Strategic Approaches to Student Loan Repayment

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2

Repayment Strategy

Choosing the "Right" Plan

In developing a strategy, borrowers must:

- Understand their options
- Estimate their budget
- Define their goals
- Evaluate possible tradeoffs
- Leverage loan repayment flexibility
- Choose the plan that best meets ***all*** their needs

2

3

When repaying Federal Direct Loans, ***faster may not be better***!

Borrowers may want to:

- Consider taking as long as possible to repay their Federal Direct Loans

Why?

- They may have better uses for their "extra" funds from an "***opportunity cost***" perspective

3

4

What other uses?

Borrowers must decide how to allocate their monthly income among four ***"buckets" ...***

4

5

The "Future" Bucket

They also should be:

- Saving for a "rainy day" – *the emergency fund*
  - **Minimum of 6-9 months of their average monthly living expenses**
- Investing for retirement
  - **Minimum of 10% of their gross monthly income**
- Saving for their children's education
  - **Minimum needed uncertain**--*may need to start paying for children's education much sooner than expected (e.g., elementary school)*
- Saving for the down payment for a home
  - **Minimum of 10% of purchase price**

5

6

What should borrowers do?

Borrowers should consider:

- Choosing the repayment plan that offers the ***LOWEST*** scheduled monthly payment

Why?

- This provides ***maximum cash flow flexibility*** so they can:
  - Maximize the amount they are prepaying in a targeted way at their most expensive debt (e.g., Grad PLUS Loans),

  AND/OR

  - Allocate "extra cash" for other expenses (e.g., the ***FUTURE*** bucket).

6

7

Won't this debt prevent them borrowing for other purposes, e.g., a home?

7

A Shifting Loan Paradigm

- Many students are graduating with a "mortgage"
- Monthly payments on Federal Direct Loans never have to exceed 15% of the borrower's monthly household adjusted gross income (AGI)
- Borrowers should never have to miss a payment or default on their Federal Direct Loans
- Federal Direct Loans have other "unique" characteristics that should impact borrower behavior

8

The Education Mortgage

- Increasing majority of students now must borrow money to pay for school
- Federal student loan debt levels are increasing significantly
  - Many undergraduates now graduate with federal loan debts exceeding $30,000.
  - For graduate/professional students, the average now exceeds $100,000; and for a growing number it is more than $200,000
- Borrowing money is not a bad thing if it allows students to obtain their education **NOW**– it is an ***INVESTMENT*** just as a home is an investment

9

But with this "Mortgage" …

… they don't get a house!

10

So, can they still buy a house?

- Surprisingly, the answer probably is:
  – "Sooner than they might think, **IF**, they make ***STRATEGIC*** financial decisions!"
- Qualifying for a mortgage requires:
  – Sufficient collateral
  – Willingness to pay
  – Ability to pay
  – Down payment

11

Will they qualify?

- Sufficient collateral
  – Typically not an issue
  – Realtors should discourage buyers from offering to pay more for a property than its worth

12

Will they qualify?

✔ Sufficient collateral
- Willingness to pay
  – Based on credit score
  – Federal student loan debt does not seem to have a significant negative impact on credit score if all other aspects of consumer's credit are good

13

Will they qualify?

✔ Sufficient collateral
✔ Willingness to pay
- Ability to pay
  – Based on monthly debt to income ratio
  – Ratio should not exceed ≈ 40% including home mortgage payment
  – Federal student loan monthly payment need not exceed 15% of household's adjusted gross monthly income so that leaves at least 25% of gross monthly income for mortgage payment

14

Will they qualify?

✔ Sufficient collateral
✔ Willingness to pay
✔ Ability to pay
- Down payment
  – Probably need at least 10% of purchase price
  – Cannot come from borrowed money
  – But, federal student loan borrowers could start saving for the down payment much sooner if they chose to pay the smallest amount possible on their federal student loans – it's about getting financially positioned to qualify for a mortgage

15

Will they qualify?

