

# *Dimensions of the student loan crisis*

## Part 1: Student and family choice

May 2016



# About this series

## **Has going to college created a personal debt crisis for the average American?**

*Student loan debt now totals **\$1.3 trillion**, surpassing auto loans and credit card debt, and second only to home mortgages. The average graduate's indebtedness in 2015 was **\$35,000**. Cost of attendance at in-state four-year public universities continues to rise at a compounded annual rate of **4%**, nearly doubling in the past two decades.*

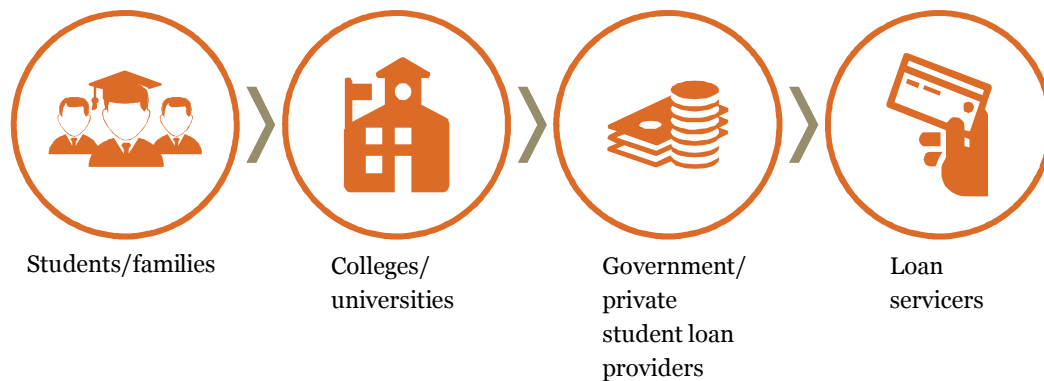
With rising tuitions and increased indebtedness, some question if a college degree is still worth it. Is there really a return on the investment in a college education or are we tying a millstone around the necks of our youth?

The student loan debt crisis is complex. It has taken generations to manifest itself and is intensely personal. Resolution of this crisis will require a concerted, collaborative, and committed effort by all its stakeholders. The time for finger pointing is over. While blaming others might garner headlines, it does nothing to effectively address the underlying causes of our crisis.

In this four-part series, *Dimensions of the student loan crisis*, PwC's student lending and higher education specialists within the Consumer Finance Group introduce a number of key factors contributing to the crisis. This series seeks to shed light on the need to first understand the crisis based on the facts, and then to address its dimensions holistically in the hopes of reversing some of its trends. In Part I we focus on the emotional elements of higher education and the financial choices made in the pursuit of a college degree. These choices include "education for education's sake," rather than education based on an anticipated return on investment. We also explore the impact of

student debt on the US economy. Part II examines the role institutions of higher education play in the crisis. With decreased state funding, reduced endowments, and aging infrastructure, colleges and universities have been more dependent on tuition dollars than they have been in the past. In Part III, we provide an overview of the originations practices surrounding student loans, including the limited underwriting criteria of entitlement-based, government-backed student and parent loans, and the differences between the government and private sectors. In our final segment, Part IV, we address loan servicers and the challenges they face in managing defaults downstream with limited margins and increasing regulatory scrutiny. Throughout the series, we call out areas where the stakeholders have influenced the crisis over the decades and areas where we need to change the conversation to arrive at sustainable solutions for the future.

