By Andrew Gillen

In Debt and In the Dark:
It's Time for Better Information
on Student Loan Defaults

Few domestic issues resonate more deeply with the public than the continually rising cost of college. With soaring tuitions (and often disappointing completion rates) have come demands for cheaper alternatives and stricter institutional accountability. The responsibility for both has traditionally resided with colleges, but the federal government can influence postsecondary behavior in two key ways that relate to student loan default rates: First, by providing better information on student loan default rates. Second, by holding colleges more accountable for their part in student loan defaults.

The three-year default rate for student loans is 13.4 percent, and the cost of default will be borne by students—and taxpayers.[1]

Tracking and reporting loan default rates are a crucial means of monitoring how well higher education dollars are spent; it is a primary federal responsibility. Better loan default data would hold institutions to a stricter level of accountability, provide more useful information to students and parents, and help researchers determine which students struggle most to afford college, why they struggle, and how to address those problems. Yet, despite the debates about ways the federal government might improve accountability and reduce student debt—for example, by providing meaningful data on industries where graduates find jobs, by tracking graduation rates for part-time students, or by increasing oversight of college accreditors—policymakers have not devoted enough attention to overhauling one basic step: how the federal government measures and reports data on student loan defaults.

Incomplete Loan Default Data

Data on loan defaults is reported by institution. That means that whether you are looking at an elite Ivy or a local community college, you can see the percentage of borrowers who attended those schools and defaulted at some point in the first three years of the repayment period.[2] But that's all you can learn. There are no breakouts of that data. Consider Pell grants, given primarily to poor students. If you want to see how many of one school's Pell grant students defaulted compared to how many of the school's other students defaulted, you are out of luck. Likewise, you can't find out how defaults among Pell grant students at one school compare to defaults of Pell grant students at another school. You also can't look at default rates for different types of degree programs—bachelor's versus

master's versus doctoral at a four-year university, or associate versus certificate programs at a community college. Nor can you look at default rates by students' age, gender, or ethnic group.

None of this information is available despite the fact that default rates are one of the primary means by which the federal government determines eligibility for federal aid. (Schools also must be accredited and approved in their home states, but the federal government does not directly influence these decisions).

Given the importance of defaults, and the recent jump in their numbers, it would make sense for the government to provide more detailed information on defaults, not just as an accountability lever but as a basic consumer right. Compared to other forms of debt, it is remarkably easy to qualify for a federal student loan (though remarkably difficult to discharge in bankruptcy): Good credit histories are not required for most loans, and the risk to students is shared by taxpayers since the federal government is the direct lender for federal loans. Parents and students would benefit from better data showing which students, at which schools, are more likely to default on higher education loans.

Elsewhere in education, actions by the federal government have flooded policymakers, parents, and other taxpayers with important and useful data. The federal No Child Left Behind Act remains controversial, but because of it, at the K–12 level, results of achievement tests are broken down by state and district. Results also are available by race and categories such as English proficiency and special education status, so that schoolwide averages no longer mask different levels of performance among sub-populations.

Why can't the same rigor be applied to reporting requirements for default rates at the college level? Already the federal government has made some changes in how it calculates default rates. Colleges will soon be judged on the percentage of

What is a Student Loan Default?

When student borrowers graduate, drop out, or fall below half-time enrollment, it's time to start paying back their student loans—what the government calls "entering repayment." Most federal loans have a six-month grace period before entering repayment. Student borrowers also can be granted deferment (a temporary reprieve from loan payments) or forbearance (an alternative payment schedule) to postpone or alter scheduled payments.

