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Applying for Financial Aid

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What is financial aid?

Financial aid is money given by colleges and federal and state governments to help students pay for college or graduate school. This money is in the form of loans, grants, scholarships, and work-study. Loans and work-study must be repaid either through financial obligation (loans) or service to the college (work-study). By contrast, grants and scholarships do not have to be repaid.

There are two types of financial aid: need-based, which is based on your family's ability to pay, and merit-based, which is based on a student's academic, athletic, or special talent. The discussion here focuses primarily on need-based aid.

Who offers financial aid?

The federal government and colleges are the largest providers of financial aid. The federal government provides loans, grants, and work-study funds directly to students or indirectly through colleges. Colleges offer both need-based and merit aid. Funds can come from the college's own reserves or from federal and state governments. Colleges that accept a student who is eligible for financial aid will attempt to create a financial aid package for that student using a combination of government and college sources.

In addition, a number of corporations, foundations, and associations of all kinds offer need-based and merit financial aid to deserving students. Free website searches can provide more information about eligibility and application deadlines.

Overview of the financial aid process

To understand how the financial aid process works, it's important to understand how your child's financial need is determined. This process is called needs analysis.

Under needs analysis, household and financial information submitted on your child's financial aid application is used to calculate your family's expected contribution to college costs. Two primary formulas are used to calculate the expected family contribution (EFC): the federal methodology and the institutional methodology (these formulas will be discussed later in greater detail). The EFC is the minimum amount that a family is expected to contribute toward their child's college costs. The difference between the cost of attendance at your child's college (a variable) and your EFC (a constant) equals your child's financial need. Note that the FAFSA also refers to your EFC as the Student Aid Index, or SAI.

Example: *If the cost of attendance at University ABC is $60,000 per year and your family's EFC is $20,000, then your child's financial need would be $40,000.*

Colleges aren't obligated to meet 100% of your child's need. If a college meets only part of your child's financial need (as is the practice at many colleges), then you have been "gapped" by the college. The remaining portion is called unmet need, and you are responsible for meeting it.

Example: *From the example above, assume University ABC offers your child $30,000 of financial aid. The result is an unmet need of $10,000. So, your family would be responsible for paying both the EFC of $20,000 and the unmet need of $10,000, for a total of $30,000.*

Note: *Starting with the 2024-2025 FAFSA (Free Application for Federal Student Aid), the term "expected family contribution," or EFC, will be replaced by "student aid index," or SAI. 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.*

The two formulas for calculating need

The two primary formulas for calculating a family's EFC/SAI are the federal methodology and the institutional methodology.

Federal methodology

The federal methodology is used by the federal government to calculate your EFC to determine eligibility for federal financial aid programs. The federal methodology is also used by colleges when federal funds are being distributed. It is codified in the federal government's aid application, called the Free Application for Federal Student Aid, or FAFSA. Congress may modify the federal methodology slightly from year to year.

Institutional methodology

The institutional methodology is an alternative to the federal methodology. It is administered by the College Scholarship Service, a private company that provides educational services to colleges and the public. The institutional methodology is used by some 3,000 colleges to calculate your EFC when the college's own private funds are being distributed. So, a college may use the institutional methodology to distribute its own funds and the federal methodology to distribute any federal financial aid funds at its disposal. You submit your information for the institutional methodology on the PROFILE form application rather than on the

FAFSA.

In some instances, a college will not use the institutional methodology when distributing its funds, but will use its own individual formula. In this case, you will need to obtain the college's particular financial aid application form.

There are differences in the way the EFC is calculated under the federal methodology vs. the institutional methodology (discussed in greater detail below). As a general rule, the institutional methodology digs deeper into a child's financial background than the federal methodology because colleges want to make sure that their own funds go to the neediest students.

How is my EFC calculated under the federal methodology?

The federal methodology examines your family's income, assets, and household information to calculate the EFC. Since most students are dependent, the discussion here focuses on dependent students and their parents, except where noted. To determine your dependency status, see the section below entitled What are the Steps in Applying for Financial Aid?

