

Private Students Loans: Understanding the Risks

Imagine. You're frantically trying to register for classes before they fill up next semester, but you just found out you don't have enough money to pay for next year's college tuition! What are you going to do?

Then you remember that pesky pop-up ad with the animated dollar bill that appeared on your computer screen. The annoying animation advertised private student loans with generous borrowing limits.

With the cost of college expenses going up, the private student loan market has become a booming business – a 17 billion dollar business to be exact! The proportion of private loans, as opposed to the federal loans, has climbed from 4 percent to 20 percent of educational borrowing over the last 10 years!

As a result of this rapid growth, private lenders are bombarding students with flashy, attention-grabbing advertisements that promote “exceptional” offers. Maybe you've seen a few of these ads in your mailbox, or on your television, or on your computer? But are private loans right for you? Unlike federal student loans, private loans vary widely and come with additional risks.

* **The terms of a private loan are dependent on your credit history.**

If you have a low credit score or limited credit history, private lenders will likely charge you a higher interest rate and/or higher fees. If you have bad credit, private lenders might not lend to you at all. Before applying for a private loan, check your credit reports and make sure your credit history is accurate.

* **Private loans have higher interest rates.**

If you do qualify for a private loan, don't forget to pay close attention to the interest rate. Unlike federal student loans, private loans have variable (not fixed) interest rates, which means that your monthly payments will go up during an environment of increasing interest rates. Additionally, private loans have no limit to how high your interest rate can go. A recent study showed that the average annual percentage rate (APR) for private loans was 11.5 percent. But the study also showed that students were being charged as high as 19 percent. That's almost triple the interest rate on an unsubsidized Stafford Loan, which has an interest rate of 6.8 percent!

* **Fees are also generally higher for a private loan.**

Much like interest rates, there is no limit to the amount or type of fees a private lender can charge. The average origination fee for a private loan is 4.5 percent (a Stafford loan charges a 1 percent origination fee and a 1 percent default fee). But private lenders also reserve the right to charge other fees, such as late fees, deferment/forbearance fees, research fees, and loan verification fees. That's a lot of fees!



* **Private loans come with certain risks.**

Private loans can be particularly risky if you start having trouble repaying the loan. With federal loans, you are in default if you fail to make payments for nine months. But, there are no specific standards for private loans. In most cases, borrowers of private loans will have a short period to resolve their problems before going into default. But it's also possible for a private loan to go into default as soon as you miss one payment.

Private lenders are also not required to offer flexible repayment arrangements, deferment and forbearance options, or loan cancellations. In fact, many private lenders won't even cancel a loan in the event that the borrower becomes disabled or dies.

* **So, when should you consider a private loan?**

The answer is, only when it's your last option. There are plenty of other ways to pay for college that are less expensive and less risky. Talk with your financial aid advisor to determine if you are eligible for additional scholarships, grants, work-studies, or federal loans. And don't let flashy pop-up ads, late-night commercials, or bulk mail push you into a risky private loan that you don't even need.

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