How Graduates Pay Loans

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Fixed Monthly Payments

Graduates have long paid loans using fixed monthly payment plans. The “Standard” plan that loans are automatically in at graduation contemplates repayment in fixed payments over ten years. Graduates, even graduates at high paying firms, rarely use the 10-year repayment plan. Traditionally, graduates have relied on extending their loans over twenty-five or thirty years in order to have a lower monthly payment; however, the longer the repayment period, the more interest is paid over time. Borrowers can, along with extended repayment, request that their payments be graduated lowering initial payments and increasing later payments in a systematic manner.

Income Connected Payments

Income-based Repayment—15% of income

In the fall of 2007, Income-based Repayment (IBR) was signed into law allowing graduates to link their federal lone payments solely to income and family size. An older plan called Income Contingent Repayment (ICR) allowed for payment to be linked to a combination of income, family size, and debt, and had only infrequently been used by graduates. ICR continues to be infrequently used as for many borrowers IBR and PAYE offer lower payments.

Income-based Repayment allows graduates to limit their loan payment to 15% of their disposable income. Disposable income is Adjusted Gross Income from the graduate’s tax return less 150% of the poverty index for the graduate’s family size. The amount of debt does not matter and is only involved in determining eligibility—if a graduate’s debt to income ratio is high enough that they save money when comparing Income-based Repayment to a 10-year payment plan, then they qualify, this called a partial financial hardship. No matter your occupation or employer, IBR can be used.

As payments are tied to income and not debt, it is possible for payments to be very low, not even covering the interest on loans or even calculating to zero. With payment amounts low, the length of repayment will stretch longer. To prevent graduates from having to service loans for extraordinary lengths of time, Income-Based Repayment offers loan forgiveness at the 25-year point. A graduate who has made 25 years worth of payments, including payments of zero dollars when that is what the formula has dictated, may request forgiveness. Presently this forgiveness is taxable as discharge of indebtedness income.

Pay as You Earn —10% of income

At the beginning of 2013, an improvement in the terms of Income-based Repayment became available to some graduates in the form of Pay as You Earn (PAYE). PAYE reduces the payment amount to 10% of disposable income and shortens the term for forgiveness to 20 years. This forgiveness remains subject to tax.

PAYE introduces three hurdles for graduates who seek to use it. First, graduates must have had a zero student loan balance on October 1, 2007 either because they had not take out any loans or they had already paid of prior loans (or if they had a balance they must have paid it off before taking any new post 2007 loans). Second, graduates must have at least one loan disbursement after October 1, 2011. Third, PAYE is only available on loans either initially issued by Federal Direct Lending or part of a consolidation loan issued by Federal Direct Lending.

Public Service Loan Forgiveness

Along with Income-based Repayment, 2007 brought to life Public Service Loan Forgiveness. In its present form, Public Service Loan Forgiveness (PSLF) erases the loan debt of graduates who can show that they have 120 loan payments that meet the following requirements.

- The right lender was used: For a payment to count, the graduate's loans must be held by Federal Direct Lending when the payment was made.
- The right payment plan: For a payment to count, the graduate must be using IBR, PAYE, ICR, or a Standard 10-year repayment plan.
- The right job: For a payment to count, the graduate must be working a full-time public service job in the month the payment was made

Public Service Work includes any full-time job with a governmental entity or 501(c)(3) non-profit. Full-time is the greater of 30 hours per week or what the employer considers full-time. Multiple part-time public service jobs can be considered full-time work if the total hours averages 30 or more per week.

Graduates may move in and out public service jobs, in and out of the work force, and between public and private sectors. If the graduate performs their 120 months of public service work directly after graduation without break, their loans can be forgiven in ten years. This forgiveness of public service work is *not* taxable.

What to expect from the future

Calls to change student loan repayment and interest rates have been made from both sides of the political spectrum. Some calls are to expand programs and some are to dismantle what exists. If changes are to come, they are likely to come in the reauthorization of the Higher Education Act of 1965 expected in 2014 or 2015.

