

PRIVATE (OR ALTERNATIVE) STUDENT LOANS

Many public and private postsecondary schools offer their students alternatives to financing their education. One such alternative is called a private alternative student loan. There are many private financial lending institutions that offer private alternative student loans. It is important to note that since these are private loans, the terms and conditions may vary between financial institutions and from person to person.

EXPLORE ALL TYPES OF FEDERAL AND STATE FINANCIAL ASSISTANCE BEFORE COMMITTING TO A PRIVATE STUDENT LOAN. TYPICALLY, PRIVATE ALTERNATIVE STUDENT LOANS HAVE VERY DIFFERENT AND MORE RESTRICTIVE TERMS THAN FEDERAL STUDENT LOANS AND ARE MORE EXPENSIVE. YOU WILL WANT TO BE KNOWLEDGEABLE ABOUT THESE LOANS AND UNDERSTAND THE AVAILABLE ALTERNATIVES BEFORE YOU SIGN UP FOR A LOAN THAT WILL REQUIRE YEARS OF REPAYMENT.

NOTE

The information contained on this web site is meant only as a general overview of private alternative student loans. Questions regarding a specific private alternative student loan should be directed to the individual financial institution offering the loan.

Private Alternative Student Loan FAQs (Frequently Asked Questions)

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What are Private Alternative Student Loans?

What Private Alternative Student Loans ARE:

- Private Alternative Student Loans are [credit-based loans](#) offered *privately* by banks or lending companies with terms and conditions that vary from lender to lender.
- Private Alternative Student Loans are similar to loans you might receive when you purchase a vehicle or appliance.
- A Private Alternative Student Loan is a contractual agreement between a student and a lending company.

What Private Alternative Student Loans are NOT:

- Private Alternative Student Loans are NOT funded or [guaranteed](#) by the federal government.
 - NOTE: As of the end of 2004, Sallie Mae, also known as SLM Corporation, no longer has ties to the federal government.
- Private Alternative Student Loans are NOT to be confused with what is commonly referred to as [Federal Financial Aid](#) or [Title IV Funding](#).
- A Private Alternative Student Loan is usually NOT a contractual agreement between a student and the school.

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How do PRIVATE alternative student loans differ from FEDERAL student loans?

Guarantees and safeguards

- Title IV federal student loans do not carry the uncertainty and risk associated with private alternative loans because federal loans are guaranteed and carry certain student safeguards. Student safeguards might include provisions on how to [defer](#) or [discharge](#) your student loan should something happen to you or the school. The Title IV federal student loans are:
 - Perkins Loans
 - Stafford Loans (Direct and FFEL)
 - PLUS Loans
- Private lending companies are not required to offer uniform or specific interest rates on their student loans or to provide student safeguards, although a few do.
 - NOTE: Not all lending companies in Maryland are required to operate under Maryland law. Find out under which state's laws the lender operates since consumer credit protections vary from state-to-state.
- Some Title IV federal student loans, but not all, contain an interest subsidy that pays the interest on the loan while the student is enrolled at the school. With private alternative student loans, the borrower is always responsible for repaying *all* of the interest, including the interest that accrues while the student is attending school.

Basis of the loans

- Title IV federal student loans are based on [financial need](#). Private alternative student loans, like those for vehicles, are based on the applicant's (and, if applicable, the co-signer's) ability to repay the loan.
- The interest rate for private alternative student loans is usually based on the student or co-signer's [credit rating](#) and the amount of the loan. If the borrower's credit rating is poor or the loan amount is low, then the interest rate on the loan may be higher.

Loan benefits and options

- Options to postpone or lower payments on a private alternative student loan may be limited and subject to additional fees.
- Private alternative student loans usually cannot be [consolidated](#) with other loans such as Title IV federal student loans.
- Private alternative student loans have the potential to provide student borrowers with greater flexibility with regard to a wider range of loan [origination fees](#), [interest rates](#), and repayment terms and conditions. However, this does not mean that they are less expensive than federal student loans.
- Private alternative student loans usually have [fixed interest rates](#) for the life of the loan, whereas federal student loans have [variable interest rates](#) set each July for loans in repayment.
- Borrowers can obtain private alternative student loans throughout the year. Applying for and obtaining federal student loans is usually limited to a few times each semester.
- Most private lending companies do not require students to complete the Free Application for Federal Student Aid ([FAFSA](#)); however, there usually are credit checks.
- One of the most important differences between federal student loans and private alternative student loans is the level of [risk](#) involved. The level of risk to the lending company is primarily determined by the borrower's credit history.
- Aspects of federal student loans can be tax deductible; however, tax deduction benefits are generally not available on private alternative student loans. (Check with a tax expert.)

