A+ Debt Management Strategies for Federal Student Loan Borrowers

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ABSTRACT

"Federal Student Loan Repayment" could be an upper-level course at all institutions of higher education. Unfortunately, for borrowers, it is not. Many borrowers, unfamiliar with financial concepts and the intricacies of the various repayment plans offered by the federal government, would benefit from sitting down with a financial advisor to formulate a plan to effectively manage their student loan debts.

This article suggests multiple ways a financial advisor can help borrowers manage their federal student loan debts by choosing the most appropriate repayment plan(s), explaining the consequences of loan forgiveness, encouraging the borrower to accumulate a "student loan savings fund," helping the borrower stick to a budget, and making other suggestions to help improve a borrower's overall financial health.

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Introduction

Besides finding a job, effectively managing student loan debt should be one of the highest priorities of every person who graduates from, or otherwise leaves, undergraduate or graduate school. The first major decision that will impact a borrower's financial future is her/his choice of repayment plan. This article provides a substantive overview of the eight repayment plans available to federal student loan borrowers.[1] In addition, other strategies that can aid a borrower's debt repayment, such as loan consolidation and the Public Service Loan Forgiveness (PSLF) program, are discussed. Finally, through the examination of four case studies, the advisor will more clearly see how all of these moving parts come together and will be better prepared to help the borrower formulate an effective student loan debt management strategy.

Understanding the Repayment Plans Available to Direct Loan Borrowers

Presently there are eight different Direct Loan repayment options that are available to federal student loan borrowers: (1) Standard; (2) Income-Contingent Repayment (ICR); (3) Graduated; (4) Income-Based Repayment (Old IBR); (5) New Income-Based Repayment (New IBR); (6) Pay As You Earn (PAYE); (7) Extended Fixed; and (8) Extended Graduated. All borrowers are eligible for the Standard, Income-Con-

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tingent, and Graduated repayment plans. If a borrower does not make a choice, she/he will be automatically enrolled in the Standard repayment plan.[2]

Taking a Look at the Non-Income-Driven Repayment Plans

The monthly payments under the Standard, Graduated, and Extended repayment plans are determined without regard to a borrower's income. These repayment plans are available to borrowers, regardless of income.

The Standard repayment plan breaks a student's total loan balance into 120 equal monthly payments. After 10 years the borrower's loan will be paid off. The Standard repayment plan often results in the borrower repaying the lowest total amount over the life of her/his loans, with moderate-high monthly payments.

With the Graduated repayment plan, payments start out low, and then increase every 2 years.[3] The monthly payment will never be less than the amount of interest that accrues between payments (i.e., monthly) and will never be more than three times any other payment. Borrowers will have their loans repaid in 10 years. Total loan repayment under the Graduated repayment plan will often be slightly more than under the Standard repayment plan. Note that borrowers will not likely be able to select the Graduated repayment plan if they are planning on loan forgiveness through the PSLF program.[4]

In order to qualify for either of the Extended repayment plans (Fixed or Graduated) a borrower must have more than $30,000 of outstanding Direct student loans.[5] The Extended repayment plan often ends up causing the borrower to repay the highest amount of any of the repayment plans over the life of the loan; however, monthly payments are lower than under the Standard repayment plan. Extended repayment plans have a maximum repayment period of 25 years. The Extended repayment plan cannot be used by borrowers planning on loan forgiveness through the PSLF program.[6]

The Income-Driven Repayment Plans

All of the following repayment plans use a borrower's income to determine her/his monthly payments.

Any borrower may select the ICR plan (there are no income eligibility requirements). Monthly payments under ICR are recalculated every year based on the borrower's adjusted gross income (AGI), family size, and loan balance. The monthly payment will be the lesser of 20 percent of the borrower's "discretionary income"[7] or what the borrower would pay on a fixed repayment plan over the course of 12 years. The maximum repayment period under ICR is 25 years;[8] any amounts outstanding at that time will be forgiven and taxable to the borrower as income. ICR often results in the borrower repaying slightly more, in total, than she/he would repay under the Standard repayment plan.

In order to qualify for Old IBR, New IBR, or the PAYE repayment plan, a borrower must demonstrate a "partial financial hardship" (which is defined differently under each repayment plan).[9]

Old IBR was originally a product of the College Cost Reduction and Access Act,[10] and is effective for borrowers as of July 1, 2009. In order to qualify for Old IBR a borrower has to demonstrate partial financial hardship. Borrowers whose annual amounts due on their loans under the Standard repayment plan exceed 15 percent of the difference between their AGI and 150 percent of the poverty level for the borrower's family size and state of residence qualify as having a partial financial hardship.[11]

Monthly payments under Old IBR are 15 percent of a borrower's discretionary income, not to exceed the monthly amount that would have been due under the Standard repayment plan.[12] The maximum repayment period under Old IBR is 25 years; any remaining debt is forgiven and taxable to the borrower as income.[13]

