Home Equity and Financial Aid

In this video, I am interviewing **Paula Bishop**, a CPA from Bellevue, WA, who has helped countless families over the years with financial aid questions, as well as with filling out the financial aid forms. I spoke to Paula at a college conference in September in Indianapolis about how home equity impacts financial aid.

Owning a primary home, regardless of how much equity it has, is irrelevant at the vast majority of colleges and universities that use the FAFSA exclusively. Home equity does matter, however, at many of the most prestigious private institutions and the following public institutions that use the CSS/Financial Aid PROFILE:

- College of New Jersey
- College of William and Mary
- Georgia Institute of Technology
- University of Colorado, Boulder
- University of Michigan, Anne Arbor
- University of North Carolina, Chapel Hill
- University of Virginia, Charlottesville
- Western Kentucky University

How Much Is a House Worth?

If your clients/families are applying to PROFILE schools, they will be expected to share what the house is valued at. Paula suggested that parents use whatever source provides the lowest home value that could include assessed property valuation from the local taxing authority, Zillow or other house comp websites or recent sales in the neighborhood.

There was a fascinating story in the *Los Angeles Times* in February 2015 that suggested that many Zillow home value estimates or *zestimates* as the site calls them are significantly flawed. Zillow says it has a **median error rate of roughly 8%**. On a home valued at $700,000, that's a valuation discrepancy of $56,000. Zillow says that 17% of its home valuations are off by more than 20%. If a college uses Zillow to double check the value of your home, it could create a problem if it's an overvalued estimate.

Here is the *LA Times'* article:

Inaccurate Zillow 'Zestimates' a Source of Conflict Over Home Prices

How A House Can Impact Financial Aid

Depending on how schools treat home equity, the chances of getting financial aid could blow up while at other institutions the odds wouldn’t be jeopardized even if a family is living in an exclusive zip code.

Many schools that assess home equity for financial aid purposes do so by linking it to the family’s income. For instance, a school might assess home equity at no more than two times the family’s income. Let’s look at an example of how this would work:

- Family’s income: $60,000
- Home equity: $400,000

Normally, the schools that use the PROFILE formula would assess the home equity (as well as other parental assets) at 5% for financial aid purposes.

400,000 x 5% = $20,000

In this example, the home equity value would have boosted the expected family contribution (EFC) by $20,000 (a huge hit!) if the school didn’t link the home equity to income.

But now let’s look at what happens when the school ties the home equity assessment to no more than two times the family’s income of $60,000.

$60,000 x 2= $120,000

In this example, the school would only use $120,000 of home equity this family’s aid calculation.

120,000 x 5% = $6,000

So in this example, the parent’s EFC would rise $6,000 rather than $20,000.

How Individual Schools Treat Home Equity

For families who hope to qualify for need-based aid, it’s important to know how individual schools treat home equity. To help you with this effort, I am sharing Paula's spreadsheet of the home-equity policies of 110 schools:

Home Equity Spreadsheet

Paula contacted the schools about their home equity policies this summer, but keep in mind that schools can change how they assess home equity at any time so don’t just depend on this list.

Schools that Ignore Home Equity

As you'll see from Paula's list, some PROFILE schools don't consider home equity at all, which is obviously the best scenario. Institutions in this smallest category include:

- Bard College
- Bucknell University
- California Institute of Technology
- DePauw University
- Hamilton College
- Harvard University
- Princeton University
- Santa Clara University
- University of Virginia
- Washington University, St. Louis
- Whitman College

Schools That Hit Home Equity Hard

On the other extreme, some schools use the full weight of parents' home equity to help determine financial need, which can seriously hurt aid changes. Here are some examples:

- American University
- Bentley College
- Boston College
- Elon University
- Emory University
- Holy Cross College
- Ithaca College
- Johns Hopkins University
- MIT
- Northeastern University
- Providence College
- Rensselaer Polytechnic Institute
- Roger Williams University
- Stonehill College
- Union College
- University of Michigan
- Williams College

Some schools that take this draconian approach will consider parent appeals, but how many families even know this is a possibility? In fact, parents typically won't even know why their aid packages seem so paltry.

It’s highly unlikely that parents are going to trace a poor award back to their home equity. But now you can tell your families that an appeal is possible.

Schools That Limit Home Equity Hit

Other institutions use a home-equity cap that’s tied to the family income so it’s less likely that someone who is house rich, but cash poor will be penalized. The home-equity caps below range from 1% to 4%, which is a huge span.

Here are a few schools in this category:

- Amherst College (1.2x)
- Brown University (3x)
- Grinnell College (1.5x)
- Haverford College (1.2x)
- Johns Hopkins University (3x)
- Lewis and Clark College (2x)
- Kenyon College (4x)
- Macalester College (2x)
- Middlebury College (1.2x)
- Muhlenberg College (1x)
- Oberlin College (1.2x)
- Reed College (2x)
- Rice University (2.5x)
- Stanford University (1.2x)
- University of Chicago (2x)
- University of Southern California (2x)
- Vanderbilt University (2.5x)
- Vassar College (1.5x)
- Wake Forest University (2x)

More Advice…

Paula Bishop recommends emailing schools to ask how they treat home equity so you have a record of their responses later on if you end up appealing a financial aid award.

