

## Private loans or federal loans? Weighing Out the Benefits

By Brooke Heath

Trying to figure out how to pay for school is an overwhelming task, especially when the cost of tuition is ever increasing. For many students, taking out student loans is the only way to finance a higher education, but with the various loan options out there, which type of loan do you choose? private loans, federal loans, or both? Do you currently know enough information about either one of these loans to make an educated decision? Read on to gain information that will help you weigh out the benefits of private loans and federal loans and see which one will tip the scales in your favor.

### Private loans

Private loans, or alternative loans, are funded by private financial institutions such as banks, schools, etc. Many institutions refer to the loans as alternative loans because they promote the loans as an alternative to federal loans as a source of educational funding. Some borrowers use private loans only to fill in the gaps that cannot be covered by financial aid. However, others feel that the benefits of private loans far out weigh the benefits of federal loans, and choose to exclusively borrow from private lenders. Keep in mind the following when considering whether or not to take out private loans.

### Advantages of Private Loans

Many students face the dilemma of having their parents make too much to qualify for federal financial aid, but do not have enough money to pay for schooling on their own. Borrowers should not resort to paying with a credit card or other means in this case, because private loans are a great option for situations like these. This is because private loans are not based on need, so regardless of your income or lack thereof, you can qualify. Also, while federal loans have deadlines that you need to meet in order to be eligible, you can apply for a private loan whenever the need arises.

Private loans do not require lengthy paperwork or long applications like the FAFSA, and some lenders can tell you over the phone, within minutes, whether or not you qualify and what your interest rates will be.

In most cases, private loans are disbursed a lot sooner than federal loans and some private lenders even send the funds right to your home for easier access. The amount that you can borrow with private loans usually exceeds that of federal loans. Some private lenders offer more than \$40,000 each year. In addition to the higher loan limits, some lenders also offer borrower benefits, such as interest rate reductions or rebates.

You may use the money you borrow from private loans to cover the cost of tuition, as well as a wide range of education-related expenses including computer purchases, costs involved with study abroad, and even previous school purchases. Some types of private loans do not require school certificates through Title IV of the Higher Education Act, which allows borrowers to have more freedom in choosing which school to attend.

Finally, private loans may assist international students with paying for school, as some private lenders allow for international students to apply for private loans with an eligible U.S. cosigner.

### **Private Loan Disadvantages**

Unfortunately, private loans are credit-based and a credit check is required. Your credit rating determines your eligibility as well as your interest rates, loan limits and origination fees. To qualify for a private loan if you have poor credit, or if you have not yet established credit, you may need a cosigner.

Private loans also have much higher interest rates that can change as often as each quarter. Therefore, they tend to cost more than federal loans. Also, they may not offer deferment or forbearance options, so it is possible that you could be faced with having to make payments on the loans right away.

### **Federal Loans**

Regulated by the government, federal loans are intended to help students pay for their education.

### **Advantages of Federal Loans**

Federal loans are the largest source of educational loans around and are usually the first choice for borrowers. This is due to the fact that they have very low interest rates, and longer repayment terms. This generally makes federal loans far less expensive than private loans.

Federal loans also offer forbearance and deferment options. This allows time for students to get on their feet after graduation without having to worry about making immediate monthly payments on their loans.

Unlike private loans, with federal loans, there is no need for a cosigner, and there are no credit checks, no origination fees and no prepayment penalties.

Also, a portion of federal loans can be subsidized, which means that the government pays the interest while the borrower is in school or the loans are in deferment.

In the unfortunate event that the borrower dies, all of the borrower's federal loans will be forgiven, although this is not usually the case with private loans.

Finally, with federal loans, the borrower has the option to lock in interest rates by consolidating the loans. This allows for an even larger savings. Consolidation is available on private loans, but the interest rate is variable, not fixed.

### **Disadvantages of Federal Loans**

There are some disadvantages to federal loans. First, federal loans are available on a first come, first served basis. If a borrower fails to meet the deadlines involved, they may not be able to receive federal loans. The amount that borrowers can receive is also limited, as the government sets caps on federal loans. Also, the majority of federal loans are need-based, so if you can not prove that you have a financial need, you might not qualify.

Finally, unlike some private loans, because federal loans are regulated by the government, they will not provide funding for students who want to attend schools that are not certified under Title IV of the Higher Education Act.

### **Types of Federal Loans**

The types of federal loans that are available include:

- Stafford loans
  - Subsidized
  - Unsubsidized
- Perkins
- Federal Parent Loan for Undergraduate Students PLUS
- Graduate PLUS
- Federal consolidation loans

### **Borrow Wisely!**

Regardless of which way the scales tip for you—federal loans or private loans or both—remember to only borrow as much as is absolutely necessary. While it may seem like a long time into the future, you will eventually have to pay all of the loans back (plus interest!), so borrow wisely!