

# Beware, if You Borrow

Variable loans, especially, should inspire caution. BY MICHAEL MORELLA

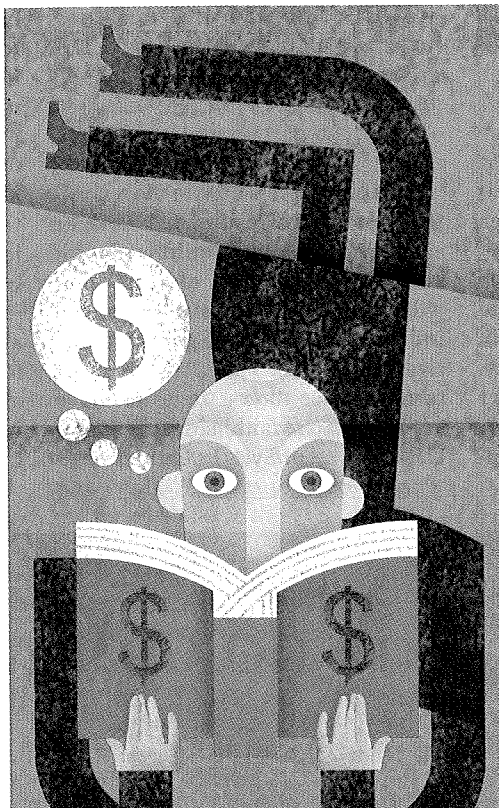
If student loans are inevitable, take them on smartly, advisers warn. With this type of debt, “there’s certainly a pecking order,” says Chuck Knepfle, director of financial aid at Clemson University in South Carolina.

About two thirds of college students take out loans, with the average debt load for the class of 2012 approaching \$29,000 for those who borrowed, estimates Mark Kantrowitz, publisher of college financial planning websites FinAid.org and Fastweb.com. Total outstanding student loan debt has now topped \$1 trillion, and a number of financial experts have recently decried it as the next big bubble, especially given some of the risks associated with private loans.

① **Federal first.** Students should always exhaust their federal options first, advisers agree; federal loans have fixed interest rates and flexible repayment options. And students should borrow only what they *absolutely* need.

(There are better ways—like a job—to pay for snacks and the movies.) “Walk back the numbers,” advises Kristine Movalli, 25, a fiscal administrator at a telemarketing firm in Boston, who pays just under \$700 a month from her \$27,000 annual salary toward her \$100,000 in student loan debt, mostly from private loans. “Know what you’re getting yourself into,” she says.

② For borrowers who qualify for need-based financial aid, a subsidized Stafford loan might be the best option. Interest doesn’t accrue while students are enrolled at least half time. Families not eligible for the subsidized Staffords can get an unsubsidized version; both allow borrowers to defer payback until six months after graduation. The former carry a fixed 3.4 percent interest



rate through at least the 2012-13 school year, while the unsubsidized loans begin accruing interest immediately at a 6.8 percent rate, plus a 1 percent fee for both. Dependent students can borrow up to \$5,500 for their first year of college, with no more than \$3,500 of that in subsidized loans. For more specifics, visit [studentaid.ed.gov](http://studentaid.ed.gov).

④ Beyond that, parents can take out federal PLUS loans, up to a max of the cost of attendance. PLUS loans accrue interest at a fixed 7.9 percent and carry a 4 percent fee. But advisers caution parents strongly about filling the gaps by piling on their own debt. “I always call it the loan of last resort,” says Jeremy Farmer, president and founder of Houston-based College Financial Advisors. And experts note

that tapping retirement funds and home equity are risky avenues for most borrowers.

⑤ Meanwhile, private loans have come under increased scrutiny for their variable rates and dearth of repayment options for strapped grads. In July, the federal Consumer Financial Protection Bureau and the Department of Education issued a report to Congress that noted rapid growth in private borrowing up until the 2008 financial crisis, with some lenders engaging in “riskier” practices like lowering their lending standards. While standards have since tightened, the authors of the report, worried that many borrowers might not have fully understood the differences between private and federal loans, called for greater clarity from lenders and colleges.

Families who do seek private funds should start with their own banks and look for guidance from their school’s financial aid office, shopping around at credit unions or their state education agency, too, to see if they can find better deals or repayment safeguards. Though private loans historically carried variable rates, some lenders, such as Sallie Mae, Wells Fargo, and Discover, have introduced fixed-rate options, too. Variable rates might change significantly during the repayment period, so families should be aware before signing of what their adjusted rates and payments might be. As of August, Discover was offering fixed-rate loans at between 6.79 and 9.99 percent, or variable ones linked to the prime index charging between 3.25 and 8.25 percent, depending on creditworthiness. A lower starting rate often requires a good credit history or a parent to co-sign. Or both. ●