Q&A responses about student debt | September 2012

MINNESOTA'S PRIVATE COLLEGES

What has changed in conversations with families when it comes to debt?		
Carol Stack	**Kris Roach**	**Stuart Perry**
What has really changed is that 10 years ago families didn't ask many questions about debt — for themselves or their student. Many families could access equity in their homes to finance a college education, and I don't think they viewed it necessarily as debt, for many it was the home equity ATM. Now there's recognition that the bulk of the money needed to cover education costs will come from income and to the extent income doesn't cover it, they have to look at borrowing. Ten years ago you would most likely hear some objection to the idea of student loan debt for their children. That conversation has now changed to one where we're talking about the student loan debt being a reasonable amount. There's a recognition that students are beneficiaries; it is reasonable to ask the students to help pay for part of their education and for most students the only way to do that is through loans.	While borrowing excessively is not what we want anyone to do, we acknowledge with students and parents that borrowing is a fact of life. If you think about it, there are three ways to pay for the student/parent portion of an education — wherever you go to school: 1) save money and write a check from past earnings, 2) write a check from current earnings and 3) borrow from future earnings. Most of us have not been able to save much and most of us are unable to simply write a check out of our monthly cash flow to pay for an education…and that means we have to borrow from future earnings. We also spend significant time talking with families about the value of a college education…including the intangible things one gains from a great private college education. Increasingly we are also sharing strategies with student and parents that may help to minimize debt: 1) Don't stay in the most expensive residence hall (or in a single room) and don't select the most generous meal plan…choose a living situation that minimizes expenses. 2) Work hard over the summer and during breaks and *save* money…plan to use that money to help pay the bill. 3) Make wise lifestyle choices…students and parents may have to sacrifice things to help pay for a college education. 4) Consider your options for purchasing books and other college materials…there are many different options today that can help manage these expenses. 5) Pursue local and regional scholarships…many organizations have scholarships available that go directly to help the student pay his/her bill and/or reduce the amount of money the student needs to borrow. 6) Remember that when the student goes off to college, certain expenses at home decrease (gas, food, athletic or music fees or the constant extraction of cash that comes with teenagers) which should help to generate some cash to help pay out-of-pocket for college expenses.	It seems that the recession and related fallout (e.g. "Take Back Wall Street," housing bubble, etc.) have raised the public's sensitivity to any kind of debt. So we have a few more families, compared to the 1990s and early 2000s, expressing concerns about their son or daughter's current or potential indebtedness. Our response to these concerns includes some common themes. We explain that student loans can be viewed as "good debt," or an investment in oneself — an appreciating asset. We also point out that CSB/SJU graduates predominantly go on to successfully repay their loans, as measured by our federal loan cohort default of just over 1% at CSB and 2% at SJU. The conversation gets more difficult when, for whatever reason, a substantial amount of private loan funding is tapped to cover what merit- and need-based aid does not. We have a financial aid awarding process that includes a loan offer in just about every financial aid package of those students who apply for need-based aid. And I think that's important. Student employment and loans are referred to as the "self-help" components in a financial aid package. We expect most students who demonstrate financial need to participate in student employment and to borrow to help finance their education. The philosophy here is that the primary beneficiary of the education should participate in financing that education. There's a greater likelihood that the student will take the college experience seriously if they have some "skin in the game."

