

AGENDA ITEM 12.

SUMMARY OF: INCREASING COLLEGE ACCESS ... OR JUST INCREASING DEBT? A DISCUSSION ABOUT RAISING STUDENT LOAN LIMITS AND THE IMPACT ON ILLINOIS STUDENTS

Submitted for: Information

Summary: The U.S. Department of Education has been collecting public comment on the Higher Education Act reauthorization. One of the issues being discussed is increasing Stafford Student Loan limits and two of the most basic questions raised in the discussion are addressed toward the borrowers: do they need to borrow more and can they afford it? The paper develops techniques for evaluating both student need and ability to repay. Based on the analysis, some students in Illinois may need to borrow more to cover their out-of-pocket education costs but many would have difficulty repaying additional loans based on expected starting salaries in Illinois.

Over half of all private school students borrow as do about 45 percent of students attending a public university, and the average cumulative debt level is now over \$16,000, not including “alternative” student loans and credit card debt. The affordability of a college education is not expected to improve. Tuition and fees are rising, real family incomes are flat, and need-based grant aid in Illinois has been cut due to budget constraints. Increasing reliance on loans is a way to fill the gap between expenses and resources and is creating pressure to increase the number and size of student loans. But it needs to be recognized that this aid is not a grant and must be repaid, with the repayment period starting shortly after departure from college, when incomes are smallest.

The distribution over time of the returns to a college education are often overlooked – most of the financial returns to education occur later in one’s working life whereas the debt incurred to attend college must be paid off during the early working years. It is the early years after college that must be assessed when attempting to determine whether or not students can afford to borrow more to pay for college. This paper assesses the income earning potential of students and finds that many of them will start out their working lives carrying debt that must be paid in installments greater than 8 percent of gross monthly income, the cut-off point where debt payment manageability ends and debt distress begins. This includes students in such vital professions as primary and secondary education and social work. Increasing allowable debt levels will simply put students in other professions, such as nursing and business, with debt levels now around 7 percent, in the same financial difficulty.

At some point the short-term financial payoff to an education needs to be considered when giving out loans. Students who borrow too much relative to future income can have many years of financial distress even if they do not default. On average, students probably cannot handle much more debt than they are graduating with right now.

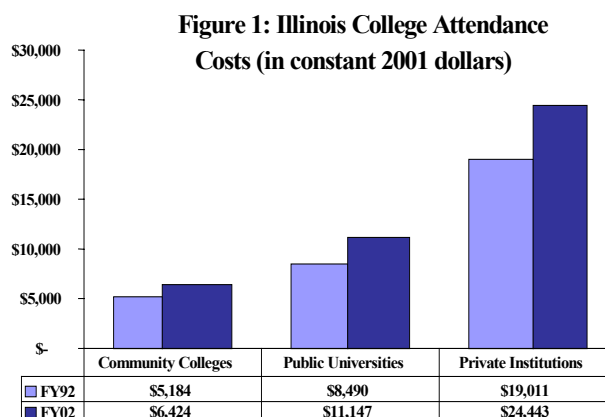
Action requested: None

SUMMARY OF: INCREASING COLLEGE ACCESS ... OR JUST INCREASING DEBT? A DISCUSSION ABOUT RAISING STUDENT LOAN LIMITS AND THE IMPACT ON ILLINOIS STUDENTS

Two of the most basic questions raised in the discussion about increasing student loan limits are addressed toward the borrowers: do they need to borrow more and can they afford it? The paper develops techniques for evaluating both student need and ability to repay. Based on the analysis, some students in Illinois may need to borrow more to cover their out-of-pocket education costs but many would have difficulty repaying additional loans based on expected starting salaries in Illinois.

Do Illinois Students Really Need to Borrow More?

In FY2002, at Illinois public universities, tuition and fees averaged \$4,786 and total college costs averaged \$11,147. Private universities had tuition and fees that averaged \$16,888 and had an average annual total cost of attendance of \$24,443. Community colleges looked like a bargain in comparison with tuition and fees of \$1,731 and total costs of \$6,424. As shown in Figure 1, the costs for all sectors have increased, and increased considerably for public universities and private schools since 1992. Private school costs have increased \$5,432 *beyond the rate of inflation* in 10 years. Public university increases are roughly half that, \$2,657, over the same period. Even community college costs have increased faster than inflation (\$1,240), although much less than the four-year schools.



