US: Student loans costs to rise from credit crisis

Naomi Spencer
4 March 2008

Millions of college students are facing higher loan rates and tighter lending standards under the impact of the US credit crisis. In the past month, several large providers of student loans announced they were suspending their programs altogether, due largely to the collapse of financial backing in bond markets. Other lenders have implemented more restrictive borrowing standards, locking out many younger, poorer students.

Higher education costs pose formidable financial challenges, and the loan rate increases and restrictions will put more strains on already struggling students and their families. Many students have little choice but to take out private loans, use credit cards, and find other ways to fund soaring tuition, with no guarantee of a decent wage job upon leaving school.

The US credit crisis began in the subprime housing mortgage market, but has rapidly spread to other forms of debt. Many institutions that provide loans, including student loan agencies, fund their operations by selling securities to investors. As investors have grown wary of buying debt, however, the loan providers have raised rates or stopped lending to students.

Both federally-guaranteed loans, which generally provide lower fixed rates, and private loans have been affected by the turmoil in credit markets. One of the largest student lenders in the country, the Pennsylvania Higher Education Assistance Agency (PHEAA), said that, effective this month, it would no longer offer federally guaranteed loans.

According to the *Pittsburgh Tribune-Review*, the organization had planned to lend $500 million to 140,000 students, but that those students would now have to find aid elsewhere.

The agency's situation is like that of many state, municipal, and non-profit entities dependent on the bond market. In February, the Michigan Higher Education Student Loan Authority, the Missouri Higher Education Loan Authority, and other organizations also cut loan programs due to loss of investor backing.

In an article published on Monday, the *Washington Post* quoted Tom Joyce, a spokesman for Sallie Mae, the leading US student loan provider: "Right now the securitization market for private loans is not there. 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."

Until recently, bonds sold by student loan agencies had been considered a secure buy for investors because students pay back their debts at a fairly high rate. In the wake of the subprime mortgage crisis, however, investors have become increasingly skeptical of bonds previously considered safe, including those used to finance federally-guaranteed student loans In particular, the credit crisis has wreaked havoc in the auction-rate municipal bond market, upon which many student lenders are dependent.

PHEAA interim chief executive James Preston explained the decision to suspend loans to the *New York Times* in an article published on February 28. "Widespread lack of confidence in the capital market has spilled over into other asset classes, driving up our cost of borrowing and denying us the capital needed to fund new student loans."

In addition to state agencies such as PHEAA, the National Association of Student Financial Aid Administrators reports that major lenders including Sallie Mae Corporation, College Loan Corporation, EdSouth, and Brazos Higher Education Service have all failed to get backing at recent securitization auctions.

Like the PHEAA, The College Loan Corporation has discontinued its federally guaranteed loans.

Sallie Mae, Wells Fargo, and Nelnet have all announced stiffer rules for loan approval, including requiring higher credit ratings from applicants. For the typical young adult with little credit history, securing funding for college will be more difficult, and cost more.

Poorer students will be particularly hard hit, because they are seen by loan agencies as greater risks for default. According to the *Post*, "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."

Sallie Mae, the largest student lender in the US, also announced it would no longer offer loans to students enrolled in some for-profit vocational and career schools and community colleges. As a result, thousands more working class students will be either priced out of higher education altogether or will be forced to take on variable-interest loans from the private sector.

Loans are the only way many families and individuals can afford post-secondary education or job training. As the cost of college has spiked, both wages and grant aid have stagnated or declined over the past ten years. As a result, debt levels have more than doubled over the period. Currently, two in every three university undergraduate students bear some debt, with the average debt load upon graduation exceeding $19,000.

A large amount of the growth in loan debt is concentrated in the private loan industry. A decade ago, private loans represented only a tiny fraction of total loan volume. But in the past two years, partly as a consequence of the housing market contraction and consequent shrinking of home equity, working families have turned to private loans for alternative sources of funds, and private lending has exploded into an $18.5 billion industry.

The *World Socialist Web Site* spoke to several students at Virginia Commonwealth University about the difficulties facing college students.

A sophomore complained about the enormous debt burden he will have upon graduating college. "Basically, all this works out to nothing," he said. "I have $20,000 worth of debt already. And it just doesn't seem worth it. I feel like I am wasting my time here."

Adam, a senior, spoke about the restrictions placed on students who graduate with a high debt burden. "The educational experience is supposed to change who you are," he said, "And you start to understand how the world works. Say you get this great passionate drive inside yourself, and you now have the knowledge to go out and change the world."

Adam said that there was a "catch-22," however: student loans. "Do I go and take a $60,000 a year job in corporate America, which is going to perpetuate everything I learned about in school to help fix, so that I can have a minimal standard of living, so I can pay off my student loans? It puts me in a very hard position."