How can families determine what is a reasonable amount to borrow?		
Carol Stack	**Kris Roach**	**Stuart Perry**
I wish I could say there's a simple worksheet to figure out what is reasonable for any given family, but there isn't. Most American families are not very good at talking about money. To figure out a real amount to borrow, you need to sit down with a sheet of paper, a list of monthly expenditures and a calculator. And then you need look at your income every month and how you are spending funds — look at that closely to figure out if there's anything discretionary and look where the tradeoffs would be in terms of diverting any income to your child's education costs. Recognize that if you borrow it that you'll pay for it, so lowering what you need to borrow is to your advantage. Parents need to talk with their students about debt. My co-author Ruth Vedvik and I are pretty adamant that students set a cap on their debt, with the $8,000 debt challenge — that students take out no more than $8,000 in undergraduate student debt per year. So that's $32,000 or less for four years. At that amount, students can do their loans almost exclusively in federal student loans, which is a much better way to go: The rate is fixed and there are multiple repayment plans. The other reason we chose $32,000 is if we were to walk down the street and ask some financial advisors, their solution would be that a student should take out no more in student loans than they expect to earn in the first year after graduating. Since the average college graduate makes around $32,000 to $33,000 a year, we recommend they keep it below that.	Each family has its own comfort level with borrowing; what is reasonable for one family may be very different for another. Parents and students are encouraged to talk about borrowing in a candid manner prior to making a college selection decision. An often talked about rule of thumb is that students should not borrow more than they would earn in their first year of employment. If, for example, someone starting as a teacher makes $32,000 a year, then the student shouldn't borrow more than $32,000 as an undergraduate. That's $8000 per year. The federal student loan aggregate limit is currently $31,000. If students limit their borrowing to the federal level, that would seem to be reasonable. There are some situations in which students find themselves where they need to borrow more than the federal student loan aggregate limit. This means that the student is choosing to pursue private or alternative loans funds. Students should be very careful when selecting a private or alternative loan as not all loans are created equal. And, students should consider their potential earning power versus total loan indebtedness and monthly loan payments upon graduation and consider those payments within the context of a budget. For a variety of reasons, some parents choose to borrow their portion of the tuition payment. The Federal Parent Plus loan is a reasonable vehicle for borrowing and it can be a real life-saver for parents experiencing challenges. Parents are also advised to think about the repayment of s loan(s) and how that fits into their overall family budget.	There are several rules of thumb for this question. One that comes to mind is to limit student loans to an amount equivalent to the average starting salary for the desired post-graduation occupation. Another is to limit the monthly loan repayment to no more than 10% of post-graduation income. If a student borrows the maximum federal Direct Loan each year, and assuming he or she graduates after four years, the amount borrowed is $27,000 and the monthly repayment is around $300. I think most experts would agree that this is a manageable amount for a liberal arts college graduate. The challenge, however, for many liberal arts college students is keeping their cumulative borrowing at or around this level.

How can families choose wisely when it comes to borrowing for college?		
Carol Stack	**Kris Roach**	**Stuart Perry**
As a family, you have to put several things together. The choice of a college shouldn’t only be about cost; cost should be one of the factors. For the family, in conversations with financial aid and admisson people, look for a college that is the best value and fit for the student. You want to look at whether the college has the academic program, the extracurricular activities and the values that resonate with the family. Working with the financial aid people, their goal is to put a scenario together that works for the family. Speaking to the college, I’d also ask about the average student loan debts and their default rates. And what happens to their students after graduation — that is a part of a larger conversation. College shouldn’t be free. Just as we pay for other goods and services, we pay for college. Maybe that means for some families that they need to alter how they spend some of their discretionary income, putting off a car purchase or vacation. It is easy to get student loans and to get the loan for the full amount of attendance and use it for other things than your education. But when you graduate, you are going to have to make a monthly loan payment. Students often haven’t had to deal with the reality of that kind of financial commitment. When you graduate, the very first item to tend to in your budget will be your student loan debt. So if you don’t need it don’t do it: That means don’t use student loans funds to pay for the vacation in Cancun or a new car. It is terribly tempting and it is too easy. The problem is just what the old saying says — at some point you are going to pay the piper. Staggering loan debt can be any amount, because it is about the circumstances of the person who has that debt. Students need to be very intentional and disciplined in taking out student loans and understanding the implications for their lives. Just because it is not $100,000, it doesn’t mean it won’t have an impact on the way they lead their lives.	Students and parents have to weigh the value of an education against the reality of the student’s life without that education and all of that has to be considered in light of their financial circumstances and risk tolerance. Families should also take the time to investigate and thoroughly understand the terms of the loans they are considering. This will require some work on the part of the family but it is better to be diligent in the beginning than caught with a difficult loan situation in the end.	Following the rules of thumb mentioned above would be a good start. To the extent possible, relying only on federal loans is also a good idea. Unfortunately, federal student loans have relatively low annual limits compared to the cost of most private colleges: $5,500 for first-year students, $6,500 for second-year students, and $7,500 for third and fourth-year students. These limits have not changed for several years, and we all know where the cost of college is headed. If a student must access private loans, they would be well-advised to borrow the minimum needed to get by . . . and live a “college student” lifestyle, which I see less evidence of these days. These loans are not going away, even under a bankruptcy scenario, so keeping good records is also important. To *be able* to choose wisely, it’s easier when the parents of a college-bound kid have chosen wisely when their child was young by opening and contributing regularly to some type of college savings vehicle. Without college savings, or a strong income from one or both parents, postsecondary options become more limited.

Other Comments		
Carol Stack		
College is a complicated thing, involving both academic content, critical thinking skills, social development, physical development, and all the things that involve learning to be an adult on your own. The stakes are high. So Ruth Vedvik and I have a preference for small liberal arts colleges that are focused on their mission of providing an undergraduate education — that's what they're all about. And a private liberal arts college doesn't necessarily involve more debt. Financing a college education is not rocket science and it is not unknowable. You can understand this. It means you may have to have some conversations that may be a little uncomfortable. But there is no reason that financial aid and financing college has to feel like something like managing derivatives. It is loaded with acronyms, but the process is relatively simple.		