



RESEARCH REPORT

Unaffordable Loans

When Should Schools Become Ineligible for Student Loan Programs?

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Chapter 1. Introduction

In this report, we develop a comprehensive set of benchmarks that provide reasonable criteria for allowing postsecondary institutions to award federal student aid. To develop these guidelines, we look to existing legislation and regulations in the US, policies that have been proposed but not implemented, and regulations in Canada.¹ We discuss the logic behind potential benchmarks, seeking ways to ground the benchmarking in evidence about the probabilities that borrowing will be a sound investment. We leave the design of specific policies that could operationalize these benchmarks to future work.

Regardless of whether they finance their education through borrowing, it is not advisable for students to enroll in colleges and universities that do not provide educational opportunities that have a high probability of improving their lives. Can we responsibly support access to government-sponsored loans and grants at institutions that do not adequately serve their students? Enrollment that does not pay off carries a high cost in terms of student time and resources. If students are also left with unmanageable debt, the difficulties they face are likely to be even more acute.

The federal government makes loans to college students because the private market would not provide the financing many students require on reasonable terms. Most students do not have extensive credit histories and have no collateral that lenders can appropriate in the event of default; many do not have willing and able cosigners.

Federal government loan programs make little attempt to assess whether students are well-suited for the educational programs for which they want to borrow. Student loan eligibility does not depend on personal characteristics or expected future income.² This is a purposeful strategy to facilitate access to postsecondary education for people with limited financial means, including those without strong academic preparation. If potential students were unable to borrow at reasonable rates, they would have no opportunity to invest in postsecondary education.

These arguments do not, however, justify the minimal standards to which institutions are subject. To participate in federal student aid programs, schools must be accredited, but the accreditation standards are not particularly stringent. Institutions with extraordinarily high student loan default rates can be barred from offering federal aid, but this rarely happens.

The goal of federal loan programs is to provide access to meaningful educational opportunities, not just to get students in the door of a postsecondary institution. Low college completion rates, high default rates, low repayment rates, and poor labor market outcomes challenge the integrity of the loan programs, both in terms of their contributions to student success and in terms of the productive use of federal funds.

A number of existing and proposed policies attempt to address this issue. First, postsecondary institutions can be excluded from federal student aid programs if they have very high default rates. Second, the federal government has implemented gainful employment regulations designed to exclude nondegree programs at public and private nonprofit institutions and all programs at for-profit institutions if their graduates do not have high enough earnings to support their loan payments. Finally, various ideas have emerged recently for requiring institutions with poor loan repayment records to bear a portion of the cost to the federal government of loan defaults. Canada has implemented similar cost-sharing policies.

Setting thresholds for the satisfactory performance of a loan portfolio is challenging. How much debt is too much for students? How high should a default rate be before it disqualifies an institution from making loans? How low can a repayment rate be? Are low average earnings among former students a reasonable criterion for disqualifying an institution from issuing loans to future students?

This report reviews issues central to defining thresholds for institutional performance and proposes benchmarks for a set of metrics. We focus on suggesting minimum thresholds that could be incorporated into different policies designed to protect students from accruing debt for an education that is unlikely to be a good investment. We do not propose policy designs for risk sharing or formal procedures for eliminating institutions from the federal student aid system.

The benchmarks proposed below are minimum standards—what might be defined as thresholds for a “red zone.” In each case, there could also be a “yellow zone” that would signal unsatisfactory performance without carrying the same sanctions. The metrics we describe could be the basis of a more effective institutional eligibility system, with falling short of these standards signaling serious institutional problems. Based on our analysis, we propose the following thresholds:

- Default rate
 - » The three-year cohort default rate should not be greater than 20 percent.
 - » The share of a cohort’s loan dollars in default should not be greater than 12.5 percent.
- Repayment rate

- » At least 15 percent of each cohort's loan principal should be paid off within five years.
- » At least 40 percent of former students should have paid some of their loan principal within three years of leaving school.
- Completion rate
 - » At least 40 percent of enrolling students at four-year colleges and universities should complete a bachelor's degree within eight years and at least 25 percent of students enrolling in two-year institutions should complete a degree or certificate within 200 percent of normal time.
- Earnings
 - » Within two to three years after leaving school, at least 60 percent of an institution's enrolling students should earn more than the median for those who ended their formal education after high school graduation.

Chapter 2 discusses some fundamental issues that arise in the design of thresholds. Chapter 3 focuses on four categories of indicators of institutional outcomes.³ Institutions receiving federal student aid funds should meet standards for default rates, loan repayment rates, completion rates, and postcollege earnings. Chapter 4 discusses the possibility of creating a single composite metric. In our conclusion, we briefly review the merits of such thresholds and raise further questions for consideration.

Chapter 2. Design Considerations

When Are Thresholds Arbitrary and When Are They Reasoned?

