

# **Cutting Interest Rates, Lowering Student Debt Updated**

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**An Analysis of the College Cost Reduction and  
Access Act of 2007 Interest Rate Reduction**

June 2008

**U.S. PIRG**  
**Federation**  
**of State PIRGs**

## Acknowledgments

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## Executive Summary

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In 21<sup>st</sup> century America, a college education is critical for individual success and the strength of our nation. Higher education is associated with better health, greater wealth and more vibrant civic participation, as well national economic competitiveness in today's global environment. As the need for a college degree has grown, however, so has the cost of obtaining that education. The result is increased reliance on loans to pay for college.

In 2007 Congress passed the College Cost Reduction and Access Act. The bill included several provisions to lessen the burden of student debt including:

- More than two billion dollars a year in additional funding for the Pell Grant program. The Pell Grant helps more than 5 million lower-income students each year.
- A new Income-Based Repayment program that allows student loan borrowers to repay their federal loans as a percentage of their income.
- Reductions in interest rates on subsidized Stafford student loans.

About 5.5 million students borrow subsidized Stafford loans every year. Of those borrowers, nearly 3.3 million attend four-year public or private non-profit institutions. The vast majority of these borrowers come from low- and middle-income families. According to the Congressional Research Service, 75%

of traditional-aged borrowers with subsidized Stafford loans come from families with incomes below \$67,374. The median income for an American family of four is \$65,000.

### Cutting Interest Rates

The College Cost Reduction and Access Act reduces interest rates on subsidized Stafford loans for undergraduates. Loans originated during the next four years are set at fixed interest rates of 6.0% in 2008-2009, 5.6% in 2009-2010, 4.5% in 2010-2011, and 3.4% in 2011-2012. After graduation, students can consolidate their loans into one loan at the weighted average of the interest rates of their various loans. Interest rates are reset on July 1<sup>st</sup> for the following school year.

### Findings: Lower Interest Rates Will Save Students Thousands of Dollars

By lowering interest rates on subsidized Stafford loans, Congress saved college students thousands of dollars over the life of their loans. We found:

- The average four-year college student starting school in 2008 with subsidized Stafford loans will save about \$2,570 over the life of his or her loans.
- The average savings for freshmen starting school in 2008 vary slightly from state to state, ranging from \$2,820 for a student in California to \$2,340 for a student in West Virginia (Table ES-1).

**Table ES-1. States with the Highest Average Student Savings From the Interest Rate Reduction in the College Cost Reduction and Access Act of 2007**

<b>State</b>	<b>Number of Subsidized Loan Borrowers at 4-Year Institutions (2004-2005)</b>	<b>Average Subsidized Stafford Loan Debt for 4-Year Graduates*</b>	<b>Savings for the Average Student Starting School in 2008 over the Life of the Loan</b>
CA	228,489	\$15,125	\$2,820
OR	40,721	\$14,832	\$2,760
AZ	33,049	\$14,801	\$2,750
DC	16,437	\$14,611	\$2,730
MS	36,603	\$14,640	\$2,720
WA	47,631	\$14,594	\$2,720
NJ	61,221	\$14,367	\$2,670
HI	8,752	\$14,321	\$2,660
SC	48,433	\$14,301	\$2,660
NY	243,696	\$14,276	\$2,660

*\*This is the average subsidized Stafford loan debt for borrowers, not their total average debt. Most borrowers with subsidized Stafford loans also take out other student loans.*

## Introduction

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In America, a college education has always served as a passport to success. As America moves to a more knowledge-based economy, a college diploma is becoming more essential than ever for even entry-level jobs.<sup>1</sup>

Higher education is equally critical for the economic, political and social health of our nation. Colleges train the corporate leaders and innovators who drive American and global businesses. They educate our nurses, teachers and public servants. They also offer opportunities for Americans of all backgrounds and thus serve as a force for fairness and equality. An educated American citizenry will continue to be critical for our nation's competitiveness in the global economy.

