Student Loans 101: Context for Reauthorization

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Title IV federal loans

- Perkins
- Federal Family Education Loan Program (FFELP) – Stafford “sub” and “unsub” for students
- Federal Direct Loans (DL) - Stafford “sub” and “unsub” for students
- PLUS – Parent Loans for Undergraduate Students in FFELP and DL
- Consolidation Loans for students and parents in both FFELP and DL
“Sub” v. “Unsub”

• “sub” means - Taxpayers pay for the cost of funds (interest) while borrower is enrolled at least half-time in college

• “unsub” means - The borrower pays for the cost of funds (interest) that accrues while the borrower is enrolled at least half-time in college, although the accrued interest is not due till the borrower enters repayment six months after leaving school.
PLUS Loans

- Available to parents of dependent undergraduates who do not have "adverse credit histories" (much lower FICO standard than "credit worthy.")
- Parent may borrow up to the cost of education less other aid
- Parent commences repayment within 60 days unless they request a "forbearance"
Consolidation Loans

• Both students and parents may obtain these to combine their Title IV (and some HHS) federal education loans

• Currently, variable rate loans are converted to fixed rate loans equivalent to the weighted average of the underlying loans rounded up to the nearest $1/8^{th}$. 
Historical use of Consolidation

- AVOID DEFAULT by stretching out the payments over a longer term for borrowers who could not afford to pay the monthly installments on their various loans on ten-year amortization schedules.
Current use of Consolidation

- Lock in historically low fixed rates
- As interest rates rise, the federal government (taxpayer) is forced to pay the difference between borrowers’ locked-in low rate and the prevailing market rates on the unpaid loan balances.
- Transfers subsidy to borrowers in repayment – amount then not available to currently enrolled students.
Perkins Was First, aka:

- “National Defense Student Loans” - NDSL
- “National Direct Student Loans” - NDSL
- “Federal Perkins Student Loans” - “Perkins”

- Campus-based appropriated funds for 46 years... creating campus revolving funds
Who Would Want Become a New Perkins Lender Today?

Perkins Loan Campuses must:

• Match each new dollar at 33%
• Pay for the cost of administering the entire life-cycle of these loans- averaging 12-18 year recovery periods
• Cannot access federal skip trace tools or use federal tax refund offset programs
Legacy Program Only

- Some participating schools have dropped out
- Not a lot of new interest in getting into Perkins, even among newly-enfranchised campuses in the campus-based programs
- Chief motivation to continue is to fill loan gap for freshmen/sophomores and borrowers who can earn cancellations (back end grants)
NICHE FILLERS

• Proposed Stafford loan maximum increases WILL NOT be enough to replace lost Perkins for those freshmen and sophomores who rely on them.

• Alternative (private) loans are the fastest growing segment of the education loan market; most of the use is among professional school borrowers, but loss of Perkins will force greater use of these costly loans among undergraduates who need more than Stafford maximums allow.
Recalling portfolio is a practical nightmare

- Current statutory sunset provision is unworkable – new law needed
- Campuses will want their “ICC” back, but won’t be otherwise motivated to spend the money to collect
- The current assignment process is Neanderthal – this has been “B” team enterprise at the Dept. of Ed for decades
Worth a Fight?

• Congress could leave the revolving funds on the campuses and not appropriate new FCC, but then there are no “savings” to spend from the recall of the loans –

• Leaving the revolving funds in place reduces the pressure to increase EVEN MORE THAN PROPOSED the annual loan maximums for freshmen and sophomores… a very expensive proposition for Congress
Unholy GSL Alliances – the 70’s, 80’s and early 90’s

• Borrowers were held hostage to very limited service levels or processing amenities
• In cartel environment, there were virtually no upfront borrower discounts or repayment benefits;
• Lenders barely competed with one another on price or service levels – seller’s market
• Schools serving high risk borrowers had difficulty finding lenders
Petri’s perennial “Income Contingent Loan Program bill”

- Congressman Petri repeatedly introduced a cross-subsidized model wherein borrowers repaid according to their incomes, rather than their debt size, and where repayments from high earners paid for the program costs and defaults – a “cost neutral” college loan program from perspective of taxpayers.
Direct Loan Pilot is introduced under Bush #1

