Who's at Fault for Student-Loan Defaults?

For-profit colleges enroll 10 percent of US students but account for 50 percent of student-loan defaults. And low-income students are hit the hardest.

By Howard R. Gold May 13, 2019 CBR - Public Policy Share This Page Credit: Chris Gash

A central driver of growing income inequality in recent decades has been the earnings premium commanded by those with technical skills, and a widening gap between college graduates and those with a high-school diploma or less.

Workers in the United States have responded by seeking college courses to improve their skills, and many have been drawn to for-profit institutions, which offer two- or four-year degrees or professional certificates in fields such as health administration, culinary arts, and cosmetology. But rather than enjoying an income boost, many graduates of for-profit schools have found themselves struggling to pay back student loans, and defaulting on their debts.

This has particularly affected nontraditional students, according to research by Harvard's David J. Deming, Claudia Goldin, and Lawrence F. Katz. Nontraditional students tend to be older than 25 and often they are the first in their families to attend college. They tend to have lower family incomes than typical college students. They are disproportionately women and single parents. They are more likely to be Hispanic or African American.

Since for-profit schools offer fully online degree programs, and night and weekend classes, they are particularly appealing to nontraditional students, many of whom have families or work full-time jobs.

And for-profit colleges have played a significant role in driving the increase in student-loan debt in the US, suggests Chicago Booth's Constantine Yannelis. For-profit colleges aggressively market themselves to nontraditional students, he argues. The colleges therefore disproportionately enroll higher-risk borrowers. Their higher fees saddle students with more debt than nonprofit colleges.

Rising tuition costs aren't driving default rates

In research with Brookings Institution's Adam Looney, Yannelis finds that nontraditional student borrowers as a proportion of all US students grew to become almost half of all new borrowers by 2011. Nontraditional students who had left school and started to repay loans in 2011 accounted for 70 percent of those who had fallen into default by 2013.

This dispels the notion that the chief cause of student-debt default is rising tuition. To be sure, college tuition rose almost 360 percent between 1985 and 2015, and graduates of professional schools, which boast some of the highest tuition rates, tend to owe the most. The median student debt of a new medical-school graduate was $190,000 in 2017, as reported by the Association of American Medical Colleges, while the average debt for graduates of US business schools was $70,000, according to the consumer-finance site SoFi.com, which derived the figure from 60,000 student-loan refinancing applications submitted between January 2014 and September 2016.

But despite their high tuition, elite private colleges and universities tend to have large endowments that enable them to offer grants to undergraduate students rather than loans. They also tend to enroll more students from wealthier families who can afford to pay full price.

Nor is the debt primarily caused by nonprofit public universities, which charge in-state residents, on average, two-thirds less than private colleges. The average debt burden for students at public schools is well below the national average.

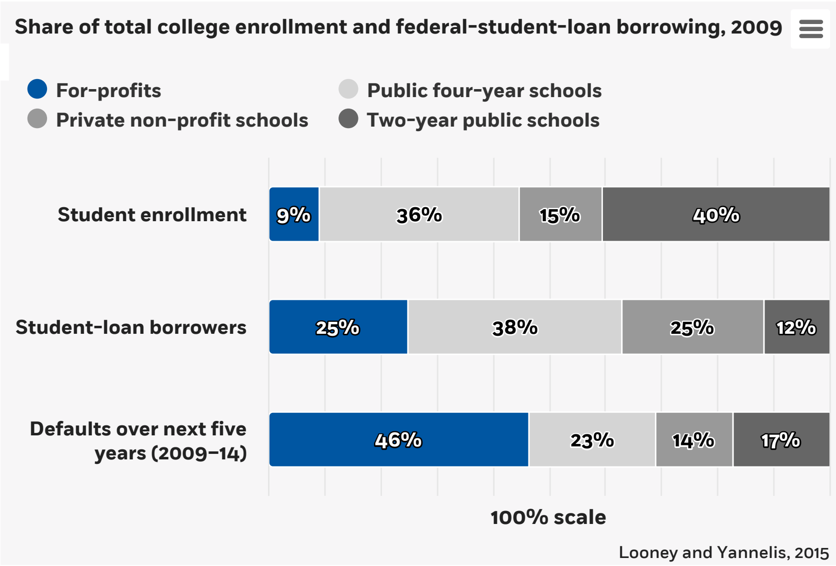
Discounting those institutions led Yannelis to look at for-profit colleges, whose enrollment rose sevenfold from 1990 through 2010, and which, he notes, "account for about 10 percent of enrollment, about 20 to 25 percent of borrowing, and approximately half of all loan defaults."

