THE LIFETIME VALUE OF A STUDENT LOAN RELATIONSHIP

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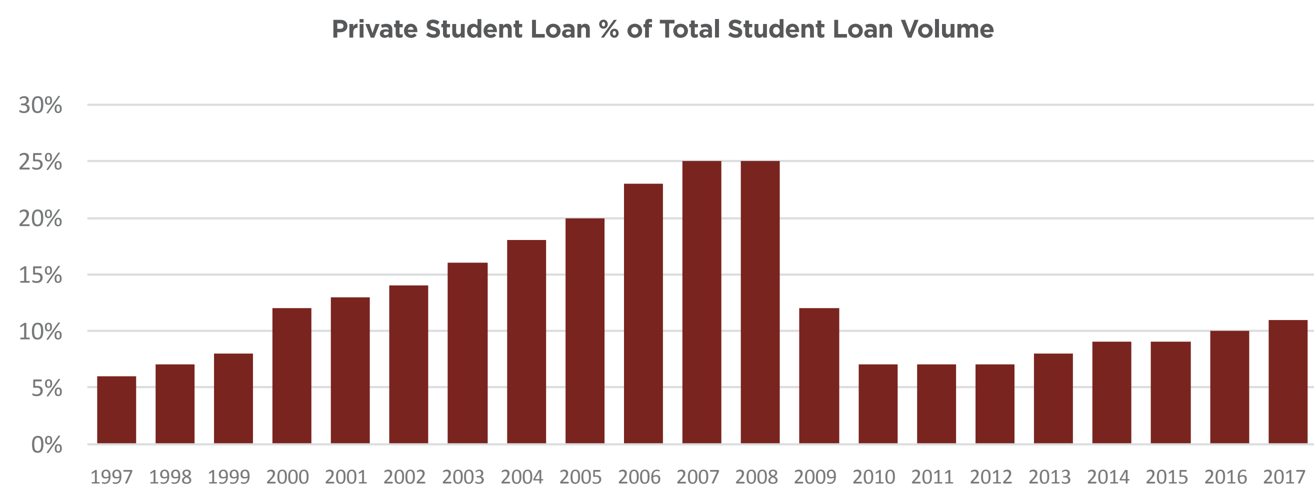
THE PRIVATE STUDENT LOAN MARKET

From a consumer perspective, the student loan statistics are scary: Americans' level of student debt exceeded $1.52 trillion in Q1 2018, up from $619 billion in Q1 2008, a 146% increase.[1] According to the Bloom Economic Research Division:

> "This unrelenting pace of growth has made student loans the second largest category of debt in the consumer credit market, second only to mortgages, a historic switch that took place in the direct aftermath of the 2008 financial crisis. This almost three-fold increase in student loan debt has occurred despite total postsecondary enrollment falling by over a million students." [2]

From a bank and credit union perspective, however, the statistics could signal a market opportunity. As a percentage of total student loans, private loans peaked at 25% in 2007 and 2008, before dropping to 7% in 2010 in response to Obama-era regulatory changes. Since 2012, however, banks, credit unions and other private lenders have slowly returned to the market, accounting for 11% of student loans in 2017 (Figure 1).

