Department of Education

STUDENT LOANS OVERVIEW

Fiscal Year 2008 Budget Request

CONTENTS

DEPARTMENT OF EDUCATION FISCAL YEAR 2008 PRESIDENT'S REQUEST

(in thousands of dollars)

Account, Program, and Activity	Category Code	2006 Appropriation	2007 Current Estimate	2008 President's Request	2008 President's Request Compared to 2007 Current Level: Amount	Percent
Federal Direct Student Loans Program Account (HEA IV-D)						
1. New loan subsidies (HEA IV-D)	M	1,806,576	474,222	509,249	35,027	7.4%
2. Upward reestimate of existing loans	M	4,900,232	4,702,101	0	(4,702,101)	-100.0%
3. Upward modification of existing loans	M	7,291	0	0	0	---
4. Downward reestimate of existing loans (non-add)	M	(522,779) [1]	(984,538) [1]	0	984,538	100.0%
5. Downward modification of existing loans (non-add)	M	0 [1]	0 [1]	0	0	---
6. Net reestimate of existing loans (non-add)	M	4,377,453	3,717,563	0	(3,717,563)	-100.0%
7. Net modification of existing loans (non-add)	M	7,291	0	0	0	---
Subtotal, loan subsidies		6,714,099 [1]	5,176,323	509,249	(4,667,074)	-90.2%
Subtotal, new loan subsidies and net reestimate/modification (non-add)		6,191,320	4,191,785	509,249	(3,682,536)	-87.9%
8. Federal administration (HEA IV-D section 458):						
(a) Federal administration	M	0 [2]	0	0	0	---
(b) Payments for services to guaranty agencies	M	220,000 [3]	0	0	0	---
Subtotal		220,000	0	0	0	---
Total	M	6,934,099	5,176,323	509,249	(4,667,074)	-90.2%
Outlays		*6,842,092*	*5,528,412*	*531,728*	(4,996,684)	-90.4%
Federal administration	*D*	*583,165*	*234,075*	*65,340*	(168,735)	-72.1%
Loan program--mandatory	*M*	*6,258,927*	*5,294,337*	*466,388*	(4,827,949)	-91.2%
Federal Family Education Loans Program Account (HEA IV-B)						
1. New loan subsidies (HEA IV-B)	M	17,273,789	5,860,262	3,861,384	(1,998,878)	-34.1%
2. Upward reestimate of existing loans	M	9,373,570	555,015	0	(555,015)	100.0%
3. Upward modification of existing loans	M	1,723,741	0	8,458	8,458	---
4. Downward reestimate of existing loans (non-add)	M	(289,237) [1]	(3,714,626) [1]	0	3,714,626	100.0%
5. Downward modification of existing loans (non-add)	M	(14,201) [1]	0 [1]	(2,812,891)	(2,812,891)	100.0%
6. Net reestimate of existing loans (non-add)	M	9,084,333	(3,159,611)	0	3,159,611	100.0%
Total, FFEL Program Account	M	28,371,100 [1]	6,415,277 [1]	3,869,842 [1]	(2,545,435)	-39.7%
Subtotal, new loan subsidies and net reestimate/modification (non-add)		28,067,662	2,700,651	1,056,951	(1,643,700)	-60.9%
Outlays	*M*	*27,131,975*	*5,861,478*	*3,281,788*	*(2,579,690)*	*-44.0%*
Federal Family Education Loans Liquidating Account (HEA IV-B)						
1. Pre-1992 student loans	M	(553,562)	(747,495)	(690,939)	56,556	7.6%
Outlays	*M*	*(825,314)*	*(747,495)*	*(690,939)*	*56,556*	*7.6%*
Federal Student Loan Reserve Fund Outlays	*M*	*30,000*	*(263,000)*	*(287,000)*	*(24,000)*	*9.1%*

[1] Beginning in 2007, portions of the reestimate and modification of existing loans reducing subsidy costs (downward reestimates), previously reflected in the program account, are recorded in a general fund receipt account. The display for 2006 has been adjusted for comparability.

[2] Adjusted for comparability. Excludes mandatory funds of $600,000 thousand in fiscal year 2006 for Federal administration costs, which are shown as discretionary funds in the Student Aid Administration account.

[3] Mandatory funds for account maintenance fees paid to guaranty agencies. As directed by the Higher Education Reconciliation Act of 2005 (Title VII-A of the Deficit Reduction Act of 2005), beginning in FY 2007, these fees are included in the cost of new loan subsidies in Federal Family Education Loans.

2007 BASED ON CONTINUING RESOLUTION (P.L. 109-289) THROUGH 02-15-07

Federal Family Education Loan Program (FFEL)
(Higher Education Act of 1965, Title IV, Part B)

William D. Ford Federal Direct Loan Program (Direct Loans)
(Higher Education Act of 1965, Title IV, Part D)

FY 2008 Authorization ($000s): Indefinite[1]
Budget Authority ($000s):

Net Loan Subsidies:	2007	2008	Change
FFEL[2]	$5,860,262	$3,861,384	-$1,998,878
FFEL Reestimate[3]	-3,159,611	N/A	+3,159,611
FFEL Modification	0	-2,804,433	-2,804,433
FFEL Total Net Subsidy	2,700,651	1,056,951	-1,643,700
Direct Loans[2]	474,222	509,249	+35,027
Direct Loans Reestimate[4]	3,717,563	N/A	-3,717,563
Direct Loans Total Net Subsidy	4,191,785	509,249	-3,682,536

[1] The Higher Education Act expires June 30, 2007. Selected reauthorizing language authorizing the loan programs beyond FY 2008 was contained in the Higher Education Reconciliation Act (HERA) of 2005, P.L. 109-171. Other reauthorization bills may still be introduced.

[2] Federal administration funds associated with the FFEL and Direct Loan accounts are shown in Student Aid Administration, beginning on page Y-1. FFEL total net subsidy in 2007 reflects the net impact of subsidy plus the upward reestimate shown in the budget program account as well as the downward reestimate shown in the general receipt account. A FFEL downward modification related to proposed policies reducing lender exceptional performance and guaranty agency retention is shown in FY 2008. Direct Loan total net subsidy in 2007 reflects the same treatment of upward and downward reestimates as shown in FFEL.

[3] The net downward reestimate related to costs of outstanding FFEL loans is due primarily to updated loan model assumptions related to interest rates and consolidation loans behavior.

[4] The net upward reestimate related to costs of outstanding Direct Loans is due primarily to loan model assumptions related to collections on defaulted loans.

PROGRAM DESCRIPTION

The Federal Family Education Loan (FFEL) and William D. Ford Federal Direct Loan (Direct Loan) programs provide students and their families with loans to help meet postsecondary education costs. Non-consolidation FFEL and Direct Loan (net commitment) volume which reflects new student loan demand, continues a strong expansion, more than doubling from $26.2 billion in FY 1996 to $60 billion in FY 2006. In FY 2006, new loan volume (excluding Consolidations) in both FFEL and Direct Loans accounted for about 78 percent of all new postsecondary aid available from the Department. Consolidation Loan volume, which represents loans issued to pay off existing student loans, grew at a tremendous pace over the past 5 years, particularly in FFEL. Since FY 1994, total FFEL and Direct Loan Consolidation loan volume increased from approximately $2 billion to $91.4 billion in FY 2006, with FFEL Consolidations accounting for about 79 percent of the FY 2006 total. Total loan volume (including Consolidations) from FFEL and Direct Loan programs amounted to over $151 billion in FY 2006, representing approximately 90 percent of all postsecondary aid available from the Department.

The FFEL and Direct Loan programs meet an important Administration goal of helping ensure student access to and completion of high-quality postsecondary education. Competition between the two programs, and among FFEL lenders, has resulted in better customer service to students and institutions, along with a greater emphasis on efficiency and borrower satisfaction.

The Higher Education Reconciliation Act (HERA) of 2005—part of the Deficit Reduction Act of 2005—which was signed into law on February 8, 2006 (P.L. 109-171), made substantial changes to the FFEL and Direct Loan programs. A number of the changes are discussed throughout the following program descriptions; budget amounts for 2007 and 2008 reflect enactment of HERA.

Federal Family Education Loan Program

The FFEL program offers federally guaranteed loans for postsecondary education through private lenders, providing more student aid funding than any other student financial assistance program. Through this program, the Federal Government helps millions of students and their parents finance attendance at over 6,000 participating universities, colleges, and vocational schools by supporting the availability of loans from approximately 3,200 participating banks and other eligible lenders.

The interest rate on new Stafford and Unsubsidized Stafford Loans starting July 1, 2006 is fixed at 6.8 percent. The interest rate on new PLUS loans starting July 1, 2006 is fixed at 8.5 percent. Under HERA, borrower origination fees are reduced by 1 percentage point as of July 1, 2006, and further reduced each year until, as of July 1, 2010, fees would be eliminated in the FFEL program. The fee decreased from 3 percent to 2 percent on all new loans—excluding Consolidation Loans which have no borrower origination fee—as of July 1, 2006. Some lenders pay part or all of this fee on behalf of students. FFEL borrowers may choose from among four repayment plans including standard, graduated, income-sensitive, and extended. Borrowers may change plans once per year. All but the extended FFEL repayment plans have 10-year repayment terms. The extended plan includes terms allowing up to 25 years for repayment.

