A Education Financing, Loans, and Scholarships

The desire to pursue higher education has grown steadily since the 1940s. According to the Census Bureau, approximately 5 percent of the population held a bachelor's degree in 1940. Today, that has grown to greater than 25 percent. The increase in demand for education has created an expansion in many areas, including the number of higher education schools, the development of different types of degree programs, specialization in occupations, and the overall cost of higher education.

Increasing Costs of Education

As college enrollments have swelled, increases in tuition, especially over the last decade, have been significant. Not only are there major increases in the numbers of traditional students coming straight from high school, but the numbers of those who are returning to school to "retool" and change careers have risen greatly as well. Some students are even staying in school to "ride out" an undesirable job market. A very common issue for many of these students is the need to find ways to pay for tuition, books, school fees, and the living expenses required so they may continue their education.

What is driving the increase in demand for education? Some of the main factors appear to be higher salaries and the reduced potential for unemployment. Numerous studies have shown that advanced education can lead to higher salaries as well as lower unemployment rates based on education level attained (see Exhibit A–1). However, along with additional education comes the opportunity costs associated with it: lost wages while in school and costs to attend school. Funding and repaying these educational pursuits is the primary focus of this appendix.

For some students, being accepted by their "dream college" can be a euphoric experience. The more earthbound question is: How do you pay for the education? This question clearly should be asked before applying to schools, but school endowments and additional assistance provided frequently add to the challenge of determining the full costs until college applications are accepted and the financial aid process begins. The majority of students fund their education through a combination of loans, scholarships, grants, savings, and current earnings. Loans have specific repayment terms, but scholarships and grants do not need to be repaid and thus are sometimes referred to as "free money." Yet "nothing in life is free," as the saying goes, and although there are no repayment requirements, you will have to put in some time and effort to find these scholarships.

digi – know?

A source to help is cnnmoney.com/collegecosts (a great tool that includes annual costs, estimated costs based on income levels, scholarship percentage and four-year graduation rates)

Exhibit **A–1** Annual Earnings by Level of Education and Work Status

		ALL PEOPLE		DID NOT WORK	
Characteristic	**Population Aged 25–64**	**Median Earnings**	**Standard Error**	**Median Earnings**	**Percent of Persons**
Total	159,814,440	$27,455	$22	$0	19%
Education					
None–8th grade	7,815,325	$10,271	$73	$0	37%
9th–12th grade	12,972,423	10,996	53	0	35
High school graduate	45,408,258	21,569	22	0	22
Some college	33,450,090	27,361	25	0	17
Associate's degree	13,299,842	32,602	60	0	14
Bachelor's degree	30,138,179	42,783	42	0	12
Master's degree	11,825,602	53,716	55	0	11
Professional degree	3,152,004	79,977	345	0	8
Doctorate degree	1,752,717	73,575	263	0	7

NOTE: Median earnings shown for the population aged 25–64, not the total population.
SOURCE: U.S. Census Bureau, American Community Survey, 2006–2008.

FAFSA (Free Application for Federal Student Aid)

The very first step to funding your education, whether with loans or certain grants, is completing and submitting the FAFSA (Free Application for Federal Student Aid) form. Many state and institutional aid programs also require that this form be remitted before they consider providing any type of funding. After the FAFSA has been processed, you will receive notification of your estimated family contribution (EFC). Clearly for a dependent student, the amount of parental income, assets, and college savings accounts will be important factors to determine the amount of the EFC. For an independent student, individual assets will also be carefully considered in determining eligibility for aid.

The schools that were designated on the FAFSA will receive notification that the FAFSA has been processed. The schools will take the information and prepare a financial aid package once the admission application is accepted. The goal is to evaluate each student's situation and provide the best possible selection of aid. In many cases, the aid package will not be able to cover the full cost of attendance. In addition, federal student aid may be reduced based on other aid that has been awarded (scholarships, state aid, etc.).

The financial aid package received from the school often includes a combination of grants, loans, and work-study options (see Exhibit A–2). Each of these aid types will now be evaluated with the goal of understanding which selection requires repayment and the terms of acceptance.

