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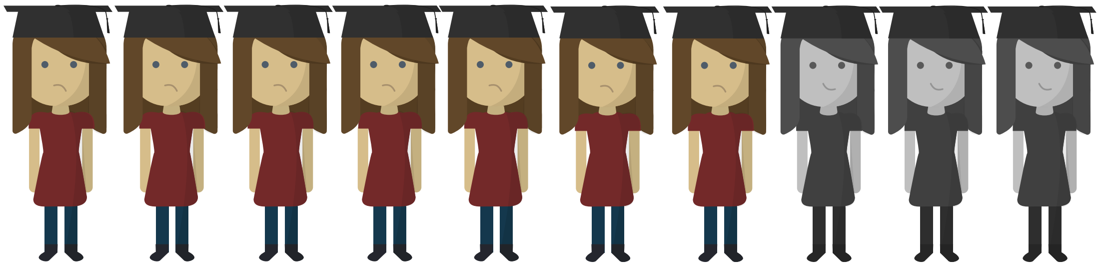
Closing the college funding gap:

How and when to turn to private student loans

If you're headed to college next fall or are the parent of a student returning to school, it may only now be dawning that your financial aid package may not cover all of your expenses.

The standard advice from college financial aid counselors is to **round up all of the grants, scholarships, work study and help from your family that you can before taking out any loans.** That's good advice.

According to latest numbers from The Institute for College Access and Success (TICAS), seven out of 10 graduates of public and nonprofit colleges in the class of 2014 had student loan debt, with an average of $28,950 in loans.



The fact is, only about one in five families are able to foot more than half of the bill for their child's education, and **most expect their children will have to rely on student loans** for funding.
The other thing you'll hear from financial aid counselors is that **if you do need to borrow to fund your education, you should start with federal student loans.** Also good advice — but keep in mind that there are several types of federal loans, and some are a better deal than others.

This guide will summarize the ins and outs federal and private student loans, and explain how and when to use private student loans to fill college funding gaps.

We'll start out talking about one type of loan -- federal direct subsidized loans -- and explain why, if you must borrow for college, they are the best deal around.

Since not everyone will qualify for a subsidized loan, and because there are annual and lifetime limits on how much you can borrow, we'll also talk about other types of loans you can fall back on.

PART 1: Direct subsidized student loans

Let's begin by getting a handle on what exactly a direct subsidized student loan is, and how it's different from other loans you might turn to.

The first thing you'll notice looking at the chart below is that direct subsidized loans and direct unsubsidized loans offer the lowest interest rate of all federal loans.

Interest rates on federal direct loans

Loan Type	Borrower Type	Disbursed on or after 7/1/14 and before 7/1/15	Disbursed on or after 7/1/15 and before 7/1/16	Disbursed on or after 7/1/16 and before 7/1/17
Direct Subsidized Loans	Undergraduate	4.66%	4.29%	3.76%
Direct Unsubsidized Loans	Undergraduate	4.66%	4.29%	3.76%
Direct Subsidized Loans	Graduate or professional	6.21%	5.84%	5.31%
Direct PLUS Loans	Parent and Graduate or Professional	7.21%	6.84%	6.31%

The primary advantage of a direct subsidized loan over an unsubsidized loan is that the Department of Education will pay the interest on your subsidized loan:

✤ While you're in school at least half-time.

✤ During the grace period of your loan (the first six months after you leave school, when you do not have to begin repayment immediately).

✤ If you apply for and are granted a deferment (a postponement of repayment).

The idea behind the grace period is to give you time to find a job that will allow you to begin making your monthly payments, so that you don't have to stress out while you're still in school.

If the grace period turns out to not be long enough and you need more time to find a job, you can also apply for deferment. During the deferment period, you will not be responsible for making any loan payments and interest will not accrue. If you need to apply for forbearance, however, you will be on the hook for interest (see "**Don't disqualify yourself from refinancing student loans**," for more detail on deferment and forbearance, and how both can help you avoid delinquency and default.)

Eligibility

In order to qualify for a direct subsidized loan, you must apply for financial aid through your school by filling out the Free Application for Federal Student Aid (FAFSA), and prove your eligibility.

