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GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

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October 30, 1992

The Honorable Steve Gunderson
House of Representatives

Dear Mr. Gunderson:

This letter responds to your request for information on the size and characteristics of nonfederal--private and state--student loan programs. Specifically, you were interested in the extent to which these programs serve nontraditional students--those who are (1) attending school less than full time, (2) age 24 or older, (3) single parents, or (4) independent of family support for determining their eligibility for financial aid.

We identified 33 private and state loan programs operating in 1991 and obtained information on 31 of them.[1] This letter summarizes and expands on information we discussed previously with your staff.

RESULTS IN BRIEF

In 1991, 31 private and state loan programs provided about $493 million in loans for students pursuing their postsecondary education. In addition, families used an estimated $2.4 billion in home equity financing to finance students' college education.

Most financial aid provided through these sources is targeted to traditional students, mostly students attending 2- and 4-year institutions. The programs generally required that borrowers demonstrate credit worthiness. Also, lenders generally consider a borrower's debts, loan size, income, and ability to repay the loan. Students must often meet other eligibility requirements, which usually include at least half-time attendance.

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[1]We were unable to obtain information on two of the programs from their sponsors.

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The 31 programs generally were not serving nontraditional students, in part because their families have lower incomes and could not meet the programs' credit worthiness requirements. Also, nontraditional students were more likely than traditional students to attend school less than half-time, failing to meet the programs' attendance requirements.

SCOPE AND METHODOLOGY

We identified 33 private and state loan programs by consulting computerized library data bases and contacting major secondary markets, education consortiums, and higher education and guaranty agencies[2] in each of the 50 states and the District of Columbia. We obtained information on 31 of these programs. For each of the 31 programs (listed in enc. I), we contacted the program's administrator and obtained information on such characteristics as funding source, amount of funding made available, eligibility requirements for borrowers, loan limits, interest rates, and repayment options. We also obtained estimates on the extent to which funds borrowed through home equity loan programs were used for education. We did not obtain information on the extent to which individual postsecondary institutions may have their own loan programs. Also, other programs probably exist that we did not identify.

We also obtained information from the Congressional Research Service (CRS) to show (1) the extent to which the private and state loan programs were serving nontraditional students, and (2) the effect that the programs' eligibility requirements had on nontraditional students. We used this information to determine the likelihood that such students were obtaining loans from these kinds of programs.

We conducted our work between January and July 1992 in accordance with generally accepted government auditing standards.

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[2]A guaranty agency serves as the link between the U.S. Department of Education and lenders participating in guaranteed student loan programs. The guaranty agency insures loans made by lenders to students and assures that lenders, students, and schools adhere to program requirements.

CHARACTERISTICS OF NONFEDERAL LOAN PROGRAMS

Of the 31 programs we examined, 13 were operated by private sector organizations, such as education consortiums and secondary markets, and 18 were operated by state agencies. In 1991, the 13 private programs provided $288 million in loans, while the 18 state programs provided $205 million.[3] In addition, recent studies by the banking industry indicate that as much as 10 percent of home equity financing is used to finance education. The banking community conservatively estimated that in 1991 home equity lending for education totaled about $2.4 billion. Loans provided for students through these nonfederal programs are relatively small compared to over $14 billion in loans made during fiscal year 1992 through student loan programs administered by the Department of Education.[4]

Unlike most federal student loan programs, nonfederal programs do not have a federal guarantee to repay lenders if a borrower defaults. (Some of the nonfederal programs' loans are guaranteed by state agencies.) As a result, private and state lenders strive to minimize their risk. Nonfederal loan programs, including home equity financing, are thus targeted at borrowers deemed to be more credit worthy.

Loan Programs' Characteristics

In the following sections, we compare certain characteristics of private and state loan programs: funding source, loan eligibility, loan limits, interest rates, and repayment options.

Funding Source

Private loan programs are funded by private capital. Generally, their sponsors--such as education consortiums--operate the programs under agreements with one or more banks.

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[3]Data were reported to us for 1991, and we recognize that the loan programs used different fiscal, academic, and calendar years.

[4]Federal loans include Stafford loans, Parent Loans for Undergraduate Students (PLUS), Supplemental Loans for Students (SLS), Consolidated loans, and Perkins loans.

State loan programs are typically funded by proceeds from the sale of tax-exempt bonds, but we identified several atypical situations. For example, two state programs use private capital from participating lenders; another is run by the state's guaranty agency using its funds; one is funded with legislative appropriations; and another is funded by a combination of state appropriations and bond proceeds.

