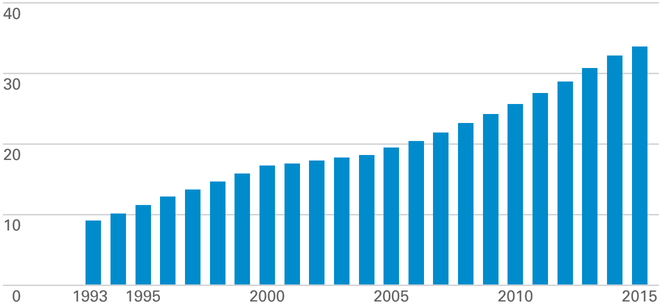
Student Loan Debt is Creating a Lost Generation

Maybe you figure you'll pay the college bills out of cash flow. Or, maybe you are banking on financial aid. On both ends of the spectrum, a lack of serious planning can spell trouble. After all, providing a college education is one of the most significant expenses families have, made more challenging by the relatively short time to save, costs that continue to increase faster than inflation,[1] and reductions in institutional financial aid.

You may not realize that failing to plan for college with the same attention you dedicate to saving for retirement can create bigger problems than struggling to pay four years of tuition.

In particular, the student loans that many families use to fill any savings gap can create future financial hurdles that often put a wedge between college graduates and the American Dream. In fact, last spring, the *Wall Street Journal* dubbed the Class of 2015 "the most indebted ever — for now," with almost 71 percent of college grads shouldering an average debt of $35,000.[2] It's no surprise, then, that student loan debt recently hit $1.2 trillion in the United States, an increase of about 84 percent since 2008.[3] Today, 40 million young Americans struggle to pay off student loans, up from approximately 29 million in 2008.[4]

FIGURE 1: CLASS OF 2015: AVERAGE DEBT PER BORROWER IN EACH YEAR'S GRADUATING CLASS



Source: Mark Kantrowitz analysis of National Center for Educational Statistics data, WSJ.com.

Roots of the Student Debt Crisis

In addition to beating the rate of inflation, the cost of higher education has risen faster than family incomes. For example, from the 1983–1984 enrollment year to 2012–2013, the inflation-adjusted cost of a four-year education, including tuition fees, and room and board, increased 125.5 percent for private school and 129.1 percent for public school. However, the median family income rose just 15.6 percent during this period.[5]

Tightening debt's stranglehold, at the same time students are graduating with greater debt, starting salaries for young college graduates have declined. Total student debt–including federal and private education loans to students and parents–is expected to top $68 billion this year for graduates with a bachelor's degree, more than a 10-fold increase since 1994.[6] And, after more than three decades of flat wages, the Economic Policy Institute reports that between 2013 and 2014 those with a college degree saw their hourly wages fal 1.3 percent, while those with an advanced degree saw anhourly wage decline of 2.2 percent.[7]

[1] Lorin, Janet. "College Tuition in the U.S. Again Rises Faster Than Inflation." *Bloomberg*. 12 Nov. 2014. Web. 3 Sep. 2015. <http://bloomberg.com/news/articles/2014-11-13/college-tuition-in-the-u-s-again-rises-faster-than-inflation>.

[2] Sparshott, Jeffery, "Congratulations, Class of 2015. You're the Most Indebted Ever (For Now)," The Wall Street Journal, Accessed on January 20, 2016 at: http://blogs.wsj.com/economics/2015/05/08/congratulations-class-of-2015-youre-the-most-indebted-ever-for-now/

[3] Ungarino, Rebecca. "Burdened with Record Amount of Debt, Graduates Delay Marriage." *NBC News*. 7 Oct. 2014. Web. 4 Sep. 2015. <http://nbcnews.com/business/personal-finance/burdened-record-amount-debt-graduates-delay-marriage-n219371>.

[4] Ellis, Blake. "40 million Americans now have student loan debt." *CNN Money*. 10 Sep. 2014. Web. 4 Sep. 2015. <http://money.cnn.com/2014/09/10/pf/college/student-loans/index.html?iid=HP_LN>.

[5] Shierholz, Heidi, Alyssa Davis and Will Kimball. "The Class of 2014: The Weak Economy Is Idling Too Many Young Graduates." *Economic Policy Institute*. 1 May 2014. Web. 4 Sep. 2015. <http://www.epi.org/publication/class-of-2014/>.

