



Financial Aid at the Crossroads: Managing the Student Debt Crisis in Texas

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Executive Summary

At approximately \$1.2 trillion, outstanding student loans have surpassed credit cards as the second largest source of consumer debt in this country behind home mortgages. Student loans now make up six percent of the national debt, representing a growth of 20 percent since the end of 2011. Of the national outstanding student debt load, Texans hold approximately \$70 billion, primarily through federal student loans. Texas postsecondary students rely heavily on the federal loan system to help finance the increasingly expensive cost of education, and this debt burden has led large numbers of students to default on their loans and/or delay major purchases, such as homes and vehicles.

Texas Students Lack Adequate Grant Aid and State-Based Funding

Texas students disproportionately rely on the federal government and on loans for student aid compared to students nationwide. In recent years, the federal government has provided 84 percent of financial aid to undergraduate and graduate students in Texas, while students nationally receive about three-quarters of their aid from the federal government. Additionally, just 38 percent of direct student aid to Texans comes in the form of grants, while approximately 62 percent is made up of loans. By comparison, loans make up just half of direct aid for the U.S. as a whole.

The Cost of Going to College Continues to Rise, Disproportionately Affecting Low-Income Students

The Hispanic population in Texas is particularly vulnerable to increases in the cost of postsecondary education, as Hispanic high school graduates are considerably more likely than African-American and White high school graduates to be economically disadvantaged.

Hispanic and African-American student borrowers as a group are also at particular risk for default, in large part because of their lower rates of college completion. Failing to obtain a degree can make repayment particularly burdensome for such borrowers because the average boost to earning power from postsecondary education is far lower for students who do not complete their programs of study. Part-time attendance, off-campus employment, and having a high amount of unmet need are all considered risk factors for dropping out and are common to many Texas students.

Texas Students Lack Financial Literacy and Do Not Take Advantage of Income-Based Repayment

Default rates in Texas and across the nation could be near zero if students and recent graduates had better financial literacy skills and took advantage of programs designed to help them manage their debt. Obstacles to more common utilization of these options include poor comprehension of student loan basics, poor general financial literacy, inadequate loan counseling, the complexity of the programs themselves, and the burdens involved in using them.

The Current Job Market Is More Difficult for Younger Workers

College and university graduates are facing a labor market that is struggling to replace medium-income jobs, while those who do not graduate are being pushed out by their degreed competitors. Nationwide, growing numbers of college graduates are involuntarily working part-time and/or working in occupations for which they are technically overqualified.

Student Loan Default Rates Are Climbing in Texas

More than one-sixth of Texas borrowers will face the consequences of default within three years of entering repayment. The 3-year cohort default rate (CDR) in Texas, currently at 17.3 percent, is higher than the national rate of 14.7 percent and has been increasing over time.

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The Impact of High Student Loan Debt and Default on Individuals

The typical 30-year-old with student loans is less likely to qualify for a home mortgage now than a decade ago because of a high debt-to-income ratio. Other factors, including tighter home lending standards, credit history issues, and rising home prices in some markets may also contribute to this trend, but high student loan debt relative to income is a particularly significant factor.

Societal Effects of the “Student Loan Crisis”

Nearly 40 million people in the U.S. currently have outstanding student loan debt, and regulatory and banking organizations have posited that there is an association between the “student loan crisis” and our present sluggish economy. A recent survey of 9,523 private student loan borrowers found that nearly a quarter of respondents had put off starting a business over concerns related to their monthly student loan payments, and a further eight percent reported being declined for a business loan. These data support the assertion that student loan debt has contributed to the steep decline in young entrepreneurship.

Strategies for Students

Borrowers can adopt a number of strategies before they borrow, while in school, and during repayment in order to manage their student loans successfully:

- If possible, students should avoid attending part time, delaying enrollment, and working off campus, as these behaviors are linked to dropping out. Failure to complete a degree program is one of the strongest risk factors for student loan default.
- Students should submit the Free Application for Federal Student Aid (FAFSA) as early as possible, ideally in January or February prior to fall enrollment. Early FAFSA submissions allow students to be considered for the broadest range of grants and work-study opportunities, which can lower the net price of attendance. This requires that a dependent student’s parents/guardians file their taxes well before the April deadline, and allows parents/guardians to use the IRS Data Retrieval Tool to expedite the process while lowering the probability of mistakes.
- Before taking out loans, students should plan a realistic, modest budget to determine their actual need. Many students who automatically borrow the maximum amount would be better off accepting only a portion of the loan funds they are offered. In addition to taking less than the full loan amount, students are permitted to return unused loan funds without penalty, which can limit excess borrowing and debt.
- Students can also make smart financial decisions when choosing what to study while in school. A student’s major can greatly influence future earnings. Students should seek the guidance of not only an academic advisor, but also financial aid and career counselors when they are deciding on a major. In general, a good choice of major lies at the intersection of interest, aptitude, long-term prospects/goals, and financial viability.
- Students should complete exit counseling on their loans. Although mandatory for graduates, not all borrowers actually complete loan counseling, and many who complete it may rush through the program their school provides, learning very little along the way. It is important that borrowers take the time to understand their rights, responsibilities, and options in order to avoid any issues.

INTRODUCTION

Over the last several years, the media, higher education researchers, and an increasing number of policymakers have pointed to the growing levels of individual and aggregate student loan debt in the United States. At approximately \$1.2 trillion, outstanding student loans have surpassed credit cards as the second largest form of consumer debt in this country, second only to home mortgages.¹ Student loans now make up six percent of the national debt, representing a growth of 20 percent since the end of 2011.²

In assessing what has largely been perceived as a student loan crisis, many have placed blame on institutions and a precipitous rise in tuition rates. Other complicating factors for current and former students, however, include stagnating federal and state grant funding, low graduation rates, insufficient financial literacy, and an economy struggling to improve after the recent recession. Increasingly, these factors have led to dangerously high initial debt-to-income ratios for many student borrowers, resulting in rising student loan default rates across the U.S.

Nationwide trends do not always correspond to the experiences of students and borrowers within individual states, a fact of particular relevance for Texas. Of the national outstanding student debt load, Texans hold approximately \$70 billion.³ This situation results from the state's reliance on federal nongrant aid, a high percentage of two-year students, and high postsecondary noncompletion rates, and leads to some of the highest default rates in the nation.

