Insight

The Cost of the Administration's Income Based Repayment of Student Loans

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While most eyes are focused on the lackluster implementation of the Affordable Care Act, the Administration has quietly embarked on a massive campaign to attract students to its income-based repayment program for student loans. Should the Department's effort prove successful, it will have massive implications for taxpayers, who will end up footing a tremendous bill for these loans.

According to several news outlets, the Department of Education plans to carry out an email campaign to reach 3.5 million borrowers presumed eligible for income based repayment programs. The program permits students to cap their monthly loan repayment obligation at a single-digit percentage of their monthly discretionary income, calculated using a formula established by Congress as part of the same legislation establishing the Affordable Care Act.

While presumably attractive to borrowers, enrollment in the IBR program has been slow, in part due to the program's complexity, although the potential negative consequences of enrollment may be a factor as well. Students enrolling in IBR plans face additional tax obligation after any portion of the borrower's loan is forgiven, and potentially onerous interest penalties are attached to a loan should a borrower miss a monthly payment. Some have also suggested the servicers contracted by the Department of Education aren't doing enough to promote the program, although it's difficult to establish any single factor as the prevailing reason the program isn't more popular.

While borrowers have been wary of entering the program, taxpayers should be paying attention as well. The Department's marketing pitch doesn't address the fact that IBR programs are expensive. Really expensive. Even the White House agrees that loans in IBR are far more expensive for taxpayers than their traditional counterparts. The following table shows the projected costs of IBR/ICR loans using data provided by the Office of Management and Budget, the Administration's own budget office:

Loan Repayment Options	FY 2012 Subsidy Rate	FY 2013 Subsidy Rate(est.)	FY 2014 Subsidy Rate(est.)
Subsidized Stafford			
Standard	6.75	2.44	0.89
Extended	9.95	4.82	0.80

Loan Repayment Options	FY 2012 Subsidy Rate	FY 2013 Subsidy Rate(est.)	FY 2014 Subsidy Rate(est.)
Graduated	10.78	5.58	1.62
IBR / ICR	17.09	10.40	10.29
Unsubsidized Stafford			
Standard	-28.36	-27.70	-29.08
Extended	-40.31	-40.26	-42.32
Graduated	-39.36	-39.62	-41.95
IBR / ICR	17.07	10.06	10.03

Interpreting these data is simple enough, a positive number indicates costs to the federal government (and taxpayers), while a negative number indicates savings, or earning on the part of the government thanks to borrower interest payments. A quick scan of the data reveals that IBR/ICR loans are easily 2-3 times more expensive than other forms of repayment and in some cases would turn projected savings on Unsubsidized Stafford loans into a cost to the taxpayers that fund the government.

The 3.5 million borrowers targeted by the Department of Education account for roughly 14.4 percent of all direct loan borrowers. According to the Department's own spokesperson, these borrowers tend to be higher volume borrowers (over $25,000) near the end or exiting grace and deferment periods. Assuming these borrowers have an average amount of debt, the Department of Education is looking to shift at least $81 billion of student loans from its existing $569 billion portfolio into IBR plans. At best, the Department's plan will increase costs for Stafford loans, potentially by $8.5 billion. At worst, the Department's plan creates costs where savings had been projected, creating new budget costs of $37.22 billion, turning the entire value proposition of the direct loan program upside down.

The unfortunate thing for the taxpayer is that any savings associated with the government takeover of student lending in 2009 have long since been obligated for other purposes (including supporting the Affordable Care Act). This means any new costs associated with direct loans impact the Treasury directly, requiring the government to fill the budget gap by borrowing more money and contributing to the national debt.

The Department of Education is quietly hoping to lure a lot more students into IBR plans. The Department should at least be honest about the cost to the taxpayer of this initiative.