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Student Loan Relief for New Graduates

By Tess Stovall, Anne Kim and Ryan McConaghy*

With the economy still in the doldrums, new college graduates are facing the toughest job market in years. Only one in five of this year's graduates left school with a job in hand. For the majority of graduates who also have student loans—an average $23,000 of debt—the rough job market could mean a greater chance of default and damaged credit. Congress can ease the burden on struggling graduates by expanding the ability of unemployed students to temporarily postpone, or defer, their loan payments interest-free. This small boost can help recent graduates avoid default and stretch their resources while they look for that all-important first job.

THE PROBLEM

Big debts and fewer jobs for recent college graduates

College graduates face tough job prospects in the current economy.

Today's graduates are entering the shakiest job market in decades. Since the recession officially began in December 2007, 7.4 million jobs have been lost in the U.S. economy.[1] According to the National Association of Colleges and Employers, fewer than 20% of 2009 college graduates who applied for a job actually had one in hand when they graduated,[2] as opposed to more than half of those who graduated in 2007.[3] And the outlook for the Class of 2010 doesn't look much better. Employers expect a 7% drop in the number of 2010 graduates they hire compared to 2009,[4] which will add to the nearly 25% hiring drop from 2008 to 2009.[5]

Even graduates a few years out of college are struggling to find work. In August 2009, 4.7% of workers with a bachelor's degree or higher were unemployed[6]—more than double the rate in August 1999.[7] Even with signs that the economy might be stabilizing, unemployment is predicted to continue increasing to 10% through the end of 2009[8] and decline only gradually in 2010.[9]

More students are leaving school with bigger debts.

The cost of going to a public four-year university has risen 84% in the last decade.[10] Tuition, fees, and room and board at a public four-year university during the 2008-2009 school year jumped 6.5% from the previous year to a whopping $14,333.[11] For students at private schools, the average one-year cost shot up 5% over the last year to $34,132.[12]

As a result of skyrocketing costs, more students at four-year schools are taking on debt to pay for college. From 1993 to 2008, the percentage of students with student loans rose by 18 percentage points, from slightly less than half to more than two thirds.[13] On average, students with debt are leaving school owing more than $23,000,[14] compared to only $9,272 in 1993.[15]

Student loan default rates are rising and are costly to the federal government.

The repayment of student loans can be a daunting task for any recent graduate. The average graduate with $23,000 in student loans will pay approximately $260 per month during a ten-year repayment.[16] But for graduates who lose a job or can't find one in the first place, having to pay their student loan bills in addition to bills for rent, utilities and groceries can be next to impossible.

The rising unemployment rate and difficult job market have already led to higher student loan default rates. According to the Department of Education, defaults on federal student loans rose to 6.7% for the 2008 fiscal year, the highest since 1998.[17] A student loan default can damage a young person's credit for years to come, making it more expensive to get a mortgage, a car loan or other forms of credit.[18]

The student loan defaults are especially costly for the federal government. In addition to having to write off any delinquent loans that come directly from the government through the Federal Direct Loan program, the federal government also has to repay private lenders if a student defaults on their loan from the Family Federal Education Loan program (FFEL). In this program, the loan is administered through a private lender, but the government guarantees 97% of the loan if the borrower defaults.[19] Therefore as loan defaults rise, so do the costs to the government. In fiscal year 2008, the federal government made $8.5 billion worth of payments to lenders for defaulted loans in the FFEL.[20]

THE SOLUTION

Expand interest-free deferment of student loan repayments

Currently, student borrowers can apply to postpone (or "defer") their loan payments if they are unemployed or face some other hardship that would make repayment difficult.[21] For students who hold so-called "subsidized" federal loans, the federal government pays the interest that accrues on the loan during the deferment period (this is the "subsidy").[22] But for borrowers with unsubsidized federal loans or private loans, the interest that accrues during a deferment period is capitalized—i.e., added to the balance of the loan, which means that borrowers end up owing more. [23] Moreover, borrowers with private loans are not necessarily guaranteed access to an unemployment deferment, which could push some borrowers into default.

Third Way proposes to temporarily eliminate this penalty for struggling borrowers by enabling *all* student borrowers, including those with private loans, to benefit from a subsidy that covers the interest that would accrue on a loan if they qualify for an unemployment deferment. In addition, all lenders would have to set uniform standards for granting unemployment deferments to borrowers. Under this proposal, student borrowers would receive a six-month reprieve on the interest their loans that would otherwise accrue. This program would be available for two years.

This proposal would help out-of-work graduates get back on their feet.

