Issue Briefs
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UW Extension Cooperative Extension

Financing Higher Education

Student loan debt has attracted widespread media attention due to recent increases in the amount of student loan debt in the US and the growing share of all household debt that student loans account for. This brief reviews these trends for Wisconsin, discusses the balance between taking on too much versus too little debt, and describes major lending programs and repayment options.

The Role of Student Loans

Education remains a key driver of economic mobility in the U.S. Data from the Bureau of Labor Statistics regularly shows that people with a college degree are less likely to be unemployed than people with less education, and they also earn significantly more.[1] Education is an up-front investment in human capital, with returns over a lifetime of work in the form of higher income. The labor market values each successively higher level of educational attainment such that earnings increases can be used to pay off the costs of education over time. Student loans allow individuals to access funds to invest in themselves today, and then repay those funds after graduation.

About 10 million students borrowed in 2012, double the number from a decade ago. In the early 1990's, about 1 in 5 undergraduates took out a loan, compared to nearly 2 out of 5 today. The amount of debt per borrower has remained relatively unchanged, however (accounting for inflation).

The media often focuses on tragic stories of uninformed students taking out massive loans that they have no hope of repaying; this scenario is not representative of the vast majority of borrowers. Fewer than 1% of borrowers have more than $100,000 in student loan debt, and these cases are primarily students who took out loans for both undergraduate and graduate/professional degrees.

Overall trends mask differences in borrowing across types of educational institutions: public; private, nonprofit; private, for-profit; two-year; and four-year. Table 1 shows 2010 debt levels for students who first enrolled in 2004 (six years after their initial enrollment). Overall, 61% of students who enrolled in public 4-year schools borrowed, and borrowers' average debt after 6 years was $11,706. About 68% of students at four-year private schools borrowed, with average debt of $16,606 after six years. A stark comparison is the 89% of students at *for-profit* four-year institutions who borrowed; six years later their average student debt was $19,726 - higher in all respects than students at 4-year public and non-profit schools.

Even more concerning is that only 15% of individuals who first enrolled at a for-profit 4-year institution had received a bachelor's degree after 6 years. Borrowing but never obtaining a degree means servicing debt without the expected boost in earnings--a situation that likely causes financial distress.

Although the trends related to private 4-year schools are troubling and consistent with problematic borrowing behavior, the data for public 2-year schools shown in Table 1 suggest an opposite but equally important problem--under borrowing. Two-year degrees are an important avenue for non-

[1] See http://www.bls.gov/emp/ep_chart_001.htm

traditional students and can serve as a step towards a 4-year degree. Two-year degrees are widely available, even in communities without a 4-year institution. Only 41% of public 2-year students borrowed, and they had an average of $5,586 in debt after six years. This is perhaps due to the lower earnings trajectories associated with 2-year degrees and the lower costs of these degrees. But note that only 13% obtained a bachelor' degrees within 6 years. Because 2-year students tend to borrow less, work more, and attend school part time, they may fail to progress along the education ladder. Borrowing more and obtaining an associate's and later a bachelor's degree might be more advantageous than not borrowing and obtaining only an associate's degree (or no degree at all).

Table 1. Average Student Loan Debt In 2010 (Students who First Enrolled in 2004)

	Public 4-year	*Private nonprofit 4-year*	*Private for-profit 4-year*	*Public 2-year*
% students who borrowed	61%	68%	89%	41%
Average amount of debt	$11,706	$16,606	$19,726	$5,586
% graduated with bachelor's degree	62%	71%	15%	13%

Source: Avery and Turner (2012)
http://www.aeaweb.org/articles.php?doi=10.1257/jep.26.1.165

Trends for Wisconsin

Wisconsin undergraduate students borrowed slightly less than their peers nationwide in 2010-11. About 52% of eligible undergraduates borrowed from federal loan programs, with the average borrower taking out $6,507. About 59% of students at four-year schools took out a federal student loan, and 40% did so at two-year institutions. Around 10% of all undergraduates in Wisconsin are enrolled at for-profit schools, but students from these schools represent 13% of all borrowers in the state. Eighty-three percent of for-profit students borrowed, with an average of $8,183 in federal student loan debt.[2]

The percentage of students failing to pay back their student loans in Wisconsin appears to be lower than the national average. The two-year default rate for the 2010 cohort was 6% in Wisconsin, well below the national rate of 9.1%.

How Much to Borrow?

Calculating the payoff of a college degree involves estimating how likely the student is to complete a degree, how long it takes to graduate, any lost income while enrolled, the income that employers will offer in a given major/field, and the value associated with the reputation of the educational institution. In Wisconsin, payback.wisc.edu offers some estimates of the costs and benefits of college attendance, but time to degree and likelihood of graduating remain important factors to consider.

