Help is on the Horizon to Ease Student Debt
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by Sponsored Content from Legg Mason

The future of college funding
The evolving partnership between 529s, colleges and the government

Student debt: by the numbers

Lately, the headlines on student debt have been nothing short of sensational — both hard for readers to miss and for publishers to pass up:

- Student loan levels in the United States now exceed $1.2 trillion.\(^1\)

- Roughly seven out of 10 college graduates in 2012 shouldered student loan debt — at an average loan balance of nearly $30,000 each.\(^2\)

- Last year, approximately 7 million borrowers defaulted on Federal or private student loans.\(^3\)

Yet, while these statistics are clearly staggering, there is an ongoing debate as to whether they collectively rise to the level of a student debt “crisis”.

\(^1\) \(^2\) \(^3\)
Alarming statistics have led to claims of a “student debt crisis”

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estimate of student debt

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Student loans the sole culprit?

Today, many families feel like they are facing the perfect storm. College debt is on the rise and some are questioning the value of a higher degree. A considerable number of young Americans are struggling, but does student debt deserve all the blame?

It is fair to say that graduates are having a harder time landing jobs — or at least ones that pay a sufficient wage, relative to their outstanding debt loads. Between 2005 and 2012, the median annual earnings of young adults age 25-34 declined by several percentage points, while the average student loan balance increased by about 35%.

What’s more, some students are compounding their woes by incurring college debt, but failing to graduate. Between 2003 and 2009 (the most recent time period available), 29 percent of student borrowers had dropped out — up from 23 percent for the period between 1995 and 2001.\(^4\)
“Crisis” a misnomer

Armed with these facts, some contend that labeling student debt a “crisis” is hyperbole — especially when it comes to assertions that student debt is a drag on the U.S. economic recovery. In reality, the monthly payment obligation for student loan borrowers has remained roughly the same over the past twenty years.

Since 1992, student loan payments have consistently consumed three to four percent of monthly income for the median borrower. The fact remains that most young adults can service the debt load, even though it may mean moving back home.

What’s in a name?

Whether we’ve reached “crisis” levels or not, the consensus is that it may be too late for the current generation. Looking back at the $1 trillion plus in debt that has already been incurred focuses on the wrong issue.

Both sides also agree that the conversation must change. Instead of denouncing the student loan crisis, the dialogue must shift to the college funding crisis that lies ahead. The current path is unsustainable and the real problem can be reframed as follows:

- How do we ensure that future generations finance college without going deep into debt?
- How can we encourage early and holistic planning so that debt does not become the failsafe?
How should the partnership between 529s, colleges and government evolve to effect change?

Don't wait on Washington

It is tempting to start by looking to Washington for potential relief, but those hopes may be misguided. While many would concede that the current mishmash of federal, state and private funding sources can be confusing and overwhelming, radical improvements are not on the horizon.

That’s because in the prevailing political climate, there appears to be a lack of consensus regarding the prioritization of higher education on the national to-do list. In addition, many point to two overriding trends — political gridlock and deficit spending — that will make it difficult for Washington to address the college funding crisis going forward.

Competing priorities

Consider that for fiscal year 2014, the Federal government spent approximately $167 billion on higher education student aid, including loans, grants, tax benefits and work study programs. And, for 2012-2013, nearly 70% of student aid was federally funded — with state, institutional and private and employer grants making up the remaining 30%.

Though these figures may seem substantial, higher education is competing against much larger priorities, such as entitlement spending for an aging population and interest obligations on the deficit. True, the latest revenue and spending trends for the Congressional Budget Office project a 33% increase in revenues from 2013 to 2024. However, that increase is more than offset by mandatory spending and debt servicing. Both are siphoning off money that could be used elsewhere — such as for financing higher education.

Competing priorities are crowding out federal funding for higher education

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<thead>
<tr>
<th>Revenue and spending trends 2013 vs 2024 (projected)</th>
<th>% change (over inflation)</th>
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<tbody>
<tr>
<td>Revenues</td>
<td>+33%</td>
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<tr>
<td>Mandatory</td>
<td>+36%</td>
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<tr>
<td>Interest on debt</td>
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<tr>
<td>Defense discretionary</td>
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<td>Nondefense discretionary</td>
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States are following suit

If families cannot rely on the federal government for future college financing, will states step in? Unfortunately, similar budgetary pressures are taking hold at the state levels, too. For instance, between 2000 and 2012, state spending on Medicaid rose from 12 percent to 16 percent of states’ own-generated funds. Conversely, in the wake of the great recession, state higher education executive officers reported a real decline in state spending per student. From 2008-2012, 49 out of 50 states cut per-student funding in order to narrow substantial budget gaps. On average, these cuts have reduced funding by $2,394 per student, or roughly 30 percent, nationwide. In effect, we are witnessing a shift in public higher education from a public good — something that everyone is invested in — to a private good that is increasingly shouldered by the individual.