✔ Sufficient collateral

✔ Willingness to pay

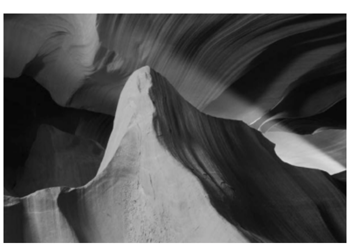
✔ Ability to pay

? Down payment

<u>*Conclusion:*</u> *It is not likely going to be the Federal Direct Student Loan debt that prevents a borrower from qualifying for a mortgage; it more likely will be the lack of a down payment!*

16

17



The "15% Reality"

17

Federal Direct Loans are unique …

Three features make them low risk debt

1. Payments never need to exceed **15%** of their household's gross monthly income ***(flexible payment options)***
2. Borrowers should never have to miss a payment due to financial hardship ***(payment relief options)***
3. Portion of debt may be cancelled, forgiven or discharged

No other type of debt (including private student loans) has these three features

– *You cannot always be sure you will have enough money to make the scheduled payment on time for all other forms of debt and this creates financial risk!*

18

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18

Federal Direct Loans have …

Flexible repayment options including income-driven payment plans

- Pay As You Earn (PAYE)
- Income-Based Repayment (IBR)
- Income-Contingent Repayment (ICR)

No other form of personal credit (including campus-based federal student loans and private student loans) offers income-driven options.

19

19

Federal Direct Loans have …

Payment relief options

- Deferment
- Forbearance
- Adjustments to monthly payment

Payment relief (if it is available at all) is much more limited with other forms of personal credit (including campus-based federal student loans and private student loans).

20

20

Federal Direct Loans have …

- Loan Forgiveness
  - Public Service Loan Forgiveness (PSLF)
  - Teacher Loan Forgiveness
- Loan Cancellation
  - Cancellation with income-driven repayment plans
- Loan Discharge
  - Discharge in case of death or total/permanent disability (TPD) of the borrower

21

21

Why are Federal Direct Loans so different from other forms of credit?

- Eligibility for Federal Direct Loans (as well as other federal student loans) is **NOT** based on the borrower's "***ability to pay***"
- Eligibility for all other forms of credit (except campus-based/private student loans) does require "***ability to pay***" on the "front end"

22

22

Why does all this matter?

- Financing a post-secondary/post-graduate education can be viewed differently from financing for all other expenditures
- Federal Direct Loans allow for "**affordable**" ***repayment options*** without sacrificing:
  - Career aspirations
  - Investing for the future (e.g., retirement, home ownership, children's education, building up an emergency fund, etc.)

23

23

Repaying Federal Direct Loans …

… ***is all about choices and strategy***

24

Repayment Choices

Stafford, PLUS and Consolidation Loan Payment Options

Options	Payment Structure	Payment Period
Standard	Fixed	10 years
Graduated	Tiered	10 years
Extended	Fixed or tiered	25 years
Pay As You Earn (PAYE) *(Direct only)*	Adjusted annually based on: - Household AGI - Household size - Poverty guideline - State of residence *10% of annual "Discretionary Income"*	20 years
Income Based (IBR)	Adjusted annually based on: - Household AGI - Household size - Poverty guideline - State of residence *15% of annual "Discretionary Income"*	25 years
Income-Contingent (ICR) (*Direct only*)	Adjusted annually based on: - Household AGI - Household size - Total amount of Direct Loans *Approx. 20% of discretionary income*	25 years

25

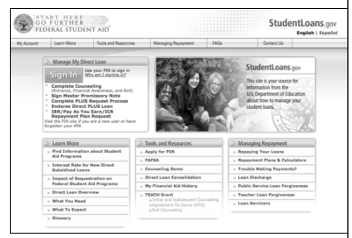
Estimating Monthly Payments

*"Repayment Estimator" available at: **StudentLoans.gov***

To "SIGN IN" enter:

- SSN
- First two letters of your last name
- Birthdate
- Dept. of Ed PIN

Duplicate PIN available at: *PIN.ed.gov*



26

27

Payment Comparisons -- Undergraduate Student

$35,000 Federal Direct Student Loan Debt (Assumed interest rate = 3.86%)
Household AGI = $30,000 (Household Size = 1)
*(Estimates calculated using "Repayment Estimator" at: **StudentLoans.gov**)*

