What the Latest FED Rate Increase Means for Student Loans

December 22, 2016 - Student loans are big business. They account for more than $1.4 Trillion in debt; most of which is owed to the federal government. And since the interest rate for most student loans is tied to the benchmark 10 year treasury rate, the latest increase in interest rates by the FED will have some consequences.

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About 8% of student loans are variable rate. The rest are fixed rate. Anyone with a variable rate loan is going to feel an immediate impact from the latest increase in interest rate from the FED. But anyone who has a federal loanâ€¦ which makes up 92% of student loan borrowersâ€¦ won't be impacted on their existing loans. The interest rates on those loans are locked in for the life of the loan.

Anyone borrowing for the 2017-2018 school year won't be so lucky. The latest increase in interest rates will add about 0.9% to the interest rates charged on new loans. For undergraduates that means that interest rates will jump from their current 3.76% to 4.65% on new loans next year. For parents and graduate students, the rate will increase from the current 6.31% to 7.2%. But that is only if there are no other interest rate increases between now and June of 2017. And that's a big "if."

In the FED's statement last week, they said that three more interest rate increases were anticipated in 2017. It is likely that at least one of those will come before June; when the interest rates for next year's student loan rates are set. And it is conceivable that a second interest rate hike could occur prior to that date.

All of this could significantly increase the cost of higher education for both students and their parents. But there are things that families can do to keep costs down.

Parents who are borrowing to help their children get through college may be able to borrow money at significantly lower interest rates if they are also homeowners. Mortgage rates remain low. Taking out a second mortgage on your home is likely to be a lot less expensive that borrowing the money through the federal student loan system.

A second mortgage may also be significantly more affordable on a monthly basis. Federal student loans are paid back over 10 years. A mortgage can be stretched out to 30 years for repayment; reducing monthly repayment costs.

Another option is for students to attend a junior college for the first two years. Most junior colleges have very low tuition rates and their credits are normally transferable to four year institutions.

In the event that neither of these options will work for you or your children, and you determine that a federal student loan is your only option, don't over-borrow. When applying for student loans, the government will allow you to borrow money for tuition, books and living expenses. But if you don't need every penny that is being offered, don't take it. If you can pay for your books yourself, then do it. If you can pay for your apartment on your own, or continue to live at home, then don't borrow the money for those items.

College is supposed to be a learning experience. But the lesson you will get from borrowing more money than you need isn't one you are likely to be happy with once you graduate.
byJim Malmberg
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