

MFS Investment Management<sup>®</sup>

# A guide to college financial aid

When savings aren't enough

# Making college affordable

For many Americans, paying for a college education trails only a home purchase as the largest expenditure they will make in a lifetime.

Some of us save a little toward these costs, but escalating college tuition and room and board bills still leave us short. Other times, conflicting financial challenges leave some of us unable to put money away toward this important goal.

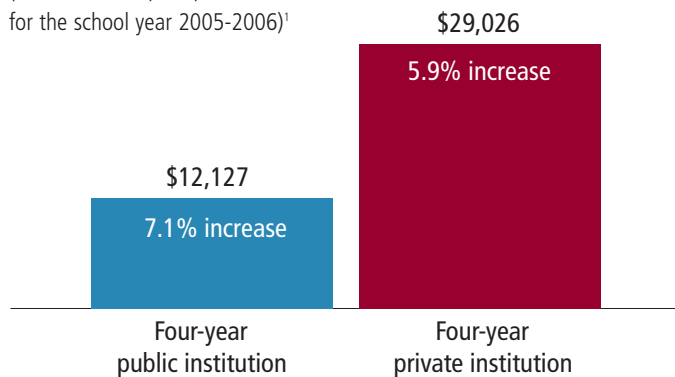
Fortunately, a combination of loans, grants, and tax credits can help many people meet or recoup a portion of higher education costs. To understand how these financing vehicles can help, you need to recognize what you are up against.

## Just how expensive is the average college education?

In 2005-2006, the average annual cost of college, which includes tuition, room and board, soared to over \$29,000 at private colleges and \$12,100 at public institutions. The average cost of tuition, fees, room and board at public institutions, has increased 7.1% from last year. Tuition alone has increased 7%, as state appropriations have not increased in line with higher education costs.<sup>1</sup> In comparison, the total average cost of a year's education at private institutions increased only 5.9%, although the average cost is almost two and half times greater than the costs for a public institution.<sup>1</sup>

### The annual cost of a college education

(includes tuition, fees, room and board for the school year 2005-2006)<sup>1</sup>



## Billions in aid

There are billions of dollars of aid available each year. Loans, both unsubsidized and those subsidized by states and the U.S. Department of Education, are often a great help in meeting college costs. About half of all aid awarded to undergraduates is in the form of loans. Over the past decade, the amount taken in loans has dwarfed the amount of money awarded through grants.<sup>2</sup>

More than \$129 billion in student aid was distributed to undergraduate and graduate students in the form of grants, work-study, federal loans, and federal tax credits and deductions in 2004-2005, an increase of almost \$10 billion more than the previous year.<sup>3</sup> Community organizations also provide countless grants, while most colleges and universities offer institutional aid comprised of loans, grants, and work study.

Financial aid is a major, but not the only, way to help reduce the burden of college expenses. On the following pages, you will learn how to identify and take advantage of these opportunities.

## Aid orientation

Long before you or a loved one attends freshman orientation classes, you'll need to understand the financial aid process. This all starts months before the first college class is taken with the Free Application for Federal Student Aid (FAFSA).

*Tip: You can pick up a FAFSA application at most libraries and high school guidance offices or complete the form at FAFSA on the Web at [www.fafsa.ed.gov](http://www.fafsa.ed.gov).*

### What you'll need to fill out a FAFSA

If you complete the application over the Internet, you'll need to request a personal identification number (PIN) by going to [www.fafsa.ed.gov](http://www.fafsa.ed.gov) and clicking "apply for pin." Paper filers will receive their PIN either by the U.S. Postal Service or through e-mail after the information in the FAFSA is submitted and verified.

Filling out the FAFSA application online is more efficient, making subsequent renewals easier. You have to fill out an application each year you apply for aid.

### Financial information required

Students applying for aid and their parents or guardians must also provide financial information if the student is considered a dependent. In situations where parents are either separated or divorced, financial information must be provided for the parent with whom the student primarily lives.

