WHITE PAPER

Student Debt-Opportunity or Crisis?

BY **BILL SPITZ**, PRINCIPAL

Economics is known as the "dismal science" because it seems to be all about bland statistics, but the economy actually has important implications for each of us in terms of the way we live as well as the collective well-being of our society. One particularly timely issue is the massive growth in student debt over the past twenty years because it is influencing young adults' decisions with respect to careers, marriage, home ownership, and even their general outlook and mental health. While these are of great concern, income data clearly demonstrate the enhancement to earning power that a college education provides, and the availability of government financing has certainly opened up educational opportunity to many for whom a college degree would otherwise be unobtainable.

continued on next page ›

Assessing this tradeoff raises a number of questions. Why has student debt increased so rapidly? Should we be concerned about its potential impact on the economy? Is excessive debt clouding the future of an entire generation? How should we evaluate the various proposals offered by think tanks, foundations, and politicians to deal with this issue? In order to begin to answer these questions, I provide a good deal of data on the growth and scope of student debt, its impact on various groups, and some potential solutions. Perhaps the best place to begin is by defining the dimensions of what many publications have labeled "the crisis in student debt."

Statistics

U.S. Government student loan programs were created by the National Defense Education Act of 1958 and The Higher Education Act of 1965, both of which were intended to encourage science and technology education in response to Russia's successful Sputnik launch. These programs expanded due to the passage of The Middle Income Assistance Act of 1978 that removed the income requirement for certain types of loans making them available to virtually all students enrolled in participating institutions. However, the total amount of debt outstanding only reached $10 billion by 1986. Student debt began to rapidly accelerate in the late 1980's as states cut back support of higher education with the total reaching $243 billion by 2003.

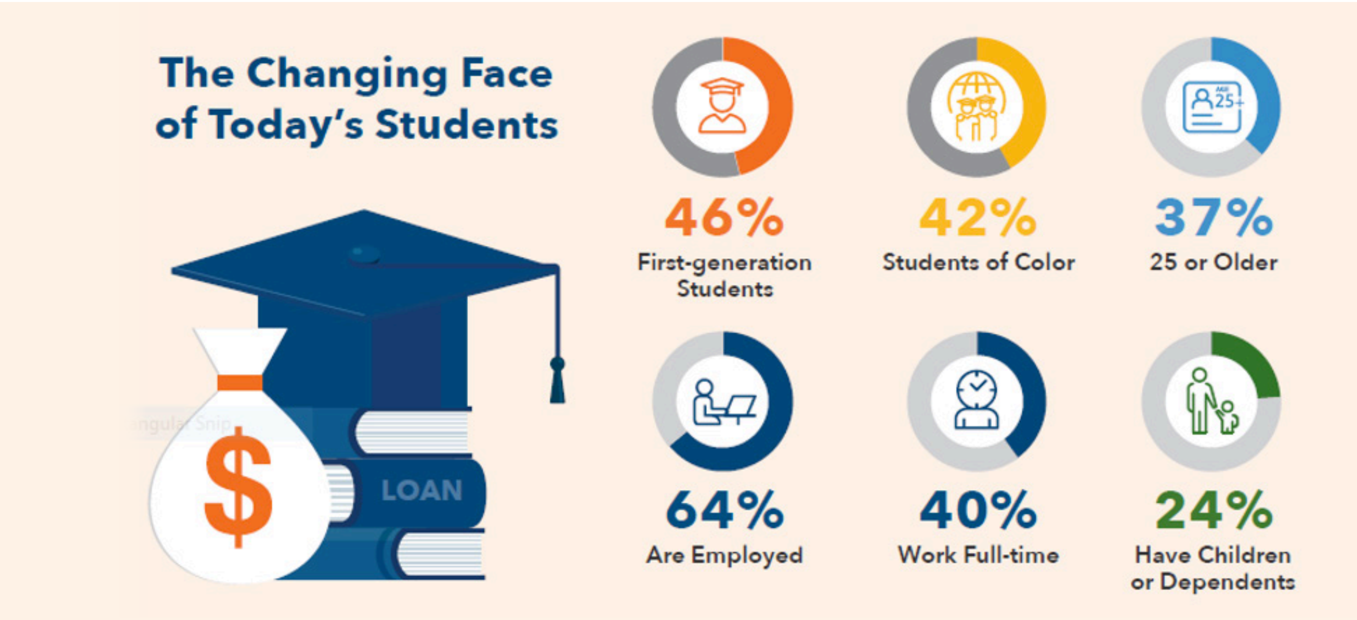
Today, total federal student debt stands at $1.5 trillion, which when added to private sources of financing of $132 billion, equals total student debt outstanding of $1.63 trillion. By way of perspective, more than 44 million Americans carry student debt that now exceeds auto and credit card loans making it the second largest consumer finance category after home mortgages. From 2006 through 2020, student debt grew at an annual rate in excess of 9%, roughly double the rate of growth in college costs during the same period. For the class of 2019, 62% of graduates relied to some extent on student loans to finance their education with an average debt burden of $29,200. Twenty percent of students have a balance in excess of $50,000 and 7% carry a debt load in excess of $100,000. The average household with student debt owes $47,671 and 18% of all adults are repaying student loans. The average monthly payment for those individuals in the repayment period is $393 although there are programs available that limit the required payment to a specific percentage of income. Additionally, loans may be subject to cancellation for individuals who choose to work in a number of public service occupations. Unfortunately, these various programs have widely differing and complex terms such

