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The Hidden Student-Debt Bomb

Under the radar, maneuvers to avoid paying off loans are surging. 'Forbearance' has hit the \$125 billion mark.

By Jason Delisle

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It is time to re-evaluate how we measure the performance of student-loan programs—particularly whether borrowers are or are not meeting their obligations. The traditional measures of nonrepayment—delinquencies and defaults—might be fine for most types of loans, but not for outstanding student loans, nearly all of which are held or backed by the federal government. Lawmakers have provided students with options that let them punt on repayment without triggering delinquency or default. Lately, students have been availing themselves of those options at rising levels.

The forbearance benefit, for example, lets borrowers postpone payments for up to three years. By law, loan-servicing companies have a lot of discretion to grant forbearances, and getting one usually takes only a phone call on the part of the borrower. Some borrowers might have to complete a simple form and meet a payment-to-income test. But overall it is the easiest and fastest way for a borrower to suspend student-loan payments.

Forbearance can also cure the delinquency status on a loan, at least on paper. A borrower who misses a few payments, and is likely to miss more, will be informed by his loan-servicing company that he can obtain a forbearance right away. Payments cease and the loan is put in good standing. When the loan finally comes due, however, the monthly payment will be higher than the payment the borrower originally found too difficult to pay, thanks to accruing interest.

Forbearances are thus a double-edged sword. They help borrowers keep their loans in good standing, but they also mean borrowers aren't making progress on paying down their debts—just the opposite. Enrollments in forbearances are really a negative indicator in the federal loan program, much like delinquency and default.

That is why the latest figures from the Education Department that show steady increases in forbearances are so alarming. Loan balances in forbearance were about 12.5% of those in repayment in 2006. In 2013, they were 13.3%. Today they are 16%, or \$125 billion of the \$778 billion in repayment.

If student-loan defaults exhibited that kind of growth it would make national headlines. Forbearance growth goes unmentioned, yet it looks a lot like a default given that the borrower isn't making payments.

Another option is income-based repayment plans, which allow borrowers to suspend or reduce payments on their loans and will also cure a severely delinquent loan. The mechanics of these plans are a little complicated, but for borrowers with incomes below 150% of poverty, payments are zero. Borrowers who earn more than that make payments between 1% and 15% of their incomes. After 10, 20 or 25 years, depending on the program, the government forgives any outstanding balances and taxpayers eat the loss.

For many borrowers, income-based repayment works like long-term forbearance, or better if their debt is forgiven. Borrowers might have their payments suspended, or lowered to the point that they will never fully repay the loan before the outstanding balance is forgiven. In some cases the payments may not even cover the interest that accrues each month. The Obama administration estimated in 2012 that the average amount forgiven in income-based repayment plans will be \$41,000 per borrower.

The Obama administration greatly expanded benefits under income-based repayment plans in recent years and has launched efforts to promote them. Enrollments are growing rapidly and now stand at an all-time high. Some 24% of Federal Direct Loan Program

balances (\$115 billion) that have come due are enrolled in the two most generous plans, Income-Based Repayment and Pay As You Earn. That is up from 14% a little more than a year ago. The number of borrowers using the plans has doubled over that time, to 2.2 million.

Despite more borrowers taking advantage of benefits to suspend and lower their payments, the share of borrowers in default is still trending upward. It now stands at 19.8% of borrowers whose loans have come due—some 7.1 million borrowers with \$103 billion in outstanding balances. That's the highest share since the Education Department began making the statistic available in 2013, and given other trends, it probably is a record high.

These trends are troubling because the U.S. economy has been improving for some time. Yet fewer and fewer borrowers are repaying their federal student loans. For those who do make payments, more of them are paying too little to retire the debt they took on.

This all makes sense, however, when you realize that the student-loan program has been designed to achieve two political goals: Loans should be available to any student, at any school, pursuing any credential; and student debt is bad and burdensome, so it should be easy for borrowers not to repay.

Based on these goals, the program is performing quite well for students and the institutions whose coffers swell under such loose lending standards. Loan issuance has grown rapidly in recent years while repayment rates have declined steadily. From the perspective of the taxpayers who must ultimately finance these liabilities, however, the federal student-loan program is performing badly and steadily getting worse.

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