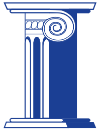

INSTITUTE BRIEF

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Debt and Default Cloud the American Dream

By Deborah D. Thornton

Our young adults are carrying huge student-loan debts for their college education, and increasingly are going into default on their payments. The U.S. Department of Education released the most current student-loan default rates on September 12. The news was not good.

Nationally, the two-year default rate for regular government loans (Federal Direct loans) has increased to 8.8 percent from 7.0 percent for the students who either graduated or left school in 2008. These students were supposed to begin paying their student loans starting between October 2008 and September 2009 – during the largest recession in U.S. history. This was whether they had a job or not.

According to the Department of Education, over 320,000 individuals from this group were in default by September 2010 – as of this time last year.[1] Unfortunately, this is the most current data available. The default rate also does not count those who were in repayment for over two years, and then defaulted. This is also a faster climb in the default rate than that reported from 2007 to 2008, another negative trend.[2] It also does not include private loans, parent loans, or credit-card debt. In reality, a significantly higher number of recent graduates are probably in default.

In order to be in default, borrowers must be at least 270 days late with their payments. Most are 360 days late because the company receiving the payments has another 90 days before they are required to report the loan to the government. Most wait the full 90 days in order to charge borrowers the highest possible amount of interest and late fees before claiming default.[3]

The Federal Perkins Loan program is specifically targeted to the lowest-income students and their families. The national default rate for this program is 10.08 percent, with 37,054 students from the 2008 group in default and over 466,000 students in default from all years. This represents over $900 billion in defaulted loans, money owed the government.[4]

Recent changes to repayment plans allow borrowers to extend the payment terms to as long as 25 years, and allow an income-based repayment (IBR) amount. While these options reduce the amount of each payment, they significantly increase the total amount paid. The 25-year option results in $40,000 in student loans actually costing our children $83,300, or more than double the amount they originally borrowed. The final payment will not be made until they are at least 46 years old.[5]

According to the Project on Student Debt, Iowa students have the fourth highest government-loan debt in the nation, at an average of $28,883, or basically the maximum amount allowable for a bachelor's degree. Almost 75 percent of our students are carrying some amount of debt, the second highest in the nation. Students graduating from the University of Dubuque and Buena Vista University are accumulating the highest debt, over $40,000 each on average.[6]

The percent of Iowa students leaving school in 2008 who are in default, as of September 2010, was 11.5 percent, or 2.7 percent higher than the national average. This ranks fifth in the nation, behind Arizona, Puerto Rico, Colorado, and Arkansas.[7]

Additionally, there are 832 Iowa students from 2008 in the Perkins program whose loans are in default, over 10 percent of those with loans. Iowans have nearly 6,400 total Perkins loans in default, representing almost $13 billion in loans.[8]

The Department of Education has also done a "draft" analysis – not officially released – of the three-year default rate for fiscal year 2007. This is the most current data available. Those results are significantly worse and do not reflect the effects of the recession. For FY2007, the national three-year default rate was almost 12 percent, over 5 points higher than the two-year rate.[9] If that trend holds true, and we have no reason to believe it will not, the current national three-year default rate is at least 14, and probably well over 15, percent.

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Therefore the real Iowa default rate is most likely over 17 percent. This means that nearly 1 of every 5 graduates of Iowa colleges and universities is probably in default on their student loans. When in default, the loans become 100 percent due and payable immediately.

How can we expect our young people to get married, buy houses, and start their own families when they have this enormous debt burden to try to manage? Importantly, student-loan debt is not dischargeable in a bankruptcy, so their only option is to continue to try paying what they can, when they can, while interest and late fees continue to accumulate.

Using the 2+2 option of attending community college for two years at a much lower cost, then transferring and finishing the final two years at a state university, is critical for reining in college debt. The Public Interest Institute POLICY STUDY, "Iowa Higher-Education's Third Way: Community Colleges 2+2 Program from February 2008, analyzes this program. Students and parents should seriously consider this option instead of loans and debt.

In the meantime, the Iowa regents raised tuition by 5-7 percent overall and by as much as 40 percent for students in nursing and other technical degrees. Then, in August, the presidents of the three regent universities each received raises of 4 percent. Their total pay packages, including deferred compensation, now range as high as $508,600.[10] The median total compensation for university presidents nationally in 2009-2010, according to *The Chronicle of Higher Education*, was $375,442.[11]

Both public universities and private colleges must review and control all costs, especially administrative overhead – holding tuition increases to the minimum. The Higher Education Price Index (HEPI) for 2010 was 0.9 percent, for 2011 just over 2 percent.[12] The regents and trustee boards should consider this, as well as the debt your children are assuming, when setting future tuition rates.

We – parents, students, and taxpayers – should insist our universities and colleges make every effort to control tuition and cost increases before the debt clouds over our heads turn into life threatening tornadoes.

(Endnotes)

[1] "Comparison of FY2009 Official Cohort Default Rates to Prior Two Official Calculations," Federal Student Aid, U.S. Department of Education, p. 3, <http://www.ifap.ed.gov/eannouncements/attachments/091211FY09CDRBriefingAttach2.pdf> accessed on September 13, 2011.

[2] Ibid.

[3] Ibid.

[4] "eCampus-Based Reports, Federal Perkins Loan Program Status of Default (Final) as of June 30, 2010," p. 187, <http://ifap.ed.gov/perkinscdrguide/attachments/0910PerkinsCDR.pdf> accessed on September 13, 2011.

[5] "Making your monthly payments," *Your Federal Student Loans, Learn the Basics and Manage your Debt*, U.S. Department of Education, p. 25-27, <http://www.edpubs.gov/document/en0989p.pdf> accessed September 13, 2011.

[6] "State by State Data – Iowa," Project on Student Debt, <http://projectonstudentdebt.org/state_by_state-data.php> accessed on September 12, 2011.

[7] "FY 2009 Official Cohort Default Rates by State/Territory," Default Prevention and Management, Federal Student Aid, U.S. Department of Education, July 31, 2011, <http://www2.ed.gov/offices/OSFAP/defaultmanagement/2009staterates.pdf> accessed on September 12, 2011.

[8] Ibid, p. 55-59.

[9] "Cohort Default Rates," FinAid, The SmartStudent Guide to Financial Aid, <http://www.finaid.org/loans/cohortdefaultrates.phtml> accessed September 13, 2011.

[10] Diane Heldt, "Regents approve 4 percent presidential salary increases," *The Cedar Rapids Gazette*, August 4, 2011, <http://thegazette.com/2011/08/04/regents-approve-4-percent-presidential-salary-increases/> accessed on September 13, 2011.

[11] Heldt, "Iowa presidents among select few."

[12] "2011 HEPI Update," Commonfund Institute, p. 5, <http://www.commonfund.org/CommonfundInstitute/HEPI/HEPI%20Documents/2011/2011%20HEPI%20Report.pdf> accessed on September 14, 2011.

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