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Student loans seen as potential 'next debt bomb' for U.S. economy

By Eric Pianin, Published: March 10

Bankruptcy lawyers have a frightening message for America: They're seeing the telltale signs of a student loan debt bubble that is placing increased financial pressure on families struggling with their children's mounting debt. According to a recent survey by the National Association of Consumer Bankruptcy Attorneys, more than 80 percent of bankruptcy lawyers have seen a substantial increase in the number of clients seeking relief from student loans in recent years.

In most cases, those clients could not meet the federal hardship standards that are necessary to discharge a student loan through bankruptcy proceedings. Instead, many of these parents or guardians who co-signed the student loans face the prospect of losing their life savings, cars or homes to collection agencies for aggressive private lenders.

William Brewer, head of NACBA, has said, "This could very well be the next debt bomb for the U.S. economy" — something akin to the housing mortgage loan crisis that triggered the U.S. financial crisis.

"Obviously, in the short term, student loan defaults are not going to have the same ripple effect through the economy that mortgage defaults did," Brewer said. "My concern is that the long-term effect may be even graver, because people who need student loans to try to get a higher education or retraining" will be unwilling to run the risk of taking out a student loan. "Our best and brightest won't necessarily get the education that they need to move us forward," he added.

The amount of student borrowing skyrocketed from $100 billion in 2010 to $867 billion last year — or more than the $704 billion in outstanding U.S. credit card debt, according to the Federal Reserve Bank of New York. Of the 37 million borrowers who have outstanding student loan balances as of third-quarter 2011, 14.4 percent have at least one past-due student loan account. Together, these balances come to $85 billion, or roughly 10 percent of the total outstanding student loan balance.

College seniors who graduated with student loans individually owed an average of $25,250, up 5 percent from the previous year, according to a study by Brewer's group. Parents are responsible, on average, for $34,000 in student loans, a figure that rises to about $50,000 over a standard 10-year repayment period. An estimated 17 percent of parents whose children graduated in 2010 took out loans, a 5.6 percent increase from 1992 and 1993.

A report last year by the Pew Research Center and the Chronicle of Higher Education warned that public anxiety over college costs is at an all-time high. Moreover, "low income college graduates or those burdened by student loan debt are questioning the value of their degrees," saying the cost of college has delayed other life decisions, the report said.

The Inghams of suburban Minneapolis are an example of how one family got into financial hot water. David Ingham, a 70-year-old disabled Vietnam War veteran, co-signed about $50,000 worth of student loans for his son to attend a fine-arts school in Minneapolis as well as Catholic University in Washington.

Ingham's son held a couple of jobs after he left Catholic University, but he was laid off in October 2009 and has not found work since. When his son could not repay his loans, a Sallie Mae collection agency took the family to court, seeking to place a lien on the Inghams' condominium in suburban Edina.

"It's a nice condo, and I worked my butt off for years to get this thing. Now we don't know what the heck is going to happen," David Ingham said. "We're in a free fall right now."

While Ingham says he and his family are in a state of shock and depression, others are angry and defiant.

More than 125,000 people have signed an online petition to protest a $50 forbearance fee that Sallie Mae, the private student loan giant, had been charging borrowers for years whenever they temporarily deferred payments on a loan. Federal programs that provide the preponderance of loans do not charge such fees.

Stef Gray, a Hunter College graduate from New York who has paid $300 in forbearance fees to the company since May, organized the petition drive in hopes of persuading Sallie Mae to drop the fee, just as Bank of America and other financial institutions dropped unpopular fees in the face of Internet protests.

Gray, 23, who lives in Brooklyn, has become a symbol of the plight of young Americans saddled with debt. With both her parents deceased, Gray has put herself through school with part-time jobs and three private loans with Sallie Mae.

Since graduating in May with a master's degree in geographic information systems, Gray has been unable to find full-time employment. Instead, she says, she has gotten by with temporary jobs and waitressing. Without a steady income, she says, it has been impossible to make the $700 monthly payments on her $40,000 in loans. Nor has she been able to consolidate the loans or negotiate more favorable terms with Sallie Mae.

Every time she deferred a payment on the three loans, Sallie Mae slapped her with a $50 forbearance fee for each loan — a total of $150.

"That may not sound like a lot of money to some," she said. "But for me, with no parents, struggling to get by without a job and not receiving any unemployment, that's a lot of money." Because of the compounding effect of the interest rate on the unpaid portion of her loan and related penalties, Gray says, her original $40,000 loan has grown to $65,000. "The interest is snowballing," she said.

Early in February, Sallie Mae announced it was changing how it would handle the $50 fee.

"When customers who are experiencing temporary financial difficulty ask to suspend scheduled payments, we ask for a good-faith payment to emphasize the terms and long-term implications of their decision to use forbearance," Sallie Mae spokeswoman Patricia Christel said.

The company declined to eliminate the penalty but said it would now apply the money toward the borrower's loan balance once on-time payments are resumed for six consecutive months.

Gray called the policy change a “partial victory” but noted that she’ll continue to be hit with $150 in fees every three months on her loans because she still doesn’t have a full-time job. Gray and other organizers met recently in Washington with Rep. Hansen Clarke (D-Mich.) to enlist his support against the Sallie Mae fee. Clarke has introduced a bill that would provide student loan forgiveness as a means of economic stimulus.

“They put me in a situation where either I pay this fee or I’m faced with default,” Gray said. “And if I default, I may never be able to buy a home at all, or rent an apartment again, or buy a car, or get a job, with employers checking credit when hiring. I think it’s ridiculous that I have to keep upholding credit card companies as much kinder to their debtors than [student loan] lenders.”

Pianin is Washington editor for the Fiscal Times, an independent news organization that provides original reporting and analysis on fiscal and economic matters.