US student loans and defaults

Total outstanding student-loan debt in the US topped $1.5 trillion by the end of 2018, according to the St. Louis Federal Reserve. About 44 million people in the US owe money on student loans, with an average debt burden of $35,000. The volume of outstanding student loans rose 157 percent from 2007 to 2018, to become the second-largest category of consumer debt, after home mortgages. For some people, paying off student loans has become a lifelong burden. According to the Federal Reserve, 2.8 million people aged 60 and over have some amount of student debt, four times the number from 2005, and they owe $86 billion in student loans, the *Wall Street Journal* reported in February 2019.

For-profit-college borrowers in trouble

Students at US for-profit schools take out an outsize share of loans and represent about half of all defaults.



The issue is of great concern to policy makers. Secretary of Education Betsy DeVos described this debt spiral as "a crisis in higher education." Federal Reserve Chairman Jerome Powell testified before the Senate Committee on Banking, Housing, and Urban Affairs in March 2018 that the amount of student debt "absolutely could hold back growth."

In most cases, a federal student loan is considered to be in default when no payments have been made for 270 days. Once a loan is in default, the entire unpaid loan balance and any interest the borrower owes are due immediately, and the borrower may be subject to wage garnishment, meaning a court orders the borrower's employer to divert a portion of paychecks to a creditor. Borrowers also may have their tax refunds and federal benefits withheld. Unlike other forms of consumer debt, student loans generally cannot be discharged in bankruptcy.

How for-profits target nontraditional students

Nontraditional students tend to find their way to for-profit colleges by responding to advertising. Large national chains of for-profit colleges spend heavily on sales and marketing to recruit students—24 percent of revenue, according to a 2011 estimate by J. P. Morgan. "These for-profit schools are spending much more on sales and marketing" than nonprofit schools, says Yannelis. "At the heart of this is an incentive . . . to get people to sign up and pay tuition. It's a very different business model from elite institutions, which, to a large extent, rely on their reputation and have a large endowment, which is in part driven by alumni donations."

For-profit colleges devote relatively more resources to signing up students. Private nonprofit colleges spent a median $2,357 to recruit each student in 2017, the educational consulting firm Ruffalo Noel Levitz estimates. Their study didn't examine for-profit colleges, but J. P. Morgan's 2011 report estimates for-profit schools spent a median $4,000 per student—almost twice as much. A February 2019 study from the progressive think tank the Century Foundation finds that for-profit schools "dominate" the list of higher education's biggest spenders in online search advertising.

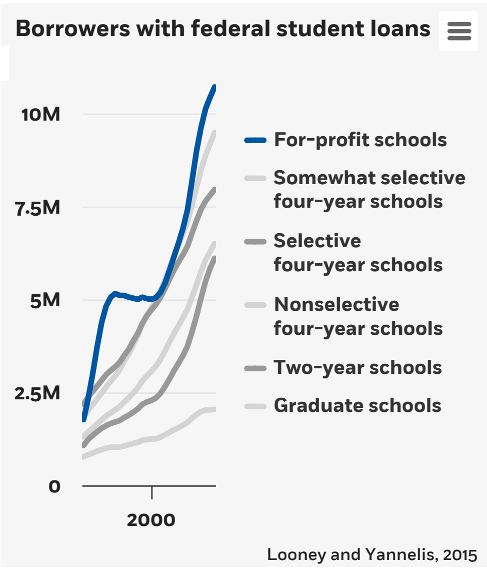
For-profit schools spend big on marketing because it produces revenue. But paying to educate students and placing them in jobs after graduation cuts into profit margins. "Their incentive is to minimize costs in terms of educating [students, and] it doesn't really matter for the school's bottom line if they don't get a job," says Yannelis.

The association representing for-profit schools says they shouldn't be judged by their past. "Don't look at yesterday's data. Look at what is happening today," says Steve Gunderson, president and CEO of Career Education Colleges and Universities, the trade association of for-profit colleges, which have rebranded themselves as "career colleges."

"Today, schools have combined a focus on outcomes with the workplace demand for skilled professionals and the nation's hope for equal opportunity in ways that rebuild our middle class," writes Gunderson, in an email response.

Reliant on student loans

After grouping schools by their selectivity, the researchers find that for-profits tend to have the most student borrowers.



