All about Alternative Loans

Alternative loans, also called private loans, are offered by lending institutions as an additional source of funds for higher education. These loans are not part of the federal government loan programs and may be more expensive for the borrower than federal loans. Alternative loans are good options after other financial aid sources have been exhausted.

Need an alternative loan? Financial aid staff at your school has likely done the research to compile a list of preferred lenders that offer you the best loan terms and customer service. This lender list may be available online or in the financial aid office. Carefully choose the lender that best meets your needs. Remember: borrow only what you need!

What do I look for in choosing an Alternative Loan?

To determine the best loan for your needs, consider *all* of these factors in your evaluation.

Annual Percentage Rate (APR)

The APR is the annual cost of your loan, including interest, fees and charges. The APR will differ depending on the terms and the amount of your loan. Make sure you use like loan amounts when you compare APRs so you receive a true comparison. If the rate is variable, the APR will change frequently during the life of the loan. The APR should not be the sole determining factor used in your loan choice. Carefully consider all of the loan terms when you borrow an alternative loan.

Pre-approval and Approval

The borrower's and cosigner's credit scores are part of the information used by lenders to approve an alternative loan. A pre-approval can let you know if you qualify usually before completing the application. Lenders may offer loan pre-approval or an instant credit decision over the Internet or telephone for timely loan processing.

Cosigner Requirement

Are you required or is it optional to provide a creditworthy cosigner? Some lenders offer better loan terms when you do. A cosigner is responsible for the loan if the borrower fails to repay it.

Loan Fees

You may be charged a fee to borrow alternative loan funds. Ask how much the fee is and when it is applied. If the fee is charged at the time of disbursement it may be deducted from the loan amount you receive. Plus, you will be charged interest on the fee while you are in school. Look for lenders that apply the fee at the start of repayment or offer a lower fee based on your credit or if you provide a creditworthy cosigner. A loan with zero fees can be offset by the lender charging a higher interest rate.

Interest Rate

Interest rates are calculated using a base rate of either the U.S. Treasury Bill (T-Bill), the London Interbank Offer Rate (LIBOR) or Prime. These rates fluctuate based on economic factors. Can you receive a lower interest rate by adding a creditworthy cosigner? Is the interest rate tiered or on a sliding scale based on the borrower's credit?

Example of Tiered Interest Rates	
Excellent Credit	Prime + 0%
Average Credit	Prime + 3%
Poor Credit	Prime + 6%

Ask your lender how to qualify for the lowest rate and for the percentage of borrowers who actually get this rate. Often only 5-10% of the borrowers have excellent credit to qualify for the lowest interest rate.

Loan Limits

Lenders set the annual minimum and maximum loan amounts you can borrow. Often the maximum is the cost of attendance minus the other sources of financial aid you are receiving. Check that the aggregate limits are high enough to complete your academic program. Try to anticipate how much you will need so that you can borrow from the same lender each year.

Interest Capitalization

Do you have the option to pay or not to pay the interest while you are in school? You can save money if you opt to make interest payments while in school. Any unpaid interest may be capitalized (added to your principal balance). Ask when the interest is capitalized. If the interest is capitalized annually, the loan will cost you more than if the interest is capitalized once at repayment.

Repayment

Repayment can begin immediately or be postponed until after you graduate or leave school. If you are required to make payments while in school but you cannot afford to do so, you will need to find a loan that does not require immediate repayment. Consider a lender that offers different repayment plans to help you budget and forbearance to temporarily postpone payments.

Repayment Period

Determine how long you have to repay the loan. It is a great idea to calculate your monthly payment before you borrow. Is there a penalty for pre-payment? By increasing the amount you pay, you will save money over the life of the loan.

Repayment Incentives

Your lender may reward you with a lower interest rate when you make a specified number of consecutive monthly payments on time or when you sign up for automatic payments. Can you lose the incentive? Offering repayment incentives does not mean that the loan has the most competitive terms. The lender may choose not to offer incentives because the cost of the loan is already reduced with a lower interest rate or fee.

Servicer

Who will be servicing your loan and how reputable is their customer service? Does your lender sell their loans to a secondary market or utilize a third party servicer? If you have a lender that services its own loans, you will continue to work with the same lender until the loan is paid in full. However, should your loan be sold, you will be notified in writing and provided with contact information of the new owner for your loan.

Paul must borrow $15,000 to complete his college education. Which of the following would NOT be likely to reduce the finance charges?

a. if the loan was insured by the federal government
b. if his parents cosigned the loan
c. if he went to a state college rather than a private college
d. if he made loan payments early

Answer: c

Are you spender or saver?