Old IBR was amended by the Health Care and Education Reconciliation Act of 2010 to include more generous repayment terms for eligible "new borrowers." New IBR defines a new borrower[14] as a person who took out a Direct Loan on or after July 1, 2014

with no outstanding Direct Loan balance.[15] In order to qualify for New IBR a borrower also has to demonstrate partial financial hardship; however, New IBR's definition of partial financial hardship includes only those borrowers whose annual amounts due on their loans under the Standard repayment plan exceed 10 percent of the difference between their AGI and 150 percent of the poverty level for their family size and state of residence. Those who qualify receive the benefit of lower monthly payments—only 10 percent of the borrower's discretionary income—but never to exceed what would have been due under the Standard repayment plan. Any remaining balance is forgiven after 20 years and taxable to the borrower as income.[16]

However, 2012 Federal Regulations[17] that became effective July 1, 2013, made a larger group of borrowers able to benefit from the more generous repayment terms called for under New IBR.[18] These Regulations go by the name Pay As You Earn.[19] PAYE includes borrowers who, as of October 1, 2007, had no outstanding student loan debt and who received a loan disbursement on or after October 1, 2011[20]—broader than New IBR's applicability to new borrowers on or after July 1, 2014. New IBR and PAYE share overwhelming similarities such as the same partial financial hardship definition, the same monthly payment calculation, and the same repayment period. However, there are small but significant differences between New IBR and PAYE.[21]

There may be additional changes to the PAYE repayment plan on the horizon, as President Obama has directed the Secretary of Education to draft new regulations by December 31, 2015 to further broaden PAYE's reach.[26]

Old IBR, New IBR, and PAYE: How They Work

It is important to remember that borrowers must requalify for Old IBR, New IBR, and PAYE each year their loans remain outstanding. Initial eligibility does not mean that monthly loan payments are capped to 10 percent or 15 percent of discretionary income for the life of the loan. That limitation will only apply for each year that the borrower demonstrates partial financial hardship. Once borrowers no longer have a partial financial hardship, their monthly payments will be recalculated, but will never exceed the amount the borrower would have paid under the Standard repayment plan;[27] however, the borrower's repayment term may exceed the 10-year term called for under the Standard repayment plan.[28]

Each year that the Secretary of Education determines that a borrower does not have a partial financial hardship, or whenever the borrower decides to leave the Old IBR, New IBR, or PAYE repayment plan, accrued interest on the loan is capitalized.[29] With PAYE,[30] if a borrower no longer has a partial financial hardship, the amount of capitalized interest is limited to "10% of the original principal balance at the time the borrower entered repayment under the PAYE repayment plan."[31] After the amount of accrued interest reaches the "10% limit," interest will continue to accrue but will not be capitalized if the borrower remains in the PAYE repayment plan. Under Old IBR and New IBR,[32] all accrued interest will be capitalized—there is no 10 percent limit.

A borrower who decides to stay in the Old IBR, New IBR, or PAYE repayment plan despite not having a partial financial hardship will still be eligible for loan forgiveness after 25 years (Old IBR) or 20 years (New IBR and PAYE), and, depending on her/his future income, may have a partial financial hardship in a future year, and thus again benefit from reduced monthly payments.[33]

A borrower who no longer wishes to continue with Old IBR, New IBR, or PAYE—even if she/he still has a partial financial hardship—can switch to any other repayment plan for which she/he is eligible.[34] Borrowers are allowed to switch repayment plans once per year, as long as the maximum loan term for the new plan is longer than the amount of time the loan has been in repayment.[35] However, this restriction does not apply to borrowers who are switching into Old IBR, New IBR or PAYE,[36] and does not apply to borrowers who are switching from

Old IBR or New IBR to the Standard repayment plan (those borrowers may make that switch regardless of how long their loans have been in repayment).[37, 38]

A Note on Consolidation and the PSLF Program

Besides choosing the most appropriate repayment plan, borrowers' decisions regarding loan consolidation and the PSLF Program will have the most impact on their future ability to manage their Direct student loan debts.

Although not technically a "repayment plan," borrowers have the option to consolidate some or all of their loans. A Consolidation Loan does have certain unique repayment features that are worthy of discussion.

All Direct Loans—except Parent PLUS loans—are eligible to be consolidated. A Consolidation Loan allows a borrower to consolidate multiple federal loans into one loan, reducing the number of monthly payments a borrower has to make, potentially down to one monthly payment. A Consolidation Loan has a fixed interest rate for the life of the loan, "based on the weighted average of the loans being consolidated."[39]

If either the Standard or Graduated repayment plans are selected in conjunction with a Consolidation Loan, the repayment period may be extended anywhere from 10 to 30 years, depending on the borrower's "total education indebtedness" (i.e., total loan balance).[40]

Whether or not consolidating all or some of a borrower's loans makes financial sense will need to be determined on a case-by-case basis; however, once consolidated, loans cannot be "unconsolidated." Borrowers have the ability to consolidate their loans at any time, not only immediately after graduation or leaving school. The Federal Direct Consolidation Loans Online Calculator is a good place to start exploring the consequences of loan consolidation.[41] The effect(s) of loan consolidation on things such as the borrower's monthly payments, interest rate, length of repayment, and total amount repaid should all be considered when deciding whether or not to consolidate.