But researchers find that students who attended these schools all too often end up jobless or underemployed and deep in debt. "For-profits leave students with far larger student loan debt burdens" as well as "higher unemployment and 'idleness' rates and lower earnings from employment six years after entering programs than do comparable students from other schools," write Deming, Goldin, and Katz, who analyzed data from the 2004 through 2009 Beginning Postsecondary Students Longitudinal Study, which includes about 1,950 students starting at for-profits, out of nearly 17,000 students in their main sample. They find that those who attended for-profit colleges had a much higher default rate than those who attended nonprofit schools, and that for-profit students reported lower satisfaction with their education and were less likely to consider it worth the cost. The researchers note that their data come from a boom time in for-profit education, and that many for-profit institutions have since closed or experienced declines in enrollment.

Students who enrolled in for-profit colleges to attain professional certificates, and graduated or dropped out from 2006 to 2008, were 1.5 percentage points less likely to be employed and had 11 percent lower earnings after attendance than students who attended public institutions, according to Stephanie Riegg Cellini of George Washington University and Nicholas Turner, senior economist for the Federal Reserve Board of Governors. This earnings gap amounts to $2,100 less in annual earnings after college than students who attended nonprofit public colleges, they calculate, using tax data from the Internal Revenue Service for 1999 to 2014. Comparing these students' postcollege earnings gains to their average debt burden, they conclude: "For-profit certificate programs do not pay off for the average student."

Gunderson, of the trade association, disagrees, citing an online survey, commissioned by CECU and conducted by Gallup in September and October 2018, that includes responses from more than 3,000 alumni of for-profit colleges who graduated between 2008 and early 2018. A higher percentage of survey respondents said they had found jobs within six months after graduation than respondents from what Gallup called "a nationally representative sample of associate degree holders." The CECU survey also suggests that most alumni are "satisfied overall with their . . . educational experience," and employed graduates of for-profit schools reported a 62 percent increase in median personal earnings after completing their education.

However, the survey had no questions about student loans, and the word "debt" never appears in Gallup's 26-page report.

The government gives and takes

For-profit schools make returns for their investors, but their students' debt is overwhelmingly funded by the federal government, which guarantees more than 90 percent of student loans, *Bloomberg* reported in December 2018.

This makes for-profit schools much more dependent on government aid than their nonprofit rivals. "Even though they're called for-profit colleges and people may think of them as wonderful free-market creatures, they largely rely on various government programs to generate revenue," says Yannelis. The 1965 Higher Education Act set up various federal-aid programs under the Department of Education (ED) and established guidelines that determine institutions' eligibility for student aid, including federally guaranteed loans, under the law's Title IV. But institutions must comply with government standards to remain eligible for the benefits.

Could bankruptcy lighten the student-debt burden?

Of all the major categories of consumer debt in the United States—including home mortgages, auto loans, and credit cards—only student-loan debt cannot be discharged in bankruptcy, except in rare cases of "undue hardship."

The reason, explains Booth's Yannelis, is that student loans aren't backed by collateral a lender can sell to recover at least part of the loan's value. Instead, lenders garnish wages, securing court orders to receive a portion of borrowers' paychecks, to try to get their money back. "If we think of a mortgage loan or an auto loan, this is secured by an underlying asset," Yannelis says. "And we seize this in the case of default. So, wage garnishment is effectively turning somebody's income into collateral for the debt."

Read more

Federal grants and loans received under Title IV accounted for 74 percent of for-profit colleges' revenue in 2011, report Harvard's Deming, Goldin, and Katz. Under the law, these institutions can get as much as 90 percent of their revenue from government sources and still maintain their Title IV eligibility.

