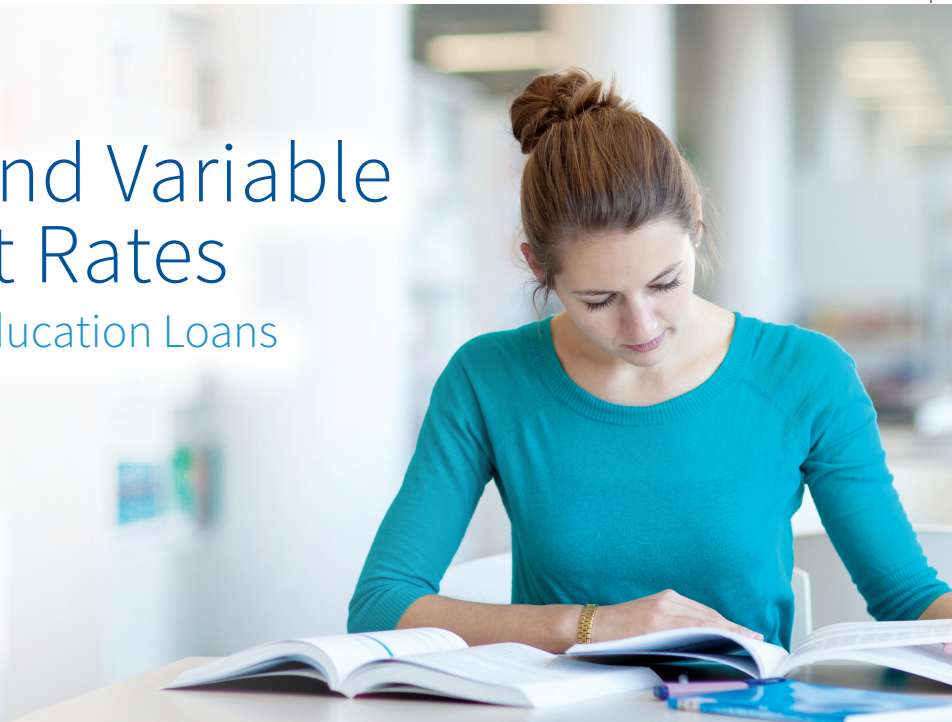


Fixed and Variable Interest Rates

for Private Education Loans



Know about interest rates

One of the first decisions you'll make when considering a private education loan is whether to apply for a fixed- or variable-rate loan.

This Handbook will give you some insights on:

- What they are
- How they work
- How they differ
- How to choose one over the other

NOTE: Underlined terms are defined on the back page.

A fixed-rate private education loan

comes with an interest rate that stays the same for the entire term of the loan, no matter how other (market) interest rates perform. This means that your payments will not change due to interest rate fluctuations during your repayment period.

A variable-rate private education loan

comes with an interest rate that can move up and down, depending on how an associated index fluctuates. As a result, your loan payments can also go up or down over time.

Compare the differences between fixed- and variable-rate loans

While both types of loans will help you pay for college, there are distinct differences.

With a fixed-rate loan, you'll:

- Generally start out with a rate that is higher than a variable rate, but it will not change with market conditions. (Fixed interest rates are higher because the lender takes on the risk that rates might rise in the future.)
- Receive a specific rate when you apply that does not change for the life of the loan.
- Get an interest rate that is based on the credit of the student and cosigner; the better the credit score, the lower the interest rate.

With a variable-rate loan, you'll:

- Generally start out with a rate that is lower than a fixed rate, but over time this rate will adjust according to market conditions. Variable rates are typically lower than fixed rates.
- Receive an interest rate that is tied to an **index** (usually the **Prime Rate** or **LIBOR**), and will fluctuate over time, based on market conditions.
- Receive a **margin** (an amount added by the lender) that is based on the credit of the student and cosigner; the better the credit score, the lower the margin. This margin is added to the index interest rate.

Understand the factors in a loan's interest rate

Here are some factors that play a role in the rate you'll pay for a private education loan.

- The **Annual Percentage Rate (APR)** represents a percentage of the *actual annual cost* of borrowing over the total life of the loan, including any fees or additional costs.
- For a variable-rate loan, a credit-based **margin** is added to the index rate. For instance, if the loan uses **LIBOR** as its index and the lender adds a 5% margin, the rate will be quoted as “LIBOR + 5%.” The index may change over time depending on economic conditions, but the margin will remain fixed.
- Federal Stafford and PLUS Loans are often referred to as variable-rate loans. They are, however, not “variable rate” loans in the traditional sense. The interest rates for these loan programs are determined each year prior to the academic year starting, but the interest rate for a Stafford or PLUS loan is fixed for the life of the loan. Since each academic year the rates for these loan programs are newly determined, a borrower could have multiple loans with different fixed interest rates. That's what the term “variable” refers to in this context.

TIP: For more information on the Prime Rate and LIBOR, visit **www.wsjprimerate.us**.

Choose the interest rate type

The type of rate you apply for depends on your individual financial situation and your personal preference.

