

# What is Gainful Employment? What is Affordable Debt?

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## EXECUTIVE SUMMARY

The Higher Education Act of 1965 requires for-profit colleges to provide “an eligible program of training to prepare students for gainful employment in a recognized occupation” but does not currently define gainful employment.

During negotiated rulemaking for Higher Education 2009-10, the US Department of Education proposed defining gainful employment by establishing an 8% debt-service-to-income threshold based on median student debt for recent college graduates with income based either on Bureau of Labor Statistics 25<sup>th</sup> percentile wage data or actual earnings of the college’s graduates. Loan payments would be based on the standard 10-year repayment plan for the unsubsidized Stafford loan program. For programs that failed to satisfy this standard, the US Department of Education proposed an alternative that requires a loan repayment rate for recent college graduates of 90%. The loan repayment rate measures the percentage of borrowers actively repaying their loans. It is a dual to the default rate, but includes borrowers who are delinquent, in an economic hardship deferment or in forbearance along with borrowers who are in default.

These proposals contain several flaws:

- The 8% debt-service-to-income threshold is so strict that it would preclude for-profit colleges from offering Bachelor’s degree programs. It would also eliminate many Associate’s degree programs at for-profit colleges. Even non-profit colleges would find it difficult to satisfy this standard if they were subjected to it.
- The 90% loan repayment rate would be the equivalent of requiring colleges to have a two-year cohort default rate of less than 2.3% for students who graduated. This loan repayment rate is unattainable for most colleges (not just for-profit colleges) as it represents a much harsher standard than the current cohort default rate requirements.
- The thresholds are based on median debt at graduation, meaning that half the students will have debt above the threshold. Affordability cutoffs should be based on excessive debt, such as cumulative debt above the 90<sup>th</sup> percentile.
- The proposed use of Bureau of Labor Statistics wage data is biased toward lower income data and is biased against Bachelor degree programs because of an “averaging down” effect. The use of this data will disproportionately harm minority and female students because a Bachelor’s degree conveys a greater increase in earnings for these students even though the median income is lower

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<sup>1</sup> Added discussion of section 494C of the Higher Education Act of 1965.

than for White and male students. The lack of regional adjustments would discriminate against colleges located in states with lower average income and higher unemployment rates.

- The proposed linking of programs with specific occupations precludes for-profit colleges from offering programs in the liberal arts or fields of study that are not career-specific.
- The loan repayment rate calculations count borrowers in income-contingent and income-based repayment as though they are actively repaying their loans even though roughly half are making a zero monthly payment.
- The proposals would apply the requirements for affordable debt only on graduates from for-profit colleges. If it is Congress's intent to limit debt by college graduates, similar standards should also be applied to non-profit and public colleges.
- The debt-service-to-income threshold effectively establishes borrowing limits based on field of study and degree program, but does not give the colleges the controls needed to enforce these limits. Current subregulatory guidance precludes colleges from establishing lower loan limits.

In addition, the proposals focus exclusively on affordable debt for the definition of gainful employment. They fail to consider other reasons for pursuing a college education, such as lower unemployment rates, more job prospects and greater job security. Benchmarking increases in income against median income for high school graduates fails to consider the zero income of someone who is unemployed. Having any job is better than no job, and a college education makes it easier to find a job, not just a better-paying job.

## **RECOMMENDATIONS**

Most of the flaws in the US Department of Education's proposals can be corrected by adjusting the thresholds. Possibilities include:

- Increasing the debt-service-to-income threshold from 8% to somewhere between 10% and 15%. Default rates start rising sharply at about 13% of income. A debt-service-to-income threshold of 13.8% corresponds to the rule of thumb that students should not borrow more for their entire education than their expected starting salary. Thus 13.8% seems like an appropriate threshold.
- Increasing the loan term in the loan payment calculation from 10 years to 20 years.
- Switching from a percentage of gross income to a percentage of discretionary income, such as 20% of discretionary income, where discretionary income is defined as the amount by which adjusted gross income exceeds 150% of the poverty line.
- Changing the loan repayment rate threshold for recent graduates from 90% to 75%.<sup>2</sup>

The US Department of Education should also consider how to treat unemployment rates in the definition of gainful employment.

Because of the interactions with cohort default rates and the 90/10 rule, the definition of gainful employment should not be proposed in isolation, but rather as part of a comprehensive and coordinated policy. Such a policy might require some statutory changes, so perhaps the US Department of Education should hold off on defining gainful employment as part of the negotiated rulemaking and instead propose a comprehensive suite of statutory changes. Congress should consider whether the affordability

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<sup>2</sup> Even with such a change, medical schools would fail to satisfy the loan repayment rate because medical students routinely use the economic hardship deferment and forbearances during residencies and internships.

restrictions should continue to single out for-profit colleges or whether they should apply to all colleges, including public, non-profit and for-profit institutions.

## INTRODUCTION

Sections 101(b)(1), 102(b)(1)(A)(i) and 102(c)(1)(A) of the Higher Education Act of 1965 require proprietary and vocational colleges to provide “an eligible program of training to prepare students for *gainful employment* in a recognized occupation.”<sup>3</sup> A similar requirement appears in the definition of eligible program in section 481(b)(1)(A)(i) of the Higher Education Act of 1965, which requires a minimum number of clock hours for programs of training to prepare students who have not yet received an Associate’s degree for gainful employment in a recognized occupation but which does not define gainful employment. Section 704(a) bans certain fellowship recipients for engaging in gainful employment, other than part-time employment by the college in a teaching or research assistantship.

The Higher Education Act of 1965 does not, however, define gainful employment. The regulations at 34 CFR 600.2 define the term “recognized occupation” but do not define gainful employment. The current regulations at 34 CFR 668.8(g)(1)(ii) specify the calculation of an institution’s placement rate in terms of gainful employment:

the number of students who, within 180 days of the day they received their degree, certificate, or other recognized educational credential, obtained gainful employment in the recognized occupation for which they were trained or in a related comparable recognized occupation and, on the date of this calculation, are employed, or have been employed, for at least 13 weeks following receipt of the credential from the institution.

The regulations at 34 CFR 668.8(g)(2) describe methods of documenting gainful employment as including “(i) A written statement from the student's employer; (ii) Signed copies of State or Federal income tax forms; and (iii) Written evidence of payments of Social Security taxes.” This implicitly defines gainful employment as employment that produces sufficient taxable income to require filing of a federal income tax return, namely \$9,350 for single filers under age 65 for the 2009 tax year.<sup>4</sup>

Section 494C of the Higher Education Act of 1965, concerning the functions of state review entities, was added by the Higher Education Amendments of 1992 (P.L. 102-325), the same legislation that added the gainful employment requirement. It was later repealed by the Higher Education Amendments of 1998 (P.L. 105-244) which dropped sections 494A, 494B and 494C during a revision of the program integrity provisions of Part H (later recoded as Part G) of the Higher Education Act of 1965. Despite the fact that it is no longer law, it does provide some insight into Congressional intent concerning the meaning of

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<sup>3</sup> One could argue that the statutory requirement to prepare students for gainful employment does not require that the college’s graduates be gainfully employed. But it would be difficult to demonstrate that a program provides preparation for gainful employment without examining the rate at which the program’s graduates obtain gainful employment. Still, unemployment rates may vary due to factors beyond the college’s control.

<sup>4</sup> The income thresholds at which an income tax return is required appear in Table 1-1 on page 16 of IRS Publication 17: Your Federal Income Tax (2009). However, taxpayers may elect to file a federal income tax return with lower income to claim the earned income tax credit and other refundable benefits, such as the Hope Scholarship tax credit. There’s also no floor on paying FICA taxes.

“gainful employment.”<sup>5</sup> Specifically, section 494C(d) required states to establish state standards for the review of all institutions of higher education (not just for-profit institutions) that met certain at-risk criteria. Paragraphs 494C(d)(7) and (8) specified some of the review standards that states were required to adopt:

- (7) If the stated objectives of the courses or programs of the institution are to prepare students for employment, the relationship of the tuition and fees to the remuneration that can be reasonably expected by students who complete the course or program and the relationship of the courses or programs (including the appropriateness of the length of such courses) to providing the student with quality training and useful employment in recognized occupations in the State.
- (8) Availability to students of relevant information by institutions of higher education, including –
  - (A) information relating to market and job availability for students in occupational, professional, and vocational programs; and
  - (B) information regarding the relationship of courses to specific standards necessary for State licensure in specific occupations.

