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Choosing a Student or Parent Loan
Quick Reference Guide

Top Ten Student Loan Tips

1. **File the Free Application for Federal Student Aid (FAFSA).** The FAFSA is a prerequisite for federal student and parent loans, plus government grants. 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. File the FAFSA 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. 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.

3. **Plan ahead.** Your total education debt at graduation should be less than your expected starting salary, and ideally a lot less. 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. You will need to use a longer term repayment plan to afford your monthly loan payments, so you will still be repaying your own student loans by the time your children enroll in college. This will also increase the cost of your loan. Estimate your debt at graduation by multiplying your first year's debt by the number of years in your degree program.

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 can increase. 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.

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. Otherwise the interest will be capitalized, increasing the loan balance by 15% to 20% by the time you enter repayment. This is called negative amortization (www.finaid.org/negamort).

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

7. **Apply for private student loans with a creditworthy cosigner.** Not only will this increase your chances of getting the loan, but it may result 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. Late payments and defaults are 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.

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. Visit www.finaid.org/interestdeduction for additional details.

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 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.

The most important differences among student loans include: interest rate (fixed or variable), fees (4% in fees equals up to about a 1% increase in the interest rate), subsidized (who pays the interest during the in-school and grace periods), interest capitalization (compounding can increase costs), loan discounts, student loan interest deduction, who is responsible for repaying the loan, eligibility (e.g., minimum GPA, good credit scores, debt-to-income ratios), eligible expenses, annual and cumulative loan limits, deferments and forbearances, repayment plans, prepayment penalties (none on student loans, see www.finaid.org/prepay), cancellation, forgiveness and the quality of customer service.

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.

Calculating Monthly Loan Payments (Loan Amortization)

The following table shows the monthly payments on a $25,000 loan for various repayment terms and interest rates.

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

This table shows the maximum cumulative debt for a given monthly payment. Multiply the monthly payment by 100 to calculate the minimum annual salary needed to repay the debt.

Loan Term	Monthly Payment	Maximum Cumulative Debt 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

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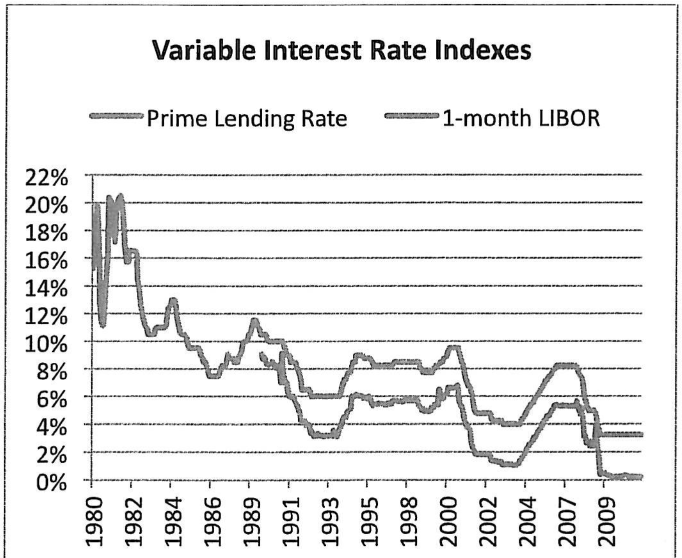
Most private student loans have variable interest rates. Since interest rates are unusually low right now, these interest rates are likely to increase over the term of the loan. The following chart shows how the two major variable rate indexes have changed over time. Given that these rates dropped by 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, so borrowers should prefer variable rate loans that are pegged to the LIBOR index.

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. Each 1% increase in the interest rate yields about a 5% increase in the monthly loan payment for a 10-year term, about a 9% increase for a 20-year term and about a 12% increase 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%

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. Borrowing excessively can be like having a mortgage without owning a home.

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 adversarial 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.

Federal Education Loans

The **Federal Perkins Loan** is based on financial need and has a fixed 5% interest rate with no fees. The interest is subsidized, meaning that the federal government pays the interest during the in-school and grace periods. Repayment begins 9 months after graduation or dropping below half-time enrollment status.

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

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. 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. 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.

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

	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 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

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

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.

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.

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) who cannot be the student.

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.

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. For example, increasing the repayment term on an unsubsidized Stafford loan from 10 years to 20 years cuts the monthly payment by a third, but also doubles 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.

A 10-page version of this quick reference guide is available at www.fastweb.com/educators.