The PSLF Program should also be considered when a borrower is deciding between repayment plans. The PSLF Program "is intended to encourage individuals to enter and continue work full-time in public service jobs."[42] Through the PSLF Program, borrowers who make 120 "on-time, full, scheduled monthly" payments will have their loans forgiven at the end of the 120-month (i.e., 10-year) period.[43] The amounts forgiven will not be taxable income to the borrower. Repayment plans that qualify for repayment under the PSLF program include the Standard repayment plan and any other repayment plan that calls for a monthly payment equal to or higher than the monthly payment under the Standard repayment plan.[44] This rule disqualifies the Graduated repayment plan and both of the Extended repayment plans from being used in conjunction with the PSLF Program. However, any of the income-driven repayment plans (ICR, Old IBR, New IBR, and PAYE) are eligible to be used in conjunction with the PSLF program.[45]

Borrowers will qualify for loan forgiveness under the PSLF Program if they are employed full-time, for 10 years by an eligible employer ("qualifying employment"), which includes employment with a federal, state, or local government agency, entity, or organization; a 501(c)(3) not-for-profit organization; or certain private not-for-profit employers that provide certain specified public services (e.g., public safety, public health services, public education, public interest law services, etc.).[46]

Direct Student Loan Repayment Case Studies: Art, Ben, Cate, and Deb

Understanding the repayment plans, loan consolidation, and the PSLF Program is an important first step for advisors to take in helping clients to achieve effective student loan debt management. However, by putting actual facts and figures to these concepts, a more accurate picture of the impact of an individual borrower's student loan debt begins to emerge. The following four case studies are meant to provide more

insight into the burden or facility of certain borrowers' student loan debt repayment and also provide a springboard for some specific recommendations that can be implemented by similarly situated borrowers to better manage their student loan debts.

The Undergraduates: Art and Ben

Art and Ben graduated from college in June 2015. They both have the same amount of student loan debt: $27,000.[47] Art began a job after graduation with an AGI of $30,000 whereas Ben began a job with an AGI of $60,000.[48] They are both single and reside in one of the 48 contiguous United States.[49] Note that neither Art nor Ben is eligible to select New IBR because they do not meet New IBR's definition of a new borrower.[50]

Case Study 1: Art

Art qualifies for repayment under both Old IBR and PAYE (Table 1). Because his cumulative loan amount is less than $30,000, Art cannot select either of the Extended repayment plans.

If Art can afford to make payments of $281 per month ($3,372/year) he will pay off his loans in 10 years on the Standard repayment plan with the lowest total amount repaid ($33,776). Otherwise, if he needs to cut his monthly payments in more than half, monthly payments under PAYE start out at $104; however, it will take him 17.5 years to repay his loans and he will have repaid a total of $42,411 (almost $10,000 more than under the Standard repayment plan). If Art intends to take advantage of the PSLF program, PAYE will cause him to repay the least amount of money over 10 years (approximately $18,500) while nearly $24,000 will be forgiven, income tax free.[51]

Based on the repayment estimator, no portion of any of Art's loans will be forgiven (outside of the PSLF Program); this means no "unexpected" future

TABLE 1
Case Study 1: Art—Undergraduate Student's Repayment Options with $30,000 AGI and $27,000 in Direct Loans

Type of Repayment Plan	Time For Repayment (Months)	Monthly Payment	Annual Payment	Cumulative Payment	Cumulative Payment (With PSLF)
Standard	120	$281	$3,372	$33,776 ($6,776 interest)	(Same)
Graduated	120	$159 - $476	$1,908 - $5,712	$35,499 ($8,499 interest)	(Same)
Old IBR	156	$156 - $281	$1,872 - $3,372	$37,075 ($10,075 interest)	$24,222 ($12,853 forgiven)
Income-Contingent	187	$184 - $226	$2,208 - $2,712	$38,378 ($11,378 interest)	$23,520 ($14,858 forgiven)
PAYE	210	$104 - $281	$1,248 - $3,372	$42,411 ($15,411 interest)	$18,480 ($23,931 forgiven)
Consolidation Loan-Graduated	240	$110.52 - $286.56	$1,326.24 - $3,438.72	$44,970.17 ($17,970.17 interest)	N/A
Consolidation Loan-Standard	240	$172.64	$2,071.68	$41,434.20 ($14,434.20 interest)	$20,716.80 ($20,717.40 forgiven)
Consolidation Loan-Income-Contingent	194	$184.34 - $215.26	$2,212.08 - $2,583.12	$38,745.10 ($11,745.10 interest)	$23,032.08 ($15,713.02 forgiven)
Consolidation Loan-Old IBR	159	$156.19 - $281.45	$1,874.28 - $3,377.40	$37,224.79 ($10,224.79 interest)	$24,228.12 ($12,996.67 forgiven)

tax liability to plan for. For Art, budgeting and saving will be extremely important. An AGI of $30,000 translates into approximately $2,500 of income per month or $625 per week. Art should be encouraged to save a minimum of $26 per week (PAYE), or $71 per week (Standard), in order to be able to make the monthly payments on his student loan.