Income

The income component of the federal methodology consists of the adjusted gross income (AGI) of both parents and student from two years prior (referred to as the "base year") plus any untaxed income and benefits, minus any applicable deductions. For independent students, only the student's AGI and untaxed income and benefits are counted, along with those of a spouse, if any. For example, the 2022-2023 FAFSA relies on your 2020 income tax return; 2020 is the base year.

The AGI figure is simply taken from a line on your federal tax return. The untaxed income and benefits portion is a bit trickier. The major untaxed income and benefits that must be added back to your income for financial aid purposes include (see the FAFSA for others) deductible retirement plan contributions made in the base year, tax-exempt interest income (e.g., municipal bond interest), untaxed Social Security benefits, child support received, earned income credit, workers' compensation, disability payments. You must also note the amount of any education tax credits you took in the base year.

After a total income figure is determined, certain deductions can be taken. One example of a deduction is any federal and state taxes you paid in the previous year, including Social Security taxes (see the FAFSA for more deductions).

Parents also get two deductions against income: an income protection allowance and an employment expense allowance. The income protection allowance is a small cost-of-living allowance for shelter, food, clothing, car maintenance, insurance, and basic medical care. This allowance depends on the total number of household members and number of dependents. The employment expense allowance is a small allowance for employment expenses.

A parent's total financial aid income (AGI plus untaxed income/benefits minus deductions) is then assessed at a rate of 0% to 47%, depending on the level of income and family household information.

Students also get an income protection allowance ($6,970 for the 2021-2022 school year), but are then expected to contribute 50% of any income over this amount.

Student countable income and parent countable income are then added together to arrive at the family's total expected income contribution.

Assets

The federal methodology looks at your current assets (as opposed to your income from two years prior) but counts some assets and excludes others in arriving at your EFC (these assets are called assessable or non-assessable assets). Your assets for financial aid purposes are those you own at the time you sign the FAFSA. The more assessable assets your family has, the more money your family will be expected to contribute toward college costs.

The following assets are not included in the federal methodology:

- Retirement accounts (e.g., 401(k)s, IRAs)
- Annuities
- Cash value life insurance
- Personal items (e.g., car, clothes, furniture, household items)
- Home equity in primary residence
- Family farm

Assessable assets are all other assets of the parents and student. These include items such as checking and savings accounts, money market accounts, certificates of deposit, stocks, bonds, mutual funds, U.S. savings bonds, tax-exempt bonds, custodial accounts, trusts, limited partnerships, vacation homes, investment properties, and business and farm assets. After total assets are determined, there are certain offsets you may be eligible for (see the FAFSA for examples).

Example: *The Glass Family has an IRA worth $50,000, an annuity worth $150,000, home equity of $60,000, and a savings account with $10,000. Their total assets under the federal methodology are $10,000.*

An important note to keep in mind is that the federal government does not care about any consumer debt you may have. In other words, your assessable assets are not reduced by the amount of your outstanding consumer debt.

Example: *The Bensons own stocks worth $50,000, a 401(k) worth $100,000, and long-term debt of $75,000. Their total assets are $50,000 under the federal methodology.*

Tip: *Regarding trust funds and custodial accounts, the income is valued as of the base year and the assets are valued as of the date the FAFSA is signed. If a trust has more than one beneficiary, only that portion attributable to the student or parent is reportable. You may need to consult a financial professional to determine income and asset values for trust funds and custodial accounts.*

When a family's total assessable assets are determined, the federal methodology gives parents a small asset protection allowance that allows them to exclude a certain portion of their assets from consideration (students don't get an asset protection allowance). The asset protection allowance varies depending on the age of the older parent at the time the student applies for aid (the older the parent, the greater the allowance).

When a final asset figure is reached for parents and student, parents must contribute a maximum of 5.6% of their assets toward college costs and the student must contribute 20% of his or her assets toward college costs.

