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Uncle Sam to the rescue

Feeling bogged down by debt from your old student loan?

By Eileen Ambrose

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If you're underpaid and overburdened by federal student loans, you're in for some relief.

A new loan repayment plan kicks in next month that can significantly reduce your monthly payment - in some cases drop it to zero - and will forgive any lingering debt after 25 years.

"People need this more than ever. It's making its debut at the right time," says Edie Irons, a spokeswoman with the Project on Student Debt.

The new Income Based Repayment Plan is just one of the borrower-friendly provisions taking effect next month in the federal loan program. Variable interest rates on older student loans will be falling to record lows. Fixed rates on certain new undergraduate loans are due to drop. And Pell Grants awarded to the neediest students are going up.

First, the Income Based Repayment Plan.

Usually, you must repay your student loans in 10 years. But this Income Based plan will tailor your payments based upon how much you earn, potentially requiring much smaller payments over a longer period. The program is targeted at those with hefty debt compared to their pay, often the case for public service workers.

Irons estimates at least 1 million people will be eligible for the new payment plan.

The Income Based plan only applies to federal student loans, such as Stafford and Grad PLUS. It won't cover private and parent PLUS loans or loans in default.

The Income Based formula is a bit complicated.

Basically, Irons says, "If you owe more than you earn in a year, you're probably eligible."

Under the plan, if you make below 150 percent of the poverty line for your household size, your payment would be zero. That threshold works out to be $16,245 this year for singles in Maryland and most other states; $33,075 for a family of four.

"You still owe the money," possibly along with accruing interest even if payments are zero, says Bob Murray, a spokesman for USA Funds, the nation's largest loan guarantor. If your income later improves enough, payments will kick in.

If your income is above that income threshold, your monthly payment under the Income Based plan won't exceed 15 percent of your discretionary income.

The lender will review your income every year, so payments could go up or down with your paycheck.

To figure what your payments would be under the Income Based plan, use online calculators at www.ibrinfo.org or www.finaid.org.

Say your adjusted gross income is $25,000, the same amount as your student loan debt. Under the standard repayment plan, monthly payments would be about $288. But under the Income Based plan, your payment would drop to around $110.

It may be that your payment will be so low under this plan that it won't cover the interest on the loan. If you have subsidized loans - meaning the government paid the interest while you were in school - Uncle Sam again will pick up the interest tab for the first three years that you're in the plan. Thereafter, or for unsubsidized loans, the interest will be added to the balance.

Reduced payments will extend the years of repayment. Any debt left after making 25 years' worth of payments will be wiped out.

Debt can be erased even faster after 120 payments - 10 years' worth - if you work in one of the wide array of public service jobs eligible for a federal loan forgiveness program launched in October 2007.

Contact your lender if you're interested in the Income Based plan.

Some Maryland colleges say they are trying to get the word out about the plan and expect graduates will sign up for it.

"Especially those who haven't been able to find the jobs they wanted and are not paid as much as they thought they would have been paid," says Sharon Hassan, financial aid director at Goucher College.

Besides the new repayment plan, other changes kick in July 1.

The variable interest rate on student Stafford loans made before July 2006 will reset to a record low of 1.88 percent for students in school or in a grace period, and 2.48 percent for those in repayment. That's a drop of 1.73 percentage points.

If you still have variable rate student loans, and fewer borrowers do, you can lock in rates close to these historically low levels by consolidating those loans after July 1.

So many lenders have gotten out of the consolidation business that borrowers should use the government's consolidation program at loanconsolidation.ed.gov, says Mark Kantrowitz, publisher of FinAid, an online provider of aid information.

Stafford loans since July 2006 have carried a fixed rate. The fixed rate for subsidized undergraduate loans will drop to 5.6 percent next month, down from 6 percent. Unsubsidized loans remain at 6.8

percent.

The maximum Pell Grant also will increase to $5,350, up $619 from the 2008-2009 academic year.

All welcome news for students and graduates during these tough times.

About the Income Based Repayment Plan

The Income Based Repayment Plan can help low-paid public service workers, whose leftover federal student loan will be forgiven after making 10 years' worth of payments.

There has been some concern lately that loan forgiveness programs may be in jeopardy, given that some states are cutting back on their promises to teachers and nurses.

FinAid publisher Mark Kantrowitz says borrowers don't have to worry about broken promises from Uncle Sam, which offers the Public Service Loan Forgiveness program among others.

"The federal ones are safe; state ones are up in the air," he says.

Maryland doesn't offer a loan forgiveness program, but awards nearly $2.7 million a year to help repay loans of teachers, doctors and other professionals working in underserved areas in Maryland, says Robert Parker, with the Maryland Higher Education Commission. The money is appropriated every year, and the program has been funded for this year, he says

Find out more information on the Income Based plan at www.ibrinfo.orgor www.finaid.org.