The U.S. Department of Education considers a loan to be in default if the borrower is more than 270 days behind on payments. The default rate is the percentage of a school's borrowers who enter repayment during a fiscal year and default within three years. Note: Only subsidized and unsubsidized Stafford loans are included in the default rate calculation. The default rate calculation ignores Parent PLUS, Grad PLUS, and Perkins loans.

borrowers who default in the first *three years* of the repayment period rather than the percentage who default in the first *two years*. (Three-year default rates were published for the first time in 2012). Under the new rules, schools with default rates greater than 30 percent for *three* consecutive years will lose access to federal student aid. (Lesser consequences kick in before that.) Under the two-year rule, the eligibility threshold was 25 percent.[3]

Two-Year vs. Three-Year Rates

Congress instituted the three-year rule because of concerns that schools were gaming the two-year requirement by delaying the date at which students would go into default (through forbearance, deferment, and other means). Since this would allow colleges to avoid accountability for their students' defaults, taking action to prevent such schemes seemed a reasonable response. But **Chart 1**, which shows the two-year and the three-year default rate for each college, indicates that with few exceptions, if you know a school's two-year default rate, you can pretty accurately predict its three-year default rate. Colleges largely did not hide default rates by shifting them outside the old two-year measurement window.
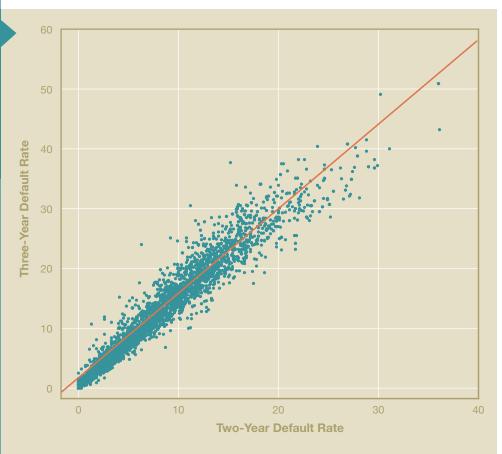
There were a few outliers such as Lassen Community College in California. Its two-year default rate was 15.2 percent; its three-year default rate jumped to 37.7 percent. Several for-profit colleges also saw unusually large jumps. For example, at ITT Technical Institute, which has many campuses, default rates for most of the system rose from 18.2 percent to 34.1 percent.

Default Rates as an Accountability Tool

Using default rates as an accountability mechanism is appealing for two reasons:

- First, the rates provide an objective and quantifiable measure of a college's success in providing a cost-effective education. For many students, the main reason for enrolling in college is to improve their lifetime financial well-being, and a high default rate indicates that a college has failed to help its students achieve this important goal.

- Second, default rates are relatively hard for colleges to game. They are a better accountability tool than, for instance, graduation rates, which a college can improve by lowering its standards. To avoid punishment for high default rates, a college could lower tuition (reducing the amount students need to borrow) or provide a better education, which should improve the job prospects of its graduates and their ability to repay their loans.

CHART 1

Two-year and three-year default rates match closely.

60

50

40

30

20

10

0

Three-Year Default Rate

0   10   20   30   40

Two-Year Default Rate

Source: Integrated Postsecondary Education Data System, Student Financial Aid, and author's calculations.

1) Each dot represents a school a.) with sufficient data, b.) for which at least 100 students entered repayment in FY2009, and c.) with at least 250 full-time-equivalent students in 2009–10.

2) The red line indicates the best fit linear regression line.

3) On average, a college's three-year default rate was 1.46 times its two-year default rate. More than 92 percent of the variation in three-year default rates is explained by variation in two-year default rates.

There are two drawbacks to using default rates as an accountability tool:

- First, employment outcomes, even when calculated on a value-added basis, are not a complete measure of educational outcomes. As hundreds of academics have argued, there is a lot more to being college-educated than getting a good job. What this means in practice is that default rates should not be the *only* accountability tool used.

- Second, some students are more likely than others to default for reasons that have nothing to do with the cost or the quality of their education. Affluent parents often can help their children with loan payments, for instance, while low-income parents often cannot. Therefore, we would expect the default rate to be higher at a college that educates more low-income students than at a college that educates more high-income students, even if the colleges are otherwise identical. An accountability system that failed to account for

this difference would punish colleges for serving students who are at greater financial risk.

