WHO BORROWS PRIVATE LOANS?

Borrowing through private student loan programs totaled $17.3 billion in 2005–06 and accounted for 20 percent of all education borrowing. While still much smaller than the federal education loan programs, which total $68.6 billion in annual volume, private loans are the fastest growing component of student financial aid. Total borrowing through private student loan programs grew by more than 900 percent, in inflation-adjusted terms, between 1995–96 and 2005–06.[1]

As a result of the rapid growth of these programs—which do not have the government guarantee, subsidized interest rates, and mandatory repayment terms that are features of the federal student loan programs—they have begun to attract significant scrutiny, both from the New York attorney general and from Congress. As a result, understanding who uses these loans has become more important than ever.[2]

Because private student loans are growing so rapidly, and because these loans are sometimes made directly to students with no involvement of campus financial aid offices, it is difficult for the U.S. Department of Education's National Postsecondary Student Aid Study (NPSAS),[3] which is the most comprehensive national study of student financing of postsecondary education, to accurately account for the amount of money students are borrowing through these programs. However, NPSAS is still the best national source of data available on the characteristics of students borrowing these loans.[4]

This issue brief answers the following key questions about private student loan borrowers:

- What types of academic programs and institutions do private student loan borrowers attend?
- What is the demographic profile of undergraduate private student loan borrowers and how do these students differ from those who don't use these loans?
- What other types of financial aid—especially federal student loans—do private borrowers receive?
- What share of students forgo federal student loans and rely exclusively on private loans? What factors might help explain this behavior?

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1 The College Board. (2006). *Trends in student aid 2006*. Washington, DC: Author.
2 This issue brief addresses only some of the important questions related to private student loans. For a comprehensive analysis of these programs, see McSwain, C., Price, D., & Cunningham, A. (2006). *The future of private loans: Who is borrowing, and why?* Washington, DC: Institute for Higher Education Policy.
3 A complete description of NPSAS as well as links to Department of Education reports based on the NPSAS data are available at http://nces.ed.gov/surveys/npsas/.
4 This analysis makes two important assumptions about the NPSAS data on private student loan borrowers. First, it assumes that the majority of student loan borrowers, who are captured in NPSAS, do not vary considerably from the much smaller group whose loans were not captured (primarily those who received a loan with no involvement by their campus financial aid office and who also did not report their loan in the student interview component of NPSAS). Second, this analysis assumes that, despite the rapid growth of these programs, the profile of student borrowers has not changed significantly since the year of the study, 2003–04.

Among the highlights:

- Eighty percent of private loan borrowers are undergraduates.
- Seventy-five percent of undergraduate private loan borrowers attend one of three types of institutions: public four-year colleges and universities (30 percent); private not-for-profit four-year colleges and universities (30 percent); and for-profit institutions offering programs of two years or more (15 percent).
- Private loan borrowers are more likely than other undergraduates to attend full time. More than 85 percent of private loan borrowers at the three types of institutions examined attended on a full-time basis.
- Private loan borrowers are disproportionately dependent students.[5]
- At public and private not-for-profit four-year institutions, the majority of private loan borrowers are middle- and upper-income dependent students, although low- and moderate-income dependent students make up a significant minority.
- At for-profit institutions, low-income dependent and independent students and middle-income dependent students make up the bulk of private loan borrowers.
- Almost 90 percent of private loan borrowers apply for other types of aid, and 64 percent receive some type of grant assistance.
- Seventy-seven percent of private loan borrowers also borrowed a Stafford federal student loan—the primary type of federal student loan.
- When students who do not meet the eligibility criteria for federal student loans are excluded, one out of five undergraduate private loan borrowers did not first take advantage of federal student loans. Half of these students did not file the necessary application for federal student loans.
- Possible reasons that private loan borrowers opt out of the Stafford program include a comparable introductory rate offered by a private program, simpler application processes for private loans, lack of comparative information on costs and benefits, and misperceptions about eligibility criteria for federal student loans.

WHAT IS THE ACADEMIC PROFILE OF PRIVATE STUDENT LOAN BORROWERS?

