# EFC Formula Guide 2020-2021 & FAFSA Basics

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Last week, the Department of Education released the FAFSA Formula Guide for the coming FAFSA. Before I give you that link, I want to share some basics about the FAFSA. I'll also break out each section of it in depth in the coming weeks– hopefully before the new FAFSA arrives on Oct. 1.

First and foremost, what are the FAFSA and the FAFSA formula? Let's start with what they are ***not***: They are not Santa's sleigh or the tooth fairy. Nor are they an arsonist trying to torch your family's financial security. They do not bring or deny financial aid awards. Rather, the FAFSA is a tool that allows a school to evaluate a family's financial strength and allocate aid dollars equitably across their student population. It is an imperfect tool, it is a blunt instrument, it does not even attempt to understand your situation, but it's the tool you need to work with if you want need-based financial aid or to borrow through the federal student loan program.

From a financial aid perspective, it's far more important to understand what the schools do with your FAFSA and EFC than to manage the data going into the calculation. Many families invest untold hours in restructuring assets to minimize their EFC only to learn that their top-choice school does not meet full need and starts their aid package with a direct student loan. So if your student has some schools in mind already, the net price calculator is going to be far more helpful cost estimator than the FAFSA.

On the other hand, parents of freshmen, sophomores or middle schoolers who are trying to get their arms around the cost of college would benefit from spending some time understanding the FAFSA, both in order to plan for FAFSA years and to get a sense of whether they're on the need-based or merit aid path to college.

With all that behind us, let's get into the basics of the formula. Parents tend to focus on assets, but that is only one of the four FAFSA "buckets" (and the one with the least impact overall for most families). Everything that a student and her parents earn, own or might spend for college goes into one of these buckets:

- **Parent income**: Besides after-tax income, this includes add-backs such as pre-tax retirement contributions, untaxed income such as child support, Roth IRA distributions, tax-exempt interest and nontaxable pension distributions. Net of a few adjustments such as taxes paid and an exemption based on family size, income above a certain threshold is assessed at progressive rates ranging from 22% to 47%, a bit like federal income tax brackets. Income for the coming FAFSA is based on 2018 data.
- **Parent assets**: Nonretirement liquid and illiquid assets are valued as of the date of the family's FAFSA filing. Liquid assets include checking, savings, brokerage and 529 accounts (for all children in the family, not just the student). Illiquid assets include the net value (market value less outstanding debt) of vacation or investment properties but not the family's primary residence. It also includes the value of larger (>100 employees) family-owned businesses. Excluded are retirement assets, life insurance policies and the family's primary residence. Assets above the Asset Protection Allowance (between around $5,000 and $9,000 for most families) are first assessed at 12%, then added to income and subject to the graduated income assessment rates of up to 47%. (The figure you've heard of 5.64% of assets counting towards EFC is 12% x 47%.)
- **Student income**: This bucket likewise includes income net of taxes. In addition, any third-party money– distributions from a grandparent-owned 529 or payments made by a non-custodial parent, for example– is

also added to student income. Earnings from a work-study job are excluded from student income since they're counted as financial aid. Students receive an income protection allowance of $6,840 on this year's FAFSA; everything above that is assessed at 50%. And again, for this year's FAFSA it's 2018 income.

- **Student assets**: Unlike parents, students do not receive an asset protection allowance and their assets are assessed at 20%. So while $1,000 in a 529 would add somewhere between $0 and $56 to the family's EFC, that same $1,000 in the student's checking account would add $200.

If you got through all of that and are still reading, here's your reward: the 2020-2021 EFC Formula Guide.