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Financial Aid 101



Colleges and financial aid packages

Colleges will attempt to meet your child's financial need with a variety of grants, scholarships, loans, and work-study using both federal and institutional aid, but they aren't obligated to meet all of it.

Many parents pay for college with a combination of savings, current income, and financial aid. By learning the basics of financial aid, you'll be able to understand how the aid process works and compare the aid awards your child receives.

What is financial aid?

Financial aid is money distributed primarily by the federal government and colleges in the form of student loans, grants, scholarships, and work-study jobs. Loans and work-study must be repaid (through monetary or work obligations), while grants and scholarships do not. A student can receive both federal and college aid.

Financial aid can be further broken down into two types: need-based, which is based on your child's financial need, and merit-based, which is based on your child's academic, athletic, or artistic merit.

How is financial need determined?

Financial need is generally determined by looking at a family's income, assets, and household information. The government's aid application, the FAFSA, uses a formula known as the federal methodology.

A detailed analysis of the formula is beyond the scope of this article, but generally here's how it works: (1) parent income is counted up to 47% (income equals adjusted gross income or AGI plus untaxed income/benefits minus certain deductions); (2) student income is counted at 50% over a certain amount (\$7,600 for the 2023-2024 school year); (3) parent assets are counted at 5.6% (home equity, retirement assets, cash value life insurance, and annuities are excluded); and (4) student assets are counted at 20%.

The result is a figure known as your expected family contribution, or EFC. Your EFC remains constant, no matter which college your child applies to.

Tip: Starting with the 2024-2025 FAFSA, the term student aid index, or SAI, will replace EFC on the FAFSA. The change attempts to clarify what this

figure actually is: an eligibility index for student aid, not an exact dollar amount of what a family can or will pay for college.

Your EFC/SAI is not the same as your child's financial need. To calculate financial need, subtract your EFC/SAI from the cost at a given college. Because tuition, fees, and room-and-board expenses are different at each college, your child's financial need will vary depending on the cost of a particular college.

Example: The FAFSA calculates your EFC/SAI at \$35,000. College A costs \$60,000 per year and College B costs \$50,000. Your child's financial need at College A is \$25,000 and \$15,000 at College B.

Colleges use their own formula for determining need when distributing their own funds. Generally, the process works the same way except that the institutional methodology in the PROFILE application takes a more in-depth look at your income and assets. For example, some colleges may consider your home equity or vacation homes.

Tip: Just because your child has financial need doesn't necessarily mean that colleges will meet 100% of that need. It's not uncommon for colleges to meet only a portion of it. If this happens to you, you'll have to make up the gap.

How do I apply and when?

The best way to file the FAFSA is online at fafsa.ed.gov. To do so, you and your child will each need to obtain an FSA ID, which you can also do online.

The FAFSA can be filed as early as October 1st in the year prior to the year your child will be attending school. It relies on income information from two years prior but current asset information. For example, for the 2023-2024 school year, the FAFSA can be filed beginning October 1, 2022, and it will use income information from your 2021 tax return (the FAFSA can directly import your tax information using the IRS Retrieval Tool) and asset information as of the day you fill out of the form.



Private colleges typically require both the FAFSA and the standard PROFILE form or their own aid form, which you'll need to submit by each individual college deadline. The PROFILE form is generally submitted in late fall or winter, but is often required earlier if your child is applying early decision or early action.

After your FAFSA is processed, you will receive a Student Aid Report that highlights your EFC/SAI. Colleges that you list on the FAFSA will also get a copy of the report. Then the financial aid administrator at each school that accepts your child will try to craft an aid package to meet your child's financial need. Colleges aren't obligated to meet all of it.

Comparing aid awards

Sometime in late winter or early spring, your child will receive financial aid award letters that detail the specific amount and type of financial aid that each college is offering. To compare offers, first determine your out-of-pocket cost, or net price, for each school by subtracting any grant or scholarship aid (which doesn't need to be repaid) from the total cost of attendance. Next, look at the loan component of each award to see how much, if any, you or your child will need to borrow. Then compare the net price and loan amounts across all colleges.

If you'd like to lobby a particular school for more aid, tread carefully. A polite email or letter to the financial aid administrator followed up by a telephone call is appropriate. Your chances for getting more aid are best if you can document a change in circumstances that affects your ability to pay, such as a recent job loss, disability, unusually high medical bills, or some other unexpected situation.

Common federal aid programs

Here are some names you'll be hearing as you navigate the world of financial aid:

Direct Loan: The most common student loan for undergraduate and graduate students. For the academic year 2022-2023 (loans disbursed July 1, 2022 through June 30, 2023), the interest rate is 4.99% for undergraduate students and 6.54% for graduate students.

Direct PLUS Loan: A loan for parents of dependent undergraduate students and graduate students. A separate application is required, though filing the FAFSA first is a prerequisite. Parents can borrow the full cost of their child's education, minus any financial

aid received; the only criteria is a good credit history. The interest rate for 2022-2023 is 7.54%.

Perkins Loan: A student loan for undergraduate and graduate students with the greatest financial need. The interest rate is currently fixed at 5%.

Pell Grant: A need-based grant available only to undergraduate students with exceptional financial need.

A word about merit aid

Colleges often use favorable merit aid packages to attract students to their campuses, regardless of their financial need. The availability of college-sponsored merit aid tends to fluctuate from year to year and from college to college as schools decide how much of their endowments to spend, as well as the specific academic and extracurricular programs they want to target. As a family researching college options, exploring college merit aid is probably the single biggest thing you can do to optimize your bottom line.

If you want to get an estimate ahead of time of how much grant aid (need-based or merit-based) your child might qualify for at a particular college, visit the college's website and fill out its net price calculator, which all colleges are required to have. Net price calculators ask for parent and student income and asset information, and they take about 10 minutes to complete. By subtracting the calculator's grant aid estimate from the college's total cost, you can get an idea what your "net price" will be at that college.

In addition to colleges, a wide variety of groups offer merit scholarships to students meeting certain criteria. There are websites where your child can input his or her background, abilities, and interests and receive (free of charge) a matching list of potential scholarships.

Beware of excessive loans

With all this talk of financial aid, it's easy to assume that it will do most of the heavy lifting when it comes time to paying for college. But remember that all financial aid isn't created equal. Grants and scholarships are great because they are essentially free money. But loans are quite different. Parents and students who rely mainly on loans to finance college can end up with a considerable debt burden that can have significant negative implications for years after graduation. So aim to borrow wisely.

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