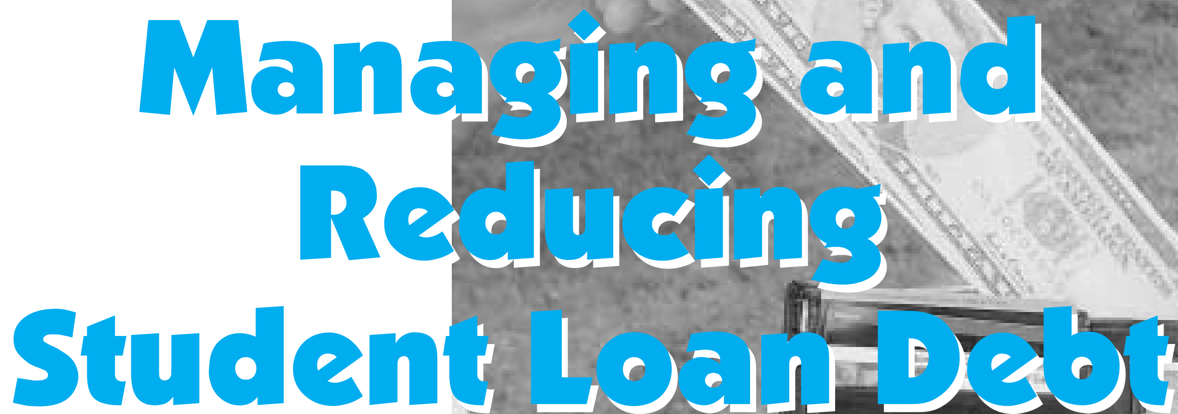

Managing and Reducing Student Loan Debt

by Melissa Campbell

With many students relying on loans and other financial aid to complete their degrees, dealing with debt is an unfortunate reality. But just as noted physician and author Christiane Northrup tells us that "Knowledge is power" when dealing with your health, becoming educated about your debt is an important part of maintaining your financial health.

Types of Loans

The first place to start is to research the types of loans you have. Two federal loan programs exist, the Stafford Loan and the Perkins Loan. There are two types of Stafford loans, subsidized and unsubsidized. With a subsidized loan, you must demonstrate financial need and the federal government pays the loan interest while you are in school. With an unsubsidized loan, you pay all the interest, but payments can be deferred until after graduation.

Stafford loans have variable interest rates that cannot exceed 8.25 percent, and there are limits to how much you can borrow. Dependent undergraduates can borrow $2,625 their freshman year, $3,500 their sophomore year. And $5,500 for both the junior and senior year. Graduate students can borrow up to $18,500 per year, although only $8,500 of it is subsidized.

The Perkins Loan provides financial aid to students with exceptional need. These federal funds are administered locally through individual colleges and carry an interest rate of 5 percent, with a nine-month grace period and a 10-year repayment period. Perkins loans are limited to $4,000 per year for undergraduates and $6,000 per year for graduate students but offer more lenient cancellation provisions than the Stafford loans. Students who need additional sources of funding may also secure private loans.

Repayment Options

Federal loans offer four repayment options: standard, extended, graduated, and income contingent. Under the standard repayment plan, you pay a fixed amount each month, a minimum of $50, for a term of up to 10 years. Depending on how much is borrowed, the loan term may be less than 10 years. With the extended repayment plan, loan terms are extended to 12 to 30 years to reduce monthly payments. However, this option increases the amount of interest paid, thus increasing the total amount repaid. Graduated repayments start low and gradually increase every two years, ostensibly to mirror salary increases, and extend the loan period to 12 to 30 years.

The income contingent repayment plan takes into account your income, family size and the total loan amount, adjusting monthly payments on an annual basis. You can extend this loan term up to 25 years and, at the end of 25 years, any remaining balance will be forgiven, although this amount is taxable under current law. This plan makes it easier for students who intend to enter low-paying fields such as public service to repay their loans. You can switch from one plan to another once per year to make the most of the program benefits.