Fortunately, it is possible to devise input-adjusted or predicted default rates to create a better accountability system, one that makes allowances for differences in students' backgrounds. Under this system, external factors that influence default rates would be taken into account, adjusting a college's actual default rate for factors such as family income. While we cannot know all the influencing factors, analysis with available data illustrates the wisdom of accounting for probable default-risk factors.

The first step is to select the risk factors. Income is one. Unfortunately, there is almost no publicly available data on the income of students at each college. But we do know what percentage of students receive Pell grants, and since these grants are awarded largely to students from low-income families, the percentage of Pell grant recipients can serve as a good proxy for the proportion of low-income

Finding the Predicted Default Rate

To find the predicted default rate, Education Sector ran a regression analysis using the default rate as the dependent variable, and the percentages of undergraduates receiving Pell grants and part-time undergraduates as the independent variables.

Four-Year Colleges' Regression Results

	Estimate	Std. Error	t value	Pr(>|t|)
Constant	-2.134891	0.256028	-8.339	< 0.001***
% Pell	0.284719	0.005995	47.49	< 0.001***
% Part time	0.037259	0.006677	5.58	< 0.001***

N = 1,600, Adj. R^2 = .61

Two-Year Colleges' Regression Results

	Estimate	Std. Error	t value	Pr(>|t|)
Constant	13.181325	1.106419	11.913	< 0.001***
% Pell	0.125689	0.014634	8.589	< 0.001***
% Part time	0.009817	0.012049	0.815	0.415

N = 1,052, Adj. R^2 = .11

The coefficient estimates were combined with each college's actual values for the percentage of Pell grant recipients and percentage of students who were part time to yield the predicted default rate. For example, a four-year college with 30 percent of students receiving Pell grants and 10 percent of students attending part time would have a predicted default rate of: -2.13489 + 30 * 0.284719 + 10 * 0.037259 = 6.8%. This predicted rate can be compared to the college's official rate to determine if the college is doing better or worse than expected.

Four-year colleges with similar students have widely varying default rates.

Predicted vs. Actual Student Loan Default Rates: 4-Year Colleges

Actual Default Rate (y-axis: 0, 10, 20, 30, 40)

Predicted Default Rates Based on % of Pell and Part-Time Students (x-axis: 0, 5, 10, 15, 20, 25, 30)

Source: Integrated Postsecondary Education Data System, Student Financial Aid, and author's calculations.

1) Each dot represents a four-year college a.) with sufficient data, b.) for which at least 100 students entered repayment in FY2009, and c.) with at least 250 full-time-equivalent students in 2009–10.

2) The red line shows all points for which the predicted default rate is equal to the actual default rate.

3) Predicted values are each college's expected default rate, based on a regression using as independent variables the percentage of students who are Pell grant recipients and the percentage of students who are part time.

students at a college. Similarly, the percentage of part-time students can serve as a proxy for nontraditional students, a category that also may present a higher default risk.

These two variables (percentage Pell and percentage part time) were used to calculate each college's expected or predicted default rate. **Charts 2 and 3** plot the predicted default rate against each college's actual default rate.

If a college's actual default rate is lower than its predicted default rate, its dot is below the red line in Charts 2 and 3, and that college is doing better than expected—given the students it educates. If a college's actual default rate is higher than its predicted default rate, its dot is above the red line in Charts 2 and 3, and that college is doing worse than expected. It is likely that fewer of these students would default if they attended other schools. Rather than holding colleges

CHART 3

Two-year colleges with similar students have wider variation in default rates than four-year schools.

Source: Integrated Postsecondary Education Data System, Student Financial Aid, and author's calculations.

1) Each dot represents a two year college a.) with sufficient data, b.) for which at least 100 students entered repayment in FY2009, and c.) with at least 250 full-time equivalent students in 2009–10.

2) The red line shows all points for which the predicted default rate is equal to the actual default rate.

3) Predicted values are each college's expected default rate, based on a regression using as independent variables the percentage of students who are Pell grant recipients and the percentage of students who are part time.

