New Insights Into Student Loans and Income-Based Repayment

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For many, the American Dream includes higher education, and rightfully so, considering a college degree is a requirement for a growing number of jobs. Recent figures from the U.S. Census Bureau continue to underscore the fact that college graduates have lower unemployment rates and command higher earnings than those of high school graduates (Figure 1). Obtaining a college education has a profound impact on potential unemployment rates, reducing the rate by more than 50 percent.
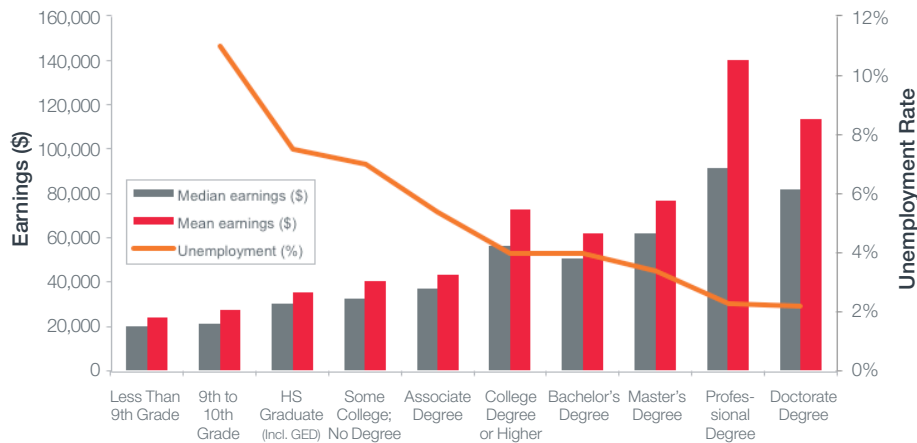
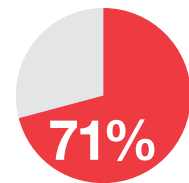A college education can reduce unemployment rates by more than

50%

FIGURE 1

Impact of Educational Attainment on Employment and Income

Source: Current Population Survey, U.S. Census Bureau, U.S. Department of Labor, U.S. Bureau of Labor Statistics, 2013
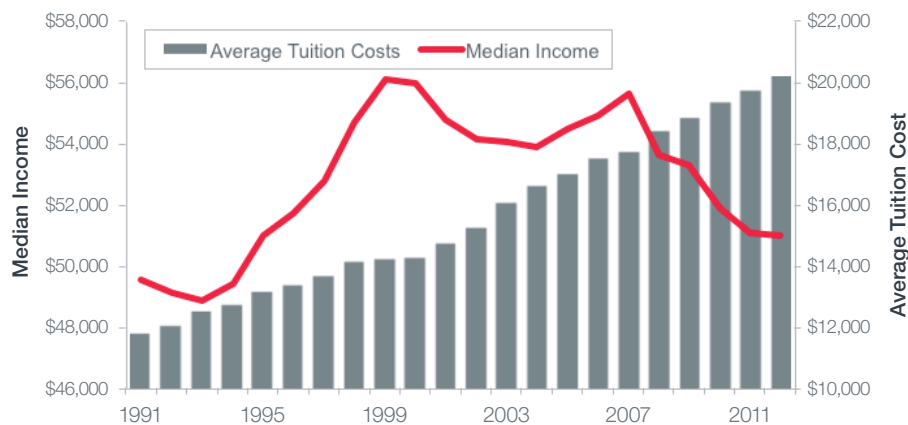
Also, based on the statistics of the U.S. Census Bureau, the inflation-adjusted income of the median American family has declined, or at best remained nearly flat, over the past 10 years. College costs on the other hand have continued their upward momentum; the average college tuition has climbed nearly $500 every year over the past 10 years (Figure 2). As such, it is no surprise that the Institute for College Access and Success reports that 71 percent of those earning a bachelor's degree graduate with student debt. It's also no secret that paying back student loans has become an issue of concern for consumers and economists alike. Politicians debate it and families stress over it. Those concerns prompted the government to propose and expand various income-based repayment programs, where the graduate's loan repayment terms are based on the borrower's adjusted gross income (AGI).

