A Student Loan Credit Crunch — But for Whom?
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The phrases “credit crunch” and “student loans” are blaring with increasing frequency from newspaper headlines and TV news broadcasts. With growing numbers of banks and other loan providers announcing layoffs or plans to leave or limit participation in the student loan market, it is clear that the general problems in the financial markets have created a credit crunch crisis for student loan providers. But is there a loan crisis for student borrowers themselves?

That depends in large part on what kind of loans — and what kind of students — you’re talking about.

To date, the impact has been largely limited to private, or alternative loans, the higher-cost loans, held by fewer than 10 percent of student loan borrowers, that students typically take out to cover the difference between the total value of their federal, state and institutional grants and loans and the full price of attending the college of their choice. Parties including Education Secretary Margaret Spellings, the National Association of Student Financial Aid Administrators, and (even) the Consumer Bankers Association have taken pains in recent days to make clear that federal loans remain available to all students who seek them.

And, to this point, the impact has been felt most heavily by far by students at for-profit colleges, which tend to be relatively high cost and to serve a disproportionate number of low-income, first-generation college students.

Those facts — that the credit squeeze has so far been relegated to private loans and to career colleges — have created a situation in which the credit crunch has become a major cause of concern for the loan industry and for the for-profit higher education sector (which are pressuring Congress and the Education Department to act to ease it) but largely played down by many traditional college officials, advocates for students, and the generally Democratic politicians with whom they are traditionally aligned.

“Students with poor credit ratings, particularly those at trade schools whose graduates have poor repayment track records, might be unable to find a willing private student loan provider,” the New America Foundation’s Education Policy program wrote on its blog this month. “All students, however, who apply for a private student loan with a creditworthy co-signer should be able to obtain a loan and obtain it at a lower interest rate than they otherwise would receive. Private student loan borrowers who don’t have a creditworthy co-signer and who are pursuing academic programs at schools with dubious job placement and loan repayment track records should consider lower cost education options.”

The idea suggested in the New America post — that the credit crunch isn’t a major problem because it is affecting mostly students at for-profit colleges, and should actually prod students who take out costly private loans at for-profit schools to enroll instead in community colleges or other lower-cost institutions — has been a subtext of some of the discussion surrounding the credit crunch, and reveal just how differently the crisis is perceived in various quarters.

The divisions were on full display Tuesday as representatives from Congress and the Education Department spoke to the Career College Association’s annual policy forum in Washington. As a panel of Congressional aides addressed the presidents, government relations officers and other leaders of for-profit technical and career-oriented institutions for what was supposed to be a general discussion of the Washington scene, most of the conversation revolved around the group’s concerns about the availability of loans for their students were palpable, and on their hopes that politicians might act to ease the crunch, perhaps by increasing limits on how much a student can borrow in federal loans.

J.D. LaRock, a top education aide to Sen. Edward M. Kennedy (D-Mass.), chairman of the Senate Health, Education, Labor and Pensions Committee, said Congressional leaders were paying close attention to the developing situation in the loan market (a view echoed by aides to Sen. Michael B. Enzi and Rep. Howard P. McKeon) but played down the impact

so far. “We have to deal with the facts at hand,” he said. While there “have been some changes in the federal loan arena,” he said, noting decisions by the College Loan Corp. and Pennsylvania’s student loan guarantor to stop making federal loans, “there remain well over 2,000 players in the [Family Federal Education Loan Program] market place.... The credit crunch has affected private loans most of all.”

When Arthur Keiser, president of Keiser Collegiate System, characterized the credit crunch as a “meltdown” of the student loan market place, and another audience member suggested that Congress should be “proactive rather than reactive,” LaRock bristled.

He noted that Kennedy was working closely with the Senate Banking Committee to monitor the burgeoning instability in the credit markets and that the House education panel plans a hearing on the loan situation this Friday, and he announced that Kennedy would hold a hearing of his panel in Boston on March 17. He also acknowledged that Kennedy and his aides had begun discussing steps that Congress might take if the situation grew worse, including “expanding federal loan eligibility if [students] can’t get private loans.” (Although that tidbit of news intrigued the crowd, LaRock said he could provide no additional details about the possible legislative proposal, such as to what kind of loans — unsubsidized, a new form of parent loans for independent students — access might be expanded.)

“It’s being proactive to think about expanding loan eligibility and to work with the Banking Committee,” LaRock said. “But it’s also important to be very careful about recognizing the realities of the situation we find ourselves in, which sometimes departs from the rhetoric we find ourselves hearing.”

