The Student Loan Landscape

Staff members at the Federal Reserve Bank of New York (Brown, et al) found that between 2004 and 2014, student loan debt has tripled, increasing by an average of 13% per year. The number of borrowers increased by 92%, while the average amount of debt increased by 74%. The average amount of debt per borrower in 2014 was $27,000.

Before 2009, student debt was the smallest category of debt held by households. But during the Great Recession, while households reduced mortgage, credit card, and auto loan debt, they continued to increase their student loan debt. Now student loan debt is the second largest debt category for households, second only to mortgage debt.

In 2004, 27% of 25-year-olds held student debt; by 2012, 43% of 25-year-olds held student debt. Researchers identified four primary causes for the increase in the number of borrowers and the amount of student debt:

1. More students are attending college (up 37% between 2000 and 2010)
2. Students are staying in college longer and increasing attendance in graduate school
3. It is now less expensive for parents to take out student loans
4. The cost of college has increased significantly

"The Health Care and Education Reconciliation Act, signed into law [in 2011], ended private lending of federally subsidized loans, approved expansion of Pell Grants, and appropriated funds to invest in institutions that serve minority and low-income populations…. Further, state budget cutbacks to higher education amid tight fiscal circumstances may result in higher tuition" ("Grading Student Loans").

In addition to the increase in student debt, the student loan repayment rate is low. Many students defer payments by continuing their education or through the use of income-based repayment plans. Others cannot afford to repay and default on the loans. It is now very difficult to discharge student debt through bankruptcy, so the debt remains with the student for as long as it remains unpaid.

As of the end of 2014, 18% of all student loan borrowers were in default (more than 90 days late in repaying their student loans) or had previously defaulted. Another 6% were behind on payments, but had not yet reached the nine-month past-due criterion for default. 37% of student loan borrowers had missed at least one payment.

In recent years, borrowers have defaulted more quickly and in higher percentages than in earlier years. Among those who took out their last student loan in 2005, 25% had defaulted nine years later. But for those who took out their last student loan in 2009, the default rate was 26% – only five years later.

Because students currently in school and in the six-month grace period after graduation are not included in the statistics, the true student loan delinquency rate is likely to be significantly higher than these data indicate. In 2011, President Obama announced that federal student loan repayment rates would be reduced from 15% to 10% of discretionary income. Because recent graduates and young workers tend to experience higher unemployment rates and lower incomes than older workers, this was a welcome development. But deferments and income-based repayment programs delay repayment of student loans.

Among those who are repaying their student debt, another disturbing pattern emerges. In 2014, 33% of loan payers saw their loan balances increasing, while another 13% were experiencing a balance that remained the same, despite their loan payments. These borrowers were not experiencing a reduction in debt. Those who owed less than $5000 in student debt had higher default rates because they did not finish their education or earned degrees that paid less than those who earned bachelor's degrees. Those who owed more than $50,000 in

debt were less likely to be in default – but more likely to have a higher balance, despite making payments. Because they were in deferred payment periods or income-based repayment programs, their payments could not keep up with the accruing interest, pushing them further into debt. Student loan borrowers overall have paid down little of their debt. Those who took out their last student loans in 2005 have only paid off 38% of their debt nearly ten years later. Had they used a 10-year amortization schedule, as would be used for a home mortgage or extended car loan, these students would have paid off approximately 90% of their student loans.

What are the ramifications of this increased student loan debt for borrowers, their parents, and society?

While collateralized loans are enforced with foreclosure on mortgage loans and repossession for car loans, student debt is not so easily discharged. Delinquent borrowers may take advantage of deferments or income-based repayment plans, but the debt remains with them. By 2012, 25- to 30-year-old student debtholders had significantly lower average credit scores than they once did, in part due to the high delinquency rate for student loans. The higher student debt and lower credit scores are now affecting their ability to secure other loans. Those delinquent on their student debt obligations were also more likely than others to be delinquent on auto loans, credit cards, and mortgages.

Increased student debt has serious ramifications for home ownership. Before the Great Recession, 30-year-old graduates with student debt were more likely than those without student loans to take out a mortgage. While the number of 30-year-olds taking out mortgages has fallen for both groups, now those with student loans are even less likely to take out a mortgage than are those with no student debt. The data suggest that the high cost of student loan repayment and the credit rating damage due to defaults make it difficult for these people to take out a mortgage. This may also be one cause of the significant increase in the number of millennials who have returned home to live with their parents.

Students who defer payments on their student loan debt accrue more interest, take longer to pay, and eventually pay more for their total student loan debt. This affects their ability to purchase consumer goods and holds ramifications for the macroeconomy. Parents are also affected by student loan debt, as repayment reduces income available for consumer purchases, also potentially affecting the macroeconomy. Finally, increased student debt and defaults pose a serious problem for the lender – primarily the federal government, and more specifically taxpayers.

Even though costs have escalated in the past decade, a college degree is still a worthwhile investment. On average, college graduates earn 80% more income than non-graduates, and they are less likely to become unemployed.

Your choice of your college and career are among the most important you will ever make. Take the time to do careful research and prepare to reduce your costs, so you can enter your career with minimal debt and make those investments and choices of your dreams!

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