

ABCs of Financial Aid

It's hard to talk about college without mentioning financial aid. Yet this pairing isn't a marriage of love, but one of necessity. In many cases, financial aid may be the deciding factor in whether your child attends the college of his or her choice or even attends college at all. That's why it's important to develop a basic understanding of financial aid before your child applies to college. Without such knowledge, you may have trouble understanding the process of aid determination, filling out the proper aid applications, and comparing the financial aid awards that your child receives.

But let's face it. Financial aid information is probably not on anyone's top ten list of bedtime reading material. It can be an intimidating and confusing topic. There are different types, different sources, and different formulas for evaluating your child's eligibility. Here are some of the basics to help you get started.

What is financial aid?

Financial aid is money distributed primarily by the federal government and colleges in the form of loans, grants, scholarships, or work-study jobs. A student can receive both federal and college aid. An ideal financial aid package will contain more grants and scholarships (which don't need to be repaid) and fewer loans.

Financial aid can be further broken down into two categories: need-based aid, which is based on a student's financial need, and merit aid, which is based on a student's academic, athletic, musical, or artistic talent. Both the federal government and colleges provide need-based aid in the form of loans and grants. For merit aid, colleges are the main source, and they often use favorable merit aid packages to attract the best and brightest students to their campuses.

It's worth noting that colleges can vary significantly in their generosity when it comes to merit aid; merit awards are typically related to the size of a college's endowment and its unique objectives. College guidebooks and marketing materials generally provide statistics on the size of a college's average aid award (both in dollar amounts and as a percentage of the typical aid package) and the family income thresholds necessary for different aid amounts. If you're a family researching college options, you can help your bottom line by targeting colleges that offer significant merit aid packages. For example, some colleges have made it a policy to replace loans with grants in their financial aid packages.

In addition to colleges, many businesses, foundations, and associations offer smaller merit scholarships with specific eligibility criteria and deadlines. Various scholarship websites allow your child to input his or her background, abilities, and interests and receive (free of charge) a matching list of potential scholarships.

How is my child's financial need determined?

Financial need is generally determined by looking at a family's income, assets, and household information. The federal government uses the FAFSA, which stands for Free Application for Federal Student Aid; colleges generally use the PROFILE form, or their own institutional form. The FAFSA uses a formula known as the federal methodology; the PROFILE uses a formula known as the institutional methodology. The general process of aid assessment is called needs analysis.

Under the FAFSA, your current income and assets and your child's current income and assets are run through a formula. You are allowed certain deductions and allowances against your income, and you're able to exclude certain assets from consideration. The result is a figure known as the expected family contribution, or EFC. It's the amount of money that you'll be expected to contribute to college costs before you are eligible for aid.

A detailed analysis of the formula is beyond the scope of this discussion, but generally here's how it works: (1) parent income is counted up to 47% (income equals AGI plus untaxed income/benefits minus certain deductions); (2) student income is counted at 50% over a certain amount (\$6,400 for the 2016/2017 school year); (3) parent assets are counted at 5.6% (home equity, retirement assets, cash value life insurance, and annuities are excluded); and (4) student assets are counted at 20%.

Your EFC remains constant, no matter which college your child applies to. An important point: Your EFC is not the same as your

child's financial need. To calculate your child's financial need, subtract your EFC from the cost of attendance at your child's college. Because colleges aren't all the same price, your child's financial need will fluctuate with the cost of a particular college.

For example, you fill out the FAFSA, and your EFC is calculated to be \$25,000. Assuming that the cost of attendance at College A is \$65,000 per year and the cost at College B is \$35,000, your child's financial need is \$40,000 at College A and \$10,000 at College B.

The PROFILE application (or the college's own application) basically works the same way. However, the PROFILE generally takes a more thorough look at your income and assets to determine what you can really afford to pay (for example, the PROFILE looks at your home equity and money you may have contributed to medical and dependent care flexible spending accounts).

What factors count the most in needs analysis? Your current income is the most important factor, but other criteria play a role, such as your total assets, the number of children you'll have in college at the same time, and how close you are to retirement age.

Estimating aid eligibility ahead of time

Getting a ballpark estimate of financial aid ahead of time can be very helpful for planning purposes. There are two ways you can do this.

First, the federal government offers an online tool called the "FAFSA4caster" that you can complete to get an estimate of your EFC. Second, every college offers a tool called a "net price calculator" on its website that you can complete to get an estimate of how much financial aid your child might be eligible for at that particular college based on your family's financial and personal profile.