Under the Administrative Procedure Act, a judge can be asked to review a decision made by a federal agency. The agency’s decision can be set aside if the judge rules that it was “arbitrary and capricious;” alternatively, the decision can be upheld if the judge rules that the agency has provided a “reasonable explanation for its decision.”⁴

This distinction became important in the context of student loan regulation in 2012, when Judge Rudolph Contreras issued his ruling in a suit challenging the gainful employment regulations issued by the US Department of Education (ED). ED proposed new thresholds for three indicators: the ratio of student loan debt to earnings, the ratio of student debt to disposable income, and the student loan repayment rate. Judge Contreras ruled that the first two indicators were based on “expert studies and industry practice—objective criteria upon which [ED] could reasonably rely.”⁵ However, he ruled the debt repayment rate standard to be arbitrary and capricious because it “was not based upon any facts at all.”⁶

Judge Contreras recognized that rules are sometimes somewhat arbitrary but argued that this state of affairs does not necessarily invalidate them. Citing previous cases, he wrote, “when an agency ‘must select some necessarily somewhat arbitrary figure’ in establishing bright-line rules, a court ‘will defer to [its] expertise if it provides substantial evidence to support its choice and responds to substantial criticism of that figure.’”⁷

Should the Thresholds Apply Similarly to All Types of Schools or Should Some Schools Be Exempt?

Thresholds for problematic institutional default rates already exist. If an institution’s default rate is more than 30 percent for three consecutive years or 40 percent for one year, it risks becoming ineligible for Title IV loans and grants.⁸ This rule applies to all postsecondary institutions—public, private

nonprofit, and private for-profit. It applies to four-year degree programs and to shorter degree and certificate programs.⁹

Trying to develop thresholds applicable to all schools may be problematic because of the differences in their student bodies. However, it should be possible to include relevant differences in the design of the regulations, rather than specifying that the restrictions apply to some sectors but not others. For example, in an effort to protect community colleges, current law and many proposals exempt schools in which less than 25 percent of students borrow. The logic here is that if only a small share of students borrows, their repayment patterns may not be representative of the student body as a whole. Even if this exclusion ends up applying only to public two-year colleges, it differentiates based on a substantive issue directly related to the regulation; if any for-profit schools successfully discouraged borrowing, they would also be exempt from sanctions.

Similarly, it makes sense to design metrics based on completion rates that account for students who successfully transfer to other institutions rather than setting lower thresholds for institutions with high transfer-out rates.

Should Thresholds Be Set in Absolute or Relative Terms?

Any threshold is to some extent arbitrary. Setting a standard based on typical institutional performance is appealing because it allows targeting of colleges with outcomes that are worse than average. The Canadian government has attempted to set benchmarks in terms of standard deviations from the mean—a measure that isolates a defined share of institutions with the poorest outcomes.¹⁰

But with relative standards, some share of institutions will always fail the test, no matter how much overall outcomes improve. The goal should be for all institutions to produce better results and exceed the thresholds. This is possible only with absolute, as opposed to relative, standards.

Should Thresholds Be Sensitive to Economic Conditions?

Student loan default and repayment rates and postcollege earnings vary with economic conditions. Institutions whose outcomes are close to specified thresholds when the economy is strong may fall below those thresholds in periods of high aggregate unemployment. The earnings metric we propose, based on the median earnings of high school graduates, would allow for lower earnings when the

economy is weak. In that case, the median earnings of those with only high school, and thus the associated metric, would be lower. Linking the student loan default and repayment metrics directly to economic circumstances is more challenging.

Should Student-Debt Thresholds Be Measured in Terms of Borrowers or Dollars Borrowed?

Two relevant loan performance indicators are default rates and loan repayment rates. One option for measuring these indicators is to count the number of borrowers who have defaulted or who have made any repayments. For example, if a cohort of an institution's former students consists of 1,000 people and 200 of them have defaulted on their student loans, the default rate could be measured as $200/1,000$ or 20 percent. Alternatively, the default rate could be measured as the dollar value of the defaulted loans divided by the dollar value of the loan principal borrowed by the cohort. Unless all former students borrowed the same amount, two schools could have the same default rate when measured as the proportion of borrowers in default but different default rates when measured as the proportion of dollars in default.

There are arguments for and against focusing on the number of borrowers as opposed to the dollars borrowed. On one hand, the number of borrowers who default is a clear signal of the share of students whose education has yielded unsatisfactory outcomes. On the other hand, the cost to taxpayers may be much greater when a small number of high-debt borrowers default than when a large number of low-debt borrowers default. For example, holding the number of borrowers constant, a 10 percent default rate with an average loss of \$50,000 will be more expensive than a 20 percent default rate with an average loss of \$20,000.

Chapter 3. Indicators of Institutional Eligibility for Federal Student Aid Programs

Our purpose here is to review expert studies on setting thresholds for institutional loan performance, to the extent that they exist; to review industry standards, as exemplified by the experience of Canada and its provinces in setting similar rules; and to develop logic for setting new benchmarks. The federal government has sought to exclude programs and institutions from participation in federal student aid programs based on student debt levels, default rates, and repayment rates. Because institutions might also be judged on their completion rates or on the employment and earnings outcomes of their students, we develop reasoning for thresholds relating to default rates, repayment rates, completion rates, and postcollege employment and earnings.

