

Loans for College

After you've applied for financial aid and have received your results (your award letters), you may find that you still have a gap – an unmet need. Sometimes even the amount that the federal government says you can afford (your EFC or Expected Family Contribution) is out of reach. Fortunately there are ways to bridge this all-too-common gap. This mini-manual will focus on one of them - loans.

Loans can be categorized in different ways. You can categorize them into those based on need, and those *not* based on need. Or, you can categorize them based on source, whether federal or private. For our purposes we will take that approach, and discuss need based vs. non need based as well, within each category.

There are two major types of loans:

- ✓ Federal Education Loans: available to students and parents
- ✓ Non-federal Loans (private): these might be home equity or other bank loans

Federal Loans (guaranteed by the federal government)

What is Title IV?

This term refers to a section of the federal Higher Education Act of 1965, as amended, which authorizes the vast majority of federal student financial assistance programs.

Title IV student financial aid programs are offered by most institutions that are accredited by an accrediting agency that is recognized by the U.S. Secretary of Education. It is important to note that not all accrediting agencies are recognized by the U.S. Secretary of Education. Students attending institutions that are accredited by agencies not recognized by the Secretary are ineligible to receive aid from the federal Title IV student financial aid programs. The Title IV loan programs are discussed below.

What does it mean when it says the loan is “guaranteed” by the federal government? It means that if the student defaults on the loan (fails to pay it back), the government will reimburse the lender. That protects the lender, so in return, the interest rates are lower. The government also pays interest while the student is in college if the loan is *subsidized*. (see below) There are three types of Federal Student Loan Programs: Perkins, Stafford and PLUS. (Note: this manual reflects loan limit changes effective 7/1/07)

How to Apply for Federal Loans

The first step in applying for these student loans is to complete the FAFSA (Free Application for Federal Student Aid). The FAFSA requires Social Security Number, Drivers License Number, and tax return information. File as early as you can after January 1 of the year the student will attend college. Ideally, have your tax return already completed. Visit www.fafsa.ed.gov for helpful information, worksheets, etc. You can also sign the FAFSA electronically which has many benefits. Visit www.pin.ed.gov to obtain an electronic PIN. Beware of other websites that look “official” but are really offering FAFSA services for a fee.

Based on your calculated need, your aid package from one or more of your colleges may include a federally guaranteed loan *IF* you have completed a FAFSA. In a recent NACAC (National Association of College Admission Counseling) survey, most college counselors indicated that they believe student loans are a good investment for a typical student at their school, assuming he or she needs financial assistance in order to attend. (83% indicated “good” while 37% indicated “very good”)

The Master Promissory Note (MPN)

If you receive a federal loan offer, you must accept it by signing a federal Master Promissory Note or MPN, which is a contract between you and the lender.

When you sign a MPN you are agreeing to the terms and conditions set forth, and you will be stating that you understand your responsibility to repay the loan as specified. The MPN also spells out loan fees, late charges, repayment options, legal rights and what occurs if you default on the loan. Usually only one MPN is needed for all education loans received over a 10 year period, but check to be sure. If you receive a Stafford or Direct loan from the same lender every year while you're in college, the same MPN should be able to serve as your sole loan contract. This is a nice convenience. In addition, the MPN can be completed on line and loan funds can also be disbursed electronically if desired. Always keep a copy of your MPN. If you receive loans from other sources, you will probably have to fill out specific promissory notes for each. The PLUS and Perkins loans, though federal, still have their own forms.

Always ask questions before signing these promissory notes, to be sure you understand all terms.

Need Based – Perkins Loans

These loans used to be known as NDSL (National Direct Student Loans) and carry a fixed interest rate of 5% as of this printing. These loans are repaid starting 9 months after the student leaves school or reduces his or her enrollment to less than half time. During the school years, no interest is charged and the student has 10 years to repay the loan. These loans are government loans, yet they are administered through the aid offices of the various colleges. The financial aid office of each college gets to determine who receives them and for how much each. The current limit is \$5500 per year for undergraduates, with a cap of \$27,500 total. There is no loan fee. These loans are very good deals and should almost always be taken if offered, but they tend to go to those with very high need levels. Also, the Perkin Loan program is believed to be at risk under the current administration, so keep an eye open for news in this area.

