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Paying for school just got easier

Quick Reference Guide on Choosing a Student or Parent Loan

Top Ten Student Loan Tips

Debt is often unavoidable when it comes to paying for college, with two-thirds of Bachelor's degree recipients graduating with student loans. Smarter borrowing, however, can help you reduce your debt burden.

1. **File the Free Application for Federal Student Aid (FAFSA).** The FAFSA is a prerequisite for federal student and parent loans. The unsubsidized Stafford and PLUS loans do not depend on financial need, so you do not need to be poor to qualify for low-cost federal education loans. You might also qualify for government grants and other forms of financial aid. You can file the FAFSA online at www.fafsa.ed.gov.

2. **Minimize debt.** Live like a student while you are in school so you don't have to live like a student after you graduate. Do not treat loan limits as targets. Students who borrow more than $10,000 a year will graduate with more debt than 90% of their peers. Every dollar you borrow will cost you about two dollars by the time you've repaid the debt. So before you spend student loan money on anything, ask yourself if you'd still buy it at twice the price. Borrow only what you really need to pay for school.

3. **Plan ahead.** Your total education debt at graduation should be less than your expected starting salary, and ideally less than half your starting salary. Otherwise you will have difficulty repaying your student loans and you may be forced to abandon your dreams by the need to repay your debt. Estimate your debt at graduation by multiplying your first year's debt by the number of years in your degree program. If you borrow more than your expected starting salary, you will need to use a longer term repayment plan to afford your monthly loan payments. This means you will still be repaying your own student loans by the time your children enroll in college. Extending the repayment term will double or even triple the total interest paid over the life of the loan. If you borrow more than twice your expected starting salary, you will be at high risk of default.

4. **Borrow federal first.** Federal student loans are cheaper, more available and have better repayment terms than private student loans. The interest rates on federal education loans are fixed, while the interest rates on most private student loans are variable and will probably increase over the life of the loan. Federal student loans are eligible for income-based repayment (www.finaid.org/ibr) and public service loan forgiveness (www.finaid.org/pslf), while private student loans are not. Federal student and parent loans can be obtained through your college's financial aid office.

Key Student Loan Resources

FinAid's Student Loans Section
www.finaid.org/loans

FinAid's Student Loan Calculators
www.finaid.org/loans/calculators.phtml

Student Loan Checklist
www.finaid.org/studentloanchecklist

Student Loan Borrower Assistance Project
www.studentloanborrowerassistance.org

Project on Student Debt
www.projectonstudentdebt.org

Federal Student Loans
www.studentloans.gov

Federal Direct Loans
www.direct.ed.gov

Direct Loan Servicing
www.dlssonline.com
1-800-848-0979 or 1-315-738-6634 or fax 1-800-848-0984
1-800-848-0983 TDD

Federal Direct Consolidation Loan
www.loanconsolidation.ed.gov
1-800-557-7392 or fax 1-800-557-7396
1-800-557-7395 TDD

Private Student Loans
www.finaid.org/privatestudentloans

Private Loan Comparison Sites
www.finaid.org/loancomparison

Private Consolidation Loans
www.finaid.org/privateconsolidation

Federal Student Aid Ombudsman
The FSA Ombudsman mediates disputes and helps resolve problems concerning federal student loans.
www.ombudsman.ed.gov
1-877-557-2575 or fax 1-202-275-0549
fsaombudsmanoffice@ed.gov

Federal Student Aid Information Center
1-800-4-FED-AID (1-800-433-3243) or 1-319-337-5665
1-800-730-8913 TDD
studentaid@ed.gov

Forgot Your Lender? Ask your college's financial aid administrator or visit www.finaid.org/lostlender

National Student Loan Data System (NSLDS)
www.nslds.ed.gov

5. **Ask about tuition installment plans.** Most colleges offer tuition installment plans which let you spread out the college bill over 9 or 12 equal monthly installments. These plans typically charge an up-front fee of less than $100 and do not charge interest. This can be a cheaper alternative to borrowing the money through education loans.

6. **Pay the interest on unsubsidized loans during the in-school and grace periods** to prevent the loan balance from growing larger. Most student loans allow borrowers to defer repaying the loans during the in-school and grace periods. If you don't pay the interest at it accrues, however, the interest is capitalized (added to the loan balance). This is negative amortization (www.finaid.org/negamort) and can increase the loan balance by 15% to 20% by the time you enter repayment. Federal and private student loans do not have prepayment penalties (www.finaid.org/prepay), so nothing prevents you from paying the interest during the in-school period. Even if you can't afford to pay the full amount of interest, try to pay something, as this will save you money in the long term. Some lenders will even give you a lower interest rate or other discounts if you agree in advance to make payments during the in-school period.

7. **Apply for private student loans with a creditworthy cosigner.** Not only will this increase your chances of getting the loan, but it usually results in a lower interest rate since eligibility, interest rates and fees are based on the higher of the two credit scores. But beware, a cosigner is a co-borrower, equally obligated to repay the debt. If the primary borrower is delinquent or defaults on the loan, the late payments and default will be reported on the cosigner's credit history too.

8. **Get organized.** Create a student loan checklist that lists all of your student loans. A blank student loan checklist is available at www.finaid.org/studentloanchecklist. Put all of your paperwork for each loan in its own file folder labeled with the lender name, date borrowed, original loan balance and loan id. Put a note on your calendar at least a week before your first payment is due. Tell the lender about your new address whenever you move.