Default Rates

High default rates among former students have long been a criterion for making a school's current and future students ineligible for federal loan programs. In 1990, for example, Congress mandated that students in schools with default rates that were higher than 35 percent in 1991 would be ineligible for Title IV aid programs, including federal grants.¹¹ Currently, as noted above, students enrolled in schools with default rates that have been 30 percent or higher for three consecutive years, or greater than 40 percent for one year, cannot receive federal student loans for the ensuing three years.¹²

The relevant default rate is what is known as a cohort default rate or CDR. Every fiscal year, a cohort of students who last attended a particular school enters the repayment process. The proportion of those students who default on their loans within a certain period after entering repayment is the school's CDR. The CDR counts defaulters rather than dollars borrowed. That is, it measures the proportion of borrowers who have defaulted rather than the proportion of dollars in default.

Table 1 shows that two-thirds of defaulters have balances of less than \$10,000 and that default rates are negatively correlated with amounts borrowed. Focusing only on dollars in default would miss part of the problem by directing attention away from those who carry smaller loans.

TABLE 1

Defaulting Borrowers Who Entered Repayment in 2010–11, by Loan Balance

Loan balance	Share of defaulters	Three-year CDR
Less than \$5,000	35%	24%
\$5,001–\$10,000	31%	19%
\$10,001–\$20,000	18%	12%
\$20,001–\$40,000	11%	8%
More than \$40,000	4%	7%

Source: Council of Economic Advisers, *Investing in Higher Education: Benefits, Challenges, and the State of Student Debt* (Washington, DC: Executive Office of the President, 2016, figure 27).

Notes: Loan balance is measured at the time the borrower entered repayment. CDR= cohort default rate.

Nonetheless, the cost to taxpayers may be much greater when a small number of high-debt borrowers default than when a larger number of low-debt borrowers default. Table 2 shows that only 16 percent of the debt is held by the 57 percent of borrowers whose balances are \$20,000 or less. Half of all outstanding federal education debt in the US is held by the 13 percent of borrowers with balances exceeding \$60,000, so defaults among this group (which are relatively rare) could be quite expensive.

TABLE 2

Distribution of Outstanding Federal Education Debt by Balance, Third Quarter 2017

Outstanding loan balance	Share of dollars	Share of borrowers
Less than \$5,000	2%	18%
\$5,000–\$10,000	4%	18%
\$10,000–\$20,000	10%	21%
\$20,000–\$40,000	20%	21%
\$40,000–\$60,000	14%	9%
\$60,000–\$80,000	12%	5%
\$80,000–\$100,000	7%	2%
\$100,000–\$200,000	19%	4%
\$200,000 or more	12%	1%
Total	100%	100%

Source: Calculations by the authors from “Federal Student Loan Portfolio: Portfolio by Debt Size,” US Department of Education, Federal Student Aid, accessed January 2, 2018, <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>.

Default rates, however, are increasingly flawed as a metric because of rising participation in income-driven repayment (IDR) plans. In 2017, 27 percent of borrowers holding 44 percent of

outstanding federal debt were enrolled in repayment plans that limit required monthly payments to what the plans define as an affordable percentage of discretionary income. Just five years earlier, only 10 percent of borrowers holding 20 percent of dollars were enrolled in these types of plans (table 3).

TABLE 3

Share of Outstanding Dollars and Borrowers Income-Driven Repayment Plans

Federal direct loan programs

Year	Total dollars outstanding (in billions)	Share of dollars in IDR plans	Number of borrowers (in millions)	Share of borrowers in IDR plans
2013	\$361.3	20%	15.76	10%
2014	\$464.3	26%	18.21	14%
2015	\$574.8	34%	20.29	19%
2016	\$672.6	40%	21.84	24%
2017	\$768.0	44%	23.18	27%

Source: "Federal Student Aid Portfolio: Portfolio by Repayment Plan," US Department of Education, Federal Student Aid, accessed January 2, 2018, <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>.

Notes: Numbers refer to the values reported at the end of third quarter in each year. IDR = income-driven repayment.

The availability of IDR plans means that borrowers with low earnings have a repayment option other than default should they be unable to keep up with their loan payments. These plans do not require payments until borrowers' incomes are deemed to be high enough to support those payments. Because borrowers on IDR plans are counted as being in good standing even when they are not required to make payments, cohort default rates no longer measure the proportion of borrowers having severe difficulty repaying their loans.

One possibility is to lower the threshold defining problematic institutional default rates. Although our intent is to establish thresholds rather than to design particular policies, we can learn from thresholds proposed by existing and proposed *risk-sharing* or *default cost-sharing* proposals.

In the 1990s, the Canadian province of Ontario instituted a default cost-sharing program to address the problem of high default rates in its postsecondary institutions. Each year since 1998, the province has set a default rate threshold. If a school's default rate, calculated as the number of loans in default as a percentage of the number of loans issued, is above the threshold, it must pay for default costs above the threshold. The threshold was initially 38.5 percent, arbitrarily defined to be 15 percentage points above the provincial average default rate; since 2014, the threshold has been 20 percent.¹³ Schools must keep their default rates below the 20 percent threshold in at least one of every

four years or lose eligibility for the federal loan program. Part of the rationale for lowering the threshold was the increasing use of the Repayment Assistance Program, an income-driven repayment program.

