

COLLEGE DEBT

By

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Today college can be the second largest expenditure a family makes next to purchasing their home. And when families purchase a home, a mortgage is an important part of that transaction. The same is true with college; education loans are an important part of that process. Too often, however, families take what loans are offered to them without thoroughly investigating what loans are available. Financing college can be confusing with all the federal, private, college and state loans available. And this doesn't even take into consideration the additional options the family may have: home equity loans, life insurance loans or intra-family loans.

When you purchase a house, you know what your mortgage is and the amount you will owe each month. When you borrow for college, you borrow to pay for one year at a time. A \$20,000 loan for the first year looks manageable but after four or more years your loans could total over \$80,000. Whether the debt is in the student's name or the parent's name that amount of debt can be a problem. So many families worry about getting through the current year and don't really pay attention to the total amount of debt they are accumulating.

The first thing a family should do after receiving their award letters is to calculate how much each school is going to cost for the total four years. This cost figure is the total cost of attendance less any grants or scholarships multiplied by four.

Example

TOTAL COST OF ATTENDANCE FOR ONE YEAR (includes tuition, fees, room & board, books personal expense, computer and transportation)	\$ 30,000
LESS GRANTS/SCHOLARSHIPS	<u>10,000</u>
AMOUNT TO BE PAID BY THE FAMILY	\$ 20,000
TIMES THE NUMBER OF YEARS OF COLLEGE	<u>x4</u>
TOTAL COLLEGE COST TO BE PAID	<u>\$ 80,000</u>

This number is an **estimate** and will increase each year with rising college costs.

In any event, the family must look at the four year cost figure and determine how they will pay for it. Will it come from savings, their current earnings or will they borrow the funds?

If the family is thinking of borrowing for college, they need to ask themselves these questions:

1. Do we manage debt well? (Debt Discipline)
2. Can we afford college debt in addition to our current debt load? (Debt Capacity)
3. Do we have other children who will be going to college in the future? (Debt Load)
4. Who can borrow? (Qualified Borrower)
5. Who will borrow the money and how much will they borrow? (Borrower(s))

Once the family has answered these questions and if they decide to borrow for college, they need to review the loan options that are available to them.

Here is a short list of educational loans that may be available to the family:

1. Federal Stafford Loan (subsidized and unsubsidized)
2. Federal Perkins Loan
3. Federal PLUS Loan (Parent Loan for Undergraduate Students)
4. Private Education Loans
5. College Loans
6. State Loans

In addition to the above education loans, the family may want to look into the following loans to finance college:

1. Home Equity Loan
2. Life Insurance Loan
3. Business Loan
4. Intra Family Loan
5. Margin Account Loan
6. Credit Card Loan
7. Retirement Plan Loan

FEDERAL LOAN PROGRAM

The federal loan program consists of two programs: the Federal Direct Loan Program (also know as the William D. Ford Federal Direct Loan Program) and the Federal Family Education Loan Program (FFEL). The terms and conditions are the same under both programs the only difference being under the Direct Loan Program the US Department of Education lends the funds, while under the FFEL program, commercial entities lend the funds. The individual school determines which program it is going to use.

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005 impacting federal student loans starting on July 1, 2006. In discussing the

following federal loans, we have given information on the loans as they are now and what they will be after July 1, 2006.

FEDERAL SUBSIDIZED STAFFORD LOAN:

The Federal Subsidized Stafford Loan is in the student’s name and is the responsibility of the student. The Subsidized Stafford Loan is a need-based loan in which the Federal government pays the interest on the loan until six months after the student leaves college. Before July 1, 2006, the interest rate is variable and is adjusted once a year on July 1st. The interest rate is capped at 8.25%. The interest rate for 2005-2006 is 5.3% for a student out of school. There is a 3% origination fee and a 1% insurance premium fee that are deducted from the loan proceeds. Payments on this loan start six months after the student has left school and can be deferred if the student goes back to school or in certain hardship cases. Interest paid by the student on these loans will qualify for the Student Loan Interest Deduction if the student’s income is within the Modified Adjusted Gross Income Limits* of the IRS. This loan will qualify for consolidation under the Federal Loan Consolidation Program.

After July 1, 2006, the interest rate will be fixed at 6.8% and the origination fee will be reduced to 2% for the 2006-2007 academic year.