9. **Sign up for auto-debit with electronic billing**, where the monthly loan payments are automatically debited from your bank account. Borrowers with auto-debit are much less likely to miss a payment. Many lenders offer discounts for borrowers who set up auto-debit with electronic billing. Federal education loans offer a 0.25% interest rate reduction while many private student loans often offer a 0.25% or 0.50% interest rate reduction for auto-debit.

10. **Claim the student loan interest deduction on your federal income tax return.** Up to $2,500 in student loan interest on federal and private student loans can be deducted on your federal income tax return each year. This deduction is taken as an above-the-line exclusion from income, letting you claim the deduction even if you don't itemize. You can take the deduction only if you are required to make payments and you can't be claimed as an exemption on someone else's return. (www.finaid.org/interestdeduction)

Criteria for Choosing a Student Loan

When evaluating an education loan, most families focus first on cash flow considerations:

- *How much money can you get to pay for college costs and/or living expenses?*
- *How much are the monthly payments?*
- *When do the payments start and when do they end?*
- *What is the total cost of the loan (the total payments over the life of the loan)?*
- *Who is responsible for paying back the loan?*

The cost of the loan depends on several factors. Of these, the interest rate has the biggest impact on loan costs. Generally, families should prefer loans with the lowest after-tax interest rate, such as federal education loans.

- **Interest rate.** Is it variable or fixed? If it is variable, how frequently does it change and is there a cap? Beware: Not everybody qualifies for the best advertised rate.

- **Fees.** Origination, disbursement and guarantee/default fees are effectively a form of up-front interest, like points on a mortgage. A good rule of thumb is that every 4% in fees is the equivalent of about a 1% increase in the interest rate on a 10-year loan and about a 0.5% increase in the interest rate on a 30-year loan (e.g., 7.9% interest rate + 4% fees equivalent of 8.84% interest rate and no fees with a 10-year repayment term, 8.33% interest rate and no fees with a 30-year term). Some private student loans charge a second fee when the loan enters repayment. Most loans also charge late fees (typically up to 6% of the late payment) and collection charges (for loans in default).

- **Subsidized loans.** The government pays the interest on subsidized federal loans, such as the Federal Perkins loan and the Federal subsidized Stafford loan, during the in-school, grace and other eligible deferment periods. Eligibility for subsidized loans is based on financial need. Unsubsidized loans are not based on financial need and may be used to pay for the family's share of college costs.

- **Interest capitalization.** Borrowers can defer repaying unsubsidized loans and private student loans during the in-school, grace and other deferment periods by capitalizing the interest (adding it to the loan balance). The frequency with which capitalization occurs can affect the cost. Monthly capitalization is the most expensive, increasing the total interest by as much as 10%. One-time capitalization when the loan enters repayment is the least expensive.

Capitalization Frequency	Capitalized Interest	Total Interest Comparison
Monthly	$4,978	+10.5%
Quarterly	$4,947	+9.8%
Annually	$4,835	+7.3%
At Repayment	$4,505	+0.0%
$27,000 unsubsidized Stafford loan ($5,500, $6,500, $7,500, $7,500) over 4 years with 2 disbursements per year, 6.8% interest.		

- **Discounts.** Some lenders offer interest rate reductions or one-time rebates that can reduce the cost of the loan. Some discounts require the borrower to agree to have monthly payments automatically debited from the borrower's bank account and to receive monthly statements by email. Other discounts require the borrower to make all payments on time. Some discounts are provided when the student graduates. Some lenders provide slightly lower Interest rates for borrowers who make payments during the in-school period, choose a shorter repayment term or have a cosigner.
- **Tax deduction.** The student loan interest deduction allows borrowers of qualified education loans, such as federal and most private student loans, to deduct up to $2,500 a year in student loan interest on their federal income tax returns.

Other criteria focus on eligibility, flexibility and convenience:

- **Who is the borrower?** Some loans are borrowed by the student (Perkins, Stafford, Grad PLUS, Private) and others are borrowed by the parent (Parent PLUS, Private) or someone else (Private). Some private student loans require a cosigner. A cosigner is a co-borrower, equally responsible for repaying the loan. If the payments are late or the loan goes into default, the loan's status will be reported on the credit history of both the borrower *and* cosigner. Some loans that require a cosigner offer a cosigner release option, where the cosigner can be removed from the loan after the borrower makes the first 12, 24, 36 or 48 payments on-time, subject to credit criteria.
- **Borrower eligibility.** Is the loan eligibility based on satisfying credit underwriting criteria (e.g., good credit scores, debt-to-income ratios, secondary criteria) or is everybody eligible? Most student loans require the student to be enrolled on at least a half-time basis.
- **Eligible expenses.** Some loans are limited to just institutional charges (e.g., tuition and fees), while others include living expenses such as room and board, books and personal expenses or the full cost of attendance.
- **Loan limits.** What are the annual and aggregate (cumulative) loan limits?
- **Deferment.** Does the loan allow borrowers to defer repayment during the in-school period or does it require that repayment begin immediately? Is there a grace period after graduation before repayment begins? How long is the grace period?
- **Repayment plans.** Does the lender offer a variety of flexible repayment plans? Does the lender offer income-based repayment? How often can you change repayment plans? How long is the repayment term in years? Will the borrower still be in repayment when his or her children enroll in college? Is the monthly loan payment affordable?
- **Prepayment penalties.** By law, neither federal nor private student loans may have prepayment penalties.
- **Tools for dealing with financial difficulty.** Does the lender offer forbearances (temporary suspensions of the obligation to repay) if the borrower loses a job or encounters financial difficulty? Is the forbearance full (suspend payments of principal and interest) or partial (suspend payments of just principal)? What are the limits on the duration of forbearances? Does the lender charge a fee for each forbearance?
- **Cancellation.** Federal education loans and some private student loans will discharge the debt if the borrower dies or becomes totally and permanently disabled. Federal loans also offer public service loan forgiveness.
- **Customer service.** Are customer service hours limited, or can you reach the lender in the evening and on weekends? Will you have to navigate a call tree or spend hours on hold? Does the lender provide an online loan application and a self-service online account management tool? Does the lender ever sell the loans to another lender, which can yield a change in the loan servicer, or does the lender provide life-of-loan servicing? How well does the lender resolve problems? Are there a lot of complaints?