These review standards did not adopt any specific formulas or thresholds, since that was left to the states, but they do suggest that Congress envisioned a framework similar to the ones proposed by the US Department of Education during negotiated rulemaking.

## **SUBSTANTIAL GAINFUL ACTIVITY**

While the term “gainful employment” is not defined in the Higher Education Act of 1965, the related term “substantial gainful activity” is defined generally in the Social Security Act at 42 USC 1382c(a)(3)(E) in terms of the services performed or earnings derived from the performance of those services:

The Commissioner of Social Security shall by regulations prescribe the criteria for determining when services performed or earnings derived from services demonstrate an individual’s ability to engage in substantial gainful activity. In determining whether an individual is able to engage in substantial gainful activity by reason of his earnings, where his disability is sufficiently severe to result in a functional limitation requiring assistance in order for him to work, there shall be excluded from such earnings an amount equal to the cost (to such individual) of any attendant care services, medical devices, equipment, prostheses, and similar items and services (not including routine drugs or routine medical services unless such drugs or services are necessary for the control of the disabling condition) which are necessary (as determined by the Commissioner of Social Security in regulations) for that purpose, whether or not such assistance is also needed to enable him to carry out his normal daily functions; except that the amounts to be excluded shall be subject to such reasonable limits as the Commissioner of Social Security may prescribe. Notwithstanding the provisions of subparagraph (B), an individual whose services or earnings meet such criteria shall be found not to be disabled. The Commissioner of Social

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<sup>5</sup> One could also argue that the removal of these provisions signaled a change in Congressional intent.

Security shall make determinations under this subchapter with respect to substantial gainful activity, without regard to the legality of the activity.

Although the Social Security Act does not define gainful employment, it does mention it as part of the definition of “child” with regard to training to prepare for gainful employment at 42 USC 1382c(c)(2).

The Social Security Administration regulations at 20 CFR 416.972 define substantial gainful activity as work that “involves doing significant physical or mental activities” and which “is the kind of work usually done for pay or profit, whether or not a profit is realized.”

Substantial gainful activity is work activity that is both substantial and gainful.

(a) *Substantial work activity.* Substantial work activity is work activity that involves doing significant physical or mental activities. The claimant's work may be substantial even if it is done on a part-time basis or if the claimant does less, gets paid less, or has less responsibility than when the claimant worked before.

(b) *Gainful work activity.* Gainful work activity is work activity that the claimant does for pay or profit. Work activity is gainful if it is the kind of work usually done for pay or profit, whether or not a profit is realized.

(c) *Some other activities.* Generally, the Board does not consider activities like taking care of one's self, household tasks, hobbies, therapy, school attendance, club activities, or social programs to be substantial gainful activity.

A similar definition appears in the Railroad Retirement Board regulations at 20 CFR 220.29 and 20 CFR 220.141.

The regulations at 20 CFR 416.974(a)(1) establish a rebuttable presumption of substantial gainful activity when the earnings exceed a specified dollar threshold. For 2010 this threshold is \$1,640 per month for blind individuals and \$1,000 per month for non-blind individuals after subtracting disability-related work expenses. These thresholds are indexed to increases in the national average wage index. While earning income above this threshold may be an indication of substantial gainful activity, it does not always demonstrate substantial gainful activity nor is it always required to have income above this threshold.

## **DICTIONARY DEFINITIONS**

Black's Law Dictionary succinctly defines gainful employment as “Work that a person can pursue and perform for money.”<sup>6</sup> The American Heritage Dictionary of Business Terms defines gainful employment as “Employment that is beneficial both to the employer and the employee.” The American Heritage Dictionary of the English Language, Fourth Edition, defines gainful as “Providing a gain; profitable: *gainful employment.*” The Random House dictionary defines gainful as “profitable; lucrative: *gainful employment.*” The American Edition of the Oxford English dictionary defines gainful as “1. (of employment) paid. 2. lucrative; remunerative.”

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<sup>6</sup> Bryan A. Garner, Black's Law Dictionary, 9<sup>th</sup> edition, page 545, July 1, 2009.

Thus gainful employment would appear to mean work done for pay or profit, regardless of whether a profit is realized, and that earnings above a specified threshold are presumed to represent gainful employment. This is as opposed to work as part of a training program, such as an internship or co-op program, or work as a volunteer.

## **DEFINITION PROPOSED BY US DEPARTMENT OF EDUCATION**

During the negotiated rulemaking for Higher Education 2009-10, Team I – Program Integrity Issues, the US Department of Education proposed several possible definitions of gainful employment.<sup>7</sup> The proposals initially included debt-service -to-income thresholds (the relationship between student debt levels or loan payment burden of recent graduates to expected earnings) and maximum payback periods (the relationship between program costs and expected earnings). The payback period proposal was subsequently replaced with a loan repayment rate proposal (the percentage of recent borrowers who are actively repaying their loans).

The debt-service-to-income proposal would compare annual loan payments for an unsubsidized Stafford loan based on the median<sup>8</sup> student debt levels for students who graduate during the college's three most recent fiscal years<sup>9</sup> with expected earnings to determine whether the earnings are sufficient to repay the debt within 10 years of graduation "while still having an adequate amount available to meet living expenses." Expected earnings would either be based on Bureau of Labor Statistics wage data for the corresponding occupations or actual wage data gathered by the colleges. The US Department of Education initially proposed a 5% debt-to-income ratio and later revised it to 8%.<sup>10</sup>

The payback period proposal, which can also be characterized as calculating a short-term return on investment, would compare the value added by the program, namely the increase in annual salary as compared with the annual earnings of a high school graduate, with the cost of the program, requiring the cost/benefit ratio to be less than 3. This effectively would require the value added to be sufficient to repay the cost of the program in 3 years, notwithstanding tax withholdings and other mandatory income offsets.

Because data concerning starting salaries by educational attainment and program is not publicly available from the Bureau of Labor Statistics (BLS) web site,<sup>11</sup> the US Department of Education proposed to base the salary benchmarks on the corresponding first deciles of BLS wage data as a proxy for entry level salaries. (This was revised later to the first quartile.) This approach is flawed as it introduces a significant bias toward lower income data, fails to adequately address occupations that involve a salary jump a few years out of college, fails to address differences according to race and gender,<sup>12</sup> does not contemplate the

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<sup>7</sup> [www2.ed.gov/policy/highered/reg/heardrulemaking/2009/integrity.html](http://www2.ed.gov/policy/highered/reg/heardrulemaking/2009/integrity.html)

<sup>8</sup> It is unclear why the US Department of Education is using median debt levels, because by definition half a college's students will have debt above the threshold. Cutoffs on the affordability of debt should be based on a determination of excessive debt, not typical debt. Debt at the 90<sup>th</sup> percentile is a reasonable approximation of excessive debt. Perhaps the US Department of Education used median debt because it is easier to define.

<sup>9</sup> This was changed later to the three most recent award years.

<sup>10</sup> The 5% threshold appeared in the December 2009 draft. The 8% threshold appeared in the January 15, 2010 draft.

<sup>11</sup> [www.bls.gov/oes/current/oes\\_stru.htm](http://www.bls.gov/oes/current/oes_stru.htm)

<sup>12</sup> US Census Bureau data shows that income by educational attainment varies significantly according to race and sex. For example, while the median income for Black Bachelor's degree recipients is \$4,077 lower than for White Bachelor's degree recipients, the financial advantage of a Bachelor's degree over a high school diploma is \$2,546

potential for graduates to start new businesses and averages down salaries of workers with a Bachelor's degree or a more advanced degree with the salaries of workers with just a Certificate or an Associate's degree. This would make it much more difficult for Bachelor's and advance degree programs to qualify since they are necessarily more expensive due to greater program length. This approach also does not consider the impact of regional differences in cost of living on program costs and starting salaries, nor the impact of regional differences in employment rates. The linking of programs with specific occupations will preclude for-profit colleges from offering programs in the liberal arts or other fields of study that provide general training that is not career-specific. There would also be problems aligning programs on a one-to-one basis with occupations, since some programs prepare students for multiple possible careers. There is also no evidence that entry level salaries correlate with the first decile or quartile of BLS wage data, so the reasonableness of this proxy has not yet been established.

