MHEC
RESEARCH BRIEF

Student Loan Interest Rates: A Survey of Federal, State, and Private Programs

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Student loans can help fill cost gaps created by insufficient grants, scholarships, and family income in funding a postsecondary education. Whereas receipt of grant aid does not require repayment, student loans must be repaid with interest. Loans provide students with additional choices, such as living independently (instead of living with parents and commuting) or working less hours or not at all.[1] However, concern has grown over the extent to which students must rely on loans to finance their college education. Nationally, student loan debt rose to $1.5 trillion in 2018[2] and is currently the second-largest form of debt in the country after mortgage and home equity debt.[3] Fifty-seven percent of college graduates from the class of 2016-17 received student loans, and the average debt was $27,293 (see Addendum). Loan interest rates constitute one factor that can influence students' ultimate loan burden. This policy scan examines changes in federal student loan interest rates over time; the wide variation in interest rates for state-sponsored student loans; and interest rates for private student loans.

KEY INSIGHTS

- The federal government offers several loans at a fixed interest rate. With the exception of Perkins loans, interest rates of federal loans fluctuate each year because they are linked to the 10-year Treasury note rate. The Treasury note rate increased between 2017 and 2018, causing student loan interest rates to increase as well. Direct undergraduate student loan interest rates are currently at 5.1 percent.
- State-sponsored student loans are offered in 15 states. The median starting interest rate was 5.15 percent for fixed-rate loans and 4.07 percent for variable-rate loans.
- Private loans accounted for nine percent of student loan debt. The average fixed rate on a private student loan was 9.66 percent, while the average variable rate on a private student loan was 7.81 percent.
- In addition to the type and level of the interest rate, students must consider other factors that can affect the total cost of the loan, such as origination fees, repayment protection, income-driven repayment options, and student loan forgiveness programs.

FEDERAL STUDENT LOANS

Direct federal loans provided by the U.S. Department of Education are available for undergraduate students, parents of undergraduate students, and graduate students.[4] Loans differ in terms of whether borrowers must demonstrate financial need and whether interest accumulates during college enrollment or is paid by the U.S. Department of Education.

- **Direct Subsidized Stafford Loan:** These loans are for students who demonstrate financial need. They are limited to undergraduate students. Interest does not accumulate while the student maintains at least part-time enrollment.[5]
- **Undergraduate Direct Unsubsidized Stafford Loan:** Undergraduate students are not required to demonstrate financial need to receive this loan. Interest accumulates while the student is enrolled.
- **Graduate Direct Unsubsidized Stafford Loan:** Graduate students are not required to demonstrate financial need to receive this loan.[6] Interest accumulates while the student is enrolled.

[1] Johnstone, D. (2005). *Higher Educational Accessibility and Financial Viability: The Role of Student Loans.*
[2] Board of Governors of the Federal Reserve System. (2018). Consumer Credit — G.19.
[3] Federal Reserve Bank of New York. (2018). Household Debt and Credit Report.
[4] Indirect student loans provided by private financial institutions but guaranteed by the federal government were eliminated through legislation in 2010.
[5] Direct Subsidized Stafford Loans for graduate students became unavailable after July 1, 2012.
[6] U.S. Department of Education. (2018c). *Subsidized and Unsubsidized Loans*.