In the following report, we highlight the state of financial aid, higher education completion, and financial literacy in Texas, followed by a review of the current job market and the individual and aggregate economic effects of increasing student loan debt. Based on these findings, we provide a list of recommendations to help Texans build healthier financial futures free of student loan default.

TEXAS STUDENTS LACK ADEQUATE GRANT AID AND STATE-BASED FUNDING

While the rising student loan debt burden is challenging for borrowers nationwide, Texans are particularly affected as a result of several characteristics of institutions, financial aid, and students that are specific to our state. Texas students are more dependent on federal aid and loans than the average U.S. student, and this contributes to the state's ballooning debt burden. In recent years, the federal government has provided 84 percent of all financial aid to undergraduate and graduate students in Texas, while students nationally received about three-fourths of their aid from the federal government. Just six percent of student aid in Texas came from the state government, while ten percent came from institutional sources, including the Texas Public Educational Grant (TPEG), a program funded through tuition set asides.⁴ Texas students are also more dependent on loans, as opposed to grants, than the rest of the nation. Just 38 percent of direct student aid to Texans comes in the form of grants, while approximately 62 percent is made up of loans. By comparison, loans make up just half of direct aid for U.S. students as a whole.⁵

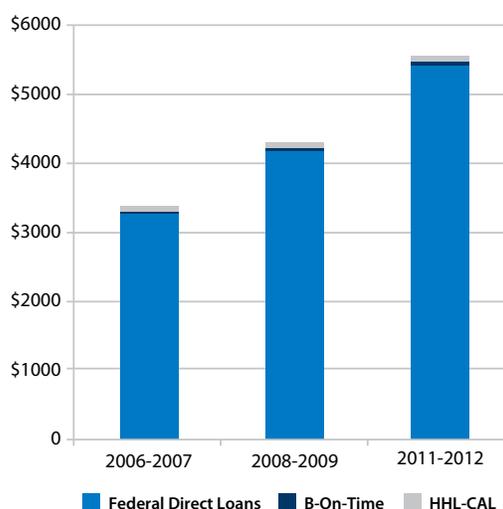
Total grant aid in Texas has grown over the last decade, due largely to a five-fold increase in Federal Pell Grant funding and the establishment of the Toward EXcellence, Access, and Success (TEXAS) Grant.⁶ During award year (AY) 2012–2013, the average Pell Grant award in Texas was \$3,488. At approximately one-sixth of the average cost of attendance at a public four-year university in Texas, this need-based award leaves the students who qualify for it still in need.⁷ More than half of all undergraduates in Texas do not receive any form of grant aid; many of them would benefit, but are prevented for reasons other than financial need. Relatively low state and institutional grant rates drive this difference, but the Texas legislature has recently approved funding increases for several grant programs, including the TEXAS grant and the Texas Educational Opportunity Grant (TEOG).

In addition to grants, Texas also offers state-based loan programs, the largest of which is the Hinson-Hazlewood College Access Loan (HHL-CAL). Recipients do not have to demonstrate financial need, and they can borrow up to the cost of attendance minus other financial aid. Following a few years of decreases, the HHL-CAL loan program volume increased in AY 2011–2012, but still represents a very small percentage of total loan aid going to Texas students. Furthermore, the distribution of HHL-CAL loans across the state is not reflective of enrollment, as just

over one percent goes to public two-year students, who make up more than half of all postsecondary enrollment. Disbursements of HHL-CAL loans to historically black colleges and universities (HBCUs) and Hispanic-serving institutions (HSIs) in Texas are considerably lower than their proportion of total enrollment.⁸

A second source of student loans is the Texas B-On-Time (BOT) Loan Program. BOT is particularly attractive because the loan comes with no interest, and because the balance can be forgiven if a student graduates within the recommended time-to-degree for his or her degree program and maintains at least a 3.0 GPA on a 4.0 scale.⁹ BOT seems to motivate students as intended, since recipients have higher graduation rates overall than other Texas students. However, like HHL-CAL, BOT loan disbursements do not parallel enrollment. Forty-five percent of BOT dollars go to the Central Texas region, while just a quarter of all Texas postsecondary students attend schools there.¹⁰ For most other regions, the loan volume is much lower than the enrollment percentages. Moreover, less than one percent of BOT loans actually go to public two-year students, while about two-thirds go to public four-year students and one-third to private four-year students.¹¹ Disbursements to HBCUs and HSIs are also proportionally lower than respective enrollments.¹² The Texas legislature recently approved increased funding for BOT, meaning more students could potentially benefit from the program. Unfortunately, BOT has never quite functioned as intended. In 2011, more than \$32 million in BOT funds was not disbursed to students, and only 38 percent of program participants met the requirements for forgiveness. Additionally, the BOT program has a higher default rate than other state-based loan programs — nearly three times higher.¹³

Loan Volume in Texas by Source (in Millions of Dollars)



Source: Texas Higher Education Coordinating Board, Texas Financial Aid Database (Unpublished tables); U.S. Department of Education, Title IV Program Volume Reports.

Public institutions are using relatively low percentages of their BOT allocations. In 2011, public two-year schools disbursed only three percent of their BOT dollars to students.¹⁴ Such low usage prompted the Texas Higher Education Coordinating Board (THECB) to recommend that such institutions be removed from the BOT program, with their allocated funding transferred into TEOG grants. As such, by AY 2014–15, BOT will be a bachelor’s degree only program.¹⁵ Four-year schools are disbursing only about two-thirds of their BOT money. Among other possible reasons, one impediment may be a federal requirement to treat state student loans in the same manner as privately funded loans. This regulation means that schools cannot advertise BOT loans unless they are included on a “preferred lender list” that includes other private loan agencies that have been vetted for recommendation. If schools choose not to do this, they cannot promote BOT loans.¹⁶ As an attempt to address this unfortunate oversight, legislation has been introduced by Congressman Joaquín Castro (D-TX) that addresses this issue for the BOT loan program, while Congressman Rubén Hinojosa (D-TX) recently introduced a bill that addresses the preferred lender list issue with respect to all state-sponsored student loan programs.¹⁷

THE COST OF GOING TO COLLEGE CONTINUES TO RISE, DISPROPORTIONATELY AFFECTING LOW-INCOME STUDENTS

Across Texas and the U.S., the cost of college continues to rise. An alarming statistic is the rate at which college costs have risen over the last 35 years: 1,120 percent. This figure outpaces the increase in medical expenses (601 percent) and food (244 percent) and is quadruple the increase in the consumer price index.¹⁸ In Texas, the rise in the cost of attendance has also outpaced the growth of grant aid. The cost of attendance at public four- and two-year schools in Texas grew three percent over a single year, from AY 2010–11 to AY 2011–12, a rate that has slowed somewhat over previous years.