If Art selects PAYE, he should also be encouraged to establish a "Student Loan Savings Fund:"[52] (a) to serve as a cushion in the event he no longer has a partial financial hardship and his monthly loan payments increase; and/or (b) if he is not aiming for forgiveness under the PSLF program, to repay his loan faster, repaying less over the life of the loan. If Art is able to save an additional $45 per week (maximum), those monies may be set aside in a Student Loan Savings Fund. Assuming Art is not aiming for forgiveness under the PSLF program, then if Art's budget allows, he will use all or a portion of his Student Loan Savings Fund to make an additional annual payment to reduce the principal balance of his student loans.[53] If possible, the additional payment should be directed to the loan(s) with the highest interest rate (6.8 percent). The annual payment, ideally, should bring Art's annual payment in line with the annual payment determined by the Standard repayment plan.[54]

Case Study 2: Ben

Like Art, Ben does not qualify for either of the Extended repayment plans (Table 2). However, unlike Art, Ben also does not qualify for repayment under Old IBR or PAYE.

If Ben selects the Standard repayment plan, although his monthly payment will be the highest ($281/month) he will have his loans paid off in 10 years with the lowest overall amount repaid. Ben may like the flexibility of the ICR or Graduated repayment plans and may prefer to choose one of them; the total amount repaid under either plan is only $1,000 or $2,000 more than under the Standard repayment plan.

If Ben intends to take advantage of the PSLF program, then consolidating his loans and choosing the Standard repayment plan will cause him to repay the least amount of money over a 10-year period (approximately $21,000); approximately that same amount, $21,000, will be forgiven and not taxable to Ben.

An AGI of $60,000 translates into approximately $5,000 of income per month or $1,250 per week.

TABLE 2
Case Study 2: Ben—Undergraduate Student's Repayment Options with $60,000 AGI and $27,000 in Direct Loans

Type of Repayment Plan	Time For Repayment (Months)	Monthly Payment	Annual Payment	Cumulative Payment	Cumulative Payment (With PSLF)
Standard	120	$281	$3,372	$33,776 ($6,776 interest)	(Same)
Income-Contingent	134	$245 - $281	$2,940 - $3,372	$34,841 ($7,841 interest)	$30,907 ($3,934 forgiven)
Graduated	120	$159 - $465	$1,908 - $5,580	$35,499 ($8,499 interest)	(Same)
Consolidation Loan-Graduated	240	$110.52 - $286.56	$1,326.24 - $3,438.72	$44,970.17 ($17,970.17 interest)	N/A
Consolidation Loan-Standard	240	$172.64	$2,071.68	$41,434.20 ($14,434.20 interest)	$20,716 ($20,718.20 forgiven)
Consolidation Loan-Income-Contingent	138	$244.67 - $270.60	$2,936.04 - $3,247.20	$35,023.18 ($8,023.18 interest)	$30,152.38 ($4,870.80 forgiven)

Ben should save $72 per week (Standard), or if he is aiming for the PSLF program he should save $45 per week (Consolidated-Standard). Because Ben's monthly student loan payment is a relatively small percentage of his monthly AGI (6 percent of AGI under the Standard repayment plan and 3.5 percent under the Consolidated-Standard plan), it would be to Ben's advantage to simultaneously work towards other important financial goals such as creating an emergency fund (i.e., 6-9 months liquidity), purchasing adequate disability insurance, and exploring other financial products.

The Graduates: Cate and Deb

Cate and Deb will be graduating from graduate school this May. Cate and Deb both have graduate school debt in the amount of $125,000, which is most representative of a borrower who attended law school.[55] However, the figures generated by their estimated repayment plans apply to all persons with $125,000 of graduate school debt.

Cate will begin a job after graduation with an AGI of $50,000 whereas Deb will begin a job with an AGI of $100,000. Cate and Deb are both single and reside in one of the 48 contiguous United States. Note that both Cate and Deb are not eligible to select New IBR because they do not meet New IBR's definition of a new borrower.[56]

Case Study 3: Cate

Cate's indebtedness is more than double her current AGI (Table 3). Cate's situation is the most dire, financially, of all the case studies. If Cate can afford a monthly payment of $1,429, the Standard repayment plan will have her loan paid off in 10 years with the lowest cumulative amount repaid. If Cate is planning on participating in the PSLF Program, Old IBR will cause her to repay the least amount over 10 years ($70,000) and nearly $247,000 will be forgiven, income tax free.[57]

For Cate, the challenge is fourfold: (1) staying on top of her monthly payments; (2) containing the cumulative amount repaid, if possible; (3) planning for the possibility of loan forgiveness and its associated tax bill under Old IBR or PAYE; and (4) maintaining a Student Loan Savings Fund to handle any capitalized interest payments or lump-sum principal payment that may come due.

Cate has an income, which is good. An AGI of $50,000 translates to approximately $4,000 per month or $1,000 per week. If the Standard repayment plan is a bit too much of a stretch for Cate's budget, the Graduated repayment plan may be appealing to her. What's appealing about the Graduated repayment plan is that it creates more easily manageable monthly payments in the early years of repayment, it does not lead to an unreasonable cumulative loan payment, and it results in no loan forgiveness. Monthly payments start out at $823 (a little more than half of the monthly payment under the Standard repayment plan) and rise gradually over the course of 10 years. If Cate can start out saving a minimum of $220 per week she will be able to manage her monthly student loan payments under the Graduated repayment plan. If she can afford it, up to $140 per week can be put into a Student Loan Savings Fund that can be used to make an additional annual payment towards the principal of Cate's loans each year. These weekly savings figures should be reexamined each year as her income changes, and at least every 2 years as the monthly payment under the Graduated repayment plan increases.

