COLUMBIA

COMPARING PRIVATE EDUCATIONAL LOAN PROGRAMS

Some international students will need to use "alternative" loan programs to finance their education, and some US citizens and permanent residents may choose to borrow these loans in lieu of Grad PLUS. Also, students who may need a bridge loan to cover expenses until their income start may also turn to these "residency/relocation" loans. When we say "alternative loans" we generally mean those that are privately insured (i.e. not authorized by Congress) and those where the borrower is responsible for interest which begins to accrue from the time the loan is disbursed. We hope this sheet will help you with some general guidelines for deciphering the terms and conditions of the various private loan programs.

What's the cheapest loan for me?

When trying to figure out how expensive a loan program is, there are three criteria to look at: (1) interest rates, (2) fees charged for guarantee/origination, and (3) frequency of interest capitalization.

How do I understand what these interest rates mean? (see last page for more detail)

Instead of a fixed interest rate that is easy to compare, such as 5% or 8%, private loan programs generally have interest rates that are variable (i.e. they change periodically). Most are based on either the "Prime Rate", LIBOR, or a "Treasury Bill" rate, such as the "91-day T-Bill", the "13-week T-Bill" or the "52-week T-Bill" rate. Usually, the interest rate on a private loan is based on one of these variable "index" rates plus a set percentage (or "points"), such as "Prime + 3.1 percent." Sometimes the points are referred to as your "margin". The margin will remain the same for the life of the loan. As all these indices fluctuate with the market, the interest rates on the loans go up or down. Usually, the interest rates on your loans are adjusted quarterly by the lender, although some may adjust more or less frequently. There also may be a different number of points added to the index rate when you are in school versus when you are in repayment.

I still don't understand which interest rate is better!

The current Prime, LIBOR, and T-Bill rates can be found in the Wall Street Journal and on www.bloomberg.com. However, the current interest rates on the loans can always be verified with the lender. What you have to decide for yourself is which rate will be comparatively cheaper in the long run. Historically, T-Bills and LIBOR have tended to be lower than Prime, but we don't have the answer on what will happen in the future - even an economist may not know for sure - so you will have to use your best judgment. Also, remember that any amounts added to or subtracted from the index used for each loan will make it comparatively cheaper or more expensive.

What kinds of fees are there, and when do I get charged for them?

Guarantee fees (also called insurance premiums) are the lender's insurance against your defaulting on the loan, and origination fees are charged for processing the loan. Fees that are charged up front usually come right out of your checks, so you will actually net **less** money than you applied for. Many lenders also add on an additional guarantee fee right at the time you go into repayment. So, when looking at how much a loan program charges in fees, make sure that you add up both the fees charged initially at disbursement, and any fees charged at the time you go into repayment, so that you know the total amount of fees you can be charged.

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What is capitalization? Does it matter?

Capitalization is important because it adds to the total cost of your loan. From the moment these loans are disbursed, interest begins to accrue on the "principal," or amount that you originally requested. Capitalization is when the interest that has accrued so far is added to the principal, and from that point on, you'll be charged interest on both the principal and the capitalized interest. Since you're paying interest on interest, capitalization can become very expensive, and the more times that a lender capitalizes the interest, the more that loan will cost you. Some lenders may capitalize as frequently as every quarter, some once a year, and some capitalize only once, at the time you enter repayment, so check to see how often the lender capitalizes interest. Of course, you will avoid capitalization and reduce the cost of your loan if you can prepay some or all of the interest before it's capitalized.

Should I consider getting a co-signer?

International students cannot apply for private loan programs without credit-worthy co-signers who are US citizens or permanent residents. Even for US citizens or permanent residents, some loan programs are only available to full-time students with credit-worthy co-signers, while other loan programs offer a choice, and charge less if you have a co-signer with a positive credit history. Securing a co-signer could give you more borrowing options or make your loan cheaper. However, there are drawbacks for co-signers, which they should carefully consider before agreeing to co-sign the loan. For instance, co-signers are responsible for the loan if you default. Also, the loan is reflected on their credit report, and it is counted towards their total indebtedness, which may be a consideration for co-signers who are trying to secure a mortgage or other loans for themselves. (Note: The terms co-signer, co-borrower, and co-maker are synonymous.)

Does having a co-signer help if my credit is bad?

Even if you have a co-signer, loan programs are still going to look at your own credit history when considering you for a loan. Even if your co-signer's credit is terrific, your own bad credit can still cause the loan to be denied. In such cases, you will need to have a credit-worthy individual take out a loan on your behalf and begin making interest payments on the loan immediately. If you are concerned about your credit, one quick way to find out if your credit is satisfactory is to call one of the lenders that offers a telephone application and pre-approval process, in which the credit check is completed first. If your credit history is okay, you should be approved. If you do not pass their credit check, you will be notified that your credit does not meet their criteria. If you are denied the loan, you are entitled to a free copy of your credit report so you can check on any problems and see if they can be corrected. You can also ask if you have a co-signer might they approve the loan.

