

Topic: financial planning

Case Study: To Become a Buckeye?

Is college “worth it”? And is a “better” college worth the higher cost? If so, how do you pay for it?

Background

Tom had always been proactive and forward-looking, so it should not have come as any surprise to his parents when the 14-year-old plopped down a thick folder labeled “College Decision” on the dinner table. Still, even though they had begun to feel anxious about their oldest child leaving home (not to mention how they would pay for it), they did not expect the choice to come so quickly.

Tom was a decent student, maintaining a solid B+ average and a spot in the top 20% of his freshman class in a medium-sized suburb of Akron, Ohio. He was a burgeoning athlete, playing junior varsity basketball in the winter and running middle-distance track events in the spring, and also had just joined the school’s drama club and debate team. Tom knew that he was not a top student, and because his interests were so diverse, he would prefer a school where he could explore possible majors and careers without the competitiveness and pressure of an Ivy League university; further, at least right now, he thought he would probably prefer to live on campus, but still be close to home, and thus planned to stay in Ohio.

Based on his preliminary research, Tom thought two schools represented the types of places that fit his desired profile. The two schools were very different, however, and

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thus represented possible opposite extremes on the continuum of schools to which Tom might apply in 3 years. The first, obvious choice was Ohio State University, one of the nation's largest and best public university systems. Located in the state capital of Columbus, OSU had almost 43,000 students and cost \$10,037 in tuition and fees for Ohio residents, plus \$10,392 for room and board for students living on campus. At the opposite extreme, Xavier University in Cincinnati was a small, private, Catholic university with just 4,500 students. Tuition and fees were \$33,000 and room and board was very similar to OSU, at \$10,520. Tom had read estimates that personal expenses, such as books and supplies, transportation around town and to visit home, personal care and toiletries, and other things would be in the range of \$3,000 to \$5,000 per year, regardless of which school he chose.

Tom knew that if he were able to get his GPA up a bit and score in at least the 80th percentile on the SATs, he would be eligible for a generous scholarship from Xavier. He had heard from friends who went to similar private schools that they received \$20,000 per year in merit scholarships. Ohio State, on the other hand, would probably only offer him about \$3,000 in scholarships. Tom's family was middle class, but with four kids and the mortgage on their home, they just barely managed to cover their bills every month. For either school, Tom predicted, based on his research, that his family would be eligible for about \$5,000 in need-based grant aid from the federal government and the state of Ohio, and that he would potentially be able to get about \$3,000 per year in private scholarships from community organizations, such as his family's church and the local Kiwanis club.

Dilemma

Tom knows that he has some time to make the decision, and certainly needs more information (including actual offers to confirm his research) before he decides anything, but he wants to have an idea of what his top choice would be and what other schools to look at.

Therefore, he first needs to decide whether any advantages of attending a small, private school, in addition to the extra scholarship money they offer, outweighs the significantly higher price. Second, regardless of the choice that he makes, he and his family will be left with significant costs that are not covered by need or merit-based grant aid—about \$15,500 per year in the case of Xavier and about \$9,500 a year in the case of Ohio State.

Of course, being quite the planner, Tom has looked into their options. He plans to get a part-time job as soon as he turns 16, and will save at least \$1,000 per year to help cover any out-of-pocket expenses. His parents have offered to match whatever he saves, and even start saving \$2,000 per year in the 2 years before he starts working. They need to consider where and how to save the money; their bank offers a “529” savings plan, but Tom doesn’t know much about what that is and is tempted to just use a regular savings account.

Nonetheless, that still leaves a large chunk of money that the family will owe that cannot be covered by savings, even with the power of compound interest over the next 4 years. Tom could consider working, either through the federal work study program or on his own, to cover part of the costs, but it is unlikely that he would earn enough to fully cover them, and he is worried that working too much could distract from his studies. His parents have seen so much in the news recently about the dangers of excessive student debt and horror stories of students who accumulated hundreds of thousands of dollars in debt and were unable to find jobs, but aren’t sure if student loans can be avoided, or if taking a modest loan would be such a bad idea, after all.

