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## A role for community banks in student loan crunch

By Douglas C. Stebbins | August 2, 2008

IT HAPPENS every spring. School winds down, college acceptance letters trickle in, a college is chosen, graduation parties are held, and newly minted graduates look forward to a restful summer.

It happens every summer. The first tuition bill arrives and disrupts the tranquility, sending parents and students into a panic. There is a greater shock when it comes to paying the bill. Many traditional forms of financing education are no longer accessible; many federal student loan providers and private student loan providers have exited the marketplace, and home equity loans are harder to obtain.

Of late, banks have structured their loans to fit the asset-backed securities, or ABS, market, where the loans are sold by issuing banks to investors such as pension funds, insurance companies, or hedge funds. This process, known as securitization, means that while you may obtain your student loan through your bank, by the time of your first mid-term exam the loan has been packaged together with similar loans and sold to nameless, faceless pools of investors.

National banks had a distinct advantage over the community banks, since their high loan volume was enough to attract the attention of Wall Street firms interested in structuring student loan backed securitizations. Unable to compete for the attention of the securitization architects, many of the smaller banks ceased offering student loan products, and national banks dominated.

This market concentration was not a point of concern until the investors in student loan securities, many of whom invest in mortgage-backed securities, were caught up in the subprime lending downturn and effectively shuttered the market. The government has stepped in to provide liquidity for federal student loan programs, but with the average annual cost at \$13,000 for an in-state university and \$32,000 for a private college, there remains a sizable gap between what federal loans provide (\$3,500 to \$5,500 per year) and the true cost of an education.

Many large banks never intended to hold the student loans for any period of time; they were generating these loans with the explicit intent of selling them off as part of an asset-backed security. But, with the collapse of the credit market in mid-2007, there is no secondary market for these loans. Faced with the prospect of holding these loans for a significant period of time, the banks decided that it was best to curtail student lending until liquidity returns to the market and they can sell the loans once again.

Here lies the opportunity for community banks. Community banks pride themselves in knowing their customers, their needs, and their dreams. A scan of their websites will reveal many loan options: car loans, boat loans, RV loans, vacation loans, pool loans, wedding loans - even snowmobile loans. While these loans serve a purpose, what better way to serve their community than for a local bank to help its neighbors pay for college?

Community banks are in a position to know and understand their clientele much better than the investment houses and pension funds that fueled the student loan securitizations. They can provide a financing solution to an underserved population of parents and students, and since these banks know their customers, their loans can be based upon the credit risk of the borrower, not the risk of the securitization marketplace.

Although there has been concern about college graduates who are over-burdened by student loans, it is vital that lenders provide access to "underleveraged" students who are not able to maximize their potential because the only loans available cover a fraction of the actual cost of college. Excessive student indebtedness is serious, but most financial experts consider student loans to be "good" debt since it is used to fund an investment that creates value over time: Holders of a bachelor's degree earn over 60 percent more than those with just a high school diploma.

Yet it is often easier for a consumer to get a lender to support bad debt, which is used to purchase items that have no return, than it is to acquire rational, useful, boring good debt. If the societal good done in helping create new college graduates is not enough, the banks should consider that a better educated populace will be in a stronger position to pay back its snowmobile loans.

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