### You are an independent student if you

- were born before January 1, 1982
- are enrolled in a Master's or doctorate program in 2005-2006
- are married or separated, or
- have children or other dependents and provide at least half of their financial support

<sup>1</sup>College Board, Trends in College Pricing 2005, [www.collegeboard.com/press/article/0,3183,38993,00.html](http://www.collegeboard.com/press/article/0,3183,38993,00.html)

<sup>2</sup>College Board, Trends in Student Aid 2005, [www.collegeboard.com/press/article/0,3183,38993,00.html](http://www.collegeboard.com/press/article/0,3183,38993,00.html)

<sup>3</sup>College Board, Trends in Student Aid 2005, [www.collegeboard.com/press/article/0,48884,00.html](http://www.collegeboard.com/press/article/0,48884,00.html)

The financial information you provide will determine how much aid you receive. Applicants are required to refer to specific lines on their latest tax returns, so it doesn't hurt to make copies of completed tax forms because schools may require copies for other types of aid. For example, if you fill out the application in January and will enter school the following fall, you must include your tax information from the previous year. If you haven't filed your last year's tax return, which isn't due until April 15, estimate your answers on the FAFSA and correct them later when your tax return is completed. You can and should complete a FAFSA even if you haven't yet been accepted at a school.

Items you need to report in the FAFSA<sup>4</sup>

- annual adjusted gross income
- home equity
- money in savings and checking accounts
- child support
- untaxed benefits including Social Security and child tax credits
- tax-deferred payments made by you or an employer to IRAs, 401(k) plans, and other pensions
- tax-exempt interest income
- education credits and other scholarships

### **File early**

Submit the completed form as early as allowable. Then, submit your completed FAFSA application, anytime between January 1 and June 30. Note that some schools require your financial information earlier than the June deadline. The sooner you submit the FAFSA application, the earlier you can apply for aid, although any applications sent prior to January 1 will be returned.

Finally, you also need to include codes for schools to which the student will apply. The U.S. Department of Education will then forward your FAFSA information and Expected Family Contribution (EFC) to the schools listed on FAFSA. You can find these codes on the FAFSA Web site, at your local library, or at high school and college career offices.

### **Review your Student Aid Report**

Within a month, the FAFSA application should be processed and you should receive a Student Aid Report (SAR). Your EFC will be included along with other personal information. The amount of tuition subtracted by your EFC equals your financial need.

Your EFC is actually two numbers — one computed that determines how much you can pay if you qualify for federal assistance and the other an institutional formula that colleges may or may not follow. Typically, students are required to pay a greater percentage of their income toward college costs — an amount as much as 50% of total income. A new law enacted in early 2006 (Deficit Reduction Act of 2005) made substantial changes to the treatment of 529 plans in the federal student aid eligibility formula. The changes are effective for the 2006-2007 school year. Today, students' assets are assessed in the financial aid formula at a much higher 35% rate, but this rate will decrease to 20% beginning with the 2007-2008 school year. Additionally, the EFC determines that students can pay as much as 35% of their asset value — equity minus debt — for college. Parents are expected to pay a much smaller percentage of income and assets, minus some deductions.<sup>5</sup>

Check your SAR since this is the basis by which colleges pay federal student assistance. If you find a mistake, you can make corrections online if you applied electronically, or write the corrections on the SAR, sign it, and mail it back. Keep a copy of the SAR for your records.

### **How much will you get?**

In many cases, more than you think. Your EFC is the amount of money the U.S. Department of Education believes you and a dependent can contribute to an education. That amount won't vary, whether you have one or more children in college, or whether your child commutes to a community college or attends the most expensive private university. A higher-income couple with two or more children in college or one child attending an expensive college can conceivably receive an EFC that is less than the cost of attending school.

However, you won't know if you qualify for aid unless you fill out the FAFSA application. Also understand that individual colleges make the final decision about your aid eligibility and are not bound by the EFC, meaning that some schools may require that you pay more or less than the EFC before they consider giving any grants.

<sup>4</sup>Source: [www.finaid.org/calculators/finaidestimate.phtml](http://www.finaid.org/calculators/finaidestimate.phtml)

<sup>5</sup>Source: [www.finaid.org/calculators/finaidestimate.phtml](http://www.finaid.org/calculators/finaidestimate.phtml)

## The ABCs of federal loans and grants

The U.S. Department of Education provides and subsidizes much of the financial aid that is available to students. These loans are numerous and their qualifications vary, although most are based on financial need. They include:

**Pell Grant** – A federal grant that doesn't need to be repaid, the Pell Grant pays up to \$4,050 annually in 2005-2006. This program is administered directly by the U.S. government.

**Federal Supplemental Educational Opportunity Grant** – Administered by individual colleges, the FSEOG is given to undergraduates demonstrating exceptional financial need. The award, up to \$4,000 annually, is a grant and doesn't need to be repaid.

**Federal Work Study** – The total amount of money you can receive from this program is predetermined by your EFC. There is no limit on the annual amount you can receive, although the school schedule will limit the number of hours worked. Unlike the first two grants, which are almost exclusively for undergraduates, work study also includes graduate students. Keep in mind that work study is neither a loan nor a grant, although it is a federal program. The student must earn the money by working at an on-campus job.

