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PRIVATE STUDENT LOANS: WHAT ARE THEY AND WHAT SHOULD YOU KNOW ABOUT THEM?

To answer, you'll want to take a step back and think carefully about your plan to pay for college. If money from your personal savings, financial aid, scholarships, and federal loans is not enough, you may want to consider a private student loan.

What are private student loans?

They are loans underwritten (offered) by banks and credit unions to help you pay for school, while federal loans are issued by the federal government. In both cases, you'll not only pay back the money you borrow, but also a certain amount of interest for the use of the money (just like with a home mortgage or car loan).

What do I need to know about private student loans?

- **They are credit-based.** That means the lender will review your creditworthiness – your ability and willingness to repay – before making the loan. Your interest rate is based on several factors, including how you've managed your credit (money you've borrowed and repaid) in the past, and what loan terms and options you choose. Private student loans typically have variable interest rates, with the interest rate pegged to an index, such as LIBOR or PRIME, plus a margin. The LIBOR index is the London Interbank Offered Rate and represents what it costs a lender to borrow money. The Prime Lending Rate is the interest rate lenders offer to their most creditworthy customers. A rate of LIBOR + 2.8% is roughly the same as PRIME + 0.0%. The spread between LIBOR and PRIME has been growing over time. So all else being equal, it is better to have an interest rate pegged to the LIBOR index, as such a rate will increase more slowly than a rate pegged to the PRIME index.

- **You can apply with a creditworthy cosigner**, such as a parent, relative, or close family friend with a good financial history, especially if you do not yet have a credit history. A cosigner might be someone who's invested in your education, wants to see you succeed and has the ability to repay if you do not. Applying with a cosigner may increase your chances of qualifying or getting a lower interest rate. It is better to apply for a private student loan with a cosigner even if you could qualify for the loan on your own. Just applying with a cosigner usually results in a slightly lower rate, as such loans are not as risky for the lender. Moreover, the interest rates and fees are usually based on the higher of the two credit scores. So if your cosigner has a much better credit score than you, it could result in a much lower interest rate.

- **Shop around.** Learning about the different loans available can help you find the one that best suits your individual needs. A good place to start is your school's financial aid office, which may have a "lender list" of providers they've worked with over the years.

- **Reading the disclosures** that are provided to you when you apply will help you understand the terms and conditions of the loan. These disclosures can help you compare different loans from different lenders when you're shopping around. Some lenders require the school you are attending to approve your loan amount to help you avoid borrowing more than you need.

- **Repayment options vary by lender**. By comparing what each lender has to offer in terms of repayment options, you can choose the loan that best fits your situation. Private student loans generally do not guarantee repayment entitlements that may be available on some federal loans. Still, most private student lenders work with you one-on-one if you are experiencing temporary financial difficulty.

In review:

Private student loans are something to consider if your personal savings, financial aid, scholarships and lower cost federal loans aren’t enough to pay for college.

These loans are offered by different types of lenders, so it’s smart to shop around and compare rates and features.

You should only use private student loans as supplemental funding after you have exhausted all other sources of financial aid.