Using a three-year payback period is a bit low. Based on 2007 US Census Bureau data for income by educational attainment for age band 25-34, median earnings are \$28,380 for high school graduates, \$35,535 for Associate's degree recipients and \$42,092 for Bachelor's degree recipients. This yields a value-add of \$7,155 for Associate's degree recipients and \$13,712 for Bachelor's degree recipients. According to the 2007-08 National Postsecondary Student Aid Study (NPSAS), 90<sup>th</sup> percentile cumulative debt at graduation (including both federal and private student loans, but not Parent PLUS loans) is \$29,414 for Associate's degree recipients and \$44,490 for Bachelor's degree recipients.<sup>13</sup> Borrowing at or above the 90<sup>th</sup> percentile is a reasonable proxy for overborrowing. This yields a payback period ratio of 4.1 years for Associate's degree recipients and 3.2 years for Bachelor's degree recipients.<sup>14</sup>

The US Department of Education subsequently dropped the payback period proposal. Instead, the Department added alternative methods for a program to qualify if it did not satisfy the debt-to-income threshold. These include

- **Actual Earnings.** This method bases the debt-to-income threshold on actual (and presumably higher) earnings of the college's graduates instead of the BLS wage data.
- **Loan Repayment Rate.** This method requires demonstrating that the program has a loan repayment rate of 75%. The loan repayment rate is the percentage of student borrowers entering repayment within a three year period who are actively repaying their loans.<sup>15</sup> Borrowers in an in-

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greater for Black Bachelor's degree recipients than for White Bachelor's degree recipients. Thus the potential job prospects for minority students may represent a more compelling argument for enrollment at a for-profit college than is reflected in the Bureau of Labor Statistics wage data. Terminating programs on the basis of the Bureau of Labor Statistics data may therefore disproportionately harm minority students.

<sup>13</sup> These figures are based on cumulative debt at graduate for students at all colleges, regardless of control of institution. In effect this pegs the definition of affordable debt for students at for-profit colleges to standards based on public and non-profit colleges. For comparison, 90<sup>th</sup> percentile debt at graduation from for-profit colleges is \$34,884 for Associate's degree recipients and \$50,709 for Bachelor's degree recipients. That corresponds to payback periods of 4.9 years for Associates degree recipients and 3.7 years for Bachelor's degree recipients. The median debt at graduation for students from for-profit colleges is \$18,738 and \$32,625, respectively, corresponding to payback periods of 2.6 years and 2.4 years.

<sup>14</sup> This approach does not account for differences according to race, gender, field of study or control of institution. The payback period is shorter for Black students because a college degree confers more of an improvement in annual income even though that income is still lower than the median income for White students with college degrees.

<sup>15</sup> This is similar to the performing assets ratio used to evaluate the quality of a loan portfolio.

school or military deferment at the end of the three year period are excluded from numerator and denominator. Borrowers who are delinquent, in a deferment or forbearance, or in default are not considered to be actively repaying their loans and are counted in the denominator but not the numerator. Borrowers who are in the income-contingent and income-based repayment plans are considered to be actively repaying their loans even if they are among the half of such borrowers who are making a zero monthly payment, and are counted in numerator and denominator.<sup>16</sup>

- **Completion and Job Placement Rates.** This method requires completion and job placement rates of at least 70% each, the same rates required of shorter-term programs.

The loan repayment rate threshold of 75% is a harsher standard than the current two-year cohort default rates. The loan repayment rate is the dual or opposite of the cohort default rate (i.e., counting borrowers who don't default as opposed to borrowers who default), except that it counts borrowers in an economic hardship deferment or forbearance or who are delinquent along with defaulted borrowers,<sup>17</sup> as was recommended by the Office of the Inspector General at the US Department of Education in a December 2003 audit report.<sup>18</sup> The use of a three-year moving average is roughly the equivalent of using a two-year cohort. To the extent that this repayment rate threshold is harsher than the current and pending standards for cohort default rates, it goes beyond the currently expressed intent of Congress and may anticipate possible future changes to the definition of the cohort default rate in a subsequent reauthorization of the Higher Education Act of 1965.

## **LOAN REPAYMENT RATE UNATTAINABLE BY MOST COLLEGES**

The US Department of Education later replaced the 75% loan repayment rate for all students with a 90% loan repayment rate for just the students who completed or graduated from the program. They also dropped the completion and job placement rates alternative proposal.

But this 90% threshold is still unattainable by most for-profit colleges (and even most non-profit and public colleges). The following table was obtained using the data analysis system for the Beginning Postsecondary Students Longitudinal Study (BPS:96/01). It compares six-year default rates for students who graduate with the default rates for students who drop out.<sup>19 20</sup> It demonstrates that students who

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<sup>16</sup> As of February 2009, of the 631,272 Direct Loan program borrowers in income-contingent repayment, 56% had negative amortization and 46% had a zero monthly loan payment.

<sup>17</sup> Note that borrowers who have a zero monthly payment under income-based repayment are counted as though they are actively repaying the loans. The Direct Loan servicers are also paid more for borrowers who are current (including those repaying their loans under income-based repayment with a zero monthly payment) than for borrowers who are in an economic hardship deferment or forbearance. This will probably lead to a strong preference for the use of the income-based repayment plan over the economic hardship deferment and forbearances.

<sup>18</sup> Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs, Office of the Inspector General, US Department of Education, ED-OIG/A03-C0017, December 2003. [www.ed.gov/about/offices/list/oig/auditreports/a03c0017.pdf](http://www.ed.gov/about/offices/list/oig/auditreports/a03c0017.pdf)

<sup>19</sup> The calculation involves a column lump on LOANEVDF, row lump on PRENRL2B or PRAT2B, span cat on ITNPCT or ITNPSAS, and a weight of WTD000.

<sup>20</sup> Restricting the data to students who received a Pell Grant in 1995-96 causes the default rates for public college graduates to increase to 5.6% and dropouts to 23.0% (14.0% overall), non-profit colleges to 7.5% for graduates and 21.1% for dropouts, and for-profit colleges to 25.8% for graduates and 37.1% for dropouts (30.0% overall). For two-year programs the default rates for dropouts are 28.5% at public colleges, 40.8% at non-profit colleges and

graduate have a default rate that is about one-third the default rate of students who drop out and about three-fifths of the overall default rate. This suggests that the FY2007 two-year cohort default rate for just borrowers who graduate from a for-profit college is about 6.3%. Some colleges will have better results, others worse.

BPS:96/01 6-year Default Rates	Students Who Graduate	Students Who Drop Out	Overall Default Rate
<b>Overall</b>	5.6%	16.3%	9.8%
<b>Public</b>	2.5%	13.3%	7.3%
<b>4-Year</b>	2.1%	12.4%	6.2%
<b>2-Year</b>	2.9%	14.0%	8.5%
<b>&lt; 2-Year</b>	NA	NA	9.3%
<b>Non-Profit</b>	3.3%	17.0%	7.0%
<b>4-Year</b>	3.1%	15.6%	6.3%
<b>2-Year</b>	8.1%	32.8%	17.3%
<b>&lt; 2-Year</b>	NA	NA	NA
<b>For-Profit</b>	21.0%	30.8%	24.6%
<b>4-Year</b>	NA	NA	24.8%
<b>2-Year</b>	13.4%	31.0%	21.0%
<b>&lt; 2-Year</b>	24.6%	31.7%	26.8%

But even if the cohort default rate for graduates is much lower, the delinquency, deferment and forbearance rates will put the 90% threshold out of reach for most for-profit colleges. There is no publicly available data that distinguishes delinquency, deferment and forbearance rates for students who graduate from for-profit colleges from those who drop out, but it seems reasonable to assume that they will follow similar ratios as for the default rates. According to a US Department of Education PowerPoint presentation,<sup>21</sup> as of the end of September 2009 there were 8.4 million active borrowers in the Direct Loan program,<sup>22</sup> with the following distribution:<sup>23</sup>

Direct Loan Status September 2009	Population Size	Percentage of Population
<b>In-School Deferment</b>	2,072,844	25.6%
<b>Grace Period</b>	451,706	5.6%
<b>Repayment (Including Delinquent)</b>	4,057,910	50.0%
<b>Economic Hardship Deferment</b>	968,478	11.9%
<b>Forbearance</b>	560,242	6.9%

38.5% at for-profit colleges. The default rates for graduates at two-year programs are 7.9%, 6.4% and 18.6%, respectively. This indicates that at least part of the higher default rates at for-profit colleges is due to a greater proportion of Pell Grant recipients who are more likely to drop out.

