BORROWING STRATEGIES

Make Smart Decisions When Borrowing Money for Law School

August 2017

Jeffrey Hanson
Education Services

Vanderbilt Law School
Majority of law students ...

... now graduate with an EDUCATIONAL MORTGAGE
You can be successful …

- In repaying this “mortgage”
- Without having to sacrifice your career aspirations or the achievement of your other financial and personal goals

But, you must make **smart, strategic, and well-informed** decisions about how you finance your education!
Decisions to be made ...

- Should you borrow private student loans rather than federal student loans if you could get a lower interest rate?
- Should you pay the interest on your loans as it accrues while in school?
- Should you borrow the minimum amount you need to achieve your goals?

You need to understand how federal student loans differ from other forms of debt (including private student loans) to make informed decisions about these questions.
Let’s talk about …

.. the “elephant in the room!”

“DEBT”
you’re “boxed into a corner” from a financial perspective!
Why are you in that “corner”?

- Because payments are based on the amount you owe—your **DEBT**—not on your ability to repay that debt.

- Your monthly payment is equal to the amount required to pay off all the debt (plus interest) in a given period of time.

*You must make that payment each and every month whether you can afford it or not!*
Debt puts you at risk and limits your options, financially

In other words, it “boxes you into a corner”

- Puts you at risk of having to miss the payment (e.g., due to loss of income or unexpected expense)

  Missing the payment will damage your credit!

- Impacts your ability to make other choices financially (e.g., changing jobs or taking time off, investing for retirement, buying a house)

  The more you owe, the more you must pay each month on your debt leaving less money for other purposes!
Not all debt is the same ...

What’s the difference?

“DEBT”
Credit cards

“Debt”
Home mortgage, private student loans

“debt”
Federal student loans
With federal student loans...

... you don’t need to be “boxed” into that corner!
In essence, federal student loans offer ...

Choice

Flexibility

Safety
How are federal student loans different?

- Payments can be based on your income rather than on the amount of your debt
  - Payments can be equal to less than 10% of your household’s monthly adjusted gross income – and that means you could have more than 90% of your income for everything else!

- Negative amortization is allowed
  - Monthly payment can be less than interest that accrues that month thereby providing more flexibility and safety in repayment—this is not allowed with any other form of consumer debt

As such, federal student loans need not “box you into a corner financially” – you have options!
Federal student loans also provide ...

- Payment relief options if you need to postpone repayment when experiencing financial hardship
  - **Deferment**
  - **Forbearance**

- Forgiveness on portion of unpaid debt
  - **Income-Driven Repayment (IDR) plans** – Balance forgiven after 20-25 years of qualifying IDR payments
  - **Public Service Loan Forgiveness** (PSLF) – Balance on Direct Loans forgiven after 120 months of qualifying public service—*but beware of the risks*

---

Vanderbilt Law School also offers a Loan Repayment Assistance Program (LRAP) to eligible alumni working in public service.
What is the “cost” of debt?

Making an informed decision requires understanding the costs of that decision.
Debt always has two (2) costs ...

- **Direct Cost**
  - Interest
  - Fees

- **Opportunity Cost**
  - Value of what you forgo each month to repay debt
“Opportunity Cost”

- It’s about **trade-offs**
- You have alternatives when you use your scarce resources (*i.e.*, time and money)
- Ask yourself:
  - “Am I putting my time/my money to its *‘highest’* and *‘best’* use?”
Another factor to consider ...  

**Simple vs. Compounding Interest**

- **Simple interest**
  - LINEAR increase over time—*it is NOT being “capitalized” (not being added to the principal balance)*
  - Interest generally accrues as “SIMPLE” interest on federal student loans in-school and during repayment  

- **Compound interest**
  - EXPONENTIAL increase over time—*it is being “capitalized” (added to the principal balance)*
  - Interest is compounding (perhaps as often as daily) on investments so value is GROWING exponentially!
So what should you do ...

... when “mapping your course” financially in law school?
Should you borrow private loans?

You have the right to do so, BUT:

- You will lose the **choice**, **flexibility** and **safety** provided by federal student loans including the income-driven repayment options.

- You may lower the **direct cost**, but will increase the **opportunity cost** (likely will have to repay the private loan faster, and therefore, have a higher monthly payment to qualify for the lower interest rate).

As such, you may be giving up more than you are gaining if you borrow a private loan – so exercise caution – be fully informed – investigate ALL the differences -- don’t focus solely on the interest rate!
Should you pay the accruing interest while in school?