FIGURE 1: **Private Student Loan Percentage of Total Market**



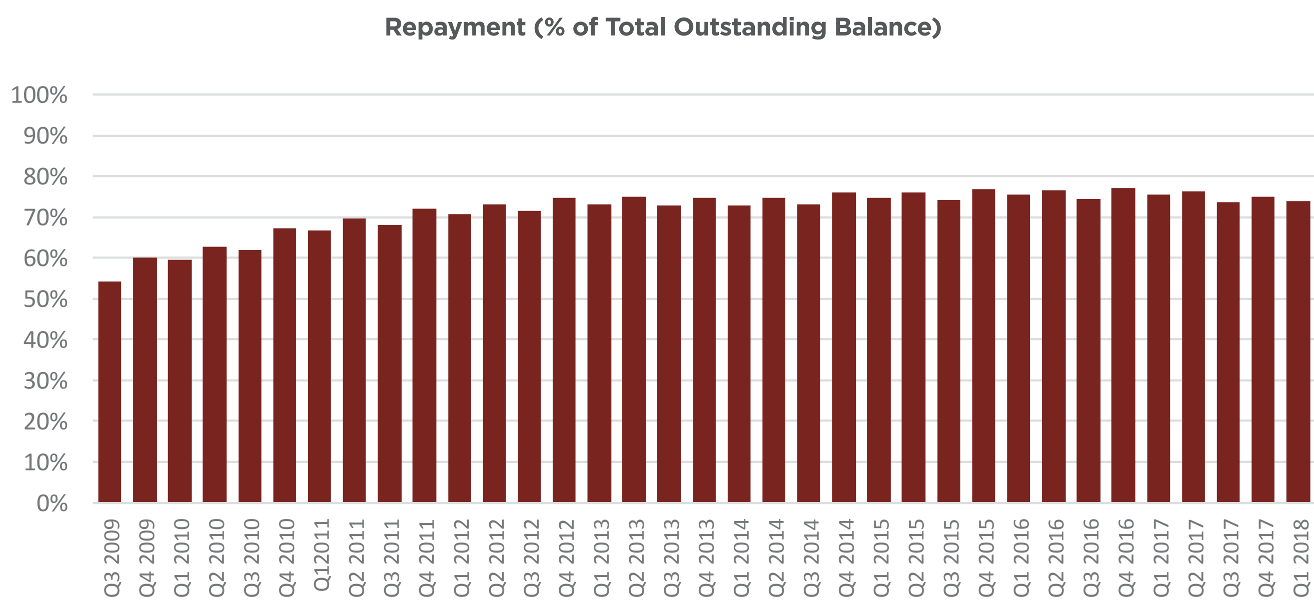
Source: CollegeBoard

KEY PERFORMANCE METRICS

Since the depths of the financial crisis, the private student loan market has shown strong improvements in key performance metrics like:

- **Repayment.** After dipping to 54% in Q3 2009, the repayment percentage has remained above 70% since Q4 2011. The increase can be attributed to the use of in-school repayment plans as well as lower rates of charge-offs and deferment (Figure 2).

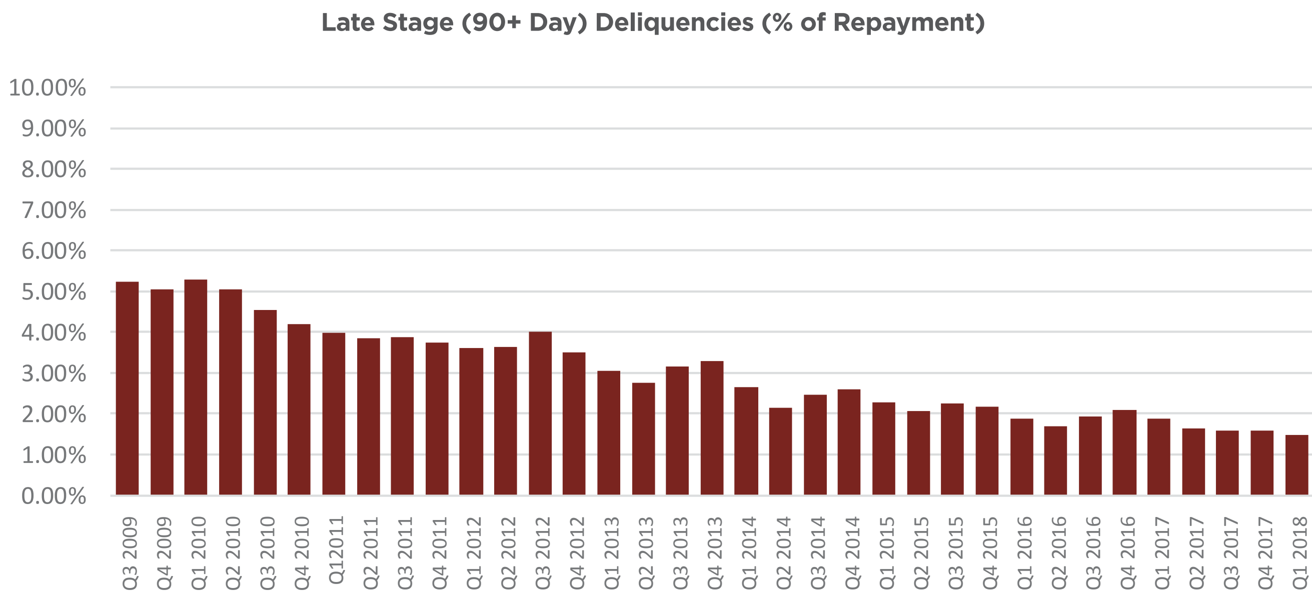
FIGURE 2: **Private Student Loan Repayment Percentage, 2009 to 2018**



