

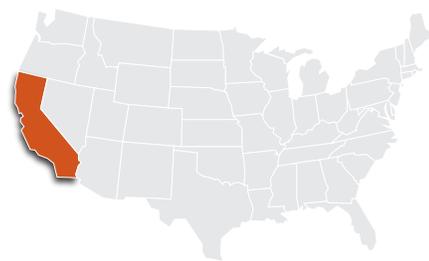
UPDATED

BORROWING FOR COLLEGE



The Campaign for
**College
Opportunity**
MARCH 2014

The State of
Higher Education
in California



Introduction

It took federal student loan programs 23 years to lend their first \$100 billion; today, these program lend more than that each year.

Families and students understand the value of a college education and degree. It is why they choose to make a financial investment in higher education. While families and students use a combination of sources to finance their college investment, ranging from personal contributions, grants, and student loans, the rate of student loan borrowing is rising significantly both here in California and nationally.

Some good news for California students is that the state has been committed to making significant investments in college affordability. Forty-seven states have higher average student loan debt than California.¹ The state's commitment to its Cal Grant financial aid program has been the driving force in keeping student loan debt at lower levels but, unfortunately, not all students are informed about their financial aid options or how to apply.

Borrowing for College is the first in a two-part series tackling issues of college affordability in California. It examines the magnitude of student loan debt taken on by undergraduate students enrolled at colleges and universities in California, explores the current federal student loan options and policies, and provides recommendations to improve affordability for California's college students. A second report in this series will focus on how lengthy time to degree compounds costs for college students and the state of California.

Student loans can help to bridge the financial gap for college after families have exhausted other forms of financial aid, and make a college education possible for millions of students. One possible explanation for the rise in the number of student loans across the country is that young adults are attending college at a higher rate, which would be an encouraging trend. Not all student debt is

harmful, but if student loan debt becomes unmanageable for borrowers, then there is valid cause for concern.

Student loan debt may be having a notable impact on the financial lives and spending habits of college graduates, including hindering a graduate's financial ability to buy a first home, a new car, or even begin retirement savings.

Now more than ever, students need a college credential to successfully enter the workforce and the state needs more college graduates. If current trends persist, California will be short 2.3 million college degrees and vocational certificates by 2025 to meet workforce demand.²

There are tremendous returns for the state when a student graduates from college. For every \$1 California spends on public higher education, it yields \$4.50 from taxes on the increased earnings of college graduates and reductions in the use of state safety net services.³ Individuals benefit as well: a bachelor's degree graduate will earn \$1.3 million more over their lifetime than a peer who only has a high school diploma.⁴ During the Great Recession of 2007-09, those with a college degree were unemployed at a lower rate than those with only a high school diploma nationwide. Furthermore, after the recession, more than two million jobs were gained by college graduates, while those with only a high school diploma or less continued to lose nearly a quarter million jobs nationally.⁵

The recommendations made in this report are immediately actionable and everyone has a role in ensuring that college is affordable for all: families and students, high schools, colleges and universities, and the state and federal government.

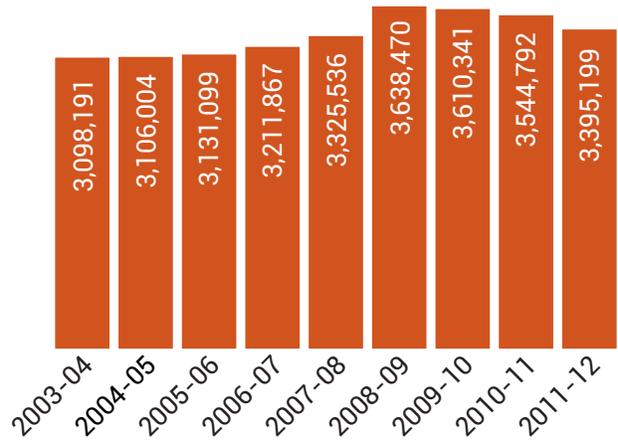
National & State Student Loan Debt Figures

As a whole, student loan debt in the U.S. at the end of 2013 was estimated at \$1.08 trillion.⁶ That surpasses the national aggregate totals of auto loan, credit card, and home-equity debt balances and is the second largest source of debt for households, behind home mortgages.⁷ The debt total continues to swell: it took federal student loan programs 23 years to lend their first \$100 billion; today, these programs lend more than that *each year*.⁸

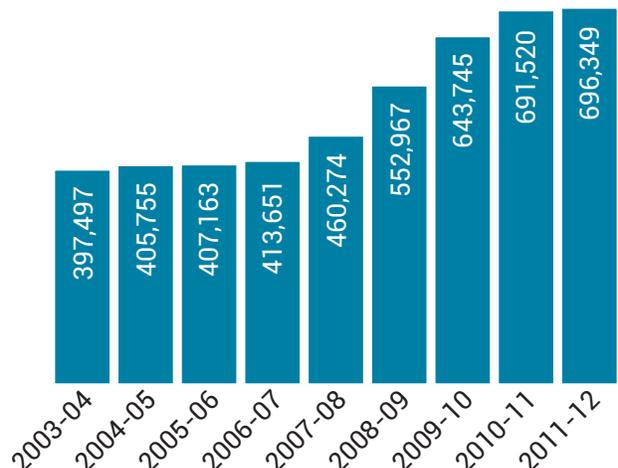
California's undergraduate population has increased by 10% from nearly 10 years ago. However, the number of undergraduates who take out federal student loans has increased by 75% during the same timeframe.

For each graduating class, the level of student loan debt and the rate of increase over time is influenced by several factors, including changes to how much of remaining college costs fall on the student after grant aid.⁹ Data shows that the number of students who take out and graduate with student loans and the average student loan debt of these student borrowers have risen dramatically within the past decade. For the 2002-03 academic year, there were 5 million federal student loan borrowers nationwide;¹⁰ eleven years later, the number of students who took out these loans to fund their college education had risen to 8.45 million, an increase of 69%.¹¹

Undergraduate Enrollment* in California



California Undergraduates with Federal Student Loans



* Undergraduate enrollment is for Title IV institutions, which are eligible to participate in federal student financial assistance programs.

Sources: Undergraduate Enrollment: U. S. Department of Education. National Center for Education Statistics. (Accessed April 2014). Integrated Postsecondary Education Data System (IPEDS): 12-month unduplicated headcount by level of student, Grand total, Undergraduate at Title IV Institutions in California.
Federal Loan Borrowers: Data provided directly to author by U.S. Department of Education, 2014

The share of 25-year-olds with student debt in the U.S. increased from 25% in 2003 to 43% in 2012.

According to the Federal Reserve Bank of New York, in just 10 years, the share of 25-year-olds with student debt nationwide increased from 25% in 2003 to 43% in 2012.¹² From a different analysis of national graduates, students who earned their bachelor's degree during the 2003-04 academic year ended up with an average of \$17,580 in student loan debt. Nine years later, that average debt amount had increased by 47%, to \$25,884.¹³

For California, half of the state's four-year university students will graduate with some level of student loan debt.¹⁴ Although it is considered a low-debt state compared to the national average,¹⁵ California students who earned a four-year degree in 2012 graduated with an average of \$20,269 in student loan debt.¹⁶ Just nine years prior, the average was \$16,071, reflecting a 26% increase.¹⁷ When adjusted for inflation to 2013 dollars, however, the average debt amount in California has increased by only 3.8% in the last decade compared to an adjusted rate of 21% nationally.

