Carnegie Mellon University
Student Financial Aid Office

Fixed Rate vs. Variable Rate – How Do You Choose?

Students or parents borrowing a private loan should consider more than just today's interest rates and which lender to choose. They must decide between fixed or variable rate loans and choose the loan that's right for them.

Fixed Rate

- The fixed rate is generally higher than a variable rate loan.
- The fixed rate remains the same over the life of the loan so your monthly payments remain the same over the life of the loan.
- If the interest rate falls after the fixed rate has been locked in, your monthly payments may be higher than with a variable rate.

Variable Rate

- The variable rate is generally lower than a fixed rate.
- The variable rate may rise or fall as the Prime Rate changes. This means your payments may vary on a monthly basis.
- If the interest rate rises, your monthly payments may be higher than a fixed rate.

Choosing between fixed and variable interest rates can be difficult. Often the initial interest rate on a variable-rate loan is more attractive than that of a fixed-rate loan with a similar term. But because the interest rate on a variable rate loan can change, comparing initial interest rates is not enough. Borrowers should also take a longer-term view, considering how market interest rates tend to rise and fall in cycles.

Three factors that students and parents should consider before borrowing a private loan:

- Before making a choice, borrowers should think about whether or not they would be comfortable with such fluctuations in interest rates and the resulting changes in their loan payments? With the possibility of such rate swings, many borrowers would prefer the security and predictability of fixed loan payments.
- Borrowers should also consider the term of the loan. The longer the term on a variable rate loan the longer the time period the borrower has to be ready to accommodate fluctuations in interest rates and the accompanying changes to the family budget.
- Finally, borrowers should consider timing. Although no one knows whether, when, or how much interest rates will change, common sense seems to indicate that rates will increase in the near term. When borrowers choose between variable and fixed rate loans, they must remember to factor this into their decisions.