4) There are several colleges (e.g. ITT Technical Institute) that report systemwide default rates, but campus-specific student characteristics. This results in slightly different predicted values (based on variations in student characteristics by campus), and the same actual values (based on the systemwide default rate), which appear on the graph as a group of horizontally arrayed dots.

accountable for whether they meet hard caps (such as an unadjusted default rate below 30 percent), we should hold colleges accountable for whether they are significantly above or below the red predicted-default line.[4] While this example only accounts for two inputs (because other desired data was not available), it does show the wisdom of designing accountability thresholds that are input-adjusted.

Consider two public, four-year universities—Central State University in Ohio and Southern University at New Orleans. Seventy-seven percent of students at Central State receive Pell grants and 7 percent attend part time. Seventy-six percent of students at Southern University at New Orleans receive Pell grants and 21 percent attend part time.

Statistical analysis indicates that the typical default rate for colleges that have similar student characteristics is around 20 percent. But Central State University's default rate is 32.8 percent; Southern University at New Orleans is 17 percent. Students from Central State are defaulting at a much higher than expected rate, while students from Southern are defaulting at a lower than expected rate.

This example shows how just two inputs can improve accountability metrics. If the federal government releases data on other appropriate input variables, these calculations would provide a fuller picture, one that better shows which schools are more successful at preparing students for life after college.

Pairing Default and Graduation Rates

The 1990 Student Right-To-Know Act required colleges to report their graduation rates for first-time, full-time degree- or certificate-seeking students. Default rates are also a key piece of consumer information for college students. **Chart 4** shows that graduation rates plus default rates provide a clearer understanding of each school's outcomes.
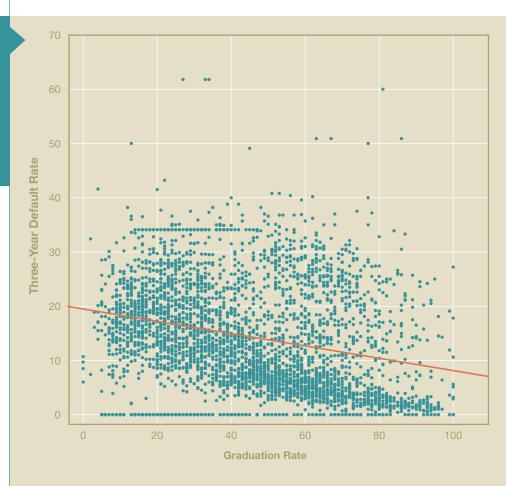
For example, Gettysburg College (Pennsylvania), St. Olaf College (Minnesota), and Martin Methodist College (Tennessee) are all private, nonprofit, four-year-and-above colleges with similar Carnegie Classifications. All have an impressive graduation rate of 85 percent. However, Gettysburg's default rate is 0.4 percent, and St. Olaf's is 1.6 percent. Yet Martin Methodist's is 26.6 percent. (Keep in mind however, that fewer of Martin Methodist's students borrow.) Students are well-advised to consider more than simply the graduation rate when choosing a college.

Toward a Better Understanding of Defaults

The federal government has long played a vital role in education research. But too often, the voluminous data the U.S. Department of Education collects focuses on inputs (such as staffing levels, expenditures, and incoming student test scores) and stops well short of providing the kind of data that could provide answers to important public policy questions. This shortcoming applies especially to higher education, where many colleges remain stubbornly resistant to providing detailed information around outcomes, and the government has not required them to do otherwise.

The U.S. Department of Education is now the sole originator of federal student loans. Given the soaring costs of college, the still-fragile job market, and rising rates of college loan defaults, the federal government should offer better data for analysis and research to reveal which types of students, in what fields and degree programs, are most likely to default. The importance of this information is clear.

Default Rates + Graduation Rates = Better Decisions.

Source: Integrated Postsecondary Education Data System, Student Financial Aid, and author's calculations.

1) Each dot represents a school a) with sufficient data, b) for which at least 100 students entered repayment in FY2009, and c) with at least 250 full-time equivalent students in 2009–10.

2) The red line indicates the best fit linear regression line.

3) Graduation rates are the Student-Right-to-Know rates for 2009–10.

