Student Loans Explained

Source: http://www.gocollege.com/

Most students rely on a variety of funding sources to pay for college. Personal savings and family contributions are one of the first places students turn, but often these resources don't cover higher- education costs.

Scholarships and grants are windfalls for college funding, because they do not require repayment. Performance and financial need are considered, and then eligible students are endowed with gifts that pay for tuition, books and housing. Do not leave free money on the table – apply for every grant and scholarship for which you qualify.

Loans are the most common funding sources for college: According to the National Postsecondary Student Aid Study (NPSAS), 65% of four-year undergraduate students take out student loans to help them pay for college. But unlike some other resources, loans must be paid back. Loans, and associated interest costs, typically keep graduates in debt for 10 years or more.

Types of Student Loans

Student loans are funded by a variety of sources including The United States Federal Government and private lenders like banks and credit unions. Federal loans are the most accessible to students, and offer the best repayment terms.

Private loans, also referred to as personal loans and alternative loans can be difficult for students to secure without cosigners. A cosigner is someone who agrees to pay the loan if you default (don't pay). Interest rates are higher than federal student loans, but still fall below most other types of private financing (home, car, etc.)

Federal Student Loans

Stafford Loans

- Subsidized Stafford Loans are available to students who demonstrate financial need. Payments are not required while you are enrolled in school, or during grace periods and deferment periods. Interest rates vary, but are currently 3.4%. Loan limits move on a sliding scale, based on what year you are in college; ranging from $5,500 annually, for first year students to $7,500, for third year students and beyond.
- Unsubsidized Stafford Loans do not require students to show a particular level of financial need. Interest accrues on these loans from the moment the funds are issued, and students are given the choice to pay as they go, or add accumulated interest to the total amount owed following school. Loan limits match those of Subsidized Stafford Loans, but interest rates are higher; currently fixed at 6.8%.

To be considered for Stafford Loans and other Federal Student Aid, you must submit a Free Application for Federal Student Aid (FAFSA). Repayment begins six-months after graduation, and is governed by repayment schedules ranging in length from 10 to 25 years.

Direct PLUS Loans

Parents of dependent undergraduate students can borrow money under this federal program. Borrowers must be able to pass a credit check, and the student whose education is being funded must be a dependent that meets these minimum requirements: Under 24 years of age, Single, No dependents

Parents access PLUS loans by filing an application, and signing a Master Promissory Note (MPN). Interest rates are fixed at 7.9%, and borrowing limits are determined by subtracting all other financial aid award amounts from the total cost of attending school.

Perkins Loans

Perkins loans are federally funded loans administered directly by your institution of higher education (IHE). The loans are extended to students who have the greatest financial need. In general, families with annual incomes below $25,000 are eligible for Perkins Loans.

These three factors determine the size of your Perkins Loan:

1. When you apply
2. Your level of financial need
3. Funding level at your school

The maximum annual loan for undergraduate students is $5500, with a lifetime loan maximum of $27,000. Graduate students can borrow up to $8000 each year, with a $60,000 lifetime cap. Perkins Loan repayment starts 9 months following graduation, with a fixed 5% interest rate.

State Student Loans

State-specific funding varies – some have none, while others have a great deal. Your FAFSA places you in contention for some state loans, but other programs require separate enrollment. Your high-school guidance counselor and college financial aid office are equipped to sort out the specifics for your state.

Private Student Loans

Private student loans, such as those offered by Wells Fargo and Chase are designed to bridge the gap between your financial aid package and the true cost of your education. Private loans require borrowers to pass credit checks, and the loans often have higher interest rates than those subsidized by the U.S. Government.

Cosigners who are willing to share responsibility for your loan provide the credit resources you need to get private financing. Federal Student Loans should be considered first, but used appropriately; private loans can effectively pay for extra educational costs, without creating unmanageable financial burdens.

Private student loans are sometimes called personal loans and alternative student loans.

Institutional Student Loans

Institutional loans are extended by colleges and universities as a means to cover educational costs that remain after other forms of financial aid have been applied. Long-term and short-term institutional loans are used to pay for books, room and board, and other student expenses.

Institutional loans are by definition campus-specific, so interest rates and repayment terms are determined by each educator. Your financial aid office is best equipped to outline specific programs offered by your school.

Student Loan Tips:

- Use student loans to supplement other financial aid awards, like grants and scholarships. Make sure to start a college savings plan as early as possible. College accounts like the 529 savings plans allow you to save pre-tax money for college.
- Understand the terms of your federal and private student loans, before you sign on. You will be bound to the conditions of your loans for many years.
- Don't miss payments. Be proactive in protecting your credit, by contacting your lender *before* you default. Consolidation loans, deferments and other accommodations are available, to keep your repayment schedule on track.