In the FFEL program, 35 State and private nonprofit guaranty agencies perform loan processing and maintenance services on behalf of FFEL lenders and the Federal Government. These agencies provide training and guidance to participating lenders and schools to ensure compliance with program regulations and assist students with appropriate financial arrangements in order to prevent students from defaulting on their student loans. Under HERA, for new guaranteed loans made after July 1, 2006, guaranty agencies are required to charge borrowers a default fee equal to 1 percent of loan principal; these fees are then deposited into the Student Loan Reserve Fund. Previously, the collection of this fee—referred to as an insurance premium—was optional.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Guaranty agencies also collect on defaulted loans on which they have paid claims to lenders, currently retaining 23 percent of each standard collection and 18.5 percent of collections through
consolidation, with the balance returned to the Federal Treasury. Borrowers may be charged for these collection costs. Under HERA, as of October 1, 2006, guaranty agencies are required to
charge borrowers collection costs of not more than 18.5 percent of the outstanding principal and interest on defaulted loans paid off through consolidation; of this amount, 8.5 percent would be remitted to the Government. Effective October 1, 2009, agencies would be required to remit the entire 18.5 percent collection cost to the Government for any default collections made through consolidation that exceed 45 percent of the guaranty agency's total collections.

New FFEL loan volume was $47.3 billion in FY 2006, accounting for 72 percent of all new (non-consolidation) student loan volume. New FFEL loan volume (excluding Consolidations) is projected to increase to $57.8 billion in the 2008 budget year. (See New Student Non-Consolidation Loan volume table, pg. Q-11.) With the annual variable in-repayment rate jumping from 5.3 percent to 7.14 percent as of July 1, 2006, many borrowers took the opportunity to lock in their payments at lower rates through Consolidation Loans. FFEL Consolidation Loan volume rocketed to an all-time high of $72 billion in FY 2006 from a previous high of $54.5 billion in FY 2005. Across the entire FFEL program, there were approximately $333.6 billion in total FFEL program loans outstanding at the end of FY 2006, plus about $10.4 billion outstanding in the Liquidating account that contains guaranteed loans issued before 1992, for a total of about $344 billion outstanding at the end of FY 2006.

William D. Ford Federal Direct Loan Program
The Direct Loan program assists student and parent borrowers by providing loans directly from the Federal Government. Under Direct Loans, the Federal Government provides loan capital to postsecondary institutions to originate loans. The Direct Loan program offers five repayment plans which borrowers may switch at any time. One option includes the Income Contingent Repayment (ICR) plan, which can extend for up to 25 years, under which borrowers repay based on their income and the amount borrowed. If there is a remaining balance after 25 years, the Government assumes that repayment. Under changes brought about by HERA, the Direct Loan standard, graduated, and extended repayment plans now conform to the parallel FFEL plans. Borrowers repay their loans directly to the Federal Government through a private loan-servicing firm contracted by the Department.

The interest rate on new Stafford and Unsubsidized Stafford Loans starting July 1, 2006 is fixed at 6.8 percent. The interest rate on new PLUS loans starting July 1, 2006 is fixed at 7.9 percent. Borrowers under the Direct Loan program pay a 3 percent origination fee on new loans—excluding Consolidation Loans—as of the date of HERA enactment. The 1 percent difference from FFEL is attributable to the 1 percent default fee charged by guaranty agencies to FFEL borrowers. Thus, the combined fee percentages are equivalent between programs. As with FFEL, HERA reduces Direct Loan origination fees by 1 percentage point annually until July 1, 2010, after which origination fees would remain at 1 percent in Direct Loans. The program offers a quarter-point interest rate reduction to Direct Loan student borrowers who repay via electronic funds transfer (i.e., electronic debit).

During FY 2006 there were 1,081 schools participating in the Direct Loan program. The Direct Loan program provided $12.7 billion in new loans (excluding Consolidations) in FY 2006, accounting for 19 percent of all new student loan volume. New Direct Loan volume is expected to grow to $15 billion in FY 2008. (See New Student Non-Consolidation Loan Volume table, pg. Q-11.) Direct Loan Consolidation Loan volume increased substantially from $15.7 billion in FY 2005 to $19.3 billion in FY 2006. As in FFEL, this surge reflects borrowers fixing their interest rate to avoid a significant increase in variable rates. However, volume is expected to diminish over the coming years due to market dynamics and statutory changes. Overall, approximately $97.3 billion in total Direct Loans were outstanding at the end of FY 2006.

Funding Characteristics

Both FFEL and Direct Loans are mandatory programs whose costs are largely driven by student loan demand, fueled by increases in the price of postsecondary education and prevailing interest rates. Defaults are also a key component of program costs. The programs are funded by indefinite budget authority and do not require annual congressional appropriations. A loan subsidy—the portion of cost paid by the Federal Government—is calculated for each loan cohort based on the Federal Credit Reform Act of 1990, and reflects the net present value of the Federal portion of all mandatory subsidy-related costs associated with each loan cohort. Many administrative costs, paid on an annual cash basis, are not included within the subsidy cost. Subsidy costs for both FFEL and Direct Loans reflect the expected lifetime costs associated with each loan cohort. Budget estimates may show a negative subsidy, indicating that for a given cohort, the estimated present value of program revenues exceeds program costs. In other words, when the present value of projected inflows exceeds that of projected outflows, the subsidy cost is negative.

Both FFEL and Direct Loan programs incur various administrative expenses, some of which are funded through subsidy while most are funded through administrative funds. There has been a mandatory, definite appropriation in Section 458 of the HEA that funds the majority of administrative costs in both the FFEL and Direct Loan programs. These costs include account maintenance fee payments to guaranty agencies and all of the non-subsidy administrative costs in Direct Loans, such as loan servicing and student aid information systems. However, as of FY 2007, HERA changes the treatment of administrative funding. Account maintenance fees retain their mandatory status, but are funded as part of FFEL subsidy cost while the balance of administrative funds previously identified as mandatory under HEA, section 458, are subject to discretionary appropriation as part of the Student Aid Administration (SAA) account. In FY 2008, the Administration requests $708.2 million in discretionary funding to administer the Federal student aid programs in the SAA account. This request is discussed in detail in the justification for **Student Aid Administration,** beginning on page Y-1.

Credit Reform Estimates

Student loan program costs are estimated consistent with the Federal Credit Reform Act of 1990. Under the Act, future costs and revenues associated with a loan are estimated for the life of the loan and discounted back to the date of disbursement using Governmentwide projected interest rates. Costs related to pre-1992 loans in the FFEL Liquidating account and most Federal administrative costs are statutorily excluded from credit reform calculations. For FFEL, credit reform costs include reimbursements to lenders for in-school interest benefits, special allowance payments to lenders, and default reinsurance payments. These costs are partially offset by student and lender origination fees and collections on defaulted loans.

In the Direct Loan program, cash transactions consist of Government loan disbursements to students, payments of student loan fees, borrower loan repayments, and the Department's

FFEL and Direct Loans

borrowing from and repayments to the U.S. Treasury. Defaults and loan discharges reduce future student loan repayments. Under some circumstances, future estimated cash income (student fees and loan repayments) could exceed future estimated cash costs in the outyears. This differential is termed a “negative subsidy”; that is, the program could potentially earn a positive return on its loan originations. However, in FY 2006 and beyond—based on current assumptions for the outyears—the Direct Loan program reflects a net total positive subsidy due in part to strong Consolidation activity in FY 2006 and reduced origination fees in the outyears attributable to HERA changes.

Federal loan programs are often compared using subsidy rates, which represent the Federal cost (the appropriation) as a percentage of loan originations. For FFEL loans originated in 2006, the Budget estimates the weighted average subsidy rate is 12.74 percent: that is, it costs the Government approximately 12.7 cents in appropriations for every dollar of loans it originates. For Direct Loans originated in 2006, the weighted average subsidy rate is estimated to be 4.98 percent; that is, the program is projected to spend about 5 cents on every dollar originated. However, per credit reform rules, this Direct Loan subsidy rate does not reflect other administrative costs incurred by the program on a cash basis.

In an effort to better reflect interest rate variability of future estimates, the Administration in 2006 implemented probabilistic scoring for the FFEL and Direct Loan programs similar to the Congressional Budget Office methodology. Before the 2007 Midsession Review, estimates for both the FFEL and Direct Loan programs were developed using point estimates of future interest rates. The updated probabilistic method factors in the probability that interest rate scenarios may differ from current economic projections. In 2006, the FFEL loan program recognized a $1.8 billion upward reestimate to reflect the new methodology, while the Direct Loan program recognized a $0.2 billion upward reestimate. Changes to special allowance formulas under HERA, and other changes to borrower interest rates, mitigated interest rate risk in future cohorts, negating the impact of the probabilistic method for those cohorts.