Source: MeasureOne

- **Delinquencies.** In Q1 2012, the percentage of student loans in late-stage delinquency surpassed that of credit cards for the first time. At the time, CNBC wrote that the situation "begs for an overhaul of this increasingly important market which has put significant taxpayer dollars at risk."[3] There was no "overhaul," yet both early and late stage (90+ days past due) delinquencies have declined since then. Late-stage delinquencies were 1.49% of repayment balance in Q1 2018—a 50% drop from five years earlier (Figure 3).

FIGURE 3: **Private Student Loan Late Stage (90+ Day) Delinquencies, 2009 to 2018**



Source: MeasureOne

CONSUMER DEMAND FOR STUDENT LOANS

Looking out to the next few years, demand for student loans will remain strong. In addition to the new crop of college-bound students, 8% of today's 18 to 24 year-olds expect to increase their level of student debt or apply for new loans—as many as intend to get an auto loan or mortgage. A similar percentage of 55 to 64 year-olds will also be in the market for student loans, presumably to help their college-age children (Table A).

TABLE A: **Consumer Intentions to Increase Debt or Apply for Loans by Category and Age Group**

Percentage of Consumers That Will Increase Debt or Apply for Loan in the Next Three Years						
Type of loan	**All**	**18-24**	**25-34**	**35-44**	**45-54**	**55-64**
Vacation spending	11%	14%	16%	5%	7%	7%
Entertainment	11%	15%	13%	10%	0%	25%
Home renovation/repair	7%	0%	22%	7%	2%	6%
Student loan	6%	8%	6%	3%	5%	8%
Home electronics	6%	8%	13%	4%	0%	7%
Health care/drugs	5%	10%	7%	3%	3%	4%
Automobile	3%	8%	2%	4%	3%	2%
Mortgage	2%	8%	2%	2%	2%	3%

Source: Filene Research Institute, Confidence in Borrowing Study, Spring 2018

THE DIGITAL STUDENT LOAN OUTLOOK

Although current use of digital platforms and lenders in the student loan space is low, awareness and consideration of these startups are increasing, especially among older Millennials and Gen Xers—key markets for student loan refinancing and parental loans.

Among Millennials in their 30s, nearly a quarter have either borrowed from, or would consider borrowing from SoFi, and 16% would do so with lenders on the LendKey platform. The percentages of Gen Xers who would consider, or who have already borrowed from these firms are only slightly lower (Table B).

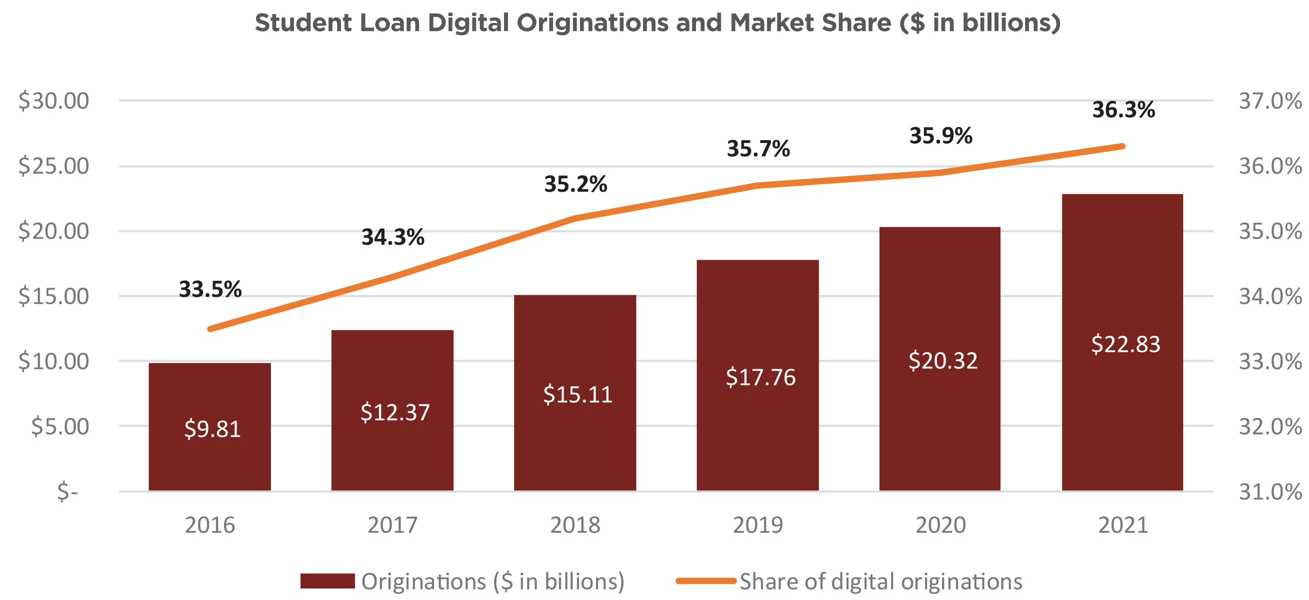
TABLE B: **Consumer Awareness and Use of Digital Student Lending Fintechs**

