

# Borrowing for College

A guide to federal loans for higher education



## Table of contents

Education loan basics	2
Applying for education loans	3
Repaying education loans	3
Controlling education loan debt	5
Glossary of education loan terms	6

**If you're considering taking out a loan to pay for your or your child's higher education, you're in good company. Loans account for more than half of all financial aid dollars received by college students. Approximately six out of every 10 students who received a bachelor's degree borrowed to pay at least some of their college expenses. Most students who borrowed to earn their degrees believe that student loans were crucial to their being able to pursue higher education.**

**New federal student loans come from the William D. Ford Direct Loan Program. Direct Loans are funded directly by the federal government.**

**Federal student loans offer several benefits. Interest rates typically are below the rates charged for other types of credit, and federal loans also offer extremely flexible repayment terms. Nonetheless, like most debts, federal student loans must be paid back with interest.**

**This publication offers guidance on applying for, managing and repaying two types of federal education loans: Stafford and PLUS loans. For more information, visit the Borrowers section of USA Funds® website — [www.usafunds.org](http://www.usafunds.org).**

# Education loan basics

## Direct Stafford loans

You may qualify for a Stafford loan if you:

- ♦ Are a U.S. citizen or eligible noncitizen.
- ♦ Have a high school diploma or its equivalent.
- ♦ Enroll at least half time in a postsecondary institution that participates in the Direct Loan Program.

There are two types of Stafford loans:

**Subsidized loans** are available to undergraduate students who meet certain financial need criteria. If you qualify, the federal government will pay the interest on the loan while you are in school at least half time and during periods when you are authorized to defer your loan payments. Note: Due to recent changes in federal law, the government no longer subsidizes interest during the six-month post-school grace period for new subsidized Stafford loans first disbursed between July 1, 2012, and June 30, 2014. In addition, effective for periods of enrollment beginning July 1, 2012, graduate and professional students no longer are eligible for subsidized Stafford loans.

**Unsubsidized loans** are available to undergraduate, graduate and professional students regardless of financial need. You are responsible for the interest that accumulates on an unsubsidized loan from the date the funds are disbursed until the funds are paid in full. You have the option to pay the interest during school or postpone payment. If you postpone payment, the interest will be added to your principal balance. This addition of interest to your principal balance is known as capitalization.

Federal law specifies annual loan limits on Stafford loans based on your year in college and your dependency status. (See "Glossary," on page 6, for definitions of dependent and independent students.)

If you are a **dependent undergraduate student**, you can borrow up to the following amounts each year:

- ♦ \$5,500 if you are a first-year student enrolled in a program of study that is at least a full academic year. (Up to \$3,500 may be in subsidized loans.)
- ♦ \$6,500 if you are a second-year student enrolled in a program of study that is at least a full academic year. (Up to \$4,500 may be in subsidized loans.)
- ♦ \$7,500 if you are enrolled in your third or subsequent year of a program of study that is at least a full academic year. (Up to \$5,500 may be in subsidized loans.)

If you are an **independent undergraduate student** or a dependent student whose parents are unable to obtain a Direct PLUS loan, you may be able to borrow up to the following amounts each year:

- ♦ \$9,500 if you are a first-year student enrolled in a program of study that is at least a full academic year. (Up to \$3,500 may be in subsidized loans.)
- ♦ \$10,500 if you are a second-year student enrolled in a program of study that is at least a full academic year. (Up to \$4,500 may be in subsidized loans.)

- ♦ \$12,500 if you are enrolled in your third or subsequent year of a program of study that is at least a full academic year. (Up to \$5,500 may be in subsidized loans.)

If you are a **graduate or professional student**, you may borrow up to the following amounts each year:

- ♦ \$20,500. (Higher limits may apply for students preparing for certain health professions.)

In addition to annual loan limits, the total amount of all Stafford loans that you take out for all years of enrollment may not exceed the following **aggregate limits**:

- ♦ \$31,000 for dependent undergraduate students.
- ♦ \$57,500 for independent undergraduate students and dependent students whose parents are unable to borrow a PLUS loan.
- ♦ \$138,500 for graduate or professional students.
- ♦ \$224,000 for graduate or professional students enrolled in approved health professions programs.