<sup>21</sup> Slide 4 of [www.ifap.ed.gov/presentations/attachments/9AdditionalLoanServicersV1.ppt](http://www.ifap.ed.gov/presentations/attachments/9AdditionalLoanServicersV1.ppt)

<sup>22</sup> Total sums to 8,111,180. The presentation may be omitting some borrowers or in error.

<sup>23</sup> The distribution seems reasonable when compared with theoretical models. For example, the average life of a loan dollar in the in-school and grace periods for the unsubsidized Stafford program, weighted by the past few years of loan volume, is about 28 months. This corresponds to 31% of overall loan program volume in an in-school or grace period status, remarkably close to the 31.2% total from this distribution.

This suggests that of the 5,586,630 borrowers in repayment, economic hardship deferment and forbearance, 72.6% are in repayment, 17.3% are in the economic hardship deferment and 10.0% are in forbearance (i.e., 27.4% in an economic hardship deferment or forbearance). An earlier US Department of Education PowerPoint presentation reports 6.6 million active borrowers in the Direct Loan program as of July 2008,<sup>24</sup> with the following distribution.

Direct Loan Status July 2008	Population Size	Percentage of Population
<b>In-School Deferment</b>	1,526,111	22.9%
<b>Grace Period</b>	352,859	5.3%
<b>Repayment (Including Delinquent)</b>	3,567,185	53.6%
<b>Economic Hardship Deferment</b>	713,705	10.7%
<b>Forbearance</b>	498,422	7.5%

Of the 4,779,312 borrowers in repayment, economic hardship deferment and forbearance, 74.6% are in repayment, 14.9% are in the economic hardship deferment and 10.4% are in forbearance (i.e., 25.4% in an economic hardship deferment or forbearance).

The FFEL program demonstrates similar statistics. For example, Fitch Ratings reported in June 2009<sup>25</sup> that in Q1 of 2009 16.77% of FFEL program borrowers were in deferments, a 1.87% increase, and 11.77% were in forbearances, a 1.18% increase. These figures sum to 28.54%. Tim Ranzetta of Student Lending Analytics reported on October 12, 2009<sup>26</sup> that 1.1 million borrowers from the FY2007 cohort were in a deferment or forbearance, roughly 33% of borrowers in repayment for that cohort.

Thus it appears that about a quarter to a third of borrowers who have entered repayment are in an economic hardship deferment or forbearance. In addition, according to the 10-Q and 10-K filings of major education lenders, about one-sixth of borrowers in repayment are delinquent on their federal education loans.<sup>27</sup> Since half of borrowers are in repayment, that suggests that 12% to 13% of borrowers in repayment, deferment or forbearance are delinquent, bringing the total who are delinquent, in a deferment or forbearance to about two-fifths. Adjusting in proportion to the default rates for just the graduated borrowers yields a loan repayment rate of less than 72%.<sup>28</sup> That suggests that a for-profit college would need to have a two-year cohort default rate for students who graduated of less than 2.3% in order to have a loan repayment rate greater than the 90% threshold.

<sup>24</sup> Slides 3 and 4 of [www.ifap.ed.gov/presentations/attachments/1208DL0208.ppt](http://www.ifap.ed.gov/presentations/attachments/1208DL0208.ppt)

<sup>25</sup> [www.reuters.com/article/idUS169561+01-Jun-2009+BW20090601](http://www.reuters.com/article/idUS169561+01-Jun-2009+BW20090601)

<sup>26</sup> [studentlendinganalytics.typepad.com/student\\_lending\\_analytics/2009/10/more-than-1-in-3-federal-student-loan-borrowers-struggling-to-make-payments.html](http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/10/more-than-1-in-3-federal-student-loan-borrowers-struggling-to-make-payments.html)

<sup>27</sup> For example, Sallie Mae's 10-K filings show delinquency rates of 17.6%, 16.5% and 16.7% for 2009, 2008 and 2007, respectively.

<sup>28</sup> Perhaps the US Department of Education should retain the original 75% repayment rate percentage after the switch to the repayment rate for students who graduated.

## WEAK JUSTIFICATION FOR THE 8% DEBT-TO-INCOME THRESHOLD

The US Department of Education justified the 8% debt-to-income threshold by stating that “Eight percent is the standard that has appeared most frequently in the literature.” This assertion is based on a single report<sup>29</sup> that is itself critical of the 8% threshold and instead suggests a 10% threshold for borrowers with median income.

The 8% threshold is not based on any measure of affordability, but rather is arbitrary and only weakly justified. The 8% threshold is based on the difference between mortgage underwriting standards for housing payments and all debt payments.<sup>30</sup> Those standards are extrema and not reflective of typical or average borrowing patterns. For example, the 2008 Consumer Expenditures Survey<sup>31</sup> demonstrates that Associate’s degree recipients spend an average of 27% of gross income on housing, including utilities and furnishings in addition to mortgage principal, interest, taxes and insurance. Bachelor’s degree recipients spend 25%. These percentages are lower than the typical mortgage underwriting standard for housing payments.

The most common standards promoted by personal finance experts are 10% and 15% of income. The loan payment calculator on the FinAid.org web site has used both the 10% and 15% standards for over a decade. For example, the calculator output for a \$20,000 unsubsidized Stafford loan (6.8% interest and a 10-year term) includes the following paragraph:

It is estimated that you will need an annual salary of at least \$27,619.20 to be able to afford to repay this loan. This estimate assumes that 10% of your gross monthly income will be devoted to repaying your student loans. This corresponds to a debt-to-income ratio of 0.7. If you use 15% of your gross monthly income to repay the loan, you will need an annual salary of only \$18,412.80, but you may experience some financial difficulty. This corresponds to a debt-to-income ratio of 1.1.

The author of this report has also promoted a rule of thumb that students should limit total borrowing for their entire education to no more than their expected starting salary.<sup>32</sup> This guideline is based on the author’s analysis of default rate statistics, finding a sharp increase in default rates when total debt exceeds adjusted gross income.<sup>33</sup> This rule of thumb is the equivalent of a 13.8% ratio of total annual student loan

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<sup>29</sup> [professionals.collegeboard.com/profdownload/pdf/06-0869.DebtPpr060420.pdf](http://professionals.collegeboard.com/profdownload/pdf/06-0869.DebtPpr060420.pdf)

<sup>30</sup> In effect, using the 8% standard would assume that home ownership is a measure of the affordability of student loan debt.

<sup>31</sup> [www.bls.gov/cex/](http://www.bls.gov/cex/)

<sup>32</sup> The author has also recommended that lenders of private student loans use a similar standard as part of their credit underwriting policies. Previously lenders did not use debt-to-income ratios when evaluating student income because a student’s current income is not predictive of their income after graduation. But a student’s major and degree program can be used to project average income for someone with the expected degree of educational attainment. Adding 25% or 50% to the result can yield a reasonable sanity check on the affordability of the student’s anticipated total debt at graduation. It makes no sense to have students graduate with more debt than they can afford to repay. This is less of an issue with federal loans, since income-based repayment pegs the loan payment to a percentage of discretionary income, but private student loans do not offer income-based repayment and might become significantly less profitable if they did.

<sup>33</sup> Using the data analysis system for the Baccalaureate and Beyond Longitudinal Study, the author found that 2.9% of borrowers default when less than 10% their gross income goes toward repaying student loan debt. This

payments to annual adjusted gross income when loan payments are based on the unsubsidized Stafford loan program (6.8% interest and a 10-year repayment term).<sup>34</sup>

The 2007 US Census Bureau data cited previously yields ratios of loan payments to income of 11.4% for Associate's degrees and 14.6% for Bachelor's degrees at the 90<sup>th</sup> percentile. The ratios for median debt<sup>35</sup> are 3.9% for Associate's degrees and 6.6% for Bachelor's degrees. For 90<sup>th</sup> percentile cumulative debt at for-profit colleges, the ratios are 13.5% for Associate's degrees and 16.6% for Bachelor's degrees. For median cumulative debt at for-profit colleges, the ratios are 7.3% for Associate's degrees and 10.7% for Bachelor's degrees.