Example: *The sum of $20,000 in your child's bank account equals a $4,000 expected asset contribution to college costs ($20,000 x 20%), whereas the same $20,000 in a parent's account results in a $1,120 expected asset contribution ($20,000 x 5.6%).*

Tip: *There is one situation in which the federal methodology does not factor in any assets of parent or student. This is when the parents' AGI (or an independent student's AGI) is below $50,000 ($60,000 for the 2023-24 school year) and the parents are eligible to file a 1040EZ or 1040A. In this case, the EFC is calculated using only income under the Simplified Needs Test. The result is generally a lower EFC and thus more financial aid. However, colleges may still require you to list your assets in order for you to be eligible for college funds.*

Household information

If the parents are both living and married to each other, the income and asset information for both parents is listed on the FAFSA. If the parents are living together but not formally married, they should file the application as if they are separated (see below), unless their state recognizes common law marriage.

If the parents are separated (living apart for an indefinite period) or divorced, then only the income and assets of the parent with whom the child lived the majority of time during the past 12 months is listed on the application. If the parent has remarried, then the stepparent's income and assets are listed on the application as though this person were the natural parent; the non-custodial parent's income and assets are not listed.

Tip: *Under the federal methodology, the federal government does not recognize legal agreements that absolve a stepparent from contributing to college costs or that make the non-custodial parent responsible for college costs. Under the institutional methodology, however, colleges may inquire about the resources of the non-custodial divorced parent or ignore the resources of the stepparent.*

On a related note, legal guardians are no longer included on the FAFSA, which means their income and assets are not automatically included. A student whose parents are deceased will be considered an independent student, regardless of any legal guardianship. By contrast, a student whose parents are living will file as a dependent student, but the FAFSA will reflect the financial information of the appropriate parent(s) rather than the legal guardian, unless the financial aid officer exercises "professional judgment."

The federal methodology also requires you to list the number of people in the household whom the parents will support during the upcoming college year. This includes the student, parents, siblings, an unborn child, and others who get more than half their support from the parents and who will continue to get this support in the upcoming college year. From this number, students must also report the total number of household members enrolled in college in the same year. The student is always counted. In addition, parents and other siblings are counted if they are enrolled at least half time in a program leading to a degree or certificate.

Steps to reduce your EFC/SAI under the federal methodology

There are legitimate steps you can take to position your income and assets to enhance your child's financial aid eligibility under the federal methodology. The idea is to lower your EFC, which, in turn, raises your child's aid eligibility. Examples of these strategies include deferring income and bonuses, avoiding the sale of investments that will result in capital gains in the base year, and paying down consumer debt. It should be noted that these suggestions are legal and are not meant to subvert the financial aid system in any way. To implement these suggestions, you should become familiar with them at least a couple of years before the year you complete the FAFSA.

The institutional methodology vs. the federal methodology

There are several differences in the way the EFC is calculated under the federal methodology (FM) vs. the institutional methodology (IM).

Regarding the institutional methodology, some of the negatives are:

- The IM formula does not recognize a simplified needs test for parents whose incomes are below a certain level.
- The IM formula requires a minimum student contribution from the student's income and does not give students an income protection allowance.
- The IM formula includes home equity and family farm assets in its calculations (and may require parents to borrow against it before aid is distributed).
- The IM formula requires parents to report any savings accounts in the names of the student's siblings (to discourage the shifting of assets among siblings) and requires students to list any retirement accounts they have.
- The IM formula requires parents to report how much they contribute to flexible spending accounts for child care and medical care.
- The IM formula requires parents to report how much money they expect to earn in the coming year. Similarly, students must report any outside scholarships they expect to receive and any relative's contributions.
- The IM formula (at a college's discretion) may only allow dependent children (not parents) to be counted as members of the household enrolled in college.
- The IM formula (at a college's discretion) may not allow losses from tax return Schedules C, D, E, or F that lower AGI and may not allow certain depreciation expenses.
- The IM formula (at a college's discretion) may require business or farm balance sheets for the prior two years, and detailed projections of future income.

On the positive side:

- The IM formula includes an allowance against income for any unreimbursed medical expenses that exceed 4% of the parents' financial aid income.
- The IM formula (at a college's discretion) may have an allowance against income for the private school tuition of other household members and for a parent's own student loans.
- The IM formula (at a college's discretion) may consider a non-custodial parent's assets and income.