Repayment Plan	Repayment Period	Monthly Payment Initial to Final Amounts	Projected Loan Forgiveness	Total Interest Paid	Total Amount Paid
Standard	120 months	$353 to $353	-	$7,324	$42,324
Graduated	120 months	$197 to $591	-	$9,134	$44,134
Extended Fixed	300 months	$183 to $183	-	$19,845	$54,845
Extended Graduated	300 months	$114 to $331	-	$24,970	$59,970
Pay As You Earn*	240 months	$106 to $353	$4,794	$21,087	$51,293
Income-Based Repayment (IBR)*	185 months	$160 to $353	$0	$13,761	$48,761
Income-Contingent Repayment (ICR)*	172 months	$232 to $302	$0	$11,365	$46,365

*Assumes Household AGI increases by 5% per year and federal poverty guideline increases by 3% per year. "Projected Loan Forgiveness" is taxable under current IRS rules

27

28

Payment Comparisons -- Undergraduate Student

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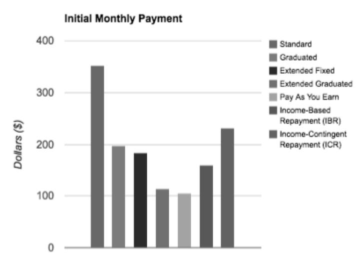

28

29

Payment Comparisons -- Professional Student

$100,000 Federal Direct Student Loan Debt (Assumed interest rate = 6%)
Household AGI = $60,000 (Household Size = 1)
*(Estimates calculated using "Repayment Estimator" at: **StudentLoans.gov**)*

Repayment Plan	Repayment Period	Monthly Payment Initial to Final Amounts	Projected Loan Forgiveness	Total Interest Paid	Total Amount Paid
Standard	120 months	$1,110 to $1,110	-	$33,225	$133,225
Graduated	120 months	$635 to $1,905	-	$42,120	$142,120
Extended Fixed	300 months	$644 to $644	-	$93,290	$193,290
Extended Graduated	300 months	$500 to $970	-	$110,289	$210,289
Pay As You Earn*	240 months	$356 to $997	$62,620	$113,265	$150,645
Income-Based Repayment (IBR)*	205 months	$535 to $1,110	$0	$71,476	$171,476
Income-Contingent Repayment (ICR)*	137 months	$808 to $1,225	$0	$41,888	$141,888

*Assumes Household AGI increases by 5% per year and federal poverty guideline increases by 3% per year. "Projected Loan Forgiveness" is taxable under current IRS rules

29

30

Payment Comparisons -- Professional Student

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Household AGI = $60,000 (Household Size = 1)
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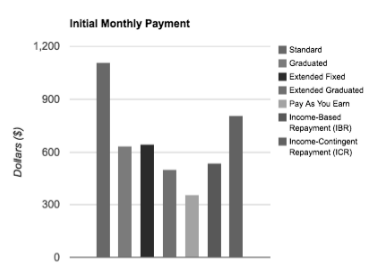

30

Loan Prepayment

- Borrowers can make prepayments on their federal student loan(s) without penalty
  - Will reduce total interest paid on loan
- Prepayment should be targeted at loan(s) with highest interest rate
  - Provides greatest potential interest savings

31

A few final comments …

32

A shifting paradigm …

- Federal Direct Loans are a ***unique*** form of credit
  - Payment relief options
  - Flexible repayment including income-driven payment options
  - Forgiveness, cancellation and discharge provisions
- Borrowers (and parents) need to be educated on these unique features so that they can make strategic repayment decisions

33

Takeaways

- What is best for students?

  It depends on student's:
  - Concerns over debt
  - Short-term and long-term financial goals
- What can you do to help students?
  - Educate them so that they are more able to make an "***informed***" strategic decision
  - Provide tools/resources such as a checklist of factors to consider, calculators and other online information

34

When making decisions about repayment …

- Borrowers need to weigh importance of reducing interest costs vs. ability to achieve other financial goals more quickly
- Beware of risks
  - Uncertainty of future income
  - Uncertainty of future expenses

35

For more information:
- General loan and repayment information:
  - *StudentAid.gov*
- "Repayment Estimator" and application for income-driven repayment options:
  - *StudentLoans.gov*
- Public Service Loan Forgiveness (PSLF program):
  - *StudentAid.ed.gov/publicservice*

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36