EPISODE 338

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[INTRODUCTION]

[0:01:38]

FT: College Week continues on So Money everyone. I hope you're enjoying this themed week. Today, a very special and important guest as we dive into college and affordability and student loans. Our guest today is a nationally recognized expert on the topic of student financial aid scholarships and student loans.

His name is Mark Kantrowitz. You may have seen his name quoted in the media often. He is my go-to expert, my go-to resource when it comes to learning more about student loans. Mark aims to deliver practical information, advice and tools and resources to students and their families so that they can make informed decisions about planning and paying for college.

In the last five years, he's been quoted in more than 5,000 newspaper and magazine articles. He has written for major publications including The Times, The Journal, The Washington Post and Forbes. He's also the author of four best-selling books about scholarships and financial aid.

We discuss what works for you and against you when it comes to receiving financial aid, demystifying the FAFSA, the free application for federal student aid, what gets factored in, what doesn't? How to earn more money as you go through college and you may experience a worsening of your financial circumstances maybe a parent at home loses his or her job, maybe you lose your job, how do you apply for more financial aid and where to find free money for school? That's what I want to know, how do I get the free money.

All that and more coming up, here is Mark Kantrowitz.

[INTERVIEW]

[0:03:09]

FT: Mark Kantrowitz, welcome to So Money. I couldn't do college week without you. I'm very honored to have you on the show. I've been picking your brain for probably the last 10, 12 years and I plan to do the same in the next 30 minutes.

[0:03:22]

MK: Thank you for having me.

[0:03:23]

FT: Mark, I didn't think I'd knew this about you but you have a background in computer science, your consulting firm focuses on computer science, artificial intelligence and statistical and policy analysis. So then how is it that you are also the foremost expert on student financial aid? Can you maybe explain that for me a little bit, how did that happen?

[0:03:47]

MK: Well, I was one of those kids who won a gazillion dollars for both my undergraduate and graduate education. I participated in a summer research internship program, called at the time, called the Ricker Science Institute. It's now known as the Research Science Institute and I compiled a list of scholarships where math and science students involved in that program.

And then somehow, a friend of mine heard about that in 1992 and asked if we'd like to do a book. The book came out in 1993, right around when the web had started and rather than answer the questions we were receiving by e-mail again and again, I started posting the answers to a website called Senaid and the website took on a life of its own and grew to become one of the top three websites about planning and paying for college.

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FT: So it started with your own genius of getting into school with all these scholarships and then that merged or migrated into you contributing to FINAID which is a phenomenal resource for college planning and then from there, you went to Advisers and now, you're independent.

[0:05:07]

MK: Well, I expect to be working for another company very soon and I was laid off by Advisers but I expect to land somewhere else very soon and the nice thing about what I do is this very good feeling knowing that you've helped literally hundreds of millions of students pay for college and my goal was to try to make it as easy as possible despite the complexity of financial aid. Financial aid is like an alphabet soup of acronyms. It's almost like speaking a foreign language.

[0:05:43]

FT: Right and no doubt, it needs someone like with your background and your experience to help us break it all down. Mark, what would you say is the characterization of the student loan situation that we're in right now? I'm looking at the numbers, over a trillion in student loans outstanding. College is not getting any cheaper, interest rates are not getting any lower so where are we right now?

You've been covering this territory for decades, where are we right now in terms of the extremity of it and give us some hope too, is there anything that might be coming down the pipeline or changing that could be beneficial to student borrowers?

[0:06:26]

MK: Well, total student loan debt outstanding exceed the credit card debts in 2010. Auto homes in 2011 and it reached a $1 trillion mark in 2012. Now, while these maybe impressive milestones, what's more important is the impact on individual students. The average debt at graduation for a bachelor's degree is about $35,000.

The average starting salary though is greater than that so long as your personal student loan debt at graduation is less than your starting salary, you'd be able to repay your student loans in 10 years or less. It's when your debt exceeds your income, when your debt is out of sync with your income that you're going to struggle to make those loan payments.

You'll need an alternate rate payment plan like extend repayment or income driven repayment to afford your monthly loan payments but those prepayment plans reduce the monthly payments by stretching out the term of the loan to 20, 25 or even 30 years which means you'll still be paying back your own student loans when your children go to college.

That's going to have a cascading impact that's very worrisome and the primary driver of this increase in debt is the failure of government grants from both the federal government and the state government and the other support in pro and secondary education to keep pace with increases in college cost.

This has shifted the burden of paying for college from the government to the families. Family income has been flat since 2000 so the only way families have to pay for the increasing cost is either go to a less expensive school or to borrow more and that's why we see debt continuing to increase.