These amounts include any balance of a Stafford loan that is included in a Direct Consolidation loan.

## Direct PLUS loans

You may qualify to take out a PLUS loan if:

- ♦ You are the parent of a dependent undergraduate student.
- ♦ You are a graduate or professional student.
- ♦ You, or the dependent undergraduate student for whom you are taking out a PLUS loan, are enrolled at least half time at a postsecondary institution that participates in the Direct Loan Program.
- ♦ You — and in the case of a PLUS loan taken out by a parent, the dependent child for whom you are obtaining the loan — are U.S. citizens or eligible noncitizens.

To qualify to borrow a PLUS loan, a parent must be the student's birth parent, adoptive parent or stepparent (if the stepparent's income and assets were taken into account when calculating the student's Expected Family Contribution). The parent applying for the loan is responsible for repaying the loan. Parents may take out a PLUS loan for more than one dependent student at a time, although a separate promissory note is required for each student.

PLUS loans are available without regard to financial need. Applicants may borrow up to the student's full cost of attendance, less any other financial aid. To qualify for a PLUS loan, your credit will be checked to verify that you do not have an adverse credit history.

## Interest rates and fees

Effective for loans first disbursed July 1, 2012, through June 30, 2013, the interest rate on new Direct Stafford loans is fixed at 6.8 percent. The interest rate on new Direct PLUS loans is fixed at 7.9 percent.

An origination fee of 1 percent for Direct Stafford loans and 4 percent for Direct PLUS loans will be deducted from the amount you borrow. These origination fees are used to offset the administrative costs of the federal student loan program.

# Applying for education loans

To qualify for Stafford or PLUS loans, you first must complete the Free Application for Federal Student Aid. This form also is used to determine your eligibility for other federal financial aid programs, as well as for many state and institutional sources of financial aid. You should submit the FAFSA after Jan. 1 preceding the academic year that you're interested in attending college. Most students and parents complete the FAFSA on the Web at [www.fafsa.gov](http://www.fafsa.gov).

Information you supply on the FAFSA is used to calculate your Expected Family Contribution, or EFC. The financial aid office of the college or university that you plan to attend will compare your EFC against the school's cost of attendance to determine your financial need. The financial aid staff then will tailor an aid package, which may include grants, work-study and loans to meet your financial need. Because loans must be repaid with interest, you should exhaust all other sources of free financial aid before taking out a loan.

If you are a first-time borrower and your school determines you are eligible for a Stafford or PLUS loan, you will be asked to sign a Master Promissory Note. The MPN is a legally binding contract whereby you promise to repay the loan. In many cases, you will be able to take out multiple loans throughout your college career by signing one MPN. By signing the MPN, you promise to repay all of these loans. You may be able to sign the MPN online using an electronic signature. If you take out both Stafford and PLUS loans, you will be asked to sign separate promissory notes for each type of loan.



## What's the maximum student loan debt you can afford?

Use this table to estimate the maximum amount of student loan debt you can comfortably afford to repay based on your expected starting salary.

Annual Income	Range of Maximum Affordable Student Loan Debt
\$15,000	\$8,690 – \$10,862
\$20,000	\$11,586 – \$14,483
\$25,000	\$14,483 – \$18,103
\$30,000	\$17,379 – \$21,724
\$35,000	\$20,276 – \$25,345
\$40,000	\$23,172 – \$28,965
\$45,000	\$26,069 – \$32,586
\$50,000	\$28,965 – \$36,207
\$75,000	\$43,448 – \$54,310
\$100,000	\$57,931 – \$72,413

*Range of maximum affordable student loan debt assumes monthly payments do not exceed 8 percent to 10 percent of your gross monthly income, level payments over a term of 120 months and a constant interest rate of 6.8 percent.*

# Repaying education loans

Because you must repay your federal education loans, make plans for loan repayment before your first payment due date. Here are some steps to take during the various stages of the loan cycle:

## In-school period

While you are in school, keep track of all of your loans and the total amount that you have borrowed. Keep all loan documents and other financial aid information in one file to refer to in the future.