The amounts the student can borrow vary for each year of school and are as follows:

	<u>Before 7/1/07</u>	<u>After 7/1/07</u>
	<u>Dependent Student</u>	<u>Dependent Student</u>
Undergraduate Student		
1 st year	\$ 2,625	\$ 3,500
2 nd year	\$ 3,500	\$ 4,500
3 rd and 4 th year	\$ 5,500 per year	\$ 5,500 per year
5 th year if needed	\$ 5,500	\$ 4,000
Graduate Student	<u>Independent Student</u>	<u>Independent Student</u>
All Levels	\$ 8,500 per year	\$ 8,500

NOTE: The total undergraduate Stafford Loans (subsidized and unsubsidized) cannot exceed \$23,000 for a dependent student or \$46,000 for an independent student. The total graduate and undergraduate Stafford Loans (subsidized and unsubsidized) cannot exceed \$138,500 (\$148,500 after July 1, 2007).

- Modified Adjusted Gross Income (Modified AGI) is the total income from all sources before deducting expenses such as IRA contributions, moving expenses, educator expenses, alimony paid, student loan interest expenses, etc. For the 2005 calendar tax year the Modified Adjusted Gross Income is line 22

on form 1040, line 15 on form 1040A and line 4 on form 1040EZ. The Student Loan Interest Deduction starts to phase out for a married taxpayer filing jointly when their Modified Adjusted Gross Income reaches \$105,000 and goes completely away at \$135,000. For single or head of household taxpayers those limits are \$50,000 to \$65,000.

FEDERAL UNSUBSIDIZED STAFFORD LOAN:

The Federal Unsubsidized Stafford Loan is in the student's name and is the responsibility of the student. The Unsubsidized Stafford Loan is not a need-based loan and interest starts to accrue on the loan immediately. Most lenders waive interest payments while the student is in school and add this interest to the principal of the loan (Interest Capitalization). Before July 1, 2006, the interest rate is variable, adjusted once a year on July 1st, and is capped at 8.25%. The present interest rate for 2005-2006 is 4.7% while the student is in college and 5.3% for a student out of school. There is a 3% origination fee and a 1% insurance premium fee that are deducted from the loan proceeds. Payments on this loan start six months after the student has left school and can be deferred for students going back to school or in certain hardship cases. Interest paid by the student on these loans will qualify for the Student Loan Interest Deduction if the student's income is within the Modified Adjusted Gross Income Limits of the IRS. This loan will qualify for consolidation under the Federal Loan Consolidation Program.

After July 1, 2006, the interest rate will be fixed at 6.8% and the origination fee will be reduced to 2% for the 2006-2007 academic year.

The amounts the student can borrow vary for each year of school and are as follows:

<i>BEFORE JULY 1, 2007</i>		
<u>Undergraduate Student</u>	<u>Dependent Student</u>	<u>Possible Additional Student Loan**</u>
1 st year	\$ 2,625	\$ 4,000
2 nd year	\$ 3,500	\$ 5,000
3 rd , 4 th , 5 th year	\$ 5,500 per year	\$ 5,000 per year
 <u>Graduate Student</u>	 <u>Independent Student</u>	
All levels	\$ 10,000 per year	

AFTER JULY 1, 2007

<u>Undergraduate Student</u>	<u>Dependent Student</u>	Possible Additional <u>Student Loan*</u>
1 st year	\$ 3,500	\$ 4,000
2 nd year	\$ 4,500	\$ 5,000
3 rd and 4 th year	\$ 5,500 per year	\$ 5,000 per year
5 th year	\$ 4,000	\$ 4,000

Graduate Student Independent Student

All levels \$ 12,000 per year

** If you are an independent undergraduate student or a dependent student whose parents are unable to get a PLUS Loan, you may be eligible for these additional student loans. These loans are in addition to any Federal Subsidized or Unsubsidized Stafford Loan amounts received and are unsubsidized.

NOTE: The total undergraduate Stafford Loans (subsidized and unsubsidized) cannot exceed \$23,000 for a dependent student or \$46,000 for an independent student. The total graduate and undergraduate Stafford Loans (subsidized and unsubsidized) cannot exceed \$138,500 (\$148,500 after July 1, 2007).

FEDERAL PERKINS LOAN:

The Federal Perkins Loan program is administered by the U.S. Department of Education, is in the student's name and is the responsibility of the student. This is a need-based loan in which the federal government pays the interest on the loan until six months after the student leaves college. The interest rate is fixed at 5%. Payments on this loan start nine months after the student has left school and payments can be deferred for students going back to school or in certain hardship cases. The amount of the loan is determined by the college and can range up to \$4,000 per year for undergraduate students and up to \$6,000 for graduate students. Interest paid by the student on these loans will qualify for the Student Loan Interest Deduction if the student's income is within the Modified Adjusted Gross Income Limits. This loan will also qualify for consolidation under the Federal Loan Consolidation Program.

NOTE: The total undergraduate Perkins Loans cannot exceed \$20,000. The total graduate and undergraduate Perkins Loans cannot exceed \$40,000.

