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Paying for College Is a Family Affair

By Elaine Floyd CFP®

College planning isn't for parents only. It's an investment that should involve the whole family and offer students their first taste of financial planning.

It's a time for parents to be realistic about what they can afford and for students to give serious thought to the value of a college education and where it will get them in life. Most important, an in-depth discussion requires families to sit down at the kitchen table and talk about money.

The psychological barriers to this discussion can be huge. Parents who think it's their obligation to pay for their children's college education (because their parents paid for theirs) are feeling guilty because they haven't saved enough. Children who never had to worry about paying for things before and who want to preserve their childhood a little longer don't think they should have to worry about where the money will come from. None of these attitudes will help get the FAFSA form filled out. Better to face the realities of college head-on now and use the experience as a lesson in financial planning.

LESSON 1: GOAL SETTING

Most families scrambling to pay for college now regret not having set college goals earlier. If they had figured out when the child was first born how much college would cost in 18 years and established an automatic savings plan when it would have required a modest monthly amount, they wouldn't be in this mess. But the failure to set college goals earlier doesn't mean families are excused from doing it now. They will, however, need to adjust the goal-setting process to account for the fact that college is upon them and no longer a vague event some 18 years in the future. Once a child gets to high school, goal-setting needs to be practical and realistic. No pie-in-the-sky dreams about obtaining multiple degrees at private colleges. And it needs to involve the child.

Moreover, it should go beyond the four years of college to include career plans, income targets, and lifestyle goals to determine how much debt the student feels comfortable taking on. Will an elite private school pay for itself in higher postgraduate earnings? Or would the child prefer a less expensive school in order not to be burdened with debt and therefore free to pursue a lower paying career such as teaching?

The goal-setting process at this stage requires the student to think beyond college majors and freshman year beer busts and do some real life planning. While the choices may be difficult, the process is invaluable. The younger a person is when life-planning and goal-setting skills are developed, the more empowered that individual will feel throughout life.

LESSON 2: TAX-DEFERRED COMPOUNDING

Regrets often provide the greatest life lessons. It's too late now for the parents of a high school senior to compound savings over 18 years, but they may be able to use this missed opportunity as a lesson in saving for their own retirement. And you can bet that a child with no college savings is determined never to come up short again, making this a perfect time to discuss some finance basics: save 10% of your income; max out your IRA; save up for what you want rather than going into debt.

Let's not forget the compounding lesson, which, paradoxically, is sometimes made more difficult by the large end-dollar amounts promised. For example, a young person can accumulate over $1 million in 50 years by saving just $150 per month at 8%. The financial services industry often holds these large amounts out as a carrot to motivate people to save, but they just make the monthly savings amount seem too pitiful to make a difference. One might as well blow it on the latest indulgence. But that $150 is the crucial seed that gets the whole ball rolling. In time, the earnings will represent a larger share of the whole, but only if the seed money is invested first. Perhaps the compounding lesson should focus on the amount going into the account, not the pot of gold at the end.

LESSON 3: BUDGETING AND CASH FLOW

College is the perfect time to introduce young people to the essentials of budgeting. Even if credit cards, payment plans, and parents help smooth out the cash flow, students should not go off to college without knowing how much everything will cost. The College Board breaks down college expenses into five categories: tuition and fees, room and board, books and supplies, personal expenses, and travel. If college is a few years away, families can use the average costs listed in the College Board's "Trends in College Pricing" (http://trends.collegeboard.org/college-pricing) to develop a preliminary budget and make basic decisions about which type of college to go to, private vs. public, instate or out, and so on.

Once a student has settled on a particular college and is preparing a more precise budget, he will want more accurate information about expenses. That can be found using the College Board's college search function (http://collegesearch.collegeboard.com/search/index.jsp) or directly from the school.

Even so, families will need to consider their own individual circumstances. Will parents visit the school several times throughout the year? (Add airfare and hotel/meal costs.) Will the child have a car at school? (Add insurance, gas, parking, and maintenance costs.) Will the child go to Miami for spring break? (Not exactly a college expense, but it should be part of the budget.) Even if parents are able and willing to pay for everything, the off-to-college budgeting exercise is a meaningful way to prepare kids for the financial responsibilities of life. And no matter how tight or loose the budget is, it never hurts to look for ways to reduce college costs (https://studentaid.gov/sa/types).

LESSON 4: DEBT MANAGEMENT

Any child who has ever borrowed money from his parents has had some experience with debt. But it probably didn't involve interest or fees, and it certainly didn't introduce the child to the nation's most unforgiving lender, Uncle Sam. Student loans seem so magnanimous at first—no payments till after graduation and forbearances relatively easy to obtain—but once the money is borrowed, the debt must be managed with care, because default is not an option.

The principles of debt management seem obvious to adults, but children swept up in the financial aid game need to learn them: don't borrow more than you can afford to repay, shop around for the best rates and terms, and understand the full cost of the loan over the entire payment period. Loan consolidation, for example, may seem like a good deal until you calculate the total interest over the life of the loan. Students will need to be reminded that many of those nice student aid people who are helping them obtain money for college are really in the business of selling loans and may not have students' best interests at heart.

Next to retirement, college planning is one of the most serious aspects of financial planning, because it influences a young adult's total lifetime earnings. The type of degree, where it comes from, and the people the student meets in college all help shape the career direction and opportunities the student will have in life. The planning process may be considered an important part of the student's education, as it prepares the student for the many financial- and life-planning issues that will come up in the years ahead.

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