Key Websites for Financial Aid Information

www.finaid.org

www.fastweb.com/

http://studentaid.ed.gov

www.equaljusticeworks.org/ed-debt/students/public-service-loan-forgiveness

www.collegeboard.com/student/pay/

www.bls.gov/oco/oco20023.htm

Exhibit **A–2**
Sample Award Package

Sample Financial Aid Award Package	
Total cost of attendance	$20,000
Expected family contribution (EFC)	$ 1,823
Outside scholarship	$ 1,000
Financial need	$17,177
Federal Pell Grant	$ 3,700
State scholarship grant	$ 1,500
Institutional grant	$ 7,500
Federal Perkins Loan	$ 1,000
Federal direct loan	$ 1,477
Federal work-study	$ 2,000
Total award	$17,177

SOURCE: https://studentaid2.ed.gov/getmoney/pay_for_college/award.htm

Grants

A grant is money that is given and does not need to be repaid. It can be used to pay for education, training, books, tuition, or any school-related expenses. Students who have demonstrated financial need may receive grants. The most common type is the federal Pell Grant, which offers a current maximum of $5,550 annually. This maximum amount can change each year and has increased significantly in the past few years. Another grant that is available is the Federal Supplemental Educational Opportunity Grant (FSEOG). It can be worth up to $4,000 annually. You must receive a Pell Grant to be eligible for the FSEOG. This grant is typically provided to those who have demonstrated exceptional financial need.

The Academic Competitiveness Grant (ACG) is a relatively new grant. Eligibility for the ACG requires that you have been offered a Pell Grant. The current maximum allowable amount is $750 for the first year and $1,300 for the second year. The one main requirement to receive this grant is that the student must be enrolled in a "recognized rigorous secondary school program of study" as determined by the U.S. Department of Education. The list of qualifying schools and programs can be found on the department's website: www2.ed.gov/admins/finaid/about/ac-smart/state-programs06.html.

In addition to the federal grants, many states offer grants that are distributed through the schools' financial aid office, called institutional grants. Certain colleges and schools also provide grants to women, minority groups, and for certain degree programs to encourage enrollment.

Loans

Education loans can be a significant part of the financial aid package. These types of loans have become a significant part of the outstanding consumer debt. It has been reported by the Federal Reserve Bank of New York and the U.S. Department of Education that the total amount of student loans distributed in 2010 was more than $100 billion dollars. Additionally, they have reported that the total loan balances outstanding are expected to grow to over $1 trillion, an amount greater than the total owed nationally on consumer credit cards.*

Federal education loans that are available today originate from the Direct Loan program. Each college's financial aid office disburses the funds provided by the Department of

*http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q32011.pdf; http://nces.ed.gov

Education. The maximum interest rates and fees can change annually and are adjusted by the federal government.

Traditional student loans are typically divided into four main categories:

1. Stafford Loans.
   a. Stafford Loans were initially called the Federal Guaranteed Student Loan Program. In 1988, the loans were renamed to honor U.S. Senator Robert Stafford, based on his work with higher education.
   b. The Stafford Loan is the most frequently disbursed loan. They are typically disbursed from the financial aid office directly to the student. (*Note:* The Stafford Loan can also be disbursed through a private lender, which will be discussed later.)
   c. One key element to the Stafford Loan is how the interest accrues while the student is in school. In some cases of extreme need, the federal government will make the interest payments during the time that the student is in school and for certain grace periods. This type of loan is generally referred to as a *subsidized loan.*
   d. However, the more frequent scenario is that the interest is the responsibility of the borrower while in school and during the grace period. Two options exist for handling the interest: pay the interest contemporaneously or have the interest added to the balance of the loan. The borrower must carefully calculate the cost of allowing this interest to add on to the loan without being paid. This is commonly called negative amortization, and it occurs when the amount of the loan exceeds the original amount borrowed. This not only adds to the amount of the loan, but can extend the time for repayment. This type of loan is commonly referred to as an *unsubsidized loan.*
   e. The maximum amounts allowed for the Stafford Loans vary considerably based upon many factors, including the student's current year in school, type of schooling, subsidized versus unsubsidized cumulative amounts, and dependency status. The federal website with the most up-to-date limit information is http://studentaid.ed.gov