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What's the relationship between a school and a private lender?

- Some schools contract or “partner” with specific private lending companies. In doing so, that particular company increases its consumer visibility while having more direct access to students who may need financial assistance. In return, the school is able to provide students with a financing option, making the school more appealing.
- In most cases, students receive the private alternative loan application materials from the school and then return the completed paperwork to the school. The school then mails the paperwork to the private lending company.
- Many times, the partnership agreement between the school and the private lending company allows private lenders to send loan [disbursements](#) directly to the school. Maryland regulations contain specific [guidelines](#) concerning when private career schools may receive loan disbursements.
- ***NOTE: The loan agreement signed at the school is a binding contract between the private lender and the student borrower and might not involve direct school liability.¹ Therefore, the student borrower is usually held responsible for repaying the private alternative loan even if the student withdraws, is terminated, or if the school closes.²***

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¹ FTC “Holder In Due Course” rule requires all contracts to state that the holder of the finance contract is subject to all claims and defenses which the buyer has against the seller.

² Maryland has a consumer protection law concerning a resident’s right to discontinue paying for certain loans that were obtained for services or materials not rendered. Seek private legal guidance if you are interested in the protection details.

Who can apply for a private alternative student loan?

- Since private alternative student loans are based on the applicant's (and, if required, the co-signer's) ability to repay the loan, most all U-S citizens and permanent residents are eligible to apply for private alternative student loans in order to attend schools within the USA.
- Always remember, though, that because a credit check is required (and most oftentimes for a co-signer, too), not everyone who applies for a private alternative student loan may be approved to receive one.

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How much can a student borrow under a private alternative student loan?

- Since private alternative student loans are based on the applicant's (and, if required, the co-signer's) ability to repay the loan, the amount any one student can borrow under a private student loan may vary according to each student's individual financial circumstance (which may include the student and co-signer's credit rating and history).
- The amount any one student can borrow under a private alternative student loan also varies between private lending companies.
- Besides each individual's financial circumstance, there are additional variables that may influence the amount a student may borrow under a private alternative student loan.
 - The overall cost of attendance. This may include, but is not limited to, expenditures such as tuition, books, fees, room, board, and transportation. Private alternative student loans are not usually granted in excess of a student's overall cost of attendance.
 - Other financing options that the student has obtained. These other funding sources might include scholarships, family or personal savings or financial resources, home equity loans, credit cards, etc.
 - Loan limitations imposed by the specific lender. Private lenders are free to set individual limitations on their private alternative student loans. Such limitations may include minimum or maximum loan amounts, or specific limitations unique to each school with whom they partner.
- Typically, private alternative student loans are not granted in excess of a student's overall cost of attendance.

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What is the interest rate for private alternative student loans?

- Historically, interest rates have varied from 6.5% to 18.5%, although they may certainly be less or greater than these percentages.
- Since private enterprise institutions fund private alternative student loans, they may establish interest rates as they choose. BUT, in a free enterprise environment, private lending companies are competing with each other for students, so it may be in their best interest to keep interest rates competitive.
- The bottom line is that interest rates differ from lender to lender, from student to student, and as the economy fluctuates, so it is in the student's best interest to shop around, if possible.
- When reviewing a private alternative student loan application, the lender usually will first analyze a student or co-signor's credit rating and loan amount. The lender then sets the loan's interest rate accordingly.
- Many times, a higher interest rate is set for borrowers whose credit rating is poor (which makes them a higher risk for the lender).
- Higher interest rates are generally assessed for borrowers who have smaller loan amounts.
- Note that some private lending companies include in their contracts a clause stating that a higher interest rate will be charged if loan payments are being deferred or are missed.

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What does a private alternative student loan cost?

To find the total cost of a loan, add together:

- all fees charged by the lending institution
- all interest accumulation, and
- the original loan amount.

