

Financing a College Education

A college education is a necessity for anyone hoping to meet the challenges in our rapidly changing world. Years ago, the majority of employers expected workers to have a high school diploma. Today a college degree is considered a minimum requirement for most well-paying jobs. In fact, according to a recent study, a college education nets graduates from \$250,000 to \$500,000 more during their working years than nongraduates.

A college education also enhances one's lifetime experience personally. It provides an opportunity to explore new ideas, to encounter different standards, and to make professional contacts. The returns greatly exceed the cost. College students have the opportunity to learn about society and to master self expression in speech and writing. An education affords them community and political awareness, and the occasion to act responsibly as productive citizens.

This publication will enable you to estimate the cost of a college education. Funding alternatives will be discussed. You will also learn of related web sites and other useful resources.

Types of Postsecondary Education

Basically, there are two types of postsecondary schooling: the community/technical/junior colleges and the four-year colleges and universities. Community, technical, and junior colleges offer programs leading to an Associate of Arts degree (A.A.), Associates of Applied Science (AAS), licensing, or certificate programs. Numerous community and

technical colleges work collaboratively with local businesses, industry, and public agencies to offer programs and training for students and employees. There are technical and community colleges that provide opportunities for students to intern with local employers while completing course work.

The academic program at many of these schools is comparable to the first two years of a four-year college or university. Nearly one-fourth of community college students transfer to a four-year school and continue study towards a Bachelor of Arts (B.A.) or a Bachelor of Science (B.S.) degree. A four-year college or university provides a program of arts and sciences leading to a bachelor's degree. A bachelor's degree is generally required prior to receiving a graduate or professional degree in areas like law, medicine, social work, or business.

Estimating College Costs

College is expensive and needs to be viewed as a long-term investment. Next to the purchase of a house, it is the second largest investment most Americans make. The availability of financial aid to help pay for college can make an expensive school affordable for a student who qualifies.

Basic college costs include tuition, room and board, books, supplies, transportation, fees, and miscellaneous expenses. Tuition is generally the most expensive cost and is the charge for instruction and the use of facilities. Fees cover nonacademic charges like athletic or student activities, special events, and clubs. In a survey by the College Board, less than half the students at four-year colleges spent under \$3,000 in tuition and fees

while seven percent spent \$15,000 or more a year. College costs are projected to increase 5 percent annually.

Three pieces of information are needed to calculate the cost of a college education.

They are:

- the current cost of a selected school
- the number of years until the student attends
- the projected average inflation rate.

Use the worksheet on page 3 to calculate the monthly savings required for a college education.

How \$100 a Month Will Grow

The following rate of return chart illustrates how a monthly savings or investment of \$100 will grow depending on the annual rate of return. Note that the annual rate of return becomes a critical factor over time.

Rule of 72

Another useful saving/investment tool is the Rule of 72. It is used to estimate how long it takes to double your savings/investments. This is determined by dividing 72 by the interest rate or rate of return. For example, if you have saved \$10,000 for college

expenses at 6 percent, it will take 12 years for it to double in value to \$20,000

$$\frac{72}{\text{interest rate}} = \frac{72}{6 \text{ percent}} = 12 \text{ years}$$

The rule can also be used to determine how much you will need to earn on savings based on the number of years before college funds are needed.

$$\frac{72}{\text{no. of years college funds needed}} = \frac{72}{8 \text{ years}} = 9 \text{ percent}$$

Developing a Funding Strategy

Advance savings and financial aid are the usual ways of affording a college education. Setting aside a specific amount each month or pay period enables you to build a college fund. The earlier savings are begun, the smaller the monthly amount required. Some families who lack complete funding can pay part of

