

Guide to Private Loans

Private Loans

Private loans are postsecondary education loans offered by private lenders to students and parents. Banks, credit unions and other financial organizations are private education lenders. Generally families use private loans to bridge the gap between the actual price of education and other sources of financial aid.

Because private loans are usually more expensive than federal loans, families should only consider obtaining a private student or parent loan after exhausting their federal loan eligibility, including Federal Stafford Loans (subsidized and unsubsidized) and Federal PLUS loans. Families should start by filing the Free Application for Federal Student Aid (FAFSA), which may qualify them for federal grants and work-study in addition to federal loans.

To assist students and parents interested in private loans we provide some tips on how to research private loans and some factors to consider when comparing private education loans.

Locating a private lender

There are many resources available online that you can utilize in your search for a private lender. You can research private education loans over the Internet, by using any search engine and entering "private education loans". However, you will easily locate general consumer information concerning private loans as well as specific information from major lenders who are still providing private loans.

Considerations for international students

If you are not a U.S. citizen or permanent resident you may not have as many private loan options as your U.S. counterparts unless you locate a cosigner who is a U.S. citizen or permanent resident and has a good credit history. Some private lenders will make loans to international students without a cosigner.

No MIT preferred lender list

MIT does not maintain a preferred lender list, as we believe it is inappropriate for us to endorse or recommend one private loan product over another as families have different needs and priorities.

How to choose among private lenders

There are a number of factors to consider when choosing a private lender, including but not limited to: eligibility, loan limits, interest rate, fees, repayment and customer service.

But your first step is to decide who will borrow. Student? Parent? Both? Some loans are only offered to students, some only to parents. Who should the responsible party be? Who is in the best position to assume debt? Who can obtain better credit terms?

Eligibility

What are the eligibility criteria? Does the loan require a cosigner? If the loan does not require a cosigner, are there any benefits to having one?

Most lenders rely on the borrower's credit score to determine eligibility for private loans. The most popular credit score is the FICO score. Other criteria may include the borrower's debt-to-income ratio and recent bankruptcies.

Even though a co-borrower, or co-signer, may not be required you may want to consider one with a strong credit history as this will make a difference in the pricing of your loan, as loans with co-signers are less risky for the lender.

Remember that federal loans do not depend on a credit score. The Federal PLUS loan does require that the borrower not have an adverse credit history. Undergraduate borrowers whose parents are denied a PLUS loan are eligible for increased Federal Stafford unsubsidized loans.

Loan limits

What are the minimum and maximum loan limits, including annual and aggregate limits?

Most private lenders require school certification, or approval, which caps the annual loan amount to the price of education (or your student expense budget) less other sources of financial aid, such as scholarships, grants, teaching assistantships, research assistantships, fellowships, other student loans and Federal Work-Study. Some loan programs have minimum annual loan amounts in addition to maximums.

Borrow only what you need even if you qualify for more. Never overextend yourself. For students a general rule of thumb is to keep your monthly student loan repayment to 10-11% of your gross monthly income, but this can vary based on other debt, especially credit card debt.

For student enrolling in non-degree programs, loans will be certified for tuition, fees and books only. MIT does not include living expenses when certifying private loans for non-degree programs.

Interest rate

Is the interest rate fixed or variable? If variable, what is the basis upon which it will vary? Does the rate change every quarter or every month or according to some other time period? When does the interest begin accruing? Do you need to pay the interest as it accrues or can it be deferred or capitalized? If capitalized, how often is it capitalized? Is the interest rate the same for the in school and grace period as it is when the loan enters repayment?

Private loans typically have variable interest rates, with the rate pegged to an index such as LIBOR or PRIME. Historically the PRIME rate has been more volatile than the LIBOR rate. The spread between PRIME and LIBOR has been increasing, meaning that over the long term a loan with interest rates based on LIBOR will be less expensive. LIBOR tends to be 2.5 to 3.5% lower than PRIME. But remember that historical data is not necessarily predictive of future movement in interest rates.

One method of securing a better interest rate is to agree to make loan payments while you are in school. You may begin repayment immediately or make interest-only payments during the in-school period.