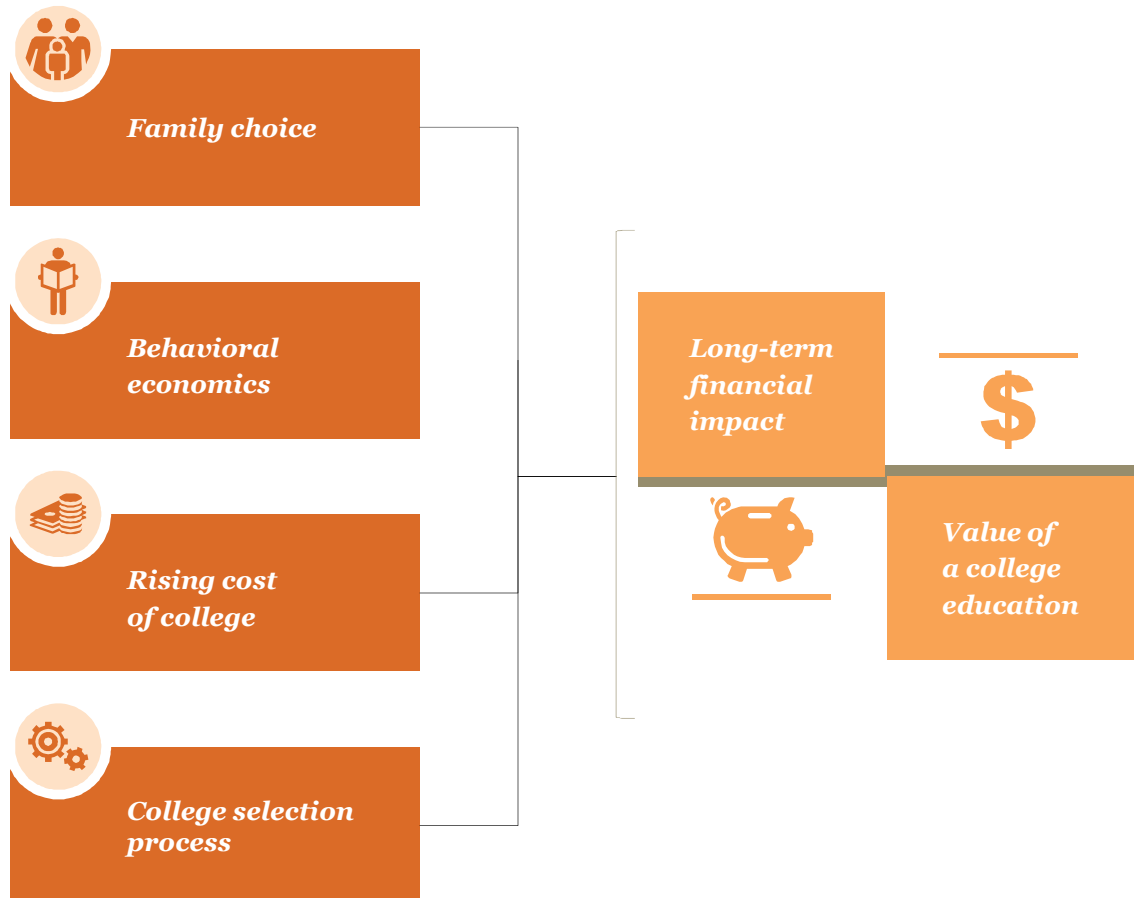
*This is not an easy fix. Every part of this value chain must come together to address its part and take ownership in moving forward to help fix this complex and important challenge.*



# Part I: The choices we make

In the first part of *Dimensions of the student loan crisis* series, we address the choices students and families are making in selecting a college. We focus on how these choices can affect borrowing for college, and how behavioral economic theory can explain why students and their parents pick one college over another. We also address

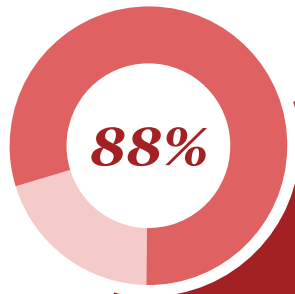
the rising cost of higher education, clarify what constitutes financial aid, and discuss the college recruitment process. Finally, we explore the long-term financial impact of student loan debt on the borrowers and our economy, and provide concluding thoughts on whether a college degree is a valuable personal investment.