To be eligible for a subsidized loan, you must:

Be an undergraduate student.

Be able to provide financial need.

Be enrolled at school at least half-time.

Be enrolled in a program that can lead to a degree or certificate awarded by the school.

How you qualify for need-based financial aid

Let's talk about **how colleges decide whether you qualify for need-based aid,** making you eligible for a subsidized direct loan and other assistance like Pell grants and federal work study.

In short, you qualify for need-based aid if your expected family contribution won't cover your cost of attendance at a particular school.

Your expected family contribution is not necessarily the amount of your family will actually have to pay for college — it's an index calculated using information you submit on your **Free Application for Federal Student Aid** (FAFSA). Your cost of attendance includes tuition and fees, room and board, books and supplies, and other eligible expenses.

So if your cost of attendance is $16,000 and your expected family contribution is $11,000, you're eligible for up to $5,000 in need-based aid.

The other factor limiting how much of your college costs you can cover with subsidized direct loans are annual and aggregate limits for both subsidized and unsubsidized direct loans.

As a freshman, you can take out no more than $3,500 in subsidized direct loans. While the amount gradually scales up to $5,500 a year for juniors and seniors, the lifetime limit on subsidized direct loans for undergraduates is $23,000.

Annual and lifetime limits for federal direct loans

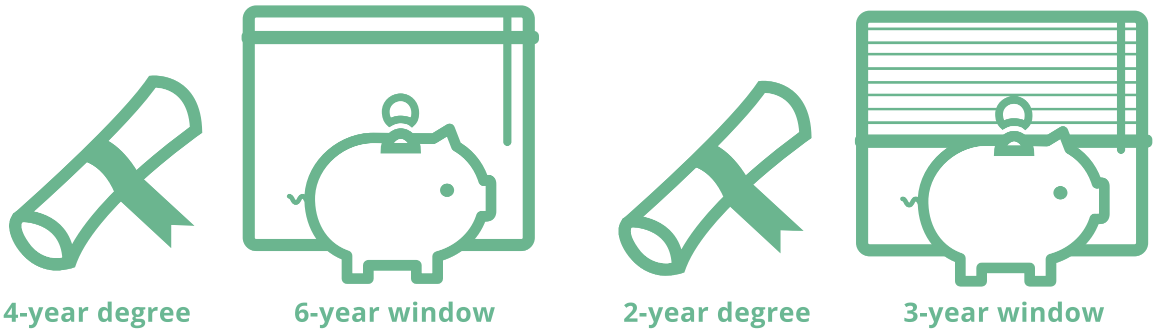
Year	Dependent Students	Independent students (and dependent students whose parents can't obtain PLUS Loans)
First-year undegraduate annual loan limit	$5,500 (maximum of $3,500 in subsidized loans)	$9,500 (maximum of $3,500 in subsidized loans)
second-year undegraduate annual loan limit	$6,500 (maximum of $4,500 in subsidized loans)	$10,500 (maximum of $4,500 in subsidized loans)
third-year and beyond undegraduate annual loan limit	$7,500 (maximum of $5,500 in subsidized loans)	$12,500 (maximum of $5,500 in subsidized loans)
Graduate or professional students annual loan limit	Not applicable (grad students are considered independent)	$20,500 (unsubsidized only)
Subsidized and unsubsidized aggregate loan limit	$31,000 (maximum of $23,000 in subsidized loans)	$57,500 for undergraduates (maximum of $23,000 in subsidized loans) $138,500 for graduate or professional students. (maximum of $65,500 in subsidized loans). Graduate aggregate limit includes all federal loans received for undegraduate study.

After you've maxed out your subsidized direct loan borrowing, financial aid advisers typically recommend that you turn to unsubsidized direct loans to cover additional expenses (unsubsidized direct loans are covered in Part 2 of this guide).

As the chart above demonstrates, students who are **independent of their parents** (at least 24 years old, married, or working on a master's degree, for example) have more leeway to take out unsubsidized direct loans. The same is true of dependent students whose parents can't take out PLUS loans.