For the 2011-12 academic year, there were 696,349 undergraduate federal student loan borrowers in California, up from 397,497 during the 2003-04 year.¹⁸ This represents a 75% increase in the number of federal student loan borrowers enrolled at California colleges and universities in just under a decade. For context, the state's total undergraduate population at Title IV colleges and universities (institutions that are eligible to participate in federal student financial assistance programs) increased by only 9.6% from about 3.1 million to about 3.4 million during the same timeframe.¹⁹

The number of borrowers and amount of student loan debt will rise if state support for California's public university systems or financial aid programs decline and if these institutions do not employ innovative strategies to contain costs. Notably, the University of California (UC) and the California State University (CSU) systems' level of state support in the 2013-14 budget

year declined by 18.9% and 21%, respectively, when compared to their pre-recessionary levels of state General Fund support in the 2007-08 budget year.²⁰

During the same period, systemwide student enrollment tuition and fees has increased by 84% at the UC and by 97% at the CSU.²¹ These systems serve a significant number of in-state students: more than 90% of the undergraduate population at each are in-state students.²² First occurring in 2011-12, the student share of the University of California budget now outweighs the share of total state General Fund support (\$3.09 billion vs \$2.64 billion in the 2013-14 budget year²³). This means that California is now asking students to shoulder a greater portion of cost to fund a world-class public university system than the state itself is willing to provide, resulting in a much larger fiscal burden on students.

Many of those students turn to loans in order to fill in the financing gap for their college education. But the rising level of student loan debt could be a troubling development if the debt becomes unmanageable for individual graduates, or worse, for students who do not complete a degree. For example, as of the start of 2014, about 11.5% of student loan balances nationwide are 90 or more days delinquent in their loan repayments or in default.²⁴ For California, 18% of student borrowers in 2012 (the most recent accessible data available) were 90 or more days delinquent in their loan repayments.²⁵ This and other trends could continue as graduates and former college students without degrees grapple with debt.

For now, the average loan totals for California graduates of four-year universities appear to be manageable. By one widely accepted measure, a borrower's student loan total should be less than his or her expected starting salary after graduation.²⁶ At \$20,269, the average student loan debt for bachelor's degree graduates from California's four-year universities appear to

be within that parameter. Still, the impact of this debt burden is already noticeable as it ripples across the economy. Some studies have found that high levels of student debt are hindering an individual's chances of participating fully in the economy, with delays in the purchase of a home or car, starting a small business, or even beginning retirement savings.²⁷ These are the

traditional financial activities expected of well-educated, young graduates in their 20s and 30s, and which our economy depends on to grow. Student loan debt is just one aspect of the overarching issue of college affordability, access, and success, but it is one that is definable, urgent, and for which there are solutions and policy interventions that can have a large and immediate impact.

FEDERAL & STATE FINANCIAL AID

The emphasis of this report is on federal student loan programs, which fall under the general scope of student financial aid. Each year, the U.S. Department of Education provides more than \$150 billion in federal grants, loans, and work-study funds for 15 million college and university students nationwide. Grant aid provided through the Federal Pell Grant Program does not have to be repaid by a student and work-study funds are earned by students through participation in the Federal Work-Study Program. For the 2013–14 academic year, students can receive a maximum Federal Pell Grant award of \$5,645.

In the state of California, the California Student Aid Commission serves as the principal agency responsible for administering the many state financial aid programs, including the Cal Grant program. The Cal Grant program is the largest state grant aid program in the nation, when measured by the amount of dollars awarded annually. Cal Grant award amounts for students vary by the type of college attended, as well as the type of Cal Grant program qualified for. For the 2013–14 academic year through the first of the two main programs, Cal Grant A, students can receive a maximum of \$12,192 if enrolled at a University of California, \$5,472 at a California State University, \$9,084 at a private, nonprofit college or university or an accredited for-profit college, or \$4,000 at an unaccredited private, for-profit college. California Community College students do not qualify for the Cal Grant A program, as these awards are based on tuition and student fees; California community college student fees are the lowest in the nation and can be covered through another financial aid program, the Board of Governors Fee Waiver. The other primary Cal Grant program, Cal Grant B, provides students with an additional “access award” of \$1,473 on top of the Cal Grant A award amount after the first year of enrollment. Community college students who qualify may utilize the access award absent the Cal Grant A award.

For the fiscal year of 2012–13, students at California's public colleges and universities received \$6.4 billion in need-based grant aid, \$1.5 billion of which came from Cal Grants.²⁸ 81% of the total Cal Grant aid offers in 2012–13 was guaranteed to students who meet the eligibility criteria; the remaining offers are made on a competitive basis. Student loans, comprised of both federal and private loans, totaled \$3.2 billion for the state's college students.

Impact of Student Loan Debt

among national survey respondents

75% student loan debt has affected decision to purchase a home

63% student loan debt has impacted ability to purchase a car

50% student loan debt has impacted ability to start a small business

73% student loan debt has prompted the delay of contributing to retirement savings

Given the rise over the past decade in the number of federal student loans issued and the average amount of student loan debt for graduates, a critical analysis of the effects and impact of these increases on students, institutions, and the overall economy is warranted. The long-term economic impact of the rise of students with loan debt remains to be determined. But preliminary research at the macroeconomic level suggests that due to the burden of student loan debt, recent college graduates delay or are less likely to make home or auto purchases. Nationally, young college graduates have traditionally comprised a large share of first-time homebuyers and therefore, generate a broad range of economic activity.

In a national study of student loan borrowers that have reached the age of 30 (the median age of first-time home buyers), homeownership trends from 2003 to 2009 showed that rates were higher among those with student loan debt than among those without loans.²⁹ However, once the Great Recession of 2007-09 was fully realized, homeownership rates fell across the board. Homeownership rates for student loan borrowers fell 8 percentage points, compared to just a 5 percentage point reduction among those without. As of 2012, for the first time in a decade, 30-year-olds without student loan debt are more likely to have mortgage debt than those with student loan repayment obligations.³⁰

Additionally, while automobile loan debt is a less effective proxy for auto ownership than mortgage debt is for homeownership,³¹

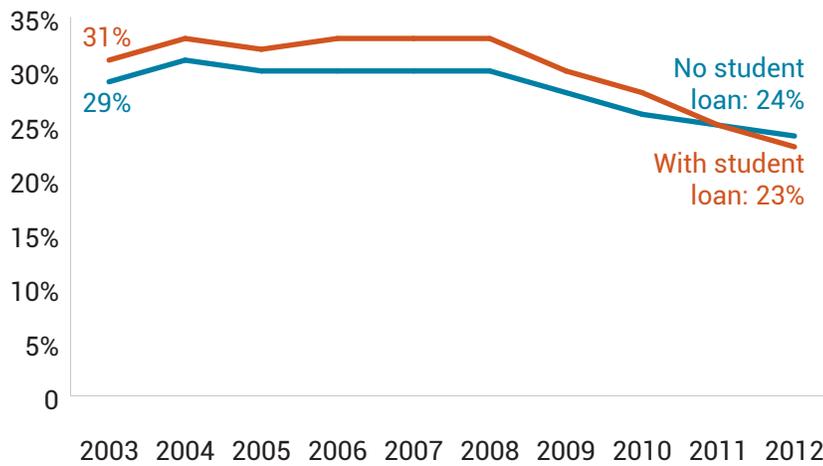
national trend data shows some indication of changes in market participation by student loan borrowers. Again, historically, while rates of auto loan debt were higher among those with student loan debt than without, the drop-off in debt-funded auto purchases was particularly steep for student borrowers in the aftermath of the Great Recession.³² By the end of 2012, similar to homeownership rates, the rate of student borrowers who held auto loan debt was surpassed by non-student loan borrowers.