Rate of Return					
Year	4%	6%	8%	10%	12%
1	\$1,230	\$1,240	\$1,250	\$1,270	\$1,280
2	2,500	2,560	2,610	2,670	2,720
3	3,830	3,950	4,080	4,210	4,350
4	5,210	5,440	5,670	5,920	6,180
5	6,650	7,010	7,400	7,810	8,250
6	8,150	8,680	9,260	9,890	10,580
7	9,710	10,460	11,290	12,200	13,200
8	11,330	12,340	13,480	14,740	16,150
9	13,020	14,350	15,850	17,550	19,480
10	14,770	16,470	18,420	20,660	23,230
15	24,690	29,230	34,830	41,790	50,460
20	36,800	46,440	59,290	76,570	99,910

College Cost Worksheet

	Example	Your Figures
1. Child's Current Age	4	
2. Current Annual College Costs	\$10,000	\$ _____
3. Rising Cost Factor (Number in column A for your child's age)	1.98	
4. Future Annual College Cost (Multiply line 2 by line 3)	\$19,800	\$ _____
5. Total Cost of Four Years of College (Multiply line 4 by 4 years)	\$79,200	\$ _____
6. Earnings on Savings/Investments Factor (Number in column B for your child's age)	0.044	
7. Amount You Must Save/Invest Each Year (Multiply line 5 by line 6)	\$3,484.80	\$ _____
8. Amount You Must Save/Invest Each Month (Divide item 7 by 12)	\$290.40	\$ _____

Age of Child	A (Assumes 5% inflation rate)	B (Assumes 7% return)
Newborn	2.41	0.029
1	2.29	0.032
2	2.18	0.036
3	2.08	0.034
4	1.98	0.044
5	1.89	0.050
6	1.80	0.056
7	1.71	0.063
8	1.63	0.072
9	1.55	0.084
10	1.48	0.098
11	1.41	0.116
12	1.34	0.140
13	1.28	0.174
14	1.22	0.225
15	1.16	0.311
16	1.10	0.483
17	1.05	1.000

the cost from current earnings while their child attends school. Some young people work part-time to fund a portion of the costs.

Investing to Meet College Goals

When deciding which savings instruments or investments are appropriate for your family situation, consider the age of the prospective student as well as the:

- **Risk**—The possibility that money you save and invest could be worth less in the future.
- **Return**—The earnings on savings and investments from interest or dividends.
- **Liquidity**—The ability to access your invested money quickly.
- **Time Frame**—The number of years needed to reach the goal.

Diversify your savings and investments by selecting more than one savings instrument or investment for college funds. This helps minimize the risk while maximizing the return or yield. Check to be certain you can access the funds without penalty when you need to pay schooling costs.

If you have from 8 to 18 years to accumulate funds, consider investments that grow in value like common stocks or stock mutual funds. Growth mutual funds are shares in companies that focus on growth and value rather than dividends. They offer a diverse mix of companies in various industries. The investor pays a fee for professional management.

If you only have 4 to 8 years to invest, consider a balanced investment portfolio with holdings in preferred stock, common stock, and bonds. Balanced mutual fund managers seek to conserve initial principal, pay current income, and promote long-term growth of principal and income.

Families with children over age 14 have a short time frame in which to invest. They should carefully evaluate investments for income and liquidity. Funds could be moved into either fixed income securities like money market funds, or bank certificates of deposits (CDs) timed to mature when the tuition and fee payments are due.

The key to saving for college is to:

- begin early;
- save regularly;
- consider risk and return;

- diversify among different investments; and
- review and adjust the portfolio as needed.

For more information on saving and investing order the following free publications, *Savings Basics* (Fact Sheet 693), *Investment Basics* (Fact Sheet 694), and *Mutual Funds* (Fact Sheet 656). They can be acquired by calling your local Maryland Cooperative Extension office listed in the blue pages of your telephone book.

Prepaid Investment Trusts

The Maryland Prepaid College Trust is a new program to help fund higher education costs. The state-sponsored plan is attractive because it permits families to make payments today in return for a guarantee that no matter what the cost of college when the child attends one of the state schools, the education costs will be fully paid by the state at that time. Families may want to evaluate the refund policy if their child does not attend college. Additional information about this program can be obtained by accessing the state of Maryland's web site at www.prepaid.usmd.edu or by calling 1-888-463-4723. If one participates in the College Trust, the Hope Scholarship Credit or the Lifetime Learning Credit cannot be used since the tax advantage is considered on the trust funds.

