Understanding Education Loans

Loans are a reality for many college students who receive financial aid.

Unlike scholarships and grants, loans must be repaid after graduation. Understanding the different loan types will help you save money in the long run.

Federal loans for education are the best place to start. The interest rate will be lower than other loans and there are often ways to reduce your monthly payments, if needed. The repayment period for federal loans doesn't begin until after college and lasts for at least 10 years. These loans are available through the U.S. Department of Education's Direct Loan Program.

Here's a brief overview of the major types of student loans:

Federal Direct Subsidized Stafford Loans – These loans are awarded to financially needy students based on their Expected Family Contribution (EFC) and the cost of attendance of a particular school. The federal government pays the interest on subsidized Stafford loans while the student is in school, and interest is not charged until the student graduates or drops below a half-time course schedule.

Federal Direct Unsubsidized Stafford Loans – Student borrowers with no calculated financial need are eligible for unsubsidized Stafford loans. Interest on these loans is not paid by the federal government and is the responsibility of the student at all times. Borrowers can either pay the interest while they are enrolled in school or have it added to the loan principal when they begin repayment (referred to as capitalization).

Federal Direct Parent Loan for Undergraduate Students (PLUS) – This loan is a good option for parents, but only after subsidized and unsubsidized Stafford loans are maxed out. The interest rate is higher than those loans. Repayment begins 60 days after the funds are disbursed, but repayment may be deferred until after the student graduates or leaves school. The PLUS program is open to any parent regardless of assets or income, but a low credit score may affect eligibility.

Federal Consolidation Loans – A federal consolidation loan allows a borrower to consolidate several types of federal education loans with various

repayment schedules into one loan. This simplifies the repayment process because there is only one payment per month.

Loans being consolidated must be federal, not private, loans. And keep in mind that the interest rate and payments on the new consolidation loan may be lower, but the extended repayment period likely increases the total interest charges over the life of the loan. Since it is so easy to set up automatic payments for student loans through a bank draft, the benefits of a consolidation loan should be carefully considered.

Private (or Alternative) Loans – These loans are from private lenders, banks, colleges, universities and other lenders that do not rely on the federal government as a guarantor (meaning they, not the government, are ultimately responsible for any losses if the student defaults). If you have borrowed the maximum amount available through federal loans and still need more, a private loan can help cover the cost of attendance. Just because you're eligible for a certain loan amount does not mean that you have to borrow the entire amount.

It's generally best for students to live like "poor students" while they actually are students – not for years after graduation as the result of poor borrowing choices. Students should borrow only the minimum that they need to get through school on a tight budget.

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