Be sure to read the fine print in the promissory note before signing it. Details matter, especially since you will be in repayment for a decade or longer. The promissory note is a binding legal agreement between you and the lender.

Quick Reference Guide on Choosing a Student or Parent Loan

Calculating Monthly Loan Payments (Loan Amortization)

A level repayment plan on a fixed-rate loan has the same monthly payment throughout the loan. During the first few years of the loan, more of each payment is applied to interest. As the end of the loan term approaches, more of each payment is applied to reducing the loan balance. It takes years before the borrower will notice a lot of progress in reducing the debt, especially if there is accrued but unpaid interest. Increasing the monthly payment will accelerate progress in paying off the loan, the equivalent of choosing a shorter repayment term.

The following table shows the monthly payments on a $25,000 loan for various repayment terms using several of the most common interest rates for education loans. To calculate the monthly payments on a $50,000 loan, just double the monthly loan payments in this table. The monthly loan payments increase in proportion to the amount owed.

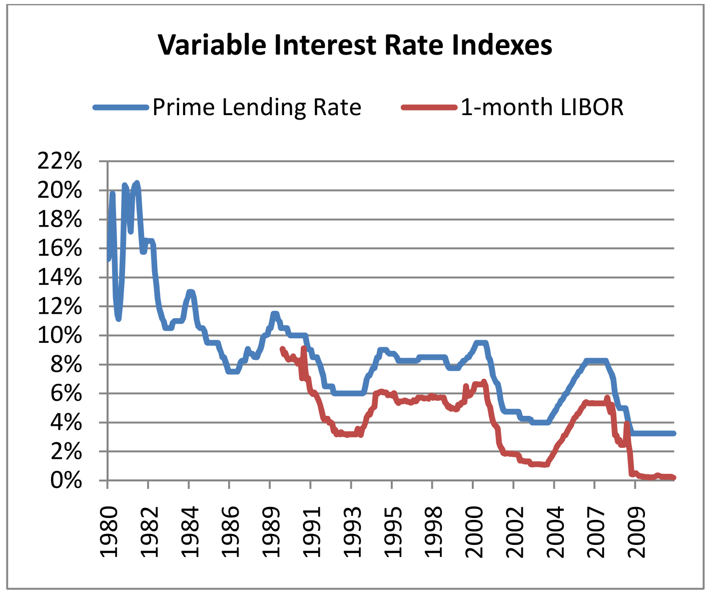
	Monthly Loan Payment on a $25,000 Loan						
Loan Term	3.4%	4.5%	5.0%	5.6%	6.0%	6.8%	7.9%
10 Years	$246	$259	$265	$273	$278	$288	$302
12 Years	$212	$225	$231	$239	$244	$254	$269
15 Years	$177	$191	$198	$206	$211	$222	$237
20 Years	$144	$158	$165	$173	$179	$191	$208
25 Years	$124	$139	$146	$155	$161	$174	$191
30 Years	$111	$127	$134	$144	$150	$163	$182

The following table shows the maximum cumulative debt corresponding to a particular monthly payment. Multiply the monthly loan payment by 100 to 150 to calculate the annual salary needed to repay the debt at 12% and 8% debt-service-to-income ratios, respectively (e.g., $500/month → $50,000/year).

Loan	Monthly	Maximum Cumulative Debt			
Term	Payment	3.4%	5.0%	6.8%	7.9%
10 Years	$50	$5,100	$4,700	$4,300	$4,100
10 Years	$100	$10,200	$9,400	$8,700	$8,300
10 Years	$250	$25,400	$23,600	$21,700	$20,700
10 Years	$500	$50,800	$47,100	$43,400	$41,400
10 Years	$1,000	$101,600	$94,300	$86,900	$82,800
20 Years	$50	$8,700	$7,600	$6,600	$6,000
20 Years	$100	$17,400	$15,200	$13,100	$12,000
20 Years	$250	$43,500	$37,900	$32,800	$30,100
20 Years	$500	$87,000	$75,800	$65,500	$60,200
20 Years	$1,000	$174,000	$151,500	$131,000	$120,400
30 Years	$50	$11,300	$9,300	$7,700	$6,900
30 Years	$100	$22,500	$18,600	$15,300	$13,800
30 Years	$250	$56,400	$46,600	$38,300	$34,400
30 Years	$500	$112,700	$93,100	$76,700	$68,800
30 Years	$1,000	$225,500	$186,300	$153,400	$137,600

Impact of Variable Interest Rates

Most private student loans have variable interest rates. Since interest rates are unusually low right now, these interest rates are likely to increase over the term of the loan. The following chart shows how the two major variable rate indexes have changed over time. Given that these rates dropped by about 5.5% during the credit crisis, they can just as easily increase by a similar amount during the economic recovery.



