How Advisors Can Help Stop Student Loan Debt from Creating a Lost Generation

When you broach the subject of college funding with clients, they may dismiss you with responses ranging from "We'll pay the bills out of cash flow" to "We're banking on financial aid." On both ends of the spectrum, a lack of serious planning can spell trouble, even for your higher net-worth clients.

Providing a college education is one of the most significant expenses families have, made more challenging by the relatively short time to save, costs that continue to increase faster than inflation, and reductions in institutional financial aid. Your clients may not realize that failing to plan for college with the same attention they dedicate to saving for retirement can create bigger problems than juggling or struggling with four years of tuition. In particular, the student loans that many families use to fill any savings gap can create future financial hurdles that often put a wedge between college graduates and the American Dream. In fact, excessive borrowing can create a debt cycle so vicious that some colleges no longer include loans as part of their financial aid packages.

As an advisor, you can work to alleviate the burden of student debt by encouraging clients to plan more thoughtfully and save more efficiently for college. From facilitating family conversations about college costs to constructing flexible, tax-efficient college savings accounts with 529 college savings plans, you can help your clients chart the course they want for their children. And, while addressing college funding provides an important value-added for your clients, it also connects you with the next generation and paves the way for their future happiness and success—something that should ultimately grow your practice.

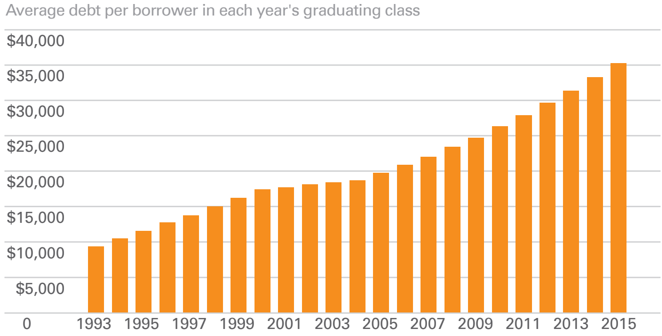
First, a History Lesson

Clients may be aware of the student debt crisis on a national level, but many do not understand its origins or appreciate the strength of its grip. Therefore, they may not realize how debt can snare their own children.

At the root of the crisis, the cost of higher education has risen faster than family incomes. For example, from the 1983–1984 enrollment year to 2012–2013, the inflation-adjusted cost of a four-year education, including tuition, fees, and room and board, increased 125.5 percent for private school and 129.1 percent for public school. However, the median family income rose just 15.6 percent during this period.[1]

FIGURE 1: CLASS OF 2015

Average debt per borrower in each year's graduating class



Source: Mark Kantrowitz analysis of National Center for Education Statistics Data. WSJ.com.

It's no wonder, then, that student loan debt recently hit $1.2 trillion in the United States, an increase of about 84 percent since 2008.[2] Today, 40 million young Americans struggle to pay off student loans, up from approximately 29 million in 2008.[3] In fact, last spring, the Wall Street Journal dubbed the Class of 2015 "the most indebted ever – *for now*," with almost 71 percent of college grads shouldering an average debt of $35,000.[4]

Tightening debt's stranglehold, at the same time students are graduating with greater debt, starting salaries for young college graduates have declined. Total student debt–including federal and private education loans to students and parents–is expected to top $68 billion this year for graduates with a bachelor's degree, more than a 10-fold increase since 1994.[5]

[1] Shierholz, Heidi, Alyssa Davis and Will Kimball. "The Class of 2014: The Weak Economy Is Idling Too Many Young Graduates." Economic Policy Institute. 1 May 2014. Web. 4 Sep. 2015. <http:// www.epi.org/publication/class-of-2014/>.

[2] Ungarino, Rebecca. "Burdened with Record Amount of Debt, Graduates Delay Marriage." NBC News. 7 Oct. 2014. Web. 4 Sep. 2015. <http://nbcnews.com/business/personal-finance/ burdened-record-amount-debt-graduates-delay-marriage-n219371>.

[3] Ellis, Blake. "40 million Americans now have student loan debt." CNN Money. 10 Sep. 2014. Web. 4 Sep. 2015. <http://money.cnn.com/2014/09/10/pf/college/student-loans/index. html?iid=HP_LN>.

[4] Sparshott, Jeffery, Congratulations, Class of 2015. You're the Most Indebted Ever (For Now), The Wall Street Journal, Accessed on January 20, 2016 at: http://blogs.wsj.com/economics/2015/05/08/congratulations-class-of-2015-youre-the-most-indebted-ever-for-now.