Rises in the cost of attendance disproportionately affect low-income students, as they are less able to manage periodic spikes in tuition and housing prices than students from higher income families. The Hispanic population in Texas is particularly vulnerable, as Hispanic high school graduates are considerably more likely than African-American and White high school graduates to be economically disadvantaged.¹⁹ While efforts to increase Hispanic enrollment in Texas higher education have found some success, much of this growth has been in two-year institutions, where tuition hikes have outpaced inflation over the years and students are typically eligible for fewer forms of financial aid.²⁰ As such, the median net price of attending community college has inflated to about \$5,000 per year across all income groups.²¹ For economically disadvantaged students, the “leftover” amount not covered by financial aid may be too much to cover out of pocket.

TEXANS ARE MORE DEPENDENT ON LOANS AND HAVE HIGH DROPOUT RATES

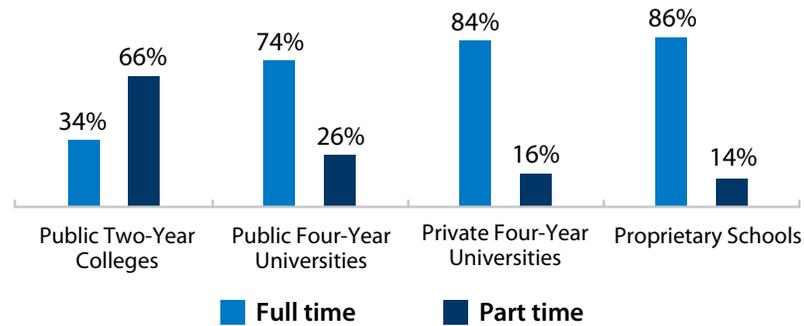
To make up for the gap between grant aid and total cost of attendance, students are taking out loans in record numbers. Over the course of the last decade, annual federal loan disbursements in Texas have more than doubled.²² Loans obtained through the Federal Direct Loan Program (FDLP) represent a good option for most students who need extra money for higher education. Federal loans have lower interest rates than most private loans, and they are eligible for various repayment accommodations, including loan consolidation, income-linked repayment plans, and public service loan forgiveness. Barring specific forgiveness programs, however, loans do need to be paid back, and despite the numerous options students now have, many find it difficult to make on-time payments and avoid delinquency or default.

Certain factors make paying off student loan debt more difficult for some borrowers than others. Chief among them is not completing a degree program. Not obtaining a degree can make repayment particularly burdensome for borrowers because they do not benefit from the higher income that is, on average, associated with postsecondary degree attainment. Part-time attendance, off-campus employment, and having a high amount of unmet need are all considered risk factors for dropping out, and a large percentage of Texas students have these and other associated risk factors. Consequently, Texas students have lower graduation rates and higher student loan default rates than national averages.²³

Part-Time Attendance

Approximately 45 percent of all Texas undergraduates attend school part time, a figure that is considerably higher than the national average. For students in public two-year programs, this figure increases to 66 percent.²⁴ Part-time enrollees are at a higher risk for dropping out because they are less likely to be engaged in campus life. They typically commute and have fewer of the academic and extracurricular associations that keep students engaged outside of the classroom. On top of the increased dropout risk, students who attend school part time, especially those who attend less than half time, may not be eligible for certain grants or in-school deferment of federal loans, meaning they may be required to make payments while enrolled.

Enrollment Intensity of Undergraduates in Texas by School Sector (Fall 2011)



Source: U.S. Department of Education, National Center for Education Statistics, *IPEDS Data Systems 2011*; TG, *State of Student Aid and Higher Education in Texas*, January 2013, p. 21.

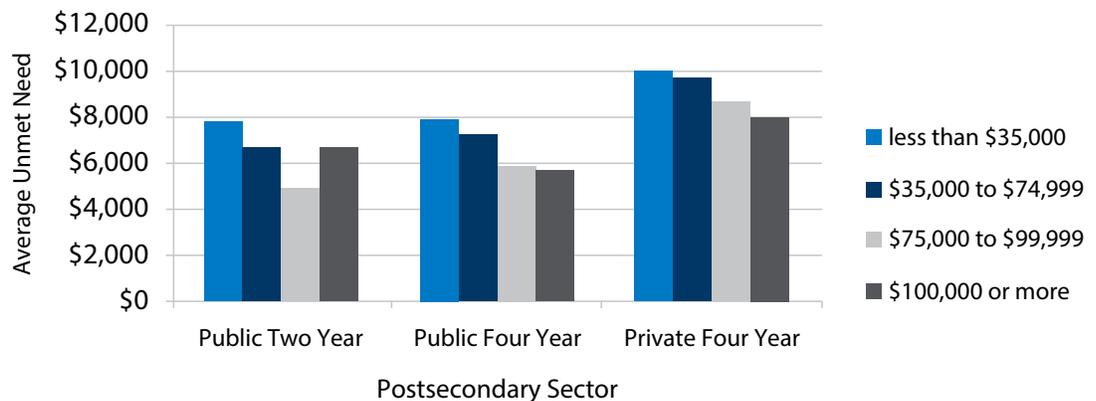
Off-Campus Employment

One reason students elect not to take a full course load is to accommodate their work schedules. In Texas, approximately 75 percent of public university students and 83 percent of community college students work at least part time. A quarter of all Texas public university students and half of all public two-year students work full time while enrolled. Of working students, 90 percent will work exclusively off campus.²⁵ Off-campus employment shares the same risks as part-time attendance, with some additions. It can be more difficult for off-campus job holders to negotiate their work schedules around class offerings, something that on-campus work-study is specifically designed for. Free time for studying can be limited, and the exhaustion that comes with carrying the extra workload can negatively impact a student’s grades and lifestyle.

Unmet Need and Low-Income Students

Unmet need is defined as the student’s cost of attendance minus his or her expected family contribution (EFC) and all financial aid including grants and loans. Unmet need is typically higher for low-income students attending two-year versus four-year public schools. It is also higher for low-income students than for middle and upper income students across all school sectors. A risk in itself, unmet need leaves students unsure of how to pay for their education and can contribute to dropout rates. However, Texas students with unmet need are also significantly more likely to have additional risk factors for dropping out. They are more likely to delay enrollment, be independent, have dependents, and be single parents than students with no unmet need. All of these factors put Texas students with unmet need at a dangerously high risk of dropping out.²⁶

Average Unmet Need for Texas Students by Sector and Income Category (Fall 2011)



Source: Texas Higher Education Coordinating Board, Unmet Need and Expected Family Contribution (unpublished tables).

