

# A New Approach to Paying for College





## A New Approach to Paying for College

**Paying for college is one of the greatest financial challenges facing middle-income America today.** College costs continue to rise at nearly twice the rate of inflation. As a result, our national student loan debt has grown from \$240 billion in 2003 to \$1.3 trillion as of March 2016—that's an increase of more than 510 percent in just the last decade, according to a 2016 study by the Global Financial Literacy Excellence Center at George Washington University. The Federal Reserve estimates we are adding \$2,726 per second to our student loan debt, putting us on pace to add nearly \$100 billion this year alone.

While the majority of families will have some amount of student loan debt in their college-funding solution, **graduates leaving college with too much debt may be forced to delay their lives.** They may not be able to save for a house or for retirement, and they may delay getting married and starting families of their own. According to the independent, non-profit Institute for College Access and Success, seven in 10 (68 percent) graduates from public and non-profit colleges in 2015 had student loan debt, with an average of \$30,100 per borrower. As a rule of thumb, for every \$10,000 borrowed, they will owe \$100 per month over 10 years.

The four-year sticker price of college today ranges from \$100,000 (in-state) to \$250,000 (elite/private)—that's a \$400,000 to \$1 million investment in education for a family with four kids. We are tasking 17-year-olds who may have never had a job, paid taxes, or had any exposure to personal finance to **make one of the largest buying decisions of their life before their adult life has even begun.**

**Many parents know that getting a good education at a reputable university is an investment worth making in their children.** In 2014, the median earnings of young adults ages 25 to 34 with a bachelor's degree (\$49,900) were 66 percent higher than the median earnings of young adults who only completed high school (\$30,000), according to the National Center for Education Statistics. Those with a bachelor's degree also reported higher job satisfaction and quality of life; so, college remains a good investment—as long as you don't overpay for it.

**Simply put: the way we shop for college is all wrong.** Because most families cannot simply save enough or earn enough to write a check for college, being smarter consumers of education is imperative.





**When you understand how financial aid works**, you will have the strategies to cut the cost of college, reduce the stress and anxiety surrounding college funding, and ease any guilt that you have not done enough to prepare. **It starts with understanding all the moving parts.**

**How can families look at their current situation and put together an executable plan?** Families need to understand not only what it costs to send their kids to college, but also how they will pay for it. How will college be paid for over all four years down to the penny, including student loans and the monthly payment for their child upon graduation as a result of those loans? You can't look at paying for college in a vacuum. **You must look at the whole picture including balancing current lifestyle with retirement and college funding goals.**

At this stage in their lives, most parents are in their late 40s or early 50s. Retirement is just around the corner, and this may be the first time that they have had to face a major expense of \$25,000 to \$65,000 per year for four years. **Building an integrated financial solution** that looks at college, retirement, investing, cash flow, and tax planning is vital.

**Families need to know how to shop for colleges** that will provide them with the most financial aid based on the financial need of the family and/or the merit of the student, and some families may wish to determine this before they schedule a college visit.



## Getting Pre-Approved for College Funding

You may want to drive a Lamborghini, but that doesn't mean it is a good financial decision or that a bank would give you a loan for one. When you buy a home, the first step is typically working with your bank to get a mortgage pre-approval letter. You are asked about your entire financial picture—down payment amount, income, assets, where you work, employment history, your credit score, etc. The banks are calculating what you can reasonably afford. Can you get pre-approved for the same mortgage as LeBron James? Probably not. **The bank will only pre-approve a mortgage amount that they are confident you can repay based on your financial resources.** College should be no different.

### COLLEGE PRE-APPROVAL™ 1 Page College Funding Plan (Sample)

#### PARENT RESOURCES

529 Savings	\$25,000
Other Assets	\$3,000
Monthly Cash Flow ( \$400 x 48 months)	\$19,200
Annual American Opportunity Tax Credit (\$10,000 Max over 4 years)	\$10,000
<b>TOTAL PARENT RESOURCES (A)</b>	<b>\$57,200</b>

#### PARENT LOANS

PARENT PLUS / PRIVATE LOANS (B) **\$0**

#### STUDENT RESOURCES

Student Savings (UTMA, Savings, etc.)	\$0
Monthly Workstudy / PT Job (\$200 x 48 months)	\$9,600
<b>TOTAL STUDENT RESOURCES (C)</b>	<b>\$9,600</b>

#### STUDENT LOANS

Student Stafford Loans (\$27,000 Max over 4 years)	\$27,000
Private Student Loans	
<b>TOTAL STUDENT LOANS (D)</b>	<b>\$27,000</b>

