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Student Loans, Student Aid, and FY2008 Budget Reconciliation

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Summary

The FY2008 budget resolution (S.Con.Res. 21, H.Rept. 110-153) contains reconciliation instructions that require the House Committee on Education and Labor and the Senate Committee on Health, Education, Labor, and Pensions to report reconciliation legislation that would reduce mandatory spending by $750 million over the period covering FY2007 through FY2012. These committees are required to report reconciliation recommendations to their parent chamber by September 10, 2007.

Each of the aforementioned authorizing committees marked up a bill in June of 2007 with reconciliation recommendations that generate the required savings in mandatory spending. A broad set of Higher Education Act (HEA) amendments are being considered in each chamber as well, in conjunction with the reconciliation proposals. Each bill achieves the required savings through cuts in payments to Federal Family Education Loan (FFEL) program lenders and guaranty agencies. Both bills actually generate substantially higher levels of savings in mandatory spending than was required by the reconciliation directive, and the additional savings are used to offset costs associated with a broad array of new or enhanced student aid benefits.

On June 25, 2007, the College Cost Reduction Act of 2007 (H.R. 2669) was reported by the House Committee on Education and Labor (H.Rept. 110-210). On June 20, 2007, the Senate Committee on Health, Education, Labor, and Pensions marked up and ordered to be reported a bill containing its reconciliation recommendations; however, this bill has not yet been reported. This report reviews and briefly describes the major changes proposed in H.R. 2669 to federal student loan and other federal student aid programs that would achieve savings in mandatory spending or that would result in changes to existing federal student aid programs. This report will be updated to reflect reconciliation recommendations contained in the Senate bill when the bill becomes available.

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Budget Resolution

The House and Senate approved the conference report (H.Rept. 110-153) on S.Con.Res. 21, the Concurrent Resolution on the FY2008 Budget on May 17, 2007. The annual concurrent resolution sets forth the congressional budget. When the federal deficit is expected to be large, budget resolutions often require reductions in mandatory spending. In such instances, the budget resolution issues reconciliation instructions that require authorizing committees to report changes to legislation to reduce spending on mandatory programs under their jurisdiction.

The FY2008 budget resolution includes reconciliation instructions that direct authorizing committees to report legislation to reduce mandatory spending for the period FY2007-FY2012. Subsequently, these proposals are to be reported by each committee to its parent chamber. Under the reconciliation instructions, the House Committee on Education and Labor and the Senate Committee on Health, Education, Labor, and Pensions are responsible for a reduction of $750 million for FY2007-FY2012.

The Federal Family Education Loan (FFEL) program and the William D. Ford Direct Loan (DL) program are two of the major mandatory programs under each committee's jurisdiction. Each committee has looked to reduce mandatory spending on these federal student loan programs to meet the requirements of recent budget reconciliations. To meet the requirements of the FY2008 reconciliation instructions, reductions in mandatory spending on the FFEL program are being considered. Proposed reductions in mandatory spending are sufficiently large that they offset a broad array of proposed new or enhanced student aid benefits.

Federal Student Loan Programs

The federal government operates two major student loan programs: the Federal Family Education Loan program, authorized by Part B of Title IV of the Higher Education Act (HEA), and the William D. Ford Direct Loan program, authorized by Part D of Title IV of the HEA. These programs provide loans to undergraduate and graduate students and the parents of undergraduate students to help them meet the costs of postsecondary education.

Under the FFEL program, loan capital is provided by private lenders, and the federal government guarantees lenders against loss through borrower default; death; permanent disability; or, in limited instances, bankruptcy. Under the DL program, operated through the U.S. Department of Education (ED), the federal government provides the loans to students and their families, using federal capital (i.e., funds from the U.S. Treasury). The two programs rely on different sources of capital and different administrative structures, but essentially disburse the same set of loans.[1]

The DL program, established in 1993, was intended to streamline the student loan delivery system and achieve cost savings. While the DL program was originally introduced to gradually expand and replace the long-standing FFEL program, the 1998 HEA amendments removed the provisions of the law that referred to a "phase in" of the DL program. Currently both programs are authorized and the two programs compete for student loan business. In FY2006, these programs provided $60 billion in new loans to students and their parents. In that year the FFEL program provided 10,982,000 new loans averaging approximately $4,308 each, and the DL program provided 2,841,000 new loans averaging approximately $4,463 each.

Mandatory Spending on Student Loans

The FFEL and DL programs are entitlements; funding is provided for these programs on a permanent indefinite basis, not subject to appropriations. The fiscal year cost estimates for both programs, under terms of the Credit Reform Act of 1990, are calculated by determining the net present value of the costs to the government over the lifetime of new loans disbursed in the given fiscal year. Under credit reform, an effort is made to capture, in the year in which credit is provided, the multi-year net cash flows associated with a new cohort of direct or guaranteed loans. This calculation establishes a "subsidy cost," which is the estimated long-term cost to the government of a direct or guaranteed loan.

