

Assessing the impact

U.S. student loan debt reaches \$1 trillion

PHOTO BY GARY BARBER





Most students don't think about the money they borrow for college until they get the bill. And the bills are piling up. Estimates show that outstanding student loan debt in the United States has reached \$1 trillion.

This increase in debt has been accompanied by an increase in default rates, which presents a number of challenges for individual student loan borrowers. This outstanding debt, however, does not necessarily pose a substantial burden on society.

Kelly Edmiston, a senior economist at the Kansas City Fed, said media reports on the student loan "crisis" focus on the enormous growth in outstanding student loan debt in recent years—from \$364 billion in 2005 to an estimated \$1 trillion in 2013—but fail to explore all the facts.

"While there has been a modest increase in average debt, the increase in total outstanding debt has come largely from an increase in enrollments," he said.

A quarter of those borrowers have more than \$30,000 in outstanding debt, and about 3 percent have debt of more than \$100,000. A quarter of borrowers, however, have debt of less than \$6,000.

The increase in overall debt reflects an occupational shift in America's labor force. Workers are performing tasks that require education beyond high school. These high-skill-level occupations have increased by 14 percent in the last three decades. So, the more education a student achieves the better employment potential they have in today's workplace after graduation.

"It's what I call an investment in human capital," Edmiston said. "It's not like credit card debt, which is acquired largely from consumption. With college loans, you're investing in something that can make an enormous difference in lifetime earnings."

Edmiston says, however, given the state of the national economy, students face many uncertainties in today's jobs market while carrying a large amount of student loan debt.

Seeing the potential

Kelly Alvarez, a graduate student at the University of Missouri-Kansas City, says it's hard to see her earnings potential in the current economy.

"Your options when you graduate aren't as great as they used to be," she said. "You're supposed to be excited about graduating college,

but a lot of students I know aren't excited."

Alvarez attends school full time and works 40 hours a week at a local restaurant to pay the rent on a "shoebox" apartment, gasoline and other expenses. She had been saving money to make a sizeable down payment on a house after she graduated, but that was before her loans were recently sold to Sallie Mae. She said the sale concerns her because the federally sponsored student loan giant's business practices underwent congressional scrutiny and several borrowers have filed lawsuits against the company.

"After I graduate, I wanted to have a good job and start a family, but with my student loans being sold, and the current economy, I want to pay off my loans."

She plans to use her down-payment money toward her student loan debt. She's also going to apply to a federal debt forgiveness pro-

gram, where she can receive credit toward loan forgiveness by teaching fine arts in an urban school district that has a teacher shortage.

"If I teach for 10 years, they'll forgive what I owe on my student loans," she said.

When Alvarez started college at Northwest Missouri State, she didn't even know how to apply for a student loan. She had a scholarship as a freshman, but when she changed her focus from journalism to art and education, she had to take out student loans.

"I learned to be smart about student loans, only taking out what I needed to pay tuition and giving back what was left over," she said.

Even for some students who receive scholarships, it's hard not to take out a loan.

"Then finding a job after graduation that not only pays the bills, but also your student loans isn't easy," she said. "I'm concerned about how this debt will affect my future plans."

THE INCREASE IN OVERALL STUDENT LOAN DEBT reflects an occupational shift in America's labor force. Workers are performing tasks that require education beyond high school. These high-skill-level occupations have increased by 14 percent in the last three decades.

PHOTO BY BOB GREENSPAN



Growing delinquencies

Delinquency rates on student loans, while equal with home mortgage delinquency rates, are unequal in one important way.

“You can’t bankrupt this debt,” Edmiston said.

In 1976, Congress changed the bankruptcy code so that student loans made by the government or a nonprofit college or university were exempt from being discharged during the first five years of repayment. If a borrower made repayment for five years, or if the borrower experienced undue hardship, courts could discharge the debt in bankruptcy proceedings. But in 1984, the Bankruptcy Amendments and Federal Judgeship Act made private student loans exempt. Congress then passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 that made all student loans exempt from discharge unless the borrower can prove repaying the loan would cause “undue hardship.”

“Loan debt stays with a student until either he pays it off or until death,” Edmiston says.

And chronic delinquencies can lead to wage garnishment, tax refund interception, the inability to borrow, and other financial consequences.

Edmiston says the federal student loan program has added features in the last decade that help delinquent borrowers. Some of the programs include loan deferment, loan forbearance, reduced payments based on income and loan consolidation. Yet, many delinquent borrowers don’t use these programs.

“We need to market these programs better,” Edmiston said.

The current delinquency rate is more of a reflection of the nation’s economy than a crisis within the student loan industry. Delinquency rates skyrocketed during the recession and throughout the recovery. Unemployment among adults aged 20 to 24 peaked at 17.1 percent in April 2010, when the national average was at 9.9 percent.

“Like much else, we need economic growth and jobs to settle many of our financial

concerns,” Edmiston said. “The younger generation was hit especially hard by the recession and has been slow to recover.”

Overcoming uncertainties

Karen Wilson graduated in 2005 from a college in Colorado with a degree in civil engineering.

“I did all the right internships and landed a good job with a firm that had plenty of work with local and state governments.”

Then the housing bubble burst, the recession occurred and the number of projects at her firm dwindled.

“Work dried up like last year’s drought,” she said.

She had attended a private college her freshman and sophomore years and was fortunate that her parents helped pay part of her tuition and housing costs. Wilson, however, still took with her a sizable loan debt when she transferred colleges.

“I was careful about my loans and expenses and even calculated my earnings potential-to-debt ratio,” she said.