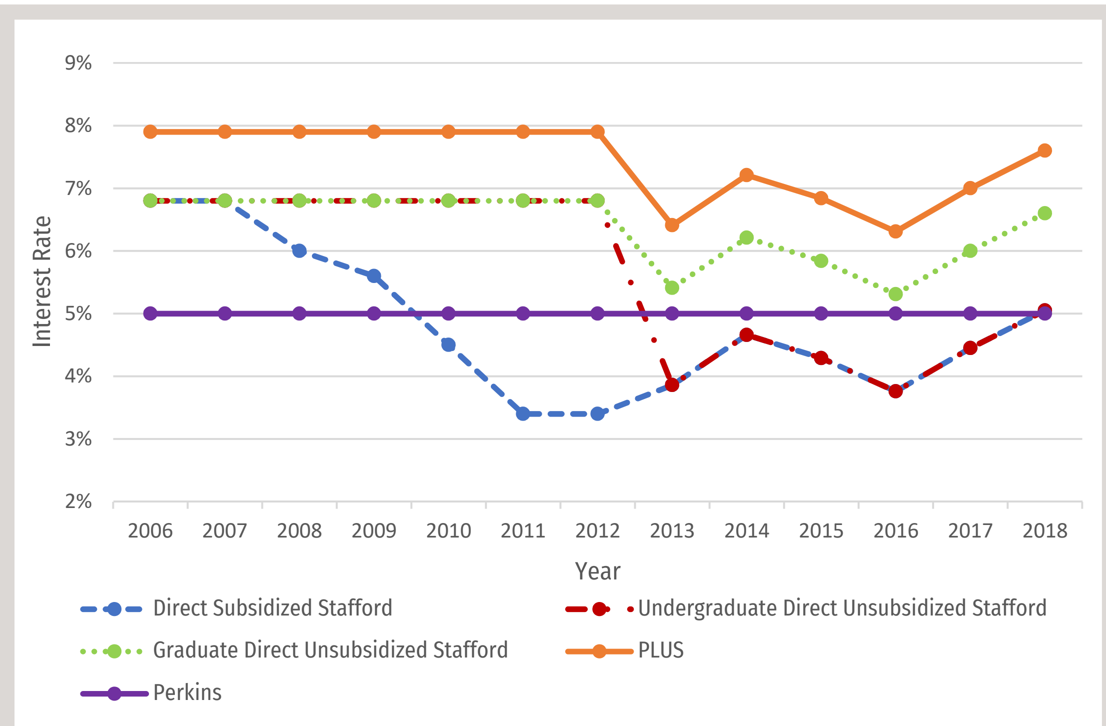
- **Direct PLUS Loan:** Demonstrating financial need is not required, and it is available to graduate students and parents of undergraduate students. Loan eligibility is contingent on the applicant's credit history.[7] Interest accumulates while the student is enrolled.

- **Perkins Loan:** These loans were available through June 30th of 2018 at participating institutions to both undergraduate and graduate students who demonstrated financial need.[8] Interest does not accumulate while the student maintains at least part-time enrollment.

The interest rates for federal student loans are determined by congressional legislation. All federal student loans have a fixed interest rate, meaning the interest rate will not change once the loan is disbursed. As seen in Figure 1, these fixed interest rates have changed over time. In 2007, the College Cost Reduction and Access Act was passed into law, which phased in a reduced interest rate on new subsidized Stafford loans to undergraduate students. The law reduced the interest rate from 6.8 percent in 2006 to 3.4 percent in 2011.[9] The interest rate on undergraduate unsubsidized loans remained fixed at 6.8 percent until it converged with the rate of subsidized loans at 3.86 percent in 2013-14.[10]

In 2013, the Bipartisan Student Loan Certainty Act was passed into law. The law set interest rates for all federal student loans except for Perkins loans to a new market-based fixed rate each academic year linked with the 10-year Treasury note yield.[11] During the years after the Great Recession of 2007-09, the demand, and consequently price, for these bonds increased, which decreased the bond yield to record lows. Due to recent strong economic and wage growth, investor demand for government bonds has been decreasing, causing bond prices to fall, bond yields to rise, and student loan interest rates to increase[12].

FIGURE 1. Federal Student Loan Rates 2006-2018



Source: U.S. Department of Education. (2018). *Interest Rates and Fees*. Interest rates are for new borrowers taking out loans from July 1, of the given year through June 30, of the following year.

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[7] U.S. Department of Education. (2018b). PLUS Loans.
[8] U.S. Department of Education. (2018a). Perkins Loans.
[9] College Cost Reduction and Access Act, Pub. L. No. 110-84, 121 Stat. 784. (2007). Under the terms of the law, the rate would revert to 6.8 percent in 2012 unless Congress acted, which it did by extending the 3.4 percent rate an extra year.
[10] U.S. Department of Education. (2018d). Interest Rates and Fees.
[11] Bipartisan Student Loan Certainty Act of 2013, Pub. L. No. 11-28, 127 Stat. 506. (2013).
[12] U.S. Securities and Exchange Commission. (2018). Interest rate risk —When Interest rates Go up, Prices of Fixed-rate Bonds Fall. *Investor Bulletin*.