The US Department of Education itself previously adopted a 10% of income benchmark. For example, the US Department of Education's FY1999 strategic plan<sup>36</sup> included a performance indicator that stated "The percentage of borrowers with student loan debt repayments exceeding 10% of their income will remain stable or decline over time." The background for the indicator stated that "In general it is believed that educational debt in excess of 10 percent of income will negatively affect a borrower's ability to repay his or her student loan and to obtain other credit."

The income-contingent repayment plan bases the monthly loan payment on 20% of discretionary income, where discretionary income is defined as the amount by which adjusted gross income (AGI) exceeds 100% of the poverty line. The income-based repayment plan bases the monthly loan payment on 15% of discretionary income, where discretionary income is defined as the amount by which AGI exceeds 150% of the poverty line. Borrowers are eligible for income-based repayment when the monthly loan payment under income-based repayment is less than the payment under standard (10-year) repayment. For most borrowers who qualify for income-based repayment,<sup>37</sup> 15% of discretionary income is the equivalent of less than 10% of AGI. President Obama's FY2011 budget proposal would change income-based repayment to base the monthly payment on 10% of discretionary income.

## **POTENTIAL IMPACT OF AFFORDABLE DEBT RESTRICTIONS ON COLLEGES**

The following chart demonstrates that students who graduate with Bachelor's degrees from for-profit colleges have greater cumulative debt than Bachelor's degree recipients from public and non-profit colleges. (The chart excludes Bachelor's degree recipients who graduate with no debt. Overall, 34.4% of Bachelor's degree recipients graduate with no debt, with 38.3% at public colleges graduating with no debt, 29.5% at non-profit colleges and only 3.9% at for-profit colleges.) As a result, for-profit colleges are more likely to be affected by any restrictions on affordable debt.

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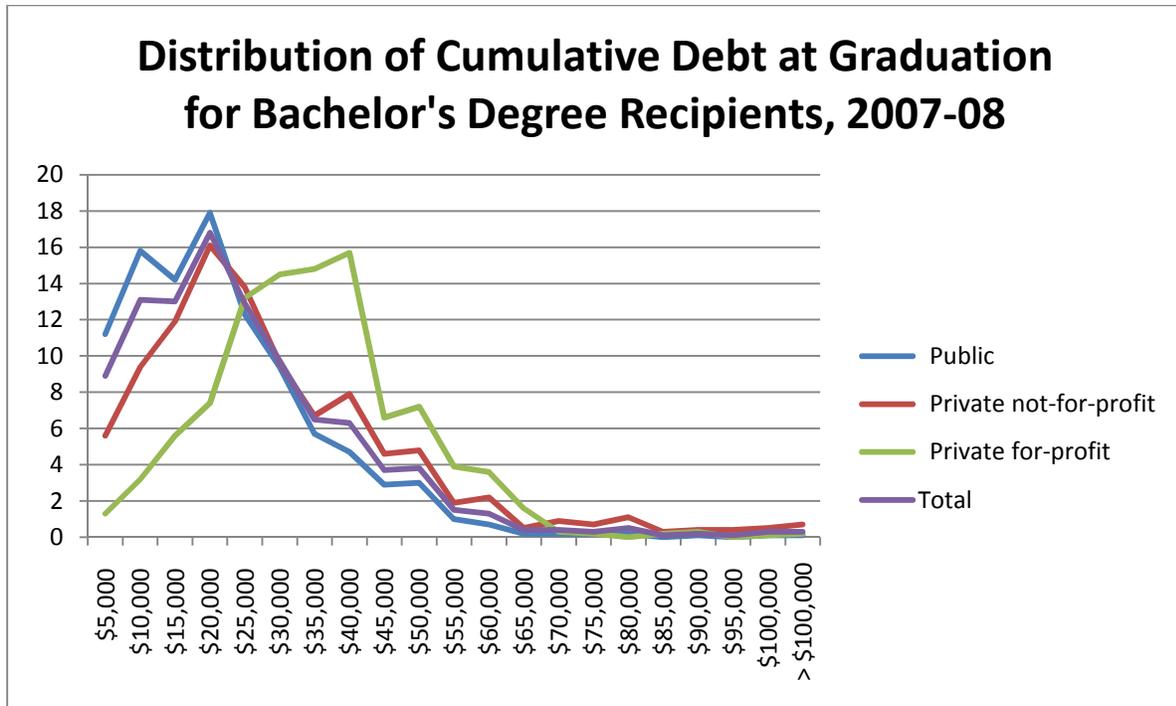
increases to 5.6% when the loan payments are 10% to 13% of gross income and to 14.3% when loan payments are 13% to 15% of gross income.

<sup>34</sup> The ratio is 9.2% for unsubsidized Stafford loans on a 20-year term. For private student loans it can be as much as 21.6% on a 10 year term and 18.5% on a 20 year term, although 15.9% and 11.6% would be more typical.

<sup>35</sup> Median cumulative debt at graduation is \$10,000 for an Associate's degree and \$19,999 for a Bachelor's degree.

<sup>36</sup> [www2.ed.gov/pubs/AnnualPlan/obj3-2.html](http://www2.ed.gov/pubs/AnnualPlan/obj3-2.html)

<sup>37</sup> AGI less than 450% of the Poverty Line and student loan debt greater than AGI.



### POTENTIAL IMPACT OF DEBT-TO-INCOME THRESHOLDS ON COLLEGES

Let's examine the potential impact of the 8% threshold on colleges by reversing the calculations to yield limits on debt at graduation. The following table uses 2007 US Census Bureau data for median income figures for Associate's and Bachelor's degree recipients age 25-34 to calculate the monthly loan payment based on the 8% threshold.<sup>38</sup> This, in turn, is used to calculate the equivalent loan balances on an unsubsidized Stafford loan. These loan balances can be used to calculate the percentage of college graduates<sup>39</sup> who graduate with less debt based on the 2007-08 National Postsecondary Student Aid Study (NPSAS). While the percentage of graduates does not indicate the number of colleges that will be able to satisfy the 8% threshold on median debt of recent graduates, if the percentage of students is much less than 50% it suggests that most colleges will experience difficulty in reaching the 8% threshold. Even if the percentage of students is close to 50% many colleges will experience difficulty in reaching the 8% threshold because debt at graduation is not distributed uniformly across colleges.

<sup>38</sup> This is a closer approximation to starting salaries for recent college graduates than the BLS data, but the Census Bureau data is not disaggregated by field of study. It also assumes that college graduates are mostly traditional students, even though a significant percentage of college students at for-profit colleges are non-traditional independent students.

<sup>39</sup> International students are excluded.

2007-08 NPSAS Implications of 8% Debt-to-Income Threshold	Associate's Degree	Bachelor's Degree
<b>Median Income</b>	\$35,535	\$42,092
<b>Monthly Loan Payment at 8% of Income</b>	\$236.90	\$280.61
<b>Equivalent Loan Balance (6.8%, 10 year)</b>	\$20,586	\$24,384
<b>Percentage of Graduates with Less Debt</b>		
<b>For-Profit Colleges</b>	60.4%	28.2%
<b>Non-Profit Colleges</b>	62.4%	54.1%
<b>Public Colleges</b>	87.2%	68.7%

The low percentage for Bachelor's degree recipients at for-profit colleges suggests that the 8% threshold, if implemented, would eliminate all Bachelor's degree programs at for-profit colleges. While the situation is less dire for Associate's degree programs at for-profit colleges, the 8% threshold is still likely to eliminate many such programs. If non-profit colleges were subjected to the same restrictions, many Associate's and Bachelor's degree programs at non-profit colleges would not be able to satisfy this standard. This suggests that the 8% threshold is too harsh.

There are several possible alternatives, such as a higher threshold, increasing the repayment term of the benchmark loans and switching to a percentage of discretionary income instead of a percentage of gross income. Establishing limits based on affordable debt seems like a good approach, so long as the thresholds are reasonable, but the currently proposed 8% threshold seems to be a bit too harsh.

