

MILLENNIALS AND STUDENT DEBT

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Student debt is a pocketbook issue for the Millennial generation. Gone are the days when students could work full time at a summer job to pay for college. As college costs have skyrocketed, students and their families have taken on debt to make up the difference. Because of the high cost of college and growing student debt, some are wondering whether college is worth it. On average, the answer is yes. However, many questions remain. Will these trends ever slow? How are student loans affecting the Millennial generation? Will a trillion dollars in debt affect the broader economy?

Current Conditions

There is no question that tuition is drastically rising. Since 1980, prices have tripled at public and private four-year universities and doubled at community colleges.¹ Students and their families borrowed more than \$106 billion in Federal Direct Loans to attend those institutions.²

Outstanding student loan debt in the United States currently amounts to over \$1.2 trillion, recently exceeding total credit card debt.³ Paying for college has become one of the largest investments in a person's lifetime.

Rising Tuition and Rising Debt

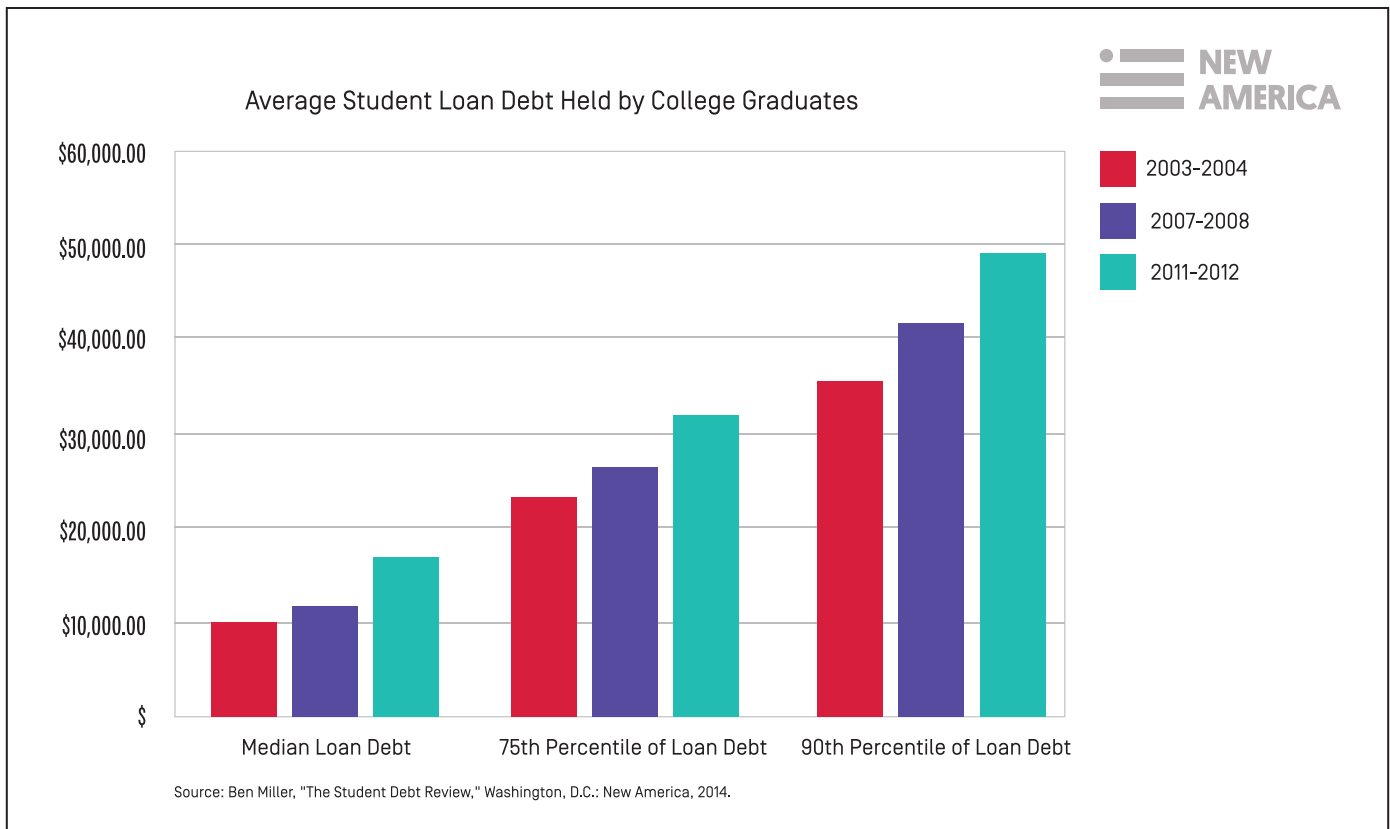
In part, student debt is rising because tuition is rising. In the recent decade from 2002 to 2012, prices for undergraduate tuition, room, and board at public institutions rose 40 percent, and prices at private nonprofit institutions rose 28 percent.⁴ This rate of increase is four times faster than inflation.⁵