Under credit reform, the Department annually reestimates the cost of all outstanding loans by cohort to reflect updated modeling assumptions, OMB economic assumptions, and actual experience. The total change in costs for all outstanding FFEL program account loans at the end of 2006 is reflected as the 2007 reestimate. The reestimate reflects a net upward component of +$555 million and a net downward component of -$3.715 billion for a total net downward reestimate of -$3.16 billion. That is, the estimated future Federal cost of the approximately $334 billion outstanding at the end of 2006 is $3.16 billion lower than was estimated in last year’s President’s Budget. This net downward reestimate is primarily due to updated loan model assumptions related to interest rates and Consolidation Loan activity.

For the approximately $97 billion in Direct Loans outstanding at the end of 2006, the Budget assumes net future Federal cost will be higher than estimated in last year’s President’s Budget. The total change in costs for all outstanding Direct Loan program account loans at the end of FY 2006 is depicted as the 2007 reestimate. The reestimate reflects a net upward component of +$4.702 billion and a net downward component of -$985 million for a total net upward reestimate of +$3.718 billion. The upward reestimate requires a current-year mandatory appropriation. This net upward reestimate is due primarily to updated loan model assumptions related to collections on defaulted loans.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Loan Terms

The guaranteed FFEL, and Direct Loan programs share virtually identical terms and conditions. Both FFEL and Direct Loans provide the following types of loans:

- Stafford Loans are subsidized, low-interest, variable or fixed rate loans based on financial need. The Federal Government pays the interest while the student is in school and during grace and deferment periods. The variable interest rate on Stafford loans made before July 1, 2006, is adjusted annually based on the 91-day Treasury bill rate, with a cap of 8.25 percent. For loans made on or after July 1, 2006, interest rates are fixed at 6.8 percent.

- Unsubsidized Stafford Loans are low-interest, variable or fixed rate loans that are available to student borrowers, regardless of financial need. The Federal Government does not pay interest accruing on Unsubsidized Stafford Loans. Borrowers may defer payment of interest while in school and have it capitalized until entering repayment. The interest rate terms are the same as for Stafford Loans.

- PLUS Loans are available to parents of dependent undergraduate students. HERA extends eligibility for these loans to graduate and professional students. The Federal Government does not pay interest accruing on PLUS Loans. For loans made prior to July 1, 2006, the interest rate is adjusted annually based on the 91-day Treasury bill rate, with a cap of 9 percent. For loans made on or after July 1, 2006, HERA provides that the FFEL PLUS interest rate is fixed at 8.5 percent, whereas the Direct Loan PLUS interest rate was unchanged at a fixed rate of 7.9 percent. (The Administration is proposing legislation to make interest rates in both programs 8.3 percent.)

- Consolidation Loans allow borrowers with existing student loans to combine their obligations and possibly extend their repayment schedules based on their total student loan debt outstanding. The rate for both FFEL and Direct Consolidation Loans is based on the weighted average of loans consolidated rounded up to the nearest 1/8 of 1 percent.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

DIRECT LOAN AND FFEL PROGRAM LOAN MAXIMUMS (Administration Proposed Changes in Parentheses)		
	ANNUAL LIMITS	
DEPENDENT UNDERGRADUATES	**Stafford**	**Total (Stafford & Unsubsidized Stafford)**
First-Year Student	$3,500	$3,500
Second-Year Student	$4,500	$4,500
Third-Year+ Student	$5,500 ($7,500)	$5,500 ($7,500)
INDEPENDENT UNDERGRADUATES [1,2]		
First-Year Student	$3,500	$7,500
Second-Year Student	$4,500	$8,500
Third-Year+ Student	$5,500 ($7,500)	$10,500 ($12,500)
GRADUATE STUDENTS[2]	$8,500	$20,500
	AGGREGATE LIMITS	
DEPENDENT UNDERGRADUATES	$23,000 ($30,500)	$23,000 ($30,500)
INDEPENDENT UNDERGRADUATES [1,2]	$23,000 ($30,500)	$46,000 ($53,500)
GRADUATE STUDENTS[2]	$65,500 ($73,000)	$138,500 ($156,000)

[1] And dependent undergraduates whose parents are unable to borrow under the PLUS program.
[2] Certain health professions students (independent undergraduates, dependent undergraduates whose parents are unable to borrow under the PLUS program, and graduate students) are eligible to receive increased annual and aggregate Unsubsidized Stafford loan limits due to the phase-out of the HEAL Program. The aggregate Unsubsidized loan limit is $189,125, less the aggregate amount of any subsidized loans made to the student.
Note: Students who qualify for only a portion of the maximum Stafford Loan limit may borrow up to the remaining loan amount available under the Unsubsidized Stafford Loan program, limited to cost of attendance minus other aid. For example, a dependent first-year student who qualifies for a $2,000 Stafford Loan would be eligible for an additional $1,500 in Unsubsidized Stafford up to the total of $3,500. For students borrowing under both programs, the Stafford and Unsubsidized Stafford Loan limits displayed above apply.

For independent undergraduate students (or dependent undergraduate students whose parents cannot borrow under the PLUS program) and for graduate and professional students, the maximum a student can borrow during any academic year is: the combined Stafford and Unsubsidized Stafford loan limit shown under the column entitled, "Total (Stafford and Unsubsidized Stafford)." For example, a second-year independent student could borrow up to $4,500 under Stafford Loans and up to an additional $4,000 in Unsubsidized Stafford Loans for a total of $8,500. Under HERA, qualified graduate students are now eligible to borrow PLUS loans, where no limit applies other than cost of attendance. The aggregate loan limit for graduate students is determined by the Secretary of Education.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Interest Rates Affecting Students and Parents and Lenders

Under current law, for new Stafford Subsidized and Unsubsidized loans that were made on or after October 1, 1998 and before July 1, 2006, the interest rate is based on the 91-day Treasury-bill (T-bill) rate plus 2.3 percent while the loan is in repayment, or plus 1.7 percent during in-school, grace or deferment status. These variable-rate loans are adjusted annually. The July 1, 2006 through June 30, 2007 student borrower interest rate is 6.54 percent during an in-school period and 7.14 percent when the loan enters repayment. As of July 1, 2006, the student borrower interest rate for new Stafford loans is a fixed rate of 6.8 percent.

The Higher Education Act (HEA) Amendments of 1998 changed the PLUS interest rate basis from the 52-week T-bill to the 91-day T-bill plus 3.1 percent for PLUS loans made on or after October 1, 1998 and it continues in effect for new loans made before July 1, 2006. For the academic year 2006-07, the PLUS interest rate for loans first disbursed on or after October 1, 1998 and before July 1, 2006 is 7.94 percent. For new PLUS loans disbursed on or after July 1, 2006, the FFEL PLUS interest rate changes to a fixed rate of 8.5 percent, per provisions of HERA, which is an increase over the 7.9 percent provided under P.L. 107-139. Due to technicalities within HERA, the PLUS rate in Direct Loans did not change to 8.5 percent, but is fixed at 7.9 percent. Nevertheless, it is apparent that congressional intent was to make the PLUS loan interest rate the same under FFEL and Direct Loans.
Effective July 1, 2001, for those PLUS loans that were made on or after July 1, 1994, but prior to October 1, 1998, the rate is based on the weekly average 1-year constant maturity Treasury yield plus 3.1 percent.

Lender Interest Rate

Since January 1, 2000, FFEL lenders earn a guaranteed rate of return, called the special allowance rate, based on the average of bond equivalent rates for 3-month commercial paper during a quarter, plus 2.34 percent for loans in repayment, and 1.74 percent during in-school, grace, or deferment periods. Under current law, FFEL lenders receive the higher of the student interest rate or the special allowance rate. If the student rate is lower than the special allowance rate, the Government makes up the difference. Under HERA, for new loans made on or after April 1, 2006, when the student rate is higher than the special allowance rate, lenders are required to rebate the difference to the Government.

Prior to the passage of the HERA, a PLUS Loan qualified for lender special allowance only if the 91-day T-bill rate plus 3.1 percentage points (set annually for the PLUS interest rate) exceeds 9.0 percent. The special allowance formula uses 2.64 percent added to the commercial paper index for both PLUS and Consolidation Loans. Under HERA, this limitation on PLUS special allowance was eliminated.