Not all schools will be forthcoming with this information. When Paula, for instance, asked New York University (a school with notoriously poor financial aid) about how it treats home equity, it declined to say.

By the way, how schools treat home equity can also depend on how desirable an applicant is.

Finally, some institutions that only use the FAFSA may request information about your home equity on a supplemental form.

Discussion/Questions

Have you had clients/families who have been hurt in the aid process because of their home equity?

If you learn about how a PROFILE school not on Paula's list treats home equity, please share with us and I'll add it to the list!

Do you have any questions about home equity?

Investments and Financial Aid

Conventional wisdom suggests that a family's assets will always jeopardize a student's chances for financial aid. That is just plain wrong.

Mark Kantrowitz, one of the nation's most respected financial aid experts, has estimated that only seven percent of families who file for financial aid see their aid eligibility decline because of their investment assets.

The reason why relatively few families need to worry about their net worth hurting aid chances is because of what the aid formulas disregard. Neither the federal formula **(FAFSA)** nor the institutional formula **(CSS/Financial Aid PROFILE)** penalize families for their qualified retirement accounts, such as Individual Retirement Accounts, SEP-IRAs, 401(k)s, 403(b)s, KEOGHs and pension plans.

Families often do not understand that the federal formula (but not the PROFILE methodology) also doesn't ask about their home equity. In fact, the FAFSA doesn't even inquire if they own a primary residence.

Schools using the PROFILE do care about your clients' home equity, but what they do with it can vary dramatically. The first lesson in this module (A Closer Look at Financial Aid Formulas), examines the home equity issue in greater detail.

529 Accounts and Financial Aid

Parents seem particularly anxious about how their 529 savings accounts might hurt their aid chances. As you'll learn in the above video, however, 529 assets are treated more favorably because they are assessed as a parent asset. The federal formula assesses parent non-retirement assets at a maximum of 5.64% while the PROFILE assesses parent assets at 5%. (Please ignore the reference to Lesson 2 in the video.)

Here's a quick example of what that means. If your client has $50,000 saved up for college, the federal formula would reduce their eligibility for aid by $5.64 per $100 dollars of savings. With a $50,000 nest egg, financial aid eligibility would drop by just $2,820. And the parents in this example wouldn't even get hit that much because of something called the *Parents' Education Savings and Asset Protection Allowance*. See the chart below.

The federal financial aid formula allows all parents to shield a portion of their non-retirement assets, whether that be 529 accounts, taxable investment accounts, savings accounts, certificates of deposits, checking accounts or any other money that isn't kept in qualified retirement accounts.

How much parents can shelter will depend on the age of the oldest parent. The calculation is based on what the age of this parent would be on the last day of the year. The older the parent, the more the household can shield. A family can protect considerably more if parents are married.

Table A5: Parents' Education Savings and Asset Protection Allowance

for EFC Formula A Worksheet (parents only)

*Age of older parent as of 12/31/2015**	Allowance if there are two parents**	Allowance if there is only one parent	*Age of older parent as of 12/31/2015**	Allowance if there are two parents**	Allowance if there is only one parent
25 or less	$0	$0	45..............	$28,200	$7,500
26..............	1,700	500	46..............	28,800	7,700
27..............	3,300	900	47..............	29,500	7,900
28..............	5,000	1,400	48..............	30,300	8,100
29..............	6,700	1,800	49..............	31,100	8,300
30..............	8,400	2,300	50..............	31,800	8,500
31..............	10,000	2,700	51..............	32,700	8,700
32..............	11,700	3,200	52..............	33,500	8,900
33..............	13,400	3,600	53..............	34,400	9,100
34..............	15,100	4,100	54..............	35,400	9,300
35..............	16,700	4,500	55..............	36,300	9,500
36..............	18,400	5,000	56..............	37,300	9,800
37..............	20,100	5,400	57..............	38,300	10,000
38..............	21,800	5,900	58..............	39,400	10,200
39..............	23,400	6,300	59..............	40,500	10,500
40..............	25,100	6,800	60..............	41,700	10,800
41..............	25,600	6,900	61..............	42,900	11,000
42..............	26,200	7,100	62..............	44,100	11,300
43..............	26,900	7,200	63..............	45,400	11,600
44..............	27,500	7,400	64..............	46,700	11,900
			65 or over ..	48,100	12,300

*Determine the age of the older parent listed in FAFSA/SAR #64 and #68 as of 12/31/2015. If no parent date of birth is provided, use age 45.

**Use the two parent allowance when the Parents' Marital Status listed in FAFSA/SAR #59 is "married or remarried" or "unmarried and both parents living together."