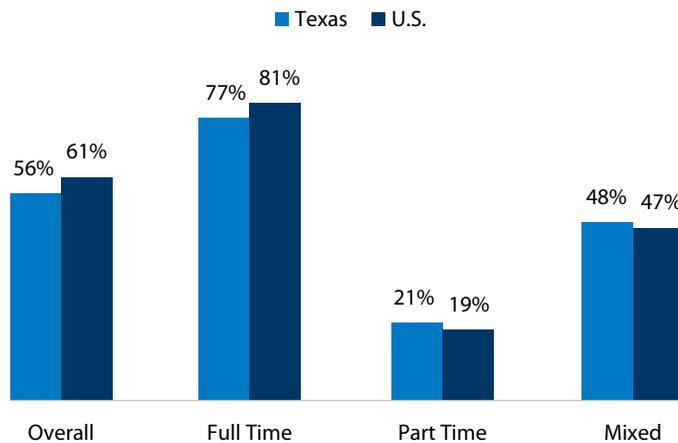
Dropout Rates

While overall graduation rates have been improving in Texas, a significant percentage of students borrow for school but do not complete their degree programs. A recent report by the National Student Clearinghouse attempts to improve upon previous graduation rate calculations that relied solely on institutional-level data collection.²⁷ The report, “Completing College: A State-Level View of Student Attainment Rates,” follows first-time postsecondary students who entered school in 2006 and tracks their graduation through 2012. What sets this report apart from others is that it includes the six-year graduation rate of transfer students, who have typically been left out of previous graduation rate calculations, in addition to native students.²⁸ The report also differentiates between students who were still enrolled somewhere in 2012 and those who were not enrolled anywhere. In most other calculations, any student who had not graduated from their original institution by 2012 was treated as a drop-out, when in fact some of them transferred and graduated elsewhere or were still working toward a degree. According to the report, 56 percent of students who enrolled at Texas public four-year institutions in 2006 graduated by 2012, including 11 percent who graduated from a school other than the one at which they started. A quarter of this cohort had not graduated and was not enrolled anywhere by 2012. The completion rates of students who enrolled full time were considerably higher. Tellingly, 70 percent of exclusively part-time public four-year students had not graduated and were not enrolled anywhere after six years. Private nonprofit four-year schools had higher completion rates across all attendance types.

Throughout the nation, the graduation rates of public two-year schools are significantly lower than four-year schools. While the Clearinghouse report did not contain information on Texas public two-year students, only 36 percent of two-year students across the nation completed their programs within six years, while 44 percent were not enrolled anywhere by 2012. In Texas, 42 percent of fall 2011 community college students who did not graduate at the end of the academic year did not return to a Texas school the following fall.²⁹ While this number may include students who continued their education outside of Texas, national trends show us that just two to three percent of community college students complete their studies outside the state where their first institution was located.³⁰

Research also shows that Texas graduation rates vary considerably by race and ethnicity. For example, 67 percent of Whites, 50 percent of Hispanics, and 37 percent of African-Americans who entered college in 2005 graduated within six years.³¹ Efforts to increase minority student participation in higher education are succeeding at variable rates. Participation success may not lead to repayment success if historical graduation rates fail to improve for these underrepresented groups. Efforts to improve graduation rates would help students avoid the financial hardship that comes from dropping out with student loan debt.

Six-Year Completion Rates of Students Who Started at Four-Year Public Institutions, by Enrollment Intensity (Entered in Fall 2006)



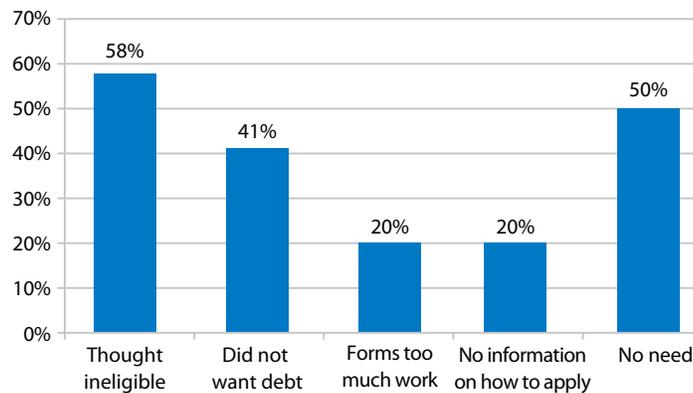
Source: National Student Clearinghouse Research Center, Signature Report: State Supplement “Completing College: A State-Level View of Student Attainment Rates,” February 2013.

TEXAS STUDENTS LACK FINANCIAL LITERACY AND DO NOT TAKE ADVANTAGE OF INCOME-BASED REPAYMENT

A sad truth is that default rates in Texas and across the nation could be near zero if students and recent graduates had better financial literacy skills and took advantage of programs designed to help them manage their debt. Increased guidance at each of the various steps in the higher education process — choosing a school, applying for financial aid, choosing a major, graduating and starting repayment — would help many remain in good financial standing down the road.

Many young Texans will decide on a postsecondary institution and never apply for financial aid. In AY 2007–2008, 20 percent of students who did not apply for financial aid did so because they thought the forms were too much work, and 20 percent said they had no information on how to apply. More than 40 percent of students not applying for financial aid did not want to take on any debt. However, filling out the FAFSA is a necessary step in receiving a Pell grant. In a randomized experiment, students who received help filling out the FAFSA were more likely to submit it and more likely to receive a Pell Grant than students who did not receive help.³² This is an important finding, indicating that Texas students could benefit from services that make completing the FAFSA easier. Pell Grants can lower the net price of attending school and student loans, while still debt, lower the need for working during school and enrolling part time, thereby lessening the risk of dropping out.³³

Percentage of Texas Students by Reason for Not Applying for Financial Aid (AY 2007–2008)



Sources: U.S. Department of Education, National Center for Education Statistics, *NPSAS 2008*; TG, *State of Student Aid and Higher Education in Texas* January 2013, p. 65.

