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August 14, 2023 – Wealth Planning Commentary

Updates on Student Debt

For the first time since the pandemic, student loan forbearance is ending. Forbearance is the pause on student loan repayments. Beginning September 1, interest on Federal loans will begin accruing, and loan payments are due in October. Please note that this applies to federal loans, not private loans. Private lenders may have offered other pandemic-related restructuring and forbearance plans.

For those who have student loans, there are a few different types of repayment plans. The first is the standard repayment, where the repayment term is ten years. A standard repayment plan results in the lowest amount of interest paid. Income-based repayment plans are available for people who have issues making monthly payments. There are various types of income-based repayment plans that are tied to the borrower's income. When the term is up, it may be possible to receive income-driven loan forgiveness for the remaining debt. Graduated repayment plans start with lower monthly payments and increase every two years over a ten-year period. Extended repayment plans offer the longest time horizon, up to 25 years. The borrower typically pays the most interest in an extended repayment plan because the principal is paid back over a long term. However, it may be a good choice if interest rates are low. Locking in a lower rate is a form of leverage that may be used to invest rather than repay.

It's possible to change repayment plans. The Department of Education offers a loan simulator to help optimize the payment plan for an individual's circumstance. Like any loan, options that decrease monthly payments will likely result in paying more interest overall. Keep in mind that certain loans can be forgiven by the government. Government and nonprofit employees are eligible for the Public Service Loan Forgiveness Program (PSLF). The PSLF program forgives student debt after the borrower makes ten years of qualifying payments.

Consolidating loans is also an option to simplify and potentially reduce payments. Borrowers may consolidate their federal loans by combining two or more existing loans into a single balance with a single loan servicer. Private loans cannot be part of a federal loan consolidation; however, they may be consolidated separately. Consolidation typically means transferring federal or private student loans to another private lender. A private lender may offer lower interest rates. There are risks associated with a consolidation, including giving up a favorable interest rate on some loans, loss of repayment history, and higher payments for income-based plans where the borrower is earning more now than when the payments began.

There is a special opportunity to consolidate federal loans before December 31. The Department of Education is performing a one-time audit of borrowers' payments under PSLF and Income-Driven Repayment programs. Borrowers may consolidate student loans without losing the payment history. Retaining the history is important for public service loans and income-driven repayment plans that require ten years of payments to qualify for forgiveness. The largest number of payments made will count toward all the consolidated loans. This benefits borrowers who have long standing loans with many years of payment history and newer loans that do not.

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The Biden administration tried to provide student loan relief, but the Supreme Court struck down the proposal earlier this year. In July, the Biden administration proposed canceling $39 billion of debt for 800,000 student loan borrowers. Borrowers with income-driven repayment plans and 20 or 25 years of qualifying months of payment history are eligible. The proposal is opposed by some groups, and it is unclear if the proposal will be enacted.

Lastly, all borrowers should be aware of many loan repayment scams. Watch for solicitations that offer to suspend federal loan payments for a fee.

Please reach out to your Wealth Manager with questions about student loan repayments.