



Paying for College

A Practical Guide for Families

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Preface

If you are reading this report, it's a safe bet that you have a son or daughter who will soon be going to college. As a result, you will likely find yourself awash in a sea of new terminology—the FAFSA form, Estimated Family Contribution, the CSS PROFILE, to name just a few—along with a dizzying array of financial aid vehicles, including grants, scholarships, work-study programs, and an assortment of federal and private loan programs. Each comes with its own unique terms and its own rules for eligibility. This report is designed to be a short, succinct guide to help parents make informed decisions about when, where, and how to assemble a financial aid package that makes sense for their family. It is aimed not at the family trying to figure out how to save for college—although some of its information will be helpful on that front—but rather at the family knocking on college's door and trying to figure out how to actually pay the bill. It seeks to help that family minimize the out-of-pocket expense of putting a student through college and reduce its reliance on student loans, which can have a damaging effect on its long-term financial well-being.

If the bad news about financing a college education is that it can be complex and time-consuming, the good news is that there are so many aid programs available that anyone willing to put in the time can almost certainly find what they need—without breaking their budget, and without jeopardizing their financial future.

A College Education: Boon and Burden

For many Americans, college has become a stepping stone to financial success. The U.S. Census Bureau estimates that students who graduate with a four-year college degree earn, on average, nearly twice as much over their lifetimes as those with only a high school diploma—\$2.1 million versus \$1.2 million.¹ But there's a flip side to this sunny scenario. Not every student who earns a college sheepskin moves on to a high-paying job, and even among those that do, income may be modest in the years immediately following graduation. Yet, many students leave school with onerous levels of student loan debt they must begin to repay almost right away—debt that can not only tax their ability to make ends meet as they embark on their careers, but also jeopardize their financial security far into the future. Where parents assume responsibility for a student's college loan debt, it can jeopardize their financial future as well.

These developments are not entirely surprising. College tuition costs have been outpacing the rate of inflation for decades,² turning a college degree into one of the biggest financial investments many families will ever make. Many types of aid are available to help defray the costs, but the process of sorting through the options and qualifying for them can be complex and confusing. The sheer variety of aid programs—grants, scholarships, government loans, work-study programs, tax

credits, tax deductions—is one complicating factor. So is the matrix of variables that can impact a student's access to aid, including a family's structure, which school the student chooses to attend, how much and where the family has saved for college, and how adept the family is at working through the procedures for applying for financial aid.

Student loans, which have to be repaid, are more widely available than grants and scholarships, which do not, and hence are a convenient funding solution for many families. However, students and parents who borrow indiscriminately can jeopardize their financial security, as repaying those loans will leave less money to start or sustain a household.

This report can help families avoid these problems. It can serve as a guide for families that want to find an effective way to finance a college education for a child based on that family's own unique circumstances. It provides basic, foundational information about qualifying for undergraduate financial aid, taking out private education loans, and taking advantage of potential tax benefits. It also offers targeted advice for single and divorced parents.

The Heavy Weight of Excessive Student Loan Debt

Student loan debt has skyrocketed over the past few decades as greater numbers of students have borrowed ever greater sums to finance a college education. Seventy percent of college graduates now leave school with debt, owing an average \$35,000 each.³ That stands in sharp contrast to the experience of baby boomers, who left school owing an average of just \$8,166 each in today's dollars.⁴ While this paper is focused on financing an undergraduate degree, it bears noting that students who go on to earn advanced degrees are even more burdened with debt. According to *U.S. News & World Report*, students who graduated in 2012 from the 10 medical schools where graduates accumulated the most debt left with an average student loan bill in excess of \$200,000. Moreover, that represented only their medical school loans.⁵

In total, outstanding student loan debt in the United States now exceeds \$1.2 trillion.⁶ This amount has tripled over the last ten years.⁷ The consequences are becoming hard to ignore. By some measures, approximately one quarter of those who owe federal student loans are estimated to be in delinquency or default.⁸ There have been ripple effects on society at large, too. It has been estimated, for example, that 414,000 home sales did not happen in 2014 due to student loan debt—lost activity that could have added \$83 billion to the U.S. economy.⁹

The soaring cost of a college education accounts for some of this, of course; it has been outpacing inflation for decades and has become an increasingly daunting challenge for students and their families. But research also indicates that many college students lack knowledge about student loans in general and about their own loans in particular.¹⁰ They also tend to overestimate how much of their income they will be able to devote to loan repayment after graduation,¹¹ leading to false expectations about their ability to manage and pay down student debt once they start working.

A multigenerational problem

Young people aren't the only ones struggling. Increasingly, student loan debt has become a burden for parents and grandparents, too. One third of outstanding student loan debt is held by individuals 40 and older.¹² Two million Americans age 60 and older carry unpaid student loans taken out for themselves or their children.¹³ Among those in the 65 to 74 age bracket, 27 percent of those loans are in default. For those 75 and older, the default rate exceeds 50 percent.¹⁴ More than 80 percent of seniors who are in default incurred their debt for their own educations.¹⁵

While debt of any kind can be problematic, student loan debt can be particularly harmful for anyone struggling with their finances because it generally cannot be dismissed in bankruptcy.¹⁶ In addition, the Department of Treasury can

garnish a portion of a retiree's Social Security benefits to pay down the retiree's federal student loan debt.

Although student loan debt can have obvious negative consequences on a borrower's short-term finances—consuming capital that otherwise might be spent on housing or raising a family—it can have a dramatic impact on long-term financial security, too, by making it harder to save for retirement. This is a bigger issue for current borrowers than it was for past generations of Americans. Why? Because many employers have stopped offering employer-funded pension plans in favor of 401(k)-style plans funded primarily by employees. As a result, workers today are more likely to be responsible for their own retirement income than were their parents or grandparents. Many employers also have stopped offering retiree healthcare programs, forcing current generations to pay for their own medical expenses in retirement, too. Finally, current generations are living longer, extending the length of time they need to shoulder these extra financial burdens.¹⁷

Against this daunting backdrop, it has become more important than ever for people to begin saving for retirement as soon as possible. Yet in a recent survey of young workers, 41 percent of those who were carrying student loan debt said they have postponed contributing to their retirement plans.¹⁸ Foregoing those savings, and, in many cases, the “free money” represented by matching employer contributions, is eroding their future financial security.

We can appreciate the scope of the problem by considering a hypothetical recent college graduate who earns \$50,000 per year but, for the first five years of her career, foregoes contributions to her 401(k) plan at a rate of, say, 4 percent of salary. During this period she also misses out on a dollar-for-dollar employer match on those contributions. If we assume she would have earned an average annual return of 6 percent on her investment, she will have lost \$245,000 of potential retirement wealth by the time she reaches the normal Social Security retirement age of 67.¹⁹

Like recent college graduates, parents can take a big financial hit, too, if their ability to save for retirement is diminished by the need to pay down a child's student loans. A 50-year-old who earns \$100,000 annually and foregoes contributing 4 percent of salary to her retirement plan for five years while paying for college—and also foregoes a dollar-for-dollar employer match, all with the same hypothetical 6 percent annual return—would lose \$85,000 in retirement savings by age 67.²⁰

Parents need to be cautious about over-borrowing for their children's college costs: unmanageable student loan debt can dramatically affect their own retirement security.