Colleges and universities respond

It seems apparent that state and federal governments are unlikely to play a leading role in solving the future college funding crisis. What level of support can families expect to receive from colleges and universities? The good news is that, generally speaking, these institutions appear to be sustaining student investment levels — as well as introducing innovative initiatives, too.

For starters, tuition freezes (or at least minimizing tuition increases), seem to be the norm among many public and private institutions. That may seem surprising to some, given the headlines about tuition rising faster than the rate of inflation. However, this disconnect can largely be explained by the difference between posted and net tuition prices. For example, posted tuition, which excludes living costs and financial aid, has increased considerably over the past 15 years. Net tuition, on the other hand, reflects the amount families actually pay after grants and tax benefits. That figure has not risen nearly as steeply — especially at four-year, public institutions.

Other initiatives that colleges and universities have introduced include no loan aid and financial literacy.
programs. The former offers aid packages where loans are not expected while the latter helps ensure that families who do borrow understand the loans’ terms. Despite these innovations, colleges and universities are unable to completely fill the void left by government. In effect, colleges and universities are making the same investment in students, while other support mechanisms are going down, leaving families to bridge the gap.

While posted tuition has climbed steadily, increases in net tuition have been more modest

![Changes in posted tuition compared to net tuition](image)

**529 plans**

It appears that families are destined to carry a disproportionate share of the college expense load going forward. However, they are not completely alone. Financial advisors and the 529 industry stand ready to help guide the way.

The 529 industry in particular has come a long way — and may be entering a new phase. Initially introduced in 1986, 529 plans have evolved from pre-paid tuition programs to multi-manager plans with a wide range of investment options and competitive fees. Yet, studies show that $150 billion was spent in 2013 on tuition alone — and only a fraction flowed through 529 plans. With just 15% of families using 529 college savings plans, investors may be missing out on important tax advantages and more can be done to get the word out.
Tomorrow’s college conversation

529 plans remain the single most effective way to set aside money today to fund future college costs and form the foundation of a complete college funding strategy. Financial advisors can help promote increasing adoption by:

- Encouraging families to get started early. Financial advisors can facilitate a focused family conversation as early as middle school, covering the amount that clients can afford to invest, then get clients started saving in a 529 plan as soon as possible. For more information, consider Scholars Choice’s “How to Pay for College” brochure.

- Providing families with comprehensive tools to educate and engage on financial aid. Explaining how much your client may be expected to contribute, admissions probability and net tuition can help quantify the goal and make it more achievable.

- Positioning colleges and universities as partners. Clients need to move away from the idea that colleges and universities are like other consumer organizations with whom they interact. Colleges are not automobile dealerships out to get the best deal.

Why Scholars Choice®

At Scholars Choice — the robust 529 college savings plan from Legg Mason and CollegeInvest — we are dedicated to making it easier for our clients to pay for college.

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- A diverse family of specialized investment managers, each with its own independent approach to research and analysis
- Over a century of experience in identifying opportunities and delivering astute investment solutions to clients in equities, fixed income and alternatives

About CollegeInvest collegeinvest.org

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All Savingforcollege.com rankings are as of June 30, 2014, and are based on the universe of 30 advisor-sold plans for Class A share performance (including maximum sales charges). The portfolios within the plans are compared and ranked based on published investment returns. The plan’s composite ranking is determined by the average of its percentile ranking. The ranking is based on short and long-term performance (i.e., rolling 1-, 3-, 5- and 10-year periods). The program ranked 4, 1, 1 and 8 for the quarterly rolling 1-, 3-, 5- and 10-year periods, respectively. Past performance is no guarantee of future results. The performance and rankings discussed are inherently limited and are not indicative of longer-term performance. Current performance may be lower or higher than performance results used for these rankings, resulting in different rankings that may be lower than
Ranking Methodology

Savingforcollege.com derives the rankings using each plan's relevant portfolio performance in seven unique asset allocation categories: 100% Equity, 80% Equity, 60% Equity, 40% Equity, 20% Equity, 100% Fixed and 100% Short Term. The plan’s composite ranking is determined by the average of its percentile ranking in these categories. Within each category, portfolios are compared and ranked based on published investment returns. Separate rankings are produced for one-, three-, five-, and ten-year periods. In addition, two versions of rankings for each performance period are produced: one based on performance without sales charges and the other based on performance with maximum sales charges. Please visit savingforcollege.com for more information about the ranking.

Additional unit classes may exist for each plan ranked. Please refer to each plan’s program disclosure statement for more information regarding its performance, fees and expenses. For Scholars Choice’s program disclosure statement, please visit scholars-choice.com.

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7. Trends in Student Aid 2013. CollegeBoard
8. CBO: August 2014 - (assumes 2.5% inflation)
9. Demos, March 2014
   Demos. March 2014
12. Drawn from Table 7 and 8 of Trends in College Pricing 2012. “Net Tuition” is posted tuition minus grants and tax benefits.
   Prices are in constant 2012 dollars. Figures do not include and board.