Despite the growing importance of higher education, many state governments have cut funding for colleges and universities over the past decade. As federal grants have grown slowly or remained stagnant, more students have had to take out larger loans to pay for college. More than two-thirds of students now borrow to pay for college, and their average debt more than doubled between 1993 and 2004.<sup>2</sup>

Student debt can affect a graduate's post-college opportunities. Many

college borrowers, for example, have too much debt to manageably repay on a starting teacher's or social worker's salary.<sup>3</sup> High student debt also can determine whether or when to buy a house, marry or start a family.<sup>4</sup> In the worst cases, high debt can lead to default, ruined credit, and wage garnishment that can take decades to resolve.

Student debt is determined by three main factors: the amount you borrow, the interest rate at which you repay your loans, and the length of the repayment period. Students taking out loans with higher interest rates end up paying more each month and more overall. Unfortunately for students, as overall loan volume has increased, so have interest rates on loans. Last summer, Congress locked in the interest rates on federal Stafford student loans at a fixed 6.8%.

In 2007 Congress passed the College Cost Reduction and Access Act. The legislation included provisions to lower interest rates on subsidized Stafford loans. This report analyzes the impact of the rate changes on students. Overall, lowering interest rates on these loans will help those most affected by rising student debt: students from low- and middle-income families.

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## Background: Stafford Student Loans

The Stafford loan began as a program for students who needed to make up the shortfall between what they could pay and the cost of going to college. To ensure that banks would offer loans to students, the federal government provided lenders two guarantees: they would always make a profit even if it meant government subsidization and the government would repay the loan in case the student defaulted. The government set an interest rate at which students would repay their loans and a guaranteed rate of return for lenders. When the student interest rate was lower than the guaranteed return rate for lenders, the government agreed to pay the difference. In addition, the government agreed to pay the interest payments on Stafford loans while the student remained in college. As college attendance and the cost of college increased during the 1970s and 1980s, Stafford loans became more common.

As part of the 1993 reauthorization of the Higher Education Act, Congress expanded the Stafford program to offer loans to all college students, regardless of demonstrated financial need. To ensure that federal subsidies remained focused on students with the greatest need, Congress called these new, non-need based Stafford loans “unsubsidized” loans, and the original Stafford loans “subsidized.” The government does *not* pay for the interest on “unsubsidized” Stafford loans while students are in school. Instead, the interest accrues and is added to the loan principal when borrowers graduate.

When a student applies for financial aid he or she fills out the Free Application

for Federal Student Aid (FAFSA), which asks for information such as family income, student savings, family size, and number of children in college. The data is used to determine the Expected Family Contribution (EFC), the amount that the student and parents are supposed to pay toward tuition and fees, as well as eligibility for federal and state grant aid. For students with an Expected Family Contribution and grant aid totaling less than the cost of attending college, federal student loans can help fill the gap.

Eligibility for subsidized Stafford loans depends not only on a family’s income but also on the cost of college. Therefore, a student from an upper income family making \$90,000 a year may be eligible for subsidized Stafford loans if he or she is attending a more expensive institution. By contrast, a student from a family making \$40,000 may not be eligible if his or her Expected Family Contribution is higher than an inexpensive college’s cost of attendance.

### **Undergraduate Subsidized Stafford Loan Borrowers**

About 5.5 million students borrow subsidized Stafford loans every year, and 3.3 million of them attend four-year public or private nonprofit institutions.<sup>5</sup> These borrowers overwhelmingly come from low- and middle-income families.

For purposes of calculating federal student aid, the government categorizes students as either “dependent” or “independent.” For dependent

students, the government expects parents to help their children pay for college and thus counts their income toward the family's expected contribution. By default, anyone under the age of 24 is considered a dependent. Independent students are 24 or older. Younger students may be considered independent only if they are a graduate or professional student, are married, have a dependent of their own, or are on active military duty, a veteran, orphan, or ward of the court until age 18. Parent unwillingness to pay for college is insufficient to be declared independent.<sup>6</sup>

### *Dependent Students*

The average family income of an undergraduate subsidized Stafford loan borrower is similar to that of the average middle class American. In 2003-2004, the median income of families with children taking out subsidized Stafford loans was \$44,000 (Table 1).<sup>7</sup> According to the Congressional Research Service, 75% of dependent borrowers with subsidized Stafford loans come from families with incomes below \$67,374.<sup>8</sup> The median income for an American family of four is \$65,000.<sup>9</sup>

**Table 1. Family Income of Dependent subsidized Stafford Student Loan Borrowers (2003-2004)**

	<b>Average Income</b>
10th percentile	\$14,553
25th percentile	\$26,353
50th percentile	\$44,681
75th percentile	\$67,373
90th percentile	\$91,468

*Source: Calculations completed by the Congressional Research Service at the request of the Committee on Education and the Workforce, December 2006.*

The spread in income is due in part to the variation in the cost of college at different types of institutions. Because private four-year institutions tend to cost more than public institutions, the median family income for subsidized Stafford borrowers is higher for those attending private colleges.

