

# what you need to know about private loans

DESPITE RISING TUITION AND LIVING-EXPENSE COSTS, more aid is being awarded on a non-need basis, while federal loan limits have remained flat. As a result, most students' packages now include a built-in portion of unmet need. When questions arise about closing this gap, students are encouraged to consult their local expert in education financing—the financial aid administrator. After other alternatives have been exhausted, are we prepared to help families find their way through the maze of private student loan options available to them?

Families surfing the Web for terms like “college,” “school,” or “scholarship” will surely run across Web sites and even banner ads for student loans. Although education loans are similar to many consumer loan products, there are important differences. With more than 250 different private educational loan products now being marketed to both students and parents, these programs have become increasingly competitive. What do we need to know to help parents and students evaluate these products and borrow wisely?

Financial aid administrators must understand several aspects of private loans to help counsel families. We should be familiar with the differences between federal and private loans, have a basic understanding of credit reporting, be aware of the factors that go into the “cost” of the loans, and comprehend how different combinations of loan provisions may be important for different students in different situations.

## First, the Federal Options

*Federal PLUS Loans:* Before turning to private loans, families should ensure that they have taken advantage of the available federal student loan options. Parents of dependent students have access to a wonderful but often overlooked federal loan, the PLUS loan. PLUS is guaranteed by the federal government, has interest rate subsidies, and can be used to borrow cost of attendance less other aid. It also requires that the parent borrower not have adverse credit. With the possible exception of a home-equity loan, the PLUS loan should be the first loan investigated before parents consider private loans.

For some reason PLUS does not always make it onto parental radar, even though many FFELP lenders have Web pages and other literature on the advantages of PLUS borrowing over other non-federal private loans. Parents of dependent students need to save, maximize other aid, assess their real need to borrow, then consider PLUS. If parents have poor credit, unsubsidized Federal Stafford Loans or Direct Loans may be available to dependent students, but the amount may not be enough to cover expenses.

Even families who are familiar with PLUS may still opt for private loans. Parents who are already debt burdened—sometimes with their own student loans—are often unwilling to borrow on the student's behalf. In other cases parents are simply ineligible to borrow PLUS. Further, some parents may mistakenly choose private loans

over PLUS because they do not recognize that signing as a co-signer on a private loan makes them ultimately responsible for that loan even when it is in the student's name.

To help families sort through the differences between PLUS and private loans, aid offices should work with the lending community to develop and disseminate informative educational material comparing these programs.

*Additional unsubsidized loans:* With no access to PLUS, independent students have fewer options than dependent students. At many institutions, Federal Pell Grants and subsidized Federal Stafford Loans or Direct Loans do not even cover tuition. Independent students and dependent students whose parents have been turned down for PLUS have access to additional unsubsidized Stafford or Direct Loans. Sometimes these additional unsubsidized loan

## What to Ask When Evaluating Alternative Loan Programs

### Questions about the Lender

- Is the lender based in the community or is it a national organization?
- Is the lender financially stable and reputable?
- To be eligible, do you have to take out a matching FFELP loan through the lender?
- Does the lender use a servicer during the interim period? If so, which servicer?
- Will the loans be sold to a servicer? If so, when?
- Is the servicer stable and reputable?
- Is the servicer likely to sell the loans to a different servicer?
- Does the lender disburse the funds by check, electronic funds transfer (EFT) or both?
- How long does it take the lender to approve or deny loans?
- How long does it take the lender to disburse loans?

### Questions about the Alternative Loan Program

- Is eligibility for the loan income-based or credit-based?
- What is the credit criteria for the borrower?
- Are tax returns required for income approval?
- Is a co-signer or endorser required?
- Does having a co-signer decrease the interest rate, loan fees, or both?
- What are the credit criteria for a co-signer or endorser?
- What are the minimum and maximum annual loan limits?
- What is the aggregate loan limit?
- Is school certification required?
- Who determines the amount approved?