4) There are several colleges (e.g. ITT Technical Institute) that report systemwide default rates, but campus-specific graduation rates, which appear on the graph as a group of horizontally arrayed dots.

Yet, despite lending more than $100 billion annually, the government requires minimal standards for students to qualify and leaves taxpayers on the hook for billions of dollars in defaults.

This needs to change.

Until we have better data on loan defaults, the federal government will continue to lend billions to students every year with little to show students, taxpayers, or policymakers about what happens when those students have to pay back that money. Recent rule changes will let us know if these borrowers default within the first three years of repayment, but beyond that, each borrower's status will remain a mystery. Further, when default rates improve as we emerge from recession, they

may well mask shortcomings in certain degree programs that, even in a strong economy, represent poor career investments for students.

At the same time, colleges that do a superior job of educating Pell students and have lower than expected default rates will still have higher default rates than other schools that enroll relatively few Pell students. Better data would highlight these colleges' accomplishments.

We have seen how changes in federal policy have led to markedly better outcomes data at the K–12 level. The federal government spends even more money on higher education, and postsecondary students assume more risk. With stakes this high, students and taxpayers need to know far more about what they are getting themselves into. Improving default-rate data would be a good place to start.

Red Flags: When Default Rates Top Graduation Rates

Exasperated financial aid expert Tim Ranzetta proposed that some colleges post this disclosure:

> **WARNING:** This education can be hazardous to your financial health. At this institution, you have a higher probability of defaulting on your student loan than you do of completing this program.[5]

These colleges should set off a red flag in the minds of prospective student borrowers—and their parents. Many students at these colleges will no doubt take out loans, graduate, and get good jobs. But the high default rates and lower graduation rates suggest that many students will not.

Comparing graduation rates and default rates for the same students would produce a list of these red flag colleges. But the U.S. Department of Education does not have that list, and the data it releases doesn't allow others to easily put one together. Instead, graduation rates are tracked only for first-time, full-time degree- or certificate-seeking students (ignoring part-time, returning, and transfer students); default rates are tracked for students based on the time period when they enter repayment.[6] In addition, campuses with several branches (such as the University of Phoenix) often have one systemwide default rate and branch-by-branch graduation rates.

Nevertheless, using the official graduation and default rates as the best estimate of the overall graduation and default rates for college borrowers, we

can identify the schools that are the most likely candidates to set off red flags. These are colleges where students who borrow are more likely to default on those loans than they are to graduate. For example, New River Community and Technical College in West Virginia has a graduation rate of 5 percent and a default rate of 25.7 percent.[7] It is not alone.

Of the 514 red flag colleges identified, 314 (61 percent) are public, two-year colleges. While these schools tend to have low tuitions, they often serve at-risk students. Among four-year colleges, the list included 100 for-profits, 48 nonprofits, and 29 public colleges.

TABLE 1

Hundreds of colleges should set off 'red flags' for borrowers.

Red Flag Colleges

	Official Default Rate > Official Graduation Rate[a]	Official Default Rate > Official Graduation Rate & at least 30% of Students Borrow[b]	Official Default Rate > Official Graduation Rate & at least 100 Students Defaulted[c]	Adjusted Default Rate > Official Graduation Rate[d]
Sector				
Private for-profit— 2-year	19	19	16	12
Private for-profit— 4-year or above	100	97	96	64
Private nonprofit— 4-year or above	48	36	33	18
Public—2-year	314	88	188	18
Public—4-year or above	29	22	24	6
Other	4	3	2	2
Total	**514**	**265**	**359**	**120**

Source: Integrated Postsecondary Education Data System, Student Financial Aid, and author's calculations.

