Welcome to RealLife

Life Lesson 13

Student Loans

OBJECTIVE: To teach students about student loans and ways to keep student loan debt to a minimum.

Question: Why would I need a student loan?
Going to college is very exciting, but it's also a very expensive. In a perfect world, parents would start saving as soon as they come home from the hospital with their bundle of joy. But that's not always possible. Most students--and parents--borrow money to cover some or all of their four- or five-year college education expenses.

According to the National Center for Education Statistics, the cost to attend a public college for four years averages $68,000. The price tag at private universities is even higher: An average of $176,000 for four years. And that's an average. Some private colleges cost $70,000 a year for a whopping four-year price tag of $280,000!

Taking out student loans is easy. Repaying them can be difficult. Large student loans can take many years—10-, 15-, 20-years—to repay. It can affect your ability to move out of your folks' home and rent an apartment or your ability to buy a home. So, before you sign the dotted line, let's explore some ways to keep your student loans to a minimum, understand how they work, and make sure it makes sense to take them out.

Question: How can I keep the cost of college as low as possible?
To keep the cost of college low and minimize the amount of student debt you graduate with, consider applying to the many excellent state schools that are less expensive than their private counterparts.

Also consider the impact of college on your career. If you'd like to work in competitive fields like investment banking or law, going to the very best college possible regardless of cost might be important and the high paychecks in those fields should make repaying student debt possible. However, if you are considering a teaching career or one in the arts, then passing state exams and raw talent may be more important than where you graduate from school. Those careers often don't have large paychecks, which makes repaying student loans difficult. Also, consider whether your career will require attending graduate school. Some students opt to go to a less expensive college because they know they have more schooling to pay for in their future.

Question: Can I apply for financial help from the college I plan to attend?
Yes! To be considered for any financial aid, you and your parents or guardians must complete **FAFSA** or **Free Application for Federal Student Aid.** This form asks you and your parents questions about their finances. They'll have to answer questions about their home, investments, mortgage, and all other debt or cash available to pay for your schooling. If a school wants to admit you, they will use the information on the FAFSA to decide whether you need financial help pay for college.

If you qualify, the college will offer you a **needs-based scholarship**. If the college decides that your family has enough money to send you to college all hope is not lost. They may offer you a **merit-based scholarship**, perhaps because of your good grades or your abilities playing a sport, an instrument or involvement in community service such as Scouting. Colleges use merit scholarships as an incentive to get you to choose their school over others. Scholarship money is given to you; it does not have to be repaid. If you receive a scholarship be sure to ask if it's guaranteed for each of your four years in college and if there are any requirements you'll need to meet—like a minimum GPA—to continue to receive the scholarship.

Question: If my school doesn't offer a scholarship, where else can I turn for financial help?
Before you borrow money that must be repaid, consider applying for grants and scholarships that don't need to be repaid. They're offered by the state and federal government and from private organizations. States and the federal government use FAFSA as part of the application for grants and scholarships. Grants are typically needs-based and scholarships can be needs or merit based. Be sure to check out the information and deadlines that your state uses. Different states have different deadlines! Check out the Findaid [website](#) for links that will take you to your state's information.

There are also many grants and scholarships given by local businesses, national companies, and other organizations. It is worth taking the time to research scholarships and grants online. Look into any companies and organizations you and your family are affiliated with. For example, your parent's employer may offer scholarships. If you are a Boy or Girl Scout, research scholarships for Eagle Scouts or Gold Awards. If you are interested in architecture, research scholarships for Architecture. Many times, people leave money in their wills for students who live in the same area or in the field they want to encourage (i.e. women in science).

You can also apply for your college's **work-study program**. Schools often have jobs on campus that are given to students who have a financial need before other students.

Question: How do student loans work?
Just like the loans we discussed in LifeLesson12, student loans charge interest, have a set date upon which the loan must be repaid, and there's a set minimum monthly payment. Usually, these terms are set when you borrow the money. Unlike credit card or auto loans, however, student loans are granted before lenders know what your job will be after school. They are unsure how much debt you will be able to repay. College lenders don't expect you to have a credit history. So, the *lack* of a credit score won't hurt you when taking out a student loan.

