Parental Borrowing for College Comes with Repayment Issues

By Wenhua Di, Carla Fletcher and Jeff Webster

ABSTRACT: As the cost of college continues to rise, parents are increasingly taking out federally backed loans to help make ends meet for their children. Parents, while often more adept at managing debt, assume some of the financial risks of their offspring who are seeking higher education.

College is an investment that generally yields benefits over a student's lifetime in the form of higher wages, more stable employment and better benefits. Typically, parents want to help their children with college costs, but they don't always have enough savings to do so.

Since the 1950s, federal government student loan programs have encouraged postsecondary education. More recently, federal assistance for parents wanting to help their children with college costs came in the form of the federal Parent Loan for Undergraduate Students (PLUS) program. It was created in 1980 and assists parents who are borrowing for their offspring's college expenses.

Parents have increasingly taken out PLUS loans, with the average amounts borrowed growing.[1] The parent loan default rate remains low, though signs of it increasing have appeared.[2]

Parents' repayment behavior differs from that of students, with parent borrowers presenting their own benefits and risks. Parent borrowers tend to have more experience dealing with debt and more realistic expectations for repayment than students. At the same time, parents say taking on loans for their children may affect their ability to save for retirement and undertake major purchases.

PLUS Program Growth

Most federal education loans are loans to students. Stafford loans make up the largest portion of the borrowing. As of second quarter 2018, there were 29.5 million subsidized Stafford loan recipients (receiving relatively favorable terms) and 28.3 million unsubsidized recipients, together representing $753 billion of the $1.4 trillion outstanding federal education loans.[3] The approximately 3.5 million parent PLUS borrowers (8.2 percent of all federal education loan borrowers) were responsible for $87.7 billion, or 6.2 percent of the outstanding loan debt.

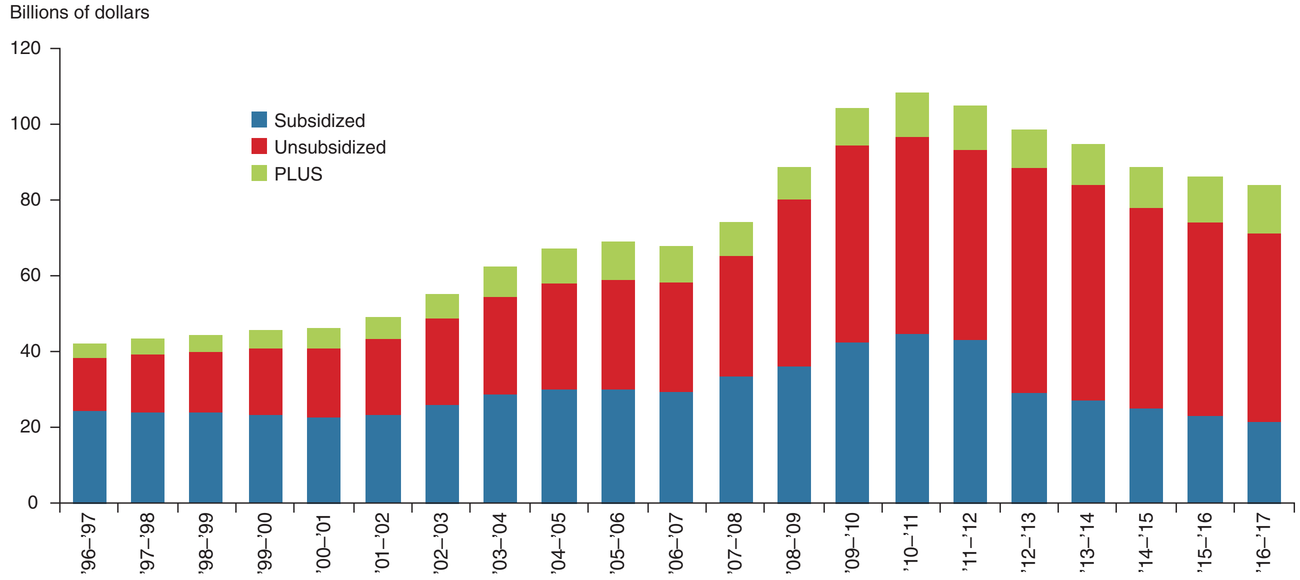
Stafford loans (named after former Vermont Sen. Robert Stafford) are based on the level of financial need calculated using data supplied by students through the Free Application for Federal Student Aid.[4] Stafford loans, available to borrowers regardless of credit score, usually carry lower interest rates than private loans. They also offer various borrower protections such as hardship deferments, forbearance, income-driven repayment options and public service loan forgiveness.

