Key Things to Know About Student Loans

❖ While student loans can be an effective way to pay for college, the resulting debt can significantly impact a borrower’s ability to save for retirement.

❖ Choosing the right type of student loan can make a big difference in the amount of interest paid and the repayment options available.

❖ As student loan debt has increased, so too have new federal loan repayment and loan forgiveness options designed to help borrowers manage this debt.

❖ Companies have recently begun introducing student loan assistance programs as a new type of employee benefit.
Introduction

As the use of student loans to pay for college has increased, so have the many options now available to repay those loans and, potentially, even have them forgiven by the government. Whether a student is still in college and already has loans, or is in high school and considering how much to borrow, understanding the different loan repayment and forgiveness options available can help families make informed decisions. By choosing wisely, both students and parents will improve the likelihood that they will be able to save for, and achieve, a secure retirement.

Over the last two decades, the use of student loans to pay for college has grown substantially. Seventy-one percent of the class of 2015 graduated with student loan debt, as compared to 54% of graduates 20 years earlier. Meanwhile, the average amount borrowed more than tripled over the same period, from an average debt amount of $11,491 in 1995 to $35,051 in 2015.

Interestingly, it is not just students who are borrowing more. Parents are also taking out more loans and borrowing higher amounts. Seventeen percent of parents of 2015 graduates borrowed from the federal government under its student loan program and had an average amount of debt of nearly $31,000. This is up from 7% of parents in 1995 under the federal program, with an average amount of $7,800.

Perhaps surprisingly, the landscape for college loans has changed dramatically over the last decade. Not only have the lenders changed, but new repayment options and loan forgiveness options have been introduced as well.

Since 2010, all new federal loans, except for Federal Perkins Loans, have been issued through the U.S. Department of Education under the Direct Loan Program. Prior to 2010, some federal loans were issued by private lenders and backed by a government guarantee. While families can also borrow from private institutions, federal loans should typically be the first option since they tend to offer better terms than private loans, including lower interest rates, loan consolidation opportunities, and flexible payment plans.

Prior to taking out loans to finance a college education, families should understand the different repayment options that will be available post-graduation. In addition, families should consider whether monthly repayment amounts will be affordable based on a student’s projected career earnings in a desired field. Online tools are available to assist in modeling the repayment amounts that student loan debt will translate into during the repayment phase.

The purpose of this guide is to help families understand how loans can be repaid after graduation. It will first describe the available federal student loans and, the federal loan repayment and loan forgiveness options available. It will then provide information on borrowing from private lenders. The guide will conclude with a discussion of how some employers are now helping their employees pay back their loans more quickly.

Federal Loans

Direct Loan Program

There are four types of loans available under the program: Direct Subsidized Loans, Direct Unsubsidized Loans, Direct PLUS Loans, and Direct Consolidation Loans.

Direct Subsidized Loans: The student is the borrower of these loans and pays no interest on the loans while attending college. Because the government picks up the cost of interest during this period, the loan is considered “subsidized.” The maximum annual amount that can be borrowed is currently $3,500 for freshmen, $4,500 for sophomores, and $5,500 for juniors and seniors.

Direct Unsubsidized Loans: These loans charge borrowers a fixed rate of interest beginning when the loan is disbursed. The maximum amount a student can borrow is determined in part by the amount of any Direct Subsidized loan taken out. The current combined limit for Direct Subsidized and Direct Unsubsidized loans is $5,500 for freshmen, $6,500 for sophomores, and $7,500 for juniors and seniors.

Direct PLUS Loans (also known as Parent PLUS Loans): Only parents of college students can take out PLUS loans. Parents’ eligibility is subject to performance of a credit check, and the maximum that can be borrowed annually is the cost of attendance of the school minus other financial assistance received. Interest accrues from the point the loan is disbursed. Payments can be deferred while the child is in school and up to six months after the child graduates.

Direct Consolidation Loans: These loans are used to consolidate a number of federal loans into one loan. In addition to Direct Loans, Family Federal Education Loans (FFEL) and Perkins Loans can also be consolidated. FFEL programs were issued by private lenders, insured by guaranty agencies, and reinsured by the federal government, and are no longer being issued. Perkins Loans are discussed later in this guide.

