Transcript

Income-Based Student Loan Repayment Plans

When considering your student loan repayment options, there are a few plans based on your income that might make your loans more manageable. This is not an unusual situation for… a lot of people—in fact, almost two million people are enrolled in one of these plans. So let’s take a look.

Three common types of these repayment plans are an Income-Based Repayment Plan or (IBR), Pay as You Earn Repayment Plan, and Income-Contingent Repayment Plan or an (ICR).

An IBR is a repayment plan where your monthly loan payment is calculated as a portion of your monthly income based on… how much you earn per year… and the state poverty level. Pay as you earn is a similar plan that offers lower payments, but it only applies to specific federal loans. And if you make a salary that’s too high to qualify for the IBR or Pay as You Earn plans, the Income Contingent Plan may be a possibility, but it also applies only to specific federal loans.

There are a lot of factors that go into whether you may qualify for any of these plans. If you’d like to learn more, visit studentaid.ed.gov for some more detailed explanations.

But to explain the basic concept behind all of these, let’s focus on IBR.

Now, let’s say you’ve got thirty thousand dollars in student loans. Five thousand of that is subsidized and twenty five thousand is unsubsidized.

If you’re not sure what subsidized or unsubsidized loans are, we look at this in another video.

But let’s say that the interest rate you have on both types of loans is four percent.

In this scenario, on a standard ten-year repayment plan, your monthly payment might be around three hundred five dollar per month.

And if you’ve got a job that pays you an income of twenty two thousand dollars per year, you might be having a hard time making your regular payments, so you apply for income-based repayment. Looking at an online calculator with these numbers, your monthly IBR could start out at around… fifty five dollars. That’s a lot lower than that original three hundred five dollars you would be paying on a standard repayment plan.

It’s important to note one major difference between subsidized and unsubsidized loans in this scenario-

if the loan is subsidized, and the monthly interest that accrues on the loan is more than your monthly IBR payment, the government will pay the difference for the first three years that you’re on IBR.

So, as an example, let’s say the monthly interest on your subsidized loans comes out to… eighty dollars a month… and your monthly payment with IBR is fifty five… the government will pay the difference—twenty five dollars. So you’ll still have to make the monthly payment, but at least you’re not going to be responsible for that extra twenty five per month… and the interest on your loan won’t accrue for the first three years.

But if you're still paying less than your monthly interest past that first three years it will start accruing after that.

And with unsubsidized loans, if you're paying less than your monthly interest it will start accruing from day 1.

And while lower payments may help you out in the present, there are some trade-offs.

For one, it will probably take a lot longer to pay off your loans.

With IBR on both subsidized and unsubsidized loans, your repayment period can be extended from ten years to twenty-five.

And this means you might end up paying a lot more in interest if you end up staying in IBR for that entire time.

Looking at our example again, let's see what happens over time.

Each year, your lender will recalculate your IBR based on your income and family size So if your salary increases, generally so will your payments.

So let's say your income increases gradually at five percent each year for twenty-five years. Over time your fifty five dollar payment will increase to three hundred five dollars. At the end of twenty-five years when you've paid off the loan, you end up paying a total of almost fifty three thousand six hundred fifty dollars - that's your thirty thousand dollar loan and twenty three thousand six hundred fifty dollars in interest. By this point, you're paying almost as much in interest as you are in principal.

Compare that to a ten-year repayment plan, where you only pay around six thousand four hundred fifty dollars in interest, and you can see how different these repayment paths can be.

It's a bit like just paying the minimum payment on your monthly credit card bill. If you're just making the minimum payment, over time, you end up paying much more than what you originally borrowed.

So what happens if you stay on IBR for the full twenty-five year period, and still have a balance on your loan? Well in certain cases, that balance might be forgiven—though you may have to pay taxes on that amount. And by this point in your repayment, you may have paid even more than your original loan.

So, hopefully you won't have to stay on an IBR plan for too long.

If you do, it's good to know you still have the option of paying more than your required monthly payment, and the protection of not having to pay the full amount you might owe on a standard repayment plan every month.

And if you land a higher-paying job one year, or find more room in your budget, you can always switch back to a standard plan to pay off your loans faster.

So again, there are trade offs. The flexibility you may need of being able to pay less now could cost you more in the future. But if you don't have other options, applying for a repayment plan that is based on your income can help take pressure off your monthly expenses. best choice for you.