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More Schools Lend Directly to Students

Programs Are Cheaper for Borrowers And Provide Cash to Universities; Some See Conflict of Interest

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A growing number of universities are making money a new way. They are lending it to their own students.

While such loans are usually slightly cheaper for students than borrowing from banks, the practice is raising questions among some educators and lawmakers about possible conflicts of interest. Through so-called school-as-lender arrangements, universities originate loans to graduate and professional students, including law and medical students. They eventually sell the debt to a partner bank or other lender for a set "premium." These premiums typically run anywhere from 2% to 6% of the total value of the loans. For budget-strapped schools, that can translate to millions of dollars of funding.

STUDENT LOANS

School-as-lender programs offer pros and cons:

- Loans typically offer **lower upfront costs** for borrowers than bank or direct-government student loans.
- The arrangements **generate revenue** for schools that can be funneled to financial-aid coffers.
- Critics say the programs can create incentives for schools to encourage **too much borrowing**.


About 100 schools now participate in school-as-lender programs, including Tufts University, the University of Arizona and Widener University in Pennsylvania. That's up from 64 in 2003-04, when schools made more than \$1.5 billion in loans, the last year for which dollar figures are available, according to a Government Accountability Office report. In 1993-94, only 22 schools participated, making loans totaling one-tenth of that volume.

Many schools say the revenues go directly back to their financial-aid coffers to help needy students. And financial-aid officials say the loans are a better deal for borrowers than loans issued by banks or directly from the government. That is because the schools typically waive certain fees. (The interest rates on these and other federal student loans are set by the government.)

But critics are concerned the programs may create incentives for schools to encourage too much borrowing. Universities themselves set the price of attendance, and play a big role in determining how much financial aid students receive. If schools stand to gain from an increase in loans, they could offer debt-heavy aid packages that aren't in the students' best interest, these critics say.

"When the more students borrow generates income, that could put [schools] in a position of not being the honest broker," says Nancy Coolidge, coordinator for student financial support for the University of California system. She says the 10-campus university nonetheless did a study last year that determined it could make about \$2 million a year from a school-as-lender arrangement. That's a big reason why, says

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Ms. Coolidge, she wouldn't "rule it out" as a possibility at some point.

Lawmakers are moving to curb these lending arrangements. The federal Higher Education Act that governs student-loan programs expires at the end of the month. And both the House and Senate versions of legislation to reauthorize it include a requirement that all profits from loans made by schools be used for aid to needy students. (Many schools already say they do that, but it isn't required by law.) The Senate version, introduced earlier this week, would also bar any new schools from lending directly to students. Though it wouldn't eliminate existing school-as-lender programs, it adds a number of restrictions.

Schools for their part say that it would be against their own best interest to abuse their role as lender by loading students up with debt. "I think all of us take our job really seriously: to help people finance their education and not hock their future by taking on more debt than they can handle," says Rick Shipman, director of financial aid at Michigan State University, which operates a school-as-lender program. If students start defaulting on their loans, he points out, "that's going to reflect on my default rate at the institution, and why would I want that?"

The law has, since the 1970s, allowed schools that subscribe to the federal government's bank-based student-loan program to themselves lend money to graduate and professional students. Some of these students -- particularly in fields considered less-flashy at the time -- had trouble finding banks to lend them money. In certain rare cases schools can also lend to undergraduates who can't find any other financing. But it's only in recent years that these programs have gained momentum, as more schools -- especially public universities hit hard by budget cutbacks -- have found they don't have to reach into their own pockets to finance the loans.

While some schools, such as Tufts, have the capital to fund the initial loans, most of the programs work like this: Schools partner with a commercial or nonprofit lending institution to establish a line of credit. They then offer loans directly to graduate, law and medical students, often placing themselves on the list of lenders the school recommends. The schools hold the loans for a period of time -- usually two to three months after the money has been fully disbursed to the borrowers. During that time, the school collects interest, plus the government subsidies provided to lenders in the federally guaranteed student-loan program. Then they sell the portfolio back to the banks for the agreed-upon premium.

Beginning with incoming graduate students this fall, the University of Arizona has adopted an arrangement with Southwest Student Services Corp., a Phoenix-based unit of student-loan giant SLM Corp., better known as Sallie Mae. John Nametz, the university's financial-aid director, estimates the premium will eventually help bring in \$400,000 a year when the program is made available to all 8,000 graduate students in about three years. That money will be used for grants for needy students, he adds.

The students, Mr. Nametz says, get a good deal: Most lenders charge an "origination fee" of about 3% on the principal amount of the loan, which he says can top \$500 a year on a typical graduate-student loan. But like most schools in these programs, Arizona waives that fee. "That's a big savings," Mr. Nametz says.

The University of Nebraska-Lincoln is in its first year of a similar arrangement where it earns a 6.5% premium on the loans it sells to **Nelnet** Inc., a Lincoln, Neb., student-loan company. Previously, all students at the university were subscribed to the William D. Ford Federal Direct Loan Program, which allows students to borrow directly from the government. (Most schools subscribe to the bank-based loan program.)

Craig Munier, director of the school's office of scholarships and financial aid, says he prefers the Direct Loan program, which is still in place for undergraduates. But he says the school-as-lender arrangement offered a new funding stream, as well as a deal for borrowers: Students won't have to pay an origination

fee that was 1.5% to 3% of the principal borrowed in Direct Loans. That generally translates to savings of \$200 to \$400 per student per year, Mr. Munier estimates.

"The turning point was, we found ourselves in difficult financial times, as most state and publicly assisted universities did," Mr. Munier says.

The University of Illinois is considering implementing a school-as-lender program that would net the university roughly \$2 million for graduate-student scholarships, estimates Chet Gardner, vice president for academic affairs. Mr. Gardner says that he and other university officials are currently assessing proposals from potential lending partners and will likely make a recommendation to the university president by the end of this month.

But many Direct Loan advocates in the state are vowing to fight. Already, state Rep. Jack Franks, a Democrat, is considering legislation that would create disincentives, such as state-funding reductions, for the university if it adopts the program. "I don't want them profiting off our kids," he says, adding that he believes that the Direct Loan program saves taxpayers money in the long run.

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