2. Perkins Loans.
   a. Perkins Loans are named after Carl D. Perkins, a former member of the U.S. House of Representatives from Kentucky. Mr. Perkins was an advocate for higher education, as well as a strong supporter of education for underprivileged students.
   b. The Perkins Loan is typically provided to students who have demonstrated exceptional financial need. This program is actually run by the school, which serves as the lender using money provided by the federal government. This type of loan is provided only in a subsidized form; it offers a very low interest rate, a long repayment schedule of 10 years, and a slightly longer grace period to begin repayment.
   c. Although each school's financial aid office will determine the amount each student receives, there are still annual and cumulative limits for this loan. Currently, the maximum Perkins Loan allowed is $5,500 per year for undergraduate students and $8,000 per year for graduate students. In addition, the cumulative limits are $27,500 for undergraduate loans and $60,000 for undergraduate and graduate loans combined.

3. Parent Loans (PLUS loans), formerly known as the Parent Loan for Undergraduate Students, now referred to as the PLUS loan for parents or the Grad PLUS loan.
   a. There are times when parents of dependent children want to contribute financially to help with educational expenses. If they do not currently have funds to contribute, they may apply for a loan. After July 1, 2010, all new PLUS loans are provided by the government and can be obtained only by contacting the financial aid office of the school, not a private lender. Currently, there is no maximum amount; however, the parent may only borrow amounts not covered by student's current financial aid package, up to the total cost of attending the school.
   b. One variant of the PLUS loan program is the Grad PLUS loan, which allows graduate students to borrow for educational expenses.

4. Private Student Loans (also called Alternative Student Loans). Private student loans should be considered very carefully. They tend to have higher interest rates than the government programs. In addition, the interest rates are commonly variable, which can make the payments more challenging to manage. The three most common reasons that borrowers choose private student loans are:
   a. To fund additional education expenses above the limits that the other programs provide.
   b. There is no requirement for a FAFSA form to be completed. The loan is based upon the creditworthiness of the borrower.
   c. They provide additional flexibility over the government loans to the borrower in terms of repayment or deferral while the student is in school.

In addition to traditional student loans, a new form of student aid, *social lending* (also known as *peer-to-peer lending*) has recently appeared. This newest form of student loan comes from the private sector. The basic premise is that borrowers can post relevant information and stories regarding why they need money, and prospective lenders or individuals can view the information and choose to fund these aspirations. A large majority of social lending has been in the form of short-term lending, six months to three years. Thus, student lending has been a little slower to catch on primarily due to the time frame for repayment. However, a few websites have started to attract interest in the characteristic longer repayment periods. Examples of social lending sites are www.prosper.com, www.lendingclub.com, and https://www.greennote.com/.

The National Center for Education Statistics, a division of the U.S. Department of Education, gathers statistics on financial aid that has been awarded. For the most current year reported, over 65 percent of all undergraduate students receive some form of financial aid with $9,100 being the average amount of aid (see Exhibit A–3).

DEFAULT RATE ON STUDENT LOANS Default rates on student loans have increased dramatically for students who have attended public, private, and for-profit schools. The likely cause for loan defaults appears to be the challenging economic times experienced in

Exhibit **A–3** Percentage of Undergraduates Receiving Financial Aid and the Average Amount Received, by Type and Source of Aid and Selected Student Characteristics: 2007–08

					FEDERAL		
Student Characteristic	**Any Aid**	**Any Grants**	**Any Student Loans**	**Parnet PLUS Loans[1]**	**Any Financial Aid**	**Any Grants**	**Any Loans**
All undergraduates	65.6%	51.7%	38.5%	3.8%	47.0%	27.6%	34.7%
Full-time/full-year	79.5	64.4	52.9	7.2	62.2	33.0	49.1
Part-time or part-year	56.6	43.5	29.2	1.5	37.1	24.0	25.3
Average amount of financial aid							
All undergraduates	$9,100	$4,900	$7,100	$10,800	$6,600	$2,800	$5,100
Full-time/full-year	12,700	7,100	8,000	11,400	7,900	3,700	5,400
Part-time or part-year	5,800	2,700	6,100	8,700	5,100	2,100	4,700

[1]Not included in "Any student loans" because these are loans that are taken out by the parents of undergraduate students.