It's reached the point where about a quarter of the students who graduate and used their loans to pay for their bachelor's degree are graduating with what I would consider to be excessive student loan debt. A debt that exceeds their annual income.

[0:08:31]

FT: As far as the government's burden, I've read also that some of these student loans, many of them will be forgiven, the federal ones, because sometimes when you enter into these relief programs if you're still have the debt after 20 years it's forgiven. Where do you see the government maybe falling apart because of this? I mean this is a huge financial burden if they're not able to manage the risk now and eventually, everyone is going to pay the price not just families.

[0:09:06]

MK: Well, with the income driven repayment plans, borrowers will have their remaining debts forgiven after 20 or 25 years in repayment but they're still going to be paying back their loans based on their income as opposed to their monthly owe for those 20 or 25 years. So for many borrowers, they will actually pay more.

Its only borrowers who are severely negatively amortized where their debt is significantly greater than their income that they'll get a net financial benefit from having the debt forgiven as well as borrowers who pursue public service loan forgiveness which has a forgiveness after 10 years. So I don't see this necessarily as being a big problem for the tax payer.

The hit to the federal budget even in the most pessimistic of models is a very small fraction of a percent. The real problem is that we should be designing our financial aid system so that people don't take on more debt than they could afford. We should give them grants before the fact not grants after the fact in the form of forgiveness.

[0:10:30]

FT: What can students do right now, they're going into college, college is looming, what can families do to maximize the affordability? To make it efficient, to make sure that they're getting what they need, as you said, the financial aid world is full of acronyms and it's very hard to analyze.

So if you could boil it down for us just simply what are the steps that families need to take to make sure that their children are off to college responsibly affording it and by the way, maybe that they shouldn't go to college right away. Is that part of the equation too or part of the consideration? Which I think 10 years ago would have been a terrible thing, a terrible thought. But now, it seems like you know what? Maybe that extra year between high school and college is a smart thing to do, the transition is smart.

[0:11:26]

MK: Well, first of all, the best thing that you can do is to save for college because every dollar you save is about a dollar less you're going to have to borrow and every dollar you borrow will cost you about two dollars by the time you pay back that debt. So simply by saving, you're going to save money.

Now, if college is just around the corner, you can still save even very late in the game but if it's time to get money to help pay for college, you want to use the first of this acronyms, the FAFSA which is the Free Application for Federal Student Aid. It is a free form that is used to apply for financial aid from the federal government, from the state governments in most colleges and universities.

There are a handful less than 200 colleges that use a different form called the CSS financial aid profile form for awarding their own financial aid but they still use the FAFSA to award the federal and state aid. And this form, the FAFSA is used to apply for grants, student appointment and loans.

There are also other forms of financial aid that are awarded through the tax system. The American opportunity tax credit provides up to $2,500 a year as a partially refundable tax credit on your federal income tax return based on the amount that you spend for tuition and text books. Now, there are rules that prevent you from double dipping so you can't use the same educational expense to justify both the American opportunity tax credit and the tax free distribution from a 529 college savings plan.

So you need to carve out $4,000 of expenses in tuition and text books each year that will be paid for not with 529 plan funds but rather with cash or student loans and in addition to the need based aid that you can get through the FAFSA, there are also private scholarships that are provided by philanthropist, foundations, corporations and a variety of other organizations to help students pay for school.

The best way to find these is to use a free online scholarship search service. There is one from fastweb.com, the college board has one, there are several free tools available and I highly recommend using these because they match you against a database of scholarships to find just the scholarships for which you are eligible.

Keep in mind that these are free services. If you have to pay money to get money then it's probably a scam. You should never invest more than a postage stamp to find out information about scholarships or to apply for scholarships.

[0:14:45]

FT: Thanks for that reminder, yeah, it's really important.

[SPONSOR BREAK]

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FT: Let's take a quick break now to give some love to one of our sponsors today, MileIQ, the number one mileage tracker app. More than a million Americans trust MileIQ to automatically log their drives every day. It's the only mileage tracker app that detects logs and calculates your drives for you automatically.

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[INTERVIEW CONTINUED]

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FT: One thing that I think a lot of parents are unsure about and students is what works against you and for you when you're feeling out FAFSA. There is this myth that, "Well, I make too much or I make too little." Can you maybe demystify that for is too as far as what might be things that you would financially would work against you? What are the assets, for example, that might impact your ability to get certain level of financial aid or not?

[0:16:43]

MK: Okay, first of all, let's answer the last question that you have which was about gap year between high school and college. While some students may benefit from an additional year in which to mature, it gets you out of this habit of studying. So I don't recommend it and also, any income that the student is going to earn during that year to help pay for college is going to count against the financial aid process.