continued on next page ›

that many borrowers may not understand the details of the obligations they assume. As of the fourth quarter of 2019, 11.1% of borrowers were in default, while another 30% of all loans were either in deferment or forbearance which are programs designed to aid those experiencing unusual financial hardship.

The demographics of college students is very different from the traditional model of 18-22 year olds attending four-year colleges and universities. Moreover, the impact of student debt varies significantly across different segments of the population.

Two-thirds of all student debt is owed by women which is particularly poignant given that average compensation for women is 82% of that of men.



Data source: luminafoundation.org/resource/todays-student/

In particular, the student debt burden falls heavily on women and minorities. Two-thirds of all student debt is owed by women which is particularly poignant given that average compensation for women is 82% of that of men. Because of both the level of their debt and discrepancy in compensation, women on average repay only 31% of their obligation after four years as compared to 38% for men.

continued on next page ›

Seventy-one percent of African American students utilize federal loans as compared to 56% of white students. According to research done by the Institute on Assets and Social Policy at Brandeis University, the average African-American borrower still owes 95% of his or her student loan balance twenty years after enrollment while white students have reduced their obligation to 6% of the original principal amount. As previously mentioned, the overall default rate on student debt is approximately 11% but that total breaks down to 21% for African American borrowers versus 6% for white students.

The default rates for students of various types of institutions are as follows:

9.3%	6.7%	14.7%
Public Colleges and Universities	Private Institutions	For-Profit Institutions

It is also noteworthy that the colleges and universities with students carrying the largest debt balances are virtually all for-profit institutions.

One somewhat counterintuitive fact is that 66% of defaults are attributable to borrowers with less than a $10,000 balance. As it turns out, those with higher loan balances are typically Medical, Law, or MBA students who have very bright income prospects whereas the smaller balances are frequently confined to the 40% of students who do not graduate in six years. In fact, 50% of all students defaulting on their loans never earned their degree. This often results in a deadly combination of poor job prospects and debilitating loan repayment obligations.

Causes of the Explosive Growth in Student Debt

The major driver of the growth in student loans has been the rapid increase in the cost of attending college. According to the National Center for Educational statistics, the all-in cost has increased at a 4.2% annual rate since 2006 as compared to 2.4% annual growth in average wages and 1.8% growth in the Consumer Price Index. Rising educational costs increase the demand for loans in two ways. First, as the annual cost increases, students require larger loans to supplement family support, financial aid, work-study, and other sources. Second, more families are pushed into borrowing by the spread between income growth and tuition increases. Subsidized federal student loans are limited to those with demonstrated financial need whereas the unsubsidized variety is available to anyone who meets basic eligibility requirements. In both cases, there are no credit checks or significant requirements beyond enrollment in a participating institution. While there are limits on the amount that each individual can borrow, there are no caps on the overall size of the federal programs.

continued on next page ›

Why have college costs increased at such a rapid rate? That is a controversial topic that deserves a deep dive but here is a brief summation of some of the most commonly cited factors:

- **The availability of loans.** In 1987, then Secretary of Education Bill Bennett posited that the widespread availability of federally subsidized loan programs allows colleges to aggressively increase prices. In other words, he argued the relationship between college costs and loan demand is circular or self-reinforcing. However, subsequent research on this hypothesis is ambiguous so this hypothesis should be viewed as questionable.

- **Cutbacks in support of higher education, particularly for state institutions.** Average support per student was 13% lower in 2018 than in 2008, and an analysis by the public policy think tank Demos indicated that cutbacks in federal and state educational funding are responsible for as much as 79% of tuition growth.

- **Financial aid.** As sticker prices increase, more of an institution's discretionary dollars must be allocated to financial aid, once again a circular relationship.

- **Employee costs.** The largest percentage of a college's budget is personnel expense (≈60%) that has increased due to rising health care costs (4.5% annual growth over the past twelve years), increased demand for student services, and so on.