#### OTHER HELP

GRANDPARENT / FAMILY HELP (E) **\$5,000**

#### TOTALS

<b>(A) PARENT RESOURCES</b>	<b>\$57,200</b>
<b>(B) PARENT LOANS</b>	<b>\$0</b>
<b>(C) STUDENT RESOURCES</b>	<b>\$9,600</b>
<b>(D) STUDENT LOANS</b>	<b>\$27,000</b>
<b>(E) OTHER HELP</b>	<b>\$5,000</b>
<b>Your 4 Year Pre-Approval Amount</b>	<b>\$98,800</b>

#### STUDENT PLANS

Anticipated Major / Career	Education
Average Starting Salary = Max Loan	\$38,548

#### Average Starting Salary By Discipline\*

Computer Science	\$71,411
Engineering	\$66,638
Math & Sciences	\$61,709
Health Sciences	\$52,076
Business	\$52,040
Communications	\$46,797
Education	\$38,548
Overall	\$50,944

\*Nation Association of Colleges and Employers  
Class of 2014 salary survey



Before the college search process begins, every family should go through a College Pre-Approval™ process just like buying a home. This exercise will show you how many families pay for college and close the gap between what you have saved and the cost of education.



## Step 1: Determine Available Personal Resources

Your family's available personal resources include 529 plans, other savings, cash flow, grandparent help, and tax benefits.

**Savings.** How much has your family been able to save for the cost of college for their student in 529 plans or other vehicles? In planning for your child's education, it's important to understand how to allocate funds for each child. You don't want your eldest to go to their dream school and suddenly have nothing left to allocate for your other children. Working with a qualified advisor in this area can help.

TOTALS	
(A) PARENT RESOURCES	\$57,200
(B) PARENT LOANS	\$0
(C) STUDENT RESOURCES	\$9,600
(D) STUDENT LOANS	\$27,000
(E) OTHER HELP	\$5,000
<b>Your 4 Year Pre-Approval Amount</b>	<b>\$98,800</b>

**Cash flow.** College is a cash flow crunch. When it comes to college, it's critical for families to get a handle on their cash flow. For example, the cost of attendance at a college includes room and board. When students live at home they are not free. So, when they are living away from home, can the family continue to commit a certain amount each month? A figure we frequently hear is that the student costs at least \$300 per month when living at home.

In addition, if a family is currently contributing \$100 per month to a 529, add that amount to the monthly commitment since they are already used to paying for it. That makes \$400 per month while in school, which adds up to \$4,800 per year, or \$19,200 toward the cost of a four-year education. Many schools offer a zero-interest payment plan where they will work with families to spread the payments over the semester (be sure you understand any costs associated with this option).

**American Opportunity Tax Credit (AOTC).** The credit equals 100 percent of the first \$2,000 of a student's qualified education expenses plus 25 percent of the next \$2,000. The maximum annual credit is \$2,500, which adds up to a maximum of \$10,000 over four years of undergrad.

Unlike other education tax credits, the AOTC includes expenses for course-related books, supplies, and equipment that are not necessarily paid to the educational institution, but room and board expenses are not qualifying expenses. The AOTC can be claimed in the same year that a family takes a tax-exempt distribution from a section 529 plan or a Coverdell Education Savings Account, **but the distribution may not be used for the same qualified higher education expenses.** Many families may be planning to use all 529 monies for the first year or two and then tap other resources. To ensure they get the AOTC each year, you need to carefully coordinate 529 distributions over four years to ensure expenses qualify for this refundable credit.





## Step 2: Establish a Maximum Student Loan Amount

As a rule of thumb, **students should not take out more in student loans than their first-year salary will be in their chosen career upon graduation** to avoid getting in over their heads. Consider a teacher coming out of school with a starting salary of \$40,000 versus an engineer coming out of school with a starting salary of \$60,000. An engineer could afford a larger loan because his or her starting salary would be larger.

In other words, **the amount invested in the education and the resulting loans needed to finance the education should be considered in the equation.** And, families should be very clear about the total amount of loans they are taking out for the entire four years.

**Loans come in two forms, federal and private (bank).** The student loan nearly every family will consider is the direct federal loan; this is typically the best loan for the student. These loans are taken out in the student's name, do not require a cosigner or underwriting, and they have reasonable interest rates (currently 3.76 percent, reset every July 1). If the student can graduate with no more than the \$27,000 in direct loans, he or she will have manageable student loan payments of around \$275/month upon graduation and, in some cases, be eligible for loan forgiveness.