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FIGURE 2

Cost of College vs. Median Household Income (2012$)

Source: U.S. Census Bureau; National Center for Education Statistics; Equifax

New data from Equifax provides unique insight into the student loan default behavior of borrowers based on various income and employment metrics. The data, not surprisingly, reveals that the student borrowers most likely to face difficulty repaying student loans are young, have lower incomes, and shorter job tenure.

Equifax data reveals the potential impact of income-based repayment on borrower segments struggling most with student debt. Based on TheWorkNumber®, a Fair Credit Reporting Act (FCRA) compliant database, income-based repayment options could help thousands of borrowers struggling to pay back their student loans. Many young adults do not secure a high-paying job right out of college, but rather gain experience and realize an increase in income over time. Structuring loan repayments so they better match this income path would likely lead to lower student loan delinquency rates and less financial distress for many borrowers.

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The Student Loan Problem

For the 2011-2012 academic year, the average price of one year of college was $23,000 at 4-year programs overall, $16,800 at public institutions and $33,700 at private not-for-profit and for-profit institutions, according to the National Center for Education Statistics. The official three-year federal student loan cohort default rate, as reported by the Department of Education, was 13.7 percent for students who entered repayment in FY 2011, the highest rate in nearly two decades.

The sheer volume of outstanding student loans is daunting. In 2006, student loan debt made up about 15 percent of non-mortgage consumer debt, according to Equifax data. But as non-mortgage consumer debt grew after the 2009 recession (Figure 3.1), student debt growth dominated this debt segment. Fast-forward to 2015, and we find that student debt is now $1.2 trillion and the largest single contributor to non-mortgage household debt at over 35 percent, rivaled only by total auto debt (Figure 3.2).

FIGURE 3.1

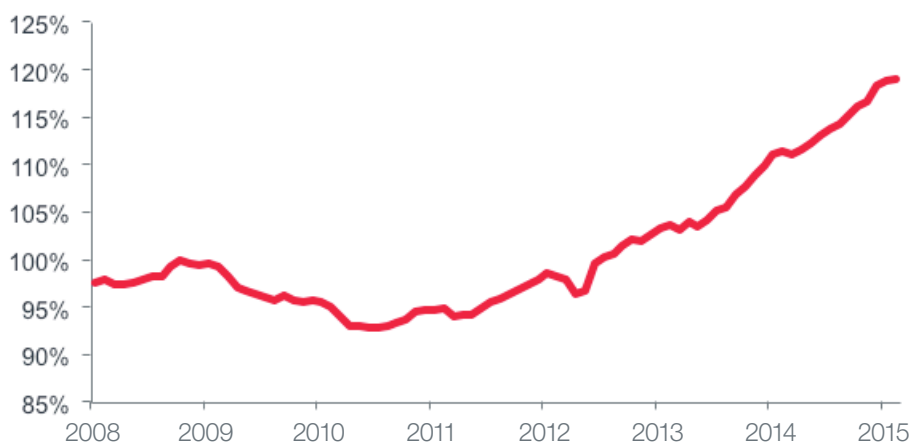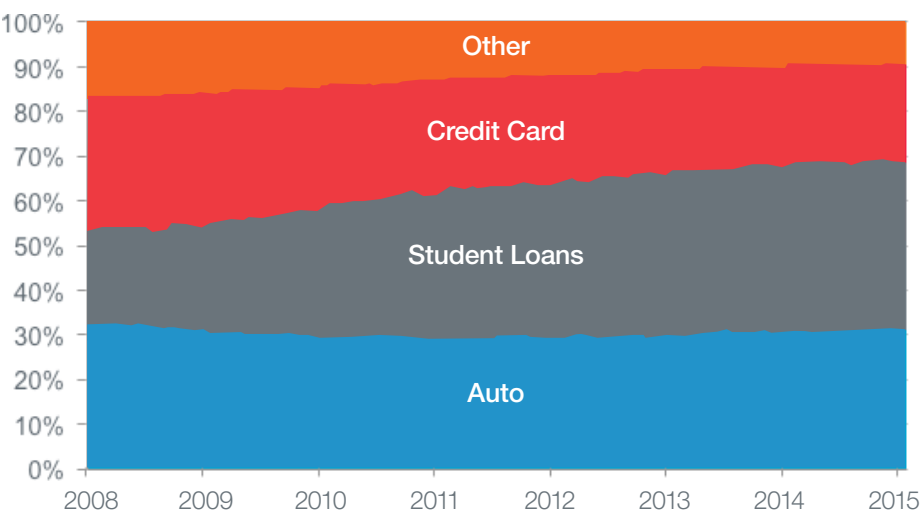## Non-Mortgage Consumer Debt
Percent of Pre-recession Peak