Student income up to $6,400 a year is sheltered but anything above that reduces ineligibility by half of that excess. So you're probably better off focusing on using income after you graduate to pay back student loans than to try to earn that money in advance and there are always exemptions like students who are being kicked out of their parents' home, they have no choice.

But generally speaking, a gap year is not beneficial from a financial aid perspective. Now with regard to the impact of the family's finances and other demographics on eligibility for need base financial aid, the formula is very heavily weighted towards income. It assesses 22% to 47% of parent income.

50% above the income protection allowance with student income. There is a similar income protection allowance for parent income that's based on family size but that has a very big impact on the ineligibility. Assets do count. They do hurt your aid eligibility but not as much as income. There is 20% of student assets and in the worst case scenario, 5.6 to 4% of parent assets.

So you want to save in the parent's name not the child's name. 529 plans have a special treatment where they are treated as though they are parent assets and then the number of children in college at the same time has a very big impact on aid eligibility because the parent finances are divided by the number of children in college.

If you go from one child in college to two children in college, it's almost the equivalent of dividing the parent income in half. So there is no explicit income cut off on eligibility for the federal grants. 95% of Pell Grant recipients which is a federal grant have family income under $60,000 a year but if you have multiple children in college at the same time, you could have a six figure income and still qualify for that.

Also, the Federal Stafford Loan which is a student loan and the Parent Plus loan which is borrowed by parents on behalf of their children are available without regards to your financial need. You still have to file the FAFSA to qualify because they want to make sure you get all the need based state for what you're eligible before turning to the loans.

But those are available to anybody regardless of income. You can be incredibly wealthy and still qualify for those loans and they are relatively low interest fixed rate loans available. The Stafford Loan is available without regard to the student's credit history and most students don't have a credit history or if they happen to have one, it's usually a bad one.

So the ways to improve your eligibility for need based aid involve avoiding artificial increase in your income during the base year. That is the year upon the FAFSA is based which is currently the prior tax year but starting 2017-18, it's going to be the prior-prior current tax year in other words, two years before.

So that families would be able to file the FAFSA based on the most recent tax return without having to do this song and dance of you have to base it on the tax return but you haven't filed the tax return so you use an estimate and you correct that estimate later. You will be able to use the actual information that is already been filed.

[0:21:12]

FT: You have a good point which is that income does fluctuate. Especially these days, parents don't necessarily have that solid nine to five job. You and I have both been laid off so we know that sometimes, one year is not the ideal year to be applying for aid or in some cases it is because you're income is relatively lower.

But it brings up a good point too that once you're in school, you parents should know and student should know that you can always reapply for aid and especially we talked about this in the past Mark, the whole idea of a professional judgment review. Does that still work and this is a sense that you can ask for more aid depending on if your family situation has worsened financially in the recent months or year that since you've gone to school?

[0:22:05]

MK: Right. First of all, we need to emphasize that the FAFSA is filed every year you're in school to provide aid for the subsequent academic year. It is not a form that you file only once. You actually have to do it on an annual basis and I've seen cases where families had only one child in college.

They filed the FAFSA, they don't get anything other than the loans, the next year they say, "Why bother?" But they would have had a lot more aid because then, they would have had two children in college. So it's important to file the FAFSA every single year even if you got nothing other than loans the previous year.

Now, if there are unusual financial circumstances that affected your finances last year that they are significantly different than this year or anything that sets you apart from the typical family or affects your ability to pay, you should ask the school for a professional judgment review. This is a process and the FAFSA doesn't have a space in it for you to say, "Oh but we have this unusual family situation."

Like, "We have a special needs child that needs 24/7 nursing care or an elderly parent who needs 24/7," or, "I just lost my job and last year's income was not reflected on my ability to pay." Those kinds of circumstances, you ask the school to do a professional judgment review. Some schools, call it special circumstances review or a financial aid appeal.

You present them with documentation of these unusual circumstances especially the financial impact of them and then the school will decide that merits and adjustment, they will base that adjustment on the financial impact of those special circumstances on the family. For example, if you got laid off last year during the base year or even after the base year, what they'll do is they'll look at your financial situation during the academic year, the award year.

They will say, "Okay, you were laid off but you got severance and then you're getting unemployment benefits and then you got a new job that doesn't pay as well. So what's your total estimated income during that academic year?" And then they will make a change to your income figures on the FAFSA corresponding to the change in your total income. Then they will also make a corresponding change to your taxes.

