

Lesson 2: Student Loans: How do They Work?

Student Guide Pages: 133-137

Lesson Objectives: By the end of this lesson, your students should be able to:

- explain the financial aid process
- explain what amortize means
- explain why the EFC is the oh-**** number

Lesson Summary:

We know student loans are either subsidized or unsubsidized. We've also learned that for subsidized loans, the government pays the interest while you are in school. For unsubsidized loans, the interest is added to the principal during your enrollment.

Unsubsidized loans can be broken down even further, into private and public loans. A *private loan* has no involvement from the government, while a *public loan* does. While a private company usually *services* a public loan (which means they collect the monthly

payments from you), the big difference between public and private loans is in the collection of unpaid debt.

Public loans enjoy the protection of the government; if you fail to pay, Uncle Sam will chase you! Remember that the government has additional collection power, and they will use that power if you fail to pay your student loans. At least some of your loans are probably public, and the government will not forget about you if you do not pay.

The financial aid process starts with a form called the Free Application for Federal Student Aid (FAFSA). This is your chance to explain your financial situation. The FAFSA is sent to the government, and they generate a Student Aid Report (SAR). The most important number on the SAR is the expected family contribution (EFC).

The EFC is the oh-**** number, because it states how much the government expects you to pay for your education. The higher the SAR is, the more you'll have to pay. The SAR is sent to the schools you chose when you filled out the FAFSA. Those schools will then issue an award letter, which lists all the loans, grants, and scholarships they can offer. If, for any reason, the award is not enough, you can choose to:

- not go to that school
- pay with more money out of your own pocket

- try to get additional scholarships
- seek additional private loans

Many students seek further education, and some have to navigate the process for their children. For this reason, it's important to know how the process works.

Here are some other concepts to understand about financial aid:

- **Is the money a loan or some sort of grant/scholarship?** In other words, do you have to pay it back?
- **How much will I owe when I graduate?** Remember, unsubsidized loans grow while you're in school.
- **Is this a public loan?** If the government is involved, they have additional collection power.
- **Loans are *amortized*.** With every payment, some of the money goes toward the principal and some toward interest.

Review Questions:

- Doug has \$20,000 in student loans at 6 percent interest. He pays \$100 a month. So far, he has paid \$1,200. Much to Doug's surprise, he wins the lottery and wants to use his prize to pay off his loans. He calls the lender and asks how much he owes, and they tell him he still owes \$19,880. "But I've given you \$1,200!" he yells. What happened?

Answer: Loans are amortized. Most of Doug's payments in the early years go toward interest and do not make a big dent in his balance.

- Why does it matter whether a loan is public or private?

Answer: When people fall behind on their loan payments, they often believe they have time to work things out. This belief comes from the fact that private lenders have to arrange court dates to garnish your wages or tax refund. In the case of public loans, this isn't true. In addition, as you'll see in upcoming lessons, public loans also have built-in repayment plans for people who fall behind. It's important to know in advance what you are dealing with in.

Homework Assignment:

Tell students to visit **www.FACScourse.com** and play around on the loan payoff calculators. If they have no real loan amounts or interest rates to toy with, they can make some up. What is the expected monthly payment? What happens if they pay an additional \$10 or \$20 or more?

Class Activity:

This exercise will take a while, but it is important. Give everyone in class a slip of paper that reads:

_____ *stopped by the Financial Aid Office for five minutes.*

Signed: _____ *Date:* _____

Tell every student to visit Financial Aid as soon as possible to ask at least one question, either a general one or specifically about student loans. Even students without loans must do this. When they stop by, the Financial Aid administrator must sign their form; if they forget, they have to go back.

After every student visits Financial Aid, give the class a treat, such as letting them out early or bringing in donuts. The point is to help them feel comfortable visiting Financial Aid even before they need to, so they can truly understand what they borrow.

Additional Information:

www.nslds.ed.gov: The National Student Loan Data System (NSLDS) is the U.S. Department of Education central database for student aid.

When you put in your information, you can access information on your loans and federal grants, including the name of the company that services your loan, your loan status, and loan disbursements. You will need a PIN to get this information; go to the FAQs to learn how to get one.

www.studentaid.ed.gov: The Department of Education Federal Student Aid Office provides information about student loans, loan repayment plans with accompanying repayment calculators, loan forgiveness for public service, postponing repayment of your loans, and more.

www.finaid.org: This very comprehensive website on financial aid offers everything from FAQs to calculators to the ability to ask questions and receive personalized answers!

Fun Facts:

www.projectonstudentdebt.org: This website provides a ton of fun facts on student loans, as well as tips on student loan debt, information on fees and rates, comparisons of private loans to government loans, and more. It also offers recent news about student loans and student loan legislation, state-by-state statistics on student loan debt, and a handy chart that summarizes federal student loan interest rates and terms.

Notes: _____

Loan Payoff: Am I Just Spinning My Wheels?

Remember, loans are amortized, which means some portion of every payment goes to principal and some goes to interest. If it feels as if you're not making any progress in the first few months, that's because you're really not!

The sample chart below is a simple version of a \$10,000 student loan at 6 percent interest. Notice that for the first year, almost *half* of every payment goes to interest. Even if you made \$1,200 of payments, you only paid down about \$616.78 of your principal.

Month	Beginning Balance	Payment	Interest	Ending Balance
1	10,000.00	100.00	50.00	9,950.00
2	9,950.00	100.00	49.75	9,899.75
3	9,899.75	100.00	49.50	9,849.25
4	9,849.25	100.00	49.25	9,798.49
5	9,798.49	100.00	48.99	9,747.49
6	9,747.49	100.00	48.74	9,696.22
7	9,696.22	100.00	48.48	9,644.71
8	9,644.71	100.00	48.22	9,592.93
9	9,592.93	100.00	47.96	9,540.89
10	9,540.89	100.00	47.70	9,488.60
11	9,488.60	100.00	47.44	9,436.04
12	9,436.04	100.00	47.18	9,383.22