The increases in total costs of college attendance have been driven by increases in tuition and fees. Real 10-year increases in tuition and fees range from 29.2 percent at community colleges to 46.1 percent at public universities. Private college tuition and fees increased 36.3 percent over the decade. Average tuition and at public universities increased by over \$500 just this year, from \$4,796 to \$5,298, while private four-year institutions increased their tuition and fees an average of about \$800, from \$17,105 to \$17,905.

After grant aid is subtracted, the out-of-pocket costs of a public university education for first income-quintile Illinois families, in constant dollars, is about \$2,600 per year, up from \$2,200 ten years ago. These costs are all “remaining need” because first income-quintile families have zero EFCs. The \$2,600 can be covered by existing Stafford student loan limits (\$2,625 for dependent freshman, \$3,500 for sophomores and \$5,500 for juniors and seniors) for all years of college. However, the picture is not as bright for second income-quintile families. Their out-of-pocket costs are over \$5,800, too large to be completely covered by even the junior/senior loan limits. Third income quintile families, with an average income of \$57,000 would have to come up with the entire cost – over \$10,000 or about one-sixth of their pre-tax income.

Both the number of Stafford loan borrowers and the amount borrowed annually has increased over the decade. About half of all Illinois students attending a four-year school now borrow at least once while attending. About 45 percent borrow at public universities and about 50 percent borrow at private colleges. The average cumulative debt for those attending public universities is about \$14,000 and for those at private institutions, about \$16,500. The increased level of borrowing is pushing students up against the loan limits. In FY2001 51 percent of the loans guaranteed by ISAC were made at or near the limits, compared to 44 percent in FY1993.

Given the financial picture described above, some students probably do need to borrow more. Indications are that family incomes are stagnant for most income quintiles and even declining for first income-quintile families. Some students at public universities are seeing the largest tuition and fee increases in a decade. The largest need-

based grant program in Illinois, the Monetary Award Program (MAP), has been cut by \$38 million (roughly 10 percent) resulting in reduced awards for all recipients. It would not be overstating the problem to suggest that the out-of-pocket costs for many attendees at public universities could increase 20 percent or more this year and family incomes are not keeping pace. Current loan limits may not allow sufficient borrowing for some students to fill the gap.

Can Illinois Students Afford to Borrow More?

A Texas study phrases it rather nicely: “Is the nation asking its youth to make investments that they cannot afford?” For the answer to this question, looking at total student loan debt alone is not sufficient. Post-graduation income must also be considered. A \$20,000 student loan debt might be very burdensome for someone making \$30,000 per year; however a \$60,000 income might be sufficient to make repaying the loan manageable.

Many analyses of the economic returns to college have concluded that a bachelor’s degree adds at least one-half million dollars to lifetime income. But this is based on averages and there is much dispersion around the mean. In addition, the economic returns from a college education are not always seen in often low starting salaries and most students are expected to begin repaying their student loan debt six months after leaving school. It comes as no surprise that most student loan defaults occur within the first two years of repayment. Starting incomes as well as lifetime incomes are important variables to look at when trying to assess debt burden.

Using data from the federal Bureau of Labor Statistics and the Illinois Department of Employment Security (BLS/IDES), Illinois-specific lifetime income ranges were constructed for groups of professions based on education levels. The most common professions were split into four categories based on education level: no postsecondary education; vocational training, associate’s degree, and bachelor’s degree. Cross-sectional data were used to get an inflation-adjusted future income stream. A starting wage was assigned that corresponded to the BLS/IDES 25th percentile wage for that profession and an ending wage assigned that was the 75th percentile wage rate. The starting wage was increased at a rate calculated to yield the ending wage in year 44. The sum of the non-discounted income stream is the gross lifetime income.

