THE AFN DEBT SERIES

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Asset Funders Network

MAJORING IN DEBT: WHY STUDENT LOAN DEBT IS GROWING THE RACIAL WEALTH GAP AND HOW PHILANTHROPY CAN HELP

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ASPEN INSTITUTE FINANCIAL SECURITY PROGRAM

In 2019, the total amount of student loan debt surpassed $1.5 trillion, now the largest source of non-mortgage debt. Student loan debt has a significant impact on the racial and gender wealth gap. In the wake of both COVID-19 and the civil rights protests of 2020, there is a renewed and overdue emphasis on asset-building strategies designed to close the racial and gender wealth gaps that persist in our society.

Philanthropy has rightly supported these efforts over the years and, in fact, many of the promising solutions gaining traction are the result of investments by funders. However, to make real progress, we must recognize that substantially negative net worth is the financial starting point for many women and people of color, particularly Black people. Unless we work to reduce the racial and gender debt gaps, we will not make a dent toward closing the racial and gender wealth gaps.

Furthermore, financial security (or insecurity) is often passed down much in the same way that generational wealth and opportunity are, making student loan debt ever more troubling for those interested in building generational wealth. Fortunately, with leadership from philanthropy, student loan debt is a solvable contributor to today's debt and racial wealth gaps, with an opportunity to impact not just today's borrowers, but also the generations who will follow them.

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For people across the United States, student loan debt is a growing portion of the household balance sheet. More than 40 million Americans have outstanding student loan balances. The problems associated with student loan debt are systemic and consequential for borrowers, their families, their communities, and the nation's economy.

Historically and on average, investments in higher education have paid off — though economic outcomes have always varied by gender and race. Generations of Americans have successfully financed their education with student loan debt and reaped the benefits of higher lifetime income. Today, however, given the difficult landscape, the calculation is less clear.

Multiple factors have contributed to the challenge of guaranteeing that all students who could benefit from a college degree are able to attend a quality school, graduate, and then repay their loans on manageable terms after they graduate. These factors include rapidly rising tuition, housing, and health care costs as well as the complexities of the labor market, varying program quality, and lack of information to help students make informed choices.

According to the Bureau of Labor Statistics, from 2006 to 2016, the price of tuition and fees increased by 63%, compared with overall inflation over that same period of 21%. As a result, the proportion of students relying on student loans has skyrocketed. In 2018, 54% of young adults who enrolled in college took on some form of debt to pay for their education, double the share of adults who did so in 1980.

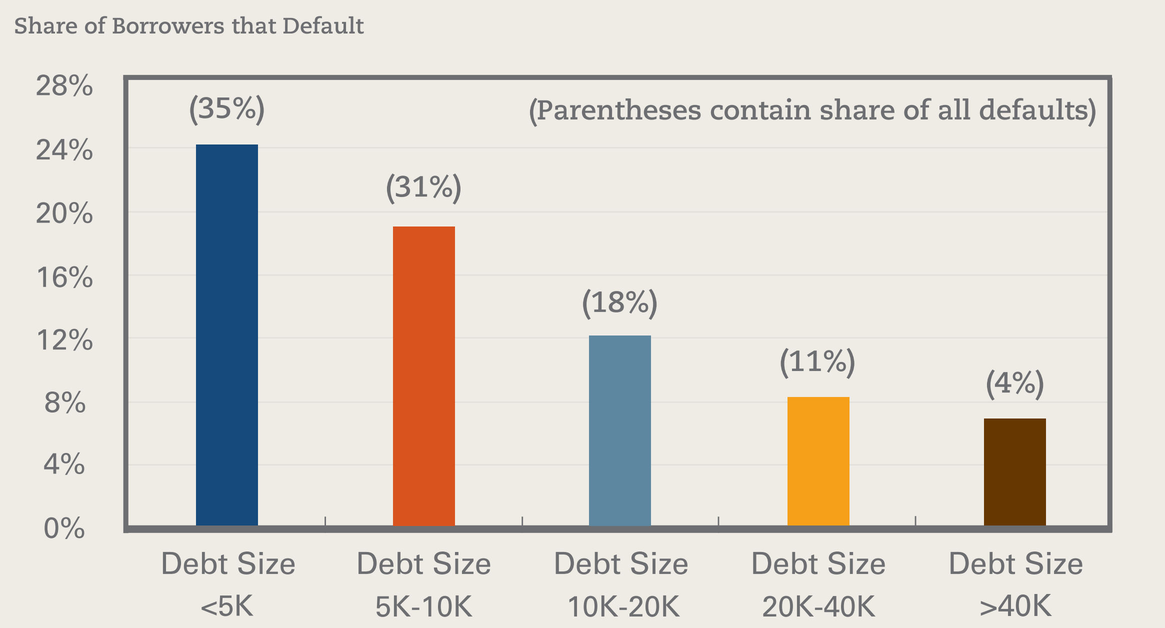
After incurring debt, many borrowers struggle to pay off their loans in a timely manner. According to the Department of Education, in 2018, only one in four current borrowers were paying down both the principal and interest of their loan. Default rates are growing across degree type and racial demographics. If the status quo continues, the crisis could worsen. A recent, pre-COVID-19 projection estimated that absent intervention, 40% of all borrowers may default by 2023.

