OBSERVATION

TD Economics

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SCHOOL'S OUT

SOFTER TREND IN U.S. HIGHER-ED ENROLLMENT TO PERSIST

Highlights

- Student debt currently sits at $966 billion. This is the second largest outstanding liability on the household balance sheet, but it's still a far second from home mortgages at $8.03 trillion.
- Households have deleveraged in all categories of debt except student loans. Post-secondary enrollment is counter-cyclical and has been pivotal to the recent run-up in student debt.
- We estimate that post secondary enrollments across all age cohorts will continue to taper off, and this trend may be disproportionately felt by private for-profit institutions. Furthermore, a deceleration in enrollments should ease the demand for student loans.
- The 90+ day delinquency rate on student loans currently sits at an all time high. However, an improved labor market coupled with a deceleration in enrollments, and a reduction in the backlog of missed payments, will lead to a slow decrease of delinquency rates in the coming years.

Since the onset of the Great Recession, households have reduced debt in every category except student loans, which have ballooned by 76%. The natural inclination is to believe that escalating tuition costs are the main culprit. This has certainly played a role, but unusually high post-secondary enrollment rates alongside a weak economy drove much of the increase in demand for student loans. Post-secondary enrollment tends to be counter-cyclical, and demand has already tappered off significantly. We believe this is the beginning of a convergence back to fundamentals, with college enrollment to grow at a modest annual pace of 1.1% over the next five years – one-fifth the pace relative to the 2007 to 2009 period. By extension, a strengthening job market will trickle down to incomes and create a greater ability to pay for student debt.

Rising pressure on tuition costs

The cost of a post-secondary education has steadily increased since 2007, outstripping economy-wide inflation by roughly 2% each year. The increase in tuition cost can be attributed to higher enrollment pressures, but this was not the only influence. The extended period of economic distress adversely impacted donations to colleges, while publicly funded institutions also had government support clawed back. State appropriations as a share of full-time equivalent enrollment averaged a yearly decline of 6.8% from 2008-10. As a result, public institutions were forced to pass an increasing amount of the cost onto their

TABLE 1: TUITION COSTS ACROSS POST SECONDARY INSTITUTIONS

Real 2010 Dollars	2004-05	2007-08	2010-11	Percent Change (2004 to 2010)
Public 4-year				
In-district	$5,720	$6,050	$6,749	18.0
In-state	$5,717	$6,054	$6,752	18.1
Out-of-state	$14,002	$14,363	$15,742	12.4
Public 2-year				
In-district	$2,340	$2,427	$2,716	16.1
In-state	$2,797	$2,904	$3,169	13.3
Out-of-state	$6,176	$6,248	$6,516	5.5
Private nonprofit 4-year	$18,587	$20,125	$21,996	18.3
Private nonprofit 2-year	$9,545	$10,037	$10,784	13.0
Private for-profit 4-year	$15,131	$15,751	$15,700	3.8
Private for-profit 2-year	$13,029	$13,055	$14,566	11.8

Source: Integrated Postsecondary Education Data System

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TABLE 2: U.S. POST SECONDARY ENROLLMENTS BY AGE									
Y/Y % Chg.		1992-2011 Avg	2005	2006	2007	2008	2009	2010	2011
Public	16-19	1.9	0.3	2.6	7.5	5.1	-0.3	2.0	1.2
	20-24	1.9	5.3	-5.5	5.9	3.5	3.2	3.3	1.4
	25-29	1.7	-2.4	0.9	6.0	4.7	10.9	-0.9	1.6
	30-34	1.0	-4.6	1.8	3.4	3.5	10.1	0.5	1.7
	35+	1.2	-7.3	2.5	-2.6	3.9	10.5	-0.8	1.4
	Total	1.6	0.1	-0.9	4.7	4.1	5.0	1.5	1.3
Private Non-Profit	16-19	1.7	1.2	3.5	7.1	4.5	-3.0	1.3	0.2
	20-24	1.6	6.2	-4.8	5.5	3.0	0.4	2.6	0.8
	25-29	1.5	-1.6	1.7	5.6	4.1	7.9	-1.7	0.5
	30-34	1.0	1.0	1.0	1.0	1.0	1.1	1.0	1.1
	35+	1.0	-6.5	3.3	-3.0	3.3	7.5	-1.5	0.3
	Total	1.3	1.0	-0.1	4.3	3.6	2.2	0.8	0.2
Private For-Profit	16-19	10.4	14.9	5.5	15.7	24.1	18.1	10.7	3.3
	20-24	10.5	20.6	-2.9	14.0	22.3	22.3	12.1	5.3
	25-29	10.3	11.7	3.8	14.1	23.7	31.3	7.4	4.1
	30-34	9.4	9.2	4.7	11.2	22.2	30.4	8.9	3.3
	35+	9.7	6.2	5.4	4.8	22.8	30.9	7.6	2.2
	Total	10.6	14.7	1.9	12.7	23.0	24.4	10.1	3.3
Total	All	2.1	1.0	-0.6	5.1	5.2	5.9	2.2	1.3