This figure was modified by assuming that payback of a student loan was required and these payments were subtracted from gross income, yielding a net lifetime income. For professions requiring no postsecondary education no student loan debt was assigned. For jobs requiring vocational training, the assumption was one \$2,625 loan. An associate degree “cost” \$6,000 and the debt level attached to a bachelor’s degree was \$16,000. The interest rate was calculated at 6 percent; the loans were assumed to be subsidized and the payback period was ten years (payback periods can now be extended.) All incomes listed in the following figures are assumed to be “after debt” income.

Figure 2: Illinois Workers’ Lifetime Income, by Level of Education, in \$1,000

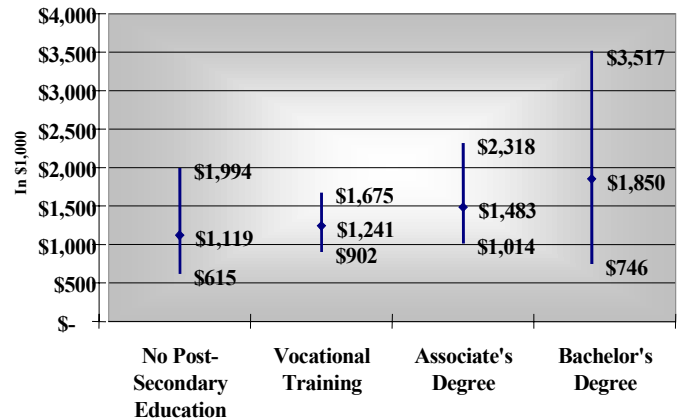


Figure 3: Illinois Workers with Bachelor’s Degrees Lifetime Income, by Profession, in \$1,000

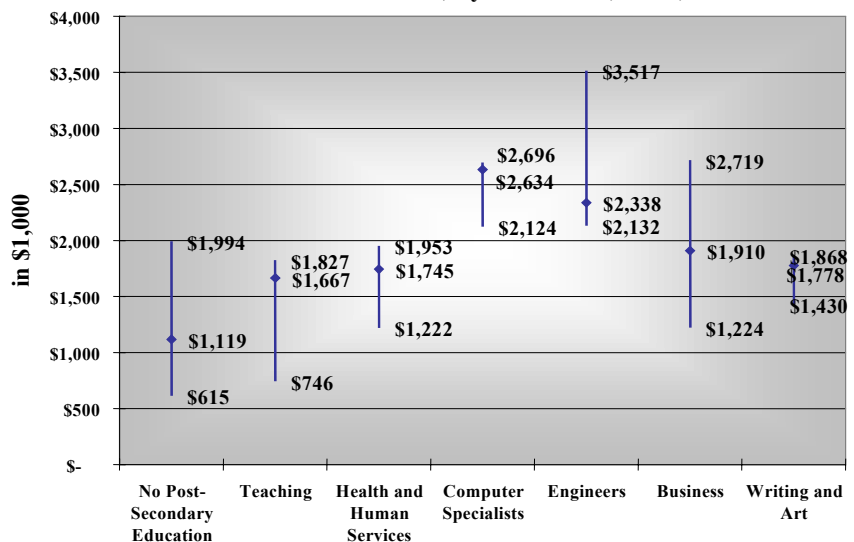


Figure 2 shows the range of Illinois lifetime incomes by level of postsecondary education. Jobs requiring no postsecondary education had lifetime earnings from \$615,000 (waiter) to \$1,994,000 (electrician.) The median lifetime income for this group was \$1,119,000. For workers with vocational training the range was \$902,000 to \$1,675,000 with a median income of \$1,241,000. Those with associate degrees saw lifetime incomes in the range of about \$1,000,000 (court reporter) to \$2,318,000 (electric tech) and a median income of about \$1,500,000. Bachelor degree recipients had the widest dispersion on lifetime income: from \$746,000 (pre-school teacher) to \$3,517,000 (engineer.) The median income of those with bachelor's degrees was \$1,850,000. It is clear that while having a bachelor's degree does provide an opportunity for the recipient to earn more money than someone with less education, it is by no means a certainty. But, in general, in Illinois, the lifetime returns to postsecondary education are significant and repayment of student loans affects this analysis very little.

Figure 3 shows lifetime income for different majors, all requiring a bachelor's degree. Net lifetime income varies dramatically for students with different majors and careers, and has an impact on the amount of student loan debt that they can handle. In general, students in computer science or engineers see strong returns on their investment dollars; the returns to those majoring in business in general see decent returns but those in teaching, health and human services and writing and art may find college does not pay off as well financially.