Contrary to popular belief, it is often not borrowers with the highest balances who struggle the most to pay off their loans. Borrowers with less than $10,000 in outstanding debt make up over 60% of all defaults, in part because many borrowers with low balances are students who left school before completing a degree.

Without the completed degree, this can mean a reduced ability to pay and more vulnerability to default. Borrowers with a large outstanding balance, on the other hand, tend to be students who have pursued graduate degrees and have higher average household incomes with which to repay their debt. While the majority of aggregate student loan debt is held by high-balance borrowers, the majority of today's student loan borrowers, and those who default on their loans, hold balances of $10,000 or less as shown in the chart below.

Importantly, borrowers with debt balances under $10,000 are disproportionately people of color, so solutions that focus on low-balances will have an important impact on racial equity. While solving student loan debt in America will require action from a variety of actors, funders have a clear and unique role to play in helping solve this problem. This brief provides funders with an introduction to student debt across the country; describes the impact student loan debt has on individual borrowers and the economy; illuminates the disparate and consequential impact debt has on low-income borrowers and borrowers of color; and importantly, identifies tangible, targeted solutions aimed at alleviating the balances of borrowers with $10,000 in outstanding loans or less.

Share of Borrowers Who Default by Year 3 by Loan Size, 2011 Repayment Cohort



Note: Years are fiscal years. Loan size is based on balance of loan when entering repayment.

Source: Department of Education

The Consequences of Student Loan Debt Reach Beyond the Individual

The following statistics are an aggregation of surveys that vary in sample size and statistical validity. The results included below are meant to illustrate the array of other financial challenges borrowers face in incurring student debt.

Student Debt Has Deep Impacts of Short-term Financial Stability

- 58% of borrowers attribute a decline in credit score to student debt
- 13% said it caused a failed credit check for apartment applications
- 6% reported having wages or social security benefits garnished because of student debt obligations
- 55% of college graduates with student debt say it forces them to delay saving for emergencies
- Four in 10 people still paying off their loans say they are struggling financially.

Student Debt is a Roadblock to Long-term Financial Security

- Among young student borrowers, those with student loan debt have half the retirement savings at age 30 of those without.
- Research shows that it is presence, not merely the size, of student debt that discourages retirement contributions.
- 83% of young student loan borrowers in repayment, who have not purchased a home, listed student loan debt as a factor for delaying them from purchasing one.
- On average, they noted a 7-year delay between the time they wanted to buy a home and when they were able to purchase one.

Student Debt Affects Career and Life Decisions

- More than half (53%) of student loan borrowers noted debt as a factor in choosing which career to pursue.
- 61% of student loan borrowers who had hoped to start a business said student loan debt affected their ability to do so.
- On average, 22% of student loan borrowers noted that they delayed moving out of their parents' home for two years due to student loan debt.

Student Debt Perpetuates and Exacerbates the Racial Wealth Gap

- 70% of Black borrowers are at risk of default.
- 20 years after starting college, a typical Black student still owes 95% of their total debt, compared with 6% for White students.
- Approximately 40% of Black borrowers drop out with outstanding debt and struggle to pay back the amount.
- Disparities in student debt outcomes place borrowers of color and their communities at a greater disadvantage in terms of accumulating and maintaing wealth.

Student Debt Poses Risks to the Broader Economy

- Consumption decreases when consumers have debt-to-Gross Domestic Product ratios that exceed 60% The debt-to-GDP has steadily declined since the Great Recession, however, it currently sits at 76%, which could present a risk to aggregate consumption.
- While economists are unsure about the broader economic effects of household debt, research shows it depresses homebuying, auto sales, and other consumption, which could slow economic growth.
- According to the Federal Reserve, larger negative economic effects are possible if student loan payments crowd out household spending.