If students do decide to apply for loans, counseling can help them decide how much debt is manageable and what will be expected when they enter repayment. Although loan counseling is required by law, not all federal borrowers are getting this much-needed information. A 2012 study targeted 13,000 current students and recent graduates with high federal student loan volumes to learn how much information they possessed. Forty percent of those surveyed responded that they never received in-person or online counseling when they became borrowers. The report offered a number of possible explanations for this statistic: schools may not be fulfilling federal requirements, counseling programs may be of such poor quality that students do not recognize them, or students are forgetting the counseling they received. Of the students who did receive counseling, 40 percent thought it was either “uninformative” or “neither informative nor uninformative.”³⁴ Additionally, not all state-funded student loan programs in Texas require counseling. During the 83rd Texas Legislature, however, the state enacted legislation requiring the THECB to educate BOT borrowers on the program’s forgiveness provisions and repayment responsibilities, along with a requirement that schools with a BOT default rate above the statewide program average offer in-person or online student loan repayment and default prevention counseling.³⁵

Texans in general could benefit from increased financial literacy training and improved financial decision making. The National Financial Capability Study (NFCS) surveyed individuals across the U.S. to learn how well they handle debt and monthly incomes, as well as their level of financial literacy.³⁶ All participants were asked a series of five questions related to everyday economics and finances, on topics such as compound interest and short vs. long loan terms, both of which are useful for student loan borrowers.³⁷ The study found that just 33 percent of Texans correctly answered more than three of the questions, for a state average of 2.73 correct answers. The U.S. average was 2.88 correct answers. The study also found that Texans are more likely to be underwater on their mortgages, that they are more likely to have overdue medical bills, and that 34 percent are only making the minimum payments on their credit cards. Finally, according to the NFCS, 54 percent of Texans spend at least their income or more every month, not including new homes, cars, or other large purchases. This means that many Texans are struggling to make ends meet.

Texans who have student loan debt and are facing financial difficulties may have helpful options that they are not taking advantage of and may not even know about. Many federal student loan holders are eligible for alternative repayment options that take one's income into account when calculating the monthly payment. The largest such program, Income-Based Repayment (IBR), accounts for family size, discretionary income, and student loan debt. For eligible borrowers, IBR caps the monthly payment at 15 percent and extends the repayment term to 25 years (to become 10 percent and 20 years for new borrowers on or after July 1, 2014), with forgiveness of any remaining balance at the end. The term of forgiveness for public service employees is a comparatively short 10 years. IBR is beneficial in that borrowers could see their monthly payments go to \$0 and still remain in good standing. This means that default would no longer be a worry for people who are sincerely trying to make their payments but cannot because they have insufficient discretionary income. Approximately 1.1 million people in the U.S. are currently enrolled in IBR, with another 500,000 enrolled in other income-linked programs.³⁸ However, according to the current Administration, many who are eligible are not enrolling, and some of the top complaints from borrowers indicate that a lack of awareness and a seemingly tricky paperwork process are partially to blame.³⁹ Simply enrolling in IBR would help many Texans with high student loan balances better manage their monthly payments.

THE CURRENT JOB MARKET IS MORE DIFFICULT ON YOUNG WORKERS

The difficulties facing Texas student loan borrowers are not just a function of the state's lower grant aid availability, increasing cost of attendance, higher than average dropout rates, and poor financial literacy. The postrecession economy is also to blame in making loan repayment more of a hardship. College and university graduates are facing a labor market that is struggling to replace medium-income jobs, while those who do not graduate are being pushed out by their degreed competitors.⁴⁰ Across the board, student loan borrowers are having a harder time meeting their monthly financial commitments, and defaults are climbing as a result.

By the Numbers

The recent recession and recovery have been particularly difficult on America's young adults. Nearly half, or 45 percent, of all unemployed Americans are between the ages of 18 and 34, but with variation based on population characteristics.⁴¹ The unemployment rate for young Hispanics is 25 percent higher than it is for Whites, while young African-American unemployment is double that of Whites.⁴² At the state level, young Texans are having a harder time finding work, with an unemployment rate of 13.4 percent as compared to the overall rate of 6.8 percent.⁴³

The recession reached all groups, but university-educated workers weathered the storm better than others.⁴⁴ The U.S. economy lost 7.2 million jobs from December 2007 to January 2010, driven by losses among workers with associate degrees or less. Meanwhile, jobs requiring a bachelor's degree made modest gains during the recession. Of the 3.4 million jobs regained as of early 2012, at least 2 million were filled by bachelor's degree recipients; workers with a high school diploma or less had still lost jobs overall by this point.⁴⁵ Young bachelor's degree holders have had higher unemployment and underemployment than more experienced bachelor's degree holders, but the differences in this group are not nearly as pronounced as they are for nondegree holders.

Despite the recent job gains among degree recipients, employment trends among young adults over the last decade have led to lower initial earnings for this group. Bachelor’s degree holders aged 26 to 30 earned nine percent less in 2012 than they did in 2000. Once again, however, this difference is not as prominent as it is for less educated groups. Young workers with at most a high school diploma earned 12 percent less in 2012 versus 2000, while people with “some college” or an associate degree earned 17 percent less.⁴⁶

Unemployment rates and earnings are vital concerns in the discussion of rising student loan debt because graduates typically need jobs in order to make their student loan payments. The particular predicament of younger people who have either graduated or discontinued their higher education is important because this group is more likely to carry an outstanding loan balance: 15 million people under age 30 and 10.9 million from ages 30 to 39 are carrying a combined \$641 billion in student loans.⁴⁷ While a number of factors will determine whether someone defaults, the disproportionate burdens imposed by our current economy and record outstanding student loan balances have led to distressing rates of default across the country — and particularly in Texas.

STUDENT LOAN DEFAULT RATES ARE CLIMBING IN TEXAS

Federal student loan CDRs have been calculated for more than two decades. Before sanctions were put in place, several schools would admit students who were not qualified for their programs or who did not benefit in a manner that would help them repay their student loans. As such, default rates for these schools were very high.