Consolidation Can Help

For students with multiple loans, loan consolidation provides the convenience of a single monthly payment, but the price is a longer loan term, which incurs more interest. However, by extending the duration of the loan, monthly payments can be reduced, making it easier to repay. Consolidating your loans into a single but larger loan may also make you eligible for alternate repayment methods, such as an extended repayment plan, which provides longer terms for larger loans.

As of July 1, 2004, interest rates for federally guaranteed loans, including Stafford, Perkins and PLUS loans (loans for parents of college students) reached a 39-year low, making this a good year to consider consolidation. Another reason to act now is to take advantage of the fixed rate structure used to determine interest rates; legislators are considering moving to a variable rate in the near future.

According to FinAid, a non-profit Web-based information service, interest rates on consolidation loans are determined by taking the weighted average of the interest rates on the individual loans, rounded up to the nearest one-eighth of a percent, but not to exceed 8.25 percent. You incur a slightly higher interest rate. Consolidating a loan while still in school will take advantage of the lower in-school interest rate, but once you consolidate, you forgo your grace period and are required to begin repayment immediately. Perkins Loan recipients may also forgo some of the loan forgiveness provisions after consolidating. Once you are no longer in school, you are required to begin repayment on your student loans.

Loan Forgiveness Also an Option

The federal government offers several ways to reduce or eliminate

your student loan debt, including volunteer work, military service and teaching or practicing medicine in certain areas. A 12-month stint with AmeriCorps provides up to $7,400 in stipends plus $4,725 in loan repayment. A two-year assignment with the Peace Corps provides partial debt forgiveness for Perkins loans and deferment options for Stafford loans and consolidation loans. Through the Volunteers in Service to America program, volunteers logging 1,700 hours of service receive $4,725 toward loan repayment. Students who are members of the Army National Guard may be eligible for the Student Loan Repayment Program, which offers up to $10,000.

Teachers working in low-income areas can take advantage of the loan forgiveness and cancellation programs outlined in the National Defense Education Act. During the first and second year of working in the school, 15 percent of the teacher's loan balance, including interest accrued during those years, is canceled each year; during the third and fourth year of service, 20 percent of the loan amount is forgiven each year and in the fifth year, 30 percent of the loan amount is canceled.

It is possible to have 100 percent of a loan canceled for teaching service. For example, if a teacher has a loan balance, including accrued interest, of $40,000, after one year of teaching in a low-income area, $6,000 would be canceled, leaving a balance of $34,000. The following year, the canceled amount would be 15 percent of the $34,000 plus the year's accrued interest (say $35,020), leaving a balance of $29,767. The third year, 20 percent of the loan plus accrued interest is canceled and so on. Depending on the original loan amount, it is possible to have 100 percent of the loan forgiven through this program.

Many law schools forgive loans for students who serve in public interest or non profit positions, and medical organizations such as the National Health Service Corps offer forgiveness programs to doctors who practice in areas lacking adequate health care, particularly in remote or poor regions. Loan cancellation programs also exist for occupational and physical therapists, nurses and child-care providers.

Don't Forget the Tax Benefits

Several tax relief programs are available to help manage out-of-pocket educational expenses. Although these programs do not apply to borrowed money, it is highly probable that some portion of a student's education was paid outright, making that portion eligible for tax relief. The Hope Scholarship gives a $1,500 tax credit per student per year for the first two years of postsecondary education. You cannot use the credit if you are married and filing separate returns.

The Lifetime Learning Tax Credit provides relief up to $2,000 per taxpayer, which represents 20 percent of the first $10,000 of tuition and related school expenses. Tuition to acquire or improve job skills is an allowable expense, making part-time study tax deductible. For example, if a taxpayer spent $8,750 on tuition and related school expenses, the taxpayer would receive a tax credit of $1,750 (20 percent of $8,750). If the taxpayer spent $14,600, the tax credit would be calculated only on $10,000, providing a $2,000 tax credit.

You can also deduct interest paid on your student loans, up to $2,500. The deduction is taken as an adjustment to your income, so you don't need to itemize your return in order to take advantage of this benefit. You must have been enrolled in a degree program at least half time to qualify for this deduction. Qualified expenses include tuition, fees, room and board, books, supplies, equipment and transportation expenses.