The U.S. Department of Education offers eligible students at participating schools **direct subsidized loans and direct unsubsidized loans**, and families must file the online **Free Application for Federal Student Aid, or FAFSA**, to be considered ([fafsa.ed.gov](http://fafsa.ed.gov)).

**Subsidized loans are needs-based.** The student must qualify based on financial need, and no interest accrues while the student is in school. **Unsubsidized loans** are offered to every student regardless of financial need, but interest accrues while the student is in school. Direct loans are available only up to a set amount each year, and each year's maximum loans are "use it or lose it" loans, so if the student doesn't use any or all of the \$5,500 loan amount available during their freshmen year, they will not be able to borrow that \$5,500 in a subsequent year. **We frequently see families using their personal resources up in the first two years and then not having enough money for the second two years, forcing them to take out private loans to meet the difference.**

In regard to the **federal direct Parent PLUS loan, we caution families.** Parents can borrow up to the total cost of attendance less financial aid. Without good guidance, they may see the Parent PLUS loan as an easy, temporary solution without fully considering the long-term ramifications. These loans are expensive (6.31 percent with a 4.725 percent origination fee during the 2016-2017 academic year), and they are non-transferrable. **Avoid taking on education loans altogether unless it is a small amount to fund a small gap.**

**Private loans are made by banks and financial institutions.** They are a rapidly-growing section of education loans because the loan amounts can be unlimited. However, students and parents should only consider a private loan after they have maxed out all the federal loan money available. Interest rates, loan fees, and repayment terms can vary immensely. In most cases, they also require a parent cosigner.

### STUDENT PLANS

Anticipated Major / Career	Education
Average Starting Salary = Max Loan	\$38,548

### Average Starting Salary By Discipline\*

Computer Science	\$71,411
Engineering	\$66,638
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GRADE/YEAR	DEPENDENT STUDENT	INDEPENDENT STUDENT
Freshman	\$5,500 (No more than \$3,500 of this may be in subsidized loans.)	\$9,500 (No more than \$3,500 of this may be in subsidized loans.)
Sophomore	\$6,500 (max. \$4,500 subsidized)	\$10,500 (max. \$4,500 subsidized)
Junior & Beyond	\$7,500 (max. \$5,500 subsidized)	\$12,500 (max. \$5,500 subsidized)
Graduate/Professional Students	Not applicable	\$20,500 unsubsidized only
Cumulative Limit	\$31,000 (max. \$23,000 subsidized)	\$57,500 (max. \$23,000 subsidized)

A mistake families often make is **using their own personal savings and 529 money first** in the first two years of college without taking advantage of the federal loans available. Then when the second two years come along, they don't have enough money saved, and they end up taking out private loans to cover the difference since federal loan amounts are capped at certain amounts each year. Avoid this mistake by creating a four-year funding plan for each student.





## Step 3: Shop for Schools Within the Budget

The next step is to research the net cost at different institutions and understand the role financial aid will play, whether it be needs-based or merit-based. Every college and university is required to have a net price calculator on their website. Visit the appropriate sites, plug in some numbers, and determine estimated costs. Once you have estimates from your choice schools, also look closely at which colleges award which kind of money—needs-based or merit. What is the college's financial aid policy? A great resource to research this is [collegedata.com](http://collegedata.com).

Are you a needs-based candidate? Need is determined using this formula (we'll discuss EFC a little later):

**Cost of Attendance (COA) - Expected Family Contribution (EFC) = Demonstrated Financial Need**

A key point to keep in mind...**not all schools can meet a demonstrated financial need**. Some can only meet a portion of a family's need. If a family is a needs-based aid candidate, they should seek out schools that meet at or near 100% of demonstrated financial need.

**Do you have a merit aid student?** Colleges award free money in the form of scholarships based on merit to talented students. Some merit scholarships are automatic and some are competitive. When schools determine who is eligible for academic merit aid, they often look at the top 25% of their incoming class as the eligible students.

## Sticker Shock?

Here is some good news: the "sticker price" of college is irrelevant. You should never rule a school out based on the top line price. Like shopping for a car, you should never pay full price if you are an informed consumer and know how to shop.

The **average discount rate** for first-time, full-time freshmen at private, non-profit colleges was 48.6 percent for the 2015–2016 school year—a figure 10 percentage points higher than a decade ago, according to a recent study by the National Association of College and University Business Officers.