### *Independent Students*

The median income for independent students is lower than the family income of dependent students, typically because they are earlier in their careers or may be working only part time (Table 2). Independent borrowers at private four-year institutions tend to have higher family incomes.<sup>10</sup>

**Table 2. Family Income of Independent subsidized Stafford Student Loan Borrowers (2003-2004)**

	<b>Average Income</b>
10th percentile	\$3,335
25th percentile	\$8,924
50th percentile	\$19,034
75th percentile	\$32,272
90th percentile	\$51,228

*Source: Calculations completed by the Congressional Research Service at the request of the Committee on Education and the Workforce, December 2006.*

## College Cost Reduction and Access Act Interest Rate Change

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The College Cost Reduction and Access Act reduced interest rates on subsidized Stafford undergraduate loans from 2008 to 2012. Interest rates are set for the following year on July 1st.

**Table 3. Interest Rate Changes in the College Cost Reduction and Access Act**

School Year	Subsidized Stafford Loan Interest Rate
2008-09	6.0%
2009-10	5.6%
2010-11	4.5%
2011-12	3.4%

Student borrowers traditionally take out a new loan before every semester. Since the proposed legislation phases in the

interest rate cut, student borrowers will graduate with loans at a variety of interest rates. Students will be able to simplify their loan repayment by consolidating their loans into one payment, as many students do already.

The interest rate for a consolidated loan is set at the “weighted average of the interest rates on the loans being consolidated, rounded up to the nearest 1/8 of a percent and capped at 8.25%.”<sup>11</sup> Students who are already in school and would borrow for only one or two years at a lower interest rate would receive some modest benefit, while students starting school after the policy is fully phased in would receive the greatest reduction in their loan payments.

## Findings: Students Will Save Thousands of Dollars with Lower Interest Rates

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By lowering interest rates on federally-subsidized Stafford loans, Congress saved college graduates thousands of dollars over the life of their loans. Under the enacted legislation, a student borrower starting a four-year program in the fall of 2008 could take out two loans at 6.0%, two loans at 5.6%, two loans at 4.5% and two loans at 3.4% over his or her college career. Assuming that the student borrowed the same amount for each semester, he or she would be able to consolidate these loans at a

4.875% interest rate. (See the methodology for a detailed discussion.)

Students will save thousands of dollars under the interest rate reductions. Specifically:

- The average four-year college student starting school in 2008 with subsidized Stafford loans will save \$2,570 over the life of his or her loans.

See Table 4 for how these savings break down by state.

## Other Borrowing

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Most subsidized Stafford loan borrowers also will take out other loans to pay for college. These loans may include unsubsidized Stafford loans or federal Perkins loans, or less regulated “alternative” loans from private lenders. While some students will take out other loans, this policy will offer meaningful

help to students with subsidized Stafford loans. To help protect all borrowers from unmanageable debt payments, Congress should pass additional student loan reforms, including limits on the percent of income that graduates must devote to loan repayment.

## Conclusion

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About 5.5 million undergraduate borrowers took out subsidized Stafford loans in 2005-2006. Most of these borrowers came from predominately low- and middle-income families. As an effort to making college more affordable, cutting interest rates on subsidized Stafford student loans will

result in significant savings. Increasing need-based federal student aid and implementing the Income-Based Repayment program included in the College Cost Reduction and Access Act of 2007 will help make college more accessible and affordable for millions of American students.