This graph also shows that the spread between the Prime Lending Rate and the LIBOR index is about 3%. The spread rises gradually by about 0.19% every 10 years. Borrowers should prefer variable rate loans that are pegged to the LIBOR index, since the LIBOR index increases more slowly than the Prime Lending Rate. This can yield an average interest rate that is about 1/8% to 1/4% lower over the life of the loan.

An increase in a loan's interest rate can significantly affect the monthly loan payment, as demonstrated by the following table. For example, a 5% increase in the LIBOR index will increase monthly loan payments by about a quarter for a 10-year term, by almost half for a 20-year term and by about three-fifths for a 30-year term.

Increase in Monthly Loan Payment Per 1% Increase in the Interest Rate	
Loan Term	Increase
10 years	4.9% ± 0.2%
15 years	7.1% ± 0.5%
20 years	9.0% ± 0.7%
25 years	10.8% ± 1.1%
30 years	12.2% ± 1.4%

As shown in the previous table, each 1% increase in the interest rate yields about a 5% increase in the monthly loan payment for a 10-year term. Longer repayment terms yield a bigger increase in the monthly payment, such as about 9% for a 20-year term and about 12% for a 30-year term. One can approximate the increase as 4.5% per each 10 years of repayment per 1% increase in the interest rate, or as 1% plus 4% per each 10 years of repayment per 1% increase in the interest rate.

Warning about Borrowing Too Much Money

Education debt might be considered by some to be good debt, because it is used to invest in your future. Yet too much of a good thing can be harmful.

You can't get away from this debt, as student loans are almost impossible to discharge in bankruptcy and there is no statute of limitations on federal education loans. A successful discharge requires demonstrating undue hardship in an adversary proceeding, a very harsh standard. Of roughly 72,000 borrowers in bankruptcy in 2008, only 29 had all or part of their federal student loans discharged. That's 0.04%. You are more likely to get cancer or die in a car crash than to have your student loans discharged in bankruptcy.

The federal government has very strong powers to compel repayment of defaulted federal education loans. The federal government can garnish up to 15% of your wages and intercept your income tax refunds without a court order. They can even garnish Social Security benefits and take your lottery winnings. A student loan default on your credit history will make it more difficult to get credit cards, auto loans, home mortgages. It can even affect your ability to get a job or rent an apartment.

Education debt can also have a big impact on your lifestyle after graduation. Students who graduate with no debt are almost twice as likely to go on to graduate and professional school as students who graduate with some debt. Students who graduate with excessive debt or who default on their loans are more likely to be depressed. They often delay getting married, having children, buying a car and buying a home. Borrowing excessively can be like having a mortgage without owning a home. The debt may make it more difficult to save for retirement or your own children's college educations.

Warning about Advance Fee Loan Scams

Beware of advance fee loan scams, in which a scam artist requires you to pay a fee before you can receive the loan. When you pay the money, the promised loan never materializes. Real educational loans deduct the fees from the disbursement check. They never require an up-front fee when you apply for the loan.

Also watch out for scam artists sending you a realistic but fake loan check. They will have a plausible excuse for you to send them some money, such as payment of origination and guarantee fees, before the check clears your bank. By the time the check is rejected by your bank, the thief is long gone with your money. Most student loan proceeds are paid directly to the school by EFT, not paper check.

Test Your Loan IQ

Think you understand how interest affects a loan? Answer this multiple choice question.

The total amount paid back (including principal and interest) for a $10,000 loan with a 10-year term at 10% interest is:

A. $1,000	D. $18,100
B. $11,000	E. $20,000
C. $15,858	F. $32,479

The answer appears on the second to last page of this quick reference guide.

Federal Perkins Loan

The Federal Perkins Loan is a need-based loan awarded by the college to students with exceptional financial need.

The money for the Perkins loan comes from a revolving student loan fund. As current borrowers repay their loans, the money is used to make loans to new students. The number of Perkins loans varies from college to college.

The Perkins loan has a fixed 5% interest rate with no fees. Repayment begins 9 months after graduation or dropping below half-time enrollment status. The repayment term is 10 years, but borrowers can obtain longer repayment terms by consolidating Perkins loans.

The Perkins loan is subsidized, meaning that the federal government pays the interest on the loan during the in-school and grace periods and other deferments. The subsidized interest benefit is lost upon consolidation of a Perkins loan.

The Perkins loan previously provided up-front loan forgiveness for borrowers who worked in certain occupations. A portion of the loan was forgiven for each year of full-time service.