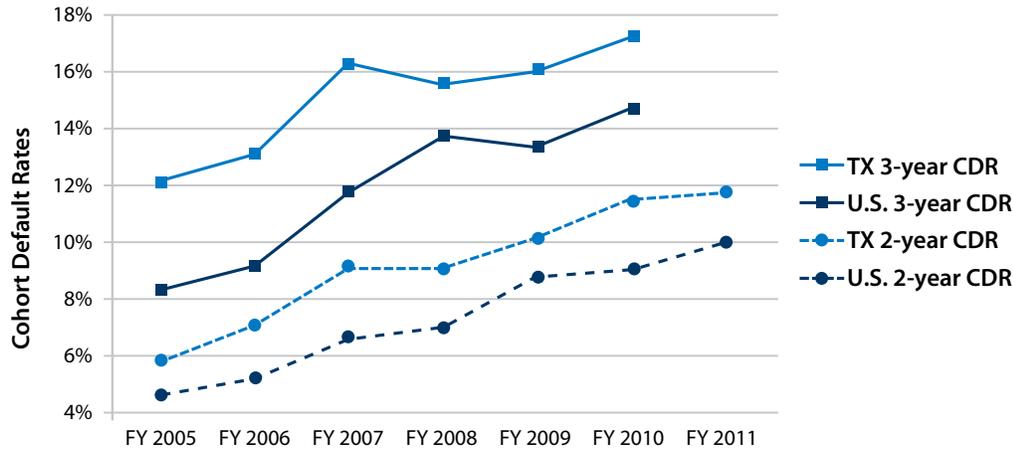
CDRs are obtained by tracking a cohort of students who entered repayment in a certain year and calculating what percentage of them default at least once over a certain period of time. Until recently, the tracking period was two years. Evidence has shown, however, that a considerable percentage of students default during their third year of repayment.⁴⁸ As such, the three-year CDR, which has recently been published alongside two-year CDRs, will become the only official rate starting with the fiscal year (FY) 2011 cohort. Once a school’s third official three-year CDR is released, which for most existing schools will take place in late 2014, it is subject to revised sanctions for poor performance. If a school’s three-year CDR meets or exceeds 30 percent for any two of the three most recent fiscal years, the school may be placed on provisional certification. If the school’s CDR is 30 percent or higher for three consecutive years, the school will lose eligibility to participate in the Direct Loan program and the Pell Grant program. A single-year CDR over 40 percent triggers FDLP eligibility loss. Schools with a single default rate of more than 30 percent must now form a default prevention task force and deliver a plan of action to the U.S. Department of Education specifying the steps the school will take to lower its rate. A second consecutive rate of more than 30 percent requires the school to submit a revised plan.⁴⁹

The U.S. Department of Education noted that 221 schools in the U.S. had three-year FY 2010 CDRs at or above 30 percent.⁵⁰ Twenty-seven of these schools (12 percent) are located in Texas; twelve are proprietary nondegree programs, four are proprietary associate or bachelor’s programs, eight are community colleges, and three are private bachelor’s programs. Five of the 27 schools have three-year CDRs of more than 40 percent. Schools that are just below or already above the 30 percent threshold face the possibility that their future students will not have access to federal funding. While some of these schools may be exactly what the CDR calculations were intended to target, many of them serve populations more likely to default, including low-income and first-generation minority students. Given Texas students’ overreliance on federal aid, if the latter such schools become FDLP and/or Pell ineligible, postsecondary options for students with financial need may be severely limited in the state. In this case, what hurts the students can hurt schools as well. If such schools can no longer attract the high proportion of students in need of federal aid, they face potential financial ruin.

The most recent three-year CDR for Texas is 17.3 percent. Of the 235,724 borrowers who entered repayment from October 1, 2009 to September 30, 2010, 40,981 of them defaulted by September 30, 2012. Tied with Kentucky, Texas has the sixth highest three-year CDR in the country, and is 2.6 percentage points above the national average.⁵¹

Considering many of the factors discussed above, including reliance on federal loans, unique demographic factors, and higher dropout statistics, the state's higher than average default rate may be expected. However, this still means that more than a sixth of Texas student borrowers will face the consequences of default, which are discussed in the following section.

Two-Year and Three-Year CDRs for the U.S. and Texas (FY 2005–FY 2011)



Note: Official three-year CDRs are available for FY 2009 and FY 2010. Trial three-year CDRs were released prior to 2009.

Sources: U.S. Department of Education, Two-Year and Three-Year Official Cohort Default Rates; U.S. Department of Education, Federal Student Aid Data Center, Trial Three-Year Cohort Default Rates; FinAid.com, Cohort Default Rates (www.finaid.org/loans/cohortdefaultrates.phtml).

It is similarly important to know that default rates are not uniform across the state or across school types. East Texas, West Texas, and the Rio Grande Valley region have recently had higher CDRs than other areas of Texas.⁵² These three regions also tend to have higher levels of poverty and unemployment and a smaller proportion of four-year public and private universities.⁵³ We know that two-year programs have lower graduation rates and that dropping out of school with student loan debt makes it more difficult to make on-time payments. As such, we find that two- and three-year CDRs are higher among borrowers who attend short-term programs.⁵⁴ Thus, the consequences of default are disproportionately affecting student borrowers from the three regions above as well as those who attend short-term programs across the state.

THE IMPACT OF HIGH STUDENT LOAN DEBT AND DEFAULT ON INDIVIDUALS

The majority of Texas student loan borrowers manage to make their payments on time and avoid student loan delinquency and default. However, possessing high student debt can be a burden, and recent studies have found that financial trends are changing among those who carry student loans.

According to the Federal Reserve Bank of New York (FRBNY), from 2003 to 2009 the proportion of 30-year-olds with a mortgage and student debt was higher than the proportion of 30-year-olds with a mortgage but no student loan debt. To analysts this trend made sense, as young student loan borrowers tend to have more education and higher incomes than the average 30-year-old without student loans. Thus, this age group was more likely to buy a home and hold a mortgage. During the recession, however, home ownership for both young student loan borrowers and nonborrowers decreased, and by 2012 the rate of home ownership for student loan borrowers dropped below that of nonborrowers.⁵⁵

The Young Invincibles, a national nonprofit organization that focuses on jobs, health care, higher education, and other issues facing young Americans blames inflated student debt loads for this shift. Their recent report concludes that the typical 30-year-old with student loans is less likely to qualify for a home mortgage now than a decade ago because of a

high debt-to-income ratio.⁵⁶ While such borrowers may be able to buy a home in the future, their student loan burden forces them to postpone the purchase. Similar trends are seen with auto loans, delayed retirement savings, and decreasing rates of entrepreneurship for student loan borrowers in this age group.⁵⁷

For many, the main difficulty posed by student loan debt comes in having to make monthly payments, but a majority of recent graduates report that they do not understand the implications of default.⁵⁸ This lack of knowledge may lead student loan borrowers to believe that they can discharge their debts in bankruptcy, which is nearly impossible given federal laws specific to student lending. Nor might they know about the wide range of collection tools that the U.S. Department of Education and guarantors have at their disposal, under federal law, to induce repayment and prohibit further delinquency.⁵⁹ Listed below, many of these actions can make it more difficult for defaulted borrowers to apply their financial resources toward other debts, find or keep employment, or pursue further education, in addition to potentially increasing what the borrower is expected to repay.