Knowledge Is Power: Understanding the Financial Aid Process

While many families appreciate that too much student loan debt can be a problem, they often lack the resources to save in advance what they will need to put a child through college or to fund that education on a pay-as-you-go basis. This makes seeking financial aid a necessity. They can minimize their use of student loans, though, and their out-of-pocket expenses, by learning how the aid process works and by taking maximum advantage of aid that does not need to be repaid. They also

can help themselves by learning to calculate the difference between the net price of a school their child is considering—the actual price after financial aid—and the gross or “sticker” price. They can then set realistic expectations for themselves and their student about which schools are affordable for them, and make an informed decision about which school to attend and how to pay for it.

Key terms

We’ll explore the various forms of financial aid, and how to qualify for them, in more detail beginning on page 9. But first, let’s define a few key terms families will encounter as they craft their college financing strategy.

Cost of Attendance (COA). Based on federal guidelines, cost of attendance is the estimated total cost to attend a college, including tuition, fees, room and board, books, and transportation for one academic year.

Free Application for Federal Student Aid (FAFSA). College-bound students and their families who wish to be considered for financial aid must file this form annually with the U.S. Department of Education’s Office of Federal Student Aid. It is used to determine a student’s eligibility for federal aid such as grants, work-study, and loans. In addition, many states and colleges use the FAFSA to determine eligibility for state and college-sponsored financial aid.

Grants. Grants are financial awards made by the federal government, colleges, and other private institutions to help students cover education expenses. They are more valuable than loans because they do not need to be paid back. Grants often are awarded based on financial need. Of the \$239 billion in financial aid issued during the 2014–2015 school year, federal grants accounted for \$46 billion. Colleges, states, employers, and other private organizations issued another \$69 billion in grants.²¹

Scholarships. Similar to grants, scholarships do not need to be paid back. Many are awarded based on a student’s academic merit or a specific skill they have exhibited, including proficiency in a sport they intend to pursue in college. However, some scholarships, like most grants, are based on financial need. Scholarships can be awarded by colleges or other private institutions.

Loans. Loans are made by the federal government and private financial institutions and must be paid back.

Work-study. Work-study programs provide part-time employment, with pay, to qualifying students. The programs are sponsored by the federal government as well as some states and institutions. To be eligible, students and their families must complete the FAFSA form. Both loans and work-study programs are referred to as “self-help aid” since the money awarded needs to be repaid or earned via work. By contrast, scholarships and grants, which do not need to be repaid, are sometimes referred to as “gift aid.”

Need-based aid. This is any type of aid that is based on a family’s finances; the lower the family’s income and the smaller its assets, the more likely a student will qualify. Need-based aid is typically formula-driven and often takes the form of a grant, low-interest loan, or work-study program. It can be awarded by the government, colleges or private foundations.²²

Merit-based aid. Merit-based aid can be based on academic, athletic, or artistic talent, or on other skills, interests, or abilities. It may take the form of scholarships or grants. Wealthier families often find that their children do not qualify for need-based financial aid, but may qualify for merit aid—if the school they are targeting offers it.

Estimated Family Contribution (EFC). The Estimated Family Contribution is a defined measure of a family’s financial strength, primarily based on income and assets. It is used to determine a student’s eligibility for need-based aid. The federal government’s method of calculating EFC is the most widely used approach, but some colleges that use the Institutional Methodology (see page 7) employ a different formula.

Net price. This is the estimated cost of attending a college for a single year after need- and merit-based scholarships and grants are considered. It is not adjusted to reflect loans, since those must be repaid.²³

Award letters. Award letters, issued by colleges, outline the financial aid for which a student qualifies. Colleges send award letters to students and their families after accepting students for admittance. The letters typically include federal loan amounts that have to be repaid, as well as grants, scholarships, and work-study offers.

Qualifying for Need-Based Aid: The Federal Methodology and FAFSA

As noted earlier, need-based financial aid is awarded based on a family's income and assets. It takes the form of grants, loans, and work-study programs. Colleges typically employ one of two methodologies for calculating whether a student qualifies for need-based aid: the Federal Methodology or the Institutional Methodology. This section of the paper highlights the workings of the Federal Methodology, which is used by the federal government, all public colleges, and many private colleges. The next section is devoted to the Institutional Methodology, which is used by some private schools to determine eligibility for non-governmental financial aid.

The FAFSA

Qualifying for financial aid under the Federal Methodology always begins with completing and filing the FAFSA—the Free Application for Federal Student Aid. The form requires financial information from both the student and at least one custodial parent, and must be filed for each year the student will be attending college. While awaiting the results of their FAFSA filing, students can get an early estimate of how much federal aid they may qualify for by completing another online form, the *FAFSA4Caster*, at the website of the U.S. Department of Education's Office of Federal Student Aid.²⁷

Families should file the FAFSA as soon as possible after October 1 of the year prior to the academic year in which the student will enroll in college, since some colleges award aid on a first-come, first-served basis—and because missing the final deadline, which is typically June 30 of the award year, means foregoing access to any form of federal aid that year.²⁸ For high school seniors, this means the FAFSA should be filed, ideally, in October or November of their senior year in high school. The October 1st date is earlier than in years past. Families can now use the IRS Data Retrieval Tool to transfer prior year income and tax information directly from the IRS to their FAFSA.

The FAFSA can be completed either online or by mail. To complete the form online, both the student and at least one custodial parent must first obtain a FAFSA ID at the Department of Education website. These IDs serve as electronic signatures for the FAFSA. If the student's parents are divorced or separated, the government considers the custodial parent to be the one with whom the child lived the most during the prior 12 months, and only that parent is required to complete the FAFSA.

When completing the FAFSA, the student will indicate which college or colleges he or she is considering attending. Those schools will be notified of the student's interest, and receive information from the student's FAFSA, via an Institutional Student Information Record sent out by the Office of Federal

How Families Pay for College Today

The typical family today relies on a web of resources to pay for college. Fifteen percent of the cost is funded by student borrowing, 7 percent by parent borrowing, 12 percent from student income and savings, 30 percent from parent income and savings, 31 percent by grants and scholarships, and 4 percent from contributions from other relatives.²⁴

How Families Pay for College

Chart View

Table View

	Borrowing	Income and Savings
Student	15%	12%
Parent	7%	30%
Grants and scholarships		31%
Other		4%

In 31 percent of families, the student provides all funds not covered by financial aid.²⁵ In another 31 percent of families, parents pay enough of the costs such that the student pays nothing, either out-of-pocket or borrowed.²⁶

Chart View

Table View

	Family Contributions
Student	31%
Parent	31%
Shared	38%

Student Aid. That office will send the student a separate report—the Student Aid Report—that includes the student’s Estimated Family Contribution to financial aid. Contrary to what the name implies, the EFC is not the amount of money the student or the student’s family will have to pay for college. Rather, it is a measure of the family’s financial strength, primarily based on its income and assets, expressed as a dollar amount for a single year of attending college. This figure is calculated according to a formula established by law, and it is used by schools to determine a student’s eligibility for federal aid. (See “Understanding the Net Price of College” on page 8.)