Question: What student loans are available from the US government?
The least expensive student loans are **federal loans** from the **US Department of Education**. They typically have a lower interest rate than student loans made by private organizations. The interest rate charged is a **fixed rate**; it's set on day 1 and doesn't change for the life of the loan. The loan's repayment schedule can vary. It can be affected by how much you earn after graduation, whether you enroll in graduate school as well as other factors. Federal loans may also be eligible for certain **Loan Forgiveness** programs, which we will discuss at the end of this LifeLesson.

Direct subsidized federal loans--also known as **Stafford loans**--are federal loans given to students that demonstrate financial need based on FAFSA. Students can borrow $5,500-$12,500 each year. The amount changes based upon how many years of college have been completed. The government "subsidizes" these loans by not charging interest on them while you are enrolled in college at least part time (taking 6-8 credit hours of classes per semester). Loans can be repaid over 10-25 years.

Direct unsubsidized federal loans are the same as subsidized loans, but they start accruing interest as soon as you borrow the funds. To borrow direct unsubsidized federal loans, you don't have to demonstrate financial need.

The US Congress sets the interest rates charged on federal student loans each year and the rate is fixed (doesn't change) for the life of the loan. The interest rates for federal loans disbursed **between July 1, 2018, and June 30, 2019**, are as follows:

- Direct subsidized: 5.05%
- Direct unsubsidized (undergraduate degree): 5.05%
- Direct unsubsidized (graduate or professional degree): 6.60%

Question: Can my parents take out loans to help me pay for college?
Yes! Parents can borrow money from the federal government by taking out **Parent PLUS** loans. Borrowers must have good credit and payments on the loan start immediately (not after college is completed). Interest rates are higher on Parent PLUS loans than on Stafford loans. Currently they're 7.08%. But there's no limit to the amount a parent can borrow under this program, so, Parent PLUS loans can be used to cover much larger tuition bills. These loans are only available to biological, adoptive or stepparents to help pay their children's undergraduate tuition.

Question: Where can I borrow more money if federal loans aren't enough?
You can borrow additional money by taking out private student loans offered by banks and other lenders, like Sallie Mae. These loans frequently are more expensive than federal loans (they charge higher interest rates) and don't have features like loan forgiveness. However, they are more flexible. You can borrow larger amounts even if you have bad credit. Private loans almost always require a **co-signer,** a person who will pay the loan back if you don't. Unlike federal loans, private lenders can set the interest rate on private loans based the credit scores of you and your co-signers. As we learned in Life Lesson 12, the better your credit score, the lower the interest rate and vice versa.

Question: How do I repay my student loan?

There are many ways to repay a student loan and the time to think about how you want to repay the loan is actually before you borrow the money. Let's review some key terms and principles so you know what to *ask* when deciding which loan to take out. Your decision may depend on "what you want to be when you grow up" or whether you'll be going to graduate school.

Deferment is the time period during which you do not have to make any payments on the loan. Some lenders allow you to defer payments for six months after graduation, others have longer deferment periods. In some cases, the repayment schedule depends on your career path. Some lenders will let you *NOT* make payments without any penalty ***if*** you are involved in any of the following activities.

- Attending school: If you are enrolled in an eligible school at least part-time you can defer payments. Deferment may even be allowed if you take a break from school as long as the break is less than six months long. This may or may not include graduate school.
- Active Military Duty: Includes performing qualifying National Guard duty.
- Public service: Performing public service for certain organizations may qualify for a deferment. For example, teaching or practicing medicine in a community that's having a teacher or doctor shortage may qualify.
- Enrollment in a health care residency program.

Forbearance is similar to deference. You don't have to make payments and it won't count as missed or late, so it won't hurt your credit score. However, forbearance is only used if you encounter a hardship like unemployment, serious illness, and other difficulties. You must communicate with your lender and make sure they agree to forbearance. Forbearance is usually limited to 12 months.