If Cate cannot afford the monthly payments under the Standard or Graduated repayment plans, the choice becomes substantially more difficult. The ICR plan may provide Cate with a more manageable monthly payment, directly linked to her AGI; however, it causes Cate to pay substantially more over the life of her loans ($70,000 more than under the Standard repayment plan).[58] A similar issue arises with either of the Extended repayment plans ($85,000 more than under the Standard repayment plan with the Extended-Fixed and $107,000 more than under the Standard repayment plan with the Extended-Graduated), and any of the consolidation loans.

If Cate chooses either Old IBR or PAYE she may have some potential additional land mines to manage.

Although Old IBR may create manageable

monthly payments, the total amount repaid is $95,000 more than under the Standard repayment plan, and what's more, at the end of 25 years, about $50,000 of the loan will be forgiven and taxable to Cate.[59] It may be prudent, therefore, to plan so that Cate's Student Loan Savings Fund has an adequate amount of money to handle this potential tax liability.

Choosing the PAYE repayment plan may create even more unexpected consequences for the uninformed borrower. The Student Loan Repayment Estimator estimates that all of Cate's monthly payments over a 20-year-period were interest payments ($122,126); in other words, no part of Cate's monthly loan payments went toward reducing the principal of her loans. According to the regulations: "If the borrower's monthly payment amount is not sufficient to pay any of the principal due, the payment of that principal is postponed until the borrower chooses to leave the … repayment plan or no longer has a partial financial hardship."[60] If this occurs when there is a substantial principal balance that has not been paid, Cate may find herself in a dire financial situation.

TABLE 3
Case Study 3: Cate—Graduate Student's Repayment Options with $50,000 AGI and $125,000 in Direct Loans

Type of Repayment Plan	Time For Repayment (Months)	Monthly Payment	Annual Payment	Cumulative Amount Repaid	Cumulative Amount Repaid (With PSLF)
Standard	120	$1,429	$17,148	$171,532 ($46,532 interest)	(Same)
Graduated	120	$823 - $2,470	$9,876 - $29,640	$184,295 ($59,295 interest)	N/A
Income-Contingent	227	$639 - $1,462	$7,668 - $17,544	$241,842 ($115,947 interest)	$104,268 ($137,574 forgiven)
PAYE	240	$271 - $832	$3,252 - $9,984	$122,126 interest ($169,329 forgiven)	$100,464 ($190,991 forgiven)
Extended-Fixed	300	$856	$10,272	$256,922 ($131,922 interest)	N/A
Old IBR	300	$406 - $1,429	$4,872 - $17,148	$267,202 ($191,849 interest) ($49,646 forgiven)	$69,984 ($246,864 forgiven)
Extended-Graduated	300	$694 - $1,234	$8,328 - $14,808	$278,524 ($153,524 interest)	N/A
Consolidation Loan-Income-Contingent	238	$639 - $1,379	$7,668 - $16,548	$249,143.71 ($124,143.71 interest)	$103,068 ($146,075.71 forgiven)
Consolidation Loan-Extended Fixed	300	$864	$10,368	$259,092 ($134,091.82 interest)	N/A
Consolidation Loan-Old IBR	300	$406 - $1,435	$4,872 - $17,220	$259,962.51 ($125,000 forgiven)	$72,192 ($244,656 forgiven)
Consolidation Loan-Extended Graduated	300	$703 - $1,237	$8,436 - $14,844	$280,781 ($155,781 interest)	N/A
Consolidation Loan-Standard	360	$811	$9,732	$291,869.14 ($166,869.14 interest)	$97,320 ($194,549.14 forgiven)
Consolidation Loan-Graduated	360	$703 - $1,050	$8,436 - $12,600	$314,511.30 ($189,511.30 interest)	N/A

If this delayed principal payment is a real likelihood for Cate, then, if possible, an appropriate amount of money should be periodically set aside in her Student Loan Savings Fund to meet this projected expense. Otherwise, Cate may face penalties and additional interest for being unable to make the payment, or may be forced to turn to a commercial lender for a loan (assuming she is able to secure one).

Also remember that in Old IBR and PAYE, the amount of accrued but unpaid interest will be capitalized if Cate chooses to leave the repayment plan and/or each year that Cate remains in the repayment plan but no longer has a partial financial hardship.[61]

Cate needs to be careful if she is able to make additional payments towards her loan, intent on reducing her principal balance; the financial impact of any additional payments should be ascertained before they are made. The regulations governing Old IBR and PAYE require that additional payments be applied in a systematic way: first to accrued interest, then to collection costs, then to late charges, then to loan principal.[62]

TABLE 4
Case Study 4: Deb—Graduate Student's Repayment Options with $100,000 AGI and $125,000 in Direct Loans