Stafford loans have annual and aggregate borrowing limits. With rising college prices and high financial need among students from middle- and lower-income families, there are often substantial gaps students must fill through savings, paid work and contributions from family and friends.

PLUS loans carry higher interest rates than Stafford loans and are intended for families who have exhausted student borrowing options.[5] PLUS borrowing limits were modified in 1992 to offer greater flexibility. Parents were subsequently allowed to borrow up to the difference between the total cost of attendance and the amount of other financial aid, regardless of expected family contribution, as long as the parental borrowers did not have an adverse credit history.[6] This modification typically provided parents with the ability to borrow much larger amounts.

Although PLUS borrowers are fully responsible for loan repayment, many proceed because they have altruistic motives.[7] College education typically

CHART 1 Parents' Share of Undergraduate Federal Loan Programs Increases



NOTE: Each time period refers to a school year.
SOURCE: College Board, Trends in Student Aid 2017.

leads to a host of financial and other lifetime benefits.[8] There could be some net gains for parents as well. Parents' net lifetime income may increase as a result of incurring PLUS debt—if a child completes a college degree, the subsequent higher income may offset the need for other future support from parents and allow contributions from children to parents in old age.

Greater Parental Borrowing

PLUS loans comprise an increasing proportion of federal aid to students and their families. About 8.6 percent of the $42.1 billion (in 2016 dollars) in undergraduate loans originated in the 1996–97 academic year were PLUS loans (*Chart 1*). The share rose to 15 percent of $84.2 billion in the 2016–17 academic year. The $15,878 average parent loan was $6,251 more than two decades earlier—much greater borrowing than the average amount of Stafford subsidized or unsubsidized loans.[9]

Like other federal education loans, PLUS loans are usually nondischargeable in bankruptcy. Borrowers may also have their wages, tax refund and Social Security benefits garnished if they default on the loans.

Deteriorating Loan Repayment

Parents can potentially access either a federal PLUS loan or a private loan. However, parents with lower credit scores can't easily obtain a private loan, which involves more rigorous underwriting. So, while PLUS loans are not need-based and were designed to support education for families of any income level, they tend to attract lower-income borrowers and those who can't qualify for private-lender funding.

This "adverse selection" of borrowers into the PLUS program became more apparent when conventional underwriting tightened following the Great Recession.[10]

The U.S. Department of Education has published default rates for PLUS loans for fiscal 2006 to 2010 (*Table 1*).[11] The overall default rate increased from 1.8 percent in fiscal 2006 to 5.1 percent in fiscal 2010. The rate more than doubled for loans involving students enrolled in proprietary, private nonprofit and public institutions during the period, with the rate at proprietary institutions being the highest.[12]

In response, the Department of Education tightened the parent PLUS credit check rules in October 2011. Loan denials increased 10 percentage points the following year.[13] The denial rate is also linked to a steep enrollment

TABLE 1 Parent PLUS Loan Defaults Increase Throughout Recession

Three-Year Cohort Default Rates	Fiscal year 2006	Fiscal year 2007	Fiscal year 2008	Fiscal year 2009	Fiscal year 2010
Parent PLUS overall (%)	1.8	2.2	2.6	3.4	5.1
Parent PLUS proprietary (%)	4.7	5.5	6.3	8.3	13.3
Parent PLUS private nonprofit (%)	1.2	1.6	2.0	2.5	3.4
Parent PLUS public (%)	1.2	1.6	1.9	2.2	3.1

NOTE: Rates are calculated based on borrowers entering repayment after in-school deferment. Proprietary institutions are generally for-profit private schools.
SOURCE: U.S. Department of Education, 2012.