*Interest on unsubsidized federal loans accrues as **SIMPLE** interest while in school!*

- It is **NOT** compounding while you are in school!
- Interest that accrues while you are in school “**capitalizes**” (i.e., is added to the principal) only when loan(s) enter/re-enter repayment.
- Therefore, it is better to reduce amount you are borrowing rather than paying the accruing interest if you have funds to pay that interest while in school—you will get more “bang for your buck!”
Did you know?
You can return unused loan funds!

If you return loan funds within 120 days of disbursement:

- Total amount owed is reduced
- Interest and fees charged on loan amount returned are reversed

Contact the Vanderbilt University financial aid staff for more information
Should you borrow the minimum amount possible?

**YES, but:**

- Borrow only what you **NEED** to achieve your goal(s).
- Make sure you differentiate between **NEEDS** and **WANTS**.
- Understand what financial aid is intended to cover—**will it be enough to achieve your ultimate goal?**
- Consider all costs you’ll incur to achieve your goal(s)
  - How will you cover your living expenses during non-enrollment periods (e.g., summer break)?
  - How will you pay for your Bar Exam expenses?
“The 39-month Budget”

Other costs to consider ...

- Bar results typically are known about 39 months after you begin law school.
- Financial aid is only available for 27 of those 39 months (9 months of each academic year).
- How will you pay for the other 12 months of expenses (living expenses, bar prep costs, relocation, etc.)?

- *Try not to use credit cards or private bar study loans*
- *Plan your 39-month budget strategically*
Why borrow the minimum?

... because when you borrow loans you are spending your FUTURE INCOME!
Be Strategic!

Plan you borrowing wisely;
don’t leave it to chance!
How did you decide on how much to borrow?

Did you?:

- Borrow amount indicated on your Financial Aid Award notice?
- Borrow maximum amount possible?
- Estimate your budget and borrow only what you needed?
## How much could you owe?

### A Vanderbilt Law School Example

#### Vanderbilt Law School Class of 2017

<table>
<thead>
<tr>
<th>Average student loan borrowing</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Unsubsidized Student Loan (DUSL) = $61,500</td>
<td>$117,992</td>
</tr>
<tr>
<td>Direct Grad PLUS Loan (PLUS) = $56,492</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Estimated capitalized interest at repayment</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Unsubsidized Student Loan (DUSL) = $7,700</td>
<td>$16,000</td>
</tr>
<tr>
<td>Direct Grad PLUS Loan (PLUS) = $8,300</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Estimated total debt at repayment (12/1/2017)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$133,992</td>
<td></td>
</tr>
</tbody>
</table>

#### Interest Rates:

<table>
<thead>
<tr>
<th>Interest Rates:</th>
<th>DUSL</th>
<th>PLUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-2015</td>
<td>6.21%</td>
<td>7.21%</td>
</tr>
<tr>
<td>2015-2016</td>
<td>5.84%</td>
<td>6.84%</td>
</tr>
<tr>
<td>2016-2017</td>
<td>5.31%</td>
<td>6.31%</td>
</tr>
<tr>
<td><strong>2017-2018</strong></td>
<td><strong>6.00%</strong></td>
<td><strong>7.00%</strong></td>
</tr>
</tbody>
</table>

Borrowing the Minimum
To borrow the minimum ...

- “BYOB”
- “SOS”
- Consider “opportunity costs”
- Manage your finances wisely
- Manage your loans responsibly
“BYOB”

Build Your Own Budget!
What is your budget?

Is it:

- **Cost of Attendance** (COA)?
- Your resources vs. your expenses?
- A spending plan?
Cost of Attendance (COA)

“Student Expense Budget”

- Calculated by Financial Aid Staff
- Includes both fixed educational costs and living expenses for academic year
- **Total financial aid cannot exceed COA**
- Not prescriptive and NOT your budget

<table>
<thead>
<tr>
<th>COA Elements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tuition</td>
</tr>
<tr>
<td>Fees</td>
</tr>
<tr>
<td>Books and Supplies</td>
</tr>
<tr>
<td>Housing</td>
</tr>
<tr>
<td>Food</td>
</tr>
<tr>
<td>Transportation</td>
</tr>
<tr>
<td>Clothing</td>
</tr>
<tr>
<td>Misc. Personal Expenses</td>
</tr>
</tbody>
</table>
### “Building Your Own Budget”