For example, if a private university is priced at \$50,000 per year, and we know that they are discounting the cost 48.6 percent, the out-of-pocket cost would be \$25,700 per year after financial aid. **The key is knowing how the financial aid policies work at each of the universities being considered.**

We meet with families every day and go through this exercise to reduce the stress and anxiety surrounding college funding. This simple exercise is just the beginning of a comprehensive college funding plan. From there, we work with you to evaluate and maximize financial aid opportunities and empower you with our process so you know exactly how you will pay for all four years of college down to the penny.



## COLLEGE PRE-APPROVAL™ 1 Page College funding Plan (Worksheet)

### PARENT RESOURCES

529 Savings	\$
Other Assets	\$
Monthly Cash Flow ( \$_____ x 48 months)	\$
Annual American Opportunity Tax Credit (\$10,000 Max over 4 years)	\$
<b>TOTAL PARENT RESOURCES (A)</b>	\$

### PARENT LOANS

**PARENT PLUS / PRIVATE LOANS (B)** \$

### STUDENT RESOURCES

Student Savings (UTMA, Savings, etc.)	\$
Monthly Workstudy / PT Job ( \$_____ x 48 months)	\$
<b>TOTAL STUDENT RESOURCES (C)</b>	\$

### STUDENT LOANS

Student Stafford Loans (\$27,000 Max over 4 years)	\$
Private Student Loans	
<b>TOTAL STUDENT LOANS (D)</b>	\$

### OTHER HELP

**GRANDPARENT / FAMILY HELP (E)** \$

### TOTALS

<b>(A) PARENT RESOURCES</b>	\$
<b>(B) PARENT LOANS</b>	\$
<b>(C) STUDENT RESOURCES</b>	\$
<b>(D) STUDENT LOANS</b>	\$
<b>(E) OTHER HELP</b>	\$
<b>Your 4 Year Pre-Approval Amount</b>	\$

### STUDENT PLANS

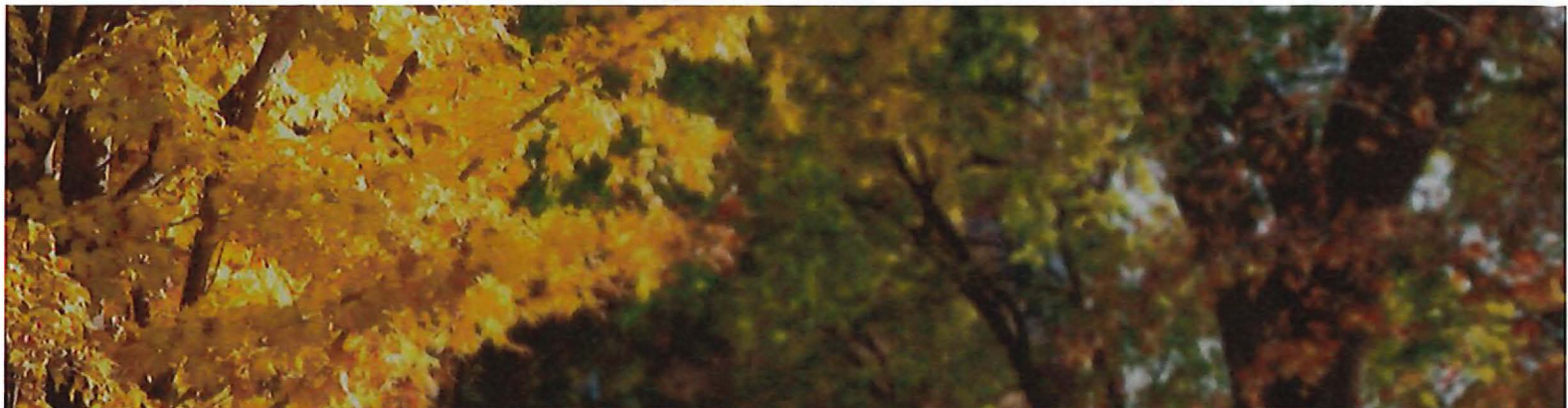
Anticipated Major / Career	
Average Starting Salary = Max Loan	\$

### Average Starting Salary By Discipline\*

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Garry P. Kohn, CFP® is President and Founder of Kohn Wealth Management Advisors, LLC. As an independent CERTIFIED FINANCIAL PLANNER® PROFESSIONAL, Garry provides guidance in the college planning process, school affordability, demystify the financial aid process and how college planning integrates with retirement planning. Garry empowers families to make informed college choices to save on the cost, not just for the cost of college.

College Pre-Approval™ is a proprietary financial planning methodology developed to help families and students reach better financial outcomes from higher education and is owned by Capstone College Partners, LTD.

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