

# Unravelling the Maze of Student Loans

# INTRODUCTION

This guide will help demystify the student loan process for you. You're about to invest in your future and you need to be equipped with knowledge so you can get the best loan and understand all your options.

Going to college is a big step in life. It is exciting, challenging and costly. One of the biggest stresses of going to college is figuring out how to pay for it. For many students paying for college involves getting student loans. Grants, scholarships and other free money does not usually cover all the costs and the only other place to turn is to a student loan.

Financial aid is quite confusing. Most of the time the student is out of the loop and really does not know what is going on except when they are informed that they need more money. The process of applying for financial aid involves a lot of numbers and applications. As if the whole process of applying for financial aid isn't complicated enough, in come student loans which add even more confusion to the whole process.

Loans are a complex topic. Many people are just not familiar with all the terms and technical aspects involved in the loan process. It can be very confusing to try to figure out what loan is the best loan. When it comes to student loans it can be almost a hassle to try to figure out exactly what terms, conditions and costs are for each loan you may be offered.

There are several things that you need to understand in order to be able to really understand the whole concept of student loans. Student loans can be either government or private loans. You will need to understand the difference in these two types of student loans. Additionally, you will want to make sure that you understand the repayment options of each type and what happens if you default on the loan, as all of this differs from loan to loan.

It is important that you completely understand student loans so that you can get the most from them. You will want to make sure that you are getting the best loan and are applying for the *right* loan.

The three main areas you will need to understand before applying for a student loan are:

- Government vs Private
- Repayment
- Default

In addition to understanding the three areas of student loans you should also become familiar with a few basic loan aspects. Every loan shares some common features and it can help to understand what they are and how they affect you as a borrower. You will want to understand:

- Interest
- Qualification
- Risks

These aspects of loans are the keys to unravelling the maze of student loans. Once you understand these six aspects of student loans you should find that applying for them and managing them is a much simpler process. You can then focus on getting an education and not be lost in the maze of student loans.

## **GOVERNMENT VS PRIVATE**

There are two main types of student loans – government and private. Both are loans that you get through a private lender, but it is the terms and conditions of the loans that make them different.

### **GOVERNMENT LOANS**

Government loans are managed by the United States Department of Education. The loans come from the Federal Family Education Loan Program (FFELP) and the Federal Direct Student Loan Program (FDLP). Funding is set aside to help maintain these programs and ensure that students are able to get the funding for college that they need.

Government loans are all based upon financial need. In order to qualify for government student loans a student must complete a Free Application for Federal Student Aid (FASFA). The FASFA is a form that collects data about the student's finances and in many cases the student's parent's finances. Additionally, the FASFA will gather information about the student's enrollment in college. This information is then used to calculate the expected financial contribution of the student and reveals the financial need of the student.

Another aspect of government loans that is important is that they are all limited in the amount of money to be loaned to the student. The maximum amounts change each year, but the general guideline is that with each year of schooling the maximum amount goes up. To put it simply, a senior year college student will qualify for more aid than a freshman year college student.

One last thing to understand about government student loans is the idea of subsidized and unsubsidized loans. Subsidized loans are loans where the government pays the interest on the loan while the student is in school. An unsubsidized loan, on the other hand, requires the student to pay all the interest and the government makes no interest payments.

There are several different types of government student loans. They are:

- Stafford Loan
- Perkins Loan
- Parent PLUS Loan
- Graduate PLUS Loan

## **STAFFORD LOAN**

The Stafford Loan is available directly to students. These loans are given based solely on need. Two thirds of the Stafford Loans available go to students with a family income of under \$50,000, one quarter goes to students with a family income of \$50,000 to \$100,000 and very few go to students who have a family income of over \$100,000.

The eligibility requirements and borrowing amounts are quite strict with a Stafford Loan. However, the benefits of a Stafford Loan are lower interest rates and more payment options than with private loans.

## **PERKINS LOAN**

The Perkins Loan is much like the Stafford Loan. It has strict requirements and is solely based upon need. With the Perkins Loan, though, the borrowing limits vary and are left to the discretion of the lender. The typical interest rate of a Perkins Loan is 5%.