Tuition is rising at public institutions because states are allocating fewer resources to them.⁶ From 2008-2013 states spent 28 percent less per student on higher education.⁷ Before the Great Recession, net tuition was around 36 percent of all higher education revenue, but today it is over 47 percent.⁸ This means that students and families are responsible for a growing share of the cost of college, and many make up the difference in student debt.

As costs rise, the importance of grant aid is ever apparent. Pell grants are an essential part of college financial aid packages for many students from lower-income families. A number of studies have shown that need-based grant aid, such as provided by Pell grants, not only increases the number of low- and moderate-income students who enroll in school, but also increases their likelihood of staying in school.⁹ Approximately 9 million students in the United States rely on funding from Pell grants to attend and complete college.¹⁰ Pell grants are particularly important for students of color. Half of Latino undergraduates rely on Pell grants to cover college expenses.¹¹ This number is even higher for African-American undergraduates, with over 60 percent of African-American students depending on Pell grants.¹² But students who receive Pell grants are more likely to have other student loans. Sixty-one percent of Pell grant recipients had student loans compared to only 29 percent of non-Pell recipients.¹³

Despite the many benefits of Pell grants, recent budget agreements reduced the size and scope of the program. The FY11 budget removed funding for "year-round" Pell grants, while additional legislation in 2012 reduced the number of students who could qualify. These changes resulted in cuts of nearly 5 billion (12 percent) per year and over \$50 billion over 10 years.¹⁴ While the amount of resources devoted to Pell grants is well above where they were before 2008, rising college costs mean that lower-income students will still require larger student loans amounts—which they must repay—to finance their education.

The average college graduate with a bachelor's degree owes almost \$30,000 in student loans.¹⁵ This amount represents approximately 80 percent of the average income of a young adult in the United States.¹⁶ Higher overall debt, which many borrowers have, likely translates to higher monthly loan payments for many borrowers. For example, a 2012 bachelor's degree graduate with an average debt load pays an estimated \$312 a month in loan payments, \$79 higher than what a 2004 graduate with an average debt level would pay.¹⁷



Recent years have not only seen an increase in the amount that students are borrowing, but have also seen an increase in the number of students who are borrowing. This is driven in part by significant increases in overall postsecondary enrollment. In the 2003-2004 academic year, 1.6 million undergraduates graduated with debt.¹⁸ This number rose to 2.4 million by the 2011-2012 school year, nearly doubling the number of college graduates with debt.¹⁹ In the 2011-2012 academic year, nearly 70 percent of bachelor's degree recipients took out loans to finance their education.²⁰ Both the amount of money borrowed and the percentage of students borrowing from 2011-2012 marked the highest rates of borrowing and indebtedness to date.²¹

This general increase in borrowing has affected graduates of certain types of degree programs and institutions more than others:²²

- 42 percent of students earning associate's degrees at (4-year or 2-year) public colleges borrow compared to 88 percent of students at private for-profit colleges.
- 64 percent of bachelor's degree graduates of public institutions graduate with debt compared to 74 percent of bachelor's degree graduates at

private nonprofit institutions and 87 percent at private for-profit institutions.