[5] Ibid.

And, after more than three decades of flat wages, the Economic Policy Institute reports that between 2013 and 2014 those with a college degree saw their hourly wages fall 1.3 percent, while those with an advanced degree saw an hourly wage decline of 2.2 percent.[6] Long-term, such a debt/earnings gap becomes a real albatross. Among college educated people, the median net worth of young households without student loan debt is seven times higher than the median net worth of young households with student loan debt.[7] Further, the Federal Reserve Bank of New York, reporting on student loan delinquencies, noted a recent decrease in mortgage and auto loans for younger borrowers, suggesting that student loan debt negatively impacts a young person's ability to make other investments.[8]

It follows that if young people struggling to repay their debt are not buying cars or homes, they certainly are not saving for retirement—or for their own children's college education. In fact, many young people are delaying getting married and having children. The Pew Research Center reports that the median age for a first marriage is now 27 for women and 29 for men. In 1960, the median age was 20 for women and 23 for men.[9]

Finally, student debt isn't an issue only for twenty-somethings. Approximately 15 percent of older students leave graduate and professional schools with six figure loan balances.[10] And, according to the Pew Research Center, nearly four of every ten U.S. households led by someone under the age of 40 is paying off student loan debt.[11]

Break the Ice and Plan in Advance

Not surprisingly, the student debt crisis is fueled by a general lack of college planning. Only 40 percent of respondents to Sallie Mae's 2015 survey *How America Pays for College* described themselves as college "planners" with a strategy in place to pay for college.[12] Throughout high school, many families focus on the admissions game, rather than college financing. They invest their time and money on music lessons, sports camps, tutors and SAT prep classes, and take dozens of college tours. Unfortunately, too many wait until senior year, or even for the arrival of acceptance letters, to discuss how they will pay for college. In fact, just 57 percent of parents reported talking with their children about the cost of college.[13]

Yet, that conversation is clearly necessary because the Sallie Mae study also found that while 64 percent of parents want to cover the total cost of college, only 28 percent are on track to do so.[14] Therefore, your work should begin by facilitating a college funding conversation between clients and their children, well in advance of high school. Many advisors first meet with parents and children in elementary school to discuss college costs and set expectations.

Get the Kids on Board

Family meetings are an ideal place to tackle the question of whether parents expect their children to contribute to college funding, either from summer jobs or work-study while in school. Here, your clients may ask your advice. Of course, there's no right answer. You might share information on how current families nationwide pay for college. According to Sallie Mae, parents' income and savings cover 32 percent of college costs while students' savings and income accounts for 11 percent. The balance of funding is provided by loans taken by students and parents (22 percent), grants and scholarships (30 percent) and family members (5 percent).[15]

Be aware, however, that the college funding paths families choose are not always predictable based on their wealth. That is, some clients who can well afford to foot the entire college bill want their children to have some skin in the game. Other families who are unable to pay the total costs decide to re-mortgage the house to do so.

What does hold true across demographics is the power of conversations between parents and children to spark college savings. (Of course, that may surprise your clients who routinely complain about being summarily ignored by their teenagers.) These clients will appreciate knowing that a T. Rowe Price study found that 58 percent of children whose parents talk frequently with them about saving for college actually put away money for that goal. Of children who reported not discussing college costs with their parents, just 23 percent had set money aside for school.[16]

Finally, if clients are looking to justify requiring their children to contribute to college costs, a recent paper, "More is More or More is Less? Parent Financial Investments during College" by University of California professor Laura Hamilton links larger contributions from parents to lower grades for students.[17]

[6] Gold, Elise. 2014 Continues a 35-Year Trend of Broad-Based Wage Stagnation, Economic Policy Institute. Accessed on January 20, 2016 at: http://www.epi.org/publication/stagnant-wages-in-2014.

[7] Fry, Richard. "Young Adults, Student Debt and Economic Well-Being." PewResearchCenter. 14 May 2014. Web. 4 Sep. 2015. <http://pewsocialtrends.org/2014/05/14/ young-adults-student-debt-and-economic-well-being/>.

[8] Shierholz, Heidi, Alyssa Davis and Will Kimball. "The Class of 2014: The Weak Economy Is Idling Too Many Young Graduates." Economic Policy Institute. 1 May 2014. Web. 4 Sep. 2015. <http:// www.epi.org/publication/class-of-2014/>.