Steps in applying for financial aid

There are several steps in the financial aid application process:

Step 1: The first step is for your child to apply to and be accepted by (hopefully) a number of colleges. This allows your student to compare and negotiate financial aid awards from several colleges. Keep in mind that the financial aid timeline and the admissions timeline are different.

Caution: *From a financial aid perspective, it is often recommended that students not apply to college on an early-decision basis. The reason is that if a college knows the student is committed to the college, it may be less inclined to award a favorable financial aid package. In addition, the student will have to examine and respond to the financial aid award before receiving awards from other schools.*

Step 2: The next step is to file the appropriate financial aid applications by the stated deadlines. Unfortunately, you must apply for financial aid at each school before you learn whether you have been accepted for admission at that school. Note that students must reapply for financial aid each year.

The two basic financial aid applications are the (1) FAFSA and (2) the PROFILE. The FAFSA is used by the federal government and colleges when federal financial aid funds are being distributed; it calculates your EFC under the federal methodology. The PROFILE is used by most colleges (approximately 3,000) when their own funds are being distributed; it calculates your EFC under the institutional methodology. In addition, some colleges use their own institutional aid forms in place of the PROFILE. If so, you will need to obtain a copy of that application from the financial aid officer at that particular college.

There are actually three different types of FAFSAs: (1) for dependent students, (2) for independent students without dependents (a spouse is not considered a dependent), and (3) for independent students with dependents. The federal methodology will vary slightly depending on what form is used. The main difference is that the dependent student FAFSA uses both parent and student financial data to arrive at the EFC, and the two independent student FAFSAs do not use parental data to arrive at the EFC.

To fill out the correct FAFSA, you must first determine your child's dependency status. A dependent student is one who is at least partially dependent on his or her parents for support. If your child is just graduating from high school or less than 24 years of age, most likely he or she will be classified as a dependent. By contrast, an independent student is not dependent on parental support.

The federal government considers you independent if you meet any one of the following conditions:

- You are 24 years of age by December 31 of the award year
- You are an orphan or a ward of the court, or were a ward of the court until age 18
- You are married or have legal dependents other than a spouse
- You are a graduate or professional student
- You are a veteran of the U.S. Armed Services
- You are an active member of the armed forces
- You are deemed independent in the professional judgment of the financial aid administrator (FAA) based upon documented unusual circumstances

Like the FAFSA, there are three different PROFILE applications that depend on whether you are a (1) dependent student, (2) independent student without dependents, or (3) independent student with dependents. You determine your dependency status the same way as for the FAFSA.

Tip: *Many colleges go beyond the federal test when determining whether you are truly independent. For example, they may ask for written proof that your parents are unable to provide you with any financial support whatsoever.*

Step 3: Once you know the correct form to fill out (dependent or independent student), you must submit the FAFSA and PROFILE by the required deadlines. The best way to file the FAFSA is online at [fafsa.ed.gov.](fafsa.ed.gov) The online option is best because potential mistakes are flagged immediately and the electronic form is processed much faster. In order to file the FAFSA online, you and your child will each need to obtain an FSA ID.

The PROFILE is also available online. Unlike the FAFSA, there is a fee for filing the PROFILE application. In addition to the FAFSA and PROFILE forms, you will also need to submit any other financial aid applications (college or state) to the appropriate institutions at this time.

When should you file your aid applications? Families can file the FAFSA starting as early as October 1 in the year before their child will start school. For example, for the 2022-2023 school year, families can file the FAFSA starting October 1, 2021.

The PROFILE (or individual college application) is usually submitted in late fall or winter, but will be required earlier if your child is applying early action or early decision. The specific deadline is set by each individual college, so make sure to keep track of all deadlines.

Step 4: After you file the FAFSA, your family should receive a Student Aid Report or SAR (or Acknowledgment Report when the PROFILE is filed). This form indicates your EFC, also referred to as your Student Aid Index, or SAI. Your Student Aid Report will also be sent to each college you listed on the FAFSA.