Managing Your Student Loans

Apply these responsible financial management principles, as you repay your student loans:

- Consider the advantages of loan forgiveness programs. These programs are available to students who agree to work in high-need fields like nursing and education. Enrolling in the military often makes you eligible for loan forgiveness. Essentially, you commit to work or serve for a designated period of time, in exchange for complete or partial loan forgiveness.
- Make student loan payments on time. In some cases, your interest rate may qualify for reduction after you make a certain number of consecutive on-time payments. If you have a cosigner, he or she may be released from responsibility for the loan, once you have exhibited a required level of consistency with your repayments. Defaulting on your student loans has far-reaching consequences, so it is never an option.
- Manage your loan repayment schedule using online calculators. If you are considering a consolidation loan, use these tools to quickly determine your total loan repayment obligation.
- Take advantage of federal education tax incentives, like the student loan interest deduction and Hope Scholarship Credit.

What You Need to Borrow for College

How Much Money is Just Enough for You?

Your final college award letter will provide you with information concerning the status of your financial aid, including any Federal loans for which you have qualified as well as any grants and scholarships which you may have been awarded.

Depending on the status of your awards and loan offers you may still require other loan assistance. Likely, a private lender loan of some form or another will be necessary to augment any scholarships you've been awarded and any Federal grants or loans for which you have qualified. Using the information provided in your award letter, you will need to outline a sound financial aid strategy that is suited to your financial situation now, as well as in the long term. Several factors to consider when determining how much you need to borrow:

- Cost of tuition and living expenses
- Federal and private loan limits
- Your existing financial commitments
- Other awarded financial aid
- How much debt you'll realistically be able to afford when you graduate

Keep in mind that, unlike grants and scholarships***, all loans must be repaid and you want to avoid taking on more debt that you can handle.***

Restrict any and all loans to the lowest dollar amount possible. Attractive "college expenses" loans for high dollar items like computers and textbooks may sound appealing, but those loans will accumulate and will be steadily accruing interest while you're in school. You will responsible for repayment on all loans to which you have agreed, and your future entry-level salary may not be enough to cover the excessive monthly payments.

Consider Cost of Attendance

Cost of Attendance, or COA, refers to the reasonable total amount of money required to complete one full year as a full time student. This includes tuition, textbooks and room and board. Consult your college for a detailed evaluation of your expected COA, and in combination with your unmet need figure calculate how much money you will need to borrow.

If you've been approved for a Federal Work Study Program, work out an estimate of how much money you will be able to earn to put towards paying for your educations costs. Work out a budget plan and stick to it.

Your Existing Financial Commitments

When calculating your education budget, you will need to take into account all of your current financial obligations: car payments, credit card bills, insurance, rent, grocery and utility bills. These monthly financial commitments will need to be covered by income, or savings, separate from any college loans you are receiving.

Student loans are first, and foremost, for your education costs. Never use college loan money, either Federal or Private, to pay for your living expenses.

Other Aid Resources

Subtract all out of pocket cash, college savings, grant and scholarship money you've been awarded from the figure you initially thought you'd have to borrow. You'll quickly realize the value of grant and scholarship money—gift aid that can significantly cut the cost of your education.

Don't stop with institutional grants and scholarships. Search for and apply to outside scholarship sources for additional free aid. Even scholarships offering smaller awards can help defray the costs of your college education. Look for local and unusual scholarships that may help you add to your education fund.

Debt You'll be Able to Afford after Graduation

It is important to be realistic about the debt you will have accumulated by the time you complete your college education. Estimate how much student loan debt, both Federal and Private, you will have amassed in two or four years of college. Next find out what a newly graduated student in your field is likely to earn in an entry-level position. Subtracting rent, car payments and any other living expenses from your projected earnings leaves you with the funds you will have to pay off your student loans.

- Always apply for Federal student loans first, as much as you can get, first in subsidized then unsubsidized Stafford Loans.
- Only borrow what is absolutely necessary to pay for college.
- Private student loans should be your final option. Don't get carried away with loans that promise to cover all your extra college expenses. Evaluate costs, ask questions and never borrow more than you absolutely need.

Serious Business: Defaulting On a Student Loan

Most college students, regardless of grants or scholarships, will likely need to secure some kind of education loan. Higher education is expensive, and unless you have a sizable nest egg set aside to cover your college costs you will need to consider a student loan. But any loan is a serious undertaking, and failure to live up to your end of the bargain can lead to equally serious consequences. Defaulting on your student loan can lead to bad credit and an end to your college career.

What Does It Mean to Default On Your Loan?

When a student loan is designated as in default, it means that the borrower has failed to make any payments against that loan for 270 days. This does not mean simply missing one payment, or being late on a few payments. A default refers to a loan that has had no payments made against it what-so-ever for a period of 270 consecutive days. At this point, the primary lender must assume that the debt is being ignored, and that it is time to take legal action against the borrower.