A number of US proposals for institutional risk sharing—analogue to the Ontario default cost-sharing policy described above—propose low thresholds for penalties. Only a fraction of these risk-sharing proposals focus on default rates as opposed to repayment rates, and the default rate thresholds in risk-sharing plans are not necessarily the same as those appropriate for disqualifying institutions from making loans. Paying a penalty for low loan performance is a much less dramatic outcome than losing the right to participate in federal student aid programs.¹⁴ Nonetheless, it is instructive to review the benchmarks incorporated in these proposals:

- Senator Jack Reed introduced legislation in 2013 proposing default rate thresholds for institutions at which at least 25 percent of students participate in the federal student loan program. Penalties would begin at cohort default rates of 15 percent, with the maximum penalty affecting institutions with default rates 30 percent or higher.¹⁵
- Ahlman, Cochrane, and Thompson (2016) propose penalizing institutions where more than 20 percent of all students default; this proposal would lead to higher thresholds at schools where smaller shares of students borrow. If, for example, half of enrolling students borrow, their default rate would have to be at least 40 percent to trigger sanctions.
- Hillman (2017) would set the default rate threshold in relation to the average default rates among two-year and four-year institutions.

Because of the ineffectiveness of the current standard, we propose lowering the default rate threshold to the Ontario threshold of 20 percent. Further, we propose invoking penalties if an institution is below the threshold for two consecutive years in addition to incorporating a “yellow” zone for schools near the threshold.

Because accountability demands looking at dollars in default as well as at the number of defaulters, we recommend setting an additional threshold for the share of dollars in default based on the relationship between the overall percentages of dollars and of borrowers in default. Table 4 shows that, as of the third quarter of 2017, 16 percent of borrowers and 10 percent of dollars in the federal education loan portfolio were in default.¹⁶ That is, the default rate in terms of borrowers is 1.6 times larger than the default rate in terms of dollars. Applying that same ratio to a 20 percent threshold for the proportion of borrowers in default implies a threshold in terms of dollars of 12.5 percent.

TABLE 4

Federal Education Loan Portfolio by Loan Status

Third quarter 2017

Loan status	Dollars outstanding (in billions)	Borrowers (in millions)	Share of dollars	Share of borrowers
In school	\$120.9	6.5	11%	16%
Grace	\$41.9	1.7	4%	4%
Repayment	\$595.9	18.3	54%	46%
Deferment	\$114.6	3.5	10%	9%
Forbearance	\$114.8	2.7	10%	7%
Cumulative in default	\$113.5	6.5	10%	16%
Other	\$9.8	0.3	1%	1%
Total	\$1,111.4	39.5	100%	100%

Source: "Federal Student Loan Portfolio: Portfolio by Loan Status," US Department of Education, Federal Student Aid, accessed January 2, 2018, <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>.

Note: Includes outstanding principal and interest balance of Direct Loans, Federal Family Education Loan, and ED-held Federal Family Education Loan Program loans.

Proposed Benchmarks

The three-year cohort default rate, as currently measured, should not average above 20 percent over any three-year period. The share of dollars borrowed by a cohort of former students that is in default should not exceed an average of 12.5 percent of the total over any three-year period. Institutions where less than 25 percent of students borrow would be exempt and those where 25 to 30 percent of students borrow would face more flexible standards.¹⁷

Repayment Rates

The declining usefulness of the cohort default rate has led policy analysts to turn toward repayment rates as an alternative accountability measure.

The College Scoreboard Repayment Rate

The repayment rate can be defined in a number of ways. In the US, this rate is generally defined in terms of the experiences of individual borrowers, rather than in terms of the dollars they borrowed. For example, the College Scorecard reports the percentage of students entering repayment in a given year who have paid down at least one dollar of their loan principal within three years. According to these data, about 45 percent of borrowers have made progress within three years on diminishing the amount they owe.

One obvious issue with the College Scoreboard repayment rate is that it fails to distinguish between borrowers who have repaid only a small fraction of what they borrowed and those who are repaying an amount that will repay the loan in full over a reasonable time period (e.g., the standard 10-year repayment period).

A less obvious problem is the potential for institutions to manipulate the rate. Institutions could, for example, simply repay a small amount on behalf of their students to increase their institutional repayment rates.

The Canadian Experience

Since agreeing on and establishing a national framework in the mid-2000s (Intergovernmental Consultative Committee on Student Financial Aid 2008), Canada has used a student loan repayment rate as the primary measure for holding postsecondary institutions accountable for the loan performance of their students. The repayment rate is defined, for a given cohort of a school's former students, as the ratio of the loan principal that has either been paid or is in good standing to the total loan principal issued to that cohort. Because the loans of borrowers enrolled in Canada's income-driven repayment assistance plan are counted as being in good standing, an institution could, theoretically, have a 100 percent repayment rate even if none of its former students had retired any of their debt.

From the beginning, the framework has specified green, yellow, and red risk zones for institutional repayment rates. Originally, schools with repayment rates above the national average were in the green zone. Schools whose repayment rates were less than one standard deviation below the national average, however, were "targeted to improve their repayment rates" (Intergovernmental Consultative Committee on Student Financial Aid (2008, 18). Those with repayment rates more than one standard deviation below the national average were in a red zone and were at risk of losing their eligibility for government loan programs if their repayment rates did not improve. Those in the yellow zone were

encouraged to improve or face sanctions. If institutional repayment rates were normally distributed, about 16 percent of Canadian institutions would be in the red zone in any given year.

