

## Financial planner offers sound advice to stressed-out parents of college students

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SOQUEL -- It costs about \$16,500 annually to attend San Jose State University and \$23,300 for UC Santa Cruz, but most families don't have that much cash stashed away for college. I asked Steve **Shapiro**, a certified financial planner, certified college planning specialist and founder of Tuition Solutions Now, to answer some key questions parents have about financial aid for college.

**Q:** About half the families in Santa Cruz County make more than \$75,000 a year. Are those families eligible for financial aid for college? How do you decide if it's worthwhile to fill out the FAFSA free application for federal student aid? .

**A:** Parents must understand there are two basic categories of financial aid that often get lumped together. The first is need-based financial aid and the second is merit-based. Need-based aid is given to a family based on their financial need. In theory, the more needy families receive a greater proportion of need-based aid. Merit-based aid is based on the perceived value of the student to the school; the family's financial need often does not enter into the decision. When Bill Gates' kids get to college, you can bet they'll be offered a ton of merit aid. .

Under the federal formula, a family that earns approximately \$75,000 or more generally will not qualify for much, if any, need-based aid from public colleges and universities. However, a family can earn up to approximately \$125,000 and still qualify for some need-based aid from a private university, which costs an average of \$30,000 a year. .

I can't stress enough that students from high-income families receive aid offers all the time. If schools want the student on their campus, they will offer grants or scholarships. Parents must not assume that they will not receive any financial assistance. .

That's why it is almost always worthwhile to apply. Parents who assume they will not receive any aid and don't take the time to file could lose out on money. Here's why. .

First, many schools, such as UC Santa Cruz, have federal funds to distribute. They can only distribute these funds to students if a FAFSA is filed. .

Next, to be eligible for certain federal or state loans and grants, the FAFSA must be filed. Many private schools will not award merit aid until they see a FAFSA. Bottom line: There is much to gain and little to lose by filing. .

**Q:** Describe that formula used with parent income and assets and the student's income and assets.

**A:** There are two formulas - the federal formula used by the U.S. Department of Education via the FAFSA process and an institutional formula determined by the College Board application via the CSS Profile. The primary difference is that the home equity is not counted as an asset available for college on the FAFSA, while it is counted on the CSS Profile required by many private colleges. The CSS Profile is more detailed than the FAFSA. Here's the asset formula: .

Parent assets are assessed at 5.6 percent. .

Student assets are assessed at 35 percent. .

This affects the amount of financial aid the family will qualify for. If a family qualifies for aid, having money in the child's name custodial account can cost you dearly. .

Example: \$50,000 in an account in the name of the parents. The asset protection allowance ignores the first \$40,000 if parents are about 40 years old. The remaining \$10,000 is assessed at 5.6 percent. Potential financial aid reduction: \$560. If that same \$50,000 were in a custodial account, it is assessed at 35 percent and there is no asset protection allowance. Potential financial aid reduction: \$17,500. So, having this money in the kid's name could cost this family \$17,000 in financial aid. .

A caveat: This is only a problem for families who qualify for need-based financial aid. For high-income families, there is nothing wrong with using a custodial account - it is the proper planning alternative. .

Here's the formula on income: Parent income is assessed on a sliding scale up to 47 percent. Student income is assessed at 50 percent over the first \$2,500.

Q: Short of quitting their jobs, what can parents do to improve the likelihood of receiving financial aid? .

A: Saving money on college costs is not just about financial aid. Parents should use all means available to reduce the impact of college costs. Other strategies can help. Tax strategies, cash flow strategies, scholarship strategies, college admission strategies and appeal/negotiation strategies can all make a significant difference. With tax and cash flow strategies, parents are in the driver's seat; with financial aid, the college is in the driver's seat. .

Small business owners and property owners have more options than people working for W-2 wages. .

Parents can encourage their children to apply to expensive private schools. They are the schools with the money. Money does not always go to the most needy. More often, it goes to the students that colleges most want. If possible, students should apply to schools that compete with one another for the same students. .

Students should try to maximize their merit appeal to colleges and enhance their college resume via grades, test scores, essay, recommendations and extra curricular/community activities. Creativity and initiative are prized attributes. .

If parents believe they will qualify for need-based financial aid, they should try to reduce their income during the "base year" and reduce their assets in "assessable accounts." .

Q: Is a teen who works during high school penalized when it comes to financial aid? .

A: Only the calendar year before graduation is considered. This is the "base year" I just mentioned. For every dollar earned over \$2,500, financial aid is reduced by 50 cents of every dollar. Example: Student will graduate in 2007. Base year is 2006. If income is \$4,000, student earned \$1,500 over the limit and \$750 in financial aid could be lost \$1,500 x 50 percent. .

Q: A lot of people save something for their child's college education, but don't have enough to pay the bills, because the cost has risen so much. What's your advice on saving for college? .

A: Start early, save regularly and be creative. One client purchased rental property several years ago, uses cash flow to build savings and plans to either sell or use equity when college time comes. .

Families who think they will qualify for need-based financial aid should avoid custodial accounts. Beware the impact of the kiddie tax rules and choose appropriate investments to minimize the tax impact. Custodial accounts are right for high-income families who likely will not qualify for need-based financial aid. .