There are also negative impacts on student borrowers at the individual level when there is an increased reliance on student loans to finance college education. Maintaining high amounts of student debt can hinder a student borrower's chances of taking on new financial obligations, such as financing a home or car. In a 2013 national survey of 1,000 college graduates who hold student loans, 75% of respondents indicated that student loan debt affected their decision to purchase a home, 63% said the debt affected their ability to make car purchases, and nearly 50% attributed their lack of ability to start a small business to student loan debt.³³ Carrying student loan debt can also lead to a borrower delaying participation in and contributions to retirement accounts, leading to lost growth in the critical early years of labor force participation.³⁴ In the survey referenced earlier, 73% of respondents stated that they have put off saving for retirement or other investments because of the impact of their student loan debt.³⁵

Source: American Student Assistance. *Life Delayed: The Impact of Student Debt on the Daily Lives of Young Americans.*

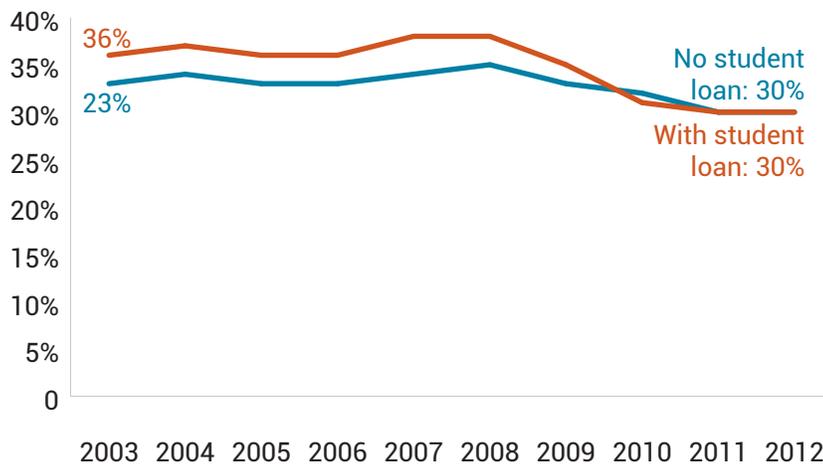
Nationwide, those carrying student loan debt are less likely to purchase a home and take on debt to purchase a car

Percentage of Borrowers with Home-Secured Debt by Age 30



Source: Brown and Caldwell. "Young Student Loan Borrowers Retreat."

Percentage of Borrowers with Auto Debt by Age 25



Source: Brown and Caldwell. "Young Student Loan Borrowers Retreat."

Student Loans & Type of Institution

The type of college or university that a student attends impacts the amount of student loans that he or she will take out. On average, students who enroll at public colleges and universities graduate with smaller amounts of debt when compared to those who attend private, nonprofit universities or for-profit four-year colleges. For the class of 2012, 52% of California's undergraduates graduated with some level of debt, with the average amount totaling \$20,269 across all four-year universities.³⁶ Again, college graduates in California, especially at public colleges and universities, rank relatively low in incurred student debt when compared with graduates in other states. This is partly due to the state's generous Cal Grant program, which ties the amount of grant aid provided to recipients enrolled at the University of California and the California State University to the actual tuition and fees charged to students at those universities. This means that as tuition levels rise at the UC or CSU, Cal Grant award amounts will correspondingly rise as well. While students enrolled at private, nonprofit and accredited for-profit colleges and universities are also eligible to receive Cal Grant awards, the 2012 state budget act reduced incoming students' maximum award amounts by 6.5% for the 2013–14 academic year and will further reduce by 10.5% in the 2014–15 academic year to just above \$8,000. For recipients attending unaccredited private, for-profit colleges, maximum grant awards were reduced by 59% to \$4,000.

At the state's public four-year universities, half of the students graduated with student debt at an average of \$17,994 in 2012.³⁷ Half of the students also borrowed federal student loans with the average amount of

that debt at nearly the same figure, \$17,558. For the class of 2012 at the state's private, nonprofit four-year universities, 62% of the graduates left with some level of student debt, with the average amount of \$29,035. 60% of graduates borrowed federal student loans to an average of \$22,331.³⁸ In addition to their federal loans, graduates from nonprofit universities are more likely to have a larger share of nonfederal student loans than graduates from public universities.³⁹ Statewide average student debt information for graduates of private, for-profit four-year colleges is difficult to obtain, as few of these colleges report the relevant debt data.⁴⁰ Beginning for the 2013 Annual Report as published by the Bureau for Private Postsecondary Education (the state agency that regulates private, for-profit colleges), institutions overseen by the Bureau will be required to report the college's three-year cohort default rate and the percentage of enrolled students receiving federal student loans.⁴¹

Nationally, 60% of the college class of 2012 graduated with some level of student debt at an average of \$25,884.⁴² Among those who attended a public, four-year university, 58% graduated with student debt at an average of \$24,443. 57% of graduates held federal student loans for an average of \$21,176. For graduates of private, nonprofit four-year universities, 65% finished with student debt at an average of \$29,309 and 63% graduated with federal student loans at an average of \$22,941. One analysis shows that nationally, 88% of graduates from private, for-profit four-year colleges in 2012 held student loans at an average of \$39,950.⁴³ This is significant, as students enrolled at private, for-profit colleges represent about 13% of the entire higher education population nationwide⁴⁴

(3.4 million students when counting institutions that award any postsecondary credential, including bachelor's degrees and certificates ⁴⁵).

Almost a third of all bachelor's degree recipients nationwide graduated with private loan debt, with the average level around \$13,600.⁴⁶ However, a higher rate, 41%, of student borrowers at for-profit colleges graduated with private loans.⁴⁷ An analysis of the class of 2012 graduates nationwide shows that 44% of all undergraduates who took out private loans did not maximize

their eligibility for federal student loans.⁴⁸ This indicates that, for students who have to resort to borrowing for college, these students are not being fully informed by high schools, colleges, or universities about their financial aid options. Steering students towards federal loan programs is preferable because federal loan borrowers have a myriad of consumer protections that private borrowers lack, such as repayment grace periods and the ability to choose between uniform, flexible repayment options, detailed later in this report.

Nationally, the share of students who will graduate debt-free varies by institution type attended

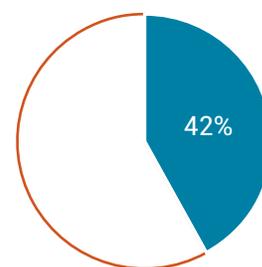
Percentage of Students Graduating Debt-Free

DEFINITIONS OF TYPES OF COLLEGES AND UNIVERSITIES

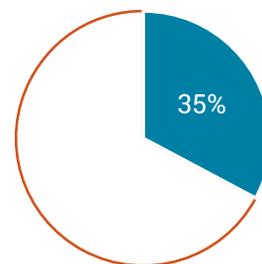
In California, public colleges and universities refer to the California Community Colleges, the California State University, and the University of California systems. Each of these three systems receive direct funding from the state government and is governed by a public entity. In contrast, a private university is not operated by a government body and its funding is derived from tuition, investments and private donors, as opposed to direct public funding. The distinction between a private, nonprofit university and a private, for-profit college or university (also commonly referred to as a proprietary school) is that a nonprofit university is largely mission-driven, while a for-profit college is defined as profit-driven; that is, a for-profit college seeks to provide financial returns for its shareholders.