Special Allowance Related to Tax-Exempt Financing

Loans funded with the proceeds of tax-exempt securities originally issued before October 1, 1993, receive substantially higher special allowance payments than are currently paid on other types of loans. These loans have come to be known as “9.5 percent” loans for their higher special allowance treatment. The Taxpayer-Teacher Protection Act of 2004 temporarily limited the ability of loan holders to retain these higher benefits indefinitely by refinancing the underlying securities. These temporary provisions were in effect through December 30, 2005. The HERA made this change permanent and also eliminated “recycling” loans for most loan holders, thereby conforming these older loans to the special allowance rates paid on most other loans.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

BORROWER INTEREST RATES BY ACADEMIC YEAR AND PROGRAM COMPONENT

Type of Loan	Loans made on or after July 1, 1995	Loans made on or after Oct. 1, 1998[1]	Loans made on or after July 1, 2006
Stafford and Unsubsidized Stafford	91-day Treasury bill rate +2.5%, during in-school, grace, or deferment periods, but T-bill +3.1% during repayment; capped at 8.25%	91-day Treasury bill rate +1.7%, during in-school, grace, or deferment periods, but T-bill +2.3% during repayment; not to exceed 8.25%	Fixed rate of 6.8%.
PLUS	Was 52-week Treasury bill rate +3.1%, not to exceed 9%-- as of July 1, 2001 converts to 1-yr constant maturity +3.1%, not to exceed 9%	91-day Treasury bill rate +3.1%, not to exceed 9%	Fixed rate of 7.9% for Direct PLUS; Increased to 8.5% under HERA for FFEL PLUS
FFEL Consolidation Loans[2]	Weighted average of the interest rates on the loans consolidated, rounded up to the nearest whole percent	Weighted average of the interest rates on the loans consolidated, rounded up to the nearest one-eighth of one percent, not to exceed 8.25%.	Weighted average of the interest rates on the loans consolidated, rounded up to the nearest one-eighth of one percent, not to exceed 8.25%.
Direct Consolidation Loans-- Stafford and Unsubsidized Stafford	91-day Treasury bill rate +2.5%, during in-school, grace, or deferment periods, but T-bill +3.1% during repayment; capped at 8.25%	91-day T-bill rate +2.3%, not to exceed 8.25% for applications received 10-1-98 through 1-31-99. Weighted avg. basis, as above, thereafter.	Weighted avg. basis, as above.
Direct PLUS Consolidation	Was 52-week Treasury bill rate +3.1%, not to exceed 9%-- as of July 1, 2001 converts to 1-yr constant maturity +3.1%, not to exceed 9%	Same as Direct Consolidation above for Stafford and Unsubsidized Stafford loans	Same as Direct Consolidation above for Stafford and Unsubsidized Stafford loans

[1] The Transportation Equity Act for the 21st Century included amendments to the HEA lowering interest rates for new Stafford, Unsubsidized Stafford, and PLUS loans made on or after July 1, 1998, and before October 1, 1998. These same rates were extended with passage of the HEA of 1998 up to July 1, 2003 and extended up to July 1, 2006 through P.L 107-139. These rates are reflected in the chart above, under "Loans made on or after Oct. 1, 1998."

[2] The Emergency Student Loan Consolidation Act of 1997, which was included in the Department's FY 1998 appropriations act, temporarily changed a number of laws affecting Consolidation Loans. Under this act, which expired September 30, 1998, the interest rate for FFEL Consolidation Loans made on or after November 13, 1997, was calculated based on the Treasury bill calculation--91 Day T-bill + 3.1%-- not the weighted average of the interest rates on the loans consolidated.

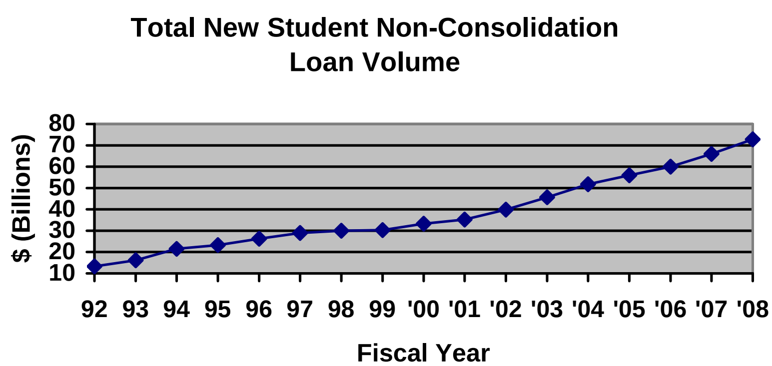
STUDENT LOANS OVERVIEW

FFEL and Direct Loans

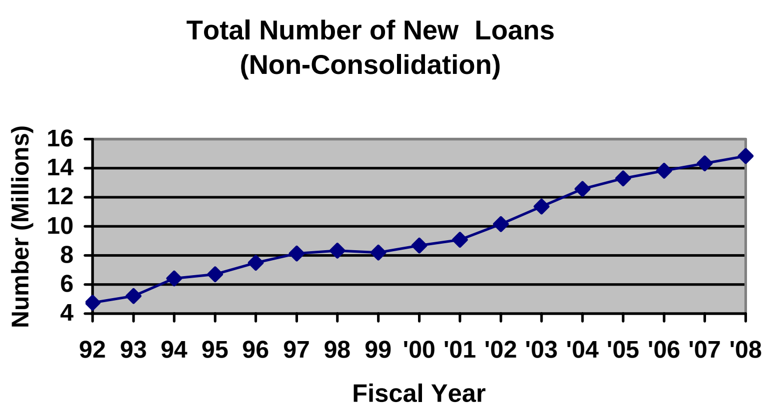
NEW STUDENT LOAN VOLUME

	2002	2003	2004	2005	2006	2007	2008
New Loan Volume ($M)							
FFEL	$28,606	$33,847	$39,234	$43,292	$47,307	$52,402	$57,845
Direct Loans	$11,184	$11,851	$12,504	$12,677	$12,677	$13,596	$15,050
Total	**$39,790**	**$45,698**	**$51,738**	**$55,969**	**$59,984**	**$65,999**	**$72,895**
Number of loans (000s)							
FFEL	7,281	8,428	9,559	10,335	10,982	11,496	11,906
Direct Loans	2,865	2,942	3,005	2,971	2,841	2,839	2,935
Total	**10,146**	**11,370**	**12,564**	**13,306**	**13,823**	**14,335**	**14,841**

Notes: Details may not sum to totals due to rounding. Loan volume and number of loans reflect net commitments, excluding Consolidation Loans.



As shown by these graphs, both total new loan dollar volume and number of new loans borrowed have increased significantly since 1992 and are projected to continue increasing in 2007 and 2008. A variety of factors such as programmatic changes that increased eligibility, State aid, Federal aid, economic conditions, college costs, and enrollment demographics may interact to affect these demand patterns.

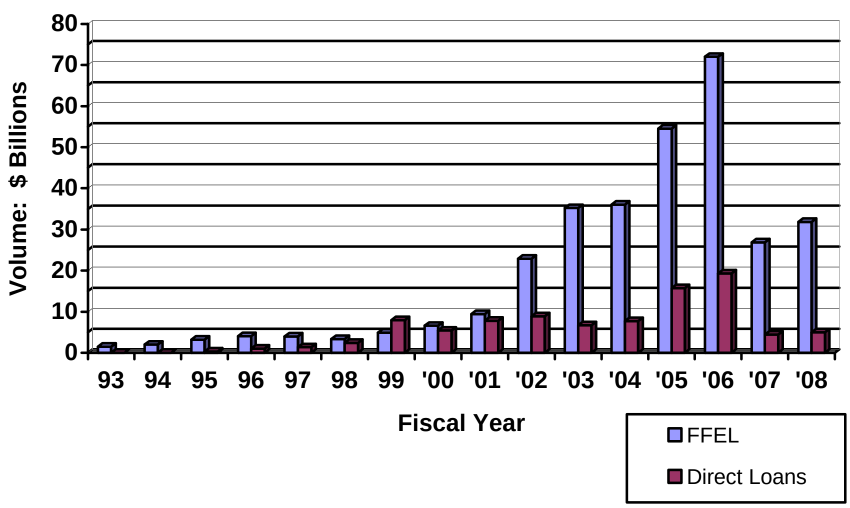


STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Consolidation Loans. A favorable interest rate environment and highly competitive marketing have resulted in a dramatic surge in FFEL Consolidation Loan volume over the past few years. From FY 2001 to FY 2006, FFEL Consolidation Loan volume grew from $9.4 billion to a record high $72 billion. The increase from FY 2005 to FY 2006 was 32 percent, as FFEL Consolidation Loan volume grew from $54.5 billion in FY 2005 to $72 billion in FY 2006. Direct Loan Consolidation Loan volume also increased substantially over the 2001 to 2006 period, from $7.8 billion to over $19 billion in FY 2006. While the Direct Loan increase was not as robust as FEEL, both programs reflected market forces where borrowers sought to lock-in lower interest rates through consolidation, prior to the annual variable in-repayment interest rate jumping from 5.3 percent to 7.14 percent as of July 1, 2006. Consolidation Loan volume is expected to decrease substantially in FY 2007 reflecting a saturated marketplace and a new statutory landscape that is less conducive to borrowers consolidating.