Defaulting on a student loan is damaging to a student's credit history, and will prevent them from being eligible for any future loans until, and unless, the defaulted loan has been satisfactorily discharged. If a borrower resumes payments, and re-establishes a history of on time payment habits, a loan can be rescued from default and a student’s credit history can be cleared.

Why Do People Default On Their Loans?

No student willingly defaults on their college loans, and most borrowers are conscientious about staying up to date on their payment schedules. But financial circumstances can change, money can become tight and it's easy to get overwhelmed with an outstanding college debt. Admittedly some students ignore their loans in the hopes that they will simply disappear, but whether by accident or design a defaulted loan has serious consequences for any student. Remember, when you sign a loan agreement you have committed to making timely payments against that loan and you are responsible for that loan in totality.

Now, having said all that there are ways to avoid going into default. It is in your lender's best interest to work with you to help you stay on track with your loan payments. Special arrangements can be made to avoid a loan falling into default, and every student borrower should familiarize themselves with these procedures.

How to Prevent Defaulting On Your Loan

There are a number of successful ways to avoid going into default on your student loan, though they require a measure of planning and preparation. The following tips will help you avoid defaulting on your student loan. Should you find yourself facing a loan default, these methods can also help you escape final judgment and rescue your personal credit.

Never Sign Anything You Don't Understand

The first rule to follow when securing any type of loan, is to read every part of the loan agreement. In it you will find everything you need to know about your responsibilities as a borrower, and your lender's policies and penalties regarding late or missed payments. Be certain you understand the loan agreement in it's entirety, and if there are portions of the contract you find confusing do not hesitate to ask the lending officer to explain them more fully. Don't be shy about asking for clarification on any portion of your loan agreement, and be sure to inquire about possible deferments or income-sensitive repayment options. Entering into a loan contract is a serious business, and you need to understand all of the aspects, and possible stumbling blocks, associated with that loan.

Keep Your Lender In The Know

Whenever anything changes in your life or finances that may affect the status of your loan, be sure to notify the lending institution immediately. For example, if you are moving be sure to notify your lender of your change of address. Don't let your loan go into default simply because you have not been receiving your monthly statements. Likewise, if you are transferring schools or have decided to drop out of college altogether it is important to notify your lender as these changes will directly affect the repayment program associated with your loan.

Should you experience financial setbacks, do not hesitate to contact your lender directly to discuss the changes in your circumstances. Oftentimes borrowers will be embarrassed about speaking to their bank or loan provider about their financial difficulties, but your lender may be able to help you navigate a path through your financial difficulties that will enable you to avoid a loan default.

Consider Deferment

One way to avoid defaulting on your college loan, is to apply for a student loan deferment. A loan deferment allows you to postpone all, or a portion of, your payments for a predetermined period of time. Loan deferments require a bit of forward thinking, and if you see a financial stumbling block ahead you should contact your lender immediately to inquire about any deferment programs for which you may be eligible. Keep in mind, however, that a loan deferment merely postpones your payments. Your student loan will continue to accumulate interest, and you will still be responsible for all money due your lender.

Make Special Arrangements, If You Can

If you find that you are not eligible for a loan deferment, or if you can only afford to make timely payments in smaller monthly installments, you should talk to your lender about adjusting your payment options. Many lending institutions can shift your loan into an income contingent, or income sensitive, repayment plan. Lowering your monthly payments and helping you avoid default. Remember, it is in your lenders best interest to have you successfully pay of your student loan, and they will work with you to make that possible. Again, keep in mind that adjusting your repayment program will result in a longer life to your student loan, and you will be responsible for any additional interest that accrues on that loan.

Consolidate Student Loans

Many students find that they can avoid defaulting on their college loans by opting to consolidate their outstanding loans into one more manageable loan package. If you have more than one student loan, and are finding it difficult to maintain the repayment schedules, you may find that consolidating your student loans can help you reduce your number of monthly bills to a single more manageable payment. When consolidating your student loans you may also find it is possible to extend the life of your loan, thereby reducing your monthly payments even further. Loan consolidation is by far the most successful, and popular, method of avoiding a default.

Consequences of Defaulting On Your Loan

By now you realize how important it is to avoid defaulting on your student loans. But before we finish let's look at the consequences of defaulting on a loan.

- Your primary lender will turn your loan over to a collection agency
- You may be sued for the balance of your loan plus damages
- Your wages may be garnished to cover the outstanding loan debt
- Any Social Security benefits may be withheld.
- You are no longer eligible for any Federal loans programs
- Deferments will no longer be an option
- You may be barred from securing a credit card, mortgage, or car loan

These are only some of the consequences associated with defaulting on a student loan. Securing a student loan is nearly always a necessity when preparing for college. Beyond the obvious benefits of paying for some or all of your tuition costs, it is also a way for young students to begin building the solid credit history they will need in later life. Don't let a loan default ruin your credit, and impede the progress of your education or your career.