The private, for-profit higher education sector has drawn scrutiny in recent years at both the national- and state-levels. Since 2010, the U.S. Department of Education has been developing "gainful employment" regulations for vocational programs at for-profit institutions and community colleges as an eligibility requirement for federal student aid. These regulations are designed to measure the employability of college graduates based on the quality of education provided at a college or university, using metrics such as the debt-to-earnings ratios of graduates. The federal Government Accountability Office had previously reported on an investigation in 2010 that examined student-recruiting practices at several for-profit colleges, which found that these institutions engaged in deceptive practices and sometimes fraud.⁴⁹

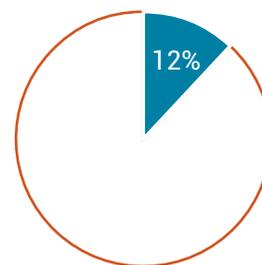
In 2011, California policymakers adopted eligibility standards for colleges and universities participating in the state Cal Grant programs, and updated those standards in 2012. Eligibility required colleges and universities to meet minimum graduation rate and maximum cohort loan default rate criteria to ensure that the state's investment in Cal Grant was beneficial to students.



Public
4-Year



Private,
Nonprofit



Private,
For-Profit

Sources: Author's analysis of College InSight. (Accessed September 2013). The Institute for College Access & Success. Retrieved from <http://college-insight.org>. Cochrane, Debbie and Matthew Reed. (December 2013). *Student Debt and The Class of 2012*. The Institute for College Access & Success. Retrieved from http://www.ticas.org/pub_view.php?idx=922.

Student Loan Default

The student loan default rates of graduates vary by the type of college or university attended. The U.S. Department of Education reported that the national three-year cohort default rate for borrowers (the percentage, over a three year period, of student loan borrowers who failed to repay their loans according to the agreed terms) who entered repayment during fiscal year 2010 reached 14.7%.⁵⁰ That means of the more than four million student loan borrowers nationwide who entered repayment between October 1, 2009 and September 30, 2010, about 600,000 graduates defaulted on their loans by the end of September 2012.

While the national default rates during that time period for graduates of public and private, nonprofit colleges and universities were 13% and 8.2%, respectively, the default

rate for those who attended private, for profit colleges was 21.8%.⁵¹ Nationally, graduates of private, for-profit colleges make up 46% of all student loan defaults, or about 276,000, between October 2009 and September 2012.⁵² Furthermore, increases in default rates have occurred more rapidly at private, for-profit colleges. Nationally, between 2007 and 2009, the default rate at for profit colleges increased by 36%, while the rates at public and private, nonprofit colleges and universities rose by 22% and 24%, respectively.⁵³ As reported by the Sacramento Bee, from 2006-08 in the Sacramento region of California, although private, for-profit colleges enrolled about one-eighth of the area's postsecondary students, these students were responsible for about two-thirds of the region's student loan defaults.⁵⁴

WHAT DOES IT MEAN TO DEFAULT ON A STUDENT LOAN?

Defaulting on a federal student loan has serious consequences for the borrower. To default means a student borrower has failed to make scheduled payments according to the terms of the Master Promissory Note, the legal document that outlines loan conditions. For borrowers who make monthly repayments, default occurs when he or she fails to make a payment for 270 days. However, loan servicers report all delinquencies of at least 90 days to the three major credit bureaus, impacting credit ratings negatively, which then will affect access to other services, such as apartment rentals. Other consequences of being in default include having the entire unpaid balance of the student loan be immediately due; loss of eligibility for additional federal student aid; and, wage garnishment whereby earnings are withheld and paid directly to the federal government. Furthermore, there is no statute of limitations on student loan debt collection.

Socioeconomic Status & Student Loans

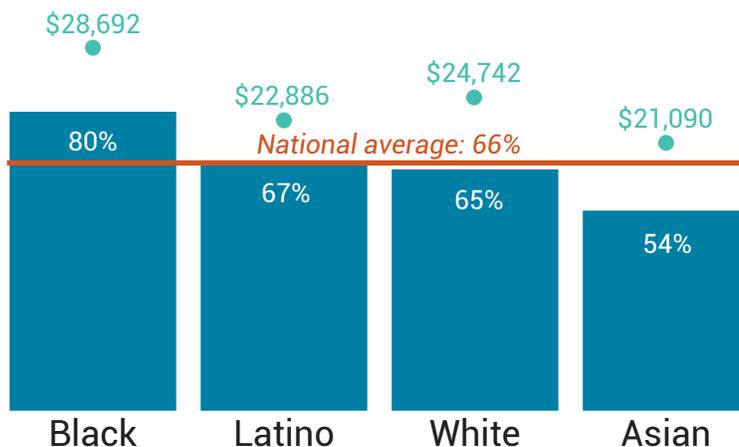
The correlations among the amount of student loan debt incurred, the type of student loan taken out, the rate of default, and the type of institution graduated from are particularly troubling because historically underrepresented populations in higher education, such as African Americans, take on higher levels of debt and at a greater frequency than their peers. Among bachelor's degree graduates in the United States in 2008, 80% of all African American college students had educational loans, the highest rate among all ethnic groups, while the average among all ethnic groups is 65.6%.⁵⁵ African American college students also have the highest average level of debt at \$28,692, nearly \$4,000 more than

the next highest ethnic group of Whites and at least \$3,800 more than the average level of all students in the country.

Another underrepresented population, students from low-income families, are overrepresented at the private, for-profit colleges. Nationally in 2008, 11% of all first year college students attended a for-profit college. However, when that rate is broken down by socioeconomic status, 19% of the first-year college students who were in poverty enrolled in one of those colleges, compared to only 5% of students who were not in poverty.⁵⁶ Enrollment data shows a trend that students in poverty have been entering private, for-profit colleges at

African Americans have the highest rate of taking out student loans to finance their education in the nation of all racial/ethnic groups

National Rates of Borrowing Among Bachelor's Degree Earners and Average Amount Borrowed by Race/Ethnicity, 2008



Source: Hiltonsmith, Robert. (August 2013). *At What Cost? How Student Debt Reduces Lifetime Wealth*. Demos. Retrieved from <http://www.demos.org/what-cost-how-student-debt-reduces-lifetime-wealth>.

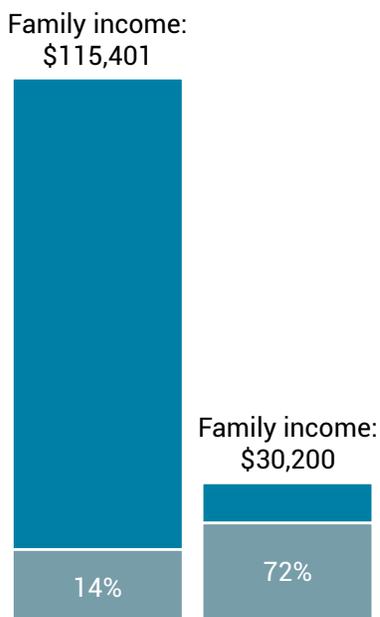
Low-income families in the U.S. will spend a much higher percentage of their income on college costs

an increasing rate: in 2000, poor students enrolled at a rate of 13% compared to 19% in 2008. Enrollment of the same population at public colleges and four-year universities decreased by 3 and 5 percentage points to 6% and 15%, respectively.⁵⁷

The relative cost of a college education is far more burdensome to lower income families than other households, according to a study by the Federal Reserve Bank of San Francisco that looked at student borrowers in the western United States. On average, for a student whose family income is \$30,200 a year, the share of income that is required to pay the net college education cost (as calculated by unmet need of the cost of attendance after considering grant aid) is 72%.⁵⁸ This is in stark contrast to a student whose family income exceeds \$115,000, as this student and his or her family would only have to spend 14% of annual income on college costs.