# Family choice

It comes as no surprise that parents want what is best for their children, and few topics elicit a more emotional response from parents than the desire for their children to go to college. Higher education has long been considered the primary path to achieving the American Dream. Parents will sacrifice almost anything to get their child into college. They take second and third jobs, refinance their homes, and tap into retirement savings. Parents often become laser focused on scholarships, preparation for SATs and ACTs, and participation in extracurricular activities, all to best position their child in the admission process. With all of this effort, sacrifice and engineering, some are asking, *“Is a college degree worth it?”*

The focus on college is so ingrained in today’s society that 9 out of 10 students in grades 6 through 12 have parents who expect them to continue their education beyond high school.<sup>1</sup> In the 2015 edition of *How America Pays for College* sponsored by Sallie Mae and conducted with the market research firm Ipsos, 88% of parents agreed that they are willing to stretch themselves financially to obtain the best opportunity for their child’s future.<sup>2</sup> In the same study, 65% of families who took out education loans strongly agreed that they would rather borrow than have their child not be able to attend college.<sup>3</sup>



*of parents agreed they are willing to stretch themselves financially to obtain the best opportunity for their child’s future.*



<sup>1</sup> US Department of Education, Institution of Education Sciences, National Center for Education Statistics, 2008, <http://nces.ed.gov/pubs2008/2008079.pdf>  
<sup>2</sup> Sallie Mae, *How America Pays for College*, 2015 Sallie Mae’s National Study of College Students and Parents [http://news.salliemae.com/files/doc\\_library/file/HowAmericaPaysforCollege2015FNL.pdf](http://news.salliemae.com/files/doc_library/file/HowAmericaPaysforCollege2015FNL.pdf)  
<sup>3</sup> 2015 Sallie Mae, *How America Pays for College*, 2015 Sallie Mae’s National Study of College Students and Parents [http://news.salliemae.com/files/doc\\_library/file/HowAmericaPaysforCollege2015FNL.pdf](http://news.salliemae.com/files/doc_library/file/HowAmericaPaysforCollege2015FNL.pdf)

The data support the fact that students and their families are indeed borrowing and are likely to continue to borrow into the foreseeable future. Every year, the Department of Education disburses more than \$150 billion in grants and loans. Of that total, federal student loans and parent loans exceed \$100 billion. These amounts refer to traditional, school certified, and disbursed borrowing channels within higher education, but do not include external sources such as home equity lines, credit cards, peer-to-peer marketplace lending, and other nontraditional sources of education finance which are difficult to measure. Regardless, it is clear that higher education is an expensive proposition for students and their families.

With the cost of a four-year, in-state public university education nearing \$100,000, it is prudent that families research their options to fully understand the financial commitment of both the student and the family. With the advent of tools such as College Navigator, College Scorecard, and Net Price Calculator, families can now arm themselves with a vast array of information on the overall economics of attending college. All families should be taking advantage of these tools. Unfortunately, research indicates that decisions are being made less on anticipated economic outcome and more on emotional choices of the student and parents.



*The advent of tools such as College Navigator, College Scorecard, and Net Price Calculator provides families with a vast array of information on the overall economics of attending college.*

# Behavioral economics in college choice

Attending college is a significant financial investment and should be decided objectively. However, it is an inherently emotional decision. Behavioral economic theory can explain this emotional response. Behavioral economics, the application of economics and psychology to explain how purchasing decisions are made, focuses on four key areas: *Decision shortcuts*, *value assessments*, *emotional impacts*, and *social impacts*.

## *Decision shortcuts*

Consumer decisions are far more complex than they appear. Consumers use “mental shortcuts” to guide them to what they feel is the right decision. There are more than 6,100 colleges in the United States, making it impossible to vet each one based on individual value propositions. Instead, for example, a family who meets a warm, likable

admissions counselor at a college fair may find it very easy to conclude that the counselor’s school is a good choice—and in selecting that school, they convince themselves that they are making a choice based on empirical evidence. Families can fall into the *decision shortcut* trap rather than establishing a set of decision criteria with which to vet their list of colleges.