Source: https://assets.aspeninstitute.org/content/uploads/2020/04/How-States-Can-Solve-the-Student-Debt-Crisis.pdf?_ga=2.83812182.153639983.1597686006-961154015.1569943140

WOMEN represent 56% of those enrolled in American colleges and universities and they **HOLD NEARLY TWO-THIRDS** of the nation's student loan debt.

STUDENT LOAN DEBT DAMAGES INDIVIDUAL FINANCIAL SECURITY & SHARED ECONOMIC PROSPERITY

While the full impact of the student debt crisis will not be felt or understood for years to come, student loan debt has a notable negative effect on the day-to-day lives of borrowers. For struggling borrowers, paying off student debt requires individuals and households to make regular financial tradeoffs by prioritizing student loan debt relative to other types of consumer debt and household needs. After debt service, borrowers are left with little leftover with which to save for emergencies, save for retirement, or make other long-term investments. Studies and surveys have also found that student loan debt can lead to the delay of important life decisions – such as marriage, having children, or purchasing a home – as well as result in increased stress and adverse health outcomes.

Within communities of color, the burden of taking on and paying back this debt is uniquely devastating. Black students take on more debt for the same degree than White borrowers. On average, Black graduates, in turn, owe $7,400 more than their White peers. Yet, as time goes on, the debt gap between these borrowers will triple to average $25,000.

Said another way, **20 years after enrollment, the median Black borrower still owes 95% of their debt, compared to 6% for White students. This means that more Black borrowers struggle to repay their loans and fall behind on their payments. Similarly, 15% of Latino borrowers are in default and another 29% were seriously delinquent. This disparity is the result of systemic barriers and challenges** that leave borrowers of color with student debt outcomes that are dramatically worse than those of White borrowers.

Student loan debt also results in long-term consequences for communities of color, with acute challenges for Black borrowers specifically. The racial wealth gap in the U.S. has its roots in 250 years of government and individual discrimination, and the patterns of racial disparities repeat themselves here. Student debt is not only disproportionately held by students of color. Students of color are also more likely to navigate debt alone and experience some of the more damaging effects of carrying debt.

Student loan debt has disproportionately negative impacts on women as well. Women represent 56% of those enrolled in American colleges and universities and they hold nearly two-thirds of the nation's student loan debt.

The gender wage gap results in women having less disposable income, making it harder for women to repay their student loans. This difficulty in repaying also results in higher default rates for women, with higher default rates for both Black and Hispanic women.

Student loan debt doesn't just damage individual financial security. The downstream effects of student loan debt threaten to undermine our broader economy. Analyses from the Federal Reserve Bank of Philadelphia and the Federal Reserve Board of Governors find that student debt is associated with slower growth of small businesses and with lower rates of homeownership. While the long-term effects of student loan debt among millennials remain to be seen, survey data suggests that student loan debt is delaying millennials' home purchases, which will likely have an effect on the strength of the real estate market. They also are delaying having children, which could have long-term impacts on the labor market and Social Security.

INDIVIDUALS MOST LIKELY TO HAVE TROUBLE REPAYING

- Women
- Borrowers of color
- Student parents
- First-generation students
- Non-completers
- Low-income borrowers
- Low-balance holders
- Students who attend for-profit institutions

SOLUTIONS & OPPORTUNITIES FOR SOLVING STUDENT LOAN DEBT

Student loan debt is a complicated problem, with action required from diverse actors to fully solve it. As such, the specific drivers and associated solutions range in size, scope, complexity, and cost. But there is a compelling case for funders to focus solutions on those who have already assumed student loan debt, and who owe less than $10,000. By specifically targeting these borrowers, we will find achievable, scalable solutions that are simultaneously a critical investment in racial equity in America.

There are two broad categories of potential investments highlighted in this brief. First, we present a curated set of borrower-level solutions designed to promote the financial security of individual borrowers with balances under $10,000. Next, we offer opportunities for philanthropy to support systems change that would ultimately lead to solutions at scale. Funders may use these examples to draw inspiration in getting started or in taking steps toward supporting this work.