TABLE 2

Loan Characteristics and Education Experience by Parent PLUS Loan Default Status*

Variables	Borrowers not in default	Borrowers in default
PLUS Loan Characteristics		
Avg. number of PLUS loans per borrower	2.0	1.5
Highest interest among PLUS borrowings (%)	7.4	7.2
PLUS loan beginning balance ($)	19,509	12,403
PLUS Loan Performance		
PLUS loan amount paid down ($)	8,080	109
Delinquency (%)	26.4	96.3
Deferment (%)	13.2	16.0
Forbearance (%)	31.8	56.5
Student Borrowing, Enrollment and Education Attainment		
Children's Stafford loan amount ($)	18,831	17,015
Second year funded by PLUS loan (%)	19.3	20.2
Third year funded by PLUS loan (%)	17.8	13.5
Fourth year funded by PLUS loan (%)	24.6	12.6
Fifth year funded by PLUS loan (%)	1.5	0.7
Two-year public (%)	3.7	5.0
Four-year public (%)	64.4	57.5
Four-year private (%)	22.4	20.1
Proprietary (%)	5.0	14.8
Minority-serving institution (%)	30.2	44.0
Graduated (%)	48.8	36.8
Withdrawn (%)	25.1	37.1

*Based on borrowers entering repayment in fiscal 2005–10.
NOTE: Loans from Trellis Co. portfolio, shown in nominal dollars.
SOURCES: Trellis Co.; authors' calculations.

decline in 2011 among historically black colleges and universities, which tend to be low-resourced schools with limited institutional grant funds to support their disproportionately large economically disadvantaged student populations.[14]

With the policy change, many parents who relied on the PLUS loans were shut out. Officials later loosened the standard to allow greater participation. Still, families with large unmet need using PLUS are the most likely to struggle with repayment.[15]

Loan Outcomes Examined

Studies of PLUS loans have been limited, largely because of the relatively small share of PLUS loans in the student loan market and the generally lower (albeit rising) default rate. Trends, patterns and the experiences of parental borrowing emerge in administrative data of PLUS borrowers assembled by the Trellis Co., a nonprofit student loan guarantor that has helped administer the Federal Family Education Loan Program in Texas since 1979.

The dataset covers 62,449 parent PLUS recipients who entered repayment between October 2004 and September 2010, with children attending Texas institutions.

Trellis' data track borrowers' repayment behavior from the beginning of repayment and continuing for the next seven years or until the loans were paid in full, consolidated and changed guarantor, or the borrower defaulted. About 8.6 percent of these PLUS borrowers defaulted during the seven-year period. Those who defaulted obtained fewer loans with smaller beginning balances, paid down less of the balance and had higher levels of delinquency, deferment and forbearance than those not in default (*Table 2*).

Parents who defaulted mostly supported students who took more time attending school.[16] Relative to borrowers not in default, the children of those in arrears were more likely to enroll in a two-year public college, a for-profit proprietary (private) school or a minority-serving institution and less likely to attend a four-year public or nonprofit private college and to have graduated.[17]

Multivariate statistical models—a means of examining the interplay between several variables and an outcome—were developed to examine how some of these factors explain the likelihood of a PLUS default.[18] Holding other factors constant, PLUS loans are more likely to default if the students also borrow large amounts, have dropped out of college without a degree or enroll in a four-year private, proprietary or minority-serving institution.

On the other hand, PLUS borrowers are less likely to default if they enter repayment with a higher beginning balance or fund children who have already completed relatively more schooling, are enrolled part time or have graduated from college. Parents' default probability is much more related to their children's college experience than to the PLUS loan's characteristics.

