STRUCTURED FINANCE ASSOCIATION

SFA Research Corner

What to Expect When You're Expecting: Student Loan Repayment, Consumer Credit and ABS

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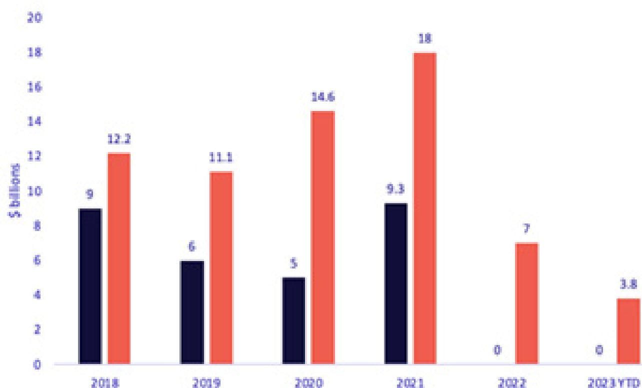
A provision in the debt limit deal negotiated by House Speaker McCarthy and President Biden marks the definitive end to the pandemic-related payment relief on federal student loans. Repayments, accrual of interest on those loans, and collections for loans in default are now expected to resume by late August. This means that 26.6 million student loan borrowers will be adding, on average, $203 to their monthly household debt obligation of $2600. Collection efforts, including wage garnishment, will resume for another 7 million loans.

The restart of payments may renew an interest in refinancing federal loans with private student loans, which has historically driven supply of private credit student loan (SL) ABS. Refinancing activity may be diluted, however, if borrowers decide to avail themselves of a new federal income-driven repayment plan. The Biden administration's proposed Revised Pay As You Earn (REPAYE) plan, announced in January, is an update to Pay As You Earn (PAYE) which became available in 1995. REPAYE is the most accommodative of the available plans as it removes the qualification for financial hardship and lowers the monthly payment amount to 5% of a borrower's discretionary income (for undergraduate loans), down from 10%, and allows for $0 payments for low-income borrowers. REPAYE will be available to borrowers with undergraduate and graduate loans and is expected to replace, over a phase out period, the four existing plans which currently provide 8.6 million borrowers more affordable ways to manage their share of $537 billion of federal student loans.

The Decision Rests with the U.S. Supreme Court

The debt deal does not address the issue of student loan debt forgiveness, which is currently in front of the Supreme Court with a ruling expected sometime in June. The cases — Biden v. Nebraska and Dept. Education v. Brown — challenged the Biden administration's legal authority to cancel student debt for borrowers of federal student loans. If the Biden-Harris student loan forgiveness plan prevails, an estimated 20 million borrowers will have student loan debts of up to $20,000 forgiven. Fifty-seven percent of those borrowers, according to a new Fed survey, would use that savings to pay off debt.

Student Loan ABS Issuance by Loan Type



Source: Finsight

The impact on consumer credit will be negative. A 2022 study from Consumer Financial Protection Bureau (CFPB) identified 15 million borrowers that are at-risk for delinquency as soon as payments resume. These borrowers had either been experiencing financial difficulty before the pause began — entering the pandemic already delinquent on student loans or receiving payment assistance — or became financially troubled between April 2020 and February 2022 by becoming delinquent on non-student loans or by entering non-medical collections. The at-risk population also includes those with multiple student loans.

Since the CFPB released that report, the count of the at-risk population may have moved even higher. Just released data from the Federal Reserve Bank of New York shows that more borrowers today are having trouble meeting their monthly credit card and auto loan payments. The delinquency rates for these loan products have risen for the fifth consecutive quarter and for certain age groups, such as auto loans for borrowers between the ages of 18 and 29, and cards and auto loans for ages 30-39, delinquency rates have surpassed pre-pandemic levels. A recent report from Citi Research expects 60+ delinquency rates to rise 10-20% above their current levels for the 23% of auto loan borrowers that carry student loans. Using Equifax data from 2012 to present, Citi shows that performance for this cohort, which has historically underperformed auto loan borrowers without student loans, has already begun to deteriorate as younger borrowers with lower credit scores are "impacted by inflation more than higher credit- quality borrowers."

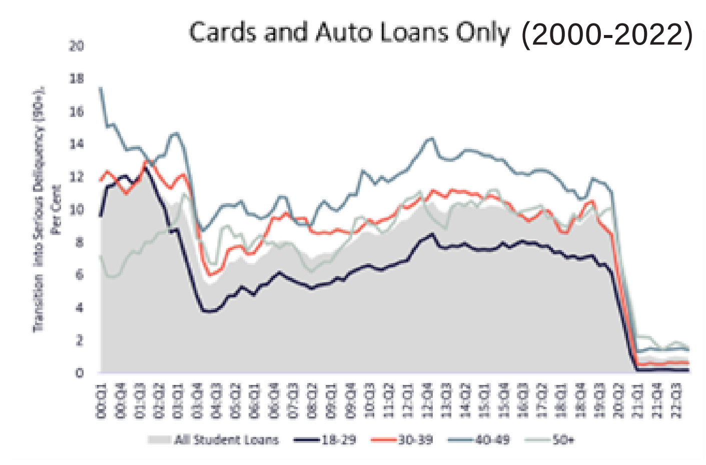
Improved Economic Conditions for Younger Borrowers

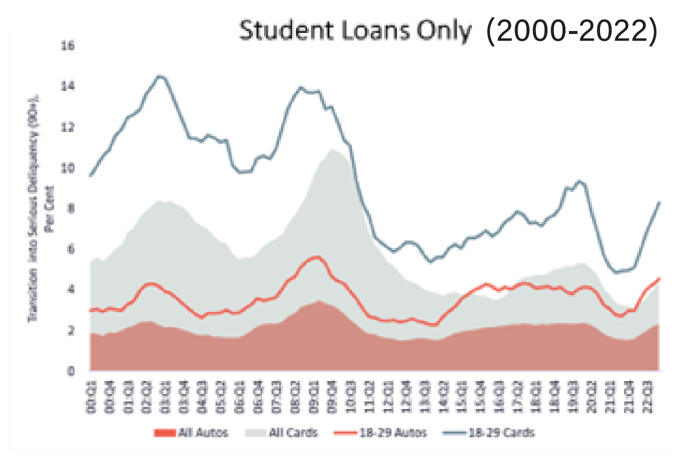
Nearly 40% of all student loans are held by borrowers under the age of 35. (24 and younger holds 7%, while 25 to 34 holds 32%). Recent research from dv01 discusses the "significant improvement" in economic conditions for younger Americans in recent years. These improvements may act counterbalance some of the increased burden posed by student loan payments.

According to the report, the inflation-adjusted median income for borrowers aged 18-24 years rose 40% over the past 10 years; incomes for those aged 25-34 years rose 22% — meaningfully above the 17% increase across all age groups. Additionally, although debt levels are still growing for younger households, growth has been coming from mortgage debt, which now makes up 46% of total debt for the 18-29 cohort. Mortgage debt has long considered to be the "good debt" given the investment aspect of homeownership. Homeownership rates for households less than 35 years have now returned to their historical levels.

We will continue to monitor the impact of the restart of student loan payments on the consumer and relevant ABS sectors going forward.

Transition into Serious Delinquency (90+ days) by Borrower Age





Source: Federal Reserve Bank of New York