As the Volume of Private Loans Soars, Students Feel the Pinch.Stephen Burd. ***The Chronicle of Higher Education*** 53.5 (Sept 22, 2006)(2821 words) From *General Reference Center Gold*.

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For Kristin Hough, life has not worked out the way she imagined it would when she was a college student. While earning a bachelor's degree at Benedictine University, in northeastern Illinois, and a master's in public-service management and public policy at DePaul University, Ms. Hough racked up more than $60,000 in student-loan debt. Now she is not sure how she's going to repay it.

To make matters worse, the money she borrowed was not through the federal loan program, with capped interest rates.

She has higher-cost private loans, with rates that vary monthly, based on market conditions -- a difference that she didn't recognize at the time. "The interest rate just keeps going up and up," she says forlornly. She now pays a total of $535 a month on her loans.

As a high-school senior, Ms. Hough had wanted to obtain a liberal-arts education at a respected private college. But because of family problems, her father, who owns an auto-repair shop, wouldn't provide the financial information she needed to apply for federal aid. So she went online and applied for private loans herself.

Now 25, Ms. Hough has moved back home with her parents and has given up on pursuing a career in social work. She is working as an assistant property manager, making $32,000 a year, and plans on taking an exam next fall to become a certified public accountant.

"My heart's in social-service work, but I know I have to pay off these loans," she says. "I'm just praying that I will earn a decent enough salary to make the payments."

Private loans are the fastest-growing form of student aid today. In 2004-5 lenders provided about $14-billion in private loans, a 734-percent increase from a decade earlier, according to the College Board.

Most students take out private loans in addition to their federal loans, which have strict borrowing limits. Others, like Ms. Hough, attracted by flashy pop-up advertisements on popular Web sites that promise loans that are easy to obtain, take out private loans exclusively.

Historically, private loans -- which usually have worse terms and conditions than those backed by the federal government -- have gone to graduate and professional students, particularly those pursuing careers in high-paying fields like law and medicine. But with the cost of attending college escalating far faster than inflation, and federal and state spending on financial aid lagging behind, private loans have become an essential tool for undergraduates trying to finance their education.

Higher-education leaders and lobbyists lament this trend, faulting Congress for failing to raise the overall limit on what students can borrow from the federal government. The current ceiling is $23,000, a figure that was set in 1992. But colleges are at least partly to blame, say student-aid experts, consumer watchdog groups, and even some lenders: Not only have they failed to control their costs, critics say, but they have made it too easy for students from low- and moderate-income families to take on unmanageable levels of debt by including the loans in the financial-aid packages they offer to students to meet their financial need.

"As competition heats up and federal monies become increasingly limited, the concern is that low- and middle-income borrowers -- those who pay more for credit and are more likely to default -- will increasingly be at risk," warns Willis J. Hulings III, president and chief executive officer of the Education Resources Institute, a nonprofit agency in Boston that insures private loans. "We are creating a generation of students who are leaving college with long-term debt that is similar in size to a mortgage, only there is no house."

Private-Loan Creep

Since the creation of the federal student-loan programs 40 years ago, generations of college students have depended on them to help pay for higher education.

From the beginning, policy makers believed that the government should make low-cost loans available to students regardless of their credit histories. To protect needy students, lawmakers put the government in charge of setting the interest rate, determining the eligibility of potential

borrowers, and limiting the size of their loans.

In the 1980s and early 90s, as the cost of attending graduate and professional schools rose sharply, new players entered the market offering private student loans. But those lenders primarily served a select clientele: professional students with great earning potential.

Private-loan programs grew steadily. But only in the past five years, as lenders have aggressively pursued the undergraduate market, has the volume of such loans soared.

"There has been an incredible creep of these programs into the undergraduate world," says Ruth Lammert-Reeves, assistant dean of financial aid at Georgetown University's law school. "I'm shocked by the number of students coming into law school who have already taken out private loans."

As late as the 2001-2 academic year, the total volume of private loans to students was less than $6-billion, according to the College Board. Next month the board will release its annual student-aid survey, which will include an estimate of how much private-loan debt students took on last year. Loan-industry officials expect the figure to be around $20-billion. Within the next 10 years, they predict, the total volume of private loans will eclipse that of the federal-loan programs, which has handed out more than $60-billion this year.

What has changed? Why are private student-loan providers suddenly so interested in helping undergraduates with low credit scores and unfavorable debt-to-income ratios?

