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Federal Versus Private Student Loans

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So you've decided to apply for a loan to finance your education—but there are so many different options to consider. How do you choose among federal loans (loans funded by the federal government), private loans (loans taken out from a financial institution), or a combination of both? We'll consider the differences between the options so that you can select the loans that are best suited for your individual circumstances.

Eligibility

Federal student loans offer a variety of benefits over private loans, including fewer restrictions on eligibility, more options for repayments, and lower interest rates. A great feature of some federal loan programs is that you may still be eligible even if you have poor credit. For example, credit scores are not considered for Federal Direct Subsidized and Unsubsidized Loans. While some types of federal loans require you to demonstrate financial need, you will likely still be eligible for federal student loans if you cannot demonstrate financial need.

Eligibility for federal student loans depends on only a few factors. The basic criteria include:

- Being enrolled at least half-time in a degree or certificate program at your school.
- Being a U.S. citizen or eligible non-citizen.
- Having registered for selective service (males) between the ages of 18 and 25.
- Having a valid Social Security number.

Private loans are offered by many different institutions, including banks, credit unions, and sometimes your school. These types of loans are often similar to typical bank loans. Your credit score will be considered, although some loans accept a lower credit score than your bank. Because these loans are offered from a variety of vendors, the eligibility requirements for private loans may vary between them. Typically, enrollment in an accredited school and a satisfactory credit score is expected. Many private loans also require a cosigner with an acceptable credit score. If you choose to apply for private loans, your school may be able to provide a list of potential lenders.

Interest Rates

When comparing federal and private loan programs, interest rates are, of course, one of the considerations. Federal loans typically have lower interest rates than private loans. For the most current interest rates for Federal Direct Loans, go to https://studentaid.ed.gov/sa/about/announcements/interest-rate.

The interest rates for Federal Direct Loans are fixed for the life of the loan, but the interest rate for new loans can change each year for loans disbursed in that period. Some federal loan programs will not require you to pay any interest during the time you are enrolled on the basis of financial need.

Private loan interest rates are often higher and are typically variable. So even if you borrow this year at a rate of 3.5% interest, the rate could change in the future and increase substantially, thus increasing your payments. Some private loans offer fixed rates, but they are often higher than federal fixed rates. Your credit score is usually a consideration in the interest rate that is offered—a lower credit score will result in a higher interest rate. Unlike many federal loans, interest on private loans typically begins accruing on the day the loan is disbursed.

Federal loans and private loans are compared in the next table. Interest rates for Federal Direct Loans are based on first disbursement on or after July 1, 2016. Sallie Mae and Discover are two of many companies offering private loans. We'll discuss other aspects of federal and private student loans in the next sections.

Federal and Private Loan Comparison

Loan Type	Borrower Type	Interest Rate(s)	Loan Term
Federal—Direct Subsidized Loans	*Undergraduate*	*5.05%*	*10 years (standard)*
Federal—Direct Unsubsidized Loans	*Undergraduate*	*5.05%*	*10 years (standard)*
Federal—Direct Unsubsidized Loans	*Graduate or Professional*	*6.60%*	*10 years (standard)*
Federal—Direct PLUS Loans	*Parents and Graduate or Professional Students*	*7.60%*	*10 years (standard)*
Private—Sallie Mae	*Undergraduate*	*• Fixed: 5.74% to 11.85% • Variable: 4.00% to 10.86%*	*5-15 years based on loan balance and year in school*
Private—Sallie Mae	*Graduate*	*• Fixed: 6.25% to 9.16% • Variable: 4.00% to 9.04%*	*5-15 years based on loan balance and year in school.*
Private—Sallie Mae Parent Loan	*Parent*	*• Fixed: 5.74% to 12.87% • Variable: 5.49% – 11.87%*	*10 years of principal and interest payments*

*Interest rates for loans disbursed on or after July 1, 2018.

Understanding Federal Student Loans

Types of Loans

You may be offered one or more of several different federal loans with your financial aid package. Understanding each of the different loans will help you to choose the best options to finance your education.

Direct Subsidized and Unsubsidized Student Loans

Direct Subsidized Loans are offered to students who have demonstrated financial need. If you qualify, Direct Subsidized Loans are one of the best options available. The interest is paid by the U.S. Department of Education while you are enrolled in school, and you are responsible for interest when the loan is in repayment.

