College Money Matters
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Newsletter

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In this article:

Insights and info from College Money Matters – a non-profit organization dedicated to helping high school students and their families make informed decisions about applying, choosing and paying for college.

Parent PLUS College Loans: How Much is Too Much Love?

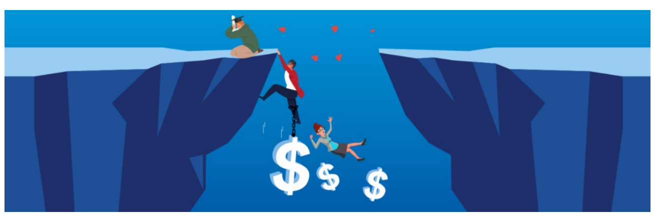
Every parent wants the best for their child. They want to see them succeed, be happy, and set themselves up for a bright future. So it's no surprise that many parents want to invest as much as they can in their child's education. After all, the median income for recent college graduates is $52,000 a year, while someone with just a high school degree earns about $30,000.[1]

That's a big difference, and it's a key reason that the US Government offers Parent PLUS Loans. These loans were created just for the parents of incoming and current undergraduate students.

However, these well-intentioned loans also lead to serious debt. In fact, parents who've taken out a Parent PLUS Loan now owe the government more than 98 billion dollars, and 1 in every 8 will wind up in so much debt that they'll have to default.

To help parents gain a clearer picture of whether or not a Parent PLUS Loan is right for their family, College Money Matters offers the following guide to the reasons for Parent PLUS Loans, their potential issues, and how parents can avoid falling into the Parent PLUS trap.

*1 **"The Labor Market for Recent College Graduates,"** The Federal Reserve Bank of New York, 2022.*



Why Parent PLUS Loans were created

When Parent PLUS Loans were first introduced in 1980, the cost of college and the rate of inflation were both rising quickly. Parents who were once in a position to send their children to prestigious and expensive colleges now found they didn't have the cash up front to pay for a full year's tuition and room and board.

The U.S. Department of Education recognized that if they could make loans available to these higher-net-worth families at a relatively high interest rate, the government would make money, and the borrowers would be able to pay the loans back quickly, once the economy turned.

In addition, unlike conventional Federal Student Loans, the only dollar limit on a Parent PLUS Loans was a college's total cost of attendance, minus any other financial aid received. All that was required was that the student complete the Free Application for Federal Student Aid (FAFSA®), and that the parents could declare that student as a dependent and meet certain financial requirements.

How Parent PLUS Loans became a debt problem

Over time and with all good intentions, policymakers opened up the program to parents with more limited resources, and changed the financial requirements to passing a credit check. The concept this time was that opportunity shouldn't just be for the more fortunate. That was good. But it came with a downside.

Since the only limit on the amount borrowed was whatever it cost to go to a specific school, a good number of parents in lower income brackets, who rightfully also wanted their kids to go to good schools, wound up with loans they couldn't repay. And now, they're saddled with decades, if not a lifetime, of almost insurmountable debt.

It's the parent who's responsible for paying back the loan

With a Parent PLUS Loan, the parent is the borrower, not the student. So it's the parents who are responsible for paying back the full amount plus interest, no matter what their income might be.

That means that if you, as a parent, get laid off, suffer a reduction in pay, or find that your income doesn't grow at the same rate as the interest on the loan, you could be stuck with monthly bills you can't afford. The rules are very straightforward: No matter how or why your income may be reduced, the repayment amount cannot be lowered. That's true whether your child completes their college education or not.

What's more, even if your child graduates and gets a good-paying job, a Parent PLUS loan cannot be transferred to your child. Only the parent is responsible for repaying the loan.

Fees and Interest Rates: The costs of a Parent PLUS Loan

Parent PLUS loans have a fixed interest rate, which means the interest rate won't change over the life of the loan. That predictability is helpful in budgeting, but as noted earlier, the interest rates tend to be relatively high compared to some other college loans.

On top of that, the government charges a fee just to start the loan. Known as an "origination fee," the current charge is 4.22% of the total loan,[1] which only adds to the cost. You can view the latest interest rates and origination fee charges at **StudentAid.gov/interest**.

In addition, if the student is borrowing through a Federal Student Loan, but that amount doesn't cover the full cost of attendance, the Parent PLUS program enables parents to borrow whatever difference is not covered by financial aid. The result: the student may have gotten into the school of their choice, but now two generations are carrying the burden of long-term college debt.

Repayment begins while your child is in college

Parent PLUS Loans require payments to be made as soon as the college receives the full loan amount for the school year. This is different from Federal Student Loans, which student borrowers typically don't have to start paying back until six months after graduation.

Under certain circumstances, you can apply for a deferment or forbearance. If it's granted, you may be able to stop or lower your payments for a temporary period of time. However, this doesn't reduce your cost. In fact, it can increase it, because the interest continues to build in the time you've deferred payment. As it says on page 9 of "Direct PLUS Loan Basics for Parents." published by the US Government, "we charge interest on all Direct PLUS Loans during all periods of deferment and forbearance."[2]

What's a parent to do? – Here are some options

It's a general rule in family finance that your overall debt should be no more than 30% of your taxable income. This includes mortgages, car loans, credit card debt, and college loans, no matter how many kids you may have in college at one time.

Obviously, that puts limits on how much you should borrow. But who wants to put limits on their child's future? The reality is that choosing a college requires a careful balancing of dreams and dollars. It's also a good "teachable moment" for kids who are well on their way to becoming adults.

The recommendation here is that you involve your college-bound student in an honest, thoughtful discussion about paying for college. Who knows? You may even find they don't want you to jeopardize your retirement years just so they can go to a bigger name college.
The bottom line is that taking out a Parent PLUS Loan is not the only option. There are many things you and your child can do to achieve a college education while minimizing college debt. Here are six possible approaches, all of which you can discuss as a family:

- Put in the time to apply for grants, scholarships, and work-study programs. Most require filling out the FAFSA, so make sure that's completed and submitted. For more information, visit **collegemoneymatters.org/scholarships-and-grants-interactive**.
- Consider community college for the first two years. This option has saved many college graduates and their families a significant amount of money. However, it's important to check which credits can successfully be transferred to the preferred four-year school.
- Plan on living at home and commuting to college. This decision saves all the money that would otherwise go to dormitory rent, meal plan costs, transportation and other away-from-home expenses.
- Choose an in-state university versus a private college. In-state public universities offer a quality education at a fraction of the price of private institutions.
- Apply to at least one "financial safety school" – one you know the family can afford. To find out more, visit **collegemoneymatters.org/how-many-schools-should-you-apply-to/**.
- Evaluate the possibility of the student taking a year off before starting college in order to work, or taking a part-time job while in college and during the summer months. The more a student is involved in contributing to their college expenses, the better everyone understands the financial realities.

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1 https://studentaid.gov/understand-aid/types/loans/plus/parent
2 https://studentaid.gov/sites/default/files/direct-loan-basics-parents.pdf

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