Pre-payment penalties are sometimes charged by lenders if you repay the loan early. Some lenders may insist you pay ALL the interest that would have been due during the life of the loan even if you repay it early! So, it's very important to ask about this BEFORE you take out the loan.

Minimum payment is the smallest amount you can pay each month on the loan. It is crucial to make timely payments of at least the minimum amount due. An easy way to ensure this happens is to have the minimum payment automatically deducted electronically from your checking account so that it's never late. Missed payments will hurt your credit score, and as we discussed in Life Lesson 12, the last thing you want to do at the start your adult life is hurt your credit score. You can always pay extra by making a separate, additional payments. But make sure the minimum payment always happens on time!

Income Based Repayment is available on federal student loans. Instead of paying a set amount every month for 10 years, you'll pay 10% of your discretionary income every month for 20 years, after which you're eligible for loan forgiveness. This option might be considered by college graduates who begin careers with low salaries and have trouble making the monthly payment over 10 years. The amount is reset each year based on your salary. So, if your salary falls, the payment will fall. But as your salary increases, the payment will increase.

Also be aware that if your 10% monthly payment is less than the interest payment that would normally be owed, the difference will be added to the loan's principal. So even if you make the 10% payment, the loan's principal could increase because of negative amortization. That means the amount you owe is GROWING even though you are making your payments. So, check to make sure your monthly payment covers interest and some principal repayment each month. And if the monthly payment only covers interest, then don't just pay the amount they tell you to pay. If you can afford to pay more, increase your payment! That way you will be reducing your loan a little bit each month.

Question: How can I get out of student debt?
WOW! We just spent most of this lesson getting into debt! How do we get out of it? It is important to understand that lenders are in business to make money. They make money when you keep your loan outstanding as long as possible and make your payments on time. They will set a low minimum payment, which might be helpful at the start of your career when your salary might be low. But if you just pay the minimum amount, it might take you 20-25 years to pay off all the loans.

If you make larger payments than the minimum amount required, your student loan debt will be repaid faster. (Be sure to ask your lender if there are any prepayment fees!) As your salary increases, consider taking the extra cash and using it to make extra payments on your student loan debt instead of eating out or buying a fancy car. Check out the activity sheet to see how much faster you can repay your student loan if you just pay an extra $280 a month!

Question: How can I get my loans forgiven?

Some loans will be forgiven if you work in certain areas of public service. **Public service loan forgiveness programs** are designed to encourage people to work in areas that have a shortage of qualified applicants. Some examples are: teachers and doctors in low-income areas, non-profit organizations, certain federal, state and government agencies, as well as AmeriCorps and the Peace Corp. You must work for 10 years in these fields and still make Income Based repayments. At the end of the 10th year of employment the balance of your loan is forgiven. For more details about the Public Service Loan Forgiveness Program and other loan programs check out StudentAid.gov.

It should be noted that all Federal loans are forgiven after 20 years, assuming you made the minimum payments required based on your income each year. However, this is not a good plan since these outstanding balances will affect your credit score, ability to get a car loan and mortgage. Paying the minimum for 20 years is not a great “strategy”.

Before making a career decision, make sure you understand ALL the rules before you assume you will be eligible for loan forgiveness. Make sure the position you’re hired for is included in the loan forgiveness program. And be sure to check for policy changes. This is a very popular program and as a result, always subject to politics and policy changes. For example, if you get married, your spouse’s income may affect your minimum payment and you may not save as much as you think.

Also, consider the benefit of the loan forgiveness program versus finding a job in the private sector. Many jobs that qualify for the job forgiveness program don’t pay as well as similar jobs in the private sector. You may save money by earning more in the private sector and paying your own loans**.**

Question: How can I repay multiple student loans?

Many students have multiple loans taken out over several years and/or from different lenders with different interest rates. We suggest approaching your student loan debt much like we suggested doing in Life Lesson 12 if you had many different credit cards with outstanding balances.

First, start a spreadsheet or make a list that contains the name of each lender, your balance on the loan, and the interest rate and minimum payment due for each loan. Be sure to make the minimum payments on ALL of your loans.

