Paying for College ... the Smart Way

The cost of college has risen faster than the general inflation rate for many years. So, it's no surprise that many parents borrow to pay for higher education and that many college graduates owe tens of thousands of dollars on student loans and related debt. Here are some strategies for keeping college financing costs down.

Make saving, not borrowing, your first choice for paying for college. "Planning and saving for college should be something parents begin when their son or daughter is still in diapers," said Kirk Daniels, a supervisor in the FDIC's consumer affairs section. "College loans can be costly, and the easiest way to avoid those costs is to have your own college savings fund."

Starting a college savings account, such as a state-sponsored "529 Plan," allows families to maximize growth in a tax-advantaged account and reap the benefits of compounding small amounts of money into a large sum when the child graduates from high school. Investment advisers also recommend setting up an automatic investment plan through your bank account or paycheck to encourage systematic savings.

Take the time to research your options for a loan. If you think you need a loan, do your homework and ask lots of questions before settling on one. Among the many options are federal government loan programs, including "PLUS" loans for parents and Perkins and Stafford loans for students (usually with fixed interest rates and some form of deferment on repayment until after graduation). Also available are loans from private financial institutions and state government agencies.

Of course, you'll want to know whether a loan is fixed or variable rate and what could trigger a rate increase. But student loans may have unusual features to consider. In particular, ask about any options for delaying payment until after graduation and any policies on "forbearance" (temporarily reducing or postponing payments from a borrower in financial distress). Also find out about any rebates for on-time payments and other incentives for good performance.

"There are often substantial differences between private loans and student loans guaranteed or insured by the government," noted Luke Reynolds, an FDIC Community Affairs Specialist. "A private lender likely will offer both types of loans, so be sure to ask questions to fully understand the pros and cons of any loan product."

Your state's department of education and the college's financial aid department may be good resources.

Think twice before borrowing against your home or retirement accounts. Parents who do not qualify for a tax deduction on loans for higher education may want to consider using a home equity loan if they qualify for a tax break on the interest. But remember, a home loan puts your house at risk. Another option is to borrow from your retirement savings, but most investment advisers recommend against that approach because it may reduce your future earnings and make it tougher for you to retire when you want.

"Given the many ways to borrow for college at competitive interest rates, ask yourself if you really want to put your house at risk with a home equity loan or reduce your hard-earned retirement savings just to pay tuition," Daniels said.

Shop for a good price on a college, not just on the college financing.

"For most families, the price of tuition and room and board should be an important part of the decision process, just like buying a home, a car or any other major purchase," said Daniels. "The cost should be considered along with the academic programs of a school."

For many families, the comparison shopping should include options such as two-year community colleges and schools close to home, which can help save on room and board, Daniels said.

Youth is no excuse for defaulting on a loan. At some point, perhaps after graduation, the loan payments will begin. How a young person manages student debt can be crucial. "Other loans, such as credit cards, and high living expenses can make it tough for a student or graduate to pay off college loans," Daniels cautioned. "The non-payment of a student loan is a bad way to start your career because your credit report will be damaged and the ability to obtain new credit or even qualify for certain jobs may be jeopardized." But what if your good intentions fail and you have no way of making a payment? Contact the lender immediately. "Many lenders would rather work out some modified payment plan than have the borrower stop making payments completely," Daniels said.

For more information, start at www.studentaid.ed.gov, a comprehensive Web site with information from the U.S. government and other sources on topics such as paying for college.