Student loan interest rates increase

The rates charged on student loans rose at the start of September.

The revised terms for interest on, and repayment of, student loans were published in August, along with the A level results for the year. From 1 September, the main interest rates for Plan 2 loans, taken out by students and recent graduates in England and Wales, are:

Period	Interest Rate
During study and until the April after leaving the course.	6.3%
From the April after leaving the course (maximum 30 years).	On a sliding scale, rising from: 3.3%, where income is £25,725 or less; up to 6.3%, where income is £46,305 or more.

Plan 1 student loans, taken out by students in Scotland and Northern Ireland (and students in England and Wales whose course started before 1 September 2012), carry a 1.75% interest rate.

Both rates represent an increase – 0.2% for Plan 2 and 0.25% for Plan 1. The first was driven by an increase in the RPI for March 2018 against March 2017, and the second by last month's base rate rise.

The income threshold at which loan repayments start to be made will also rise from 6 April 2019, to £25,725 for Plan 2 RPI-linked loans and £18,935 for the older Plan 1 loans. The repayment level will be held at 9% of the excess income, meaning the cheaper loans will require higher repayments.

Tax implications

The 9% repayment rate has the same effect as an increased tax rate above the threshold. An employed basic rate taxpaying graduate therefore could suffer a marginal 'tax' rate of 41% in 2019/20 – 20% income tax + 12% national insurance contributions (NICs) + 9% loan repayment.

Including auto enrolment, the same graduate could also be required to make pension contributions of 4%, net of tax relief, making for total deductions of 45%. As auto enrolment contributions disappear above the upper earnings limit and NICs drop to 2% above the higher rate threshold, the maximum overall rate facing a higher rate taxpaying graduate is 51% (40% income tax + 2% NICs + 9% loan repayment).

The Institute for Fiscal Studies believes that in practice 80% of graduates will never fully repay their loans, as they will have the outstanding amount written off after 30 years (or an earlier death). That makes planning to provide funds for your student child/grandchild to help them avoid having to borrow a potentially unrewarding idea.

A more effective strategy could be to make sure that they have adequate financial resources when they graduate to help them cope with those high effective rates of tax. For help with how that can be arranged, please talk to us now – even if the graduate is still only at primary school, it is never too early to start planning.