DOLLARS & Sense

Family Financial Education Foundation

Edition 7, Volume 1

The Cost of a Good Education

Chances are you've been told more than once in your life that to get a good job, you need an education. While many people got a good job without an education, there are many more who got a good job because they did have an education. "Consider the median wage of full-time workers who are at least 25 years old. At the end of last year, it was $986 a week for those with a bachelor's degree or higher, versus $574 for those with only a high-school education, according to the most recent calculation from the Bureau of Labor Statistics." (The New York Times, October 7, 2005.) A four-year college degree can be a solid investment, but there is no guarantee you will get that well-paying job as soon as you graduate so be prepared to be patient.

An education costs money. When you are trying to get out of debt, the last thing you want to do is create new unnecessary debt, but it is very difficult to complete an education without some form of financial assistance unless you or your parents planned for college many years ahead. Typical debt statistics for graduating college seniors is more than $19,000 at public institutions and nearly $22,000 for private colleges. Some undergraduates borrow as much as $35,000. Graduate students typically borrow even higher amounts, with the additional debt for a graduate degree ranging from $27,000 to $114,000 for a medical degree.

There are many things to consider before taking on education debt. Financing an education can take many forms. An education loan is a form of financial aid that you repay, with interest. Scholarships do not have to be repaid. There are three types of education loans: student loans (e.g., Stafford and Perkins loans), parent loans (e.g., PLUS loans) and private loans (alternative student loans). Federal laws establish the maximum interest rates and fees that can be charged for federally guaranteed loans. Lenders are free to charge lower fees, and so many offer some form of discount to attract borrowers.

Interest rates on federally guaranteed education loans are generally reasonable. For instance, Stafford Loans that were first granted after July 1, 2006, have a fixed interest rate of 6.8%. It's important to know, however, that if you receive an Unsubsidized Stafford Loan, this rate also applies while you're still in school. Interest accrues even if you are not yet repaying the loan. If you are able to get a Subsidized Stafford Loan, interest will not begin accruing until you graduate.

The fixed interest rate on new PLUS loans granted after July 1, 2006 is 8.5%. PLUS loans are designed for parents who are paying some or all of their undergraduate child's college expenses. Parents must be creditworthy and may borrow up to the cost of the child's education that remains after financial aid is deducted.

Repayment of PLUS loans also differs from repayment for Stafford loans. Parents must begin to repay a PLUS loan within 60 days after the student withdraws the loan money. Unlike a Stafford loan, repayment must begin while the student is still enrolled. The parent has up to 10 years to repay the loan with a $50 minimum monthly payment. ■

Becoming a Nontraditional Student

If you have not attended school since leaving high school, you have probably been told many times by well-meaning friends and family that one way to improve your financial stability is by getting an advanced education. We've certainly mentioned it in our FFEF publications. And chances are you have given some thought now and then to continuing your education. Because deciding whether or not to return to school can be a stressful decision to make and because the thought of going back to school can be daunting, this edition of the FFEF newsletter is dedicated to clearing the path a little and offering food for thought.

Chances are, if you were to return to school, you would be doing so as a "nontraditional" student. Just exactly what is a "nontraditional" student? The term is not a precise one and usually includes a much broader group than many of us think. Most people relate the term to age, meaning students who are older than 25. Although age is one of the defining characteristics, financial dependency status, family situation, and high school graduation status are also considered. Many colleges today offer information specifically for nontraditional students and there seems to be a general consensus among these colleges that nontraditional students have one or more of the following characteristics:

- Does not enter postsecondary education in the same calendar year as high school completion
- Attends school part-time for at least part of the school year
- Works full-time (35 hours or more per week) while enrolled
- Is no longer dependent on parents for financial support
- Has one or more children and is a single parent
- Does not have a high school diploma

You may be surprised to learn that large numbers of adults are making the decision to advance their education. If you were to enroll in a college course today, you would discover that many of your fellow students are adults. In fact, the population of college and university students over the age of 25 is at an all-time high with estimates that the nontraditional group of students makes up between 40% and 50% of all students. This large number of adult students entering or returning to college has led to many colleges offering support services geared specifically to nontraditional students.