Current LIBOR and Prime Lending Rates can be found in the Federal Reserve's Statistical Release. The LIBOR rate appears in the London Eurodollar Deposits lines (1,3 and 6 month figures) and the Prime Lending Rate appears in the Bank Prime Loan line.

While private lenders might advertise a low interest rate, these rates may only be available to the best credit customers. The actual interest rates and fees you pay on a private education loan are based on your credit score, and the credit score of your cosigner, if any. It is better to apply for a private student loan with a cosigner even if you qualify for the loan on your own as applying with a cosigner usually results in a slightly lower rate.

Interest ordinarily accrues from the date of the first disbursement and can be paid while enrolled or deferred and capitalized at the time of repayment.

Be aware of teaser interest rates that disappear when the variable rate indexes start increasing. Be concerned about how the rates might change over the life of the loan unless you are intending to repay the loan in full only a few years after disbursement.

Fees

Are there any loan fees? What is the impact of any loan fees on the overall cost of the loan?

The fees charged by some lenders can significantly increase the cost of the loan. A loan with relatively low interest rate but high fees could cost more than a loan with a somewhat higher interest rate and no fees. Some lenders do not charge fees but adjust the interest rate upwards to compensate. A good rule of thumb is that an extra 1% in the interest rate costs more than a 1 point increase in fees: in fact a 1% higher interest rate may be the same as 3 to 4% in fees.

Repayment

What are the repayment options? How long is the loan term? Are there any consolidation options? Are there any borrower benefits?

Repayment options vary across lenders and may include options for standard, extended and graduated repayment. Find out if there is an optional in-school deferment of principal. Keep in mind that interest will continue to accrue, increasing the amount owed.

Some lenders offer financial incentives, or borrower benefits, to reduce the price of your loans. For example, there may be principal balance or interest rate reductions tied to repayment performance. Some repayment benefit plans are simple and others are complex. Make sure you understand the terms you must meet and the likelihood of receiving the benefit before choosing a private loan on that basis alone.

Loans with different repayment terms are challenging to compare. Keep in mind that the annual percentage rate, or APR, may not be a good tool for comparing loans. For example, a loan with a longer repayment term will have a lower APR even though the borrower will pay more interest over the life of the loan.

Customer service

Is the application process simple and straightforward? Is it possible to reach a knowledgeable representative to check your loan status? Is customer service available 24 by 7 or at minimum during hours convenient for you? Will the lender handle the origination of the loan as well as the repayment? If not, what organization(s) will?

Some lenders only handle the up-front administration of the loan including the origination and disbursement. It is common for large lenders to have online application and signature processes, including the use of Master Promissory Notes.

If the lender will not service the loan during the in-school or repayment periods make sure you know which organization will, their customer service hours, and how to contact them especially if you want to speak to a representative in person.

Since you are about to enter into what may be a long-term relationship, it is important that you do your research and select a loan program with a demonstrated record of excellent customer service.

How to apply

After you have selected a lender, you will submit a loan application. Ensure you understand the lender's application process, also known as origination, as well as the process by which you receive the funds, known as disbursement. Apply for the full amount needed for the entire academic year. MIT will disburse the loan in two equal payments -- once in September for the fall semester and once in February for the spring semester.

Most lenders have on-line application processes, often with a master promissory note. Ordinarily your school will need to certify your eligibility for the loan. Student Financial Services (SFS), specifically the Financial Aid Office within SFS, performs the certification. In addition to school certification, you will be required to complete and sign a Private Education Loan Applicant Self-Certification and submit it to your lender before your loan can be disbursed. Completion of this form is a federal requirement for U.S. citizens as well as international students. The form may be provided by your lender or is available from the SFS web site. If you need assistance with completing Section 2 of the form, which asks for the cost of attendance and estimated financial assistance, please reference your financial aid award letter. If you have further questions, call the Financial Aid office directly at 617-253-4971, Monday, Tuesday, Thursday and Friday from 9:00am - 5:00pm and on Wednesday from 10:00am - 5:00pm. Your lender will advise you of any additional application requirements, such as loan entrance counseling.