The chart above was pulled from the latest federal **EFC Formula Guide, 2015-2016 (page 19)**. The amounts on this chart will change yearly.

Let's say the oldest parent is 50. The family would be able to shield $31,800 in 529 savings plan money, as well as any other cash kept in non-retirement accounts such as savings, checking and brokerage accounts.

The amount a mom or dad could shelter in a one-parent household is significantly less. A 50-year-old single parent, for instance, could shelter just $8,500. I have never found any satisfactory answer as to why the sheltered amount for single parents is much lower than half of what a married couple can shelter.

The federal aid software will automatically shelter this money.

You can see examples about how this formula works in the video above. Keep in mind that the video doesn't have the latest 2015-2016 asset protection figures.

The Asset Allowance Has Been Shrinking

A visitor to my blog at **TheCollegeSolution.com**, posted this comment about the asset protection allowance that has been shrinking in recent years. Here is his note:

The EFC formula has evolved in the past few years to greatly reduce the asset protection allowance of parents. For example, the allowance for a 60-year old in 2011-2012 was $64,000 and only $45,500 for 2014-2015. That would amount to an increase of $2000 in EFC for many families. Do you know of any rationale for this? I thought the government was trying to make college more affordable, not less.

The dad who posted that comment was correct. The EFC asset protection allowance has been declining for year and can fluctuate up or down.

The asset protection formula is impacted by the inflation rate. When inflation and interest rates are low - as it's been for quite some time - the allowance declines. A very old federal formula assumes when inflation/interest rates are low, families don't have to save as much for retirement. It's clearly a broken formula.

When I asked an expert at the U.S. Department of Education why single parents are particularly penalized with the asset formula, he didn't have an explanation. Only allowed to talk on background, he just said the formula has always been harsher on single parents since it was created decades ago.

Here is an article from **Troy Onik**, who is a nationally known college expert, financial advisor and **Forbes columnist**, that explains what's going on:

New College Aid Formula Is Out, Penalizes Savers Additional 25%

Student Assets and Financial Aid

The FAFSA formula allows students to shield all or a portion of their income. For the 2015-2016 school year, a student can earn up to $6,310 for the year and not jeopardize aid.

In contrast, the PROFILE does not provide an allowance, but rather it assumes that students will contribute something to their college education. Many PROFILE colleges require that students contribute in the $2,200 range (the EFC is increased by this much) for their education regardless of whether they have a job or a savings account.

Money that teens have in non-retirement accounts is assessed at stiffer rates than parent assets. The PROFILE assesses student assets at 25% and the FAFSA assesses them at 20%. Unlike their parents, students do not have an asset protection allowance.

Here's an example:

If a student has $2,000 in his checking account, schools would consider that $500 (PROFILE) and $400 (FAFSA) in that account would be available to pay for college. The student's EFC that's generated using the FAFSA methodology would be $400 (assuming he/she had no income beyond $6,130 that would boost the EFC further.)

Most students do not have to worry about their assets or income making much of an impact on their financial aid eligibility. An exception are UGMA or UTMA and any other custodial accounts, which parents or grandparents might be using the save for college. These accounts will be assessed as student assets. As I mention in the video, it can be a smart idea to move this money into custodial 529 plans because the money will then be treated as parent assets at the much lower rate.

Trusts funds set up for the benefit of a child will also be considered a child asset even if the student doesn't currently have access to the money.

Money that students have sitting inside a retirement account, such as a Roth IRA, does not count in aid calculations.

When Do You Calculate Your Assets?

While all financial aid formulas will want to know what the income for parents and the student was for a calendar year - just like the IRS requires - the financial aid applications only want you to share the value of you and your child's assets on the day that you submit the FAFSA or PROFILE. So if the stock market has a bad day, this could be a good time for you to file your financial aid forms. It would also be better to file the applications after you have tapped your investment accounts to buy a car, pay a tuition bill, pay credit card bills and cover other expenses.

Learn More...

Funding Your Child's College Education With Stock Options and Other Stock Grants

Paying for College: How the Financial Aid Formulas Work

Can a Summer Job Hurt a College Student's Financial Aid Chances?

529 Plans: Why You Should Invest for just 24 Hours

Questions/Discussion

Do you have any questions about how investments impact financial aid? Would you agree that how investments impact financial aid is a significant concern of parents?

Ways to Maximize a Financial Aid Package

Parents often want to know if there are ways that they can increase their chances for financial aid. They often think that positioning their money creatively will boost their chances. Much of the time this isn't wise or necessary.

Whether a child will qualify for financial aid will depend heavily on these factors:

- Parental income
- Number of students in household
- Number of children in college simultaneously
- Whether or not parents are divorced or separated

Some assets will matter, but not as much as you might think.

Retirement assets are not counted in financial aid formulas. And most of the time not all of the cash in college accounts and taxable accounts is counted either.

Maximizing eligibility for aid can often only be tweaked at the margins. Consequently, some of the suggestions I'm making here may not have much, if any, impact on increasing financial awards.

