Business Standard

Preparing your child for education loan

This is perhaps the first time your child is taking a loan. Here's how you can guide her to use it wisely

Kiran Telang November 09, 2013 Last Updated at 21:19 IST

You've wisely earmarked certain investments for your child's education. For some reason, though, a shortfall looms. Perhaps the cost of the course selected by your child is more than what you planned. Or s/he wishes to go abroad for higher studies. And you were unprepared for that. An education loan can bridge the gap.

In their eagerness to embark on a career, children may not grasp the significance of taking loans - or of repaying them. It's perhaps the first time they face a loan officer - and the first ever situation of negotiating a loan. This, therefore, calls for greater parent participation.

But first, here's the lowdown on education loans.

A primer
Education loans are available for studies beyond the plus-2 or higher secondary school. They can be availed of by a student with parents/guardians as co-applicants, or by a parent for a child. Various banks and financial institutions provide loans for education, both in India and abroad. Though each institution has its own set of rules, they are fairly standardised across the board.

The limit for education in India is Rs 10 lakh and Rs 20 Lakh for education abroad. Interest rates on the loan vary from 9 to 14 per cent per annum. Of the cost of the education 15 per cent is to be provided by you; the balance can be funded by a loan if the total cost of education crosses Rs 4 lakh. If you intend to take a larger loan amount, you may have to provide third-party guarantees or additional collateral.

Such loans generally cover costs of admission, tuition, boarding and books; for studies abroad, travel cost is included. Payments are made directly to the college every year. Of course, good academic performance constitutes one of the terms and conditions in order to continue to be eligible for the loan. Progress reports need to be submitted regularly during the period of the loan. Details of such terms and conditions are available on websites of banks and financial institutions.

Courses that usually get preference
Generally medical, engineering and MBA courses figure higher on the list of approvals for loans. While for banks, education loans are considered part of priority-sector lending. they have to ensure that such loans do not turn into non-performing assets (NPAs).

In the last few years the number of education loans becoming NPAs has risen, primarily because of the unfavourable economic environment. One of the factors for the provision of loans is the repayment capacity of an applicant. It is usually easier, therefore, to secure loans for courses which have a greater chance of employment and income generation. The repayment capacity of a parent taking on a loan for a child will be taken into consideration. The reason is that there is the greater likelihood that the parent already has loans to his/her name like a home loan or a vehicle loan.

This naturally affects repayment capacity and reflects in an application for an education loan.

What parents should take cognizance of
Parents are advised to have open discussions with their children about money and taking loans. Both affordability and willingness to fund a child's higher education should be openly discussed.

Parents should consider several aspects before they sign for educational loans for their children. The primary one is their own preparedness for retirement. A retirement corpus should not be touched in order to fund any other goals. In such cases, a student taking an education loan would be a far better idea. S/He can start repaying the loan once s/he starts earning. Most banks provide a pause period for re-payments. Re-payments are generally due on securing a job or six months from completing a course, whichever is earlier.

If you actually begin paying off the interest component during the course period, you will get one per cent on the interest rate. If a person is unable to secure employment on completing a course, the parent will have to start repaying the loan. So parents have to prepare for the worst case and judge how such payments will affect their own finances.

Of course, a student will start life - and a career - with the burden of debt. S/He will have up to eight years to repay the loan in full. Naturally, that will affect her/his own financial goals. For them, the prime responsibility would be to pay off the student loans as quickly as possible so as to free up cash flow towards their own financial goals.

The person who has taken the loan (parent/child) will be eligible for tax benefits under Section 80E of the Income Tax Act, 1961. This offers deduction of the interest amount from your income, the benefit only applicable on the interest. This tax benefit comes over and above the benefits available under Section 80C. However, tax benefit should not be the primary reason for taking a loan; and instead should be looked on as a bye-product of fulfilling a need.

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FURTHER YOUR CHILD'S CAREER SMARTLY

- Education loan can bridge the funding gap for your child's further studies, so use it judiciously
- Parents will need to sign up as co-guarantors or put up additional collateral for higher loan amounts
- There's a moratorium on interest repayment till the course is over, but paying early helps reduce costs
- Tax breaks are available on interest payments, but that should not form the basis for taking a loan