Note that while the lifetime borrowing limits for graduate students are higher, grad students aren't eligible for subsidized direct loans. Rates on unsubsidized direct loans for graduate students are higher than rates for undergraduates, although not quite as high as PLUS loans. Perkins loans were once an option for graduate students who could demonstrate "exceptional financial need," but that program is being wound down.

Also keep in mind that for borrowers who took out their first student loan **after July 1, 2013**, there's a limit on how long you can receive subsidized direct loans. This eligibility window is equal to 150 percent of the time that you need to complete your degree. So if you're shooting for a four-year bachelor's degree, you can take out subsidized direct loans for no longer than six years. For a two-year associates degree, the eligibility window stays open for three years.



Once the eligibility window closes, interest will start accruing on your older subsidized direct loans. If you transfer from a four-year program to a two-year program after having received subsidized direct loans for three years, your eligibility window will close and interest will start accumulating on your loans.

What happens if you've taken out all the subsidized and unsubsidized federal direct loans you qualify for? The next step on the federal student loan ladder are PLUS loans, which are available to parents and graduate students.

Although the federal government is still the lender, PLUS loans share some characteristics with private loans — they involve some limited underwriting, sometimes require a cosigner (or "endorser"), and carry higher rates than subsidized and unsubsidized federal direct loans.

In Part 3 of this guide, we'll compare rates and features of PLUS loans with private loans. For many borrowers, private loans can be quite competitive with PLUS loans.

PART 2: Hidden costs of federal direct unsubsidized student loans

If you needed money for college and a stranger walked up to you on the street and asked if you'd rather have a subsidized or an unsubsidized loan, you'd probably say "subsdized," right?

If so, you'd be correct. As we explored in Part 1 of this guide, federal direct subsidized loans are indeed the best deal for borrowers in town (assuming you've taken advantage of all the scholarships, grants and other free aid that's available to you to pay for college).

But that doesn't mean federal direct unsubsidized loans are a bad deal. They are still government student loans, and that means they come with low, fixed rates and some valuable borrower benefits.

In fact, direct unsubsidized loans for undergraduates carry the same interest rate as subsidized loans. But that interest starts piling up sooner — one of several hidden costs of direct unsubsidized student loans you should know about (more details below).

As the chart above shows, direct unsubsidized loans for grad students are a bit more expensive than those for undergraduates. But the government loans that you really want to think twice about taking out are PLUS loans, which we'll explore in Part 3 of this guide.

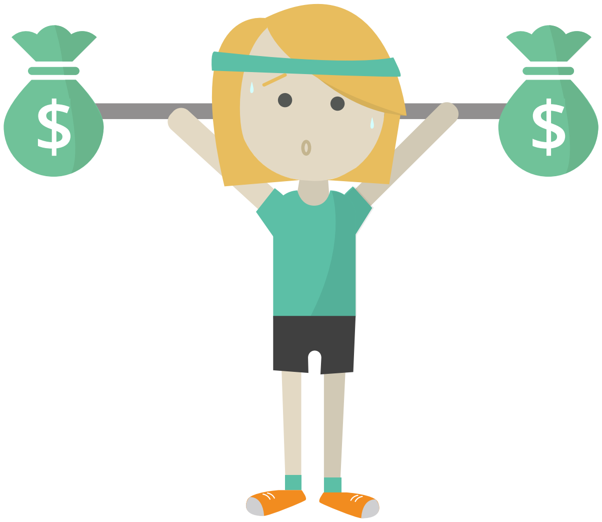
Why take out direct unsubsidized loans?

You may find yourself turning to direct unsubsidized loans for a couple of reasons.

1ST	Subsidized loans are only available to undergraduates who can demonstrate financial need. That determination hinges on the cost of the school you're attending, and information you provide about your income on the Free Application for Federal Student Aid, or FAFSA.
2ND	There are strict limits as to how much you can borrow in subsidized loans. Currently you can take out $3,500 in subsidized loans as a freshman, $4,500 as a sophomore, and $5,500 a year when you're a junior or senior. If you're in a four-year degree program, you can tap subsidized loans for six years, but there's a $23,000 lifetime limit on subsidized direct loans for undergraduates.

