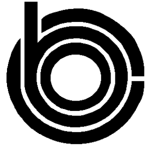

CONGRESSIONAL BUDGET OFFICE
PAY-AS-YOU-GO ESTIMATE

October 6, 1998

H.R. 6
Higher Education Amendments of 1998

As cleared by the Congress on September 29, 1998

SUMMARY

H.R. 6, the Higher Education Amendments of 1998, would amend the Higher Education Act of 1965 by making numerous changes in the student loan programs and eliminating the Perkins loan revolving fund. In addition, H.R. 6 would amend the Bankruptcy Code regarding student loan bankruptcies. CBO estimates that the act would have a $2.5 billion net budgetary effect over the 1999-2003 period—it would save $220 million in 1999 and cost $2.8 billion in the following four years. Over the 10-year period from 1999 to 2008, the total costs amount to $2.4 billion.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 6 is shown in Table 1. The budgetary impact of this legislation falls within function 500. For purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted.

Table 1. Summary of Effects of H.R. 6 on Direct Spending and Receipts

	By Fiscal Year, in Millions of Dollars									
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Change in outlays	-220	655	710	700	700	20	0	-85	-85	-5
Change in receipts	Not applicable									

BASIS OF ESTIMATE

Student Loans

H.R. 6 makes several changes in the student loan programs, which under current law are expected to guarantee or issue about 44 million loans totaling $179 billion over the 1999-2003 period. The legislation would slightly modify the conditions of eligibility for loans and would increase the government's cost of ensuring that sufficient loan capital is available to students and parents. In general, the proposed changes may be classified by their impacts: changes affecting interest rates for borrowers and lenders, changes affecting guaranty agencies, changes affecting lenders, and changes affecting borrowers. The act also contains a number of other changes to the program.

Most provisions affecting the student loan programs are assessed under the requirements of credit reform. As such, the budget records all the costs and collections associated with a new loan on a present-value basis in the year the loan is obligated. The costs of all changes affecting outstanding loans are displayed in the year a bill is enacted—in this case 1999. The changes included in this act would decrease program costs by $180 million in 1999 but increase costs by $2.7 billion over the 1999-2003 period (see Table 2) and $2.8 billion over the 1999-2008 period. The overall federal discounted cost of providing loan capital to students and parents would be increased by about 2 percentage points per each dollar loaned from an estimated 11.6 percent to 13.7 percent.

Changes Affecting Interest Rates for Borrowers and Lenders. Under current law, a new formula for establishing the variable interest rate on guaranteed and direct student loans is scheduled to take effect in October 1998.[1] The interest rate received by private lenders will be the interest rate on bonds of comparable maturity plus 1.0 percentage points.[2] Borrowers will pay the same rate, but no more than 8.25 percent. To the extent that the yield to lenders exceeds the rate paid by borrowers, the federal government pays lenders the difference, which is called a special allowance. In addition, the federal government pays the interest for

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[1] Before July 1998, borrowers in the guaranteed and direct student loan programs paid an interest rate based on the bond equivalent of the 91-day Treasury bill rate plus 2.5 percentage points while the borrower is in school, grace, and deferment and 3.1 percentage points when the borrower is in repayment. The interest rate cap is 8.25 percent. The interest rate on guaranteed and direct parent loans is the bond equivalent of the 365-day Treasury bill rate plus 3.1 percentage points, with a cap of 9 percent. As a result of the Public Law 105-178, rates on loans (except consolidation loans) issued between July 1, 1998, and September 30, 1998, are the same as those that would apply on loans issued after September 30, 1998, and before July 1, 2003, under H.R. 6.

[2] The CBO baseline assumes that the rate on bonds of comparable maturity is the 10-year bond rate. Recently, the Administration indicated that it expected to use a blended rate of 10-year and 20-year maturities.

student borrowers with subsidized loans while they are in school or in a period of grace or deferment.

For the period October 1, 1998, until July 1, 2003, H.R. 6 would set the rate paid by student borrowers at the bond-equivalent 91-day Treasury bill rate plus 1.7 percentage points while the borrower is in school, grace, or deferment and 2.3 percentage points when the borrower is in repayment. Lenders would receive a rate that would be 50 basis points (0.5 percentage points) higher, and the difference would be paid by the federal government. In addition, the cap of 8.25 percent on borrowers' rates would be retained. (H.R. 6 would also change the rates on direct and guaranteed parent and consolidated loans.) In July 2003, the borrower interest rates and lender yields would revert to the current-law rates.

The changes in borrower interest rates and lender yields would increase federal costs over the 1999-2003 period by about $3.3 billion relative to current law. The increased cost is associated with the new, minimum 50-basis-point special allowance payment as well as the increased exposure of the federal government to interest rate subsidies when rates rise sufficiently to cause the borrowers' interest rates to be constrained by the statutory caps. The proposed new interest rate structure would move the interest rates closer to the caps. Moreover, the 91-day Treasury bill is a more volatile instrument than the 10-year bond rate. These costs are partially offset by higher borrower interest payments in the direct loan program.

