College-bound? Private loans should be last resort

By Janet Lorin | BLOOMBERG NEWS  JUNE 06, 2012

JPMorgan Chase & Co. charges Mirella Tovar as much as 10.25 percent annual interest on her student loans — a rate as high as a credit card’s.

The 24-year-old is among millions of former students paying off high-interest loans to private lenders like JPMorgan, SLM, and Discover Financial Services. In a good month, Tovar earns $730 as a part-time hostess, and most of that goes toward her debt of $98,000.

Unlike the federal student loan program, which lets consumers borrow at fixed rates, loans from at least 30 banks and other private lenders feature mostly variable rates that can be more than twice what some people pay in the federal program. Regulators say teenage consumers often don’t understand the terms.

“It was like signing up for iTunes,” said Austin Bousley, 25, who applied on the Internet for a private loan from SLM, known as Sallie Mae, as a student at Suffolk University in Boston. Some of his loans carried rates as high as 9.25 percent. “I have a feeling I’ll be making payments forever,” he said.

Loans from private lenders make up about 15 percent of the $1 trillion in outstanding student debt, according to FinAid.org, a website about college grants and loans. And with college costs soaring, Discover and SLM are working to expand their student-loan businesses.

“Student lending is a good investment,” said Carlos Minetti, a Discover executive.
JPMorgan will stop offering student loans on July 1 except to bank customers. It cited a shrinking market and the government’s expansion into originating student loans.

“Like mortgages before the financial crisis, many borrowers took on private student-loan debt with terms and conditions they didn’t fully understand,” said Rohit Chopra, ombudsman at the Consumer Financial Protection Bureau.

Students typically rely on fixed-rate government-backed loans, with current interest rates for undergraduates ranging from 3.4 to 6.8 percent. These loans are capped at $31,000 for a dependent student’s undergraduate career. Parents can also take out federal loans at 7.9 percent up to the cost of attendance, less any financial aid. Private loans often bridge the gap between the cost of college and what a student can take in federal loans. Private loans don’t offer the same protections as federal loans, such as income-based repayment plans and deferment. Private loans aren’t guaranteed by the government and can carry higher rates.

More than two-thirds of borrowers with private loans in an online survey said they didn’t understand the main differences between private and government loans.

Tovar advises the college-bound to use private loans as a last resort. “I wish someone would have told me that,” she said.

*Janet Lorin writes for Bloomberg News.*