As the chart above demonstrates, grad students and students who are independent from their parents (at least 24 years old, married, or active duty military, for example) can take out more unsubsidized direct loans — up to $57,500 — than undergrads who are dependent on their parents, who currently max out at $31,000.

Those higher limits also apply to dependent students whose parents can't take out PLUS loans on their behalf. All of which means that you should be aware of the features of federal direct unsubsidized loans, because you may need to rely on them pretty heavily.



Subsidized vs unsubsidized student loans

There are some subtle differences between direct subsidized loans and their unsubsidized counterparts that you should keep in mind when borrowing money for college and making plans for repaying those debts.

The biggest difference between subsidized and unsubsidized loans is when interest is charged, and when it's not.

Although unsubsidized loans to undergraduates carry the same low rate as subsidized loans, interest starts accruing on unsubsidized loans while you're still in school, as soon as the loan is disbursed.

With both subsidized and unsubsidized loans, you get the same six-month grace period after you leave school before you have to start paying your loans back. But with an unsubsidized loan, any interest that you don't pay while you're in school and during your grace period will be "capitalized" — added to the principal amount of your loan — when it's time to start making monthly payments.

Subsidized student loans	VS	Unsubsidized student loans
✤ Interest starts accruing **after school**		✤ Interest starts accruing **while in school**
✤ **Six-month** grace period after leaving school		✤ **Six-month** grace period after leaving school
✤ Interest will not be capitalized		✤ Interest will be "capitalized"
✤ Government takes care of interest if deferment is needed.		✤ Interest continues to accrue during a deferment.
✤ Interest accrues if granted forbearance		✤ Interest accrues if granted forbearance
✤ Ineligible for grad school students		✤ Pay higher interest rate for grad school

While the government will take care of any interest if you need a deferment on a subsidized loan, interest continues to accrue on unsubsidized loans during a deferment. Interest accrues on both types of loans if you are granted forbearance (for more on the differences between deferment and forbearance, and how both can help you avoid delinquency and default, see "**Don't disqualify yourself from refinancing student loans.**")

Another feature of federal direct unsubsidized student loans to keep in mind as you chart your journey through higher education is that if you're planning on going to grad school, you'll pay a higher interest rate. Remember, grad school students aren't eligible for direct subsidized student loans, no matter how great their financial need.

But direct unsubsidized loans are still a less costly option than federal PLUS loans. If you take out a PLUS loan between July 1, 2016 and June 30, 2017, you'll pay 6.31 percent interest, and an onerous 4.3 percent up-front disbursement fee. Before doing that, it's worth taking a look at offers from private student lenders, who provide student loans to undergraduates, graduate students and parents that are priced competitively with PLUS loans (see Part 3 of this guide).

Repayment strategies

If you have unsubsidized student loans, one thing you can do to make repayment more manageable is to make voluntary payments on the interest they accrue while you're in school, or in deferment or forbearance. Depending on your loan balance, you may be able to keep interest from accruing by paying just $20, $50 or $100 month.

Once your grace period has expired and interest is accruing on all of your loans, consider allocating more of your financial resources to paying down high-interest loans first. Note that if you choose to combine all of your loans into a federal direct consolidation loan in order to take advantage of an income-driven repayment plan, you won't be able to implement this strategy. Your federal direct consolidation loan will have a weighted interest rate based on the rates of the loan's you've consolidated.

The only way to lower your interest rate is to refinance your loans with a private lender. Although you'll lose access to some borrower benefits that come with government loans, such as income-driven repayment plans and potential loan forgiveness, refinancing is an increasingly popular option for those who don't expect to benefit from loan forgiveness.

Income-driven repayment plans can be a lifesaver for borrowers with enormous student loan balances and modest incomes, particularly if they expect to qualify for loan forgiveness after 10, 20 or 25 years of payments. But for others, stretching out payments over a longer period of time will **increase the total amount repaid**. If you do qualify for loan forgiveness under an income-driven repayment plan, you may face a large tax bill.

