Student Loans

Introduction

Loans are far and away the single largest aid program available to students. In the 2003-2004 academic year, nearly $67 billion was delivered in the form of loans to students. That figure represents roughly 56% of all aid distributed that year. A student loan is extremely accessible and very often a student's first venture into the world of credit/debt. Because loans must be repaid, the decision to borrow should be made carefully, and the resulting debt be managed methodically.

The College Board. (2004). Trends in Student Aid: 2004

Completing the FAFSA is the first step in determining your loan eligibility. Once the EFC is calculated, and you receive your award letter, additional steps will be communicated to you on how to actually receive the loan proceeds at your institution. This usually involves completing a paper or electronic promissory note called an MPN (Master Promissory Note). Below are the different loan programs available to students and their parents:

Types of Loans

Stafford Loan: Stafford loans are loans that the student will borrower in his/her name. There are two types of Stafford loans: subsidized and unsubsidized. Subsidized loans have the government paying the interest for the student while he/she is in school and during their grace and deferment periods. Unsubsidized loans have interest accruing while the student is in school. Subsidized loans are based on need while unsubsidized loans are not need-based. Both loans are not required to be repaid until six months after the student graduates or drops below half-time. Interest rates on Stafford loans will be fixed at a rate of 6.8% for all loans disbursed after July 1, 2006.

The maximum yearly amount a dependent, undergraduate student may borrow in combined subsidized/unsubsidized Stafford loan eligibility is:

- $2,625 for freshmen
- $3,500 for sophomores
- $5,500 for juniors and seniors

The maximum yearly amount an independent, undergraduate student or dependent student whose parent was denied a PLUS loan may borrow in combined subsidized/unsubsidized Stafford loan eligibility is:

- $6,625 for freshmen (maximum of $2,625 subsidized)
- $7,500 for sophomores (maximum of $3,500 subsidized)
- $10,500 for juniors and seniors (maximum of $5,500 subsidized)

The maximum yearly amount a graduate student may borrow in combined subsidized /unsubsidized Stafford loan eligibility is:

- $18,500[*] (maximum of $8,500 subsidized)

Stafford loans carry with them fees and interest charges that should be considered when making the decision to borrow. Fees up to 3% may be deducted from the loan. Stafford loans also come standard with a ten year repayment plan with a minimum payment of $50. There is no penalty for paying the loan off early.

[*] Some exceptions exist for medical students.

Parent Loan for Undergraduate Students (PLUS): PLUS loans are loans made available to credit-worthy parents of dependent, undergraduate students. The maximum yearly amount a parent may borrow under this program is the student's cost of attendance minus any other financial aid he/she is receiving. This loan is not based on need. A parent may borrow for multiple children during the same year. The interest rate for PLUS loans disbursed after July 1, 2006 will be fixed at 8.5%. Repayment begins within 60 days of the loan being fully disbursed. Fees up to 4% may be deducted from these loans.

PLUS loans for graduate students: As a result of the Higher Education Reconciliation Act of 2005, PLUS loans will now be made available to graduate students beginning July 1, 2006. The same terms and conditions apply to these loans as those used in determining Parent PLUS loan eligibility...including a credit check. Applicants for a Graduate PLUS loan must first exhaust their Stafford loan eligibility; thus requiring the completion of the FAFSA. Fees up to 4% may be deducted from these loans.

Perkins Loan: These loans are funded by federal and institutional dollars and given to the neediest undergraduate and graduate students. They carry a 5% interest rate and do not have to be repaid until nine months after the student graduates or drops below half-time. The maximum an undergraduate student can borrow is $4,000 annually and $6,000 annually for graduate students.

Private loans: Recently, there has been a huge increase in private loan funding in order to fill the gap created by the rising costs of education while federal loan limits remained relatively dormant. Some schools have begun actively awarding private loans on the award letter since the demand is so strong. Private loans are inherently more costly to borrow as they carry higher interest rates and fees than federal loans. The higher rates and fees are due to the private lenders owning 100% of the risk of lending the money. The federal government does not back these loans as they do with Stafford, PLUS and Perkins loans.

Student Loan Players

Typically a college participates in one of two programs to deliver its students loans: the Federal Family Educational Loan Program (FFELP) or the Federal Direct Loan Program (FDLP). The majority of schools today participate in the FFELP and that introduces several entities outside of your college into the loan process. They are:

- Lender: A lender is the agency that actually provides the money for the loan. Most schools will provide a list of preferred lenders on their web site or office publications.

- U.S. Department of Education (ED): In addition to overseeing all federal aid programs, ED also serves as the lender in the FDLP.

- Guarantor: The guarantor serves as the "insurance agent" for the lender. A guarantor will repay the lender if the borrower defaults on the loan.

- Servicer: Many lenders contract with other companies to "service" their loans. This may include processing the loan application, billing the student and collecting on delinquent or defaulted loans.

How Do I Get a Loan?

Below are the typical steps in securing a student loan:

- Step 1: Complete the FAFSA and any other institutional forms the school requires.

- Step 2: The schools you listed on your FAFSA will receive an ISIR and be able to calculate your loan eligibility.