Student-aid experts say a confluence of developments has motivated lenders to expand their private-loan offerings to undergraduates. Those circumstances have included:

* Declining profits in the federal student-loan program. With interest rates falling to historically low levels, providers of federal student loans, like Sallie Mae and Citibank, saw their yields shrink, particularly as borrowers rushed to lock in the low interest rates by consolidating their debts. The lenders recognized that marketing their private-loan products more aggressively to undergraduates could bring in hefty profits.

* An enrollment boom. The record number of students has meant a burgeoning market for lenders.

* A change in the law, which has reduced the risk of offering private loans. After five years of lobbying, the loan industry won a major victory early last year when Congress approved legislation making it virtually impossible for borrowers to avoid repaying private educational loans by filing for personal bankruptcy.

Not Keeping Pace

None of those factors would have mattered much, however, if the loans had not been in such demand.

With college prices climbing, and the borrowing limits in federal loan programs failing to keep pace, colleges have increasingly advised their students to close the gap with private loans.

Alarmed by that trend, the leading higher-education associations tried to persuade Congress to raise the loan limits as part of legislation it was considering to revise the Higher Education Act, the law governing most federal student-aid programs.

They pointed out that the current limits on what students could borrow from the government -- $2,625 for a first-year student, and $23,000 over an undergraduate career -- were set more than a decade ago and lagged far behind today's levels of student need.

But the groups ran into heavy resistance from two national organizations representing students. The United States Student Association and the State Public Interest Research Groups argued that students were already up to their necks in debt, and that raising the federal loan limits would only bury them deeper. The advocacy groups called on Congress to significantly increase spending on the Pell Grant program, for low-income students, to reduce their need to take out loans in the first place.

Republican Congressional leaders, too, were wary of raising the loan limits. Their primary concern, however, was how much such a change would cost the government. In February, Congress approved a budget-cutting bill that included a slight increase in the amount that freshmen and sophomores could borrow from the federal loan programs, but left the overall ceiling at $23,000.

Some higher-education lobbyists, who believe the increases are inadequate, blame the student-advocacy groups for the loan-limit defeat. "They gave cover to some people who otherwise would have been embarrassed that they haven't raised the limits," says Dallas Martin, president of the National Association of Student Financial Aid Administrators.

Luke Swarthout, a higher-education associate with the State Public Interest Research Groups, disputes that characterization. He says his organization would have been willing to compromise had the higher-education associations agreed to support proposals designed to protect students from taking on too much debt.

"In the face of higher college costs, it is unacceptable to simply pass the burden of paying for college on to students in the form of larger loans," says Mr. Swarthout.

Nonetheless, the failure of Congress to raise the overall limit ensures that students' dependence on private loans will grow. "The hard reality is that the average family needs 20 percent more money to go to school after they have exhausted all federal loans and aid," says Tamera Briones, chief executive officer of Education Finance Partners, a private-loan provider.

Filling the Gap

In the competitive world of college admissions, it is crucial for high-priced colleges to show students and their families how they can afford to attend.

That is not much of a problem for elite private colleges that are wealthy enough to meet the full financial needs of their students.

Although those colleges are among the most expensive in the country, they provide such generous amounts of institutional aid that financially needy students do not need to borrow as much as they would if they attended a lower-priced public institution. The most extreme example is Princeton University, which doesn't require undergraduates to take out student loans at all.

Colleges with multibillion-dollar endowments, however, are few and far between. So less wealthy institutions are increasingly directing their students to take out private loans.

"It's an utter necessity for private colleges and many of the pricier publics to have some kind of private loan available," says Barmak Nassirian, an associate executive director of the American Association of Collegiate Registrars and Admissions Officers. "If they don't have something handy, they will find themselves at a significant disadvantage."

Many students would not ordinarily qualify for private loans because they have no credit histories, or they have bad credit. But luckily for the colleges, "there's an absolute feeding frenzy" in the loan industry to help them meet their students' needs, says Brian Zucker, president of Human Capital Research, an Illinois-based higher-education consulting firm.

As part of deals they make with colleges, lenders are often willing to waive, or at least loosen, their credit requirements. As a result, the colleges can include the loans as part of the aid packages they offer to financially needy students without having to worry that the students' loan applications will be rejected.

Rude Awakening

But students don't always realize what kinds of loans they are being offered.

Some private-loan companies, like First Marblehead, even encourage colleges to "brand" their loans. In its marketing materials for its GATE Student Loan Program, the Boston-based lender writes, "The loan may carry your institution's name, connecting it more directly to your institution than possible with traditional outside loans."