A shortcoming of setting benchmarks in relative terms became clear, however, when repayment rates increased over time and institutions found themselves chasing a moving target. The current benchmark for the red zone was therefore set “manually” at a 60 percent repayment rate.

The Chou, Looney, and Watson Proposal

Recent works by Chou, Looney, and Watson (CLW) (2017a, 2017b) adopt a metric for measuring loan performance based on the amount of principal paid within a five-year time period. The measure, which CLW call the institutional cohort repayment rate, is calculated as one minus the ratio of the principal outstanding five years after the loans entered repayment to the principal outstanding when the loans entered repayment (2017a, 8). Unlike the Canadian repayment rate, it includes all loans in repayment, whether or not the borrowers are enrolled in an IDR plan. This is a more effective approach, since it holds institutions responsible for their students’ low postcollege earnings even as the loan repayment system protects individual students.

Table 5 shows the proportion of loan principal that would be repaid after five years if the borrower made the payments required to pay off the loan in 10, 15, and 20 years.¹⁸ CLW propose a threshold of 20 percent of a cohort’s debt being paid down after 5 years, which would correspond roughly to the entire balance being paid off after 15 years. Schools with cohort repayment rates below 20 percent would begin to incur financial penalties under the proposed risk-sharing plan. Those with repayment rates below 15 percent would face heavier penalties. The authors estimate that about one-third of all postsecondary institutions in the US had repayment rates less than 15 percent on loans entering repayment in 2009–10 (Chou, Looney, and Watson 2017a, 2017b).

The CLW cohort repayment rate provides strong grounds for a metric based on the share of dollars borrowed that have been paid down. We propose CLW’s less stringent cut-off of 15 percent of loan principal repaid after five years as the threshold below which institutions would not meet repayment rate requirements.

TABLE 5

Progress on Repayment of Loan Principal after Five Years, by Length of Repayment Period

Repayment period	Principal repaid	Principal remaining
10 years	41.6%	58.4%
15 years	22.9%	77.1%
20 years	14.9%	86.0%

Source: Tiffany Chou, Adam Looney, and Tara Watson, *A Risk Sharing Proposal for Student Loans* (Washington, DC: Brookings Institution, 2017, 15).

Note: Assumes a 6.8 percent fixed annual interest rate.

A Threshold Using the College Scoreboard Repayment Rate

The CLW measure of the share of debt actually repaid may be the most logical approach to setting a repayment rate metric. The problems with poor loan performance, however, are not limited to the financial burden imposed on taxpayers. Regardless of how much they borrow, former students who default on their student loans can suffer significant hardship in the form of loss of eligibility for credit, wage garnishment, and even difficulties in getting a job or renting an apartment.

An additional metric based on the share of borrowers paying down at least \$1 of their loan principal (i.e., the College Scoreboard repayment rate) pays more attention to the problem of low repayment rates among borrowers with small debts, who constitute the majority of defaulters.¹⁹ A threshold using this metric could be based on the typical incomes of adults and typical levels of outstanding debt. In 2017, the average outstanding debt in the federal student loan portfolio was about \$28,000.²⁰ This includes borrowers with high levels of graduate and professional school debt and is significantly higher than the typical debt of borrowers who did not complete any postsecondary credentials. At a 6.8 percent interest rate—the rate that prevailed on Stafford Loans before rates were lowered and began to vary with market conditions—annual interest payments would be about \$1,900. Current IDR provisions assume that it is reasonable to expect borrowers to make student loan payments equal to 10 percent of the amount by which their incomes exceed 150 percent of the federal poverty level. For a single individual, 150 percent of the 2017 poverty level is \$18,090.

Under the IDR provisions, a borrower owing \$28,000 would need an income of at least \$37,000 to be required to pay the full \$1,900 in interest.²¹ An income higher than \$37,000 would allow the repayment of some principal. In 2015, only 30 percent of individuals age 25 and older with some college but no degree had incomes this high and would therefore be expected to be able to pay at least \$1 toward principal. Thirty-eight percent of associate degree holders and 53 percent of adults whose highest degree was a bachelor's degree met this standard. We propose basing the minimum threshold on the share of associate degree holders who would be paying down principal on the average loan for all borrowers. It would be unreasonable to apply a standard based on the earnings of bachelor's degree recipients since many institutions do not even offer these degrees. But the proposed standard is generous since it is based on average debt levels for all federal student loan borrowers.

Using the actual average borrowing of those with no degree or those with an associate degree would significantly increase the proportion who would be expected to pay down the principal by at least \$1. For example, basing the threshold on \$10,000 of debt instead of \$28,000 would reduce the required annual interest to \$680. Under the IDR provisions, borrowers would be expected to pay that \$680 in interest if their earnings were \$6,800 above 150 percent of the poverty level. Adding \$6,800 to \$18,090 (i.e., 150 percent of poverty level) would yield an earnings threshold of about \$25,000. In contrast to the 38 percent of associate degree holders with high enough earnings to pay down at least \$1 of a \$28,000 debt, 73 percent earned more than \$25,000 in 2015, allowing them to reduce the principal on a \$10,000 debt.