- **Demand.** Critics argue the tremendous demand for spots at elite institutions has given them unusually strong pricing power.

- **Administrative bloat and excessive amenities.** While it is popular to heap scorn on these factors, the Demos report suggested that they only account for about 10% of the problem.

Along with many others, I have felt for a number of years that higher education's financial model is Byzantine and unsustainable. Of course, we have been wrong up to this point because tremendous demand allowed the trends cited above to persist. However, it may well be that the pandemic and resulting move toward distance learning with associated tuition cuts and refunds may represent a pivotal moment.

continued on next page ›

Impact of Student Debt Growth

There have been innumerable headlines in both the popular and financial press expressing alarm at the growth in student debt so it is important to evaluate its potential implications. First, private loans and some older federally guaranteed loans have been securitized in what are called SLABS or Student Loan Asset Backed Securities. Student loans are not collateralized so a material increase in defaults would result in losses for the owners of these securities. However, the amount of SLABS is relatively small versus the level of both total student loans and overall debt in the economy so this does not seem to pose a serious threat.

Second, more than 90% of all student loans are owned by the U.S. Government so we should consider the implications of student debt for government finances. Because of the government's ability to borrow at very low interest rates, federal student loan programs are expected to produce something between a modest loss and slight profit so the federal budget is not really impacted. Moreover, delinquent loans are turned over to collection agencies that have the right to garnish wages and tax refunds as well as pursue legal action, so actual credit losses should be manageable. Therefore, the real impact of the growth in student debt is likely to be on the health and well-being of borrowers that may in turn influence many of their financial decisions, and ultimately, the overall trajectory of the economy.

On a macro scale, student debt has important implications for racial inequity, income disparity, and upward financial mobility. With respect to individual borrowers, a significant percentage report that student debt results in high stress levels and a degree of pessimism regarding their future prospects. In terms of specific actions, 21% of borrowers indicate they have postponed marriage due to the burden of loan repayment and 26% report delaying having children. The following table was included in a February 2020 report prepared by The Aspen Institute Financial Security Program titled **Solving the Student Debt Crisis**. It represents a compilation of surveys of student loan borrowers, and while surveys are not definitive, provides some insight into the impact of student debt on a wide range of social and economic factors.

continued on next page ›

ASPEN INSTITUTE FINANCIAL SECURITY PROGRAM — MAKING THE CASE: SOLVING THE STUDENT DEBT CRISIS

The Consequences of Student Loan Debt Reach Beyond the Individual

The following statistics are an aggregation of surveys that vary in sample size and statistical validity. The results included below are meant to illustrate the array of other financial challenges borrowers face in incurring student debt.

Student Debt Has Deep Impacts on Short-term Financial Stability

- 58% of borrowers attribute a decline in credit score to student debt.[22]
- 13% said it caused a failed credit check for apartment applications.[23]
- 6% reported having wages or social security benefits garnished because of student debt obligations.[24]
- 55% of college graduates with student debt say it forces them to delay saving for emergencies.[25]
- Four in 10 people still paying off their loans say they are struggling financially.[26]

Student Debt is a Roadblock to Long-term Financial Security

- Among young student borrowers, those with student loan debt have half the retirement savings at age 30 of those without.[27]
- Research shows that it is the presence, not merely the size, of student debt that discourages retirement contributions.[28]
- 83% of young student loan borrowers in repayment who have not purchased a home listed student loan debt as a factor for delaying them from purchasing one.[29]
    - On average, they noted a 7-year delay between the time they wanted to buy a home and when they were able to purchase one.

Student Debt Affects Career and Life Decisions

- More than half (53%) of student loan borrowers noted debt as a factor in choosing which career to pursue.[30]
- 61% of student loan borrowers who had hoped to start a business said student loan debt affected their ability to do so.[31]
- On average, 22% of student loan borrowers noted that they delayed moving out of their parents' home for two years due to student loan debt.[32]

Student Debt Impedes Career Advancement and Employee Retention

- Nine in 10 college students with student loans are looking for a company that offers a student loan benefit.[33]
- Six in 10 say they would consider switching employers to gain a student loan benefit.
- 86% of young workers say they would commit to their employer for five years if they helped pay off student loans.[34]

Student Debt Poses Risks to the Broader Economy

- Consumption decreases when consumers have debt-to-GDP ratios that exceed 60%.[35] The debt-to-GDP has steadily declined since the Great Recession, however, it currently sits at 76%, which could present a risk to aggregate consumption.[36]
- While economists are unsure about the broader economic effects of household debt, research shows it depresses homebuying, auto sales, and other consumption, which could slow economic growth.[37]
- According to the Federal Reserve, larger negative economic effects are possible if student loan payments crowd out household spending.[38]