The benefits of loan consolidation include simplifying multiple bills into one, potentially lowering monthly payments by allowing up to 30 years of repayment, gaining access to alternative repayment plans, and switching from a variable interest rate loan to a fixed interest rate loan.
Another valuable benefit of loan consolidation is that Direct Consolidation Loans made to students are eligible for Income-Driven Repayment plans. Consolidating loans does not lower the interest rate since the interest rate on the consolidated loan is made up of the weighted average of interest rates of the old loans being consolidated.\(^7\)

Borrowers should be careful to understand all of the details involved in loan consolidation, as certain benefits available on old loans could be lost. One downside to loan consolidation is that when loans are pooled, borrowers can’t target extra payments to pay down loans with higher rates first. Borrowers can also lose interest rate discounts, principal rebates, or loan cancellation benefits available on an original loan.\(^8\) That said, individuals who choose loan consolidation do not have to consolidate all of their federal loans. For example, a borrower could choose not to fold an old loan with a favorable interest rate into the new consolidated loan.

**Perkins Loan Program**

To qualify for a Perkins Loan, students must demonstrate exceptional financial need. Undergraduates may borrow up to $5,500 per year, up to a maximum of $27,500.\(^9\) The interest rate for these loans is 5% and, unlike the Direct Loan program options, the school is the lender. As a result, repayment of these loans is made to the school, or the school’s loan servicer. While loans are made by individual colleges, not all colleges participate in the program.

As a result of the Federal Perkins Loan Program Extension Act of 2015, the Perkins Loan Program will only be available through the 2017-2018 academic year, at which point the program will cease. Additionally, current undergraduate students who have an outstanding balance on a Perkins Loan may receive an additional loan only if the school attended has awarded all Direct Subsidized Loan aid the student is eligible for.\(^10\) New undergraduate students may only receive a Perkins Loan if all Direct Subsidized and Unsubsidized loan options are exhausted.\(^11\)

**Repayment Options for Students with Federal Loans**

Federal loans generally require repayment six or nine months after a student graduates, leaves school, or drops below half-time enrollment.\(^12\) There are multiple repayment plans now available for these loans. The Department of Education has online tools available to assist individuals in repayment status, including Studentloans.gov/Repay, a new application which helps borrowers easily navigate repayment options in five easy steps.\(^13\) The following provides a summary of the repayment options currently available to student borrowers with undergraduate loans made under the Direct Loan Program and the FFEL program. Student borrowers under these programs can choose from any of these options. Repayment options for Federal Perkins Loans differ from other federal loans, and are covered at the end of this section. Repayment options for parents with PLUS loans also differ, and are covered in the sidebar on page 6.

**Standard Repayment Plan**

This option allows for level payments over the course of the repayment period. The repayment period is up to 10 years for all plans except Direct Consolidation Loans, which vary based on the size of the outstanding loan. For example, a Direct Consolidation Loan of less than $7,500 has a standard repayment period of 10 years, while a loan between $10,000 and $20,000 has a repayment period of 15 years.\(^14\) The Standard Repayment Plan has the highest payments compared to the other options, but the smallest amount of lifetime interest.

**Graduated Repayment Plan**

Repayment amounts increase every two years with this option. The repayment period is up to 10 years for all loan types except Direct Consolidation Loans, which have a repayment period between 10 and 30 years. Like the Standard Repayment Plan, the Direct Consolidation Loan repayment period is between 10 and 30 years.

**Extended Repayment Plan**

This option has level payments like the Standard Repayment Plan, but the payments are lower, as the repayment period is longer—up to 25 years. Direct Loan or FFEL borrowers must have outstanding loans of at least $30,000 to use this option.

**Income-Driven Repayment Plans**

Income-Driven Repayment Plans have generated significant media interest in recent years, as they can be extremely beneficial to graduates who have a high amount of student loan debt relative to their income. Payments are intended to be affordable, and are based on the borrower’s income and family size (i.e., the student, the student’s spouse, and the student’s children, if applicable). Repayment amounts are often based on a percentage (e.g., 10%) of discretionary income, defined as the difference between a household’s income and 100% or 150% of a poverty guideline for a family, based on family size and state of residence.\(^15\) The repayment period is generally 20 or 25 years.
A unique feature of these plans is that the outstanding loan amount at the end of a repayment period can be forgiven. However, if a loan is forgiven, the amount that is forgiven is treated as taxable income to the individual. Having a large balance after 20-25 years is not an unlikely event for many individuals with low payments, as interest can accrue over the lifetime of the payment plan.

It is critical for borrowers to recognize that if they choose to use any of the Income-Driven Repayment Plans, they are required to go through a recertification annually by providing the loan servicer with updated information on income and family size.

