UNIVERSITY OF CALIFORNIA Student Loan Law Initiative

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FACT SHEET: EXPOSING AND ADDRESSING HARDSHIP FROM STUDENT DEBT

As the Education Department Prepares to Address Student Borrower Hardship, New Study by University of California Scholars Exposes Effects of High Student Debt Burdens on Lower- and Middle-Income Borrowers; Scholars Propose New Debt Relief Program for Tens of Millions

December 8, 2023 | Berkeley, CA— Today, an interdisciplinary team of economists and law scholars affiliated with the University of California Student Loan Law Initiative (UC SLLI) published a pathbreaking new study finding that millions of lower- and middle-income student loan borrowers suffer hardship from their student debt burdens. For the first time, this study looks at a wide variety of indicators of financial health— from bankruptcy and foreclosure to past-due credit cards and other debts– to measure student debt's impact on financial wellbeing.

This new study comes as the U.S. Department of Education prepares to write new rules establishing a series of targeted student debt relief programs, including one effort specifically focused on alleviating hardship caused by student debt.

Based on their analysis, the authors identify the level of student debt, depending on borrower income, that significantly increases risk of bad financial outcomes and decreases financial wellbeing. The authors recommend that policymakers cancel student debt in full for all lower-income borrowers (those from households earning less than $71,000 per year) and provide debt relief to middle-income borrowers (those from households earning between $71,000 per year and $131,500 per year) to ensure that their debt-to-income ratios do not exceed 30%. Recognizing that these recommendations do not fully consider the role that intergenerational wealth plays in borrowers' future financial wellbeing and the ways in which student debt exacerbates racial and economic inequities, the authors note that these recommendations should not preclude additional debt relief for borrowers who used a Pell Grant to pay for college.

A copy of the new UC SLLI study, *Financial Hardship Among Student Loan Borrowers*, authored by economists Sultana Fouzia and Marshall Steinbaum, and law scholars Dalié Jiménez and Jonathan Glater, is available here:
https://slli.org/databrief3

For more than a decade, a growing body of research has documented the myriad ways student debt affects borrowers' lives and livelihoods– diminishing homeownership, jeopardizing retirement security, inhibiting savings, undermining financial security, increasing the cost of other financial products, steering borrowers away from public service careers, contributing to workforce shortages in healthcare, driving highly-educated young people out of rural communities, slowing small business formation and dampening growth of the entire U.S. economy.

Using the University of California Consumer Credit Panel, the authors build on this foundational research– measuring the relationship between student debt load (a borrower's total student loan balance) and student debt burden (a borrower's student-debt-to-income ratio), on the one hand, and six indicators of borrower hardship, on the other. The six indicators of borrower hardship considered in this study are:

1. Credit score
2. Homeownership
3. Access to and use of credit cards and other "unsecured" credit
4. Trouble repaying any credit or debt that appears on a credit report
5. Bankruptcy, foreclosure and other "adverse" legal proceedings
6. Repayment of an auto loan

The authors consider indicators that may be associated with increased hardship, such as a decline in credit score and the existence of past-due debts, as well as indicators that may be associated with the pursuit of economic opportunity, such as homeownership. The frequency with which these positive and negative indicators of hardship appear on a credit report is closely linked with borrowers' student debt burdens– suggesting that tens of millions of people who owe a student loan are at risk of experiencing hardship. This first-of-its-kind analysis uses the University of California's Consumer Credit Panel, a dataset composed of anonymized credit reports belonging to 2% of all consumers nationwide.

Findings and Recommendations

To better understand the relationship between student debt burden and financial precarity, the authors considered these six measures of hardship for three different cohorts of student loan borrowers: lower-income borrowers (those from households earning less than $71,000 per year), middle-income borrowers (those from households earning between $71,000 per year and $131,500 per year), and higher-income borrowers (those from households earning above $131,500 per year). The authors observed that for lower-income and middle-income borrowers, student debt poses hardship:

- **Lower-income borrowers face hardship across their financial lives.** The authors observe that, for borrowers with incomes in the bottom half of the income distribution, having any amount of student debt can result in borrower hardship. Specifically, the authors find that for borrowers from households that earn $71,000 or less, any student debt burden is associated with a substantial decline in borrowers' credit score, a decline in homeownership, an increase in bankruptcy, foreclosure, and other adverse outcomes, failure to pay down car loans, and an increase in trouble repaying financial obligations including medical bills and other debts. For example, having even a small amount of student debt is associated with a drop in credit score of around 50 points for borrowers in this group. **As a result, the authors recommend that the Secretary of Education cancel all student debt owed by borrowers from households that earn $71,000 or less.**

- **Middle-income borrowers with higher debt burdens face barriers to economic opportunity.** The authors also observe that, for borrowers with household incomes in the top half of the income distribution for all borrowers, but who are not in the top ten percent, student debt poses hardship when borrowers' debt burdens exceed 30 percent of their household income. Specifically, the authors find that for middle-income borrowers (those from households earning more than $71,000 and less than $131,500), student debt burdens in excess of 30 percent are associated with a substantial increase in trouble repaying financial obligations, including medical bills and other debts. Increased debt burdens are also associated with a decline in middle-income borrowers' credit scores and an increase in bankruptcy, foreclosure, and other adverse outcomes. **As a result, the authors recommend that the Secretary of Education cancel debt in an amount that ensures that no borrower's total student debt load exceeds 30 percent of their annual income.** That would guarantee no borrower from a middle-income household would owe more than $40,000 in student debt.

- **Borrowers without the benefit of intergenerational wealth face additional economic hardship over their lifetimes.** Although the authors' analysis did not consider whether a borrower used a Pell Grant to pay for college, the authors acknowledge the existing body of research that shows a close association between Pell eligibility and long-term financial distress. **As a result, the authors note that these recommendations should not preclude additional debt relief for borrowers who used a Pell Grant to pay for college.**

Delivering Student Debt Relief via Executive Action

The Higher Education Act of 1965 provides the Secretary of Education with broad authority to compromise, waive, release, and modify borrowers' obligations to repay federal student loans. In June 2023, President Biden announced his administration's intention to write new rules defining when and under what circumstances the Secretary of Education would exercise this authority. President Biden announced this rulemaking in the hours following a June 2023 decision by the U.S. Supreme Court that invalidated the previous effort by the Biden Administration to deliver student debt relief to 40 million people.

Beginning in October, the Education Department impaneled a group of expert negotiators to help the federal government write new rules to this effect. As part of this "negotiated rulemaking," the Education Department asked negotiators to consider whether the Secretary of Education should deliver debt relief to borrowers "experiencing hardship." Specifically, the Education Department asks:

Borrowers who experience hardship with respect to their student loans may have certain ways to reduce or delay loan payments or seek forgiveness on their loans. Yet borrowers may continue to experience hardship in ways that the current student loan system does not adequately address. What are potential types of hardship that borrowers may continue to face and how might the Department address those cases of hardship?

Today's study attempts to answer this question, demonstrating that student debt burden substantially increases negative financial indicators and detracts from financial wellbeing.

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About the UC Student Loan Law Initiative

The Student Loan Law Initiative (SLLI) is a partnership between the Student Borrower Protection Center, the University of California, Irvine School of Law and the University of California, Berkeley School of Law to develop a body of rigorous research around how to address the student loan crisis.

Learn more at www.slli.org.