Percentage of Consumers That Will Increase Debt or Apply for Loan in the Next Three Years					
Generation	**Fintech**	**Have borrowed money from (or through) them in the past 2 years**	**WOULD consider them if I needed to borrow**	**WOULD NOT consider them if I needed to borrow**	**Have not heard of them**
Young Millennials	**CommonBond**	1.5%	7%	8%	83%
	LendKey	1.5%	5%	7%	86%
	SoFi	3.4%	11%	12%	73%
Old Millennials	**CommonBond**	1.2%	14%	11%	73%
	LendKey	3.1%	13%	14%	70%
	SoFi	3.1%	20%	14%	63%
Gen Xers	**CommonBond**	2.2%	11%	7%	80%
	LendKey	2.2%	12%	10%	76%
	SoFi	2.4%	19%	11%	68%
Boomers	**CommonBond**	0.1%	2%	2%	96%
	LendKey	0.1%	2%	3%	95%
	SoFi	0.3%	8%	10%	82%

Source: Cornerstone Advisors

Overall, digital student loan originations will more than double between 2016 and 2021 from $9.8 billion to more than $22.8 billion. As a share of all digital loan originations, student loans will grow from 33.5% to 36.3% of the loan volume (Figure 4).[4]

FIGURE 4: **Digital Student Loan Forecast**



Source: SNL

SO WHAT

Despite the positive trends, many banks and credit unions have stayed out of the market. Some experts, like a senior credit officer at Moody's, think they're missing an opportunity:

> "The private student loan market is a growth area some banks could consider getting into. The market has been growing; federal loans don't come close to covering the cost of education, so there's definitely a vibrant market for private student loans."

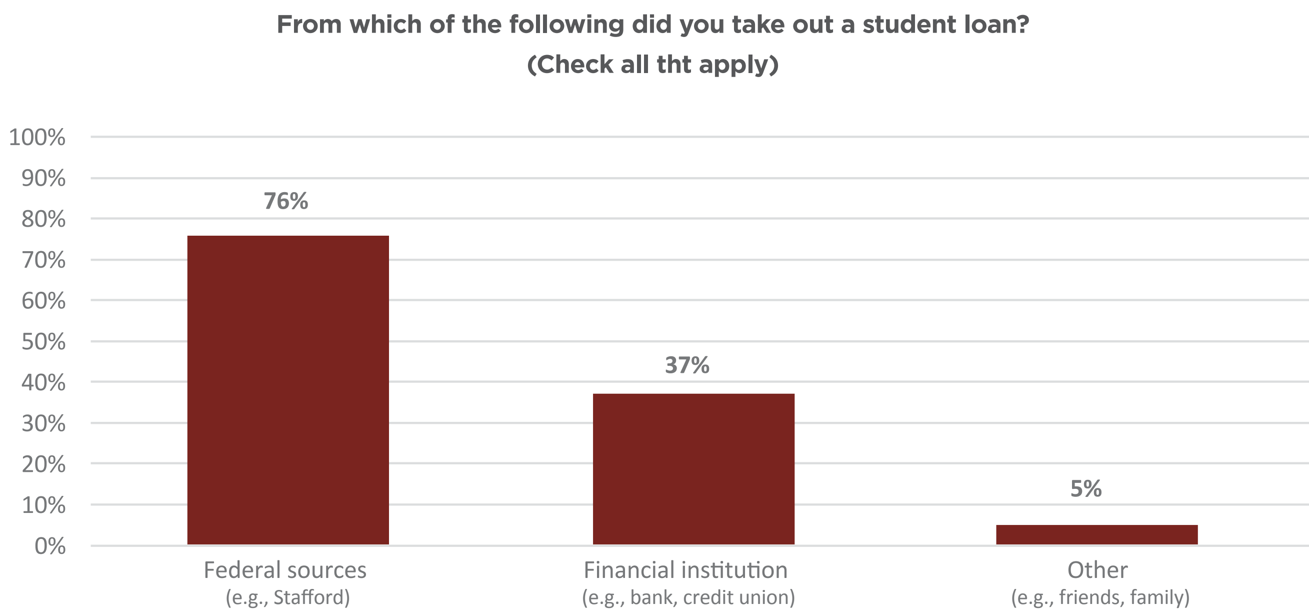
Based on our consumer research and a customer lifetime model for student borrowers, Cornerstone Advisors agrees.