Before parents try any strategies involving their assets, they should run the numbers on the College Board's **Expected Family Contribution calculator**. You'll learn more about EFC calculators in the first module, *Your Families' First Step*. Parents may discover that making any moves will not lower their Expected Family Contribution.

Consult Real College Experts

They should also consider consulting a tax professional or financial planner who is truly an expert on college financing before making any significant moves. Unfortunately, many self-described college financing experts are insurance agents who know little about college financing.

These agents often troll for clients by holding free college workshops. They will promise to help boost the family's financial aid, but their prime goal is typically to sell annuities or life insurance to hide the family's assets. This is a very expensive move and the insurance agent will pocket a hefty commission for a misguided financial transaction.

Counselors should also be leery if financial professionals want to give presentations at their schools. Some would-be presenters will be legitimate and others who are seeking clients, will be looking for ways to peddle annuities and life insurance.

Here is a link to an excellent article that my friend Kim Clark of *Money* magazine wrote in 2103 about the hazards of depending on product pushers for college advice:

College Aid: Don't Take the Bait

Important to Know

Whether a child will receive the maximum financial aid award for which he or she is eligible, will be heavily dependent on the child's college list.

Parents may position their income and assets in an effort to obtain more aid, but if the schools their child applies to are stingy, a larger financial aid package could simply include more loans.

How to Maximize Financial Aid Awards

1. Complete the applications.

This might sound like obvious advice but millions of families never complete the FAFSA. When applicable, families also need to complete the CSS/Financial Aid PROFILE.

Parents shouldn't expect schools to alert them about their financial aid deadlines or notify them if they fail to submit their aid application. These institutions, after all, can potentially save money if a student doesn't seek financial aid. Without filing a financial aid form, a child can't receive need-based aid.

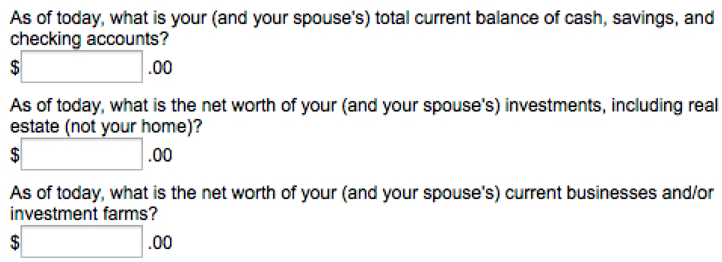
College consultants and high school counselors, in particular, might be interested in seeing just how many FAFSA applications are submitted at individual high schools in their area. Here is the federal link to the **FAFSA Completion Rate by High School**. Counselors should make a point of urging their parents to file!

2. Don't include retirement assets on the FAFSA.

Colleges and universities don't care how much money parents (or children) have tucked away in retirement accounts, such as IRAs, 401(k)s, 403(b)s and SEP-IRAs. You could have millions sitting in retirement accounts and the FAFSA won't even inquire about this money.

Consequently, parents should NOT include retirement assets when completing the

FAFSA! Unfortunately, the FAFSA is not clear on this issue. As you can see from the following screenshot of the 2014-2015 FAFSA, the aid application inexplicably doesn't explain that parents and students should not include the value of qualified retirement accounts when asked about cash, savings and investments.


As of today, what is your (and your spouse's) total current balance of cash, savings, and checking accounts?

$ .00

As of today, what is the net worth of your (and your spouse's) investments, including real estate (not your home)?

$ .00

As of today, what is the net worth of your (and your spouse's) current businesses and/or investment farms?

$ .00

While the PROFILE will ask parents and the student how much money they have invested in retirement accounts, it's rare that a school would lower an aid award because of this.

3. Sink more money into retirement accounts.

If parents can swing it financially, it's a good idea to invest more money into retirement accounts. They will boost their chances of enjoying a comfortable retirement and at the same time you'll be able to shield this money from financial aid calculations.

Here is something, however, that aggressive retirement savers need to keep in mind:

If families contribute to a retirement plan, such as a 401(k) or a traditional IRA, the year before their child heads to college and every subsequent year that they file for aid, the financial aid formula will adjust their income upward. The formulas will add back to their income the contributions dollars to the family's retirement plan, but this money will no longer be considered an asset for financial aid purposes. This money is considered the parent's *untaxed income*.

Parents won't generate untaxed income, however, if they contribute to a Roth IRA because those contributions are made with after-tax dollars. People who contribute to a Roth don't receive an upfront tax break like investors, for instance, who sink money into a 401(k) or a traditional IRA.

4. Do not tap into retirement accounts.

Parents should not withdraw money from retirement accounts in the calendar year before they apply for financial aid. Withdrawals from retirement accounts such as traditional IRAs and workplace accounts such as 401(k)s and 403(b)s will be treated as taxable income.

If they pull the cash out because of a financial emergency, they can ask the school to disregard it by seeking a professional judgment, but there is no guarantee that this will work.