SOURCE: U.S. Department of Education, National Center for Education Statistics (2009). *2007–08 National Postsecondary Student Aid Study (NPSAS:08) Student Financial Aid Estimates for 2007–08,* Selected Findings.

recent years, yet it may also be an indication of how easily loans can be obtained without the careful consideration of the costs associated with repaying them.

REPAYING YOUR LOANS Acquiring the funding to attend school is only the beginning of the financial aid process. The much more lengthy part of the process is the repayment. Many of the different types of loans have differing *grace periods* until the first payment is due.

- Stafford Loans historically require repayment to begin six months after the student no longer attends school or has dropped below half-time enrollment. Recent legislation eliminates the six-month grace period on loan repayment after a student graduates or drops below half-time enrollment for Stafford Loans originating between July 1, 2012, and July 1, 2014.
- Perkins Loans require repayment to begin nine months after the student no longer attends school or has dropped below half-time enrollment.
- Federal PLUS Loans, which are typically taken out by parents or graduate students, require repayment to begin 60 days after the loan is disbursed. The repayment can sometimes be deferred while the student is in school, but the interest will still accrue, much like an unsubsidized Stafford Loan.

Once repayment begins, there are numerous plans to repay the money. The most common are as follows:

- *Standard repayment.* This is still one of the most common repayment plans. A fixed monthly amount is paid for a loan term not to exceed 10 years.
- *Extended repayment.* Students elect this option to lower the monthly payment amounts. The length of the loan is up to 30 years. One point to consider is the increase in the amount of total interest that will be paid over this time period.
- *Graduated repayment.* This repayment plan allows newly graduated students to make lower payments as they start their careers and then slowly increase the amount of the monthly payment over the life of the loan.
- *Income-contingent repayment.* This repayment plan is designed to provide the borrower with some leniency in terms of the amount to be repaid. The monthly payments are recalculated annually, based on the most recent reported income as well as the total debt amount. The length of the loan is up to 25 years. If the borrower follows through with the entire repayment plan, any remaining balance will be forgiven. One thing to keep in mind: The forgiven amount will be considered taxable income to the borrower.
- *Income-sensitive repayment.* This repayment plan is similar to the income-contingent repayment plan. The income-sensitive plan allows the borrower the option to set monthly payments based on a percentage of gross monthly income. The length of this loan is limited to 10 years.
- *Income-based repayment (IBR).* This repayment plan is currently calculated as 15 percent of discretionary income. To calculate discretionary income: take your adjusted gross income (see Chapter 3) and subtract 150 percent of the poverty line for your state and family size. The plan provides a reduction to the previously discussed income-contingent and income-sensitive repayment plans. This program provides forgiveness beyond a 25-year time period, if all prior payments were made on time. This newer repayment plan was included in the College Cost Reduction and Access Act of 2007.
- All six plans are available for student loans, but only the first three plans are available for parent loans.

Did You Know?

Recently enacted legislation has further reduced the requirements for the IBR program to cap monthly payments at 10 percent of discretionary income and provide for forgiveness after 20 years starting in 2014. In addition, the president indicated his interest in speeding up the adoption even sooner, in a "pay-as-you-earn" proposal.

CONSOLIDATION LOAN Another attractive repayment option for borrowers is the option to combine their student loans into one loan, and thus one convenient monthly payment. Just like the extended repayment plan, this method will lower the total monthly payment amount and increase the length of the loan up to 30 years. Remember to carefully consider the increase in the amount of total interest that will be paid over this time period. Unless you are struggling to make the individual loan payment amounts, consolidating loans typically presents no advantage other than ease of administration (i.e., one payment).