THE STUDENT LOAN CROSS-SELL OPPORTUNITY

The business opportunity for banks and credit unions extends beyond the student loan itself—the longer-term relationship building opportunities are substantial. To better understand and quantify those opportunities, Cornerstone Advisors surveyed consumers who applied for and received a student loan sometime in the past 10 years.

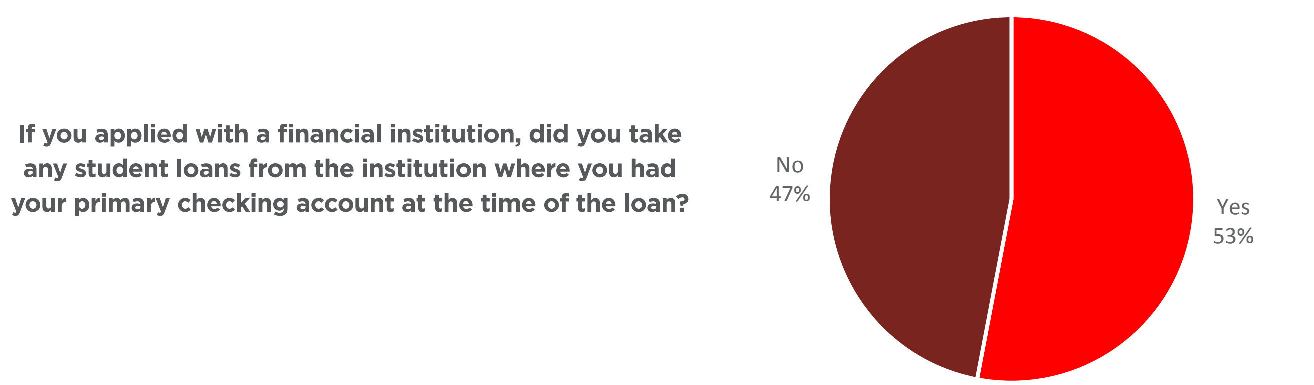
Three-quarters of student loan borrowers took out a loan from federal sources, 37% from a financial institution, and 5% turned to other sources like friends and family (Figure 5). Of those that applied with a financial institution, 53% applied with the financial institution where they had their primary checking account at the time of the loan (Figure 6).

