Fixed Rates vs. Variable Rates: A Beginner's Course

The student loan industry can be perplexing, especially for those financially challenged individuals who don't know the difference between a fixed interest rate and a variable interest rate. It is essential for any and all borrowers to understand this vital loan information, as interest rates directly affect the loan amount borrowed and the amount a borrower will pay over the life of the loan. Below you will find some basic definitions of fixed interest rates and variable interest rates, as well as some advantages and disadvantages of each type of interest rate.

Interest rate: The cost of borrowing money, usually expressed as a percentage, paid to the lender.

Fixed interest rate: An interest rate that remains the same for a set period of time regardless of the changing underlying interest rate index.

Why am I charged interest?

- Borrowers pay interest for the privilege of borrowing
- Lenders charge borrowers fees and interest for the use of their money
- Interest is charged because the lender is taking a risk lending money to a borrower

Advantages of a fixed interest rate

- Borrower will know what all future monthly payments will be
- Monthly payments will never change
- Borrower can calculate how long it will take to pay off all the interest and principal

Disadvantages of a fixed interest rate

- Might have a higher monthly payment than with other interest rate loans
- This is due to the fact that lenders are making borrowers pay for this luxury
- Interest rate will never go down even if underlying interest rate index goes down

Variable interest rate: An interest rate that moves up and down based on the changes of an underlying interest rate index.

Advantages of a variable interest rate

- Offer the most attractive interest rates at the beginning of the loan
- A borrower's interest rate can go down if the underlying interest rate index goes down
- Might be a cap on the interest rate

Continued on back

Disadvantages of a variable interest rate

- Monthly payments will fluctuate as interest rate fluctuates
- Might not be a cap on the interest rate
- Interest rate is adjusted monthly, semi-annually, annually, etc.
- Thus, monthly payments will be adjusted monthly, semi-annually, annually, etc.

The information above can be used to determine the benefits and costs of consolidating student loans. Read more in "Frequently Asked Questions" or go to http://www.lawschoolloans.com/lslfederalstudentloan.php.