THE PROJECT ON STUDENT DEBT

Brief Analysis of Congressional Proposal to Cut the Student-Loan Interest Rate in Half

On January 17, 2007, the U.S. House of Representatives passed legislation that cuts the interest rate on certain federal student loans in half, from a fixed rate of 6.8% to a fixed rate of 3.4%.

What loans are affected?

- The legislation applies to Federal Subsidized Stafford Loans made to undergraduate students. Eligibility for Subsidized Stafford Loans is based on financial need. These loans are called "subsidized" because the federal government pays the interest while the borrower is in school, for six months after they leave school, and during periods of deferment for reasons such as economic hardship.

- If the legislation becomes law, the lower interest rate will be phased in over a five-year period, and apply only to new loans taken by undergraduates at colleges, universities and trade schools participating in the federal student loan programs. Loans currently held by students will not be affected.

    - The interest rate phase-in would occur according to the following schedule: 6.12 percent in 2007, 5.44 percent in 2008, 4.76 percent in 2009, 4.08 percent in 2010, and 3.4 percent in 2011 (and in subsequent years if the legislation is extended).

Who would benefit?

- If enacted, this legislation will benefit students who take out new loans during or after July 2007. It will not affect student debt accumulated before then. Because the interest rate reduction will be phased in over five years, borrowers who take out Subsidized Stafford Loans starting after July 2011 will benefit the most (if the legislation is extended). Approximately 5.5 million undergraduates took out Subsidized Stafford Loans in the 2004-2005 academic year.

- Subsidized Stafford Loans go primarily to students from middle- and low-income families, although a significant number of families with incomes of $80,000 or more also utilize the program. Eligibility is determined by a formula that includes both family income and actual college costs.

  - Most dependent undergraduate borrowers (those under age 24) with family incomes of $80,000 or less have Subsidized Stafford Loans. This includes 94% of student borrowers with family incomes below $40,000, and 80% of those with family incomes between $40,000 and $80,000. In addition, 40% of dependent undergraduate borrowers with family incomes above $80,000 carry Subsidized Stafford Loans.

- The majority of borrowers with Subsidized Stafford Loans (53.4%) attend public two-year and four-year institutions. However, there is significant Subsidized Stafford borrowing in other institutional sectors as well.

- Public four-year institutions, which represent 41% of the total undergraduate full-time enrollment, carry a comparable 43.9% of the Subsidized Stafford Loan volume. While 32% of full-time undergraduates attend public two-year institutions (community colleges), these schools account for a much smaller share -- 9.8% – of Subsidized Stafford borrowing. In contrast, private nonprofit four-year schools and private for-profits receive significantly larger shares of the subsidized loan volume than their shares of the full-time undergraduate population.

Proportion of Undergraduate Subsidized Stafford Loans (Volume and Borrowers) to Full-Time Enrollment

Institution Type	% of Total Full-Time Undergraduate Enrollment	% of Undergraduate Stafford Subsidized Loans	
		Volume	Borrowers
2-Year Public	32.0%	9.8%	13.5%
4-Year Public	41.0%	43.9%	39.9%
4-Year Private Nonprofit	18.0%	26.8%	26.8%
For Profit	8.0%	18.8%	18.8%

Source: U.S. Department of Education (loan data) and College Board (enrollment data)

<u>How much can students borrow in Subsidized Stafford Loans?</u>

- There are annual and aggregate loan limits on Stafford Subsidized Loans. The annual limits in effect beginning academic year 2007-2008 range from $3,500 to $5,500, based on the student's year in school. There is an aggregate limit of $23,000.

Federal Annual and Aggregate Borrowing Limits for Subsidized Stafford Loans	
1st Year	$3,500
2nd Year	$4,500
3rd, 4th, and 5th Years	$5,500
Aggregate Limit	$23,000

How much of Stafford loan borrowing do Subsidized Loans represent?

- The $16.3 billion in Subsidized Stafford Loans to undergraduates in 2004-5 represented 56.8% of all Stafford volume. Unsubsidized Loans make up the remaining 43.2%, a percentage that has been growing.

    - Unsubsidized Stafford Loans are available to all students, regardless of need. Students who are eligible for Subsidized Staffords are also eligible for Unsubsidized Staffords, which currently carry the same fixed interest rate of 6.8%. Borrowers must pay all of the interest that accumulates on Unsubsidized Stafford Loans both during and after school.

- In addition to federal student loans, college students are increasingly taking on private debt to finance their education, through non-federal or "alternative" student loans.

How much will students save if the interest rate is cut in half?

- A student with $20,000 in loans, paying under a standard 10-year repayment schedule, has a monthly payment of $230.16 at the current 6.8% fixed interest rate.

- If the interest rate is cut in half to 3.4%, the monthly payments will be $196.84, 14.5% lower than under the original interest rate.

- This would result in a savings of approximately $4,000 over the life of the loan.

The Project on Student Debt
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updated 1/17/07