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How Not to Blow It With Financial Aid

Common mistakes parents and students make when seeking help with college costs

By RACHEL LOUISE ENSIGN

What do last year's bonus, your kids' straight As and the money grandma socked away for their education have in common?

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They can all hurt your chances of landing financial aid.

After handing out lots of free money to families at the height of the recession, colleges are tightening their criteria for aid. They're looking much more closely at the financials parents lay on the table—and it's all too easy to make a misstep that costs your family thousands of dollars a year in assistance. More than ever, you need to know what colleges want to see and how to make yourself look as deserving as possible.

It takes a lot of work to cover all the bases of financial aid. But putting in the effort can save you a heap of money up front—and keep your child from becoming yet another heavily indebted college graduate.

Here's a look at the some of the biggest mistakes families make in the aid process, and the best ways to steer clear of them.

Earning too much at the wrong time.

Many parents wait until late junior year or early senior year to start thinking seriously about college. But by then, you may have blown your best chance to position yourself for the most aid.

John Kuczala

Why? Your "base income year" is already well under way.

The Free Application for Federal Student Aid, which determines your eligibility for federal help and aid from many schools, is based on your family's tax return for the year *before* the child enrolls in college. In other words, if your child plans to start college in fall 2013, schools will look at your return for 2012—the base income year.

Many people don't realize this, and don't take any steps to adjust their income, the biggest factor in determining aid. Experts urge families to get an early start and keep their earnings as low as possible during that year.

For instance, take any big windfalls, such as capital gains or the sale of a property, *before* the Jan. 1 when your child is a high-school junior, says Mark Kantrowitz, publisher of financial-aid website finaid.org. If you own a business, you may want to defer compensation or take a lower annual salary.

"Every $10,000 reduction in income is going to improve your aid eligibility by [about] $3,000" if you have one child in college, says Mr. Kantrowitz. In other words, if you're the sole breadwinner with one kid in college and cut your pay to $100,000 from $150,000, your child will be eligible for about $15,000 more aid annually. (This is a simplified rule of thumb that doesn't apply in all cases, he says.)

Still, you don't want to overdo it. The Internal Revenue Service may come after you for not paying yourself a fair wage, and "the colleges don't like it when someone is rich but appears poor," says Mr. Kantrowitz. They may pull back on their institutional aid if they decide your family doesn't actually need the help.

About 250 mostly private colleges also ask parents to fill out a supplemental form called the CSS/Financial Aid PROFILE for awarding institutional funds.

Letting the wrong family members hold college money.

Not all family members' assets are considered equal by colleges in the standard federal aid formula.

For one thing, a child's income and assets count heavily against their potential aid. Every dollar a child has in assets—that includes bank accounts or trust funds—cuts their possible award by 20 cents. Every dollar a child makes in income above $6,130 (the limit for 2013-14 aid) cuts their possible award by 50 cents.

Before the base income year starts, parents should transfer the child's assets—that includes any money in checking and savings accounts—into a 529 plan, a tax-advantaged savings account for college, says Mr. Kantrowitz.

Money held in a 529 belonging to a student or custodial parent reduces the student's eligibility for financial aid only up to 5.64%—meaning an account with $10,000 could knock off a maximum of $564 in aid.

But families should be careful about letting relatives other than custodial parents—like grandparents, aunts and uncles—set up 529s for kids. Every dollar a student gets from a 529 plan owned by other relatives is considered

income to the student and reduces potential financial aid by 50 cents if the student is above the income threshold, says Mr. Kantrowitz. A $10,000 withdrawal would reduce aid eligibility by up to $5,000.

Where's the Money?

Here's a look at the most popular types of college financial aid:

Grants and Scholarships

Pell Grants
A grant from the federal government intended for low-income families. The maximum amount last academic year was $5,550.

Institutional Grants and Scholarships
After ramping up aid during the recession, many colleges are cutting back on grants they give to students. Overall, the average amount a family got in grants and scholarships from all sources fell 15% last academic year.

Outside Scholarships
The Internet has made competition for many of these scholarships from outside institutions fierce. But the same percentage of high-income students land one as low-income students, about 10%.

Loans

Stafford Loans
Students who demonstrate financial need are eligible for so-called subsidized Stafford loans, which the government pays interest on while you're in school and carry a 3.4% rate in 2012-13. Everyone is eligible for unsubsidized Stafford loans, which have a 6.8% interest rate. There's a maximum amount students can take out of each.

Parent Plus Loans
Parents of dependent students without bad credit can take out federal parent Plus loans, which carry a fixed interest rate of 7.9%.

Private Loans
Some loans from private lenders like Sallie Mae or Discover may come with lower rates than some federal loans. But experts say you should borrow the maximum amount of federal loans before turning to them.

Federal Work-Study

This federal program gives needy students money toward college costs if they work part-time. The average undergraduate participating in the program received $2,342.

Child's Summer Earnings

Many colleges also expect students to put some of their summer earnings toward their college costs. For instance, Brown University expects freshmen to contribute $2,500 from a summer job.

Source: WSJ research — The Wall Street Journal

Associated Press

A Duke freshman organized her things last month as she prepared to move into a residence hall on campus.

Making assumptions about what schools will offer.

When figuring out where your child will apply, don't just guess what schools might offer in aid. Colleges make it easy to figure out how much they're likely to give, with net-price calculators on their websites.

You input financial data like your income, assets and family size, and the calculator spits out an estimate of what you'll pay for tuition, fees and room and board, minus any estimated grants or scholarships. They generally don't factor in things like loans or work study.