Federal Stafford Loans

- a) Subsidized – based on need, and the student is not charged interest until 6 months after the student leaves school (considered a grace period). As such, these loans are “subsidized” by the federal government.
- b) Unsubsidized – not based on need, and any student who fills out a FAFSA is eligible. However, interest starts accruing the day the loan is taken, and students are given options for repayment. They can either pay the interest while in school or defer the payment of interest until the repayment of the principal begins.
- c) Mixed – sometimes students with limited need are offered part of the Stafford loan as subsidized and the remainder unsubsidized. Also, some schools will not specify clearly in the award package whether or not the Stafford Loan is subsidized or not so, in those cases, be sure to call the financial aid office.

Because the federal government guarantees these loans, the interest rate is low. However, Congress passed the College Cost Reduction and Access Act of 2007 which gradually cuts that rate on subsidized Stafford loans in half to 3.4% by 2012, starting with the drop from 6.8% to 6% in July 2008 and continuing to drop each year. (For 2009-10 the rate is 5.6%) As of now, most dependent undergraduate students may borrow subsidized amounts up to \$3,500 for the freshman year, up to \$4,500 for sophomore year, and up to

\$5,500 for the remaining undergraduate years up to a total of \$23,000. Independent undergraduates whose parents have been turned down for a PLUS loan (see below) are eligible to borrow an additional \$4,000 for the first two years and \$5,000 for the third year and beyond to a maximum of \$46,000 total. But only \$23,000 can be subsidized. These amounts may change so always be sure to verify the maximums, and remember, these loans are not subsidized. Lastly, effective July 1, 2007 graduate and professional students can borrow up to \$20,500 per year but with only a maximum of \$8,500 per year a subsidized Stafford. There is also a \$138,500 total borrowing limit including any undergraduate Stafford Loans, with no more than \$65,500 being subsidized.

The administration of these Stafford loans can vary. Since 1994, some colleges use the William D. Ford Direct Loan program such that the funds come directly from the federal government through the financial aid office. (Direct Loan) Other schools use the FFEL (Federal Family Education Loan) program through which students obtain their funding through banks or other private lenders that coordinate with the school. The interest rates currently vary based on the program used, but this may change. (See a sample loan repayment chart at the end of this manual.)

Note that there are often other fees and charges associated with these loans, such as loan insurance, loan origination fees and so on. These fees are generally deducted from the amount the student receives so beware! On the brighter side, one advantage of student loans is that the interest paid is tax-deductible.

Monitor your Loans at NSLDS

You can monitor your loans and grants at http://www.nsls.ed.gov/nsls_SA/ The National Student Loan Data System (NSLDS) is the U.S. Department of Education's (ED's) central database for student aid. NSLDS receives data from schools, guaranty agencies, the Direct Loan program, the Pell Grant program, and other Department of ED programs. NSLDS Student Access provides a centralized, integrated view of Title IV loans and Pell grants so that recipients of Title IV Aid can access and inquire about their Title IV loans and/or Pell grant data. Using this tool you can keep an eye on your total loan limits.

Non-Need-Based: PLUS (Parent Loan for Undergraduate Students)

First of all, these loans are for parents, not students. (As of this printing, graduate students are eligible as well.) These are credit-based loans and are hard to beat if you are lucky enough to qualify. It's all about the credit test. If qualified, parents can borrow up to the total cost of attendance at college minus any other financial aid received. Again, remember that these are not need-based, so income is not a factor.

Use of PLUS Loans

Parents often use PLUS loans to cover some or all of their EFC, which is the government's assessment of what you can afford to pay.

Interest, Fees, and Limits

The interest rates on these loans are fixed and the interest begins accruing immediately. If the school uses the Direct Loan program, it is currently 7.9%, while the FFEL program is 8.5%. Repayment of PLUS loans begins 60 days after the loan is received, and may extend up to 10 years. Sometimes a co-borrower is permitted. The loan money is sent directly to the school in at least two installments. After payment of tuition, fees, room, board and other charges is made, the balance of the loan is sent to the parents or, if authorized, to the student.

