CREDIT BUILDERS ALLIANCE

Student Loans and Credit

Tips for Coaches and Lenders

CREDIT BUILDERS TOOLKIT®

Tips for Coaches

Making Sense of Student Loan Repayment and Credit

Millions of Americans are managing and often struggling with student loan debt. However, student loans can be powerful credit and asset building tools as long as they are managed well over time.

How do Student Loan repayment statuses impact Credit Scores?

Although credit scores are not used to underwrite federal student loans, how they are repaid will have an impact on credit scores. As with all credit accounts, it is critical to keep student loan accounts current for the best impact on the credit score. Let's consider how different loan repayment statuses can affect credit scores.

DEFINITIONS:

- **Deferment** is a period when loan payments are postponed and interest does not accrue. Typical for consumers who are currently in school and for some types of economic hardship.
- **Forbearance** is a period when loan payments are temporarily suspended or reduced. Principal payments are postponed, but interest will continue to accrue. May be requested due to economic hardship or illness, or for specific circumstances such as medical residency programs or national service positions.
- **Income Driven Repayment Plans** are repayment options for consumers with federal student loans that are determined based on a consumer's household income and require an application and ongoing income verification.

Current statuses (as long as the repayment amount is greater than $0) will have a positive effect on credit scores!

Recommendation: Keep up payments and if student loans are the only active credit accounts that your client has, consider adding a manageable revolving line for a healthy mix of credit types!

Forbearance or Deferment statuses will not have a positive or negative effect on credit scores (unless a borrower was delinquent prior to going into deferment or forbearance status). Loans with these statuses may not considered active credit – but they have the potential to become active in the future!

Recommendation: Encourage your clients to consider their options for once repayment begins. Remind them that repaying their loans as agreed will help them to build credit!

Delinquent and Default statuses will have a negative effect on credit scores. The impact will be more severe if the consumer has little or no other credit accounts.

Recommendation: If possible, help your client to avoid or recover from delinquency by enrolling in an income-driven repayment plan or if necessary, contact the servicer to assess options for a temporary deferment or forbearance.

www.creditbuildersalliance.org programs@creditbuildersalliance.org 202-730-9390

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Private vs. Federal Student Loans?

There is no distinction between how a private student loan and a federal student loan affects the credit score. However borrowers with private student loans may have fewer options (such as deferment, forbearance or income driven repayment plans) for preventing loans from becoming delinquent if they cannot make the required payments.

Recommendation: Encourage your clients to consider consolidation options and stay in communication with the servicer to avoid default

Beyond the score

Even though the ***status*** of non-active student loans may not impact a credit score, the amount of outstanding debt certainly still can. In addition, even if your client is not actively making payments on student loans in good standing because they are in forbearance, deferment or because they are on an income-based repayment plan, a lender or other business may still consider their loans and the total amount of outstanding debt that they owe in deciding whether they qualify for credit or other services. For example:

- **Lenders** will most likely calculate student loan debt into an applicant's DTI (Debt-to-Income) Ratio, in anticipating a future loan payment even if the borrower isn't making payments currently. *For example, FHA requires that 2% of an applicant's student loan debt be included in a DTI calculation, even if the loans are in deferment.*
- **Landlords, Employers,** and other businesses that access consumer credit reports may not be aware of what deferred status' means and could potentially assume that an applicant is struggling to pay their bills. *Encourage your clients to be proactive in explaining the status of their student loans, and offer documentation from the loan servicer stating that the loans are in good standing.*

Did you know...

The average Class of 2015 college student graduated with $35,000 of student loan debt

Source: MarketWatch

HELPFUL LINKS to learn more

U.S. Department of Education Financial Aid Toolkit
www.financialaidtoolkit.ed.gov

Project on Student Debt
www.ticas.org/posd/home

The Financial Clinic's Change Machine Platform
www.change-machine.org

NerdWallet comparison of private loan consolidation options
www.nerdwallet.com/blog/loans/student-loans/private-student-loans/

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How to assess applicant student loan debt:

- Develop clear policies and procedures for how your organization assesses and calculates student loans, including those with deferred or $0 payment status.
- Do not ignore student loans that don't require borrower payment. Anticipating future payments on student loans can be critical in assessing an applicant's ability to pay and be successful with your loan products. Request additional information from applicants about when repayment will commence and their repayment options.
- For lenders making SBA loans: understand SBA requirements regarding student loans. Work with applicants to help them understand their options for addressing student loans in default, such as resources for rehabilitating federal student loans.

Watch out!

Help your clients avoid student loans scams such as:

- **Companies that require payment for consolidation or monitoring services.**
- **Companies that advertise immediate and/or permanent loan forgiveness or rehabilitation.**

Similar to other types of "credit repair" services, these types of predatory companies are seeking to profit from consumers who struggle with student loan debts.

Visit CBA's Learning Library for more tip sheets, tools, and resources on a variety of Credit Building topics!

creditbuilders alliance.org/ learning-library

In 2016 the DOE, Treasury and CFPB began an initiative to address consistency and consumer advocacy in reporting student loans. Learn more by clicking here.