If you have extra money at the end of the month, make extra payments on the loan with the highest interest rate first. The goal is to pay the loan with the highest interest rate first. When that loan is repaid, start making extra payments on the loan with the next highest interest rate. Try saving money by eating at home more often or not taking as many ride shares. Have a less expensive night IN with the friends instead of night out! Visit Life Lesson #8 on Chopping and Swapping for ideas how to save each month.

You can see the difference paying your highest cost debt first makes in the following example. Let's say you have three loans with three different interest rates and you have $150 a month to use to reduce your student loan debt. In the first example, you pay off the same amount, $50, on each loan:

Balance	**$6,000**	**$6,000**	**$6,000**
Interest rate	**3%**	**6%**	**9%**
Min Payment	$15	$30	$45
Your payment	$50	$50	$50
Years to repay	**11.9 years**	**15.3 years**	**25.8 years**
Amount of interest over life of loan	$1,142	$3,186	$9,408

By making $50 payments evenly on each loan, you will be out of debt

in **26 years** and you will pay **$13,736** in interest.

Now let's assume you still have $150 a month to make student loan payments, but this time you pay off your highest interest rate student debt first. If you make $105 payments on the 9% loan it will be completely repaid in a little over 6 years. The other two loans are still at $6,000 even since you have been paying just enough to keep the interest from accruing (making principal grow) Now take $135 ($105 from the loan that is now paid off, plus the min pay on the other 2 loans) and pay the 6% loan off while still paying the $15 a month for the 3% loan. Once the 2nd highest rate loan is paid, now pay the full $150 a month for the last 3% loan.

Balance	$6,000 1st	$6,000 2nd	$6,000 last
Rate	9%	6%	3%
Pay min pay	$105 for 6 years	$30 for 6 years	$15 for 10 years
Payment strategy	Paid off in 6 years	Then pay $135 for 4.3 years	$150 for 3.6 years
Amount of interest over loan	$1,864	$2,963	$2,184

This strategy has you done in 14 years and saves you almost half the interest cost!
You would have only paid $7,011 in interest!

This Life Lesson was just an overview of the very vast topic of student loans. Here are some great links to help you learn more. Our goal is to help you understand the things you should consider and the questions you should ask when choosing loans and lenders. Private lenders have many different ways of doing things. Shop around!

LEARNING THE LINGO:

FAFSA	Needs-based scholarship	Merit scholarship
Work-study program	Federal student loans	Private student loans
Department of Education	Fixed interest rate	Maturity date
Loan forgiveness	Stafford loans	Parent-PLUS loans
Co-signer	Deferment	Forbearance
Pre-payment penalties	Minimum payment	Income-based repayment

ACTIVITIES:

1. To understand how much money you will earn after graduation, research starting salaries in the career of your choice. Your school may have the information use the U.S. Department of Labor's Occupational Outlook website.

What occupation are you considering and how much will you earn per year?
What will you take home after taxes are deducted from your salary?
Is that enough to pay for rent, basic expenses and a student loan?

2. John graduated college with $45,000 in student loans that have a 3.75% interest rate. He is excited to start his first full-time job working 9-5 in the City with a starting salary of $60,000 a year. Between commuting and working late to try to make a good impression, he has been too tired to cook or go food shopping. He came home this weekend to pay bills and got his first student loan bill and was relieved that he only has to pay $141 a month for his first year (the minimum payment will go higher as his income goes higher).

How long will it take John to pay off his loans? Use this online calculator to help (even though it says Credit card debt, it works for all loan types)

3. John did the math himself and realized the problem. Looking at his budget he realized he is spending $6 a day on breakfast, $10 a day on lunch and $12 a day on

dinner. If starts cooking and either eating at home and/or bringing lunch for 1/3 of the time, how much faster can he pay off his loans if adds the savings to his original $141 a month?

4. If John cooked at home and/or brought lunch 1/3 of the time, how much sooner can he pay off his loans?

n: Alpha Stock Images - link to - http://alphastockimages.com/