Source: National Center for Education Statistics, U.S. Department of Education

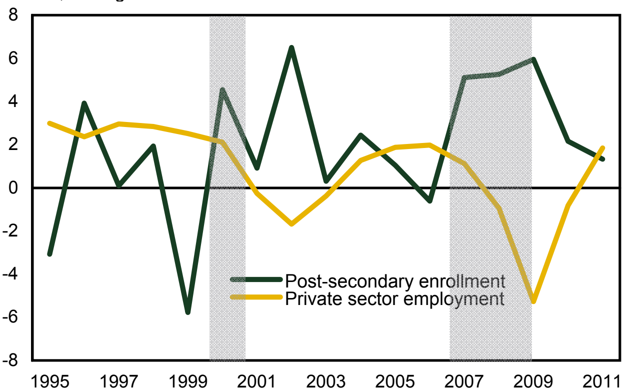
students in the form of higher tuition and administration fees.

Weak economy causes influx of enrollment

All higher education institutions saw an influx in enrollment, but it was particularly evident among private for-profit institutions. Since 2001, enrollment at these institutions increased from 675,000 to well over 2.5 million – nearly a 4-fold increase. This is in stark contrast to enrollments at private non-profit and public institutions, which have increased at more modest rates of 22% and 25%, respectively.[2] As a result, private for-profit institutions now represent 10% of total post-secondary enrollment – up from 2.1% in 2001. Although this is still a relatively small base, it captures a broad shift in Americans' attitude towards proprietary education. In part, this is a result of many individuals going back to school due to a weak economy. For those wishing to pursue a post-secondary degree, private for-profit institutions offered a viable alternative for the influx in applications. Most of the publicly run state universities were already operating at or near capacity, while a 4-year degree at private non-profit institutions often come with a hefty price tag. The distribution of Federal Pell Grants shows that the majority of students who attend private for-profit institutions are low-income and, hence, require considerable government assistance. In Table 2, we can see that at the deepest period of economic distress (from 2007-2009), enrollments at public institutions and non-profit institutions increased moderately – growing by an annual average rate of 4.6% and 3.4%, respectively. During that same period, enrollments at for-profit institutions exploded, growing by an average rate of 20% a year. However, this rapid increase in enrollment was paralleled with elevated debt and drop-out rates among its students. This undesirable combination was quickly proven to be unsustainable.

CHART 1: POST-SECONDARY ENROLLMENT RATES AND GROWTH IN PRIVATE-SECTOR EMPLOYMENT

Y/Y, % Chg.

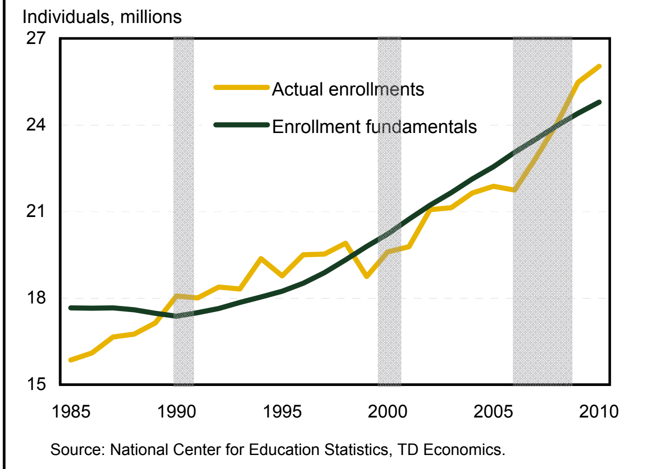


Source: National Center for Education Statistics, TD Economics.

Enrollment fundamentals & projections

By 2010, enrollment at for-profit institutions faced a perfect storm of increased regulatory scrutiny and improved business cycle fundamentals. In reference to the latter point, it may seem counter-intuitive to suggest a strengthening economy detrimentally impacts enrollment, but this is, in fact, the case. During periods of economic distress and weak employment prospects, enrollment growth accelerates, as individuals consider career alternatives, upgrade skills, and seek higher education (see Chart 1). The peak in post-secondary enrollment growth (5.9%) occurred in 2009. It has since decelerated across all educational institutions to 1.3%, but considerably more so among the private for-profit entities (see Table 2).