She met her husband, Justin, her senior year at a church function for young singles. Justin graduated with a degree in education from a college in Florida and taught at a private academy outside Denver. After dating more than a year, the two planned to marry after Karen graduated and established her career.

Justin paid for his tuition with scholarships and by working almost full time while in school. As a Florida resident, he also benefited from a subsidy program he qualified for through that state.

“When I finally learned how much Karen owed, I was a little nervous about paying off that debt, but she assured me that with both our incomes, we would be fine,” he said. “We wouldn’t live in luxury, but we could start our life together.”

And Karen was right. She graduated college, got a job and they married. The couple saved money for a down payment on a house while making monthly payments on Karen’s

more than \$50,000 in student loans.

Everything changed after Karen was laid off.

“My teacher’s salary was nowhere what Karen earned and her health insurance was much better than what my employer offered, so we had to put a lot of things on hold until she found a new job,” Justin said.

They received some help from their families, but the last few years have been difficult for their parents. Karen worked a part-time job at a grocery store and picked up contract work to help pay the bills.

It took her more than three years to find a full-time job, and that was after she went back to college. During this time, she received forbearance on her student loans, which accumulated interest until she could make

innovative and useful programs to educate students about loans, and the U.S. Department of Education also is developing programs to help in this area.

“These programs should help the next generation of borrowers be more educated about student loans,” he said.

Loan education is not the only area undergoing reform. The market for federal student loans also has changed recently, mostly due to the recession and modifications in the federal government’s role and to its programs.

The federal loan program is the most commonly used financial aid program for higher education, accounting for about 75 percent of total aid in the 2013 U.S. Department of Education budget. This has increased, in part, because private lenders have left the market

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regular payments again.

“Like the saying goes, sometimes you have to spend money to make money I guess,” Karen said.

“We’ve already spent enough money, and it’s going to take us a long time to show anything for it,” Justin added.

Justin says parents, colleges and financial institutions need to do a better job of educating students about the ramifications of student loan debt.

“When you’re a young college student, you just don’t think about the significance of it,” Justin said.

Educational reform

Edmiston agrees that the U.S. student loan industry and higher education institutions need to do a better job of educating loan borrowers.

“We have done a very, very poor job of educating students about the consequences of their borrowing,” he said.

But there are signs of improvement. Some colleges and universities have developed

before, during and after the recession.

Edmiston said many private lenders left the market because investors were demanding higher returns on federally guaranteed student loans as credit markets tightened. Legislative caps limited returns; those caps were lowered further in 2007. And borrowers’ options were limited again when the federal government stopped guaranteeing student loans made through private lenders in 2007.

Students, however, still take out unsubsidized loans from private lenders to finance the gap between the cost of education and federal student loan limits. Price and terms vary widely among lenders, and in many instances, the students’ limited credit histories requires co-signers for the loans.

Edmiston understands why the public is concerned about the increase in outstanding student loan debt. Student loan borrowers’ total debt is significantly higher than that of consumers who do not hold students loans.

The average total debt for student loan borrowers, which includes mortgages, was

\$82,994 in the first quarter of 2012, compared to \$66,227 for consumers, with credit reports, who did not hold student loans. The difference, Edmiston said, is the student loan debt. If the loan debt, which averaged \$24,218, is subtracted from the total, remaining debt is lower, on average, for the student loan borrowers.

“This is not revolving debt, like many other forms of debt,” Edmiston said.

Student loan debt can decrease a borrower’s ability to access other forms of credit, especially for someone with a large amount of student loan debt. The student loan borrower’s earning potential, however, is much greater than someone who did not attend college and has a significant amount of revolving debt.

The College Board estimates that lifetime earnings for those with a bachelor’s degree are 66 percent higher than those with a high school diploma. Another recent report estimated that the median lifetime earnings of those with a high school diploma to be more than \$1.3 million, compared to nearly \$2.3 million for those who have a bachelor’s degree, and even greater for those with advanced degrees.

Even considering wages lost while attending college and the effect of paying off student loans after graduation, the average borrower pays off student loans by the time they reach their 30s. Almost one-third of student loan borrowers, however, are over the age of 40.

There are several reasons why borrowers over 40 have student loan debt, such as attending college at a nontraditional age, taking out loans to pay for their children’s college and pursuing graduate education and not starting repayment until they are older.

“You can’t assume that older borrowers have had this debt for a long period and been unable to repay it,” Edmiston said.

Rethinking career paths

When you’re 18 years old, it’s difficult to understand the concept of accumulating a large

amount of debt, Ashley Warner said.

“How much your education is going to cost really isn’t talked about at college, or I just wasn’t listening,” she said.

Warner’s passion was painting and she focused most of her attention on being a successful student.

“In college you know you’re going to be broke, there’s lots of things to distract you, then reality hits when you graduate,” she said. “Having to make a living, owing money on student loans, it did change the kind of day job I would work.”

Warner found it difficult to support herself and achieve her professional expectations after graduating with a bachelor’s degree in fine arts from the University of Kansas, especially in the current economic conditions.

She works in security at the Nelson-Atkins Museum of Art in Kansas City, Mo., just to pay the bills. She plans to go back to college and get her master’s in education from the University of Missouri-Kansas City.

“I like teaching. I’ve given (painting) lessons from time to time, and I think teaching art is a way I can meet my (financial obligations) and do what I love.”

But she also expects to accumulate more student loan debt in the process.

“That’s just the way things are right now,” she said. “You have to rethink your path according to what’s going on in the world.”



BY KEVIN WRIGHT, EDITOR

FURTHER RESOURCES

“STUDENT LOANS: OVERVIEW AND ISSUES”

By Kelly D. Edmiston, Lara Brooks and Steven Shepelwich.
KansasCityFed.org/publications

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.