PART 3: How and when to use private student loans to fill college funding gaps

As we explored in Part 1 of this guide, the federal loans that deliver the most bang for the buck are direct subsidized loans. Rates on direct subsidized loans made to undergraduates after July 1, 2016 **will be 3.76 percent**. Not only is that a great, fixed rate, but interest on subsidized loans doesn't start accruing until your grace period expires, six months after you leave school.

But direct subsidized direct loans are only available to students who can demonstrate financial need. As we detailed in Part 2 of this guide, direct unsubsidized loans to undergraduates carry the same low rate as subsidized loans, but interest starts piling up as soon as you take the loan out — while you're still in school, in other words. There's no break on interest during your grace period, and if you need a deferment or forbearance, **you'll still be on the hook for interest**.

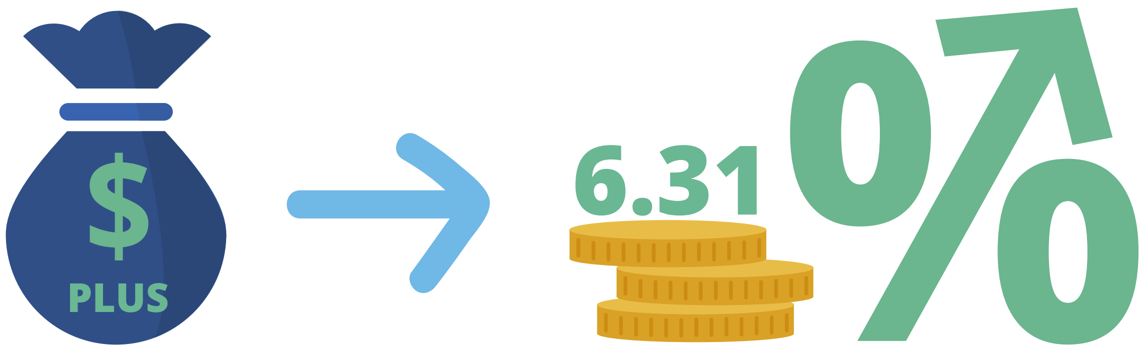
Another issue with subsidized and unsubsidized direct loans are the annual and lifetime limits. If you're a dependent of your parents, the limit for direct loans in your freshman year is $5,500, and no more than $3,500 of that can be in subsidized loans. The aggregate, or lifetime limit for dependent undergraduate students is $31,000, of which only $23,000 can be subsidized loans.

Once you move on to graduate school, you're no longer eligible for direct subsidized loans, regardless of your financial need. Rates on direct unsubsidized loans for graduate students are significantly higher — they'll be 5.31 percent for new loans issued after July 1, 2016. The aggregate borrowing limit for federal direct subsidized and unsubsidized loans for graduate and professional students is $138,500.

For students who need to cover additional expenses at either the undergraduate or graduate level, there's another type of government loan to be aware of — **PLUS loans for parents and graduate students**.

You can pretty much take out all of the PLUS loans you need to cover school attendance costs that exceed the other financial assistance and loans you've received. The catch is that **you'll pay a price**.

Interest on PLUS loans issued from July 1, 2016 through June 30, 2017 will be 6.31 percent. On top of that, PLUS loans carry a costly 4.3 percent up-front disbursement fee.



Before you turn to PLUS loans, it's worth **comparing offers from private student lenders**, who provide student loans to undergraduates, graduate students and parents that are priced competitively with federal PLUS loans.

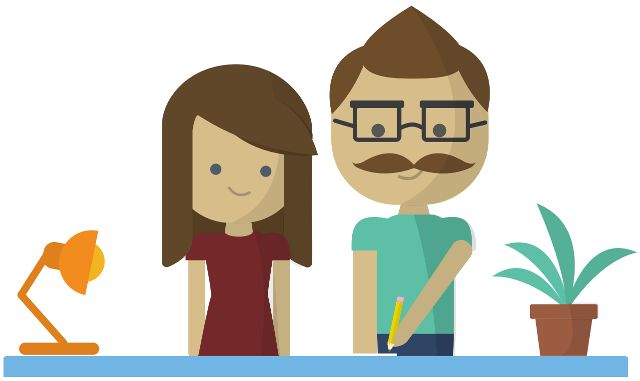
College Ave, for example, offers fixed-rate loans to undergraduates starting at 4.99 percent, and variable-rate loans starting at 2.20 percent — with no up-front fees (those rates, which include a discount for autopayments, are good as of May 24, 2016).