If an individual fails to recertify, payments can jump back up by hundreds of dollars per month. In the 12-month period ending October 1, 2014, more than half of borrowers failed to recertify on time and had their payments increase.16

There are four types of Income-Driven Repayment Plans:
• Income-Based Repayment Plan (IBR Plan)
• Pay As You Earn Repayment Plan (PAYE Plan)
• Revised Pay As You Earn Repayment Plan (REPAYE Plan)
• Income-Contingent Repayment Plan (ICR Plan)

IBR Plan
With the IBR Plan, the monthly payment is capped based on income and family size. To qualify for an IBR Plan, payments calculated based on a predetermined formula must be less than would be paid under the 10-year Standard Repayment Plan. Payments are then capped, and will not exceed the amount the borrower would have paid under a 10-year Standard Repayment Plan, based on what was owed when repayments began.

For new borrowers with loans taken on or after July 1, 2014, payments are based on 10% of discretionary income, and the repayment period is 20 years. For borrowers with loans taken prior to July 1, 2014, payments are based on 15% of discretionary income, and the repayment period is 25 years.17 Discretionary income is defined as the difference between income and 150% of the poverty guideline,18 and includes a spouse’s income if taxes are filed jointly.

Figure A shows how an IBR Plan might work in the first year for a hypothetical individual in a one-person household with an adjusted gross income of $40,000 a year. The example assumes this person is living somewhere in the contiguous 48 states or the District of Columbia, where the poverty level for a one-person household in 2016 is $11,880. She has just graduated with $80,000 in student loan debt bearing an interest rate of 6%, and her income will increase 5% annually.

| A) Adjusted gross income | $40,000 |
| B) Poverty level | $11,880 |
| C) 150% of Poverty Level (B X 1.50) | $17,820 |
| D) Discretionary income (A – C) | $22,180 |
| E) 10% of Discretionary Income (D X 0.10) | $2,218 ($185/month) |
| F) Annual payments under standard 10-year plan | $10,656 ($888/month) |
| G) Is F greater than E? (If yes, qualifies for IBR plan) | Yes |
| H) Annual first-year payments due under IBR (D X 10%) | $2,218 ($185/month) |

The borrower in Figure A would see her monthly payment increase over time as her salary increases. The U.S. Department of Education estimates that her final monthly payment would be about $612. By that time payments will have equaled $87,704 and although the loan with interest would not be paid in full, the remaining debt of just over $88,000 would be forgiven.19

PAYE Plan
This option is essentially the same as the IBR Plan, but became available before new rules permitting IBR Plans took effect in 2009. The PAYE Plan calculates the payment amount in the same ways as the IBR Plan, and schedule payments over a 20-year period. Similar to IBR Plans, any outstanding loan forgiven at the end of the repayment period is treated as taxable income.

Repayment amounts are based on 10% of discretionary income, defined as income over 150% of the family’s poverty guideline. Discretionary income includes a spouse’s income if taxes are filed jointly.20 Repayment amounts are recalculated each year based on updated income and family size. To be eligible, an individual must be a new borrower on or after October 1, 2007, and must have received a disbursement of a Direct Loan on or after October 1, 2011.21 The PAYE Plan caps repayment amounts so that the borrower will never pay more than would have been paid under the Standard Repayment Plan with a 10-year repayment period.

REPAYE Plan
Introduced in late 2015, this new option extends the ability to cap payment amounts at 10% of discretionary income to older
borrowers, since eligibility on other repayment programs with this cap were limited to newer borrowers as of certain dates. With the REPAYE Plan, income includes a spouse’s income whether or not taxes are filed jointly. This is different than the PAYE and IBR Plans.

The REPAYE Plan allows borrowers with only undergraduate education loans to have their outstanding loan balance forgiven after 20 years of repayment. It also provides a new interest subsidy that prevents loan balances from ballooning significantly due to interest accrual.

Unlike the PAYE and IBR Plans, the REPAYE Plan does not cap payment amounts at the Standard Repayment Plan amount for a 10-year period. This means that a borrower could eventually be making higher payments than the 10-Year Standard Repayment Plan if his or her income rises significantly. Therefore, as a borrower’s income rises, repayments could also be higher than PAYE or IBR Plans.

ICR Plan

This option allows the monthly payment to be adjusted each year based on the borrower’s annual income, family size, and size of the loan. Payments are made for a maximum of 25 years and are the lesser of 20% of discretionary income, defined as a household’s income over 100% of the family’s poverty guideline, or whatever the borrower would pay under a 12-year Standard Repayment Plan adjusted by an “income percentage factor,” which is based on the borrower’s income.22

Typically, payments are higher under the REPAYE Plan than they are under other Income-Driven Repayment Plans. Similar to other Income-Driven Repayment Plans, any outstanding loan forgiven at the end of the repayment period is treated as taxable income.