Traditionally, private student loan borrowers were primarily graduate students in professional degree programs in fields such as law and medicine. These students are still the most likely to borrow private loans (24 percent borrowed private loans in 2003–04); however, the share of undergraduates borrowing private loans has grown rapidly, from less than 1 percent in 1995–96 to 5 percent in 2003–04, and undergraduates composed approximately 80 percent of private loan borrowers in 2003–04. Because graduate students now may borrow through the new federal Graduate/Professional PLUS student loan program,[6] the undergraduate share of private

[5] Undergraduates are considered *dependent*, and their parents' income is included in determining their eligibility for financial aid, if they are aged 23 or younger, single, do not have children, and are neither veterans nor wards of the court. Students who do not meet these criteria are considered *independent*.

[6] Graduate and professional degree students are now eligible to borrow under the Graduate/Professional PLUS loan program up to their cost of attendance minus other estimated financial assistance. Approval of these loans is subject to a minimal credit test, and repayment must begin once the loan is disbursed. The interest rate for these loans is fixed at 8.5 percent in the guaranteed student loan program and 7.9 percent in the Direct Loan program.

loan borrowers will at least hold steady and may continue to grow. As a result, this issue brief concentrates on undergraduate borrowers.

Seventy-five percent of undergraduate private student loan borrowers attend one of three types of institutions: public four-year colleges and universities (30 percent); private not-for-profit four-year colleges and universities (30 percent); and for-profit institutions with programs of two years or more (15 percent).[7] These institutions enroll 30 percent, 13 percent, and 5 percent of all other undergraduates, respectively (see **Figure 1**).

As one might expect, at both public and private not-for-profit institutions, 95 percent or more of undergraduate private loan borrowers are enrolled in bachelor's degree programs. At for-profit institutions, 58 percent of private loan borrowers are in associate degree programs, 32 percent are in bachelor's degree programs, and 8 percent are in certificate programs. No one field of study attracts a majority of private loan borrowers; the largest concentrations of private loan borrowers are in business, humanities, and social sciences at public and private not-for-profit institutions, and in computer and information science and vocational/technical fields at for-profit institutions.

Private student loan borrowers are more likely than other undergraduates to attend full time. In fall 2003, approximately 90 percent of private loan borrowers at public and private not-for-profit institutions attended full time, compared with 80 percent of other students. Likewise, at for-profit institutions, 87 percent of private borrowers in attendance in fall 2003 were studying full time, compared with 70 percent of others (see **Figure 2**).[8]

WHAT IS THE DEMOGRAPHIC PROFILE OF PRIVATE STUDENT LOAN BORROWERS?

Private student loan borrowers are disproportionately dependent students; 67 percent of these borrowers are considered dependent, compared with 49 percent of other undergraduates (see **Table 1**). As a result, private loan borrowers, with an average age of 23.5 years, are younger than other undergraduates. Undergraduates who did not borrow these loans have an average age of 26.6 years.

The dependency status of private loan borrowers does vary markedly by type of institution; however, at each institution type, private loan borrowers are more likely to be dependent students than others at that type of institution. Eighty percent of private loan borrowers at public and private not-for-profit colleges and universities are dependent students versus 65 percent and 60 percent of other students at these types of institutions, respectively. At for-profit institutions, 34 percent of private loan borrowers are dependent students, compared with 19 percent of students who did not borrow these loans.

[7] Most of the subsequent analysis compares private loan borrowers at these three types of institutions, referring to them more succinctly as public, private not-for-profit, and for-profit institutions. Because of the size of the sector, public two-year institutions account for 12 percent of undergraduate private loan borrowers even though only 1.4 percent of community college students borrowed private loans in 2003–04. Because borrowing private loans is so rare among community college students, these institutions are not included in subsequent comparisons. However, the figures reported for all undergraduates encompass all institution types, including community colleges.

[8] Because many for-profit institutions do not follow a traditional academic calendar, 37 percent of students who borrowed private loans for the 2003–04 academic year were not in attendance in fall 2003. The statistics reported above reflect only students who attended during the fall term.

Consistent with private loan borrowers' more traditional profile, at public and private not-for-profit institutions, those borrowers also are slightly more likely to be white than other undergraduates. Seventy-seven percent of students with private loans are white, versus 70 percent of other undergraduates, at public institutions, and 73 percent versus 67 percent at private not-for-profit institutions. At for-profit institutions, private student loan borrowers are less likely than students who did not borrow these loans to be white or African American (48 percent versus 53 percent are white, and 15 percent versus 25 percent are African American), and more likely to be Hispanic or Asian American (23 percent versus 16 percent are Hispanic and 7 percent versus 3 percent are Asian American).