The Student Aid Report is generated within three to five days if the FAFSA was filed electronically, and within seven to 10 days if it was submitted on paper. If a student lists a valid email address when completing the FAFSA, he or she will receive instructions via email on how to access an online copy of the report.²⁹

The FAFSA filing process is repeated each year to qualify for aid for the following school year. Students who applied for aid in one year may be eligible to reapply the next using a renewal FAFSA available online.³⁰

For students and families who need help completing the FAFSA or understanding how federal education aid works, the U.S. Department of Education’s Federal Student Aid Information Center sponsors a toll-free hotline at 1-800-4-FED-AID (1-800-433-3243).

Key considerations when completing the FAFSA

Many parents will find it beneficial to understand how the Federal Methodology formula works before a student files the FAFSA, as this may help them take advantage of strategies that increase the likelihood of qualifying for federal aid. Such strategies can include postponing or shifting discretionary income, choosing the most appropriate college savings vehicle, or rethinking which parent will serve as the custodial parent if the parents are divorced. Here are the key considerations:

Income: Since the FAFSA is filed as early as October 1st, the prior calendar year is used as the base year for income purposes when calculating a student’s eligibility for aid. For example, a high school student applying for college for the 2017-2018 year would typically complete the FAFSA in October or November of 2016, when he or she is a senior in high school. This means the base year for FAFSA and income purposes would be 2015. In this example, parents and students who have discretion over when they take income—in the form of bonuses, for example, or by selling profitable investments—may have wanted to avoid taking that income in 2015, as it could decrease the chance of being awarded need-based aid.

Under the Federal Methodology, students’ and parents’ actual income is adjusted for various allowances to arrive at their “available income”—the amount that is considered in determining aid eligibility under the EFC formula. For students, 50 percent of income above a certain threshold—the “income protection allowance”—counts toward available income. That income protection allowance increases each year; for the 2017-2018 school year, it is \$6,420.³¹ Here’s an example. A student who had income of, say, \$9,000 in 2015 would subtract \$6,420 from that sum and then multiply the result by 50 percent to determine their available income. In this case, it would be \$1,290. (Actual income of \$9,000 less the \$6,420 income protection allowance is \$2,580, and 50 percent of \$2,580 is \$1,290.)

For parents, the income protection allowance varies based on the number of family members in the household and the number of those people who are currently college students. In the 2017-2018 school year, for example, a parent with one college student and five members in the household would have an income protection allowance of \$32,490.³² Parents also may be entitled to an employment expense allowance that reduces their available income. For one-parent families as well as two-parent families with two income earners, the employment expense allowance is the lesser of \$4,000 or 35 percent of income.³³ In addition, allowances are permitted for Social Security taxes, federal income taxes, and state and other taxes.³⁴

For parental income, the rate that available income counts in the aid formula is not fixed at 50 percent, but varies according to a sliding scale. Figure 1 illustrates a hypothetical family’s available income calculation.³⁵

Figure 1
An example: Calculating parents’
“available income” for federal aid purposes

Parents’ adjusted gross income	\$60,000
U.S. income tax	–\$5,000
State and other taxes	–\$4,950
Social Security tax	–\$4,590
Income Protection Allowance	–\$32,490
Employment expense allowance	–\$4,000
Total allowances	–\$51,030
Available Income (Income – Allowances)	\$8,970
Rate at which Parents’ Income Counts in EFC	X 0.22
Parents’ Contribution from Income in EFC	\$1,973

Note: Example ignores parents’ assets. Also, where parental income is less than \$25,000, and the parents are not required to file a tax return or can file using either form 1040A or 1040EZ, the EFC is \$0.³⁶

Assets: The EFC calculation counts 20 percent of student assets and anywhere between 2.64 percent and 5.64 percent of parent assets depending on the type of asset and available income.³⁷ In addition, a portion of the parents’ assets, typically between \$17,000 and \$30,000 for two-parent families, is sheltered from the calculation based on the age of the older parent. This amount is referred to as the “asset protection allowance.” Finally, if parental assets are less than \$50,000 and all family members are eligible to file their annual tax returns using either IRS Form 1040A or 1040EZ—or do not need to file a federal tax return at all—the formula disregards assets completely.

Because parent assets are counted less than student assets, some families may wish to hold savings earmarked for college in a parent’s name rather than a child’s name. Or, they may wish to shelter those assets in a qualified college savings vehicle, such as a 529 plan, which will have a minimal impact on the EFC and financial aid awards.

Parents will want to note that equity in the family home does not count against federal aid eligibility, nor do assets in qualified retirement savings plans such as 401(k)s or Individual Retirement Accounts. However, cash in a savings account typically does count. Accordingly, parents who are considering taking out a home equity loan and parking the proceeds in a bank account to pay for college at a later date may want to consider a home equity line of credit instead. With a line of credit, the necessary cash is borrowed only when and as needed, and only then counts toward the family’s assets.

Here are several key points relating to assets held in college savings vehicles:

529 Plans

- Up to 5.64 percent of assets held in parent-owned 529 plans count toward the financial aid formula, but withdrawals from those plans do not count as income to either the parent or student when filing the FAFSA.
- Student-owned 529 plans are considered an asset of the parent and are treated as such for aid calculations.
- Assets in grandparent-owned 529 plans are not counted in the aid calculation, but distributions from those plans count as untaxed income for the student. As such, they could reduce aid by 50 percent of the amount withdrawn. To minimize the impact, grandparents can transfer ownership of a 529 plan to a parent, if the plan allows it, or withdraw assets for college expenses after the final FAFSA has been filed in the student’s junior year of college.

Coverdell Education Savings Accounts

- Like 529 plans, Coverdell Education Savings Accounts are treated as an asset of the parent, and up to 5.64 percent of the assets in these accounts are counted in the financial aid formula.

Uniform Transfer to Minors Act (UTMA) and Uniform Gift to Minors Act (UGMA) custodial accounts (non-529 plan)

- These accounts are considered completed gifts to the student, and therefore 20 percent of the assets in these accounts are counted in the determination of financial aid. This means they count more severely against aid than 529 plan and Coverdell accounts.³⁸
- Income from UTMA and UGMA accounts also may increase a student’s annual income.

Qualifying for Need-Based Aid: The Institutional Methodology

More than 200 private colleges use the Institutional Methodology to determine whether students are eligible for non-governmental financial aid they issue directly, including grants, loans, and scholarships.³⁹ In addition, 14 percent of public colleges report they use the Institutional Methodology together with the Federal Methodology to determine aid.⁴⁰ The Institutional Methodology gives colleges some flexibility in how they treat certain income and assets, which means that not all colleges using this methodology will award financial aid the same way.