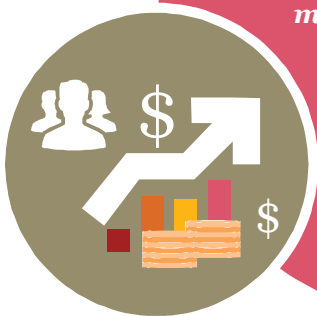
## *Value assessments*

Value is a relative concept. In assessing the value of a product or service, consumers often use seemingly emotional metrics and concepts to guide their behavior. Justifying the value of pursuing a higher education is easy. If I go to college I will earn more. Justifying a private education in which the school provides a tuition discount in the form of a scholarship makes the decision easier. The “tuition discount” is ascribed more value than it is worth. It is no different than the perception that \$9.99 is significantly less than \$10. Later on in this piece we discuss tuition discounting and the perceived value students receive when obtaining their college education “on sale.”

## *Emotional impacts*

Emotions often get the better of people. As mentioned, few topics elicit more of an emotional response from parents than the idea of what’s best for their child. Universities utilize the campus tour as one of their top recruiting tools. If they can get you on campus, you begin to see yourself there, develop an emotional connection, and may be more likely to apply and enroll.

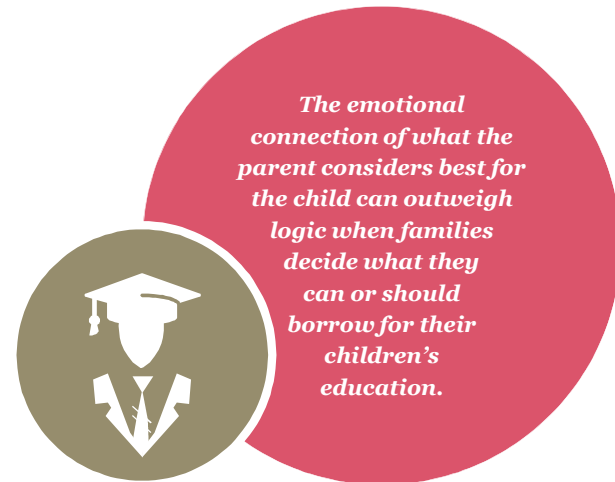
*Emotional impacts can be more powerful than a price reduction in driving demand.*



### ***Social impacts***

By examining the social circles of high school seniors and their families applying to college, we can see the influence of the social network. Often, parents have close relationships with the parents of their children's friends. The prestige of your child going to a private college or a highly rated out-of-state public university can signal that a family is successful enough to afford it. The desire to be seen in the eyes of your peers as providing the best for your child can be a powerful factor in making decisions, though not always in the best financial interest of the student or family over the long term.

In applying behavioral economics to the college decision-making process, we clearly observe a variety of buying behaviors. If the decision was based solely on return on investment, students might begin their higher education at a local community college (often the least cost option) and transfer to a four-year institution later, saving tens of thousands of dollars on tuition and expenses.



*The emotional connection of what the parent considers best for the child can outweigh logic when families decide what they can or should borrow for their children's education.*

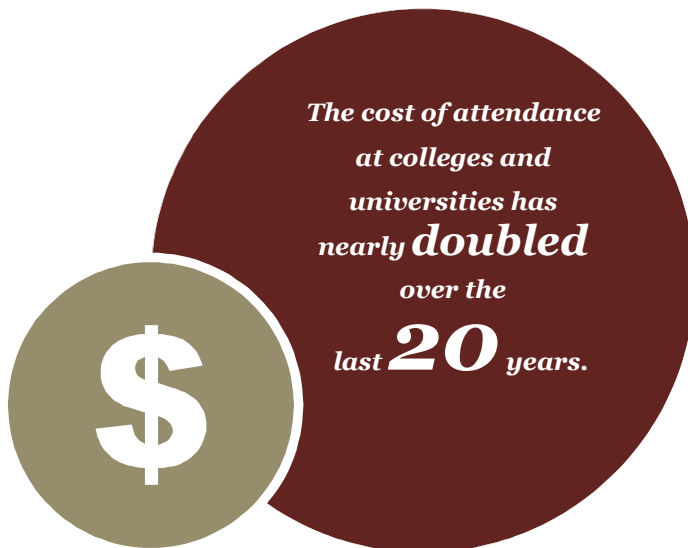


Is the decision to attend college irrational? Not at all, but the choice of which college to attend can be. If the choices are emotionally driven and based on the parents' perception of a particular college or their desire to send their child to a private college rather than to a public university, economic reasoning may not be strong enough to sway their decision. Emotions can lead to spending and borrowing in a manner that may not be in the best economic interests of the student or the family. As difficult as it may be, students and their families should consider a carefully thought through set of decision criteria, including evaluating total cost of college (tuition, room board, books), graduation rates, and degree employment prospects.