[6] Sparshott, Jeffery, "Congratulations, Class of 2015. You're the Most Indebted Ever (For Now)," The Wall Street Journal, Accessed on January 20, 2016 at: http://blogs.wsj.com/economics/2015/05/08/congratulations-class-of-2015-youre-the-most-indebted-ever-for-now/

[7] Gold, Elise. 2014 Continues a 35-Year Trend of Broad-Based Wage Stagnation, Economic Policy Institute. Accessed on January 20, 2016 at: http://www.epi.org/publication/stagnant-wages-in-2014/

Long-term, such a debt/earnings gap becomes a real albatross. Among college educated people, the median net worth of young households without student loan debt is seven times higher than the median net worth of young households with student loan debt.[8] Further, the Federal Reserve Bank of New York, reporting on student loan delinquencies, noted a recent decrease in mortgage and auto loans for younger borrowers, suggesting that student loan debt negatively impacts a young person's ability to make other investments.[9]

It follows that if young people struggling to repay their debt are not buying cars or homes, they certainly are not saving for retirement — or for their own children's college education. In fact, many young people are delaying getting married and having children. The Pew Research Center reports that the median age for a first marriage is now 27 for women and 29 for men. In 1960, the median age was 20 for women and 23 for men.[10]

Finally, student debt isn't an issue only for twenty-somethings. Approximately 15 percent of older students leave graduate and professional schools with six figure loan balances.[11] And, according to the Pew Research Center, nearly four of every ten U.S. households led by someone under the age of 40 is paying off student loan debt.[12]

Financial Aid Myths Exacerbate the Crisis

Some parents choose not to save aggressively for college because they wrongly believe it will hurt their chances of getting a large financial aid package. However, the amount you save will have a relatively small impact on financial aid. The federal formula's Expected Family Contribution (EFC) factors in just 5.6 percent of assets held in a parent's name. (It taps student-owned assets at 20 percent).

What's more, "financial aid" is a broad term that covers non-need-based merit scholarships, lower interest rate federal loans, need-based grants from colleges, and work study. That is, not all financial aid is a "gift." In fact, student loans make up nearly a quarter of aid — and the interest rates vary dramatically, based on whether the loans are government subsidized or private.

Unfortunately, when non-savers file the Free Application for Federal Student Aid (FAFSA), many discover they qualify for little or no aid. At that point, with limited college funds saved, student loans can become the only option

Save in a 529 College Savings Plan to Help Your Children Avoid Debt

The more you know about how financial aid is calculated, the easier it is to save efficiently, both in terms of the FAFSA'srules and the account's taxability.

For families who can afford to save all or a substantial portion of expected future college costs, the 529 college savings plan's tax advantages and high contribution limits may make it one of the most tax-efficient investment vehicle for college savings. While a 529's tax deferral gives your assets a chance to grow faster than they would in a comparable taxable account, withdrawals for qualified education expenses are tax free. Some states also offer additional tax deductions. And, because 529 accounts remain under the account owner's control, the account holder can change the beneficiary to another eligible "member of the family" (according to the Internal Revenue Code) if needed. Additionally, it is also possible to take a non-qualified withdrawal of the account assets at any time. In that event, account earnings would be subject to federal income tax and may be subject to a 10 percent federal penalty tax, as well as state and local income taxes.

The bottom line, of course, is to begin saving for college as early as you can and to stick with your plan. It can be daunting to consider the size of future tuition bills. However, anything you save for college means your children may need to borrow less, reducing the likelihood of debt negatively impacting their future. Simply, taking on student debt can not only force your children to make compromises with their education and career, but prevent them from investing in their own family's future. Having the resources to pay for college gives your children the freedom to pursue their dreams and enter adulthood financially stress-free, ensuring that they become empowered by their college education, rather than trapped by its costs.

[8] Fry, Richard. "Young Adults, Student Debt and Economic Well-Being." *PewResearchCenter.* 14 May 2014. Web. 4 Sep. 2015. <http://pewsocialtrends.org/2014/05/14/young-adults-student-debt-and-economic-well-being/>.

[9] Shierholz, Heidi, Alyssa Davis and Will Kimball. "The Class of 2014: The Weak Economy Is Idling Too Many Young Graduates." *Economic Policy Institute.* 1 May 2014. Web. 4 Sep. 2015. <http://epi.org/publication/class-of-2014/>.

[10] Wang, Wendy and Kim Parker. "Record Share of Americans Have Never Married." PewResearchCenter. 24 Sep. 2014. Web. 4 Sep. 2015. <http://pewsocialtrends.org/2014/09/24record-share-of-americans-have-never-married/#gender-education-and-marriage>.

[11] Wang, Wendy and Kim Parker. "Record Share of Americans Have Never Married."PewResearchCenter. 24 Sep. 2014. Web. 4 Sep. 2015. <http://www.pewsocialtrends.org/2014/09/24/record-share-of-americans-have-never-married/>.

[12] Fry, Richard. "Young Adults, Student Debt and Economic Well-Being." *PewResearchCenter.* 14 May 2014. Web. 4 Sep. 2015. <http://pewsocialtrends.org/2014/05/14 young-adults-student-debt-and-economic-well-being/>.

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