- Administrative wage garnishment: The loan guarantor can withhold up to 15 percent of a borrower’s disposable income when he or she enters default. This percentage increases up to 25 percent if an individual’s loans are held by multiple guarantors or the U.S. Department of Education.
- Treasury offset: Defaulted loans may be eligible for the Treasury offset program, which diverts federal money, like income tax refunds, to guarantors or the U.S. Department of Education.
- Withholding or suspension of professional license: In Texas, professional/occupational licenses can be withheld at the time of renewal if a borrower enters default. Affected occupations include nursing, optometry, real estate, and cosmetology, among others. Attorneys’ licenses can be suspended if they default on student loans.
- Collection costs: When borrowers sign promissory notes, they agree to pay the cost of collecting debt should they default. A cost of up to 24.34% of the total loan amount may be added as principal to the balance. Not only does the borrower pay the added amount, but he or she pays the added interest that accrues as well.
- Loss of federal student aid eligibility: Borrowers who default on their student loans typically lose their eligibility to take out additional federal student aid. While they can make payment arrangements to reinstate this ability, additional late payments may force them to lose eligibility for the entire period under which the borrower holds a balance.
- Release of school transcripts and records: Depending on individual school policies, some may refuse to release academic records and transcripts if a former student enters default. Such action can make it more difficult for job seekers to verify their educational background.⁶⁰

A final consequence of delinquency and default is a damaged credit history. Consumer reporting agencies receive information on student loans in repayment and will update credit files if accounts fall into delinquency or default. From 2003 to early 2009, the credit scores of 25- and 30-year-olds without student loan debt were within a few points of nonborrower credit scores. Since 2009, however, the credit scores of young student loan borrowers have dropped well below nonborrowers in each age group.⁶¹ Lower credit ratings only further complicate the future financial habits of student loan borrowers.

Moreover, most people know that dings in their credit reports can make it difficult to buy homes, cars, and other big-ticket items, but many may not realize that it could affect their employment as well. Under the Fair Credit Reporting Act, employers are allowed to access current or potential employees’ credit reports for “employment purposes.” Provided employers follow certain disclosure guidelines and obtain authorization, they can use credit information in hiring, promotion, and retention decisions. According to a study from the Society for Human Resource Management, 47 percent of surveyed companies reported that they conduct credit background checks for selected job candidates.⁶² An additional 13 percent conduct credit checks for all job candidates. Position descriptions that most often warranted credit checks were those with financial responsibilities or that gave employees access to sensitive client or consumer information. While very few companies stated that they would forego hiring someone simply for possessing educational debt, nearly half responded that they would not extend a job offer to someone with accounts in debt collection. Almost a fifth responded that they would not hire someone who just had a high debt-to-income ratio. For borrowers who may already be wrestling with default or a high debt load, the added difficulty these may pose in the job hunt only further exacerbates their struggle.

SOCIETAL EFFECTS OF THE “STUDENT LOAN CRISIS”

Nearly 40 million people currently have outstanding student loan debt in the U.S. Regulatory and banking organizations are now stating that there is an association between the “student loan crisis” and our present, sluggish economy. The Student Loan Ombudsman for the Consumer Financial Protection Bureau (CFPB) has been one of the first to point to precise effects, stating in October 2013 that “three-fourths of the fall in household formation can be directly correlated to student debt.”⁶³ Such inaction is dragging down the postrecession housing recovery, meaning that skyrocketing student loan debt is not just affecting borrowers; it potentially reaches everyone.

Experts are also concerned that student loan debt is inhibiting the entrepreneurial spirit of new graduates. While self-employment has fallen seven percent from 2005 to 2010 for all Americans, it fell by 19 percent for individuals 25 and under.⁶⁴ According to a recent survey of 9,523 private student loan borrowers, nearly a quarter responded that they had put off starting a business over concern for their monthly student loan payments. A further eight percent reported being declined for a business loan, data which supports the assertion that student loan debt shares responsibility for the steep decline in young entrepreneurship.⁶⁵ This decrease is a concern for society at large as new businesses account for 70 percent of gross job creation.⁶⁶ Additional stress on new and/or small businesses comes when graduates are forced to take jobs with larger, more established companies in order to pay their loan balances. The necessity that companies pay enough to cover their employees’ student loan payments means that new and/or small businesses are struggling to attract the best and the brightest among recent graduates. The effects of this are potentially widespread, including the staffing of doctors and nurses in areas of high poverty, of which Texas has many.

STRATEGIES FOR STUDENTS

Historical evidence shows that a college education is one of the best investments someone can make. Average lifetime earnings of degree holders are significantly higher than high school graduates’, with recipients of associate degrees earning nearly a third more and bachelor’s recipients earning 74 percent more.⁶⁷ As discussed previously, people with more than a high school education are also less likely to be unemployed and are less affected by recessions. Postsecondary degree holders also tend to be healthier in that they are less likely to smoke, more likely to exercise, and have lower rates of obesity.⁶⁸ The benefits of a college education are also passed along to communities and families. College graduates volunteer at higher rates and are more likely to vote than nondegree holders.⁶⁹ Working mothers with bachelor’s degrees spend more time with their children, on average, than working mothers with high school diplomas.⁷⁰ Additionally, the progeny of parents who received degrees are more likely themselves to enroll in higher education, continuing down the road to higher earnings, healthier bodies, and increased engagement in social and civic life.⁷¹

Fortunately for our state, more Texans are receiving college and university degrees, including more minorities and women, than in decades past. Federal student loans have made higher education possible for millions of students, offering terms and repayment options that make borrowing an affordable way to invest in their futures. For many, loans could offset other methods that students use to meet the expenses of school — attending part time, delaying enrollment, or working off campus — which in turn could lessen the likelihood that those students will drop out. Loans also allow many students who might otherwise only be able to afford a two-year program to attend four-year public or private programs.