[9] Fry, Richard. "Young Adults, Student Debt and Economic Well-Being." PewResearchCenter. 14 May 2014. Web. 4 Sep. 2015. <http://pewsocialtrends.org/2014/05/14/ young-adults-student-debt-and-economic-well-being/>.

[10] Ibid.

[11] Ibid.

[12] How American Pays For College 2015. Sallie Mae's National Study of College Students and Parents.

[13] "Time to Break Open the Piggy Bank: Parents Expect Kids to Pay For More Than One-Third of College Costs." Fidelity. 20 Aug. 2014. Web. 25 Sep. 2015. <http://www.fidelity.com/inside-fidelity/individual-investing/time-to-break-open>.

[14] How American Pays For College 2015. Sallie Mae's National Study of College Students and Parents.

[15] Ibid.

[16] "Boys and Girls Not Equally Prepared for Financial Future." Money Confident Kids. T. Rowe Price, 18 Aug. 2014. Web. 4 Sep. 2015. <https://corporate.troweprice.com/Money-Confident-Kids/Site/Media/News/Articles/boys-and-girls-not-equally-prepared-for-financial-future>.

[17] Hamilton, Laura T. "More is More or More is Less? Parental Financial Investments during College." American Sociological Review. 3 Jan. 2013. Web. 25 Sep. 2015. <http://asr.sagepub.com/content/78/1/70>.

What Does College Cost?

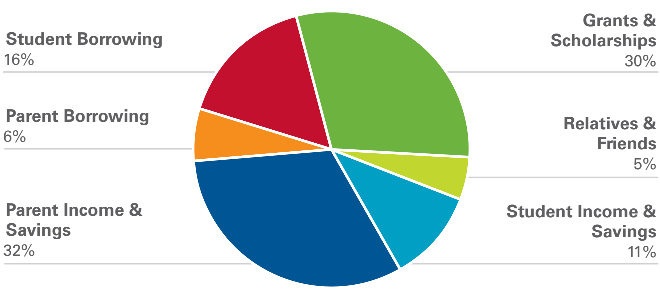
- Between 2013–14 and 2014–15, average published tuition and fee prices increased by 2.9 percent for in-state students in the public four-year sector, by 3.3 percent for out-of-state students in the public four-year sector and for in-district students at public two-year colleges, and by 3.7 percent at private nonprofit four-year institutions. These increases are higher than the 2.0 percent increase in the Consumer Price Index between July 2013 and July 2014, but in all sectors these price increases are lower than the average annual increases in the past five years, the past 10 years, and the past 30 years.
- Average published tuition, fees, and room and board for in-state students in the public four-year sector increased to $18,943 in 2014–15. At private nonprofit four-year institutions, average total charges increased to $42,419.[18]

Calculate College Costs

It may be easier to get children to buy into funding some of their education when they understand that their parents could potentially spend more than a quarter of a million dollars on their undergraduate education. And that's at today's costs. Yet, although college is an expense that clearly warrants advance planning, even your most cost-conscious and proactive clients may find it difficult to take the important first step of realistically estimating costs. That's because, somewhat inexplicably, colleges rarely focus on cost in their catalogs or on websites and tours. And, when they do address finances, it can be confusing. For example, tuition might be listed with no mention of room and board, leading to the faulty assumption that tuition is the total cost. That's especially misleading because at state schools, room and board can rival the cost of tuition. And an additional "fees" category represents different expenses at each school and can add thousands to the total college bill.

FIGURE 2: HOW IS COLLEGE FUNDED?

Average debt per borrower in each year's graduating class*



*Numbers are rounded

Source:http://news.salliemae.com/research-tools/america-pays-2015.

Because colleges present costs differently and have varying capacities to offer institutional financial aid, comparative shopping is virtually impossible. That is, a college with a high sticker price and a large endowment may actually be less costly than a college with a lower sticker price and smaller endowment once financial aid is awarded.

Congress tried to legislate greater pricing transparency in 2008 by requiring all colleges to place "net price calculators" on their websites that could, with the input of basic family financial information, approximate the college's cost after grants and scholarships are factored in. However, a study by the Institute for College Access and Success, a nonpartisan research and advocacy group, found that many calculators are virtually hidden on college website and others are difficult to use.[19] Plus, quality aside, users get frustrated with the net calculator process because they need to re-enter their financial data for each college they are interested in.

