College Loan Confusion

College students have steep learning curves. In high school, they were tasked with doing well academically, participating in extracurricular activities, complying with the rules of their parents' homes and, possibly, having a job. At college, they must decide what to study, how many credits to take, and other important decisions, while adapting to a new environment and learning to manage time, communicate with professors and administrators, network with peers, and manage finances.

Borrowing for college

A key aspect of finances for many college students is student loans. When scholarships, grants, income, and savings are not enough to cover the cost, students often borrow to pay for college. In fact, 70 percent of college graduates leave school with a loan, and the average amount owed is about $30,000, according to a survey by *Lendedu.com*.[1] At graduation, accumulated debt may include:[2]

- Direct subsidized loans (the government pays interest while students are in school)
- Direct unsubsidized loans (students owe interest while in school)
- Direct PLUS loans (for parents and graduate students)
- Perkins loans
- State and private loans (usually co-signed with an adult)

Different types of loans offer different interest rates and repayment schedules. The federal government finances some loans. Private lenders finance others. Some loans are need-based, while others are not.[2] All in all, outstanding student loan debt in the United States totals about $1.2 trillion.[1]

Many students don't know much about their loans

There are a lot of details to understand and track when students borrow. That's one reason many colleges and universities require student borrowers to attend loan counseling sessions before receiving loans.[3] Unfortunately, the survey found few students retain much of the information presented:[1]

- 94 percent of students did not know their repayment terms
- 93 percent were uncertain what type of loan they held
- 92 percent did not know their current loan interest rates
- 75 percent understood how interest rates work

A *Brookings Institute* study found about one-half of students underestimate the amount of debt they have and one-third cannot provide an accurate estimate of their debt. The survey concluded:[4]

"It is clear from the analysis presented here that enrolled college students do not have a firm grasp on their financial positions, including both the price they are paying for matriculation and the debt they are accruing. Without this information, it's unlikely that students will be able to make savvy decisions regarding enrollment, major selection, persistence, and employment. Without knowledge of their financial circumstances, a student with a large sum of debt might be unprepared to compete for the jobs that would pay generously enough to allow them to repay their debt without having to enter an income-based repayment program."

The confusion carries into repayment options

Unfortunately, student loan confusion doesn't end with college. In large part, that's because there a multitude of repayment options for college graduates. *The Department of Education's Federal Student Aid* website offers an overview of the eight repayment options for Direct Loans and Federal Family Education Loans. These include:[5]

- Standard repayment plan (fixed payments)
- Graduated repayment plan (increasing payments)
- Extended repayment plan (fixed payments over 25 years)
- Income-based Repayment Plan (income-based repayment)
- Income Contingent Repayment (income-based repayment)
- Income Sensitive Repayment Plan (income-based repayment)
- Pay As You Earn Repayment Plan (income-based repayment)
- Revised Pay As You Earn Repayment Plan (revised income-based repayment)

Of course, the choices available for repaying private student loans are different and vary by lender. In addition, marketplace and peer-to-peer lending platforms make it possible to refinance and consolidate student loan debt, sometimes at lower interest rates.[6]

Tax implications may also play a role into loan repayment decisions. Interest paid on student loan debt may be tax deductible. Earlier this year, *Forbes* suggested it could reduce taxable income by as much as $2,500 for some Americans. However, this article cautioned monthly loan payments could limit the ability of many young Americans to save for financial goals like starting a business, buying a home, or retiring from work at a reasonable age.[7]

Is borrowing for college worth it?

A college degree is almost a necessity today. In 2014, Pew Research Center reported, "On virtually every measure of economic well-being and career attainment – from personal earnings to job satisfaction…young college graduates are outperforming their peers with less education."[8]

When a degree confers so many benefits, borrowing to pay for college appears to be a reasonable choice as long as students make sound repayment choices. In a world where so many repayment options are available, graduates may want to work with financial professionals to accurately determine which repayment programs may be the most beneficial.

Sources:
[1] https://lendedu.com/blog/January-student-loan-survey
[2] https://bigfuture.collegeboard.org/pay-for-college/loans/types-of-college-loans
[3] https://studentloans.gov/myDirectLoan/index.action
[4] http://www.brookings.edu/~/media/research/files/reports/2014/12/10-borrowing-blindly/are-college-students-borrowing-blindly_dec-2014.pdf (*Pages 1 and 10*)
[5] https://studentaid.ed.gov/sa/repay-loans/understand/plans#direct-and-ffel
[6] http://www.business.com/finance/finance-meet-your-new-match-fintech-trends-to-watch-in-2016/
[7] http://www.forbes.com/sites/stephendash/2016/03/04/long-term-tax-strategies-for-student-loan-borrowers/#4360b54b443f (*or go to* https://s3-us-west-2.amazonaws.com/peakcontent/Peak+Documents/Forbes-Long-Term_Tax_Strategies_for_Student_Loan_Borrowers-Footnote_7.pdf)
[8] http://www.pewsocialtrends.org/2014/02/11/the-rising-cost-of-not-going-to-college/