Fees

Fees are the lender's cost for processing, issuing and maintaining the loan that are passed on to the borrower.

Origination fees

- Generally, origination fees range from 5% to 10% of the original loan amount, paid up-front.
- That means that a 7.5% origination fee for a \$10,000 private alternative student loan would amount to \$750 as an up-front cost.

Service fees

- These are charges for processing additional paperwork, usually due to changes in the loan for items like a deferment, forbearance or early repayment.
- Such fees are either set fees or a percentage of the loan amount.

Interest

Interest is the percentage amount that the private lender is charging a borrower for the loan. It is a percentage of the outstanding (remaining) loan balance.

The table below shows the total amounts, including interest, that are actually paid for a \$10,000 loan that takes 10 or 20 years to repay at various interest rates.

What Loan Interest Costs <i>(Based on a \$10,000 loan)</i>	Original Loan Amount	Origination Fee (7.5%)	Total Interest Paid If Paid Off In 10 Years	<u>TOTAL</u> Paid If Paid off In 10 Years	Total Interest Paid If Paid Off In 20 Years	<u>TOTAL</u> Paid If Paid off In 20 Years
8% annual interest rate	\$10,000	\$750	\$4,559.60	\$15,309.60	\$10,073.60	\$20,823.60
10% annual interest rate	\$10,000	\$750	\$5,858.00	\$16,608.00	\$13,160.00	\$23,910.00
12% annual interest rate	\$10,000	\$750	\$7,216.40	\$17,966.40	\$16,426.40	\$27,176.40
14% annual interest rate	\$10,000	\$750	\$8,632.40	\$19,382.40	\$19,844.00	\$30,594.00
16% annual interest rate	\$10,000	\$750	\$10,101.20	\$20,851.20	\$23,391.20	\$34,141.20
18% annual interest rate	\$10,000	\$750	\$11,622.80	\$22,372.80	\$27,039.20	\$37,789.20

The table below shows the private student loan outcomes for seven students who enrolled in and began attending the **same** program and class in February 2006. They all were processed within weeks of each other by the same lending institution.

<u>Student</u>	<u>Tuition</u>	<u>Interest Rate</u>	<u>No. Years</u>	<u>Finance Charge</u>	<u>Monthly Payment</u>	<u>Repayment Amount</u>
1	\$7,910	11.015%	3	\$183.20	\$398.84	\$ 9,695.75
2	\$7,910	15.676%	11	\$725.00	\$185.92	\$10,000.00
3	\$7,910	9.409%	6	\$183.20	\$178.62	\$10,833.01
4	\$7,910	9.937%	10	\$208.20	\$105.00	\$12,289.78
5	\$7,910	15.462%	13	\$578.70	\$139.27	\$20,152.04
6	\$7,910	19.142%	11	\$736.90	\$171.35	\$20,664.42
7	\$7,910	19.213%	11	\$761.90	\$171.86	\$20,726.74

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Things to consider when determining if a private alternative student loan is right for you

Understand what you sign

- Read and understand the contract agreement before you sign.
- The contract should clearly state the interest rate for which you will be contracting, the total amount that you are borrowing, the total amount that you will have paid once the loan is paid off, the number of years it will take to pay off the loan, and the monthly payment amount(s).
- If you do not clearly understand something, ask questions *before* you sign the contract agreement.

Disputes

- Understand how contract disputes over the private alternative student loan will be settled should any arise. This should be contained within the contract.
- Some institutions require [civil court hearings](#) while others require [binding arbitration](#).

Default

- Understand what will happen should you fail to make the contracted payments ([default](#)) on the private alternative student loan.
- The following may occur:
 - harm to your credit rating
 - harm to your co-signer's credit rating
 - harm to your ability to obtain future credit (for vehicles, appliances, other student loans, homes, etc.)
 - harm to your co-signer's ability to obtain future credit
 - you may get sued for the entire amount of the loan, immediately payable
 - you may become ineligible for deferments or [forbearances](#) on this private student loan
 - you may be held liable for the costs associated with collecting your loan, including court costs and attorney fees
 - you may have a payment lien placed on your home

Choices (if applicable)

If you have the opportunity to choose between private lending companies, take into consideration:

- interest rate options
- repayment options
- consumer credit protections outlined in the contract
- the lender's business reputation
- the lender's service reputation
- the lender's ability to provide the tools *you* need to understand and manage your loan account

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Where can I obtain more information on private alternative student loans?