There is no difference in gender between private loan borrowers and other undergraduates at either public or private not-for-profit institutions. In contrast, at for-profit institutions, a large difference in gender exists between private loan borrowers and other undergraduates: 61 percent of private loan borrowers are male versus 42 percent of other undergraduates. This gender disparity may be related to the high concentration of private loan borrowers in computer and information technology and other vocational/technical fields—areas that traditionally attract more male students.

At public and private not-for-profit institutions, more than half of all private loan borrowers are dependent students from families with annual incomes of $50,000 or more. While middle- and upper-income dependent students are primary users of private loans at these institutions, a significant minority of borrowers come from low- and moderate-income backgrounds. The next largest group (approximately 25 percent at both public and private not-for-profit institutions) consists of dependent students from families earning less than $50,000. At public institutions, private loan borrowers are more likely than other undergraduates to be dependent students from families with incomes between $50,000 and $100,000. At private not-for-profit institutions, they are more likely than others to be dependent undergraduates with family incomes between $30,000 and $100,000.

At for-profit institutions, low-income students in both dependency groups, and middle-income independent students, are primary users of private student loans. One-third of private student loan borrowers at for-profit institutions are independent students with annual incomes less than $20,000; another 15 percent are dependent students with family incomes less than $30,000; and 25 percent are independent students with family incomes between $20,000 and $50,000.

Combining the academic and demographic information on private loan borrowers, a largely traditional student portrait emerges—especially at public and private not-for-profit institutions. Private loan borrowers at these institutions are primarily full-time, dependent middle- and upper-income students. However, low-income and minority students make up a significant minority of private loan borrowers. At for-profit institutions, the picture is more diverse. Males, Hispanics, low-income students, and middle-income independent students all make up a disproportionate share of private loan borrowers at for-profit institutions.

WHAT OTHER TYPES OF FINANCIAL AID DO PRIVATE STUDENT LOAN BORROWERS RECEIVE?

Given that private student loans generally have higher interest rates and less flexible repayment options than federal student loans, these loans ideally should supplement grants and federal loans. Students typically apply for private loans directly to banks; this type of aid usually is not awarded through the main financial aid application process. To apply for most other types of aid, including government and institutional grants as well as federal student loans, students must complete the Free Application for Federal Student Aid (FAFSA).

Fortunately, 88 percent of private loan borrowers do file the FAFSA—a much higher rate than among other undergraduates—making themselves eligible to receive other types of financial aid (see **Table 2**). The share of private loan borrowers filing the FAFSA ranged from 83 percent at public institutions to 98 percent at for-profit institutions, and from 73 percent among independent students with incomes of $50,000 or more, to 95 percent of dependent students with family incomes of less than $30,000. While these application rates are high, they still beg the question of why some private borrowers do not complete the paperwork necessary to apply for other types of assistance.

Overall, 64 percent of undergraduate private loan borrowers received some type of grant assistance in 2003–04. The average amount these students received was $5,555. This pattern compares favorably with students who did not borrow private loans; 50 percent of students who did not borrow private loans received grant aid averaging $3,912. As one would expect, lower-income students were most likely to receive federal Pell Grants and state grants, and students at private not-for-profit institutions were most likely to receive institutional grants.

Despite being more likely to receive grants, private loan borrowers face higher educational prices, after grants are deducted, than other undergraduates. At each institution type, and at almost every dependency and income level within each institution type, private student loan borrowers face average total educational and living costs, net grant aid, that are at least $2,000 higher than the average costs borne by other undergraduates. Therefore, it is not surprising that these students borrow.

Most private borrowers have federal student loans as well. Seventy-seven percent of private student loan borrowers also had a Stafford federal student loan—the main type of federal student loan—in 2003–04 (see **Figure 3**). Because federal loans offer a low fixed rate, an in-school interest subsidy for qualified students, and flexible repayment options, most experts advise students to borrow the maximum amount available through the Stafford program before turning to private loans. More than half of private loan borrowers (56 percent) borrowed the maximum amount allowable through the Stafford program.[9] Another 21 percent borrowed less than the annual maximum. Many circumstances could explain why a student might have received less than the annual maximum; most common would be that the student had not attended for the full academic year.

WHY DO SOME STUDENTS FORGO FEDERAL STUDENT LOANS IN FAVOR OF PRIVATE LOANS?

Of greater concern than those students who borrowed less than the maximum Stafford loan amount are the private loan borrowers who did not borrow a Stafford loan at all. If private loans should only be used as a supplement to federal loans, why did almost one out of four private borrowers not take advantage of federal student loans?