A students' college experience may be tied to family finances, academic aspirations and borrower risk preferences, all of which can influence repayment behavior.

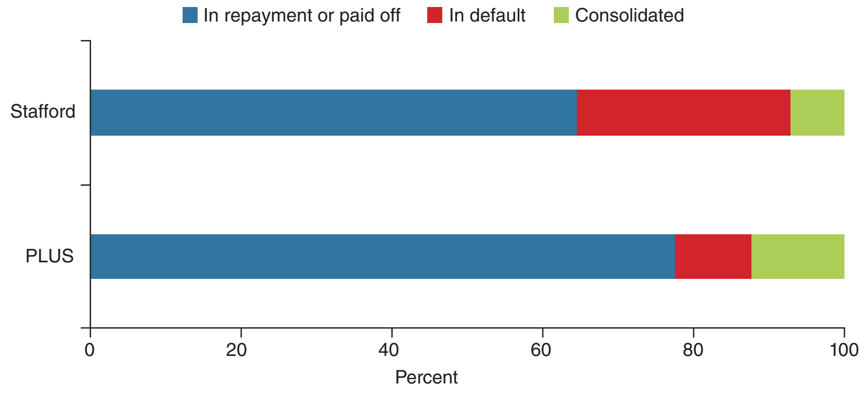
Outperforming Stafford Loans

The Trellis data also include information on Stafford loans, allowing review of overlapping parent PLUS and student Stafford loan data from September 2006 to August 2009.

Compared with Stafford borrowers, PLUS borrowers on average took out fewer loans, had higher initial balances and paid a higher interest rate. PLUS borrowers' children were more likely to attend four-year public or private institutions instead of a two-year public institution or proprietary college, had a higher graduation rate, were more likely to enroll full time and much less likely to drop out.

Since parents are generally older, financially more stable and more experienced with debt, it is not surprising that PLUS loans have better repayment outcomes than Stafford loans (*Chart 2*). For borrowers seven years into repayment in the Trellis portfolio, the default rate on Stafford loans was 28.3 percent, 18.1 percentage points higher than that of PLUS loans.

CHART 2 PLUS Loans Outperform Stafford Loans Seven Years After Repayment Begins



SOURCE: Authors' calculation based on Trellis data for fiscal 2007, 2008 and 2009.

Despite a default rate increase around the recession, PLUS loans have been the only federal student loan program that generates profits for the government and, thus, helps offset other federal educational loan program costs. PLUS loans are forecast to generate a $20.6 billion profit for the federal government from 2018 to 2028.[19]

PLUS loans also outperform Stafford loans after controlling for other factors.[20] Student borrowers are more likely to default if they attend a two-year public institution, enroll part time or withdraw without a degree. Attending a nonprofit, private four-year institution tends to to increase the chance of default for parent borrowers but not for students.

Parent, Student Interviews

To learn more about PLUS expectations and experiences, 49 parent borrowers and 36 students whose parents had borrowed on their behalf were interviewed. Parent borrowers tended to have more experience dealing with debt and had more realistic expectations for repayment than did students.

Overall, the majority of the parents and students expected the parents to repay the PLUS loans. The decision to pay for college through PLUS loans didn't always follow thoughtful discussions with students about explicit academic expectations and implications of ongoing financial obligations.

Parents also reported that PLUS loans affected their ability to save for retirement and make major purchases. The collegiate pathway to adulthood, when parental borrowing is involved, seems to come with parental sacrifice as well as a transfer of financial responsibility.

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Notes

[1] Parents may also borrow from private lenders with terms, conditions and interest rates set by the lender based on the borrower's creditworthiness. Graduate students can obtain loans for themselves under a separate program, also called PLUS. That program is not the focus of this article.

[2] The PLUS loan default rate increased around the recession. Recent official data are unavailable.

[3] Federal Student Loan Portfolio, U.S. Department of Education, accessed July 20, 2018, https://studentaid.ed.gov/sa/about/data-center/student/portfolio.