You might suggest that clients try a new free online tool produced by College Abacus that is attempting to do what Congress could not. Created by two Rhodes Scholars, the online tool allows college shoppers to enter financial information just once and check the net price of all the schools they are interested in. Although some colleges currently block College Abacus from obtaining their financial data, the tool makes estimating cost more efficient and increasing pressure may result in the uncooperative colleges being more forthcoming.

Dispel Financial Aid Myths

You have probably had clients tell you they are not saving for college because they believe it will hurt their chances of getting financial aid. Unfortunately, however, many of these families end up not qualifying for any aid at all and are left with little in the way of college funds. To correct this misunderstanding, it's important that you convey to clients that financial aid is a broad term that covers non-need-based merit scholarships, lower interest rate federal loans, need-based grants from colleges, and work study. Not all financial aid is a "gift." Also, interest rates on the loans that make up nearly a quarter of aid[20] vary dramatically, based on whether the loans are government subsidized or private. Once your clients file the Free Application for Federal Student Aid (FAFSA), they may be surprised to learn that skimping on saving for college has not resulted in more aid, but in the need for loans to cover college costs.

To motivate clients to save so they don't have to borrow, make clear that any amount they save will have a relatively small impact on financial aid. In fact, the federal formula's

[18] Baum, Sandy and Jennifer Ma. "Trends in College Pricing 2014." The College Board. 2014. Web. 4 Sep. 2015. <https:// secure-media.collegeboard.org/digitalServices/misc/trends/2014-trends-college-pricing-report-final.pdf>.

[19] "Comparison Shopping for College Tuition." The New York Times. 25 Feb. 2012. Web. 25 Sep. 2015. <http://www.nytimes.com/2012/02/26/opinion/sunday/comparison-shopping-for-college-tuition.html?_r=0>.

[20] How American Pays For College 2015. Sallie Mae's National Study of College Students and Parents.

Expected Family Contribution (EFC) factors in just 5.64 percent of assets held in a parent's name. (It taps student-owned assets at 20 percent.)

Another mistake to help clients avoid is not filing the FAFSA because they think they earn too much money. Families earning six figure incomes can qualify for need-based aid if there are multiple family members attending college in the same year. Also, colleges offer merit aid that is not based on financial need to entice students with desirable academic, demographic or geographic characteristics to enroll.

Colleges have different deadlines for filing the FAFSA, so encourage your clients to get organized and file on time. Note, too, that some schools require a secondary financial aid form, the CSS Financial Aid Profile to be filed through the College Board. This form is not free to file.

Save Efficiently with 529 Plans

Once you've debunked these college savings myths, ensure clients save in the most efficient way possible, both in terms of the FAFSA's rules and the account's taxability.

For families who can afford to save all or a substantial portion of expected future college costs, the 529 college savings plan's tax advantages and high contribution limits may make it the most tax-efficient investment vehicle for college savings. While a 529's tax deferral gives your assets a chance to grow faster than they would in a comparable taxable account, withdrawals for qualified education expenses are tax free. Some states also offer additional tax deductions. And, because 529 accounts remain under the account owner's control, assets can be reclaimed at any time by paying taxes and a 10 percent penalty on account gains, or simply by transferring the account to another beneficiary.[21]

Additional 529 advantages include high maximum contribution limits set by the plans themselves, as high as $400,000 per beneficiary. (Each state sets its own limits.) Further, while the annual limitation for tax- free gifts to family members is $14,000 per individual per year for 2015, a special gift tax exclusion permits five years' worth of gifts to the beneficiary of a 529 plan, in a single year, without triggering the federal gift tax.[22] That amounts to $70,000 for individuals and $140,000 for married couples. Once you open a 529 college savings plan, your clients can reach out to grandparents and other family members who may want to help finance college.

In more good news, federal financial aid formula treats a 529 account for a dependent student as a parental asset. Therefore, no more than 5.6 percent of the value of the 529 account is considered when determining the Expected Family Contribution (EFC) towards college costs. Also, withdrawals from your tax-free 529 plan do not add to your family's income, which would reduce the next year's eligibility for financial aid. (Note, though, that withdrawals from a 529 account opened by a grandparent do, indeed, count as student income. For that reason, many families that receive financial aid choose to reserve grandparent accounts for the final year of college when they would not be filing a FAFSA to qualify for financial aid for the following year.)