## **PARENT PLUS LOAN**

The Parent PLUS Loan is a student loan given to parents. The parent is responsible for the loan, including repayment. Requirements for the PLUS loan are that a student is enrolled at least part time in an approved program. The borrowing amount is much larger than with the Stafford or the Perkins, but the interest is higher as well.

### **GRADUATE PLUS LOAN**

The Graduate PLUS Loan is just like the Parent PLUS Loan as far as the higher borrowing amounts and interest rates, but it is available only to graduate students. It has the same repayment options as Stafford and Perkins loans.

### **PRIVATE LOANS**

Private student loans can be obtained through a private lender. The same lenders that offer government loans usually also offer private loans. Private loans are going to have higher interest rates and different terms than government loans. The best aspect of private student loans is that they can be obtained for much larger amounts than government loans.

Additionally, they are credit based loans not need based loans. There are no specific types of private loans, such a with government loans because each lender will offer different loan packages based on the credit of the borrower. Many times with a private loan a student will need someone to co-sign the loan.

# REPAYMENT

Just as government and private student loans differ in general description, the repayment options sometimes differ, as well. The following outlines the repayment options for both types of loans and the special repayment options for government loans.

## **STANDARD PLAN**

Under a standard repayment plan you will have five to ten years to repay the loan. This type of repayment will have the highest monthly payment amount.

## **GRADUATED PLAN**

Under a graduated repayment plan the payments in the beginning are small and increase gradually. The typical schedule for repayment is every two years the payment goes up. The typical payback term is ten years maximum.

## **EXTENDED PLAN**

As the name suggest the period for repayment is extended beyond the typical maximum period of ten years. Many times an extended repayment plan is coupled with a graduated repayment plan. The monthly payment is going to be less then with a standard plan due to the extended period of time for pay back.

## **PERKINS LOAN PLAN**

The repayment amount under a Perkins Loan repayment plan is set by law for a maximum amount. Schools have the ability to extend the repayment period.

## **FFEL INCOME SENSITIVE PLAN**

Loans that are received under FFEL offer a repayment option that is calculated based upon the student's monthly income. The payments must cover the interest payments at minimum.

## **DIRECT LOAN INCOME CONTINGENT PLAN**

This is like the FFEL plan; however, there is no minimum payment. The payment amount may even be reduced to nothing.

As mentioned, for private loans the lender can develop their own repayment options. They may offer these options, but they may also have different options. It is important to understand the repayment terms of every student loan you acquire.

Something to note about student loan repayment is that students will usually be offered the right to defer payments until after they graduate. Deferment does not stop the accumulation of interest, though, in most cases.

# **DEFAULT**

The main reason that understanding the repayment terms of a student loan is so important is that not understanding them can easily lead to defaulting on the loan. When you fail to meet the terms of a loan you are, generally, considered to be in default on the loan. Most of the time lenders will work with you when you become delinquent or miss a payment, and help you to get back on track with your loan payments, but they can only be patient for so long before they must start the process of collecting the money due to them for the loan balance.

As with other aspects, defaulting on government and private loans are different processes. Take a look at how each works.

## **GOVERNMENT LOAN DEFAULT**

In order to be considered in default on a government loan you have to fail to meet the terms of the loan for nine months. Defaulting can include missing

payments or not meeting other terms of the loan agreement. Once you are in default you become responsible for paying the entire balance of the loan.

Once you are delinquent the lender must send a written notice of delinquency within the first 15 days after a missed payment. The lender must also inform you about the Student Loan Ombudsman. The Student Loan Ombudsman guarantees that the lender will exhaust all possible options to help you get back on track with your loan commitment before seeking other collection methods. After nine months the lender will declare you in default.

Since government student loans are considered high risk loans, due to the fact they are not credit based, they have some serious consequences when you default. Defaulting on a government student loan may result in:

- Disqualification for future government student loans.
- Ineligibility for other federal assistance programs.
- Seizure of income tax returns.
- Social Security benefits garnished.
- Negative mark on credit report.
- Garnishment of wages.
- Denial of federal interest benefits.
- Ineligibility to renew professional license.

## **PRIVATE LOAN DEFAULT**

Private lenders are a bit stricter in declaring you in default on a student loan. Private lenders do not have to give the nine month delinquency period required for government loans. Instead, one missed payment puts you in default under a private loan. Private loan contracts are going to vary in what constitutes default. Common things that put you in default on a private loan are:

- Failure to make a payment.
- Your death.
- A broken promise under loan note.
- Filing bankruptcy.
- Making a false statement on the loan application.
- Becoming insolvent.
- The circumstances of your ability to repay changes.
- Become in default for any other loan you may have with the lender.