However, Congress has not provided funding for this loan forgiveness program since FY2010 and is unlikely to provide funding in the future. However, Perkins loan borrowers may obtain public service loan forgiveness (a back-end loan forgiveness program that requires 10 years of full-time service) by consolidating their loans into the Direct Loan program.

Perkins Loan Limits Year in School	Annual Loan Limit	Aggregate Loan Limit	Average Loan
Undergraduate Students	$5,500	$27,500	$2,000
Graduate and Professional Students	$8,000	$60,000	$3,650

Federal Stafford Loan

The Federal Stafford Loan has two versions, subsidized and unsubsidized. Subsidized Stafford loans are awarded based on financial need. Unsubsidized Stafford loans are not based on financial need. The government pays the interest on subsidized Stafford loans during the in-school and grace periods and other deferments. The interest on unsubsidized Stafford loans continues to accrue during the in-school, grace and deferment periods. The borrower may defer paying the interest by capitalizing it, which adds it to the loan balance. Capitalizing interest can increase a borrower's debt by as much as 20% by the time the borrower enters repayment.

Since July 1, 2010, all new Stafford and PLUS loans have been made through the Direct Loan program, with money provided by the US Department of Education through eligible colleges and universities. Federal education loans are no longer made by banks and other financial institutions, although some education lenders may be involved in the servicing of loans in the Direct Loan program.

Repayment begins 6 months after graduation or dropping below half-time enrollment status. The standard repayment term is 10 years (up to 25 years with income-based repayment), but borrowers can obtain longer repayment terms by consolidating their Stafford loans.

	Undergraduate Students Stafford Loan Interest Rate	
Year	Subsidized	Unsubsidized
2007-08	6.8%	6.8%
2008-09	6.0%	6.8%
2009-10	5.6%	6.8%
2010-11	4.5%	6.8%
2011-12	3.4%	6.8%
2012-13	6.8%	6.8%

The Stafford loan has fixed interest rates and a 1% default fee. The default fee is deducted from the disbursement check. The interest rate on the unsubsidized Stafford loan is 6.8% for undergraduate, graduate and professional students. The interest rate on the subsidized Stafford loan for undergraduate students depends on the academic year, as illustrated in the previous table. The interest rate on the subsidized Stafford loan for graduate students is 6.8%.

The annual limits on the Stafford loan depend on whether the loan is subsidized or unsubsidized, on the borrower's dependency status and on the borrower's year in school. Dependent students whose parents are denied a Parent PLUS loan are eligible to borrow at the independent student limits, which are $4,000/year higher during the freshman and sophomore years and $5,000/year higher during the junior and senior years. Students can borrow unsubsidized Stafford loans up to the overall limit minus any amounts received as subsidized Stafford loans. The subsidized Stafford loan limits are the same for dependent and independent students.

Annual Loan Limits	Subsidized	Unsubsidized Stafford Loan	
Year in School	Stafford	Dependent	Independent
Freshman	$3,500	$5,500	$9,500
Sophomore	$4,500	$6,500	$10,500
Junior	$5,500	$7,500	$12,500
Senior	$5,500	$7,500	$12,500
Preparatory Coursework Undergraduate Programs	$2,625	$2,625	$8,625
Preparatory Coursework Graduate Programs	$5,500	$5,500	$12,500
Teacher Certification	$5,500	$5,500	$12,500
Graduate and Professional Students	$8,500	NA	$20,500
Medical School Students	$8,500	NA	$40,500

The aggregate loan limits on the Stafford loan depend on whether the loan is subsidized or unsubsidized, on the borrower's dependency status and on the borrower's year in school. Dependent students whose parents are denied a Parent PLUS loan are eligible to borrow from the unsubsidized Stafford loan program at the higher independent student limits. Aggregate loan limits for subsidized Stafford loans to graduate, professional and medical school students include undergraduate student loans.

Aggregate Loan Limits	Subsidized	Unsubsidized Stafford Loan	
Year in School	Stafford	Dependent	Independent
Undergraduate Students	$23,000	$31,000	$57,500
Graduate and Professional Students	$65,500	NA	$138,500
Medical School Students	$65,500	NA	$224,000

Federal PLUS Loan

The Federal PLUS Loan has two versions, one for parents of dependent undergraduate students (Parent PLUS Loan) and one for graduate and professional students (Grad PLUS Loan). The terms of the loans are identical. Independent undergraduate students are not eligible to have their parents borrow from the Parent PLUS loan program. (Independent undergraduate students have higher unsubsidized Stafford loan limits.)

The PLUS loan has a fixed 7.9% interest rate with 4% fees. The PLUS loan is an unsubsidized loan, with interest accruing during in-school, grace and deferment periods.

Grad PLUS loan borrowers may defer repayment during the in-school period, but there is no grace period after the student graduates or drops below half-time enrollment. Parent PLUS loan borrowers may defer repayment while the student is in school and during a 6-month grace period after the student graduates or drops below half-time enrollment status. Otherwise repayment begins 60 days after full disbursement.

The repayment term is 10 years (Grad PLUS loans can get up to 25 years with income-based repayment), but borrowers can obtain longer repayment terms by consolidating PLUS loans.

