

Med-Ex *On-Call*

FACTSHEET

MARCH 2018

STUDENT LOANS – HOW DO THE REPAYMENTS WORK AND IS IT WORTH PAYING THEM OFF EARLY?



This factsheet applies to English student loans taken out for courses starting from September 2012.

Many parents and students are worried by the prospect of students leaving university with student debt of £50,000 or more, together with an interest rate well above the level of inflation.

However, it is important not to confuse the size of the debt (the total amount of tuition fees, maintenance loan and interest) with the amount students will actually repay.

This is because the amount you repay depends primarily on what you earn after university, not what you owe. Those who earn a lot after graduating will repay a lot, while those who don't will repay far less.

How are the repayment amounts calculated?

- From the April after students graduate from or leave university, they will pay **9% of everything they earn above the student loan repayment threshold for a maximum of 30 years.**
- The repayment threshold is currently £1,750 a month (£21,000 a year), and is expected to be increased to £25,000 a year in April 2018.
- Earnings are defined as money from employment or self-employment, and in some cases income from savings and investments over £2,000 a year. If your earnings fall, your repayments drop accordingly.
- Student loans are repaid through payroll, like income tax. Employers deduct the repayments automatically from your salary before you get it. For those who are self-employed, repayments will be made via the HMRC self-assessment scheme.
- You only make repayments if you earn enough once you graduate.
- You only have to contribute for a maximum of 30 years, after which the debt is wiped.
- Interest is charged from the day you take out the loan, but doesn't change what you repay each year.

Examples:

- ❖ A graduate earning £22,000 in a year will pay £90 for that year (9% of £1,000).
- ❖ A graduate earning £40,000 in a year will pay £1,710 (9% of £19,000).

The repayment for the year is the same whether the student loan and interest is £20,000 or £50,000.

How long do the repayments continue for?

Student debt repayments cease either when the debt has been cleared or after 30 years from the April after graduation, whichever comes first. After 30 years, all debt is wiped. Loans are also cancelled on death or permanent disability. If a graduate never earns above the threshold during that time, they will repay nothing. Only those earning higher incomes are likely to repay all their student debt plus interest.

The Institute for Fiscal Studies estimates that 83% of those with English student loans won't clear the debt (including interest) within the 30 years (Source: IFS).

How is the interest rate calculated?

The interest added depends on a graduate's income, as shown in the table below:

Earnings	Interest Rate
From the date you take out the loan until the April after graduating or leaving university	RPI + 3%
Less than £21,000 (<i>£25,000 from April 2018</i>)	RPI
Over £41,000 (<i>£45,000 from April 2018</i>)	RPI + 3%
£21,000 - £41,000 (<i>£25,000-£45,000 from Apr 18</i>)	Rises gradually from RPI to RPI + 3%

However, as already explained, the amount owed doesn't change how much has to be repaid each year, as this is determined by earnings.

Does student debt impact your ability to get a mortgage?

Student loans don't go on credit files but they will impact the affordability checks which establish whether you can afford to make repayments on a mortgage.

Is it worth paying off student loans early?

Graduates will only pay the interest if they earn enough to have cleared the amount they originally borrowed within the 30 years. If not, they are just making repayments against the amount borrowed.

To clear the whole debt and interest within 30 years, a graduate would need to earn a consistently high income, either with a starting salary of £40,000 + and above-inflation rises, or lower but with very big pay rises later on.

For overpaying to have any impact, you need to repay enough that it would lower the amount you repay within the 30 years, otherwise it will not be worth it, as shown in the table below:

Example 1

	Without overpaying	£10,000 extra paid off
Student Debt (tuition and maintenance)	£55,000	£55,000
Extra Repayment	-	£10,000
Remaining Debt	£55,000	£45,000
Salary	£36,000	£36,000
Annual Repayments	£1,350 (9% of £15,000)	£1,350 (9% of £15,000)
Total repayments over 30 years	£40,500 (£1,350 x 30)	£50,500 (£1,350 x 30 + £10,000)

The example above is based on a repayment threshold of £21,000 over the 30-year period and assumes a level salary of £36,000.

You can see that in this scenario, the extra payment has not reduced the annual repayments at all, as they are based purely on income. It has actually increased the total repaid, so is effectively money wasted.

It is only really worth considering repaying a student loan early if the graduate is a high earner who is likely to repay the loan and interest in less than 30 years, or if you are considering overpaying a large lump sum which will radically reduce the amount owed.

It's also worth bearing in mind what their future earnings are likely to be. If their income falls, or they take time out to bring up a family, their repayments will fall too.

In the following example, the graduate has a higher salary but has taken a career break for 5 years to start a family:

Example 2

	Without overpaying	£10,000 extra paid off
Student Debt (tuition and maintenance)	£55,000	£55,000
Extra Repayment	-	£10,000
Remaining Debt	£55,000	£45,000
Salary	£40,000	£40,000
Annual Repayments	£1,710 (9% of £19,000)	£1,710 (9% of £19,000)
Total repayments over 30 years	£42,750 (£1,710 x 25)	£52,750 (£1,710 x 25 + £10,000)

Even though the salary is higher, the £10,000 over-payment has not reduced the annual repayments and has meant that overall more has been repaid.

Of course, it is important to consider the individual's specific situation. For example, if the initial student debt is less, repayments based on the level of income may mean that it is fully repaid sooner, and in this case it may also incur payment of any accrued interest within the 30-year period. In this scenario, it may be worth considering repaying any outstanding debt sooner in order to limit interest payments. This will also depend on the level of inflation and interest rate applicable.

Please note that voluntary payments cannot be refunded.

Sources and further information:

<https://www.moneysavingexpert.com/students/student-loans-tuition-fees-changes>

<https://www.gov.uk/education/student-loans-bursaries-and-sponsorship>

This factsheet is based on our understanding of the current student loan system. It is possible that the system could change in the future.

It is important to take professional advice before making any decision relating to your personal finances. Information within this factsheet is based on our current understanding of taxation and legislation and can be subject to change in the future. It does not provide individual tailored investment advice and is for guidance only. Some rules may vary in different parts of the UK; please ask for details. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from, taxation are those currently applying or proposed and are subject to change; their value depends on the individual circumstances of the investor.

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