Consolidation Loan Volume



Subsidy costs—for new loans and reestimates for existing loans—for the past 5 fiscal years are shown below: ($000s)

	FFEL	Direct Loans
2003	$3,431,572	$4,224,527
2004	5,980,621	2,457,222
2005	12,321,033	2,349,124
2006	28,067,662	6,191,320
2007	2,700,651	4,191,785

Note: Subsidy costs include net reestimates (combined upward and downward) of prior cohorts and net modifications, which may produce significant annual fluctuations.

FY 2008 BUDGET REQUEST

The Administration's FY 2008 budget request proposes a package of student aid reforms to address inadequate aid to low-income students as well as excess subsidies to financial institutions. The FY 2008 budget request for the loan programs is best understood in the context of the Administration's overall package of proposals for the student aid programs. Accordingly, program-specific funding information and policy proposals are discussed in the **Student Aid Overview** beginning on page N-1. Tables appearing in this section show program information consistent with requested funding levels.

The Role of Student Loans

A major goal of the Federal student aid program is to assist families in meeting college costs. Federal student loans play a key role in this assistance and constitute the largest component of the Federal postsecondary aid system, accounting for about 72.7 percent of Federal student aid available in academic year 2005-2006, according to the "College Board Trends in Student Aid 2006" report ("Student Aid Trends"). The report also indicates that Federal grants and work-study funds account for about 21 percent of Federal aid, while education tax credits provide approximately 6.3 percent. Overall, the Federal Government accounts for about 62 percent of aid used to finance postsecondary education, while State, institutional, and private sources provide 38 percent.

According to cost of attendance tables in the 2006 "College Board Trends in College Pricing" (College Pricing") report, the average total cost of attendance (in current dollars) at a 4-year private college increased from $17,382 in 1995-96 to $28,743 in 2005-06, representing a 65 percent increase. The average total cost at a 4-year public college increased almost 80 percent, from $6,743 to $12,115 over the same period. In constant 2006 dollars, after adjusting for inflation, private 4-year college costs increased about 29 percent and public 4-year college costs increased about 40 percent during this 10-year period.

Over the same 10-year period, the "Student Aid Trends" report shows total Federal aid—including postsecondary education tax credits—increased by 95 percent in constant 2006 dollars. Federal loans have played a significant role over this period, growing by some 86 percent. This report also reveals that Pell Grant funding, which is specifically targeted to low-income students, increased by 80 percent in constant 2006 dollars during the same period.

The "College Pricing" report includes enrollment data showing that of all full-time and part-time undergraduates in 2004-2005, 28 percent attended public 4-year institutions full-time and 13 percent attended private 4-year institutions full-time. Approximately 16 percent attended 2-year public schools full-time. When combining full and part-time categories across public versus private schools, the report reflects that 76 percent of all undergraduates were enrolled in public 2 or 4-year institutions. When viewing full-time versus part-time status overall, approximately 64 percent of all undergraduates were full-time and 36 percent attended part-time. Note that these statistics also include for-profit institutions.

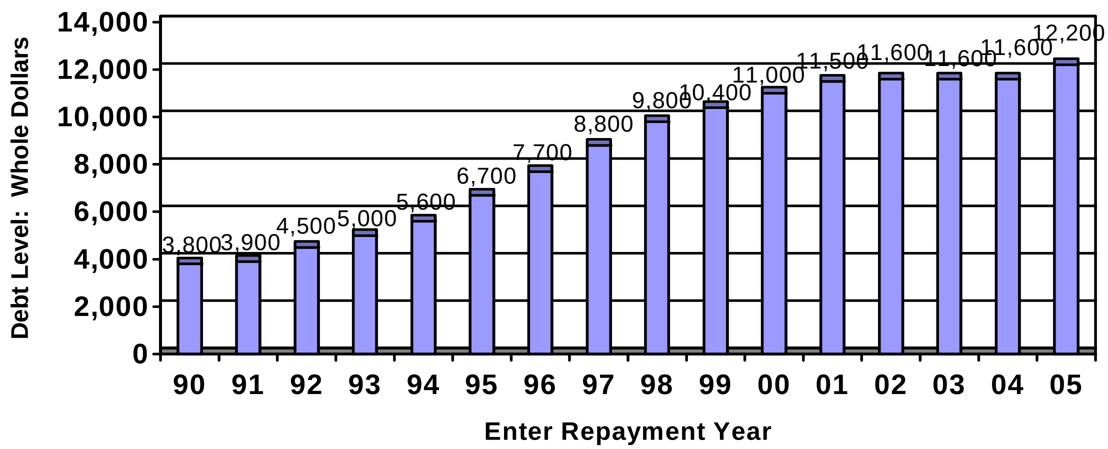
STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Students rely on the Federal loan programs to help close the gap between what their families can afford to pay ("estimated family contribution") and the cost of attendance (including tuition, fees, and room and board). Based on the latest National Postsecondary Student Aid Study of 2004 (NPSAS:2004), about 62 percent of seniors who graduated in 2003-2004 from a 4-year institution reported borrowing a Federal loan at some point in their undergraduate studies. Data available from the 1993, 1996, 2000, and 2004 NPSAS shows the average cumulative Federal debt owed by **undergraduate degree holders** has more than doubled, from $8,000 reported in 1992-1993 to about $16,600 in academic year 2003-2004. Nevertheless, little change has occurred to this measure since the 2000 NPSAS.

As shown in the graph below, data from the National Student Loan Data System (NSLDS) reveals that the median level of cumulative Federal borrowing (i.e., Stafford and Unsubsidized Stafford Loans) per student for **all borrowers across all educational levels** has more than tripled since 1990, rising from about $3,800 to $12,200 in 2005.

Median Federal Student Loan Debt When Entering Repayment



Program Output Measures on the following pages show program information for FFEL and FDSL program loans for fiscal years 2006 and 2007 consistent with requested funding levels and proposed policies for 2008.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

PROGRAM OUTPUT MEASURES

FFEL Program Loans	2006	2007	2008
Stafford Loans:			
Loan volume[1] (million $)	$19,856	$21,410	$23,722
Number of loans (000s)	5,706	5,913	6,090
Average loan (whole $)	$3,480	$3,621	$3,895
Subsidy rate[2]	18.55%	18.03%	17.33%
Unsubsidized Stafford Loans:			
Loan volume[1] (million $)	$20,068	$21,785	$23,913
Number of loans (000s)	4,585	4,786	4,976
Average loan (whole $)	$4,377	$4,552	$4,806
Subsidy rate[2]	1.66%	0.01%	-0.95%
PLUS Loans:			
Loan volume[1] (million $)	$7,383	$9,208	$10,210
Number of loans (000s)	691	797	840
Average loan (whole $)	$10,678	$11,557	$12,152
Subsidy rate[2]	0.27%	-0.28%	-0.55%
Consolidation Loans:			
Loan volume[1] (million $)	$72,010	$26,853	$31,882
Number of loans (000s)	2,622	992	1,137
Average loan (whole $)	$27,465	$27,075	$28,040
Subsidy rate[2]	15.46%	5.22%	-1.82%
Subsidy Net Reestimates[3](million $)	$9,084	-$3,160	0
Net Modification[4] (million $)	$1,710	0	-$2,804
Total FFEL Program Loans:			
Loan volume[1] (million $)	$119,316	$79,255	$89,727
Number of loans (000s)	13,604	12,487	13,043
Average loan (whole $)	$8,771	$6,347	$6,879
Net Subsidy cost[3] (million $)	$28,068	$2,701	$1,057
Subsidy rate[2]	12.74%	6.65%	3.88%
Outstanding: (billion $)			
Total FFEL Loans Outstanding	$334	$371	$409
Total Liquidating Loans Outstanding	10	9	9
Total Outstanding[5]	344	380	418

Details may not sum due to rounding.