There is no maximum borrowing limit on PLUS loans, but a school can refuse loans or can

certify amounts that are less than what the parent would otherwise have been eligible for. If this happens, the school must document and explain in writing the reason for the decision. In addition, the student may be eligible for a higher Stafford Loan limit if the parents are restricted on the PLUS loan.

Loan fees vary, but can be up to 4% of the loan total and are subtracted from the loan amount.

How to Apply

Parents apply for PLUS loans by filling out and submitting a special application and promissory note. They can usually obtain the required forms from the college financial aid office, or can try the lenders themselves or the Department of Education financial aid websites. (see www.studentaid.ed.gov) Although a FAFSA is not required for a PLUS loan, it is still recommended because it is required for other forms of aid.

To qualify, parents must be U.S. citizens or eligible non-citizens and they must certify that the loan is to be used solely for educational purposes.

Sample Stafford Loan Repayment Chart

Based on 6.8% interest rate, 10 year repayment period and a minimum \$50 per month payment
(Note: current rate is 6%, not 6.8%, so this chart is conservative)

<i>If you borrowed:</i>	<i>You will need to make per year:*</i>	<i>To Pay this amount monthly:</i>
\$5,000	\$6,905	\$50
\$15,000	\$20,714	\$173
\$23,000	\$31,762	\$265
\$46,000	\$59,382	\$495
\$55,000	\$75,953	\$633
\$65,500	\$90,454	\$754
\$138,500	\$191,263	\$1,594

**Recommended annual salary figures are based on 10% of your gross monthly income available for student loan payments. Assumes you are paying your interest for any unsubsidized loans while in school to avoid capitalizing the interest to your final outstanding principle balance.*

Private Loans (sometimes called personal loans or alternative loans)

Loan Terms

These are loans that are not guaranteed by the federal government. Another key characteristic of private loans is that they are *not based on need*. They are designed to help pay for the “net gap” or EFC. In most, if not all, cases they must be repaid starting immediately and they have interest rates that are generally higher than federal loans. In addition, the *interest rates on private loans can fluctuate*. These sorts of loans have terms that are entirely controlled by the lender and they can differ significantly. As such, private loans may require more effort on your part.

Most of the time, the primary lender on a private college loan is the student. Parents may be able to cosign in order to help obtain the loan, but it’s advantageous to allow the student to establish good credit. You might be able to negotiate terms such that the

cosigner is released from obligation after the student makes a certain number of on-time payments.

There are other terms that can vary for private loans. For example, you may be able to defer repayment until after the student graduates but, unfortunately, interest will be accruing the entire time most likely. These are the types of terms that you must be sure you fully understand. Ask questions of your lender, and don't sign anything until you are absolutely sure you understand your obligations.

A home equity loan is a good choice for some situations. Generally they are at low interest rates (or can be) and also generally result in an income tax deduction on your return. Another advantage is that the use of the monies is not limited to college expenses.

Finding Lenders

There are all sorts of private lenders and it's worth shopping around. If you have a good relationship with your bank or credit union, that's a good place to start. Also, check with your colleges as they will often recommend certain lenders with whom they have had positive experiences. In fact, some colleges have their own lending programs with attractive interest rates. Sallie Mae offers a good college loan website at www.salliemae.com and several private education loans to supplement the federally sponsored loan programs. Compare rates, fees and discounts and remember to fully understand terms. For example, it might be better to get all fees waived as opposed to a reduced interest rate. Try to do the math yourself to be sure.

What Determines Eligibility?

You are generally able to borrow the amount of your net gap, or your total educational expenses minus any aid you received. However, various aspects of your loan, such as fees, interest rates, etc. are tied to the borrower's credit and that of the cosigner if applicable. Yes, that's right – the better the credit rating the lower the interest rate in many cases. It is highly unlikely that you'll find a private loan where the interest is deferred. It will almost certainly begin accruing immediately. Be careful when making these sorts of commitments, and seek professional advice if need be.