**Perkins Loan** – The most income-sensitive loan available, the Perkins Loan, provides up to \$4,000 annually to undergraduates, up to a total of \$20,000, and as much as \$6,000 annually for graduate and post-graduate students. This loan typically is available to students demonstrating financial need and requires no fees as the following loans will.

### Two programs, many loans

The most widely used loans are administered by two federal programs: the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Loan program. FFELs are private loans made by a bank or other lending institution. The U.S. Department of Education makes and administers direct loans and pays the subsidy for FFEL subsidized loans.

Each program offers three types of loans to both undergraduate and graduate students: subsidized and unsubsidized Stafford loans for students and federal PLUS loans for parents and guardians.

**Subsidized Stafford Loan** – Your EFC comes into play again because a subsidized Stafford Loan is based on

## Aid opportunities at a glance

Aid program	Type of aid	Annual limits	Income sensitivity	Repayment responsibility
Pell Grant	grant	\$4,050	high	none
FSEOG	grant	\$4,000	high	none
Perkins Loan	loan	\$4,000 undergraduates \$6,000 graduates	high high	student student
Subsidized Stafford Loan	loan	Undergraduate: \$2,625 to \$23,000 <sup>6</sup> Graduate/Professional student: \$18,500 <sup>7</sup> to \$138,500 <sup>8</sup>	medium	student
Unsubsidized Stafford Loan	loan	Undergraduate: \$2,625 to \$23,000 <sup>6</sup> Graduate/Professional student: \$18,500 <sup>7</sup> to \$138,500 <sup>8</sup>	low	student
PLUS Loan	loan	Cost of attendance minus other aid	low	parent

Source: [http://studentaid.ed.gov/students/publications/student\\_guide/2004\\_2005/english/types-stafford.htm](http://studentaid.ed.gov/students/publications/student_guide/2004_2005/english/types-stafford.htm)

<sup>6</sup>Depending on grade level

<sup>7</sup>No more than \$8,500 of this amount may be in subsidized loans.

<sup>8</sup>No more than \$65,500 of this amount may be in subsidized loans.

financial need. However, financial need is defined more liberally than, say, for a Perkins Loan. When a loan is subsidized, the Department of Education pays interest while the student is in school at least half-time and during the grace period after. Loan amounts vary by grade level. For freshmen, the annual loan limit is \$2,625. Sophomores can receive as much as \$3,500 and juniors and seniors can borrow up to \$5,500. The maximum total debt from Stafford Loans you can have when you graduate is \$23,000. Graduate students may have as much as \$18,500 annually available to them. Independent graduate and undergraduate students may receive more than dependent graduate and undergraduate students.

**Unsubsidized Stafford Loans** – When the aid awarded doesn't equal the amount needed to meet college expenses, many students opt for an unsubsidized Stafford Loan. Limits are the same as for the subsidized version. Although you needn't begin paying this loan until after a grace period following graduation elapses, interest accrues from the time you receive the loan. Both types of loans are available at a fixed rate of 6.8% for borrowers who are in school, in their post-school grace period, or in deferment.

**PLUS Loans** – These loans are for parents and guardians of students and can pay up to the full cost of college, less any Stafford Loans or other federal financial aid received by the student. One caution: applicants can be declined due to a poor credit history. Payments are due 60 days after the final disbursement of the loan, and variable interest rates are capped at 9%.<sup>9</sup> Plus Loans are available at a fixed rate of 8.5%.

## Making up the shortfall

If federal loans and grants are not enough to cover college costs, you might consider taking out a private loan. Most major banks offer private college loans, although interest rates and repayment terms may not be as attractive as for federal loans. Additionally, large quasi-government agencies, such as Sallie Mae and Nellie Mae, do nothing but offer college loans.

## Thousands of scholarships

There are thousands of private grants available to students from virtually every walk of life.<sup>10</sup> Adult students, who make up a large portion of the total student population, may be able to tap an employer education benefit to help defray college costs. Typically, these plans require that you take a course of study that is directly related to your job.

Employers are often a ready resource of student scholarships offered to family members of employees, based on each company's qualifications. Community groups including Kiwanis, Elks, and the American Legion offer small grants, as do local business groups.

There are scholarships for people of different ethnic and religious backgrounds, students who demonstrate specific academic prowess such as writing or the sciences, scholar-athletes, and even one for a left-handed student who attends Juniata College in Pennsylvania. The U.S. Armed Forces also offer college aid, either after service or as part of a ROTC commission. AmeriCorps and other national service initiatives also offer scholarships. Individually, some colleges and universities offer grants to students in specific academic disciplines or who participate in community endeavors.