Specifically for California students attending one of the three public college or university systems, a separate analysis shows that the share of total income required to pay the net cost of higher education for a student whose family annual income is \$30,000 is more than the share of a student whose family annual income is \$150,000.⁵⁹ The difference is more dramatic when examining the share of discretionary income for students attending the University of California: a student whose family annual income is \$30,000 will have to spend 64% of discretionary income for college, while a student whose family annual income is \$150,000 will have to spend a much smaller share: 21%.⁶⁰ This means that the financing gap between the net cost of higher education and discretionary income is largest for families in the lowest income range, and likely has to be met by non-grant aid such as student loans.

Higher Education Costs by Family Income, 2007



Source: Lynch, M., Engle, J., & Cruz, J. (2011). *Priced Out: How the Wrong Financial-Aid Policies Hurt Low-Income Students*. The Education Trust, June 2011. Retrieved from <http://www.edtrust.org/dc/publication/priced-out>.

THE COST OF HIGHER EDUCATION TO A STUDENT

Traditionally, when a student and his or her family evaluate the cost of attending college, the focus lies on the college's tuition and fee rates. However, other costs of attendance, such as housing and transportation, are significant factors, particularly as these costs rise. A student's total financial aid package, including loans, cannot exceed the school's estimated total cost of attendance, which includes not only tuition and fees, but also estimated housing, transportation, and personal expenses. However, this ends up serving as a ceiling to limit the amount of financial aid available, as opposed to a floor. Moreover, when students take longer to complete an educational program, they incur more costs through continued attendance, miss out on years of potentially higher earnings, and increase their risk of dropping out altogether. Therefore, in addition to improving the percentage of students applying for financial aid and reducing students' time to completion, federal and state grants should be designed to help students pay for the total cost of education beyond just tuition and fees, in order to help reduce reliance on student loans.

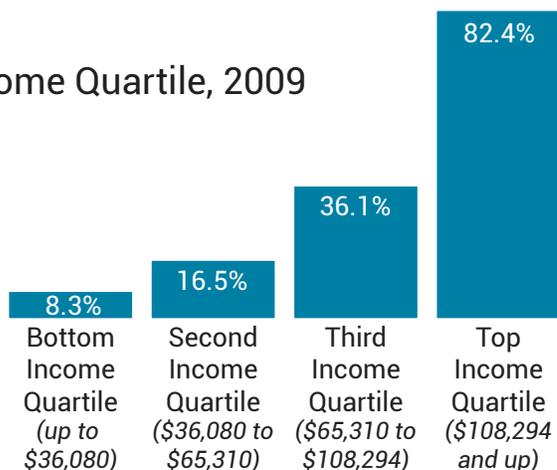
Private student loans are intended to “fill the needs gap” of students whose financial aid and federal loans cannot fully cover the cost of higher education, and are not meant to be the primary mechanism for financing higher education. However, as indicated previously, nationwide data shows that 44% of all undergraduates who took out private loans did not maximize their eligibility for federal student loans. Further affecting the neediest populations, low income students will carry just as much in private loan debt as peers from higher income backgrounds.⁶¹ Nationally for the 2007-08 school year, students whose parents earned less than \$36,000 utilized private loans at about the same rate as students whose parents earned more than \$105,000.⁶² This aligns with other indicators that low-income students are not receiving enough need-based financial aid and/or that low-income students are attending expensive, for-profits in greater proportion than other students from different economic classes, both troubling trends.

Low-income students, and especially those who are first in their families to go to college, already face several challenges to success in obtaining a college education. These students are disproportionately from ethnic and racial minority populations that have historically lower levels of academic preparation. They also tend to be older, are less likely to receive financial support from their family, and are more likely to have obligations outside of their college education, such as work.⁶³ Some of these factors have been found to be predictors of whether a student will default on his or her student loan obligations.⁶⁴

One national study found that 82% of young adults from the top income quartile (defined as annual incomes of greater than \$108,294) earned a bachelor's degree by age 24, but only 8% of those from the bottom income quartile (\$36,080 or below) had done so.⁶⁵ This means that low-income students graduate with similar debt burdens to their higher income peers, but attain a four-year degree at a much lower rate.

Nationally, students with family incomes in the top income quartile are nearly 10 times as likely to earn a BA by age 24 than students in the bottom income quartile

Bachelor Degree Attainment by Income Quartile, 2009



Source: Postsecondary Education Opportunity. (November 2010). *Family Income and Educational Attainment, 1970 to 2009*. Retrieved from http://www.postsecondary.org/last12/221_1110pg1_16.pdf.

Federal Loans Available to Undergraduate Students

Per federal regulations, a student's total financial aid package, including student loans, cannot exceed the school's declared total cost of attendance. The basic process for establishing eligibility for federal student loans remains the same, regardless of which program or type. The student must have completed a Free Application for Federal Student Aid (FAFSA), a common form used by the U.S. Department of Education to determine eligibility for student financial aid. Applicants must be U.S. citizens or permanent residents, and be enrolled at least half-time in a qualified program at a participating college or university. Additionally, the applicant cannot be in default on a prior federal student loan or have been previously convicted of a drug offense while receiving federal financial aid.

There is a strong correlation between a student completing a FAFSA and then going on to attend college, as more than 80% of eligible high school students who did not enroll in college cited cost as a key barrier.⁶⁶ However, not enough high school graduates are even applying for federal and state financial aid. For California's high school graduates in 2013, data shows that only 61% of the state's more than 400,000 public high school graduates completed the FAFSA.⁶⁷ Additionally, only 58% of graduates applied for Cal Grants (the state's primary financial aid program, which uses the FAFSA and GPA verification to determine eligibility, detailed in sidebar). This means that there are potentially millions of dollars in federal and state financial aid being unclaimed by eligible students. Receiving grants that

Undergraduate Federal Student Loan Options (for loans disbursed between July 2013 and July 2014)

Loan Type	Annual Maximum	Maximum Total	Interest Rate	Subsidized/ Unsubsidized	Lender	Borrower
Federal Perkins	\$5,500	\$27,500	5% fixed	Subsidized	Educational institution	Undergraduate students with exceptional financial need
Direct Subsidized	Varies depending on class standing and dependence of student (\$5,500 annual maximum for dependent freshman; \$12,500 annual maximum for independent student)		3.86% fixed	Subsidized	U.S. Department of Education	Undergraduate students with financial need
Direct Unsubsidized	Unsubsidized	Undergraduate students, no financial need required				
Direct Parent PLUS	Student's total borrowed loan amount based on school's declared total cost of attendance, minus other financial assistance		6.41% fixed	Unsubsidized	U.S. Department of Education	Parents of dependent undergraduate students

do not need to be repaid or opportunities for work-study would reduce a student's reliance on student loans to fund his or her higher education.

In addition to submission of a completed FAFSA application to demonstrate eligibility for financial aid, student borrowers are required to sign a Master Promissory Note, a legal document that outlines the loan terms and conditions, such as how interest is calculated and what payment deferment provisions are available. Borrowers are also required to complete an entrance counseling session before loan disbursement and an exit counseling session before leaving school. Entrance counseling focuses on how to manage educational expenses, and rights and responsibilities as a borrower. Exit counseling focuses on how to avoid default and available repayment options.