The PLUS loan is the only federal education loan that considers the borrower's credit history. Eligibility does not depend on credit scores, but rather on whether the borrower has an adverse credit history. An adverse credit history is defined as having a derogatory event within the last 5 years (e.g., tax lien, bankruptcy, foreclosure, repossession, wage garnishment or default determination) or a current delinquency on any debt of 90 or more days. Borrowers with an adverse credit history may still obtain the PLUS loan with a creditworthy endorser (cosigner). Dependent students whose parents are denied a Parent PLUS loan are eligible for the higher unsubsidized Stafford loan limits available to independent students.

The annual loan limit on the PLUS loan is up to the full cost of attendance minus other aid received. There is no aggregate loan limit. Graduate students are required to exhaust the Stafford loan limits before borrowing from the Grad PLUS loan program. There is no similar requirement for Parent PLUS loans, but families are advised to exhaust the Federal Stafford loan limits first, since the Stafford loan is a less expensive loan.

To obtain a Grad PLUS or Parent PLUS loan, contact your college's financial aid office.

Federal Consolidation Loan

The Federal Consolidation Loan is used to combine several federal education loans into a single loan. This will streamline repayment but does not save money.

Consolidation also provides access to alternate repayment plans that reduce the monthly payment by increasing the term of the loan. Borrowers can obtain repayment terms of up to 30 years, depending on the amount borrowed. Increasing the repayment term can significantly increase the cost of the loan. For example, increasing the repayment term on an unsubsidized Stafford loan from 10 years to 20 years will cut the monthly payment by a third, but it will also more than double the total interest paid over the life of the loan (a factor of 2.18 increase).

$25,000 @ 6.8% Loan Term	Monthly Payment	Total Interest	Total Payments
10 Years	$288	$9,524	$34,524
20 Years	$191	$20,802	$45,802
Difference	- $97	$11,278	$11,278
Change	- 33.7%	x 2.18	+ 32.7%

The interest rate on a federal consolidation loan is a fixed interest rate that is the weighted average of the interest rates on the loans being consolidated, rounded up to the nearest 1/8th of a percentage point and capped at 8.25%. The weighted average preserves the overall cost of the consolidated loans and will always be between the highest and lowest interest rates.

Private Student Loans

Private student loans (www.finaid.org/privatestudentloans), also called alternative student loans, are non-federal loans made by banks and other financial institutions. Some private student loans are made by non-profit state loan agencies. The terms of the loans are set by the lender, not the federal government, and vary from lender to lender.

Most private student loans are credit-underwritten, with eligibility based on the credit scores of the borrower and a creditworthy cosigner, if any. If the borrower has a thin or non-existent credit history, or the borrower's credit score does not satisfy credit criteria, a cosigner will be required. Even if the borrower has a satisfactory credit score, it is better for the borrower to have a cosigner. Eligibility, interest rates and fees are based on the better of the two credit scores.

Note, however, that a cosigner is a co-borrower, equally obligated to repay the loan. Delinquencies and defaults on a cosigned private student loan are reported on the credit history of both the borrower and cosigner.

Many lenders have cosigner release options, which release the cosigner from his or her obligations after 12, 24, 36 or 48 months of consecutive on-time monthly payments, provided that the primary borrower satisfies credit criteria. Borrowers have reported some difficulty in qualifying for cosigner release requirements. Another approach to cosigner release is for the primary borrower to obtain a private consolidation loan without a cosigner. This will pay off the original private student loans, effectively releasing the cosigner from his or her obligation.

Interest rates on most private student loans are variable, typically changing on a monthly, quarterly or annual basis. The interest rate is pegged to a variable rate index plus a fixed rate margin. Common indexes include the 1-month or 3-month LIBOR index or the Prime Lending Rate. Given that interest rates are unusually low right now, variable interest rates will probably increase significantly over the term of the loan.

The fixed rate margin depends on the higher of the two credit scores. Typically, lenders will group credit scores into 5 or 6 tiers, with each tier being assigned to a particular interest rate. Borrowers with excellent credit (in the top tier) might get an interest rate of LIBOR + 2.0%, while borrowers with inferior credit (in the bottom tier) might get an interest rate of LIBOR + 10.0% or higher. Most private student loans require a credit score of at least 650 on an 850 scale, though some lenders have much higher minimum credit scores.

Borrowers with excellent credit scores may still be denied a private student loan because of secondary criteria, such as a high debt-service-to-income ratio (e.g., insufficient income or excessive debt), volatile annual income and self-employment.

Generally, private student loans are more expensive than federal student loans. Borrowers should exhaust federal loan eligibility (and gift aid, such as government grants and private scholarships) before considering a private student loan. Needing to borrow a private student loan (or a Parent PLUS loan) can be a sign of overborrowing. Students are more likely to need private loans at high-cost colleges or institutions that do not meet their full demonstrated financial need.

Shop around for the lowest rate when borrowing from private student loan programs. Private student loans from state loan agencies tend to be slightly less expensive for state residents and in-state students than private student loans from banks and other financial institutions, but it is impossible to predict which lender will offer an individual borrower the best rates. The lender with the lowest advertised rate will not necessarily be the lender that offers you the best rate. It is often necessary to apply for several loans to find the best rates. There are a variety of loan comparison sites (www.finaid.org/loancomparison), but most compare interest rates from only a handful of lenders or do not compare actual rates.