- What are the loan fees and when are they paid?
- Is there an additional fee charged at graduation and/or repayment?
- Can the fees be waived? If so, how?
- How is the interest rate calculated?
- Is the interest rate fixed or variable?
- If the interest rate is variable, how often does it change? Is it monthly, quarterly, semiannually, or annually?
- What is the current interest rate?
- What is the Annual Percentage Rate (APR)?
- How often is interest capitalized?
- Is there a grace period? If so, how long?
- When does repayment begin?
- What are the deferment and forbearance provisions?
- Are payments required while the borrower is in school? In residency?
- What are the repayment options?
- If the borrower experiences temporary difficulty in making payments, how will the lender work with the borrower to prevent default?
- Are there any cancellation provisions?
- How often will the borrower be billed (monthly? quarterly?) and will the borrower receive a coupon book?
- Can the borrower make payments via the Web, by phone, or through direct deposit?

---

Source: 2003 NASFAA Conference Workshop by Pamela Nyiri, director of financial aid for Yale University School of Medicine, and Michael Goodman, director of financial aid for Tulane University Health Sciences Center.

## Useful Debt Management Web Sites

### Access Group

[http://www.accessgroup.org/loan\\_terms/contents.htm](http://www.accessgroup.org/loan_terms/contents.htm)

General student loan debt management information

### Bank Rate

[http://www.bankrate.com/brm/rate/calc\\_home.asp](http://www.bankrate.com/brm/rate/calc_home.asp)

Credit cards, mortgages, autos, managing your money, investing, etc.

### Equifax

<http://www.equifax.com>

Credit reporting agency

### Experian

<http://www.experian.com>

Credit reporting agency

### Fair, Isaac

<http://www.myfico.com/myfico/CreditCentral/Calculators.asp>

Calculators for mortgages, autos, all types of loans, savings, budgeting, investing, retirement, etc. Also includes credit scoring information

### National Foundation of Credit Counseling

<http://www.nfcc.org>

List of Consumer Credit Counseling Service offices, which provide counseling on credit, debt management, and budgeting at no cost or for a reasonable fee

### Nellie Mae

<http://www.nelliemae.com/calculators>

Award letter comparisons, budget worksheets, capitalized interest, prepayment savings, and loan repayment plans

### Smart Money

<http://www.smartmoney.com/debt>

Mortgage calculators, comparing credit cards worksheet

### TransUnion

<http://www.transunion.com>

Credit reporting agency

### U.S. Department of Education

[http://studentaid.ed.gov/students/publications/repaying\\_loans/2003\\_2004/english/index.htm](http://studentaid.ed.gov/students/publications/repaying_loans/2003_2004/english/index.htm)

An overview of federal student loan repayment terminology and requirements

### USA Funds

[http://www.usafunds.org/financial\\_aid/debt\\_management/index.html](http://www.usafunds.org/financial_aid/debt_management/index.html)

Loan repayment calculator, loan consolidation calculator, general debt management information

Source: NASFAA 2003 Spring Training Workshop

funds are enough to meet the budget gap, but often they are not.

Many FFELP lenders offer private educational loans as part of a suite of products that include federal loans. Most encourage federal borrowing first, and some only offer private loans to families who have first applied for federal loans.

## Private Loans: A Few Basics

The differences among various private loan programs can be dramatic in terms of costs, interest rates, fees, repayment options, and eligibility criteria. Because most families and some financial aid administrators are not familiar with the nuances of private loan programs, we need to understand as much as possible about these programs ourselves so we can help them make informed choices.

Private loans are not federally guaranteed. If the borrower defaults, there is no guarantee agency, so the lender has no recourse for payment except the borrower. For this reason, many lenders charge guarantee fees based on the risk of the loan: the riskier the borrower, the higher the fees. This reflects the need for a reasonable rate of return for the risk, factoring in delinquencies and default. Other lenders charge low or no fees, but may set a higher interest rate to make up for the cost of anticipated defaults.

Interest on most private loans is variable and accrues from disbursement. It may be capitalized more frequently than on federal student loans. Of course, more frequent capitalization raises the cost of the loan. Further, most private loans have no interest rate cap. While this may not seem troubling in the current low interest-rate environment, rates will undoubtedly fluctuate in the next 15 to 20 years.