Source: Equifax Credit Trends data through February 2015

FIGURE 3.2

Non-Mortgage Consumer Debt

Source: Equifax Credit Trends data through February 2015

In attempting to better understand why delinquency and default rates within the student loan credit segment seem to consistently exceed those of other credit segments, we need to consider the underwriting criteria employed when debt is originated. The vast majority of student loan debt originates from the federal government. Since most forms of federal student loans are not subject to the same credit-worthiness and ability-to-repay criteria that almost all other forms of private lending are subject to, it is no surprise that student loans exhibit higher delinquency and default rates.

A recent study by the Federal Reserve Bank of New York revealed that in the 10 year period from 2004 to 2014, there was nearly an 89% increase in the number of student borrowers and a 77% increase in the average balance size. Additionally, as of 2014 only 37% of borrowers were both current on their loan and actively paying down their student debt.

Student loans can continue to affect borrowers throughout their lives, as it is extremely difficult to have student loans forgiven, even after declaring bankruptcy. The Higher Education Amendments of 1998 made student loans non-dischargeable, absent proof that the debt imposed undue hardship on the borrower.

13.7%

of students were defaulting on their loans within **three years** of graduating reported the Department of Education in late 2013
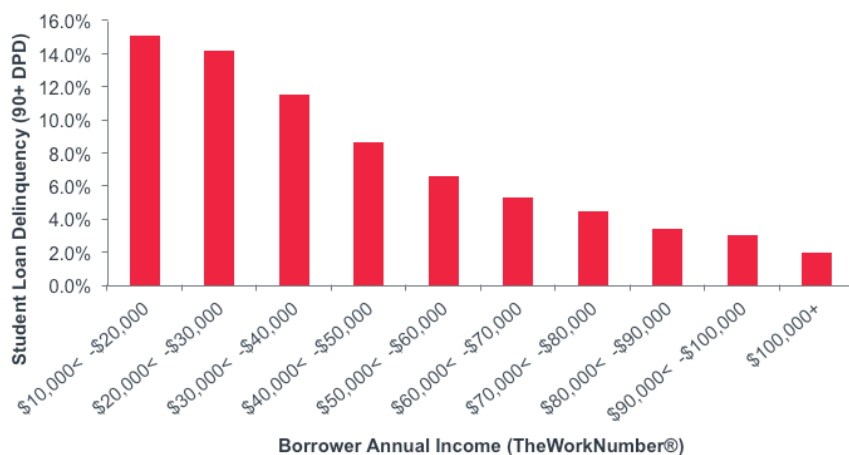
Who is Affected?

Analysis shows certain groups are more at risk of falling behind on student loans: younger borrowers, those with lower income, those with short job tenures, and hourly/part-time employees.

Equifax research shows a strong correlation between income and student loan delinquency risk (90+ days past due) (Figure 4). When taking consumers with annual incomes of less than $30,000 as a baseline (the highest risk income group), the delinquency rate is reduced by about 20 percent with each additional $10,000 in annual income.

FIGURE 4

Student Loan Delinquency by Income Band

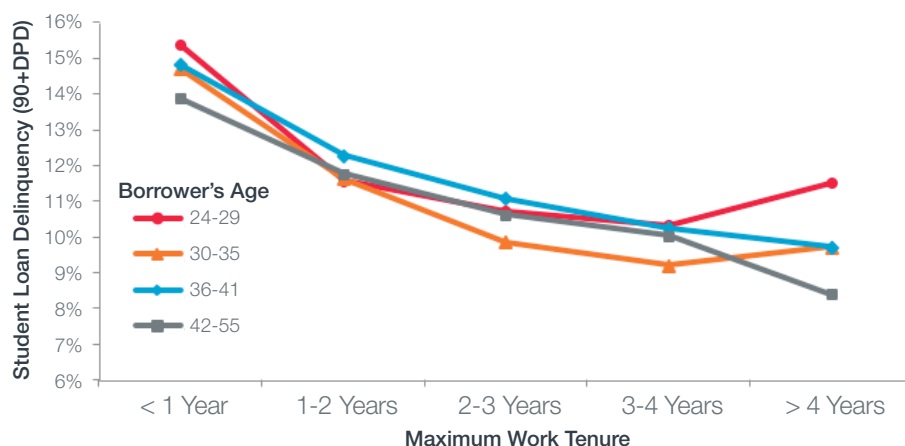
Source: Equifax Credit Trends and TheWorkNumber® income data, 2014