Eligibility. Unsubsidized loans are available to all eligible students regardless of financial need. The interest on unsubsidized loans begins to accrue when the loan is disbursed.

The number of subsidized and unsubsidized loans offered depends on your financial need, dependency status, and year in school. The greater your financial need, the higher the amount of subsidized loans you will be offered. As you progress in your education, the amount you can borrow will increase. The loan amounts for dependent students are lower than the amounts for independent students. Dependency is based on the questions you answer when you file your FAFSA. You can find the current loan limit amounts for each year of school and dependency status at https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized#how-much.

Application. The first step in the application process is completing the FAFSA or Renewal FAFSA (for returning students) at FAFSA.ed.gov. You will receive your financial aid award letter by mail or email from your school's financial aid office, which will summarize your available financial aid, including Direct Subsidized Loans (if eligible) and Direct Unsubsidized Loans. The next step is to talk to your financial aid office and decide whether to accept the financial aid, including student loans. Finally, you will need to sign any associated paperwork, such as the Master Promissory Note (MPN), which is a binding legal contract that obliges you to repay your loan according to the terms.

Limits. Federal Direct Unsubsidized and Subsidized Loans have aggregate loan limits. That is, you cannot attend school indefinitely and continue to receive federal financial aid. The maximum amount you can borrow as a dependent student will be lower than that of an independent student. The current aggregate loan limits can be found at https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized#how-much.

Direct Subsidized Loans have a time limit, which is 150% of the time required to complete your program, known as the maximum eligibility period. For example, if you are enrolled in a program that requires four years (such as a bachelor's degree program), you will be eligible for subsidized loans for six years if you maintain your other eligibility requirements. Changing the length of your program of study (for example, from a four-year bachelor's degree program to a two-year associate degree program) may impact your eligibility for Direct Subsidized Loans. More information about time limits and program changes can be found at https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized#eligibility-time-limit.

Rates. Interest rates for Direct Subsidized and Unsubsidized Loans disbursed on or after July 1, 2016 and before July 1, 2017 are 3.76%, which is lower than the interest rates for other federal student loans. In addition, loan fees that are a percentage of the total loan amount are deducted from each loan disbursement you receive. The loan fee rate for loans taken from July 1, 2016 to July 1, 2017 is 1.069%.

Repayment. Direct loans do not require payment while you are enrolled at least half time (typically defined as six credit hours). The payments are deferred until you are out of school or attend less than half time. If you withdraw from school, graduate, or enroll less than half time, you have a grace period of six months before your payments begin. At that time, you will be contacted by the U.S. Department of Education to set up your payments and consider your repayment options.

Direct PLUS Loans

In addition to Direct Subsidized and Unsubsidized Loans, students may apply for federal Direct PLUS Loans. These are available to parents of dependent undergraduate students and to graduate students. The parent, not the student, is responsible for repaying the parent loan.

Eligibility. The student the loan benefits must meet the same eligibility requirements as for the student Direct Loan program. The parent must also meet the basic eligibility requirements, except for school enrollment. The parent can be a biological parent or adoptive parent—step-parents may also qualify.

Federal PLUS loans are also available to graduate students. The borrower criteria is the same—the student must pass a credit check and can borrow up to the cost of attendance. The student is responsible for repaying graduate PLUS loans. PLUS loans are not available to undergraduate students—only to the parents of dependent undergraduate students. The U.S. Department of Education's publication on PLUS loans is available at https://studentaid.ed.gov/sa/sites/default/files/direct-loan-basics-parents.pdf.

Direct PLUS Loans require a credit check—a key difference. Borrowers with an adverse credit history may not be eligible for a Direct PLUS Loan. Borrowers with low credit scores might still be able to borrow with a cosigner or if they document extenuating circumstances for their credit history.

If a parent applies for a Direct PLUS Loan and is denied, the student's eligibility for a Direct Unsubsidized Loan may increase. So if a parent is willing to apply for a Direct PLUS Loan for their student, they should still apply, even if they don't think they will pass the credit check. The requirements are not as stringent as with many other lenders, and even if they do not pass, the student will then be eligible for more federal loan assistance through the Direct Unsubsidized Loan program.

