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Federal student loan cap to drive boom in private SLABS

The White House on March 18 announced proposals to limit the amount of government student loans available to individual borrowers, a reform of the Higher Education Act meant to curb soaring student debt and which will likely result in a jump in private student loan ABS issuance.

By Jennifer Kang *25 Mar 2019*

"The rising cost of college education and the accompanying growth in student loan balances erode the wage premium associated with a college degree," the proposal reads. "It is therefore the policy of the Trump Administration to increase access to affordable, flexible, and innovative post-secondary education and skills attainment to meet the interests and lifelong learning needs of every American."

The proposal aims to restrain the rising costs of college tuition and relieve mounting student debt, which stands at approximately $1.5tr. The figure has increased by more than 350% since 2003, according to the announcement. The specific loan program targeted is Direct PLUS Loans, which allows eligible parents and graduate students to take out a maximum loan of whatever the cost of attendance is, minus any other financial aid received. The White House has not stated a specific limit in the proposal.

For the ABS market, a potential significant impact of capping federal loan allowance would be an increase in private loan volume, according to a Bank of America securitization report published on Monday. As students and parents find that they need more than what they are allowed to borrow from the government, they will turn to the private student loan lenders such as Navient and Sallie Mae to fill in the gap.

"I think [the volume] could double," said Jonathan Riber, senior vice president of US ABS at DBRS. "Those who are going to benefit the most are private lenders, including state agencies."

By December 2018, outstanding Grad PLUS and Parent PLUS disbursed under federal loan programs was $67bn and $90bn, respectively. The average amount borrowed was $24,811 for Grad PLUS and $16,452 for Parent PLUS in academic year 2017-2018, according to College Board. Compared to federal loans, the volume outstanding for private student loans is much smaller, standing at $31.6bn since Q3 2018, according to DBRS.

However, unlike federal student loans, private loans are often FICO based and private student lenders are more selective of who they make loans to.

"I think in terms of private student loan ABS volume, [it's a] net gain for the sector if Parent PLUS and Grad PLUS were capped, I just don't know how much," Grant Carwile, managing director at SL Capital Strategies said. "It wouldn't be dollar for dollar… because not all of those people will be eligible for private loans."

While the federal loan cap may be good news for private student lenders, some players could be hurt by the proposed reforms.

"People who should be afraid are graduate schools and small independent colleges," a student loan market source told *GlobalCapital*. "The independent, smaller colleges rely heavily on PLUS to help fill in seats for admission. Likewise, the professional schools, law schools, medical schools, MBAs, there's a fair bit of grad PLUS borrowing people use to cover their tuition."

With the new cap on federal loans, graduate schools and smaller colleges who use federal loans will likely be competing for their attendance. For students, the effect will be felt differently depending on what field of study they choose to enter.

"If those programs are capped, I think it could have a negative effect on certain students that want to enter certain professions," Riber said. "For students entering higher-paid fields, like medical school or law school, it would be easier for them to get private student loans to fill the gap. But students entering high tuition programs for low pay fields like public service or social work - they could struggle."

In the long run, however, all student loan borrowers may benefit from a capped federal loan system because it may put pressure on institutions to keep tuition costs down, Riber added. This is the rationale the Trump administration has provided to justify the loan restriction.

"Research shows a correlation between the availability of Federal student aid and tuition increases," the government proposal states. "The current system provides institutions of higher education with few incentives to control costs and saddles parents and graduate students with debt with little attention to borrowers' likely ability to repay."

Other suggestions made to Congress include consolidating the five existing income-driven repayment options into one and extending loan forgiveness to all undergraduate students. If implemented, the new income-driven repayment will cap monthly payments at 12.5% of a borrower's discretionary income.

The Trump-proposed Public Service Loan Forgiveness policy will support all undergraduate students after 180 months of repayment, regardless of what field of study they are in. Currently, loan forgiveness is granted to individuals working for certain types of employers, such as a government agency or a specific non-profit.

Whether the proposals will be written into law is yet unclear. Since its introduction in 1965, the Higher Education Act was last modified in 2008. However, the question around how much money students and parents should be allowed to borrow has been an ongoing debate, usually resurfacing every two years in Congress, said James Bergeron, the president of the National Council of Higher Education Resources. Because there is considerable disagreement between Republicans and Democrats, there is not a strong likelihood that the proposal is passed into law, he said.

"Both arguments have merit," said Bergeron. "I think Republicans have merit because you've got parents taking out too much debt without the ability to repay… Democrats have a really good point as well. Some borrowers are not credit worthy enough to receive private loans. Without some federal borrowing, they won't be able to attend a post-secondary institution."

Moreover, while the fiscal year 2020 budget released by the administration last week included provisions regarding consolidating the income-based repayment plans and eliminating the current loan forgiveness program, it did not mention the provision to cap PLUS loans. The omission further raises questions as to whether that specific proposal will be enacted into law.

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