Community
Legal Services

Dealing With Federally Guaranteed
Student Debt

Do you have questions regarding your student loan obligations?

This brochure discusses how payment obligations for federally guaranteed student loans can be (1) reduced, (2) postponed or (3) eliminated or discharged.

Private student loans are subject to different rules and are not addressed here.

Reducing Payment Obligations:

Repayment plans can reduce or even eliminate a borrower's payment obligations. These fall into three primary categories: Income Based Repayment Plans, Income Contingent

Repayment Plans, and Income Sensitive Plans. Each of these plans has different requirements and benefits. In addition, there are repayment plans available to Perkins loans which are not covered by the three programs.

Income Based Repayment Plans (IBR)

Applies to: Federal Family Education Loans (FFEL) and DIRECT Loans. Consolidation loans can also be repaid through IBR as long as they have not been used to discharge Parent PLUS loans.

Requirements:

1. Borrower must demonstrate a partial financial hardship. This basically means that the amount of the borrower's income that goes to student loans is above a certain minimum, which is determined by a formula; and.

2. The borrower's loan must not be in default. Benefits: Payments are reduced according to a formula based on the borrower's income. This formula is generally the most favorable of available repayment plans. After 25 years (or 10 years if you are in public service), the loan is forgiven. This is reduced to 20 years for loans taken out on or after July 1, 2014. The Government pays the accrued interest for up to 3 years.

Partial financial hardship means that a borrower's annual federal student loan payments under a ten year payment plan are:

1. greater than 15% of the difference between the borrower's adjusted gross income, and

2. 150% of the poverty guideline for the borrower's family size and state.

Gross income is adjusted by deducting specific items from the income, i.e. IRA, student loan interest, and alimony paid by borrower.

Monthly payments are capped at 15% of adjusted gross income that is above 150% of the HHS poverty guideline divided by twelve.

For families whose adjusted gross income falls below the poverty line, payments are reduced to zero.

Income Contingent Repayment Plans (ICR)

Applies to: DIRECT loans only (including DIRECT Consolidation loans)

Requirements: The borrower's loan must not be in default status.

Benefits: ICR reduces payments according to a formula based on borrower's income. After 25 years the loan is forgiven (but the amount forgiven may be considered taxable income). Payments are capped at 20% of borrowers income above poverty guidelines. Payments are zero for borrowers below poverty guidelines.

Drawbacks: The formula is less favorable than that for IBR's, so payments are generally larger under this plan. ICR's do not provide for government payment of accrued interest.

Income Sensitive Plans (ISP)

Applies to: FFEL loans

Benefits: Payments are adjusted annually based on the borrower's expected monthly gross income.

Drawbacks: Generally the formula for ISP's is less affordable than either IBR or IRC plans because monthly payments under ISP's must cover at least accruing interest.

Postponement of Payment Obligations:

Deferment

Sometimes a borrower can benefit from a temporary postponement of his or her obligation to make loan payments. This is called a deferment. During a deferment the need to make payments is postponed, and in the case of subsidized loans the government pays the borrower's interest obligations. This postponement is temporary, however, as most deferments have maximum time limits.

Borrowers whose FFEL and Direct loans are in default are not eligible for deferments. For information about how to get out of default, see below.

A borrower may qualify for a deferment if…

- the borrower has previously qualified under another federal loan program.
- the borrower receives public assistance benefits.
- the borrower is serving as a Peace Corps volunteer.
- the borrower is working full time and does not receive an income higher than either minimum wage or 150% of the federal poverty guideline for the borrower's family size and state.
- the borrower is unemployed (although additional conditions apply).
- the borrower is a student studying at least half-time or participating in a graduate fellowship.

Different but similar rules apply to deferment of Perkins loans. Borrowers may be eligible to defer repayment of Perkins loans if, for example, they are teaching full time in a qualifying school, have in school status, are in the military or Peace Corp, are unable to find full time work, or satisfy economic hardship standards.

Getting Out of Default:

In order to qualify for IBR, ICR, new student loans or grants, or deferment of payment obligations, a borrower's loan cannot be in default status. If a loan is in default status, there are ways to bring it out of default. The two primary ways of doing this are consolidation and rehabilitation.

