Money and You: Where to find the fairest prices for student loans

by Lynn_O'Shaughnessy

Can you imagine someone ripping you off for a Payday candy bar? Something close to that apparently has been happening at the University of Texas, where the financial aid office maintained a list of the freebies showered on the staff by student loan companies. Payday candy bars caught my eye; however, there were other goodies, including barbecue lunches, lasagna, cakes, popcorn and ice cream.

Why would student loan companies want to give these folks sugar highs? Think about it for a second. Student loans are an $85 billion a year business and companies want to get their names on college and university preferred-lender lists.

Many colleges hand these lists to parents who need to borrow money and wonder where to turn. Families aren't obligated to obtain loans from these anointed firms, but the overwhelming majority does. After all, why wouldn't you trust a college to direct you to the best loans?

Maybe the better question, in light of the unfolding student loan scandal is this: Why should you trust your son or daughter's school?

The University of Texas student newspaper uncovered the candy bar shenanigans in May. The lenders on the university's list knew how to pamper college staffers, but some of their loans should never have been recommended to students. The resulting fallout led to the resignation of the university's director of financial aid after it was discovered that he owned stock in the parent company of a student lender he was recommending to students.

Unfortunately, this is not an isolated case. The scandal came to light this year when New York Attorney General Andrew Cuomo started examining the relationships between schools and lenders. While the investigation isn't complete, it's clear that many schools have put financial institutions on their preferred-lending lists in exchange for perks and financial kickbacks. Students be damned.

Obviously, this behavior is despicable. And if the people responsible aren't fired, they should at least be required to share face time with the professors who teach ethics on their campuses.

While it's discouraging to discover that financial aid offices are sometimes more interested in aiding themselves, there are steps that parents and students can take to find the lowest-priced loans:

- Let students borrow first.

You are going to find the best interest rates on student loans backed by the federal government. These are called Stafford loans, which require students to act as the borrowers. The other federally backed option is the PLUS loan, which is used exclusively by parents.

Even if the parents help, it's better for students to take out a Stafford loan first because it carries a lower interest rate. The maximum interest rate now for a Stafford loan is 6.8 percent versus 8.5 percent for the PLUS loans. These rates are just ceilings, so you'll want to borrow from lenders with much lower rates. If a family needs more money after a Stafford is maxed out, parents are going to have to decide whether to use a PLUS loan or perhaps dip into a home-equity line.

- Be careful where you borrow.

Obviously you don't want to limit yourself to the preferred list provided by your child's school. Maybe the lenders who wormed their way onto the list do offer the best deals, but you won't know for sure until you do your homework.

Unfortunately, most lenders have made it difficult to compare their loans. To confuse you, loan companies offer all sorts of hocus-pocus discounts that look impressive but often aren't. Here's one of the most common: Students are promised a 2 percent interest rate drop on their Stafford loans if they make timely payments for 48 months.

Sounds great, but hardly anybody qualifies for this. Four years provides plenty of time for kids to mess up. In fact, only 3 percent of students snag this discount, says Mark Kantrowitz, the founder of FinAid, a financial aid Web site. And because a student has to wait four years into the loan to earn the discount, its actual value will drop to 0.63 percent.

To decipher what these discounts really mean, head to FinAid (www.finaid.org/calculators) and use its loan-discount calculator.

The superior loans provide significant interest rate discounts that you can immediately earn once you begin making payments. Where can you find these loans? You should check out governmental, quasi-governmental and nonprofit lenders, such as ALL Student Loan in California, www.allstudentloan.org, 877-255-0006.

This nonprofit lender, based in Los Angeles, offers a 2.25 percent up front rate reduction on Stafford and PLUS loans for any student attending school in California. The rate discounts from ALL Student Loan are nearly as good for borrowers outside California.

Another resource is the Missouri Higher Education Loan Authority, www.mohela.com, 888-866-4352.

A private lender worth checking out is MyRichUncle, www.myrichuncle.com, 888-697-4248.

By the way, not all students will need to shop for federally backed loans. A minority of schools, including most of the University of California campuses, offer loans direct from the federal government, so there will be no preferred-lender list. The direct-loan approach is vastly cheaper for taxpayers - since it cuts out private lenders as intermediaries - and it can often be a better deal for students.

Only the direct-loan program, for instance, provides a financial safety valve that allows borrowers who choose lower-paying careers to make monthly payments based on their income, says Barmak Nassirian, associate executive director of the American Association of Collegiate Registrars and Admissions Officers.

The so-called income-contingent repayment provision, he says, "is worth its weight in gold."

Avoid private loans. Unless you've maxed out the Stafford and PLUS, stay away from private loans. If you're a graduate student, there is no reason to obtain a private loan because Grad PLUS loans impose no lending limit. Unlike federally backed loans, private loans have no caps and the interest rates are variable. Some of these variable rates can be as bad as the subprime loans that have been burning homeowners.

What's more, private-loan lenders don't treat all borrowers equally, as the federally backed program does. Families with better credit ratings will receive better deals. Beware of private loans masquerading as school loans; they are nothing more than "marketing ploys," advises Robert Shireman, the executive director of the nonprofit Project on Student Debt, which promotes student loan reform.

Students will assume that school-branded loans are more favorable, but, Shireman warns, "most of these loans are just like any other private loans and in some cases they could be worse."

Because this is the third column in a row on college, I promise to move on to other subjects next week. But for those who can't get enough of this subject, I'm working on a book about college strategies.

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