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Student Loans That Make Sense

By Elizabeth LaScala

Elizabeth LaScala Ph.D. guides families through the sometimes complex world of college admission. She helps students identify college majors and career paths, develops good fit college lists, and provides essay coaching and application support to help students tackle each step of the admission process with confidence and success. Elizabeth also helps families maximize opportunities for scholarships and financial aid awards. Visit www.doingcollege.com; Call (925) 891-4491 or email at elizabeth@doingcollege.com.

The wide availability of student loans in the U.S. reflects the value our nation places on access to higher education. As a college admission counselor, I have worked with students who could not attend college without the help of a student loan. However, student loans are often viewed negatively, in part because they are associated with the rising cost of higher education.

From the consumers' perspective, the rising costs of education can put students or parents in serious debt. But loans can also be viewed as a sensibly used credit card or home equity line of credit. If you choose and use credit judiciously, it can build a sound credit history, add value to your life now and help you prepare for your future. For these reasons, there is no need to avoid student loans entirely, and some good reasons to take out a loan. For example, a student can build a good credit history with a small loan that she can afford to pay off after graduation. Some affluent families may still include a loan in the plan to fund college so the student can be a stakeholder in his or her own education. The key for students is to use loans wisely so you end up with a manageable loan debt while building and maintaining a good credit history.

One way to conservatively manage your loan debt is to plan on borrowing no more than the maximum allowed by a direct student loan, a federal loan made through the William D. Ford Federal Direct Loan Program for which eligible students and parents borrow directly from the U.S. Department of Education. There are two types: Direct Subsidized Loans are available to undergraduate students with demonstrated financial need and Direct Unsubsidized Loans are available with no requirement to demonstrate need. The college you attend determines the amount you can borrow based on your cost of attendance, your need and other financial aid you may receive. If a student were to take a maximum subsidized student loan for each of four years, the aggregate total allowed would be $19,000. If a student does not qualify for subsidized loans, she or he could still borrow the unsubsidized version and the full amount of $27,000 would be available. If there is need for some of the time a student is in college, these two types can be mixed, but the aggregate amount cannot exceed $27,000 over four years. Thus, this loan program has built-in caps which keep a student from going beyond certain limits. The interest rate on the Direct Student Loan Program is fixed for the current year at 3.86 percent. Interest rates are tied to the 10-year Treasury bill and may rise in future years. The rate is set every July 1st. The Department of Education (http://studentaid.ed.gov/eligibility) provides very clear and annually updated guidelines to the affordability of college and reasonable levels of college debt.

Taking advantage of the direct student loan program should not overburden a recent graduate.

Loans from these programs are designed to be affordable and many entry level employment positions will permit a careful spender to make a repayment plan work.

So, let's take a concrete example. Since interest rates are expected to slowly rise, let's use a rate of 4.62 percent. If a student qualifies for a subsidized loan and takes the aggregate limit of $19,000 at an interest rate of 4.62 percent, repayments would be right around $200 per month to pay off the loan in 10 years. This is manageable on an income of $30,000 a year. If the same student took the full aggregate limit of subsidized and unsubsidized loans and accrued a debt of $27.000, he or she would have to earn closer to $35,000 with a monthly payment of about $280. There are loans that tend to sink families into deep debt and these are the ones that give all loans a bad name. Take for example a family that takes out an $80,000 Parent Plus loan at an interest rate of 8.5 percent. To pay off this loan in one decade would take an annual salary of at least $119,000 with monthly payments of $991. That's a huge chunk of change!

For a useful tool that estimates the salary one needs to earn to pay back a specific dollar amount of loan under various terms and limits, visit http://www.finaid.org/calculators/loanpayments.phtml.

Paying for college should never be an afterthought, and families who construct a sensible plan to pay for college costs by reviewing the full range and mix of options, including the federal student loans, fare best.

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