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College Costs and Sallie Mae, Rising Hand in Hand

By JENNIFER A. KINGSON

The escalating costs of higher education may be a burden to young adults and their parents, but they are an opportunity for student loan companies, both specialty finance companies and the big banks.

More young people are going to college, but federal grants are not rising commensurately. The maximum that students can borrow in federally guaranteed loans has remained relatively flat for years. And on July 1, the government raised interest rates on these loans for the second consecutive year.

While the student loan market has become more competitive, the biggest lender, the [SLM Corporation](#), better known as Sallie Mae, has been widening its reach and depth in ways that make some traditional banks squirm.

“They’ve built a tremendous amount of scale in a very competitive, low-margin business,” said Matt J. Snowling, an analyst with Friedman, Billings, Ramsey & Company. “The asset is very low-yielding, but profitable if it’s done right.”

On top of its bread-and-butter business of extending loans to students — it has a \$127 billion portfolio and 10 million borrowers — Sallie Mae has built, largely through acquisition, a major debt-collection arm that serves large clients like the [Internal Revenue Service](#). Sallie Mae has also picked up a coveted type of banking charter (something that [Wal-Mart](#) is seeking) to compete more aggressively with banks in the lucrative area of private loans, which are becoming a hotter product as tuition rises.

And last month, Sallie Mae announced a deal for Upromise, a company that markets accounts in the 529 program and other college savings plans. The acquisition will probably lengthen the potential life span of customers’ relationships with Sallie Mae, turning recent graduates who are parents of young children into people who are not only repaying student loans to Sallie, but also saving for future college costs with it.

As a result, Sallie Mae is starting to look a little more like [J. P. Morgan Chase](#), [Citigroup](#), [Bank of America](#) and Wells Fargo, whose eagerness to court the student marketplace stems in part from the

potential to pick up customers for life: well-educated customers with high earning potentials.

Executives at Sallie Mae declined to comment for this article.

The student loan marketplace has only recently come into its own. Back in the early 1990's, when Sallie Mae was under the government's auspices, default rates on student loans were so high that most mainstream banks viewed the market as toxic.

Changes in the law — including longer repayment periods on loans, bankruptcy overhaul and the rise of products that let students refinance their debts at more manageable rates — have not only brought default rates to record lows but also attracted swarms of new lenders. And during the Clinton administration, the federal government itself got into the direct lending business, essentially competing with the banks.

“It's quite a market out there,” said Alicia D. Hurley, associate vice president for government and community affairs at [New York University](#), saying that she has seen many unfamiliar companies approaching the university to provide loans. “These companies put a lot of pressure on the institutions” to place them on preferred lender lists that are circulated to incoming students, offering such enticements as price breaks and extended repayment times.

Ms. Hurley says she feels the pressure as a consumer. She earned a doctorate in higher education policy three years ago and was able to lock in a loan at good rates, but continues to be besieged by offers to refinance. “I get so much mail,” she said.

Students and their families have seen some benefits from the heightened competition. Financial aid officers say some lenders, including Citibank and Sallie Mae, have been lowering fees; in some cases, for example, they swallow a 3 percent loan origination fee charged by the Department of Education. Recent legislation will have that fee phased out by 2010, but smaller players, including Nelnet, have complained that such pricing tactics take a toll.

“Pricing pressures in the student lending industry are symptomatic of supply catching up to demand,” said Kenneth A. Posner, an analyst with [Morgan Stanley](#).

Sallie Mae's acquisitions of debt collectors, Upromise and other related companies are a further signal of maturity in the sector, Mr. Posner said. But he added: “New businesses are sometimes more difficult than they look. We do see promise in the private student lending business, where the company is well positioned. We're not as convinced about the marriage of the debt-collection business,” in which other companies have more experience, he said.

Nelnet, a company in Omaha that is sometimes called a mini-Sallie Mae, has not been sitting on the sidelines. “What we are trying to do is diversify more into fee-based businesses,” said Cheryl E. Watson, a spokeswoman for Nelnet. For instance, among other deals, Nelnet recently bought the Facts

Management Company, which offers tuition payment plans for private and parochial schools, kindergarten through 12th grade.

In another legal change that took effect July 1, graduate students got access to a federal loan program called Plus, which had been available only to undergraduates. This is expected to be a boon for lenders, Ms. Watson said.

Given that educational costs keep rising, nobody expects the student loan market to level off anytime soon. "Most of the growth has been in unsubsidized loans, for which you do not need to show financial need," said John Lee, vice president for research at Student Marketmeasure, a company in Bethesda, Md., that sells data to banks. "A lot of that money is going to middle-income families and students as loans of convenience as opposed to loans of necessity, so the percentage of students borrowing has expanded."

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