Students who want to attend a school that uses the Institutional Methodology must complete not only the FAFSA but also the more comprehensive College Scholarship Service Profile, sometimes referred to as the CSS PROFILE or simply the PROFILE. As a result, students applying to these schools will have their federal financial aid determined by the Federal Methodology (based on the FAFSA), and their university-awarded financial aid determined by the Institutional Methodology (based on the CSS PROFILE). Unlike the FAFSA, the CSS PROFILE may require financial information from non-custodial parents in cases where the parents are divorced or separated.⁴¹ Also unlike the FAFSA, there is a fee—currently \$25—to file the CSS PROFILE, which covers a report to one school. Additional reports are \$16 each.⁴² Students may file the CSS PROFILE as early as October 1 of the year prior to the start of the college school year, but are advised to file no later than two weeks before the earliest priority filing date provided by their college or program.⁴³

Some students may find they qualify for less college-awarded financial aid under the Institutional Methodology than the Federal Methodology.

Some colleges using the Institutional Methodology also require students to complete the school's own financial aid form in addition to the CSS PROFILE and the FAFSA—and may require copies of both student and parent federal tax returns.

In some families, students may find that they qualify for less college-awarded financial aid under the Institutional Methodology, using the CSS PROFILE, than under the Federal Methodology using the FAFSA. Families can see which schools require the CSS PROFILE, as well as those that also require a Non-Custodial CSS PROFILE, by visiting the College Board website at <https://student.collegeboard.org>.

Custodial 529 plans resulting from an asset transfer from a UTMA or UGMA custodial account

- These assets count as a parent asset, similar to assets in a parent-owned 529 plan. Up to 5.64 percent of the total value of the account can be included in the aid calculation, but withdrawals do not count as income to the student.

Individual Development Accounts

- These special savings accounts are designed for low- and moderate-income families whereby each dollar saved receives a corresponding match from a government agency or private foundation.
- These assets count on a sliding scale from 2.64 percent to 5.64 percent of the account value.

Qualified retirement accounts such as IRAs and 401(k) plans

- Account values in either of these accounts do not count as assets in the federal EFC formula.
- IRA withdrawals can be made without paying a 10 percent early withdrawal tax if used for qualified educational expenses (albeit with federal and state income taxes due), but count as income when the FAFSA is filed in the following year. As a result, financial aid and/or tax credits may be lost.
- Parents should remember that withdrawals from IRAs and 401(k) plans to fund college expenses will reduce the funds available to them in retirement and may have a severe impact on their financial security after they stop working.

Qualifying for Aid at Selected Private Colleges

Many private colleges award only need-based financial aid. A student who does not qualify for this type of aid should expect to pay full cost to attend one of these schools. While their parents will likely qualify for federal and private loans, those loans typically will need to be repaid in full. However, as discussed in Appendix B, the federal government does provide limited opportunities for loan forgiveness.

Merit-Based Aid: Rewards for Academic, Athletic, Artistic, or Other Talent

Merit-based financial aid is offered by schools that wish to provide financial assistance based on a student’s academic, athletic, or other talents without regard to need. Athletic scholarships are perhaps the best-known example of the type. (For more detail on scholarships, see “Types of Financial Aid: A Deeper Dive,” beginning on page 9.)

If merit-based aid is important to students and their families, they should determine in advance which schools offer it and focus their application efforts on them. Otherwise, the student could win admittance to his or her “dream school,” only to find that the lack of merit aid makes the school unaffordable for them. Parents can find out which schools provide merit-based aid by visiting [CollegeData.com](#) and using its College Match application.⁴⁴

Some colleges will utilize “preferential packaging,” also known as differential packaging, in awarding merit aid. With preferential packaging, colleges change the type of aid, offering a higher level of gift aid (grants and/or scholarships) than they might typically offer, based on the desirability of the student. A college may have a higher level of interest in a student based on factors that include: alumni relationship, academic merit, ethnicity, gender, geographic diversity, first generation status, athletic ability, other special talents such as musical or artistic ability, or likelihood a student will enroll.⁴⁵ According to the National Association for College Admission Counseling, 15 percent of public colleges and 63 percent of private colleges utilize preferential packaging.⁴⁶

Understanding the Net Price of College

As noted earlier, the EFC, or Estimated Family Contribution, is a measure of a family’s ability to pay for college.⁴⁷ It is expressed as a dollar amount but does not represent the actual amount of money a family will pay for a student to attend college.⁴⁸ The EFC is calculated according to an established formula that looks at the family’s income, assets, and other benefits, including Social Security or unemployment, as well as the size of the family and the number of family members attending college at the time the number is calculated.⁴⁹ The Federal Methodology and the Institutional Methodology will typically yield different EFC numbers. As mentioned earlier, the Federal Methodology is always used for federally awarded financial aid. In addition, many schools use the Federal Methodology to award their own institutionally funded financial aid. Students that apply to schools that use the Institutional Methodology will have their federally awarded financial aid eligibility determined by the Federal Methodology

and their college-awarded aid eligibility determined by the Institutional Methodology. Schools express that eligibility in the form of a student’s “Demonstrated Financial Need,” which is calculated as follows:

Cost of Attendance (COA)

– Expected Family Contribution (EFC)

Demonstrated Financial Need

Often, colleges will offer financial aid packages that meet less than 100 percent of a family’s Demonstrated Financial Need. If the COA is \$50,000, for example, and the school’s policy is to try to meet 85 percent of a student’s Demonstrated Financial Need, it might put together a freshman-year aid package that looks like the one shown in Figure 2.

Figure 2
Example: Calculating the Net Price to attend college

A) Cost of Attendance (Gross Cost)	\$50,000
B) Expected Family Contribution	\$20,000
C) Demonstrated Financial Need (A – B)	\$30,000
D) Financial Aid (C X 85%)	\$25,500
E) Net Cost (A – D)	\$24,500*

*Amount paid directly by student and/or student’s family.

Keep in mind that most financial aid awards include a federal direct loan that will need to be repaid. As a result, the net price to attend a school, after repayment of the loan, may be higher than it first appears. In the example above, factoring in repayment of a student loan would make the final net price more than \$24,500. The financial aid package also may include a work-study program, which will require that the student work part-time to help cover some of the cost of the student’s education.

The term “gapping” refers to admitting students but not meeting their full financial need. While most schools gap all categories of students, private schools are most likely to gap less academically talented students.⁵⁰

Net price calculators

In the initial stages of researching schools, students and parents can see what percentage of their student's Demonstrated Financial Need different colleges have provided in the past, on average, by using the College Match tool found at the CollegeData.com website. Before a student actually files for aid and applies to schools, parents also can compare possible financial aid packages at specific schools by using each school's online Net Price Calculator, which all schools have been required to provide since 2011. While colleges are allowed to use a Net Price Calculator template provided by the U.S. Department of Education, many have created their own calculators that reflect their policies and more accurately estimate the amount of financial aid they may be able to offer, including, in some cases, merit-based aid. Estimates for merit-based aid are based in part on user input of a student's grade point average, SAT score and/or ACT score.

