Key Concepts:
financial aid
Expected Family Contribution
FAFSA (Free Application for Federal Student Aid)

Chapter 6
Strategies for Financing College & Keeping Debt Under Control

So far, we have avoided a difficult subject associated with the college decision – how to finance the investment. This is an extremely complex topic, and the complexity is why so many families get in over their heads. Before we talk about financing the education investment, let's talk about financing large family investments in general.

Probably the two largest investments of resources for many families are a car (or cars) and a house. Putting aside the peculiarities of the mortgage crisis and the 2008 financial collapse, let's look at a few numbers regarding the relationship between what families earn and what most reasonable lenders generally are willing to loan.

Most online debt calculators will return similar numbers. The calculations aren't exact, but they are in the right ballpark. What you should notice about this table

What Banks Will Generally Let You Borrow		
	For a House	For a Car
$30,000 Household Income	$90,000	$20,000
$40,000 Household Income	$120,000	$26,000
$50,000 Household Income	$150,000	$32,000
$60,000 Household Income	$200,000	$38,000

is that, in general, *the more money you have, the more money you can borrow.* People who have lower incomes are more limited in their borrowing capacity than people with higher incomes. Banks and other lenders make this a fairly standard rule because it increases the likelihood that they will get their money back. Lenders who allow applicants to borrow more than they can afford risk losing their money if borrowers end up not being able to make the payments.

Here is how higher education is absolutely unique: In the wacky world of financial aid, the less money you have in hand to pay your out-of-pocket expenses for college, the *more* you are eligible to borrow. (Notice we said "borrow." We aren't talking about scholarships and grants here.) In other words, people with lower incomes are often invited to dig bigger financial holes for themselves.

We know that this seems like a very strange thing to say, and we recognize that there are good intentions behind this practice. Higher education is a path to a better-paying job and presumably a better life. Student loans provide access for families who otherwise might not be able to afford college and the opportunities that a college education brings. That's the positive side of student loans. But the all-too-frequent dark side is that students and families are encouraged and allowed to take on more college debt than is wise, given the payback they are likely to see.

Financing Strategy 1: Don't take on more debt for a college education than you and your family can afford!

Most students and their families fund the college investment with money that could be used for other purposes. Very few students have a large pile of cash in the bank to be used exclusively for college. Many families use personal savings, loans against home equity, loans against retirement and credit cards to put together the payments necessary for their daughters or sons to go to college. In addition, students access credit cards and student loan programs with the expectation that they will have the money in the future to repay whatever amount they borrow.

It is *very* likely that you and your family are going to have to borrow some money before you finish your college degree. Our advice to help keep debt in perspective is to think in terms of a new car. How much would you, or your mom and dad, be willing to spend on a new car? If you think that spending $100,000 is too much for a college student's car, maybe it's too much for a college education investment.

Financing for the college investment is hard to figure out. And it is incredibly easy to run up extremely large bills that will eventually have to be paid. At the same time, it is *really* unlikely in the current economic climate that a typical American family has easy access to the amount of ready cash that the government calculation of Expected Family Contribution says you should have. Maybe your family has the money in hand. If so, you are one of the lucky ones. Given that many families are living paycheck to paycheck, with their mortgages underwater and their retirement accounts underfunded, it is a real challenge to generate the extra money every semester to cover college expenses for four or five years.

Strategy Tip

Don't get sucked in! Financial aid advisers at expensive colleges like to show prospective students how much money they are eligible for. It looks really impressive when, at a $35,000-per-year college, you are told you can get up to, say, $18,000 in loans and grants per year. The adviser will then show you that you might only be eligible for $5,000 per year in loans at a Noname Regional State University. For some reason, families often think that the first option is a "better deal" because they get so much more money. NO! The families aren't getting the money, the COLLEGE is! Unless the money is coming in the form of grants or scholarships, you will have to pay it back. It's not free.

How Much Do Families Tend to Owe?