This rings true across all age groups, with those earning less than $30,000 suffering from triple or even quadruple the delinquency rates of their higher-earning peers within the same age group.

Similarly, consumers with shorter job tenure (higher churn) prove to be more susceptible to student loan delinquency as well (Figure 5). According to Equifax analysis, employees whose job tenure is under a year are at the highest risk of becoming delinquent on their student loans. After one year on the job, delinquency risk drops by 20 percent, and after another year it drops by an additional 10 percent. The relationship between tenure and loan delinquency holds across age groups, as shown in Figure 5.

FIGURE 5

Student Loan Delinquency by TheWorkNumber Tenure and Borrower Age

Source: Equifax Credit Trends and TheWorkNumber® employment data, 2014

Consumers with full-time (salaried) positions are more likely to stay current on their student loan payments versus part-time (hourly) workers. This could be attributed to hourly workers having a lower overall income than salaried workers as well as lower income stability across pay periods further contributing to financial stress.

A recent study by the Federal Reserve Bank of New York investigated student debt and its performance using Equifax Consumer Credit Panel data. The analysis demonstrated that borrowers with higher student debt, along with the associated increase in delinquency rates, were less likely to purchase a home and access credit (Figure 6).

Consumers with full-time (salaried) positions are more likely to stay current on their student loan payments versus part-time (hourly) workers.

The study also goes on to show that where there is student loan delinquency, there is also a much higher incidence of delinquency on other forms of credit (Figure 7).

Average Non-Student Debt Balances Among Ages 25-30 with Student Loans ($, NSA)

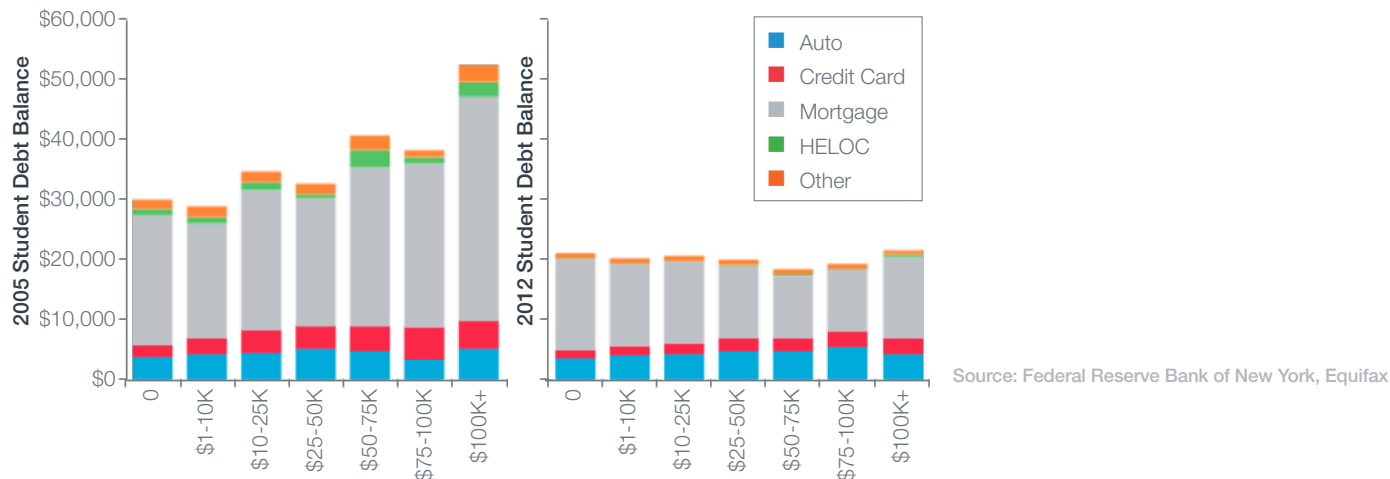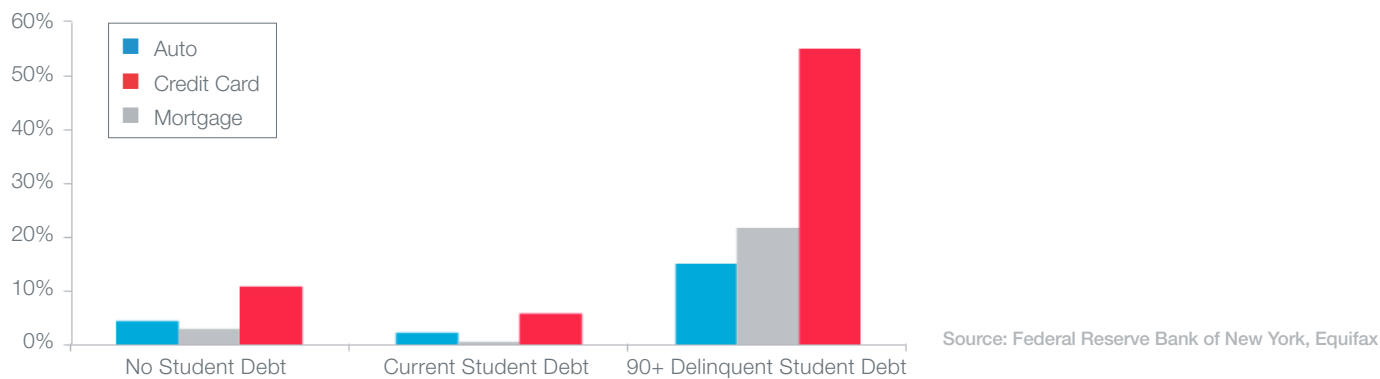Source: Federal Reserve Bank of New York, Equifax

