HB 4021 Executive Summary

Given the growth in both the cost of higher education and student loan debt over the past decade, there is growing interest among states to implement policies aimed at easing students' financial burden. Pursuant to Oregon House Bill 4021, this report studies and explores approaches for lowering interest rates on student loans for borrowers in Oregon, existing interventions aimed at student debt relief, and proposed additional policies that warrant further consideration by policymakers.

To best address student debt in Oregon, this report begins by examining underlying trends in student borrowing. Although there have been significant gains in both the cost of education and proportion of students graduating with student loan debt, data indicates that the net increase in earnings associated with education significantly outperforms the cost of a degree[1]. In fact, borrowers with the greatest student loan burdens are generally doing just fine, as borrowers' student debt amount is closely linked to their level of education[2]. Conversely, the most vulnerable populations of borrowers are among those with the lowest amounts of student loan debt, as lower levels of borrowing generally indicate drop-out status[3].

<u>Existing Student Loan Relief Programs</u>

Nearly 90 percent of outstanding student loans were made by the federal government[4]. Since 2009, the federal government has offered Income Based Repayment (IBR) plans to borrowers, capping monthly student loan payments to a percentage of the borrower's discretionary income, while extending the loan term from the standard ten years to as many as 20 or 25 years and pledging to forgive any remaining loan balance at the end of the repayment term[5]. These policy changes were made to help federal student loan borrowers better manage their monthly payments.

Creditworthy borrowers with high earning potential, such as graduates of professional schools in medicine, law, engineering and business have an ever-expanding network of competitive private sector refinance options. However, borrowers should carefully consider the tradeoffs of refinancing their federal student loans for private loans before discharging benefits associated with federal loans, including the ability to apply for deferment, forbearance, and income-based repayment and public service loan forgiveness programs. Given the competitiveness of both the federal student loan benefits and private sector refinance products, a state-sponsored student loan refinancing program would only be of added benefit to a limited segment of student loan borrowers.

<u>Launching a State-Run Refinance Program</u>

At the end of 2015 seven states had authorized pilots or legislation aimed at refinancing borrowers' student loans at reduced interest rates. Several of these state-run programs had existing student loan

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[1] Gale, William, Benjamin Harris, Bryant Renaud, and Katherine Rodihan. "Student Loans Rising: An Overview of Causes, Consequences, and Policy Options." Economic Studies at Brookings, May 2014. https://www.brookings.edu/wp-content/uploads/2016/06/student_loans_rising_gale_harris_09052014.pdf.

[2] "Report on Economic Well-Being of U.S. Households in 2015." Board of Governors of the Federal Reserve System. November 18, 2015. https://www.federalreserve.gov/econresdata/2016-economic-well-being-of-us-households-in-2015-education-debt-student-loans.htm.

[3] Kamenetz, Anya. "5 Ideas to Ease the Burden of Student Loans." NPR. June 26, 2015. http://www.npr.org/sections/ed/2015/06/26/412870161/5-ideas-to-ease-the-burden-of-student-loans.

[4] "Total Federal and Nonfederal Loans over Time." CollegeBoard. 2016. https://trends.collegeboard.org/student-aid/figures-tables/total-federal-and-nonfederal-loans-over-time

[5] "If Your Federal Student Loan Payments Are High Compared to Your Income, You May Want to Repay Your Loans under an Income-driven Repayment Plan." Federal Student Aid: Office of the U.S. Department of Education. https://studentaid.ed.gov/sa/repay-loans/understand/plans/income-driven.

finance authorities with long-standing experience in the student loan business. In contrast, the state of Oregon does not possess the same existing infrastructure and would require considerably more resources and time in order to establish a student loan bond-issuing entity. This entity would need to recruit and hire qualified staff, and would require market access to the state bonding authorities. Moreover, the new financing authority would not possess the track record or adequate loan-loss reserve needed to achieve an investment-grade credit rating. Therefore, securing a credit rating high enough to reduce student loan interest rates for Oregonians would present significant challenges[6].

Alternative State-Run Interventions

The state of Oregon does have experience managing a loan program, whose structure could be duplicated in creating a more efficient student loan refinance program. The Oregon Capital Access Program (CAP) is a small business loan program that enables small businesses and non-profit organizations, lacking collateral or the required credit profile, to gain access to lines of credit. Within this structure, private financial institution dollars are matched by the state and then allocated to a loan-loss reserve. The larger loan-loss reserve incentivizes banks to lend to a wider range of borrowers than would otherwise qualify for funding, while avoiding the need for the state to establish a loan origination and servicing infrastructure. Theoretically, the state could replicate this model for a student loan refinance program.

In addition to policies regarding student loan repayment, refinance, and forgiveness plans, policymakers also have the ability to establish policies that encourage private sector involvement through the use of tax incentives. Tax policies could be utilized in order to encourage employers to offer student loan repayment plans to their employees as part of their benefit packages. In effect, this program would mirror retirement savings policies that encourage workers to save for retirement. This type of benefit is in increasing demand; therefore, the creation of a relevant tax incentive would likely increase the utilization of this benefit by employers.

Finally, state efforts could certainly enhance, leverage, and market existing financial literacy and relief programs for Oregonian borrowers. It is estimated that 51 percent of Federal Direct Loan program borrowers are eligible for Income Based Repayment programs. However, only a small subset of eligible borrowers utilizes this program[7].

Conclusion

While student loan debt in Oregon warrants the attention of policymakers, a state-run student loan refinance program would not adequately address the student loan borrowers who are most at-risk of default. Higher levels of student debt are associated with higher earnings, as the higher tiers of student loan debt often translate into advanced degrees in fields such as medicine and law[8]. Therefore, such a program would disproportionately provide the greatest benefit to those with the largest loan balances, and consequently, higher-income households. In reviewing several policies that target the student loan burden in the state of Oregon, it is clear that to design a more effective intervention, policymakers should directly target the most vulnerable, or at-risk of default populations, and through a more efficient and cost effective mechanism, such as through the expansion of existing scholarship and grant funding in Oregon, or tax incentives for the broader student loan borrowing population.

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[6] Assuming no State subsidy.

[7] "Education Could Do More to Help Ensure Borrowers Are Aware of Repayment and Forgiveness Options." United States Government Accountability Office, August 2015. http://www.gao.gov/assets/680/672136.pdf.

[8] Chingos, Matthew. "Refinancing Outstanding Student Loans: Not as Progressive as It Seems." Brookings, March 19, 2014. https://www.brookings.edu/research/refinancing-outstanding-student-loans-not-as-progressive-as-it-seems/.