FEDERAL PARENT LOAN FOR UNDERGRADUATE STUDENTS (PLUS):

The Federal PLUS Loan is in one of the parent's name. If one parent does not qualify for the loan then the other parent can apply for the loan. This loan is

neither need-based nor merit-based. Before July 1, 2006, the interest rate is variable and tied to the 90 Day Treasury Bill Rate as of May 31st of each year. The rate is adjusted once a year on July 1st and is capped at 9%. The interest rate for 2005-2006 is 6.1%. Payments on this loan start within 60 days of the final disbursement of the loan and are based on a 10 year term. The amount that can be borrowed is the total cost of college less any financial aid and distributions from certain educational tax benefit accounts. If at any time the borrower dies or becomes totally disabled, the loan is forgiven. There is a 3% origination fee and a 1% insurance premium fee that are deducted from the loan proceeds. Interest paid by the parent on this loan will qualify for the Student Loan Interest Deduction if the parents' income is within the Modified Adjusted Gross Income Limits of the IRS. This loan will qualify for consolidation under the Federal Loan Consolidation Program.

After July 1, 2006, the interest rate will be fixed at 8.5% and the origination fee will be reduced to 2% for the 2006-2007 academic year. Starting in July 2006, graduate students will be permitted to borrow under the PLUS Loan program for graduate work.

NOTE: If both of the parents fail to qualify for a PLUS Loan, the student may qualify for an additional \$4,000/\$5,000 Stafford Loan.

PRIVATE EDUCATION LOAN:

The Private Education Loan is offered by a financial institution and can be in the student's name or in a parent's name. If the loan is in the student's name, the commercial lender will probably require that he/she have a co-borrower for the loan. These loans are neither need-based nor merit based. The interest rate on these loans is variable with no cap on the rate. The rate can be based on the prime rate or the LIBOR Index plus a percentage and may be adjusted quarterly. If the loan is in the student's name, repayment usually starts after the student leaves school. If the loan is in the parent's name, repayment can start immediately. The loan amount can be up to the total cost of college less any financial aid or a fixed annual dollar amount, which ever is lower. These loans are subject to various fees that are deducted from the loan proceeds. Interest paid on these loans will qualify for the Student Loan Interest Deduction if the taxpayer/borrower's income is within the Modified Adjusted Gross Income Limits of the Internal Revenue Code.

COLLEGE LOAN:

College loans administered by the college may come from the school's endowment or from a loan program set up with a financial institution. The loan may be either in the student's name or the parent's name. The interest rate

could be variable or fixed and repayment usually begins after the student leaves school. The amount of the loan is determined by the college. Interest paid by the taxpayer/borrower on this loan will qualify for the Student Loan Interest Deduction if their income is within the Modified Adjusted Gross Income Limits of the Internal Revenue Code.

STATE LOAN:

Some states offer college loans to the student and/or parent. If these loans are available, it is best to check with the college to see what terms and conditions apply. Interest paid by the taxpayer/borrower will qualify for the Student Loan Interest Deduction if their income is within the Modified Adjusted Gross Income Limits of the Internal Revenue Code.

WEB SITES – EDUCATION LOANS

<u>Lender</u>	<u>Web Site</u>
Citibank	www.studentloan.com
Sallie Mae	www.salliemae.com
Nelnet	www.nelnet.net
Total Higher Education Loan Program	www.northstar.org
Rhode Island Student Loan Authority	www.risla.com
Next Student	www.nextstudent.com
Key Bank	www.key.com/educate
American Education Services	www.aessuccess.org
Bank of America	www.bankofamerica.com/studentbanking
Wachovia	www.wachovia.com/education
National Education	www.nationaleducation.com

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Biography

Gary Carpenter is a Certified Public Accountant (CPA) in New York and a Certified College Planning Specialist (CCPS). He is the owner of College Planning Services and is the Executive Director of the National Institute of Certified College Planners (NICCP). Mr. Carpenter has also provided continuing education courses in the area of college planning and financial aid for various state CPA societies, the New York State Bar Association and the Financial Planning Association of New York. He is co-author of College Financial Planning for Any Income Level and has been quoted in “Kiplinger’s Personal Finance”, AARP magazine, “The Greentree Gazette” (a business magazine for Higher Education), MSNBC and on CNBC. He has had over thirty years experience in tax and financing and has spent the past eight years in college planning and consulting. He is a member of the New York State Society of Certified Public Accountants, the American Institute of Certified Public Accountants and the National Institute of Certified College Planners. He is active in committee service for the New York State Society of CPA’s and serves on the boards of several non-profit organizations.

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