

Which is better: Federal PLUS/Graduate PLUS or Alternative Loan?

With interest rates on the Federal PLUS/Graduate PLUS being set at a high 8.5% with a 3% origination fee, some borrowers will be asking themselves if the Federal PLUS, locked in at an 8.5% interest rate will be better in the long run than an alternative loan with a variable interest rate.

Federal loans have the advantage of cancellation for death or disability of the borrower, which most alternative loans do not have. They may also be consolidated with other Federal loans to stretch out the length of the repayment period and lower monthly payments. Federal loans often have more deferment and forbearance options. Finally, for borrowers whose income is very low over a long period of time (25 years), loan forgiveness might be an option. While Federal Stafford loans have a moderate interest rate, Federal PLUS/Graduate PLUS loans are set at a rate that is currently similar to many alternative loans.

Most alternative loans are offered by commercial lenders, such as banks (Comerica, LaSalle, Citibank, Chase), savings and loan associations, credit unions, etc. Students attending UDM or other approved Michigan colleges may apply for a MI-Loan, which is the Michigan alternative loan—a loan not available to students attending college in any other state.

Because the MI-Loan is administered by the State of Michigan and funded by a state bond issue, interest rates are generally more competitive for the MI-Loan than other alternative loans.

There are two types of MI-Loans: Creditworthy and Credit Ready. Of the two, the Creditworthy loan has better terms.

The MI-Loan Creditworthy loan program allows borrowers to choose between a fixed and a variable interest rate. As of July 2006, the fixed rate was 5.95% and the variable rate was 6.18%. The variable rate changes annually based upon the 12-month LIBOR rates. The Creditworthy MI-Loan has an origination fee of 3.5%.

Currently, the Credit Ready MI-Loan has a flat interest rate of 8.5% with a 5% origination fee, and therefore is not as attractive a loan as the Creditworthy MI-Loan or some other alternative loans.

While Federal PLUS/Graduate PLUS and other alternative loans often have deferment or grace periods allowing students (although usually not parents) to begin their repayments after leaving school, the MI-Loan goes into repayment within 60 days of the last disbursement of each year's loan. However, MI-Loan borrowers may request a forbearance of principal or principal and interest payments for up to five years during the 25-year repayment period. These five years do not need to be taken consecutively. Students who wish to put their loans into forbearance while they are in school are reminded that the in-school years count toward the 5-year limit, and will reduce forbearance periods available after leaving school for times when the student may be unemployed, working part time, returning to school, or otherwise be unable to make payments. Unlike most alternative loans, the MI-Loan is cancelled in the case of death or permanent and total disability of the student.

Alternative loans through commercial lenders generally allow forbearances for periods of unemployment or return to school, and possibly for temporary disability. Each loan will have its deferment or forbearance conditions spelled out on the promissory note the borrower signs before the loan is disbursed. Most alternative loans have interest rates that vary quarterly, with no interest rate cap. Interest rates are generally indexed to either the Wall Street Journal Prime Rate or LIBOR (the London Interbank Offered Rate); for example, a loan may offer a rate of LIBOR + 3.6%, or Prime - 1/2%. As of the end of June 2006, Prime was approximately 8% and the 3-month LIBOR was approximately 5.4%. Please see the next pages for program comparisons.