Loan Eligibility

Eligibility for student loans from private sources is primarily based on the borrower's credit worthiness. For example, two private programs make loans only to parents, and the others make loans to students, if they meet the credit criteria. If a student borrower fails to meet the credit worthiness criteria, a credit worthy individual--such as a parent--must cosign the loan.

The definition of "credit worthiness" varies from program to program, but essentially involves the lender's assessment of the borrower's ability to repay the loan. A lender's examination of a borrower's credit history generally includes an analysis of the borrower's debt-service-to-income ratio--monthly principal and interest payments relative to the borrower's income. Most programs will not approve borrowers whose ratio exceeds 40 to 45 percent. In addition, 6 of the 13 private programs required borrowers (or cosigners) to have a minimum income to be eligible for a loan--4 programs required an annual income of $15,000, and the other 2 required $30,000.

Eligibility for a state program loan is typically based on the credit worthiness of the borrower--either the student, parent, or cosigner. Like private programs, most state loan programs review the borrower's credit report and analyze the debt-service-to-income ratio. State programs typically limit the ratio to no more than 40 percent, but the ratios varied from 33 to 45 percent.

Some state programs include a residency restriction. For example, six programs limit loans to state residents. Eight programs allow loans to be "transportable," that is, state residents may use their loan proceeds at schools outside the state, or out-of-state residents may use them at in-state schools.

Other state programs have different restrictions. For example, six programs limit loans to students attending selected colleges and universities and do not make loans to students at proprietary (for-profit trade) schools. Officials at two state programs said this was necessary because their programs' loans do not have federal guarantees and default rates associated with some proprietary schools make loans to their students too risky.

Loan Limits

Borrowers can typically borrow more under private loan programs than they can under federal programs. Before October 1992, the most an undergraduate student could borrow from any one federal loan program in a single year was $4,000.[5] For 11 of 13 private programs, annual loan limits ranged from $15,000 to $25,000. The other two programs limited loans to their definition of the "cost of education."

State program loan limits also vary. The Minnesota program has the lowest annual maximum loan--$4,000--mirroring federal PLUS and SLS loan limits of $4,000 annually in the 1991-92 school year. The programs with the largest specified annual maximum loan amount--$20,000--are in Connecticut and New Hampshire. Six state programs limited loan amounts to the cost of education less other aid received.

Interest Rates

Of the 18 state programs, 12 charge interest at a fixed rate, and 6 use variable rates. Variable rates are based on the 91-day Treasury bill or prime rate, and are adjusted either annually or quarterly, depending on the program. As of June 15, 1992, variable rates on state loans ranged from 5.75 to 9.9 percent. Fixed rates ranged from 3 to 10.75 percent.

Interest rates available on private loans are typically tied to either the prime, the 91-day Treasury bill, or commercial paper rate. As of June 15, 1992, variable

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[5]With the Higher Education Amendments of 1992 (P.L. 102-325), loan limits and other characteristics for federal loans changed, depending upon such things as class grade, kind of loan, and other aid received.

rates on private loans ranged from 7.52 to 9.94 percent. A few private programs offered fixed rates, which ranged from 9.5 to 11.95 percent.

Repayment Options

The private and state loan programs generally use one of three repayment options. Under the first, the borrower begins repaying loan principal with interest shortly after the funds are disbursed. Under the second, the borrower makes interest-only payments while the student is enrolled, and principal payments begin within 60 days after the student leaves school. A third option allows the borrower to delay interest and principal payments while the student is enrolled. In this instance, interest usually accrues and is capitalized, that is, added to the loan principal.

There was no clear trend of preference for loan repayment between state and private loan programs. Of the 31 nonfederal programs,

- 7 require that interest and principal payments begin after loans are disbursed,
- 15 give the borrower a choice between the first two options,
- 6 allow the borrower to delay interest and principal payments while the student is in school, and
- 3 offer a mix of repayment options.

Home Equity Financing

Home equity financing takes two basic forms--loans and lines of credit. Home equity loans are for a specified amount, with either a fixed or variable interest rate and fixed payments. Lines of credit feature variable interest rates and monthly payments based on the outstanding balance. In both cases, the equity in a borrower's home is collateral for the loan.

Generally, home equity financing can be arranged for an amount equal to up to 80 percent of the borrower's equity in the property. The advantage to borrowing money for education through an equity loan is that most interest paid is deductible for federal income tax purposes, unlike the interest paid on private, state, or federal student loans.