When you default on a private loan the lender has some of the same remedies that the government has in collecting the loan amount due. They can:

- Garnish wages.
- File a negative report with credit bureaus.
- Send the loan to a collection agency.

Usually, though, the lender will have to go through court in order to enforce any remedies to collect the loan. The government, on the other hand, does not always need court interaction to seek remedies.

Now you have the basic information you need about student loans. It is time for you to get a little more basic loan information before you are ready to start applying for student loans. The following outlines the topics of interest, qualification and risk.

## **INTEREST**

Interest is the fee that a lender charges to loan you money. Interest rates are based upon the federal interest rate. In general, the lender will add onto the federal rate and increase the interest rate so that they can earn money on the transaction. The general rule of thumb is that lenders increase the interest rate for bad credit. This is because every loan payment you make is paying the interest and then the rest goes to pay the actual loan. Since people with a poor credit score are more likely to default, the lender safeguards their investment by making sure they are getting more money up front through the interest.

The reason why interest rates are important to you is that they make up a large part of the costs associated with getting a student loan. You have heard them mentioned and see that they play a large role in the student loan process. It is important to understand interest rates because you should always be aware of the rate you are getting and negotiate a better rate, if possible.

Interest adds up over the life of the loan. You will be given an Annual Percentage Rate or APR, which represents the percentage of interest that you will pay for one year of financing. The APR is not set in stone, though. Various factors can change the APR throughout the year, so looking at only the APR is not a good idea. For example, if you pay more or less than the regular monthly payment then the APR will change.

Instead of focusing on the APR you should look at the actual interest rate you are being charged every month. To gauge the fairness of the interest rate you can compare it with the average interest rate in your area for student loans. You should also find out what the Federal rate is and see how much higher your interest rate is or how it compares overall.

Interest rates are usually reflective of your credit. With government loans, they are set rates that are not based on credit. So, the only time you will really need to worry about negotiating a rate is with a private loan. You will need to do that before signing the loan documents.

Understanding what an interest rate is, though, is important no matter what type of loan you have since it is extra cost that you will be paying.

## **QUALIFICATION**

Qualifying for a loan always requires that you meet certain criteria. Lenders will always make you file an application and will make you meet certain guidelines before they will approve you for a loan.

With government student loans the qualification is solely based upon need. It is rather simple because if you meet guidelines then you are approved and if you do not meet guidelines then you are not approved.

Private loans are different, though. Private loans have an array of criteria that they look at, including:

- Credit record
- Ability to repay
- Personal financial history
- Employment history

A private loan lender may require a co-signer to approve the loan. A co-signer is someone who is credit worthy and signs the loan with you. If you default then the lender has the right to go to that person for payment.

# RISKS

Every loan comes with risks. Earlier on you learned about all the remedies both government and private lenders can take to get the loan paid if you default. You have to take risk seriously because it can cause real damage to your finances. In the past many students wiped away student loan debt by filing bankruptcy, but new laws now make that almost impossible.

If you find yourself in trouble with student loan debt the best solution is to consolidate your student loans. Consolidation is where you put all your loans into one large loan. You have a single monthly payment to make instead of multiple monthly payments. There are many companies that offer consolidation services.

Another perk to consolidating is that you may qualify for government consolidation programs. These programs will offer you the ability to qualify for special government repayment plans even if some of your loans were private loans.

You have to understand that student loan debt will not go away. It is your responsibility to make sure that it is paid. Be responsible about it and you should have no problems. Always stay in contact with your lenders. They will usually be quite happy to help you out in any way they can with getting back on track with your student loan payments.

# CONCLUSION

As you can see there is quite a difference between government and private student loans. You may still be wondering how to make the choice between them and which one would be the better option for you. Here is an outline for each loan of the type of situation or person who would be best choosing that type of student loan.

