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Business

Talking Money: Private lenders to return to student-loan game

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July 1 has always been a big day when it comes to federal student loans. Not only is it when interest rates on variable-rate loans readjust, but last year, it brought the introduction of the income-based repayment option that has been a boon to borrowers with outsized loans and undersized paychecks.

So it's no surprise that this year, another change is coming our way on the very same date: Under the Health Care and Education Reconciliation Act, federal student loans are no longer going to be offered by private lenders. Instead, all federal student loans will be issued by the Department of Education's Direct Loan program.

What that means for you is that we're likely going to see more private lenders come back into the private student loan game after stepping out over the last few years during the credit crisis.

Here's a guide to borrowing money for college:

Federal comes first. This is a hard and fast rule: Before you even think about taking out private loans, you need to max out your federal loan options. Sounds like a no-brainer, but it certainly isn't. Last year, the Project on Student Debt found that during the 2007-2008 school year, 64 percent of private loan borrowers could have borrowed more in federal Stafford loans. Federal Stafford loans carry lower interest rates -- 6.8 percent fixed if taken out after July 1, 2006, but capped at 8.25 percent if taken out before. They also have a wide range of repayment options. Private loans, on the other hand, tend to have higher variable interest rates based on your credit score, set repayment periods, and less flexibility overall.

Note: Once federal student loan options are maxed out, parents should consider a PLUS loan, says Kevin Walker, co-founder and CEO of SimpleTuition. These loans come with a fixed interest rate of 7.9 percent. If you can work out an agreement with your student so that he or she covers or at least contributes to the payments, it could save a lot in interest.

Start close to home. Deposit institutions are going to be the primary source of private loans, and your best bet is to start your search with the bank or credit union you already belong to. They may offer you a better rate. If that doesn't work, expand your search a bit. Sites like Walker's SimpleTuition.com will help you search a wide range of lenders, and the recently established StudentChoice.org focuses on credit unions. If you have a bad credit score or can't find a co-signer, a credit union may be your best bet, says Walker, as long as you're eligible to become a member.

Compare apples to apples. First of all, ignore advertised rates. Instead, look at the total cost of the loan, which combines the interest rate, fees and the length of the repayment period. All of these things add up to what comes out of your pocket.

Consider a co-signer. I'm against co-signing, in general, but when it comes to private student loans, there's really no way around it. The market may be loosening up, but credit standards are still as tight as ever, says Walker. "The thing that hasn't changed is that lenders are still conservative about the borrowers' profiles. They may have a private loan program this year when they didn't have one last year, but it's still something that is only available to students and co-signers with relatively strong credit."

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