The following tables explore the implications of using a 10% or a 15% threshold, showing that these percentages aren't as harsh as the 8% threshold, and that a threshold somewhere between 10% and 15% would be less likely to eliminate Bachelor's degree programs at all for-profit colleges.

2007-08 NPSAS Implications of 10% Debt-to-Income Threshold	Associate's Degree	Bachelor's Degree
<b>Median Income</b>	\$35,535	\$42,092
<b>Monthly Loan Payment at 10% of Income</b>	\$296.13	\$350.77
<b>Equivalent Loan Balance (6.8%, 10 year)</b>	\$25,732	\$30,480
<b>Percentage of Graduates with Less Debt</b>		
<b>For-Profit Colleges</b>	73.6%	45.1%
<b>Non-Profit Colleges</b>	74.2%	66.8%
<b>Public Colleges</b>	92.6%	81.6%

2007-08 NPSAS Implications of 15% Debt-to-Income Threshold	Associate's Degree	Bachelor's Degree
<b>Median Income</b>	\$35,535	\$42,092
<b>Monthly Loan Payment at 15% of Income</b>	\$444.19	\$526.15
<b>Equivalent Loan Balance (6.8%, 10 year)</b>	\$38,598	\$45,720
<b>Percentage of Graduates with Less Debt</b>		
<b>For-Profit Colleges</b>	93.3%	84.0%
<b>Non-Profit Colleges</b>	91.0%	86.0%
<b>Public Colleges</b>	97.6%	94.6%

The following table explores the implications of using the 8% threshold with a 20-year extended repayment term, demonstrating that this would yield a reasonable result.

<b>2007-08 NPSAS Implications of 20-Year Repayment Term</b>	<b>Associate's Degree</b>	<b>Bachelor's Degree</b>
<b>Median Income</b>	\$35,535	\$42,092
<b>Monthly Loan Payment at 8% of Income</b>	\$236.90	\$280.61
<b>Equivalent Loan Balance (6.8%, 20 year)</b>	\$31,035	\$36,761
<b>Percentage of Graduates with Less Debt</b>		
<b>For-Profit Colleges</b>	85.2%	63.6%
<b>Non-Profit Colleges</b>	86.2%	75.2%
<b>Public Colleges</b>	95.7%	88.1%

The following table explores the implications of basing the affordable debt determination on the current definition of a partial financial hardship instead of the 8% threshold.<sup>40</sup> It appears to be somewhat less aggressive but still suffers from the problems which would have the effect of eliminating all Bachelor's degree programs at for-profit colleges. While this has the potential benefit of aligning the definition with the US Department of Education's economic interests by penalizing underperforming assets (e.g., loans repaid using income-based repayment), it still appears to be too harsh.

<b>2007-08 NPSAS Implications of Partial Financial Hardship (IBR)</b>	<b>Associate's Degree</b>	<b>Bachelor's Degree</b>
<b>Median Income</b>	\$35,535	\$42,092
<b>Monthly Loan Payment at 15% of Discretionary Income (IBR)</b>	\$241.13	\$323.09
<b>Equivalent Loan Balance (6.8%, 10 year)</b>	\$20,953	\$28,075
<b>Percentage of Graduates with Less Debt</b>		
<b>For-Profit Colleges</b>	60.4%	36.7%
<b>Non-Profit Colleges</b>	62.8%	61.9%
<b>Public Colleges</b>	87.9%	77.3%

Using 20% of discretionary income instead of 15% of discretionary income appears to address these problems. Note that even though this uses a 20% threshold, it is not the same as income-contingent repayment since it defines discretionary income as the amount by which adjusted gross income exceeds 150% of the poverty line. (Using income-contingent repayment would yield 91.1% of Associate's degree recipients and 82.3% of Bachelor's degree recipients at for-profit colleges graduating with less debt.)

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<sup>40</sup> This is partial financial hardship as currently defined, namely 15% of the amount by which adjusted gross income exceeds 150% of the poverty line, not President Obama's FY2011 budget proposal to cut the percentage to 10%.

2007-08 NPSAS Implications of 20% of Discretionary Income	Associate's Degree	Bachelor's Degree
<b>Median Income</b>	\$35,535	\$42,092
<b>Monthly Loan Payment at 20% of Discretionary Income</b>	\$321.50	\$430.78
<b>Equivalent Loan Balance (6.8%, 10 year)</b>	\$27,937	\$37,433
<b>Percentage of Graduates with Less Debt</b>		
<b>For-Profit Colleges</b>	79.0%	64.3%
<b>Non-Profit Colleges</b>	76.6%	76.0%
<b>Public Colleges</b>	93.6%	88.5%

## WHAT IS AFFORDABLE DEBT?

Affordable debt is debt that the borrower can afford to repay while still maintaining a minimal standard of living. Borrowers who are unable to repay their debt do not have an affordable amount of debt. These include borrowers in an economic hardship deferment or forbearance, borrowers who are delinquent on their debt and borrowers who have defaulted on their debt. The inability to repay the debt may be due to temporary problems, such as unemployment, or more permanent problems, such as excessive debt compared with income.<sup>41</sup>

The affordability of debt can be affected by the repayment plan. A repayment plan with a longer loan term yields a lower and more affordable monthly payment, but increases the total cost of the loan. For example, increasing the loan term on an unsubsidized Stafford loan from 10 years to 20 years cuts the monthly payment by about a third, but more than doubles the total interest paid over the life of the loan. Using extended repayment and income-based repayment can make the monthly loan payments more affordable,<sup>42</sup> but there is some concern about repayment terms that are greater than 20 years<sup>43</sup> because of the potential to affect the next generation of college students.

Affordability of education debt is usually measured through one or more of the following financial ratios:

- **Debt-Service-to-Income Ratio.** The ratio of monthly education loan payments to monthly adjusted gross income.
- **Debt-to-Income Ratio.** The ratio of total education debt to annual adjusted gross income.
- **Debt-Service-to-Discretionary-Income Ratio.** The ratio of monthly education loan payments to monthly discretionary income, where discretionary income is the excess of adjusted gross income over a basic living standard.

<sup>41</sup> Disability is a frequent cause of an inability to afford the monthly loan payments on federal and private student loans. Federal education loans provide for a discharge due to total and permanent disability. This is a harsher standard than is used for Social Security disability, meaning that some borrowers on Social Security disability are unable to afford their monthly loan payments and end up having their disability payments garnished to repay their federal education loans.

<sup>42</sup> There is some potential for moral hazard in the income-based repayment plan, since some borrowers may choose to over-borrow from the federal student loan programs because of the availability of this repayment plan. However, the low limits on the federal Stafford loan program currently preclude such over-borrowing.

<sup>43</sup> About half of borrowers who consolidated their loans in 2007 chose extended repayment with terms of 25 or 30 years, based on data reported in the prospectuses of FFELP securitizations for the largest education lenders.

The economic hardship deferment illustrates several of these ratios. A borrower will qualify for an economic hardship deferment if their loan payment under standard 10-year repayment exceeds their discretionary income and their adjusted gross income is less than 300% of the poverty line. The original definition of discretionary income was the amount by which adjusted gross income exceeds 100% of the poverty line for a family of two. Now it is the amount by which adjusted gross income exceeds 150% of the poverty line for the actual family size.

The criteria for the economic hardship deferment also previously included the 20/220 rule, which required the loan payment to exceed 20% of income. The loan payment also had to be greater than a much smaller definition of discretionary income, namely the amount by which adjusted gross income exceeds 330% (220% of 150%) of the poverty line.

With the enactment of the College Cost Reduction and Access Act of 2007, Congress added the income based repayment plan and specified eligibility in terms of a partial financial hardship. The definition of a partial financial hardship is similar to the eligibility criteria for the economic hardship deferment, but instead of requiring the loan payment under standard 10-year repayment to exceed 100% of discretionary income, it requires the loan payment to exceed only 15% of discretionary income.

There is no simple correlation between a percentage of discretionary income and a percentage of gross income, as a fixed percentage of gross income represents a larger percentage of discretionary income as income decreases. The following chart shows the relationship when adjusted gross income (AGI) is at various multiples of the poverty line. If  $p$  is the percentage of discretionary income and AGI is a multiple of  $n$  times the poverty line, then the corresponding percentage  $r$  of AGI is  $r = p (1 - 1.5/n)$ .