This is because for-profit institutions came under intense scrutiny due to their high student public funding rates and poor graduation rates. Students at these institutions represented 26% of student loans and 46% of those dollars in default, even though they only made up roughly 10% of the entire post-secondary student body.[3] As a result, tighter regulations were introduced regarding how a for-profit institution can obtain approval to offer an educational program, alongside specific performance-based guidelines to determine whether students within those programs can be eligible for Federal aid. Thus, it is no coincidence that a sharp deceleration in enrollment at for-profit entities occurred alongside an outright contraction in Federal aid to



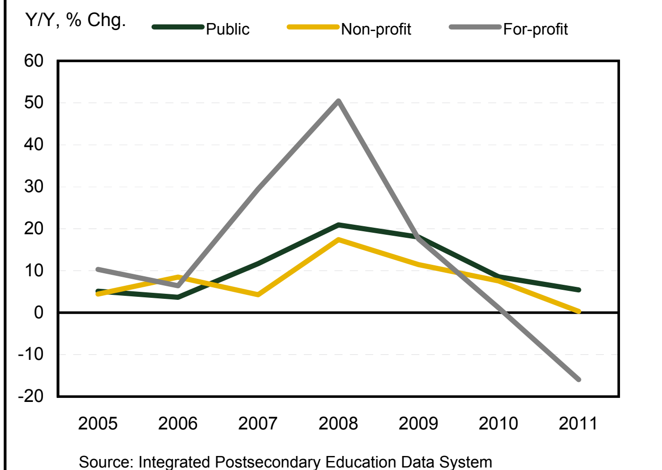
students at those institutions.

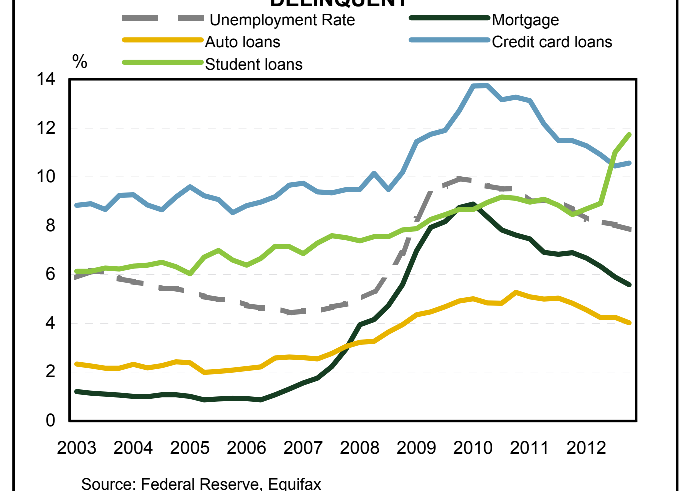
However, student Federal aid at all post-secondary institutions shifted into a lower gear in the 2011/12 year, arguing that what we are seeing more broadly is the beginning of a convergence back to fundamentals for student enrollment.[4] We expect college enrollment to grow at a modest annual pace of 1.1% over the next five years, roughly one-fifth the pace seen over the 2007 to 2009 period. Our projections are consistent with those done by the National Center for Educational Statistics and account for college-age populations, disposable income and unemployment rates among the different age cohorts.

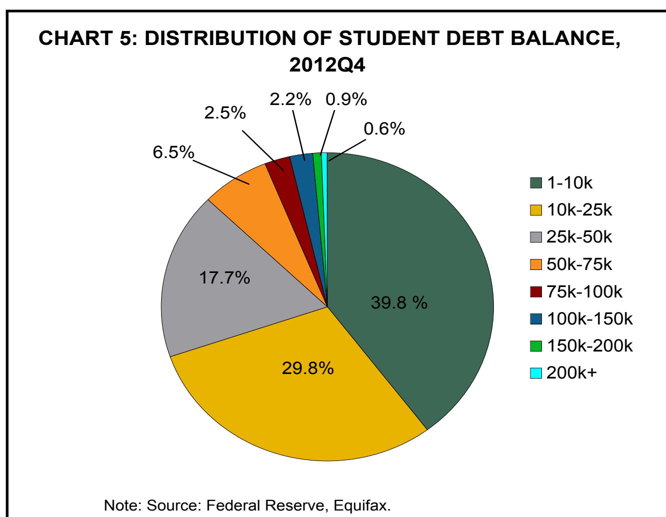
Delinquency Rates

Greater program scrutiny on private for-profit institutions, coupled with a broader deceleration in enrollment and a strengthening job market should lead to lower delinquency rates over time. Leading up to, and throughout, the financial crisis, 90+ day delinquency rates on all types of loans were trending up. However, since mid-2010, delinquency rates have decreased off their highs with the exception of student loans. In fact, since 2004, delinquency rates on student loans have tripled, and currently sit at 11.73%. And, this elevated rate masks an even bleaker picture. Delinquency rates are calculated from all outstanding student loans, including those who are not yet required to begin repayment. If you consider only those loans required for repayment, the delinquency rate is hovering just above 30%.