We found no data on how much home equity financing was used to provide financial assistance to nontraditional students. However, the banking industry has studied this issue and reported that the average annual income of home equity borrowers generally exceeds $30,000.[6] This is more than the annual income of most nontraditional students.

NONFEDERAL LOAN PROGRAMS' ASSISTANCE PROVIDED TO NONTRADITIONAL STUDENTS

State and private programs provide limited loan assistance to nontraditional students. In 1991, the Congressional Research Service (CRS) reported information on several characteristics of nontraditional students.[7] Its data show that nontraditional students would be less likely than traditional students to qualify for loans from state and private sources. For example, nontraditional students more often:

-- Attend school less than half-time. CRS found that most nontraditional students attend school on less than a half-time basis. Most of the programs we examined had enrollment requirements that would preclude nontraditional students from obtaining loans. For example, 5 of the state programs required students to be enrolled full time, and 10 required students to be enrolled at least half time.

-- Have annual incomes below program minimums. The CRS study found that nontraditional students generally have annual incomes below $25,000 and are more likely then traditional students to have annual incomes below $15,000. Of the 31 programs we examined, 8 had minimum annual income requirements ranging from $15,000 to $30,000. Also, representatives from two programs that did not have minimum income requirements said that most of their loans were made to borrowers with annual incomes exceeding $25,000.

[6]1990 and 1991 Home Equity Lines of Credit Reports, American Bankers Association, and 1991 Home Equity Loan Study, Consumers Bankers Association.

[7]"Nontraditional" Students Attending Postsecondary Institutions, Congressional Research Service, June 13, 1991.

-- Attend proprietary schools. CRS reported that nontraditional students were more likely than traditional students to attend proprietary schools. Eight of the programs we examined did not make loans for students attending proprietary schools. Officials of several programs said that the high loan default rates associated with proprietary schools make loans to their students too risky.

The state loan program administered by the Michigan Higher Education Loan Authority illustrates the predominance of some traditional student characteristics among their borrowers. Of all loans the Michigan program made between October 1990, when it began, and March 1992:

-- 98 percent were for students attending school full time,
-- 89 percent were made to students or coborrowers with annual incomes greater than $25,000, and
-- 97 percent were for students attending a 4-year school.

Copies of this letter will be provided to other parties upon request. Should you wish to discuss this information further, please call me on (202) 512-7014.

Sincerely yours,

Edward A Densmore

for Linda G. Morra
Director, Education and
Employment Issues

Enclosure

PRIVATE AND STATE STUDENT LOAN PROGRAMS EXAMINED BY GAO

PRIVATE

Knight Tuition Payment Plans
A Better Loan for Education

Knight Tuition Payment Plans
Extended Repayment Plan

The Education Resources Institute
Alliance Education Loan

The Education Resources Institute
Maine Education Loan Authority Loan

The Education Resources Institute
Professional Education Plan

The Education Resources Institute
SHARE/EXCEL

The Education Resources Institute
Success Loan

The Education Resources Institute
TERI Loan

The Education Resources Institute
Universal Education Loan

United Student Aid Funds
Option IV Loan

University Support Services
ConSern Loan

University Support Services
PLATO Loan

University Support Services
Olympus Loan

STATE

Alaska Commission on Postsecondary Education
Alaska Student Loan Program

Alaska Commission on Postsecondary Education
Family Education Loan Program

Connecticut Higher Education Supplemental Loan Authority
Family Education Loan Plan

Consortium of Universities of the Washington Metropolitan Area
DC ConSern Loan

University of Hawaii
State Higher Education Loan Fund

Massachusetts Education Finance Authority
Family Education Loan

Massachusetts Education Finance Authority
Graduate Education Loan

Michigan Higher Education Student Loan Authority
MI-Loan

Minnesota Higher Education Coordinating Board
Minnesota Student Higher Education Loan Fund

Granite State Management and Resources (New Hampshire)
Alternative Loan for Parents and Students

New Jersey Higher Education Assistance Authority
New Jersey College Loan to Assist State Students

New Mexico Education Assistance Foundation
Parents Alternative Loan

Dormitory Authority of the State of New York
State Higher Education Loan Fund

Pennsylvania Higher Education Assistance Authority
Alternative Loan Program

Texas Higher Education Coordinating Board
Hinson-Hazelwood College Access Loan Program

Vermont Student Aid Commission
EXTRA Loan

State Higher Education Assistance Authority (Virginia)
Edvantage Loan

Student Loan Finance Authority (Washington)
Private Resource Education Loan

(Code 104699)