STATE STUDENT LOANS

Many college students also have the option of receiving a student loan through a state-sponsored student loan program. A state student loan program offers loans through either a state agency or a state-chartered, not-for-profit organization. These loans have interest rates that are usually lower than those of private student loans. Accordingly, most state loan programs are restricted to residents.[13] State student loans are currently available to students in 15 states (see Table 1).[14] Because they are not originated by the federal government, every state student loan program uses its own unique method to determine interest rates. While all federal loans have a fixed interest rate, state student loans can have either fixed or variable interest rates. In some states, the specific interest rate for a given loan is partly dependent on the borrower's credit score, and loan eligibility may depend upon a willing co-signer.

Interest rates vary considerably across state student loans. At the low end, students pay a rate of one percent in Georgia. At the upper end, Indiana has the highest fixed interest rate with students potentially paying up to 11.15 percent. Indiana and Iowa both have a maximum potential variable interest rate at 21 percent over the life of the loan. Indiana also has the widest range for both fixed (6.41 percent to 11.15 percent) and starting variable (3.46 percent to 8.19 percent) interest rates. While there are significant differences in interest rates across states, most states have interest rates within three percentage points of both types of undergraduate Stafford loans. Even so, for most state student loan programs, students can potentially pay a higher interest rate than they would under the undergraduate Stafford loan program.

TABLE 1. Interest Rates of State Student Loan Programs

State	Fixed Interest Rate	Starting Variable Interest Rate	Maximum Variable Interest Rate	Loan Name	Lending Organization
Alaska	6.65% to 6.90%	n/a	n/a	Family Education Loan	Alaska Commission on Postsecondary Education
Alaska	5.15% to 8.50%	n/a	n/a	Alaska Supplemental Education Loan	Alaska Commission on Postsecondary Education
Connecticut	4.95%	n/a	n/a	Governor M. Jodi Rell and Credit Union League of Connecticut Student Loan Program	Connecticut Higher Education Supplemental Loan Authority
Georgia	1.00%	n/a	n/a	Student Access Loan	Georgia Student Finance Commission
Indiana	6.41% to 11.15%	3.46% to 8.19%	21.00%	INvestEd Student Loan	INvestEd
Iowa	5.50% to 6.30%	n/a	n/a	College Family Loan	Iowa Student Loan
Iowa	5.50% to 7.22%	5.63% to 7.85%	21.00%	Partnership Loan	Iowa Student Loan
Kentucky	3.80% to 6.99%	n/a	n/a	Kentucky Advantage Educational Loan	Kentucky Higher Education Student Loan Corporation
Maine	4.99% to 7.49%	n/a	n/a	Maine Loan	Finance Authority of Maine
Massachusetts	4.50% to 7.20%	n/a	n/a	MEFA Loan	Massachusetts Educational Financing Authority[15]
Minnesota	6.00%	4.30%	No maximum	SELF Loan	Minnesota Office of Higher Education
New Jersey	4.79% to 7.20%	n/a	n/a	NJCLASS Loan	Higher Education Student Assistance Authority
North Dakota	5.45%	3.84% to 4.84%	10.00%	DEAL Loan	Bank of North Dakota
Rhode Island	4.24% to 6.49%	4.33% to 6.58%	21.00%	RISLA Loan	Rhode Island Student Loan Authority
South Carolina	3.99% to 7.99%	3.63% to 7.68%	12.00%	Palmetto Assistance Loan	South Carolina Student Loan
Texas	5.30%	n/a	n/a	College Access Loan	Texas Higher Education Coordinating Board[16]
Vermont	5.90% to 7.55%	n/a	n/a	Vermont Advantage	Vermont Student Assistance Corp.

Source: Author's analysis of provider websites. (September 2018).

[13] Edvisors. (2018). *State Loans*.

[14] Arkansas, Michigan, New York, and North Carolina have state student loan programs that are currently suspended.

[15] The Massachusetts Educational Financing Authority also operates the Massachusetts No Interest Loan program, which provides zero-interest student loans to those who demonstrate financial need.

[16] The Texas Higher Education Coordinating Board also operates the Texas B-On-Time Loan program which provides zero-interest student loans to those who demonstrate financial need.