However, in the state of California, there is lack of consistency in the method and the type of information provided to student borrowers through counseling. Some colleges may require each counseling session to be performed in-person, while others may allow the sessions to be completed online simply by clicking through a series of screens. Furthermore, counseling sessions largely serve to disclose general, legal information about student loans instead of individualized support based on a borrower's specific situation and needs.⁶⁸ Ideally, as opposed to the current use of average loan amounts, these sessions would base figures and suggested actions on the amount of debt the student has actually incurred. This tailored information could include the resulting monthly and total payments under different repayment plans (detailed below) in order to help the student minimize his or her total borrowed debt and interest amount.⁶⁹

For undergraduate students, there are three main types of federal student loan programs available. Rates and figures below are for

loans disbursed between July 2013 and June 2014.

The Federal Perkins Loan

At participating institutions, the Federal Perkins Loan Program is a loan program available to undergraduates and graduate students who have exceptional financial need, which is defined by the school, but generally means students who have an Expected Family Contribution (EFC) of less than \$10,000 and who have remaining financial need after taking into account other financial assistance.⁷⁰ Students are eligible to receive up to \$5,500/year, for a maximum of \$27,500 for an undergraduate program. This loan has a fixed interest rate of 5%, which is subsidized by the federal government, meaning a borrower does not accrue interest on the loan until the student leaves school or is no longer enrolled at least half-time. Borrowers have a grace period of nine months after graduation before repayment begins. Under this program, the school is the lender, as opposed to the federal Department of Education; payments are made to the school or the school's loan servicer instead of the Department. This also means that Perkins Loan amounts are dependent upon the availability of funds set aside at each college or university for each award year and therefore, make up a small share of all student loans issued.⁷¹

Stafford Subsidized and Unsubsidized Loans

The Direct Loan Program, which issues Stafford loans (alternatively referred simply as a Direct loan⁷²), makes up the largest segment of federal student loan offerings. Initially, these loans were made through two providers, with the first being the Federal Family Education Loan Program, in which loans were issued by private lenders, such as banks or credit unions. Loans administered by these lenders were guaranteed against default by the federal government. This

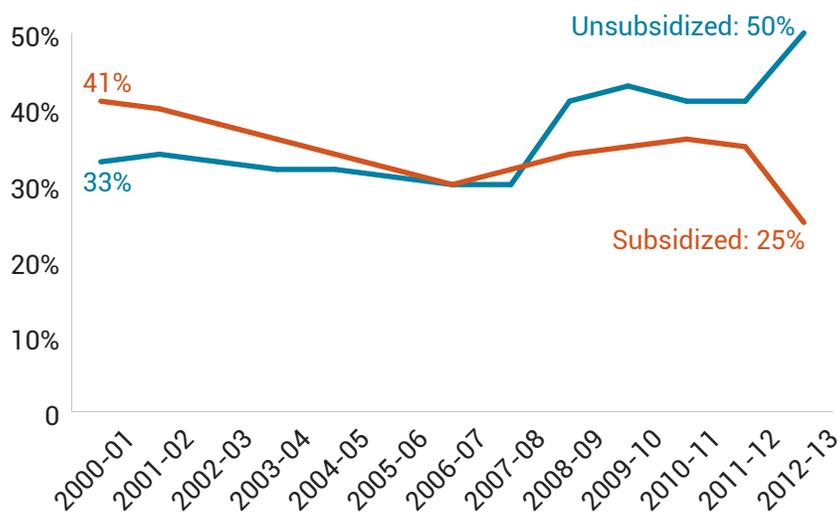
program was eliminated in 2010, and now all Stafford loans are provided to students by the federal Department of Education through the Direct Loan Program. The maximum loan amounts for undergraduates are based on class standing (e.g. freshman vs senior) and whether a borrower is considered dependent (most students under the age of 24) or independent (students age 24 or older). The annual amounts range from \$5,500 for a dependent freshmen to \$12,500 for an independent senior (exceptions to this cap are allowed for certain circumstances, such as when an undergraduate's parent is denied a loan under the Direct Parent PLUS Program).

There are two types of loans available to undergraduate students through the Direct Loan Program, neither of which require a credit check. The current interest rate for both loan types, which is fixed for the life of the loan, is 3.86%.

- Subsidized loans are made to eligible undergraduate students on the basis of financial need and, similar to the Perkins Loan, the interest on these loans is subsidized by the federal government while the borrower is enrolled at least half time. The portion of an annual Stafford Loan that may be subsidized is also based on class standing.
- Unsubsidized loans are available to undergraduates regardless of financial need. Under this loan, interest is charged throughout the life of the loan. Additionally, borrowers have a grace period of six months after graduation before repayment begins. Nationwide from 2000-01 to 2012-13, the proportion of Stafford subsidized loan dollars among all other student loan dollars decreased from 41% to 25%, while the proportion of unsubsidized loan dollars increased from 33% to 50%.⁷³ This is likely due, in part, to a federal change

During the Great Recession, the amount of unsubsidized dollars loaned to students in federal Direct Loans began to outpace subsidized dollars

Federal Direct Loan Dollars in 2010 Dollars



Source: College Board. (October 2013). *Trends in Student Aid 2013*. Retrieved from <http://trends.collegeboard.org/student-aid>.

in 2008 that increased the annual and aggregate unsubsidized loan limits for undergraduate students.

Direct Parent PLUS Loan

The PLUS Loan is offered to, in addition to graduate or professional students, parents of dependent undergraduate students, where the parent is the borrower on behalf of the student child. For the Parent PLUS Loan, both the parent and student must meet eligibility requirements for federal student aid and a credit check on the borrower is required. If the parent borrower has an adverse credit history, a co-signer/endorser that qualifies for the Parent PLUS Loan must be added onto the agreement. While there is no maximum loan amount under the Parent PLUS Loan Program, the loan cannot exceed a student's total financial aid need based on a school's declared total cost of attendance,

minus other financial assistance. The interest rate for this category of student loan is currently 6.41%, which is fixed and is not subsidized.⁷⁴ There is no grace period for the Parent PLUS Loan, so repayment begins as soon as the loan is disbursed.

Finally, the federal government also offers consolidation loans, which allow borrowers to combine all eligible federal student loans into a single loan with one loan administrator. The advantages for borrowers are the ease of dealing with a single servicer and a single monthly payment, which may be lower than the borrower's existing combined payments when the repayment term on a consolidated loan is longer than a standard 10-year term. The fixed interest rate for the consolidated loan is based on the weighted average of the interest rates of the loans being combined, and is not capped%.⁷⁵

Repayment Plans for Federal Student Loan Borrowers

There are several repayment options for Direct subsidized and unsubsidized student loans (not Perkins or Direct Parent PLUS loans), and the benefits of each option are dependent upon the individual circumstance of the borrower, factoring in the amount borrowed, annual income, etc.

- **Standard repayment plan** is applied should the borrower not select another option (generally, lenders allow borrowers to change repayment plans at least once a year). Under this

repayment option, payments are set to a fixed amount of at least \$50 per month for up to 10 years. Through standard repayment, borrowers will pay less interest on the loan over time than under any other plan.

- Borrowers can opt for the **graduated repayment plan**, for which monthly payments are lower at first and then increase over time, usually every two years, for up to 10 years. This plan is intended to mirror a borrower's

income earnings in the workforce and expected increases over the years after graduation.