Many adults are intimidated about returning to college because they feel that college is only for young people or they may feel too far removed from school. If you have feelings of apprehension, please keep in mind that college is for anyone who wants to learn. Many professors actually prefer to teach adult students because adults bring real world experience to the classroom and often have more motivation and desire to learn than younger students.

Retirement planning and education are taxpayers' two most important financial planning concerns. The convenience of automatic deductions and tax-deferred deductions encourage us to fund our retirement plans while education accounts for our children are often forgotten until it's almost time for them to register for college. The growing concern for many parents is whether or not they will be financially capable of sending their children to college. College tuition can range anywhere from $5,000 to $30,000+ per year, and the average bachelor's degree requires at least four years to complete. Add the cost of room and board, textbooks, and activities, and you can be looking at as much as $50,000 per year. Pretty scary.

With the cost of living continually increasing, you will want to be sure that at least a portion of your children's education costs will be covered. You will be happy to know that there are several ways to do that.

Over the last few years, the Federal Government has created some ways to help make saving for an education a little easier. In addition to more standard methods of saving, there are three plans that are geared specifically to financing an education.

1. Coverdell Education Savings Account (formerly known as Education IRA): A Coverdell ESA is an education fund that is a great way for parents, grandparents, and others to help meet the rising costs of a student's education. You can set up an ESA for a designated individual (beneficiary) who must be younger than 18 years old when the account is opened. There are exceptions to this for individuals with special needs. You will have control over the account only until the beneficiary reaches his or her 18th birthday.

The maximum annual amount you can deposit in the account is $2,000. A nice feature of this account is that funds can be used to pay qualified expenses not only for college and university, but also for elementary and secondary school. Qualified expenses include activity fees, textbooks, supplies, equipment, and some boarding fees. A drawback is that if the beneficiary must apply for additional financial aid to pay for college, the funds must be declared as an asset.

While there is no tax deduction for amounts contributed to an ESA, the earnings are tax free and no tax-

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es are due upon withdrawal if the guidelines are met. The funds must be withdrawn by 30 days following the beneficiary's 30th birthday or the fund can be designated to a different beneficiary within the same family.

Benefits:

- Qualifies as a tax shelter for parents for capital gains.
- Up to $2,000 per child per year can be deposited, depending on your income.
- Withdrawals are penalty free if they are for qualified education expenses.
- Withdrawals are taxed at the beneficiary's tax rate rather than at the parents' rate.
- There are flexible investment choices.
- Funds can be used for elementary, secondary, and higher education qualified expenses.
- Anyone who meets the income requirements can contribute to the account, including aunts, uncles, grandparents, friends, and even the beneficiary.
- If the designated beneficiary doesn't use all the funds, the remaining funds can be changed to any other family member younger than 30 years old. Qualifying family members include: son/daughter, stepson/stepdaughter, brother/sister, stepbrother/stepsister, father/mother, stepfather/stepmother, niece/nephew, any in-law, spouse of any of the above, and first cousins.

Drawbacks:

- Contributions cannot be made after the beneficiary turns 18.
- If the beneficiary applies for financial aid, the account funds are considered an asset for the beneficiary.
- Funds must be withdrawn before 30 days after the beneficiary's 30th birthday or be switched to another beneficiary.
- If the funds are not used for education expenses, the earnings are treated as ordinary income and may also be subject to a 10% penalty.
- You will have control over the account only until the beneficiary reaches his or her 18th birthday.
- The beneficiary is then free to use the funds as he or she sees fit.

2. 529 Savings Plan: This is a plan that is provided by all 50 of the United States. It is intended to allow you to prepay or to contribute to an account established for the beneficiary's expenses at a pre-established higher education institution. You should check with your bank or with the school itself to see what expenses qualify for payment from a 529 Savings Plan.

The nice thing about this plan is that there are no age or income restrictions, and although the plans are offered by individual states, there is no residency restriction, which means that if you live in one state, you are allowed to participate in a plan offered by another state.