Borrowers can adopt many strategies before they borrow, while they are in school, and when they are in repayment in order to successfully manage their student loans, as well as their other financial obligations down the road. First, students should submit the FAFSA as early as possible in January or February if they plan to enter school the following fall. On-time FAFSA submissions allow students to be considered for grants and work-study opportunities, which could lower the net price of attendance. This requires that a dependent student’s parents file their taxes well before the April deadline, which also allows them to use the IRS Data Retrieval Tool to lessen the probability of mistakes, making the FAFSA paperwork that much easier to complete.

Filling out the FAFSA is also necessary if students intend to take out federal student loans. A successful tool for managing one's federal loans is to just borrow what is needed, and students are allowed to accept only part of a loan or to return unused portions. However, it is generally not advisable for a student to take less than what is needed in order to lower the amount owed later on. Students with unmet need must find other methods for funding their education, many of which decrease the likelihood of graduation.

Students can also make smart financial decisions when choosing what to study while in school. A student's major is highly predictive of future earnings. The initial income that a borrower can expect to make upon graduation will determine whether their monthly student loan debt percentage remains at or under 10% of income, considered to be within an easily manageable range.⁷² As such, it is a good idea for students to not only seek the guidance of an academic advisor, but also financial aid and career counselors when they are deciding on a major. There are also free tools online that can give students information if they are wavering between degrees, or even schools, such as Major Choices on TG's *Adventures In Education* (AIE™) website (www.AIE.org/MajorChoices).⁷³ This tool compares majors within a single school or a single major across multiple schools in Texas, providing median incomes and student loan balances to determine a borrower's expected debt percentage should they choose said institution and major. Such guidance can help students make the best decisions for their financial futures.

Perhaps one of the wisest financial decisions that a student can make while in school is to complete his or her degree. As earlier sections in this report attest, graduates typically fare better after school than students who drop out because they have the added income boost that comes from a college or university degree. While graduation is usually the best option for all students who enter higher education, it is especially critical for students who have borrowed loans to avoid compounding their financial hardship upon exit.

When a student graduates, drops below half-time attendance, or leaves school without completing, they enter a six-month grace period on their federal student loans.⁷⁴ The grace period allows students time to find employment and get settled before making their initial monthly loan payments. During the grace period, students should decide what repayment options are best for them. One way to do this is to complete student loan exit counseling. Although mandatory for graduates, not all borrowers actually complete their loan counseling, and many who complete it may rush through the program their school provides, learning very little along the way. It is important that borrowers take the time to understand their responsibilities in order to avoid any issues. At the beginning of the grace period, borrowers should contact their loan servicers to obtain their payment start dates, to get information on more flexible repayment options like IBR, and to begin the paperwork process that may be necessary if they decide against the default standard repayment plan. While all federal student loans are now originated by the U.S. Department of Education, borrowers may have multiple loan servicers, or older loans that were originated under the Federal Family Education Loan Program (FFELP), which can make entering repayment confusing. The National Student Loan Data System (NSLDS) at www.nsls.ed.gov is a central repository of federal loan and grant information, allowing borrowers to determine which entities hold their loans and whom to contact. Borrowers with large balances shared among multiple holders may benefit from consolidation, which could allow them to take advantage of the various income-based repayment options. Proper preparation before and during the grace period will ensure that borrowers are ready for their first payment and able to manage their new financial responsibilities.



RECOMMENDATIONS

1. Expand funding for Texas-based financial aid programs. Texas students are highly dependent on federal student aid, and federal loans in particular, as compared to the national average. It is time for the state to increase funding for the TEXAS grant program, the B-On-Time and HHL-CAL loan programs, and the state college work-study program. Additionally, Texas should expand student loan forgiveness programs for degrees in high demand fields. This will not only help students find high-level work after graduation, but also help the state fill positions that are critical to development and to remaining competitive in an ever-advancing world market.
2. Enroll more borrowers in income-linked repayment programs. There are currently three such programs available for federal loans — Income-Based Repayment, Income-Contingent Repayment, and Pay As You Earn — with each setting monthly payments based on a percentage of income with differing repayment terms. For students struggling with high debt-to-income ratios, an income-linked repayment plan could help them stay current on payments and avoid the consequences that come with delinquency and default.
3. Improve college retention and graduation rates. Leaving school without completing one’s course of study presents a major hurdle to staying out of default and paying off student loans. Multiple factors contribute to a student’s success in higher education, and some of them, such as family characteristics, cannot be controlled by the academic institution. However, there are many strategies that schools can employ to improve retention rates and graduation rates. Making school more affordable is key, which can be achieved by lowering tuition rates, increasing aid, or better targeting students who have the most financial need. Other nonfinancial retention methods can be found through numerous education research and advocacy organizations, including the U.S. Department of Education.
4. Integrate student loan counseling, academic advising, and career guidance. Financial aid counseling should do more than just bookend a student’s time in school. In order to help students manage both the numerator and denominator of the debt-to-income ratio, financial considerations should become part of the decision-making process when students are determining their major course of study and career aspirations. Institutions of higher education can aid in this process by ensuring that their financial aid officers, academic advisors, and career centers are working in concert to provide a holistic approach to student counseling. Schools can also promote query tools such as AIE’s Major Choices (www.AIE.org/MajorChoices) to help students understand how their major can affect their income, which in turn affects how they will manage student loan repayment.
5. Support to state-based entities that offer student loan counseling, debt management, and financial literacy. Many institutions and organizations other than schools have expertise in and knowledge of student aid, delinquency and default prevention, and other forms of financial literacy training. The legislature should support these programs and encourage them to coordinate their efforts to offer services on a statewide basis and to make recommendations to the legislature to strengthen their activities. Furthermore, student borrowers would benefit from a public relations campaign across Texas on the availability of programs designed to assist them with postsecondary financing options and repayment.
6. Advocate the passage of legislation by Congress to exempt state-sponsored loan programs, including B-On-Time, from private loan disclosure requirements. Two separate pieces of legislation have already been introduced to remove the “preferred lender list” conditions on Texas-based student loan programs. Passing the bills would allow the loan programs to be more efficient and accessible to Texas students.
7. Expand in-school counseling requirements to apply to all state loan programs. As a number of the studies referenced in this report attest, many students do not understand the responsibility of borrowing student loans and the consequences of default. Requiring counseling for all the Texas loan programs would give students the information they need to successfully meet their loan obligations.

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Behind the Numbers: Making Sense of Cohort Default Rates, December 2013

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