Because colleges typically mail out financial aid award letters around April of the student's senior year of high school, parents also can compare those award letters before making a final decision about which school the student will attend. During this analysis, families will want to be sure to distinguish between gift aid such as scholarships and grants, and self-help aid such as loans and work-study.

Types of Financial Aid: A Deeper Dive

As noted earlier, the financial aid menu is long and diverse, encompassing gift aid and self-help aid in a variety of forms, each with its own set of limitations. This section of the paper provides additional details on the most common types of aid, including grants, work-study awards, federal loans, private loans, and scholarships.

Grants

Grants are offered by the federal government, colleges, and other institutions. They do not need to be repaid. Among the most common grants offered by the government are Pell Grants and Federal Supplemental Educational Opportunity Grants. Pell Grants are earmarked for low-income families. Their maximum size increases each year; for the 2016-2017 academic year the limit is \$5,815. Students can receive Pell Grants for a maximum of 12 semesters. Federal Supplemental Educational Opportunity Grants provide additional need-based aid to supplement Pell Grants. The maximum award is \$4,000 per year and is based on the college's award policy. Grants offered by colleges themselves can be need-based or merit-based. Some students are able to secure multiple grants from different sources.

Work-Study

Work-study awards provide part-time jobs to students, allowing them to earn money that can be applied to their education expenses. The Federal Work Study (FWS) program is available to need-based students. While funded by both the federal government and colleges, the FWS program is administered by participating schools. Students and their families should note that a work-study award does not guarantee a job, nor does it guarantee that any job assigned will yield earnings equal to the amount listed in the financial aid package. Students and families also should know that many colleges offer employment opportunities outside the FWS program, including jobs in individual academic departments.

Federal Loans

Since 2010, all new federal loans, except for Federal Perkins Loans, have been issued through the U.S. Department of Education under the Direct Loan Program. Federal loans typically offer better terms than private loans, including lower interest rates, loan consolidation opportunities, and flexible repayment plans. There are five types of federal loans: Direct Subsidized, Direct Unsubsidized, Federal Perkins, Direct PLUS, and Direct Consolidation.⁵¹ Here's a look at each in more detail:

Direct Subsidized Loans. These loans are subsidized in the sense that students pay no interest on the loans while attending college (the deferment period) or for six months after graduation (the grace period). To receive a Direct Subsidized Loan, students must qualify based on financial need. The annual subsidized loan maximum is \$3,500 for freshmen, \$4,500 for sophomores, and \$5,500 for juniors and seniors. The cumulative maximum that can be borrowed over the course of a student's undergraduate studies is \$23,000. Direct Subsidized Loans can be taken over a period of more than four years, but may not exceed the cumulative maximum amount. To receive a Direct Subsidized Loan once offered, borrowers must complete a Master Promissory Note (MPN) that can be submitted online.

Direct Unsubsidized Loans. These loans charge borrowers a fixed rate of interest beginning when the loan is disbursed. Borrowers can choose to let the interest accrue while in school and during grace periods, but the accrued interest is capitalized, meaning it is added to the loan's principal. Student borrowers do not need to demonstrate financial need to receive a Direct Unsubsidized Loan. The maximum amount they can borrow is determined in part by the amount of any Direct Subsidized Loans they have taken out. The combined limit for Direct Subsidized Loans and Direct Unsubsidized Loans is \$5,500 for freshmen, \$6,500 for sophomores, \$7,500 for juniors, and \$7,500 for seniors. The combined cumulative amount that can be borrowed during a student's undergraduate years is \$31,000.

Federal Perkins Loans. Perkins loans are part of the federal loan program, but the student's college is the lender. Perkins loans are only for students with exceptional financial need. Interest is subsidized, meaning it is not charged while the student is in college. The interest rate is fixed at 5 percent, and the maximum that can be borrowed is \$5,500 per year. The Perkins Loan Program will only be available through the 2017-2018 academic year, at which point the program will cease.

Direct PLUS Loans (also known as Parent PLUS Loans).

Only parents of college students can take out PLUS loans. Borrowers must not have a poor credit history, which is verified by a credit check, but there is no requirement to demonstrate financial need. The yearly limit that can be borrowed is the Cost of Attendance less any other financial aid that has been awarded. Direct PLUS Loans are not subsidized, and therefore accrue interest from the time they are disbursed. Interest is accumulated at a fixed rate that can vary depending upon when the loan was initially disbursed. Loans originating between July 1, 2016, and June 30, 2017, carry a 6.31 percent interest rate.

Direct Consolidation Loans. With a Direct Consolidation Loan, a variety of eligible federal student loans, including loans of different types with different terms and repayment schedules, can be replaced by a new loan managed by a single loan servicer.⁵² Because the interest rate on a Direct Consolidation Loan may be lower than the rate charged on one or more of the existing loans, and because the time for repayment may be extended, a Direct Consolidation Loan may make loan repayment more manageable for the borrower.

Several legislative and regulatory developments since 2007 have made federal loans more affordable for graduating students who will not earn high salaries, at least early in their careers. (*See Appendix B, "Repayment Options for Federal Loans."*)

In addition, the College Cost Reduction and Access Act of 2007 discharges any remaining student loan debt after 10 years of full-time employment in public service. Under the act's Public Service Loan Forgiveness Program, eligible loans include federal loans such as, Direct Subsidized Loans, Direct Unsubsidized Loans, Direct PLUS Loans, and Direct Consolidation Loans. Organizations that meet the definition of public service employers include government organizations, not-for-profits, and other private for-profit companies that provide certain public services.

Private Loans

Prior to 2010, private lenders processed and disbursed federal loans, but since then all new federal loans (other than Perkins Loans, where the lender is the college) have been issued by the U.S. Department of Education. As a result, new private student loans are even less common today than they were five years ago, accounting for only about 10 percent to 15 percent of outstanding student loan debt.⁵³ Most families use private loans primarily to fill any financing gaps that may remain after federal loans are exhausted.

Banks and credit unions are the most common private lenders. They qualify borrowers, and set loan terms, based on the borrower's credit worthiness.

Private loans offer many repayment options, including deferment of interest while the student is in school.

Unlike Federal Direct Loans, which forgive outstanding loan debt in the event of a student's death, either before or after graduation, private loans have no such feature. Parents who co-sign large private loans for a child should consider purchasing life insurance on the child in an amount sufficient to repay the loan should the child die prematurely.

Scholarships

Many schools and private foundations offer scholarships. Most are awarded based on a student's specific skills or interests, although some are based on need.

Athletic scholarships – Division I and Division II schools.

Both Division I and Division II schools can provide athletic scholarships, although scholarship limits are lower for many sports at Division II schools. Also, with non-revenue generating sports such as men's lacrosse (which allows up to 12.6 scholarships per team at the Division I level), scholarships are frequently divided up and parceled out among many different players.

Athletic scholarships – Division III schools. Division III schools do not offer athletic scholarships, but may offer students with specific skills an admissions advantage.