In estimating the expected federal costs of the interest rate formula change, CBO used a vector autoregressive model to simulate the variation in interest rates around the CBO's baseline forecast. The model provided probabilities of how often and by how much the simulated rates exceeded the 8.25 percent interest rate cap. These probabilities were then used in CBO's model of the student loan program to estimate changes in subsidy costs.

Changes Affecting Guaranty Agencies. H.R. 6 would restructure the financing of guaranty agencies and divide the current agency reserve funds into federal and agency property. In addition, many of the federal payments to and from the guaranty agencies would be altered. Overall, the provisions affecting guaranty agencies are estimated to reduce federal costs by $264 million over the 1999-2003 period and by $444 million through 2008.

This act would reduce the federal reinsurance rate on new insured loans from 98 percent to 95 percent; the reinsurance rates for high default agencies would also be lowered. This change would lower costs by $355 million over the 1999-2003 period.

Table 2. Estimated Impact of H.R. 6 on Direct Spending

	By Fiscal Year, in Millions of Dollars									
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
STUDENT LOANS										
Interest Rates [a]										
Budget Authority	770	750	813	845	435	0	0	0	0	0
Outlays	505	675	713	750	635	0	0	0	0	0
Guaranty Agencies										
Budget Authority	-379	55	40	-30	70	-15	-15	-98	-102	-25
Outlays	-384	50	40	-30	60	20	-5	-83	-97	-15
Borrowers										
Budget Authority	-127	21	61	103	105	110	110	110	115	115
Outlays	-127	11	36	86	95	95	100	100	105	105
Lenders										
Budget Authority	-270	-70	-70	-70	-70	-75	-80	-80	-85	-90
Outlays	-240	-60	-60	-65	-65	-70	-70	-75	-75	-75
Other										
Budget Authority	-47	0	0	0	0	0	0	0	0	0
Outlays	-47	0	0	0	0	0	0	0	0	0
Interactions Among Provisions										
Budget Authority	118	29	21	7	5	25	25	18	27	35
Outlays	113	19	21	-1	15	15	15	13	22	20
Subtotal										
Budget Authority	65	785	865	855	545	45	40	-50	-45	35
Outlays	-180	695	750	740	740	60	40	-45	-45	35
OTHER PROGRAMS [b]										
Perkins Loan Revolving Fund										
Budget Authority	-40	-40	-40	-40	-40	-40	-40	-40	-40	-40
Outlays	-40	-40	-40	-40	-40	-40	-40	-40	-40	-40
TOTAL										
Budget Authority	25	745	825	815	505	5	0	-90	-85	-5
Outlays	-220	655	710	700	700	20	0	-85	-85	-5

a. The estimated costs of the interest rate changes excluding the expected government costs associated with the cap on borrower interest rates are as follows:

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Budget Authority	255	220	253	250	130	0	0	0	0	0
Outlays	165	200	213	220	195	0	0	0	0	0

b. H.R. 6 would also increase the Government National Mortgage Association (GNMA) fees from 6 basis points to 9 basis points beginning on October 1, 2004. This change affects a discretionary program and, thus, is not considered direct spending. The cost reductions associated with the fees are shown below.

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Estimated Authorization Level	0	0	0	0	0	0	-40	-40	-40	-40
Estimated Outlays	0	0	0	0	0	0	-40	-40	-40	-40

H.R. 6 would lower the retention allowance on default collections by the guaranty agencies. Currently, agencies are allowed to retain 27 percent of their recoveries from loans that default; the remainder goes to the federal government. This act would reduce the retention allowance to 24 percent except for consolidations of defaulted loans, where the percentage would be set at 18.5 percent. H.R. 6 would further lower the retention allowance to 23 percent in 2004. This change would apply to all default collections as of October 1, 1998, and result in an estimated $385 million in savings over the 1999-2003 period.

The legislation would eliminate the payment to guaranty agencies in cases where the agencies assist lenders in attempting to avert defaults. Currently the payment is equal to 1 percent of the principal and interest of loans for which the lenders do not file a default claim for at least 270 days after the loan is determined to be delinquent. The elimination of this payment, which would apply for outstanding as well as new loans, would save $260 million from 1999 to 2003.

H.R. 6 would reclaim $85 million in agency reserves over the next five years and an additional $165 million during the 2004-2008 period. Although agency reserves are considered the property of the federal government, federal budgetary documents have never displayed these reserves as assets of the federal government. Consequently, as with the reserves recaptured in the Balanced Budget Act of 1997, the Office of Management and Budget (OMB) has displayed any reserves being reclaimed as offsetting receipts, and CBO has followed this budgetary treatment.