Adjusted Gross Income (AGI)	% of AGI at 10% of Discretionary Income	% of AGI at 15% of Discretionary Income	% of Discretionary Income at 8% of AGI	% of Discretionary Income at 10% of AGI
<b>150% Poverty Line</b>	0.0%	0.0%	NA	NA
<b>200% Poverty Line</b>	2.5%	3.8%	32.0%	40.0%
<b>250% Poverty Line</b>	4.0%	6.0%	20.0%	25.0%
<b>300% Poverty Line</b>	5.0%	7.5%	16.0%	20.0%
<b>350% Poverty Line</b>	5.7%	8.6%	14.0%	17.5%
<b>400% Poverty Line</b>	6.3%	9.4%	12.8%	16.0%
<b>450% Poverty Line</b>	6.7%	10.0%	12.0%	15.0%
<b>500% Poverty Line</b>	7.0%	10.5%	11.4%	14.3%
<b>550% Poverty Line</b>	7.3%	10.9%	11.0%	13.8%
<b>600% Poverty Line</b>	7.5%	11.3%	10.7%	13.3%
<b>650% Poverty Line</b>	7.7%	11.5%	10.4%	13.0%
<b>700% Poverty Line</b>	7.9%	11.8%	10.2%	12.7%
<b>750% Poverty Line</b>	8.0%	12.0%	10.0%	12.5%

The following tables analyze average, median and 90<sup>th</sup> percentile cumulative debt at graduation<sup>44</sup> according to degree program and control of institution, yielding estimates of the percentage of gross income and discretionary income based on the monthly loan payments for the unsubsidized Stafford loan with 10-year and 20-year repayment terms.

2007-08 NPSAS Institution Type	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation	Percentage Graduating with Debt
<b>4-Year</b>	\$22,675	\$19,750	\$43,631	67.4%
<b>Public</b>	\$19,825	\$17,250	\$39,643	62.0%
<b>Non-Profit</b>	\$27,438	\$22,376	\$50,000	71.8%
<b>For-Profit</b>	\$24,637	\$22,750	\$44,490	97.2%
<b>2-Year</b>	\$12,308	\$9,615	\$26,701	45.2%
<b>Public</b>	\$10,439	\$7,500	\$22,930	37.7%
<b>Non-Profit</b>	\$14,919	\$12,000	\$29,517	64.0%
<b>For-Profit</b>	\$17,309	\$15,625	\$31,542	97.6%
<b>Less than 2-Year</b>	\$10,179	\$8,200	\$18,602	75.0%
<b>Public</b>	\$10,321	\$6,774	\$25,437	36.1%
<b>Non-Profit</b>	\$11,111	\$7,095	\$24,250	47.5%
<b>For-Profit</b>	\$10,126	\$8,450	\$18,000	86.1%

2007-08 NPSAS Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation	Percentage Graduating with Debt
<b>Bachelor's Degree</b>	\$23,142	\$19,999	\$44,490	66.2%
<b>Public</b>	\$20,027	\$17,572	\$39,999	62.1%
<b>Non-Profit</b>	\$27,630	\$22,385	\$50,000	71.8%
<b>For-Profit</b>	\$32,919	\$32,625	\$50,704	96.2%
<b>Associate's Degree</b>	\$13,291	\$10,000	\$29,445	47.6%
<b>Public</b>	\$10,575	\$7,668	\$22,709	39.4%
<b>Non-Profit</b>	\$19,294	\$16,130	\$35,550	71.1%
<b>For-Profit</b>	\$19,681	\$18,783	\$34,884	97.9%
<b>Certificate</b>	\$11,305	\$9,000	\$22,286	63.5%
<b>Public</b>	\$9,719	\$6,625	\$24,750	32.1%
<b>Non-Profit</b>	\$15,339	\$11,000	\$38,000	51.0%
<b>For-Profit</b>	\$11,576	\$9,858	\$21,443	89.9%

<sup>44</sup> Percentiles are based on borrowers who graduate with some debt, not all students. The statistics also exclude international students since they cannot be employed in the United States.

The following table shows the monthly payments under standard 10-year repayment for the unsubsidized Stafford loan, which has a 6.8% interest rate.

2007-08 NPSAS 10-Year Stafford – Loan Payment Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation
<b>Bachelor’s Degree</b>	\$266.32	\$230.15	\$511.99
<b>Public</b>	\$230.47	\$202.22	\$460.31
<b>Non-Profit</b>	\$317.97	\$257.61	\$575.40
<b>For-Profit</b>	\$378.83	\$375.45	\$583.50
<b>Associate’s Degree</b>	\$152.95	\$115.08	\$338.85
<b>Public</b>	\$121.70	\$88.24	\$261.34
<b>Non-Profit</b>	\$222.04	\$185.62	\$409.11
<b>For-Profit</b>	\$226.49	\$216.16	\$401.45

This table shows the corresponding percentage of gross income, where gross income is based on the median income as reported in 2007 US Census Bureau data for median income by educational attainment for ages 25-34. Certificate recipients are omitted because the US Census Bureau data does not track that level of educational attainment.

2007-08 NPSAS 10-Year Stafford – % Gross Income Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation
<b>Bachelor’s Degree</b>	7.6%	6.6%	14.6%
<b>Public</b>	6.6%	5.8%	13.1%
<b>Non-Profit</b>	9.1%	7.3%	16.4%
<b>For-Profit</b>	10.8%	10.7%	16.6%
<b>Associate’s Degree</b>	5.2%	3.9%	11.4%
<b>Public</b>	4.1%	3.0%	8.8%
<b>Non-Profit</b>	7.5%	6.3%	13.8%
<b>For-Profit</b>	7.6%	7.3%	13.6%

This table shows the corresponding percentage of discretionary income, defined as the amount by which income exceeds 150% of the poverty line. A family size of 1 is assumed.

2007-08 NPSAS 10-Year Stafford – % Discret. Income Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation
<b>Bachelor’s Degree</b>	12.4%	10.7%	23.8%
<b>Public</b>	10.7%	9.4%	21.4%
<b>Non-Profit</b>	14.8%	12.0%	26.7%
<b>For-Profit</b>	17.6%	17.4%	27.1%
<b>Associate’s Degree</b>	9.5%	7.2%	21.1%
<b>Public</b>	7.6%	5.5%	16.3%
<b>Non-Profit</b>	13.8%	11.5%	25.5%
<b>For-Profit</b>	14.1%	13.4%	25.0%

The following table illustrates the total debt to income ratio. Notice how the 90<sup>th</sup> percentile cumulative debt tends to involve total education debt that exceeds total income.

2007-08 NPSAS Total Debt to Income Ratio Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation
<b>Bachelor's Degree</b>	55.0%	47.5%	105.7%
<b>Public</b>	47.6%	41.7%	95.0%
<b>Non-Profit</b>	65.6%	53.2%	118.8%
<b>For-Profit</b>	78.2%	77.5%	120.5%
<b>Associate's Degree</b>	37.4%	28.1%	82.9%
<b>Public</b>	29.8%	21.6%	63.9%
<b>Non-Profit</b>	54.3%	45.4%	100.0%
<b>For-Profit</b>	55.4%	52.9%	98.2%

While the standard 10-year repayment plan is being used as a benchmark of affordability, today most borrowers at four-year colleges, including public and non-profit colleges, opt for a longer repayment term. Among borrowers who consolidate their loans, the weighted average term is between 20 and 25 years. The following table shows the monthly payments under an extended 20-year repayment for the unsubsidized Stafford loan.

2007-08 NPSAS 20-Year Stafford – Loan Payment Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation
<b>Bachelor's Degree</b>	\$176.65	\$152.66	\$339.61
<b>Public</b>	\$152.87	\$134.13	\$305.33
<b>Non-Profit</b>	\$210.91	\$170.87	\$381.67
<b>For-Profit</b>	\$251.28	\$249.04	\$387.04
<b>Associate's Degree</b>	\$101.46	\$76.33	\$224.77
<b>Public</b>	\$80.72	\$58.53	\$173.35
<b>Non-Profit</b>	\$147.28	\$123.13	\$271.37
<b>For-Profit</b>	\$150.23	\$143.38	\$266.28

This table shows the corresponding percentage of gross income based on the 2005 Census Bureau data.