- Another option, specifically for borrowers whose loan balances exceed \$30,000, is the **extended repayment plan**, in which monthly payments may be fixed or graduated over a period of up to 25 years. Payments will be significantly lower for extended plans than the other options, but borrowers will pay more on the loan over time due to interest.

In addition to the traditional repayment plans for Direct subsidized and unsubsidized loans, student borrowers also have a number of repayment options based on their future income and earnings. Income-based repayment options are not available to borrowers in default (discussed in the sidebar on student loan default).

- Under the first plan, **income-based repayment (or IBR)**, the maximum monthly payments are set at 15% of discretionary income, which is largely defined as the difference between a

PRIVATE STUDENT LOANS

Although the vast majority of student loan debt is held or guaranteed by federal loan programs, the impact of private student loans cannot be ignored. Private student loans are made by private banks or lenders from for-profit businesses, as opposed to the federal government. Estimated at approximately \$165 billion nationwide,⁸² private student loans are disproportionately held by borrowers who owe significantly more in student loan debt. Of all student borrowers nationwide who held over \$40,000 in student debt by graduation, 81% did so with some level of private student loans.⁸³

These borrowers lack the consumer protections that federal student loan borrowers have, such as repayment grace periods and the ability to choose between the myriad of flexible repayment options. Without uniform, flexible repayment options available, borrowers face difficulty in modifying repayment terms in times of hardship; this lack of protection was most common type of complaint filed with the federal Consumer Financial Protection Bureau during 2012-13, numbering in the thousands.⁸⁴ Moreover, students who take out private loans are not required to complete any entrance or exit counseling regarding the loan terms or the responsibilities of the borrower.

While other sources of unsecured credit, such as credit card or gambling debt, can be discharged in bankruptcy, in 2005 Congress reformed bankruptcy laws so that private student loans could not be discharged unless the borrower meets a very high burden of proof in an adverse proceeding. Recent efforts in Congress have been introduced to attempt to eliminate these protections for private lenders for the benefit of student borrowers, but the outlook on these efforts are not certain. Likewise, federal student loans cannot be discharged in bankruptcy, but most federal loans offer several repayment options to borrowers in order to help reduce the risk of default.

borrower's adjusted gross income and 150% of the poverty guideline for the borrower's family size and state of residence. The borrower, whose monthly payment will change as earnings change based on the formula for discretionary income, must demonstrate a partial financial hardship. Hardship is defined as when a student borrower would be required to make monthly payments under a standard repayment plan that would result in a higher monthly payment amount than under an IBR plan.⁷⁶ Additionally, federal student loans that qualify for IBR are eligible to be forgiven after 25 years of qualifying monthly payments (if the loan has not been repaid at this point), although the forgiven amount would be considered taxable income for filing purposes.

- In addition to eliminating the Federal Family Education Loan Program, the 2010 Health Care and Education Reconciliation Act modified the IBR provisions, set to be effective for new loans made after July 1, 2014.⁷⁷ The terms under this option are slightly less burdensome: the maximum monthly payment will be set at 10% of discretionary income and the loan forgiveness period is after 20 years of qualifying monthly payments. Similar to the IBR provisions, a borrower must demonstrate a partial financial hardship and may end up paying more on the loan over time than under the 10-year standard repayment plan. A similar plan to fill the gap before the 2014 change is the **Pay As You Earn** repayment plan. The Pay As You Earn plan is specifically for new borrowers between October 2007 and October 2011, and has the same terms as the 2014 IBR plan.⁷⁸

- The **Income-Contingent repayment plan (ICR)** is another form of a repayment plan based on a borrower's earnings, as monthly payments are calculated each year for up to 25 years and are based on adjusted gross income, family size, and the total amount of federal student loans owed. The maximum monthly payment under ICR is set at 20% of discretionary income. Loans under ICR are also eligible to be forgiven after 25 years of qualifying monthly payments; however, like all other income-based repayment options, borrowers may have to pay income tax on the loan amount that is forgiven.
- No longer available to new borrowers who receive disbursements after 2010, the **Income-Sensitive repayment plan** allowed monthly payments that could increase or decrease, based on a borrower's annual income.

As of the end of 2013, nationwide there are 1.69 million student loan borrowers participating in some form of repayment plan based on income and earnings.⁷⁹ That figure is dwarfed by the remaining 14.28 million loans under standard or other repayment plans; the Obama administration has identified at least 3.5 million other borrowers who are eligible for a loan repayment plan based on income, but are not participating.⁸⁰ As of May 2013, 97,822 of borrowers participating in the income-based repayment plan are located in California; state participation in Pay As You Earn and income-contingent repayment plans is not publicly available.⁸¹

Recent Changes to Federal and State Policy Affecting Student Loans

Federal

In 2007, the College Cost Reduction and Access Act was signed into law, which produced major changes in federal financial aid administration. The major provisions of the bill relating to the federal student loan programs include the creation of the income-based repayment plan, ensuring that qualified borrowers with student loan debt will have manageable payments.⁸⁵ The law also phased in a reduced interest rate on Direct subsidized loans for undergraduates, to a low of 3.4% in 2011. Finally, the 2007 College Cost Reduction and Access Act also allowed student borrowers in the Direct Loan Program, who spend ten years in a public service profession and make regular payments, to be eligible for loan forgiveness.

The 2008 reauthorization of the Higher Education Act also made several changes to federal financial aid regulations, such as simplification of the FAFSA application and the mandate of a net price calculator posted on a college's or university's website. The bill increased the annual Perkins Loan maximum limit from \$4,000 to the current \$5,500. The law also required institutions participating in federal financial aid programs to develop a transparent "code of conduct," detailing the responsibilities of the school regarding financial aid.

The 2010 Health Care and Education Reconciliation Act contained two key provisions relating to federal student loans: 1) modification of terms for the income-based repayment plan for new loans issued in 2014 and 2) the elimination of the Federal Family Education Loan Program, whereby all federal student loans are now issued directly by the U.S. Department of Education.

In December of 2011, President Barack Obama signed the Consolidated Appropriations Act, which made cuts to the funding of federal financial aid programs, including the elimination of interest subsidies during the six-month grace period post-graduation.⁸⁶ This change affected all new Direct subsidized loans made from 2012 to 2014. Most recently signed into law in the summer of 2013, the Bipartisan Student Loan Certainty Act ties student loan interest rates to a new market-based fixed rate. The rate is formulated each academic year based on the rate of the 10-year Treasury note, plus a set amount that depends on the type of loan received, ranging from 2.05% points for Direct loans to 4.6% points for PLUS loans. For the 2013-14 academic year, the interest rate of Direct loans for undergraduate students will be 3.86%, lower than the 6.8% interest rate through the expiration of the rate cuts from the 2007 College Cost Reduction and Access Act. However, the change in the interest rate formula also increased the maximum allowable interest rate for undergraduate student loans to 8.25%.