Financial Aid Possibilities

Financial aid is the difference between what families can afford to pay and the actual cost of a college education. It consists of three kinds of assistance (1) grants and scholarships, (2) work-study programs, and (3) student loans.

It is rare when families can meet their portion of costs from current income. Therefore, many fund the family portion with a combination of savings, current income, and loans. Having savings or assets does not automatically exclude a family from receiving financial aid. Income is the major factor in establishing a family's contribution level. Assets and savings are considered in the calculation but not more than 6 percent is included in any given year.

College financing is considered a “shared responsibility” by the family and the educational institution. Most financial aid is need-based and is available to qualified students. Qualifications are determined using formulas to estimate a family’s ability to pay, relative to other applicants. The formulas are based on the number of family members in college and a conservative allowance for living expenses.

Families are generally eligible for financial aid equal to the amount of demonstrated need. The expected family contribution is subtracted from attendance costs at a particular college to arrive at an estimate of the demonstrated financial need. The “need” might be great at a high-priced college and nonexistent at a low-priced school.

Usually more expensive schools tend to have more financial aid money available. It is important to explore every college that interests your child with the idea that financial aid will be obtained. Some schools meet the full financial need of each student, others try to assist as many individuals as possible by meeting a portion of all the requests. All schools offer a combination of grants, on-campus employment, and loans. The packages differ depending upon how eager the school is to persuade your child to enroll.

Grants, Scholarships, and Loans

Grants and scholarships are forms of financial aid that do not have to be repaid. Some require recipients to maintain a certain grade point average (GPA) or take specified courses. If grants or scholarships are merit-based they generally are not related to financial needs as they are usually awarded on the basis of academic performance or potential.

The federal government is the largest supplier of student aid with programs like the Federal Pell Grants which are need-based and do not have to be repaid and the Federal Stafford Loans which are both subsidized and unsubsidized. Subsidized Stafford loans are need-based and are interest free while the student is in school. Unsubsidized Stafford Loans are not need-based and do accrue interest while the student is in school. Payments for both Stafford loans may be deferred while the student is in school and for 6 months after the student leaves school.

The Federal PLUS Loan program allows parents to borrow additional funds for their student’s education. PLUS loans are not need-based, accrue interest while the student is in school, and payments cannot be deferred while the student is in school.

States provide student grants and scholarships based on a combination of merit and financial need. Most colleges offer several kinds of grants which may or may not be based on financial need. States also support higher education in the form of budget subsidies to the state university system. This support lowers the tuition for all students attending these schools. Additionally, there are state scholarships available for eligible students.

Thousands of grants and scholarship programs are available to students with superior academic records, special interests, and other qualifying characteristics. Certain corporations, labor unions, professional associations, religious organizations, foundations, and even credit unions award financial aid. Check your public library and on-line resources for directories of such listings. College admission officers and high school guidance counselors may also be able to provide some of this information.

Student Loans

Sixty percent of all financial aid is in the form of educational loans borrowed by students and their parents. Student loans are available to both students and parents. Loans must be repaid. The interest rates are lower on educational loans than on commercial loans. The payments on many student loans do not begin until school is completed.

There are many different kinds of student loans. Ask the following questions prior to taking out a loan:

- What are the exact provisions of the loan?
- What is the interest rate—the APR (annual percentage rate)?
- What is the total finance charge—loan fees plus dollar amount in interest payments?
- What are the monthly payments?
- When do the monthly payments begin?
- How long will the payments last?
- What happens if one payment is

missed?

- Is there a grace period for the repayment of the loan?

In all cases, a loan taken out to pay for a college education must be repaid whether or not a student finishes school or gets a job after graduation. Failure to repay a student loan can ruin an individual's credit rating, is rarely dismissed from bankruptcy, and makes access to credit difficult in the future. For this reason, evaluate the job placement rates and school completion rates when helping your child select a career and a school.