Proposed Benchmarks

Following the CLW proposal (2017a, 2017b), each institution should have a cohort repayment rate of at least 15 percent. That is, 15 percent of the cohort's loan principal should be paid off within five years.

Alternatively, using the College Scoreboard repayment rate, a minimum of 40 percent of former students should be repaying at least some of their loan principal within three years, corresponding to the share of associate degree holders with income high enough to repay a portion of the principal on the average outstanding debt.

Completion Rates

Based on data from the Integrated Postsecondary Education Data System (table 7), 40 percent of first-time students who enrolled full time in a four-year institution in 2008 graduated from that institution within four years and 62 percent graduated within eight years. Only 29 percent of first-time students who enrolled full time in a public two-year institution and 36 percent of those who enrolled in any two-year institution in 2012 graduated within 200 percent of the expected time.²²

TABLE 7

Share of First-Time Full-Time Students Completing at First Institution within 150 Percent and 250 Percent of Normal Time

Percentage of normal completion time	All	Public	Private nonprofit	For-profit
Seeking bachelor's degree at four-year institution (2008 cohort)				
100%	39.8%	34.4%	52.9%	16.8%
150%	59.7%	58.4%	65.5%	26.0%
200%	61.9%	61.2%	66.6%	27.3%
Seeking degree or certificate at two-year institution (2012 cohort)				
100%	19.1%	12.6%	46.0%	42.8%
150%	31.5%	23.5%	56.7%	61.9%
200%	36.1%	29.0%	61.1%	63.0%

Source: Scott Ginder, Janice Kelly-Reid, and Farrah Mann, *Graduation Rates for Selected Cohorts, 2008–13; Outcome Measures for Cohort Year 2008; Student Financial Aid, Academic Year 2015–16; and Admissions in Postsecondary Institutions, Fall 2016* (Washington, DC: National Center for Education Statistics, NCES 2017-150rev, table 2).

Completion rates like those in table 7 are imperfect indicators of institutional success. Completion rates are highly correlated with the academic preparation of incoming students. For example, six-year completion rates for first-time full-time students at their first institution range from 32 percent for open admissions institutions to 56 percent for those accepting 75 to 90 percent of applicants and 88 percent for those with admissions rates below 25 percent.²³ Despite strong evidence that similar students are more likely to complete bachelor's degrees if they enroll at more selective four-year institutions than if they begin at two-year or less-selective four-year colleges and universities (Bowen, Chingos, and McPherson 2009; Kelly, Howell, and Sattin-Bajaj 2016), it is not reasonable to expect institutions that accept most or all comers to meet the same completion rate standards as selective institutions. The completion rate is partly an indicator of the characteristics of incoming students, not necessarily of the value of the education provided.

Using institutional completion rates to measure success also fails to capture the benefits of allowing students to try different paths before deciding on any one of them. For example, switching from an unsuitable program at one community college to a more suitable program at a different community college will lower the completion rate at the first institution if transfers are not appropriately accounted for, but it might not say anything about its quality or the long-run success of its students. The problem is less severe for four-year institutions, where changing majors may not affect completion rates, even if the switch leads to an extra year of enrollment.

Current official US Department of Education metrics count only first-time full-time students and do not track students when they transfer and complete a degree at another institution. However, ED is now publishing more meaningful completion rates that include part-time and returning students. These more comprehensive completion rates provide a stronger foundation for benchmarking.

Although developing meaningful standards for completion rates is difficult, we believe that it is reasonable to do so by setting a low threshold. The federal government should not fund or encourage students to enroll at institutions where virtually none of the students graduate, no matter how poorly prepared the student body is. Accordingly, we propose a threshold for completion rates below which institutions should not be eligible for federal student aid, recognizing that such a policy would be unlikely to have an impact on selective institutions. We propose that at four-year institutions, the threshold for eight-year completion rates should be the current average official on-time completion rate of 40 percent. At two-year institutions, the threshold for the completion rate within 200 percent of normal time should be 25 percent—approximately the current average completion rate within 150 percent of normal time for public two-year colleges.

Proposed Benchmark

At four-year institutions, at least 40 percent of enrolling students seeking bachelor's degrees should complete their degrees within eight years. Students who transfer to and complete at other institutions should be counted as successes for the first institution. A lower threshold at two-year institutions reflects the reality that fewer of their students consistently enroll full time. At least 25 percent of students should complete a degree or certificate within 200 percent of the normal time.

Employment and Earnings

It is important that earnings metrics be based on minimum thresholds, rather than average earnings. A goal of postsecondary education is to ensure that the vast majority of students are able to support themselves at a standard of living higher than they would have had if they had not gone to college. But focusing on average earnings can create perverse rewards and punishments based on fields of study. For example, institutions educating teachers and social workers will always have below-average earnings and those educating engineers will have above-average earnings. Moreover, calculating a mean allows for a few former students with very high earnings to compensate for a large number with earnings below the threshold.