In addition, most federal consolidated loans can't be refinanced to obtain a lower interest rate in the future. Private loans may provide a lower future interest rate based on an improved credit situation for the borrower.

LOAN DEFERMENT Loan deferment allows you to temporarily stop making payments on existing student loans. The most common reasons for the deferments are reenrollment in school, demonstrated financial hardship, unemployment, and military deployment.

LOAN FORGIVENESS Loan forgiveness can be an option to have all or a portion of your student loan forgiven (paid off on your behalf). The most common forgiveness options are for volunteer work and public or military service.

The Public Service Loan Forgiveness Program was established by the College Cost Reduction and Access Act of 2007. Under this program, if the borrower makes 120 qualifying loan payments on eligible federal direct loans while working full-time in a qualifying public service position, the balance of the federal direct loan will be forgiven. Eligibility for the public service position includes working for the government, an organized nonprofit organization, service in the Peace Corps or AmeriCorps, or even working for a private organization that provides public service.

Many of the organizations mentioned also have specific programs to allow a portion of the loan to be canceled even sooner. For example;

- The Peace Corps provides partial cancellation of Perkins Loans (15 percent for each year of service, up to 70 percent in total).
- AmeriCorps volunteers who serve for 12 months can receive $4,725 to be used toward cancellation of their loan.
- Military service also offers a cancellation program. Students who enlist in the Army National Guard may be eligible for up to $10,000 of cancellation of student loans.
- A variety of other programs are available for teachers who serve in low-income areas, work with students with disabilities, or work in high-need schools. Law students can also find loan forgiveness programs for serving with nonprofit or public interest organizations. Medical students may also be eligible for loan forgiveness for performing certain medical research, working in low-income or remote areas. It is strongly advised that you review each program's requirements for eligibility, conditions of employment, and repayment options to ensure that you are a good candidate for the program.

LOAN CANCELLATION (DISCHARGE) In very special circumstances, student loans may be permanently canceled. The most common situations include:

- Death.
- Total and permanent disability.
- Fraud by the school (e.g., in the event of forged promissory notes, the school owes the lender a refund).
- Bankruptcy (very rare because the bankruptcy court would need to establish that repayment would create a significant hardship).

Scholarships

Scholarships, just like grants, do not have to be repaid. Scholarships do have to be reported on the FAFSA or to the financial aid office, if awarded later. Big-name scholarships (e.g., Coca-Cola and Prudential) receive an extraordinary amount of applicants, but there are also many other places to consider. Examples include rotary clubs, churches, professional associations, and local or regional businesses. Although the reward amounts may be smaller, they might add up to big dollars and some may have the benefit of being renewed in subsequent years. Be aware of the deadlines for each scholarship. Carefully research the type of candidate they are interested in helping and tailor your information to show how you qualify, much like you would do with a resume. Some websites to consider are www.scholarships.com, www.collegeboard.org/scholarships, www.collegenet.com,and www.fastweb.com.

Key Websites for Scholarships

www.scholarships.com

www.collegeboard.org/scholarships

www.collegenet.com

www.fastweb.com

Work–Study programs

Aside from loans, there are other ways to earn money to pay for educational expenses. The Federal Work–Study Program is available at many schools. It is commonly included as part of the financial aid package. Students who decline this option are expected to fund the amount from another source. Some students like the options that the program offers: they can work on campus without needing additional transportation, apply to a variety of positions that interest them, and get to know faculty and staff who they may want to work with on teaching or research assignments. Some students decline the option in favor of higher paying jobs off-campus. You should consider very carefully the opportunity costs with this decision: fuel costs, commuting time, wardrobe needs.

Navigating the process of financing an education can be very daunting and time-consuming,but the rewards are very high. Finding the money for school and repaying the loans in a manner that works best for your personal situation can lead to long-term success, improved credit scores, higher salaries, and a lowered potential for unemployment.