A Final Word on Income-Driven Repayment Plans – The use of Income-Driven Repayment Plans is growing rapidly. As of the end of 2015, over 4 million borrowers were enrolled in Income-Driven Repayment Plans, up from 1.69 million borrowers in 2013.23 (See Figure B)

Those in Income-Driven Repayment Plans make up 21% of those in all repayment plans, up from 10% just two years ago. Income-Driven Repayment Plan borrowers held 36% of total outstanding debt in repayment plans, up from 21% just two years ago.24

While growth in these plans is a good sign of progress in students’ ability to manage student loan debt, it’s worth reiterating the importance of annual recertification due to the potential adverse impact on financial wealth over the short term (i.e., the monthly payment can jump by several hundreds of dollars) and the long term (e.g., under PAYE, REPAYE and IBR Plans, any unpaid interest will be added to the principal balance of a loan and, therefore, interest will be paid on a higher loan balance going forward25). To manage student loan debt in an efficient way, Income-Driven Repayment Plans can be tremendously helpful to borrowers, but borrowers must commit to handling the recertification process in a timely manner each year.

Tip: Those enrolled in an Income-Driven Plan would be wise to set up an annual calendar reminder to proactively ensure that the proper forms are submitted to the loan servicer in plenty of time to ensure the recertification process goes smoothly.
Repayment Options for Direct PLUS Loans for Parents

Parents can choose a repayment plan such as the Standard Repayment Plan, the Graduated Repayment Plan, and the Extended Repayment Plan. If a parent consolidates a Direct PLUS Loan into a Direct Consolidation Loan, the parent becomes eligible to use the ICR Plan. This is the only Income-Driven Repayment Plan available to parents.

Repayment of Federal Perkins Loans

Since loans are made from the schools themselves under the Federal Perkins Loan program, individual schools handle loan repayment options. Federal Perkins Loans can be consolidated into a Direct Consolidation Loan.

Loan Forgiveness and Cancellation Options

There are a few popular loan forgiveness and cancellation options available for federal student loans. Discharge provisions can vary depending on the type of loan taken out. For a full listing of all available programs, visit the Department of Education website at https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/charts#perkins-loan-cancellation.

Public Service Loan Forgiveness Program

This program was created to encourage individuals to enter, and continue to work full-time in, public service fields. To be eligible, an individual must work in public service, such as in a law enforcement job or for a not-for-profit 501(c)(3) organization. Any non-defaulted Direct Loan is eligible for loan forgiveness. Under this program, 100% of certain Direct Loan balances are forgiven after 10 years of timely payments that began after October 1, 2007. The 10 years of repayment can be made under the Income-Driven Repayment Plans, such as the IBR and REPAYE Plans.

Although not all federal loans qualify, individuals typically can consolidate their federal loans into a new Direct Consolidation Loan to qualify. Unlike Income-Driven Repayment Plans that forgive loans at the end of a 20- or 25-year repayment period, any loans forgiven under the Public Loan Forgiveness Program are not treated as taxable income to the individual. A Public Service Loan Forgiveness: Employment Certification Form must be submitted each year.

Parents who received a Direct PLUS Loan are also eligible for the Public Service Loan Forgiveness program if the parent borrower is employed by a public service organization.

Teacher Loan Forgiveness Program

This program was created to encourage individuals to enter, and continue to work full-time in, the teaching profession in communities that serve low-income families. Under the Teacher Loan Forgiveness Program, up to $17,500 towards Direct Loans or Stafford Loans (which were federal loans made under the FFEL program) may be forgiven. The borrower must teach for five complete, consecutive academic years in a qualifying school district. To be eligible for up to $17,500 of forgiveness, the borrower must be considered a "highly qualified" full-time math or science teacher in an eligible secondary school. To be considered “highly qualified,” the borrower has to have a bachelor’s degree, pass certain tests, and be state certified. Up to $5,000 may be forgiven if the borrower is a full-time elementary or secondary school teacher.

Unlike Income-Driven Repayment Plans, any loans forgiven under the Teacher Loan Forgiveness Program are not treated as taxable income to the individual.

Federal Employees Loan Forgiveness

Federal agencies may forgive the student loan debt of employees up to $10,000 annually, and a maximum of $60,000 over a lifetime. The program was designed to attract and retain highly skilled employees who could make more working in the private sector. In 2014, nearly 8,500 employees benefited from this type of loan forgiveness, at an average of approximately $6,900 per employee.

Cancellation of Perkins Loans

Teachers can also qualify for cancellation of up to 100% of Perkins Loans by: (1) teaching at a school serving low-income families, (2) teaching in the fields of mathematics, science, foreign languages, or bilingual education, or in any other field of expertise determined by the state education agency to have a shortage of qualified teachers, or (3) teaching special education.