[1] Reflects net commitments (disbursements), which are less than amounts committed (e.g., due to loan cancellations).
[2] This rate generally reflects the Federal cost per new loan dollar. When negative, this rate indicates a net gain to the Government. Reestimates and modifications are not reflected in the subsidy rate.
[3] Subsidy amounts are estimated on a net present value basis and include loan net reestimates (of updated interest rates and technical assumptions) and net modifications. A negative subsidy cost results in a net gain to the Federal Government.
[4] Reflects impact in FY 2006 on prior cohorts from legislative changes due to HERA and in FY 2008 from proposed policies.
[5] Reflects total FFEL and Liquidating account loan principal (including consolidations) as end of year estimate.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Direct Loans	2006	2007	2008
Direct Stafford Loans:			
Loan volume[1] (million $)	$5,604	$5,944	$6,637
Number of loans (000s)	1,513	1,503	1,547
Average loan (whole $)	$3,704	$3,954	$4,290
Subsidy rate[2]	10.65%	11.06%	11.46%
Direct Unsubsidized Stafford Loans:			
Loan volume[1] (million $)	$4,784	$5,159	$5,650
Number of loans (000s)	1,091	1,094	1,133
Average loan (whole $)	$4,386	$4,715	$4,987
Subsidy rate[2]	-7.56%	-7.60%	-7.13%
Direct PLUS Loans:			
Loan volume[1] (million $)	$2,288	$2,493	$2,763
Number of loans (000s)	237	242	255
Average loan (whole $)	$9,675	$10,300	$10,834
Subsidy rate[2]	-6.05%	-4.91%	-5.66%
Direct Consolidation Loans:			
Loan volume[1] (million $)	$19,347	$4,466	$4,996
Number of loans (000s)	756	200	220
Average loan (whole $)	$25,607	$22,292	$22,673
Subsidy rate[2]	7.70%	7.04%	5.67%
Subsidy Net Reestimates[3] (million $)	$4,377	$3,718	0
Net Modification[4] (million $)	7	0	0
Total Direct Loans:			
Loan volume[1] (million $)	$32,024	$18,062	$20,046
Number of loans (000s)	3,596	3,040	3,155
Average loan (whole $)	$8,905	$5,942	$6,353
Net Subsidy cost[3] (million $)	$6,191	$4,192	$509
Subsidy rate[2]	4.98%	2.43%	2.35%
Outstanding: (billion $)			
Total Direct Loans Outstanding[5]	$97	$103	$109

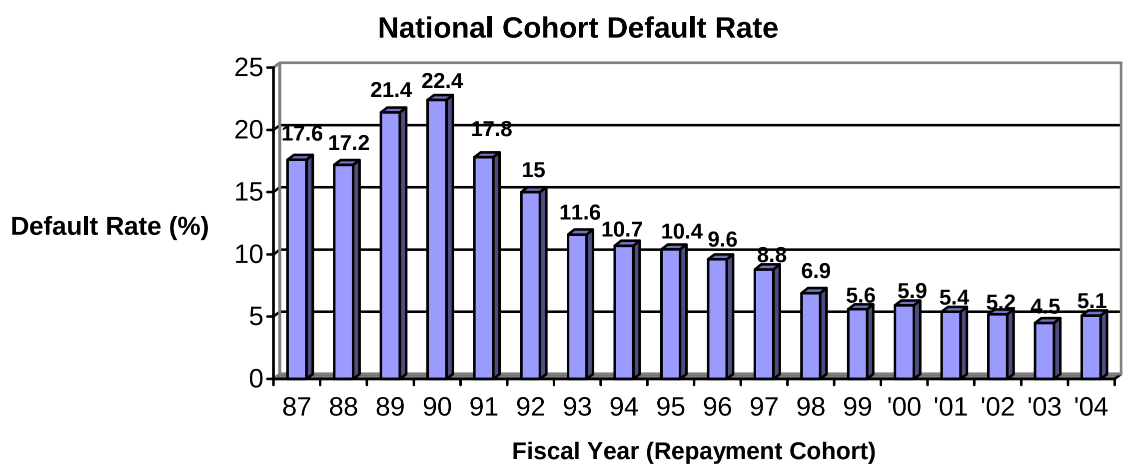
Details may not sum due to rounding.

[1] Reflects net commitments (disbursements); which are less than amounts committed (e.g. due to loan cancellations).
[2] This rate generally reflects the Federal cost per new loan dollar. When negative, this rate indicates a net gain to the Government. Reestimates and modifications are not reflected in the subsidy rate.
[3] Subsidy amounts are estimated on a net present value basis and include loan net reestimates (of updated interest rates and technical assumptions) and net modifications. A negative subsidy cost results in a net gain to the Federal Government.
[4] Reflects impact on prior cohorts from legislative changes due to HERA of 2005.
[5] Reflects total Direct Loan principal (including consolidations) as end of year estimate.

PROGRAM OUTCOMES

Loan Defaults. One key measure related to default management is the cohort default rate. The national student loan "cohort default rate" provides a measure of **borrower** default behavior in the first 2 years after entering repayment. This national cohort default rate measure was first established by the Omnibus Budget Reconciliation Act of 1990 (OBRA) to exclude "high-default" institutions from participation in the loan programs. Under current law, these institutions are excluded—for at least 2 years— if they hit or exceed a 25 percent statutory default rate threshold for 3 consecutive years. Since 1993, 1,161 individual schools have lost their student loan program eligibility due to high default rates. However, over the past 7 years, the number of institutions facing sanction has dropped markedly. For example, only five schools have been sanctioned over the past 5 years and no schools hit the criteria in the past 2 years.

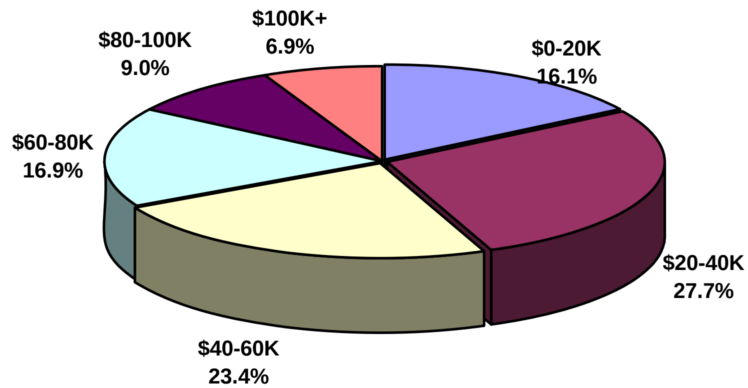
The national "cohort default rate" (as shown below) measures **borrower** default behavior in just the first 2 years after entering repayment—any defaults occurring outside this statutory period are not incorporated into the default rate for that particular cohort. As a result, this index does not reflect the "lifetime **dollar** default rates" that are used in budget formulation to project future default costs. The lifetime rates account for defaults over the entire life of the loan and are significantly higher than the national cohort rates. Thus, the cohort default rate must be viewed in context with other budget tools.



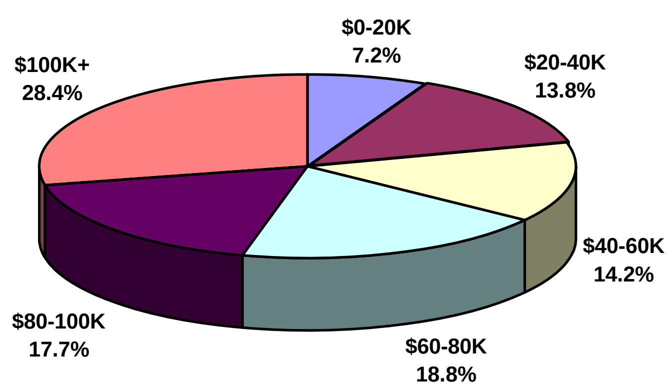
Distribution of Undergraduate Stafford Loan Borrowers by Family Income Category. The Stafford Loan, where the Federal Government pays the interest while the student is in an in-school, grace, or deferment period, is a need-based loan relied on predominantly by low- and middle-income families. Students across many income levels may be eligible for Stafford Loans depending on a number of financial considerations. Unsubsidized Stafford loans complement Stafford and are not need-based. The following charts reflect the percentage of dependent and independent undergraduate Stafford Loan and Unsubsidized Stafford Loan borrowers at various adjusted gross income family levels according to the most recent NPSAS:2004 data. Notably, over 67 percent of Stafford dependent borrowers are students from families with under $60,000 in family income while about 65 percent of the Unsubsidized Stafford dependent borrowers are students from families with over $60,000 in family income.

FFEL and Direct Loans

Undergraduate Dependent Stafford Loan Borrower Distribution--Source: NPSAS: 2004

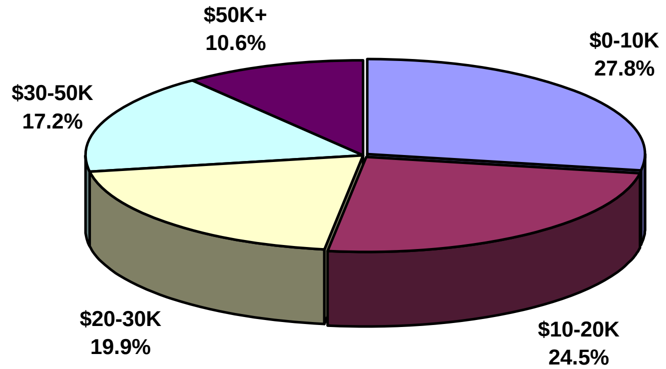


Undergraduate Dependent Unsubsidized Stafford Loan Borrower Distribution--Source: NPSAS: 2004

