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Who Qualifies for Obama's 10% Student Loan Payment Cap?

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Borrowers who hope to save the most from the president's executive orders will look to this provision -- but it only applies to those who take loans for education in 2012 or later

With a splashy headline yesterday, I revealed that the farthest reaching aspect of President Obama's executive order to help student loan borrowers would save the average person less than $10 per month. I also commented on the other two aspects of the plan, which I observed also wouldn't help most Americans with their student loans. That is all correct, but some additional nuances about the 10% payment cap that have been brought to my attention are worth explaining better.

The Basics

This aspect of the new law attempts to relieve students with relatively high student loan costs and relatively low incomes. It does this by capping student loan payments at 10% of a person's discretionary income. Even the basics of this calculation are complicated, so please bear with me. (And check out this website for additional information.)

To calculate your eligibility, you must figure out your discretionary income under the definitions of the law. This is calculated by taking your gross income and subtracting 150% times the poverty line.

For example, in 2010 for a single person, the poverty line is $10,890. Multiply that by 150% and you get $16,335. If you're single, subtract that number from your gross income. For example, let's say you make $40,000 per year. Your discretionary income per this law would be equal to $23,665.

Under current the old system, you would multiply that by 15% to get the maximum annual student loan payment you would be required to make. That's $3,550 or $296 per month.

Under the new law, the calculation would be almost identical. The difference is that the cap is now at 10%, instead of 15%. That makes your annual maximum student loan payment $2,367 or $197 per month. You could pay up to $100 per month less in this example, compared to the old system.

That is, if you have enough student loans. Remember, if your student loan payments are smaller than that maximum, then the law doesn't help you.

In the scenario above, you would need to have graduated with loans in excess of about $28,000 (assuming a 6% interest rate and a 20-year term) before you see any payment reduction.

The Details

Now even if you appear to qualify for a payment reduction according to those calculations above, you still might not. There are a few more things you need to know.

First, the loans we're talking about aren't just any loans. They're direct federal loans or government-guaranteed private loans. If some of your loan balances are purely private, then subtract those out from your total balance to see if you qualify. And the payment reduction would only apply to what you pay on your government-backed loans.

Second, whether or not you can benefit from the new 10% cap depends on when you took out your first student loan. You may qualify if:

- You took out all of your loans in 2012 or later (future students)
- You took out the loans in question after 2008 and a loan after 2012 (mostly current students)

So if you graduated college in 2011, then you don't qualify. (But you could still qualify for the 15% cap. I'm just considering Obama's executive order here.)

Finally, if you're already in default, then you won't qualify.

The Reach Rethought

First, considering that this will really only apply to graduating seniors and maybe a handful of graduate students, we can re-think the average case.

But that's because the pool we're talking about now is much, much smaller than I had previously thought. I had initially believed that anyone with student loans could potentially benefit from this program, which led me to use the decade average student loan burden (~$21,760).

Instead, the much tinier pool would more aptly be characterized as having an average student loan balance of $28,720, according to projections I've seen. Student loan interest rates are also much higher now than they were earlier in the decade, in the ballpark of 8%. With those assumptions, a single person making less than $45,000 would begin to see some savings. That's about the median earnings for a young adult with a bachelor's degree, according to the Department of Education, which implies that as many as half of graduates could potentially qualify for the program.

That is significant. But remember, the universe we're talking about here is just new graduates. And as their incomes rise, those savings will begin to decline as they're forced to pay for more of their loans. So this program isn't really meant to assist with the overall burden of student loans of the average American. Instead, it intends to help those with lots of student loans who either have a low income after school during their early years or have a relatively low income throughout their career.

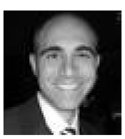
Economic Impact

To be sure, this rule will provide some relief to the handful of borrowers who qualify. But due to the limiting criteria of who can actually take advantage of this program, it's hard to see how moving up the implementation date to 2012 instead of 2014 would provide much immediate stimulus to the U.S. economy. The earliest pool of college students that the law would apply to won't graduate until June 2012. They already get a six-month grace period after that. So they won't have to begin paying loans until 2013 anyway. And other hardship programs already exist to let them wait even longer to pay, if necessary. It may be available sooner to some who earned master's or doctor's degrees, but they tend to have higher incomes -- so its impact should also be limited for advanced degree holders.

As a stimulus measure hoping to help the broader economic recovery, this program's impact will be extremely small in 2012. Only a handful of graduate students will be participating. In 2013, some 2012 college graduates may begin participating as well. The department of education expects 1.7 million students to graduate this spring, and some portion of that number will begin to take advantage of the program in 2013.

Image Credit: REUTERS/Robert Galbraith

ABOUT THE AUTHOR



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