5. If possible, avoid IRA rollovers.

Parents should try to avoid rolling a 401(k) or other workplace account into an IRA while they are seeking financial aid. Moving money from a workplace account to an IRA should not impact financial aid at all, but there have been cases where that rollover amount has been added to the parent's income!

This has been happening when parents have used the **federal Data Retrieval Tool** to update their FAFSA after they have filed their federal income taxes. I am sure some students did not receive aid due to this problem and didn't even know this was the problem. Two former colleagues of mine at the *Los Angeles Times* had this happen to them after the wife moved her newspaper 401(k) to an IRA rollover. The parents had a heck of a time trying to convince American University, where their daughter wanted to attend this fall, that their EFC was vastly inflated because of this federal mistake.

6. Move money out of child's name.

Financial aid formulas penalize money held in a child's name more harshly than parents' assets. Most students don't have enough assets for this to make a difference. A major exception can be money tucked away in custodial accounts -- Uniform Gift to Minors Act (UGMA) and Uniform Transfer to Minors Act (UTMA).

Parents can close down an UGMA or UTMA and pay any applicable taxes and then move the cash into a *custodial* 529 college savings account for their child. The money in any kind of 529 plan will be treated more favorably as a parent asset for financial aid purposes.

The money from a closed custodial account can also be used for the benefit of the child before a parent completes any financial aid applications.

Be careful about the timing of shifting money from a custodial account to a custodial 529 account. Liquidating the account can generate capital gains (reportable on the FAFSA and PROFILE) so it's best to make this move two or more years prior to enrolling in college.

Keep in mind that if a child has a retirement account, such as a Roth, this money should stay put. It will not hurt a child's aid chances as long as it remains in the account.

7. Have a child take a gap year.

A family's EFC will shrink if more than one child is in college at the same time. With two children in college, the parent EFC for a PROFILE school will drop 40%. Consequently, the PROFILE EFC would end up being just 60% of the parent EFC if only one child was in college.

Here is a handy chart from a new guidebook, **Filing the FAFSA: The Edvisors Guide to Completing the Free Application for Federal Student Aid**: that shows how the number of children in school will reduce an EFC for the federal methodology (FM) and the institutional methodology (IM).

Number in College	FM	IM (CSS/Financial Aid PROFILE)
1	100%	100%
2	50%	60%
3	33%	45%
4	25%	35%

8. Spend child's money first.

If a family ends up with assets in the child's name, they should spend that money first to cover college costs rather than parent assets. Once the child's assets are gone, the student's EFC will drop.

9. Exploring whether families qualify for the simplified means test.

If the parents' adjusted gross income is less than $50,000 and meets certain other criteria, including being eligible to file the IRS Form 1040A or 1040 EZ, they do not have to share their non-retirement assets on the FAFSA. This could be a huge boon to parents who have lost their jobs or are underemployed, but have accumulated a significant nest egg over the years. The PROFILE does not have a simplified means test.

10. Apply for aid early.

It's best for families to apply for financial aid as early as possible. There is essentially no deadline for seeking federal aid – the application period for the 2015-2016 school year extends from Jan. 1, 2015 to June 30, 2016. States, however, have much shorter deadlines for their aid.

The following states advise families to apply as soon as possible after Jan. 1 each year because the money is dispensed to eligible students on a first-come-first-served basis until it runs out:

- Illinois
- Kentucky

- Tennessee
- South Carolina
- Vermont
- Washington

States with early fixed deadlines in February or early March:

- California
- Connecticut
- Indiana
- Maryland
- Michigan
- Montana
- Rhode Island
- West Virginia

There could be more states that have early deadlines and the dates can change yearly. Always check!

Here is the link to the **financial aid deadlines for each of the 50 states**.

If families up against a tight deadline, they can file their aid applications using estimated tax information. They can update their aid application with new figures later.

The FAFSA is available beginning Jan. 1 each year, but the **CSS/Financial Aid PROFILE** is available beginning Oct. 1. If a family is applying early, they will have to estimate their taxes.

11. Pay attention to college aid deadlines.

Don't give a school an excuse not to award a child financial aid. Make sure that families meet the aid deadlines for each school. If a child is applying Early Decision or Early Action, it's likely that the schools will want them to complete the aid application in the fall of the child's senior year in high school.

12. Know the rules for divorce.

Make sure the right parent files for financial aid – it can make a significant difference in how much aid the child receives. I cover this issue in a lesson in the module entitled, *A Closer Look at Financial Aid*.

13. Understand financial aid award letter.

Many financial aid awards are misleading. Some schools intentionally make their letters confusing, such as making loans appear to be grants, in the hopes that parents won't appreciate how poor the awards are. I give advice about evaluating financial aid letters in the module entitled, *Financial Aid Awards/Tax Credits*.

14. Don't hide home equity.

Most schools don't even inquire about the value of a family's house, which makes home equity irrelevant if parents are only filing the FAFSA. PROFILE schools will inquire about home equity.