PRIVATE STUDENT LOANS

When students cannot completely cover the costs of college after exhausting grants, scholarships, federal student loans, and state student loans, private student loans are another option. Banks and other financial institutions provide private student loans without any financial backing from the federal or state government. Private loans accounted for nine percent of student loan debt in 2015.[17] Table 2 displays the interest rates of some of the largest private student loan lenders. In 2017, the average fixed rate on a private student loan was 9.66 percent, while the average variable rate on a private student loan was 7.81 percent.[18] Several factors affect the range of interest rates available for private loans, while others influence the rates offered to individual borrowers.[19]

Factors that determine the range of rates include:

- The supply and demand of credit: an increase in the demand for money or credit will create pressure to raise interest rates, while a decrease in the demand will reduce them.
- The cost of servicing the loan.
- The lender's cost of raising capital.
- A profit margin on each loan that provides the lender with an adequate return.

Factors that affect rates offered to individual borrowers include:

- The borrower's credit history.
- The length of time to repay the loan.
- Whether or not there is a cosigner on the loan.
- The likelihood of the loan being repaid.
- A risk premium that compensates the bank for default risk inherent in the loan.

TABLE 2. Starting Interest Rates for Selected Private Student Loan Lenders

Lender	Fixed Interest Rate	Variable Interest Rate
Citizens One	5.25% to 12.19%	4.04% to 11.91%
Discover	5.99% to 13.99%	3.99% to 12.99%
Sallie Mae	5.74% to 11.85%	4.12% to 10.98%
SunTrust	5.35% to 14.05%	3.88% to 12.88%
Wells Fargo	5.94% to 11.26%	4.57% to 10.51%

Source: Author's analysis of provider websites. (September 2018).

FINAL REMARKS

Student loan interest rates vary a great deal depending on the type of loan and the lender. Congress has changed the method for determining federal student loan interest rates over the years, most recently by linking the interest rate for all federal loans to the 10-year Treasury note rate (except the now defunct Perkins loan program). Interest rates have begun to increase due to the decreasing demand for government bonds. State student loans have considerable variation in interest rates as well as how rates are set. Students pay a higher interest rate, on average, with private student loans than they do for federal and state loans.

Given the variety of student loans described, students must decide which types of loans are the best to borrow when paying for their education. In addition to the type and level of the interest rate, students should also consider factors such as origination fees, repayment protection, income-driven repayment options, and student loan forgiveness programs, which can affect the total cost of the loan.

Type of Interest Rate

For many state and private student loans, students have a choice between taking out a loan with a fixed rate or variable rate. Since a fixed interest rate does not change over the life of the loan, personal budgeting during repayment is more manageable. Also, a fixed rate provides insulation from market-driven increases in interest rates. Conversely, whereas a variable rate introduces some unpredictability in personal budgeting, it does allow the

[17] Consumer Bankers Association. (2015). *Private Student Loan Facts*.
[18] Brown, M. (2017). The State of Private Student Loans. *Lend Edu*. The average rate was calculated from 80,000 private student loan applications processed by LendEDU between 2016 and 2017.
[19] Diette, M. (2000). *How Do Lenders Set Interest Rates on Loans?* Federal Reserve Bank of Minneapolis.

borrower to save money if market conditions lead to a relatively lower interest rate.

Loan Origination Fees

Loan origination fees (which cover the cost of approving and processing the loan) are not negligible. For example, Stafford loans have an origination fee of 1.07 percent while PLUS loans have an origination fee of 4.26 percent. From the perspective of students, paying origination fees is tantamount to paying interest on money they never received for their education.[20]

Repayment Protection and Forgiveness

Another factor to consider is the type of repayment protection provided by the loan. Three of the most common protections are deferment, forbearance, and income-based repayment. Deferment and forbearance both allow the borrower to temporarily stop payments, though interest does not accrue during deferment periods (except for unsubsidized federal loans).[21] Accrued interest during a forbearance period will be added to the loan's principal balance. While a deferment is more advantageous, borrowers must meet more stringent criteria related to unemployment, economic hardship, college enrollment, or military service. Additionally, federal loans provide income-driven repayment options. Income-driven repayment allows the amount of each monthly payment to be based on a percentage of a borrower's discretionary income instead of the amount owed.[22] A final factor worth considering is whether loans can be discharged through a loan forgiveness program.[23]

[20] Pingel, S. (2018, June 21). Personal communication. Education Commission of the States.
[21] U.S. Department of Education. (2018e). *Deferment and Forbearance*.
[22] U.S. Department of Education. (2018f). *Income-Driven Plans*.
[23] Wiederspan, M. (2018). *Understanding State Loan Forgiveness and Conditional Grant Programs*. MHEC Policy Brief.