- Elements of Petri loan bill were married to plan to streamline federal loan programs: federal government could provide new, improved FISL by providing capital directly to students, bypassing lenders and GAs. Feds would manage administration of the program using federal contractors (servicers.)
Full Blown Direct Loan program becomes Clinton’s signature

- DL scoring provides huge savings to support increases in higher education programs;
- Income Contingent Repayment Plan offers political solution for dealing with loan default.
- FFELP counters by improving service and prices and aggressive lobbying against DL
States use GA as revenue centers

• In last reauthorization, the feds defined the GA “operating fund” and the “federal reserve fund” such that some states are now claiming ownership of the GA operating fund and using all or part of it for state priorities.

• GAs that do not develop other sources of revenue (“vertical integration”) are unlikely to survive entirely on the reimbursements from the federal government for their guarantee services.
How Lenders are compensated…

“Would you like some bread with honey or butter, Pooh?”

“Both, and never mind the bread…”

..and how much “trimming” of their subsidy can occur without doing significant harm to borrowers or institutions?

See HANDOUT from Greentree Gazette
Entitlement is to LENDERS, not to borrowers in FFELP

- Lenders are guaranteed a yield specified in statute, which has varied over time…

- In addition to the statutory changes affecting lender yield, economic conditions may result in lenders realizing MORE than their promised yield ---
CBO report on Lender Yield

- [http://www.cbo.gov/showdoc.cfm?index=5586&sequence=0](http://www.cbo.gov/showdoc.cfm?index=5586&sequence=0)
- By nearly any measurement, Direct Loan school and borrowers get less subsidy than FFELP schools and borrowers, the latter indirectly through shared profits from lenders
- Nabeel Alsalam provides excellent explanation of CBO scoring of student loans for those needing the details
“Leveling the Playing Field…”

• To the extent that FFELP industry players share their profits with states, schools, and borrowers, the federal lender subsidy may be used for “good works;”

• DL advocates want the taxpayers to spend as much on their students as they spend on those in the FFEL program (STAR bill)

• Congress is looking for “savings” to move to new federal student support priorities
School As Lender shows

- How much lenders can afford to share with institutional “partners”
- How much efficiency can be wrung out of certain administrative processes
- How inefficient most institutions are as loan administrators by comparison (e.g., Perkins operations)
Without intervention…

• Interest rates charged to students will move on July 1, 2006 to a fixed rate of 6.8% (the administration is proposing to continue with the current variable rate with an 8.25% cap)
• Interest rates on consolidation loans will continue to be at fixed rates, thus continuing to cost the federal taxpayers more than if they were made variable rate.
Perkins Institutional Contribution

- Schools own a share of the Perkins revolving fund (from 11% in the 1960s – 1970s and phasing up to now 33% of every dollar lent)
- Schools must honor statutory cancellations of Perkins loans, even when the feds don’t provide funding to replace the school’s share of the “forgiven” funds
Special Allowance “bleed” will continue...

• 9.5% floor rate for lenders continues to use up nearly a billion dollars per year – excess profits to a handful of lucky lenders

• Stopping this “bleed” is going to be challenged legally, as the “half life” of these rolled-over loans will continue to be very costly for more than a decade.
Hot Buttons for Reauthorization

• Increasing annual loan limits:
  
  **Subsidized loans only** for undergrads:
  – From $2625 to $3500 for freshmen
  – From $3500 to $4500 for sophomores

  **Unsubsidized loans only** for grads:
  – From $10,000 to $12,000
More Hot Buttons

• Requiring FFELP borrowers to pay the 1% Guarantee Fee
• Variable rather than fixed rate for consolidation loans
• Reconsolidation would be allowed
• STAR bill to provide funds for need-based aid at new DL campuses
Even more Hot Buttons…

• The administration is proposing to pay for the Pell shortfall by mandating the return of the Perkins Federal Capital Contribution (FCC)

• The sunsetting of the Perkins program currently in legislation is unworkable and must be revised if the recall of funds is actually to be implemented