You also should consider how much you can afford to borrow based on an estimate of your initial income following graduation. Use the table at the right to estimate the maximum amount of education debt you can comfortably afford to repay based on your prospective income.

Although students are not required to make payments of loan principal on Stafford or PLUS loans while they are in school at least half time, if you have unsubsidized Stafford or PLUS loans, you may make arrangements to pay the interest on your loans while you are in school. If you don't select this option, the interest will be added to your loan principal before your loans enter repayment. This capitalized interest will add to the cost of your loan.

Parent-borrowers of PLUS loans also may choose to delay loan payments while they are or their child is in school at least half time and for up to six months after they or the student cease to be enrolled at least half time. Interest will continue to accumulate during this period, however.

## Grace period

You are not required to make any payments on Stafford loans until six months after you leave school or drop below half-time enrollment. New PLUS loans also qualify for a six-month post-enrollment deferment period before repayment begins.

Use this six-month period to develop a strategy for repaying your loans. Consider your monthly loan payment and your gross monthly income. If your payment is within 8 to 10 percent of this monthly income, you probably would be better off selecting the standard repayment option. If payments represent a higher percentage of your income, you should consider one of the flexible repayment options or loan consolidation.

Both Stafford and PLUS loans may be repaid using the following options:

**Standard repayment.** Typically, this is the least expensive option in terms of total interest costs. Most borrowers choose this plan. Also known as “level” repayment, this option provides a fixed monthly payment of at least \$50 over a period of up to 10 years.

**Graduated repayment.** Monthly payments start low and increase over time. Graduated repayment may be a good choice if you currently have limited income but expect higher earnings in the future. Unless you consolidate several federal education loans, the maximum repayment term under this option is 10 years. Total interest costs are higher under this option than with standard repayment.

**Income-sensitive repayment.** This option is available only for Federal Family Education Loan Program loans. Payments can be adjusted up or down annually to account for changes in your income. The minimum payment must be enough to cover accruing interest. The repayment period of 10 years can be extended to 15 years under a special forbearance provision. Total interest costs will be higher with this option than with standard repayment.

**Extended repayment.** This option is available only if you did not have a balance on a FFELP loan or a Direct Loan as of Oct. 7, 1998, or at the time you received a new FFELP loan or Direct Loan after Oct. 7, 1998. Extended repayment is available only if you have an outstanding education loan balance of more than \$30,000 in FFELP or Direct Loans.

Under this plan, you may reduce your monthly payment amount by spreading payments over a period of up to 25 years. You may choose to make payments over this extended period under a level or graduated schedule. Because payments are stretched over a longer term, total interest costs will be significantly higher than with other repayment plans.

**Income-based repayment.** You may qualify for this repayment option if your loan payments during the year exceed 15 percent of your “discretionary” income. Under this plan, you may limit your payments to 15 percent of your “discretionary” income. In addition, your payments may be less than accruing interest, you may qualify to pay back your loans over a period of up to 25 years, and you may qualify for forgiveness of any remaining amount you owe after 25 years of repayment. Parent PLUS loans do not qualify for income-based repayment.

**Income-contingent repayment.** This option is available for Direct Loans, except Direct PLUS loans to parents. Your payments are based on your income, family size and outstanding loan balance. Payments may be less than the accruing interest. If you haven’t fully repaid your loan after 25 years, you may qualify to have the unpaid amount forgiven.

**Loan consolidation.** Consolidation permits you to bundle multiple federal education loans into one new loan with the benefit of a convenient single monthly loan payment. Depending on your total outstanding loan balance, you also may be able to extend your repayment period and lower your monthly payments.

Loan consolidation is not the best choice for every borrower. You are likely to pay more total interest because you are extending your payment period and making smaller payments over a longer term.