Recommendations

If you were Tom, which school would you list as your top choice, for now? What more would you want to know about the schools, about Tom, or about anything else, to have more confidence in the choice? How would you decide if the costs of a private university are justified by any additional benefits?

If you were Tom’s parents, what choice would you make regarding saving to help Tom pay for college? What recommendation would you make to Tom regarding taking out loans, in particular to help pay for living expenses? Finally, what other options would you encourage Tom to consider, both in terms of the school he will attend and how he plans to pay for it?

What else would you want to know to make a better recommendation?

Terms

- Bank
- Certificates of deposit
- College savings plans
- Interest (APR)
- Simple interest vs. compounding interest
- Student loans
- Time value of money
- U.S. savings bonds

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Resources

Unemployment Rate – Bachelor’s Degree vs. High School Diploma

A graph from the St. Louis Federal Reserve demonstrating how unemployment varies by level of education.

<http://research.stlouisfed.org/fredgraph.png?g=73B>

Is a College Cap and Gown a Financial Ball and Chain?

A brief report summarizing the statistics on whether college is worth the cost.

http://research.stlouisfed.org/pageone-economics/uploads/newsletter/2011/Cost_of_Higher_Education_0811_Liber8_Newsletter.pdf

Savingforcollege.com

A guide to 529 college savings plans and other ways to pay for college.

<http://www.savingforcollege.com>

Now Offering College Loans: ‘High School Funds’

With ever-increasing tuition and a limited pool of funds for traditional financial aid, alternative means of financing a college education are becoming available.

http://www.marketwatch.com/story/now-offering-college-loans-high-school-funds-2012-10-11?mod=rss_Money

Stafford Loan Frequently Asked Questions

Answers to common questions about the large and popular Federal student loan program.

<http://www.staffordloan.com/stafford-loan-info/faq/>

Federal Student Aid: PLUS Loans

Information from the U.S. Department of Education about the PLUS loan program for parents which can help cover college expenses not covered by other aid.

<http://studentaid.ed.gov/types/loans/plus>

What is the FAFSA?

Some information about the Free Application for Federal Student Aid (FAFSA), the mandatory form providing information to schools about a student and his or her family's finances to determine eligibility for different forms of financial aid.

http://collegeapps.about.com/od/payingforcollege/f/fafsa_info.htm

Compound Interest Formula

Whether you are saving in anticipation of college or borrowing to pay for college, your savings or debt will be subject to an interest rate which will likely compound over time. In short, compound interest means that you earn interest on interest that you've already earned, or pay interest on accumulated interest on a loan, accelerating the rate at which savings (or debt!) grow (given enough time and a high enough interest rate, sometimes dramatically).

<http://math.about.com/od/formulas/a/compound.htm>

529 Rebels: Alternative Ways to Pay for College

While 529 savings plans are a popular way for families to save for college, there are alternatives that may be preferable under certain conditions.

<http://www.reuters.com/article/2013/05/28/us-college-savings-529s-idUSBRE94R0FC20130528>

12 Insider Tricks to Pay for College

Beyond savings plans and financial aid, there are several other ways to save money on college, including selecting schools with lower or no cost, such as spending the first 2 years at a community college and transferring, or receiving a free education from a military academy in exchange for a service commitment for a number of years.

<http://www.forbes.com/sites/baldwin/2013/01/02/12-insider-tricks-to-pay-for-college/>

College Cost Calculator

With average college tuition rising faster than inflation every year, it can be difficult to plan for how much college will cost. This tool takes tuition inflation and savings into account to estimate how much will be needed from financial aid and other sources to pay for college.

<https://bigfuture.collegeboard.org/pay-for-college/college-costs/college-costs-calculator>

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Families Make Big Changes to Pay for College

One family's story of how they managed to pay for college for multiple children, simultaneously, including some useful facts about how the average family pays for college.

[http://www.npr.org/2012/08/02/157657475/
families-make-big-changes-to-pay-for-college](http://www.npr.org/2012/08/02/157657475/families-make-big-changes-to-pay-for-college)