In calculating the subsidy costs for the two programs, the main cost components are the interest benefits to students in the subsidized Stafford program, the special allowance payments to lenders,[2] and defaults. Subsidy cost calculations are highly dependent on interest rate forecasts over the life of the loans and therefore can vary significantly depending on these forecasts. In order to achieve savings in mandatory spending on the loan programs, Congress has often cut loan subsidies or introduced fees to generate funds that offset mandatory spending.

Each year the Congressional Budget Office issues a baseline budget forecasting estimated spending over a 10-year period under current law, assuming no policy

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[1] For detailed information on the array of FFEL and DL program loans, see CRS Report RL33673, *Federal Family Education Loan Program and William D. Ford Loan Program Student Loans: Terms and Conditions for Borrowers*, by Adam Stoll. For a thorough discussion of how the loan programs operate, see CRS Report RL33674, *The Administration of the Federal Family Education Loan and William D. Ford Loan Programs: Background and Provisions*, by Adam Stoll.

[2] The special allowance payment (SAP) amount is determined on a quarterly basis by a statutory formula which is tied to a financial index and ensures lenders receive, at a minimum, a specified level of interest income on loans. The special allowance is designed to compensate lenders for the difference between the below-market, statutorily set interest rate charged to borrowers and a market set interest rate that is intended as fair market compensation on the loan asset.

changes are enacted over that time period. The CBO baseline serves as a benchmark for budgetary analyses. When legislation that would affect mandatory spending is introduced, its budgetary impact is measured against the CBO baseline. The current CBO baseline projects that over the 2008-2012 period the federal student loan programs would guarantee or disburse about $406 billion in new loans — costing about $21.2 billion.[3]

House Reconciliation Provisions

As has been noted, the FFEL program is being relied upon to produce the savings in mandatory spending required by the FY2008 budget reconciliation instructions to the House Committee on Education and Labor, and the Senate Health, Education, Labor, and Pensions Committee. On June 25, 2007, the House Committee on Education and Labor reported The College Cost Reduction Act of 2007 (H.R. 2669, H.Rept. 110-210). On June 20, 2007, the Senate Health, Education, Labor, and Pensions Committee marked up and ordered reported the Higher Education Access Act of 2007. With the markup of these measures, each committee has approved reconciliation recommendations required by the budget resolution. These bills may next receive floor consideration in each chamber.

This report reviews and briefly describes the major changes proposed in H.R. 2669 to federal student loan and other federal student aid programs that would achieve savings in mandatory spending or that would result in changes to existing federal student aid programs. This report will be updated to reflect reconciliation recommendations contained in the Senate bill when the bill becomes available.

H.R. 2669, the House reconciliation bill's student loan provisions produce a total of $18.8 billion in savings in mandatory spending over the 2008-2012 period, of which roughly $1.8 billion in "net savings" would be used to meet the requirements of the reconciliation directives. The additional savings of roughly $17 billion would be used to support a series of new or enhanced student aid benefits included in H.R. 2669.[4] The principal savings provisions included in the House reconciliation bill would:

- effective October 1, 2007, change the formulas used to calculate lender yields on student loans, reducing the lender rate by 0.55% on Stafford and consolidation loans, and by 0.85% on PLUS loans;[5]
- effective October 1, 2007, raise a loan origination fee that for-profit lenders pay to the federal government on all new loans from 0.50%

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[3] Congressional Budget Office Memorandum, *CBO March 2007 Baseline Projections for the Student Loan and Grant Programs, March 2,* 2007. Tables 1&2.

[4] See Congressional Budget Office, *Cost Estimate, H.R. 2669, College Cost Reduction Act of 2007, as ordered reported by the House Committee on Education and Labor on June 13, 2007, June 25, 2007.*

[5] The lender rate formulas (embedded in the SAP formulas), under current law, are based on the 91-day commercial paper (CP) rate plus an "add-on" of 1.74% (in-school) and 2.34% (in repayment) for Stafford loans and 2.64% for Consolidation and PLUS loans. The add-ons would be reduced under the proposal by the amounts indicated.

to 1%; and as of the same date, eliminate the 0.50% fee for loans held by those for-profit holders receiving a newly available "smaller lender" designation,[6] and for all non-profit lenders;

- reduce the level of insurance provided to lenders from 97% to 95% for new loans made on or after October 1, 2007, and eliminate exceptional performer status;[7]
- effective October 1, 2007, reduce guaranty agency retention amounts from 23% to 16% of collections on defaulted loans; and
- effective October 1, 2007, replace guaranty agency account maintenance fees, which are paid to guarantors annually by the federal government and currently equal 0.10% of original principal of loans guaranteed, with a "unit cost" fixed dollar payment per loan.[8]