SOLUTIONS FOR INDIVIDUAL BORROWERS

To positively impact borrowers struggling with balances of $10,000 or less, philanthropists have an opportunity to invest for impact at multiple points in the life cycle of already-assumed student debt. Below we outline opportunities for innovative investment in (1) access to tools to optimize loan decision-making and management, (2) matching programs to reward and accelerate loan repayment, (3) legal services to ensure that borrowers facing debt collection litigation are fairly represented, and (4) individual loan cancellation.

OPPORTUNITY:

FACILITATE BORROWERS' ACCESS TO LOAN OPTIMIZATION TOOLS

An emerging category of financial technology ("fintech") companies exist to help student loan borrowers better manage their student loan debt. These fintechs, whose services are largely accessed via a mobile app, help borrowers navigate and optimize multiple kinds of decisions about their loan. These tools can help borrowers understand their loan and how it works, choose the best repayment plan, assess their eligibility for loan forgiveness, evaluate decisions about consolidation, or access additional tools to help borrowers pay off their loan faster.

Examples:

These examples do not imply endorsement and this list is not exhaustive but serves to illustrate potential tools that are available.

- Summer: Summer helps student loan borrowers save on their loans by identifying and enrolling users in the best repayment and forgiveness programs.
- ChangEd: For a $1/month fee, ChangEd is a subscription-based app that helps student loan borrowers manage their debt and build "round-up" savings toward repayment.

Role for Philanthropy:

Funders can facilitate borrowers' access to these tools in several ways. First, they can underwrite the cost of subscriptions to these types of tools for a large cohort of borrowers, helping to make sure that more individuals have access to these promising resources. This could happen through a distribution partnership with either a non-profit direct service and/or asset-building organization in which the funder could underwrite not only borrowers' usage fees, but also the cost of the partner organization's efforts to directly counsel borrowers. This would ensure that these tools are being optimally accessed by those most in need.

Alternatively, funders might partner directly with a well-vetted fintech. One version of that partnership would be to jointly select a group of borrowers within the company's user base who are eligible to have their usage fees covered. Another way to support these solutions is to make an equity investment in a company with proven results around borrower outcomes, to support the sustainability and equitable usage of the solution.

OPPORTUNITY:

SUPPORT STUDENT LOAN DEBT REPAYMENT ASSISTANCE

A growing trend in workplace benefits is for employers to match employees' student loan debt repayment in different ways. A common model is for employers to directly match student loan debt repayment, sending matching contributions directly to the employee's student debt servicer. In another model, first implemented by medical device manufacturer Abbott, the employer makes a retirement plan contribution on behalf of an employee who is meeting a specified threshold of student loan debt repayment, thus helping the employee simultaneously pay down debt and build savings for the future.

Currently, just 8% percent of all workers have access to college savings or debt-related benefits plans through their employer. In 2020, however, as a response to the COVID-19 crisis, the CARES Act gave employers the ability to provide up to $5,250 tax-free repayment on their employees' student loan debt. With interest already growing among employers, the tax incentive may further accelerate the trend toward offering these benefits.

Examples:

- Aetna: Provides matches up to $2,000 a year for their full-time employees, up to $10,000 total.
- CommonBond: This student loan debt-focused company supports its own employees' student loan debt repayment. Each worker can receive up to $100 per month toward student loans with no lifetime cap.
- Estee Lauder: Provides matches up $100 per month, up to $10,000 total.

Role for Philanthropy:

Funders can support these programs in several ways. First, funders can partner with an employer, or several employers within a sector of choice or concern (e.g. schools, hospitals, or local small businesses) who might not be able to otherwise afford such a program. Funders might finance both the ongoing management of the program — including the staff time required to administer the program — and the critical matching dollars. Importantly, funders should also consider underwriting rigorous evaluation of these programs.

Another entry point to this opportunity is through the technology companies who often facilitate student loan debt repayment through servicers. Partnering with a company such as Vault, Gradifi, or Peanut Butter & Co., a funder might develop a scholarship program for employer clients whose employees fit the profile of greatest interest to them. Both of these models have the potential to more equitably distribute the benefits of repayment matching, as compared to today's status quo.

OPPORTUNITY:

PROVIDE BORROWERS WITH PROTECTIONS FROM COLLECTION ACTIONS

For many borrowers, current student loan debt collection policies and practices pose additional threats to their financial security. Most at risk are the borrowers who default and are already experiencing financial insecurity, suddenly facing wage, tax refund, and federal benefit garnishment. While less common, they can also face lawsuits from the federal government or private loan servicers suing to collect on student loans.