Q: What are the pros and cons of a 529 College Savings Plan? How about U.S. Savings Bonds? .

A: The plus side of a 529: Tax-sheltered growth, taxfree withdrawal if used for college this provision will end in 2011, diversity of investment, can be transferred to another family member, and large deposit potential. .

The down side: Expenses tend to be higher than non-529 mutual fund program; it's limited to mutual fund investments; must be used for higher education for taxfree benefits; penalties apply if not all the money is used for college. .

529 plans are a good strategy for families likely to qualify for financial aid because the 529 is considered a parent asset and assessed at only 5.6 percent. For families unlikely to qualify for need-based aid, custodial accounts are much more flexible than a 529 plan in terms of withdrawal provisions and range of investments. Money deposited to a 529 plan is removed from the donor's estate, so this is useful for grandparents trying to reduce their taxable assets. .

Savings bonds are excellent options for conservative investors who are not comfortable with the stock market. Series I bonds pay 6.73 percent, with no taxes paid while owned, and taxfree if used for qualifying education expenses. .

Q: What's the biggest mistake people make when filling out the FAFSA form? How can you avoid that mistake? Give an example to explain it. .

A: The biggest mistake is waiting for the tax returns to be completed before filing the FAFSA. It is perfectly acceptable to file the FAFSA with preliminary numbers and file final numbers after the tax return is completed. Since many schools dole out aid on a first-come, first served basis, it is important to get those numbers in as soon as possible. .

Another mistake is overstating income and assets. Examples: Parents including retirement account and annuity balances as assets when they are specifically excluded on the FAFSA; divorced parent including ex-spouse's income unnecessarily. Parents should read up or get some help to understand the rules. .

Many parents overstate the value of their real estate holdings. The rules allow you to report a value that would apply if you had to sell in a hurry - a fire sale situation. Expenses of the sale, such as commissions and taxes, can be considered. They can have a significant effect on net proceeds. .

Q: Explain some of the other common mistakes and how to prevent them. .

A: Clerical errors are common. Also, using a nickname rather than legal name, confusing student and parent information, and reporting taxes withheld as shown on a W-2 Form rather than the tax liability on page 2 of the 1040 federal tax return. Reading the instructions makes the biggest difference. .

Errors are common in divorce situations. Parents must be careful not to over-report income and assets. With ex-spouses and sometimes new spouses, it can get quite confusing. .

Q: What's the difference between financial aid and a scholarship? .

A: In the case of private institutions, not much. Financial aid officers can bend the rules if they want to attract the students they want. .

Financial aid consists of gift aid grants and scholarships and self-help loans and work study. So scholarships are a type of financial aid. Scholarships are normally awarded in recognition of some form of merit - academic, athletic, musical, artistic, etc. .

Q: I've read about students who worked hard to win \$5,000 in scholarships to reduce the loan burden for themselves and their parents, and then the college took away \$5,000 in grants so the loan needed remained the same. Isn't this a disincentive to apply for scholarships? .

A: This practice is a disincentive but is becoming less common. If this happens, I suggest parents respectfully request the loans be reduced and the gift aid be untouched. This is considered an appeal - it never hurts to ask. You won't be any worse off and it can only help. You'd be surprised what can happen if you ask. .

Q: Give me an example or two of how you helped parents make college more affordable. .

A:

1. Corrected errors on FAFSA: increased financial aid by \$16,000. .
2. Tax and cash flow planning, saving \$3,000 to 5,000 per year, which can be used for college. .
3. Helped parents appeal when appropriate for a better offer. In one case, the college offer increased by \$4,000. .
4. Asset planning: the expected family contribution toward college costs was reduced by \$30,000 for one year. This family qualified for need-based aid but was offered no grants or scholarships. It was disappointing but illustrates that even if you arrange your finances to qualify for need-based aid, there is no guarantee you will be offered anything but loans. .

Q: You have two children in college. If you had to do it over again, what would you do differently? .

A: I would have started earlier and saved more. I would have purchased my first investment property 10 years ago rather than just 2 years ago. .

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What parents can do.

When your children are in elementary school: .

Save early and often. Do not save in child's name if you think you will qualify for need-based financial aid. Beware of the kiddie tax and use investments with a low-tax impact. .

When your children are in middle school: .

More of the same and begin to identify ways your child can get involved in the community. .

When your children are in high school: .

Stress to kids they must do their part. Stress the importance of grades, test scores, recommendations and extra-curricular activities. Colleges like students who are passionate about something. They are not looking for well-rounded students; they are looking for a well-rounded student body. .

The bottom line: .

Consider income and assets and plan for college and retirement together. College has become so expensive that parents who fail to coordinate their college and retirement needs could find themselves short on retirement funding because they spent too much of their nest egg putting their kids through college. .

**Steve Shapiro.**

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[www.tutionsolutionsnow.com](http://www.tutionsolutionsnow.com). .

Education: B.A., business administration and accounting, Cal State Northridge. .

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Family: Married 27 years, two kids, one at UC Santa Cruz, the other at San Francisco State. .

Hobbies: Hiking, golf, trying to read more books. .

What he reads: 'Running with the Bulls,' 'The Price of Loyalty: George W. Bush, The White House and the Education of Paul O'Neill,' 'The Kill Artist,' The Wall Street Journal every day.

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