The House reconciliation bill also includes provisions that would increase direct spending. As was noted above, the amount of savings required by the reconciliation instructions has been exceeded by roughly $18 billion, and approximately $17 billion in savings would be used to offset the costs of new loan and grant aid. The provisions providing new or enhanced loan aid would:

- incrementally reduce interest rates on subsidized Stafford Loans for undergraduate students from the current rate of 6.8% to 6.12% for loans for which the first disbursement is between July 1, 2008 and June 30, 2009 (and by an additional 0.68 percentage points each subsequent year), and to 3.4% for loans for which the first disbursement is between July 1, 2012 and June 30, 2013;
- effective July 1, 2008, increase annual loan limits on subsidized and unsubsidized Stafford Loans from $5,500 to $7,500 (and from $10,500 to $12,500 in combined Stafford Loan borrowing by undergraduate independent students) for borrowers who have completed two or more years of undergraduate study;
- effective July 1, 2008, increase aggregate loan limits on subsidized Stafford Loans from $23,000 to $30,500 for undergraduate students, and from $65,000 to $73,000 for graduate and professional students;
- effective October 1, 2007, establish a new loan forgiveness program for new borrowers under which $1,000 in outstanding loan balance would be forgiven for each complete year of service in specified

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[6] Smaller lenders include the subset of consecutively ranked holders, starting with the holder with the lowest amount of outstanding loans, whose combined holdings total 15% of all outstanding loan volume, but excluding the final holder (if any) whose holdings when added to the group causes the group's total holdings to exceed 15%.

[7] Lenders and loan servicers with "exceptional performer" designations currently receive an insurance rate of 99%. Exceptional performer status is awarded to those with high compliance ratings with regulatory loan servicing requirements.

[8] The fixed payment amount is based on a calculation that determines the total amount currently spent on a per loan basis, and fixes this amount as the program-wide per-loan unit cost. This per-loan cost is, in subsequent years, indexed for inflation.

areas of national need, up to a maximum of $5,000 in loan forgiveness for five years of service;[9]
- effective October 1, 2007, grant loan forgiveness of remaining loan balances for DL borrowers who have made 120 payments according to the income-contingent repayment plan and who at the same time have been employed in certain public sector jobs;
- effective October 1, 2007, establish a new income-based repayment plan under which borrowers' loan payments would be capped at 15% of any amount by which their adjusted gross income (AGI) exceeds 150% of the poverty line; and under which any loan balance not repaid after 20 years in repayment or economic hardship deferment would be forgiven (this repayment plan is not available for Parent PLUS loans);
- effective October 1, 2007, raise the income threshold under which borrowers may qualify for economic hardship deferment to 150% of the poverty line; remove the existing three-year limit; and grant loan forgiveness after 20 years in economic hardship deferment; and
- effective on the date of enactment, grant deferment for up to 13 months following the completion of active duty military service to borrowers who are members of the National Guard or other reserve component of the armed forces, or are members of the armed forces in retired status, who are called to active duty service while enrolled, or within six months of being enrolled, at an eligible institution.

The provisions providing new or enhanced grant aid or adjustments to need analysis calculations would:

- authorize the Pell Grant program through FY2013;[10]
- effective on the date of enactment, eliminate the Pell Grant tuition sensitivity provision;
- effective July 1, 2009, permit students who are enrolled and pursuing an associates degree, baccalaureate degree, or a certificate, and who take courses for more than two semesters or three quarters in a given academic year to receive more than one (but not more than two) Pell Grant awards in a single academic year;[11]
- add mandatory funding for the Pell Grant program through FY2017: $840 million for FY2008, $870 million for FY2009, $1.34 billion for FY2010, $2.28 billion for FY2011, $2.35 billion for FY2012, $2.4 billion for FY2013, $2.51 billion FY2015, $2.55 billion for FY2016, and $2.57 billion for FY2017; these mandatory funds are

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[9] Areas of national need include early childhood educators, nurses, foreign language specialists, librarians, highly qualified teachers of bilingual education in low-income schools, child welfare workers, speech language pathologists, national service workers, and certain public sector employees.

[10] For comprehensive information on the Pell Grant program, see CRS Report RL31668, *Federal Pell Grant Program of the Higher Education Act: Background and Reauthorization*, by Charmaine Mercer.

