

# Borrowing Wisely

**Many students find it necessary to borrow money to help pay for college, but it's important to make smart borrowing decisions.**

In other words, borrow as little as possible without sacrificing the quality of the educational experience. Every dollar borrowed *must* be paid back later with interest - which will have a definite impact on life after college.

## Consequences of Student Loan Debt

Think about it – borrowing \$2,500 a semester during four years of college results in a payment of \$250 per month or more for 10 years. \$5,000 per semester could result in a \$500 per month payment – and a possibly very different lifestyle as the result of student loan payments.

Also, the total amount of student debt and how well monthly payments are handled influences credit reports and credit scores – crucial factors that affect the ability to qualify for other loans in the future – from cars and homes to private graduate school loans.

That said, for most students, one of the realities of attending college is a student loan – or several student loans in fact. But the type of loans and how those loans are handled (even during college) is another part of a well-considered aid strategy.

### Subsidized Loans and “Capitalization”

Many students with federal loans receive a combination of subsidized and unsubsidized loans. Subsidized loans are loans for which the government pays the interest on the loan while you are in school, potentially saving thousands of dollars. If available, subsidized loans should be your first choice.

With unsubsidized loans, the interest is added to the loan amount from day one, thus increasing the size of the loan. This process is called “capitalization”. For example, if \$1,000 is borrowed at an interest rate of 7% per year, at the end of year one the total amount owed is not \$1,000, but \$1,070, which continues to accrue interest on the new higher amount. So after four years, the original \$1,000 loan would actually be a \$1,310 loan. And that means you will be paying interest on the higher amount, effectively paying interest on interest.

If possible, a great loan management strategy is to pay the interest on unsubsidized loans before it is capitalized. To use this strategy, you'll need to



contact your lender to get more information on how to pay early and when interest is capitalized.

## Managing Money While in School

Finally, after you've selected the least expensive loans and borrowed only what's needed, the next step is to manage money responsibly while in school. Being responsible includes understanding the basics - needs vs. wants, budgeting, and credit management. It also includes understanding how *expectations* about debt may affect spending behavior while in school.

Based on surveys of tens of thousands of students from all over the country, we've found that most students expect to graduate with little, if any, credit card debt. But in reality, the average student earning a four-year degree graduates with around \$4,000 in credit card debt alone, and up to one in three graduates with \$10,000 or more. The amounts are even higher for graduate students. If a student does not understand how unexpected debt can happen to them, it's way too easy to fall into the minimum payment trap – ending college with an unexpected high-interest credit card payment in addition to a student loan payment.

Part of borrowing wisely is to set financial goals in school and to track progress monthly. One important goal could be sticking to a sensible budget. Another goal could be to repay interest that accrues on non-subsidized loans prior to capitalization.

**If you are unsure about the consequences of your loans and how to minimize your overall debt, talk with a financial aid administrator or financial advisor.**