

# **COLLEGE PLANNING**

## Facts About College Loans

**By**

**Gary E. Carpenter, CPA, CCPS**

**Copyright 2008**

# **Gary E. Carpenter, CPA, CCPS**

## **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 co-founder of the CollegeLOAN Evaluator. 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, MONEY, Financial Advisor, and on MSNBC and CNBC. He has had over thirty years experience in tax and financing and has spent the past nine 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.

Gary E. Carpenter, CPA, CCPS

E-mail address: [gec@collegeloanevaluator.com](mailto:gec@collegeloanevaluator.com)

In recent months we have watched the subprime mortgage crisis develop. At the same time, in the background, a student loan crisis was developing. Like the subprime mortgages, private student loans are packaged together and sold to investors. Recently, investors have not been buying these packages because they are concerned these student loans may not be paid. At the same time, lenders are reducing or eliminating the benefits they would give on federal student loans because the recently passed "College Cost Reduction and Access Act" has reduced federal subsidies for those loans.

So what is the effect of all this on your student loans? Well, you'll see fewer benefits offered by lenders when applying for a Federal Stafford or PLUS Loan. As for private education loans, we will see fees and interest rates increase in the coming year.

Still, most families are going to have to borrow for college, so now, more than ever before, it is important that you take a few minutes to understand what you are getting into and what is available to you.

For most families today college is the second largest expenditure they will make 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 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 known 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.

In 2006 President Bush signed the Deficit Reduction Act of 2005, which impacted federal student loans starting 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, 2008.

#### **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. Loans disbursed before July 1, 2006 have a variable interest rate and are adjusted once a year on July 1<sup>st</sup>. The interest rate is capped at 8.25%. The interest rate on these loans for 2007-2008 is 7.22% for a student out of school. For loans disbursed after July 1, 2006, the interest rate is fixed at 6.8%. There is a 1.5% origination fee for 2007-2008 and that fee will be reduced to 1% for the 2008-2009 academic year. In addition to this origination fee, there is a 1% insurance premium fee. These fees 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.

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

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

On September 27, 2007, President Bush signed the “College Cost Reduction and Access Act”, which, among other things, changed the interest rates on Subsidized Stafford Loans. Effective October 1, 2007, interest rates on these loans will be reduced as follows:

- Loans disbursed after July 1, 2006 and before July 1, 2008 will have a fixed interest rate of 6.8%
- Loans disbursed after July 1, 2008 and before July 1, 2009 will have a fixed interest rate of 6%
- Loans disbursed after July 1, 2009 and before July 1, 2010 will have a fixed interest rate of 5.6%
- Loans disbursed after July 1, 2010 and before July 1, 2011 will have a fixed interest rate of 4.5%
- Loans disbursed after July 1, 2011 and before July 1, 2012 will have a fixed interest rate of 3.4%

**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 \$148,500.

\* 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 2007 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. For the 2007 tax year the Student Loan Interest Deduction starts to phase out for a married taxpayer filing jointly when their Modified Adjusted Gross Income reaches \$110,000 and goes completely away at \$140,000. For single or head of household taxpayers those limits are \$50,000 to \$70,000.

**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). Loans disbursed before July 1, 2006 have a variable interest rate which is adjusted once a year on July 1<sup>st</sup>. The interest rate on this loan is capped at 8.25%. The present interest rate for 2007-2008 is 6.62% while the student is in college and 7.22% for a student out of school. For loans disbursed after July 1, 2006, the interest rate is fixed at 6.8%. There is a 1.5% origination fee for 2007-2008 and that fee will be reduced to 1% for the 2008-2009 academic year. In addition to this origination fee, there is a 1% insurance premium fee. These fees 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.

The amounts the student can borrow vary for each year of school and after July 1, 2007 are as follows:

<u>Undergraduate Student</u>	<u>Dependent Student</u>	<u>Possible Additional Student Loan*</u>
1 <sup>st</sup> year	\$ 3,500	\$ 4,000
2 <sup>nd</sup> year	\$ 4,500	\$ 5,000
3 <sup>rd</sup> and 4 <sup>th</sup> year	\$ 5,500 per year	\$ 5,000 per year
5 <sup>th</sup> year	\$ 4,000	\$ 4,000
<u>Graduate Student</u>	<u>Independent Student</u>	
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 \$148,500.