[11] Under current law only one such award is allowed per academic year.

to be used to increase the amount of the maximum Pell Grant award by the following amounts: $200 for award years 2008-2009 and 2009-2010; $300 for 2010-2011; and $500 for 2011-2012 and each subsequent award year;

- increase the need analysis income protection allowance (IPA) for dependent students from $3,000 to $3,750 for academic year 2009-2010, $4,500 for academic year 2010-2011, $5,250 for academic year 2011-2012, and $6,000 for academic year 2012-2013; increase the IPA for independent students without dependents from $6,050 to $6,690 for academic year 2009-2010, $7,160 for academic year 2010-2011, $7,630 for academic year 2011-2012, and $8,090 for academic year 2012-2013; increase the IPA for independent students without dependents, who are married and one is enrolled in postsecondary education, from $9,700 to $10,720 for academic year 2009-2010, $11,470 for academic year 2010-2011, $12,220 for academic year 2011-2012, and $12,960 for academic year 2012-2013;
- establish a special rule for the 2009-2010 academic year that would increase the IPA tables for independent students with dependents by 10% for that academic year and for each of the three succeeding academic years. For each academic year after 2012-2013, all IPA tables would be updated by a percentage equal to the percentage increase in the Consumer Price Index (current law).
- effective July 1, 2009, amend the eligibility criteria for the need analysis simplified needs test (SNT) to include a parent who is a dislocated worker in the case of a dependent student or the student, if he/she is an independent student. Also amends the eligibility criteria to include parents of a dependent student or the student, in the case of a dependent or independent student, who received a benefit under a means-tested benefit program in the last 24 months as opposed to the last 12 months under current law;
- effective July 1, 2009, amend the eligibility criteria for automatic-zero expected family contribution (auto-zero EFC), for need analysis, to include a parent who is a dislocated worker in the case of a dependent student or the student, if he/she is an independent student. Further, it would amend the eligibility criteria to include parents of a dependent student or the student, in the case of a dependent or independent student, who received a benefit under a means-tested benefit program in the last 24 months as opposed to the last 12 months under current law. Finally, it would increase the income eligibility threshold for auto-zero EFC from $20,000 to $30,000 for both parents and independent students with dependents, and specifies that the income threshold shall be adjusted annually using the Consumer Price Index (CPI);
- effective July 1, 2009, expand special circumstances for financial aid administrators to utilize professional judgment to include a family member who is a dislocated worker as defined by the Workforce Investment Act of 1998;

- effective July 1, 2009, clarify that a distribution from a qualified education benefit[12] is excluded from the need analysis calculation, and should not be considered as other financial assistance in the aid packaging process;
- effective July 1, 2009, eliminate some untaxed income from consideration in calculations of total income of students and parents in need analysis (e.g., welfare benefits, the earned income tax credit, credit for special fuel and the amount of foreign income);
- effective July 1, 2009, clarify that in need analysis qualified education benefits shall be treated as an asset of the parent if the student is a dependent, and as an asset of the student if the student is independent; and
- effective October 1, 2007, establish the TEACH Grants program, under which students preparing for a career in teaching and who agree to teach in a high-poverty school may receive TEACH Grants of $4,000 per year of study (and under which prospective mathematics and science teachers may also receive Bonus TEACH Grants of $500 per year of study). Maximum total awards would be $16,000 for students who receive only TEACH Grants and $18,000 for TEACH Grants and Bonus TEACH Grants, combined. Recipients who do not complete their service requirement would be required to repay TEACH Grants as loans under HEA, Title IV, Part D.

The provisions for new or enhanced aid to specific institutions of higher education (IHEs), or adjustments to campus-based aid would:

- establish an incentive award program for IHEs that increase tuition less than the national average and provide through mandatory appropriation $15 million per year in FY2008-FY2012 for grants to such IHEs to increase Pell Grants by up to 25% (funds are allocated first to IHEs with the lowest increases until exhausted);
- create Centers of Excellence at minority-serving institutions (MSIs) which are focused on teacher preparation programs and provide through mandatory appropriation $50 million for FY2008 through FY2012;
- create a new program for historically black colleges and universities (HBCUs), Hispanic-serving institutions (HSIs), tribal colleges and universities, Alaska Native and Native Hawaiian-serving institutions, Predominantly Black Institutions (PBIs), and Asian and Pacific Islander-serving institutions, and provide through mandatory appropriation $100 million per year for FY2008-FY2012;[13]

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[12] Qualified educational benefits include Section 529 Savings Plans and Coverdell Education Savings accounts.

[13] Forty percent of the funding is allocated for HSIs, for the authorized activities specified in Section 503; 40% is allocated for HBCUs and PBIs, and should be distributed according to the formula in Section 324; and the final 20% should be allocated to all of the other (continued...)

- create and support through a mandatory appropriation of $300 million for FY2008-FY2012, a College Access Challenge Grant Program, which makes funds available to philanthropic organizations to provide need-based grants, mentoring, and outreach programs;
- provide, through mandatory appropriation, $30 million per year for FY2008-FY2011 to support specified Upward Bound programs that receive a high rating on their grant application; and
- provide $100 million in mandatory funding for Perkins Loan federal capital contributions annually for FY2008 through FY2012.

[13] (...continued)
minority-serving IHEs