The Rising Cost of Student Loans

As Student Debt in the Empire State Nears $70 Billion, Congress Could Avert Debt Increase for 422,000 New Yorkers

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On July 1, 2012, the interest rate on subsidized Direct Federal Loans for college students (also known as Stafford Loans) is set to revert to 6.8 percent for new loans, unless the U.S. Congress acts to prevent the increase. As a result of temporary reductions enacted in 2008, the current rate for new loans is 3.4 percent. Congress is considering extending the provision for lower interest rates for one year.

The average annual growth in student loans – 15.8 percent nationally since 2003 – has outpaced growth in all other categories of household debt. Regardless of any short-term action, the costs of higher education and student loans will have major implications for New York's economy for the foreseeable future.

Student Loans in New York

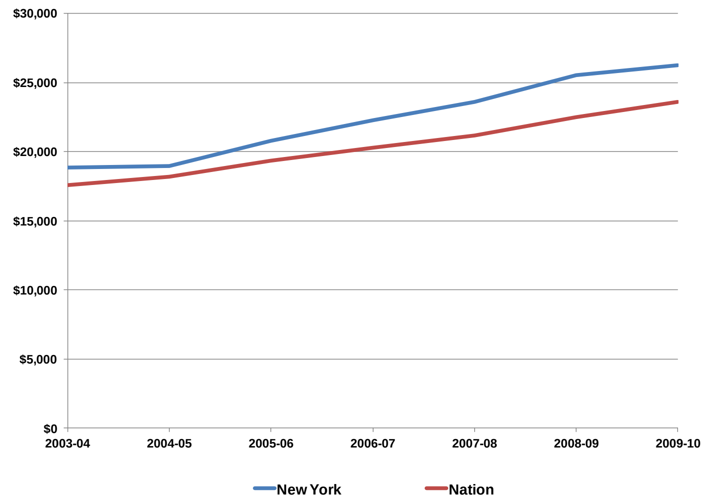
As of 2010, the average student loan debt for public and private college graduates in New York was the tenth highest in the nation, according to the Project on Student Debt.

The average New York student who graduated in 2010 with loans carried debt totaling $26,271, or 11.2 percent more than the national average.

If the 3.4 percent rate that has been in effect since July 2011 remains in effect for the coming four years, a student who took the maximum subsidized Direct Loans of $19,000 over that period would incur monthly payments of $187 after graduation, assuming a standard ten-year term. At 6.8 percent, the graduate's monthly payment would be $219, an increase of 17 percent.

The lower payment would equate to savings of $380 per year, or more than $3,800 over a standard ten-year loan term if the 3.4 percent rate remains in effect. Repayment terms and costs will vary from case to case, based on a variety of options under separate federal loan programs.

Average Cumulative Student Loan Debt for Graduates Who Borrowed to Finance College



Source: The Institute for College Access and Success

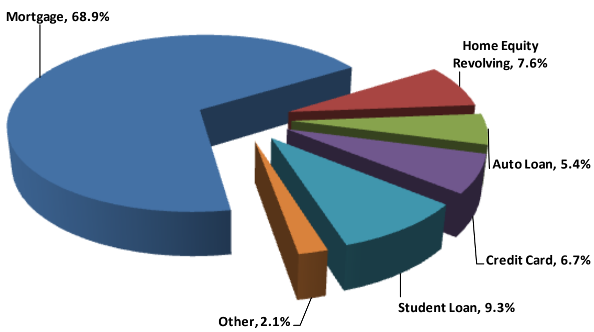
Overall, the federal government estimates the scheduled increase in the lower interest rate would affect more than 422,000 students in New York, with estimated loans of approximately $1.7 billion in the coming year.

Student loans are big business in New York. As of the first quarter of 2012, outstanding student loan debt for New York residents totaled $66.8 billion, according to data from the Federal Reserve Bank of New York. This figure is derived from data on credit reports and thus excludes some borrowers, so the actual total in New York is likely to be higher. Among the roughly 14 million State residents whose credit histories are captured in the Federal Reserve data, student loan debt amounted to $4,610 per capita, 11 percent higher than the national average.

Student loans in New York represent 9.3 percent of total debt for consumers with credit reports – more than credit cards, auto loans or any other category of household debt other than mortgages.

The burden of such debt is higher in New York than in other comparable states, including California (4.6 percent) and New Jersey (6.7 percent), primarily due to higher shares of mortgage debt in those states. The national share of student loan debt is 7.9 percent.

Components of Household Debt in New York 2012 Q1



Source: Federal Reserve Bank of New York

As of 2009-10, 58 percent of New York's college graduates had used federal loans to finance some portion of their education (a proportion that is similar to the national rate). Such assistance includes the subsidized Direct Loans currently under discussion in Washington, as well as other programs such as unsubsidized Direct Loans, Perkins Loans, and Parent PLUS Loans.

In the wake of the Great Recession, default rates on student loans rose by roughly a quarter from 2007 to 2009, both in New York and nationally, according to the U.S. Department of Education. In 2009, the default rate in New York was 7.1 percent. The national rate was 8.8 percent.

New York State's efforts to ameliorate the rising costs of higher education have significant budgetary implications. The State is among the national leaders in providing student aid, with grants of $1,027 per undergraduate in 2009-10 – more than 50 percent higher than the national average.

The 2012-13 State Budget includes $930 million for the Tuition Assistance Program. New York provides additional support for families with college students through the tuition tax credit, which amounts to an estimated $286 million in taxpayer savings this year.

Higher education is widely considered a key economic advantage for New York State. As of 2010, 32.1 percent of residents 25 years or older had attained a bachelor's degree or higher, compared to 27.9 percent nationally, according to the U.S. Census Bureau.

Recommendations / Policy Implications

Access to higher education is important not only to individual students and their families, but to the future of New York's economy. Rising costs for student loans depress consumers' ability to purchase new homes and make other expenditures that generate economic activity and employment.

Discussion of extending temporary, lower interest rates could be the opening to a broader debate over the issue of burgeoning student debt and the cost of higher education generally.

Economists debate whether the benefits of subsidies for higher education – including lower interest rates and various other forms of financial assistance for students – may be partially offset by increased cost inflation as colleges and universities raise tuition to capture newly available aid.

Policy makers may wish to consider steps such as:

- Exploring options for repayment terms that allow students to take advantage of current low interest rates, while discouraging loan extensions that would increase lifetime costs.
- Applying disclosure principles used in other areas of consumer debt to enhance borrowers' understanding of actual costs. Examples elsewhere include New York State's disclosure requirements for home mortgage providers, and the federal credit-card restrictions enacted in 2009.
- Re-examining fees and penalties during periods of severe economic stress. For example, default penalties are currently up to 18.5 percent of the loan's principal and interest value.