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Income Contingent Repayment Plans, Part 2

Other individuals who might want to consider an income contingent repayment plan are those who have specific prospects for higher incomes in the future. This might be if you know you're getting married, for example, and in a year from now your income combined with your spouse's will be higher than it is now. Or maybe you're in an apprentice-type program on your job, and if you successfully complete your training you'll get a pay raise next year. In these types of scenarios, you might find comfort in using the income contingent repayment method to pay down your student loan debt.

Who do you think is likely to live longer: you or your parents? If you're a student and you guessed yourself, you get a pat on the back. Now who is likely to go into retirement first? If you said your parents, right again. I don't think the government wants parents, who might be in their 40s, 50s, or 60s when their children are in college, having to pay back loans for 25 years throughout their retirement. On the other hand, they probably wouldn't want the risk of that older American dying before he or she has a chance to pay off that loan.

Here's a calculation of what your monthly payments would look like, assuming you had \$20,000 in college loans, used an income contingent repayment plan, and started out making an annual salary of \$50,000, which rose to \$65,000 five years later.

Interestingly, if you had a much lower salary, say \$30,000 instead of \$50,000 annually, and you predicted that your income would rise to \$39,000 after five years, your monthly repayment plan wouldn't look all that different. The monthly payment would drop by just \$43.87. But with a lower salary, the total amount of interest you paid would rise by \$3,303.77. This is because with income-sensitive plans, higher wage earners actually pay a larger percentage of their income toward student loan debt, and lower-wage earners pay a smaller percentage of income toward college loans – ultimately resulting in lower-paid workers doling out more in finance charges in the long run.

Before you choose any plan, do take the time to run some numbers on a college loan calculator.

Paying on time not only saves you money (in finance charges in the long run), it can also lower your monthly rate in the short-term because many companies give you a break on the interest rate for timely payments. So set up an automatic deduction to get those payments in consistently, and on time. Having an automatic debit of your checking or savings account will also entitle you to get a break from your lender. If not, call them up and ask why not – let them know you will take your loans elsewhere if they don't shave your interest rate at least 1/4 percent. In fact, many lenders will cut your student loan interest rate by 2 percent after 48 consecutive on-time payments. On Federal Direct Consolidated Loans, you get an 0.8 percent interest rate decrease after 12 months.