## Repayment

Your first payment will be due within 60 days after the end of your grace or post-enrollment deferment period. In advance of your first

payment date, you will receive important information, including directions for submitting your payments, your estimated loan balance, your payment schedule — including the payment due dates — and your repayment options. You also can prepay all or part of your federal education loan at any time with no financial penalty.

If you previously borrowed loans through a private lender in the FFELP, you should be aware that your lender may sell your loan to another organization. This sale does not change the terms of your loan or your responsibility to repay the loan. You will be advised of the new holder of the loan and where to send payments. Some lenders contract to specialized third-party servicers the job of collecting payments and handling borrower inquiries.

A key consideration for you during the repayment of your loan is to consistently make your payments on time. You will establish a positive credit history showing on-time payments.

You must notify your lender if you move, change your phone number, change your name, return to school or withdraw from school, or if the address of your employer changes.

If you experience difficulties that prevent you from making your loan payment at any time during your repayment period, contact your lender or loan servicer immediately and ask for assistance. Federal education loans offer very flexible terms for borrowers who are having loan payment problems, and you may qualify for one of the following options:

**Deferment.** If you are unemployed, facing certain economic hardships, on active duty in the military, or returning to school for additional studies, you may qualify for a deferment. Eligible borrowers are entitled to defer principal payments, in the case of unemployment or economic hardship, for up to a total of three years during the term of their loans. There is no maximum time limit for an in-school deferment or deferment for certain types of military service.

**Forbearance.** If you don’t meet the standards for deferment but still need payment relief, you may appeal to your lender or servicer for forbearance. Forbearance permits a borrower to reduce or postpone payments or extend the time for making payments, usually at the discretion of the lender. Forbearance requests typically are granted for periods of up to 12 months.

**Flexible repayment options or loan consolidation.** You may be able to reduce your monthly payment by requesting a change in your repayment plan or by applying for a Direct Consolidation loan.

**Loan forgiveness.** Only in rare cases will all or a portion of a Stafford or PLUS loan be discharged, relieving you of any further obligation to pay the remaining balance. For example, your obligation to repay your loan may be discharged if you meet one of the following conditions:

- You die, or the dependent for whom you took out a PLUS loan dies.
- You meet the criteria for total and permanent disability.
- You prove undue hardship before a bankruptcy court.
- You are unable to complete your studies because your school closes.
- Your school falsely certified your eligibility for a loan or failed to make a refund owed to your lender, or you are the victim of identity theft and someone else obtained a loan in your name.

In addition, there are federal loan forgiveness provisions for certain teachers and certain public service occupations.

You must repay your loans even if you don't complete your studies, if you fail to complete your program of study in the regular period for program completion, if you are dissatisfied with the quality of your education, or if you're unable to find employment after you graduate.

## Loan default

If you fail to repay your loans, you ultimately will end up in default. Loan default results in the following consequences:

- ♦ Your entire outstanding loan balance becomes due and payable immediately.
- ♦ Your default will be reported to national consumer reporting agencies and will affect your ability to obtain other consumer credit for up to seven years.
- ♦ Your federal and state income tax refunds or other government benefit payments may be withheld.
- ♦ You will lose deferment, loan forgiveness and repayment options.
- ♦ Your wages may be garnished.
- ♦ You will be ineligible to receive any further federal and state financial aid.
- ♦ You may lose or be denied a state professional license.
- ♦ You may be sued.

Because of these severe consequences, avoid default and work with your lender or servicer in the event that you encounter payment problems.

## Resources to assist borrowers

As you repay your student loan, you should be aware of additional resources to assist you.

You can get information about your federal education loans and other sources of financial aid by visiting the website of the National Student Loan Data System at [www.nslds.ed.gov](http://www.nslds.ed.gov), or by calling the Federal Student Aid Information Center toll-free at (800) 4-FED-AID or TDD (800) 730-8913.

If you have a dispute with your school, lender or guarantor regarding a federal education loan, and you've been unable to resolve the issue, you may contact the U.S. Department of Education's Federal Student Aid Ombudsman's office at (877) 557-2575.



