What You Need to Know: Federal Student Loans (Part 1) - An ACCESS Special Report

January 9, 2015 - Our federal government has been encouraging students and their families to take out federal student loans for years now. The reasoning behind this is traditionally those with a better education have been able to earn more money and live better lives. As a generalization, that remains the case but it isn't always true for every individual. It has become increasingly important for anyone considering a federal student loan to understand the costs, benefits and the long term ramifications of this particular type of debt.

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This report is broken into four parts this being the first one. Here we review your options for financing college. In part two, we will answer questions about the applications process. Part three addresses the cost of college and loan acceptance. Our final part answers key questions for after college and loan repayment options.

Options For Financing College

Who is eligible to apply for federal student loans?

American citizens, immigrants and refugees who legally reside in the United States, along with their children. Basic eligibility criteria with links to more detailed information can be found here.

NOTE: Criminal convictions can make you ineligible for federal student loans. This is true even after you begin college and even for violations of the law that you may personally believe to be insignificant. For instance, a conviction for drug abuse or drunk driving in your freshman year could make you ineligible to receive any additional loans and force you to drop out or find another form of financing. And if you are forced to drop out of college, any student loans that you have already taken out will need to be repaid.

Are federal student loans the only type of loans available to finance an education?

No. There are also private lenders that offer student loans, but they make up less than 10% of the student loan market. The vast majority of student loans are made by the federal government. Some families may elect to take out home equity loans or home equity lines of credit if they have enough equity in their homes. These types of loans may offer some significant advantages to borrowers such as lower interest rates and longer repayment periods.

Other than paying cash or a private loan, are federal student loans the only way to finance college?
No.

In addition to federal loans, many states and some local governments provide financial assistance to residents. Check with your state and city governments to see if they offer any college financing options. Your high school should be able to provide you with a list of state and/or city financial aid programs that are available in your area.

There are also a wide variety of scholarships and grants available to college students. Most of these require students to apply. Students and their parents should ask their university's Admissions Office, Office of Financial Aid or the Bursar's Office for a list of scholarships and grant opportunities. While this is unlikely to be a comprehensive list, most schools will have access to information on scholarship; some of which are only available at their institution. A similar inquiry should be made with your high school as there may be alumni funded scholarship opportunities that are only available through your school.

Many employers also offer educational programs. Employees should check with their Human Resources Department or their manager to find out about educational assistance programs offered by their employer. Many companies will agree to reimburse current employees for educational costs after they successfully pass courses which will help further their career. Others may offer scholarships or grants to the children of employees.

Keep in mind that grants and scholarships â€“ unlike student loans - do not have to be repaid. They are essentially free money and should be your first choice for financing college.

How are federal student loans different from other types of loans?

Federal student loans are made directly to students and their parents by the federal government. There is no bank involved in the process. As you will see below, the laws associated with the issuance and repayment of these loans are significantly different from laws associated with other forms of debt. Because this is a federal loan, technically owed back to the taxpayers, this loan cannot be discharge through bankruptcy.

Are federal student loans given to students or their parents?
The answer depends on the type of loan.

Loans for undergraduate degrees are available to parents and to students. Graduate loans are available to graduate students only.

How much money can I borrow with a federal student loan?

The amount of money that you can borrow through a federal student loan is ultimately up to the school you will be attending. The overall amount of student aid offered is based on the cost of tuition, books and anticipated living expenses. Borrowers can cover all of these expenses with their loans but should not take more money than they will actually need.

Do all federal student loans have the same repayment terms and interest rates?
No.

Once you are notified that student loans have been awarded to you by your school, you will be asked to accept your loans through the FAFSA.gov website. The very first time you go through this process, it can be confusing since it is likely that you will be offered more than one type of loan.

Loans may be subsidizedâ€¦ meaning that you will not accrue any interest charges until you graduateâ€¦ or unsubsidized. And each loan type may have a different interest rate. Loan types include Student Plus, Parent Plus (for parents of students) and Stafford loans.

NOTE: Do not let the names of the loans confuse you. "Stafford" loans are simply named in honor of Senator Robert T. Stafford because of his work on issues involving higher education. The differences between Stafford Loans and Plus Loans are in the loan terms.

Parents taking out loans will have a separate account from their child. This means that if both the parents and the student are applying for loans, both the parents and student should look at the terms associated with each loan offered prior to accepting any loans.

Borrowers need to be aware of the fact that federal student loans have origination fees. These are fees in addition to the interest rate which are charged to you at the time that you accept the loan. These fees can be quite steep and need to be included when determining the overall cost of a loan. For Direct Subsidized and Unsubsidized loans, the fee is currently 1.072%. For PLUS loans, the current fee is 4.288% of the amount borrowed. Additional information on origination fees can be found here.

Borrowers should accept any subsidized loans offered first. These loans can save borrowers thousands of dollars because interest charges don't begin accruing until the student graduates. But it is important to note that not all applicants will be offered subsidized loans. Awards of this type are income based.

Other loans should be accepted based on their interest rate and origination fees. FAFSA provides an explanation of student loan interest rates here. Additionally, the Department of Education provides repayment calculators and charts here

Under current rules, federal student loans have a fixed rate of interest for the life of the loan. But each year you borrow may have a different interest rate. For instance, Direct Subsidized Stafford Loans for undergraduates made before July 1st, 2014 have an interest rate of 3.86%. Those made from July 1st on have an interest rate of 4.66%. By law, interest rates are reset each year on July 1st.

What else do I need to know about federal student loans?

The decision to take out a student loan is really a business decision and should be approached as such; with clear goals and objectives. Families should sit down together to outline these goals and objectives and then do some research to make sure they are being realistic.

All business decisions involve an element of risk. The question is, are the risks reasonable? In this case, only the borrower can answer that question.

In Part 2, weâ€™ll be discussing the application process.
Links to Other Articles in this Series:

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