This analysis assumes borrowers complete their programs and start paying off student loans six months after they graduate. Most defaults on student loans occur within the first two years of repayment in part because while most of the payoff to education is back-loaded; most of the cost is front-loaded. The difference in income between those with a college degree and those without, increases with age, with much of the increase occurring later in life. Many starting salaries, regardless of the education required, are in the \$20,000 to \$27,000 range. Considering that the job seeker with a college degree has given up four work years to attend college as well as taken on \$16,000 in student loan debt, the range on salaries during the first 10 years after high school becomes very small. Figure 4 illustrates the range of incomes, by education level, for those first 10 years. Workers who earned a four-year degree gave up four years of work; their 10-year income is really only 6 years. For those with associate's degrees, their 10-year income is 8 years and for those with vocational degrees, 9 years.

The ranges represented in this graph are much narrower and closer together than those in shown in Figure 2. The median incomes, in particular, are very close. Many professions that require associate's or bachelor's degrees actually have a ten-year net income level lower than those professions that require no postsecondary education at all, as shown in Figure 5. Teachers, workers in health and human services, writers and artists and some business majors see very little return on their four-year investment in their early years in the work force. However, those in computer science or engineering are already enjoying generally high returns on their investments.

Figure 4: Ten-Year Income by Education Level, in \$1,000

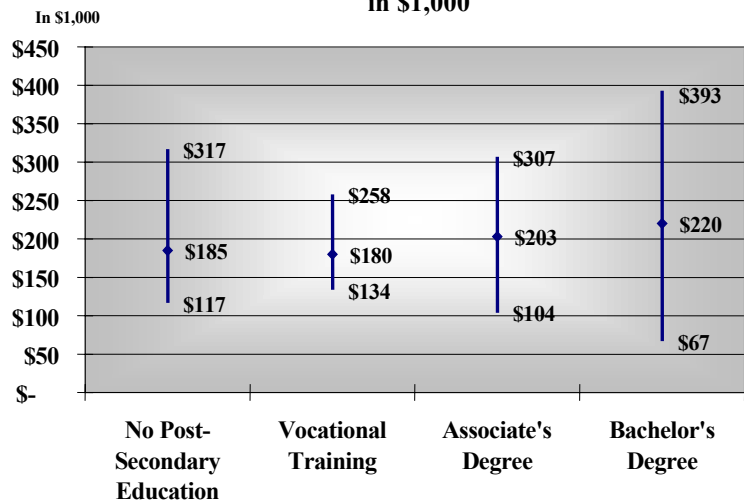
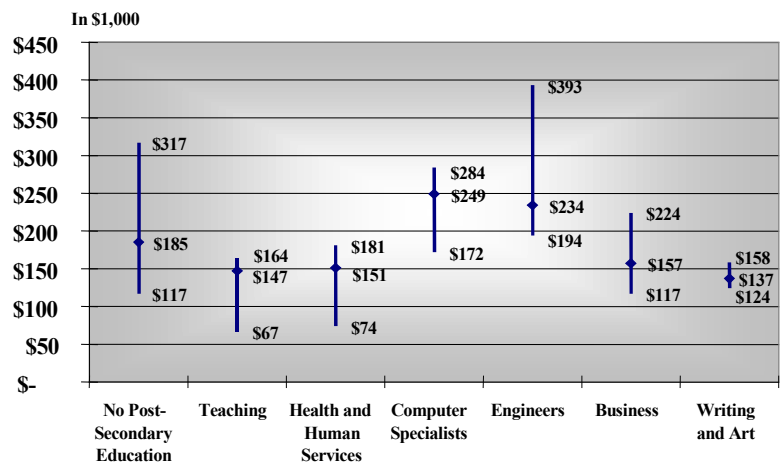