I'd suggest giving parents copies of these blog posts about financial aid and home equity:

Will Your Home Equity Hurt Financial Aid Chances? A Case Study

Is It Okay to Hide Home Equity?

15. File the FAFSA on a bad day for stocks.

The parents and child should report their income for the previous calendar year on their aid applications. For instance, when applying for financial aid for 2015-2016 school year, they would report their 2014 income. The rule is different, however, for assets. Families are expected to report the value of their assets on the day they file the FAFSA so it's better to submit the application on a day when the stock market has performed poorly or after they have paid their bills. For financial aid purposes, the lower the account balance, the better.

And, by the way, if the financial markets crash after they have filed the FAFSA, they cannot go back and update the aid application with their assets' lower value.

16. Be careful with grandparent contributions.

Grandparents can hurt financial aid chances if they aren't strategic when helping out with college costs. I provide an overview of this topic in a lesson entitled: *Grandparent Savings and Financial Aid* in this module - *A Closer Look at Financial Aid Formulas.*

Learn More...

UGMA and UTMA Accounts

Questions/Discussion

Can you suggest any other financial-aid tips? Have you tried any of these financial-aid strategies with your clients?

Divorce, Separation and Financial Aid

To understand how divorce can impact financial aid, watch this interview that I conducted three years ago at the annual conference of the National Association for College Admission Counseling in New Orleans. I interviewed **Paula Bishop**, a CPA in Bellevue, WA, who is a national expert on all aspects of financial aid.

A California Divorce Case Study

Once you've seen the video, click the link below to see how the rules regarding divorce and financial aid played out for a California family that did not approach the college search strategically. And then read the rest of this lesson to learn what you need to know about financial aid for divorced and separated couples.

A Case Study: Financial Aid and Divorce

If your clients are divorced or separated, the financial aid formulas may treat their child differently. The child might even enjoy a financial advantage that other students don't have.

How divorce and separation will impact a family's chances for financial aid will depend on which aid applications parents must complete - the FAFSA alone or also the CSS/Financial Aid PROFILE.

How the FAFSA Treats Divorce or Separation

In cases of divorce or separation, chances are they will only need to complete the FAFSA because most colleges and universities just require this federal form. This will be a plus for some students.

Here's why: The FAFSA only asks for the financial information of the custodial parent.

Unusual Definition of a Custodial Parent

If your client knows they are not the custodial parent, don't be so sure.

They might be custodial parents even if they don't claim the child on a tax return or pay child support. Here's why: The higher-ed world relies on an unusual definition of custodial.

For financial-aid purposes, the custodial parent is the one who took care of the child the majority of the 12-month period dating from the day the FAFSA is filed.

Let’s say the FAFSA was submitted on Feb. 1, 2014. The parent who completed the FAFSA would have been the one who took care of the child for more than six months going back to Feb. 1, 2013.

FAFSA Example

Let's use an example to see how this custodial rule can play out:

The mom is a financial advisor who makes a hefty salary and the ex-husband is a high school teacher.

If the family wants to reduce their college costs, it would make sense for the teen to live with the lower wage earner long enough for the parent to be considered the custodial parent. That would mean at least six months and a day.

If the dad was the custodial parent in this case, the mother’s income and assets would not be divulged. With only the lower-income parent filing the FAFSA, the student would be more likely to qualify for more financial aid.

Separation and Divorce

Separated parents don't have to be legally separated to be treated the same as divorce couples, but they can't be living in the same residence.

FAFSA and Remarriages

So what happens if the custodial parent remarries?

The custodial parent would have to include the income from the new spouse on the FAFSA. And it won’t matter if the married couple signed a pre-nuptial agreement stipulating that the new spouse would have no financial obligation to help pay for college.

If a new spouse is supporting his/her own children or was only recently married, the family could try appealing to a school.

FAFSA Take Away:

- The FAFSA divorce and separation rules can be a huge plus for families when one

parent earns significantly less than the other and hasn't remarried.
- The rules can benefit families because the income and assets from one ex-spouse will never be counted.

How the CSS/Financial Aid PROFILE Treats Divorce

If the child applies to schools that also require filing the CSS/Financial Aid PROFILE, the rules on divorce and separation will vary by school. Institutions using this extra aid application are mostly expensive private schools.

Here is the list of all **participating PROFILE schools**.

PROFILE schools that want the non-custodial parents to share financial information will require them to complete what's called the *Noncustodial PROFILE*.

When considering PROFILE schools, your clients should check out which schools do and don't require the Noncustodial PROFILE. In this screen shot, the red arrow is pointing to the Noncustodial PROFILE column.

Name	State	PROFILE	PROFILE for International Students	Noncustodial PROFILE
10,000 Degrees	CA	Yes	Yes	No
Adrian College	MI	Yes	No	No
Alabama A&M University	AL	No	No	No
Albany College of Pharmacy	NY	Yes	No	Yes
Albany Law S of Union U	NY	Yes	No	No
Albert Einstein C of Medicine	NY	Yes	No	Yes
Albright College	PA	Yes	No	No
Alfred University	NY	Yes	No	No
Alma College	MI	No	Yes	No

At the bottom of this lesson, you will see my list of all the undergraduate institutions that do not require the Noncustodial PROFILE.