**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 nine 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 GRAD PLUS LOAN:**

This loan was established under the "Deficit Reduction Act of 2005" and is available to graduate students for academic years starting after July 1, 2006. This Federal Grad PLUS Loan is in the student's name. The loan is neither need-based nor merit-based. The student can borrow up to the total cost of college less any financial aid and/or distributions from certain educational tax benefit accounts. The loan has a fixed interest rate. If the loan is under the Federal Direct Loan Program, the fixed interest rate is 7.9%. If the loan is under the Federal Family Education Loan Program (FFEL), the fixed interest rate is 8.5%. Payments on this loan start after the student has left school and are based on a ten year term. There is a 3% origination fee and a 1% insurance premium fee that are deducted from the loan proceeds. After the loan is disbursed, if the student dies or becomes totally disabled, the loan is forgiven. Interest paid by the student on this loan 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.

**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 the other parent can apply for the loan. This loan is neither need-based nor merit-based. Loans disbursed before July 1, 2006, have a variable interest rate and are 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 2007-2008 is 8.02%. Loans disbursed after July 1, 2006, have a fixed interest rate. If the loan is under the Federal Direct Loan Program the fixed interest rate is 7.9%. If the loan is under the Federal Family Education

Loan Program (FFEL) the fixed interest rate is 8.5%. 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.

**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 is usually in the student's name. Loans in the student's name will almost always require a co-borrower. These loans are neither need-based nor merit based. These are credit based loans. 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. Loans in the student's name start repayment after the student has left school. 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 is usually in the student'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.

## **CONSOLIDATION OF EDUCATION LOANS**

There are two types of college loans that can be consolidated: federal loans that can be consolidated under the Federal Loan Consolidation Program and private education loans that can be consolidated with private lenders.

### **FEDERAL LOAN CONSOLIDATION PROGRAM:**

Under this program the borrower can consolidate the following federal loans:

1. Subsidized Stafford Loans
2. Unsubsidized Stafford Loans
3. Perkins Loans
4. PLUS Loans
5. Grad PLUS Loans

The borrower can only consolidate loans that are in his name: example - a Stafford Loan (student loan) cannot be consolidated with a PLUS Loan (parent loan).

The term of the loan is determined by the amount being consolidated and could be as long as 30 years. The interest rate is fixed and is the weighted average of the rates being consolidated. The consolidation does not require an income or credit check of the borrower and can only be done after the student has left school. If the borrower goes back to school, the loan will go into deferment and if new education loans are incurred they could be consolidated with the first consolidation after the borrower leaves school.

**NOTE:** Students and parents with federal loans disbursed before July 1, 2006, may not want to consolidate these loans until after July 1, 2008, when variable interest rates are expected to decrease from their present levels.

### **PRIVATE LOAN CONSOLIDATIONS:**

Some private lenders are now offering to consolidate various private education loans. These lenders will consolidate the private education loans into one loan and depending on the amount being consolidated, the term could be as long as 30 years. In most cases the interest rate is variable and adjusted monthly. There are a few lenders who offer fixed interest rate loans but these rates are higher than the variable rate loans. Some loans may have fees associated with them. The consolidation loan is a credit based loan. The credit of the borrower will determine the interest rate and fees charged.

## **WEB SITES – EDUCATION LOANS**

<b><u>Lender</u></b>	<b><u>Web Site</u></b>
Citibank	<a href="http://www.studentloan.com">www.studentloan.com</a>
Sallie Mae	<a href="http://www.salliemae.com">www.salliemae.com</a>
Nelnet	<a href="http://www.nelnet.net">www.nelnet.net</a>
Total Higher Education Loan Program	<a href="http://www.northstar.org">www.northstar.org</a>
Rhode Island Student Loan Authority	<a href="http://www.risla.com">www.risla.com</a>
Next Student	<a href="http://www.nextstudent.com">www.nextstudent.com</a>
Key Bank	<a href="http://www.key.com/educate">www.key.com/educate</a>
American Education Services	<a href="http://www.aessuccess.org">www.aessuccess.org</a>
Bank of America	<a href="http://www.bankofamerica.com/studentbanking">www.bankofamerica.com/studentbanking</a>
Wachovia	<a href="http://www.wachovia.com/education">www.wachovia.com/education</a>
National Education	<a href="http://www.nationaleducation.com">www.nationaleducation.com</a>
Missouri Higher Education Loan Authority	<a href="http://www.mohela.com">www.mohela.com</a>
My Rich Uncle	<a href="http://www.myrichuncle.com">www.myrichuncle.com</a>

We do not recommend one lender over another when providing this list. There are additional lenders that you may want to consider when applying for an educational loan.