2007-08 NPSAS 20-Year Stafford – % Gross Income Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation
<b>Bachelor's Degree</b>	5.0%	4.4%	9.7%
<b>Public</b>	4.4%	3.8%	8.7%
<b>Non-Profit</b>	6.0%	4.9%	10.9%
<b>For-Profit</b>	7.2%	7.1%	11.0%
<b>Associate's Degree</b>	3.4%	2.6%	7.6%
<b>Public</b>	2.7%	2.0%	5.9%
<b>Non-Profit</b>	5.0%	4.2%	9.2%
<b>For-Profit</b>	5.1%	4.8%	9.0%

This table shows the corresponding percentage of discretionary income, defined as the amount by which income exceeds 150% of the poverty line. A family size of 1 is assumed.

2007-08 NPSAS 20-Year Stafford – % Discret. Income Degree Program / Institution Control	Average Cumulative Debt at Graduation	Median Cumulative Debt at Graduation	90 <sup>th</sup> Percentile Cumulative Debt at Graduation
<b>Bachelor’s Degree</b>	8.2%	7.1%	15.8%
<b>Public</b>	7.1%	6.2%	14.2%
<b>Non-Profit</b>	9.8%	7.9%	17.7%
<b>For-Profit</b>	11.7%	11.6%	18.0%
<b>Associate’s Degree</b>	6.3%	4.7%	14.0%
<b>Public</b>	5.0%	3.6%	10.8%
<b>Non-Profit</b>	9.2%	7.7%	16.9%
<b>For-Profit</b>	9.3%	8.9%	16.6%

## GAINFUL EMPLOYMENT IS MORE THAN JUST AFFORDABLE DEBT

The US Department of Education’s proposals are narrowly focused on affordable debt as the source of a definition of gainful employment. Both the debt-to-income ratios and the loan repayment rates are different manifestations of affordability. But students pursue a college education for a variety of reasons, not just to obtain an improvement in income. Other common reasons include:

- **Lower Unemployment Rates.** College graduates have lower unemployment rates than high school graduates, and find it easier to get jobs. According to the Bureau of Labor Statistics, the unadjusted unemployment rates in December 2009 for people age 25 and older were 10.6% for high school graduates with no college (9.7% annual), 7.0% for people with an Associate's degree (6.8% annual), and 4.7% for people with a Bachelor's degree (4.6% annual). Thus the unemployment rates for Bachelor’s degree recipients are half those of high school graduates.
- **Greater Employability.** The median income of high school graduates might not be the appropriate baseline for calculating the improvement in income, since some people go to college because they have been unable to find a job, especially in the current economic downturn. The Bureau of Labor Statistics provides wage data only for people who are employed and as such does not reflect the zero income for people who are unable to find employment in their chosen career. Many jobs require a college degree, and jobs for people with just a high school diploma are getting harder and harder to find. Someone who has been laid off might seek retraining in a new field even if that field pays less because of the better job prospects. Any job is better than no job, and a college education makes it easier to find a job, not just a better-paying job.
- **Better Job Security.** With the meltdown in the US auto industry, there's been a substantial decrease in jobs. This high level of unemployment will likely persist indefinitely. So even if there is no improvement in income, retraining for a new career may still be worthwhile.
- **More Flexibility.** Flextime and the ability to work from home (telecommute) are important to employees who want to raise a family.
- **Less Stress.** Some jobs are less stressful than others. Some people may pursue a career change for health reasons.

- **Greater Fulfillment.** Some people pursue jobs in public service, such as teaching, because they want to give back to the community. This often involves taking a substantial pay cut.
- **The Two-Body Problem.** Sometimes an employer relocates an employee's position. If this employee is married, their decision whether or not to relocate may also affect their spouse's employment and vice versa. If there are young children, the employee may be unwilling to relocate because of the potential disruption in their education and so be forced to accept a lower-paying position that does not involve relocation.
- **Personal Enrichment.** A college education is not always about the financial rewards. Some people pursue a degree in culinary arts, for example, in order to learn how to cook for their family.

## CONCLUSIONS

The US Department of Education's proposed definition for gainful employment puts for-profit colleges between a rock and a hard place. Compliance with the proposed definition of gainful employment would limit the ability of for-profit colleges to increase tuition, since increases in tuition correlate strongly with increases in federal and private student loan debt.<sup>45</sup> But increasing tuition beyond the total amount of federal student aid is the main tool available to for-profit colleges to comply with the 90/10 rule.<sup>46</sup> It will be extremely difficult for even high quality for-profit colleges to comply with both sets of rules.

The US Department of Education also appears to be using its regulatory authority to define gainful employment as a means toward remedying flaws in the definition of cohort default rates. That is a very aggressive step that goes far beyond merely interpreting and implementing Congressional intent.

The proposed regulations would penalize for-profit colleges for students taking on unaffordable debt without giving the colleges any direct controls over the borrowing by their students. Section 479A(c) of the Higher Education Act of 1965 allows colleges to reduce the loan amount on federal education loans on a case-by-case basis so long as they do not discriminate on the basis of race, national origin, religion, sex, marital status, age or disability status. However, subregulatory guidance from the US Department of Education has severely limited the ability of colleges to use this authority to limit over-borrowing by students. For example, the 2009-10 Federal Student Aid Handbook states on page 3-94: "... note that your school cannot engage in a practice of certifying Stafford loans only in the amount needed to cover the school charges, or to limit unsubsidized Stafford borrowing by independent students." In effect, the US Department of Education's proposed definition of gainful employment would establish field of study and program-specific limits on borrowing without giving colleges the controls needed to enforce those limits.

Rather than tackle the problems with the 90/10 rule and cohort default rates piecemeal as part of the process of defining gainful employment, perhaps it would be better to develop a comprehensive and coordinated policy. The potential impacts of the policy changes should be evaluated in advance, instead

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<sup>45</sup> In effect, the proposed definition of gainful employment represents a kind of implicit price control since affordable debt restrictions translate into caps on the average cumulative debt at graduation, and that in turn limits the amount a college can charge for tuition since there are limits on the amount of non-debt resources available to students to pay the college bills. Establishing indirect price controls is a bold move by the US Department of Education.

<sup>46</sup> The 90/10 rule requires for-profit colleges to obtain no more than 90% of their revenues from federal student aid.

of being based on a few hasty and messy back-of-the-envelope calculations. The evaluation process should not only consider the potential impact on colleges and programs, but also on students, especially low-income, minority, first generation and other at-risk populations. These issues are complicated and should be explored carefully with sufficient time to evaluate them against all available data. The consequences of these policy changes should be explored thoroughly to ensure that the right policies are established.

There are many questions that should be answered as part of a complete policy concerning for-profit colleges. For example:

*Should the repayment rate threshold supplement or replace the cohort default rate?*

*Should the debt service to income ratio supplement or replace the 90/10 rule? What are the appropriate thresholds?*

*Is a percentage of AGI most appropriate, or would a percentage of discretionary income be better?*

*What is the relationship between gainful employment, partial financial hardship and the economic hardship deferment?*

*Should these rules apply to all colleges, or just for-profit colleges?*

*Is standard 10-year repayment the proper benchmark, or should the benchmark reflect current borrower practice in spreading out repayment over longer terms?*

*How should the definition of gainful employment address students who pursue more advanced degrees, such as medical school students?*

*Is the 25<sup>th</sup> percentile of Bureau of Labor Statistics wage data an appropriate proxy for the entry level salaries of recent college graduates?*

*Should the definition of gainful employment be implemented by requiring additional disclosures for for-profit colleges instead of or in addition to a set of restrictions?*

*How well do the proposed rules separate the wheat from the chaff?*

The negotiated rulemaking does not appear to have answered any of these questions.

Since addressing changes in the 90/10 rule and cohort default rates is a Congressional prerogative,<sup>47</sup> perhaps the US Department of Education should hold off on issuing new regulations to define gainful employment at this time and instead recommend a comprehensive suite of statutory changes.

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<sup>47</sup> For example, conflicts between the definition of gainful employment and the 90/10 rule might require a repeal or modification of the 90/10 rule, something that is clearly beyond the US Department of Education's authority.