- **What is Default?** To default is to fail to make payments as scheduled. Loans which require monthly payments enter default status once the borrower has failed to make payments for 270 days. If payments on the loan are due less than once a month, a loan enters default status after no payments have been made for 330 days.

- **Consolidation-** A borrower can bring his or her loans out of default by taking out a new loan to pay off the old loans. This is called consolidation. As long as the borrower has at least one FFEL or DIRECT loan, a borrower can consolidate his or her loans into a DIRECT Consolidation loan, which can be paid off through a payment plan tied to the borrower's income.

  Advantages may include lower monthly payments through extension of the loan period and a possible reduction in interest rate.

  There are drawbacks to consolidation. For example, because of collection fees, the overall debt owed will increase when consolidating (up to 18.5%). Also, a DIRECT Consolidation loan generally cannot be re-consoli dated, so borrowers who use this way of getting out of default usually only have one chance to consolidate out of default.

- **Rehabilitation-** A loan can also be brought out of default by rehabilitation. FFEL and DIRECT loans can be rehabilitated by making nine payments within twenty days of the due date during a ten-month period (meaning a loan can still be rehabilitated if one payment is missed). Perkins loans can be rehabilitated by making nine timely payments in a row, but there are additional rules which must be followed.

  There are drawbacks to rehabilitation also. Loans can only be rehabilitated once (unless the previous rehabilitation happened before August 14, 2008). Collection fees may also be added on to the principal when rehabilitating.

- **Consolidation vs. Rehabilitation-** The main advantages of consolidation are that consolidation is faster and easier (the borrower does not have to make any initial payments to qualify).

The main advantage of rehabilitation is credit reporting, but this benefit is often oversold by collectors. After consolidating, a borrower's credit report says that a defaulted loan has been paid. After rehabilitating, the fact that the loan was defaulted is no longer noted. HOWEVER, any other negative credit history remains on the report until it becomes obsolete, so the benefits of rehabilitation for credit reporting are often exaggerated.

Postponement of Payment Obligations Continued:

Forbearance

A forbearance is similar to a deferment in some ways. It can include all of the following:
A temporary stoppage of the obligation to make loan payments.
An extension of time for making payments.
An acceptance of smaller payments.
Forbearances are easier to obtain than deferments and can be granted even if the borrower is in default. Unlike deferments, however, the government will not pay interest on subsidized loans during a forbearance.

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Discharge:

In some cases it may be possible to eliminate the obligation to repay a student loan entirely, but this can be very difficult to do. There are two primary ways of discharging a student loan: bank-ruptcy and administrative discharge

Bankruptcy

It is in rare circumstances possible to discharge a student loan through bankruptcy. Discharge through bankruptcy is possible if the borrower can prove that he or she is unable to maintain a minimal standard of living for himself or herself and his or her dependents, and that this situation is likely to continue for a significant portion of the period during which the loan is to be repaid. This is very difficult to establish in practice, however, and discharges of this kind are rarely granted.

Administrative

Loans can be discharged entirely without bankruptcy in certain circumstances:

1. **School Closure**

-If the school closed before the student could complete the program, the loan can be discharged.

2. **False Certification**
    - If the school falsely certified a non high-school graduate's ability to benefit from the pro-gram OR
    - the school enrolled a student unable to meet the minimum state requirements for the job for which the student was trained OR
    - the school forged or altered a loan note or check endorsement OR
    - the borrower was the victim of identity theft, then the loan can be discharged.

3. **Unpaid Refunds**

If the school has not paid the student a refund the student is owed, the loan may be dis-charged.

4. **Disability**

Discharges may be available to disabled borrowers.

5. **Death**

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Community Legal Services (CLS) is committed to eliminating poverty-based inequities in the civil justice system by providing high-quality legal advice, advocacy and assistance to low-income Arizonans.

This brochure is not intended to replace legal advice but to share legal information only. This legal information is periodically updated. Please contact CLS to find out if this information has been updated since this printing date of September 2018.

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Additional Helpful Online Resources:

studentaid.gov
studentloans.gov
ibrinfo.org

This brochure is available in alternate formats. Call
602-258-3434
Resource Development
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