FIGURE 5: **Sources of Student Loans**



Source: Cornerstone Advisors

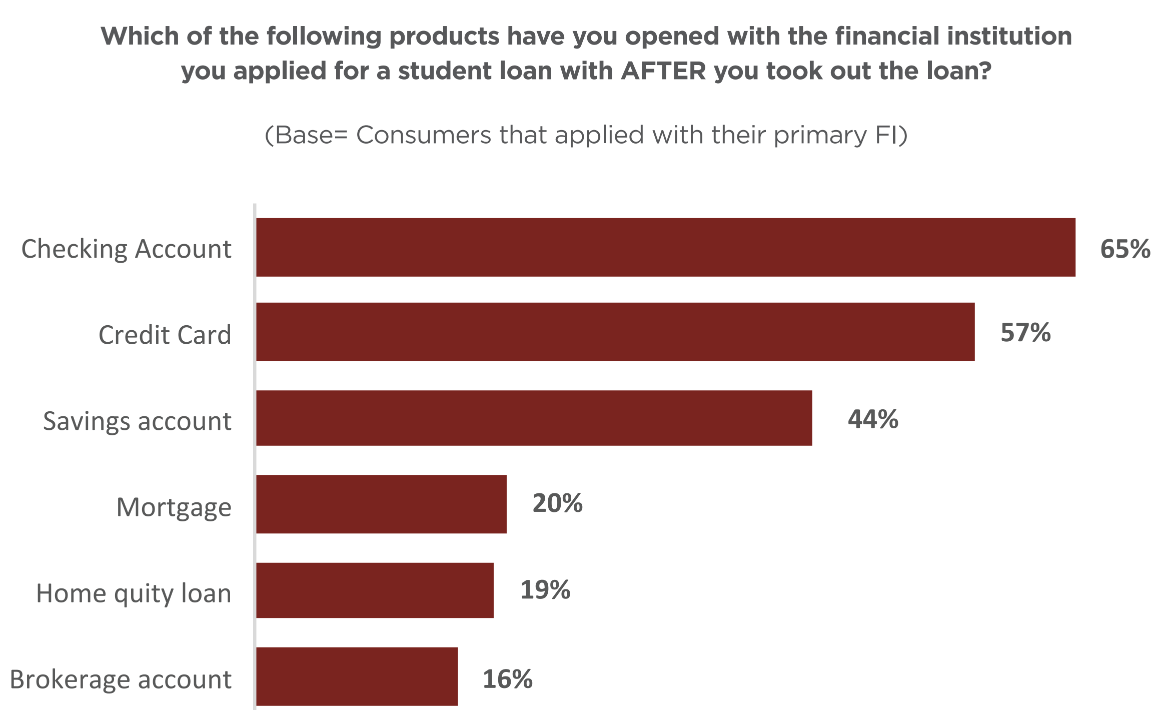
FIGURE 6: **Student Loan Borrowers Applying With Primary Financial Institution**



Source: Cornerstone Advisors

Among consumers who borrowed from their primary bank or credit union, after taking out a student loan, two-thirds opened a checking account, nearly six in 10 got a credit card, and roughly one in five took out a mortgage or home equity loan from that institution (Figure 7).

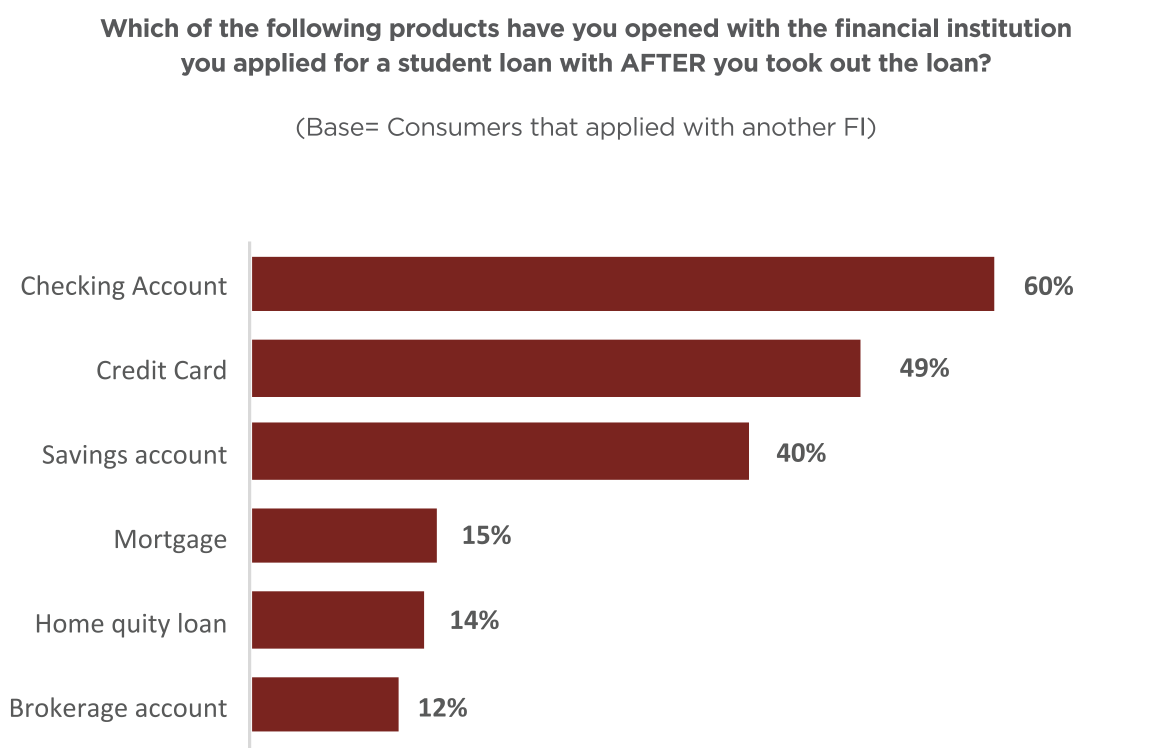
FIGURE 7: **Products Opened With Primary FI After Taking Student Loan**