Application. To apply for a Direct PLUS Loan, check with the school to find out their procedures. Some schools require the parent or graduate student to apply online at https://studentloans.gov/myDirectLoan/index.action. Some schools have their own application that they will submit for you. In either case, the first step is to fill out the FAFSA (Free Application for Federal Student Aid) at https://fafsa.ed.gov/. Then, after the parent or graduate student has applied, a notification of eligibility will be sent to the student. Depending on the school's process, this notification may come from the school or the U.S. Department of Education. The parent or graduate student will then need to complete Direct PLUS Loan entrance counseling and a Master Promissory Note online for the loan funds to be disbursed. They will need to log in at https://studentloans.gov/myDirectLoan/index.action with a valid FSA ID and pin number (go to https://fsaid.ed.gov/npas/index.htm to obtain an FSA ID).

Limits. Federal PLUS loans do not have set aggregate limits per borrower. The maximum loan amount is based upon the total cost of attendance less any other financial aid the student receives. For example, if the school set the cost of attendance at $20,000 for the year, and the student is borrowing $3,500 in Direct Unsubsidized Loans and receiving a $5,000 scholarship, then the maximum Direct PLUS Loan available will be $11,500 ($20,000 – $3,500 – $5,000). Remember, the cost of attendance is not necessarily the amount you will be billed from the school. The cost of attendance is an estimate of annual expenses based on tuition, fees, a housing stipend, and other miscellaneous expenses set by the school each year. If you live off campus, your bill from the school will only include tuition and other fees. Your living expenses may be less than the amount used to compute the cost of attendance, so you may not need to borrow the entire amount. You should only borrow the amount you need for the year.

Rates. Interest rates on Direct PLUS Loans are typically higher than the interest rates for Direct Unsubsidized and Subsidized Loans. Direct PLUS Loans also have a loan fee. The loan fee is a percentage of the loan amount and the percentage varies based on when the loan is first dispersed. The current rate of interest and loan fee can be found at https://studentaid.ed.gov/sa/types/loans/plus#interest.

Repayment. When Direct PLUS Loans are disbursed, these funds will first be applied to any balanced owed to the school. Excess funds will be disbursed to the parent or the student, depending on the option selected. The school should provide the parent or graduate student with the option to choose how excess funds are disbursed. The borrower will receive a notice of disbursement. Repayment of Direct PLUS loans typically begins after the loans are disbursed, but deferment options are available. The parent or graduate student can request that the payments are deferred while the student is enrolled at least half time in a degree or certificate program. Interest will continue to accrue while the loans are in deferment.

Even after the student graduates, loans obtained by parents under the Direct PLUS loan program remain the responsibility of the parent. The loan cannot be transferred to the student.

Comparing Loans

The next two tables summarize the differences for eligibility, interest accrual, and loan limits for federal loans.

Federal Student Loan Eligibility and Interest Accrual

Federal Loan Program	Eligibility	Interest Accrued
Direct Subsidized Loan	Financial need must be demonstrated.	Government may pay the interest during the deferment.
Direct Unsubsidized Loan	Financial need is not required.	Individual is responsible for interest accrued during the deferment.
Direct PLUS Loan	Financial need is not required; borrower must not have negative credit history.	Individual is responsible for interest accrued during the deferment.

The current aggregate loan limits can be found at https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized#how-much. The aggregate limits include all loans received for both undergraduate and graduate studies. Federal PLUS Loans borrowed by parents are not subject to aggregate limits.

Federal Student Loan Aggregate Loan Limits

Year	Dependent Students (except students whose parents are unable to obtain PLUS Loans)	Independent Students (and dependent undergraduate students whose parents are unable to obtain PLUS Loans)
First-Year Undergraduate Annual Loan Limit	$5,500—No more than $3,500 of this amount may be in subsidized loans.	$9,500—No more than $3,500 of this amount may be in subsidized loans.
Second-Year Undergraduate Annual Loan Limit	$6,500—No more than $4,500 of this amount may be in subsidized loans.	$10,500—No more than $4,500 of this amount may be in subsidized loans.
Third-Year and Beyond Undergraduate Annual Loan Limit	$7,500—No more than $5,500 of this amount may be in subsidized loans.	$12,500—No more than $5,500 of this amount may be in subsidized loans.
Graduate or Professional Students Annual Loan Limit	Not Applicable (all graduate and professional students are considered independent)	$20,500 (unsubsidized only)
Subsidized and Unsubsidized Aggregate Loan Limit	$31,000—No more than $23,000 of this amount may be in subsidized loans.	$57,500 for undergraduates—No more than $23,000 of this amount may be in subsidized loans. $138,500 for graduate or professional students—No more than $65,500 of this amount may be in subsidized loans. The graduate aggregate limit includes all federal loans received for undergraduate study.

