



## **Financial Aid 101**

Many parents pay for college with a combination of current income, savings, and financial aid. By learning the basics of financial aid, you'll be able to understand how the aid process works and compare the aid awards your child receives.

### **What is financial aid?**

Financial aid is money distributed primarily by the federal government and colleges in the form of student loans, grants, scholarships, and work-study jobs. Loans and work-study must be repaid (through monetary or work obligations), while grants and scholarships do not. A student can receive both federal and college aid.

Financial aid can be further broken down into two types: need-based, which is based on your child's financial need, and merit-based, which is based on your child's academic, athletic, or artistic merit.

### **How is financial need determined?**

Financial need is generally determined by looking at a family's income, assets, and household information. The government's aid application, the FAFSA, uses a formula known as the federal methodology.

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A detailed analysis of the formula is beyond the scope of this article, but generally here's how it works: (1) parent income is counted up to 47% (income equals adjusted gross income or AGI plus untaxed income/benefits minus certain deductions); (2) student income is counted at 50% over a certain amount (\$6,570 for the 2018/19 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%.

The result is a figure known as your expected family contribution, or EFC. This is the amount of money you must contribute to college costs to be eligible for aid. Your EFC remains constant, no matter which college your child applies to.

Your EFC is not the same as your child's financial need. To calculate financial need, subtract your EFC from the cost at a given college. Because tuition, fees, and room-and-board expenses are different at each college, your child's financial need will vary depending on the cost of a particular college.

*You fill out the FAFSA and your EFC is calculated at \$35,000. College A costs \$60,000 per year and College B costs \$50,000 per year. Your child's financial need at College A is \$25,000 and \$15,000 at College B.*

Colleges use their own formula for determining financial need. Basically, the process works the same way except that the institutional methodology in the standard college PROFILE application typically takes a more in-depth look at your income and assets. For example, some colleges may consider your home equity in assessing your ability to pay college costs.

*Just because your child has financial need doesn't necessarily mean that colleges will meet 100% of that need. In fact, it's not uncommon for colleges to meet only a portion of it. If this happens to you, you'll have to make up the gap, in addition to paying your EFC.*

## **How do I apply and when?**

The best way to file the FAFSA is online at [fafsa.ed.gov](https://fafsa.ed.gov). To do so, you and your child will each need to obtain an FSA ID, which you can also do online.

The FAFSA relies on income tax information from two years prior (for example, the 2018/19 FAFSA relies on your 2016 tax return) and current asset information. The FAFSA has the ability to directly import your tax information using the IRS Retrieval Tool, which is built into the form, though you will also need to answer additional questions. The FAFSA can be filed as early as October 1st in the year prior to the year your child will be attending school.

Private colleges typically require both the FAFSA and the standard PROFILE form or their own aid form, which you'll need to submit by each individual college deadline. The PROFILE form is generally submitted in late fall or winter, but is often required earlier if your child is applying early decision or early action.

After your FAFSA is processed, you will receive a Student Aid Report that highlights your EFC. Colleges that you list on the FAFSA will also get a copy of the report. Then the financial aid administrator at each school that accepts your child will try to craft an aid package to meet your child's financial need. Colleges aren't obligated to meet all of it.

## **Comparing aid awards**

Sometime 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. To compare offers, first determine your out-of-pocket cost, or net price, for each school by subtracting any grant or scholarship aid (which doesn't need to be repaid) from the total cost of attendance. Next, look at the loan component of each award to see how much, if any, you or your child will need to borrow. Then compare the net price and loan amounts across all colleges.

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 for 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 unforeseen event.

## **Common federal aid programs**

Here are some names you'll be hearing as you navigate the world of financial aid:

**Direct Stafford Loan** – The most common student loan for college and graduate students. For undergraduate students, the interest rate is currently fixed at 5.045% for loans disbursed July 1, 2018 through June 30, 2019, and 6.595% for graduate students.

**Perkins Loan** – A student loan for college and graduate students with the greatest financial need. The interest rate is currently fixed at 5%.

**Direct PLUS Loan** – An education loan for parents of college students and independent graduate students. A separate application is required, though filing the FAFSA first is a prerequisite. Parents can borrow the full cost of their child's education, minus any financial aid received; the only criteria is a good credit history. The interest rate is currently fixed at 7.595% for loans disbursed July 1, 2018 through June 30, 2019.

**Pell Grant** – A Pell Grant is available only to undergraduates with exceptional financial need.

## **A word about merit aid**

Colleges often use favorable merit aid packages to attract certain students to their campuses, regardless of their financial need. The availability of college-sponsored merit aid tends to fluctuate from year to year and from college to college as schools decide how much of their endowments to spend, as well as the specific academic and extracurricular programs they want to target. As a family researching college options, exploring college merit aid is probably the single biggest thing you can do to optimize your bottom line.

If you want to get an estimate ahead of time of how much financial aid (need-based or merit) your child might qualify for at a particular college, visit the college's website and fill out its net price calculator, which all colleges are required to have on their websites. Net price calculators ask for parent and student income and asset information, and they take anywhere from 5 to 15 minutes to complete.

Besides colleges, a wide variety of groups offer merit scholarships to students meeting certain criteria. There are websites where your child can input his or her background, abilities, and interests and receive (free of charge) a matching list of potential scholarships.

### **How much should I rely on 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 paying 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 often make up the largest percentage of the typical aid package, not grants and scholarships. Remember, parents and students who rely mainly on loans to finance college can end up with a considerable debt burden that can have negative implications for years after graduation.