The College Scorecard provides data on the percentage of each institution's students who earn more than \$25,000 (somewhat below the median for high school graduates) six years after enrolling and on median earnings 10 years after enrolling. According to these data, among those students who have any earnings, about 53 percent have earnings over \$25,000 six years after enrolling. Too many students spend time in college but emerge unable to make a living wage.

We propose a benchmark based on the distribution of income among adults with different levels of educational attainment. In 2015, about 47 percent of individuals ages 25 to 34 with some college but no degree earned less than the median for high school graduates, reinforcing the importance of incorporating a metric for completion rates. Among associate degree holders, about 60 percent of those with earnings made more than the median for high school graduates with earnings (table 8). We propose a benchmark based on this reality, parallel to the reliance on the earnings of associate degree recipients incorporated in the repayment rate metric.

TABLE 8

Share of Adults, Ages 25 to 34, Earning Less Than the Median for High School Graduates

Highest level of education	Median earnings	Share earning less than median for high school graduates
High school	\$27,223	50%
Some college, no degree	\$29,854	40%
Associate degree	\$31,535	33%
Bachelor's degree	\$50,147	17%

Source: Calculation by the authors from US Census Bureau, Current Population Survey, 2016 Annual Social and Economic Supplement, table PINC-03, <https://www.census.gov/data/tables/time-series/demo/income-poverty/cps-pinc/pinc-03.html>.

Proposed Benchmark

Sixty percent of an institution's enrolling students should earn more than the median for high school graduates within 10 years of enrolling.

Chapter 4. Combining the Metrics

The default rate is an increasingly problematic metric, but it remains the established standard for determining institutional eligibility for participation in federal student aid programs. In the future, repayment rates, completion rates, and postcollege earnings should become standard criteria for determining whether postsecondary institutions are meeting minimum standards for serving their students. We have proposed thresholds in each of these areas. We recommend two metrics on default and on repayment, measuring success both in terms of numbers of borrowers and in terms of amounts of debt.

Using these thresholds to develop the specifics of policies for determining eligibility for participation in federal student aid programs or for requiring institutions to bear a portion of the cost of nonpayment of loans is beyond the scope of this paper. Nonetheless, it is worth considering the possibilities for combining the metrics into a single indicator.

It might be reasonable to argue that if postcollege earnings are high enough, the institution should not be held responsible for whether students repay their loans. However, any measure of earnings is imperfect and it also abstracts from the value the institution has added. Students from some institutions could have low earnings even if the credentials earned have given graduates a significant earnings boost. Other more selective institutions could have higher average earnings even with little value added.

Passing on one metric should not be sufficient, just as failing one metric would not be a reliable basis for judging an institution. One possible approach would be to specify the minimum number of the six thresholds institutions should be required to meet. To account for possible measurement problems and unusual circumstances, it would be reasonable to require that institutions not fail more than two, or possibly three, of the tests

Another option would be developing a composite indicator—one number that combines several separate indicators.²⁴ A single composite indicator is simple but invites the ranking of institutions without any differentiating by mission or student body, which can lead to inappropriate comparisons.

Another approach would be to assign weights to each of our six metrics (two for default, two for repayment, one for completion, and one for earnings) and then set a threshold for the resulting index. We would argue that default rates should carry the lowest weight because of the role of IDR plans in diminishing their usefulness. The repayment metric based on the share of the portfolio that has been

retired after five years should carry more weight than the share of students who have paid down any of their loan principal, which is a much cruder measure. But the specifics of such a measure require further analysis.

Chapter 5. Conclusion

Why not allow schools to enroll and offer loans to all of their students who qualify? If institutions enroll students who have almost no chance of success in their programs and offer loans to them, they are violating both the public trust and their responsibility to their students. Even in the absence of stricter institutional eligibility requirements for participation in the federal student loan programs, schools whose outcomes are below the thresholds we describe might well be deemed to be exploiting their students.

We recognize that there is not one right answer to the question of how to establish reasonable thresholds for acceptable loan performance. However, the evidence and logic we discuss provide a strong grounding for the standards we propose.

Borrowing for college makes sense because for most students, postsecondary education is an investment that pays off over a lifetime. But too many students borrow to attend colleges and universities that have little chance of improving their life opportunities. Until we exclude these schools from the federal student loan programs, we will continue to see too many stories of students for whom education debt is an unmanageable burden with no visible benefit rather than a means to a productive and rewarding work life.

Appendix

A potential model for a composite index of institutional student loan performance might be the initial (pre-2010) Human Development Indicator (HDI) maintained by the United Nations, which used just three indicators of human development despite there being many more potential indicators available. Similarly, factors other than those we propose are relevant to assessing institutional eligibility for federal loan programs. The HDI is a simple index, although its methodology has become more complicated in recent years. Like the HDI, a simple index of institutional eligibility would be an initial step forward.

Before 2010, the HDI used only three pieces of information for each country—indicators for health (life expectancy at birth), knowledge (a weighted average of the adult literacy rate and a measure of school enrollment), and living standards (based on gross domestic product). Each of the three indicators was transformed into a unit-free number between 0 and 1.²⁵ The HDI was the simple average of those three numbers.