<table>
<thead>
<tr>
<th>Expense (9 months) 2017-2018</th>
<th>“Cost of Attendance”</th>
<th>Your Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tuition</td>
<td>$54,526</td>
<td></td>
</tr>
<tr>
<td>Activity and Recreation Fees</td>
<td>$457</td>
<td></td>
</tr>
<tr>
<td>Books and supplies</td>
<td>$1,842</td>
<td></td>
</tr>
<tr>
<td>Housing (rent, mortgage)</td>
<td>$11,160 ($1,240/month)</td>
<td></td>
</tr>
<tr>
<td>Utilities (electricity, phone, etc.)</td>
<td>$4,248 ($472/month)</td>
<td></td>
</tr>
<tr>
<td>Food (groceries, eating out, etc.)</td>
<td>$2,070 ($230/month)</td>
<td></td>
</tr>
<tr>
<td>Miscellaneous personal [includes health insurance, clothing, entertainment, personal care (haircuts, cosmetics, etc.) and other miscellaneous personal expenses]</td>
<td>$5,436 ($604/month)</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong> (includes $1,162 in loan fees)</td>
<td><strong>$80,901</strong> (L/E = $2,546/month)</td>
<td>$</td>
</tr>
</tbody>
</table>
“The 39-month Budget”
Other costs to consider …

- Bar results typically are known about 39 months after you begin law school.

- Financial aid is only available for 27 of those 39 months (9 months of each academic year).

- How will you pay for the other 12 months of expenses (living expenses, bar prep costs, relocation, etc.)?
  - *Try not to use credit cards or private bar study loans*
  - *Plan your 39-month budget strategically*
“Saving on Spending” means making good choices!

Think about your spending, are you:

- Sharing the cost of housing with one or more roommates OR living alone?
- Bringing food/beverages from home OR buying them at school?
- Shopping for new clothes, eating out in restaurants, taking vacations or making weekend trips to get away, going to sporting events, etc.?

YES!

BUT, be mindful how much you spend on these things—that money could be saved for future uses such as bar prep costs—consider the “opportunity costs”.
Get your financial “ducks in a row”!
Managing Your Finances in Law School

- Follow your budget plan
- Manage your loans responsibly
- Keep accurate financial records
- Develop and maintain good credit
Don’t run out of funds!

- Financial aid funds are disbursed once each term – **budget accordingly**

- Consider opening a savings account to “hold” your funds until needed – **then “pay yourself” each month**

- Contact the financial aid staff immediately if you are having financial challenges
Managing Your Loans

Start now! Take control! Plan ahead!
Managing Your Loans

- Understand the loan terms
- Don’t ignore mail from loan servicer(s)
- Promptly report changes in your address, etc., to loan servicer(s)

**Establish online access to your account with your loan servicer(s)**

- Meet all other borrower responsibilities
- Request deferments/forbearance if needed to postpone repayment
- Repay all that you owe on time
NSLDS.ed.gov

“Financial Aid Review”—A Useful Resource

To access, enter your FSA ID:
- Username
- Password

Select the “Financial Aid Review” option to view a summary and details of your federal student loans regulated by the U.S. Department of Education.
# Plans fall into two (2) categories

**Original Plans**
- Payment based on **DEBT**
- Plans
  - Standard
  - Graduated
  - Extended *(fixed)*
  - Extended *(graduated)*

**Newest Plans**
- Payment based on **INCOME**
- Plans
  - Revised Pay As You Earn *(REPAYE)*
  - Pay As You Earn *(PAYE)*
  - Income-Based Repayment *(IBR)* – 2 options
  - Income-Contingent Repayment *(ICR)*
## Payment Plans

**Payments Based on DEBT**

<table>
<thead>
<tr>
<th>Plans</th>
<th>Payment Structure</th>
<th>Term</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard</strong> <em>(default plan)</em></td>
<td>Fixed payments <em>(do not change)</em></td>
<td>10 years* <em>(up to 30 years on Consolidation Loans)</em></td>
</tr>
<tr>
<td><strong>Graduated</strong></td>
<td>Payments increase in graduated steps every 2 years</td>
<td>10 years* <em>(up to 30 years on Consolidation Loans)</em></td>
</tr>
<tr>
<td><strong>Extended</strong> <em>(fixed)</em></td>
<td>Fixed payments <em>(do not change)</em></td>
<td>25 years</td>
</tr>
<tr>
<td><strong>Extended</strong> <em>(graduated)</em></td>
<td>Payments increase in graduated steps every 2 years <em>Interest-only payments for first 2 years</em></td>
<td>25 years</td>
</tr>
</tbody>
</table>

- Payments are based on an **amortization schedule**— must fully repay all the debt in the maximum repayment term of the loan
- Monthly payment must at least equal the accrued interest each month— "**negative amortization**" is NOT permitted in these plans

