<u>Audio Lesson #4 – Choose a School You Can Afford</u>

It's not a hill, it's a mountain
As you start out the climb…

Hello. My name is Jeff Tyburski. Welcome to my fourth in a series of audio lessons. I teach financial literacy with a focus on helping you save money. Unfortunately, you can't even begin to save if you have too much college debt. This is the third and final session devoted to ensuring you end up with minimal student debt. Doing so will keep you in a *position* to save. **This session will focus on choosing a school you can afford.**

This session specifically builds on the prior session in which you deeply considered your passions and arrived at career objectives you will be driven to achieve**. *Now, we will consider the future earning power associated with your career choice which indicates your ability to pay off student debt. The amount of debt your future job can support impacts the schools you can afford.***

Think of it this way…Think of an iconic brand: Coke, Pepsi, a Disney character, Band Aids, Kleenex, etc. For some real or perceived reason, we are willing to pay more for these brands versus their competitors. These brands earn strong cashflows during both good and bad economic times. **The high and stable cash generation allows the companies behind these brands to take on more debt** (that is, to borrow more) than their competitors. That debt allows them to invest in new plants, R&D, marketing, and other ways to increase their already strong competitive positions. This illustrates how market share begets market share.

Circling back to our effort and personal process to minimize college debt…**Think of your income potential as *your* ability to take on and service debt.**

So how do you research your potential income? I have provided some links if you print the outline and notepad for this session.

At this point I want to acknowledge the obvious, that **this exercise of researching your earning power produces *at best an estimate*. Why is it at best an estimate?**

- Precise information may not be available.

- You simply may not yet know the eventual, specific job or application of a broader degree you want to pursue. For example, do you use a biology degree to work in a lab or as a steppingstone to pursue a pre-med track? Or, you pursue a general business degree but don't know if you will end up working for a corporation or non-profit.
- Or Your career goals may radically change. For example, you may start out studying engineering and switch to economics.
- And Salary decisions vary based on applicant-specific personal qualities and also the required cost of living in the area of the country offering the job opportunity.

More importantly, **why is it *okay* to use an estimate** of earning power?

- **The goal here is a simple *reality check*. I hope to open your eyes to catch potential *extreme outcomes*.** If your self-assessment zeroed in on careers that pay about $30,000 a year, you will have *much* less ability to pay off debt than most future engineers, computer coders, financial analysts, or many in the medical field, who may start out earning over $60,000 per year. For example, we need many more good teachers and I encourage students to pursue teaching if that is their passion. While teachers are fortunate to someday receive a pension, lessening their need to save during their working years, the reality is their starting income level is typically not high and importantly is not really dependent on where the student goes to school. A student pursuing a teaching career will have difficulty paying off loans if they attend an expensive private school.

Think again about those iconic brands. Now imagine instead a start-up with no proven technology, commercial product, or revenue stream. Or consider a company that produces a commodity like steel or oil. Commodity companies can earn a lot in good times, but they can see earnings evaporate in a recession when demand falls. Compared to the iconic brands, which generate high and *steady* cashflow, here, the unproven start-up and cyclical commodity producers generate **inconsistent cashflow and can't support much debt** (i.e., as there will be times when they can't make debt payments).

So how does this fit with our framework? We are developing a personal plan for a student to get the career and degree they need without crippling amounts of student or parent college debt. The plan is a three-part solution which begins with the student deeply considering their career goals. Next, the student estimates the future earning power of such a career. So, after deciding on your career goals and estimating your earning power or income potential, do you look more like an iconic brand or more like a commodity producer? That is, **do you expect a fairly high starting salary that can support college debt or a low/uncertain income that cannot pay off much debt?**

Let's get specific for Sizing the Student Debt Load

An appropriate college debt load is about *one times* the student's estimated future starting salary: the lower the better.

Remember, **debt load is your accumulated total of debt** (e.g. after all two, four, or more years of school). Don't make individual semester or school year debt decisions in isolation. Even early on, calculate and forecast what your total debt load will likely be when you finish school**,** hopefully graduating on time.

Please know that a fair amount of math and analysis goes into deriving this *seemingly simple rule of thumb*. I don't want you to have more **college debt than would be manageable.** I also want you still to be in a position to save money at a young age.

Definitely do not exceed 1x if you are likely to have a lower salary.

Federal student loans are easily obtained up to a cumulative maximum amount (four-year total amount) of about $27,000. Thus, for some students who expect to be low-income earners (about $30,000), they really shouldn't take on any more loans! Higher expected income (e.g. greater than $50,000) can support a bit more debt but even at 1.25x (debt at 1.25 times the starting salary), annual debt payments will be approaching 20% of gross income!

My analysis is generic and obviously cannot factor in each individual's personal situation. My model and rule of thumb may suggest a safe level of debt but if the individual does not control personal spending, lives in an especially expensive area or city, does not prioritize paying off debt, or does not maintain their earning power, then the individual may still run into problems paying off their college debt

To be successful at *choosing* a school you can afford, you should begin by only *looking* at schools you can afford. Importantly, decide this early so you don’t visit other schools that will tempt you to make a purely emotional decision. Don’t underestimate the potential to be tempted. It is hard not to fall in love with a beautiful college campus when visiting on a gorgeous autumn day.

I encourage open communication between parents and student; talk openly about what the family has saved for college and what the financial implications would be to take on too much debt. **The more you stick to a process, the easier it will be to remove the emotion from this major financial decision.** College is expensive. We can’t change that fact. **In the end, it is the student and family’s responsibility to make a sound financial decision and select a school they can afford.**

My message suggesting that you only look at schools you can afford may **sound harsh and is likely unpopular**. It can sound **limiting**. It may even sound **unfair**. *I* actually think it is *empowering.* I think my approach allows you to take more control. **I simply care about your future financial situation**. As we have discussed, there is a millennial financial crisis. **Young people aren’t saving** money or building wealth because they **are instead digging out of a debt-driven financial hole**.

I really do empathize with how students and families may struggle with my advice. I am not suggesting attending college without any borrowing; I am urging you to *minimize* debt. I acknowledge:

- Some parents do take loans to help their children attend college.
- Some students and parents can’t put aside a dream school or legacy opportunity.
- There is some level of rationalization that some debt is an investment in a higher paying future job.
- And…Some parents want their children to have a *financial stake* in going to college, and they see a loan as that stake. That is a reasonable argument, often motivated by a parental desire for children to learn to manage their finances. *My experience, however*, is that students don’t relate to the financial stake of having a loan because the impact is deferred (that is, the effort, and perhaps even hardship, associated with repayment is too many years in the future after the time of loan disbursement to pay for school). I believe the financial lesson parents think they are teaching often fails to hit the mark. I’d prefer that

graduates be in a position to save and build wealth rather than be in a hole paying off debt.

To wrap up this session, really the 3 sessions on minimizing student debt, please don't lose sight of my primary goal which is to help you recognize and avoid a problem that is literally crippling many of your peers. I want you to at least have a framework and personal process to make a better college selection decision than you might otherwise make. My advice is challenging, but I think it is in your best interest in the long run.