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Guide to Student Loans

By JONATHAN D. GLATER

A college education may be the most important investment in a child's life and has become one of the most costly, too. The publicly reported tuition charged by private colleges and universities for the 2007-2008 can reach \$50,000 a year. The trends are alarming, too. And while tuition at public universities is generally lower, costs there have been growing even more steeply in recent years as government support has lagged.

So it is no wonder that more students and their families are borrowing ever larger amounts to pay for college. Last academic year, they took out more than \$78 billion in loans, both federally guaranteed and private.

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But understanding how student loans work is not easy, and the unwary borrower can end up paying a high interest rate for years after graduation. For the millions of students who will need to borrow to pay for college, it makes sense to learn about the financial aid system even before applying.

Types of Loans

There are three basic types of loans undergraduate students should know about: federal loans made by the government directly; federal loans made by banks or other lenders and guaranteed by the government; and private or alternative loans from banks or other private lenders that carry no government guarantee. (Sometimes a college itself may make loans, too, usually in partnership with a financial institution.)

Every student should first look to federal loans, either those made by the government, or a bank or other lender, because the interest on these loans is capped at a fixed rate set by Congress. Every financial aid administrator at every college in the country should tell students this. And students should be wary of any lender that tries to steer them away from federal student loans.

The most popular federal loan is the Stafford loan, available to students regardless of financial need, and either from a lender or from the government directly. Perkins loans are available to students who have the greatest financial need; priority is given to students receiving federal Pell grants, which are awarded to low-income students. Parents of students can also take out federal loans, known as Parental Loans for Undergraduate Students or "PLUS" loans.

The federal Education Department has information on [Stafford](#), [Perkins](#), and [PLUS loans](#) on its Web site, which can be hard to navigate.

The simplest way to borrow may be directly from the federal government, through the William D. Ford Federal Direct Loan Program. But this option exists only for students attending a college that participates in the direct loan program. For students attending institutions that do not participate, shopping around for the best deal is imperative.

Interest on Federal Loans

Congress sets the maximum interest that a lender can charge on federal loans, and most lenders do charge the maximum. Currently the maximum interest rate on new Perkins loans is 5 percent; on Stafford loans, it is 6.8 percent (but 6 percent for subsidized Stafford loans, on which the government pays the interest); and on PLUS loans, borrowers pay 7.9 percent if they borrow through the direct loan program and up to 8.5 percent if they borrow from a bank or other, non-governmental lender. Students should check these rates because they do change. The Education Department currently posts the [maximum rates](#).

The government also imposes limits on how much money students may borrow under each type of loan program. As of July 1, 2008, the typical dependent Stafford borrower can take out \$5,500 in the first year of college, \$6,500 the second year and \$7,500 in later years. The maximum amount an undergraduate can borrow through the Stafford loan program is \$31,000. These loan limits are specified [here](#).

Families taking out PLUS loans can borrow enough to cover their full "cost of attendance" less any other financial aid, like scholarships or grants, that they receive. The cost of attendance is defined by law and is made up of more than just tuition and fees, and includes room and board, an allowance for books and

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supplies, transportation and other personal expenses. Every college should provide incoming students with its cost of attendance.

Just to make this more complicated, there are two types of Stafford loans available to students. For those who demonstrate sufficient financial need, the government will pay the interest on "subsidized" Stafford loans for students while they are enrolled in college. Otherwise, loans accumulate interest while a student is in school, and the student may either pay that interest as it comes due or let it be added to the principal balance.

Filing the FAFSA

Where to begin? With a first step that unfortunately is not easy -- filling out the Free Application for Federal Student Aid, or FAFSA. There was talk in Congress earlier this year of simplifying [this form](#), which is long and detailed, but no changes have been approved by lawmakers yet. The good news is, it is free and can be completed online. The reward for slogging through it is eligibility for the federal loans, which may save a borrower hundreds or thousands of dollars in interest.