Work Study Programs

Many students fund part of their college costs through summer and or part-time work. Some students obtain jobs on their own while some colleges offer work-study programs. A work-study job is frequently part of a student's financial aid package. These positions are on campus and the money earned is used for tuition or other school charges.

Education Tax Credits

Federal tax credits are a resource for those paying out-of-pocket qualified tuition payments. The Hope Scholarship Credit offers up to a \$1,500 annual tax credit for tuition and fees for each student enrolled at least part-time in the first two years of postsecondary education. The education tax credit cannot be used for room and board, books, equipment, or activities. The Lifetime Learning Credit applies to college juniors, seniors, and graduate students. It allows taxpayers supporting a college student to claim a tax credit equal to 20 percent of the first \$5,000 of tuition and fees, not to exceed \$1,000 per family. Both credits are phased out at adjusted gross income (AGI) of \$40,000 (single filers) or \$80,000 (joint filers) and are eliminated at AGI of \$50,000 (single filers) and \$100,000 (joint filers).

Nondeductible contributions of \$500 per year can be made to an Education IRA for children to age 18. The money grows tax deferred and any withdrawals not more than the amount of qualified education expenses for that tax year are not subject to federal taxes. The money must be withdrawn before the

beneficiary turns 30 years of age or may be transferred to a younger child. Couples can make a contribution on behalf of the child provided their adjusted gross income does not exceed \$150,000 on a jointly filed return.

Borrow from Yourself

Another source of funding may include loans from your retirement funds, though this should be done with caution since it negates the objective of saving for retirement. Some 401(k) and other retirement plans allow borrowing at favorable rates to pay for college. These loans need to be repaid within 5 years. If you change jobs, the loan has to be repaid in full or taxes must be paid on the loan amount plus a 10-percent early withdrawal penalty. Individual Retirement Account (IRA) money can be used to pay for college before age 59½ without the early withdrawal penalty.

A home equity loan is another option for meeting college expense. The interest on a home-equity loan is tax deductible making this a tempting choice for many house-rich and cash-poor families. This should be weighed carefully since you will have to begin repaying the loan immediately. If a job loss or uncovered disability were to occur, you could risk the loss of your home if the home equity payments are not made on time.

Some life insurance policies have a cash value. You may borrow against the cash value. Though you do not have to repay the loan, you must pay the loan interest each year. Should you die while the loan is outstanding, that amount will be deducted from the face value of the policy.

Ways to Keep College Costs Down

- Take advantage of reduced tuition. Some schools give discounts to older students, alumni children, and families with two or more members in school, student leaders, or children of faculty and staff.
- Attend the less expensive community college for two years and then transfer to a four-year college or university to complete your degree.

- Check the number of credit hours needed for graduation and plan a course of study carefully—many schools charge tuition based on credit hours taken.
- Some schools give Advanced Placement credit for courses completed in high school. Others offer three-year programs. Adults can enroll in the CLEP (College Level Examination Program) that tests for knowledge obtained outside the school setting. You can obtain 1 to 2 years of college credit this way.
- Take classes in off-load times. Tuition sometimes is lower for night, summer, or weekend classes. Investigate classes taught on the World Wide Web.
- Cut housing costs. Live off campus if housing and food costs are lower than on campus. Consider working as a resident advisor to receive reduced or free room and board.
- Check the state prepaid guaranteed tuition programs.
- Inquire about tuition installment payment plans. This will not reduce the costs but may make it easier to meet smaller payments rather than a large lump sum at the start of each semester.
- Take part in the college's Cooperative Education program. Combine a full- or part-time job and a college career to finance all or part of education costs.
- Take advantage of armed forces educational opportunities. The government will pay a considerable sum toward educational costs during or after active duty.
- Consider work with AmeriCorps. This is a program that enables participants to earn education awards in return for national service. Contact the Corporation for National and Community Service at 1-800-942-2677.

Beware of Scams

Be wary of scholarship and financial aid scams. Some offer a variation of the "you have won a prize" promotion targeted to students and parents anxious to pay for college. The ploy guarantees free scholarship money for an up-front fee.