** Must have more than $30,000 in Direct/FFEL Loans to use EXTENDED plans to repay Direct/FFEL Loans
# Payment Plans

Payments Based on **INCOME**

<table>
<thead>
<tr>
<th>Plans</th>
<th>% of Disc. Income</th>
<th>New Borrower</th>
<th>PFH Required</th>
<th>Forgiveness (taxable benefit)</th>
<th>Subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>REPAYE*</td>
<td>10%</td>
<td>NO</td>
<td>NO</td>
<td>20/25 yrs (UG only/UG&amp;Grad)</td>
<td>All loans (No time limit)</td>
</tr>
<tr>
<td>PAYE*</td>
<td>10%</td>
<td>YES</td>
<td>YES</td>
<td>20 yrs</td>
<td>Sub. only (up to 3 yrs)</td>
</tr>
<tr>
<td>IBR for New Borrowers</td>
<td>10%</td>
<td>YES (New borrower as of 7/1/2014)</td>
<td>YES (payment capped)</td>
<td>20 yrs</td>
<td>Sub. only (up to 3 yrs)</td>
</tr>
<tr>
<td>IBR</td>
<td>15%</td>
<td>NO</td>
<td>YES</td>
<td>25 yrs</td>
<td>Sub. only (up to 3 yrs)</td>
</tr>
<tr>
<td>ICR*</td>
<td>20%</td>
<td>NO</td>
<td>NO</td>
<td>25 yrs</td>
<td>NO</td>
</tr>
</tbody>
</table>

* Only Federal **DIRECT** Loans are eligible for this plan (**FFEL loans must be consolidated to be eligible for REPAYE, PAYE and ICR**)
To “Log In” enter your FSA ID:
- Username
- Password

Then select the “Repayment Estimator” from the tools and calculators that are available on the Welcome Screen.
### Sample Monthly Payments

**Assumed Amount Owed = $134,000**

**Assumed Interest Rate = 6.3%**

<table>
<thead>
<tr>
<th>Plans</th>
<th>AGI $50,000</th>
<th>AGI $120,000</th>
<th>AGI $180,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard (10 yrs)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>ALL = $1,508</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Graduated (10 yrs)</td>
<td></td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $865</td>
<td>120&lt;sup&gt;th&lt;/sup&gt; = $2,595</td>
</tr>
<tr>
<td>Extended Fixed (25 yrs)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>ALL = $888</td>
<td></td>
</tr>
<tr>
<td>Extended Graduated (25 yrs)</td>
<td></td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $703 (interest only)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>300&lt;sup&gt;th&lt;/sup&gt; = $1,310</td>
<td></td>
</tr>
<tr>
<td>REPAYE (10%)</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $266</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $849</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $1,349</td>
</tr>
<tr>
<td></td>
<td>300&lt;sup&gt;th&lt;/sup&gt; = $1,078</td>
<td>175&lt;sup&gt;th&lt;/sup&gt; = $1,770</td>
<td>108&lt;sup&gt;th&lt;/sup&gt; = $2,034</td>
</tr>
<tr>
<td>PAYE (10%)/IBR for NEW Borrowers (10%)</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $266</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $849</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $1,349</td>
</tr>
<tr>
<td></td>
<td>240&lt;sup&gt;th&lt;/sup&gt; = $817</td>
<td>179&lt;sup&gt;th&lt;/sup&gt; = $1,508</td>
<td>124&lt;sup&gt;th&lt;/sup&gt; = $1,508</td>
</tr>
<tr>
<td>IBR (15%)</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $399</td>
<td>1&lt;sup&gt;st&lt;/sup&gt; = $1,274</td>
<td>Not eligible (no PFH)</td>
</tr>
<tr>
<td></td>
<td>300&lt;sup&gt;th&lt;/sup&gt; = $1,508</td>
<td>128&lt;sup&gt;th&lt;/sup&gt; = $1,508</td>
<td></td>
</tr>
</tbody>
</table>
For more information...

- Contact the financial aid office
- Contact your loan servicer(s)

**Online resources:**
- Federal student loans: [StudentAid.gov](https://StudentAid.gov)
- Federal student loan repayment: [StudentLoans.gov](https://StudentLoans.gov)
- “Repayment Estimator”: [StudentLoans.gov](https://StudentLoans.gov)
- Federal Direct Consolidation Loans: [StudentLoans.gov](https://StudentLoans.gov)
- National Student Loan Data System: [NSLDS.ed.gov](https://NSLDS.ed.gov)
- Public Service Loan Forgiveness Program (PSLF):
  - Online at: [StudentAid.gov/PublicService](https://StudentAid.gov/PublicService)
  - Call **Fedloan Servicing** at: 1-855-265-4038
TAKE CONTROL OF YOUR FINANCES

Be smart about your borrowing; it will bring you greater success!

Jeffrey Hanson
Education Services

Vanderbilt Law School