Do I Need a Cosigner?

If you are turned down when applying individually, a cosigner may save the day. If you have no credit history, or poor credit, this could be the case. But in addition, some lenders have a tiered interest rate structure where excellent credit can make a large dollar difference. So if you have someone with excellent credit who is willing to cosign for you, investigate your options thoroughly and shop around.

Cosigner Responsibility

Cosigning a loan makes you as responsible as the other party for repayment so it's a large responsibility not to be taken lightly. The cosigner guarantees the debt and will have to repay it if the borrower does not. If you are considering cosigning a loan, be very clear about this and be sure you want to accept the responsibility. Ask yourself:

- ✓ Can you repay the loan if need be?
- ✓ Are you willing to risk your credit rating if you need to repay and cannot?
- ✓ Your liability for the debt may be included in other lenders calculations, making you less eligible for other loans you might want – even if you never have to repay this one.
- ✓ Lenders must give you paperwork that clearly explains your responsibilities and obligations as a cosigner. Be sure to read them carefully as well as all the loan documents and the Truth-in Lending Disclosure Statement.

Private Loans as Aid from Colleges

Sometimes private loans can be offered through the colleges as part of their aid award package to the student. Because they come from the college aid office, don't be confused into thinking they are federal loans. They might be, but might not as well. Remember that you don't have to accept the loans in order to attend the college, so shop around regardless of what the college disperses. If it is a federal loan, it is likely to be attractive in terms of interest and terms. If it's a private loan, you may not be getting the best deal.

Remember that if you do decide to accept a loan offered in your award letter from the college, it isn't automatic. You have to apply for it and the instructions should be included in the material sent to you.

The College Preferred Lender List

Almost all colleges will provide some sort of preferred lender lists that single out four or five lenders for you. These are supposed to be lenders that the college's financial aid office has determined will provide the best deals and service to its students. As such, the lenders on these lists typically receive up to 90% of the loans taken out by that school's student /parent population. However, it is wise to beware and be aware. Recently investigations showed that some lenders have been paying their way onto school lender lists and some schools were receiving kickbacks and other "perks" as well. Hopefully colleges are remedying this situation if they were ever a part of it, but you can ask the tough questions and be sure. Don't automatically reject lenders that are on a preferred list, but don't automatically accept them either. In other words, ask questions and shop. Remember, you are not obligated to use a lender the school suggests.

State Loans

Sometimes there are lower-cost loans based on the state of residence and/or where the student will be attending school. These are usually attractive options if available, so research your particular state thoroughly before resorting to private loans. If you don't know where to start, try an internet search using your state plus terms such as "higher education commission" or "higher education financial aid". For example, *New Jersey Higher Education Commission* and this may lead you to the source. From there, look for financial aid links.

Interest-Free or Low-Interest College Loans

Some charities and religious or ethnic organizations offer low or even no interest college loans. Here are just a few:

- Evalee C. Schwartz Charitable Trust for Education – students attending in state school and whose families have EFCs under \$4000, high test scores and grades and not intending to pursue legal careers. www.evaleeschwarztrust.org
Deadline: April 15
- The Scholarship Foundation of St. Louis – meritorious students from parts of Missouri and Illinois whose families have EFCs under \$12,000. www.sfstl.org
Deadline: November 15
- Hattie Strong Foundation – meritorious and needy 4th year college students. www.hmstrongfoundation.org Deadline: April 30 (not accepting for 2009-10)
- Bill Raskob Foundation – US citizens attending accredited US colleges after freshman year. www.billraskob.org Deadline: May 1

- Central Scholarship Bureau – meritorious students in Maryland; family income less than \$91,000. www.centrlsb.org Deadline: May 31
- Abe and Annie Siebel Foundation – Texas residents attending Texas schools and who have good grades and test scores. (409) 770-5665 Deadline: Feb 28

Note: The financial information in this manual is of a general nature and may not apply to all situations. Contact a financial and/or tax advisor before making significant decisions.