As we've noted before, about two-thirds of students who graduate from a four-year college leave with loan debt, according to the Project on Student Debt. In 2008, undergraduate students who borrowed left school owing, on average, $23,200. That's quite a lot of money for a 22-year-old just starting out in the job market to owe, but it does fall within our rule of thumb that college debt not exceed what would be a reasonable price for you to pay for a new car. However, the $23,200 average in student loans *underrepresents* the total amount of debt a student and his or her family might have. The $23,000 borrowing average includes only federal and non-federal loans that are held by a *student* and that are accounted for in government reports. As far as the student's debt level is concerned, that number doesn't include any credit card debt used to pay for tuition, room and board, books or supplies. Credit cards are the biggest debt trap of all for young people, who are often charged interest rates above 20 percent.

In reality, the $23,200 average debt load is often just the tip of the iceberg. That's because this "average" debt load significantly masks the total debt *families* are taking on for higher education because *it doesn't include parent loans.* A 2010 College Board report called "Who Borrows Most? Bachelor's Degree Recipients With High Levels of Student Debt" found that, among students who took on high levels of debt, *the average federal Parents Loan for Undergraduate Students (PLUS) was $30,900!*

It isn't just lower income families who are piling on the debt. Nearly 50 percent of parent households earning $60,000 or more took on PLUS debt. Among households with incomes of $100,000 or more who took on debt, *47 percent borrowed an average $41,500 through the federal PLUS program.* The report noted that these loans were in addition to the $30,500 or more taken on by student borrowers who graduate with higher than average levels of debt. The final piece of the hidden debt iceberg is that even these large amounts *don't include* any home equity loans or other sources of credit (like credit cards) that parents may have tapped to pay for the college investment.

It's safe to assume that the total amount of debt families are incurring for college is *significantly* underreported. As we've said before, the college decision isn't just about you, the student; it's a family decision because it is a significant allocation of family resources. Investing so much of your family's financial resources in one undergraduate bachelor's degree may not be the best decision for your family as a whole.

What Does This Mean for You?

Here is the big picture perspective: Parents who may need to get serious about saving for retirement or grandparents who need to conserve resources for health care shouldn't be using their purchasing power for a college degree UNLESS they AREN'T going to need the money themselves.

Yes, this flies in the face of the tradition that parents and grandparents sacrifice for the younger generation. But times are different now. People are living longer, health care is increasingly expensive, and returns from stock market investments (if you are lucky enough to have them) are erratic and unreliable. It isn't an easy decision, but the uncertain economy suggests that parents and grandparents must be more conservative in their financial decisions. They can't rely on the notion – in reality, they probably never really could – that their home or stock investments will appreciate enough to make up for any debts. Keeping the price tag for college in line with the resources of the family will reduce financial stresses for everyone in the long run.

Although you need to think in terms of the total amount of borrowing that will be necessary, you also need to think about the impact of all this borrowing on your finances and opportunities down the road – *after* college.

Financing Strategy 3: Before you commit to a college, know how much your monthly payment on your total loan obligation is likely to be after graduation.

In business, there is a term called "cash flow." For a business to be successful, it has to have a positive cash flow. This means that regardless of how much debt the business has, as long as the company can generate enough revenue to cover its operating costs plus pay off debt, it can usually stay in business. Not getting enough cash in the door is another common reason that companies fail.

For you, at 18 or 19 and thinking about college life and not the work world, the idea of cash flow may not seem relevant. But remember, we're trying to get you to think about the big picture. When it comes to planning for college, you can't just think about your life as it is now. You also have to think five years down the road. When you are finished with college, will you have the monthly cash flow that you will need to pay back your college loans?

Figuring out your student loan payment in the future is another example of how financial aid looks *nothing* like a car payment or a mortgage payment. In an attempt to make you feel comfortable borrowing money to invest in a college education, the federal government has created a laundry list of repayment options. Although this has helped a lot of people manage the monthly payment, it doesn't change the fact that *the longer you take to pay a loan off, the more it is going to cost you.* This is because interest on the loans accumulates and increases over time.