When it was her turn to speak to the career college meeting, Diane Auer Jones, assistant U.S. secretary for postsecondary education, also characterized the credit crunch as a potential rather than existing crisis. While emphasizing that department officials are “monitoring it very carefully — we’re reading the same newspapers, hearing the same concerns,” she said that at this point in time, we haven’t had a single institution say, ‘No, we don’t have a lender.’ We haven’t had a single student say, ‘No, I don’t have a [federal] loan.’ “

Comments like that did not resonate with many of the career college officials and their supporters, who believe they and their students have been hurt, but they veered between noting the powerful impact their institutions were feeling and warning that it would be a mistake to characterize the credit crunch as limited to their sector.

“One reason why this credit crisis is so huge for us is because we’re dealing with a lot of nontraditional students, independent students,” many of whom have already been extended credit for their homes or other purposes, said Mark Dreyfus, president of ECPI College of Technology, in Virginia. “On top of the fact that federal financial aid is skewed to traditional students, now they cannot get credit” to pay for their educations, either.

“Is it an acceptable policy outcome for Sen. Ted Kennedy for students attending career colleges to have their educational plans disrupted, often in mid-program, because of the lack of availability of student loans?” John Dean, a lawyer who represents the Consumer Bankers Association, asked rhetorically (LaRock had already left the meeting).

Dean warned that just because the impact of the credit crunch on federal loans (and therefore on many traditional nonprofit colleges) had been mild so far, that could change in a snap. Barring a major turnaround in the credit markets (which the Federal Reserve took steps Tuesday to try to bring about), he predicted “dramatic announcements in the next month” in which lenders might announce that they were, for instance, toughening their criteria for awarding federal loans (in ways that could affect other institutions with large numbers of low-income students more prone to default on loans, such as historically black and community colleges). Perhaps only when those institutions start to have their students affected, Dean said, will a “broader array of voices” be raised to urge Congress and the Bush administration to take steps to bolster the loan programs.

Mark L. Pelesh, executive vice president for legislative and regulatory affairs at Corinthian Colleges Inc., said that many institutions face a problem with financing the “gap” between what federal student aid covers and a student’s college

payments. As available loan capital shrinks, he said, “I believe it will affect all institutions, all types, sizes, missions. Elite institutions may be able to manage this, but I believe the problem of financing this gap, coupled with the collapse of the lending market for lower-income students ... is not just a for-profit or proprietary school issue. There are HBCU’s, private not-for-profit institutions that have a more substantial gap than many proprietary schools do. All of them will be facing this problem.”

And yet, Dean asked, “Have you heard from the other sectors of higher ed? ... You don’t have independent colleges knocking on the doors of Congress saying you need to do something. But I can tell you that their anxiety is very high.”

Nonprofit colleges may have been publicly quiet, but Dean is right that for some of them, especially tuition-dependent private institutions without huge endowments, concern is indeed growing.

The National Association of Independent Colleges and Universities is surveying its members now about “if they do or don’t have a problem” with loan availability, said Sarah A. Flanagan, vice president for government relations and policy development at the private college group. “It is serious enough that people are responding; there’s definitely a lot of nervousness, because we’re all reading the same papers.”

David B. Laird, president of the Minnesota Private College Council, said the credit crunch is beginning to have an impact for families with college students in the Midwest. “We’re just beginning to see students that aren’t making the credit score thresholds and are not able to use any kind of co-signer within the family, mostly with private loans but also with unsubsidized federal loans,” he said.

The big crush for Minnesota’s private colleges, he fears, could come “when the FFEL lenders run out of capital later this spring” if they are unable to find investors to finance a new round of loans for the fall. Anticipating that eventuality, Laird said, some colleges are “signaling to families, ‘Get your loan applications in now during the spring, while [the lenders] still have their capital.’ “

Right now, many institutions aren’t quite sure what to expect, and they’re not necessarily getting good information from the lenders they work with, Laird said. “Put yourself in the position of being a lender marketing rep. Until you know you’re running out of capital, you’re not going to tell anybody the bad news.”

Laird said he understood that career college officials might be frustrated that their nonprofit peers were not joining them in sounding an alarm about the credit crunch. But “most responsible people [in the traditional college sectors] are waiting until they see pretty significant signs of problems before they put the red flag up,” he said. “I think they’re actually being responsible. No doubt they’re anxious and on edge, but I give them credit for the fact that they’re not standing on the top of the hill and yipping about it” to Congress or the Education Department.

“For everybody except the proprietary sector, the need is not well enough defined for us to expect them to act yet.”