One of the most important factors for a student to consider when shopping for a student loan is the loan’s interest rate. Beyond simply how much the student can borrow, the student loan interest rate will determine the amount of interest that will be paid over the life of the loan. Therefore, the student will want to get the lowest possible rate on their education loan.

But the interest rate number isn't the only factor to weigh; a borrower also needs to know whether the loan has a fixed or variable rate, and how long they'll take to repay the loan (i.e. the loan term). And, of course, it matters when they start repayment.

Here's some information to review about student loan interest rates before making a decision about which student loan(s) to apply for:

**How student loan interest rates work**
The interest rate on a student loan is a percentage of the amount borrowed that must be paid back in addition to the principal — in other words, the cost to borrow money.

Lenders calculate the rate on the remaining unpaid portion of your loan and express it as an annual amount, also known as the annual percentage rate (APR).

If that sounds confusing, let's use a simple example: If someone borrows $100 for one school year, with a 12% APR, they would need to repay $112. The 12% interest rate equates to $12 in interest over the year, or $1.00 per month in interest.

The interest rate on a loan stems from a variety of factors, including market conditions; the type of loan (federal or private); loan term; income; credit history; and the income and credit history of a potential cosigner.

Typically, the shorter the loan term, the higher someone's income, and the better their credit score, the lower the student loan interest rate will be.

**Variable vs. fixed rate student loan interest rates**
There are two main types of student loan interest rates — variable and fixed rate. Variable rate student loans adjust the interest rate at a set frequency (usually monthly or annually) over the course of the loan term. Fixed rate student loans offer the same interest rate over the loan term.

Federal student loans offer fixed rates that are set on an annual basis. Since the student loan interest rate on a fixed rate loan is the same over the life of the loan, the monthly payment will also be fixed over the life of the loan.
Private student loans may have fixed interest rates or variable interest rates that a lender calculates based on its own formula. Most private lenders use a base rate (say 1%), plus the LIBOR rate (set by a group of banks). As such, the interest rate on a variable rate student loan could go up or down over the course of the loan term.

With a variable student loan interest rate, the monthly payment could fluctuate based on the current interest rate. However, most variable rate loans set caps for how much the rate can rise. Student loan documents will specify the potential maximum rate for a loan.


How to calculate student loan interest
To calculate student loan interest, you need to know the loan amount, loan term, and student loan interest rate.

For a fixed rate loan, you take the loan balance and multiply it by the monthly student loan interest rate. You can find the monthly interest rate by dividing your annual rate by 12.

If a loan has 6% APR (or 0.50% monthly), the formula would look like this:
Loan balance x 0.0050 = Monthly interest
For a $10,000 outstanding principal balance on a student loan with a 6% APR, the monthly interest on the loan would be $50.

Next month, if the outstanding balance drops to $9,900, the monthly interest would drop to $49.50.

If a student has a variable rate loan, the same formula applies, but the interest rate may change each month based on the underlying rate.

It can be challenging to calculate student loan interest over the life of a loan — especially one with a variable rate.

A calculator can help you compare fixed rate monthly student loan payments with estimates for variable rate loans.

However, it’s impossible to estimate an exact future payment for variable rate loans since the interest rate can fluctuate. Given that the rate will typically have a cap, however, you can calculate the maximum amount you could pay each month.
Understanding capitalized student loan interest

Another factor that can make it challenging to understand student loan interest rates is capitalized interest, which is unpaid interest that's added to the total student loan balance.

This can happen under several scenarios, but the most common is when a student defers their loans while in school. Deferment allows a student to put on hold their loan payments while they're in school. Many deferment options also offer a grace period after graduation (usually six months), to allow someone to gain employment before they have to start making loan payments.

However, the interest on any student loans continues to accrue even though they're not making payments, both while in deferment and during the grace period.

When someone starts repayment, the outstanding interest on their student loan will be added, or capitalized, into their student loan balance.

For example, let's say someone borrows $20,000 in student loans, and during school, $2,000 in interest accrues on their student loans based on the student loan interest rate. When they start repayment, that $2,000 will be added to the loan balance — making the total outstanding loan balance $22,000.

The monthly student loan interest will now be calculated on the new loan balance that includes the capitalized interest.

Where to find the lowest student loan rates

Many factors help determine the student loan interest rate, including: loan term, repayment options, and cosigner requirements.

Some lenders offer student loan interest rate reductions to borrowers who set up automatic payments or maintain other accounts with the same financial institution. These types of discounts can help lower the student loan interest rate, which in turn lowers the payment — saving money each month.

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