Which loan program should I choose?

It is up to you to decide which private loan program(s), if any, you will use to finance your education, since you will be the one paying back the loans that you borrow. It is also your responsibility to know the terms and conditions of any loans you borrow. You have the best idea of your future plans and how your loans will fit into them. For example, factors such as whether or not you can prepay some or all of the interest prior to capitalization, as well as the length of time over which you repay the loan, will affect how expensive a loan will be for you. Co-signers are required for international students, but other students must decide whether or not having a co-signer is an option for them. On the other hand, if your credit history is not satisfactory, you may need to have someone take out the loan on your behalf and begin making payments immediately. Note also that some lenders may offer repayment incentives, such as discounts for on-time repayment or electronic payment.

Above all, borrow only what you need. Remember, if you live like a doctor while you're a student, you'll live like a student while you're a doctor!

Indices Used as the Basis for Variable Rate Educational Loans
(taken from *Forbes Magazine* and Wikipedia, July 2012)

What is LIBOR?

The **London Interbank Offered Rate** is the average interest rate estimated by leading banks in London that they would be charged if borrowing from other banks. It is usually abbreviated to **Libor** or **LIBOR**, or more officially to **BBA Libor** (for British Bankers' Association Libor) or the trademark **bbalibor**. It is the primary benchmark, along with the EURIBOR and TIBOR, for short term interest rates around the world.

LIBOR and its Brussels and Japanese equivalents (the European Interbank Offered Rate (EURIBOR) and the Tokyo Interbank Offered Rate (TIBOR), respectively) are set through a process whereby each day about 40 banks submit their interest rates at which they are willing to lend, to the respective trade organizations in their regions. Once the high and low bids are discarded, the rates of the two middle quartiles are arithmetically averaged. This process is repeated about 150 times to determine the final rates each day. Libor rates are calculated for ten different currencies and 15 borrowing periods ranging from overnight to one year and are published daily at 11:30 am (London time) by Thomson Reuters.

The interbank offered rates serve as a reference for the pricing of financial products worth $350 trillion that include floating rate mortgages, savings accounts, interest rate swaps, other OTC derivatives, student loans, corporate loans and credit cards.

What is Prime Rate?

Prime rate or **prime lending rate** is a term applied in many countries to a reference interest rate used by banks. The term originally indicated the rate of interest at which banks lent to favored customers, *i.e.*, those with high credibility, though this is no longer always the case. Some variable interest rates may be expressed as a percentage above or below prime rate.

The prime rate is used often as an index in calculating rate changes to adjustable rate mortgages (ARM) and other variable rate short term loans. It is used in the calculation of some private student loans. Many credit cards and home equity lines of credit with variable interest rates have their rate specified as the prime rate (index) plus a fixed value commonly called the spread or margin.

What are T-Bills?

A **United States Treasury security** is a government debt issued by the United States Department of the Treasury through the Bureau of the Public Debt. Treasury securities are the debt financing instruments of the United States federal government, and they are often referred to simply as **Treasuries**. There are four types of marketable treasury securities: Treasury bills, Treasury notes, Treasury bonds, and Treasury Inflation Protected Securities (TIPS).

Direct Unsubsidized and Direct GradPLUS Loans: Interest rates for variable-rate loans under this program are determined annually and are good for each July1 – June 30. They are based on the high yield of 10-year Treasury notes auctioned at the final auction held before June 1st of each year. It is rare today to have other private educational loans with variable rates using Treasuries as their interest rate base.

ALTERNATE LOAN WORKSHEET

Name of loan program ______________________

Date ______________________

Lender ______________________

Website ______________________

Phone ______________________

Fees ______________________

At Origination/Disbursement ______________________

At graduation ______________________

At repayment ______________________

Interest Rate ______________________

At Origination/Disbursement ______________________

At Graduation/Repayment ______________________

Are interest payments required before active repayment? ______________________

Credit Criteria - Score or Judgmental Criteria? ______________________

Co-signer option? Yes or No ______________________

If yes, any reduction in fees or interest rate? ______________________

Is there a co-signer release option? ______________________

Minimum Loan Amount/Maximum Loan Amount ______________________

Aggregate Debt Limit ______________________

Interest Capitalization Policy ______________________

1st time ______________________

Frequency thereafter ______________________

How is "at repayment" defined? ______________________

At graduation? ______________________

Following a grace period? ______________________

Following consecutive deferments? ______________________

How many years to repay, i.e. term? ______________________

Any grace period? ______________________

Any deferments? ______________________

Any forbearance options? ______________________

Apply by web? Yes or No ______________________

Apply by phone? Yes or No ______________________

Service during repayment ______________________

Website and phone numbers ______________________

Any repayment incentives? ______________________

Insurer/Guarantor ______________________

Website and phone numbers ______________________