- 36 percent of certificate graduates at public institutions incur debt to attend college compared to 86 percent of certificate graduates at private for-profit colleges.²³

Private Loans

In some instances, grants and federal loans are not enough to cover the cost of attending college. Many students turn to private loans to make up the difference. Private loan debt accounts for \$150 billion of the current outstanding loan debt in the United States.²⁴ However, the decision to take out private loans instead of federal loans can have serious financial implications for students for a number of reasons.²⁵ Unlike federal loans, many private lenders do not offer borrowers the safety net features such as deferment, forbearance, and income-based repayment that accompany federal loans.²⁶ Private student loans are also more difficult to discharge in bankruptcy (and in death) compared to other types of non-education debt.²⁷

Despite the relative risk associated with private loans, the volume of private loans has steadily increased since 2010-2011, reaching \$6.2 billion in 2012-2013.²⁸ The most recent

federal survey data available shows that nearly 1.4 million undergraduates (6 percent of all undergraduates) took out private loans in 2011-2012.²⁹ Students at for-profit colleges took out private loans at three times the rate of all undergraduates in 2008.³⁰ Unfortunately, almost half of these borrowers qualified for higher amounts of safer federal Stafford loans than they took out.³¹ Worse still, they graduated with higher levels of debt and are employed at lower rates than students at public and private non-profit institutions.³²

Economic Impacts

Young adults today have struggled with student debt after graduating from college and looking for jobs during the Great Recession. Higher levels of debt in recent years, in combination with economic factors, have contributed to troubling outcomes for borrowers. Even though unemployment rates are significantly lower for young college graduates compared to those without a degree, young adults have an unemployment rate of 7.4 percent, a rate nearly double that of older graduates in their 30s and early 40s (3.4 percent).³³ Latino and African American populations are significantly affected by unemployment: the unemployment rate for African-American and Latino young men in some cities is often double the rate of white males.³⁴

Many young adults who are able to find work are underemployed and working for reduced wages. According to a study conducted by the Center for College Affordability and Productivity, approximately 50 percent of all college graduates are employed in jobs that do not require a four-year degree.³⁵ The study suggests that this trend is more likely to affect younger graduates, making them more likely to be underemployed than older graduates. The Economic Policy Institute released equally troubling findings, noting that real wages for young graduates have fallen by 8.5 percent from 2000-2012.³⁶ However, there are findings about how college graduates still earn 84 percent more over their lifetimes.³⁷ Nonetheless, this combination of debt and poor employment prospects have increased the likelihood of falling behind on loan payments, which can lead to lower credit scores and wage garnishment.

High debt impacts the ability of borrowers to achieve the financial stability needed to build wealth and reach many milestones that previous generations had, such as owning a home, getting married, and starting a family.³⁸ In a recent survey conducted by American Student Assistance (ASA), respondents discussed how student loan debt affected their lives and factored into their financial decisions. Student debt affected the ability of over 60 percent of respondents to

purchase more expensive items such as a car.³⁹ Seventy-three percent of participants noted that student debt caused them to delay investing and preparing for retirement.⁴⁰

Student debt played a central role in the ability or willingness of 75 percent of respondents to buy a home.⁴¹ Those borrowers willing to purchase a home often find it difficult or impossible to be approved for a mortgage due to problems with loan delinquency or a high debt-to-income ratio.⁴² Loan delinquency, a problem affecting 30 percent of student loan borrowers in repayment, creates adverse credit history that makes mortgage approval more difficult.⁴³ Borrowers with substantial monthly loan payments can find it difficult to save up the money for down payment on a home.⁴⁴

An increasing number of borrowers are moving back in with their parents after graduation to save money for larger expenses. Over 21 million 18- to 31-year-olds lived with their parents in 2012.⁴⁵ This amounts to 36 percent of the young adult population and represents a 46 percent rise in this practice since 2007.⁴⁶

Policy Landscape

The Higher Education Act is overdue for reauthorization. Congressional action will offer an opportunity to reform the ways in which students finance their post-secondary education. The growing awareness of rising student debt should inform this process. The Higher Education Act is the law that determines how federal funds are distributed to students and postsecondary institutions.⁴⁷ Lawmakers will use this opportunity to propose ways to address the persistent challenges of rising tuition, high unemployment rates, and delinquent payments.⁴⁸ Proposed changes are likely to include finding new ways to ensure that colleges take more responsibility for the cost of attendance and the success of their students. There is growing interest in simplifying the process of applying for aid, exploring less-expensive educational models such as competency-based education, improving the federal student loan and repayment system, and revisiting Pell grant eligibility.⁴⁹