Any borrower's first choice, of course, would be the Perkins loans, for those who qualify. Then look to see if your school participates in the direct federal loan program.

Shopping for Federal Loans

For those taking out bank-issued federal loans, some shopping around is in order. There are some differences in the loans being offered -- but not ones that are easy to weigh.

For instance, even though the maximum interest rate is fixed, some lenders will offer discounts -- for example, cutting the interest rate or reducing the principal balance -- to borrowers who meet certain targets. In some cases, borrowers who make 36 consecutive on-time loan payments may qualify for certain reductions.

Financial aid administrators advise caution when considering these benefits. First, few ex-students are such punctual borrowers, so the benefit is worthless to many. Second, of those students who do meet the target, not all remember to ask for it, and the lender has no obligation to provide reminders. By some estimates, fewer than 10 percent of borrowers end up getting such benefits.

Students should look for benefits that they receive immediately, not in future years, like waivers of loan origination or loan guarantee fees. That is money that the borrower saves right away, and can spend on something useful, like books or pizza.

For more detailed tips on shopping for a Stafford loan, [check out this article](#).

Private Loans: The Wild West

For those students who need to borrow more money than is available through a federal loan program, there are "private" or "alternative" loans. These are basically just like any other consumer loan from a bank or student loan company. The interest rates charged on private loans are almost always higher than those on federal loans, and the interest rates can change over time.

The interest rates on these loans also vary from lender to lender and from borrower to borrower, leading some to describe the private loan market as the "wild west" of the student loan industry. Because there is so much variability in loan terms, students must apply for a loan merely to find out what rate they might have to pay. This can be time consuming, but it is better to shop around than to accept a rate that is going to make repayment difficult. The rates charged can [vary dramatically](#).

Because private loan interest rates change over time, it is more difficult for borrowers to predict their monthly payments in the future. In general, students should borrow as little as they can in the form of private loans, no matter how much easier the application process is than the FAFSA.

Private loans also do not enjoy some of the protections that federal loans provide, such as the possibility of temporary deferment or forbearance -- meaning that a borrower does not have to make payments on a loan under certain circumstances. There is more information about [how to cope with repayment difficulties for federal loan borrowers](#).

Getting Advice

In the wake of all the negative attention to financial aid offices this year, students might well be nervous about relying on advice they get from their colleges or about borrowing from a company on a college's list of "preferred" or "recommended" lenders.

While it is certainly the case that this year investigators for Congress and various state attorneys general uncovered questionable relationships between lenders and both colleges and individual financial aid administrators, students should still start with their financial aid offices. More coverage of the tangled arrangements some colleges had with lenders is available [here](#), [here](#) and [here](#). Many of these arrangements have since ended.

But students should learn from the scandals of the year and should ask, for example, how recommended lenders were selected and what are the terms of the loans those lenders offer? Under the terms of an agreement with the New York attorney general's office, more and more lenders are required to tell colleges exactly how much students are paying in interest.

For more information, there are plenty of Web sites out there aimed at future college students. Some sites even can help compare loan terms from different lenders to help students choose the best deal, like [SimpleTuition](#) and [Graduate Leverage](#). But some sites are in fact owned by lenders or other companies, or – like SimpleTuition – they are paid referral fees by lenders, so students should not rely on any one source of information.

Some helpful sites are maintained by both nonprofits and for-profit organizations not directly in the student loan business. Those seeking to learn more may want to check out The Institute for College Access and Success (www.ticas.org). The nonprofit's Project on Student Debt provides tips on shopping for and comparing different student loans. Mark Kantrowitz runs www.finaid.org, a popular source of information for students.

Most of the information provided discussed above is included in the [Education Department's Guide to Federal Student Aid \[pdf\]](#).

After reading this far, you might feel like as much work is involved in paying for school as getting through it. But remember: a little effort now could pay off in savings for years and years after graduation. -- *Jonathan D. Glater, Nov. 30, 2007*

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