Serious Delinquency Rate By Student Loan Status in 4Q 2013
Percent of loans in repayment 90+ days past due, NSA

Source: Federal Reserve Bank of New York, Equifax

Borrowers with higher student debt, along with the associated increase in delinquency rates, were less likely to purchase a home and access credit.

About Equifax

Equifax is a global leader in consumer, commercial and workforce information solutions that provide businesses of all sizes and consumers with insight and information they can trust. Equifax organizes and assimilates data on more than 600 million consumers and 81 million businesses worldwide. The company's significant investments in differentiated data, its expertise in advanced analytics to explore and develop new multi-source data solutions, and its leading-edge proprietary technology enable it to create and deliver unparalleled customized insights that enrich both the performance of businesses and the lives of consumers.

Headquartered in Atlanta, Equifax operates or has investments in 19 countries and is a member of Standard & Poor's (S&P) 500® Index. Its common stock is traded on the New York Stock Exchange (NYSE) under the symbol EFX. In 2013, Equifax was named a Bloomberg BusinessWeek Top 50 company, was #3 in Fortune's Most Admired list in its category, and was named to InfoWeek 500 as well as the FinTech 100. For more information, please visit www.equifax.com.

What Can Be Done?

In recent months, the Department of Education has expanded access to income-based repayment programs. Such programs allow qualified borrowers to reduce their student loan payments to a percentage of their Adjusted Gross Income.

The key deficiency in the current system is the overreliance on outdated (the prior year's) tax transcripts to qualify consumers that are already struggling with their student loan debt repayment for income based repayment options. Unfortunately, many of those borrowers have already fallen delinquent. A more proactive approach to identifying at-risk borrowers can be taken with access to payroll data. Employer-direct income and employment information can be used to provide a real-time view of a consumer's financial situation thus proactively qualify borrowers for repayment options that are more in line with their income. This type of solution may enable government entities and private lenders to help at-risk borrowers before their student loan payments becomes too cumbersome, and could potentially prevent the consumer from falling into delinquency.

Staying current on student loan payments and not biting off more than you can chew are critical to a young borrower's sound financial future. By proactively matching borrowers up with loans that won't outweigh their incomes, consumers are better equipped to manage their money and maintain better credit.

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