Keep in mind

Students with little income or credit history will typically need a cosigner to qualify for a private student loan. A cosigner can also help you get the best rate.

Cosigning a loan is no small responsibility — you are essentially asking your cosigner to take on all of your obligations to repay the loan if you cannot, sometimes without all the rights enjoyed by the borrower. The good news is, your cosigner won't necessarily be taking on those obligations forever — many lenders will release the cosigner after the borrower has established a track record of making payments (for more on the topic, see "**How adding a cosigner can help you get a better loan**").

Graduate students and parents seeking to take out federal PLUS loans may also need a cosigner — the government's term is an "endorser." You won't qualify for a PLUS loan without a cosigner if you have "adverse credit history," such as bills that are more than 90 days late, or a bankruptcy or foreclosure within the last 5 years.



Another issue to be aware of is that while government student loans are "one size fits all," private student loans offer more options when it comes to rates and terms.

When you take out a federal student loan, the interest rate is fixed for the life of the loan. Private loans come in more flavors than government loans. Everyone who takes out the same type of government loan at the same time pays the same interest rate.

With private loans, the interest rate depends on the borrower or cosigner's credit risk, and whether you'd rather have a fixed-rate or variable-rate loan.

Pick a variable-rate private student loan, and you'll start out with a better interest rate than you'd get on a fixed-rate private loan with the same repayment term.

If you'd rather have the certainty of a fixed-rate student loan, most private lenders offer those, too. You'll pass up the chance to start out making lower monthly payments but if interest rates go up, your monthly payments will remain unchanged (for more on this topic, see "**What every borrower should know about variable-rate student loans**").

Also keep in mind that private student loans don't offer some of the borrower benefits packaged with federal loans, like access to income-driven repayment (IDR) plans and the potential for loan forgiveness after 10, 20 or 25 years of payments.

IDR plans can help graduates with modest earnings pay off big loan balances. But they aren't the best solution for everyone — stretching out your payments over a longer period will in many cases **increase the total amount repaid**. If you do qualify for loan forgiveness, you may face a large tax bill.

Many private lenders are adopting borrower-friendly features like grace periods and optional deferment. Just keep in mind that interest will accrue during these periods (just as it does on unsubsidized federal direct loans and PLUS loans).

Since private lenders compete for your business, it's wise to:

Do your research and comparison shop.
Remember that private lenders offer different types of loans on rates and terms that depend on the borrower — it can pay to shop multiple lenders before you commit to one. **Credible's online comparison tool** lets you find the actual rates you could qualify for with multiple, vetted lenders, saving you time and effort.

Keep an eye out for discounts.
Many student lenders offer discounts to borrowers who agree to have payments automatically deducted, for example, so be sure to **check for such offers**.

Boost your chances by *applying with a cosigner*.
Getting the best interest rate on a private loan depends largely on credit history. As a student, it's likely that you haven't had enough time to establish your credit. But if you have a parent, legal guardian, friend, or employer who's willing to help, you can ask them whether they'd be willing to cosign a loan for you.

THANK YOU!

We'd love to hear from you!

Credible is here to help you with all your student loans needs. See how much you can save by refinancing your student loans with Credible at www.credible.com! If you have any questions about refinancing, or you just want to chat about what options are available to you, please contact us directly at **866.540.6005** or email us at support@credible.com.

We look forward to hearing from you!

—The Credible Team

About Credible

Credible's founding principle is to provide borrowers the level of transparency they deserve.

As a multi-lender marketplace that allows borrowers to receive competitive loan offers from its vetted lenders, Credible empowers consumers to take control of their student loans. Borrowers can fill out one form, then receive and compare personalized offers from numerous lenders and choose which best serves their individual needs.

Credible is fiercely independent, committed to delivering fair and unbiased solutions in student lending.

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