Unlike legal matters of the criminal justice system, civil legal challenges do not require legal representation to proceed. But for borrowers already experiencing financial hardship, this can mean navigating the justice system without a lawyer. To ensure that borrowers can engage in a fair process and successfully navigate collections actions and litigation, they need access to legal representation. Specifically, borrowers need legal help to navigate their relationship with their student loan servicer, whether resolving errors and disputes, or managing hardship and default situations. In case of a collections action, borrowers often need legal representation to prevent being unduly impacted by the powerful debt collection tools that can be used against them.

Example:

- Student Borrower Protection Center's Student Loan Law Initiative: The Student Borrower Protection Center works to advance reforms across the student loan market through advocacy, research, and creative litigation strategy. It has partnered with the University of California, Irvine School of Law to create the Student Loan Law Initiative to define the field of student loan law and protect borrowers' rights. The partnership between the Student Loan Law Initiative and UCI Law Consumer Law Clinic provides free legal assistance to alumni struggling to have their Public Service Loan Forgiveness applications approved. The Student Loan Law Initiative also works to support law school clinics and legal service providers across the country to provide important support to low-income borrowers and organization clients.
- Legal Aid Foundation of Los Angeles: Legal Aid Foundation of Los Angeles seeks to achieve equal justice for people living in poverty across Greater Los Angeles. They work through direct representation, systems change, and community education. Their consumer work focuses on assisting clients who cannot afford to repay their loans and/or have attended for-profit colleges that engage in predatory, deceptive, or illegal practices.

Role for Philanthropy:

As it stands today, there are limited legal resources to help student loan borrowers, but there are organizations in every state that provide free legal help to low-income borrowers. There is an unmet need for civil legal aid, and philanthropy is well positioned to increase access by funding legal aid at various levels. Funders can expand access to legal aid for low-income borrowers by giving grants to free law clinics and other legal aid organizations that provide legal representation to student loan borrowers.

SOLUTIONS FOR SYSTEMS CHANGE

Reducing the individual and societal impacts of student loan debt at scale will require policy innovation at several different levels of government. The range of investments include creation of and access to data from innovative government-facilitated pilot programs, continued research on the micro- and macro-level impacts of student loan debt, and support for policy advocacy to advance major solutions. Importantly, there is also a need for leaders — including funders — to contribute to real narrative change on student loan debt. Below we offer a curated list of investment opportunities for grantmakers who value investment in scale solutions.

OPPORTUNITY:

FUND INNOVATIVE PILOT PROGRAMS FOR RE-ENROLLMENT PROGRAMS AND ASSOCIATED PROGRAM EVALUATION

While many of the key drivers of student loan debt are driven by federal policy, states and other large institutions, such as public universities, are beginning to take action. Re-enrollment programs provide pathways to postsecondary completion for non-completers (students who have taken loans, but who have not completed a degree) and are often paired with some amount of debt forgiveness to increase incentives for re-enrollment. The student loan debt burden of non-completers is often a major barrier to reentry and the completion of their degree. As expected, college completion is crucial to a borrower's ability to repay their debt, as those who graduate repay their loans at higher rates. Non-completers are disproportionately represented among those delinquent on their loans, and also do not benefit from the wage increases associated with a degree. Re-enrollment programs can minimize debt while improving educational and career outcomes for students, which ultimately strengthens their long-term financial security.

Example:

The Warrior Way Back program at Wayne State University was developed to help 13,000 non-completers in the Detroit area who initially attended Wayne State University. This program enables students with outstanding debt to re-enroll. The university also writes off up to $1,500 for all participants of the program, easing financial barriers to reentry.

Role of Philanthropy:

While we have yet to see state-level action in developing a comprehensive re-enrollment program with student debt forgiveness at public institutions, the program described above at Wayne State University is beginning to be replicated and scaled by institutions across the country. Funders can support the development of more innovative programs as well as underwrite critical program evaluation research. Thorough tracking and evaluation of outcomes and metrics will allow those in the field to better understand and improve upon innovative solutions as they are being implemented.

OPPORTUNITY:

SPONSOR RESEARCH TO ENSURE A CONTINUOUSLY REFRESHED EVIDENCE BASE ON THE IMPACT OF STUDENT LOAN DEBT

Student loan debt has become one of the most pressing financial security issues, with implications for future asset building. More research is needed to understand the ways in which this kind of debt crowds out other financial stability, mobility, and security choices to make the case for national-scale solutions. Philanthropy is needed to support research and pilot programs that shine light on student loan debt and the consequences of inaction. The goals of addressing student loan debt should go beyond delinquency and default. The ultimate metric of success for solutions must consider the broader impacts of student loan burdens on household finances.

