Addendum to
"The Profitability of Federally Guaranteed Student Loans,"
an attachment to a letter to
The Honorable Pete V. Domenici,
March 30, 1998

The accompanying table was prepared at the request of the staff of the Senate Committee on the Budget as an addendum to the Congressional Budget Office's analysis of the profitability of Federal Family Education loans (FFELs). The table compares the expected returns from federally guaranteed student loans under three interest rate formulas. For each formula, the table compares the returns of lenders that hold FFELs in their portfolios through repayment with the returns of lenders that securitize the loans when borrowers begin repayment.

Under the first formula, which under current law applies to loans made through June 30, 1998, the interest rate earned by lenders on FFELs is the bond-equivalent yield (BEY) on 91-day Treasury bills plus a certain percentage-point additive: 2.5 percentage points when borrowers are in school or are in the grace period, or if they defer repayment; and 3.1 percentage points when borrowers are repaying their loans. (Under current law, the interest rate earned by lenders on loans made beginning July 1, 1998, will be based on the BEY on Treasury securities with a maturity comparable to FFELs [about 10 years], as established by the Secretary of Education, plus 1 percentage point.) Under the second formula, the assumed rate that lenders earn equals the BEY on the 91-day T-bill plus 2.35 percentage points when borrowers are in school, are in the grace period, or defer repayment; and 2.95 percentage points when borrowers are repaying their loans. Under the third formula, the additives are 2.2 percentage points and 2.8 percentage points, respectively.

Any legislation that established a new formula for determining the interest rate earned by lenders on FFELs made beginning July 1, 1998, might make other changes that affect the profitability of federally guaranteed student loans. CBO's analysis examines only the effect on profitability of differences in the interest rate formula. For an explanation of the assumptions of CBO's analysis, see the attachment to the letter from June E. O'Neill to Senate Budget Committee Chairman Pete V. Domenici, March 30, 1998.

EXPECTED AFTER-TAX RATES OF RETURN ON EQUITY FROM FEDERAL FAMILY EDUCATION LOANS TO STUDENTS ENTERING SCHOOL IN THE FALL OF 1998 (In percent)

Type of School/ Borrower	Current Formula		Current Formula Minus 15 Basis Points		Current Formula Minus 30 Basis Points	
	Portfolio Lending	Securiti-zation	Portfolio Lending	Securiti-zation	Portfolio Lending	Securiti-zation
Two-Year School						
Low-balance loan	16	22	13	17	10	11
High-balance loan	19	30	17	25	14	19
Four-Year School	18	26	16	22	13	17
Graduate School	23	35	21	29	18	25

SOURCE: Congressional Budget Office based on data from student lenders. For information on the assumptions of CBO's analysis, see the attachment to the letter from June E. O'Neill to Senate Budget Committee Chairman Pete V. Domenici, March 30, 1998.

NOTE: The current interest rate formula is the bond-equivalent yield on the 91-day Treasury bill plus an additional 2.5 percent or 3.1 percent, depending on the school status of the borrower. Under current law, this formula applies only to loans made through June 30, 1998.