Non-athletic scholarships. Many private schools provide scholarships or grants to students who are majoring or specializing in certain areas, such as creative writing. Families may find it beneficial to conduct online research to see whether the schools a student is considering offer non-athletic scholarships for which the student might qualify. High school guidance counselors and the financial aid offices of colleges can be useful sources of information.

It is not uncommon for ambitious students to apply for and win multiple scholarships, some of which may be small individually, but collectively can pay a meaningful share of college expenses.

Families should note that some scholarships may be renewable for each of a student's four years of college, although the student may need to maintain a minimum grade point average or meet other standards in order to renew.

Private Scholarships. A number of private scholarships not associated with a specific college are available for students who qualify. Unfortunately, private scholarships often reduce the amount of institutional aid offered by a college, and thus may not lower the net cost to the student. Families can conduct a search for available scholarships at the College Board website at Bigfuture.collegeboard.org.

Tax Credits and Deductions

In addition to providing financial aid awards, the federal government offers a variety of tax credits and deductions to help middle- and low-income Americans manage college costs. Of the two types of help, tax credits are the most valuable, providing a dollar-for-dollar reduction in the taxes paid by parents of dependent students. Tax deductions, by contrast, simply reduce the amount of income that is taxed, and their value is dependent upon the taxpayer's federal income tax bracket. For someone in the 25 percent tax bracket, a \$4,000 tax credit would reduce their tax bill by \$4,000. A tax deduction of the same size would only reduce their bill by \$1,000.

Parents can claim either a tax credit or a tax deduction—as long as Congress continues to make them available—for qualified education expenses in a given year, but cannot claim both for the same expenses. Nor can they claim credits or deductions for expenses covered by grants, scholarships, or withdrawals from 529 college savings plans.

Two types of tax credits

There are two types of tax credits: The American Opportunity Tax Credit and the Lifetime Learning Credit. Parents can use only one of the credits in any one year for any one student. However, parents with more than one student attending college in the same year can claim the credits on a per-student, per-year basis. In other words, they may choose to use the same credit for both students, or they can use one credit for one student and the other credit for the other student.⁵⁴

To reiterate, if there is a choice between taking a tax deduction or a tax credit, the tax credit is preferable. A deduction simply lowers the amount of income that is taxed, while a credit directly reduces the taxes owed.

The American Opportunity Tax Credit

The American Opportunity Tax Credit was made permanent by the Consolidated Appropriations Act, 2016.⁵⁵ It can be used to cover 100 percent of the first \$2,000 of tuition and other qualified education expenses, and 25 percent of the next \$2,000, up to a total credit of \$2,500.⁵⁶ If the credit reduces the parents' tax bill to zero, the parents can have 40 percent of any remaining amount of the credit, up to \$1,000, refunded to them.⁵⁷

The American Opportunity Tax Credit can be used in each of the first four years a student is in college. The full credit is available to single taxpayers with a modified adjusted gross income (MAGI) of up to \$80,000, and to married couples filing jointly with a MAGI of up to \$160,000. (For most taxpayers, MAGI is the "adjusted gross income" shown on line 22 of their Form 1040A federal tax return, or on line 38 of their Form 1040 return.⁵⁸) Partial credits are available for singles earning between \$80,000 and \$90,000, and for married couples earning between \$160,000 and \$180,000. The credit is phased out completely, and thus not available, for singles earning above \$90,000 and for married couples earning more than \$180,000.

The Lifetime Learning Credit

The Lifetime Learning Credit covers 20 percent of the first \$10,000 of tuition and other qualified education expenses annually, for a maximum credit of \$2,000.⁵⁹ There is no limit to the number of years the Lifetime Learning Credit can be used for a given student. The full credit is available for singles with a MAGI of up to \$55,000 (in 2016), while a partial credit is available to those earning between \$55,000 and \$65,000. For married couples, the full credit is available to those filing a joint return with a MAGI of up to \$110,000, while a partial credit is available to couples earning between \$110,000 and \$130,000.⁶⁰

Parents who plan on using either type of educational tax credit should be careful about taking any ordinary income whose timing they can control, such as a withdrawal from an Individual Retirement Account, beginning in the year before their child starts college through the filing of their final FAFSA. Large increases in ordinary income could put them over the threshold for qualifying for a credit.

Tax deductions

A tax deduction may or may not be available going forward to help offset qualified education expenses. As of October 2016, the deduction had been extended by Congress through the end of 2016. A tax deduction is still available for interest paid on student loans. However, taxpayers cannot claim deductions for expenses already covered by a tax credit.

Parents who claim a student on their tax return are able to deduct up to \$4,000 of that student's college expenses—again, assuming the expenses haven't been covered by a tax credit.

To claim the deduction (if made available), single parents must have a MAGI of \$80,000 or less, and married parents must have a MAGI of \$160,000 or less.⁶¹ Married couples must file jointly to use the deduction.

Both parents and students may claim a tax deduction for student loan interest they have paid, up to a maximum of \$2,500 of interest annually. Interest is deductible only by the person who took out the loan. It is fully deductible, up to the \$2,500 annual limit, for borrowers with a MAGI of up to \$65,000 if they are filing taxes as a single person or head of household. It is partially deductible if their MAGI is between \$65,000 and \$80,000.⁶² For married couples filing a joint return, the full deduction is available to those with a MAGI under \$130,000 and partially deductible for those with a MAGI between \$130,000 and \$160,000.⁶³ Student loan interest can be deducted for the life of the loan.

To reiterate, if there is a choice between taking a tax deduction or a tax credit, the tax credit is preferable. A deduction simply lowers the amount of income that is taxed, while a credit directly reduces the taxes owed.

Considerations for Divorced Parents

Not surprisingly, financing a child's college education can become more complicated when parents are divorced. Parents must figure out who will pay for what, and how much. Some colleges treat divorced parents more favorably than others when determining eligibility for financial aid. Also, some states have stricter rules than others regarding a parent's obligation to contribute toward a child's college expenses. In many states, parents are legally expected to pay only as much as the state's flagship university charges, even if the child chooses a more expensive private school. (In New Jersey, this is known as the Rutgers Rule; in New York, the SUNY Cap Rule.)

A divorce settlement should be clear and concise in spelling out parents' obligations for college expenses. Among other things, it should specify:

- Which college expenses will be covered.
- The percentage contribution each parent will make to those expenses.
- How college expenses will be capped (spelling out, for example, whether expenses will be covered for public schools or private schools).
- Whether a 529 college savings plan should be established and funded.⁶⁴
- How much life insurance is needed on each parent to ensure there will be enough money to pay college expenses in the event of a parent's premature death.

Divorce and 529 Plan assets

Parents should make sure any assets accumulated in a 529 college savings plan during a marriage are clearly identified as joint marital assets. Then, unless clearly indicated otherwise in a settlement agreement, 529 plan assets accumulated during a marriage should not be used to fulfill a non-custodial parent's obligation to pay for college, since those assets belong to the custodial parent as well.

Divorce and the Federal versus Institutional Methodology

Parents who are already divorced and have a child approaching college age may be pleased to learn that certain colleges make it easier for students to qualify for financial aid if their parents are divorced, since the schools consider only one parent's income and assets when assessing need. In fact, it is quite common for students to receive more financial aid if parents are divorced.

