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Interest Rates on Federal Student Loans Will Rise in July

Despite the uptick, one financial aid expert says rates “are still very low.” The new rates for undergraduate loans for next school year are expected to go up nearly a percentage point.

By Ann Carrns

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Students attending college in the fall will pay higher interest rates than last year on money borrowed to finance their education.

Interest rates on federal student loans for the coming academic year will rise nearly a percentage point on July 1 after falling for several years, according to an analysis by the financial aid expert Mark Kantrowitz.

Still, rates on loans for undergraduates hit a record low during the 2020-21 academic year. So while rates are rising, he said, they “are still very low.”

The interest rates on federal student loans are tied to the 10-year Treasury note at the May auction, and the rate on that note has risen since the depths of the pandemic.

By Mr. Kantrowitz’s calculations, the rate for direct loans for undergraduates will rise to 3.73 percent from 2.75 percent. Three years ago, the rate was just over 5 percent.

The new rate increases the interest charges on a 10-year loan by $549 per $10,000 borrowed, or $4.58 per month, according to Mr. Kantrowitz, the author of a book on appealing for more financial aid.

The rate is rising amid a national debate about whether to cancel some student debt to help struggling borrowers.

President Biden has endorsed canceling up to $10,000 in federal debt per borrower, while other Democrats are pushing for far broader relief. It’s unclear whether any debt cancellation will occur, however, so students shouldn’t count on that as they consider how much to borrow, student debt experts advise.

“Caution is always the best approach with student loans,” said Persis Yu, director of the Student Loan Borrower Assistance project at the National Consumer Law Center.

She said students weighing how much to borrow for next year and beyond should bear in mind why student debt had become such a hot topic: Many borrowers struggle to make their payments. More than a million students default each year on their federal student loans, according to the Pew Charitable Trusts.

Natalia Abrams, executive director of Student Debt Crisis, a group working to change higher-education loan policies, recommended that a student “always take out as little in loans” as possible.

But the reality is that many students can’t avoid borrowing to go to college, said Michele Streeter, senior policy analyst at the Institute for College Access & Success, a nonprofit group that works to make college more affordable. The average published cost of attending a four-year public university as an in-state student is now just under $27,000 a year for tuition, room and board, and other expenses, while the average cost after grant aid is about $19,500, according to estimates from the College Board.

And there are valid reasons to borrow: College graduates with a four-year degree tend to earn significantly more over their lifetime than workers with a high school diploma.

Students who need to borrow, Ms. Streeter said, should focus on federal loans, and aim to borrow the maximum amount allowed of federal loans before considering private loans from banks or other nongovernment lenders. Private loans are typically more expensive and lack the consumer protections that come with federal loans, like repayment plans tied to the borrower's income and deferment options when borrowers run into financial trouble.

Almost two-thirds of college seniors who graduated in 2019 had student loan debt, owing an average of about $29,000, according to the Project on Student Debt, an initiative of the institute for college access. That was down slightly from the 2018 average, continuing a trend of "relatively flat" student debt levels in recent years, the project said.

But the pandemic upended many aspects of higher education, and it remains uncertain whether increases in student debt will resume as the nation begins to return to normal functioning, the student debt project reported last year.

The Education Department hasn't officially announced the new student loan rates, but Mr. Kantrowitz calculated them using the government's formula, which adds an extra fixed rate depending on the type of loan.

The rate on direct loans for graduate students will rise to 5.28 percent from 4.3 percent. The rate on PLUS loans, additional loans available to parents and graduate students, will rise to 6.28 percent from 5.3 percent.

The new rates don't apply to private student loans.

Here are some questions and answers about student loans:

Can I take out loans for next year now to get lower rates?

No. Rates on new federal student loans are set for each academic year, starting on July 1, using a formula set by Congress. The loans are offered through colleges, based on information you report on the Free Application for Federal Student Aid, or FAFSA.

The increase doesn't affect rates on student loans that have already been borrowed. Once loan rates are set, they are fixed for the life of the loan.

How much can I borrow?

There are limits on the amount of money students can borrow in federal loans, annually and in total. In general, first-year, dependent students can borrow up to $5,500 and sophomores up to $6,500. For the third and fourth years, the limit is $7,500. The total cap is $31,000 — higher than the combined annual limits, in case a student takes longer than four years to graduate. Limits are higher for independent and graduate students.

When does the current pause on student loan payments end?

In March 2020, as part of the government's pandemic relief program, Congress allowed most federal student loan borrowers to temporarily stop making monthly payments and set the interest rate on the loans to zero during the suspension. The suspension was extended several times, most recently in early 2021, when the Biden administration extended it at least through Sept. 30. Some advocates for borrowers support another extension, but it's uncertain if that will happen.

Normally, so-called unsubsidized loans accrue interest while the borrower attends college, but under the relief plan the interest on those loans is temporarily zero as well, "even while you are in school," according to the Education Department's website.

The temporary zero interest rate is unlikely to have a meaningful effect on loans taken out after June 30, Ms. Streeter said. The "short window" with no interest, before repayments are scheduled to resume on Oct. 1, would mean that the impact would probably be negligible, she said.