You can find thousands of scholarships on the Internet. Use extreme caution, however, when considering a scholarship search service that charges hundreds of dollars. For the most part, you can find these same scholarships yourself, although many free sites require registration and may sell your personal information to others.

## Scholarship resources on the Web

- [www.students.gov](http://www.students.gov)  
run by the Department of Education
- [apps.collegeboard.com/cbsearch\\_ss/welcome.jsp](http://apps.collegeboard.com/cbsearch_ss/welcome.jsp)  
a Web site of the College Board
- [fastweb.monster.com](http://fastweb.monster.com), and [www.srnexpress.com](http://www.srnexpress.com)  
private, free registration sites
- [www.collegenet.com](http://www.collegenet.com)  
a private site with college applications online

<sup>9</sup><http://studentaid.ed.gov/PORTALSWebApp/students/english/parentloans.jsp?tab=funding>

<sup>10</sup>[www.students.gov](http://www.students.gov); scholarships and grants

## Not set in stone

Neither your EFC nor your initial aid package from a school is necessarily set in stone. Certain events, such as disability, unusual medical expenses, or unemployment, can be cause for changes in the amount you are expected to contribute. Additionally, college financial aid offices may review your aid package if it means attracting a top student or athlete. For example, a student may have the type of academic record that helps build the reputation of the school. If you or your child falls in this category, don't be shy about comparing what other schools might have offered you. If you believe the financial aid figure is too low, say so. You might receive more aid.

## Still time to save

Another effective way to meet college costs, especially during junior and senior years and for graduate school, is to save now. Even with only a few years to go before the start of college, the compounding of potential earnings can add up. By saving in a college savings plan such as a section 529 state tuition savings plan or a Coverdell Savings Account, you have the advantage of making tax-deferred contributions and tax-free withdrawals for qualified education expenses. There are additional fees and expenses associated with 529 savings plans. And, investments in 529 plans involve investment risks. Depending on your state of residence and the state of residence of the beneficiary, an investment in a 529 savings plan may not afford your beneficiary a tax benefit. Talk to your investment professional to learn more about these savings vehicles.

## Tax benefits

One last way to help manage college costs is to take advantage of tax deductions and credits specific to paying for college.<sup>11</sup>

### Tax credits

The HOPE Scholarship grants an annual tax credit of up to \$1,500 for college expenses incurred during the first two years of undergraduate or graduate study. A tax credit differs from a tax deduction in that the credit is deducted directly from taxes owed, while a deduction reduces the amount of taxable income.

To qualify for the full credit, you must earn less than \$87,000 annually if you are married and file your taxes jointly, and the student must be enrolled at least half-time for at least one academic period during the year.

Partial credits for the 2006 tax year will be available for taxpayers earning between \$87,000 and \$107,000 annually. Single taxpayers may claim a full or partial credit if they earn up to \$53,000 annually. You may take the tax credit for yourself, a spouse, or a dependent even if you use other credits or deductions, as long as they are for different expenses.

The Lifetime Learning credit is available in any college year, provided you don't take the HOPE credit at the same time. Income limits are the same as for the HOPE credit, but the annual credit is higher — up to \$2,000, based on 20% of eligible expenses up to \$10,000 per taxpayer in any year. While the HOPE credit can be taken for however many students in a family qualify, the Lifetime Learning credit is per taxpayer. Unlike the HOPE credit, the Lifetime Learning credit is available to part-time students who take as few as one course.

### Tax deductions

A tax deduction on student loan interest of up to \$2,500 annually is also available. Even grandparents can take the deduction if they paid qualified expenses for a student who attends school at least half time.

The annual income limits to qualify for a full deduction are \$50,000 for a single taxpayer or a single head of household and \$105,000 for married couples filing jointly. There is no phase-out of the deduction for singles, but single heads of households and married couples filing jointly may claim a partial deduction if their incomes are between \$50,000 and \$65,000 and \$105,000 and \$135,000, respectively.

You can also take up to a \$4,000 deduction annually for tuition and fee payments. Single taxpayers get the full deduction if they earn less than \$65,000 and a \$2,000 deduction if their adjusted gross income is between \$65,000 and \$80,000. Joint filers get the full credit when income is less than \$130,000 annually and the partial credit when income falls between \$130,000 and \$160,000. You can use loans taken but not yet paid in your calculations.

<sup>11</sup>[www.irs.gov/pub/irs-pdf/p970.pdf](http://www.irs.gov/pub/irs-pdf/p970.pdf)

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