Federal Student Loan Options

Four primary federal loan programs exist, all of which are based on information collected through the Free Application for Federal Student Aid (FAFSA):

Perkins Loans

- Based on financial need, as determined by the FAFSA
- Current fixed interest rate of 5%
- Distributed by colleges and universities, not lenders
- Maximum of $5,500 per year (as determined by the college/university)

Subsidized Stafford Loans

- Based on financial need, as determined by the FAFSA
- Current fixed interest rate of 3.4%[3]

[2] See http://projectonstudentdebt.org/state_by_state-data.php
[3] Until June 30, 2013. The subsequent interest rate will depend on federal legislation

- Government pays interest that accrues while student is enrolled at least half-time
- Annual maximum depends on class year and dependency status
- Only available to students who have not earned a bachelor's degree

Unsubsidized Stafford Loans

- Awarded based on need, but eligibility does not require the borrower to be *needy*
- Current fixed interest rate of 6.8%
- Borrower is responsible for interest accrued while in school, but can defer payments until after graduation
- Annual maximum between $5,500 and $20,500, depending on year and dependency status
- Available to undergraduate, graduate, and professional students

PLUS Loans

- Not based on need
- Available to parents of students and graduate students in excess of the unsubsidized Stafford Loan limit
- Credit check required
- Current fixed interest rate of 7.9%

Students who need funds in excess of their annual or lifetime federal student loan caps, or students who do not qualify for federal financial aid, may turn to private-market student loans.

Repaying Loans

Under current U.S. law, student loans are ineligible for cancellation (discharge) in bankruptcy. This means that unlike most other forms of debt, there is no way to eliminate student loans besides paying them off. Private loans that are in default can become legal judgments. Federal student loans can result in a garnishment of wages (up to 15% of take home pay), tax refunds, and Social Security payments.

Not making loan payments negatively impacts credit histories and increases loan balances as collection fees are added. Temporary or permanent relief from making payments is possible through deferment or forbearance programs. Deferring federal loan payments is allowable for specific life events such as returning to school, military service, economic hardship, or unemployment. Interest does not accrue on subsidized loans during the deferment period, but a borrower cannot fall more than 9 months behind on payments before applying. In a forbearance, interest continues to accrue. Like deferments, only certain circumstances qualify such as poor health or financial problems. Loan cancellation is available only in unusual situations such as attending a school that closes, falsified documents, or the death or disability of the borrower.

Borrowers with Perkins or Stafford federal loans may qualify for programs that reduce monthly payments. The newest of these programs is Income-Based Repayment (IBR), which was introduced in 2007 and revamped in 2010. Through IBR, a borrower's monthly repayments are capped at 15% of discretionary income. Any outstanding debt is forgiven after 25 years of consecutive payments. Borrowers must apply to the IBR program. The IBR website includes a simple eligibility calculator. The similar "Pay as You Earn" program will be available at the end of 2012 and will offer even more advantageous terms than IBR to eligible borrowers. Pay as You Earn will cap monthly payments at 10% of discretionary income, and any outstanding balance is forgiven after 20 years of consecutive payments.

The Department of Education's Public Service Loan Forgiveness program allows borrowers employed by a state agency (including teachers) or a 501(c)(3) organization to have their federal student loans forgiven after 120 on-time payments.

Another option is consolidation, which allows borrowers to combine two or more of their federal loans into a single loan, with a single monthly payment. Related to consolidation is rehabilitation, which allows borrowers to remove the "default" distinction from their credit report by making nine payments on the loan.

Students with private student loans may encounter greater difficulty if they fall behind on payments. For instance, borrowers with private loans will not benefit from newer programs introduced by the U.S Department of Education such as IBR, consolidation, and forgiveness. Private lenders often require regular repayments regardless of a borrower's economic situation, and private borrowers have experienced difficulties enrolling in alternative repayment strategies.

Conclusion

Although student loan debt continues to increase, figures on total debt and default rates for the US and Wisconsin fail to tell the whole story. The percentage of students who take out loans and amounts of student loan debt vary widely across institutions, and average debt load per borrower has remained fairly constant. Furthermore, the one-sided focus on the small minority of students who are tens of thousands in debt runs the risk of discouraging prospective students from investing in their human capital. College degrees are still associated with higher earnings over the life course and significantly lower unemployment rates. Nonetheless, the payoff of a college degree varies depending on a wide array of factors. Payoff calculators can help future students gain a better sense of the costs and benefits of a degree. In terms of the types of loans available to students, federal loans make up over 90% of the student loan market. Federal loans offer key advantages for borrowers struggling to make their payments, including access to Income-Based Repayment, consolidation, and forgiveness programs.

Tools and Resources

The Free Application for Federal Student Aid (FAFSA)

- Form students and families must use to apply for all forms of federal financial aid

Federal Student Aid Website

- Provides a range of information about paying for college and student loans

FinAid.org

- Provides information on all forms of financial aid for families and school staff
    - Affiliated with FASTWEB.com, the largest online scholarship database
- A source of research on financial aid trends

Consumer Financial Protection Bureau's Complaint Website

- Allows a borrower to file a complaint for their non-federal student loan
- Know Before You Owe: http://www.consumerfinance.gov/students/knowbeforeyouowe/

The National Student Loan Data System

- Provides borrowers with information about their loan servicer(s)

More Information:

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The University of Wisconsin-Extension (UWEX) Cooperative Extension's mission extends the knowledge and resources of the University of Wisconsin to people where they live and work. Issue Briefs are an ongoing series of the Family Financial Education Team. This brief was drafted by J. Michael Collins, Assistant Professor in Consumer Finance and Extension State Specialist, Center for Financial Security Research assistance was provided by Collin O'Rourke and Ryan Eisner of the Center for Financial Security