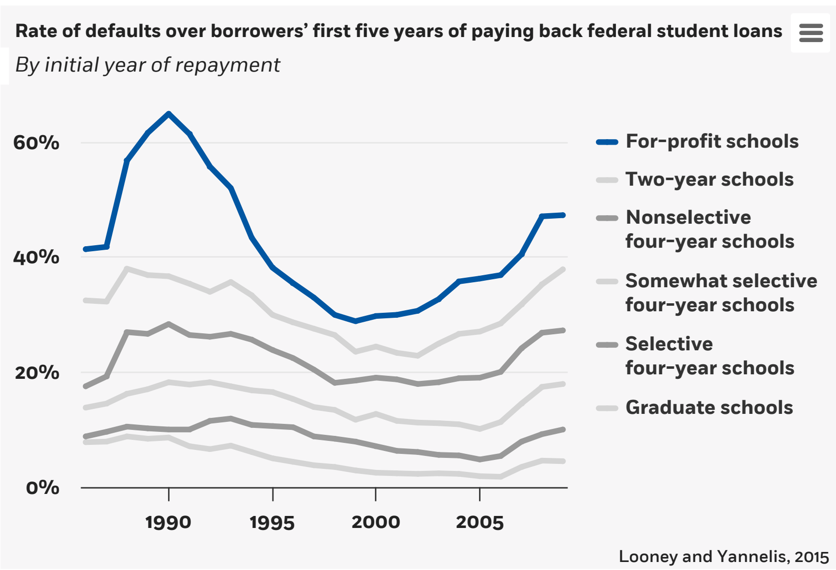
Veterans who get grants and loans to attend these schools don't count as part of the 90 percent, which may be why for-profit colleges enroll so many of them. In 2016, six for-profit education companies enrolled 35 percent of all students using the GI Bill, which provides education benefits to veterans, reported Veterans Education Success, a nonprofit that offers legal advice to veterans.

The Obama administration demanded that for-profit colleges produce better outcomes for their graduates in exchange for the government largesse the schools receive. In 2014, the ED announced it would enforce a provision in the Higher Education Act that stated career-education programs must “prepare students for gainful employment.” If most of a program’s graduates didn’t earn enough income to repay their loans, the ED would deny Title IV federal student aid to that institution. It mandated that a program’s graduates have annual loan payments less than 8 percent of their total earnings, or 20 percent of discretionary income.

In 2015, the ED fined Corinthian Colleges $30 million for misrepresenting job-placement data and altering grades and attendance records, *NBC News* reported. Shortly afterward, the chain closed its doors, stranding 16,000 students. Another large for-profit operator, ITT Technical Institute, also went out of business. In all, since 2010, nearly half of all US for-profit colleges and career programs have shut down, and student enrollment has dropped by 1.6 million, the *New York Times* reported in August 2018.

About half of all student-loan defaults

Even as defaults rose and fell with the economic times, student loans from for-profit schools remained the leading segment.



During this time, the New York attorney general and plaintiffs in two class-action cases sued Donald Trump over misleading marketing claims for his Trump University, a for-profit real-estate training program that operated from 2005 to 2010. Trump agreed to settle the lawsuits for $25 million shortly after he was elected president, in November 2016.

That is just one of many cases brought by state attorneys general against the industry. In a settlement with 48 states announced in January, for-profit Career Education Corporation agreed to wipe away nearly $500 million in loans taken on by 180,000 students—but the settlement covers only debt owed directly to the company, not third-party loans. And for-profit schools continue to close. Another for-profit provider, Education Corporation of America, shut down in December 2018, affecting 20,000 students.

The future of for-profits

But for-profit colleges have been granted something of a reprieve. Under the Trump administration's sweeping deregulatory agenda, Secretary DeVos rescinded the "gainful employment" rule and loosened accreditation standards, giving some former operators with poor track records a second chance.

Rapid reversals of fortune mark for-profit colleges' entire history, which is characterized by surges in enrollment and openings, followed by periods of retrenchment. Yannelis and Looney studied three decades of expansions in student loans, driven by new players entering the for-profit arena. In the 1980s–2000s, changes in federal education policy, such as increased eligibility for loan programs and higher borrowing limits, prompted entrepreneurs to jump into the market with new educational offerings.

"These new institutions and the student borrowers they enrolled were substantially higher risk, and the change in the composition of borrowers led to a sharp increase in loan default rates," Yannelis and Looney write. The expansions were followed, predictably, by tightened federal credit standards and big increases in defaults. About half of the increase in student-loan defaults between 2000 and 2010 can be attributed directly to for-profit colleges entering the market, they conclude.

Researchers such as Harvard's Goldin and Katz and Chicago Booth's Kevin M. Murphy, Robert H. Topel, and Steven J. Davis have stressed the importance of acquiring "human capital," the skills necessary to compete and succeed in a global, high-technology labor market. Nontraditional students seem most driven to close this skills gap, often making personal and financial sacrifices to develop their human capital and improve their lives.

This presents a policy conundrum: on the one hand, we want workers to improve their skills, but we also want to make sure they do not overly indebt themselves in doing so. The research suggests that for-profit colleges are more likely to leave students struggling to repay their loans. Gunderson argues that they have changed. But so long as the relationship continues between for-profit college expansion and borrower defaults, efforts to address the student-loan crisis will receive a failing grade.

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