

AUGUST 2021 NEWSLETTER

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HOW SHOULD PARENTS PLAN FOR A CHILD'S COLLEGE EDUCATION?

BY: ROBERT STOLL, CFP® CFA

It's that time of year! For the first time in two years, college campuses are welcoming students back to campus for in-person classes. That also means parents are getting bills for the Fall Semester tuition, room & board.

With the cost of college where it is these days, education expenses can come as a surprise to many parents. How should parents plan for a child's college education? How will it be paid for? That's the topic of this post. We'll look at:

- How the cost of college has increased over the last 25 years.
- Why you may need to change your mindset about paying for your children's education.
- Determining how much you can realistically afford to pay for college.
- The benefits of sharing the cost of college with your child.

- Why Federal student loans may be a suitable tool to help students cover their share.
- Is a 529 college savings plan the best way to save for college?

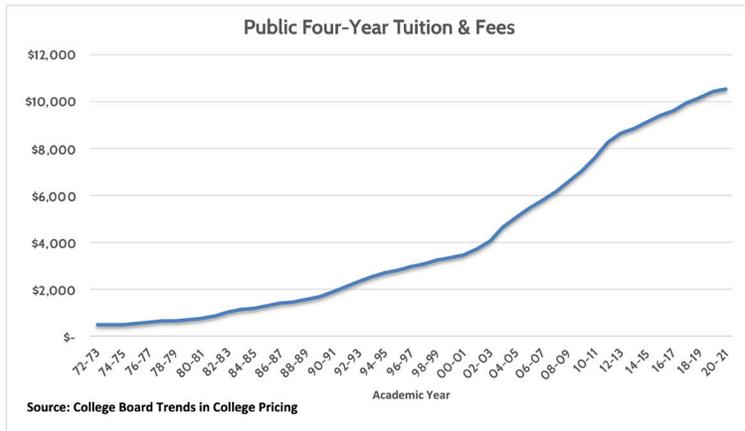
The Cost of College Has Increased A Lot!

Many of us who are parents of kids already in college know first-hand the conundrum of paying for college education. "When I went to college, it wasn't this expensive!" It wasn't.

For much of the 70s, 80s, and early 90s, the cost of college wasn't too bad. Summer work and a part-time job were usually enough to pay a good portion of college expenses. But that's changed a lot since the mid-90s.

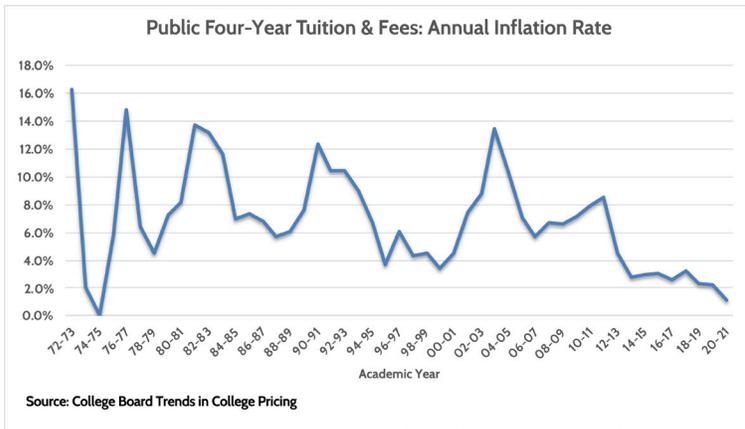
The chart below shows the average cost of in-state, four-year college tuition. It's somewhat deceiving,

however, as it doesn't include the cost of room & board, technology, and other expenses that really add up. But it's clear the cost has gone up a lot in the last 25 years.



If there's any "good" news on the college front, it's that the rate of tuition inflation has slowed markedly in recent years. The 2020-2021 academic year saw the slowest rate of tuition inflation (+1.1%) since the mid-70s.