To develop an HDI-like indicator for institutional eligibility, policymakers could use the cohort repayment rate, the completion rate, and average earnings. For a metric ranging from 0 to 100 percent, a school with a 25 percent completion or repayment rate would get a value of $(25-0)/(100-0) = 0.25$. A similar calculation could be undertaken for earnings after specifying the relevant minimum and maximum.

Like the HDI, this composite indicator would undoubtedly attract considerable criticism. Why only those three metrics? Why this indicator and not that one? Why weight the three indicators equally? But, like the HDI, the indicator would draw attention to the multiple dimensions of institutional participation in the federal loan programs and away from an overemphasis on one dimension, like default rates.

Notes

1. We discuss the Canadian situation because Canada has a fairly comprehensive policy for removing the eligibility of institutions from federal aid programs.
2. Most students must hold a high school diploma or GED to participate in federal student aid programs and, under the false certification provisions, schools cannot give loans to students who would not be eligible for employment in the occupation for which the program supported by the loan is intended. In addition, enrolled students must meet Satisfactory Academic Progress requirements to maintain their eligibility for federal aid.
3. These thresholds might be applied to programs rather than to entire institutions.
4. *Ass'n of Private Colleges and Universities v. Duncan*, 870 F. Supp. 2d 133, 22 (2012).
5. *Id.* at 30.
6. *Id.* at 31.
7. The full quotation is as follows (*id.* at 30): When an agency “must select some...necessarily somewhat arbitrary figure” in establishing bright-line rules, a court “will defer to [its] expertise if it provides substantial evidence to support its choice and responds to substantial criticism of that figure” *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1141 n. 45 (D.C. Cir. 1996). Such rules “generally do not violate the APA’s deferential arbitrary-and-capricious standard . . . so long as those rules fall within a zone of reasonableness and are reasonably explained” *Emily’s List v. FEC*, 581 F.3d 1, 2 n.20 (D.C. Cir. 2009).
8. Federal loan and grant programs are authorized under Title IV of the Higher Education Act of 1965.
9. The gainful employment rules discussed above, however, apply only to programs explicitly intended to provide “gainful employment in a recognized occupation.” The vast majority of such programs are operated by for-profit schools.
10. The relative complexity of this concept might dictate using a standard, such as less than half the median.
11. The official two-year cohort default rate for federal student loans peaked at 22.4 percent in 1990 and fell gradually to 4.5 percent in 2003. See “FY 2011 2-Year National Student Loan Default Rates,” Federal Student Aid, US Department of Education, accessed January 3, 2018, <https://www2.ed.gov/offices/OSFAP/defaultmanagement/defaultrates.html>.
12. The threshold for problematic cohort default rate increased from 25 to 30 percent in 2008, when the official rate shifted from a two-year to a three-year measure. Very few institutions, however, have been disqualified by this standard.
13. See “How the 2015 OSAP Default Rates Work,” Ontario Student Assistance Program, accessed February 21, 2018, <https://osap.gov.on.ca/OSAPPortal/en/PlanYourEducation/ChooseaCareerSchoolProgram/PRDR016177.html>.
14. In an interview, staff of the Ontario default cost-sharing program told us that some institutions did not respond to that program by making efforts to reduce default; they simply treated the payments as another “cost of doing business.”
15. Protect Student Borrowers Act of 2013, S.1873, 113th Congress (2013–14), <https://www.congress.gov/bill/113th-congress/senate-bill/1873>.
16. “Direct Loan Portfolio by Loan Status,” US Department of Education, Federal Student Aid, accessed September 20, 2017, <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>.
17. If only a small fraction of students borrow, the default rate is not a reliable indicator of institutional quality.

18. The standard repayment period for federal loans is 10 years.
19. This is true among borrowers entering repayment in 2011–12. Thirty-four percent of those who defaulted within three years owed less than \$5,000 and another 31 percent owed between \$5,000 and \$10,000 (Council of Economic Advisers 2016, figure 27).
20. According to ED, the total federal student loan debt outstanding was about \$1.1 trillion and the number of borrowers was 39.5 million. Thus, the average debt outstanding was 1.1 trillion divided by 39.5 million or \$28,000. See “Federal Student Loan Portfolio: Portfolio by Loan Status,” US Department of Education, Federal Student Aid, accessed January 2, 2018, <https://studentaid.ed.gov/sa/about/data-center/student/portfolio>.
21. An income of \$37,000 is about \$19,000 above the poverty line. Paying 10 percent of that \$19,000 toward the student loan would cover the interest and at least \$1 of the principal.
22. These completion rates are flawed because they do not include students returning to college after a break or those who enroll part time. In addition, they do not account for students who successfully transfer from one institution to another.
23. National Center for Education Statistics Digest of Education Statistics, 2017, table 326.120.
24. A potential model for this approach might be the initial (pre-2010) Human Development Indicator maintained by the United Nations, which used just three indicators of human development. See the appendix for details.
25. The indicator depends on a country’s place in the range between the minimum and maximum value for each indicator. For example, suppose that the highest possible value of life expectancy at birth is 85 and the lowest is 25. If a country has a life expectancy of 50, its value would be $(50-25)/(85-25) = 25/60 = 0.42$.

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