Preparing Students for the Hard Reality of Post-college Debt

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Welcome to the PwC-KWHS Podcast Series for High School Educators on Business & Financial Responsibility.

I'm Diana Drake, managing editor of Knowledge@Wharton High School, and today we are talking about the economic value of higher education and how to help students prepare to manage college costs and debt*. During our discussion, we will traverse the rugged financial landscape that surrounds higher education. Students are faced with ever-rising tuition costs, staggering student-loan debt, a difficult job market and the inevitable question: Is college worth the investment? I'm here today with two experts who will help us sort through these important issues, and offer high school educators some practical insights and advice to help their students make more informed decisions about their financial lives after high school and on college campuses.*

This is part three of our four-part discussion on the value of higher education with Wharton management professor Peter Cappelli and retired PwC Partner Michael Deniszczuk. Here, we look at helping students manage post-college debt.

Below is an edited transcript of the conversation.

Knowledge@Wharton High School: Let's move on to helping students manage post-college debt. I'd like to start with the example of Zina Kumok, who's a regular contributor to the Knowledge@Wharton High School business journal. Zina graduated from college a few years ago with thousands of dollars in debt. She vowed to become debt-free in three years and was successful in doing so. She has said many times that she had no idea what she was getting into when she signed on the dotted line. For instance, she didn't know that interest was increasing the size of her debt burden while she was in school for four years.

The easy answer is to give high school students more financial knowledge. That's why we're all here. But more deeply, how can we help our students be better prepared and possibly even avoid taking on too much debt? Where does the responsibility lie?

Michael Deniszczuk: I want to congratulate Zina, who set a goal of becoming debt-free and achieved it. I'm sure it took a lot of hard work to do that but it paid off, literally. Again, I'm going to go back to the planning piece of this thing because I think that is extraordinarily important. You need to first decide what college is right for the student based upon the career they're planning.

Not everyone knows the career they're getting into. But they may know an area that they want to go into. For myself, I was very interested in math and chemistry and so forth. I ended up being an accountant, which I guess is somewhat close to the math piece. You may need to say that, 'Hey, I don't know what I want to do, so I need to pick a college based upon the fact that it gives me a wide variety of majors where I don't have to be switching colleges.'

Second, look for ways to avoid borrowing before you even get into college. … There are lots of scholarships that go unclaimed each year. You've probably heard stories about that. Then you've heard stories about outstanding students who can't get scholarships. But in fact there are lots of scholarships out there and some of them have very specific eligibility criteria. You need to research your scholarship opportunities early and try to determine what's out there and what you have to do to get it.

Think about working during college to help offset costs. While it may not pay your tuition, maybe it'll pay for books or other incidentals for college. Working in an area related to your career choice can also help make you a more desirable candidate when you're looking for a job after college. My view is that any work you do during college will at least show employers your drive and work ethic, which are very important traits for any job.

Finally, family resources. It may be cheaper and less of a hassle — although maybe it would be more of a hassle in some families — to borrow from family members such as grandparents, if they have the wherewithal, before subjecting yourself to borrowing from external sources.

I was kind of shocked at the interest rates: 7% for private and 4.8% for federal. That's a heck of an interest rate to pay. You might even convince a family member to make you a loan at 2% or 3%, which would potentially be a lot better than having to borrow externally. If you have to get a loan from an external source, shop around for the best deals, the same way you would when you're buying the latest technology gadget on the Internet. You don't pick the first deal you see. You shop around for the best deal. Not all lenders are the same and I don't think they all have the same rates and requirements.

Once you graduate, you need to focus on getting that loan paid off. But I would say you also need to work on budgeting and making sure that you don't ignore things like your retirement because I think that's a very important long-term goal that people sometimes ignore because of the short-term types of budget constraints.

Lastly, as a CPA, I'd be remiss if I didn't remind students and parents about the tax benefits that are available to college students under our tax laws. There are deductions and credits that can help to offset some of the expenses of higher education. There are tax benefits that a student may be eligible for that would assist in offsetting some of these expenses such as the Education Savings Bond Program, the American Opportunity Tax Credit, Lifetime Learning Credit and tuition and fees deductions.

Peter Cappelli: The only thing I would add to that is one of the things we know from empirical evidence is that people in debt choose different career paths — and they're not necessarily the career paths that they would have chosen otherwise. For example in law school, a big proportion of kids coming into law school think they want to do public interest law. By the time they graduate and look at their debts, they end up working for private firms because that's the only way they can pay off their loans.

If you take out a lot of loans, it structures your choices on the way out. … It would be great through programs like this if we can get kids to be more sophisticated about loans. But it's not just financial education. It's also about life experience. When you're 18 and you're thinking about the future, your time horizons are just not quite the same. Something that is four years away seems like forever when you're 18. But when you're older and if you're a parent, you know that it sneaks up on you pretty fast. You can imagine what this big debt burden will do to you in a way that somebody who's 18 can't.

We as adults dealing with high school students have to make them see how much of a burden this is going to be to have to pay off this much money. … There's pretty much a calculator to help you with any of this stuff, but there are some that will do college loans and tell you how much you have to earn in order to take out various kinds of loans and pay them back.

The federal government has got a couple of really helpful websites. One of them will tell you, if you've applied for financial aid, what else you might have missed and whether there's any kind of federal aid that might be available that you haven't been offered yet. I would make use of these calculators. Also, just Google or research 'calculator financial aid' or 'calculator loan payments' or something like that. You'd be amazed at what will turn up. As adults, we have to make the kids not only understand at a cognitive level — here's how much it will cost — but make them feel what this really means. It's very difficult to do that at 18.

