**Banks Take Interest in College Lending**

Lenders Are Lured by Declining Default Rates

By AnnaMaria Andriotis, WSJ.com, Updated Feb. 24, 2014 8:52 p.m. ET

Lenders are reacquainting themselves with college students, lured by the prospect of building ties with young customers and encouraged by declining loan-default rates among these borrowers.

The increase in lending means some students and their families get a shot at lower interest rates than the much-larger federal loan system offers. For others, it is a source of cash needed to meet rising tuition costs that some government loans may not be able to fully cover.

The seven largest private lenders to students issued nearly $6.9 billion in loans last year, up 8.1% from the previous year, according to data compiled for The Wall Street Journal by MeasureOne, a San Francisco firm that tracks the student-loan market.

That marked the second consecutive year of growth and the largest dollar amount of annual originations since 2009, when rising defaults during the downturn pushed dozens of private lenders out of the business.

An improving employment picture has made it easier for new graduates to find jobs, making lenders more comfortable with the private student-loan market, especially as they tighten underwriting standards. In addition, banks, searching for new revenue, are viewing students with high-income potential as lifelong customers to whom they can later sell products, such as mortgages and wealth-management services.

"We are at a turn—there's a lot of momentum and a lot of interest in private student loans," says MeasureOne Chief Executive Dan Feshbach. "Banks are seeing more upside than downside to these loans."

These trends are helping to create a two-tier system in which borrowers with high credit scores stand to benefit from private loans while those with weaker credit are mostly limited to government loans.

Joshua Deese, a sophomore at the University of Maryland, pays for college using a mix of federal and private loans. Mr. Deese, 20 years old, has taken out six private student loans with SLM Corp., better known as Sallie Mae, the largest private lender to students. The loans total more than $86,500 and carry interest rates between 8% and just over 9%.

To get those rates, he needed his uncle to cosign the loans. Mr. Deese says his parents, a police officer and a nurse, earn too much to help him qualify for free financial aid but not enough to help him pay for college. So he has to rely largely on private loans.

"They are getting me through school, but I'm going to have a huge amount of debt," he says.

Rates on private loans vary widely. Borrowers with excellent credit can find rates as low as 2% on variable-rate loans or as low as around 5.5% on fixed-rate loans, though rates can be much higher—even more than 10%—for people with lower credit scores.

To be sure, private student loans account for just 13.9% of total outstanding student-loan debt, down from a peak of 18.6% in 2008, according to estimates from Mark Kantrowitz, a senior vice president at Las Vegas-based Edvisors.com, which tracks the business, and the U.S. Department of Education.

The $1.2 trillion student-loan market remains dominated by federal loans. Legislation in 2010 ended the private sector's role in originating federally backed loans, and all those loans have since been made directly by the government.

Government-sponsored loans, which have fixed rates and flexible repayment options and sometimes allow loan forgiveness, expanded significantly during the recession just as private lenders retreated. The total dollar amount of private loans originated fell about 50% during the 2008-09 academic year from the previous year, while federal-student-loan funding increased 26%, according to non-inflation-adjusted data from the College Board, a nonprofit in New York.

Demand for federal loans picked up partly because of the loans' loose underwriting standards, says Barbara Lambotte, manager of Moody's Investors Service student-loan ratings team, which rates student-loan securitizations. The government doesn't run credit-score checks on applicants, allowing more financially troubled borrowers to get credit. Applicants for the federal PLUS loan undergo a modest credit-history review.

Ten percent of borrowers who began paying back their federal loans from October 2010 through September 2011 defaulted by September 2012, according to the latest data released by the Education Department. This figure has been rising each year since fiscal year 2005 when it was 4.6%.

By contrast, the default rate among the seven largest private lenders fell to 3.02% during the third quarter of 2013, down from 3.81% a year earlier and 4.56% the same period in 2011, according to MeasureOne. The rate peaked in 2009 at 9.92%.

Sallie Mae originated $3.8 billion of private student loans in 2013, up 14% from the previous year. It is projecting $4 billion in new loans this year. Volume at No. 2 lender Wells Fargo & Co. rose around 6.5% to nearly $1.6 billion last year. [Discover Financial Services](http://quotes.wsj.com/DFS) Inc., the third-largest lender, gave out more than $1 billion in new loans last year, up slightly.

Tighter underwriting standards—and the increasing use of cosigners—have created more confidence among lenders. "It's the customers who have the financial ecosystem where they can get someone to sponsor them—most kids can't demonstrate ability to repay," says John Rasmussen, head of education financial services at Wells Fargo.

—Alan Zibel contributed to this article.

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