Student Loans: Five Steps College Graduates Should Take -- WSJ

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FULL TEXT

By Anne Tergesen

Many new graduates are holding out hope they might not have to repay all of their student loans. But graduating without a plan to tackle your college debt can cause problems down the road.

Federal student-loan payments are suspended through Aug. 31, with some betting the Biden administration will extend the payment pause until after the November midterm election. Government leaders, including President Biden, have discussed forgiving about $10,000 in student debt for some borrowers.

While it might be tempting to wait to see what happens, there are benefits to getting organized now. For one thing, with about $30,000 in student loans at graduation, the average borrower is unlikely to see his or her entire balance eliminated.

Figuring out the best way to pay off your loans can be complicated. Borrowers have about a dozen repayment plans to choose from, and should consider factors including their likely profession, what they can afford to pay, and how their incomes might change over time. They should also weigh competing financial goals, including some that might seem far in the future, such as the need to save for retirement.

"It's important to figure out a repayment strategy and it's not too early to think about it," said Betsy Mayotte, president of the nonprofit Institute of Student Loan Advisors, which helps borrowers with college debt.

Your approach can evolve over time. "Get in the habit of re-evaluating your strategy every year," Ms. Mayotte says.

Here are five steps graduates should take:

1. Update your contact information

Make sure your contact information is up-to-date on your loan servicer's website and on your profile at the U.S. Department of Education's studentaid.gov.

That will enable you to receive the notices loan-servicing companies must send before payments resume.

"This is a time when the rules are changing. It's really important to pay attention," said Heather Jarvis, a lawyer who teaches financial professionals about student loans.

2. Make a list of your loans

Compile a list of your loans, including the loan type, principal amount and interest rate.

There are two basic types of student loans: federal loans, which comprise more than 90% of total student debt, and private loans underwritten by financial firms. To find your federal loans, log into your account at studentaid.gov. Private loans should be on your credit report at AnnualCreditRepor t.com.

With federal loans, borrowers can choose from nearly a dozen repayment options, each with a different monthly payment and terms that range from 10 to 30 years. The longer the term, the lower the monthly payment generally is, but borrowers are likely to pay more interest in total. Some options come with the possibility of debt forgiveness.

Because interest rates on federal loans are now zero, call your loan servicer to find out what the rates will be when payments resume.

Payments on federal loans typically start six months after graduation. Some private lenders may require payments to start immediately.

The federal loan-payment suspension is an opportunity for people with private loans to pay those down more aggressively, Ms. Jarvis said.

Borrowers considering refinancing federal loans into private loans should be aware that they will lose benefits, including the flexibility to qualify for partial loan forgiveness and to suspend payments for reasons including a layoff.

3. Plug your information into a repayment calculator

To see what monthly and total payments would be under the various federal loan-repayment options, borrowers can enter their loan information into the Education Department's online loan simulator.

The default option requires borrowers to make fixed monthly payments for up to 10 years. In comparison with other plans, this typically means paying higher monthly amounts but less in interest over the life of the loan.

An income-driven repayment plan might be best for some borrowers. These plans set federal-loan repayments at 10% to 20% of a borrower's annual discretionary income, an amount determined by factors including the borrower's income and family size. Using these plans, a borrower can free up cash for other long-term financial goals, such as repaying private loans.

Income-driven plans also offer the possibility of loan forgiveness after 10 to 25 years of repayments, depending on the plan and the borrower's profession.

Borrowers who can benefit most from an income-driven plan generally have debt in excess of their income, a threshold at which they might eventually see some of their loan balances forgiven, says Mark Kantrowitz, a student-loan expert.

Income-based repayment options are generally more attractive than graduated and extended plans, Ms. Jarvis says.

Graduated plans start with lower payments that increase every two years over 10 to 25 years, depending on the balance. Extended plans lower monthly payments by allowing up to 25 years for repayment. These can make sense for someone with a relatively high income who lives in an expensive city, Ms. Mayotte said.

4. Check whether federal loan forgiveness programs make sense for you

Borrowers with federal loans who use income-driven repayment plans might be able to have some of their debt forgiven.

Under the federal government's Public Service Loan Forgiveness program, which was recently streamlined to make it easier to qualify, teachers, doctors, nurses and others who work full-time for 10 years for certain types of nonprofits or government are eligible to have their remaining balances forgiven tax-free after 10 years of qualifying payments.

Those not in public-service jobs must typically repay their loans for 20 years or 25 years and owe income tax on any debt that is canceled. Federal tax has been waived for those who qualify for debt forgiveness from Jan. 1, 2021, through Dec. 31, 2025, and Mr. Biden has proposed making that permanent, Mr. Kantrowitz said.

5. Balance your student loans with other financial goals

If payments under a 10-year plan leave too little money to cover other bills or to start saving for retirement, consider an income-driven repayment plan.

Use the cash you free up to build an emergency fund and contribute enough to your employer's 401(k) plan to get the full matching contribution.

"That's free money and it's hard to beat," said Mr. Kantrowitz.

The more you contribute to a traditional 401(k) plan, the lower your taxable income will be, which can help reduce income-driven student-loan payments the next year.

Then pay down any debt you owe that charges a higher interest rate than your student loans. As you get on firmer financial footing, you can extinguish your student loans faster by voluntarily paying more, although if you're on track for loan forgiveness, doing so would result in less debt being wiped away.

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