- There are many sources of information regarding private alternative student loans, many of which are published or posted by private lending companies.
- An Internet search of “private alternative student loans” nets over 40,000 entries.
- Contact your bank or credit union and request information on whether they offer private alternative student loans.
- State and federal organizations may also provide information regarding private alternative student loans.
 - The Maryland Higher Education Commission compiles this web page and publishes a simple brochure that can be requested or downloaded from this web site. [[Private \(or Alternative\) Student Loans](#) brochure.]
 - Every year the US Department of Education publishes **The Student Guide: Financial Aid** which can be ordered or downloaded from the Internet. It contains information on federal student aid as well as sources of nonfederal aid.
 - http://studentaid.ed.gov/students/publications/student_guide/index.html)
 - The Federal Trade Commission (FTC) publishes brochures on vocational education that contain information on private student loans. These brochures can be ordered or downloaded from the Internet.
 - <http://www.ftc.gov/bcp/menu-jobs.htm>
 - <http://www.ftc.gov/bcp/conline/pubs/services/votech.htm>
 - Loan [amortization](#) tables are available by purchasing computer software or using simple and free calculations on the Internet.

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amortization

Repayment of the loan in a series of installments or transfers; the allotment of the total loan by prorating its cost over a period of years.

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binding arbitration

The final judgment, made by an independent third party (not the court system), to settle a dispute between two other parties and may be either voluntary or compulsory.

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civil court hearings

Process by which civil disagreements are decided by a state judge or jury.

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consolidate

To combine separate loans or debts requiring individual payments into one individual loan or debt payment.

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credit-based loans

Loans where the approval, amount, terms and conditions of the loan are determined by an applicant's credit rating and credit history. Typically, the worse an applicant's credit history, the higher the interest rate on the loan.

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credit rating

An estimate of the amount of credit that can be extended to a person without undue risk. It is an evaluation of an individual's ability to repay the loan or the likelihood of not repaying the loan.

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default

Failure to pay money when it is due.

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defer (deferment)

To postpone or delay payments. A deferment is the legal approval to do so.

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disbursements

The act of paying out money.

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discharge

To relieve or release a borrower from repaying a portion or the entire loan.

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FAFSA

Free Application for Federal Student Aid. This is a form required by the government for application to any federal education aid program. The FAFSA is used to determine the expected family contribution based on family financial information (financial need).

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Federal Financial Aid

Financial assistance given by the federal government to help pay for education. It is important to note that not all schools qualify to participate in federal financial aid programs.

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financial need

Financial need is defined as the difference between the cost of attending a school and the amount the family is expected to contribute based on income and assets.

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fixed interest rates

An interest rate that is determined in the contract and will extend for the life of the loan.

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forbearance

A forbearance is an agreed-upon temporary suspension of or reduction in loan repayments. Ultimately, it generally does not change the total amount owed.

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guaranteed

The federal financial aid guarantee means that all students who are enrolled at least half time at participating schools, and who are eligible to receive a loan as determined by their FAFSA, will be approved for a federal student loan. In other words, students' credit histories do not affect their ability to obtain federal loans. Because the federal guaranteed loan program is subsidized by the government, the interest rate on federal student loans is regulated and traditionally is more favorable to student borrowers than private loans.

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guidelines

The Code of Maryland Regulations (COMAR) specifies how private lending companies must disburse student loans to private career schools. This information can be found in COMAR, Title 13B, Subtitle 01, Chapter 01, Section 13D (13B.01.01.13D).

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interest rate

An interest *rate* is a percentage of the loan that is charged for its use and is in addition to the principal of the loan.

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origination fees

A fee, often a percentage of the total principal of a loan, charged by a lender to a borrower on initiation of the loan.

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risk

Simply put, risk is the lending company's assessment of whether the borrower will or will not repay the loan.

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Title IV Funding

This term refers to the section of the federal law under which federal financial aid is defined.

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variable interest rates

An interest rate that may increase or decrease over the life of the loan depending upon multiple factors. These factors may include the strength of the economy as well as the borrower's repayment performance. [\(Return to text\)](#)