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With Student Loans Back on the Books, Other Types of Credit Will Be Tougher to Get

Here's yet another snag for borrowers resuming student loan payments this fall

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If you've got student loans, don't assume it will be as easy to get credit this fall. SDI Productions/Getty Images

As millions of people with federal student loans brace themselves for their first monthly bills in more than three years, there may be more downsides than they realize.

Besides having to make payments again — a budget hit made no smaller by Friday's Supreme Court ruling against loan cancellation — they may find it harder to borrow other types of money, according to lenders.

Here's why: After the pandemic triggered a government moratorium on monthly student loan payments in 2020, many lenders changed how they accounted for those obligations when deciding whether applicants were qualified for other types of credit. That made it easier to get loans for everything from cars to houses — but only temporarily. When borrowers resume making payments this fall, things will go back to the way they were.

"Some people are going to be shocked to find out that their buying power will be reduced when student loan payments kick back in," said Bobby Atkisson, a mortgage loan officer and a senior vice president at The Federal Savings Bank in Columbia, Missouri. "If someone calls me today, I'm going to pre-approve them off today's guidelines. If they call me back in October and tell me they finally found a home, the amount they qualify for is going to be smaller."

Credit may become less available just as borrowers need it more, too. Making payments averaging an estimated $275 a month means borrowers will have less cash for other expenses as the threat of an economic recession looms.

"There will be a significant amount of people who aren't going to look as good, credit-wise, when student loan payments resume, and it might come right when they need access to credit," said Dean Baker, who has written more than half a dozen books on the economy and co-founded the Center for Economic and Policy Research in Washington D.C. Many people "are going to feel some serious pain."

Besides a person's income, lenders consider all loan payments and other monthly obligations when determining whether someone qualifies for a loan, and for how

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much. During the moratorium, credit reports have shown the size of the outstanding student loans, but have typically listed zero on the line for monthly student loan payments.

Some lenders — particularly auto lenders that offload risk by selling the loans to investors — have taken that zero payment at face value, while others have used a percentage of total outstanding student loans when deciding how much, if anything, to lend, according to Greg McBride, who advises people on personal finance as chief financial analyst at the website Bankrate.

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Mortgage backers including Freddie Mac and the Federal Housing Administration, which together fund almost half of newly issued mortgages, are in the latter category.

During the pandemic, they began telling lenders to use 0.5% of the outstanding student debt balance as the monthly payment rather than the 1% standard that had typically been applied in situations when the borrower wasn't paying.

The change helped some house hunters get bigger mortgages.

For example, someone with $25,000 of outstanding student loans paying a 5% interest rate over 10 years would have had a monthly payment of about $265 before the pandemic. But 0.5% of $25,000 is $125, so lenders using the 0.5% rule during the pandemic have been factoring in an obligation of less than half that, according to Atkisson.

Factoring in only $125 allows an applicant to qualify for a $250,000 mortgage right now, he said. Once lenders go back to factoring in $265, that same applicant will only be able to get a $230,000 mortgage.

Making matters worse, many borrowers wanting a mortgage won't have the same cash reserves they built up during the pandemic, so they won't appear as creditworthy once they resume making payments, said Bill Banfield, executive vice president of capital markets for the lender Rocket Mortgage.

Auto lenders and credit card issuers aren't as transparent as mortgage lenders about their vetting formulas, but many — particularly auto lenders — were using that zero for the student loan payment line even though they knew it wouldn't stay that way, said McBride.

Borrowers may see more of a shift trying to get car loans than credit cards this fall, however, McBride said. Card issuers tend to be more cautious since there's no asset to seize if borrowers fall behind on their credit card payments, he said.

Caution is something that student loan borrowers should think about as well. They shouldn't rush out to secure more debt before credit gets tighter, McBride said.

"If you have too much debt, don't take on more debt," he said. "If it's going to be hard to make your payments, why paint yourself into a corner?"

One way for borrowers to qualify for a larger mortgage could be to lower their monthly student loan payment by applying to an income-based repayment program.

Prior to the pandemic, Fannie Mae, Freddie Mac, and Ginnie Mae — the company that backs FHA loans — hadn't allowed mortgage lenders to qualify applicants using the lower payments afforded by income-based programs, but they will when the moratorium ends, said Atkisson.

SAVE, a new Department of Education program rolling out over the next year, will reduce student loan payments to 5% of a borrower's discretionary income, down from 10%, and raise the threshold for what's considered non-discretionary income.

"For some people, the new income-based repayment plan is what's going to make the difference between getting a mortgage or not," said Atkisson.

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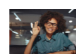

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