Submitting financial aid applications

The best way to complete the FAFSA is to fill it out and submit it online (it can also be completed manually and mailed to the address listed on the form). The online route is best because mistakes are flagged immediately and electronic FAFSAs take only one week to process (compared to two to four weeks for paper FAFSAs). In order to complete the FAFSA online, you and your child will first need to obtain an FSA ID, which you can also do online.

Starting with the 2017/2018 school year, families will be able to file the FAFSA as early as October 1, 2016, using their 2015 tax return. Going forward, the FAFSA will rely on tax information from two years prior. The FAFSA has the ability to directly import your tax information using the IRS Retrieval Tool, which is built into the form. However, you will also have to answer additional questions.

The PROFILE (or individual college application) is usually submitted in late fall or winter but is typically required earlier if your child is applying to college early decision or early action. The specific deadline is left up to the individual college, so make sure to keep track of all college deadlines. In addition to the form itself, the CSS Profile will typically require you to submit tax returns, and possibly other financial documents, at a later date. If so, you'll receive instructions on how to do this.

After your FAFSA is processed, your child will receive a Student Aid Report highlighting your EFC; the colleges that you list on the FAFSA will also get a copy of the report. When your child is accepted at a college, the college's financial aid administrator will attempt to craft an aid package to meet your child's financial need. This is done using a combination of the following (typically in this order):

- Federal Pell Grant (for students with exceptional financial need)
- Federal Direct Stafford Loan (subsidized for students with financial need)
- Federal Direct Stafford Loan (unsubsidized for all other students)
- Federal Perkins Loan, Supplemental Educational Opportunity Grant (SEOG), and work-study (funds for these programs are allocated to colleges by the federal government for distribution to students; whether a student receives any of these funds depends on timing of application, financial need, and availability of funds)
- College grant, scholarship, or tuition discount (at the college's discretion)

Keep in mind that colleges aren't obligated to meet all of your child's financial need. In fact, it's not uncommon for colleges to meet only a portion of a student's need, a phenomenon known as getting "gapped." If this happens to you, you'll have to make up the shortfall, in addition to paying your EFC. On the flip side, if a college says it is meeting "100% of your demonstrated need" keep in mind that the college is the one who determines your need, not you, and that you'll still have to pay your EFC.

Comparing aid awards

In late winter or early spring, your child will receive financial aid award letters that detail the specific amount and type of financial

aid that each college is offering. When comparing aid awards, read each award letter carefully and make sure you understand exactly what the college is offering. The goal is to compare your out-of-pocket cost at each college. To do this, look at the total cost of attendance for each college and subtract any grant or scholarship aid the college is offering. If the grant or scholarship is merit-based, find out if it's guaranteed for all four years and what requirements must be met in order to qualify for it each year. If the grant or scholarship is need-based, find out whether you can expect a similar amount each year as long as your income and assets stay roughly the same (and you have the same number of children in college), and ask the aid office whether it increases to keep up with annual increases in tuition, fees, and room and board.

The difference between the total cost and any grant or scholarship aid is your out-of-pocket cost or "net price." Compare this figure across all colleges. Once you determine your out-of-pocket cost at each college, determine how much, if anything, you or your child will need to borrow. Then multiply this figure by four to get an idea of what your total borrowing costs might be. Armed with this information, you'll be in a position to make the best financial decision for your family.

If you'd like to lobby a particular school for more aid, tread carefully. A polite letter to the financial aid administrator followed up by a telephone call is appropriate. Your chances of getting more aid are best if you can document a change in circumstances that affects your ability to pay, such as a recent job loss, unusually high medical bills, or some other event that impacts your finances. Your chances of getting more aid by asking one college if they'll match a favorable aid offer from another college is a less reliable strategy, but may be worth a shot if the colleges are direct competitors.

How much should our family rely on financial aid?

With all this talk of financial aid, it's easy to assume that it will do most of the heavy lifting when it comes time to pay the college bills. But the reality is you shouldn't rely too heavily on financial aid. Although aid can certainly help cover your child's college costs, student loans make up the largest percentage of the typical aid package, not grants and scholarships. As a general rule of thumb, plan on student loans covering up to 50% of college expenses, grants and scholarships covering up to 15%, and work-study jobs covering a variable amount. But remember, parents and students who rely mainly on loans to finance college can end up with a considerable debt burden.

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