Type of Repayment Plan	Time For Repayment (Months)	Monthly Payment	Annual Payment	Amount Repaid	With PSLF
Income-Contingent	102	$1,472 - $1,718	$17,664 - $20,616	$164,905 ($39,905 interest)	(Same)
Consolidation Loan-Income-Contingent	104	$1,472 - $1,679	$17,664 - $20,148	$166,040 ($41,040 interest)	(Same)
Standard	120	$1,429	$17,148	$171,532 ($46,532 interest)	(Same)
Graduated	120	$823 - $2,470	$9,876 - $29,640	$184,295 ($59,295 interest)	N/A
Old IBR	142	$1,031 - $1,429	$12,372 - $17,148	$185,259 ($60,259 interest)	$154,821 ($30,438 forgiven)
Consolidation Loan-Old IBR	143	$1,031 - $1,435	$12,372 - $17,220	$185,507 ($60,507 interest)	$154,122 ($31,385 forgiven)
PAYE	213	$687 - $1,429	$8,244 - $17,148	$231,065 ($106,065 interest)	$104,940 ($126,125 forgiven)
Extended-Fixed	300	$856	$10,272	$256,922 ($131,922 interest)	N/A
Extended-Graduated	300	$694 - $1,234	$8,328 - $14,808	$278,524 ($153,524 interest)	N/A
Consolidation Loan-Extended Fixed	300	$864	$10,368	$259,092 ($134,092 interest)	N/A
Consolidation Loan-Extended Graduated	300	$703 - $1,237	$8,436 - $14,844	$280,781 ($155,781 interest)	N/A
Consolidation Loan-Standard	360	$811	$9,732	$291,869 ($166,869 interest)	$97,320 ($194,549 forgiven)
Consolidation Loan-Graduated	360	$703 - $1,050	$8,436 - $12,600	$314,511 ($189,511 interest)	N/A

Finally, because preserving Cate's monthly income level is so important to any repayment plan she chooses, making sure that Cate has adequate disability insurance, and properly budgeting for the cost of Cate's disability insurance, should also be part of Cate's student loan debt management strategy.

Case Study 4: Deb

Since Deb has an AGI of $100,000 she has much more flexibility when it comes to choosing a repayment plan. The ICR plan will have her loans paid off in the shortest time (8.5 years), and with the least total amount repaid ($164,905) (Table 4). However the ICR also requires Deb to make the highest monthly payment (between $1,472 and $1,679). If Deb likes the idea of consistent monthly payments ($1,429), she should consider the Standard repayment plan. If a lower monthly payment is desired she should consider the Graduated or Old IBR plan. Both of these repayment plans produce a lower monthly payment with a similar cumulative amount repaid, which is not substantially more than the ICR plan. Although Deb qualifies for PAYE, which results in significantly lower monthly payments, it also results in her repaying significantly more than the ICR, Standard, Graduated, or IBR plans.

If Deb is planning on utilizing the PSLF Program, the most financially efficient option is for her to consolidate her loans and select the Standard repayment plan. Over 10 years Deb will repay only $97,320 and nearly $195,000 of her loan will be forgiven (with no income tax consequences to her!).

Saving and budgeting are still important for Deb, along with an appropriate amount of disability insurance to make sure that she will be able to maintain her monthly payments under whatever repayment plan she selects. Helping her choose the most effective repayment plan will allow her to achieve other important financial goals such as establishing adequate savings (i.e., a 6- to 9-month emergency fund), purchasing appropriate financial products, and contributing to any retirement accounts.

Conclusion

With a firm grasp of the fundamental features of the repayment plans available to them, Direct Loan borrowers can be empowered to take an important step towards financial freedom. By taking the fear out of the unknown, advisors can help borrowers confront the financial reality created by their student loan debts and guide borrowers in making important repayment decisions, resulting in effective management of a borrower's monthly and annual student loan payments. ■

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(1) Federal student loans made through the William D. Ford Direct Loan program will be referred to as "Direct Loans."
(2) 34 CFR 685.210.
(3) U.S. Department of Education, Federal Student Aid, "Graduated Plan;" accessed at: https://studentaid.ed.gov/repay-loans/understand/plans/graduated.
(4) In addition to ICR, IBR, and PAYE, which all can be used in conjunction with the PSLF Program, "[o]ther PSLF-qualifying repayment plans are the 10-Year Standard Repayment Plan or any other repayment plan where your monthly payment amount equals or exceeds what you would pay under a 10-Year Standard Repayment Plan." U.S. Department of Education, Federal Student Aid, "What Is the Public Service Loan Forgiveness Program?;" accessed at: https://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service#qualifying-repayment-plan.
(5) U.S. Department of Education, Federal Student Aid, "Extended Plan;" accessed at: https://studentaid.ed.gov/repay-loans/understand/plans/extended.
(6) U.S. Department of Education, Federal Student Aid, "What Kinds of Employment Qualify?"; accessed at: https://studentaid.

ed.gov/repay-loans/forgiveness-cancellation/charts/public-service#qualifying-repayment-plan.

(7) "Discretionary income" is defined as the difference between a person's income and 100 percent of the poverty guideline for that person's family size and state of residence. See: https://studentaid.ed.gov/glossary#Discretionary_Income. The poverty guidelines are maintained by the U.S. Department of Health and Human Services and are available at: www.aspe.hhs.gov/poverty.

(8) Note that payments made while a loan is in default do not count toward the 25-year period. For a list of qualifying payments under ICR see 34 CFR 685.209(b)(3).