One explanation is that these students may not have qualified for a Stafford loan. The four main ways that a student may not qualify for a Stafford loan are (1) attending an institution that is either ineligible to participate in the federal financial aid programs or that chooses not to

[9] The maximum annual amount students may borrow through the Stafford program varies by student dependency status and academic level. In some cases, dependent students may borrow more than the annual limits typically allowed in the Stafford loan program; 8 percent of all private loan borrowers had Stafford loans in excess of the annual limits in 2003–04. For more information on borrowing limits and borrowing in excess of these limits, see King, J. (2003). *2003 status report on the federal education loan programs.* Washington, DC: American Council on Education. The report is available at http://www.acenet.edu/bookstore/pubInfo.cfm?pubID=304.

participate in these programs; (2) attending on a less than half-time basis; (3) not being a U.S. citizen or permanent resident; and (4) failing to file the FAFSA.[10] NPSAS includes only students attending institutions that participate in the federal student financial aid programs, so all students in the study meet that criteria. Six percent of private loan borrowers with no Stafford loan are foreign students and 8 percent are less-than-half-time students, so these students do not account for a large share of those who rely on private loans instead of federal loans. When these students are excluded, the share of all private loan borrowers with no Stafford loan drops by only 2 percentage points to 21 percent. In other words, one out of five undergraduate private loan borrowers—who appear to be eligible for a Stafford loan—did not take advantage of this option.

When foreign and less-than-half-time students are excluded, the NPSAS data reveal that half of private loan borrowers with no federal loans did not file the FAFSA. The other half filed the FAFSA but, for some reason, did not borrow a Stafford loan. Some portion of these latter students may have begun the application process by filing the FAFSA, but did not complete other required steps in the process. Others may have initially declined to borrow a Stafford loan, then later turned to private loans, assuming that they had made themselves ineligible by initially declining a government loan. Equally troubling is that those private loan borrowers who did not file the FAFSA also may have qualified for federal, state, or institutional grant aid that could have reduced their need to borrow.[11]

The share of private loan borrowers with no Stafford loans (excluding foreign and less-than-half-time students) ranges from 6 percent at for-profit institutions to 27 percent at public institutions (see **Table 3**). Upper-income dependent and independent students were most likely to borrow private loans instead of federal loans. These students may have opted out of applying for financial aid assuming that they would not qualify, but unsubsidized Stafford loans are available to students without regard to financial need and it is surprising that these students—who seemingly should have the best access to information about financial aid—likely missed out on using a lower cost form of credit to finance their postsecondary education. In some cases, these students may have been offered an interest rate that is the same or even lower than the rate available through the federal program due to their (or their co-signer's) favorable credit history. Because the interest rate on private student loans is variable, however, this advantage may only be temporary.

Regardless of whether students filed the FAFSA, private loan borrowers who did not use the Stafford program may simply have been attracted to private loans because of the way these programs are marketed. They also may have chosen private loans because the application process is simpler and easier than completing the FAFSA, which is eight pages long, contains more than 100 questions, and is only the first step in a multistep application process. Additionally, these students may not have been aware of the differences in cost between the government programs and private loans. Many private loan programs use direct-to-consumer marketing, bypassing campus financial aid offices, so families can make loan decisions without a campus financial aid officer or other expert offering an objective comparison of the costs and benefits of the various loan options.[12] Students—and parents—may therefore opt out of the

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[10] Students who have filed the FAFSA also may not obtain a federal student loan if they fail to complete other paperwork required in later stages of the application process (for example, failing to sign a promissory note).
[11] These students may have qualified for other types of aid, such as scholarships from private organizations or employer-provided tuition assistance, which are awarded outside the FAFSA process.
[12] Lenders vary in the information they provide to consumers. See, for example, the consumer information offered online by Sallie Mae, which does participate in the federal loan programs (www.salliemae.com), and Loan to Learn (www.loantolearn.com), which does not.

Stafford program under the impression that there is no cost difference or that the difference in cost is small enough that it is outweighed by the convenience of the simpler private loan application process.

CONCLUSION

Of all the characteristics of private loan borrowers reviewed in this issue brief, two stand out: One out of five forgoes less expensive federal student loans, and half of these students don't even file the paperwork necessary to qualify for federal, state and institutional grant aid, in addition to federal student loans. This finding is even more surprising given that many private loan borrowers are middle- and upper-income students who should have the best access to financial aid information.

