PCM Insights and Interests: Education Planning

May 2022

"Education is the Passport to the future,
for tomorrow belongs to those who prepare for it today."
– Malcolm X

Graduation season is here and reminds us of the importance of education planning for our clients and their families. The task of preparing to send your student to college may seem daunting and there are many factors that should go into the decision, but active forethought and planning are crucial to properly financing your child's education.

IT'S NEVER TOO EARLY TO START PLANNING

Parents should start actively discussing college planning with their children during their middle school years. While your student need not have their post-high school years completely planned, they should understand what types of schools are in and out of budget. Being open to options like starting at a community college or considering vocational training are conversations that can meet needs other than purely financial. Prepared parents should understand the reality of the situation and have honest conversations with the future student to set expectations.

HOW TO PAY

There are four basic ways to pay for college: save, finance, pay as they go, and financial aid. While each present unique benefits and challenges, generally a combination of the four is utilized. Below is a brief description of each payment method:

- SAVE – Saving options for college come in many different forms: 529s, Coverdell IRAs, traditional taxable savings, and investment accounts. These are assets that have been previously set aside with the explicit purpose of funding tuition and other education related costs. Some of these accounts have tax benefits if used for education.

- FINANCE – These are student loans, Parent PLUS loans, HELOCs and other debt related ways of covering the out-of-pocket cost of attendance outside of what has been saved.

- PAY AS THEY GO – This is a combination of using your income as a parent to fund college one semester at a time. Your student may also take up employment to help cover their cost of living or other related costs of attending school.

- FINANCIAL AID – Some students may receive aid directly from the college in the form of merit (academic), need based, or athletic scholarships as part of the financial aid package. It is also worth researching scholarship opportunities from community or affinity groups.

COLLEGE FUNDING CHALLENGES

Understanding how to pay for college is only part of the puzzle and there exist myriad of challenges that a family can run into when looking at funding a college education. Some of those challenges include addressing questions such as the following:

1. What do I think I can afford vs. what does the *college* think I can afford?
2. Each college operates on a different business model – How do we know what model the college uses and how does that impact our situation?
3. How do I find "generous" schools?
4. What's my real out of pocket cost going to be for four years?
5. What's my funding gap and how do I close it?

Once these challenges are addressed, a family will have a much better understanding of how funding their child's education will impact their current and long-term finances, how they should address those challenges today, and how to determine whether any additional steps should be taken to address funding shortfalls *before* they arise.

FINANCIAL AID

One significant method of addressing college funding shortfalls is through financial aid. Financial aid reduces the overall cost of attending college. According to Sallie Mae's "How America Pays for College 2021", merit-based scholarships and need-based grants pay for less than one-fourth of the cost of college. However, each college is different, and each meets the financial aid needs of students in different ways. Georgetown University, for example, in 2019 provided need-based aid to approximately 43% of first year students while providing merit-based scholarships to 0%.[1] On average though, only 56% of families receive merit-based scholarships, of this, private schools cover about 24%, and public about 12% of the cost of attendance.[2]

Free Application for Federal Student Aid (FAFSA)

FAFSA is the form that federal government, states and colleges use to estimate and determine your family's expected family contribution ("EFC"). FAFSA plays an important part in standardizing and relaying your financial situation and expected ability to contribute to your student's education cost. This EFC is then used to determine student eligibility for need-based aid, access to work-study programs and more. The FAFSA Simplification Act that passed in December 2020 and is slated to be in effect for the 2023-24 academic year, makes significant changes to the treatment of income and assets, as well as other rule changes. The updated FAFSA, which is also 66% shorter, is planned to be available in October 2022.

Understanding the inputs of the FAFSA and the EFC is extremely important. For example, if you have a 529 plan owned in your name for the benefit of your child, would you list that as your asset or your child's? Understanding this question is important – student assets count at a higher percentage of your expected family contribution than parent assets.

[1] https://www.usnews.com/best-colleges/georgetown-university-1445/paying. (last visited 5-11-2022)
[2] J.P. Morgan Asset Management, College Planning Essentials, 2022 Ed.

Assessable vs Non-Assessable Assets
It is extremely important that FAFSA forms are filled out correctly so that assets are correctly and accurately reflect your expected family contribution.

When completing the FAFSA, assets must be bucketed into one of two categories: Assessable and Non-Assessable. **Assessable assets** are those that will be included in the family's EFC calculation; versus **Non-Assessable** assets, which are those that will be excluded from the EFC calculation. The EFC amount calculated will ultimately be used by schools to determine your federal aid eligibility and financial aid award. The below chart provides examples of which category assets should be placed when determining your EFC:

Assessable	**Non-Assessable**
Cash	Traditional IRA
529 Savings Plans	Roth IRA
Coverdell ESA	401(k), 403(b), 457
Mutual Funds	Pension
Bonds	Annuity
Stocks	Cash Value of Life Insurance
Rental Real Estate Equity	Home Equity
Vacation Property Equity	Small Business (under 100 employees)

Financial Aid Deadlines for the class of 2023:

Item	**Deadline**
College begins	Fall of 2023
College admission applications	November 1, 2022
FAFSA available	October 1, 2022 (file by Nov 1, 2022)
Tax year figures used (Base Year)	2021
Asset figures used	As of filing date

CLOSING THOUGHTS

"We'll figure it out" is no longer an acceptable approach to education funding. With countless choices for schools, majors, programs, etc., an education plan is more important than ever to have in place before sending a child to college. At PCM, we are working with our clients and their college bound children and grandchildren to stay up to date with rule changes and help navigate the funding maze of college. Please reach out to your advisor with any questions you might have.

Sincerely,
The Private Capital Management Team