# Rising costs of higher education

The cost of attendance at colleges and universities has nearly doubled over the last 20 years.<sup>4</sup> Multiple cost drivers are at play. Year-on-year, decreases in state funding has resulted in college operating budget deficits. Fierce competition to fill seats, increasing marketing spend, and student expectations of higher quality accommodations and enhanced services, all contribute to the ever increasing cost of obtaining a college degree.

As a result, financial aid has become a deciding factor in school choice for 60% of millennials.<sup>5</sup> In a recent survey by Junior Achievement, in partnership with PwC, millennials said that while they know college will likely burden them with debt and will not guarantee them a job, a four-year degree is still considered a life requirement.<sup>6</sup>



---

*Some students and families think of financial aid as free money. This is simply not the case.*

It's important to distinguish what *financial aid* means as there are varying definitions. For the purposes of this series, financial aid is made up of institutional, federal, and state grants, work study, student loans, and internal and external scholarships.

Interest-bearing loans can represent the largest portion of the overall financial aid package, including the Federal Direct Loan and the Parent Loan for Undergraduate Students (PLUS) programs.

---

*PLUS loans carry a 6.84% interest rate and a 4.272% origination fee with a 10-year repayment period. While federal loans are more readily available than any time in history, it may no longer be the cheapest option.*

While Federal Direct Loan amounts are capped based on annual and aggregate borrowing limits, PLUS loans are not. Parents may borrow up to cost of attendance at the institution. Some institutions even package PLUS in the student award letter to show zero unmet need. This packaging is a presumptive step that can lead to indebtedness.

<sup>4</sup> US Department of Education, Institution of Education Sciences, National Center for Education Statistics, 2015. <https://nces.ed.gov/fastfacts/display.asp?id=76>

<sup>5</sup> Millennials and College Planning, <http://www.pwc.com/us/en/about-us/corporate-responsibility/publications/millennials-and-college-planning.html>

<sup>6</sup> Millennials and College Planning, <http://www.pwc.com/us/en/about-us/corporate-responsibility/publications/millennials-and-college-planning.html>

As an example, to pay the annual cost of attendance of \$30,000, a student may be eligible for loans totaling \$5,500. Aid from the institution or other sources may total \$14,500, leaving a funding gap of \$10,000. Colleges may package PLUS to show that financing for that \$10,000 is available. Since the credit requirements for PLUS loans are much less stringent than that of traditional consumer lending, a high percentage of parents qualify and accept the loan. But parents should clearly understand that the PLUS loan is indeed a loan, and that PLUS loans carry a 6.84% interest rate and a 4.272% origination fee with a 10-year repayment period. While federal loans are more readily available than any time in history, it may no longer be the cheapest option.

The cost of a four-year degree grows when it takes five or more years to earn it. Still, the number of students who complete their degrees in four years is staggeringly low. On average at public, flagship institutions, the completion rate is just 36%. At non-flagship institutions, it's 19%.<sup>7</sup> At an average cost of around \$25,000 annually, those extra years in college add up to a significant incremental amount of money spent for the same degree. This critical area needs to be understood by families and higher education institutions.