The proliferation of loan programs, each with its own marketing information, reinforces the need for clear, unbiased consumer information. This responsibility will only become more important—and more challenging—as the private loan market continues to grow. Meeting students' and families' needs for information on the wide array of college financing options will require heightened efforts by government, lenders, colleges and universities, journalists, and guidebook publishers.

THE AUTHOR

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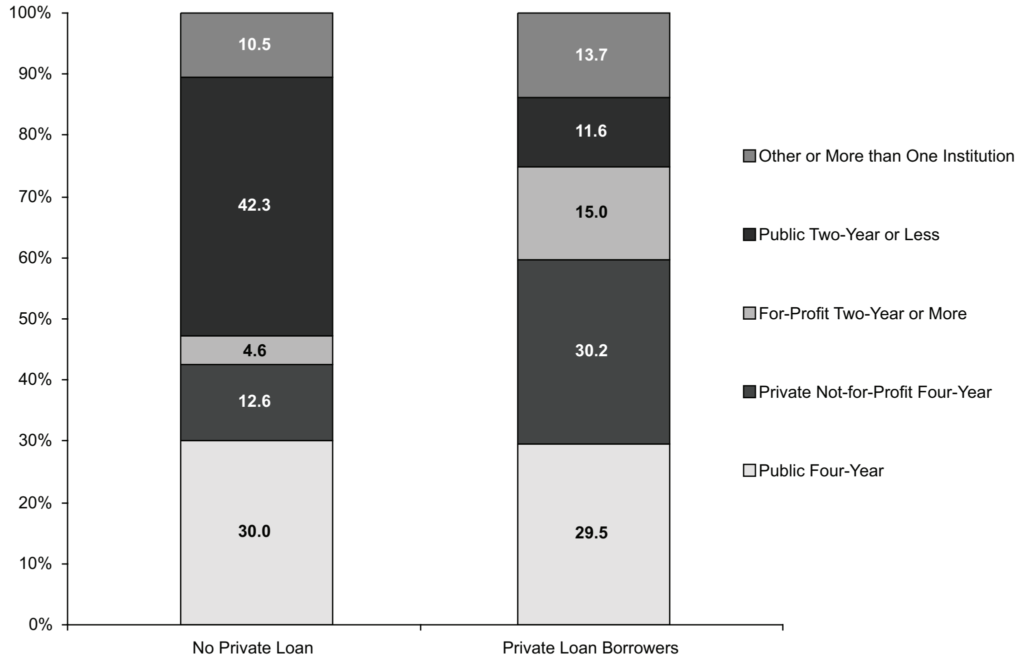
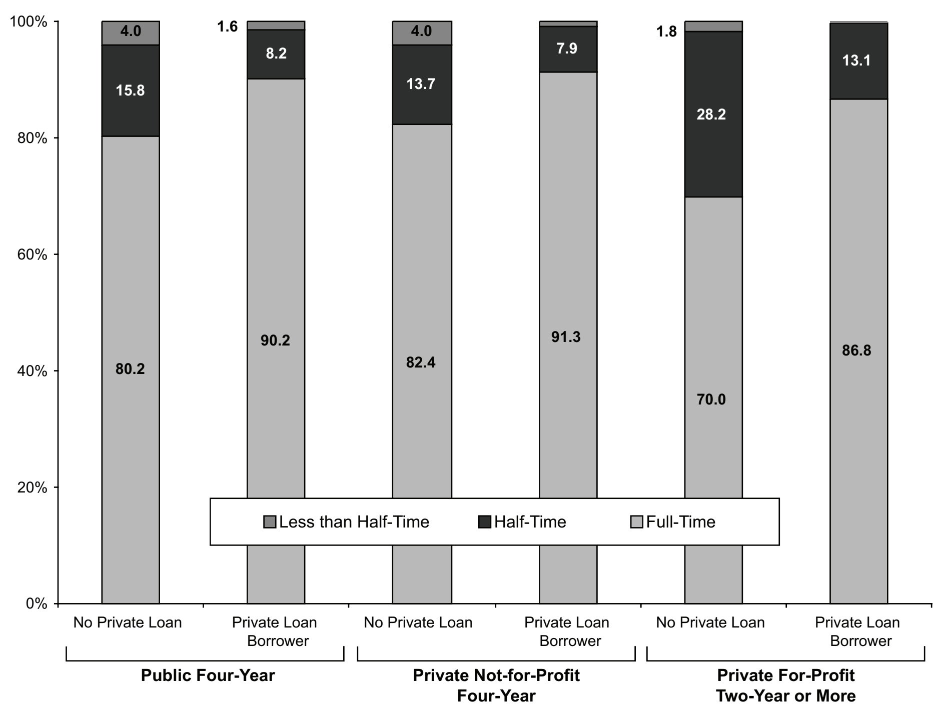
Figure 1.
Distribution of Undergraduates, by Institution Type and Private Loan Status: 2003–04