You should review the SAR to make sure the EFC was calculated using accurate information. Any corrections should be made immediately and sent back for reprocessing (e.g., updating estimated tax information, arithmetic errors, or clerical errors).

Tip: *If there is an asterisk (*) next to the EFC reported on the SAR, your family has been chosen for verification. Verification can range from providing tax returns and household information to providing appraisals for certain assets listed on the FAFSA. Don't take it personally if you are chosen--nearly a third of all FAFSAs are verified.*

Step 5: After you (and the colleges) receive the SAR, the college's financial aid administrator (FAA) at each school your child is accepted to goes to work. The administrator subtracts your EFC from the cost of attendance at that particular college to arrive at your child's financial need. The FAA then attempts to create a financial aid package to meet that need. The package will include various combinations of loans, grants, scholarships, and work-study programs (the type and order of financial aid resources typically used to fulfill a student's financial need is discussed in greater detail below).

Tip: *Your goal is to have your child's financial need met with the highest amount of gift aid (scholarships and grants) and the least amount of self-help aid (loans and work-study). Private colleges tend to provide more gift aid than public colleges so they can better compete with their less expensive counterparts. As a guide, the average financial aid package consists mostly of loans that must be paid back.*

Caution: *As mentioned previously, colleges are not obligated to meet all of your child's financial need. Colleges have limited financial aid budgets and tend to offer the most aid to those students who meet their specific enrollment goals. If the college does not meet all of your child's needs, then you have been "gapped" and you are responsible for the shortfall.*

Step 6: Sometime in March or April, the FAA notifies the student of the financial aid package in an award letter (the student must first be accepted to the college). The award letter states the specific amount and type of financial aid being offered, and a date by which the letter must be returned.

You may accept, decline, or attempt to renegotiate any part of the financial aid award. It is important to reply by the required date because otherwise your child's award will be cancelled and the money freed up for some other student. Note that accepting the award does not commit your child to attending that school; it just safeguards the award.

Ideally, students will want to have all of their award letters from various colleges on hand before making a decision. This is sometimes easier said than done, however. The financial aid process and the admissions process operate on different schedules, and occasionally students must make a decision to enroll at a particular college before they know the contents of their award letter. Similarly, a student may not have received all of his or her outstanding award letters before being called on to make an acceptance decision at a college from which an award letter was received. In either case, the student or parent should contact the appropriate FAA to see if you can expedite the consideration of the aid package.

Step 7: If you want to appeal all or part of your child's financial aid award, follow the instructions in the award letter. This usually involves a polite business letter to the FAA and a follow-up telephone call or meeting.

The process of renegotiating your child's financial aid package has been much publicized as of late, with descriptions ranging from haggling to dialing for dollars. Rare a decade ago, negotiating is now so much part of the picture that some colleges have set aside funds specifically for maneuvering at season's end. Some educational professionals have criticized this process on the grounds that those parents that yell the loudest reap the biggest rewards. This is not necessarily true. In fact, you'll do much better if you approach the FAA without carrying a big stick.

Your chances of successfully renegotiating your child's aid package are best if you can document a special circumstance that affects your ability to pay the EFC (rather than a simple plea of inability to pay). Such special circumstances may include the recent death or disability of a parent, divorce, prolonged unemployment, unusually high medical expenses, or a natural disaster than destroyed certain assets. In addition, more obscure circumstances may be the reason for negotiation. For example, your income on last year's tax return may have been higher than usual because you converted a traditional IRA to a Roth IRA or because you received a one-time windfall, such as a special bonus, insurance settlement, or inheritance. Make sure to document any change with the appropriate paperwork.

In addition to a special family circumstance, many parents and students attempt to play one college's aid package against another college's aid package. This strategy has the best chance of success if College A and College B are direct competitors and you have the qualities that College A is looking for. Keep in mind that the college market, like the housing market, can be a seller's market or a buyer's market, and that this can affect the negotiation process.