(9) Nonfederal loans, loans currently in default, and Parent PLUS loans are not eligible for IBR or PAYE; see: https://studentaid.ed.gov/repay-loans/understand/plans/income-driven.

(10) Text of the College Cost Reduction and Access Act, accessed at: https://www.govtrack.us/congress/bills/110/hr2669/text.

(11) 26 CFR 685.209(1) (note that for joint filers, both spouses' AGIs are considered in this calculation).

(12) If a borrower's monthly payment under IBR is not sufficient to repay any of the principal due, the payment of that principal is postponed until the borrower leaves the IBR plan or no longer has a partial financial hardship. 34 CFR 685.221(b)(5).

(13) 34 CFR 685.221(f).

(14) "New borrowers" also included borrowers with loans through the Federal Family Education Loan (FFEL) program. The FFEL program was actually eliminated (i.e., no further loans were to be made under the program) by the Health Care and Education Reconciliation Act of 2010.

(15) 34 CFR 685.221(a)(4).

(16) Note that time spent in or payments made during a noneconomic hardship deferment, forbearance, or a default, do not count towards the 20-year requirement; 34 CFR 685.209(a)(6).

(17) These regulations were in response to President Obama's executive order; see: http://www.whitehouse.gov/the-press-office/2011/10/25/we-cant-wait-obama-administration-lower-student-loan-payments-millions-b.

(18) The regulations governing Old IBR and New IBR are a good place to start to understand the nuances between the two repayment plans; 34 CFR 685.221.

(19) Interestingly, the Federal Regulations enacting PAYE can be found with the regulations that enacted the Income Contingent Repayment plan back in 1992. PAYE is also referred to as ICR-a and the original ICR as ICR-b due to their placement in the Federal Regulations.

(20) 34 CFR 685.209(a)(1).

(21) A comparison of their respective regulations provides a good place to start: 34 CFR 685.221 and 34 CFR 685.209.

(22) 26 CFR 685.209(1).

(23) 34 CFR 685.221(a)(f) ("New borrower means an individual who has no outstanding balance on a Direct Loan Program or FFEL Program loan on July 1, 2014 or who has no outstanding balance on such a loan on the date he or she obtains a loan after July 1, 2014.").

(24) 34 CFR 685.221(a)(5).

(25) 34 CFR 685.209(a)(1)(iii) ("Eligible New Borrower means an individual who (A) has no outstanding balance on a Direct Loan Program Loan or a FFEL Program loan as of October 1, 2007, or who has no outstanding balance on such a loan on the date he or she receives a new loan after October 1, 2007; and (B) (1) receives a disbursement of a Direct Subsidized Loan, Direct Unsubsidized Loan, or student Direct PLUS Loan on or after October 1, 2011 or (2) receives a Direct Consolidation Loan based on an application received on or after October 1, 2011, except that a borrower is not considered an eligible new borrower if the Direct Consolidation Loan repays a loan that would otherwise make the borrower ineligible under paragraph (a)(1)(iii)(A) of this section."

(26) In a Presidential Memorandum dated June 9, 2014, President Obama directed the Secretary of Education to draft new proposed regulations by December 31, 2015 that would further expand the eligibility of borrowers to elect the PAYE repayment plan; see: http://www.whitehouse.gov/the-press-office/2014/06/09/presidential-memorandum-federal-student-loan-repayments.

(27) Calculated using the principal balance at the time the borrower entered the Old IBR, New IBR, PAYE repayment plan.

(28) 34 CFR 685.221(d)(1); 34 CFR 685.209(a)(4).

(29) 34 CFR 685.221(b), 34 CFR 685.209(a) (borrowers under the old IBR, new IBR or PAYE plan with subsidized loans may be eligible for an interest subsidy).

(30) See 34 CFR 685.209 (a)(2)(iii); except for direct subsidized loan borrowers who qualify for an interest subsidy.

(31) 34 CFR 685.209(a)(2)(iv).

(32) 34 CFR 685.221(b)(4); except for direct subsidized loan borrowers who qualify for an interest subsidy.

(33) 34 CFR 685.221(e)(4); 34 CFR 685.209(a)(4).

(34) 34 CFR 685.221(d)(2)(i); 34 CFR 685.209(a)(4). Note there are certain restrictions for switching repayment plans for certain borrowers who have defaulted. See 34 CFR 210.

(35) 34 CFR 685.210. For example, if a borrower starts out with the Standard repayment plan (maximum loan term is 10 years) and in year 5 wants to switch to the Graduated repayment plan (maximum loan term is 10 years), that is a permissible switch because the maximum loan term of the Graduated repayment plan is longer than the time the borrower's loans have been in repayment, whereas, if the borrower started out with PAYE (maximum loan term is 20 years) and in year 12 wanted to switch to the Graduated repayment plan, that would not be a permissible switch because the loan has been in repayment longer than the maximum loan term of the Graduated repayment plan.

(36) 34 CFR 685.210.

(37) 34 CFR 685.221(d).

(38) 34 CFR 685.209(a)(4). The regulations do not contain an ex-

plicit provision allowing borrowers under the PAYE repayment plan to switch into the Standard repayment plan at any time, although once the borrower no longer has a partial financial hardship, her/his payments under PAYE may very well approximate the payments she/he would have paid under the Standard repayment plan.

