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COLLEGE PLANNING

Interest Rates Fall For Student Loans Despite Fed Move

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With all the hoopla over higher interest rates, here's one lending sector where rates actually dropped after the Federal Reserve's decision to boost interest rates last week: federal student loans.

Starting last Thursday, interest rates on federal student loans fell to 3.37% from 3.42% for those in repayment and to 2.77% from 2.82% for current students -- the lowest rates in the student-loan program's history. The interest rate for PLUS loans, or Parent Loan for Undergraduate Students, slipped to 4.17%, down from 4.22%. The lower rates apply to loans issued after 1998; older loans will have slightly higher rates.

Indeed, student borrowers have a yearlong reprieve from the higher rates that are expected to hit every other type of consumer debt, from mortgages and credit cards to new-car loans. That's because rates on federal student loans -- the most common of which are Stafford loans -- are linked to the last auction in May of the 91-day Treasury bill, plus a set margin. Rates are reset every July 1.


However, interest rates on private education loans are likely to start ticking higher since the rates are variable and are often tied to the prime rate, which tends to move in lockstep with the Fed's changes in short-term interest rates. Rates on private loans -- which typically range between 5% and 6% -- are often updated quarterly.

Since last Wednesday's rate move is expected to be the first in a series of gradual rate increases, it is a good idea to consolidate any student loans as a way to lock in current rates. Unfortunately, if you have already consolidated your loans, you are out of luck since you are only allowed one shot at consolidation.

Keep in mind that rates are fixed until next July 1, so you don't have to rush to consolidate. Just be sure to leave at least a month or two before rates are reset next year to give lenders enough time to process your application.

Rates on consolidated loans are calculated by taking the weighted average of the interest rates on the loans being consolidated and rounding up to the nearest one-eighth of a percent.

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