Selecting Private Student Loans

Understanding the Risks

You may find it necessary to borrow additional funds from a private lender to cover your costs while attending school. Before taking out a private student loan, be sure to exhaust all your federal loan options because of their relatively low, fixed interest rates and more flexible repayment options. Then, only borrow what you need from a private lender. Private loans do not offer the same benefits as federal loans and often cost significantly more over the life of the loan. In addition, your credit score will be a factor in your ability to borrow and in your interest rate. Interest on private loans typically starts accruing immediately, and many lenders will require payments while you are attending school. Many students need a cosigner to obtain a private student loan. Before taking out private loans, be sure to ask lots of questions and choose the lending institution that will provide a combination of the lowest cost and most flexibility for your individual circumstances.

Questions to Ask

Once you decide that you need a private student loan, be sure to ask the right questions of the lenders to select the best options. Private loans can vary significantly among lenders. Here are some key questions to consider.

Will payments be required while attending school?

Some lenders allow deferred payments while attending school either full- or part-time. If the lender offers deferred payments, be sure to ask what enrollment status is required to maintain deferment. Some lenders may require that you are enrolled full time and may require loan payments even while you are attending school. If a deferment plan is available, ask how long the grace period will be after you leave school. Also, almost all loans will accrue interest during deferment (with the exception of federally subsidized loans), so you may want to consider making interest-only payments while in school. The next table provides an example of the amount of money you can save by paying money during deferment.

Example of Amount Saved by Making Interest Payments During Deferment

Loan amount	$10,000
Loan interest rate	8.25%
Loan term	20
Deferment (months)	36
Capitalization frequency	Monthly

	No Payments During Deferment	Interest-Only Payments During Deferment
Monthly payment during deferment	$0.00	$68.75
Total interest paid during deferment	$0.00	$2,475.00
Loan balance after deferment period	$12,797.35	$10,000.00
Monthly payments after deferment	$109.04	$85.21
Total payments after deferment	$26,169.60	$20,450.40
Total amount paid	$26,169.60	$22,925.40
Amount saved		$3,244.20

Is the interest rate fixed or variable?

Many private lenders offer variable interest rates and advertise a range of rates that can be misleading. Most of the time, the lowest advertised rate will only be available to borrowers with extremely high credit scores. If the rate is variable, it may change significantly over the life of the loan. Ask if the lender has a maximum interest rate that can be charged. Sometimes it is better to accept a slightly higher fixed rate loan than risk the variable interest rate reaching 18% or more.

What repayment options are available?

You will want to find out the timeline for repaying your loans. Repayment may be over only a few years, or may be extended for 10 years or more. The length of repayment will significantly impact the amount of your payment and the amount of interest you will pay over the life of the loan. You will also want to ask about income-based repayment, graduated repayment, or interest-only payment options in the event that you are unable to make the full amount of your loan payment when you leave school. Many private loans will not offer these benefits. Alternatively, if you are thinking of prepaying your loans, you may want to calculate how much interest you will save at https://www.balancepro.org/resources/calculators/student-loan-consolidation-and-debt-payoff-calculator/.

Are there deferment options in cases of hardship?

Most private loans will require payment even if you are experiencing financial hardship or unable to find work after leaving school. Ask if the lender offers any deferment plans based upon financial hardship.

Does the loan have additional fees or prepayment penalties?

Don't forget to ask the lender about any fees associated with the loan in addition to the interest. Some lenders have hidden fees in the fine print. Be sure to find out if there are any penalties or fees for paying your loan off early. You may also ask how the additional payments will be applied to your loan. Will they be applied to the principal or to future payments? You may make a lump sum payment, thinking that you have made your payments for several months, only to learn that you have an outstanding payment due to the lender's policies about prepayment or extra payments.

Are there any forgiveness options available?

Although it is unlikely that any private loan will offer forgiveness options, it certainly wouldn't hurt to ask. Some lenders may have partial forgiveness for certain areas of study or circumstances. Ask your lender if any such options are available.

Conclusion

Financing an education in today's economy is not easy. Knowing your options, increasing your debt management skills, and making some long-term plans can help ease the process and allow you to focus on your dreams in your field of choice.

Click here to schedule your Personal Financial Checkup today for helpful guidance and more tips!

Or contact us directly via email: TruliantAtWorkTeam@Truliantfcu.org

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