I wish I could tell you what schools do with the information contained on the Noncustodial PROFILE, but I can't. Every school follows its own in-house rules.

Some PROFILE schools will only consider the income and assets of the two biological parents. Some will consider the financial wherewithal of new spouses too.

In the video above, Paula Bishop mentioned a wealthy parent who completed the Noncustodial PROFILE, but that parent's income was not considered by the school. That's yet another scenario.

How a PROFILE school handles the divorce/separation issue can depend upon how much a school likes an applicant.

Mixed Financial Aid Results

When a school requires the FAFSA and the PROFILE, it is possible that your clients could qualify for financial aid from the federal and state governments, but be denied institutional need-based aid from the school.

Here's why:

PROFILE schools will use the FAFSA to determine a child's eligibility for federal and state financial aid. The institutions, however, will rely on the PROFILE to determine if a child will qualify for their own in-house aid. In contrast, most colleges and universities rely on the FAFSA to determine which students are also eligible for their in-house aid.

Bottom Line:

1. The only way that you will know how a school handles divorce is to call and ask the financial aid office.

2. Some students will qualify for more financial aid if they apply to schools where the noncustodial parent does not have to submit financial information.

3.Don't assume that a PROFILE school that doesn't use the Noncustodial PROFILE will never ask about the other parent. Schools that rely exclusively on the FAFSA may have their own in-house form for a divorced parent. Ask a school what forms it uses in cases of divorce.

Questions/Discussion

Do you have any questions about divorce/separation and financial aid? Can you share any experiences on this topic?

Downloads

Schools that do not require the Noncustodial Profile.docx

When a Child Is an Independent Student

I received an email once from a high school student in Maryland whose parents earned about $130,000 a year, but had only managed to save a total of $8,000 for her and her twin brother's college costs. The parents expected the twins to cover the rest of the tab.

These teenagers were at a real disadvantage because financial aid formulas are heavily based on the parents' income. So students who face this financial burden on their own aren't going to get a break unless they can qualify as "independent students."

Some parents hope their teenagers can be declared independent students so they can qualify for need-based financial aid, but earning that designation will be impossible for most teenagers.

Independency Questions

Just how difficult is it?

You must answer yes to at least one of the questions that the federal government asks to determine if an undergraduate is eligible for financial aid as an independent student.

Here are the questions:

1. Are you at least 24 years old?

2. As of today, are you married?

3. At the beginning of the 2015-2016 school year, will you be working on a master's or doctorate program (such as an MA, MBA, MD, JD, PhD, EdD, or graduate certificate, etc.)?

4. Are you currently serving on active duty in the U.S. Armed Forces for purposes other than training? (If you are a National Guard or Reserves enlistee, are you on active duty for other than state or training purposes?)

5. Are you a veteran of the U.S. Armed Forces?

6. Do you now have children - or will you have - children who will receive more than half of their support from you between July 1, 2015, and June 30, 2016?

7. Do you now have dependents (other than your children or spouse) who live with you and who receive more than half of their support from you, now and through June 30, 2015?

8. At any time since you turned age 13, were both your parents deceased, were you in foster care or were you a dependent or ward of the court?

9. Has it been determined by a court in your state of legal residence that you are an emancipated minor or that you are in a legal guardianship?

10. At any time since were 13, were you determined to be an unaccompanied youth who was *homeless* or was self-supporting and at risk of being homeless, as determined by (a) your high school or district homeless liaison, (b) the director of an emergency shelter or transitional housing program funded by the U.S. Department of Housing and Urban Development, or (c) the director of a runaway or homeless youth basic center or transitional living program?

Qualifying as an Independent Student

Not living with parents or not being claimed by them on tax returns does not make a student independent for purposes of applying for financial aid!

When students do qualify as independent, they often can qualify for more financial aid, including federal Pell Grants, state aid, and assistance directly from the colleges themselves. This is possible because the parents' income and assets wouldn't be considered in financial aid formulas.

Certainly students need to contribute to their college education no matter how much their parents make. It is, however, unfathomable that some students are taking on debt of $50,000 or more for a college education.

You should tell your families about these rules before they proceed to move their children out of the house without any chance for capturing an independent designation.

Learn More...

I've had more comments (293 and counting) generated for this blog post than any other I have written:

[Deadbeat Parents Who Won't Pay for College]

Questions/Discussion

Do you know parents who have tried to get their children declared independent for financial aid purposes?

Grandparent Savings and Financial Aid

It’s always wonderful when grandparents can help with college costs.

Grandparents, however, have to be careful about how they pitch in if their grandchildren have a shot at receiving need-based financial aid.

Friends of mine experienced first hand how grandparent generosity can backfire. Their story is an extreme example, but there are lessons here for other families as well.