So they do this as a holistic review like if you lost your job and you just won the mega millions jackpot, you're probably not going to get more financial aid. They're not going to look just to change an income from your loss of employment. They are going to look at all the factors affecting your family. But if there's anything unusual, always, always ask the school for a professional judgment review. The worst that can happen is they say no.

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FT: And I think that's the overarching tip here right? That if you want money, you need to ask for it. They're not going to necessarily say, "Hey Farnoosh, I understand you're going through some troubling times," or, "Understand maybe you got laid off last year, here is some extra aid," or, "Here is that grant that you didn't qualify for last year but this year you qualify." You have to be the one, that's your biggest advocate.

Some advice now Mark and before we go, some advice for graduates who have the loans, who have the debt and they may not have been the ones who were conservative, who only borrowed less than their starting salary. They may be the ones like you characterized or they have a detrimental amount of debt.

Something like twice their income or six figures in debt, what do they do and assume some of their debt is private loans so they're not necessarily be able to go into a relief program for all of that. What can they do?

[0:26:10]

MK: Yeah, well the first thing is that both federal and private student loans qualify for a student loan interest deduction, where up to $2,500 of interest that you spent on federal and private student loans is deductible as an above the line exclusion from income on your federal income tax returns that means you can claim that even if you don't itemize your deductions.

Everybody who has student loans should take advantage of that. Also, many lenders including the federal student loans offer an interest rate reduction if you sign up for auto debit where your monthly payments are automatically transferred from your bank account to the lender and this is typically a quarter of a percent.

Some of the private student loans will offer as much as half a percent interest rate reduction. So take advantage of that because not only are you going to be less likely to be late with the payment but you are getting this additional financial benefit. This is something that's kind of unique to student loans.

Mortgages don't do that, I wish they did and certainly on my own mortgage. Now, if you're encountering financial difficulty, the first thing is talk to the lender. Explore your options because if you ignore the problem, it's only going to get worse and you will lose options for a financial relief.

For example, if you default on your federal student loans, you will lose the deference of forbearances that are available on federal student loans. So you need to talk to the lender and if the financial difficulty is short term like you got laid off but you expect to get a new job in a few months or you have medical and maternity leave and you need to suspend your loan payments, that's where you can get these deferments and forbearances that provide temporarily relief.

The problem with deferments and forbearances however is that interest may continue to accrue during that time period and if you don't pay it as it accrues, it will cost your loan balance to go get bigger and bigger digging you into a deeper hole. So they are not good solutions for more long term financial difficulty where you are employed and you're getting a good salary but your salary just isn't enough for you to afford your loan payments.

In that case, you need to explore the alternate repayment plans such as extended repayment and income driven repayment which will reduce your monthly loan payments by stretching out the term of the loan. There are alternatives such as that you can always get a second job in the evenings and weekends to help pay back your student loans or ask your employer for overtime or a raise.

The benefit of that approach is that you have less time available to spend money. Now let's suppose you have extra money that you want to use to your advantage beyond the required monthly payments. Well, you can accelerate repayment of your student loans because there are no pre-payment penalties on federal and private student loans.

You need to be careful to tell the lender that this extra payment that you're making should go be applied to the principal balance of the loan and not treated as an only payment of the next instalment due because otherwise, they might simply skip that next instalment. You want them to require the regular payments and this extra money will go to paying down the principle balance of the loan.

The most cost effective method of doing this is to target the highest interest rate debt for a quicker repayment. Now that may not be your student loans. That might be credit card debt or some other form of debt but what you do is you make the extra payments on that highest interest debt, which will reduce your overall average interest that you're paying and save you the most money in the long term.

So definitely focus on that. There are some other things though that I strongly recommend before you try paying off your student loans quicker. One is if your employer has an employer match to your retirement plan contributions, maximize the employer match because that is free money and make sure you have at least three to six months of income saved in an emergency fund.

Which is enough money to tie you over if you were to be laid off and have the typical duration of a retirement and unemployment. Those, you take care of that first before you start trying to pay off your debt more quickly but then, once you've got that under your belt, you accelerate repayment of the highest interest rate debt. That will pay off all your loans quicker and will save you more money on interest than any alternatives.

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FT: Thanks for that reminder. Yes, it's very important but of course, at least make those minimum payments. I think someone made the great analogy for me which was that student loans can start off as medicine but it can quickly become poison. If you ignore them and you miss those payments, they can come to haunt you for the rest of your life because they are pretty impossible to throw out in a bankruptcy.

Mark Kantrowitz, thank you so much for sharing your wisdom with us this college week on So Money. We really appreciate it.

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MK: You’re welcome.

[END]

