



OLR RESEARCH REPORT

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STUDENT AID PROVISIONS OF FEDERAL DEBT AGREEMENT

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You asked for a description of the changes to federal student aid made in the debt ceiling agreement (Public Law 112-25, the Budget Control Act of 2011). You also asked (1) how the changes would impact students at UConn and the Connecticut State University System (CSUS) and (2) for program-specific effects.

SUMMARY

The Budget Control Act prohibits graduate and professional students from receiving subsidized federal student loans (known as Stafford loans) on and after July 1, 2012. It also eliminates certain loan repayment incentives for both graduate and undergraduate loans. The Congressional Budget Office estimates that these changes will reduce direct federal spending by \$21.6 billion between 2012-2021 and that \$125 billion in loan volume will be shifted from subsidized to unsubsidized loans. The act also provides an additional \$17 billion for Pell Grant Funding, with \$10 billion in FY 12 and \$7 billion in FY 13.

The act increases borrowing costs for graduate students who would have otherwise received subsidized loans, but the amount of additional costs depends on several factors, including the value of the loan, its interest rate, the number of months a student defers repayment, and the terms of the repayment plan. CSUS reports that, in the 2010-2011 year, 34.5% of its graduate students received subsidized Stafford loans. We have not yet received this information from UConn but will update the report when we do.

We do not have program-specific data for CSUS, but national data from the U.S. Department of Education (DOE) shows that borrowing rates and amounts vary by program. Students in health, medicine, and law borrow the most while students in non-education Ph.D. programs borrow the least.

STUDENT LOANS

Subsidized Stafford Loans for Graduate Students Eliminated

The act prohibits graduate and professional students from receiving subsidized Stafford loans on or after July 1, 2012. Subsidized loans remain available to non-degree students enrolled in (1) programs necessary for a state teaching credential or certification and (2) up to one year of prerequisite courses for an eligible graduate program (e.g., a post-baccalaureate, pre-med program).

The primary benefit of a subsidized loan is that the federal government pays interest on the loan while the borrower is enrolled in school, the first six months after leaving school, and during deferment periods (such as a deferment for unemployment). With an unsubsidized loan, the borrower is responsible for interest that accrues during these periods. The borrower is not required to pay the interest while in school, but any accrued interest is capitalized (added to the loan's principal balance) once he or she graduates or separates from the institution.

Graduate and professional students remain eligible for the same amount of Stafford loans (generally up to \$20,500 per year with a lifetime maximum of \$138,500; for students in health profession fields these totals are \$40,500 and \$224,000, respectively). But under the act, all of the aid will be in the form of an unsubsidized loan, rather than split between subsidized and unsubsidized loans. Before the act, students could accrue \$8,500 in subsidized Stafford loans per year up to a lifetime maximum of \$65,500.

The act does not affect in-school deferments of graduate and professional students' undergraduate loans. If a graduate or professional student defers a subsidized undergraduate Stafford loan, the government would continue paying the interest on that loan during the deferment period.

Repayment Incentives Eliminated

The act also eliminates certain repayment incentives for graduate and undergraduate student loans disbursed on or after July 1, 2012. Borrowers of both subsidized and unsubsidized Stafford loans are charged a 1% loan origination fee but currently receive an up-front rebate for half of that amount (0.5%). Another federal loan, the PLUS loan (an unsubsidized loan available to parents and graduate students), has an origination fee of 4% and an up-front rebate of 1.5%. Both loans allow the borrower to keep the rebate if he or she makes the first 12 payments on time. The act eliminates these rebates.

The act maintains the current quarter point interest rate reduction for borrowers who have payments automatically debited from a bank account.

EFFECT OF LOST SUBSIDY

The effect of the lost subsidy depends on several factors, including the value of the loan, its interest rate, the number of months a student defers repayment, and the terms of the repayment plan.

Graduate and professional student Stafford loans have a fixed interest rate of 6.8%. Federal loans use simple (rather than compound) interest and are not capitalized until the borrower enters repayment. At this rate, interest accrues at a monthly rate of approximately \$5.67 per \$1,000 borrowed. For a student who borrows \$8,500 (the annual subsidized loan limit), interest accrues at a rate of approximately \$48.17 per month.