As of May 2004, origination fees for school loans and deferred interest that is capitalized count towards loan interest. Capitalized means added to the loan amount. For example, if student John Doe borrows $10,000 to go to college but defers his repayments of this loan, the interest that accrues on the borrowed amount is simply added to the $10,000 he borrowed. When he begins repaying his loan, he would be making repayments based on the $10,000 plus the accrued interest. This happens with unsubsidized loans. Interest payments made during grace periods are not eligible and interest paid on consolidated loans obtained to pay for both educational and noneducational expenses are ineligible.

If the thought of plowing through pages of tax laws intimidates you, consider retaining a certified public accountant to prepare your tax returns. The money you invest in this service could pay great dividends.

Federal loans offer four repayment options: standard, extended, graduated and income contingent.

Adopt Winning Financial Strategies

For many students with thousands of dollars in loans, it is not uncommon to simply stick your head in the sand and try not to think about your personal finances. This might be the most detrimental thing you could do. By proactively managing your money and your debt, you increase your likelihood of financial security and maintain a sense of control in your life.

All good financial planners advise their clients to "pay yourself first" and that goes for people with student loans, too. Make a point of contributing to an employer-sponsored retirement plan such as 401k, 403b or TIAA-CREF. Contributions to these funds are often employer-matched, but you have to participate in the plan to receive the match. Contributions often serve to lower your taxable income as well.

After paying yourself and paying your loan, two personal finance imperatives, you may now turn to other basic expenses such as housing, transportation, food, and clothing. Preparing a budget may help you to plan for extras such as vaca-

tions, holiday gifts and charitable donations (tax deductible!).

Operating on a cash-only basis helps you to stick to a budget and can keep you out of revolving credit card debt, another financial pitfall for most Americans. The Consumer Federation of America estimates that about 70 percent of undergraduates at four-year colleges possess at least one credit card carrying thousands of dollars in debt. To reduce your dependence on credit cards, consolidate all balances onto one card and ask your lender for a reduced interest rate. Then, place the card in a drawer and only use it for emergencies.

Don't forget to adequately insure yourself and your assets. An unprotected accident or misfortune could seriously compromise your financial health. Charles González, financial expert and author of *Si Se Puede: Every Latino's Guide to Building Family Wealth*, advises maximizing the amount of protection for which you pay. He suggests increasing the collision and comprehensive deductibles on auto insurance and applying the savings, which result to the liability coverage, which protects larger investments such as a home or retirement savings. Another important asset that needs protection, according to González, is the ability to work. If an employer does not provide long-term disability coverage, purchase a policy that provides 60 percent of your salary after 90 days of disability until the age of 65.

Another way to boost your financial health is to find a part-time job. It may seem like a step in the wrong direction, but finding a position that incorporates a hobby or personal interest is a great way to round out your life while lining your pocket.

When debt is concerned, the old adage, "Ignore it and it will go away," couldn't be farther from the truth. Learning to control your finances, including your debt, is far healthier than having your finances control you.

LEARN MORE ABOUT FINANCIAL HEALTH

www.salliemae.com
Learn about SMART loan consolidation.

www.non-profit-credit-counseling.org
A national nonprofit credit counseling service that provides free budget advice and debt consolidation services.

www.personal-budget-planning-saving-money.com
A long address, but this site provides a wealth of financial information including budgeting, net worth analysis, and money saving tips.

www.betterbudgeting.com
You'll need to register for this site's free electronic newsletter, which includes information on coupon savings, unadvertised discounts, and credit reports as well as an extensive article archive on related topics.

www.rightonthemoney.org
This site has a great information on student loans in the Education section and recommends two books: *Take Control of Your Student Loans*, by Robin Leonard and Shae Irving and *The Guerrilla Guide to Mastering Student Loan Debt*, by Anne Stockwell.

www.ed.gov
The Department of Education site provides information about loan consolidation.