OPPORTUNITY:

SUPPORT ADVOCACY ORGANIZATIONS ADVANCING FEDERAL AND STATE SOLUTIONS

The student loan debt crisis sits at the intersection of several thorny state and federal policy issues — the cost of higher education, how much a state invests in and subsidizes public institutions, borrowers' rights and legal protections, availability of scholarships and other non-loan aid and grants, what to do about the existing debt burden for so many borrowers, and equity in pay and other benefits for women and Black, Indigenous, and people of color. Without a doubt, policy change is needed for borrowers to fully realize the potential of their degree and career and to implement systemic, scaled solutions that will stop the continued build-up and burden of student loan debt.

To advance policy change, advocacy organizations are focused on a range of potential solutions. Some organizations have invested deeply in analyzing various forms of federal student loan debt cancellation, with a growing convergence around the idea for universal cancellation of the first $10,000 in student debt. The progressive and equitable nature of this idea has helped create strong momentum, as has the realization that dealing with the racial debt gap is a critical part of closing the racial wealth gap.

Policy advocacy organizations are focused on other changes to the system, as well. Expanding and strengthening loan forgiveness and repayment programs, strengthening borrowers' rights and consumer protections, and creating tax incentives for employer repayment matching would each contribute to scale solutions and offer real relief for struggling borrowers.

In addition to funding the important work listed above, resources are needed to support advocacy and policymaker education that will prioritize new voices and new perspectives – reflecting the realities of today's borrowers.

OPPORTUNITY:

HELP CHANGE THE NARRATIVE

An updated understanding of the student loan debt crisis and its consequences is needed to shift the interpretation of the issue. While a common perception faults the individual borrower, research shows that policies and institutional structures are at the foundation of the problem. A more updated and accurate view of the choices that student borrowers are making will support better solutions, tailored to the need of those experiencing the most consequential impact of student loan debt. Funders have an opportunity to use both their voice and societal influence to help correct the narrative, creating the necessary conditions for policy change.

CONCLUSION

Student loan debt is not just about student loan debt. Solving for this problem is at the center of racial equity, gender equity, inclusive economic systems, and economic mobility in this country. The short-term and long-term impact of student loan debt harms everything from short-term savings and mental and physical health to wealth creation and the economic dignity that comes from choices such as getting married and having children. This kind of debt exists in the U.S. not because of individual "bad" choices, but because of a series of systemic choices that leave little space for "good" choices to be made.

But there is good news. By being more strategic in the approach and focusing on the existing debt for borrowers under $10,000, there are both doable and scalable solutions that will have important equitable results. Student loan debt is a problem that can be solved — and will be solved — by the leadership from philanthropy and others to tackle the issue from the household level to the systemic level.

RESOURCES

How States Can Solve the Student Debt Crisis: A Framework for Reducing Student Debt Burdens for Present and Future Borrowers: To provide options to states to address this growing threat to financial security, Aspen FSP conducted a scan of possible state solutions to address student loan burdens.

Fewer Resources, More Debt: Loan Debt Burdens Students at Historically Black Colleges and Universities: This brief examines the rates, amounts, and distribution of student-loan debt among historically Black college or university students relative to their non-historically Black college or university peers.

Debt to Society: The Case for Bold, Equitable Student Loan Cancellation and Reform: This report discusses several policy options to make student loans less burdensome, more humane, and less complicated.

Buried in Debt: A national survey report on the state of student loan borrowers in 2018

Student Loan Cancellation: Assessing Strategies to Boost Financial Security and Economic Growth: This brief analyzes and categorizes 16 proposals put forth by policymakers across political parties and ideologies, researchers, advocates, and others that could aid the 44 million borrowers who have student debt today.

Borrowers Discuss the Challenges of Student Loan Repayment: This report seeks to provide insight into the characteristics of borrowers who have the most difficulty repaying their loans.

Making the Case: Solving the Student Debt Crisis: The brief explains the student debt crisis as it exists today, how it affects household financial security, and who is most impacted. Government officials, researchers, policymakers, private and nonprofit organizations, as well as the public, can use this brief for building momentum and driving action to solve this evolving crisis.

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