The reasons for this slowdown aren't clear. But we believe it's because parents are pushing back against the cost of sending kids to college. In the commodity world, they say, "the cure for high prices is high prices." Meaning, if prices get too high, demand suffers, which brings pricing back down. That seems to be what's happening.



Another reason for the slowdown in tuition inflation is the explosion in student loan debt. Recent graduates are finding that their income prospects are falling way short of what it cost them to get their degree. And they're burdened by ridiculously high student loan debt, which impedes getting married, buying a first home, etc.

Preparing Yourself to Pay Your Child's College Education

Adding all the above up, parents are having to re-think how they plan to send their kids to college. For reference, here in Illinois, it will cost a resident \$35,000 per year to send their kids to the University of Illinois Urbana-Champaign. That's \$140,000 over four years!

Juggling the cost of sending kids to college with an ever-rising cost-of-living – not to mention having to save for retirement – puts many families into a bind. With that comes the need to think differently about how you plan to pay for college.

The first thing we recommend to parents planning for college is to remove emotion from the equation. Too many parents feel like they have to cover 100% of their kid's college because that's what their parents did for them. But times have changed. So the first thing you need to do is to adapt your mindset to today's reality.

Once you've done that, you can consider some strategies we outline below. Mind you, every family is unique. These aren't definitive answers as much as they are guides to help you think about how you can attack the problem.

Strategy 1: How much room do you have in your budget to save for college?

The first thing we recommend doing is looking at your income, living expenses, and savings needs. Working with a financial advisor or a financial coach can help a lot with this exercise. Here, you're looking at your monthly cash flow and making projections of how much you can realistically save each month towards college.

Money Needed for College:	\$ 140,000
Investment Returns	5.00%
Years to Save*	18
Monthly Amount to Save	\$401
*Save monthly starting at child's birth	
Source: Financial Design Studio, Inc.	

Here's a good place to start. Using the example of our Illinois resident wanting to send their kids to Urbana-Champaign, we can figure out how much they'd need to save each month to cover the \$140,000 cost. Here, they'd need to save \$401 per month from the day their child was born until they turned 18!

The example here doesn't factor in future tuition cost inflation, or the fact you may want to send more than one child to college. But you can quickly see how for most families, the idea of paying 100% of college expenses isn't realistic.

To see how much this monthly amount would take out of your monthly budget, here's a simple equation.

Add up your family's Gross Income for a full year. Take out 25% for taxes. Divide that amount by 12 to get an estimate of your monthly after-tax income. Then see what percentage \$401/month would be out of that. Here's an example of how to do that.

Example:

\$100,000 Gross Annual Income - \$25,000 Taxes @ 25% Rate = \$75,000 after-tax annual income / 12 months = \$6,250/month
 --> \$401 / \$6,250 monthly after-tax income = 6.4%

Once you do this, you'll quickly realize what's realistic – and what's not – with saving for college.

Strategy 2: Share the Cost of College With Your Child (Burden-sharing)

As mentioned before, many parents have the mindset that they have to pay 100% of college expenses. Right or wrong, that's what we run into a lot of times when working with clients.

But if you don't have the financial capacity to pay 100% of college expenses, it's time to look for other options. One option is to "share" the cost of college with your child. Given the cost of college these days, having your child pay for a share of their own education is a way to give them "skin in the game."

For example, a parent above might decide to cover 50% of the cost of their child's college tuition. So instead of having to save \$401/month for college, they'd only need to save \$200/month, which is much more manageable.

The child would be responsible for the other half. If

you're clear and up-front with them starting in middle school about your intentions to cover 50% of the cost, it can incentivize them to do their best in high school.

There are tons of scholarships out there, so if they're motivated to get good grades, join clubs, and take part in athletics while in high school, they have a good shot at winning scholarships which can help pay for their half of college expenses.

Strategy 3: Taking Advantage of Federal Student Loans

Given the student loan crisis we have, it may seem odd to advocate for students to take out loans. But if parents and students are thoughtful about utilizing loans, they can be a suitable tool for students to "bridge the gap" when paying for college.