## Controlling education loan debt

Don't leave college with excessive education debt. These tips may help you keep your student loan debt affordable.

- ♦ Borrow only what you need to cover the cost of education.
- ♦ Pay the interest on education loans as it comes due.
- ♦ Enroll in a tuition payment plan, which lets you pay in installments rather than a lump sum. Check with your school to learn if it offers a tuition payment plan.
- ♦ Budget to control expenses. Include out-of-pocket education costs as well as expenses for transportation, personal items and entertainment. Find ways to cut costs, such as by buying used textbooks, using public or school-provided transportation, eating out less, and finding a roommate to share expenses. Always ask yourself before buying: "Is this something I really need?" If you don't know, then you usually can skip the purchase.
- ♦ Consider working part time. Plan your work schedule so your academic work will not suffer, and investigate campus work-study opportunities.
- ♦ Determine how much education debt you can afford to repay by estimating your future earnings. Try to keep monthly education loan payments to less than 8 to 10 percent of your expected gross monthly income.
- ♦ Complete your degree on time. You will accumulate more education debt if you extend your school enrollment.
- ♦ Keep a file of your education loan documents and other financial aid papers.



## Glossary of education loan terms

**Capitalization.** The addition of accrued interest to the principal balance of the loan.

**Default.** A borrower's failure to fulfill the agreement signed when taking out a federal education loan. For example, you would be considered in default if you failed to make your monthly federal student loan payment when due for a period of at least 270 days.

**Deferment.** A period during repayment in which the borrower is not required to make payments of loan principal.

**Dependent Student.** A student who does not meet the eligibility requirements for an "Independent Student" (see definition). Dependency status affects the maximum amount that a student may borrow in Stafford loans and whether a parent may take out a PLUS loan on behalf of the student.

**Disbursement.** The transfer of the loan proceeds to a school.

**Discharge.** The release of a borrower from all or a portion of a loan obligation.

**FAFSA.** The Free Application for Federal Student Aid is the form that the student (and parents of dependent students) must complete to apply for federal financial assistance, including loans.

**Forbearance.** The period during which a borrower is permitted to temporarily cease making payments or reduce the amount of the payments. The borrower is responsible for the interest that accrues on the loan during the forbearance period. In many cases, forbearance is granted at the lender's discretion; in other instances, borrowers are entitled to forbearance.

**Grace Period.** The six-month period that begins the day after a Stafford loan borrower ceases to be enrolled at least half time at an eligible school. During the grace period, payments of principal are not required. Certain PLUS loan borrowers also may defer payments for a six-month period after they, or the student for whose benefit a parent took out a PLUS loan, cease at least half-time enrollment.

**Guarantor.** A private, nonprofit organization or state government entity that guarantees to the lender repayment of loans made through the Federal Family Education Loan Program. The guarantor works with borrowers whose student loan payments are seriously past due to help them avoid default. If a borrower does default, the guarantor partially reimburses the lender, purchases the defaulted loan, and continues efforts to recover the amount owed by the borrower.

**Holder.** The current owner of a federal education loan.

**Independent Student.** A student who meets one or more of the following criteria: is at least 24 years old by Dec. 31 of the financial aid award year; is an orphan, in foster care, or ward of the court; is an emancipated minor or in a legal guardianship; is an unaccompanied youth who is homeless; is serving on active duty in the Armed Forces for purposes other than training; is a veteran of the U.S. Armed Forces; is a graduate or professional student; is married; has legal dependents other than a spouse; is a student for whom the school's financial aid administrator determines and documents the student's independent student status based on the administrator's professional judgment of the student's unusual circumstances.

**Interest.** The charge made to a borrower for use of a lender's money.

**Lender.** The organization that funds education loans for students and parents.

**Master Promissory Note.** A legally binding agreement under which the borrower promises to repay one or more loans.

**Principal.** The amount of money borrowed plus any capitalized interest.

**Servicer.** An organization that contracts with a lender or other loan service provider to administer any aspect of the provider's participation in the loan program.

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