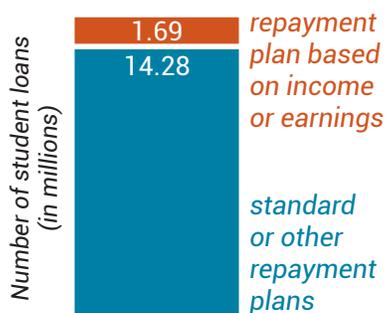
State

As federal student loans are administered by the U.S. Department of Education, policy changes are largely made at the Congressional level. However, there have been several efforts in the California Legislature to support student loan borrowers. In 2012, SB 1289 (Corbett) was signed into law (Chapter 623, Statutes of 2012). SB 1289 required private or independent postsecondary colleges and universities, the California State University, and the University of California (by request to the Regents) to provide certain information to students regarding federal and private student loans. Community colleges were requested to comply with the bill provisions. The bill requires schools to provide: materials to prospective or matriculated student that details federal student loan programs and repayment plans; information that clearly distinguishes between federal and private student loans, including variables such as interest rates and fees; and, should a private loan lender list be provided by an institution, for the list to contain general information about the loans and disclose that a student borrower can choose any loan lender.

While not directly affecting student loan policy, as part of the 2012-13 state budget act, updates were made to the institutional eligibility requirements for the state Cal Grant financial aid program, first established in the 2011-12 budget act. Colleges or universities with more than 40% of their students borrowing federal student loans have to meet these new requirements. A participating institution in the Cal Grant program must keep its federal student loan cohort default rate below 15.5%, meaning that 84.5% or more of the institution's federal student loan borrowers must not be in default within 3 years of completing their educational program. Additionally, more than 30% of an institution's students must complete his or her educational program within 150% of the published program length (e.g. within 6 years for a 4 year degree). While this change affected institutional eligibility, the Cal Grant eligibility of students themselves was not affected. At the time of enactment, all of California's public colleges and universities maintained eligibility for the Cal Grant state financial aid program; about 200 private colleges (primarily for-profit colleges) became ineligible.⁸⁷

Only a small fraction of student loans are being repaid through a plan based on income or earnings

December 2013



Source: Author's analysis of Federal Student Loan Portfolio. (Accessed January 2014). Federal Student Aid, U.S. Department of Education. Retrieved from <http://studentaid.ed.gov/about/data-center/student/portfolio>.

Recommendations to Improve College Affordability

In order for California to improve college affordability and reduce the number of students borrowing and the amount of loan debt, changes in policy, legislative, regulatory, institutional, and student behavior are necessary. Below are a set of recommendations that could help ensure greater college affordability. Some of the recommendations are as simple as urging students and families to apply for federal and state financial aid. Others require that high schools and colleges do a better job at educating students about debt options and alternatives.

High Schools

- Provide information on financial aid options to all students in high school, and incorporate this information into the school curriculum in order to better align with new Common Core state standards and other college-readiness initiatives.
- Require high schools to track how many students complete the FAFSA and apply for state financial aid, and require schools to use this data to set goals for increasing those rates of completion.
- To meet the requirement of the Cal Grant application and to reduce the burden on the student, require all high schools to electronically submit GPA and graduation verification for all high school seniors directly to the California Student Aid Commission.

Students and Families

- Ensure students maximize their federal and state financial aid and work-study offers by completing FAFSA and Cal Grant applications.
- If students have to utilize student loans, ensure that students maximize their eligibility for federal student loans before resorting to private student loans.
- Before choosing a college or university, review student success data and information on cost of attendance and loan default rates using the Federal College Scorecard as provided by the U.S. Department of Education (<http://collegecost.ed.gov/scorecard/index.aspx>).

Colleges and Universities

- Improve education and distribution of financial aid information to students and their families, especially on federal student loan repayment options in order to reduce the risk of default among graduates.
- Improve student loan entrance and exit counseling by utilizing common guidelines and to personalize counseling based on a student's financial situation.
- Reduce college time to completion in order to decrease the overall cost of a higher education, by offering

streamlined academic programs and more student support resources to help reduce unnecessary coursework.

- Control costs as a way to minimize tuition increases.

State Policymakers

- Preserve and, where possible, expand state financial aid opportunities to help students reduce their reliance on student loans.
- Increase the amount of state financial aid to cover necessary costs of attendance beyond tuition and fees for low- and middle-income students, especially for those enrolled at community college.
- Increase the number of competitive financial aid grant awards for students who do not receive a guaranteed grant.
- Expand funding and resources for the state's public colleges and universities to grow capacity, but hold the institutions accountable for improving

time to completion and graduation rates for all students, especially for those who are low-income and/or historically underrepresented minorities.

Federal Policymakers

- Make enrollment into flexible loan repayment options automatic when a federal student loan borrower is in danger of default.
- Allow private student loans to be discharged in bankruptcy, like all other consumer debt.
- Preserve and, where possible, expand the Pell Grant program to help close income gaps in college access and completion.
- Consider requiring private loan lenders to provide consumer protections that match what federal student loan programs offer, such as repayment grace periods and required entrance and exit counseling sessions.



Conclusion

California is in urgent need of more college-educated workers. The good news is that more and more students understand the value of a college degree and are pursuing a higher education. The challenge is that families and students are increasingly turning to borrowing to finance college. Students may not be taking full advantage of financial aid opportunities or flexible repayment options that exist to reduce financial their burden.

Student loans play an important role in making a college education accessible and affordable to millions of students, but the growth in student loan borrowing should be of concern. There are several factors driving the increase in student borrowing. Like many other states, California has cut back significantly on state support for public colleges and universities, leading to increases in student tuition and fees. Some college students may not be maximizing the financial aid available to them, potentially leaving millions of dollars in federal and state financial grant aid unclaimed. Finally, some financial aid packages do not necessarily reflect the full cost of a college education, including housing, transportation, and supplies, especially for community college students. This expands the financing gap for many students, who increasingly turn to borrowing.

As families are searching for ways to pay for college, some turn to private loans. These loans lack the consumer protections that federal student loan programs offer, such as repayment grace periods, uniform, flexible

repayment options, and required entrance and exit counseling sessions. While there have been some efforts to better regulate private lending at the federal and state level, shortfalls in student protections remain.

Many of the causes of increased student borrowing are identifiable, as are the many steps that could be taken to reduce student loan debt or make it more manageable. Students and families need to access existing grant programs to their fullest. High schools, colleges, and loan providers all need to do a better job of informing students of their financial aid options. Grant aid programs should be expanded to consider the full cost of attending college. Colleges and universities need to do a better job of graduating students on time. And any future tuition and fee increases should be moderate and predictable. All of these solutions will keep college affordable.

Recognizing the size and scope of student loan borrowing is a start in dealing with the problem. This report has documented the magnitude of borrowing and the trends.

Understanding the ramifications of growing debt is only now becoming fully realized and deserves to be watched closely for its impact on the overall economy and the growing disparities in wealth and income in the U.S.

Confronting the causes of what may be unnecessary or unmanageable borrowing and the roadblocks to solutions is an immediate necessity that cannot be understated.

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Methodology

The state and national figures throughout this report are not always directly comparable, as data for this report was collected from a variety of sources. Efforts were undertaken by the author to minimize the intersection of findings pertaining to national information and findings pertaining to California. In sections where multiple sources were used to illustrate figures, the text is clearly marked when separate populations are cross-examined. The dollar amounts and figures throughout the report have not been adjusted for inflation, as data is drawn from multiple sources. Several sources provide an analysis of figures based on current or nominal dollars at the time of publication, and are not adjusted for inflation.

The Campaign for
**College
Opportunity**

Los Angeles Office

714 W. Olympic Boulevard, Suite 745
Los Angeles, CA 90015
Tel: 213.744.9434
Fax: 800.207.3560
Executive Director: Michele Siqueiros

Sacramento Office

1512 14th Street
Sacramento, CA 95814
Tel: 916.443.1681
Fax: 916.443.1682
Associate Director: Jessie Ryan

www.collegecampaign.org



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