My reading of this material suggests that we are not facing an imminent financial crisis of any sort, but rather a developing problem in the form of a "lost generation" that may well dampen long-term economic growth and stimulate considerable disillusionment and even social unrest.

continued on next page ›

Solutions

Potential solutions to the student debt problem range from mild tinkering at the margin to a fundamental reshaping of higher education. While I will briefly note a number of proposals, each has significant pros and cons along with widely varying cost. Moreover, it is very difficult to forecast the broader economic impact of each of them. In order to sort through some of these issues, I suggest **Addressing the $1.5 Trillion in Federal Student Loan Debt**, published by the Center for American Progress in June of 2019. First, let's consider proposals that represent modifications or enhancements to existing practice and programs:

- Encourage more employers to offer tuition assistance and debt repayment benefits.
- Increase the number of federal programs offering income-dependent payments and loan forgiveness.
- Allow borrowers to refinance at current interest rates. (The interest rate on federal loans is set at the time that a loan is made and is fixed for the life of the loan)
- Reduce the interest rate on federal loans. (Currently 2.75% for undergraduates and 4.3% for graduate and professional students)
- Increase outright grants as substitutes for debt. The source of these grants could be federal or state dollars or the funds of individual institutions.

Encourage more employers to offer tuition assistance and debt repayment benefits.

continued on next page ›

Now, we turn to more radical solutions knowing that many of them are quite controversial:

- Pass legislation to limit the rate of growth in tuition and fees at public institutions.
- Similarly, limit federal and state support to private institutions that increase prices at a rate exceeding some appropriate benchmark.
- Limit the availability of federal loans to institutions with poor student outcomes and graduation rates.
- Steer more students away from college toward technical and trade schools.
- Forgive debt owed by former Pell Grant recipients. (students from low income families)
- Forgive debt to all borrowers up to a certain dollar amount.
- Forgive all student debt.
- Make attending a public institution free for all students.

Clearly, some of the latter proposals convert higher education in the U.S. into an entitlement as is the practice in some other countries, and they certainly have massive implications for the way education is financed. Several of the proposals also involve forgiving large amounts of debt which some will find very difficult to swallow on principle. Many readers will undoubtedly dismiss the second set of recommendations as unworkable and radical, but it may well be the more modest proposals are not sufficient to materially change the student debt trajectory and that bold actions are therefore required.

continued on next page ›

Important Notes And Disclosures

This White Paper is being made available for educational purposes only and should not be used for any other purpose. Certain information contained herein concerning economic trends and performance is based on or derived from information provided by independent third-party sources. Diversified Trust Company, Inc. believes that the sources from which such information has been obtained are reliable; however, it cannot guarantee the accuracy of such information and has not independently verified the accuracy or completeness of such information or the assumptions on which such information is based. Opinions expressed in these materials are current only as of the date appearing herein and are subject to change without notice. The information herein is presented for illustration and discussion purposes only and is not intended to be, nor should it be construed as, investment advice or an offer to sell, or a solicitation of an offer to buy securities of any type of description. Nothing in these materials is intended to be tax or legal advice, and clients are urged to consult with their own legal advisors in this regard.

DIVERSIFIED TRUST

Conclusion

My goal in writing this paper was not to lobby for a particular approach to dealing with student debt, but I do believe the potential problem is of such a magnitude that we cannot simply ignore it. As I previously mentioned, it doesn't seem that a financial crisis stemming from student debt is imminent, but I am worried about the prospects for an entire generation. Specifically, I am concerned about the impact of student debt on income inequality, racial inequality, upward mobility, and the basic mental health and quality of life for 44 million borrowers. And, to the extent these factors influence student debtors' decisions regarding marriage, consumption, the purchase of durable goods such as homes and automobiles, and career choices, the overall trajectory of the economy will be impacted which will affect us all. With the election of Joe Biden and the new Democratic majority in the Senate, it seems likely that the issue of student debt will be addressed in some way. As good citizens, it therefore behooves each of us to get up to speed on this question and provide your representatives with your preference among the alternative courses of action.

With the election of Joe Biden and the new Democratic majority in the Senate, it seems likely that the issue of student debt will be addressed in some way.

ATLANTA

400 Galleria Parkway, Suite 1400
Atlanta, GA 30339
Phone: 770.226.5333

GREENSBORO

701 Green Valley Road, Suite 300
Greensboro, NC 27408
Phone: 336.217.0151

MEMPHIS

6075 Poplar Avenue, Suite 850
Memphis, TN 38119
Phone: 901.761.7979

NASHVILLE

3102 West End Avenue, Suite 600
Nashville, TN 37203
Phone: 615.386.7302