The legislation would establish a new federal subsidy payment to guaranty agencies equal to 0.65 percent of new guaranteed loan volume. Based on CBO's estimate of loan volume, this provision would cost $690 million over the next five years.

H.R. 6 would also increase the current $150 million annual mandated set-aside of Section 458 funds to be used for guaranty agencies' administrative costs. The new payments would be 0.12 percent of outstanding guaranteed loan volume for 1999 and 2000 and 0.1 percent thereafter. Section 458 funds would be increased by $131 million over the 1999-2003 period.

Changes Affecting Lenders (exclusive of changes in interest rates). H.R. 6 would make several changes that affect lenders. In total these changes reduce federal costs by $240 million in 1999, $490 million through 2003, and $855 million through 2008.

H.R. 6 would increase the time period lenders had to resolve delinquent loans by 90 days, to a total of 270 days from first delinquency. Currently, some defaulters are brought back

into repayment status within a relatively short time after the default claim is filed. H.R. 6 would allow these claims to be resolved before they resulted in default and would thereby reduce federal payments of retention allowances. This change would affect both new and currently outstanding loans. CBO estimates that this provision will reduce federal costs by $265 million in 1999 and $515 million over the 1999-2003 period.

H.R. 6 would also temporarily reduce the federal loan consolidation fee charged lenders on the outstanding balance of a consolidated loan. For new consolidated loans made between October 1, 1998, and February 1, 1999, the fee would be reduced from 1.05 percent to 0.62 percent. This change would increase costs by $20 million in 1999.

H.R. 6 would provide federal payments to holders of loans for the amount of a student loan that a school failed to refund to the borrower's account. This provision is expected to cost $5 million in 1999 and negligible amounts thereafter.

Changes Affecting Borrowers (exclusive of changes in interest rates). H.R. 6 would make numerous changes in the student loan program that could have implications for borrowers. In total, the provisions affecting borrowers—excluding the change in interest rates—would cost the federal government an estimated $101 million over the 1999-2003 period and $606 million over the 10-year period.

The legislation would provide for a degree of loan cancellation for some teachers in public or private elementary or secondary schools in school districts eligible for Title I grants and in a school with more than 30 percent of students from low-income families. Teachers would have to demonstrate knowledge and teaching skills (in the case of elementary school teachers) or be teaching in a subject area relevant to their college major (in the case of secondary school teachers). Loan cancellation would apply to both subsidized and unsubsidized loans up to a maximum of $5,000, and the loans and accrued interest would be canceled after completing five years of teaching. Eligibility would be restricted to new loans issued to new borrowers beginning on the date of enactment of this legislation. The estimated costs of this provision were based on information from the National Center on Education Statistics on the number of newly hired teachers who are recent college graduates and the number of teachers who teach in the types of schools that would be eligible to participate under this program, as well as information on the number of elementary teachers who are certified to teach and the number of secondary teachers who are teaching in their major. By 2003, some 35,000 new teachers are estimated to be participating in this program. The estimated subsidy costs of the provision are $200 million over the 1999-2003 period.

H.R. 6 would amend the Title 11 of the United States Code to prohibit the automatic discharge under Chapter 7 of the bankruptcy law of student loans, which have been in repayment at least seven years. This change, effective for any new bankruptcy filing after the date of enactment, would allow the holders of the loans to continue to collect recoveries of defaulted loans and would allow the government to recover more default losses. Costs would be reduced $175 million in 1999 and $280 million over the 1999-2003 period.

This act would also modify certain rules with regard to loan disbursements, change the calculations determining eligibility for loans, and modify various repayment rules and terms. Some of these provisions would expire in 2002 and 2003. Together these changes would increase costs by $181 million over the 1999-2003 period.

Other Changes. H.R. 6 would rescind the authority of the Secretary of Education to spend any funds in the Student Loan Insurance Fund at the time of enactment. Those funds would be required to be deposited in Treasury. According to the Department of Education, $47 million currently in this account would be deposited in the Treasury in 1999.

Interactions Among Provisions. Because the proposed changes in the student loan programs interact with each other, the total budgetary effects from all of the provisions together do not equal the sum of the individual components. For example, changes in loan volume due to changes in eligibility rules would affect the costs of the change in interest rates. When all of the provisions are considered together, the interactions increase the costs by $113 million in 1999, $167 million through 2003, and $252 million through 2008.

Perkins Loans

Under current law, the Perkins loan revolving fund collects receipts of certain repayments from Perkins loans that have been assigned, referred to, or transferred to the Department of Education. The moneys in this fund are to be disbursed by the Secretary to Perkins loan schools in the form of grants for new capital. H.R. 6 would repeal this fund and deposit its current balances in the Treasury. This change would save $200 million over the 1999-2003 period and $400 million over the 10-year period. H.R. 6 would also mandate that the Secretary of Education pay off Perkins loans for borrowers whose schools closed before they completed their course of education. Few borrowers would be affected by this provision, and its cost would be negligible.

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