[4] Subsidized and unsubsidized loans have the same interest rate fees. Students who demonstrate financial need and qualify for subsidized loans do not have the loan interest accrued while in school or during the grace period.

[5] As of July 1, 2017, the PLUS loan interest rate was 7.0 percent, and the loan fee at disbursement was 4.26 percent, while Stafford loan interest was 4.45 percent and the loan fee 1.07 percent.

[6] Parents need to pass the PLUS loan credit check. See, "Direct PLUS Loans and Adverse Credit," U.S. Department of Education, March 2015, https://studentaid.ed.gov/sa/sites/default/files/plus-adverse-credit.pdf.

[7] See "Borrowing Constraints, Parental Altruism and Welfare," by Jorge Soares, *Journal of Macroeconomics*, vol. 45, 2015, pp. 1–20.

[8] "America's Divided Recovery: College Haves and Have-Nots," by Anthony P. Carnevale, Tamara Jayasundera and Artem Gulish, Georgetown University Center on Education and the Workforce, June 2016.

[9] All calculations are in 2016 dollars. PLUS loans totaled $12.6 billion in 2016–17. Data are from "Trends in Student Aid 2017," College Board, accessed July 20, 2018, https://trends.collegeboard.org/student-aid.

[10] Some families prefer PLUS loans because of the repayment flexibility federal loans offer. PLUS borrowers can consolidate their loans and join the Income-Contingent Repayment Plan, which is less generous than most other income-driven repayment plans but caps payments at a share of earnings.

[11] A cohort default rate, the standard measure of federal education loan performance, is the percentage of borrowers who enter repayment during a particular federal fiscal year, Oct. 1 to Sept. 30, and default or fail to meet other specified conditions prior to the end of the second following fiscal year.

[12] Proprietary postsecondary institutions refer to those private, profit-seeking colleges that operate as businesses.

[13] "Cracking Down on PLUS Loans," by Libby A. Nelson, *Inside Higher Ed*, Oct. 12, 2012, www.insidehighered.com/news/2012/10/12/standards-tightening-federal-plus-loans?.

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[14] Before 2010, federal student loans were either made directly by the federal government or by private lenders but federally guaranteed. The guaranteed loan program implemented stricter credit checks on borrowers than the direct loan program. Officials subsequently made all new student loans direct loans, though underwriting became stricter. PLUS default rates are not factored into an institution's student loan default rate, which determines the institution's eligibility for federal aid. See, "The Wealth Gap PLUS Debt: How Federal Loans Exacerbate Inequality for Black Families," by Rachel Fishman, New America Foundation, May 2018, https://s3.amazonaws.com/newamericadotorg/documents/Wealth_Gap_Plus_Debt_FINAL.pdf.

[15] The U.S. Department of Education sets the minimum total debts with adverse conditions (i.e., accounts in collection or charge-offs) as exceeding $2,085 (inflation adjusted, 2015 dollars), instead of any amount. Thus, fewer borrowers are disqualified.

[16] Some students may take more than four years to complete a standard four-year program.

[17] The minority-serving institutions were defined according to the integrated postsecondary education data system data, which include historically black colleges and universities, predominantly black institutions and Hispanic-serving institutions. Some of minority-serving institutions are eligible for federal Title III funding under the Higher Education Act. In Trellis data, the largest historically black colleges and universities in Texas include Texas Southern University and Prairie View A&M University; the largest Hispanic-serving institutions include the University of Texas at San Antonio and the University of North Texas at Dallas.

[18] A logit model and a proportional hazard model are developed. The results are consistent across econometric specifications.

[19] Authors' calculation based on "Student Loan Programs—CBO's April 2018 Baseline," Congressional Budget Office, April 2018, www.cbo.gov/sites/default/files/recurringdata/51310-2018-04-studentloan.pdf.

[20] As shown in a logit regression of the likelihood to default on a loan and borrower characteristics.

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