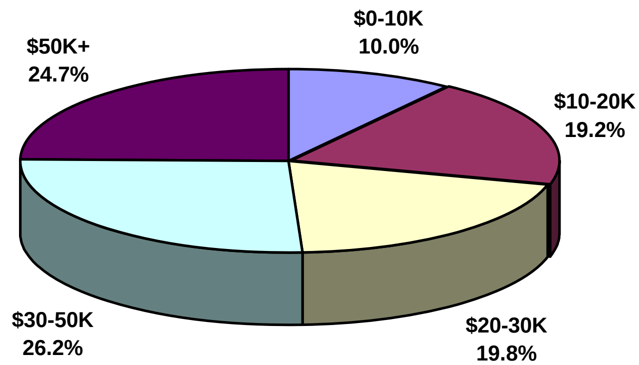


FFEL and Direct Loans

Undergraduate Independent Stafford Loan Borrower Distribution--Source: NPSAS: 2004



Undergraduate Independent Unsubsidized Stafford Loan Borrower Distribution--Source: NPSAS: 2004



LOAN VOLUME

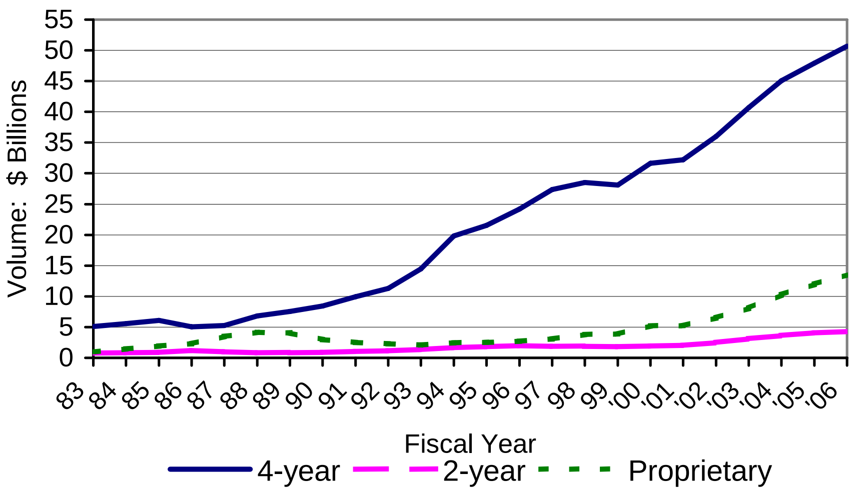
Institutional Sector Trends. Based on NSLDS and related data, about two-thirds of all Direct Loan volume occurs at 4-year public institutions, while in the FFEL program 4-year private institutions account for the largest sector of borrowing.

Distribution of New Loan Volume Dollars by Institution within FFEL and Direct Loans

FY 2006	4-Yr. Public	4-Yr. Private	2-Yr. Public	2-Yr. Private	Proprietary
FFEL	31.4%	38.8%	6.3%	0.5%	23.0%
Direct Loans	69.8%	19.3%	3.8%	0.1%	7.0%

The following graph depicts annual gross commitment loan volume trends by 4-year, 2-year, and proprietary school sectors. (Direct Loan volume data is included beginning with program inception in FY 1994.)

Annual Loan Volume



- Loan volume at 4-year institutions continues to show substantial growth, increasing from $5 billion in FY 1983, to $51 billion in FY 2006, representing 74 percent of all loan volume in FY 2006.

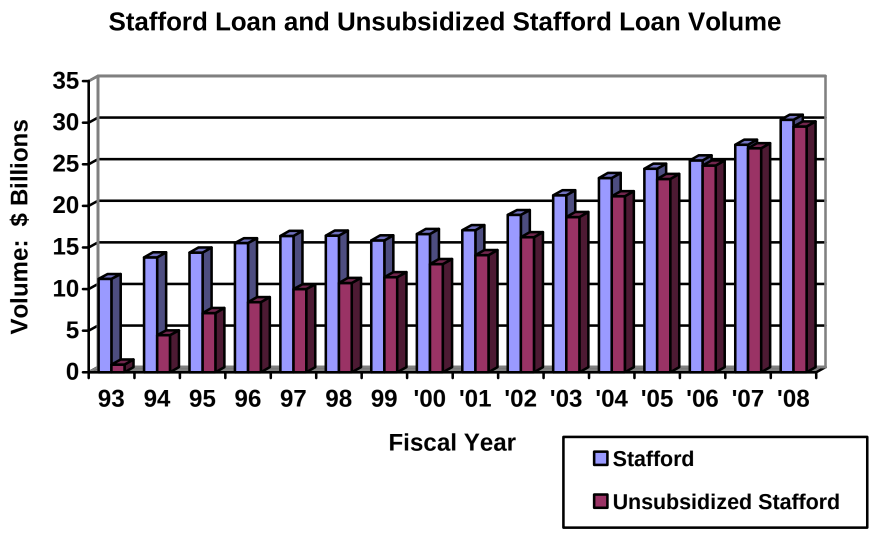
- Loan volume at proprietary institutions grew 13 percent between 2005 and 2006 and has more than doubled since FY 2000. Nevertheless, at $13.5 billion in FY 2006, proprietary loan volume represents only 19.8 percent of the total, compared to the 35 percent portion it accounted for in 1988.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

- Loan volume at 2-year institutions remained fairly steady during the early 1990's, possibly due to relative lower overall cost of attendance. However, volume has increased significantly since then, more than doubling from $1.9 billion in FY 2000 to over $4 billion in FY 2006. Nevertheless, volume at 2-year schools is comparatively small, accounting for only 6.2 percent of all loan volume in FY 2006.

A substantial portion of loan volume growth in the last decade is attributable to the Unsubsidized Stafford Loan program, where students may borrow regardless of financial need. Unsubsidized Stafford Loans have enjoyed strong popularity from inception, as shown in the following graph. In an effort to provide greater funds for college costs, the Administration is proposing an increase of $2,000 to the annual Stafford and Unsubsidized loan limit for juniors and seniors. Loan limits for juniors and seniors have not been raised since 1992. These increased limits will address growing demand for student loans and provide more aid at a crucial time, the last years of undergraduate study, which may have the added benefit of positively impacting undergraduate completion rates.



FFEL and Direct Loans

PROGRAM PERFORMANCE INFORMATION

Performance Measures

This section presents program performance information, including GPRA goals and objectives; measures; and performance targets and data; and an assessment of the progress made toward achieving program results. Achievement of program results is based on the cumulative effect of the resources provided in previous years and those requested in FY 2008 and future years, and the resources and efforts invested by those served by this program. The student loan programs and the other Federal student financial aid programs share a common goal of helping remove financial barriers to postsecondary education. Accordingly, these programs share common performance measures, such as student persistence and attainment; these measures are discussed under section O, **Student Financial Assistance**.

Program Assessment Rating Tool (PART) Issues

Both the FFEL and Direct Loan programs received a rating of "adequate" in 2004, when assessed under the PART criteria established by the Office of Management and Budget (OMB). Generally, FFEL and Direct Loans meet many of the assessment criteria contained in the OMB PART, particularly regarding program purpose, Federal role, and strategic planning. The loan programs have a clear program purpose of helping ensure access to postsecondary education by providing families with needed resources that they would be unlikely to obtain elsewhere. The Federal Government's role here is critical since most private lenders would not be providing loans to students with little or no work experience or credit history.

In FY 2006, these loan programs provided approximately $151.3 billion worth of loan assistance to over 10 million qualified borrowers. Both FFEL and Direct Loans are authorized as entitlement programs in order to meet demand.

Based on NPSAS:2004, 46 percent of all undergraduates received Federal financial aid in 2003-04 and about one out of every three undergraduates borrowed a Federal student loan. In 2003-04, of those undergraduates who borrowed a Federal loan, the average amount borrowed was $5,100. In addition, approximately 40 percent of graduate students borrowed Stafford Loans with the average amount borrowed about $15,500. Of all professional degree candidates, approximately 74 percent borrowed Stafford Loans, averaging $22,500 in 2003-04. These statistics provide a key indication of the significant role that the Federal loan programs play in providing access and reducing financial barriers to postsecondary education for a variety of postsecondary students.

Follow-up on PART Findings and Recommendations

There are two major PART recommendations and subsequent actions that affect both FFEL and Direct Loan Programs:

1) <u>Explore statutory changes in the fiscal year 2007 appropriations process and the reauthorization of the HEA aimed at improving program efficiency, enhancing program stability, and streamlining program operations</u>. The Department is responding by implementing legislative changes brought about by passage of HERA of 2005. New statutory requirements include increased borrower loan limits, reduced borrower origination fees, reduced lender yields

using tax-exempt bonds, and mandatory guaranty agency default fees. Enacting these and other changes will affect borrowers, lenders, and guaranty agencies as well as the Department.

2) <u>Improve the Department's present student loan cost model to more accurately project future cash flows and predict the impact of variables affecting these cash flows</u>. The Credit Reform Work Group (CRWG) held in-depth monthly meetings throughout 2006 at which senior leadership reviewed a broad range of credit reform issues, including 2006 student loan cost estimates, the development of sensitivity and scenario analyses highlighting the impact of changes in key variables on program cost estimates, and an analysis of the relationship of model outputs and cohort-level balances in the Department's financial system. CRWG subgroups also conducted weekly meetings for much of the year at which program managers reviewed and validated model assumptions and supporting analyses. In addition, Department staff worked closely with OMB to incorporate probabilistic interest rate forecasts into student loan program cost estimates.