Private Consolidation Loans

Federal and private student loans cannot be consolidated together. Borrowers who want to consolidate their private student loans will need to obtain a private consolidation loan (www.finaid.org/privateconsolidation). Borrowers might seek a private consolidation loan to streamline repayment, to release a cosigner from the repayment obligation, or to get a lower interest rate.

The interest rates on a private consolidation loan will depend on the borrower's and cosigner's credit scores, just like the original private student loans. Typically a student's credit score will decrease with each successive year in school, and then start increasing after graduation if the borrower makes all the payments on the loans on time as per the agreement. For a borrower to get a better interest rate on the private consolidation loan, the his or her credit score will have to be at least 50-100 points better than the higher of the borrower's or cosigner's credit scores when the original loans were borrowed.

However, you may want to keep the loans separate if the interest rates differ, because this will let you save money by targeting the loans with the highest interest rates for earlier repayment. (There are no prepayment penalties on student loans.) For example, suppose you have $11,820 in 6.8% loans and $10,000 in 5.6% loans and could consolidate them at 6.25%, all with 10-year repayment terms. After making the required payments on the loans, if you apply an extra $50 a month to accelerate repayment of the 6.8% loans, you'd save about $121 more than applying it to the consolidation loan.

Home Equity Loans and Lines of Credit

Home equity loans typically have fixed rates that are competitive with the Parent PLUS loan. Home equity lines of credit (HELOC) typically have variable rates that are competitive with private student loans.

Home equity loans and lines of credit typically have a 10 or 15 year repayment term. Federal education loans start off with a 10-year repayment term, but borrowers can get alternate repayment plans with loan terms of up to 30 years. However, parent borrowers should stick with a 10-year term, since they should seek to pay off all debt by retirement.

There is no in-school deferment or economic hardship deferment on home equity loans and lines of credit, unlike the Parent PLUS loan.

Interest paid on home equity loans and lines of credit is tax deductible on your federal income tax return, if you itemize deductions on Schedule A of IRS Form 1040. This includes the interest on up to $100,000 used to pay for items other than improvement of the home, such as paying for college.

If you default on a home equity loan or line of credit, you can lose your home. Remember: Education lenders can't repossess your education.

Credit Card Debt

The Credit CARD Act of 2009 has made credit cards less available to college students by requiring a cosigner for most financially dependent students under age 21. Even so, college students should pay off their credit card balances in full each month to avoid spending beyond their means and to cut costs.

Credit cards are generally more expensive than private student loans. They are not eligible for the student loan interest deduction, even if used to pay for school. While some credit cards may offer rebates of up to 1%, the fine print usually excludes tuition from eligibility. Colleges may even charge a fee for tuition payments made with a credit card.

Credit card limits are usually lower than the aggregate limits on student loans. Most credit cards do not have flexible repayment plans. Credit card debt cannot be deferred while the student is in school or during an economic hardship. Minimum payments on a credit card are based on a percentage of the outstanding balance (e.g., 4%), so they start off higher and gradually decrease. Credit card debt can be discharged in bankruptcy.

Borrowing from Retirement Plans

You may be able to borrow for college expenses from a 401(k), 403(b) or 457(b) plan but not from an IRA. You can borrow up to half of the vested balance in your 401(k) plan or $50,000, whichever is less, to pay for college expenses for yourself, your spouse, or your children. (Some plans provide an exception which lets you borrow up to $10,000 if 50% of the vested balance is less than $10,000.) The debt must be repaid within 5 years in substantially level payments on at least a quarterly basis over the life of the loan. You may have to repay the debt immediately if you lose your job, otherwise you will have to pay income taxes and a 10% tax penalty on the remaining loan balance (including any accrued but unpaid interest). Usually the loan's interest rate will be a percentage point or two above the prime lending rate. The interest is not tax deductible. Although you are paying yourself interest, those interest payments are merely substituting for the money the retirement funds would have been earning otherwise.

Answer to Loan IQ Test

C. $15,858 is the correct answer

A good rule of thumb for estimating the interest paid over the lifetime of a loan is to multiply the loan amount, interest rate and loan term in years, and divide the result by 2. This yields an underestimate of the total interest, $5,000 in this example. (The actual amount is $5,858.) Don't forget that the monthly loan payments also pay off the original $10,000 loan balance.

Glossary of Terms

Adverse Credit History. To be eligible for a Federal PLUS loan, the borrower may not have an adverse credit history, which is defined as having had a bankruptcy, foreclosure, repossession, tax lien, wage garnishment or default determination in the last five years or a current delinquency of 90 or more days.

Alternative Student Loan. See *Private Student Loan*.

Amortization. Amortization is the gradual paying off of a debt through periodic installments of principal and interest.

APR. The Annual Percentage Rate (APR) is the annualized rate of interest, including the nominal interest rate, fees and term of the loan, as well as the impact of the in-school deferment. A 10-year 6.8% loan with 1% fees and no deferment has an APR of 7.02%. With a 20-year term the APR is lower (6.93%), because the fees are amortized over a longer term. A 10-year 7.9% loan with 4% fees and no deferment has an APR of 8.84%.

Capitalization of Interest. Interest capitalization occurs when unpaid interest is added to the loan balance. This causes the loan to grow larger, increasing the cost of the loan. Interest can be capitalized monthly, quarterly, annually or when the loan enters repayment. Capitalization causes interest to be charged on top of interest, also referred to as compounding of interest.