Stay in Touch Once the Kids Go to School

While parents have no control over tuition increases, they do have some small measure of control over how many years student takes to graduate. While your clients may think year five will not be necessary for their child, just 41 percent of students graduate in four years, according to data reported by 1,207 ranked colleges and universities in an annual U.S. News survey.[23] And that extra time is extra costly, especially when loans are involved. That is, in addition to borrowing more money, tuition and living expenses increase each year, and the student enters the workforce a year later. Temple University recently reported that students who take six years to graduate have nearly twice the student debt of students who earn a diploma in four years.[24]

Therefore, when evaluating what schools students should apply to, encourage clients to consider schools with high graduation rates. While they might assume that more selective colleges boast high graduation rates, an American Educational Research Journal study found that tuition had the greatest influence on a student graduating on time. Each time tuition increased by $1,000, students' four-year graduation chances inched up by a fraction of a percent. Of course, that may be little consolation for clients looking for affordable schools. And, in fact, the top 10 colleges with the highest 4-year graduation rates had an average acceptance rate of just 19.6 percent for fall 2013,[25] making them very competitive.

Perhaps the best you can do is to ask parents very specific questions during your regular meetings, questions that might jog their memory about issues they need to address with their college students. For example, rather than ask, "Is Alex still planning to go to Rome next semester?" ask "Has Alex met with his advisor to ensure that going to Rome won't compromise fulfilling his double major requirements?" Also, encourage your clients to remind their sons or daughters to meet regularly with their academic advisors.

Summary: Do the Homework and Reap Rewards

If all this advice seems too much to convey to your clients individually, consider hosting a college planning night. You could even invite a member of the admissions department or financial aid office from a local college. Clients who have already put their children through college also might attend to share their perspectives. Topics to address could include the benefits

[21] The beneficiary may be changed at any time without tax consequences as long as the new beneficiary is a "Member of the Family" of the designated beneficiary (as defined under Section 529).

[22] In the event the donor does not survive the five-year period, a pro-rated amount will revert to the donor's taxable estate. Rules regarding gifts and generation skipping transfer tax may apply in the case of a change in beneficiary. You should consult with your tax advisor when considering a change of beneficiary.

[23] Snider, Susannah. "Avoid Turning Into a Scary Student Loan Stat." USNews. 23 July 2014. Web. 25 Sep. 2015. <http://www.usnews.com/education/best-colleges/paying-for-college/articles/2014/07/23/avoid-turning-into-a-scary-student-loan-stat>.

[24] Ibid.

[25] Haynie, Devon. "10 Colleges With the Highest 4-Year Graduation Rates." USNews. 14 Oct. 2014. Web. 25 Sep. 2015. <http://www.usnews.com/education/best-colleges/the-short-list-college/articles/2013/10/15/10-schools-with-the-highest-4-year-graduation-rates>.

of investing in 529 plans, how to position students to earn merit scholarships, and the difference between federal and private student loans.

In conclusion, providing a college education is a big dream with a big price tag and families need all the planning help they can get. Yes, majors, dorms and dining halls matter, but how you pay for college matters, too. Although lauded as the "great equalizer" in America, a college education is difficult to afford for many families. And, as loans become a bigger part of financial aid packages, college graduates increasingly find themselves trapped by their college education rather than empowered by it.

If you're ready to help guide your clients and their families with college planning and funding to ensure they escape the snare of student debt, here's your assignment:

Meet with families to discuss college costs and funding solutions

- Discuss the children's financial contributions to their education
- Introduce the 529 college savings plan as a flexible, tax-efficient vehicle
- Dispel financial aid myths and offer to evaluate aid packages
- Once college starts, stay in touch to monitor costs and adjust the plan

It might even be helpful to assign someone in your office to coordinate your college planning efforts. Of course, we have plenty of resources to help, including client-ready pieces. Just visit ssga.upromise529.com/advisor

As you invest time in college planning, remember that, in addition to helping your clients, your efforts will deliver real benefits for your practice, such as stronger client relationships that can result in more referrals and a greater share of wallet. However, most significantly, developing college funding solutions results in meaningful connections with your clients' children—debt-free young adults who will graduate ready to invest in their bright futures.

Definitions

Qualified Educational Expenses include amounts paid for tuition, fees and other related expense for an eligible student that are required for enrollment or attendance at an eligible educational institution (Source: https://www.irs.gov/Individuals/Qualified-Ed-Expenses).

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