PAYING BACK YOUR STUDENT LOAN

When possible, fund your education with a grant or scholarship, which does not require you to pay money back. You should complete the Free Application for Federal Aid (FAFSA) at www.fafsa.ed.gov to see what resources are available to you.

How Do Loans Work?

You will pay interest on a loan. Interest is essentially the "rent" that lenders charge you for using their money. It is the part of repaying the loan that frequently gives borrowers the most problems.

Interest charges on a loan make the debt that you must repay larger. Any time you have a debt, the interest charges will increase your balance over time.

Loan Repayment

Imagine that you have been awarded a $1,000 student loan and that the interest rate is 5% per year. This means that every year your $1,000 loan goes unpaid, you owe an additional 5% on the balance. If you don't make any payments, after a year the loan balance increases by $50. If you don't make a payment during the second year, your balance rises by another 5% not just on the $1,000, but also on the $50 interest charged during the first year. This interest-on-interest charge is called **COMPOUND INTEREST**.

If, on the other hand, you begin paying the loan after the first year, you reduce the amount that you owe in the future. So, if after the first year you make a $100 payment, then you will have paid off the $50 in interest and reduced your $1,000 mortgage loan balance by $50. Therefore, during the second year you will pay 5% interest on $950 rather than the full $1,000. **Making these payments on time is the best way to reduce your debt**.

Compound Interest Breakdown

Year 1
owed **$1,000.00**
x 5%
+$50.00

Year 2
owed **$1,050.00**
x 5%
+$52.50

Year 3
owed **$1,102.50**

The interest for Year 2 is $52.50.
That's just a little more than the previous year.
That extra $2.50 is called **COMPOUND INTEREST.**

Year 1
owed **$1,000.00**
x 5%
+$50.00

Year 2
owed **$1,050.00**
-$100.00
$950.00
x 5%
+$47.50

Year 3
owed **$997.50**

Getting started on your payments early means you pay less in the long run. Here, making a payment as early as Year 2 made sure no **COMPOUND INTEREST** was added to the pot!

Failing to pay your debt as scheduled can hurt your credit rating, which may endanger your ability to borrow money to buy cars and homes for years to come. **Remember, loans must be repaid even if you do not complete your degree and/or program**.

Let's take a closer look at the effects of **COMPOUND INTEREST** and how you can avoid it by making regular payments.

	LaToya	**David**	**Natasha**	**Lee**
Base Loan:	$1,000.00	$1,000.00	$1,000.00	$1,000.00
Year Payment Begins:	Year 1 Immediately starts paying off $100.00 every year.	Year 2 Decides to wait a year before making payments.	Year 3 Doesn't start making payments until the 3rd year.	Doesn't make any payments the first 5 years.
Total Interest Accumulated After 5 Years of Payments	$196.09	$223.73	$245.27	$276.29
Total Owed After 5 Years	**$696.09**	$823.73 -$100.00 **$723.73**	$945.27 -$200.00 **$745.27**	$1,276.29 -$500.00 **$776.29**

Even if David, Natasha and Lee try to catch up to LaToya by matching her overall payments after year 5, compound interest leaves them short!

David, Natasha, and Lee got a deferment, or a postponement, on the debt, but their debts were growing! Even if a lender agrees not to enforce the debt (an agreement called a "forbearance"), it is getting bigger. Lee especially was running into some problems. What would happen to Lee if he didn't get around to making any payments after his forbearance was up? That's called **DEFAULTING** on the loan, and has some serious consequences!

What Are the Consequences of Default?

The consequences, which can be severe, include the following:

- The entire unpaid balance of your loan and any interest you owe becomes immediately due (This is called "**ACCELERATION**").
- You can no longer receive deferment or forbearance, and you lose eligibility for other benefits, such as the ability to choose a repayment plan.
- You will lose eligibility for additional federal student aid.
- The default will be reported to credit bureaus, damaging your credit rating and affecting your ability to buy a car or house or to get a credit card.
- Your tax refunds and federal benefit payments may be withheld and applied toward repayment of your defaulted loan (this is called "**TREASURY OFFSET**").
- Your wages will be garnished. This means your employer may be required to withhold a portion of your pay and send it to your loan holder to repay your defaulted loan.
- Your loan holder can take you to court.
- You may not be able to purchase or sell assets such as real estate.
- You may be charged court costs, collection fees, attorney's fees, and other costs associated with the collection process.
- It may take years to reestablish a good credit record.
- Your school may withhold your academic transcript until your defaulted student loan is satisfied. The academic transcript is the property of the school, and it is the school's decision—not the U.S. Department of Education's or your loan holder's—whether to release the transcript to you.

Although the consequences for **DEFAULT** are severe, they can be avoided by making early and regular payments.

Source: Federal Student Aid, an Office of the U.S. Department of Education

Paying off Your Loan

Now that we have a better understanding of loans, compound interest, and the importance of making payments on time, let's take a closer look at some repayment options and how they could affect your overall debt.

Assume you borrow $34,722 (4-year public college average tuition and fees) over four years at a 3.9% interest rate. Not including income based repayment plans that might be available to you, these would be your repayment options.

Many loans have a **STANDARD REPAYMENT PLAN**, in which payments are fixed and the loan is for up to 10 years. **GRADUATED LOAN PLANS** require payments that increase every 2 years. These loans are also for up to 10 years. In **EXTENDED REPAYMENT PLANS**, you can take up to 25 years to repay your loans. Of course, you will pay more interest with this type of repayment plan.

	INITIAL MONTHLY PAYMENT	TOTAL AMOUNT PAID	REPAYMENT PERIOD
STANDARD FIXED PAYMENTS	$350	$41,987	10 years
GRADUATED PAYMENTS INCREASE EVERY 2 YEARS	$196	$43,784	10 years
EXTENDED PAYMENTS ARE LOWER AND CAN BE FIXED OR CAN INCREASE	$181	$54,409	25 years

The higher your initial monthly payment, the quicker you'll pay off your loan, and the more money you'll save in the long run!

More information can be found at: **https://studentaid.ed.gov/sa/types/loans**