FACT SHEET

The Future of **Private Loans:**

Who Is Borrowing, and Why?

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The Future of Private Loans: Who Is Borrowing, and Why?

This report examines recent developments in the private loan industry, characteristics of private loan borrowers, and trends that might impact the growth of private loans in the future. To download a free copy of the entire publication, *The Future of Private Loans: Who Is Borrowing, and Why?*, visit www.ihep.org.

Private Student Loans

The vast growth in private loans is being facilitated by several factors, including:

- rising prices of attendance and remaining need faced by students, combined with stagnant federal loan limits; and
- developments within the private loan industry, such as increased private loan profitability, and increased sales of private loans on capital markets.

Private and federal loans are distinct from one another in a number of important ways, including:

- funding and guarantee structure;
- associated risk of default;
- terms of interest rates, repayment, and fees; and
- variability in products offered and the borrowing process.

These distinctions can translate into significant differences between the pricing and eligibility for private and federal loans. Whereas the interest rates on federal loans are fixed and set by law, private student loans mostly carry a variable interest rate based on current market rates and on a borrower's credit rating.

Who Borrows and Why?

The majority of private loan borrowers are undergraduate students; however, professional students are much more likely to borrow and receive higher amounts.

- In 2003-2004, 83 percent of private loan borrowers were undergraduate students while 9 percent were graduate students and seven percent were professional students (e.g., medical or law).
- Yet nearly a quarter of all professional students took out a private loan, compared with five percent each of all undergraduate and graduate students.

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Students may turn to private loans for a number of reasons, such as to:

- meet higher prices and fill gaps of remaining need;
- afford enrollment at private institutions; and
- attend more classes throughout the year, and work less while enrolled.

Students who borrow private loans are mostly doing so in conjunction with federal Stafford loans.

- Eighty percent of dependent and 76 percent of independent undergraduate private loan borrowers also received a federal Stafford loan, and the majority of those who received a Stafford loan borrowed at the maximum.
- Ninety percent of professional and nearly three-quarters of graduate private loan borrowers also received a Stafford loan, and the majority of those who received a Stafford loan borrowed at the maximum.
- Yet some private loan borrowers do not take out the maximum Stafford or receive a Stafford at all. The reasons for this are unclear, but may include: initially low-interest rates on private loans, inability to qualify for federal loans, perceptions about the ease of obtaining private loans, or lack of awareness about federal loan options and benefits.

The Future of Private Loans

The future of private loans depends on the behavior of both lenders and students within a broader policy and economic environment.

- The future growth of private loan volume can be impacted by legislative changes made to federal student loan policies, general economic and interest rate environments, conditions of the student loan securitization market, and development of changing marketing strategies and competition.
- Students will be faced with increasingly complex decisions about postsecondary education funding, and must consider the trade-offs or potential costs of taking out a private loan. Thus, the need for targeted consumer education on the pros and cons of private loan borrowing is critical.

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