(39) U.S. Department of Education, Federal Student Aid, "Loan Consolidation;" accessed at: https://studentaid.ed.gov/repay-loans/consolidation.

(40) See Direct Consolidation Loans, Information Center Glossary; accessed at: http://loanconsolidation.ed.gov/help/glossary.html#indebtedness.

(41) See: https://loanconsolidation.ed.gov/loancalc/servlet/common.mvc.Controller?controller_task=startCalculator. Note that the consolidation loan calculator does not provide information for borrowers who select New IBR or PAYE. Prior to making a decision to consolidate, eligible borrowers should contact their loan servicer and/or the Direct Loan Servicing Center to see if a projection is available for a Consolidation Loan under the New IBR or PAYE. Also note that although the term "calculator" is used, these figures are simply estimates. Actual figures may depend on a borrower's AGI and other factors.

(42) U.S. Department of Education, Federal Student Aid, "Public Service Loan Forgiveness;" accessed at: https://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service#qualifying-repayment-plan.

(43) *Ibid.*

(44) U.S. Department of Education, Federal Student Aid, "Public Service Loan Forgiveness;" accessed at: https://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service.

(45) U. S. Department of Education, endnote 42.

(46) U. S. Department of Education, endnote 44.

(47) The average loan debt of an undergraduate borrower is $29,400. See Ben Miller, "Policy Brief: The Student Debt Review—Analyzing the State of Undergraduate Student Borrowing," New America, Education Policy Program, February 2014; accessed at: http://newamerica.org/downloads/TheStudentDebtReview_2_18_14.pdf.

(48) The average starting salary of a person with a bachelor's degree is about $45,000. National Association of Colleges and Employers, "Starting Salaries Up 1.2 Percent for Class of 2014 Grads," April 2, 2014: accessed at: https://www.naceweb.org/s04022014/starting-salary-class-2014.aspx.

(49) All repayment plan estimates were calculated with the assistance of the U.S. Department of Education's "Student Loan Repayment Estimator" and the "Direct Consolidation Loan Repayment Calculator," accessed respectively at: https://studentloans.gov/myDirectLoan/mobile/repayment/repaymentEstimator.action and https://loanconsolidation.ed.gov/loancalc/servlet/common.mvc.Controller?controller_task=startCalculator. Note that with any income-driven repayment plan actual monthly payments will vary annually (based on the borrower's AGI, family size, and state of residence). Some important assumptions used by the "Student Loan Repayment Estimator" are that a borrower's AGI will increase by 5 percent each year, her/his family size will stay the same throughout the life of the loan, and the poverty guidelines will be increased pursuant to the Congressional Budget Office's estimate of inflation. Finally, the Direct Consolidation Loan Repayment Calculator does not calculate an approximate repayment plan utilizing New IBR (PAYE); this information should be explored prior to choosing a repayment plan and the borrower is encouraged to contact her/his loan servicer to obtain a sample repayment schedule.

(50) See endnote 14, and pertinent discussion.

(51) Note, Art may want to compare New IBR (PAYE) with and without a consolidation loan, especially if he is going to take advantage of the PSLF program.

(52) Ideally the Student Loan Savings Fund should be a separate account (e.g. savings, money market, CD) for this particular purpose.

(53) Note that the borrower will be required to notify her/his lender in writing that she/he wants the additional monies to go towards the principal balance of the loan. Otherwise, the additional monies will not reduce the principal balance of the loan, but will be applied to the next month's payment(s). 34 CFR 685.211.

(54) Note that any "extra" payments are applied according to the rules of 34 CFR 685.221 for loans under IBR and according to the rules of 34 CFR 685.209 for loans under ICR or PAYE.

(55) Unlike undergraduate student loan debt, the amount of graduate student loan debt varies dramatically by the type of degree pursued. See Jason Delisle, "The Graduate Student Debt Review," *The Weekly Wonk,* March 25, 2014; accessed at: http://www.newamerica.net/publications/policy/the_graduate_student_debt_review.

(56) See endnote 14 and pertinent discussion.

(57) Note, Cate may want to compare using PAYE with a consolidation loan, to using Old IBR with a consolidation loan, especially if she is going to take advantage of the PSLF program.

(58) 4 CFR 685.209(b)(3)(iv) (Note that if the amount of Cate's monthly payment is less than the accrued interest on her loan, the unpaid interest is capitalized "until the outstanding principal amount is 10% greater than the original principal amount. After the outstanding principal amount is 10% greater than the original amount, interest continues to accrue but is not capitalized … [T]he original amount is the amount owed by the borrower when the borrower enters repayment."). This possibility should be explored by Cate and her financial advisor, and planned for, accordingly.

(59) As a single filer, $50,000 of ordinary income puts Cate in the 25 percent bracket and will generate an additional $8,300 of income tax.

(60) 34 CFR 682.209(v); 34 CFR 685.221(b)(5).

(61) Recall that if the borrower no longer has a partial financial hardship under PAYE, capitalized interest will be limited to 10 percent of the principal balance as of the time the borrower entered repayment under PAYE. 34 CFR 685.209(a)(2)(iv).

(62) See 34 CFR 685.221; 34 CFR 685.209.