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Students resort to private loans, staggering debt

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Ethan Winsby considers himself in financial ruin at age 27 -- but not because he lost at gambling or risked everything on a startup that went bust.

Like a growing number of young adults, he had to take out private loans to attend college.

He graduated from the California Culinary Academy in San Francisco in 2005, but he said his subsequent low-paying job as a cook has made it nearly impossible for him to repay the $35,000 he borrowed.

As the 18 percent interest rate compounded, his debt has soared to $50,000. The monthly payments, if he made them, would be two-thirds of his $1,200 monthly after-tax salary.

With no prospects of paying his loans off quickly, Winsby sees his debt spiraling out of control.

"At this rate, I'm going to be in default," he said. "Default means you have no options. It's the main source of stress in my life. It shouldn't be. I was trying to make a career for myself. I wish I hadn't even gone to school."

As the cost of college skyrockets and the federal government limits how much it will loan students, young adults increasingly are taking out private loans to finance their education.

The amount loaned to students nearly tripled between 2001 and 2006, from $6.1 billion to $17.3 billion, according to an annual student aid survey released Tuesday by the College Board.

"I am shocked and worried about the amount of debt these companies are encouraging students to take out," said Robert Shireman, executive director of the Project on Student Debt.

The trend is especially dangerous, he said, because such loans almost always carry a variable interest rate and lack the protections offered by federal loans, "so if interest rates go up, your private student loan can look like a credit card pretty quickly."

Recent changes in federal law make it nearly impossible to discharge any kind of student loan debt through bankruptcy. Instead, a borrower faces the possibility of a ruined credit rating or being forced into an unaffordable payment plan.

Education experts are calling on the federal government to raise the amount it will loan students and to give them more grants to keep them from having to turn to private loans to fill the gap.

Historically, private lenders have marketed loans to students in professional schools who have high earning potential once they graduate. But increasingly, they are targeting undergraduates.

One company, Loan to Learn, advertises on Google with this tantalizing ad: "Financial Aid Not Covering Your Costs? Get up to $50,000 in five days." The company will loan qualifying undergraduates $50,000 a year, up to $250,000.

The United States Student Association filed a complaint with the Federal Trade Commission in September saying that Loan to Learn engaged in "false and deceptive advertising practices" by encouraging students to view its private loans as a preferable alternative to federal grants and loans.

If the FTC finds a company has violated the law, it can seek a court order to require changes.

Loan to Learn officials deny misleading students and say they provide a needed service.

"To say that Loan to Learn doesn't have an interest in the students cuts to the core," said Catherine Reynolds, chairwoman and CEO. "What we do is simply try and help families have an option."

Students and families are finding it increasingly hard to pay for college. In the past five years, the cost of attending a public university has risen 35 percent after adjusting for inflation, according to the College Board. Meanwhile, federal loan amounts have stagnated.

For example, under the most popular federal program, called Stafford, an undergraduate can borrow no more than $23,000 over five years -- roughly what the average private university charges for a single year's tuition and fees. The maximum Pell Grant for needy students has stayed at $4,050 for three years.

Many students turn instead to private loans.

A decade ago, such high-interest loans represented 6 percent of all the cash loaned to students. Today they are 20 percent, according to the College Board.

When Beccie and Carl Smalls' son decided to attend Brooks Institute of Photography in Santa Barbara in 2002, they realized federal loans wouldn't come close to covering tuition and expenses.

The Smalls co-signed on two private loans totaling $50,300 through Stillwater Bank (which later sold the loans to the Sallie Mae company) so their son could get a lower interest rate. He racked up another $31,976 in private loans that his parents didn't co-sign -- the interest rate on those ranged from about 12 to 17 percent -- then dropped out to keep from going deeper into debt.

When his loans came due six months later, he didn't make enough money as a fledgling photographer to cover the $1,000 monthly payment. Sallie Mae agreed to postpone the due date two more years, but with compounding interest, his debt grew to at least $110,000. And because he didn't graduate, he couldn't consolidate his loans under a fixed interest rate, Beccie Small said.

As co-signers of two of the loans, the Smalls became fearful. What if their son failed to make his payments? A collection agency could ruin the Smalls' credit rating and eat up any savings they had.

In 2006, they took a second mortgage on their house to pay off the two loans they co-signed, which had grown from $50,300 to $67,200. Their son still owes $555 a month for the next 15 years on the rest of the loans. By the time he pays them, he will have given Sallie Mae $98,877. And the Smalls owe $712 a month to pay off their house loan.

"There should be more options for these kids," said Beccie Small. "There was one option for him -- private loans. He wanted to go to school so bad, he took what they gave him."

Students often get into trouble because they don't fully understand the terms and agreements of what they're getting into, said Alan Collinge, who founded Student Loan Justice in Washington 18 months ago to collect stories of wronged students and to advocate for change. He did this after unemployment caused him to default on a $38,000 loan to attend the University of Southern California. That loan has grown to $105,000 with compounding interest, penalties and fees.

"College students are an extremely vulnerable segment of the population," Collinge said. "They will sign virtually anything you put in front of them."

Ethan Winsby feels like he signed away his freedom. Every night, he searches the Internet for a way out of the financial mess and wonders what will happen when Sallie Mae no longer allows him to put off the payments. In reviewing his situation, Sallie Mae spokesman Tom Joyce called Winsby an "unusual case" and said few of the company's borrowers have such high variable interest rates. He added that less than 2 percent of Sallie Mae's private loan borrowers default.

But higher-education experts counter that default rates are deceptive. Companies use techniques such as allowing borrowers to defer payments to avoid defaulting -- but loan recipients still owe many times what they originally borrowed.

They say too many people are like Winsby, struggling with loans they might never be able to repay.

"What sense does it make to dig the hole deeper and create an underclass who because of their student loan default will never get out of debt?" asked Barmak Nassirian, associate executive director of the American Association of Collegiate Registrars and Admissions Officers. "We're marginalizing a significant portion of our population."

Protect yourself

Some tips for students facing the high cost of college:

-- Exhaust all federal loan possibilities as well as state and institutional grants and aid.

-- Ask questions. If the interest rate is variable, for example, ask the lender if there is a limit on how high the rate can go. For more questions, go to projectonstudentdebt.org/private_loan_questions.vp.html.

-- Talk to the financial-aid adviser at your college about the loan before agreeing to borrow the money.

-- Document everything. If you are offered a discount, get the terms in writing.

Source: Project on Student Debt

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