Types of financial aid programs

There are several types of financial aid programs. The most common financial aid programs are those offered by the federal government. The main federal programs are as follows:

Pell Grant and Supplemental Educational Opportunity Grant (SEOG)

The Pell Grant is available to undergraduate students. It is an entitlement program, which means the grant is available to all students who qualify.

The SEOG is reserved for undergraduate students with the most financial need (Pell Grant recipients are given priority). The SEOG is a campus-based program, which means that each college receives a limited amount of money for this program and the FAA at each college decides which students will receive this grant. Once the funds are awarded, there are no more until the following year. This is an example of a first-come, first-served program.

Direct Loan, Perkins Loan, and Direct PLUS Loan

The federal Direct Loan is a low-interest loan made to both undergraduate and graduate students. The interest rate is set each June.

A Direct Loan may be subsidized or unsubsidized, depending on whether you have a financial need. With a subsidized Direct Loan, the federal government pays the interest on the loan while you are in school, during deferment periods, and for six months after you leave school. Like the Pell Grant, the subsidized Direct Loan is an entitlement program and is thus available to all students who qualify. With an unsubsidized Direct Loan, you (not the federal government) are responsible for paying the interest during the school year and deferment periods. Regardless of whether the loan is subsidized or unsubsidized, there are limits on the amount of money that can be borrowed each year, as well as limits on the total debt that may be incurred.

A Perkins Loan is a low-interest loan available to both undergraduate and graduate students with the lowest EFCs. Like the SEOG, the Perkins Loan program is campus-based, which means each college receives a certain amount of money for this program, and you borrow the money directly from the college. When the funds run out, there are no more until the following year. This loan is subsidized; that is, the federal government pays the interest while you are in school, during deferment periods, and for nine months after you graduate.

The Direct PLUS Loan is a non-need-based program; that is, you can qualify without financial need. The loan is for parents with good credit histories who want to help pay for their child's education and for graduate and professional students. Borrowers are eligible to borrow up to the full cost of their education, minus the EFC and any other financial aid received. The loan is obtained through the federal government.

Work-study

The federal work-study program is a need-based program that subsidizes jobs for both undergraduate and graduate students. Like the SEOG and Perkins Loan, the federal work-study program is campus-based. The funds are distributed on a first-come, first-served basis. Often, these jobs involve community service work and can be related to your course of study.

Do colleges award financial aid resources in a specific order?

Generally, yes. Colleges usually fulfill a student's financial need by awarding financial aid resources in the following order:

- Federal Pell Grant (for those students who qualify)
- State grant
- Federal Direct Loan (subsidized first, then unsubsidized)
- Company and organization scholarships and grants, military financial aid programs, or any other outside financial aid resources
- Perkins Loan, SEOG, or federal work-study (funds for these programs are allocated to colleges by the federal government for allocation to students; whether a student receives any of these funds depends on timing of application, financial need, and availability of funds)
- College grant or tuition discount (at the college's discretion)

Although this is the typical order, it may vary according to the availability of funds at a particular college and/or the particular student's merit. The more merit a student has, the better types of financial aid he or she will likely receive (e.g., less loans, more grants).

Should you apply for financial aid even if you don't think your family will qualify?

Generally, yes. No matter how high your income or asset base is, your family should apply for financial aid. At the very least this means filing the FAFSA. In addition, you may choose to file the PROFILE or other individual college application. There are a few reasons for this suggestion.

First, it can be difficult to predict whether your child will qualify for financial aid without actually filing the FAFSA because the federal government's eligibility criteria for certain aid programs may change unexpectedly from year to year. Second, some financial aid programs are not based on need--such as the federal government's PLUS Loan and certain state programs--yet you must still file a FAFSA to be eligible to borrow funds. Third, you really lose nothing (except a few hours of your time) for filing the FAFSA because it is a free form that costs nothing to process.

Although the PROFILE application does have a processing fee, it is a small investment to make for the opportunity to learn whether your child qualifies for a college's own aid programs. The worst that can happen is that you discover you don't qualify for any financial aid. In that case, you won't be left wondering whether you should have applied. Considering that your child may be awarded gift aid that you won't have to repay, the investment of your time may well be worth it.

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