Source: Cornerstone Advisors

Many student loan borrowers who took out a loan from a bank or credit union that *wasn't* their primary institution did more business with that institution after taking out the student loan, as well—six in 10 opened a checking account, half got a credit card, and 15% got a mortgage from that institution at some point after the student loan (Figure 8).

FIGURE 8: **Products Opened With Non-Primary FI After Taking Student Loan**



Source: Cornerstone Advisors

STUDENT LOAN LIFETIME VALUE MODEL

Based on our consumer research and industry benchmark data, Cornerstone Advisors developed a customer lifetime value model to estimate the potential value of a student lending relationship over the term of the loan. We made assumptions regarding product acquisition costs; retention, interest and discount rates; and other additional product variables (Table C).

TABLE C: **Student Loan Lifetime Value Model Assumptions**

	Variable	Value
Marketing	Acquisition cost (initial student loan)	$1,000
	Acquisition cost (per additional product)	$250
	Retention rate	90%
Student loan	Average student loan funded amount	$10,000
	Average student loan interest rate (fixed)	10.00%
	Student loan term (in years)	10
	Average cost of funds	0.75%
Cross-sell	Annual fee/debit/ATM income per checking account	$160
	Annual credit card interchange income per account	$150
	Average mortgage funded amount	$200,000
	Average mortgage interest rate (fixed)	4.75%
	Mortgage term (in years)	30
	Annual fee income from investment account	$360
	Annual fee income from insurance account	$500

Source: Cornerstone Advisors

To model the student loan lifetime value, we created six scenarios based on the likelihood of a student loan borrower purchasing additional products over the repayment life of the student loan (Table D). We then created a portfolio of 100 student loan borrowers with the mix based on the distribution of each scenario. For our model, we assumed the term of a private student loan at 10 years.

TABLE D: **Student Loan Lifetime Model Scenarios**

Year of Repayment Period in Which Student Loan Borrower Adds Additional Product						
Scenario	**Student loan**	**Checking account**	**Credit card**	**Mortgage**	**Insurance policy**	**Investment account**
One	1	-	-	-	-	-
Two	1	1	-	-	-	-
Three	1	1	3	-	-	-
Four	1	1	3	5	-	-
Five	1	1	3	5	7	-
Six	1	1	3	5	7	9

Source: Cornerstone Advisors

The results of the model show that the lifetime value of a student loan borrower ranges from roughly $3,000 (for a borrower who adds no additional products) to nearly $23,000 for borrowers who expand their relationship by five additional products. For a portfolio of 100 borrowers, the lifetime value approaches $650,000 based on a conservative estimate of the percentage of borrowers in each scenario (Table E).[5]

TABLE E: **Student Loan Lifetime Value Model**

Scenario	Lifetime value per customer (discounted)	Lifetime value per customer (gross)	Scenario distribution	Lifetime value per 100 borrowers (discounted)	Lifetime value per 100 borrowers (gross)
One	$1,939	$3,049	44%	$85,295	$134,173
Two	$2,380	$3,842	25%	$59,495	$96,038
Three	$2,607	$4,331	15%	$39,098	$64,965
Four	$9,688	$21,732	10%	$96,883	$217,320
Five	$9,959	$22,513	5%	$49,797	$112,565
Six	$9,979	$22,700	1%	$9,979	$22,700
Total	**$36,552**	**$78,167**	**100%**	**$340,547**	**$647,760**

Source: Cornerstone Advisors

Note that the model only considers the 10-year life of the student loan. Since many of the products are assumed to be purchased at staggered intervals during the life of the loan, the true lifetime value could be significantly higher. If an institution cross-sells additional products earlier in the relationship, it will have a positive impact on the lifetime value.