Notes: This table includes every college with a) sufficient data, b) for which at least 100 students entered repayment in FY2009, and c) with at least 250 full-time equivalent students in 2009–10. There are several colleges that report systemwide default rates, but campus-specific student characteristics. Each campus with a lower graduation rate than the systemwide default rate was counted as a separate college. We also excluded roughly 100 colleges whose Office of Postsecondary Education identification number (OPEID) could not be matched to an OPEID number in the default rate database.

a) The official graduation rate is for 2009–10. The official default rate is the three-year rate for all students who entered repayment between Oct. 1, 2008 and Sept. 30, 2009.

b) The official graduation rate is for 2009–10. The official default rate is the three-year rate for all students who entered repayment between Oct. 1, 2008 and Sept. 30, 2009. The percentage of students who borrow is defined as the percent of undergraduate students who took out a federal loan in 2009–10.

c) The official graduation rate is for 2009–10. The official default rate is the three-year rate for all students who entered repayment between Oct. 1, 2008 and Sept. 30, 2009. The number of students who defaulted is from the Student Financial Aid database.

d) The adjusted default rate is the college's three-year default rate for all students who entered repayment between Oct. 1, 2008 and Sept. 30, 2009 multiplied by the percentage of undergraduate students who took out federal loans in 2009–10.

Among these colleges, there is considerable variation in the percentage of students borrowing, so the second column in **Table 1** shows only those colleges where at least 30 percent of undergraduate students took out federal loans. The number of colleges drops to 265, of which 97 are for-profit, four-year colleges; 36 are nonprofit, four-year colleges; 88 are public, two-year colleges; and 22 are public, four-year colleges.

The third column in Table 1 shows only those colleges where the absolute number of students who defaulted is at least 100. The result is a new list of 359 colleges. Most of the change in the list occurs among 188 public, two-year colleges.

The last column of Table 1 provides a final alternative list. Multiplying the default rate by the percentage of undergraduate students who took out federal loans yields an "adjusted default rate." This new rate estimates the prevalence of default among the whole student body rather than just among borrowers. For example, Los Angeles City College, Blue Ridge Community and Technical College (West Virginia), and Lane Community College (Oregon) are all public, two-year community colleges with an official default rate of 19.5 percent, indicating that borrowers at all three schools have a similar likelihood of defaulting. But there is considerable variation in the percentage of students who borrow. Only 4 percent of Los Angeles City College's students took out a federal loan in 2009–10, but 33 percent of Blue Ridge students and 65 percent of Lane students did. Using this information to calculate an adjusted default rate that applies to all students—as opposed to just borrowers—estimates that less than 1 percent of all students at Los Angeles City College defaulted on their student loans, 6.4 percent of Blue Ridge students defaulted, and 12.7 percent of Lane Community College's students defaulted.

Of the 120 red flag colleges using the adjusted rate, more than half (64) are four-year, for profits. There are 18 public community colleges and 6 public, four-year universities.

Table 1 makes two main points. First, some student loan borrowers are attending colleges where it appears that they are more likely to default than they are to receive a degree. Second, red flags will pop up across all types of schools—public, private nonprofit, and private for-profit.

Notes

1. U.S. Department of Education, "Three-year Official Cohort Default Rates for Schools," available at http://www2.ed.gov/offices/OSFAP/defaultmanagement/cdr.html

2. Prior to 2012, the two-year default rate was reported.

3. Details on the sanctions tied to default rates can be found at http://ifap.ed.gov/DefaultManagement/guide/attachments/CDRGuideCh2Pt4CDREffects.pdf

4. The line used for accountability purposes should take into account the confidence intervals for the predicted default rates.

5. Tim Ranzetta, "Warning: This Education Could Be Hazardous To Your Financial Health," *Student Lending Analytics Blog*, October 18, 2009. http://studentlendinganalytics.typepad.com/student_lending_analytics/2009/10/warning-this-education-can-be-hazardous-to-your-financial-health.html

6. The graduation rate used in this study is the Student Right-To-Know rate for 2009–10. The three-year default rates used in this study are for those students who entered repayment in fiscal year 2009 (between Oct. 1, 2008 and Sept. 30, 2009).

7. This graduation rate is from the U.S. Department of Education's Integrated Postsecondary Education Data System (IPEDS). The default rate is from the U.S. Department of Education's Student Financial Aid database.

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