---

*On average at a public, flagship institution, the completion rate is just 36% in four years. At non-flagship institutions, it's 19%.*

<sup>7</sup> Four-Year Myth, Make College More Affordable, Complete College America, 2014 <http://completecollege.org/wp-content/uploads/2014/11/4-Year-Myth.pdf>

# The college selection process

As admission officers begin their annual recruitment drives, they understand that most millennials will not make decisions about their education options without the support of their families. Colleges are recruiting students—but they are also recruiting parents. The next generation to enter college, Generation Z, (children born in the mid-1990s to the mid-2000s), tends to be more financially driven than the millennial generation. These students see college as a means to securing a good job with a future. Many have seen their parents live through the economic uncertainty of 2008, and that uncertainty shapes their attitudes about money. The cost of higher education weighs on their minds, and financing that education is their No. 1 concern.<sup>8</sup>

Many private colleges offer some form of tuition discounting to prospective students exploring financial aid. Private institutions on average discount their tuition by 48% for full-time freshman,<sup>9</sup> while public universities on average may discount around 10%. A family's ability to negotiate price can provide a higher satisfaction level around value. If the discount is presented in the form of a scholarship, it may be perceived as a reward for achievement, emotionally connecting the student—and the parents—to the university.

---

*Private institutions on average discount their tuition by 48% for full-time freshman, while public universities on average may discount around 10%.*



*Colleges are not only recruiting  
**students**, they are recruiting  
**parents***

<sup>8</sup> Getting to Know Gen Z: Exploring a New Generations' Expectations for Higher Education, University Business, 2015. <https://www.universitybusiness.com/article/getting-know-gen-z-exploring-new-generation%E2%80%99s-expectations-higher-education>

<sup>9</sup> Discounting Grows Again, Kellie Woodhouse, Inside Higher Ed, 2015. <https://www.insidehighered.com/news/2015/08/25/tuition-discounting-grows-private-colleges-and-universities>

# Post-graduation: Downstream effects for students and the economy

It is impossible to look at news headlines and not see the student loan crisis compared to “the bubble” of the 2008 mortgage crisis. Some say that word bubble connotes an economic term that something will pop and that it will be quick and dramatic.

Still, while the term may be a misnomer, students and families who have may have overextended themselves may face financial difficulties for years to come. Among families who have taken out student loans, students borrowed in 83% of families, parents borrowed in 28% of families, and both parties borrowed in 11% of families. Students signed for nearly three-quarters of the total dollars borrowed.<sup>10</sup>

A recent PwC study in partnership with the George Washington Global Financial Literacy Excellence Center (GFLEC) found that millennials have inadequate financial knowledge. When tested on financial concepts, only 24% demonstrated basic financial knowledge. When asked about their ability to repay their student loan debt, more than 54% of millennials expressed concern.<sup>11</sup>

With so many millennials making life choices based on student loan debt, the downstream effects of delaying a home purchase or starting a family could continue to impact the economy. While the bubble may not be poised for a dramatic burst, the debt does have a lingering effect on students and parents who will be paying these loans for decades.



<sup>10</sup> Sallie Mae, How America Pays for College, 2015 Sallie Mae's National Study of College Students and Parents [http://news.salliemae.com/files/doc\\_library/file/HowAmericaPaysforCollege2015FNL.pdf](http://news.salliemae.com/files/doc_library/file/HowAmericaPaysforCollege2015FNL.pdf)

<sup>11</sup> Millennials and Financial Literacy – The Struggle with Personal Finance, 2015. <https://www.pwc.com/us/en/about-us/corporate-responsibility/assets/pwc-millennials-and-financial-literacy.pdf>

# *Is a college degree still worth it?*

Absolutely. It's important to note that those who default on student loans are generally those who don't complete their degree or did not attend a four-year public or private nonprofit university.

From a pure return on investment perspective, workers with a bachelor's degree on average earn well over \$1 million more than high school graduates during their working lives. Those with an associate's degree earn about \$325,000 more. Assuming a national average of indebtedness per student of \$35,000, the return on investment is thirtyfold.

The knowledge, critical thinking abilities, and teaming skills obtained in college are invaluable. Beyond academics, students learn networking, problem solving, and other skills that can position them for satisfying and successful careers. According to a study by the Georgetown University Center on Education and the Workforce, 24 million new jobs will open between now and 2020, and 31 million more will open as baby boomers retire. Without major changes to the US postsecondary education system, the economy will fall short 5 million workers with postsecondary degrees by 2020.<sup>12</sup> A college degree will be more valuable than ever.



