washingtonpost.com The Washington Post

Credit Crisis May Make College Loans More Costly

Some Firms Stop Lending to Students

By David Cho and Maria Glod
Washington Post Staff Writers
Monday, March 3, 2008; Page A01

Many college students across the nation will begin to see higher costs for loans this spring, while others will be turned away by banks altogether as the credit crisis roiling the U.S. economy spreads into yet another sector, student lenders and Wall Street firms say.

Students seeking federally guaranteed loans, which are popular because they offer fixed, below-market rates, could be required to pay higher fees to borrow money, according to university finance directors and lenders.

An even greater burden may fall on those taking out private loans, which have become increasingly common as students look for new sources to finance the soaring costs of college. These loans often have variable rates, and they are projected to jump this year.

And at community and for-profit colleges, some students may be denied private loans entirely because the financial industry considers them riskier investments than their peers at other educational institutions.

"It's a little bit of a crunch. The money will be there; it's just going to be more expensive," said Yvonne Hubbard, director of student financial services at the University of Virginia. "The federally guaranteed loan program is always going to be available . . . but the good deals are harder to find. On the private side, loans are getting more and more expensive."

Many lenders are scaling back their activities because of turmoil in the credit markets, initially caused by the subprime-mortgage meltdown last year, and cuts in federal subsidies, firms said. Others have moved out of the business.

Last week, the Pennsylvania Higher Education Assistance Agency, one of the nation's largest student loan organizations, announced that it will temporarily stop making federally guaranteed loans this month. The College Loan Corp., the nation's eighth-largest student lender, also is leaving the federal loan program.

At least a dozen firms have stopped issuing private loans, citing problems in the debt markets. Sallie Mae, the largest student loan provider in the country, said it is tightening credit requirements for borrowers and pulling out of offering loans to students attending some for-profit career schools and community colleges.

The growing exodus has some college administrators worried. Georgetown University, for one, has devised an emergency plan to become a direct lender, like hundreds of other colleges and universities, in case more firms close shop. Other colleges are calling lenders to see whether they'll be in business next school year.

Members of Congress last week asked for assurances from the Bush administration that the federal program providing loan money directly to colleges will be able to handle increased demand. They also asked the Department of Education to gear up its "lender of last resort" program, which provides a safety net should many student loan firms fail.

If firms decide to stop lending late in the summer, "there will be a lot of people scrambling to find another lender in the fall," said Guy Gibbs, interim director of financial aid at Northern Virginia Community College, the largest higher education institution in the region, with 40,000 students.

The student loan troubles are being felt unevenly. Those attending institutions with high graduation rates and low default rates among their alumni may still be able to get low-cost private loans. Students at lower-ranked schools with higher defaults among graduates are likely to get hit with stiffer fees and rates.

Even at a highly ranked school such as Georgetown, some students are anxious about rising rates.

Andrew Helms, 24, a master's student in Arab studies at Georgetown, said he had to take out $50,000 in loans to cover the first of his two years of graduate studies. He still has undergraduate debt to pay off. His federal loan is fixed at a 6.3 percent interest rate, while his private loan rate has reached 7.8 percent. Any rise in the latter would be "a substantial concern," he said.

School debt "determines what you'll do after graduation," he said. "People who want to go into humanitarian work will have to wait until 10 to 15 years down the road until after you have paid off your loans. . . . I might have to sell my soul to an oil company."

In addition, Robert Shireman, president of the California-based Institute for College Access and Success, said too many students already take out expensive private loans for technical training programs that often don't lead to high-paying jobs. "Some of those loans are predatory loans that should not have been made," Shireman said.

The cost of college is a significant concern from living rooms to Capitol Hill as declining housing values and the economic slowdown force families to tighten their budgets. Debt levels of college graduates more than doubled to $19,200 over the past decade, according to the Institute for College Access and Success.

More students are turning to private loans, which are more costly because they lack a federal guarantee. With college costs rising faster than the maximum loan amount students are allowed under the federal program, the share of education loans that are

private has quadrupled over the last decade, to 24 percent last year, according to the nonprofit College Board.

Most first-year college students can borrow a maximum of $3,500 through a federal Stafford loan, and the cap rises to $5,500 for the third year and beyond. Maximum loan amounts are higher for students who are not dependents and for graduate students. Other federal grants and loans also may be available.

Jevita de Freitas, director of student financial aid at George Mason University, said Virginia's budget has put some state higher-education funding in jeopardy, which could force more students to seek private loans. She added that the school has gone so far as to advise some students to lower their loan amounts by living with their parents.

"We do know that students are finding it much more difficult to get loans from the agencies that have served them in the past," said Alvin Thornton, associate provost at Howard University. "What's required of a student and a family to qualify for a loan is much more rigorous, much more demanding. We're talking about not wanting to lose any student because they can't pay their tuition."

The cost of making loans to students has gone up largely because lenders have struggled to find investors to buy this debt. Without the ability to securitize loans in this fashion, firms don't have the money to lend to students.

"Right now the securitization market for private loans is not there," said Tom Joyce, a spokesman for Sallie Mae. "And if you thought there was an asset class that would be okay, it would be federal loans that have a guarantee from the government. But even that market has gone from tremors to earthquakes."

But federal education officials and financial aid officers say students who want federally subsidized loans will ultimately be able to get them. The Department of Education is working to assure schools that federal loans will be available, said Larry Warder, the department's acting chief operating officer for federal student aid, noting that the lending picture is mixed. He added that while some lenders are raising fees, J.P. Morgan Chase recently announced that it is waiving fees and reducing rates on those loans.

"We're concerned, as everybody is, because there is turmoil in the financial markets, but so far we haven't found it in the student loan office," Warder said. "I'm afraid people are panicking with no reason to."

Lenders say a cut in congressional subsidies last year also hit them hard, though lawmakers such as Sen. Edward M. Kennedy (D-Mass.) said financial firms are overstating the impact. These subsidies had been meant to help firms and banks issue federally guaranteed loans at below market rates.

But Kennedy said the subsidy cuts are helping students, not hurting them. "The stress some lenders are experiencing is related to changes in the credit markets, not the reductions in lender subsidies passed in last year's student aid law," he said.

But Joyce, the Sallie Mae spokesman, said those reforms are having an unintended effect. "Congress enacted this legislation when credit markets were at their best. The subsidy cuts are clearly not designed for times like these."

Some borrowers are already feeling the squeeze from the tightening credit market. Rebecca Reynolds, 23, who graduated from Northern Illinois University in May, said the variable interest on her $15,000 debt has already hit 8.7 percent. Her monthly payments are at $183, which is difficult for a public interest worker.

"Working at a nonprofit, it's really hard to pay off your loans quickly," said Reynolds, who works at U.S. Public Interest Research Group. "My paycheck is not getting bigger, and if the whole economy is this way for a long time, . . . it's definitely something that hangs over your head."