- Step 3: The school will send you an award letter displaying your loan eligibility and instructions on how to pursue the loan

- Step 4: The borrower must complete a promissory note. In the case of a Stafford or PLUS loan, this is called an MPN.

- Step 5: The school will certify your loan eligibility to the lender on the MPN.

- Step 6: The lender will disburse funds via paper check or EFT to your school on the scheduled disbursement date (the disbursement date is established by the school and is included in their certification to the lender in Step 5).

- Step 7: The school will apply the loan amount to your student account at the school.

- Step 8: Any remaining balance can be refunded to the student to be used toward living expenses, books, etc.

What Kind of Loan Should I Borrow?

It's possible that several loan options may appear on your award letter. If this is the case, it's best to go in this order:

1. Perkins Loan - Perkins Loans have a fixed interest rate of 5% and no fees. Going into the 2006-2007 academic year, this is the best deal. Again, not everyone will be eligible for a Perkins Loan. Consult your award letter.
2. Stafford Loan – For the 2006-2007 academic year, Stafford Loans have a fixed interest rate of 6.8%. Also, an origination fee and/or guarantee fee of up to 3% can be deducted from the proceeds of the loan.

3. PLUS Loan – For the 2006-2007 academic year, PLUS Loans have a fixed interest rate of 8.5%. Also, an origination fee and/or guarantee fee of up to 4% can be deducted from the proceeds of the loan. (These terms and conditions apply to both Parent and Graduate PLUS loans.)

4. Private Loans – Typically, these loans have the highest interest rates and fees. Your credit rating can also affect your interest rate and fees. Use a private loan only if you have exhausted all programs listed above first.

You should also note any borrower benefits that may be offered on these loans. Many loan providers offer up-front and back-end benefits that can substantially reduce the cost of borrowing. Examples include: 1) lowering the interest rate after so many on-time payments, 2) waiving fees altogether, and 3) interest rate discounts for borrowers participating in auto-debit. These are important factors when choosing what loan to borrow and who the lender will be.

<u>When Do I Have to Repay?</u>

Perkins and Stafford loans do not need to be repaid until the borrower either graduates or drops below half-time enrollment. As long as the student remains enrolled at least half-time, the loan stays in what is called an "in-school deferment" status. (In the case of an unsubsidized Stafford loan, interest accrues during in-school deferment periods and can either be paid monthly, quarterly or annually. It can also be deferred and added to the principal balance at the time of repayment.)

Perkins and Stafford loans also offer a "grace period." The grace period is defined as a period of time between the date a student graduates or drops below half-time status and the date loan repayment actually begins. The grace period for a Perkins loan is 9 months. For a Stafford loan, it is 6 months.

PLUS loans (Parent and Graduate) do not have an in-school deferment or grace period. Repayment begins typically within 60 days of the loan being fully disbursed.

Most private loans can be deferred while the student remains enrolled. Private loans may or may not carry a grace period. Check with your loan provider to make sure.

All federal loans and most private loans can be prepaid early with no penalty.

<u>How Much Will My Payment Be?</u>

Your monthly payment of the loans you borrow throughout your college career will depend on the repayment term, interest rate and amount borrowed. Therefore, you'll have to look at each loan independently. Using the Stafford loan interest rate of 6.8% and standard repayment term of 10 years, you can expect to pay roughly $115/month for every $10,000 borrowed. Again, this is a standard repayment plan. Depending on the type of loan, other repayment options may exist. Here are some other plans that may be available:

- Extended Repayment Plan – This plan simply extends the repayment period of the loan. The maximum repayment term is limited to 25 years. The result is lower monthly payments, but more interest paid over the life of the loan.

- Graduated Repayment Plan – This plan typically allows borrowers to make interest-only payments for a period of time and then gradually increasing the amount they pay over the course of the repayment term. This plan can be combined with an extended repayment plan.

- Income-sensitive Repayment Plan - This plan is specific to the FFELP. It allows borrowers to make monthly payments equal to a percentage (between 4% and 25%) of their monthly gross income.

- Income-contingent Repayment Plan – This plan is specific to the FDLP. Each year, the borrower's monthly payment is based on their adjusted gross income (as reported on the U.S. income tax return) family size, the interest rate, and total amount of Direct Loan debt.

<u>Loan Consolidation</u>

Consolidation allows the borrower to combine multiple types of federal education loans into one loan, so that only one monthly payment is required. The repayment term can be between 10 and 30 years depending on how much you consolidate and which repayment option you choose. The primary benefit is a more manageable monthly payment, but the cost being in the form of substantially more interest being paid over the life of the loan. The consolidation interest rate is the weighted average of the underlying loans rounded up to the nearest one-eighth percent.

Both the FDLP and the FFELP offer consolidation programs. Under FFELP consolidation, if the same holder holds all the loans you want to consolidate, you must obtain your consolidation loan from that holder, unless you haven't been able to get a loan with income-sensitive repayment terms. If both subsidized and unsubsidized loans are being consolidated, they'll be grouped accordingly so the interest subsidy on the subsidized loans is not lost. Borrower benefits on student loans can also be lost when consolidated. Be sure to check with your loan provider before making this decision.