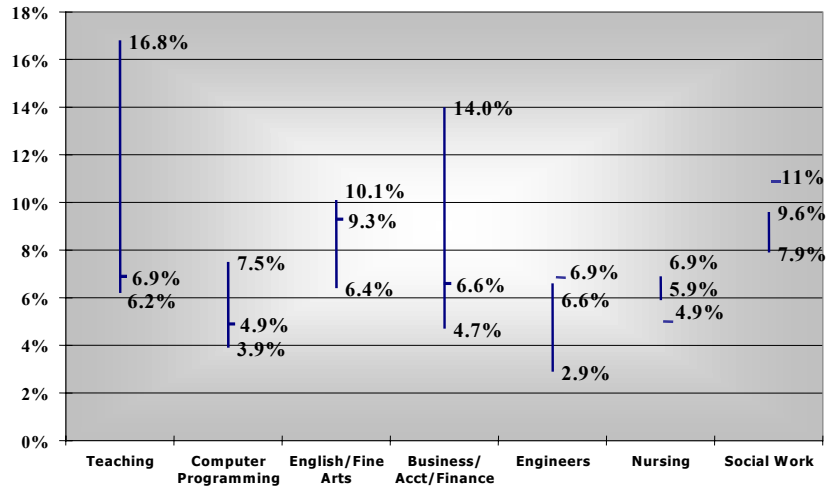
Figure 5: Illinois Workers with Bachelor's Degrees 10-Year Income, by Profession, in \$1,000



These numbers look a little better if the time frame is extended to 14 years to cover the four years of undergraduate work plus ten working years. But even fourteen years after high school or ten years after college, many college graduates are seeing essentially no economic returns to their degrees. Their “after-debt” 14-year median incomes are about the same or even less than those who did not attend college at all. If no debt payments had been made, the median incomes for the workers with Bachelor’s degrees would shift up by \$21,000, or about 8 percent of the cumulative income to this point. Increased debt levels that would occur if loan limits were raised would make this return even less rewarding.

When trying to measure “debt distress” the measure most often used is the ratio of monthly student loan payments to monthly gross income. It is generally agreed that when this ratio exceeds 8 percent, real debt burden may occur. Figure 6 shows student loan debt ratios by profession during the first year of employment. Each profession has three ratios presented. The ratios at the ends of the range line indicate the highest and lowest debt ratio calculated from the starting salaries derived from the BLS/IDES data. Note that many professions have starting salaries that yield debt ratios well in excess of 8 percent.

Figure 6: Student Loan Debt Ratios During the First Year of Employment



The ratio next to the tick mark on each line is the actual debt ratio for each profession calculated from survey data of Illinois repayers. The actual ratios generally fell within the ranges calculated for each profession.

Table 1 lists the current average cumulative debt levels for ISAC guaranteed loans by sector and class level. Graduating seniors at public universities who borrow (44%) have an average cumulative debt level of almost \$14,000. Those at private universities who borrow (50%) have an average cumulative debt level of almost \$16,500. At starting salaries of \$24,000 to \$32,000, the prospective debt ratios range from 9.2 percent to 5.8 percent. Since the average loan size is now over \$4,000, the average cumulative debt levels will likely rise to over \$16,000. This constricts the range of debt ratios to the higher end: 6.9 percent to 9.2 percent. Many new graduates are going to emerge from college with debt ratios in excess of 8 percent.

Table 1: Loan Levels and Debt Ratios in Illinois, FY2001

	<i>Average Cumulative Debt Level</i>						Debt Ratio Range*
	% who borrow	Freshman	Sophomore	Junior	Senior	Monthly Payment	
Public Universities	44.4%	\$ 3,308	\$ 6,173	\$ 9,279	\$ 13,944	\$ 155	5.8% to 7.7%
Private Universities	50.4%	\$ 4,027	\$ 7,577	\$ 11,474	\$ 16,485	\$ 183	6.9% to 9.2%
Community Colleges	3.2%	\$ 3,202	\$ 5,464	\$ -	\$ -	\$ 61	3.0% to 4.5%
Proprietary Schools	87.0%	\$ 5,247	\$ 10,713	\$ -	\$ -	\$ 119	5.9% to 8.9%

* University ratios based on a starting salary range \$24,000 to \$32,000

* Community College and Proprietary ratios based on starting salaries from \$16,000 to \$24,000

A debt ratio of 8% is generally considered to be the maximum for a manageable debt burden.