What is already coming: PAYE for all

In June of 2014, President Obama charged the Department of Education to draft new regulations expanding the Pay as You Earn plan to all federal student loan borrowers regardless of when their first loan was disbursed. The regulations are due by December 2015 with the new-PAYE likely to begin in early to mid 2016.

What is uncertain

In his 2015 Budget proposal, President Obama laid out a set of policy positions on student loan repayment. He called for new-PAYE for all (with 20-year forgiveness for low-balance borrowers and 25 for high-balance borrowers), a removal of the cap on IBR and PAYE payments at the amount a graduate would pay under a 10-year standard repayment, and a limit to the amount that can be forgiven under Public Service Loan Forgiveness. The President stated that those already in repayment would be able to keep their plans; the Department of Education reiterated this statement and in private conversations with some news agencies indicated that they considered the present terms of PSLF to be part of the plans that current borrowers are using.

So far, other than the expansion of PAYE, the President's proposals are just that proposals. Any changes to the forgiveness terms and PSLF will require Congress to act and the President to sign-off on that action.

Who misses out?

Public Defenders at Private Firms

The determining factor in Public Service Loan Forgiveness is the kind of entity employing the graduate. Public defenders working for non-profits and as government employees will accrue time toward Public Service Loan forgiveness. Their counterparts doing the same work at a private firm or consortium with a public defense contract will not, even if all of their work involves indigent defense.

Some Married Graduates

The formulas for calculating IBR and PAYE begin with a graduate's tax return whether that graduate files an individual return or a joint return. For married graduates, this means that their spouse's income can influence their loan payments. Graduates may file their taxes as Married Filing Separately, but they give up deductions and credits to do so.

If both partners in a marriage have federal student loans and file a joint return, the calculated IBR or PAYE payment is split between the partners based on their share of federal student loans. In this case, graduates will typically end up with a similar family loan cost as they would if both partners filed individual returns. If only one partner has federal loans, with a dual income household and a joint tax return, the total family loan cost will be increased over each partner filing a separate return.

Payment Plans

Payment Outlook for Public Service Workers

- $125,000 student loan debt ($25,000 Subsidized Stafford, $35,000 Unsubsidized Stafford $65,000 Grad PLUS)
- $45,000 starting salary (Median starting Public Interest salary for the Class of 2011), with a 4% annual raise.
- Single Tax Filer.

Plan	First Payment	Last Payment	Total Interest Paid	Total Paid
Standard (10-year)	$ 1,475	$ 1,475	$ 52,081	$ 177,081
Extended (30-year)	$ 863	$ 863	$ 185,807	$ 310,807
Graduated (30-Year)	$ 768	$ 1,092	$ 180,612	$ 305,612
IBR (25 year forgiveness)	$ 353	$ 1,016	$ 176,842	$ 189,478
IBR w/ PSLF	$ 353	$ 527	$ 52,229	$ 52,229
PAYE (20 year forgiveness)	$ 235	$ 545	$ 88,980	$ 88,980
PAYE w/ PSLF	$ 235	$ 351	$ 34,819	$ 34,819

Payment Outlook for Small Firm Workers

- $125,000 student loan debt ($25,000 Subsidized Stafford, $35,000 Unsubsidized Stafford $65,000 Grad PLUS)
- $50,000 starting salary (Median starting 2-10 attorney firm salary for the Class of 2011), with a 4% annual raise.
- Single Tax Filer.

Plan	First Payment	Last Payment	Total Interest Paid	Total Paid
Standard (10-year)	$ 1,475	$ 1,475	$ 52,081	$ 177,081
Extended (30-year)	$ 863	$ 863	$ 185,807	$ 310,807
Graduated (30-Year)	$ 768	$ 1,092	$ 180,612	$ 305,612
IBR (25 year forgiveness)	$ 415	$ 616	$ 188,270	$ 220,713
PAYE (20 year forgiveness)	$ 277	$ 410	$ 103,869	$ 103,869