The massive amount of debt that many graduates carry around with them after they graduate has a significant effect on their spending power. Many young people report that they delay buying a house, getting married, or having a child because of the large amount of student debt they possess.[24] This proposal would help struggling borrowers reduce their debt burden by subsidizing the interest that would otherwise be capitalized if they aren't able to get a job or become unemployed. For a graduate with $10,000 in unsubsidized federal loans and $10,000 in private loans, this proposal would save $800 in interest accrued over a six-month deferment.[25] As a result, this proposal would help to tide jobless graduates over and allow them to more easily move forward with their lives after they are able to find work.

This proposal would benefit borrowers, lenders and the federal government by lowering the student loan default rate.

Under this proposal, more borrowers would be able to avoid loan defaults, which are costly not only to the borrowers but also to lenders and the federal government. For a borrower, defaulting on a student loan can mean garnished wages, a credit score hit that lasts up to seven years, and additional loan collection fees on top of the repayment amount.[26] For private lenders, defaults mean writing off millions of dollars of unpaid private loans. In the first two quarters of 2009, Sallie Mae, the largest private student lender, wrote off $557 million for borrowers missing payments.[27] In 2008, the federal government spent $8.5 billion in payments to private lenders for defaulted student loans.[28] By investing in assistance for struggling student borrowers, this proposal would help to head off these negative consequences and reduce costs for all of these stakeholders.

THE ROLLOUT

Ideas for launching and rolling out an expanded interest-free deferment of student loan repayments

- **Hold a press conference or speech** with recent college graduates struggling to find their first job or who have been recently laid off.
- **Hold a press conference or speech** at a local college or university with soon-to-be college graduates.

CRITIQUES & RESPONSES

Expand interest-free deferment of student loans repayments

It's too expensive.

The cost of this program would go toward helping recent graduates who are unable to find a job or have recently been laid off. Rather than penalizing graduates for incurring debt while they were in school, this proposal will help those graduates while they ride out the rocky job market. This proposal is a worthwhile, up-front investment in recent graduates that seeks to limit the significant economic damage and costs associated with potential defaults.

It will encourage people to game the system and/or remain unemployed.

Not at all. The government already has unemployment deferment criteria that an applicant must meet before they are granted a deferment, and the existing deferment system has not led to gaming or manipulation. This proposal maintains the current requirements set forth by the government, which ensure that borrowers are unemployed and actively searching for a new job and applies it to private lenders. Additionally, the government subsidy is only available for six months, which is hardly a free pass to remain unemployed.

Recent graduates already receive a six-month grace period from the federal government before they are required to start repaying federal student loans. Why do they need another one?

This proposal would help those borrowers who are struggling to find a job even after the six-month grace period. As of August 2009, one-third of unemployed individuals have been looking for a job for six months or longer.[29] Additionally, it would help the borrowers who are one or two years out of college and are in the process of repaying their student loans at the time they lose their job. Simply getting through the first six months after graduating from college doesn't ensure stability in the job market. During the current economic downturn, the government needs to do all it can to help the responsible borrowers who've fallen on hard times and are having trouble making their student loan payments.

APPENDIX

Details of an expanded interest-free deferment of student loan repayments

Under this proposal, the federal government would subsidize the interest that accrues during the first six months of an unemployment deferment, with the possibility of one six-month extension, for all of the loans a student takes out during his or her time as an undergraduate. This proposal would cover all federal loans, government-guaranteed loans financed through private lenders, and private loans.

The federal government has set forth criteria that designate borrower qualifications for an unemployment deferment for Federal Direct Loans and Federal Family Education Loans and the steps the borrower needs to take to prove the unemployment status. Under the current criteria, a borrower must reapply for unemployment deferment every six months for a maximum deferment length of 36 months. Under this proposal, the existing criteria would be maintained for any borrower applying for a deferment for their Federal Direct or Federal Family Education Loans, and a borrower would have the possibility of receiving an interest subsidy for 12 of those 36 months.

Current Unemployment Deferment Criteria for the Federal Loans[30]

Maximum Length of Deferment	Frequency of Re-Application	Requirements
36 Months	Every Six Months	• Diligently seeking employment. • Registered with an employment agency. • For extension, must prove that six attempts at employment had been made in the past six months.

Private lenders would also be required to adopt the federal government's criteria to ensure that borrowers are being held to uniform standards throughout the student loan industry. Additionally, in order to be eligible for the subsidy, the borrower will need to have graduated from college in 2008 or 2009. Under this proposal, the federal government would reimburse private lenders directly for any interest that accrues on Federal Family Education Loans or private loans.

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ENDNOTES

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