KWHS: A recent study suggests that nationwide, only 50 of more than 580 public four-year institutions graduate a majority of their full-time students on time. More time in college means more money put toward yearly tuition bills, and for some, even larger student loans that they must pay off when they leave campus for the real world. The time you spend in college is an important consideration when assessing the financial commitment of college. What are some other similarly important considerations — like a check list for students, if you will, about things they need to think about in relation to the money they're putting out and the debt that they might get into?

Cappelli: There are a bunch of things that are important to look at about the programs themselves. One of the biggest issues for students, but especially for their parents, is will I get out of here on time? If you go to the super-elite universities — like ours at the University of Pennsylvania — the graduation rate here is about 100%.

If you go to an elite state university, you'll find graduation rates there are considerably less. One of the things that you're buying at the elite universities is a lot of support. There are a lot of things that cause kids to struggle in college that are completely predictable. There's a short list of them and in my book (*Will College Pay Off? A Guide to the Most Important Financial Decision You Will Ever Make*) I summarize one of the short lists about the kinds of programs that help students succeed, like freshmen seminars.

After you arrive on campus, there are small classes dedicated just to you — to freshmen. They're not available to all undergraduates. Only your peers are going to be in that class. You get a real professor. They get to know what you're doing. They can sense when you're having trouble. They're hands-on classes.

There are a series of interventions at many schools where they require you to demonstrate your ability to take upper-level courses. They can basically predict whether you're going to struggle in a class. It might be surprising, but a lot of undergraduates, maybe the majority, way over-estimate their ability to do things. One of the reasons they get into trouble is they take courses that are too hard for them. Many schools have programs that help you head that off.

More generally, is it the kind of college that has a very supportive atmosphere? … If you're in trouble, they're going to be able to figure it out and get you through. For parents, especially those who have a better sense of all the ways their kids can get into trouble, it is very important to look to see whether the college you're thinking about has this kind of support system. If you're thinking about making a financial bet, this is the place you want to spend your time and money because the most predictable thing that gets in the way of a good return on your education is if your kid gets into trouble and doesn't graduate. That's the worst outcome.

The second worst is they graduate but it takes them a very long time to do it. A lot of those things are predictable; a lot of them have to do with the nature of the college experience. Those are things you can figure out in advance.

Deniszczuk: My advice is to give yourself some options. Just don't focus on one school. Look at a variety of schools. But … don't give yourself too many options. I know so many parents that are looking at 10, 15, 20 schools with their kids. It gets to the point where the kids are just totally confused. The parents are totally confused as well because there are so many options. So narrow your list down to a reasonable number, but that number should be more than just one or two.

KWHS: Speaking of options, a student graduates from college mired in debt and quickly becomes overwhelmed with the drain on her starting salary paycheck. She misses some minimum payments. What are her options? What advice do you have for that student to help her manage her post college debt?

Deniszczuk: Twenty million Americans attend college every year. Of that number, 12 million, or 60%, borrow to help cover the cost of education. It's important that students develop financial skills and knowledge to control their spending and their debt. First, the graduates should get organized. You compile a list of your loans and the name, web address, contact information for the lender, loan ID number, current loan balance, interest rate and date that the first payment is due. Make sure that you keep track of that.

You sign up for auto debit and with that service, your monthly loan payments are automatically transferred from your checking account to the lender. Now, you've got to make sure you have the amount in your checking account, otherwise you create a problem there. But it saves you the hassle of writing a check and the postage. … Sometimes a lender will give you a quarter to a half percent interest rate cut if you use the auto debit feature.

Now, if you can't pay your loans and you're going to miss a payment, you need to work with your lender before you start missing payments. You need to know when things are starting to run tight here. Talk to your lender early before you start missing payments, as opposed to just missing payments.

Sometimes there are some federal student loans that offer temporary suspension of the obligation to repay the debt, such as deferments or forbearances. It's a good option for short-term financial difficulties. but make sure you note that even when there's forbearance that interest continues to accrue. Then there's alternate repayment plans, such as extended repayment plans that lenders can provide or income-based repayment to provide a lower monthly payment. These are best for longer-term financial difficulties, such as income that's insufficient to pay the debt.

But again, all you're doing is extending the problem. You're going to be paying lower amounts so it's going to take you longer to pay off the loan. What you need to do is if you're in that situation — you've graduated but your income is not sufficient — you need to talk with your lender. Don't ignore the loans because if you default you lose options such as access to deferments and forbearance and so forth. A default increases the cost of a loan because if you ever read the fine print in these loan agreements, once you default they can start charging you for all kinds of things in addition to just the principal and the interest.

It's important for students to become financially literate. They need to use budgeting to monitor their spending and control spending, make sure they're going to have enough money to make their payments in college and once they get out of college. It's easy to say, but hard to do. Students really need to start thinking about their spending and budgeting. Write down what you spend, and determine whether you need that cup of latte at Starbucks every morning. If you cut that out maybe it would save you X hundreds of dollars a year, which could be used then to make loan payments.

The best way to ensure you don't get in trouble with loans is to plan at the front end and maybe even before you take on the debt. What is the average starting salary for the profession I plan to go into? Will it cover my debt payments? If it won't, then you probably shouldn't be getting into that line of work. You should be looking at doing something else.

Cappelli: But there is one other thing to think about and that is a lot of these student loans are administered by private banks. But they're actually kind of controlled by the federal government. The federal government has guidelines and help for students who are in financial trouble. There's some evidence that not all the banks have been particularly forthcoming in terms of giving the students who are in trouble all the access to all the information and all the opportunities to deal with those special circumstances.

The other thing you want to do is check with the federal government (*see related links for a good resource*). Don't just check with your lender, because the lenders haven't all been terrific about this.… There's not a ton of help but there are some kinds of help that you might be able to get if you're in trouble.