Some students and their parents pay as much as \$1,500 to a company to search for

scholarships and grants. Most of this information can be obtained for free by searching the web. According to the Federal Trade Commission, warning bells should ring if you are told:

1. The scholarship is guaranteed (or your money back).
2. The scholarship will cost you money.
3. You need to give a credit card or bank account number to hold this scholarship for you.
4. You can't get this information anywhere else.
5. We do all the work for you.

To identify legitimate sources of college financial aid, call the College Parents of America. They can be reached at 888-256-4627 or accessed at the web site below. You can also check the accreditation of an educational institution by contacting the Council for Higher Education Accreditation. They can be reached at One Dupont Circle, Suite 510, Washington, DC 20036-1135, or 202-955-6126, or at the web site below.

In summary, develop a long-range plan to pay for a college education. Plan to help your child make informed decisions regarding a choice or career and college by utilizing the following resources.

Resources

There are literally hundreds of resources to assist you in planning for the costs of a college education. You may wish to start with a high school guidance counselor or the college financial aid office. Check the Internet for on-line information. The following list will get you started. You will find a wealth of valuable information in the publications listed in the reference books section.

On-line Resources

The Internet can provide a crash course in what you need to know about college. In addition to the sites listed here, most banks and universities have web sites with extensive information about loans and other financial aid.

www.chea.org is the web site for the Council for Higher Education Accreditation. It is the voice of the nation's colleges and universities on all

matters regarding accreditation assuring quality and public accountability in institutions and programs through voluntary, non-governmental self-regulation.

www.collegeboard.org has useful financial aid calculators, such as one that lets you see if the amount of debt a student plans to take on meshes with how much he or she can expect to make in a given field. In addition to a scholarship search engine, it includes the College Scholarship Service/Financial Aid Profile that many schools use to award non-federal student aid.

www.collegeparents.org is the web site for the national nonprofit organization College Parents of America. They identify legitimate financial aid sources, make college debt recommendations, and advocate on Capitol Hill.

www.ed.gov is the Department of Education's site, where you'll find the government's comprehensive *Student Guide to Financial Aid*, as well as the Free Application for Federal Student Aid, the required form for anyone applying for college financial assistance.

www.fastweb.com has a search engine that gives you access to information on some 400,000 scholarships. You can customize your search based on such criteria as your ethnic background, academic interests, and extracurricular activities.

www.finaid.org is a comprehensive site that offers links to college financial aid offices, financial calculators that can help parents figure out how much college debt they can afford, and information on prepaid tuition plans.

www.nelliemae.org is the web site for the New England-based company that makes and buys student loans. Along with general information on student aid, it offers calculators, including one that helps you compare financial aid award packages of the schools that accept your child.

www.salliemae.com has useful calculators that let you figure out your family's expected contribution to college costs and how much you need to invest to meet a particular savings goal. It also has a scholarship search program and a host of other information on financial aid.

Reference Books

There are dozens of books available to help you make wise college financing decisions. You may want to begin your literature search by ordering the free booklet *Preparing Your Child for College: A Resource Book for Parents*. To receive a copy write to Consumer Information Center, Preparing Your Child for College, Pueblo, Colorado 81009. Consider purchasing, or checking out from your local library, one or more of the following books:

Bellatoni, Patrick L. *College Financial Aid Made Easy: For the 1998-1999 Academic Year*. 1998.

Cassidy, Dan. *Last Minute College Financing: It's Never Too Late to Prepare for the Future*. 1999.

Chany, Kalman A. *Paying for College Without Going Broke* 1998. 1997.

Diers, Rochell. *How to Buy a College Education: A Consumer Planning Guide Featuring Real Costs, Real Money, Real Choices*. 1996.

Latimer, Joe. *Peterson's College Money Handbook* 1999. 1998.

Ordovensky, Pat. *College Planning for Dummies*. 1997.

Robinson, Marc. *Paying for College* (Time-Life's *Your Money Matters*, vol. 3). 1997

Smith, Marguerite. *Paying for Your Child's College Education*. 1996.

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