Private loans generally do not offer deferments as federal loans do, although many private loans offer forbearance options. Some set a time limit to education. For example, repayments may begin five years after borrowing regardless of whether student is still enrolled in school. Some will only recognize one degree, with no educational deferments for study beyond that first degree. Many lenders offer repayment periods longer than the standard 10 years, and some offer repayment incentives.

All of these factors result in differences in the costs for private education loan programs. Lenders are required to disclose the Annual Percentage Rate (APR) to the borrower before disbursement. The APR is one of several formulas aid administrators and borrowers can use to assess the loan's cost over time. In some cases, however, the APR

may not be the best way to assess costs. For example, some borrowers plan on repaying their loans over a long period of time, while some will repay over a much shorter period. If the guarantee fees are high (either at disbursement or at repayment), the longer a borrower takes to repay the loan, the lower the impact of the fees on the APR. A borrower expecting to spend 20 years in repayment may prefer a loan with a lower interest rate but high fees. Conversely, the borrower expecting to repay in a short period of time might choose a low- or no-fee loan with a higher interest rate. My crystal ball does not work well enough to gaze into my students' futures, so I present them with these as options to consider. They may not know what they want to be when they grow up, but they probably have a slightly better idea than I do about their plans for the future.

### Good Credit – It's Essential

Because private loans are not guaranteed the way many federal student loans are, good credit is of utmost importance. Most education loans do not require the student to prove his or her ability to repay the loans (although most parent loans do). Generally, student loans simply require a credit check. To assess whether a student or parent is a good risk for a loan, some lenders use credit scores, others use specific criteria related to number of accounts and payment history. Still others specialize in loans to certain majors, professions, or schools. Some lenders do offer private loans to students with poor credit, but usually at significantly higher rates or with other less favorable terms than their loans to borrowers with good credit. Lenders also differ in how they handle individuals who have no credit history. In many cases, a co-signer is required, particularly for students with little credit history or a poor credit history.

Unfortunately, a number of students have already developed and destroyed their credit rating by the time they need to borrow student loans. I remember when the only way to obtain a major credit card in college was to be a graduating senior with a "B" or better average, have parents as co-signers, and be subject to a \$500 maximum credit limit. Now credit card issuers are marketing to high school students.

**One account 60 days  
past due may be  
enough to disqualify  
a student from  
obtaining a private  
student loan.**


Most credit grantors report monthly to one of the three major credit reporting agencies (Experian, TransUnion, and Equifax) although there are eight other regional credit reporting agencies. The credit reporting agencies collect information on accounts, credit limits, utilization of credit, and payment history. Many utilities, cell phone companies, and gyms also report payment history, since they have extended credit. One account 60 days past due may be enough to disqualify a student from obtaining a private student loan. Before beginning the loan process, prospective borrowers should obtain copies of their credit reports

and review them for accuracy. Errors in credit reports may take considerable time to resolve. Web sites for the credit reporting agencies are a good resource for consumer information on credit problems.

### Research Is Critical

Armed with this very basic information, I encourage all aid administrators who encounter students and families needing private loans to research programs further. Learning more about credit, typical graduate career paths, and introductory finance concepts are good ways to understand these products from the lenders' perspective. Become familiar with the

provisions of the loan instruments you certify for families, and to the extent possible, keep up-to-date on changes in these programs or emerging programs that may benefit your students.

Understanding private loans will ensure your place as an education financing expert, earn the gratitude of your students and families, and help you to teach your students to be educated consumers. 

---

By Stephen Brown, director of financial aid for the Fordham University School of Law in New York. He may be reached at [sbrown@law.fordham.edu](mailto:sbrown@law.fordham.edu).

The author wishes to thank Pamela Nyiri, director of financial aid for Yale University School of Medicine, and Michael Goodman, director of financial aid for Tulane Health Science Center, for the use of their chart, "What to Ask When Evaluating Alternative Loan Programs." The chart was based in part on recommendations from their peers in the student aid community.