CONCLUSIONS

Talk of a student loan crisis often overlooks the distinction between federal and private loans. Looking at just the average debt per person fails to take into consideration the deviations from the norm. As the Cleveland Federal Reserve Board wrote:

> "In Q2 2015, the average student loan payment for 20- to 30-year-olds was $351. But 50% of borrowers had payments of $203 or lower, and another 25% had payments between $203 and $400. This means that 75% of student loan borrowers in this age range would be better off with a student loan if going to college increased their monthly take home earnings by $401 or more. In 2014, labor force participants aged 20 to 30 who had at least some college on average earned $2,353 per month, $750 more than people the same age with just a high school degree. This is more than double the average monthly student loan payment, suggesting that the increase in earnings from going to college more than offsets the cost of student loan payments for most borrowers." [6]

The business case for student loans goes beyond the lending transaction, however. Two-thirds of consumers who take out student loans from their primary bank or credit union add additional products after the student loan, as did 60% of those who applied with an institution other than their primary institution.

The overall lifetime value of a student loan borrower is dependent on how well an institution cross- and up-sells, but the consumer research shows that many student loan borrowers continue their relationship beyond the loan. Over a 10-year period, one borrower could put more than $20,000 on an institution's bottom line.

The challenge for many mid-size institutions is how to profitably get into the market. The rise of digital student loan platforms over the next few years will help address that. Beyond the obvious (but needed) support for lead generation, these platforms help financial institutions with:

- **Loan origination.** Platforms' digital origination processes enable financial institutions to review electronic loan jackets and include electronic signature and account verification, and automatic funds disbursement.

- **Credit decisioning.** Platforms provide customized credit criteria and program guidelines that fit an institution's risk level and goals.

- **Loan servicing.** Platforms typically service your loan portfolio, including invoicing, payment processing and real-time reporting.

ENDNOTES

[1] https://fred.stlouisfed.org/series/SLOAS

[2] https://bloom.co/berd/student_debt_crisis.pdf

[3] https://www.cnbc.com/id/49983471

[4] 2017 US Fintech Landscape, https://www.snl.com/web/client?auth=inherit#news/docviewer?id=42877606

[5] Our consumer survey found a higher percentage of borrowers adding additional products.
For the purpose of the model, we changed to distribution to produce a more conservative estimate.

[6] www.clevelandfed.org/newsroom-and-events/publications/forefront/ff-v7n02/ff-20160516-v7n0204-is-there-a-student-loan-crisis.aspx

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CORNERSTONE ADVISORS

Cornerstone Advisors takes financial institutions from strategy to execution through an array of solutions offerings, including Strategy, Performance, Technology, Mergers & Acquisitions, Payments, Risk Management, System Selection & Implementation, and Delivery Channels.

Cornerstone publishes the Insight Vault, a digital platform explaining the So What? of the news, fintech trends, research and ideas impacting the banking industry; the *Cornerstone Performance Report*, a series of annual benchmarking studies; and commissioned research on topics impacting the industry.

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LendKey

LendKey pioneered the lending-as-a-service model enabling white-labeled, digital lending solutions that help financial institutions establish a strong digital lending presence and acquire prime borrowers for a lifetime of lending. LendKey's customized solutions help financial institutions improve lives with lending made simple while managing liquidity, reducing costs, and mitigating risk. The company revolutionized the entire lending process for institutions including demand generation, online decisioning, loan origination, customer service, compliance, and proprietary balance sheet management. Founded in 2009 and based in New York and Cincinnati, LendKey works with hundreds of credit unions and banks who have deployed more than $2 billion in loan capital to date through LendKey's platform. LendKey was recently named one of Fortune's Great Places to Work®. For more information, please visit www.lendkey.com/lend or email info@lendkey.com.

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