The Obama Administration has been active in searching for ways to alleviate the burden of student loan debt for borrowers. One of the Administration's most important initiatives is the Pay As You Earn (PAYE) Repayment program. The program ensures that loan payments remain affordable by capping monthly payments at 10 percent of a borrower's discretionary income and allowing any remaining debt to be forgiven after 20 years.⁵⁰ Borrowers working in public service may be eligible for loan forgiveness within 10

years.⁵¹ This plan is currently only available to recent borrowers. However, this year, the President signed an executive order that intended to expand eligibility for the program to include up to 5 million earlier borrowers.⁵²

Unfortunately, Pay As You Earn and other existing repayment programs have traditionally been underutilized, possibly due to lack of public knowledge.⁵³ Advocacy organizations, consumer groups, and the Department of Education are working hard to change this. Earlier this year, the Secretary of the Treasury and the Secretary of Education announced plans to partner with two of the nation's largest tax preparation companies, Intuit and H&R Block.⁵⁴ Each department will share information about federal loan repayment options with the millions of customers the tax companies see each year.⁵⁵ The Administration will work with educational and professional organizations throughout the country to broadly disseminate information about federal loan repayment plans and tax benefits.⁵⁶ Earlier outreach efforts by the Department of Education have already proven effective.⁵⁷ Over 200,000 borrowers enrolled in income-based repayment between the end of September and December 2013, and an increase of 20 percent.⁵⁸

The Consumer Financial Protection Bureau (CFPB) continues to play an important role in educating borrowers about different loan options investigating complaints of unfair and deceptive financial practices.⁵⁹ Their complaints system gives consumers the opportunity to file complaints about their experiences with a variety of consumer products, including private student loan companies and in some cases, federal student loan servicers.

The Challenges to Address

With the reauthorization of the Higher Education Act on the horizon, there are opportunities to engage a full range of stakeholders, such as state governments, institutions, and students themselves. Integral to the discussion of how to address rising student debt are financial literacy, institutional accountability, and public sector support.

Federal financial aid is a tangled, complex web that is difficult for students and families to navigate. Complexity during student loan repayment is one factor that some say has even led to high default rates on student loans.⁶⁰ Advocates, consumer groups, and stakeholders in Washington are pushing for simpler financial aid systems that could increase college access and decrease student loan default rates. Simplifying how people apply for federal financial aid system, including improving the Free Application for Federal Student Aid (FAFSA), is an important

measure to ensure that those seeking postsecondary education can secure the funds to do so. And as stated above, income-based repayment and Pay As You Earn are two simple repayment relief mechanisms that many hope to see improved and expanded.

Financial aid counseling and simple, transparent consumer tools are lacking in the student loan market. Key aspects of both the public and private student loan processes are complex, and borrowers often do not have the tools they need to make informed decisions.⁶¹ The current loan counseling system can be improved in a number of ways. Counseling could be better tailored to respond to the needs of individual students, taking place with information personalized for the borrower. Loan counseling could take place earlier, before students commit to borrowing and could clearly highlight the differences between private and federal loans. Counseling could take place more frequently, throughout the borrowing experience, to better ensure that students are exposed to the information and aware of their financial obligations and repayment options before the repayment period begins.

Another solution to the problem of high student loan debt would focus on the role that institutions themselves play in the professional success of graduates. The federal government and state governments could find ways to hold postsecondary institutions accountable for the outcomes of their students, including the amount of debt that some graduates cannot repay. Linking state and federal aid to accountability metrics such as student graduation rates and loan repayment rates is one means of addressing this issue.⁶² At present, 31 states currently use or are developing “outcome-based metrics” as part of a performance-based funding policy (PBF).⁶³ However, no state PBF policy includes considerations of student debt levels or the ability of borrowers to repay their student loans.⁶⁴

The federal government and state governments could partner to develop institutional accountability metrics and practices that encourage schools to keep student debt at manageable levels. Schools could do so by decreasing tuition, expanding existing grant programs, or counseling students to ensure that they only borrow what they need.

The Department of Education could hold states accountable for the performance of their colleges. Such a measure could encourage states to begin to take a more active role in ensuring institutional quality and perhaps bring down the number of students who borrow for school and do not complete a degree. This greater sense of shared responsibility could also result in greater state oversight of

educational institutions and increased state funding for higher education. Accountability metrics will continue to play a vital role in ensuring that postsecondary institutions produce graduates who can secure jobs and repay their loans.

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