**Table 4. Student Savings From the Interest Rate Reduction in the College Cost Reduction and Access Act of 2007: By State**

<b>State</b>	<b>Number of Subsidized Loan Borrowers at 4-Year Institutions (2004-2005)</b>	<b>Average Subsidized Stafford Loan Debt for 4-Year Graduate</b>	<b>Savings for the Average Student Starting School in 2008 over the Life of the Loan</b>
AK	5,119	\$12,854	\$2,390
AL	62,996	\$13,572	\$2,530
AR	39,385	\$13,022	\$2,420
AZ	33,049	\$14,801	\$2,750
CA	228,489	\$15,125	\$2,820
CO	45,588	\$13,455	\$2,500
CT	33,567	\$14,263	\$2,660
DC	16,437	\$14,611	\$2,720
DE	9,534	\$13,927	\$2,590
FL	125,475	\$13,663	\$2,540
GA	83,942	\$13,234	\$2,460
HI	8,752	\$14,321	\$2,660
IA	53,285	\$13,944	\$2,590
ID	26,305	\$13,221	\$2,460
IL	128,765	\$14,111	\$2,630
IN	94,267	\$12,967	\$2,410
KS	42,932	\$13,827	\$2,570
KY	46,963	\$13,026	\$2,420
LA	68,261	\$13,077	\$2,430
MA	98,990	\$13,994	\$2,600
MD	48,484	\$14,096	\$2,620
ME	21,210	\$13,173	\$2,450
MI	143,699	\$13,256	\$2,470
MN	67,468	\$13,480	\$2,510
MO	82,921	\$13,305	\$2,480
MS	36,603	\$14,640	\$2,730
MT	16,212	\$12,587	\$2,340
NC	92,244	\$13,332	\$2,480
ND	17,358	\$12,890	\$2,400
NE	28,021	\$13,248	\$2,470
NH	20,317	\$13,853	\$2,580
NJ	61,221	\$14,367	\$2,670
NM	20,899	\$12,792	\$2,380
NV	10,545	\$13,655	\$2,540

<b>State</b>	<b>Number of Subsidized Loan Borrowers at 4-Year Institutions (2004-2005)</b>	<b>Average Subsidized Stafford Loan Debt for 4-Year Graduate</b>	<b>Savings for the Average Student Starting School in 2008 over the Life of the Loan</b>
NY	243,696	\$14,276	\$2,660
OH	173,312	\$13,495	\$2,510
OK	47,528	\$13,535	\$2,520
OR	40,721	\$14,832	\$2,760
PA	211,832	\$13,866	\$2,580
RI	19,649	\$13,822	\$2,570
SC	48,433	\$14,301	\$2,660
SD	19,727	\$13,122	\$2,440
TN	67,410	\$13,886	\$2,580
TX	205,508	\$14,233	\$2,650
UT	35,000	\$12,988	\$2,420
VA	73,696	\$13,842	\$2,580
VT	13,575	\$13,671	\$2,550
WA	47,631	\$14,594	\$2,720
WI	75,905	\$13,379	\$2,490
WV	35,194	\$12,579	\$2,340
WY	3,904	\$13,836	\$2,580
<b>U.S. Average</b>	<b>3,301,841</b>	<b>\$13,821</b>	<b>\$2,570</b>

*See the Methodology section for a discussion of the data sources and calculations.*

## Methodology

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To calculate the average savings of a student borrower, we used the Economic Diversity of Colleges Database of higher education institutions (including two and four-year public and private institutions) from The Institute for College Access and Success (TICAS). The data file (available at <http://www.economicdiversity.org>) comes from five main sources from 2004-2005, four of which are compiled by the federal government.<sup>12</sup>

To calculate the per student savings under the proposed legislation for the average four-year student, we first used the TICAS data set to total all subsidized Stafford loan dollars (SSTOTC) in each state and subsidized Stafford borrowers (SSNUMC) in each state at four-year public and private schools.<sup>13</sup> We then divided state volume by state borrowers to generate the average annual subsidized Stafford loan debt for a four-year student in that state. (For convenience, we will refer to this number as “annual per student borrowing.”) We followed the same process to come up with an annual average subsidized Stafford loan debt by campus. To estimate the average four-year subsidized Stafford total loan volume of a student we multiplied average per student borrowing by 4.