As Chart 4 shows, delinquency rates across various loan types are typically correlated with conditions in the labor market. However, this relationship is more difficult to establish with student loans. First, there is a very short history on student loans – only dating back to 2003 – so comparison with past business cycles cannot be made. Second, recent revisions have caused the current trend in the data to be somewhat misleading. The sharp rise in student loan delinquency rates in the third quarter of 2012 does not reflect a sudden deterioration of credit. This adjustment is capturing previously defaulted student loans that had not been accounted for. Rather than revising the historical data for the quarters in which the under-reporting actually occurred, the revision was all captured in the third quarter of 2012. While it does not alter the elevated delinquency rate, it does pose a problem in the analysis of trends. However, it is reasonable to believe repayment of student debt (like all other loan types) is sensitive to job market conditions. And, this business cycle has not been kind to new graduates. The duration of unemployment has been significantly longer than







at any other time in the history of the data, while the share of under-employed workers has also been historically high. This combination has compromised the ability of graduates to finance their debt.

The challenge has gained particular attention because the distribution of student debt has worsened over the last seven years. In 2005, approximately 55.5% of the individuals with student debt owed somewhere between $1,000-$10,000. As of 2012, that share shrunk to 39.8%, while the holdings of larger amounts (e.g. $10,000-$25,000, $25,000-$50,000, etc) all grew. This is consistent with rising tuition and enrollment.

A natural question to ask is whether the recent shift in debt loads will undermine future economic momentum. Although further analysis may be needed, on the surface, it seems unlikely to do so. Enrollment rates have already started to decelerate and we believe this trend will continue, thereby stabilizing the price of tuition and accumulation of student debt. In addition, although there has been a shift in student debt balances, 70% of those individuals owe $25,000 or less. This can certainly lead to some near-term deferral of purchases upon initial entry into the job market, and limit or cut off access to other types of loans (especially for those delinquent on repayment). But, the median student debt load must be counterbalanced against the benefits that come with an education. College graduates have lower unemployment rates, fare much better during periods of economic distress and earn a large wage premium for their efforts. Our preliminary estimates show that the median Bachelor degree holder will earn roughly $500,000 more in their lifetime over a high school graduate (discounted to present value).[5] The earnings premium widens further among those with advanced degrees. (In the coming weeks, TD Economics will publish a report on the rate of return from higher education.) Likewise, we anticipate nearly 5 million new jobs over the next two years. Although challenges persist for those entering the job market, the ongoing improvement in labor market conditions will trickle down to a greater ability to pay for student debt and other purchases.

Bottom Line

While enrollment rates have slowed considerably since 2010, we believe that we have not seen the end of this trend. History tells us that post secondary enrollments have always been countercyclical – rising during weak times of the business cycle and declining during the strong times. The past run-up in enrollment rates was no exception. Hence, as the economy continues to gain traction, post-secondary enrollment rates should stabilize at an average growth rate of 1.1% a year through 2017. To be clear, we are talking about a normalization in post-secondary enrollment that is more consistent with the demographic profile. The trend will remain towards a more educated and skilled workforce, which enhances national productivity and income. It should also produce a lower level of drop-outs relative to the recent cycle that contributed to a counterproductive accumulation in student debt. Likewise, an improving job market also creates the needed backdrop for student delinquency rates to taper from current elevated levels over the coming years.

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End Notes

1. In the U.S., a publicly funded post-secondary institution refers to state universities that were founded and are run by the local state. A private non-profit institution is any school that is run without the intention of making a profit and is typically granted special tax exemptions by the IRS. For-profit institutions on the other hand, are generally owned by large corporations and are run for the sole purpose of generating a profit.

2 It should be noted that the 12 month enrollment rates referred to throughout this note include enrollment in both two-year and four-year programs. Two-year programs grant associates degrees and provide adult vocational education, while four-year programs award bachelors and masters degrees.

3 http://www.ed.gov/news/press-releases/gainful-employment-regulations

4 Enrollment fundamentals were calculated based on demographics and long-run averages of post secondary enrollments among the different age cohorts as far back 1970.

5 The earnings premium reflects full-time workers. It takes into account the opportunity cost of being absent from the job market while earning a four-year Bachelor's degree, in addition to out-of-pocket educational cost.

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