## **WHEN TO CHOOSE A GOVERNMENT LOAN**

Government loans, as you have learned, are need based. Government loans are the best choice for a person who has limited earned income. The terms of the loan are pretty set so they also work best for someone who is willing to accept the terms as is. Government loans are not based on credit at all, so a person with a stellar credit history may actually find that government loans cost more in the long run than a private loan, so checking into a private loan may be worthwhile.

## **WHEN TO CHOOSE A PRIVATE LOAN**

Private student loans are credit based. Lenders do not consider need at all. In fact, a low income may actual work against you with a private loan because lenders will see that as a risk. If you have a fairly good income and good credit then a private loan may be the best choice because you can negotiate terms that work for you.

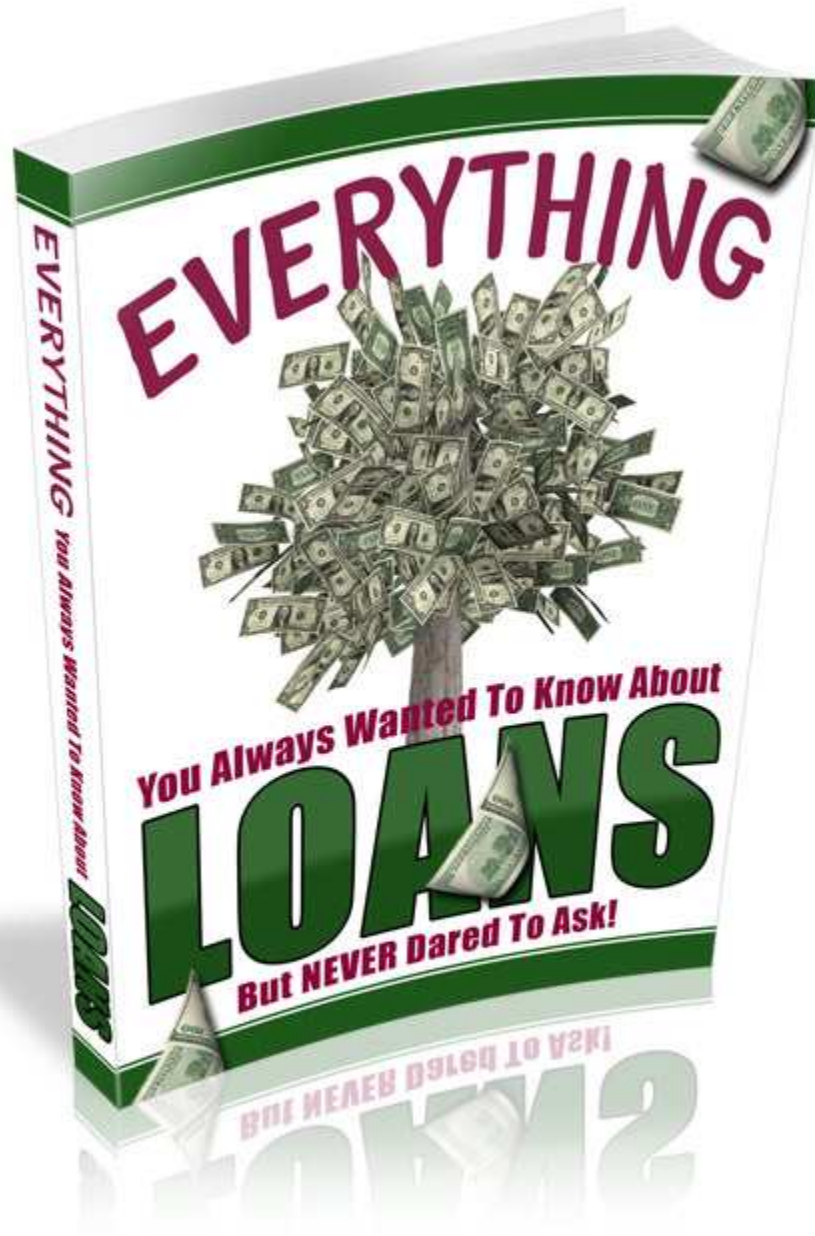
While nobody can tell you what is best for you, these are simple guidelines that can point you in the right direction. You now have all the information you need to be able to be educated about student loans and to get a student loan that will be the best for you. Funding your education does not have to be an endless maze of confusion. You now have the knowledge to go forward and obtain the funding you need to earn your college degree.

This Report was brought to you by: **Leona Lai**

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