*Workers with a bachelor's degree on average earn well over \$1 million more than high school graduates during their working lives. Those with an associate's degree earn about \$325,000 more.*

<sup>12</sup> Georgetown Center on Education and the Workforce Recovery 2020. New Study Finds there will be 55 million job opening by 2020, Georgetown Public Policy Institute, 2013. <https://cew.georgetown.edu/wp-content/uploads/2014/11/Recovery2020.Press-Release.pdf>

---

## *Final thoughts*

Families should approach the process of selecting a college in the same way they would in making any other large investment or purchase, with a clear set of decision criteria. While the emotional aspects of college can influence decision making, it is important to recognize one's financial limitations. As baby boomers and Generation X parents continue to be in the "sandwich generation," caring for both children and parents, the focus on financial security is paramount. Prudent financial decisions should be made, for students and parents alike.

The student loan crisis may not be a "bubble" poised to burst, but it is a personal financial crisis. This crisis is likely to linger, stressing American families and our economy as millennials face challenges in moving forward with their lives due to student loan debt. In looking at the long-term return of a college degree, it's clear that the investment for a 40- to 50-year career is a good decision. The key to ensuring success is to make rational college choices, complete one's degree in a timely manner, and repay student debt in an efficient way.

---

## *Preview of Part II*

As mentioned in our introduction, the solution to the student loan debt crisis isn't easy, nor is it quick. Student and family choice is only one stage in the creation of the crisis.

In Part II of this series, we address the role of colleges and universities and how they are affected by the student debt crisis, the impact of degree competition, and the increased public scrutiny educators can expect.

# How PwC can help

PwC's student lending and higher education specialists within the Consumer Finance Group are comprised of talented individuals with decades of experience working with clients across the student value chain. Our approach to supporting our client's challenges is holistic and always considers the cross-value chain impacts and influences. We understand how the increasing cost of higher education influences borrower indebtedness and therefore their repayment strategies. We have a deep understanding of the regulatory requirements facing the industry and how regulation and compliance affects universities, lenders, servicers, and collection agencies on a daily basis.

Our work with colleges and universities is focused on helping boards, presidents and senior administration with sustainability, operational efficiencies and strategic focus to remain competitive in the unstable higher education market. With lender clients, we help craft and develop business and risk models to succeed in the highly competitive environment and help provide guidance on legacy portfolio management. Our work with Title IV servicers (TIVAS) is unparalleled in the industry, creating effective operational models and assessing risk. Our team is passionate and committed to improving student lending and higher education space.

## Strategy & Growth

- Enrollment management and institutional positioning
- Channel strategy and optimization
- Development of growth of student loan portfolios
- Advanced decision analytical tools, models and management



## Regulatory & Compliance

- Assessment of higher education institution's compliance system
- Risk & compliance assessments
- Third Party Risk Management Assessment
- Compliance Management System
- CFPB oversight and readiness evaluation



## Customer Experience

- Development of Customer & Student experience strategy
- Service positioning and value proposition
- Default management strategy and business model implementation
- Enterprise-wide process to perform root-cause analysis and identify trends



## Operational & Financial

- Operating cost & strategic sourcing
- Academic resource optimization
- Operations excellence, business process optimization & propensity modeling
- Policy and procedure development and assessments



## PwC's student lending and higher education specialists

PwC's student lending and higher education specialists within the Consumer Finance Group work with clients throughout the student lending value chain, assisting stakeholders throughout the life cycle with solutions to their complex business challenges. To discuss a range of services tailored for your organization's needs, please contact:

**Andy Hawley**  
Principal  
+1 617 803 5993  
andy.hawley@pwc.com

**Mindy Hager**  
Senior Manager  
+1 913 209 4837  
mindy.m.hager@pwc.com

**Adam Kelly**  
Senior Manager  
+1 317 918 4413  
adam.p.kelly@pwc.com

**Mark Shura**  
Manager  
+1 617 620 3601  
mark.shura@pwc.com

### PwC Student Lending and Higher Education Value Chain