Efficiency Measures

The Department has established unit administrative cost as the appropriate efficiency measure for the student loan programs. These programs—and the other student aid programs—have the common goal of helping low- and middle-income Americans pay the increasingly high cost of obtaining a postsecondary education.

Given this shared goal, an analysis of the cost of providing student aid gives Department policymakers and managers a key measure with which to compare the efficient use of Government funding across a variety of delivery mechanisms. In addition, the program-specific unit cost analysis is part of a more comprehensive cost accounting system used by managers at the Department's Federal Student Aid (FSA) office, which has primary responsibility for administering the student aid programs, to monitor operational costs, identify potential processing improvements, and assess the impact of system and organizational refinements.

For the student loan programs, the unit cost reflects the cost of originating loans in the current year and all future costs associated with servicing these loans, forecast out to the year the final loan is retired. Costs in future years are then discounted back to the current year using OMB economic assumptions to determine the overall cost in current dollars of administering that cohort of awards. For example, as can be seen in the table which follows, for the 2002 Direct Loans cohort, discounted future administrative costs total $453 million with a unit administrative cost of about $214 per borrower.

Direct Loans and FFEL Unit Costs—2002 through 2004 Cohorts

Programs	2002 Cohort	2003 Cohort	2004 Cohort
Federal Direct Student Loans:			
Origination Costs	$149,755,883	$148,159,243	$107,271,003
Servicing Costs	303,427,034	312,366,241	320,293,462
Total Costs	453,182,917	460,525,484	427,564,465
Number of Borrowers	2,118,598	2,076,802	2,151,824
Unit Costs	**$213.91**	**$221.75**	**$198.70**

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Programs	2002 Cohort	2003 Cohort	2004 Cohort
Federal Family Education Loans:			
Origination Costs	$140,056,389	$147,414,140	$136,014,159
Servicing Costs	241,022,972	248,123,704	254,420,580
Total Costs	381,079,361	395,537,844	390,434,739
Number of Borrowers	4,875,856	5,991,882	6,611,921
Unit Costs	**$78.16**	**$66.01**	**$59.05**

Total costs for the FFEL 2002 cohort total $381 million with a unit cost of about $78 per FFEL borrower. The FFEL program has much of its administrative cost borne by the lenders who actually make the loans; therefore, direct comparisons to Direct Loans may not be entirely significant.

As noted above, these unit costs are based on detailed data from FSA's activity-based cost system, which uses a series of allocation algorithms to generate reports by program, by organizational unit, or by business process for all activities for a given fiscal year. This system, which focuses on expenditures, was applied to annual obligation data to establish baseline costs for each fiscal year. Lifetime costs for each cohort were then calculated based on these baselines. For the loan programs, a methodology for estimating lifetime costs had already been established as part of an exercise for the FY 2006 President's Budget (Budget). A separate methodology was developed for the non-loan programs, where administrative activities occur over a much shorter period.

These unit cost measures for the loan programs differ from unit administrative costs—presented in the President's Budget—in a number of ways. The unit cost measures discussed here reflect administrative costs incurred directly by the Department, regardless of funding source, while the materials in the Budget reflect Federal administrative costs as defined under the Federal Credit Reform Act of 1990. Accordingly, the unit cost measures shown above include costs such as default contract collection costs, which are funded from loan subsidy accounts and therefore excluded from the administrative cost materials in the Budget. Correspondingly, payments to FFEL guaranty agencies from non-subsidy accounts are included in the Budget presentation but excluded from cost measures included in this presentation.

FY 2008 ESTIMATED PROGRAM COSTS

The largest loan *subsidy costs* involve in-school interest subsidies for borrowers and costs associated with borrowers who default on their loans. Under the FY 2008 budget, FFEL costs for new loan subsidies are estimated at $3.9 billion, supporting approximately $89.7 billion in total FFEL net commitment volume. Direct Loan subsidy costs in fiscal year 2008 are estimated at $509 million, supporting $20 billion in estimated total Direct Loan net commitment volume. Generally, these costs reflect a combination of positive and negative subsidy by loan type with the relative weightings by loan type and other accounting rules determining the overall positive or negative subsidy cost. A negative subsidy occurs when the present value of cash inflows to the Government is estimated to exceed the present value of cash outflows.

STUDENT LOANS OVERVIEW

FFEL and Direct Loans

Subsidy rates represent the Federal portion of non-administrative costs--principally interest subsidies and defaults--associated with each borrowed dollar over the life of the loan. Under Federal Credit Reform Act rules, subsidy costs such as default costs and in-school interest benefits are embedded within the program subsidy, whereas Federal administration costs are treated as annual cash amounts and are not included within the subsidy rate. However, based on new HERA provisions, the costs of Account Maintenance Fees paid to guaranty agencies which were partially coming out of Direct Loan administrative funds, are, starting in FY 2007, calculated totally as part of the FFEL subsidy cost. This increases FFEL subsidy costs. In addition, the other administrative funds that support Direct Loans which had been categorized as mandatory would, as of FY 2007, cease to be mandatory and are subject to annual discretionary appropriations within the **Student Aid Administration** Account.

The subsidy rate for a FFEL or Direct Loan reflects the estimated unit cost per loan to the Federal Government. For example, a $1,000 loan with Federal subsidy costs of $100 would have a subsidy rate of 10 percent.

For fiscal year 2008, the weighted average FFEL subsidy rate reflecting proposed policy is estimated at 3.88 percent; while the weighted average Direct Loan subsidy rate reflecting proposed policy is estimated at 2.35 percent. Annual variations in the subsidy rates are largely due to variations in short- and long-term interest rates and technical assumptions. The loan subsidy estimates are particularly sensitive to fluctuations in interest rates. Even small shifts in interest rate projections may produce substantial movement, up or down, in the subsidy rate. Also, under HERA, the origination fees paid by students gradually are phased down to zero in FFEL and 1 percent in Direct Loans as of July 1, 2010. This reduction in fees paid to the Government results in considerable additional subsidy cost in the outyears. Certain policies proposed for FY 2008, such as increasing loan limits, would increase estimated costs in the outyears, while other proposed FFEL policies, such as reducing lender special allowance, would provide savings.

Variations in the subsidy rates between the two loan programs largely exist because borrower repayments in the FFEL program go to lenders, while Direct Loan borrower repayments can be used to offset Federal borrowing and other program costs.

LIQUIDATING ACCOUNT

The cost of FFEL student loan commitments made prior to fiscal year 1992 (the start of credit reform) is appropriated annually under indefinite authority in a Liquidating Account on a cash basis. This account does not issue any new loans, nor estimate loan-lifetime costs by cohort, and does not use a net present value calculation. The Liquidating Account pays pre-1992 student loan activities, such as loan default payments, special allowance payments, and interest benefits. Consequently, as default and in-school interest costs on these older loans decline over time, and recoveries on defaulted loans continue to be collected, annual revenues—also referred to as offsetting collections—will more than offset annual costs, resulting in negative program costs for which no new budget authority is needed. Total net outlays are estimated to be -$690.9 million in FY 2008. This portion of offsetting collections that exceeds program costs is returned to the U.S. Treasury as a capital transfer resulting in net budget savings.

FEDERAL STUDENT LOAN RESERVE FUND

The Higher Education Amendments of 1998 clarified that reserve money held by public and non-profit guaranty agencies participating in the Federal Family Education Loan (FFEL) program are Federal property. These funds are used to pay default claims from FFEL lenders as well as other claims such as those related to death, disability, bankruptcy, and closed schools. The fund, commonly referred to as the Reserve Fund, also pays fees to support successful guaranty agency efforts to avert defaults.

Federal payments reimbursing agencies for default claim payments are paid into these funds, as are borrower insurance premiums based on 1 percent of loan principal. HERA mandates that guaranty agencies are ***required*** to collect the 1 percent insurance premium—previously optional—on all loans guaranteed or disbursed after July 1, 2006.

The FY 2002 President's Budget clarified that the Reserve Fund should be included on-budget. As required by law, the Reserve Fund returned $1.085 billion to the Treasury in FY 2002 under a scheduled recall of $1 billion in reserves mandated by the 1997 Balanced Budget Act, and an additional $85 million in reserves required to be returned by the Higher Education Amendments of 1998.

The Reserve Fund had a balance of about $888 million at the beginning of FY 2006. As required by HEA, $82.5 million in guaranty agency reserve funds were returned to the Treasury during FY 2006. Another $82.5 million of reserves held by the Reserve Fund are scheduled for return in FY 2007.

The Fund's major revenues are primarily reinsurance payments from the Federal Government and its major expenses are insurance payments to lenders. After these and other cash flows, the Fund had an ending balance in FY 2006 of about $579 million that becomes its starting position for FY 2007.