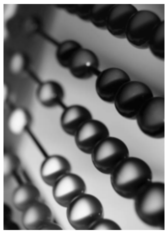

Student Debt:

A Changing Paradigm for Grad-Professional Students

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The Changing Paradigm

- GP 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
- As such, students should be strategic when borrowing and repaying Federal Direct Loans—***How can we help?***

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The Education Mortgage

- Increasing majority of GP students now must borrow money to pay for school
- Many graduates have debts that exceed $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 just as a home is an investment

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But with this "Mortgage" …

… they don't get a house!

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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

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Will they qualify?

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

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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

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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

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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

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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!

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The "15% Reality"

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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!*

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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.

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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).

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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

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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"

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Why does all this matter?

- Financing for graduate/professional school 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.)

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Repaying Federal Direct Loans …

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

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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

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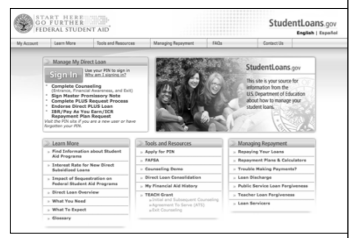
Estimating Monthly Payments

"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***



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Payment Comparisons

$192,000 Federal Student Loan Debt (Weighted average interest rate = 5.44%)
Household AGI = $60,000 (Household Size = 1)
(Estimates calculated using "Repayment Estimator" at: ***StudentLoans.gov****)*

Repayment Plans	Repayment Period	First Payment	Final Payment	Total Paid
Standard	120 months	**$2,078**		$249,320
Graduated	120 months	**$1,181**	**$3,543**	$264,347
Extended Fixed	300 months	**$1,172**		$351,532
Extended Graduated	300 months	**$870**	**$1,839**	$383,403
PAYE	240 months	**$356**	**997***	$150,645 ***$250,115 cancelled*****
IBR	300 months	**$535**	**1,949***	$331,486 ***$106,799 cancelled*****
ICR	250 months	**$808**	**2,287***	$354,279 ***$0 cancelled*****

*Assumes AGI increases by 5% per year and federal poverty guideline increases by 3.3% per year.
** Cancelled amount is taxable under current IRS rules

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Repayment Strategy

Choosing the "Right" Plan

In developing their 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

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What are their goals?

Borrowers likely want to:

- Repay the debt as fast as possible
- Pay as little interest as possible

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But, what about their OTHER goals?

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**

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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

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What other uses?

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

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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).

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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

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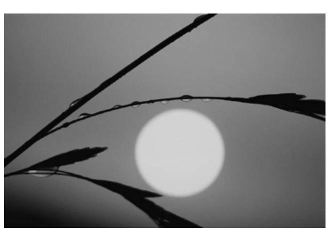
A few final comments …



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A changing paradigm …

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

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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

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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

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Another unique attribute …

Borrowers can return unused Direct Loan funds

If they return Direct loan funds within 120 days of disbursement:

- Total amount owed is reduced
- **Interest and fees charged on loan amount returned are reversed**

Should be able to reinstate portion of returned loan funds later in loan period, if needed

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A few words about borrowing private student loans …

Private loans may be best when:

- Federal loan funding is not available …
  - Borrower is not eligible for federal loans, OR
  - Expenses cannot be covered by available federal loan eligibility (e.g., bar exam expenses, residency interviewing/relocation)
- Private loan would be less costly (at least in short-term), AND:
  - Money is needed for short-term cash flow rather than financial need
  - Funds will be repaid quickly
  - Borrower is not worried about **INTEREST RATE** or **REPAYMENT RISK**

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Borrowing federal student loans may be best when …

- Borrower is eligible for them
- Borrower does not expect to be able to pay the money back quickly
- Borrower is worried about repayment risk factors
- Borrower plans a career in public service
- Borrower has credit issues

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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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