Individuals working in other occupations, including law enforcement, nursing, or as a medical technician, are also eligible for Perkins Loan cancellation. In addition, attorneys employed full-time in a federal or community defender organization are eligible.
Additional Options for Managing Outstanding Federal Loans

Deferment

If an individual returns to school, is unemployed, is in the military, or is on disability, loans can be deferred for up to three years. During deferment, the loan balance on subsidized loans doesn’t accrue additional interest; however, additional interest does accrue on unsubsidized loans. Deferring a loan does not impact a borrower’s credit score.\(^9\)

Forbearance

If a borrower does not qualify for a loan deferment, but needs to postpone repayments, a loan servicer can grant a temporary postponement for up to 12 months. Putting a loan into forbearance does not impact a borrower’s credit score.\(^40\)

Private Loans

Private loans can be taken out in addition to, or in lieu of, federal loans. There is much more variation in types of private student loans. They can have either a fixed or variable interest rate, and the rate is typically based on the credit rating of the borrower. Parents who co-sign a child’s student loan assume equal responsibility for the debt. As such, late payments can hurt the parent’s credit rating, as well as the child’s. Loans may be paid back to a private lender or a loan servicer, which collects payments and handles other administrative duties associated with the loans.

Outstanding loan(s) can also be refinanced in the private loan marketplace in order to reduce overall interest. To refinance, borrowers will need: (1) a good credit score, (2) steady employment, and (3) a favorable debt-to-income ratio. Federal loans may also be refinanced into a private loan. However, before refinancing federal loans into private loans, borrowers should consider favorable repayment terms that are often available with federal loans, such as those provided by Income-Driven Repayment Plans, and possible loan forgiveness options. In addition, consideration should be given to the fact that forbearance is typically not an option for private loans.

One consideration related to private loans that is often overlooked is the purchase of life insurance on the borrower or co-signer of a loan. Unlike federal loans, private loans are often not forgiven in the event of the death of a borrower. If the borrower dies, the borrower’s estate, spouse,\(^44\) or co-signer of a loan could be liable for the outstanding loan.

As a result, life insurance can provide much-needed protection to ensure a surviving beneficiary can repay a loan timely and in full.

Workplace Loan Assistance Programs

Some employers are now offering student loan repayment and loan consolidation programs as a new type of employee benefit. For example, in September of 2015, PricewaterhouseCoopers became one of the first employers to offer employees a match of student loan repayments. The benefit provides a match of up to $1,200 annually ($10,000 lifetime) towards an employee’s student loans.\(^45\) This new type of benefit can be designed in different ways. While some employers provide a match to a loan service lender to pay down the employee’s student loan, others provide the match in the form of a 401(k) employer contribution.
Conclusion

Student loans have been on the rise in recent years, leading to the emergence of new federal loan repayment and forgiveness programs. While student loans can be an effective way to pay for college, the resulting debt can significantly impact a borrower’s ability to save for retirement. It is important for borrowers to have a firm grasp on repayment and forgiveness options in order to make informed decisions about taking out student loans.

With college graduates entering the workforce with much higher levels of student loan debt than before, employers are beginning to take notice. Should the recent introduction of student loan assistance programs in the workplace prove popular in helping young employees pay down student loan debt more quickly and improve their ability to save for retirement, the prevalence of these programs is likely to grow over time.
Footnotes


2 Ibid.

3 These figures represent amounts borrowed from the federal government and do not include private loans. The term “private loans” refers to loans made by private institutions that are not backed by a government guarantee. Federally backed private loans that were made prior to 2010 are not considered private loans in these figures.


8 Ibid.

9 https://studentaid.ed.gov/sa/types/loans/perkins#am-i-eligible


11 Ibid.


18 Ibid.


24 Ibid.


26 Department of Education, “Direct PLUS Loan Basics for Parents.”


28 Ibid.


30 Ibid.


33 Qualifying school districts are those with low-income students that meet certain qualifications. The U.S. Department of Education website provides additional details, https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/teacher#what-are-the-eligibility

34 Ibid.

35 Ibid.

36 Washington Post, 10/20/2015, based on OPM report.


38 Ibid.

39 Debt.org, https://www.debt.org/students/forbearance-deferment/

40 Sallie Mae, “Understanding Credit: What it is, why it’s important, and how you can maintain it,” p. 8.


42 Ibid.

43 Ibid.

44 If a couple resides in one of the nine community property states, the other spouse is likely responsible for the outstanding student loan debt if the money was borrowed while the couple was married. In a community property state, property and debts acquired during a marriage are considered jointly owned.

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