By using these calculators, some families will find that generous private colleges may cost them less than their in-state public university, says Robert Weinerman, senior director of college finance at consulting firm College Coach and a former financial-aid officer at the Massachusetts Institute of Technology. That's because the Harvards and Yales of the world give many low-income students a nearly full ride, and many midtier schools give desirable students a lot of money off the sticker price to get them to attend.

Still, there are a number of questions about the accuracy of these estimates; for one thing, some use two-year-old data to make their calculations. That's why it's crucial that your child applies to a "financial-aid safety school," such as a state university, that you'll be able to afford with no aid at all, says Mr. Kantrowitz of finaid.org.

Thinking merit money is all about grades and SATs.

If you assume your child's good grades guarantee a merit scholarship at a safety school, you may be in for an unpleasant surprise.

Colleges can figure out when top-flight students are using them as safety schools; these kids' grades and SAT scores will be significantly better than those of the average student who enrolls. With less scholarship aid available at most places, some midtier schools are less willing to offer high-performing students merit money if they think it's unlikely they'll enroll, says Alex Bickford, senior manager of college finance at College Coach and a former financial-aid officer at Southern New Hampshire University.

So, if students want the college to try to lure them with merit money, they should visit the campus and show a genuine interest by contacting professors and alumni, he says.

Not applying for all the aid you're eligible for.

In the heat of the application process, some affluent families don't apply for aid because they assume they're not eligible. Nearly 30% of high-income families didn't fill out the FAFSA last academic year, according to a recent Sallie Mae survey.

That's usually a big mistake, says Mr. Bickford, since affluent families may qualify for at least *some* aid. The typical family earning more than $100,000 received $5,451 in grants and scholarships last academic year, Sallie Mae says. Not filling out the FAFSA can disqualify you from merit-based aid at some schools, says Mr. Kantrowitz.

Upper-income families shouldn't count themselves out for outside scholarships either, says Mr. Kantrowitz. Roughly the same percentage of students with family incomes over $100,000 or more received scholarships from sources outside of the college as did students with family incomes under $50,000: about 10%, he says.

Figuring the "expected family contribution" is all you're paying.

When you actually get your child's acceptance letters in hand, there are plenty more pitfalls to watch out for, such as missing the nuances of the financial-aid offers.

Most schools have their own format for these offers, but one constant is the expected family contribution—a gauge of how much your family can expect to pay each year out of pocket. The catch, which often isn't immediately obvious, is that the expected contribution often isn't all you're paying.

To fill any gap between the expected family contribution and the total cost of attendance, a college may offer your family some "free money" in the form of grants and scholarships. But they may also expect you to take out loans, and have your child contribute money from work-study and summer jobs to meet your need. They may also leave some need unmet.

It's also important to bear this in mind when using net-price calculators on school websites. By law, the calculators must show the net price of the school—what you'll pay after grants and scholarships—but some calculators add another estimate that includes loans and makes it look like you'll pay less than you really will, says Lauren Asher, president of the Institute for College Access and Success, a nonprofit group that monitors student debt.

Going for the loan with the lowest interest rate.

If you do plan to take out loans, be wary of ones from private lenders that boast good-looking interest rates.

For instance, Sallie Mae, the largest private student lender, is offering loans with a variable rate as low as 2.25% and ones with a fixed rate as low as 5.75%. In comparison, new federally subsidized loans taken out by undergraduates currently carry a fixed 3.4% rate, and federal parent Plus loans currently have a fixed 7.9% rate.

"Are these low rates appealing to parents? Absolutely," says Mr. Bickford, the former financial-aid officer. But it's hardly ever a good idea to go with one of these private loans instead of a federal one, no matter the difference in rates, he says.

With the variable-rate options, the rate may rise above the fixed federal rate in the years that you or your child are paying it back. Private loans are also less flexible than federally backed ones if you're in a tough financial situation later on.

Thinking an aid offer is set in stone.

In many cases, colleges will increase your aid package if you appeal it. But you'll have to know what information to put forward to convince them.

If your family has financial constraints that don't show up on the FAFSA—the form doesn't ask about things like high medical bills or support for a special-needs child—you should send financial documents that attest to this. Send similar documents if you've had a big financial change since your base income year.

Colleges may also boost your aid package if you tactfully show them that directly competing colleges are offering you a better aid package. At many schools, "they're figuring out the minimum amount of aid they need to give you to get you to come," says Kalman A. Chany, a New York City-based consultant who helps families maximize their financial-aid packages.

Send the aid office the award letters from the other colleges and reiterate your child's interest in their school. Even at need-only institutions, you may land a better package, says Mr. Weinerman. "There's a lot of art in need-based financial aid," he says.

Figuring aid will be about the same all four years.

Once your child's freshman aid package is set, remember that you'll have to go through the process again with a new FAFSA each subsequent year, and that the results may well be different, even if your financial picture doesn't change in your new base income year.

Many colleges these days practice "frontloading," where they offer students more money freshman year than in later years to get them in the door. The typical student at a four-year public or private nonprofit college will get around $1,400 less in grants and scholarships their sophomore year, according to an analysis of aid data done by Mr. Kantrowitz.

If their financial situation stays the same, there's little families can do to prevent this drop-off in grant aid, says Mr. Kantrowitz.

Still, a college's financial-aid office may be forthright about frontloading if you ask, he says. Once you know you'll likely get less aid, you can start saving to cover the shortfall.

One more thing to bear in mind: Even if your child didn't receive any aid in the first year of college, keep applying in subsequent years. If you have a change in your family situation—say, another child goes off to college or your family income goes down—you could become eligible for aid.

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