The government limits the amount of Federal student loans students can take out while they're doing Undergrad, but these loans are lower-cost and have interesting features that may make them easier to pay off after graduation, such as loan forgiveness and income-based repayment plans.

Continuing with the example above, if a child foots 50% of the \$140,000 total cost of college, then taking advantage of Federal student loans can cover almost 40% of that burden. [\$27,000 of the \$70,000 of expenses they're responsible for.]

Maximum Federal Student Loans Available by Year



- Freshman Year: \$5,500
- Sophomore Year: \$6,500
- Junior Year: \$7,500
- Senior Year: \$7,500
- TOTAL: \$27,000**

To get these loans, parents and students must fill out FAFSA forms each year they're in school. We have a blog post that covers what FAFSA is and why it's important. But I want to stress that ALL parents and students should fill this out each year regardless of whether or not you expect to get tuition assistance. You can't get Federal student loans without filling out the FAFSA.

Is a 529 College Savings Plan the Best Way to Save for College?

As if figuring out how to pay college isn't confusing enough, you also have to grapple with how best to save for college! Much like the issues we've discussed, there's a wide range of opinions about whether a 529 is the "best" plan or not.

We've done a video that gives an excellent overview of the benefits of 529 college savings plans. From a purely mathematical standpoint, 529s make sense when saving for college. Many states allow a tax deduction for contributions to your state's 529 plan. You get tax-free growth on your investments within a 529 plan. And if you take money out for Qualified Education Expenses, you're not taxed on the growth in your investments.



Despite these benefits, we find a lot of parents are reluctant to use 529s. The issue that comes up is the belief that money in a 529 becomes "trapped." What if your child gets scholarships and doesn't need all the money in a 529? What if you over-saved? What happens if they don't even want to go to college?!

If you take money out of a 529 savings plan for expenses that don't qualify as education expenses, the IRS will tax you on the growth of your investments AND issue a 10% penalty tax on top of it. Not ideal.

So what can you do if you didn't need all the funds in a 529?

- You can bite the bullet, liquidate the account, and pay the taxes.
- Shift the 529 beneficiary to another child with no tax consequences.
- Name yourself as a beneficiary and go back to school (no tax consequences).
- Change the 529 beneficiary to a child who has student loans, allowing them to use up to \$10,000 to pay back student loans.
- Leave the 529 plan in place and name a future grandchild.

You're not "stuck" if you over-funded a 529. But there will still be parents that are wary of contributing too much to a 529. So what's the other option?

The other option that we recommend is to open a regular taxable brokerage account. There's no limit to how much you can put in. And you can use the funds for anything – including paying for college. In short, it's an extremely flexible account to save for various future financial goals.

The downside is that you'll pay capital gains taxes on investment growth when you take money out. This isn't the end of the world, however, because if you're a married couple filing joint taxes, you can make up to \$500,000 a year and still only pay a 15% capital gains tax rate. To some parents, that's an acceptable trade-off vs. having money get trapped in a 529.

Conclusion

Of all the financial planning topics we deal with at Financial Design Studio, college planning is always one of the tougher issues. That's because it's very dependent on a family's opinions on college planning issues.

The goal of this post was to give you a framework to think about in planning for college. Knowing how much you can realistically afford is a key step. Burden-sharing with your child can be a good way to make them responsible for their education. And we've seen that there's no perfect way to save and invest for college.

We always stress the point that this is ONE piece of your financial planning picture. You have retirement to worry about as well. That's why getting a comprehensive financial plan from us is so valuable.

SKILLS THAT ARE ALWAYS IN DEMAND

BY: MICHELLE SMALENBERGER, CFP®

How often do you daydream in your head a job that you think would be really cool? Or maybe you dreamed about being a professional athlete? And maybe some of you had the skills that you could have done that. But you just missed an opportunity, or didn't quite make the cut.