Benefits:

- A 529 Savings Plan can create a tax shelter for the beneficiary.
- Interest and qualifying withdrawals are tax exempt.
- Anyone can open an account, contribute, and be listed as the beneficiary.
- The owner of the account (the donor) is always in control of the money.
- Beneficiaries can be changed easily and as often as once a year.
- The funds are not considered to belong to the beneficiary so they do not affect applications for college financial aid.
- Some employers now partner with these programs so contributions can be deducted automatically from your paycheck. Check with your employer.
- Contribution limits are high, as much as $300,000.

Drawbacks:

- Investment choices are quite limited. The choice is generally between mutual funds or annuities.
- In some cases, the choices are based on the age of the beneficiary.
- The name of the plan refers to a tax loophole in the IRS code's section 529

3. UTMA Custodial Account: This plan allows an adult to open an account using the beneficiary's Social Security Number in the beneficiary's behalf. The adult acts as custodian of the account. This is a more flexible account as the funds are not required to be used exclusively for education-related expenses. Contributions can be made up to $11,000 per year. The first $750 is not taxed. If the beneficiary is under 14, the next $750 is taxed at the child's rate, but any contributions over $1500 are taxed at the parent's tax rate. If the beneficiary is over 14, any contributions beyond the first $750 are taxed at the child's rate, which can be considerably less than the parent's rate.

Benefits:

- Account does not have to be opened by a relative.
- Funds are directed to a predetermined institution so savings amount needed can be better assessed.
- Funds are flexible and can be used for expenses in addition to education-related needs.
- A portion of annual contributions is not taxed.
- There is no contribution limit.

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ARTICLES

TIPS & TRICKS

It's Important to Manage Your Student Loan Debt

If you do take out loans to finance your education, it is just as important to repay them properly as it is any other loan.

Be sure you understand just how much you owe and to whom you owe it. When you are worried about classes and homework, sometimes you may not think about just how much debt you are accruing. Those federal loans can seem pretty easy to qualify for, and if you're not careful, you will have more debt than you can handle. Know which financial institutions hold your loans. It may only be one or it may be several.

Make your payments on time. Making your student loan payments on time will help you establish good credit and improve your credit rating. It will also decrease the amount of interest you pay. Student loans are just like any other loan—delinquent payments or defaulting on a loan will do damage to your credit worthiness. Not only that, if you default on a student loan, it will be turned over to the federal government for collection.

Make your payments affordable. Don't accept the first loan and terms that come along. You have the right to negotiate. Many financial institutions will offer benefit programs to entice students to borrow from them. These benefits can include lower interest rates and repayment options. A common benefit is a reduced interest rate for payments that are automatically deducted from your bank account every month, or for a certain number of payments that are paid on time. Find the program that works best for you.

Some repayment options include:

1. Standard Option: Monthly loan payments have a fixed amount and can be paid back in up to 30 years, depending on how much you borrow. Ten years is a more common repayment term. Paying each payment on time for the life of the loan will mean you pay the least amount of interest of all your options.

2. Graduated Payment Option: This plan allows you to have lower monthly payments for the first few years and then the payments increase gradually over the life of the loan.

3. Income Sensitive Option: While this option may sound appealing, it can be a little risky if you're not careful. With this option, the monthly payment amount is adjusted annually based on your income, but if you're not careful, your monthly payment may not be enough to cover the interest accruing on your loan, and you are never able to pay off the principle.

4. Consolidating Your Loans: Usually you must apply for a new school loan each year you are in college. This means that when you are through, you may have three or more student loans. If so, you may want to consider consolidating your loans. Loan consolidation, in very simple terms, means you combine all your loans into one so you only have one monthly payment with a fixed interest rate. Because the combined total is higher, it also usually means you will have a longer repayment term. To really benefit from a consolidation option, your loans should total at least $10,000, and all the loans must be under your social security number. ■

Find more great money saving ideas on our web site, FFEF.org

Becoming a Nontraditional Student *(Continued from page 3)*

Drawbacks

- The beneficiary takes control of the account at age 18.
- The account must remain in the original beneficiary's name.
- The funds are considered assets of the beneficiary so they affect applications for college financial aid.

Be sure to compare the plans carefully with the help of your financial advisor so you can decide which features and benefits are best suited to the educational goals you have. ■

Business Hours!

Monday-Friday: 7:00 a.m.-7:00 p.m.

Saturday: 8:00 a.m.-12:00 noon

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