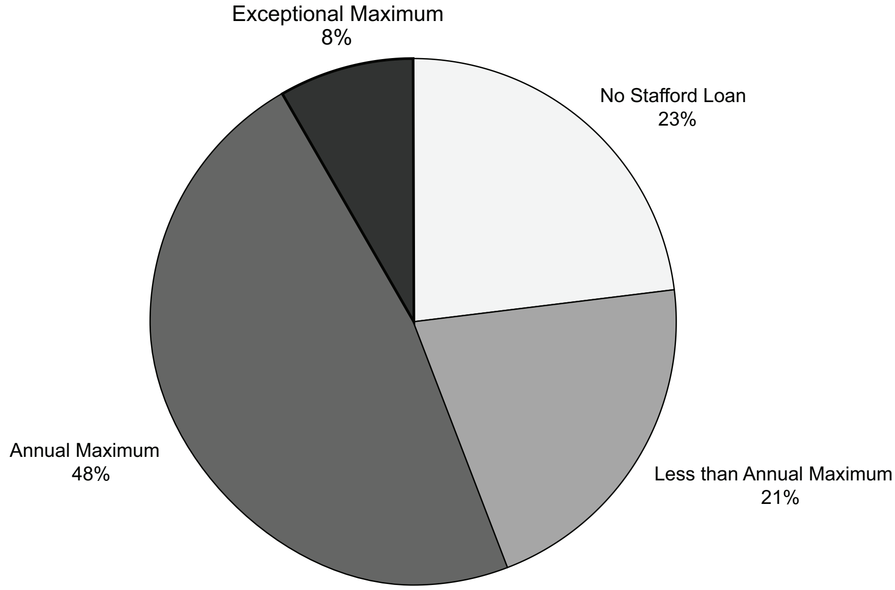
Source: U.S. Department of Education, National Center for Education Statistics. National Postsecondary Student Aid Study: 2003–04. Analysis by author.

Figure 2.
Distribution of Undergraduates, by Private Loan and Attendance Status: Fall 2003



Source: U.S. Department of Education, National Center for Education Statistics. National Postsecondary Student Aid Study: 2003–04. Analysis by author.

Figure 3.
Distribution of Private Loan Borrowers, by Stafford Loan Status: 2003–04



Source: U.S. Department of Education, National Center for Education Statistics. National Postsecondary Student Aid Study: 2003–04. Analysis by author.

Table 1.
Distribution of Undergraduates, by Private Loan Status and Various Demographic Characteristics: 2003–04

Demographic Characteristics	Public Four-Year		Private Not-for-Profit Four-Year		For-Profit Two-Year or More		All Institution Types	
	No Private Loan (%)	Private Loan Borrower (%)	No Private Loan (%)	Private Loan Borrower (%)	No Private Loan (%)	Private Loan Borrower (%)	No Private Loan (%)	Private Loan Borrower (%)
Dependency Status								
Dependent	64.9	79.4	59.9	80.5	18.9	33.5	48.8	66.5
Independent	35.1	20.6	40.1	19.5	81.1	66.5	51.2	33.5
Race/Ethnicity								
White	69.8	76.7	66.5	73.0	53.0	47.6	62.9	67.2
African American	10.6	8.3	13.7	7.6	24.6	15.4	14.1	11.4
Hispanic	9.0	6.0	12.2	10.3	14.6	23.3	12.8	11.7
Asian American	5.9	4.8	4.2	4.0	2.9	7.3	5.4	4.7
American Indian or Alaska Native	1.0	0.8	0.4	0.7	0.7	0.7	0.9	0.7
Other or more than one race	3.7	3.4	3.0	4.4	4.3	5.8	3.3	3.8
Gender								
Male	45.5	46.6	44.2	43.8	41.9	61.2	42.2	45.6
Female	54.5	53.4	55.8	56.2	58.1	38.8	57.8	54.4
Dependency and Family Income								
Dependent: Less than $30,000	12.7	11.0	11.9	13.0	8.1	15.0	11.2	12.1
Dependent: $30,000 to $49,999	12.0	14.1	10.2	14.2	4.2	5.8	9.4	12.6
Dependent: $50,000 to $69,999	12.1	18.2	8.9	15.2	2.7	5.3	8.7	13.3
Dependent: $70,000 to $99,999	13.4	20.5	12.0	20.9	2.0	4.2	9.2	15.8
Dependent: $100,000 or more	14.8	15.6	16.8	17.2	1.9	3.2	10.3	12.7
Independent: Less than $10,000	9.2	6.1	8.1	5.9	17.0	16.6	11.4	9.1
Independent: $10,000 to $19,999	6.7	4.4	6.3	3.9	15.7	15.9	9.3	7.3
Independent: $20,000 to $29,999	5.6	2.4	6.3	2.5	14.9	10.4	8.1	5.1
Independent: $30,000 to $49,999	6.1	3.5	7.8	3.3	15.2	14.3	9.7	6.4
Independent: $50,000 or more	7.4	4.2	11.5	3.9	18.3	9.3	12.7	5.6

