on an expense account, ask your employer to reimburse you directly so that any reimbursement amounts do not artificially inflate your income.

### **Pay all federal and state income taxes due during the base year**

This strategy is advantageous for two reasons: It reduces the amount of available cash on hand, and you can deduct the total amount of federal and state taxes you pay during the base year on the FAFSA.

### **Leverage student income limit**

For the academic year 2007/2008, the first \$ **3,080.00** of income a student earns is not considered in determining a child's total income. This is known as the student's income protection allowance. However, everything a student earns beyond the allowance is first taxed and then assessed at 50% for financial aid purposes. In other words, the federal government expects your child to contribute 50% of all income earned over the allowance (after taxes).

To avoid this result, parents may want to consider having their children perform volunteer work once their kids reach the allowance limit. However, some children may balk at this suggestion because they want a job to earn extra spending money.

## **STRATEGIES TO REDUCE AVAILABLE ASSETS**

There are a number of steps you can take to reduce the amount of assets that will be included under the federal methodology. Under this formula, the federal government includes some assets and excludes others in arriving at your family's total assets (review “**Applying for Financial Aid**” Page 1-18). The lower your assessable assets, the less money you will be expected to contribute toward college costs and the higher your child's aid eligibility.

It is important to remember that the relevant date for determining whether you own a particular asset is the date that you submit the FAFSA. Consequently, the following strategies can be implemented up to the time you complete the FAFSA.

### **Use cash to pay down consumer debt**

The federal methodology does not care about the amount of consumer debt you may have. So if you have \$ **10,000.00** in assets and \$ **10,000.00** worth of consumer debts, the federal government still lists your total assets as \$ **10,000.00**. When you use available cash to pay down consumer debt, you reduce the amount of your cash on hand.

**Tip:** It is usually a good idea to retain three to six months worth of liquid assets for emergencies. See Using the "3-6 Months Rule" to Determine Your Cash Reserve Needs.

### **Use cash to make large purchases**

Another strategy to reduce cash on hand (an assessable asset) is to make large planned purchases the year before your child begins college. Such items may include a car, furniture, or the like for parents and a car (second-hand, of course), computer, or the like for students. Remember, the idea is not to go out and spend the money on anything; the purchase should have been previously planned.

### **Increase home equity**

The federal methodology does not count home equity as an asset in determining your child's financial aid eligibility. So using assessable assets to pay down the mortgage on your home is one way to reduce these assets and benefit yourself at the same time. For additional information, review the discussion “**Prepaying Your Mortgage**”.

**Caution:** Although the federal government does not include home equity in determining a family's total assets, most private colleges do include home equity in deciding which students are most deserving of campus-based aid.

In addition, some colleges may expect parents to borrow against the equity in their homes to help finance their child's college education.

### **Leverage parents' asset protection allowance**

Once the parents' assessable assets are totaled, the federal methodology grants parents an asset protection allowance, which enables them to exclude a certain portion of their assets from consideration. The amount of the asset protection allowance varies depending on the age of the older parent at the time the child applies for aid (the idea being the closer the parents are to retirement age, the larger the asset protection allowance).

Once parents determine what their asset protection allowance will be, one strategy is to consider saving an equal amount of money in assets that are counted under the federal methodology. Then, any savings above this amount can be shifted to assets that are excluded by the federal methodology, such as home equity, retirement plans, cash value life insurance, and annuities. For additional information, review the discussion “**Applying for Financial Aid**” Page 1-18.

### **Use student's assets for the first year**

Under the federal methodology for financial aid, the federal government expects a child to contribute 20% of his or her assets each year to college costs, whereas parents are expected to contribute a maximum of 5.6% of their assets. If assets have been accumulated in a child's name, parents may want to consider using these assets to pay for the first year of college. By reducing the child's assets in the first year, the family will likely increase its chances to qualify for more financial aid in subsequent years.

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