There are things in our life that we look back and daydream what could have been. But I want to encourage you that there are some things we can do in life, that are skills we could use throughout the rest of our life— or with anything that we decide to do. Whether it's being a professional athlete or some other job.

Skills Learned On The Job

When I was in college, one of the jobs I had was to be an usher at a coliseum. Now this was not a job that anyone necessarily wanted to have. But I will tell you that when I was in college, it was something that I was able to do and I was able to watch all of the events at school. I could cheer on our team and get paid to do it.

One thing I found is that I was actually developing a skill that I can use in so many areas of my life! And that was the skills to start a conversation from nothing – with someone that I don't know. Someone I've just met. Just walked up to or just walked up to me. And I don't have anything in common with them. This was something I practiced all four years that I was in school.

And as I started doing it, I had people that I worked alongside –supervisors over the years– that actually showed me how to do a really great job at it.

But there were little things like: what do I say, what's a little thing that I can do, or how can I make them laugh. Things like that to really help change the atmosphere. I was learning how to interact with people.

Some people would walk into the game happy. This is a game, we're cheering, it's our team.

Other guests were the opponent. They may have been a really tense rival.



Everyone was coming to this event with a different

point of view. I was learning how to navigate that and this was a skill that I have found very useful – even now as a financial advisor.

So Who Can't Use People Skills?

As I was in this position for four years, I became one of the usher supervisors. And I started to learn how to be a leader and how to motivate people to do something that they didn't think was the greatest job, or something they were daydreaming about.

Those skills have really stuck with me.

This was an experience that I had in college and I've carried it throughout my life. Are there things that you may be presented with? Opportunities that you can learn a new skill. And this could be for the short term or for the long term. But is there something that you could actually do and it could be fun?

It doesn't even have to be a work experience, it could be volunteering. There are things you can do to strengthen skills or develop new skills! So that you can now bring those over to another area of your life. There aren't too many things, that when we put our mind to it and when we try to grow or get better, that are worthless. They aren't a waste of our time. If there's something that you want to do, and you want to get better at, spend the time. Invest the energy. But hopefully those will be skills, that you can carry through anything that you're doing in your life.



COLLEGE FUNDING OVERVIEW

BY: STEPHEN SMALENBERGER, EA

College funding is a topic we get asked about a lot for two reasons: the importance of the decision and the magnitude of it, or the money involved.

You, as a parent, should think through the values you want to pass down to your kids. Do you want them to focus on school and their grades? Or do you want them to have some skin in the game and be working during school or getting loans? If they're involved maybe they will understand the value of their education. The values you want to pass on and your ability to help pay will help determine how much you actually help fund.

Let's consider the cost of college. There are two components: you and your child. How do you help contribute as a parent?

1. Cash flow: Maybe you're planning to fit the cost of college into your budget or work extra or overtime to have the funds necessary.
2. Savings: Maybe since your child was born you've been saving each year to have enough saved.
3. Investments: There are different types of accounts and investments to help as you're saving money.

How will your student help contribute to their education?

1. Earn money before college or during college:

There are a variety of ways they can work such as babysit, caddy, mow lawns, be employed in a job of the field they're studying.

2. Gifts: using birthday or Christmas gifts to put toward their education costs
3. Scholarships: whether these are education or athletic.
4. Loans: Will they apply for loans and help pay that off to pay their way through school?

As you can see there are many different ways to fund college. It will depend on whether you will attend an in-state or out-of-state school or public vs. private. Will it be two or four years of school

Then you as a parent can help decide how to fund that.

- Maybe you'll decide to fund a certain dollar amount.
- Or you'll pay a percentage of the total cost.
- Possibly you'll pay the first four years and after that your child has to pay for the rest.

This is a big decision. There's a lot to consider. Hopefully this has sparked some ideas and given you some things to consider. If you have questions about college funding please reach out to us we would love to discuss it with you.