Schools that count only one parent include any schools using the Federal Methodology, which requires filling out the FAFSA. On that form, only the custodial parent will need to supply financial information. The custodial parent is the parent the child resided with for the majority of the year prior to starting school, which may or may not be the parent claiming the child as a dependent for income tax purposes.

In contrast, many colleges that use the Institutional Methodology to calculate aid consider the income and assets of both the custodial and the non-custodial parent. Also, the CSS PROFILE that students must complete at schools using this methodology asks whether students will receive money from other relatives to help pay for tuition.

Divorced parents who wish to have only the custodial parent's income and assets considered for financial aid purposes should have their children focus on colleges that require only the FAFSA, or the FAFSA along with a CSS PROFILE from only the custodial parent. A list showing which schools require the non-custodial parent to complete a CSS PROFILE and which do not can be found at collegeboard.org, the website of the College Board, the nonprofit corporation that developed the CSS PROFILE.⁶⁵

Divorce and child support

Child support is reported by the custodial parent and is factored into the aid formula. In addition, if the non-custodial parent contributes to the educational expenses of the child, the following year's FAFSA will need to reflect those payments as non-taxable income to the child. Thus, the child's financial aid could be affected in subsequent years. This also could be the case in situations where the non-custodial parent owns a 529 plan and makes a withdrawal from it to pay for the child's college expenses. The 529 plan would not count in the Federal

Methodology formula since it is not owned by the custodial parent, but the withdrawal amount would be counted in the subsequent year as income to the student.

Here's an example of how all this might work. Jud earns \$100,000 a year and his divorced spouse Leslie earns \$40,000. Their daughter, Margie, lives with Leslie. According to the terms of their divorce settlement, Jud will contribute \$5,000 per year of his income to Margie's college costs, and Leslie will contribute \$2,000. The balance will be paid from student loans and from \$80,000 in a 529 plan owned by Leslie. If Jud and Leslie were married, their combined income of \$140,000 might disqualify Margie from receiving financial aid. But because they are divorced, and because Margie's school uses the Federal Methodology to determine eligibility for aid, she may qualify since only her mother's income, plus any alimony and child support she receives, will be considered in the aid formula. (As mentioned earlier, only a maximum 5.64 percent of assets in a 529 plan are counted in the aid formula, and they are counted as an asset of the custodial parent.) Note that in subsequent years of filing the FAFSA, Jud's \$5,000 contribution to Margie's college expenses would be considered non-taxable income to her.

Divorce and remarriage

A divorced parent who is relying on financial aid to help a child attend college, and is considering getting remarried, should remember that the new spouse's income will be included in the financial aid formula. The only way the new spouse's income will not be considered is if the marriage occurs after the filing of any FAFSA, CSS PROFILE, or other required financial aid forms during the student's junior year of college.

Note that for colleges requiring submission of a non-custodial CSS PROFILE, up to four parents' incomes may be included in the financial aid calculation—the income of both of the original parents and the income of their new spouses if both have remarried.

Divorce and tax credits

Divorced parents may find that they can maximize the value of available tax credits if they are willing to be flexible in deciding which parent claims a child as a dependent for tax purposes. Because of the applicable income limits, a higher-earning parent may not be able to benefit from a tax credit but a lower-earning spouse may. If divorced parents with more than one child are willing to negotiate, they may be able to work out a strategy in which the children each claims as dependents varies from year to year, such that the lower-earning spouse can claim the child attending college.

Considerations for Single Parents

Many single parents labor under the burden of a single income, but financial aid formulas can help mitigate the hardship, especially under the Federal Methodology. If a single parent has adjusted gross income of less than \$50,000 and all family members are eligible to file their annual tax returns using either IRS Form 1040A or 1040EZ—or do not need to file a federal tax return—the family qualifies for the Simplified Needs Test, which disregards assets when determining financial aid. Also, if parental income is less than \$24,000, the EFC—Estimated Family Contribution—is \$0.⁶⁶

As with divorced parents, a single parent intending to get married may wish to consider when the marriage takes place, since a new spouse's income and assets will be taken into account when filing the FAFSA. For purposes of determining eligibility for financial aid, parents will be considered married for the full year in which they married, regardless of the wedding date. Suppose, for example, that a single parent earning \$75,000 per year files the FAFSA in October 2016 after getting married at the beginning of December 2015 to someone earning \$100,000. The FAFSA will look back at income in 2015, and even though the single parent was only married for one month of that year, his or her family income will be counted as \$175,000. However, if the single parent waited until February 2016 to get married, only his or her 2015 income—\$75,000—would be counted.

Legal parents who are not married but reside together

As of the 2014-2015 academic year, legal parents of any gender who live together are both being considered in the Federal Methodology of calculating aid. The FAFSA terminology is now gender neutral, referring, for example, to "Parent 1" and "Parent 2" rather than "father" and "mother."

Legal parents who were never married and do not reside together

The rules for filing for financial aid will differ for parents who do not live together, but are both recognized as legal parents of a child, depending upon whether the school requires submission of the FAFSA alone or also the CSS PROFILE. Those using the FAFSA will require financial information only from the parent with whom the child resides. Those using the CSS PROFILE, or another institution-specific form, will likely require financial information from both parents. As noted earlier, a list showing which schools require non-custodial parents to complete a CSS PROFILE and which do not can be found at collegeboard.org, the website of the College Board.⁶⁷

Conclusion

A college education can be extraordinarily valuable, but its cost can be daunting. Student loans are a workable solution for many families, but can impose significant financial burdens on borrowers if used indiscriminately.

Families owe it to themselves to take a carefully considered approach to financing a college education, becoming familiar with the various types of aid available and understanding how the differences between them can impact out-of-pocket expenses. Students can help by applying for grants and scholarships that don't need to be repaid, which will minimize the need for loans that do have to be paid back. Students and parents can further help their cause by familiarizing themselves with the types of aid offered by the specific schools they are considering, and finding out in advance what percentage of the family's Demonstrated Financial Need those schools typically cover. All this will make it easier for families to choose a school that fits their ability to pay for college while also meeting the student's educational goals.

With so many variables in play, an undergraduate degree can cost a family nothing, or in excess of \$200,000. The final number depends on factors both within and outside of the family's control, including the family's income, the school selected, and the strategies used to take advantage of available aid programs. Smart shoppers will secure the best bargains, and in doing so help to realize their students' college dreams while also safeguarding their long-term financial security.