Consolidation. Consolidation is a form of refinance, where multiple loans are combined into a new loan with a single monthly payment.

Cosigner. A cosigner is a co-borrower, equally as obligated to repay the debt as the primary borrower.

Cost of Attendance. The cost of attendance is the full one-year cost of enrolling in college, including tuition and fees, room and board, textbooks and supplies, as well as travel and transportation, personal expenses, computer, student health insurance and dependent care.

Default. Default occurs when a borrower fails to make payments on a federal loan for 360 days and on a private student loan for 120 days. A defaulted loan is due in full immediately and may be sent to a collection agency.

Default Fee. See *Guarantee Fee.*

Deferment. Deferment is the temporary suspension of the obligation to repay a debt. Interest on subsidized loans is paid by the federal government during a deferment. Interest on unsubsidized loans continues to accrue and remains the responsibility of the borrower and is capitalized if unpaid. Federal education loans may be deferred while the borrower is enrolled at least half-time, during the grace period and during periods of economic hardship. The economic hardship deferment has a three-year limit. See also *Forbearance.*

Delinquent. A delinquency occurs when a borrower fails to make payments on a loan when due. If a borrower is delinquent long enough, the loan will go into default.

Disbursement. Disbursement is the payment of a loan's proceeds to the student and college. Loans may be paid in multiple disbursements.

Federal Education Loan. Federal education loans are cheaper, more available and have better repayment terms than private student loans. The interest rates on federal loans are fixed, while most private loans have variable rates. Examples include the Federal Perkins, Stafford and PLUS Loans. Since July 1, 2010, all new federal education loans have been made through the US Department of Education's Direct Loan program.

Forbearance. A forbearance is a temporary suspension of the obligation to repay a debt. Interest continues to accrue during a forbearance and will be capitalized if unpaid. Unlike a deferment, the borrower is responsible for the interest on both subsidized and unsubsidized loans during a forbearance. Forbearances on federal education loans have a five-year limit.

Forgiveness. Forgiveness is cancellation of a debt, usually for working in a particular occupation, such as a public service job, teaching in a national shortage area or serving in the military.

Grace Period. The grace period is the time after the student graduates, withdraws or drops below half-time enrollment and before repayment begins. The grace period is 6 months for the Federal Stafford and Parent PLUS loans and for most private student loans, and 9 months for the Federal Perkins loan. The Grad PLUS loan does not have a grace period.

Guarantee Fee. A guarantee fee, sometimes called a default fee, is a fee charged by a lender to cover the cost of defaults. It effectively insures the lender against borrower defaults.

Interest. Interest is a periodic fee charged for the use of borrowed money. The interest rate is expressed as a percentage of the loan balance and may be fixed or variable.

Lender. A lender is a bank, government agency or financial institution that lends money to borrowers.

LIBOR. The London Interbank Offered Rate (LIBOR) is a variable rate index that is based on the average interest rate paid on deposits of US dollars in the London market. It is used in the pricing of securitizations of student loans.

Loan. A loan is borrowed money that must be repaid usually with interest. See also *Federal Education Loan* and *Private Student Loan*.

Loan Limit. The maximum amount one can borrow, either per year (annual limit) or cumulative (aggregate limit).

Master Promissory Note (MPN). A promissory note is a legal contract in which the borrower agrees to repay the loan. It specifies the terms of the loan, such as the interest rates and fees. The Master Promissory Note is a promissory note that is effective for a continuous period of enrollment up to 10 years.

Prepay. To prepay a loan is to make a payment before it is due, accelerating repayment of the loan. There are no prepayment penalties (extra charges) on federal and private student loans.

Prime Lending Rate. The Prime Lending Rate is a variable rate index that is the interest rate that banks charge their most creditworthy customers.

Principal. The principal is the amount of money borrowed or still owed on a loan, not including interest and other charges.

Private Student Loan. A private student loan is made and funded by a private lender, such as a bank or other financial institution. Private student loans tend to be more expensive than federal loans and have less flexible repayment terms.

Promissory Note. See *Master Promissory Note*.

Repayment Term. See *Term.*

Servicer. The servicer of a loan collects payments and manages all correspondence and statements.

Subsidized Loan. The federal government pays the interest on subsidized loans during the in-school deferment, during the grace period before repayment begins and during an economic hardship deferment. The Federal Perkins Loan and Federal Subsidized Stafford Loan are examples of subsidized loans. Eligibility is based on demonstrated financial need.

Term. The length of time during which a loan is repaid. Also referred to as the *Repayment Term*.

Tuition Installment Plan. A tuition installment plan or tuition payment plan spreads out college costs into 9-12 equal monthly installments. Tuition installment plans usually charge an up-front fee without separate interest charges. This is in contrast with loans which are typically repaid over a much longer term and which usually charge interest.

Unsubsidized Loan. Interest on unsubsidized loans continues to accrue during the in-school deferment, during the grace period before repayment begins and during an economic hardship deferment. If the borrower does not pay the interest as it accrues, the interest is capitalized (added to the loan balance). The Federal Unsubsidized Stafford Loan and the Federal PLUS Loan are examples of unsubsidized loans. Eligibility is not based on financial need, so even wealthy families may qualify.