Community college debt levels are lower and few community college students borrow. Therefore, lower starting salaries are matched with lower debt levels and the debt ratio range of 3 percent to 4.5 percent appears to be manageable. The majority of students who attend proprietary schools, however, borrow nearly \$11,000 to pay for their schooling. This translates into a debt ratio range of 5.9 percent to 8.9 percent.

Based on a recent survey of IDAPP repayers, the average monthly payment on their IDAPP loans was \$289, or about 7.4 percent of their monthly family income. The debt ratio jumps to 9.6 percent for single

respondents and falls to 5.6 percent for married respondents. The respondents were asked to indicate their average monthly payments from all types of consumer debt, including Stafford student loans and “alternative” college loans, but *excluding* mortgage payments. The average monthly payment on debt was \$742, or over 20 percent of pre-tax family income. For singles, with lower incomes, the monthly debt payment was \$699 but the percentage was higher, 23.5 percent. Married couples paid out more, \$850, but also earned more, and had a total debt to monthly income ratio of 18 percent.

The repayers were sorted by occupation and average total debt and student loan debt ratios, average income and average after-debt income were calculated for each profession. Lawyers had one of the highest total debt ratios (27.9%) but still had an “after-debt” income that was higher than most professions’ “pre-debt” income. However, nurses had a student loan debt ratio of 4.6 percent but a total debt ratio of nearly 30 percent. This reduced income to an “after-debt” level of only \$31,609. Paying the loan associated with the 4.6 percent debt ratio may be more difficult for a nurse than the loan associated with the 12.1 percent ratio for a lawyer. The 8 percent threshold level for debt burden may not be appropriate for all income levels.

The respondents’ debt ratios were then ordered by income levels. A pattern of increasing debt levels as income falls emerges. The 19 respondents who had family incomes less than or equal to \$20,000, had an average student loan debt ratio of over 17 percent and a total debt ratio of 36 percent. This group, poor to begin with, are paying out over a third of their pre-tax income in debt service every month. The \$20-40,000 group was not much better off. Their average student loan debt ratio was 8.4 percent and their average total debt ratio is 25 percent. One dollar in four of this group’s pre-tax income went to debt reduction. The student loan and total debt ratios continue to fall as incomes rise. For respondents with incomes from \$40-60,000, about one dollar in five goes to debt reduction. For upper income respondents, the ratios were even lower, with student loan ratios under 7 percent and total debt ratios under 15 percent.

Table 2: Repayer Total Debt Levels

	Number	Average Family Income	Student Loan Debt Ratio	Total Debt Ratio
<=\$20,000	19	\$ 20,000	17.1%	36.1%
>\$20-40,000	87	\$ 30,201	8.4%	25.0%
>\$40-60,000	77	\$ 48,604	6.2%	19.4%
>\$60-80,000	39	\$ 69,808	5.1%	12.5%
>\$80,000	45	\$ 95,944	6.7%	14.2%

Conclusion

Do students need to borrow more? The answer is a qualified “yes” – some probably do, particularly those in the second and third income quintile who attend four-year institutions. These students are seeing levels of out-of-pocket costs that exceed the loan limits now in place.

Can current undergraduates afford to take on more debt than current repayers? Only in some instances. Students who major in certain fields at four-year institutions may have sufficient income to handle higher debt levels. However, students training for many popular and necessary but lower paying occupations at both two- and four-year schools are already showing signs of stress as measured by the total student loan debt to annual income ratio. At the current loan levels, dependent students graduating with a four-year degree can incur up to \$23,000 in debt and are already averaging over \$16,000; increasing the freshman and sophomore limits to match the junior and senior limits will send this level higher. Given the large number of starting salaries in the \$24-30,000 range, \$23,000 of debt is very high, creating a debt ratio of 10.2 percent on a \$30,000 income.

At some point the financial payoff to an education needs to be considered when giving out loans. Students who borrow too much relative to future income can have many financially difficult years even if they do not default. On average, students probably cannot handle much more debt than they are graduating with right now. However, some students in occupations such as engineering or computer science with high starting salaries could afford to borrow more but these students comprise a very small percentage of students in Illinois postsecondary schools.