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Federal and Private Loans

Some of you may be thinking: "What about me? I didn't take out a federal loan. I got a private loan through a state organization, bank, or other lender." This is an increasingly common scenario.

In fact, private loans, which are funded by commercial or state sources, now total 25 percent of the dollar volume of all federal loans, \$17.3 billion versus \$69 billion, respectively. That's a remarkable difference from a little more than a decade ago, when the dollar value of private loans – also called alternative loans – came to just 5 percent of the volume of federal loans in the 1994-95 academic year, according to the College Board. And over the past five years, the number of private loans taken out for educational purposes has surged by an average annual rate of 27 percent. So if you took out private loans, you'll have to get information about those debts directly from the bank or institution that lent you money, or from the organization that is servicing your loans.

As a loan recipient, does it really matter if that \$20,000 you borrowed came from the federal government or from a private lender? You bet your college degree it does. For starters, Perkins loans and many Stafford loans are federally subsidized, meaning the government actually helps you pay back part of the loan – by making interest payments on the loan while you're in school, during the six months after you graduate, and then further subsidizing the interest payments you later make over the life of the loan. Subsidized Stafford loans are need-based loans.

There are some federal loans, however, that are unsubsidized. These loans, including certain unsubsidized non-need-based Stafford loans, begin to accrue interest as soon as they are issued. Both subsidized and unsubsidized government loans are federally guaranteed, and both have interest rates below market levels.

By contrast, private loans are not subsidized at all. Because they're based in part on the applicant's credit history, the interest rates on private loans can vary wildly, though they currently average about 10 percent, which is higher than the rates on most federal loans. Nevertheless, the main appeal of private loans is that they've become increasingly available for students and their families who need help bridging the gap between what they can afford to pay for school and the total cost of getting that degree.

In short, private loans are more accessible for student and parents when they can't get enough grant aid or work study from school, or when they fail to secure big enough loans from the federal government.