FILLING OUT THE FAFSA: GETTING YOUR FSA ID

BY: ROBERT STOLL, CFP® CFA

With the start of the 2021-2022 college application season coming up on October 1st, we've created a 2-part series called "Filling out the FAFSA" to guide you through the process. This post will help you understand what FAFSA is and why it's important to fill it out. Specifically, this post is about getting an FSA ID for FAFSA.

Who Should Fill Out The FAFSA?

In short, everyone. Many parents fall into the trap of assuming they earn too much money or have too many assets to qualify for any form of Federal student aid. That may end up being the case for you, but filling out the FAFSA is important nonetheless for a number of good reasons:

- Many schools that issue merit-based awards require the applicant to have completed the FAFSA form;
- Does your child need access to Federal student loans, or if you as the parent need access to Parent PLUS loans to help pay for college, you need to fill out the FAFSA;
- If you encounter a job loss or sudden change of income, you can ask the school to reexamine your eligibility for financial aid – but only if you already have a completed FAFSA on file;
- Some states offer their own financial aid and require students to fill out the FAFSA in order to get it;
- If your child is eager to enter public service or become a teacher, then considering Federal student loans might be a good option as there are debt forgiveness programs for these professions.

In short, there are a lot of good reasons to fill out the FAFSA even if you think it unlikely that your student will receive any grants or merit-based scholarships.

Key FAFSA Dates to Remember

Before October 1: Get your FSA ID (Federal Student Aid ID) prior to filling out the FAFSA. An FSA ID is required if you want to fill out and sign the FAFSA online and make online changes later. We show you how below.

October 1: The first day that prospective students and parents can start filling out the FAFSA.

FAFSA Deadline: Depends on the schools your child is applying to. My suggestion would be to fill out the FAFSA early (in October or November) so you have it done and out of the way. You can always go back and revise data or school choices if needed.

Getting Your FSA ID

Before you can fill out the FAFSA online, you need to first obtain an FSA ID. While you can technically fill out the FAFSA online without an FSA ID, you would then have to print, sign and send the form manually. Save yourself the hassle by getting an FSA ID.

Who needs to get an FSA ID: the student, the parent, or both? Definitely, the student. For parents, it depends. If the student is a dependent of the parent(s), then one of the parents will have to get an FSA ID as well in order to sign off on the student's FAFSA form. If the student is not a dependent, then the parent should only get an FSA ID if they intend to take out Parent PLUS loans to help their child pay for college.

What you'll need: The student (and parent, if necessary) will need an email address, mailing address, and Social Security Number in order to get an FSA ID. It is also recommended to link your mobile phone number to this ID as well in case you have to reset passwords.

Step 1: Go to <https://fsaid.ed.gov/> and create FSA Username And Password

Step 2: Enter Name, Date of Birth And Social Security Number

Step 3: Enter Mailing Address And Mobile Phone #

Step 4: Fill Out Your Challenge Questions

Step 5: Confirm And Verify Information

Step 6: Verify Mobile Phone Number And Submit

You are now ready to fill out the FAFSA form when the application window opens on October 1.

FREQUENTLY ASKED QUESTIONS

Are you a Fiduciary?

Yes, we are! This means we have a duty to act in your best interest. A person acting in a fiduciary capacity is held to a high standard of honesty and full disclosure in regard to the client and must not obtain a personal benefit at the expense of the client.

You're Fee-Only: What does that mean?

We have chosen to be a fee-only advisory firm. This means we do not accept any fees or compensation based on product sales. While we know our clients need products like insurance we do not receive any benefit from any source when you buy a product.

How does Financial Planning Work Virtually?

With advances in technology, it is amazing how much we can accomplish virtually! We are able to share everything we do in person, virtually. We simply use screen sharing and video software so we can see you and look at the same documents, together. Most forms can also be electronically signed.

Are you taking on new clients?

Yes! We are happy to work with friends or relatives that you think would benefit from a Financial Advisor relationship. A quick phone call is all it takes to see if they are a great fit.

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21660 W. Field Parkway
Suite 118
Deer Park, IL 60010