Table 1 shows the effect of the lost subsidy on a hypothetical law student who would have borrowed the maximum subsidized amount of \$8,500 each year for three years. Borrowing an unsubsidized rather than a subsidized Stafford loan adds nearly \$45 to the student's monthly repayment and nearly \$5,400 to the student's borrowing costs under a standard 10-year repayment plan. Note that for students using graduated, income-sensitive, or extended repayment plans, the additional costs of unsubsidized loans will be even greater. The repayment amounts were calculated using DOE's online repayment calculator.

Table 1: Example of Subsidized and Unsubsidized Loan Cost Differences

| | <i>Subsidized</i> | <i>Unsubsidized</i> | <i>Difference</i> |
|---|-------------------|---------------------|-------------------|
| Amount Borrowed Each Year | \$8,500 | \$8,500 | - |
| Total Amount Borrowed | \$25,500 | \$25,500 | - |
| Interest Rate | 6.8% fixed | 6.8% fixed | - |
| Capitalized Interest | \$0 | \$3,903 | \$3,903 |
| Principal Balance at Beginning of Repayment | \$25,500 | \$29,403 | \$3,903 |
| Repayment Term | 10 years standard | 10 years standard | - |
| Monthly Repayment Amount | \$293.45 | \$338.37 | \$44.92 |
| Interest Costs | \$9,714 | \$11,201.40 | \$1,487.40 |
| Total Amount Repaid | \$35,214 | \$40,604.40 | \$5,390.40 |

A student can mitigate some of the additional costs by paying the interest as it accrues, thereby reducing the amount that will be capitalized. If the student in the above example could pay off the accrued interest before it capitalizes (thereby preserving the principal balance of \$25,500), he or she would save \$1,487.40 in interest costs over the repayment term. The interest payments are also tax deductible.

Program-Specific Effects

Data from DOE’s National Center for Education Statistics show that 35.5% of graduate and professional students borrowed subsidized Stafford loans in 2007-08, the most recent year for which data are available. These students borrowed an average of \$7,100. However, among full-time, full-year students, the percentage who borrow subsidized Stafford loans rises to 52.3%, with the average amount rising to \$7,700.

Borrowing rates also vary by graduate program. For example, more than 70% of students in medicine, health sciences, and law borrowed subsidized Stafford loans, most of whom borrowed the annual maximum of \$8,500. For non-education doctoral programs (e.g., humanities programs), borrowing rates were less than 20%.

Table 2 shows the subsidized Stafford Loan borrowing rates and average amounts for students in selected academic programs in 2007-2008. It includes data for (1) full-time, full-year students only and (2) all graduate and professional students in these programs.

Table 2: Graduate Student Subsidized Stafford Loan Borrowing in 2007-2008

| Program | Percent | | Average Amount | | Percent who Borrowed \$8,500 Maximum | |
|--|-----------------------------|---------------------|-----------------------------|---------------------|---|---------------------|
| | <i>Full-time, Full year</i> | <i>All students</i> | <i>Full-time, Full year</i> | <i>All students</i> | <i>Full-time, Full-year</i> | <i>All students</i> |
| Other Health Science (first professional degree program) | 83.1 | 76.9 | \$8,300 | \$8,200 | 77.5 | 70.3 |
| Law (J.D. or LL.B.) | 77.3 | 76.5 | 8,300 | 8,200 | 73.3 | 69.5 |
| Medicine (M.D. or D.O.) | 75.3 | 73.8 | 8,400 | 8,300 | 72.4 | 69.6 |
| M.A. (except Education) | 59.4 | 42.0 | 7,900 | 7,100 | 48.3 | 27.7 |
| Education (any master's) | 56.7 | 35.5 | 6,700 | 6,400 | 31.4 | 17.1 |
| M.B.A. | 51.4 | 36.4 | 6,800 | 6,400 | 30.8 | 18.0 |
| Education (any doctoral) | 44.1 | 31.1 | 7,500 | 7,000 | 33.9 | 18.7 |
| M.S. (except Education) | 40.5 | 27.5 | 8,000 | 7,100 | 32.2 | 16.7 |
| Ph.D. (except Education) | 17.7 | 17.2 | 7,400 | 7,300 | 11.7 | 11.1 |
| Total | 52.3 | 35.5 | 7,700 | 7,100 | 41.0 | 22.6 |

Source: DOE National Center for Education Statistics, 2007-08 National Postsecondary Education Survey

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