When the three children of my friends were young, the grandparents gave each of their grandchildren a significant amount of money in trusts. The grandparents intended each of the children to eventually use the money to help buy a house in San Diego, one of the nation's most expensive real estate markets.

The dad and mom are middle class, but the money in the children's names eliminated their chances of receiving financial aid. The children were bright and probably would have been admitted to some excellent private schools that offered strong aid packages if the grandparents hadn't made those early gifts.

If the children had attended private colleges, it would have come out of their house funds which no one in the family considered tenable.

All three children ended up attending state universities in California and paying full fare.

If the grandparents had kept the money until the children graduated from college, their school choices would have expanded greatly.

How Grandparents Can Help Safely

1. If you won't qualify for need-based aid, there is no issue.

If your family is too affluent to be eligible for need-based financial aid, it doesn't matter how grandparents save for college or how they help pay the tab.

Grandparent contributions only jeopardize need-based aid and not merit scholarships. Schools award merit scholarships regardless of need.

2. Grandparent savings won't hurt as long as the money isn't used.

Grandparents, aunts, uncles or other relatives or family friends can save for college without jeopardizing a child's chances for financial aid as long as the money stays in their accounts. These can be 529 college savings plans or other investment accounts.

The **Free Application for Federal Student Aid** does not inquire about third parties saving for a child's college education.

Except in rare cases, schools that use the **CSS/Financial Aid PROFILE** also do not ask about non-parents holding money for a student. Those schools that do ask about outside accounts intended for the child can decide to assess that money any way they wish.

3. Withdrawn money does count against a child.

When grandparents eventually withdraw money from an investment account to use for their grandchild, parents must report this money as the child's income on the FAFSA and PROFILE (if applicable) the following year. This income can reduce aid eligibility by as much as half of the cash withdrawn from the college account.

Let's say a grandmother contributed $10,000 to help defray her granddaughter's tuition cost. The next year when the family was completing the FAFSA, the parents would have to declare this gift.

This contribution would be treated as the child's income and be assessed at 50%.

$10,000 X 50% = $5,000

Based on the formula, the child's financial aid eligibility would drop by $5,000. Put another way, the child's EFC would rise by $5,000.

The FAFSA does provide a way to help blunt or eliminate the penalty triggered by a grandparent's largesse. The FAFSA gives each student an automatic income allowance that is adjusted annually. For the 2014-2015 school year, the allowance is $6,260. A student can earn $6,260 without having his or her income subject to the 50% assessment.

Consequently, in this example the student's income allowance would help blunt the impact of the grandparent's $10,000 gift to help pay her college costs.

4. Grandparents should be strategic when withdrawing money.

If financial aid is at stake, grandparents could wait to withdraw money until after the family has filed for financial aid in the late winter or spring of a child's junior year in college.

Why then? Because this represents the last financial aid application the family will submit (assuming that the child graduates from college in four years). After that form is completed, a college will no longer ask about a family's finances.

5. Time gifts to parents.

Another way to avoid the draconian grandparent penalty is for grandparents to simply give their adult children a cash gift. The aid formulas don't treat gifts to parents as untaxed income. Instead, the formulas just want to know how many assets parents have on the day the aid application is field. So if the grandparents give parents money after the aid application is filed and the parents spend it on tuition before the next aid application is filed, there will be no financial-aid hit.

This method won't work with the PROFILE because the aid application asks parents this question:

Enter the amount of cash your parents received and any money paid on their behalf (e.g., bills) in 2014. (Don't include child support or any other amounts reported elsewhere on this application.)	0	PI-230A

If grandparents gave money to parents, this is where the amount is supposed to be shared. As a practical matter, most parents won't even know to share any money they received from grandparents or other generous sources in this section of the PROFILE.

6. Contribute to a parent 529 account.

Another option for grandparents is to simply contribute to a 529 account that parents have already established. This way, all the assets will be assessed at the lower parent rate.

7. Move the money to the child's parents.

A grandparent with a 529 plan could transfer the ownership of the account to a 529 account controlled by one of the parents of the child. Once the transfer is made, the money is treated as a parent asset which is assessed at no more than 5.64%.

About a half dozen states, however, only allow a change in 529 account ownership if there's a court order or the owner dies. This restriction, by the way, is different from a change in beneficiaries which you can do in any state. For instance, if money is remaining in a 529 account when a student graduates, the owner (parent, grandparent or someone else) can change the beneficiary to another individual.

Lend money to the parents

If parents borrow money from grandparents to pay for college, the debt won't hurt financial aid chances. The loan, however, has to represent a legitimate lending arrangement and the grandparents need to charge interest. Once the parents are done paying for college, the grandparents do have the option of forgiving the loan.

Read More...

Paying for College: Help From Grandparents

When Can a Student's Grandparents Substitute for the Parents on Financial Aid

Forms?

Discussion/Questions

Have you had experience with grandparents helping out with college? If so, how did it go?