In calculating this average, we grouped freshmen, sophomores, juniors, seniors and fifth-year seniors together, although loan limits on Stafford borrowing set the maximum loan for freshmen at \$2,625, for sophomores at \$3,500, and for juniors and seniors at \$5,500. Because students borrow different amounts in different school years, annual per student borrowing is not a useful way to calculate how much any individual student will borrow in a given year. By multiplying annual per student borrowing by 4, however, we provide an estimate for total per student borrowing over a four-year college career. Because the annual per student borrowing averages students from different years, it closely approximates the total borrowing of one student over a four year college career.

We calculated the expected student debt of a borrower under current law using the following formula to generate cumulative subsidized Stafford debt:

$$\frac{[\text{loan amt} * (\text{rate}/12)] * [1 + (\text{rate}/12)]^{(\# \text{ of years to repay} * 12)}}{[(1 + (\text{rate}/12))^{(\# \text{ of years to repay} * 12)} - 1]} \times (\# \text{ years to repay}) \times 12$$

In addition to the average subsidized Stafford loan debt, we assumed 6.8% fixed interest rate repayment and a 15-year repayment period, which is standard under student loan consolidation.

To calculate the savings generated for students starting school in 2008, we first calculated the average interest rate under which they would repay after graduation.

We assumed that their loan volume would remain constant over the course of their college careers. This likely underestimates the potential savings, as freshmen and sophomores have lower borrowing limits than juniors and seniors. Because the interest rate cut will be phased in, the later the borrowing in their college careers, the lower the consolidated interest rate. We use the following formula to estimate the interest rate at which a 2008 freshman would repay his or her loan.

$$\frac{(\text{loan amt.} \times 6.0\%) + (\text{loan amt.} \times 5.6\%) + (\text{loan amt.} \times 4.5\%) + (\text{loan amt.} \times 3.4\%)}{(\text{avg. loan amt.}) \times 4}$$

With loan volume remaining constant, the repayment rate for students starting school in 2008 would be 4.875%. We plugged this new interest rate into the debt formula above to calculate repayment costs over 15 years at these lower interest rates.

Our methodology does not address the fact that many students will take out other Stafford, Perkins or private student loans to pay for college. However, while those loans are necessary to assess a student's average monthly loan payments, they are not necessary to determine the savings under a lower interest rate.

## End Notes

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<sup>1</sup> Donna Desrochers, *Higher Education's Contribution to the Knowledge Economy, Solutions for Our Future Project*. Accessed June 20, 2006 at [www.solutionsforourfuture.org/site/DocServer/08.Knowledge-Economy.pdf?docID=103](http://www.solutionsforourfuture.org/site/DocServer/08.Knowledge-Economy.pdf?docID=103).

<sup>2</sup> National Center for Education Statistics (NCES), National Postsecondary Student Aid Study (NPSAS), 1993 and 2004 undergraduates, Data Analysis System (DAS); calculations by the Project on Student Debt.

<sup>3</sup> Luke Swarthout, State PIRGs' Higher Education Project, *Paying Back, Not Giving Back*, 9.

<sup>4</sup> *Ibid.*, 9.

<sup>5</sup> U.S. Department of Education, Office of Postsecondary Education, National Student Loan Data System.

<sup>6</sup> FinAid.com Glossary, accessed at <http://www.finaid.org/questions/glossary.phtml>

<sup>7</sup> Calculations completed by the Congressional Research Service at the request of the Committee on Education and the Workforce, December 2006.

<sup>8</sup> Calculations completed by the Congressional Research Service at the request of the Committee on Education and the Workforce, December 2006.

<sup>9</sup> U.S. Census Bureau, *Median Income for 4-Person Families, By State*. Accessed December 28, 2006 at <http://www.census.gov/hhes/income/4person.html>.

<sup>10</sup> Calculations completed by the Congressional Research Service at the request of the Committee on Education and the Workforce, December 2006.

<sup>11</sup> Finaid.com, *Student Loan Consolidation*. Accessed January 2, 2007 at <http://www.finaid.org/loans/consolidation.phtml>.

<sup>12</sup> The Institute for College Access and Success, *Sources*. Accessed December 13, 2006 at <http://www.economicdiversity.org/sources.php>.

<sup>13</sup> The Institute for College Access and Success, *Code Book*. Accessed December 13, 2006 at [http://www.economicdiversity.org/economic\\_diversity\\_codebook.pdf](http://www.economicdiversity.org/economic_diversity_codebook.pdf).