ADDENDUM

Percentage of College Graduates with Debt and Average Debt of Graduates at Four-Year Public Institutions

	2010-11		2013-14		2016-17	
State	Percent of graduates with debt	Average debt of graduates	Percent of graduates with debt	Average debt of graduates	Percent of graduates with debt	Average debt of graduates
Alabama	51%	$25,538	51%	$29,163	50%	$32,307
Alaska	N/A	N/A	50%	$9,238	46%	$25,682
Arizona	49%	N/A	57%	$26,274	54%	$23,948
Arkansas	54%	$29,258	54%	$27,514	52%	$25,136
California	50%	$30,581	53%	$28,463	50%	$20,382
Colorado	56%	$27,130	57%	$28,593	53%	$26,351
Connecticut	69%	$36,461	65%	$37,526	N/A	N/A
Delaware	N/A	N/A	62%	N/A	62%	$34,144
Florida	47%	$33,237	52%	$31,620	48%	$21,626
Georgia	56%	$31,359	62%	$30,977	56%	$27,625
Hawaii	40%	N/A	45%	N/A	45%	$24,233
Idaho	66%	N/A	71%	N/A	60%	$27,317
Illinois	61%	$30,289	66%	$30,056	59%	$27,723
Indiana	60%	$32,281	60%	$32,961	55%	$27,761
Iowa	65%	$32,198	62%	$33,439	57%	$27,312
Kansas	62%	$30,951	63%	$25,749	57%	$27,281
Kentucky	57%	$24,933	63%	$24,994	64%	$28,697
Louisiana	42%	$34,988	44%	$29,618	49%	$25,970
Maine	78%	$25,750	80%	$28,796	76%	$34,092
Maryland	54%	$31,212	56%	$31,783	53%	$28,047
Massachusetts	72%	$30,563	75%	$30,719	73%	$30,679
Michigan	60%	$33,029	61%	$32,651	56%	$30,910
Minnesota	70%	$35,010	69%	$35,893	68%	$29,467
Mississippi	54%	$26,383	60%	$28,875	58%	$30,561
Missouri	67%	$26,860	62%	$26,235	60%	$26,990
Montana	64%	$30,646	66%	$27,211	57%	$28,137
Nebraska	60%	$31,761	61%	$32,267	52%	$22,278
Nevada	44%	N/A	46%	N/A	49%	$22,064
New Hampshire	79%	$35,492	81%	$29,295	79%	$35,657
New Jersey	64%	$31,981	69%	$29,150	61%	$32,390
New Mexico	N/A	$27,334	48%	$26,476	53%	$20,830
New York	54%	$32,708	54%	$31,340	54%	$26,380
North Carolina	53%	$27,345	62%	$29,004	61%	$25,575
North Dakota	83%	$28,060	N/A	N/A	N/A	N/A
Ohio	66%	$35,100	65%	$33,836	62%	$29,465
Oklahoma	53%	$26,710	54%	$29,803	48%	$25,370

Oregon	60%	$29,786	59%	$27,870	54%	$26,676
Pennsylvania	71%	$33,962	72%	$33,996	71%	$36,704
Rhode Island	74%	$36,465	71%	$35,671	75%	$31,442
South Carolina	53%	$29,517	58%	$30,578	57%	$30,958
South Dakota	75%	$34,667	67%	$35,693	74%	$29,801
Tennessee	51%	$23,512	60%	$27,211	58%	$23,769
Texas	56%	$31,649	59%	$34,074	55%	$24,587
Utah	51%	N/A	54%	N/A	47%	$19,763
Vermont	60%	$31,909	64%	$32,122	57%	$29,012
Virginia	56%	$32,637	57%	$25,370	54%	$29,523
Washington	53%	$29,609	55%	$30,106	49%	$21,559
West Virginia	63%	$35,253	69%	$30,364	75%	$26,940
Wisconsin	64%	$35,009	68%	$33,638	63%	$28,171
Wyoming	47%	N/A	46%	N/A	47%	$22,524
U.S.	57%	$31,603	60%	$30,717	57%	$27,293

Source: Institute for College Access and Success (2018). *College InSight Database.*
Note. Estimates have been adjusted for inflation (CPI).

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This brief examines a critical state policy issue identified through the College Affordability Research Initiative. Additional resources are available at MHEC.org/affordability_and_finance