Ask the Experts

Will the current credit crunch impact my child's ability to get a student loan for college?

It's hard to say whether the credit crunch will prevent students from obtaining the financing they need to pay for college. According to the College Board, last year students and their families borrowed nearly $60 billion in federal loans and $17 billion in private loans for college. In order to understand the current student lending market, some background is helpful.

Federal student loans. Under the Federal Family Education Loan Program (FFELP), private lenders receive subsidies from the federal government to issue federal student loans at reduced interest rates. But last year, Congress slashed subsidies to FFELP lenders. This, coupled with tightening credit and near paralysis in the secondary debt markets, created the perfect storm--a student lending market in potential turmoil due to the unwillingness and/or inability of some private lenders (to date more than 50) to make, package, and sell federal student loans.

The problem was big enough to attract the attention of the federal government--legislation passed in May allows the Department of Education to buy billions of dollars in federal student loans from private lenders to keep money flowing into the widely used FFELP. The consensus is that there will be enough federal student loan money--Stafford, Perkins, and PLUS Loans--in the FFELP to go around for the 2008/09 academic year.

Private student loans. Over the past decade, the use of private student loans to finance college has soared as federal student loans fail to keep up with rising costs. This year, college students in need of private loans are expected to face higher interest rates and more stringent credit checks. Unfortunately, this means that some students who qualified for a loan last year may not this year, or they may have to pay a higher interest rate. The federal government has not proposed buying private student loans, so lenders will be on their own to raise the necessary capital.

What is a Parent PLUS Loan?

A Parent PLUS Loan is a federal student loan available to parents with good credit histories who want to help pay for their dependent child's undergraduate education. (A similar Graduate PLUS Loan is available to graduate students.) Under the program, parents can borrow up to the full cost of their child's college education each year, less any financial aid received. For example, if college costs $30,000 this year and a student receives $10,000 in financial aid, parents would potentially be eligible for a $20,000 PLUS Loan. To qualify, students must be attending an eligible school at least half time.

PLUS Loans aren't based on financial need; parents need only pass a credit check. Under new federal legislation passed in May, parents who are delinquent up to 180 days on their home mortgage or medical debt will still be considered creditworthy to borrow under the program.

The interest rate on all PLUS Loans issued on or after July 1, 2006, is capped at 8.5%. (For PLUS Loans issued before this date, the interest rate is variable, adjusted each July, and capped at 9%.)

Interest begins accruing upon the first loan disbursement, but thanks to the recent legislation, parents have the option to defer repayment of the loan for up to six months after their child leaves school. Previously, repayment was required to begin within 60 days of the last loan disbursement for that year.

PLUS Loans can be made either by private lenders who participate in the Federal Family Education Loan Program (FFELP), or directly by the federal government under the William D. Ford Federal Direct Loan Program. The federal government recently took steps to pump liquidity into the FFELP market due to turmoil in the general credit markets, so fund availability isn't expected to be a problem.