Appendix A: Accessing Financial Aid for College: A Checklist

DATE/TIME FRAME	ACTIVITY
First semester of student's junior year of high school	Begin evaluating colleges student may wish to attend. Consider academic programs offered, availability of merit aid, if applicable, and costs.
Junior/senior year of high school	Complete the FAFSA4caster.
Junior/senior year of high school	Visit websites of colleges under consideration and use their Net Price Calculators to assess what percentage of the family's Demonstrated Financial Need they typically cover. Also determine whether schools require filing of CSS PROFILE in addition to FAFSA, and, where applicable, if they require filing of a non-custodial CSS PROFILE.
Senior year of high school	Meet with high school guidance counselor to identify and apply for any available grants and scholarships.
October/November of student's senior year of high school, and each year thereafter that the student will be attending college	Complete and file the FAFSA. Utilize IRS Data Retrieval Tool.
October/November of student's senior year of high school, and each year thereafter that the student will be attending college	Complete and file the CSS PROFILE, if required by your school.
Senior year of high school	Review and compare award letters from colleges to which the student applied. Remember that grants and scholarships, which do not need to be repaid, are more valuable forms of aid than loans, which must be paid back.
March/April of student's sophomore year of college and each year thereafter, up until first year after graduating college	If eligible based on income, apply for either the American Opportunity Tax Credit, Lifetime Learning Credit, or currently available tax deduction.

Appendix B

Repayment Options for Federal Loans

Borrowers generally have 10 to 25 years to repay federal student loans under standard repayment plans. If they agree to have their loan payments withdrawn automatically from a bank account, they enjoy an interest-rate reduction of one-quarter percentage point. Borrowers can choose payments that are fixed (stay the same over the life of the loan), graduating (increase over time), or income-driven (variable over time based on the borrower’s income).

A number of legislative developments over the past decade have made federal loans more affordable for many graduating students who will not be high earners, at least early in their careers, and can demonstrate financial hardship under a government formula. Under the Income Based Repayment Plan created in 2007, for example, repayment terms became more generous, and under the Patient Protection and Affordable Care Act of 2010, even more favorable repayment options were introduced. New Federal Direct loans now allow repayment based on 10 percent of discretionary income, and loans are forgiven after 20 years.

“Important changes to the income-based repayments were made, but because they were passed under legislation that created the Affordable Care Act, few people paid much attention to them.”

THE NEW YORK TIMES, JANUARY 25, 2015

Here’s how the three types of income-driven repayment plans work:

- **Income-Based Repayment (IBR) plan.** Under an IBR plan, the borrower’s monthly payment is capped based on income and family size. It generally equals 10 percent of the borrower’s discretionary income, which for this purpose is defined as the amount of income above 150 percent of the family poverty level.⁶⁸ The loan is repaid over a period of 20 years. The borrower must demonstrate financial hardship to enroll in the plan,⁶⁹ meaning the amount he or she owes annually under a standard 10-year repayment plan exceeds the IBR payment amount.
- Figure 3 shows how an IBR plan might work in the first year for a hypothetical individual in a one-person household with an adjusted gross income of \$40,000 a year. The example assumes this person is living somewhere in the contiguous

48 states or the District of Columbia, where the poverty level for a one-person household in 2015 is \$11,770. He has just graduated with \$80,000 in student loan debt bearing an 8.25 percent interest rate, and will see his income go up 5 percent annually.

Figure 3
Example: How an Income-Based Repayment Plan Works in the First Year of Repayment

A) Adjusted gross income	\$40,000
B) Poverty level	\$11,770
C) 150% of Poverty Level	\$17,655
D) Discretionary income (A – C)	\$22,345
E) 10% of Discretionary Income (D X 0.10)	\$2,235 (\$186/month)
F) Annual payments under standard 10-year plan. Is F greater than E? (If yes, qualifies for IBR plan)	\$11,775 (\$981/month) Yes
G) Annual first-year payments due under IBR (D X 10%)	\$2,235 (\$186/month)

The borrower in Figure 3 would see his monthly payments increase over time as his salary increases. The U.S. Department of Education estimates that his final monthly payment would be about \$620. By that time his total payments will have equaled just over \$89,000, and although the loan with interest would not be paid in full, the remaining debt would be discharged.⁷⁰

Note that the discussion above applies to new borrowers who began taking loans on or after July 1, 2014. Depending on the loan program and a student’s individual circumstances, this more favorable repayment program may or may not be available.

- **Pay As You Earn Repayment (PAYE) plan.** This is essentially the same as the IBR plan, but became available before new rules permitting IBR plans took effect in 2009. The PAYE plan calculates the payment amount in the same way as the IBR plan and also schedules payments over a 20-year period.

- **Revised Pay As You Earn Repayment (REPAYE) plan.** Introduced in late 2015, this plan allows anyone who has eligible federal loans to qualify. REPAYE also has a new interest rate subsidy feature that prevents loan balances from ballooning.
- **Income-Contingent Repayment (ICR) plan.** The ICR plan allows the monthly payment to be adjusted each year based on the borrower's annual income, family size, and the size of the loan. Payments are made for a maximum of 25 years and are the lesser of 20 percent of discretionary income or whatever the borrower would pay if payments were fixed over 12 years but adjusted for the borrower's income.⁷¹ Typically, payments under the ICR plan are higher than they are under the other two income-driven plans.

Appendix C: Employment-based Repayment Options

The federal government sponsors two unique programs to help graduates with their loans, the Federal Student Loan Repayment Program and the Public Service Loan Forgiveness Program.

Federal Student Loan Repayment Program

Under this program, federal agencies can pay up to \$10,000 annually towards a graduate's federal loan debt when the individual is employed by the agency. A total of \$60,000 lifetime payments are permitted.⁷²

Public Service Loan Forgiveness Program

Individuals who work full-time in public service jobs may be eligible to have loans made under the Direct Loan Program forgiven after 10 years of payments.⁷³

Appendix D: Helpful Websites

U.S. Department of Education

Federal Student Aid, an office of the U.S. Department of Education, provides information about the Free Application for Federal Student Aid (FAFSA), and allows students and families to complete and file the FAFSA at fafsa.ed.gov. The website also provides information regarding federal loan repayment, including special programs such as the Income-Based Repayment Plan.

Families can estimate a student's eligibility for federal financial aid by using the FAFSA4caster at fafsa.ed.gov.

The Department of Labor also provides a free scholarship research tool at careerinfonet.org/scholarshipsearch.

Corporation for Enterprise Development

cfed.org

This website provides information on Individual Development Accounts, which are special matched savings accounts for low- and moderate-income households.

The College Board

bigfuture.collegeboard.org

The College Board provides information on available scholarships. Type "scholarships" in the search tool.

Students and families can complete and file the CSS PROFILE online. Type "CSS Profile" in the search tool.

College Data

collegedata.com

The College Data website allows families to search for colleges that provide merit and/or need-based financial aid. Click on "College Match."

College Navigator

nces.ed.gov/collegenavigator

This website allows families to search, compare, and build a list of schools based on selected criteria.

Appendix E: Footnotes

- ¹ U.S. Census Bureau, “The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings,” pp. 4-5, July 2002, <http://www.census.gov/prod/2002pubs/p23-210.pdf>
- ² *BloombergBusiness*, “College Tuition in the U.S. Again Rises Faster than Inflation,” November 13, 2014. Source: College Board, Bureau of Labor Statistics. <http://www.bloomberg.com/news/articles/2014-11-13/college-tuition-in-the-u-s-again-rises-faster-than-inflation>
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