Source: U.S. Department of Education, National Center for Education Statistics. National Postsecondary Student Aid Study: 2003–04. Analysis by author.

Table 2.
Percentages of Undergraduates Filing the FAFSA and Receiving Grants, and Average Net Price, by Private Loan Status: 2003–04

	Public Four-Year		Private Not-for-Profit Four-Year		For-Profit Two-Year or More		All Institution Types	
	No Private Loan	Private Loan Borrower	No Private Loan	Private Loan Borrower	No Private Loan	Private Loan Borrower	No Private Loan	Private Loan Borrower
Filed the FAFSA								
Yes	61.7	82.8	68.9	94.1	88.4	97.7	57.2	88.2
No	38.3	17.2	31.1	5.9	11.6	2.3	42.8	11.8
Received Grant Assistance								
Any type of grant	51.6	54.3	72.0	85.1	66.9	64.2	49.9	64.1
Pell Grant	26.0	20.1	26.9	28.6	50.4	50.7	26.6	30.0
Institutional grant	20.7	23.7	47.0	69.4	7.3	9.5	16.7	32.7
State grant	18.8	15.6	21.2	29.3	11.2	10.8	14.5	17.8
No grant aid	48.4	45.7	28.0	14.9	33.1	35.8	50.1	35.9
Average Net Price After Grants								
Total budget less grants	$10,048	$13,769	$16,010	$20,518	$12,557	$17,471	$8,829	$15,931

Source: U.S. Department of Education, National Center for Education Statistics. National Postsecondary Student Aid Study: 2003–04. Analysis by author.

Table 3.
Distribution of Private Loan Borrowers, by Use of Stafford Loans: 2003–04
(Note: Excludes foreign and less-than-half-time students.)

	No Stafford (%)	Less than Annual Maximum (%)	Usual Maximum (%)	Exceptional Maximum (%)	Total (%)
All Private Loan Borrowers					
	20.5	22.0	49.0	8.5	100
Institution Type					
Public four-year	27.3	18.3	48.9	5.6	100
Private not-for-profit four-year	12.4	16.6	64.1	6.9	100
For-profit two-year or more	6.4	21.4	51.6	20.6	100
Dependency and Family Income					
Dependent: Less than $30,000	16.0	16.6	41.2	26.2	100
Dependent: $30,000 to $49,999	18.7	17.7	48.5	15.1	100
Dependent: $50,000 to $69,999	16.2	15.4	57.9	10.5	100
Dependent: $70,000 to $99,999	23.5	14.3	55.0	7.2	100
Dependent: $100,000 or more	24.3	11.3	58.9	5.5	100
Independent: Less than $10,000	22.4	42.8	34.8	NA	100
Independent: $10,000 to $19,999	21.1	35.3	43.4	NA	100
Independent: $20,000 to $29,999	19.7	41.8	38.4	NA	100
Independent: $30,000 to $49,999	19.3	33.9	46.9	NA	100
Independent: $50,000 or more	26.6	27.8	45.6	NA	100

NA: There is no provision for independent students to qualify for more than the usual maximum annual loan amount.
Source: U.S. Department of Education, National Center for Education Statistics. National Postsecondary Student Aid Study: 2003–04. Analysis by author.