Officials of some colleges that participate in the GATE program say it is appropriate for the loans to carry a college's name because the institution is able to specify the terms, and to share in the risk if borrowers default.

But Ellen Frishberg, director of student financial services at the Johns Hopkins University, says "it confuses families" when a college puts its name on a loan and includes it in a financial-aid package. "They think it's going to be a more friendly kind of arrangement and not something they can get on the open market."

Just ask Barbara Peppey.

Last summer Ms. Peppey and her son, who asked not to be identified in this article, discovered that more than half of the $25,000 he had accumulated in his first three years at American University could not be refinanced in the federal loan-consolidation program. To the Maine family's shock, they learned that he had accrued a significant amount of private-loan debt.

Ms. Peppey recounts this story with some embarrassment. She readily admits that she did not spend enough time investigating the different elements of the student-aid award packages the university had offered her son. Had she been more careful, she says, she might have thought twice about allowing him to borrow the "American University educational loans" that the institution had included in those packages.

But she had trusted the university. She had assumed that any loans it recommended -- particularly those with its name attached -- would have terms at least as generous as, if not better than, those offered by the government.

"I expected that the loans would have a low interest rate that was capped," she says. "I figured they'd be more manageable than they are."

In part, she says, she was confused because when her son took out the loans, they carried an attractive interest rate, 5.8 percent. Since then the rate has climbed to about 9 percent. Whether the rate rises further will depend on whether the Federal Reserve continues to increase the prime rate.

No matter how good a deal a college gets for its students, private loans seldom have capped interest rates.

"What students don't understand is that private loans are a lot like credit cards," says Ms. Lammert-Reeves, of Georgetown. "If you're late on your payments, they'll track you down. There are no forgiveness programs, and you can't lock in interest rates."

Brian Lee Sang, American University's financial-aid director, says, "This is the first time I've heard the loan being put in a negative light."

The university describes the terms of the loans -- which it gets through First

Marblehead's GATE program -- on the student-aid award notices sent to freshmen, and includes extra materials explaining the loans as part of the packets sent to incoming freshmen, he says. On the online version of the award notices, adds Mr. Lee Sang, students can click on the name of the loans and get more information about them.

"I'm sorry this family felt that the information we provided was not clear enough," he says. "We do try to make it as clear as possible."

Ms. Peppey doesn't blame the university, which, she says, was generous with institutional aid for her son. But she recommends that colleges go out of their way to make sure that students and their parents "truly make informed decisions" before taking out private loans.

Robert M. Shireman, an education-policy adviser in the Clinton administration who heads the Project on Student Debt, agrees that colleges need to redouble their efforts to make sure that students who take out private loans know what they are getting into. The project is intended to develop public-policy proposals to reduce the burden of student debt on those least able to afford it.

"Schools need to draw a much better line between federal loans and private loans," he says, "so that students recognize that they are entering more hazardous territory."

'A New Era'

Craig Sneider, financial-aid director at Ohio Northern University, says that with students getting deeper and deeper in debt, financial-aid offices have to find ways to offer better advice to their students.

"It's a new era of financial aid, and we need to think outside the box about how we counsel our students," he says. "We don't want to just give them packets full of information that are full of complex terms. We need to bottom-line it and show them the long-term implications of borrowing."

Mr. Sneider practices what he preaches. Last year, when he arrived at Ohio Northern, he found that it was including private loans in its financial-aid packages. He decided that the practice was "irresponsible," and the university is no longer doing it.

The financial-aid letters sent to students now simply list private loans as one of several options that they can use to fill their remaining need after federal, state, and institutional aid dollars have been exhausted. Other alternatives include having their parents borrow PLUS loans -- federal loans that allow families to cover the cost of attendance -- or taking advantage of plans that allow borrowers to pay off loans in installments.

Students and their parents also must attend an orientation session before they receive their financial aid from Ohio Northern. "It's important that I teach students about loan debt, repayment, default, and responsible borrowing," says Mr. Sneider. "Our average cost is $35,000 a year, so I have to at least give students that."

Mr. Sneider does not believe that colleges with private loans included in their aid packages "are trying to pull a fast one on students."

"This is just the way most schools have always presented loan eligibility," he says. "But as schools and financial-aid directors and administrators become more aware of the ramifications of borrowing these loans, it's time for us to change." @import url(http://chronicle.com/styles/data/datastyle.css);@import url(http://chronicle.com/styles/sections/news/newsstyle.css);

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