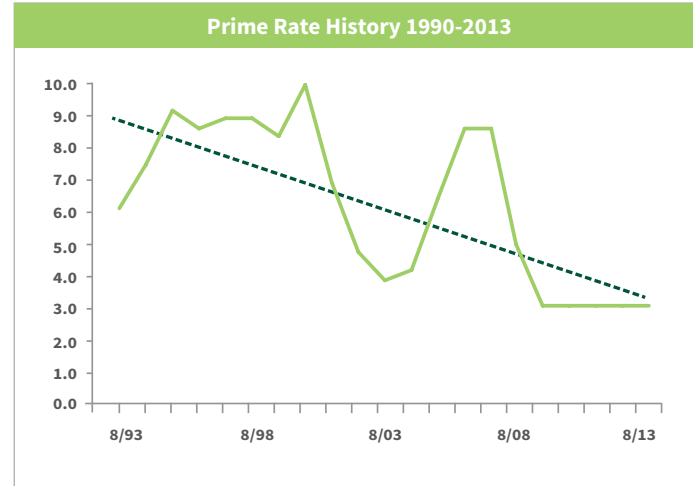
Benefits of a fixed-rate loan:

- Predictability; you don't have to worry about whether the market is moving up or down.
- You know your total loan cost because your interest rate is locked in. Keep in mind that there are typically no penalties for early repayment for fixed- or variable-rate loans, so total loan cost could actually be less if you pay off the loan faster.

Benefits of a variable-rate loan:

- A variable rate can go up, but it can also go down.
- Variable rates usually start out lower than fixed rates.
- While there are no guarantees, studies have shown that over time, a person is likely to pay less with a variable rate than with a fixed rate (see examples on the next page).¹

Example: Over the past two decades, variable rates have decreased slowly with movement in both directions.



¹ www.investopedia.com

Example: Two consumers took out a \$10,000 loan in 1997. The first opted for a fixed rate at 9.0%; the second chose a variable rate of LIBOR + 3.0% (8.73% at the time, assuming no rounding up or down). Both loans had a 10-year repayment period. Here is what their payments would have looked like:

Repayment Period	Monthly Payment Fixed-Rate Loan @ 9.0%	Monthly Payment Variable-Rate Loan	Variable Rate @ LIBOR + 3.0%: Changing every 12 months
Year 1	\$126.68 for 120 months	\$125.22	LIBOR = 5.73% + 3.0% = 8.73%
Year 2		\$123.45	LIBOR = 5.37% + 3.0% = 8.37%
Year 3		\$129.08	LIBOR = 6.63% + 3.0% = 9.63%
Year 4		\$117.11	LIBOR = 3.58% + 3.0% = 6.58%
Year 5		\$111.36	LIBOR = 1.82% + 3.0% = 4.82%
Year 6		\$109.47	LIBOR = 1.12% + 3.0% = 4.12%
Year 7		\$110.62	LIBOR = 1.65% + 3.0% = 4.65%
Year 8		\$114.05	LIBOR = 3.69% + 3.0% = 6.69%
Year 9		\$115.94	LIBOR = 5.33% + 3.0% = 8.33%
Year 10		\$116.03	LIBOR = 5.50% + 3.0% = 8.50%
Total Repaid:	\$15,201	\$14,068	Average Rate: 7.04%

The initial interest rate and payments were very similar for both customers.

While there were changes in the monthly payment with the variable-rate loan, these were not dramatic — the largest upward jump happened in year 3, when the monthly payment increased by \$5.63. Overall, the customer choosing the variable-rate loan saved \$1,133 in total loan costs in an environment where rates moved noticeably in both directions over time. Keep in mind that historical performance is no guarantee of future performance. It's also important to note that LIBOR is currently at historic lows so there is much more room to go up than down.

Remember

- ☐ Before you make any borrowing decision, consider all your available options.
- ☐ Make sure you understand the terminology and pricing factors.
- ☐ Carefully weigh your specific needs against what the loan offers and its total cost.
- ☐ When in doubt, it's always a good idea to consult a financial advisor.

For more information, visit **SallieMae.com/PlanForCollege**.



Notes

Remember

Definitions

APR (Annual Percentage Rate)

Your total loan cost expressed as a percentage. APR represents the actual annual cost of what you're borrowing over the term of the loan — including fees or other costs.

Fixed interest rate

A rate that stays the same for the entire term of a loan, whether or not the rates go up and down. Your payments do not change due to interest rate fluctuations during your repayment period.

Index

A statistical measurement of the change in value of a particular set (portfolio) of stocks, bonds, or other securities. An index's value is given as a percentage. The index increases when the value of the underlying securities rises, and decreases when the value becomes lower. An index can also indicate changes in the economy. Variable interest loans are linked to a particular index, like LIBOR.

LIBOR (London InterBank Offered Rate)

An example of an index rate. This is the interest rate at which banks can borrow funds from other banks. LIBOR is a common rate used for loans — it reflects the ups and downs of the market at large.

Prime Rate

An interest rate that large commercial banks charge their clients with the best credit ratings (usually large businesses). It reflects the ups and downs of the market at large. The Prime Rate can be used as an index as a basis for interest rates for private education loans.

Margin (or credit-based margin)

A credit-based part of the variable interest rate that is determined by the lender. In a private education loan, which is credit based, students and cosigners with better credit scores qualify for lower margins.

Market rate

The “going” interest rate in the marketplace. The market rate is usually based on other financial products that have a similar length as the loan. For example, if a loan is for five years, the market rate may be based on the 5-year U.S. Treasury Bond.

Variable interest rate

An interest rate that can move up or down, depending on how an associated index performs. As a result, your loan payments can also go up or down over time.

Encouraging Responsible Borrowing

Sallie Mae has helped more than 30 million Americans pay for college since 1972. We encourage students and families to supplement their savings by exploring grants, scholarships, federal and state student loans, and to consider the anticipated monthly payments on their total student loan debt and their expected future earnings before considering a private education loan.

For more information on saving, planning, and paying for college go to Salliemae.com/PlanForCollege

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